Economics

# DBS Flash

# Trip notes from India – cautious but not outright bearish

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- *We met corporates, financial institutions (banks and non-banks), insurance firms, trade missions and regulators across cities in India, last week.*
- *The mood is cautious, but not outright bearish as bulk of the negativity is seen as baked in the price across asset classes.*
- *Key questions revolved around the US Federal Reserve's ability to continue to hike rates in the face of the reservations expressed by the US administration. Oil prices and developments in China were the other topics of interest.*
- *Domestically, monetary and fiscal policy outlook, along with timing of a non-resident scheme to shore dollar supplies, dominated discussions. Stress in the NBFIs (Non-Bank Financial Institutions) space was expected to persist. Bonds are expected to take a breather, while rupee and equity underperformance are a source of concern.*


**We met corporates, financial institutions (banks and non-banks), insurance firms, trade missions and regulators across cities in India, last week.** The mood is cautious, but not outright bearish as bulk of the negativity is seen as baked in the price across asset classes. Market participants sought clarity on how global developments will drive domestic markets, with upcoming state and central elections to add to broader caution. **We share few highlights:**

*Global watch factors*: Key questions revolved around the US Federal Reserve's ability to continue to hike rates in the face of the reservations expressed by the US administration. We have justified in recent notes in that the US rate hikes are likely to continue in so far as inflation hovers around the target and labour market conditions stay tight. Strength and longevity in US growth outperformance was also discussed. Here we reasoned that the divergence of momentum between the US and the rest of the world is likely to become unsustainable, with the latter eventually, likely to drag down the former.

Not surprisingly, most discussions veered towards oil prices, with geopolitical unease expected to keep prices high, but not translate into further acute economic pain. We learned from an oil major that the prospect of continuing oil imports from Iran hinges on receiving waivers from the US sanctions, barring which purchases are expected to slow. There was also an interest in the fallout of the US-China trade war, particularly from the perspective of diversion in flows and investment interests into India. Yuan weakness and impact on China's economy was the other area of interest, which is believed will cause further weakness in the Indian rupee, alongside other Asian currencies.

*Domestic policy direction*: Investors flagged the risk that centre's fiscal deficits are at risk in midst of a busy political calendar and a likely miss in revenue collections. We believe that the deficit is likely to be restricted to -3.4-3.5% of GDP, with spending to be rolled back to make-up for lower revenues. Instead, fiscal risks have been transferred to the states, following a 0.4% of GDP miss in FY18, which left the revised annual deficit at -3.1% of GDP. This leaves the consolidated (centre + state) deficit at over 6.5% of GDP in FY18, with a similar gulf likely in FY19 despite states projecting a smaller deficit of -2.6% of GDP. Pressures are likely to remerge from housing rent allowance increases, higher social sector/ capital expenditure particularly in poll bound states and potential revenue miss. States have budgeted GST revenues at 2.6% of GDP vs 1.5% in FY18. This has implications not only on the quality of fiscal consolidation (as much interest in fixated on the centre' finances) but brings us back to the question of crowding out of the private sector, as the scale of states' borrowings near the size of the centre's debt issuance.

There was also a lack of clarity on the direction of monetary policy, with infrequent guidance from the authorities seen as a sticking point. The regulators' focus on the main policy mandate i.e. inflation and a shift in the oil goalposts, lowered our conviction that a rate hike is in the offing in the December meeting, barring a surge in global volatility.

*Asset markets' underperformance*: Recent underperformance in the domestic bond markets is expected to take a breather due to RBI's liquidity support and bonds in oversold territory. Considerable anxiety remains on the rupee's sensitivity to the US dollar movements and pressures on the EM space, alongside early signs of weakness in equity markets. Measures to restrict INR depreciation were also discussed, with the timing of a non-resident scheme to shore dollar supplies, in focus. We shared that while such an initiative will attract strong interests given inherent attractive returns, its ability to stabilise markets will hinge on the global environment. Costs of a scheme similar to 2013, have also risen due to a jump in broader USD funding costs. Finally, a boost might be overwhelmed by a surge in oil prices, which in turn widens the CAD beyond -3% of GDP and raises financing needs. The special window for oil marketing companies to raise external commercial borrowings for working capital needs has been received positively, with the provision to keep such funding unhedged also defacto lowering capital raising costs.

Stress in the NBFIs (Non-Bank Financial Institutions) space was expected to persist. Calibrated efforts to provide liquidity to NBFCs, including banks' selective purchases of the former loan portfolios is seen as a good move. But liquidity problems are expected to resurface this quarter and the next, as shorter-tenor maturities fall due and rollover becomes a challenge. Weaker players are expected to shrink balance sheets, resulting in an overhaul in the industry, hurting credit availability and credit growth.

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**Sources**: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).