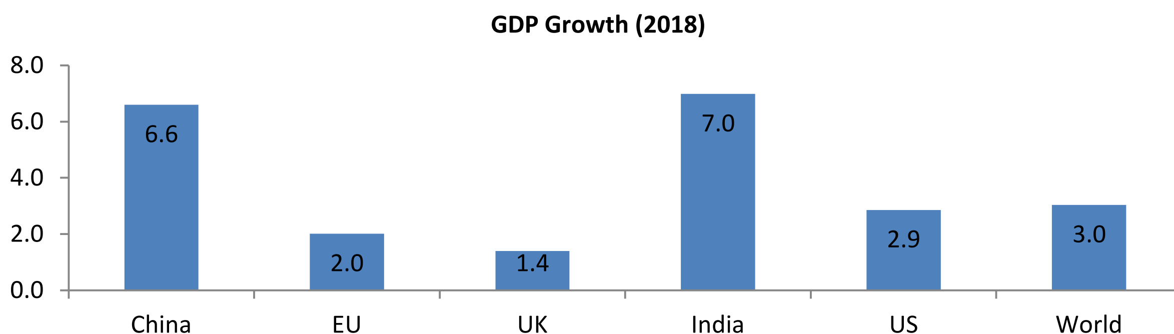
India Market Report 2019

Macroeconomic Overview

India – The Growth Story

For the global economy, 2018 turned out to be a challenging year wherein the world output growth declined from 3.8% in 2017 to 3.6% in 2018. Growth rate of world output is projected to fall further to 3.3% in 2019 as growth of both advanced economies and emerging & developing economies are expected to decline. Growth of the Indian economy moderated in FY19 with a growth of 6.8%, slightly lower than 7.2% in FY18. Yet, India continued to be the fastest growing major economy in the world. India maintained its macroeconomic stability by containing inflation within 4% and by maintaining a manageable current account deficit to GDP ratio. The current account deficit to GDP was higher in FY19 as compared to FY18, primarily due to higher oil prices, which were about 14 $/bbl higher in FY19 vis-à-vis the previous year. However, the current account deficit started to narrow in the third quarter of the year. The manufacturing sector was characterized by higher growth in FY19 while the growth in agriculture sector witnessed tapering. Growth in investment, which had slowed down for many years, has bottomed out and has started to recover since FY18. Overall investment rebounded in FY19 with fixed investments growing by 12.2% as compared to 7.6% in FY18, moreover the investment to GDP ratio is estimated to have improved to 32.9% in FY19 compared to 30-31% over last 5 years. Capital expenditure of Central Government grew by 15.1 % in FY19 leading to increase in share of capital expenditure in total expenditure.

