Strong Headwinds

IMA India's 24th Annual CFO Roundtable

February 2020, Colombo

Adit Jain; Editorial Director
IMA India

India Outlook

Are we losing the plot?

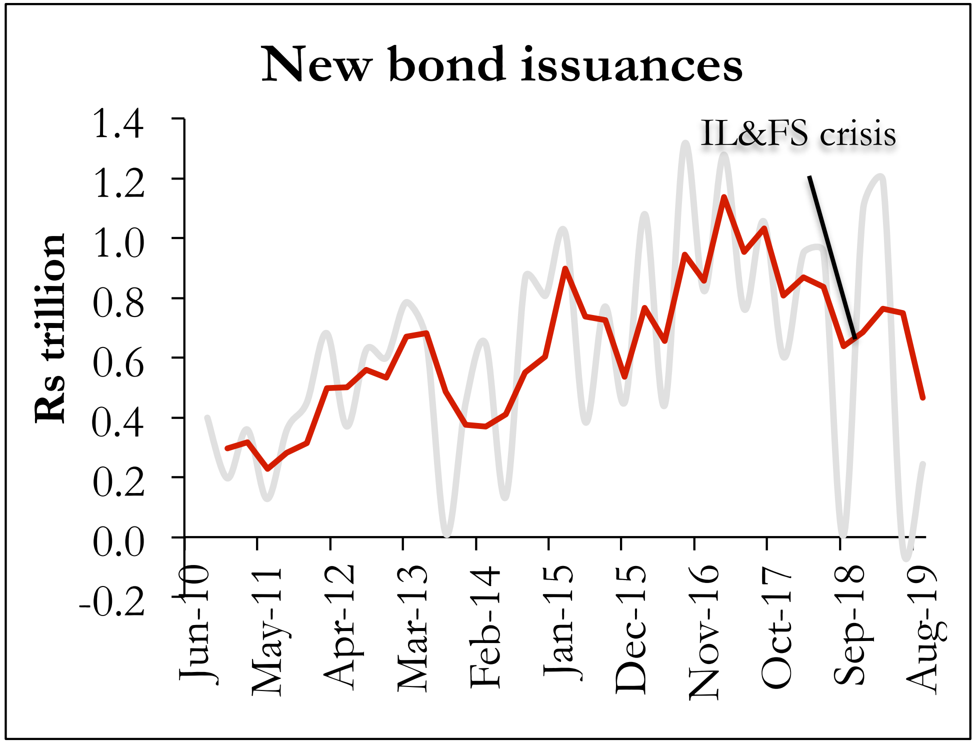
- A troubled financial system has damaged the credit flow pipeline; banks and NBFCs in trouble
- Market and investor sentiments were damaged by a mis-match of expectations from the budget
- An unreasonably high indirect tax environment together with culmination of issues has impacted the automotive industry – 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

