Capital League outlook

November, 2020

Indian Economy

- High frequency economic growth indicators are coming in strong, government policy action is beating expectations and corporate results are giving evidence of pick -up in activity.
- IHS Markit India Manufacturing Purchasing Managers' Index (**PMI**) rose from 56.8 in Sep'20 to 58.9 in Oct'20. The growth was led by the intermediate goods category, but significant expansions was also witnessed in the consumer and investment goods.
- India **Services Business Activity** Index rose from 49.8 in Sep'20 to 54.1 in Oct'20. The rise can be attributed to improved market conditions and relaxation of restrictions on COVID-19 induced lockdowns.
- The Nomura India **Business Resumption Index** rose to 85.8 as compared to 82.9 posted in March before lockdown.
- Government has approved an INR 1.45 Tn package for 10 sectors - textiles, auto component, pharma, white goods, telecom, solar modules etc. This will help these sectors to attract investments, boost domestic manufacturing, enable companies to become part of the global supply chain and generate employment opportunities.
- Goods and Services Tax (GST) collections for October came in at Rs 1.05 lakh crore breaching the Rs 1-lakh-crore mark for the first time in the current fiscal.
- Unemployment rate In Oct'20 was 6.98% lower than 7.5-8% Pre-Covid.
- India Inc showed a gradual improvement in its financial performance for Q2 FY21 as compared to Q1 FY21. Net profit of a sample of 2199 companies increased by over 164%, in the Sep'20 quarter helped by higher cost efficiency and a low base in the year-ago.

QUARTER	SALES (INR Crs)	OPERATING PROFIT (INR Crs)	NET PROFIT (INR Crs)
Q2FY21	19,03,466	5,71,480	1,62,630
Q2FY20	19,59,684	4,57,129	61,391
% CHG	-2.8	25.0	164.9

- Equity markets touched record peaks on account of high FII flows, high surplus liquidity, outcome of US election results and progress in vaccine development. Market cap to GDP has rebounded above its long term average.
- FPIs bought equity worth USD 2.7 Bn in Oct'20, as compared to being net seller of USD 1.1 Bn in Sep'20. Most of the recent FII flows into India are due to the change of weight of India in MSCI emerging market index, hopes for a successful coronavirus vaccine and better than expected quarterly results.
- Retail inflation accelerated to 7.61% in Oct'20 as compared to 7.27% in Sep'20, exceeding the target rate, on account of high food inflation.

- Centre's fiscal position is likely to remain challenging and fiscal deficit is likely to be ~8% of GDP as against budgeted estimate of 3.5%. Further, States fiscal position remains stretched too due to impact on revenues and thus, aggregate fiscal deficit of State and Centre could be closer to 12.5% of GDP in FY21 (Source: Kotak Institutional Equities).

Global Economy

- The election of new President in US is likely to bring a change in policy framework that US has followed over the last four years especially in foreign and economic domain.
- Sequential improvement was seen in economic activity indicators of United States (US), Europe, China, etc. with many of them now at near or above pre-COVID-19 level. However, re-imposition of restrictions by few countries like Italy, UK, Germany, etc. are likely to slow down the momentum of recovery in near term.
- Commodities prices were a mixed bag with Brent crude prices falling sharply due to concern over demand outlook in view of re-imposition of lockdown in many European nations. Prices of other major commodities however registered an m-o-m growth supported by strong economic recovery globally.

	Market Price (USD)*	Change in price (%)	
		Oct'20	FYTD 21
Brent Crude (per barrel)	37.5	-8.5	64.7
Gold (per ounce)	1,879	-0.4	19.1
Steel (per tonne)	3,909	1.5	15.0
Copper (per tonne)	6,695	1.3	39.6
Aluminium (per tonne)	1,847	6.8	23.8

Source: Bloomberg; *Market prices as on October 31, 2020;

Outlook

- India’s external sector is very favourable. Low oil prices help India reduce trade deficit significantly. Also, lower dependence on exports (~ 11% of GDP in 2019), compared to other EMs, makes it less vulnerable to global economic conditions.
- The COVID-19 episode has highlighted the risks of high dependence of supply chain on a single country. This is likely to accelerate the shift of manufacturing from China which was already underway because of rising wages, compliance costs, etc. This bodes well for India as factors like large domestic market, skilled population, abundant natural resources, competitive wages, concessionary tax rates, favourable reforms and policies, etc. should act in its favour to attract global manufacturing. Moreover, recent border standoff between India and China has prompted India to take a focussed approach to attract global manufacturing by raising import restrictions, providing incentives and improving ease of doing business.
- Equity valuation indicators are near long term averages. As on 31 Oct'20, NIFTY 50 was trading near 24.6x FY21E and 18.7x FY22E price to earnings ratio.
- While India's GDP is likely to contract in FY21, it appears that worst is largely behind and economic activity is likely to improve sequentially. This should be supported by easing restrictions, pent up demand, strong rural economy along with fiscal & monetary policies.

- Real estate, which has an important bearing on the economy owing to the high multiplier impact, is showing initial signs of recovery. Private sector balance sheets are in better health to capitalize on growth opportunities.
- The recovery so far may have been pent-up demand led and it remains to be seen how consumption and savings patterns eventually shape up in the aftermath of the crisis.
- Bond markets have a glut of supply. The Yield curve has flattened somewhat.
- India’s forex reserves at USD 560 Bn are at highest. INR has appreciated and this may attract Foreign investors to invest in Indian bonds and also help ease inflation.
- RBI has been aggressive and unconventional in addressing the challenges thrown by the crisis - ensuring abundant liquidity, aggressive rate cuts, unorthodox measures like TLTROs, Operation Twists, OMOs for SDLs and easing of prudential norms. Also, Government’s credit guarantees have helped provide a multiplier effect.
- With RBI staying accommodative and with the moderation in virus spread leading to continued pick-up in economic activity, improvement in transmission should continue, which should further aid economic and corporate activity.
- Since, the longer end of the yield curve remains elevated, RBI is likely to continue with various operations to flatten the curve or reduce term premium for better transmission.
- The quantum of rate cuts will be far lower going forward compared to last one year hence bulk of return in debt funds should come from accrual strategy rather than capital appreciation.
- Consequently, we continue to recommend Short/medium-term, Corporate bond and Banking & PSU bond funds with return expectations of 5-6%.