Research Report No. 18 India: Macros and policies and their impact on equities 5/4/2022

The story for investors

Although macro data are, in general, poor indicators of stock market trends, in the case of India it does not help that the macro outlook has become less favorable pressed by accelerating inflation and a deteriorating C/A deficit. All these constrain the ability of the RBI and of the Modi administration to support the recovery process by looser monetary and fiscal policies. The Ukraine war will maintain pressure on oil prices and thus constraint any state infrastructure spending (see below). India's economy is primarily domestically driven, rather than by exports. At this juncture of the trends in the global economy, this might be "good news" for India as growth drivers will be found at home as opposed to export markets, which are constrained at this time by politics as well as by economics.

Investment conclusions

From an investor's point of view Sensex's current and future performance will be affected by the following developments. **First** the current performance of the Sensex, still positive in YTD USD terms, is one of the lowest in Asia with its current P/E at 25.0 being among the higher in Asia. **Second**, high oil prices threaten further acceleration of the CPI thus constraining RBI rates policy keeping in mind, though, that on a 2015=100 basis the USD/INR had been remarkably stable versus the USD DXY index. **Third**, Modi's administration will try to maintain its 2022 -23 Budget infrastructure spending plans **thus favoring domestic growth drivers.** This includes roads, railways, ports, airports, mass transport, waterways, and logistics. In roads alone the plan aims at 25,000 klm of, highways construction

Macro trends and policy issues

The bounce back in the GDP growth rate from the 2020 recession is loosing steam. (Fig. 1 red). The current account deficit is widening (Fig. 1 mauve) and may stay so under the pressure of higher commodity and oil prices. Inflation has fluctuated and remains above the 6.0% official target. Oil prices have a double impact on India's economy. **First**, India is the third biggest oil importer in the world with the government subsidizing the price of oil, LNG and kerosene (the latter used for cooking and heating by the poorer classes). The subsidies can run into billions of USD and the sharp rise of oil during the Ukraine war may partially derail the FY 2022-23 budget plan on infrastructure by diverting funds to the subsidies. **Second**, RBI's rate policy could come under pressure if inflation is not brought under control. Hence oil subsidies are of importance here as offering a trade off of lower (higher) subsidies but higher (lower) interest rates. Last but not least, the forward-looking PMI index (Fig.1 Blue) is relatively flat. To add to all this, the US implied that India's support of Russia, via its purchase of Russian oil, may have future consequences, one of which being some form of sanctions. India cannot afford to lose US support on its own China containment policy thus putting at risk its oil-inflation policies.

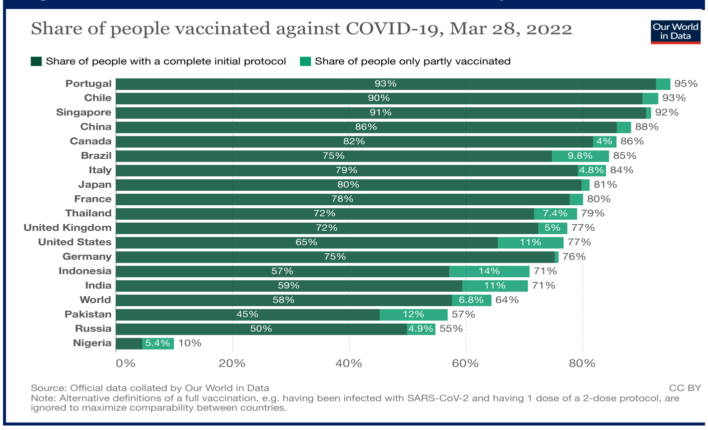
Going forward

The political position of the Modi administration remains quite strong notwithstanding the willingness to balance electoral benefits versus longer-term macro policies. For a developing economy such as India, "sexy" reform policy announcements, deregulation and liberalization policies are always a good booster of equities. The Modi administration has been relatively slow in that area, bar the listing/IPO of the Life Insurance Corporation of India. Actual privatizations such as that of Bharat Petroleum may be added to the list. What, however, has remained below the radar screen and not mentioned in GDP growth rate forecasts **is the very poor vaccination rates in India**. As Fig 2 shows a 60.0% coverage leaves hundreds of millions of people either poorly or not covered at all. China's travails in dealing with the "Nth covid wave" shows that India can not, and will not, be immune of a repetition of May 2021.As a total lock down, Chinese style, is not only politically but also physically impossible in India, the consequences will be measured in high death rates and possibly steep falls in GDP growth. Unfortunately the world approach to Covid, bar China and HK, is reliance on vaccination and removal of restrictions and hoping for the best. India is still ill prepared for this policy shift.

Fig 1:India GDP (red) CPI (gr), C/A (mauve), PMI (blu), 2015-22

Source: Bloomberg

Fig 2: Global vaccination trends and India's poor record



Source: Oxford University, Our World in Data

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