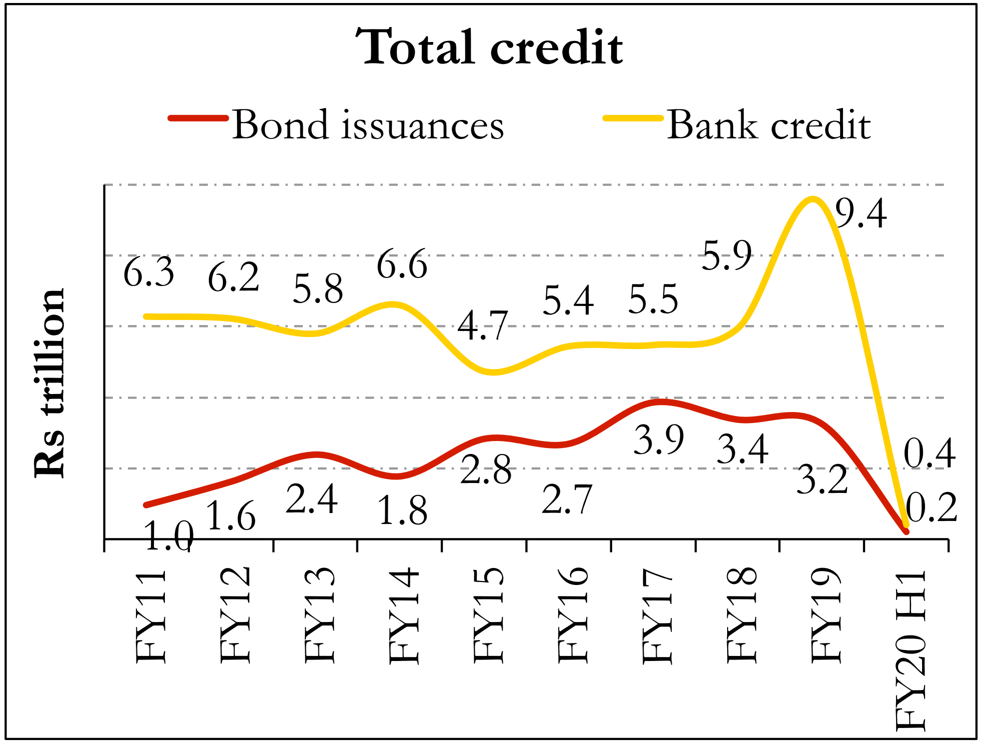
Growth has fumbled

- 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

IMA





- 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

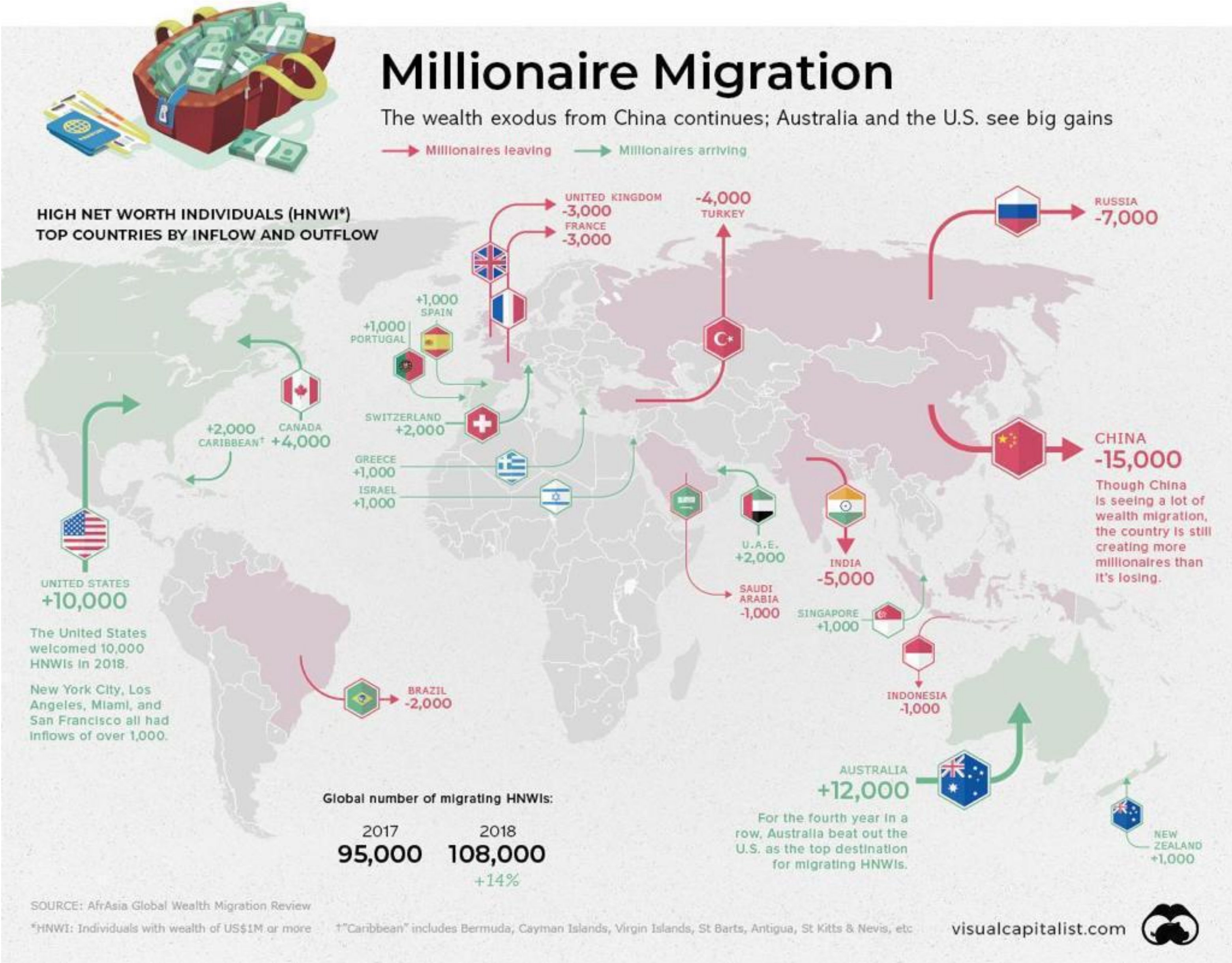
- The sustainability of Government spending depends on a rise in the tax-to-GDP ratio; currently this stands at 11%
- India has expanded its tax base but negated the effect through exemptions to farmers and the lower-middle class
- The solution lies in the lowering of GST rates to a single figure – 12% – 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

