Strong Headwinds

IMA India’s 24th Annual CFO Roundtable

February 2020, Colombo

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IMA India
Are we losing the plot?

- A troubled financial system has damaged the credit flow pipeline; banks and NBFCs in trouble
- Market and investor sentiments were damaged by a mis-match of expectations from the budget
- An unreasonably high indirect tax environment together with culmination of issues has impacted the automotive industry – spread to others like a domino effect
- Rural consumption has faltered due to stagnant wages
- Lack of structural reforms in the three factor markets of land, labour and capital
Growth has fumbled

• Business sentiment is subdued, demonstrating a lack of inspiration on the economic outlook and mellowed demand

• Gross investment has fallen; corporate sector feels unsure

• Consumption too has crumbled – could be an outcome of the wealth effect phenomenon?

• Exports are no longer contributing to growth – currently at a 14-year low

• IMA’s Business Confidence Index is at 50.4 barely above the threshold

• Anecdotally, businesses report weak sales and shrinking margins
Now capital availability has fallen

- Bond issuances collapsed after the IL&FS crisis from about Rs 3.4 trillion a year to under a trillion in H1 of FY20
- With damaged balance sheets and wrong exposures lenders have become cautious

Source: CEIC, RBI, IMA analysis
Tax reforms are essential

- The sustainability of Government spending depends on a rise in the tax-to-GDP ratio; currently this stands at 11%
- India has expanded its tax base but negated the effect through exemptions to farmers and the lower-middle class
- The solution lies in the lowering of GST rates to a single figure – 12% – to spur consumption and encourage compliance
- On direct taxes, the rate needs to be lowered for the rich and thresholds and exemptions revisited – everyone must pay
- There is the risk of imposition of wealth taxes and death duties – these have never worked as they are hard to compute. They would be damaging
- Put federal and state budgets back on FRBM
More corrective measures needed

• A reduction in corporation tax from 30% to 22% is a damage control measure – will it raise investment?

• The problems are no longer on the supply side – capacity utilisation rate of 76% is below the investment threshold

• The reallocation of capital and trade from China has benefited some South East Asian countries with a limited impact on India

• India cannot sustain spending on its expanding welfare programmes without growth; something will have to give

• The Government has enhanced efficiency but has failed to liberalise and reduce its role

• The key issue is market reforms in land, labour and capital – a lack of serious economic reform since 2004
Millionaire Migration
The wealth exodus from China continues; Australia and the U.S. see big gains

HIGH NET WORTH INDIVIDUALS (HNWIs)
TOP COUNTRIES BY INFLOW AND OUTFLOW

Global number of migrating HNWIs:

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>95,000</td>
</tr>
<tr>
<td>2018</td>
<td>108,000</td>
</tr>
</tbody>
</table>

For the fourth year in a row, Australia beat out the U.S. as the top destination for migrating HNWIs.

SOURCE: AfrAsia Global Wealth Migration Review
*HNWI: Individuals with wealth of US$1M or more
1*“Caribbean” includes Bermuda, Cayman Islands, Virgin Islands, St Barts, Antigua, St Kitts & Nevis, etc.
The short term

• Growth is likely to linger in the 5% range – lower than forecasts by agencies suggest

• The first step to address this is to fix defunct banks and NBFCs

• Privatisation is essential to improve productivity

• Budget imbalances will be higher than the Government’s generous assumptions – a risk of foreign investor panic and serious outflows

Source: CEIC, CSO, IMA analysis
Where it all began: auto

- The automotive industry entered a downward spiral in mid 2018, and has yet to recover
- Over April-October PVs declined by 20%; CVs by 23% and 2W by 16%; some recovery now
- The new insurance norm was the trigger – but higher product specs add to costs
- As things stand, there are no immediate green shoots

Source: CEIC, SIA, IMA analysis
Other sectors: varying impact

• Tyres and components better off – helped by after market sales
• Consumer durables – AC sales surged through the summer but this came at the expense of other durables; durable companies also have to shoulder much of the finance burden for EMI-based purchases by consumers
• Real estate – a recession for now but many believe that in the long term, the sector will emerge stronger as a result of RERA
• Other industries doing well – refineries, infrastructure, speciality chemicals, pharmaceuticals, packaged foods
The misery is widespread

• IMA India’s business confidence index dropped to 45.7 last quarter, the lowest in the Modi Government’s tenure; now a small recovery
• The greater concerns stem from macroeconomic factors

Source: IMA India’s Business Confidence and Performance Index (BCPI)
Travel and Trade affected

- Domestic air travel growth has dropped from levels of over 20% yoy to about zero; international traffic has fallen from 10% to 0.
- Port cargo traffic, a good proxy for commerce, has also dropped to 0.

Source: CEIC, IMA analysis
## Capital formation, by sector

<table>
<thead>
<tr>
<th>% share</th>
<th>3-year CAGR</th>
<th>5-year CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall GFCF</td>
<td>100%</td>
<td>9%</td>
</tr>
<tr>
<td>Agri</td>
<td>7%</td>
<td>3%</td>
</tr>
<tr>
<td>Mining</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>Mfrg</td>
<td>17%</td>
<td>8%</td>
</tr>
<tr>
<td>Power</td>
<td>8%</td>
<td>6%</td>
</tr>
<tr>
<td>Construction</td>
<td>6%</td>
<td>28%</td>
</tr>
<tr>
<td>Trade and hospitality</td>
<td>10%</td>
<td>12%</td>
</tr>
<tr>
<td>Transport and comm.</td>
<td>10%</td>
<td>26%</td>
</tr>
<tr>
<td>Financial services</td>
<td>1%</td>
<td>2%</td>
</tr>
<tr>
<td>Real estate</td>
<td>22%</td>
<td>1%</td>
</tr>
<tr>
<td>Government</td>
<td>11%</td>
<td>14%</td>
</tr>
<tr>
<td>Other</td>
<td>7%</td>
<td>20%</td>
</tr>
</tbody>
</table>
A silver lining?

A possible turnaround in the investment pattern

Source: CEIC, SIA, IMA analysis
QE: A possible solution?

• Commercial lending rates are not responding to cuts in the repo rate
• Growth in M4, the widest measure of money supply has fallen to single digits; it was >20% in 2005
• The problem is a lack of credit worthy borrowers; deposits and money supply will only increase if there are sufficient avenues to lend to
• QE can help but not the conventional variety – India can experiment with US-style QE
• The Indian Government’s debt stands at USD 827 billion and is owned by RBI (15%); banks (40%) and non-bank (45%)
Land, labour and capital

- Economic growth is the only way to drive people out of poverty; high levels of investment are essential for this
- Investment is a function of land, labour and capital – these markets need to be efficient, transparent and accessible
- Land and labour – largely a state subject; centre can tweak but cannot radically reform; early efforts at land reforms failed and were not repeated
- Capital – more amenable to federal diktat; demonetisation and GST has created greater financialisation – this needs to continue
- The focus of the next Government must be on these three issues
Risk factors ahead

• The Coronavirus threat and the decoupling of the Chinese economy
• Possible spike in commodity prices because of middle east tensions and its twin impact on the current and fiscal deficits
• Slowdown in advanced economies including America, Europe, Japan and China, leading to a global downturn
• Risk of capital flight should India’s fiscal deficit exceed targets and the consequent risk of a downgrade by rating agencies
• Foreign investors have started doubting the sustainability of the India story; if interest rates rise in the US, capital could flow out
• The global trade architecture has crumbled and bilateral agreements will replace the multi-lateral framework
Changing trade architecture

1995

2015

IMA
Thank you