

Indian Economy after COVID-19 – Turning crisis into an Opportunity

Reflecting on 2020 one feels that COVID-19 was a lesson on life, that combined many learnings in one i.e. the fragility of life & uncertainty of future, the power of nature, what really matters and what does not in life and above all, the need to move on. The experience of this episode shall not only shape our social behavior going forward but will also impact how corporates and economies operate for years to come. It is well known that COVID-19 has not only been a public health crisis but has also severely impacted the economy in near term. However, the good news is that situation is improving. As life limps back to normalcy, the outlook for the Indian economy is positive, supported, amongst other factors, by:

- Low oil prices and record low global interest rates, a result of COVID-19. These are two things that matter most to India from an external perspective.
- Improvement in corporate profitability driven by cost savings
- Economic disruption caused by COVID-19 and the recent border standoff have galvanized the government into action and it has made the most of this environment by ushering in a flurry of long pending reforms, especially to boost domestic manufacturing

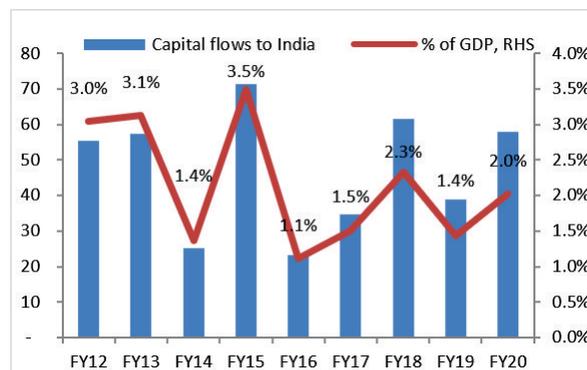
In our view, the current external environment is one of the finest that India has experienced in a long time on back of low interest rates globally, weak oil prices and likelihood of India benefiting from realignment of global supply chain. In this note, we briefly highlight the impact of each of aforesaid factors on India.

Low interest rates, Low oil prices and India:

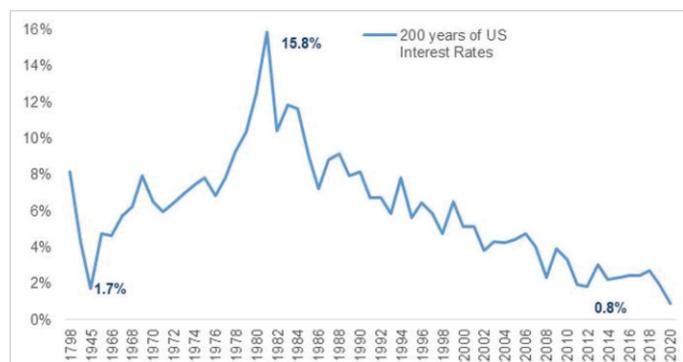
India is a net recipient of capital and over the last 8 years, has received foreign capital flows to the tune of ~2.2% of GDP, on an average, each year.

Sharply lower interest rates and ample global liquidity in the current environment, a result of COVID-19, are conducive for increased capital flows into India. Moreover, comments by Global central banks suggest that lower interest rates and high liquidity are here to stay for a while.

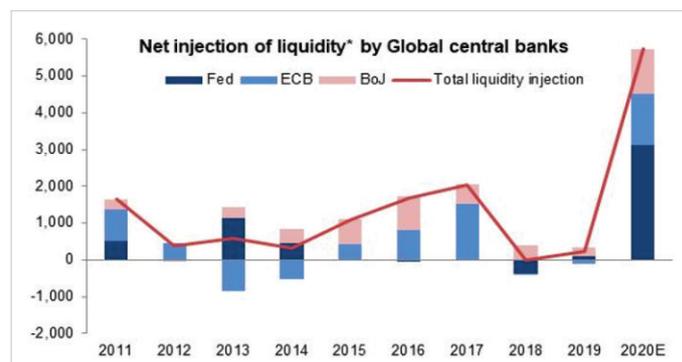
Given this backdrop, not surprisingly, India has seen a sharp increase in FPIs and FDI flows in recent times with FPI flows rising by 68% (till Nov'20) and net FDI increasing by 6.4% (till Sep'20) on YoY basis in FYTD21. *We had highlighted the likelihood of higher capital flows into India in our Mid year outlook titled "COVID-19, Lockdown, Oil & More" published in June 2020.*



Source: CMIE; Capital flows is aggregate of net FDI, FII, ECBs, etc (USD bn)



Source: <https://advisor.visualcapitalist.com/us-interest-rates/>
Macrotrends.net, Kotak Institutional Equities



* change in total balance sheet size of each bank; All figures in USD bn

One of the obvious beneficiaries of low cost of capital and surplus global liquidity is Infrastructure sector in India. Access to cheap and long term capital is critical for building infrastructure for countries like India. The relatively attractive yields on infrastructure assets in India is visible in rising interest amongst global investors to buyout these assets or through investments in REIT, InvITs, etc. Government is rightly focused on capitalizing this environment and has an aggressive plan to boost capital spending through National Infrastructure Pipeline wherein it is targeting infrastructure spending of INR 110 trillion by FY2025 (Source: National Infrastructure Pipeline database).