IMA

- 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

Migrations

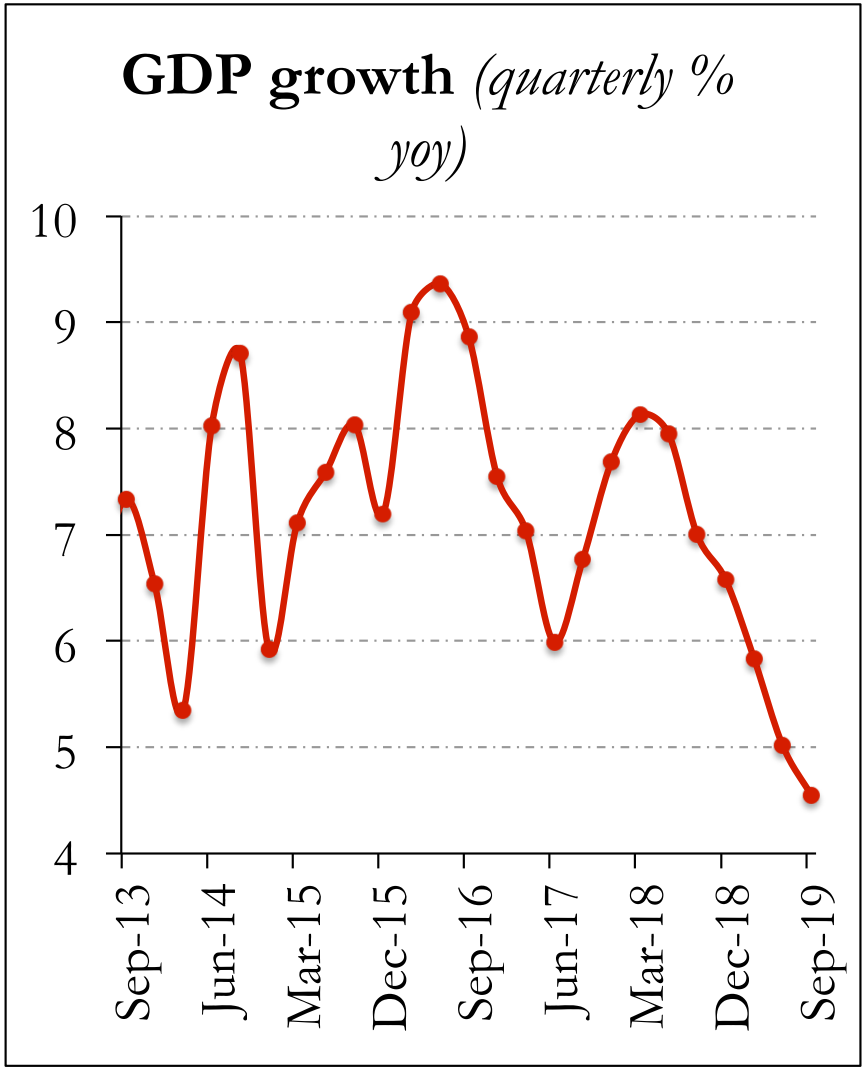


Millionaire Migration
The wealth exodus from China continues; Australia and the U.S. see big gains
Millionaires leaving
Millionaires arriving
HIGH NET WORTH INDIVIDUALS (HNWI*)
TOP COUNTRIES BY INFLOW AND OUTFLOW
UNITED KINGDOM -3,000
FRANCE -3,000
-4,000 TURKEY
RUSSIA -7,000
+1,000 SPAIN
+1,000 PORTUGAL
SWITZERLAND +2,000
GREECE +1,000
ISRAEL +1,000
+2,000 CARIBBEAN†
CANADA +4,000
CHINA -15,000
Though China is seeing a lot of wealth migration, the country is still creating more millionaires than it's losing.
U.A.E. +2,000
INDIA -5,000
SAUDI ARABIA -1,000
SINGAPORE +1,000
INDONESIA -1,000
UNITED STATES +10,000
The United States welcomed 10,000 HNWIs in 2018.
New York City, Los Angeles, Miami, and San Francisco all had inflows of over 1,000.
BRAZIL -2,000
AUSTRALIA +12,000
For the fourth year in a row, Australia beat out the U.S. as the top destination for migrating HNWIs.
NEW ZEALAND +1,000
Global number of migrating HNWIs:
2017 95,000
2018 108,000
+14%
SOURCE: AfrAsia Global Wealth Migration Review
*HNWI: Individuals with wealth of US$1M or more
†"Caribbean" includes Bermuda, Cayman Islands, Virgin Islands, St Barts, Antigua, St Kitts & Nevis, etc
visualcapitalist.com

