L&T Financial Services

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1. Global Economic Outlook

- The global economy that was growing at a moderate but steady clip for nearly ten years, is expected to witness a slowdown in 2019 amid Brexit related risks, trade wars and higher interest rates.
- Global data trackers including the IMF and OECD are less optimistic in their global growth projections for 2019.
- Citing the potential fallout from the Sino-US trade war, the IMF had cut its global growth projection for 2019 from 3.9% to 3.7% in October, 2018. Now IMF is hinting a further likely reduction in growth forecasts when there will be a review in January, 2019 given emerging signs of slowdown in Asia, Europe & the US.
- The OECD also observed that global growth has peaked and the global economy "is navigating rough seas". It too slashed its global growth projection from 3.7% in 2018 to 3.5% in 2019 & 2020.
- However, some analysts at global investment firms feel that the combination of a peak in US rates and the start of tighter monetary policy elsewhere could result in a weaker US dollar in 2019. Currency markets will increasingly focus on the growing budget & current account deficits in the US, which will drag the US currency lower – which will be a silver lining for emerging market economies. Thus in 2019, there is scope for some of the negative factors to unwind, thereby easing financial conditions and supporting emerging market assets. (for example, Schroders' Report, Dec 21, 2018).

2. Outlook on Indian Agriculture

- Quarterly average GVA growth for India's agriculture during Sept, 2017 through Sept, 2018 has been healthy at 3.9%, yet the farm sector is under distress due to a crash in food prices.
- In terms of WPI statistics (which represents mandi prices), food inflation has turned negative since July, 2018 and averaged at just 0.98% during Sept, 2017 through Sept, 2018. During this period, non food inflation (from the primary sector) too averaged at a low of 0.95%.
- A multitude of factors has contributed to this situation including the disruption created by demonetisation, the GST implementation in the informal sector and the ineffectiveness of MSPs in improving farmers' cash-flows.
- According to farm sector watchers, the year 2019 could witness the national elections being fought on farmers' issues.
- India's government is considering several measures to support farmers in distress as pressures mount for a broad-based farm loan waiver scheme ahead of the national election. These include doubling collateral-free loans under Kisan Credit Cards (KCC) to Rs 2 lakh & changes in the Pradhan Mantri Fasal Bima Yojana (Crop Insurance) to enhance coverage & ensure faster settlement of claims. There is also some discussion (on whether) the classification of agricultural bad loans can be looked at. The upcoming Budget too is expected to have a strong rural & agriculture focus.

3. Outlook on India's Macros & Policies

- Economists expect India's macros & markets to witness heightened volatility in 2019 on the back of increasing global headwinds & looming elections.
- Political uncertainty in the run-up to the 2019 general elections and elevated cost of borrowings post the IL&FS debt defaults are expected to impact negatively investment spending (esp large-ticket projects) and hence, growth during FY19. Real GDP growth may hover near 7% over the year 2019.

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- According to Fitch Ratings, populist measures by the State & Central governments ahead of elections in May, 2018 may exert pressure on India's fiscal scenario; India's general debt to GDP ratio may touch 70.1% in FY19.
- There is a strong possibility that the Central government may miss the fiscal deficit target for FY19 and "fiscal consolidation in line with the FRBM roadmap" will be restored only after the new government is in place.
- With a number of states due for elections in 2019 (AP, Haryana, Odisha, Arunachal Pradesh, Sikkim, Jammu & Kashmir), higher budget spending and another wave of populist spending (farm loan waivers) can be expected.
- Continued disinflation in food prices, significantly lower oil prices, growing weaknesses in rural demand, dovish US Federal Reserve summary, stabilisation of INR, etc. may prompt the RBI for a rate cut in the first policy meeting under the new RBI governor in February, 2019.
- While lower oil prices augur well for India's import bill, a slowdown in global growth would be a drag on exports growth. Net capital inflows to finance the CAD – both portfolio inflows as well as FDI will remain volatile in H1, 2019 due to election –related uncertainty. On the positive side, expected weaknesses in the US dollar augur well for INR in 2019.

4. Outlook on Liquidity & Interest Rates

- Currently there is a gap between the growth in credit and deposits of the banking industry, with deposits growing at 9.7% and credit at 15.1%. The RBI's open market operations (which may touch Rs 2.5 trillion for the full year FY19 versus Rs Rs 12.35 billion in FY18) are helping to a great extent. Continuation of OMOs at the current pace combined with the reduced SLR requirements in 2019 should ensure adequate systemic liquidity to finance productive sectors.
- While the MPC has not changed the policy stance on paper, for all practical purposes the RBI has become accommodative.
- With the expectations of a benign inflation trajectory on the back of continued deflation in food prices, crude price expected to hover near $55/bbl and weaknesses in rural demand, we see a policy rate cut in February, 2019.
- So far as the private sector is concerned, interest rates on short-term instruments (that are more sensitive to immediate changes in policy stance & policy rates) may fall faster than interest rates on long term instruments as monetary policy loosens. Long-term rates will continue to factor in political and fiscal risk premium. Hence, we expect the yield curve to stay steep during 2019.

6. Outlook on Indian Gilts

- The first half of 2019 may bring more gains to India's sovereign bond market as demand supply dynamics has turned favourable and inflation remains under control.
- Yield on India's benchmark 10-year bonds has plunged more than 70 bps since Sept 30 to head for its biggest quarterly slide since 2008. It had risen in each of the past five quarters.
- However even in sovereign bond market, traders are more bullish on the relatively liquid part of the market, which is 5-7 years part of the curve. Fiscal risks and political uncertainties will limit the fall in longer-tenure bond yields and make the yield curve steeper in 2019.

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7. Outlook on INR

- Forex strategist expect the INR to be a top performer in 2019 on a “total return” basis amid low oil prices, a less hawkish Fed and an improving portfolio flow outlook.
- However, downside risks for INR remain in the form of – a reversal in oil prices, potential for slowing of capital inflows with increased political uncertainty ahead of the national elections and any significant deviation from the fiscal consolidation path.

8. Outlook on Indian Stocks

- Indian stock market activity is expected to stay highly volatile in H1, 2019 ahead of the general elections and amid several global headwinds like expectations of a slowdown in global growth, trade frictions, uncertainty about Brexit and central bank actions.
- In India, stock market participants are viewing the ongoing recovery in investment cycle with cautious optimism. While large-ticket investments are not happening in major manner, the smaller size capex has begun to come on stream.
- From the stocks’ perspective, the key trends to watch out for will be – the outcome of general elections & the perceptions of foreign investors about “political stability”; sustainability of the ongoing recovery in investment cycle; recapitalisation of select PSBs that may release risk capital for select sectors; oil price trajectory and the management of liquidity by the central bank.

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