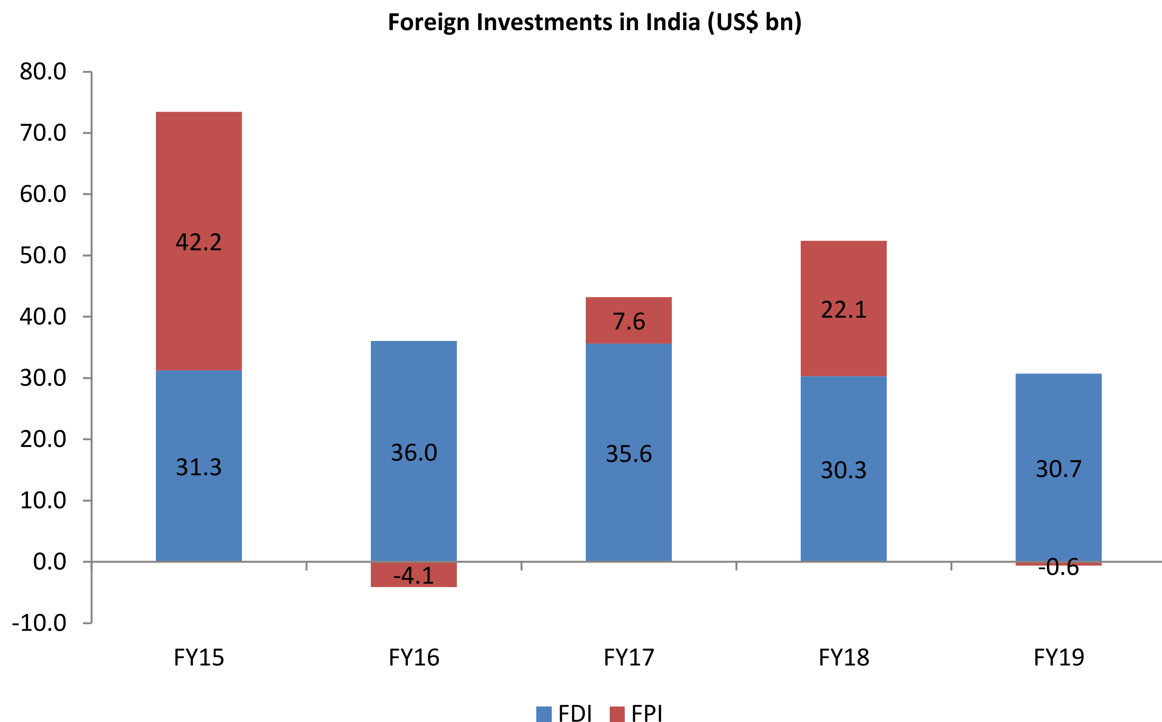


Source: World Bank

India's GDP growth decelerated to a more than five-year low at 5% in the June quarter of FY20, against 5.8% in the previous quarter. This is way below analysts' expectations of economic growth at 5.7% in the June quarter. This is likely to increase demand for a stimulus package from the government and indicates that the pain for the economy is not over yet. Manufacturing growth almost collapsed to 0.6% in the June quarter, against 3.1% in the March quarter, in a sign of the dismal state of the industrial sector of the economy. Among services sectors, only trade, hotels, communication segment have grown faster in the June quarter at 7.1%, compared with the March-quarter growth of 6%. Both financial services (5.9%) and public administration services (8.5%) decelerated in the June quarter. The only sector that registered a robust pick-up is electricity, growing at 8.6% in the June quarter, from 4.3% in the preceding quarter. Given the macroeconomic situation and the structural reforms being undertaken by the government, the economy is projected to grow at 6.3 % in FY20.

Foreign Investments in India

Net Foreign Direct Investment (FDI) inflows for FY19 remained flat at US$ 30.7 bn compared to US$ 30.3 bn in FY18. Among the top sectors attracting FDI equity inflows, services, automobiles and chemicals were the major categories. The assets of the FPIs in India, as reported by the custodians, decreased marginally from US$ 483.7 bn in FY18 to US$ 481.4 bn in FY19, due to lower INR vs USD.