The short term

IMA

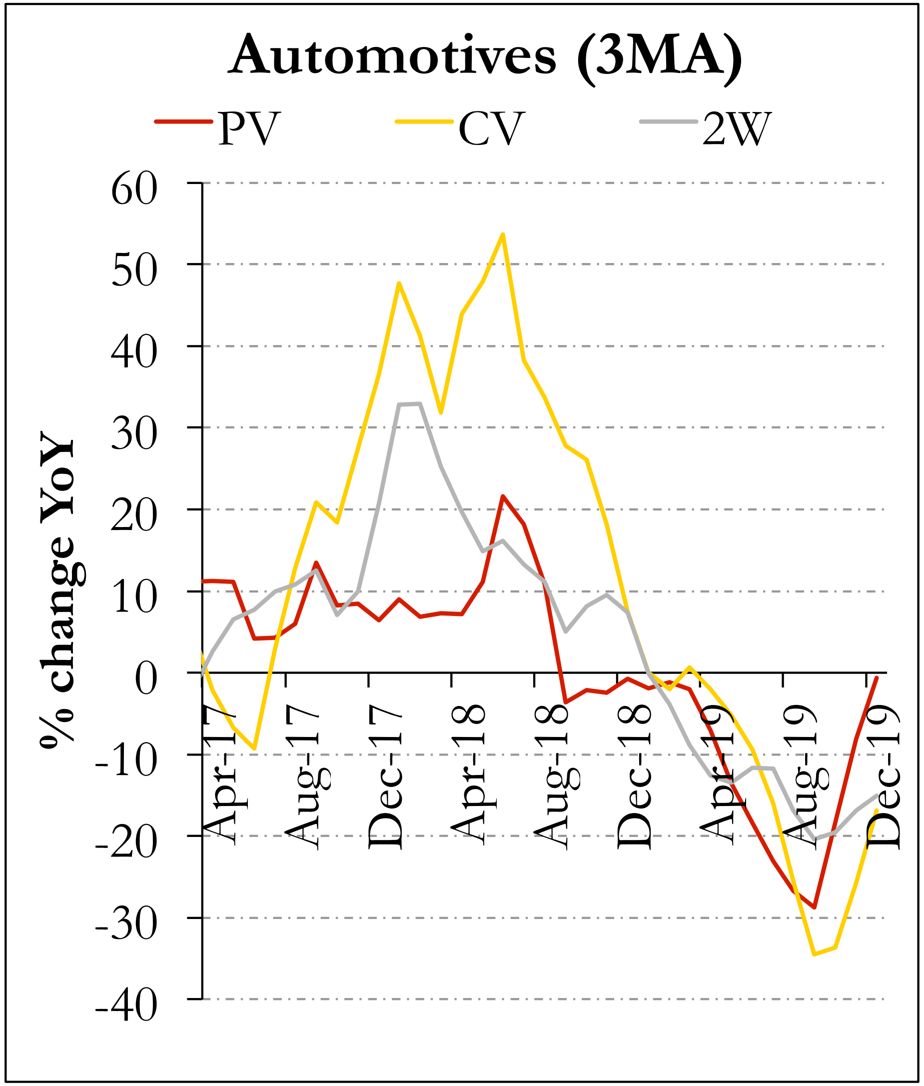
- Growth is likely to linger in the 5% range – lower than forecasts by agencies suggest
- The first step to address this is to fix defunct banks and NBFCs
- Privatisation is essential to improve productivity
- Budget imbalances will be higher than the Government's generous assumptions – a risk of foreign 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