Further, sharply lower domestic interest rates have resulted in lowering EMIs for home loans, personal loans, car loans, etc. and this is supportive of revival of economy. The high frequency economic activity indicators, as indicated in table below, are also suggesting an improving economic outlook

YoY Growth (%)	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20
Railway tonnage movement	-35.2	-21.6	-7.8	-4.7	3.8	15.3	15.2	8.8
Power demand	-24.0	-15.2	-10.5	-2.7	-2.1	4.6	12.1	3.5
Average E-Way bill generated	-83.6	-53.0	-12.7	-7.3	-3.5	9.6	21.4	7.3
Average Daily import duty collection	-49.4	-35.2	-30.1	-15.7	-18.8	-2.7	11.1	21.3
Manufacturing PMI*	27.4	30.8	47.2	46.0	52.0	56.8	58.9	56.3
Services PMI*	5.4	12.6	33.7	34.2	41.8	49.8	54.1	53.7
Gross GST Collection	-71.6	-38.2	-9.0	-14.4	-12.0	3.9	10.2	1.4
Unemployment rate (%)	23.5	21.7	10.2	7.4	8.4	6.7	7.0	6.5
Average Daily Retail E-transactions^	-12.6	16.5	46.7	52.1	50.2	67.4	58.3	70.2
PV registration@	-90.2	-83.9	-26.3	-5.4	11.3	31.9	4.2	0.0
2W registration@	-75.9	-88.6	-37.8	-33.4	-25.3	-11.0	-25.6	-22.5
Tractor registration@	-84.2	-74.9	6.9	42.6	28.7	88.1	62.1	11.0

Source: Raildrishti.com, MOFSL, gstn.org.in, www.icegate.gov.in, CMIE, PIB, RBI, vaahan.parivahan.gov.in

* Does not reflect yoy change; number >50 reflects expansions and number <50 reflects contraction compared to previous month

^sum of UPI+IMPS; @ - November 2020 figures are preliminary estimates and are subject to be upward revision

Impact of low oil prices: India meets ~85% of its crude oil requirements through imports. Also, oil imports accounted for over 1/4th of import bill and more than 100% of our current account deficit in FY20. Importance of oil prices, therefore, cannot be over emphasized for India. Oil prices have fallen sharply and average in FYTD21 is ~USD 40/barrel (FY20: ~USD60/barrel). Every USD 10 / barrel fall in oil prices results in saving of USD 12-14 bn on annual basis i.e. ~0.4 to 0.5% of GDP. Consequently, India is likely to experience a current account surplus in FY21, a first after 16 years!

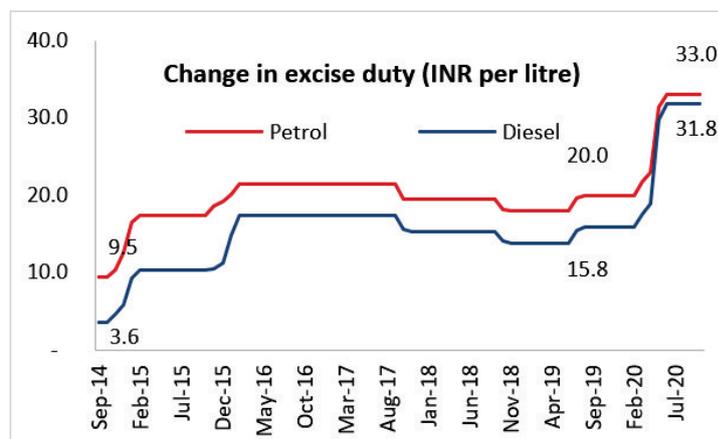
(Source: Kotak Institutional Equities)

Lower oil prices also have a favourable bearing on fiscal deficit. The bulk of the benefit of lower oil prices has been retained by the government through increase in duties on petrol and diesel. Revenues from excise duty on petroleum products are, therefore, expected to increase from 1.1% to 2% of GDP in FY21E, thus, providing cushion to government revenues in an otherwise difficult year. If oil prices sustain around current level and duties are not reduced, this should help fiscal deficit even in FY22.

Lower global interest rates and weak oil prices, a result of COVID-19, have thus favourably impacted India's external situation/macro-economic stability and should also aid revival in economic growth.

USD bn	FY17	FY18	FY19	FY20	FY21E
Trade Deficit	112	160	180	158	85
Net oil imports	55	71	94	88	43
Current Account Deficit	-14	-49	-57	-25	28
CAD as % of GDP	-0.7	-1.9	-2.1	-0.9	1.1
Foreign Exchange Reserves	370	424	412	476	575*

* As on 20 November, 2020



Source: PPAC

Improvement in corporate profitability: Against the initial fear of sharp fall in corporate profitability, India Inc. responded prudently and proactively reduced costs post the outbreak of pandemic. This resulted in NIFTY50 stock earnings growing at healthy pace and higher than expectations in Q2FY21 (+16.4% YoY, Source: Kotak Institutional Equities), despite the softness in revenues. Given the prospects of sequential recovery in economic activity, demand is expected to improve Q3 onwards. Thus, driven by growth in revenue and cost savings, earnings growth should continue to remain healthy and augurs well for health of corporate balance sheets. This can reverse the trend of weakness in earnings seen during the past few years and can provide flip to private capex which should aid growth over medium term.



