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On different planes

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The December quarter GDP print showed that the economy possibly weathered the storm more comfortably than expected. The double-digit growth reported in manufacturing, despite the floods in Chennai, goes against signs of slowdown in other indicators, and can only partly be explained by falling input costs, HSBC said. However, stock markets were cold to this data release. Who can blame them! These days, global factors have an overbearing effect on Indian stocks and the only news that market players possibly pay attention to is bad news. The global equity selloff has shaken Indian benchmarks.

The S&P BSE Sensex has tumbled about 23 per cent from its January 2015 peak and has joined equity benchmarks from Tokyo to London in a bear market. The earnings of Sensex companies also lagged. Fourteen, or 52 per cent, of the 27 Sensex companies that have reported earnings for the December quarter have beaten estimates. But that’s hardly an improvement, as the figure was 57 per cent in the September quarter, data compiled by Bloomberg show.

With India’s real GDP growth (market prices) in the fourth quarter coming above expectations, what does the future hold for stock markets desperately looking for some good news? It’s been a particularly trying start to the new year, with benchmarks down over 12 per cent year to date. Some market experts argue that now as the sentiment will see a gradual recovery in step with the economic growth being boosted by higher real disposable income (from low inflation) and better corporate profitability on the back of sustained low commodity prices. Others, how ever, see no bright rays of hope.

Vikas Gupta, executive vice-president and chief investment officer at ArthVeda Capital, is bullish on the market, and says GDP (gross domestic product) numbers clearly show that India is growing at the fastest pace in the world for any large sized economy. “This is already recognised by the global sell-side and buy-side analysts across the globe. That India will remain one of the few growth spots in the world for the next several years is already recognised by FII (foreign investment institutions) analysts.”

The promise held by China and other emerging markets is no longer there. Though there is negative sentiment about emerging markets, India is viewed as the exception. “This means eventually India is likely to be overweight in most emerging market portfolios. This means that FII money is likely to start rotating into India and out of other emerging markets (EMs) over the next few quarters. When that happens, the domestic investors will follow,” Gupta points out.

But GDP data is still an issue. Nomura, for instance, argues that there remains a disconnect between GDP and real data. “For example, the 12.6 per cent manufacturing growth in Q4FY16 is not consistent with the current low production/capacity utilisation in the manufacturing sector. It is true that GVA captures value additions and could be getting a boost from lower input costs (higher profitability), but the rise in manufacturing value added appears too high.”

If GVA is any indicator of future corporate earnings growth, some do not think signs are good at all. “Ebitda for the BSE 500 companies (excluding banks and financial services) is likely to grow in a single digit for FY16 and FY17, given the sharp decline in gross value added (GVA) growth expectation for FY16,” said India Ratings and Research. If proved

right, this would be much lower than the Ebitda growth of 17-22 per cent seen in the post-financial crisis period (FY10-12).
Some, however, prefer the brighter side. Gupta of ArthVeda Capital says corporate earnings as a whole should not be analysed. “One should break it down into resource companies, i.e. oil & gas and materials, financials and core (i.e. the remaining sectors). We expect core earnings to do well, and in fact very strong, in the next two-three quarters or even earlier. Resource companies and financials will keep struggling for a year or two,” he said.
Jimeet Modi, chief executive officer, Samco Securities, is extremely positive about what he terms “encouraging GDP numbers”. The ease of doing business initiatives, the opening up of foreign direct investment (FDI) in the insurance sector and the prime minister’s foreign visits—which increased FDI flow from across the globe—bore fruits, he says.
“The services PMI rose to a 20-month high while manufacturing PMI stood at a four-month high, all of the above indicate that the economic engine has started to move and we believe going forward this will further accelerate in view of the reform agenda on the cards. The stock market is right now influenced by international headwinds, which we believe will subside soon and the markets will then notice domestic realities, bringing in much-needed stability in the market. The sentiments will change quickly in view of the encouraging GDP numbers,” Modi argues with die-hard optimism.
While a few pockets are showing growth, broad-based growth is expected to come, Modi hopes. “When the government spending picks up, the seventh pay commission benefits are doled out, various forward looking legislation like the GST (goods and services tax) and bankruptcy code are cleared, these will quickly boost investor confidence and kickstart the private investment cycles, which will in turn lead to larger and more sustained growth for the country. We believe 2016 would be the tipping point for the Indian growth journey to accelerate,” the Samco Securities chief said.
Near-term triggers would be a reform-oriented budget that controls fiscal and budgetary slippages, interest rate reductions by the Reserve Bank of India, passage of stuck bills in Parliament. A good monsoon would be another trigger.
India Ratings and Research believes corporate profitability growth will rely largely on urban consumption –which could fade as inflation increases–and general government expenditure (the Centre and the state), the two pillars of growth in FY17. Export growth and private corporate capital expenditure are unlikely to contribute meaningfully to growth during FY17, and if the government sticks to the path of fiscal consolidation, Ebitda recovery would remain in a single digit.
In a hypothetical scenario of the government expanding its fiscal purse, the growth rates could inch up to 12-14 per cent, but will remain short of the average of 20 per cent achieved during FY10-12. “The metals space along with real estate and construction could be the most impacted whereas there could be positive growth trends in auto and auto ancillaries, power, telecom and pharma,” the research outfit said.
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