Published on *mydigitalfc.com* (http://www.mydigitalfc.com)

Mauled by bears, bulls pray for Budget magic

Feb 10 2016

With the famed Indian stock market in the steely grips of a bear market, as the Sensex has tumbled about 20 per cent from its January 2015 peak, the road ahead for the 30-share benchmark that closed at 23,758.90 on Wednesday will be decided by the Union Budget on February 29.

BSE's market capitalisation, which had soared above Rs 100 lakh crore in November 2014, has fallen by more than Rs 10 lakh crore to Rs 89,49,175 crore as on Wednesday. While the long-term investment case remains intact, bulls have understandably gone into hiding, as session after session bears have hammered down stocks. Unlike in earlier years, when the first few months of a new year saw large inflows from foreign institutional investors, this year has seen a net outflow from FIIs. This has further pressured broader markets.

"The mood in the market clearly seemed to be in the risk-off mode while investor sentiment remained weak, as participants opted to exit long positions," said Shreyash Devalkar, fund manager - equities, BNP Paribas Mutual Fund.

While the recent stock market losses may be more globally linked than locally triggered, there is now rising pressure on the government to pull a rabbit from the hat and revive expenditure. But that's easier said than done as troubles in the banking space, low capacity utilisation in industry and poor balance sheet for many companies have complicated a straight-forward recovery. The RBI too has virtually put the ball in the government's court. The importance of more rate cuts and lower borrowing costs are well accepted but equally important is preserving government's fiscal health, says experts.

A global equity rout that started from a slowing China, spread to the US and then to Europe has triggered a risk-off sentiment across stocks in almost every country. Year to date, the Sensex's 9 per cent decline may look too bad, but when compared with most stock markets in Europe and Asia-Pacific, there is a sense of relief. However, losses do not bode well for investors who want to stay long on the India growth story. Risk-averse global funds have pulled $1.8 billion from Indian shares since January 1. This capital outflow has also pressured the rupee that has fallen from the 66.5 levels against the dollar at the end of 2015 to nearly 68 now.

The banking space is now creating a difficult situation for the Indian stock market to script a turnaround. On Thursday, India's biggest bank, SBI, will announce its results and if those results show a major increase in non-performing assets, like PNB and Allahabad Bank showed this week, it would indicate a major problem, feel market veterans. Trouble in the books of SBI would indicate that things haven't improved in the industrial sector, especially the small and medium enterprises sector where SBI has large exposure. This is because if things have not improved for SMEs, it would indicate that the growth shown in macroeconomic numbers is far removed from reality.

Besides banking, IT stocks are also under pressure after a poor guidance from Cognizant. Both banking and IT sectors hold significant weight in benchmark indices. These are probably why the Budget has suddenly become so much more important for the Indian market.

If the Union budget is populist in its outlook and lacks a real vision for attracting investment, market experts say outflows will most likely continue. Questions also abound on what the BJP government can really do given the limited scope. "If the Indian stock market continues to do badly and deliver another bad month in February (after one of the worst in January), the government would be under tremendous pressure to do something about it. Interestingly, it really does not matter if this underperformance is linked to global factors or is it entirely locally manufactured. And, what the government can really do? The easiest thing for the government to do is to increase public expenditure in the budget and put more money in people's hands," said Pankaj Sharma, head of equities, Equirus Securities.

Some market experts feel that foreign funds coming in post-budget or ahead of the budget day on a whiff of a positive reform agenda will be a likely trigger. "It could happen before the budget, depending on the positive news flows coming out of the government," said Vikas Gupta, executive vice president and chief investment officer at ArthVeda Capital.

The government's work on fiscal math is clearly cut out. Foreign brokerage Macquarie feels that considering the government had already deviated from the fiscal consolidation path in FY16 by targeting a higher than expected deficit, doing it for the second consecutive time might raise questions about the "credibility" of its commitment. "At the same time, this will push up borrowing costs and affect public sector debt dynamics considering that nominal GDP growth has decelerated significantly," it said.

Macquarie expects finance minister Arun Jaitley has to balance the three key but competing objectives in the upcoming budget – (1) meeting the fiscal consolidation requirement of 0.4% of GDP as envisaged under the FRBM Act, (2) continue to boost public capex (additional 0.2% of GDP) and (3) provide for a higher wage and pension bill under the seventh pay commission and the OROP scheme (another 0.6% of GDP fiscal space). "At the same time, we expect the government to provide clarity on time line for GST implementation and a clear road map for corporate tax reduction (from 30% to 25% over the next four years)," Macquarie said.

The upcoming Budget might unveil some agriculture-specific measures to lower monsoon-dependency and increase rural productivity, according to DBS group.

The budget will be important for financial and rate sensitive stocks. Nomura expects the RBI to cut the repo rate by 25 basis points in the April policy meeting after the budget. Many see lending rate cuts, and not reforms, as the solid trigger that will probably lift the economy. That makes the Budget critical because rate cuts are dependent on RBI's monetary policy. "Our standing view is that lending rate cuts hold the key to recovery, rather than reforms or project clearances. Lending rate cuts are critical to revive demand, in our view. This will exhaust capacity. That, in turn, would spur investment. To expect a capex revival now is surely to put the cart before the horse," according to BofA Merrill Lynch Global Research.

Historically, Budget day market reactions are not a good indicator of what's in store. In the past few budget days, there have been about an equal number of Sensex rises and falls. However, the budget to budget performance shows that the budget effect quickly wears off and other factors start playing. On February 28, 2015, the Sensex ended over 141 points down at 29,361.50 in what was the new government's first full-year budget. Due to global and local factors, the Sensex is now down over 5,600 points, or 19 per cent from then. On July 10, 2014, in the interim budget, the Sensex had slipped by 72.6 points to end at 25,372.75 but went on to scale the 29,000-mark, or a rise of nearly 4,000 points till the next Budget. Before that, on February 28 2013, the Sensex fell about 291 points to end at 18,861.54 after former finance minister P Chidambaram presented the Budget, but then the index rose to 25,000 levels till the next budget on hopes that a Narendra Modi-led BJP government would unleash reforms and bring the economy to a high growth path.

The road ahead looks jittery, with the upcoming Union budget and the deepening slowdown in the rest of the world," says Vinod Nair, head-fundamental research, Geojit BNP Paribas Financial Services.

(With inputs from Rajiv Nagpal in New Delhi and Ravi Ranjan Prasad in Mumbai)

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