COVID-19, global supply chain realignment, Border standoff and Make in India

The rise of Chinese manufacturing since early 2000s is well documented and is clearly reflected in rise of its share in global merchandise trade to ~13.6% by 2015. However, in last few years, due to rising labour costs, higher environment compliance costs, etc. competitiveness of China has been reducing and their share in global merchandise exports has been trending down. In our opinion, this process can accelerate in the backdrop of COVID-19 and India can be a potential beneficiary.

Factors like strong association of COVID-19 with China, over dependence of global supply chain on China and consequent widespread disruption caused in supply chain due to COVID-19, keenness of global MNCs to derisk and follow China plus one strategy, trade tensions between US and China and the recent border standoff between India and China have all come together to create a very favourable environment for boosting manufacturing in India. Reflecting on the almost eerie coincidence of simultaneous happening of these unrelated events, it appears that nature is conspiring to provide a second opportunity to India to gain a foothold in global manufacturing, after it missed the first opportunity in early 2000s.

Sensing this opportunity, Government has spurred itself into action, especially post the border standoff, and has taken series of steps in quick succession over the past few months like launching PLI schemes for multiple sectors, raising tariff and non-tariff barriers, rationalizing labour laws, etc. Further, it is for the first time, India is leveraging its large domestic market to incentivize domestic manufacturing. Apart from above, over last few years, Government was implementing measures at a steady pace by focusing on improving ease of doing business, reducing corporate tax rates, Aatma Nirbhar package, etc. We believe that these measures and current environment bodes well for manufacturing in India.

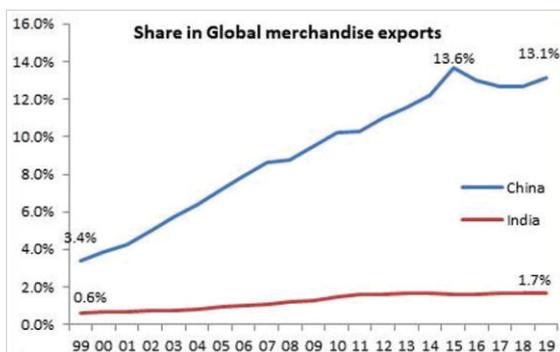
The size of the manufacturing opportunity is enormous and a 0.3% gain in share of global merchandise exports (~USD 65 bn) each year can push India's GDP growth by over 2% per annum. It is interesting to note that China gained share of ~0.7% each year, on an average, in global merchandise trade over 15 years. To sum up, India's cost competitiveness, large domestic market compared to regional peers, favourable government policies, manufacturers' keenness to adopt a China + 1 strategy, etc. should enable India to materially increase its share in global manufacturing, in our opinion.

Conclusion:

COVID-19 was akin to a flood that causes damage but also leaves behind silt, nutrients, etc., thus improving the fertility of soil for years to come. While COVID-19 has caused deep pain to individuals/society and near term economic disruption but has also led to lower oil prices, low interest rates, ample global liquidity and favourable environment for increase in manufacturing. These factors coupled with accelerated pace of reforms focused around improving India's local manufacturing and a conducive environment to gain share in global manufacturing has the potential to put Indian economy back on a high growth trajectory on a sustained basis.

DISCLAIMER

The views expressed herein are as of 02 December 2020 and are based on internal data, publicly available information and other sources believed to be reliable. The statements contained herein are based on our current views and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. HDFC AMC / HDFC Mutual Fund is not guaranteeing / offering / communicating any indicative yield or returns on investments. Neither HDFC AMC and HDFC Mutual Fund (the Fund) nor any person connected with them, accepts any liability arising from the use of this document. The recipient(s) before acting on any information herein should make his/her/their own investigation and seek appropriate professional advice.

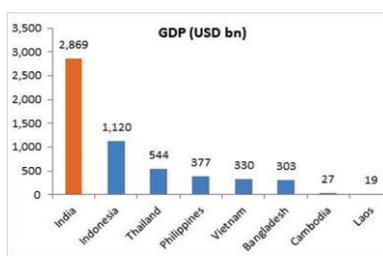


Source: Worldbank

List of reforms done in past one year or so

Production Linked Incentive Schemes for select industries to promote import substitutions and increase exports
Raising duties under Phased Manufacturing Programme to strengthen domestic manufacturing and discourage imports
Rationalisation of Labour Laws
Agriculture reforms to remove bottlenecks and improving market access
Reduction in Corporate tax rates
Opening up defence sector and banning imports of select items
Revision of MSME definition to incentivise scaling of operations

Source: Morgan Stanley; Publicly available information



Source: IMF, JETRO. GDP in 2019

