FAITH & *PATIENCE*

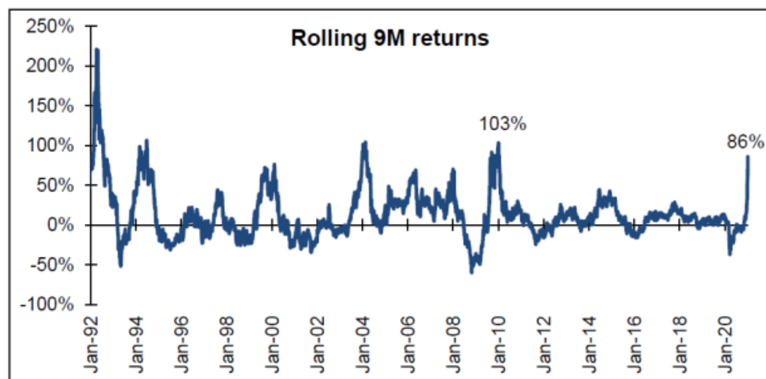
January 29, 2021

For the month ended January 29, 2021, Nifty 50 index was down 2.48% over previous month's close. Midcaps and smallcaps outperformed large caps. NSE Midcap 100 Index was up 0.32% and NSE small cap 100 index was up 1.32%. Within sectors, auto, public sector banks, technology, consumer durables and media outperformed Nifty 50 index whereas pharma, metals and private banks underperformed. Foreign investors (FII or FPI) were net buyers again at USD2.6bn in January 2021 whereas domestic funds were net sellers at USD1.6bn.

Index Name	1M %
NIFTY Auto	6.74
NIFTY PSU Bank	3.50
NIFTY IT	1.74
NIFTY Smallcap 100	1.32
NIFTY Consumer Durables	1.12
NIFTY Midcap 100	0.32
NIFTY Media	0.07
NIFTY Bank	-2.23
NIFTY Oil & Gas	-2.46
NIFTY 50	-2.48
NIFTY Realty	-2.62
NIFTY FMCG	-3.09
NIFTY Private Bank	-3.23
NIFTY Financial Services	-4.04
NIFTY Metal	-5.45
NIFTY Healthcare Index	-5.45
NIFTY Pharma	-5.77

(Source: NSE; INR returns)

The current market has seen a peculiar divergence between domestic institutional flows and foreign funds flows. The Nifty 50 index, on a nine-month rolling basis, is inching closer to the previous fastest rally of FY2010 when it had gained 103% in a similar timeframe. While foreign funds have been consistent net buyers through this rally, domestic funds have been net sellers. In FY2010 rally both domestic institutions and foreign funds were net buyers. Given that consumer sentiment is still weak, which is reflected in the form of weak household spending, we believe post recently announced growth-oriented budget by government of India, aggregate demand going ahead should pick up strongly. Needs to be seen if it is reflected in domestic fund inflows as well in the days ahead.



Another aspect of the current rally is that it is broad-based compared to the one in FY2017. While bulk of the equity market performance since FY2017 has been driven by a handful of stocks while the broader indices have underperformed significantly, the tide appears to be turning. In terms of the number of stocks contributing to majority of the index performance (>75% of BSE 100 index movement) it is 24, which is the highest over the past four years. Small-cap and midcap indices have also outperformed large-caps for the first time since FY2017.

So far quarter three FY2021 is turning out to be the third quarter in a row with more beats than misses (beat/miss ratio of 3.2 within the Nifty 200 index) indicating corporate profitability continues to be ahead of expectations which should lead to further upgrades. However, banks had a relatively lower beat/miss ratio of 1 as gross NPAs and credit costs continued to be elevated although operating performance remained strong for most banks. Breaking up the Nifty 200 index, the free float PAT (earnings) growth for the Nifty 50 was 16%, while for the Nifty Next50 and Nifty Midcap 100 it was at 41% and 55% respectively driven by swing in profitability of corporate banks and metal stocks.

Index	Sales YoY	EBITDA YoY	PAT YoY	PAT (incl. financials) YoY	Count
Nifty	-5%	16%	22%	16%	18
Next50	-4%	2%	-11%	41%	14
Midcap100	13%	46%	99%	55%	23
Nifty 200	**-4%**	**18%**	**26%**	**20%**	**55**

The learned and the holy ones have said "Expectation reduces joy." Well easier said than done, ordinary souls had built in expectations, rather fear, of tax hikes and Covid related cess. Markets too were expecting some increase in STT (securities transaction tax), crowding out due to heightened Government borrowing and continued conservatism on the fiscal side. To the surprise of most, Government announced a budget strong on growth without putting additional burden on taxpayers. In fact, it gave a gift to senior citizens in recognition of their contribution towards nation building, by exempting them totally from filing taxes on their income from pension and bank deposits. Markets had much to cheer as Government announced huge infrastructure spend through asset monetisation and Rs.1.75tn divestment program instead of borrowing. STT too was not increased.

While last two budgets, FY2020 and FY2019, markets had fallen 2.5% and 1.1% respectively post the announcements, this time round the markets were up ~5%. The Economic Survey of India, presented on January 29, 2021 had clearly laid down a detailed roadmap for the Government and it is encouraging to see their suggestions being welcomed.

What was the market looking for in the budget?