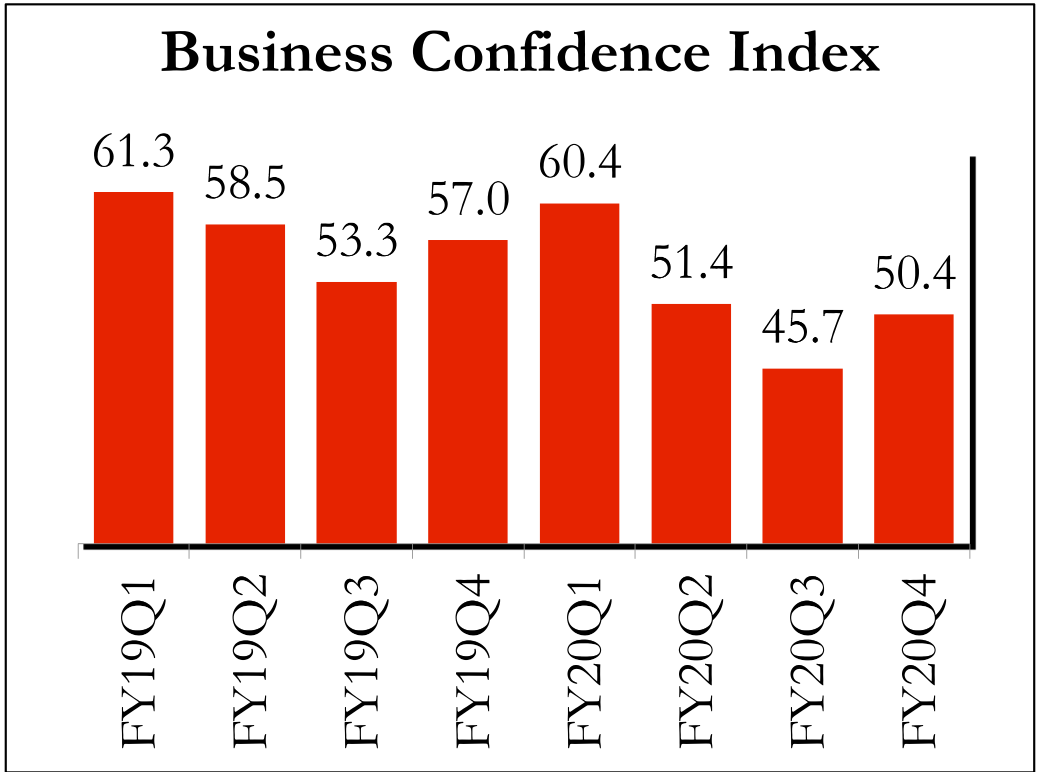
Source: CEIC, SIA, IMA analysis

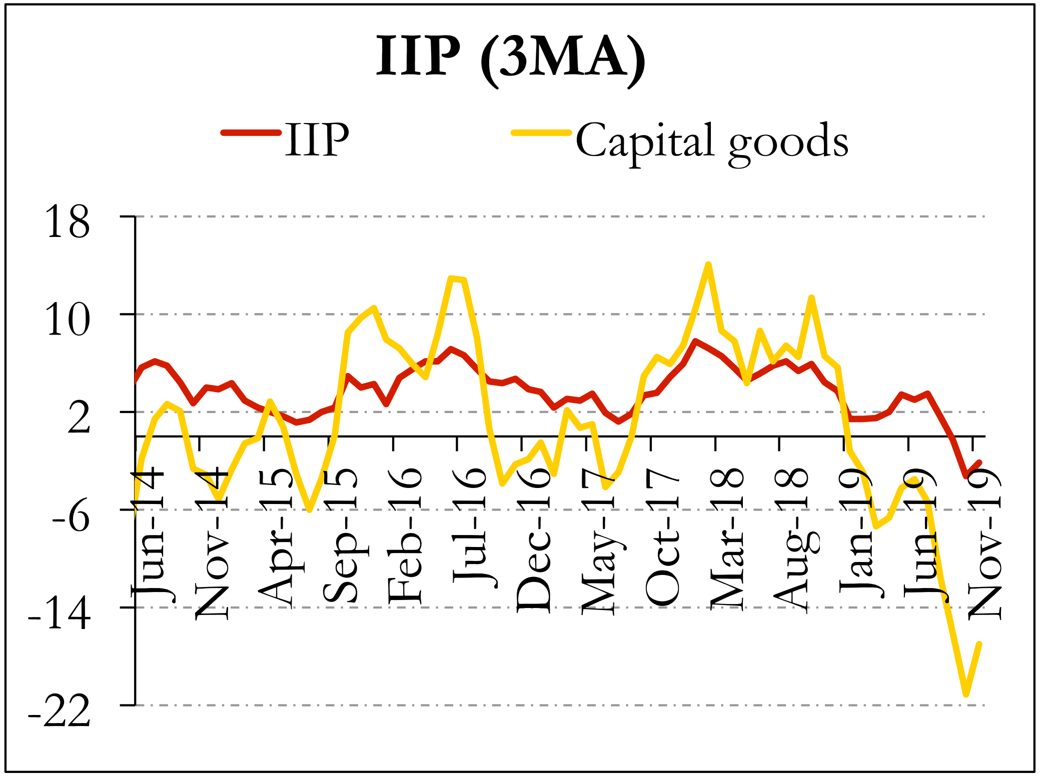
Other sectors: varying impact

IMA

- 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

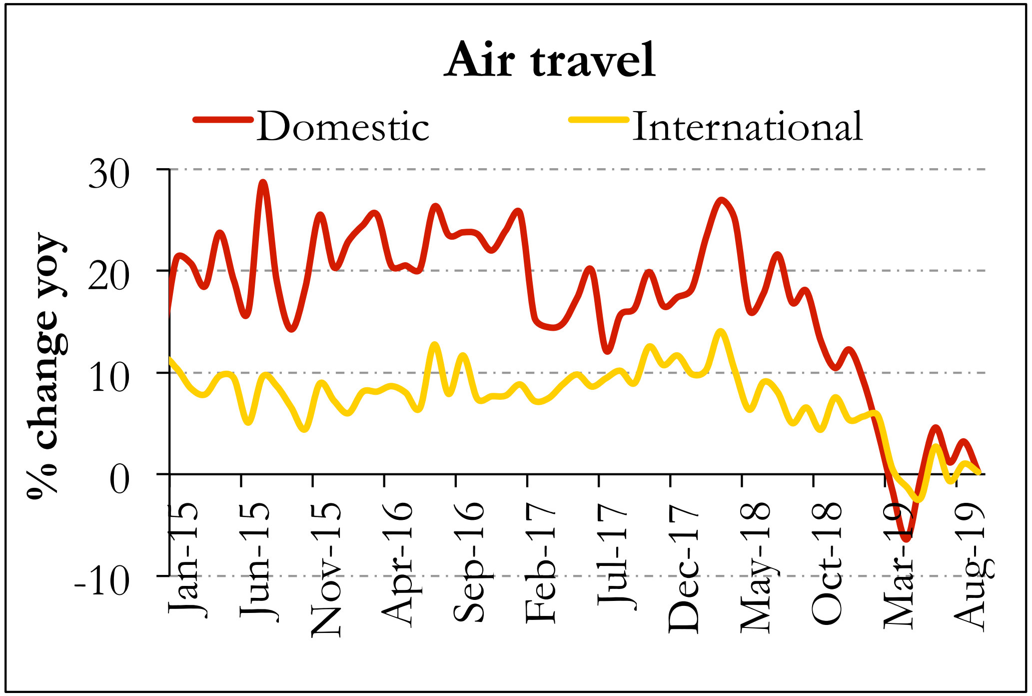


