FAITH & *PATIENCE*

August 31, 2021

For the month ended August 31, 2021, Nifty 50 index was up 8.68% over the previous month's close. Midcaps and small caps underperformed large caps. NSE Midcap 100 Index was up 2.16% and NSE Small cap 100 index was down 2.29%. Within sectors, technology, consumer goods, oil & gas, and metals outperformed Nifty 50 index whereas banks, pharma, realty, media and automobiles underperformed. Foreign funds (FIIs/FPIs) were net buyers in August 2021 at USD1.16bn and domestic funds were also net buyers at USD0.93bn.

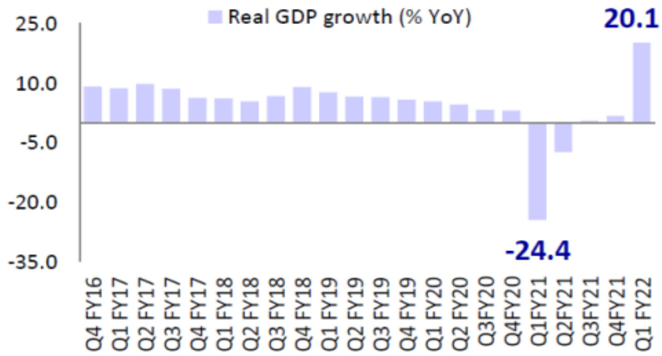
Fig: Index returns

Index Name	1 month %
NIFTY 50	8.74
NIFTY Midcap 100	2.16
NIFTY Small cap 100	-2.29
NIFTY Auto	0.07
NIFTY Bank	5.36
NIFTY Consumer Goods	9.66
NIFTY IT	13.43
NIFTY Media	-10.67
NIFTY Metal	-0.86
NIFTY Pharma	-0.34
NIFTY Realty	-2.79
NIFTY Consumer Durables	4.26
NIFTY Oil & Gas	10.08

Source: NSE

India's real GDP grew 20.1% YoY in quarter one FY2022. In quarter one FY2021, real GDP had contracted 24.4% to Rs.26.9trn due to Covid-19 related national lockdown. While in quarter one FY2022 real GDP increased 20.1% to Rs 32.4trn, the economy is still smaller than its pre-Covid level by ~9%. GDP grew 31.7% YoY to Rs.51.2trn in nominal terms and has surpassed its level in quarter one FY2020. In quarter one FY2021 sectors which contracted the most, recorded the strongest growth in quarter one FY2022. Construction sector grew 68% while manufacturing and trade sectors grew 50% and 34% respectively. These three sectors collectively accounted for 81% of the growth. However, construction, manufacturing and trade sectors are still smaller than their Q1FY20 levels. Only agriculture sector is 8% larger than its pre-Covid level and industry is 6% smaller while the more contact-intensive services sector is 12% smaller.

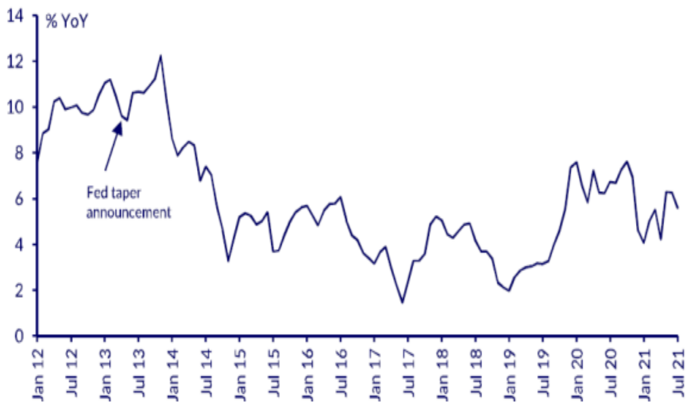
Fig: Real GDP growth (%)



Source: RBI

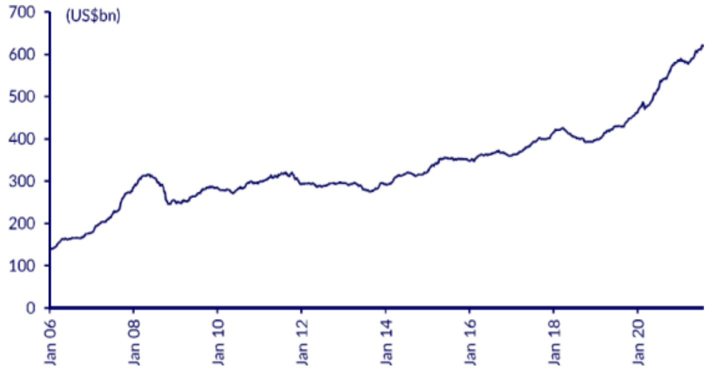
Last week news around the start of tapering by the US Fed made markets worry about a repeat of the 2013 “taper tantrum”. Interestingly, Indian economy is on much stronger footing than in 2013. CPI inflation rate of 5.6% is lower than 9.4% witnessed in 2013. India’s foreign exchange reserves are at USD616bn significantly higher than in 2013 and the foreign exchange reserve cover is 9.5 months of imports versus 6.1 months in 2013.