1. An equity friendly budget to raise resources rather than tax increases
2. Acceleration of divestments
3. Higher fiscal deficit target rather than attempts to rein in deficit below 4%, at the cost of growth or by raising taxes.
4. A budget focused on capex.
5. Setting up a large infra financing bank to raise long term debt.
6. Control on subsidies.
7. Elevated healthcare spends
8. Stimulating private spends including asset monetisation.

The Union budget 2021-22 not only delivered on key expectations, but also positively surprised on multiple fronts. In a positive surprise for the economy, the Government pegged the FY2022 fiscal deficit at 6.8% of the GDP and at 9.5% in FY2021. The unexpected hike in market borrowings, while raised bond yields, the doubling of reliance on securities for small savings in FY2021 is noteworthy (at INR 4.8trn vs. 2.4trn in BE). After disregarding sovereign rating for India to not reflecting India's fundamentals, the Government however comforted on the fiscal consolidation path by aiming to reach 4.5% deficit by FY2026, which in our view is a credible target. Further, the discontinuation of Food Corporation of India loans from the National Small Savings Fund from FY2022 onwards, reflects the Government's willingness to reduce off-budget spending and increase transparency.

The Government has walked the talk in meeting its FY2021 capex target. Overall budgeted capex has inched up 31% in FY2021 revised estimates, and another +26% YoY budgeted in FY2022. The quality of spending too has improved with - i) higher capex-to-GDP at 2.5% of the GDP vs. FY2014-FY2020 average of 1.68%, ii) share of capex in total expenditure stands the highest in more than 10+years at 16%, iii) fall in share of committed spending to 43% of total expenditure (vs. 49% in FY2021 revised estimates, and 57% average between FY2014-2020). The key beneficiaries of Government spending are infrastructure, public health and rural sector. Infrastructure spending in FY2022 has been pegged at INR 14.2tn (or 6.3% of the GDP), 2.4% YoY. From a two-year CAGR it stands at 11.7%, marginally lower than during FY2014-20 of 13.2%, but as % of GDP, infra spend has touched 6.3% in FY2022. vs. average 5.2% during FY2014- 20. Further, the set-up of a Development Finance Institution bodes well for the financing needs of the INR100tn infrastructure target with a lending ability of INR 5tnin the next 3 years. Implementation would be key and markets would be keenly monitoring that.

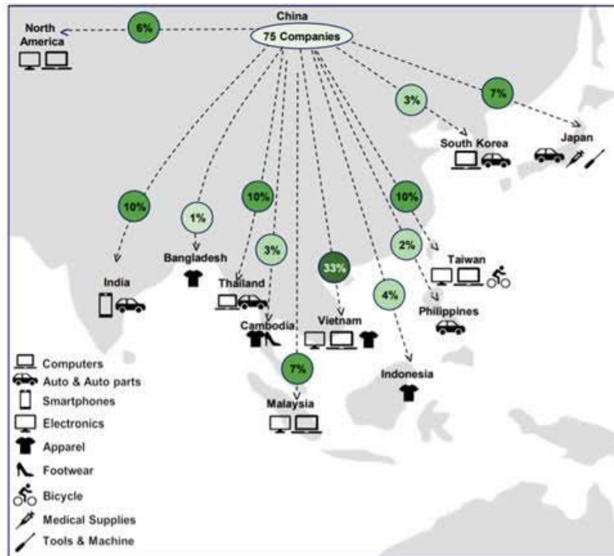
Indicators	FY21RE	FY22BE
Tax/ GDP ratio (%)	9.8	9.9
Subsidy/ GDP ratio (%)	3.3	1.7
Capex/ GDP ratio (%)	2.3	2.5
Rural Spending (INR bn)*	3,508	3,383
Road Spending (INR bn)	650	650
Rail spending (INR bn)	2,437	2,178
IEBR/ GDP ratio	3.3	2.6
Gross Fiscal Deficit/ GDP (%)	9.5	6.8
Revenue deficit/ GDP (%)	7.5	5.1
Primary deficit/GDP (%)	5.9	3.1
Gross market borrowings (INR bn)	12,800	12,055
Interest payment/ revenue receipts (%)	45	45
Centre's debt/ GDP ratio (%)	62	61

Our view:
Government of India has presented a landmark, growth oriented, bold and transparent budget. Though it has announced a fiscal deficit target of 9.5/6.8% for FY2021/22, these were higher than estimates but for the right reasons - higher-than-expected spending on growth and infrastructure capex, bringing large off-balance sheet funding on the books and using quite believable revenue estimates. The fact that no direct taxes were raised despite fiscal pressures has come as a relief. Clear statements to fund this capex-linked growth via divestment, privatisation, monetisation of operational infrastructure assets, and selling non-core assets is a big positive.

We see a new capex cycle starting, albeit a year late due to Covid-19 and delayed announcement of the USD1.5tn National Infra Pipeline (NIP). We expect the capex cycle to be led by the central government and its entities till state government and private capex pitch in by FY2022/23. We believe that with focus on unleashing animal spirits, and continuation of the pro-growth sentiment, push to build more roads and rail capex, urban infra and water, augurs well for the economy.

A recent study mapping 75 global companies which already had a manufacturing capacity in China, and which announced a new capacity/shift in base to another country shows that Vietnam has been a major beneficiary. We believe the Government of India is mindful of the opportunity and its significance, has through this budget taken steps to encourage shift in manufacturing to India. Benefits of various steps taken including PLI (productivity linked incentive), labour reforms, agriculture reforms and competitive corporate tax regime should be visible in the days ahead.

Fig: Beneficiaries of shift in manufacturing



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