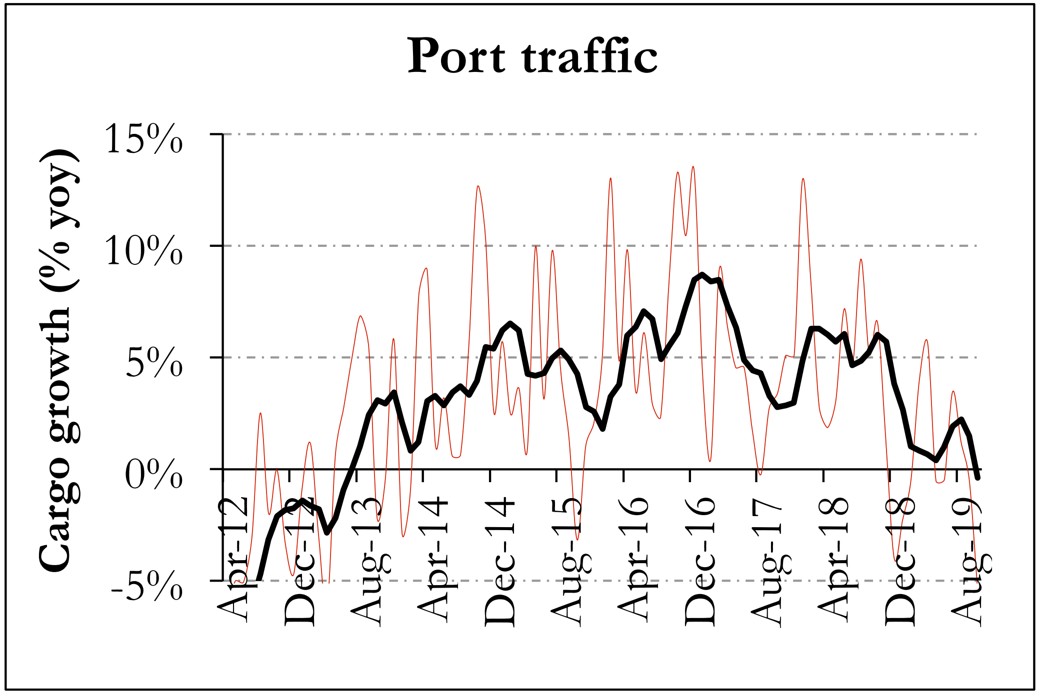


- IMA India's business confidence index dropped to 45.7 last quarter, the lowest in the Modi Government's tenure; now a small recovery
- The greater concerns stem from macroeconomic factors