Fig: CPI Inflation



Source: Ministry of Statistics and Program Implementation

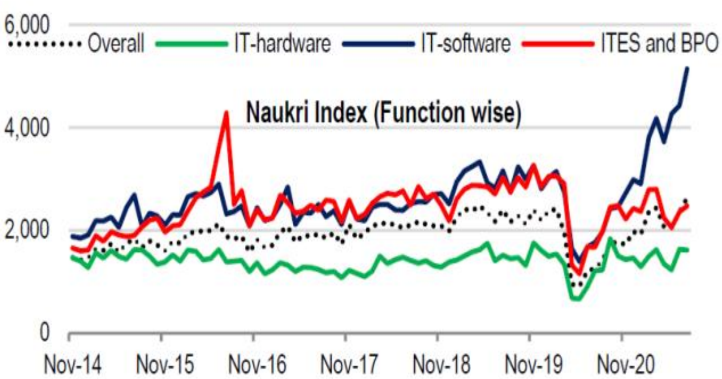
Fig: India forex reserves



Source: RBI

Indian software services industry has been in the news lately for a sharp demand for software professionals. In addition to the pickup in industry revenue growth, there is a sharp rise in share of offshore revenues for Indian software services companies. Person-hours grew much faster than revenues even in FY2021. Funding for Indian SaaS (software as a service) companies has doubled, in addition to a likely 50%-plus growth in revenues. Moreover, global software/SaaS firms continue to expand their development presence in India, Indian tech startups too are expanding with their fund raisings, and larger companies are investing as well. Industry manpower is expected to grow by 500,000 this year compared with five-year average of 160,000, the net addition being of entry-level engineers. The supply of graduates +3mn per year is expected to suffice but the challenge is likely to be in the 5–12-year experience level. SaaS and global software firms target these highly skilled engineers and their supply cannot grow rapidly. This bracket is getting and can continue to get significant wage hikes. The wage bill of the industry could thus is expected to grow by US$13 bn. This naturally provides boost to economy, consumption and discretionary demand.

Fig: Software services job openings



Source: Naukari.com, market leader in e-recruitment space.

Our view:

Looking at the various micro and macro data points, and the mixed signals emanating from them, we are forced to ask ourselves this question, “Is the glass half-full or half-empty?”

Quarter one FY2022 corporate earnings have been in line with the elevated expectations, aided by the deflated base of quarter one FY2021 and localized, less stringent lockdowns compared to quarter one FY2021. Sectoral earnings have diverged sharply on account of the impact of second Covid-19 wave and higher commodity prices impacting the margins of select sectors like auto, consumer staples and consumer durables. Cyclical sectors such as metals and oil and gas have benefitted, driving in-line aggregate earnings.

Management commentaries across the board indicate an improvement in the demand environment post June 2021, led by the easing of restrictions and sharp reduction in active Covid-19 cases. The pace of vaccination has picked up - average daily doses in August stand at 5.2mn doses per day versus 4.3mn doses per day in July. India has so far administered 630mn doses of Covid-19 vaccine with August 31, 2021, witnessing a record 13mn doses administered on a single day. Amid the likelihood of a normal monsoon season, corporate earnings can be expected to grow as economic activity picks up and pace of vaccination accelerates further.

While the economy grew 20.1% in real terms in Q1FY2022, it also expanded 31.7% in nominal terms. This indicates significant price rise which can be a drag on the economy if global commodity prices and domestic fuel prices do not correct. Moreover, growth in Q1FY2022 while strong YoY basis, it is weaker compared to Q4FY2021 or compared to the exit quarter growth. This indicates that second wave did impact the economy. Bright spark in this data, which stands out, is agriculture sector. Agriculture grew 4.5% and continues to perform well as it remained largely insulated from lockdowns. Thus, there is no base effect in agriculture growth and the Government policy has moved in the right direction here, be it meeting domestic demand or on farm exports.

Compared to quarter one FY2020, private final consumption expenditure (PFCE) and gross fixed capital formation (GFCF) are still lower. PFCE of Q1FY2022 in real terms is 88% of Q1FY2020. Accumulation of inventory and fall in GFCF points to lower consumption. Bright spark though is that, of the investment announcements made so far in Q1FY2020, 70% are coming from private sector. Auto sales numbers though challenging, they are also a function of shortage in supply of semi-conductors or chips. GST collections though strong at Rs.1.12trillion, and up 30% YoY, are lower than July 2021. This mixed data bag, accelerating vaccinations leading to opening of trade, transport, hotels and tourism sector in Q3FY2022 seem to suggest that the glass may well be half full!

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