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Flash Note
28/02/2019

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India - A general assessment of the economy, geopolitical uncertainties and Indian assets

Economy:
- (+) Credit growth is picking up and liquidity also shows an improving trend with Indian banks' loans rising 14.5% y/y. Deposits also rose 9.6% (supporting the idea that savings are building)
- (+) Although GDP growth slowed to 6.5% y/y in the last quarter, GDP could still hit a 7.5% in the fiscal year ending on march31, 2019 as the government has relaxed its deficit fiscal target for the current fiscal year.
- (+) Looking ahead, the very low headline inflation (now at 2%) typically boosts real purchasing power, which could help to reach the 7.4% growth in GDP for FY19-20 (projected by the IMF).
- (+) The Indian government had no outstanding loans with the central bank in the week ended 8 Feb, which means that public spending could add to private spending.
- (-) On the negative side, labor market deteriorated during 2018, with the unemployment rate being fixed at 7% (above the 5% seen in Dec17).
- (-)The external position does not exactly inspire confidence: India's structural current account deficit is a perennial worry. The fall in oil prices late last year ensured that India's C/A deficit should remain near the level of 2.5% of GDP. But India is vulnerable if the current tick-up in oil prices continues.
- (+) The positive news are that a current account deficit of 2-3% of GDP is generally considered manageable in India since it is usually covered by relatively stable FDI flows.

Politics continue to drag down sentiment
- Political risk will weigh on Indian equities in 2019 as Modi faces a tough race.
- The government released its interim budget in response to the Congress Party's leftist populism and had to present a fiscal plan that could spare fears among market participants.
- One of Modi's achievements has been to cut consumer price inflation from 10% to 2%, but this was achieved through a policy shift that favored urban consumers at the expense of farmers, resulting in economic stress in the rural areas.
- The opposition leftist party (Congress) is capitalizing on this stress, with Rahul Gandhi offering a waiver on farm loans in the state elections and is promising to extend the scheme nationally.
- Growing risk that the latest bout of "competitive populism" takes India's fiscal position from bad to worse, threating to crowd out private-sector capital spending, impedes the revival of the capex cycle.

The general consensus about the Indian market
- The general consensus is that even though stock market volatility may persist (owing to election uncertainty), the business models of the corporates are much more robust than before and able to withstand any transient volatility.

- India is becoming a more popular destination for portfolio investors, although fears of another rupee blowout could scare them away.
- Said this, we consider now that the rupee is at fair value vs the USD (based on REER -using consumer and industrial prices)
- Indeed, if the BJP falls behind the opposition in the polls, asset prices are likely to take a hit. Yet despite this, the key reforms undertaken in recent years are here to stay, and with the benefits of these efforts just coming through, India's growth story will not be derailed.

Geopolitical uncertainties between Pakistan and India cloud the outlook for the rupee

- India finally took military action against Pakistan after a February 14 terrorist attack in Indian-controlled Kashmir killed 44 Indian officers. Narendra Modi faces pressure to burnish his "strongman" credentials and whip up nationalist fervor ahead of the May general election.
- Outlook about this conflict: Today, the South Asian Association for Regional Cooperation urged the Indian leadership to embrace Pakistan's peace overtures to avoid escalation in bilateral tensions.
- Pakistan's Prime Minister Imran Khan's gave a speech last night, inviting India for parleys to avoid war in the region: "We can convince the world of our strength by achieving more economic and political empowerment"
- China also urged India and Pakistan to ease tension through talks. Indian Foreign Minister Sushma Swaraj traveled to China to met her Chinese counterpart on Wednesday. During the meeting, Chinese official expressed Beijing's concern over the current tension.

Assessment and targets:

- In summary, with the economy at a crucial juncture, a generally optimistic mood regarding the economy and the fact that corporate performance seems to have decoupled from election cycles, the situation still bodes relatively well for a bottom-up recovery, although Indian equities could underperform (relative to its EM peers) due to the aforementioned Geopolitical uncertainties and domestic elections.
- Equities – SENSEX Index: 12 month view POSITIVE. Target price 40,850. Exit 42,800. Today at 36.800
- Bonds – Govies (Local) : POSITIVE (target yield 6.80%). Today at 7.5%.
- Forex – INR/USD: STABLE (target 72). Today at 71.

Best regards

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