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

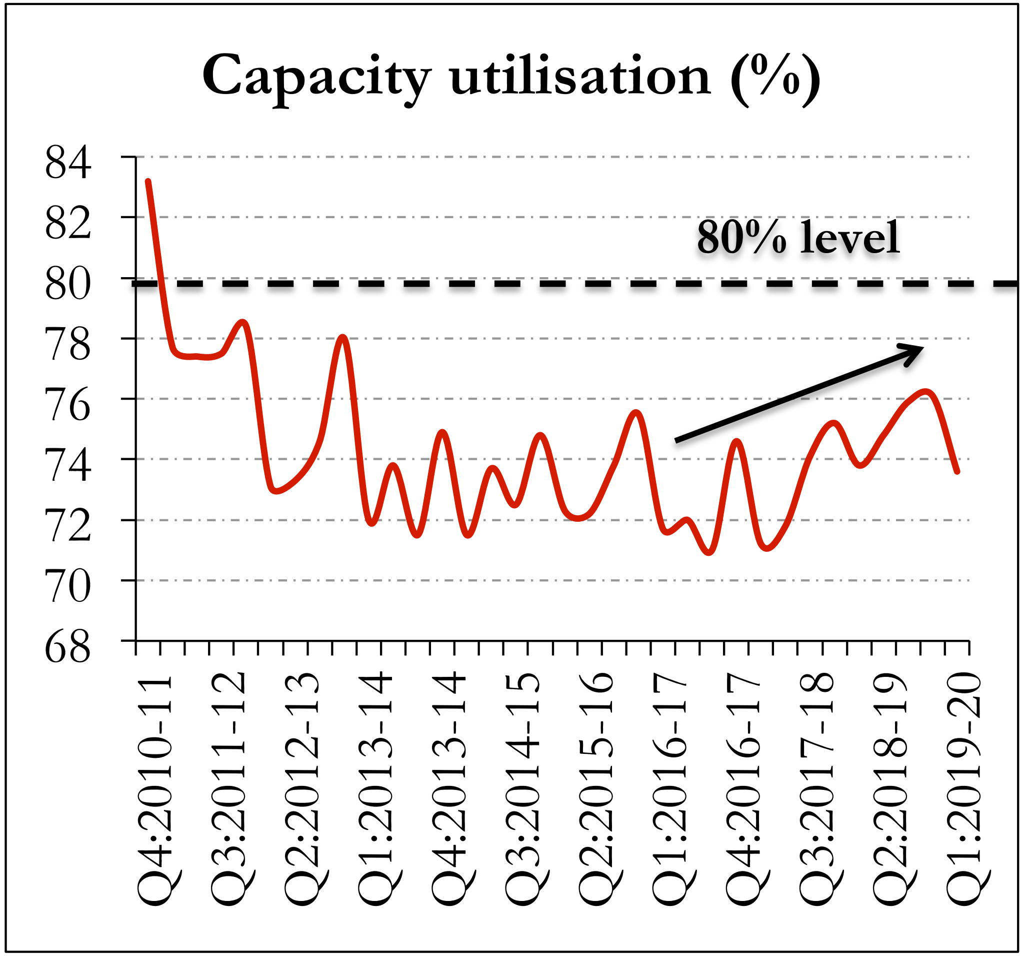
Source: CEIC, IMA analysis

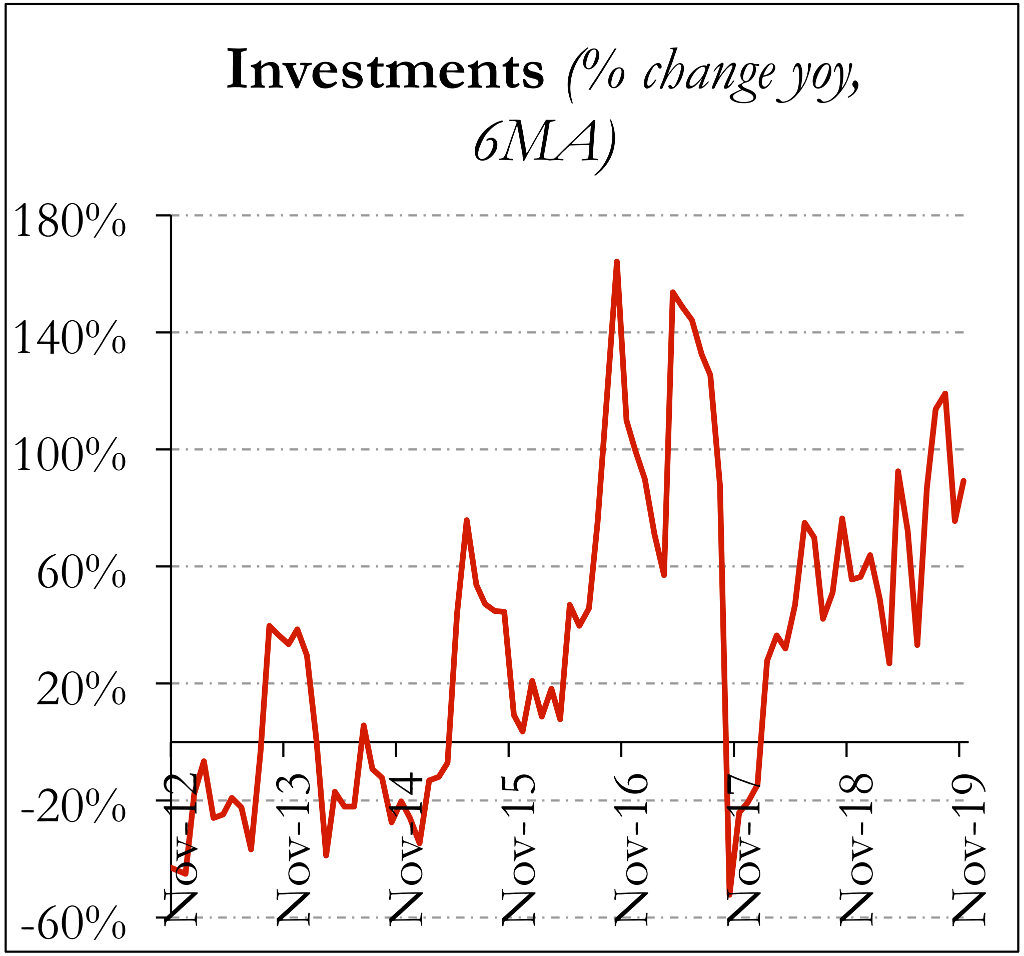
Capital formation, by sector

	% share	3-year CAGR	5-year CAGR
Overall GFCF	100%	9%	8%
Agri	7%	3%	6%
Mining	2%	4%	-1%
Mfrg	**17%**	8%	7%
Power	8%	6%	5%
Construction	6%	28%	6%
Trade and hospitality	**10%**	12%	6%
Transport and comm.	**10%**	26%	12%
Financial services	1%	2%	5%
Real estate	**22%**	1%	6%
Government	**11%**	14%	14%
Other	7%	20%	19%

A silver lining?

IMA





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

IMA

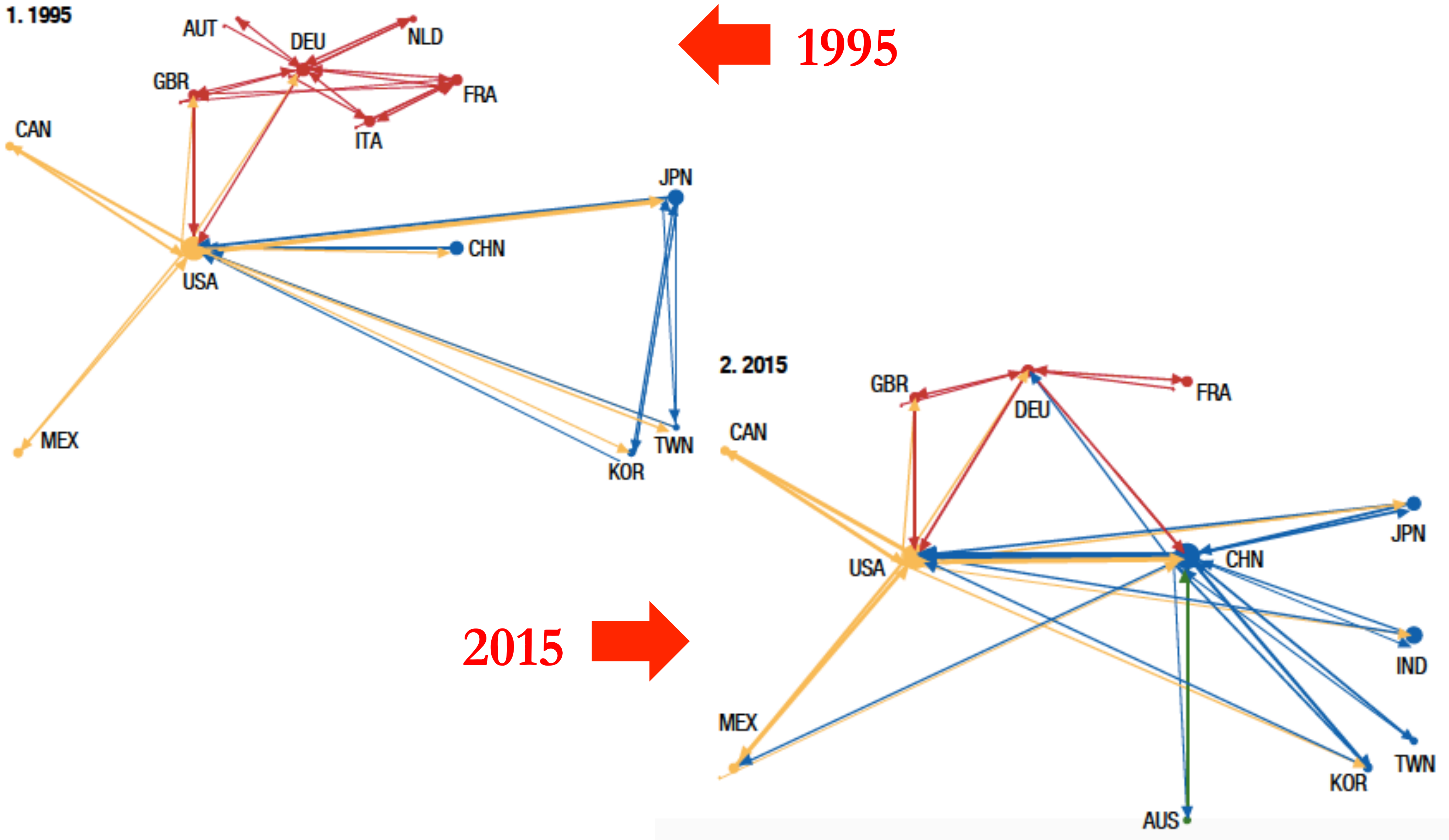
- Economic growth is the only way to drive people out of poverty; high levels of investment are essential for this
- Investment is a function of land, labour and capital – these markets need to be efficient, transparent and accessible
- Land and labour – largely a state subject; centre can tweak but 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

IMA

- 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



Thank you