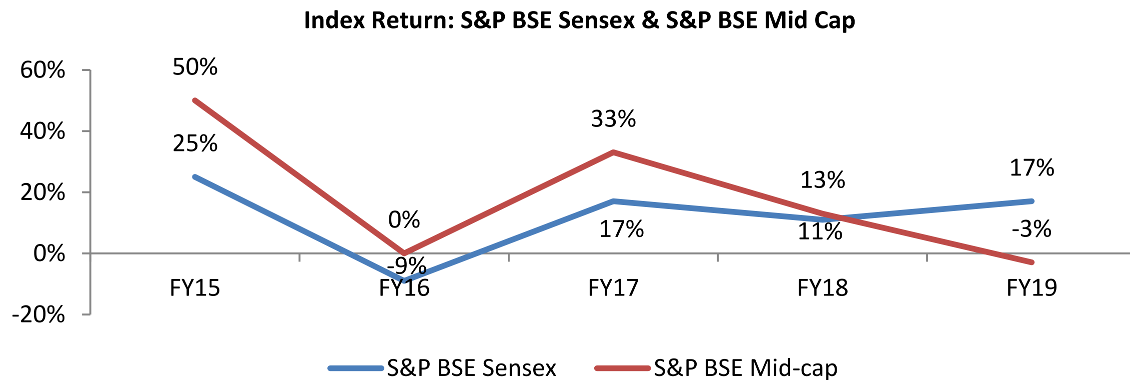


Source: RBI

Secondary Market

Securities Market Returns- A roller-coaster ride

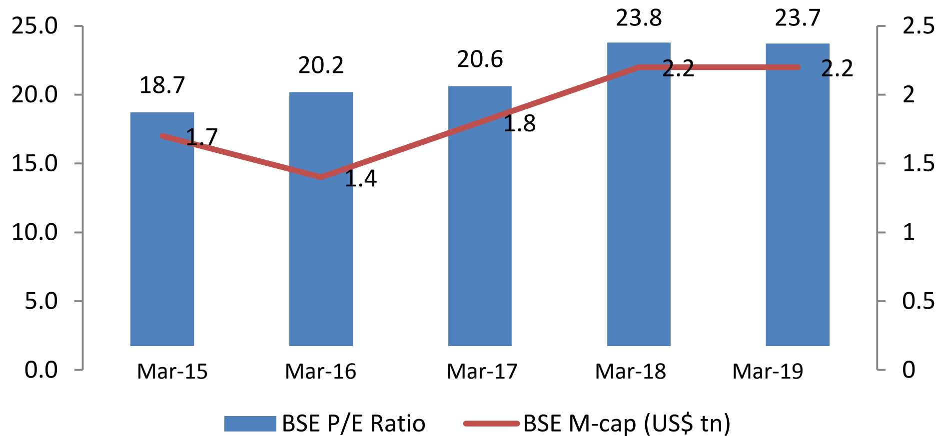
Equity market returns witnessed strong rally over the past three years, with S&P BSE Sensex and NSE Nifty touching new peaks, tempered by intermittent corrections. Some of the factors that contributed to investor's confidence in the Indian markets were – strong growth rates, benign inflation, key structural reforms like implementation of GST, recapitalization of public sector banks, progress in resolution of insolvency and bankruptcy matters, reduced geo-political tensions and a normal monsoon rainfall.



Source: BSE

Having said this, the index returns over the past do not paint the true picture of the pain that investors went through wherein the mid-cap stocks witnessed massive fall. The liquidity crisis led to sharp de-rating in few sectors like Auto, BFSI and individual stocks which were out of the index witnessed major wealth erosion in FY19 and hence we feel that the positive return generated by the benchmark index in India doesn't give the right picture. As it can be seen from the above graph while BSE Sensex delivered 17% positive return, the BSE Mid-Cap Index delivered negative 3% return in FY19.

BSE's Market Capitalization stood at US$ 2.2 tn and P/E ratio was 23.7 in March -19.

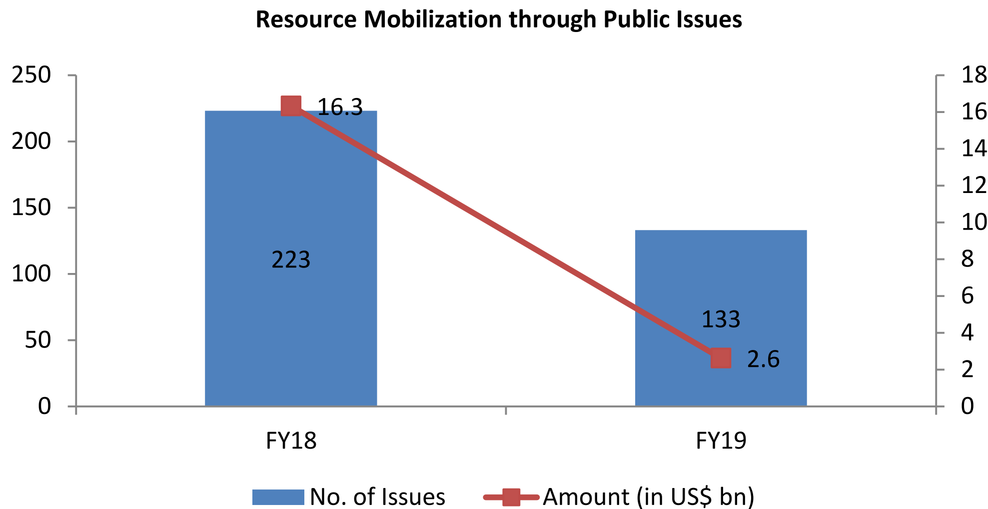


Source: BSE, SEBI

Primary Market

Public and Rights Issues

The fund-raising during FY19 was subdued vis-à-vis FY18 from Public Issues (including Rights Issues). During FY19, 133 companies accessed primary market and raised US$ 2.62 bn as against 223 companies which raised US$ 16.15 bn in FY18.



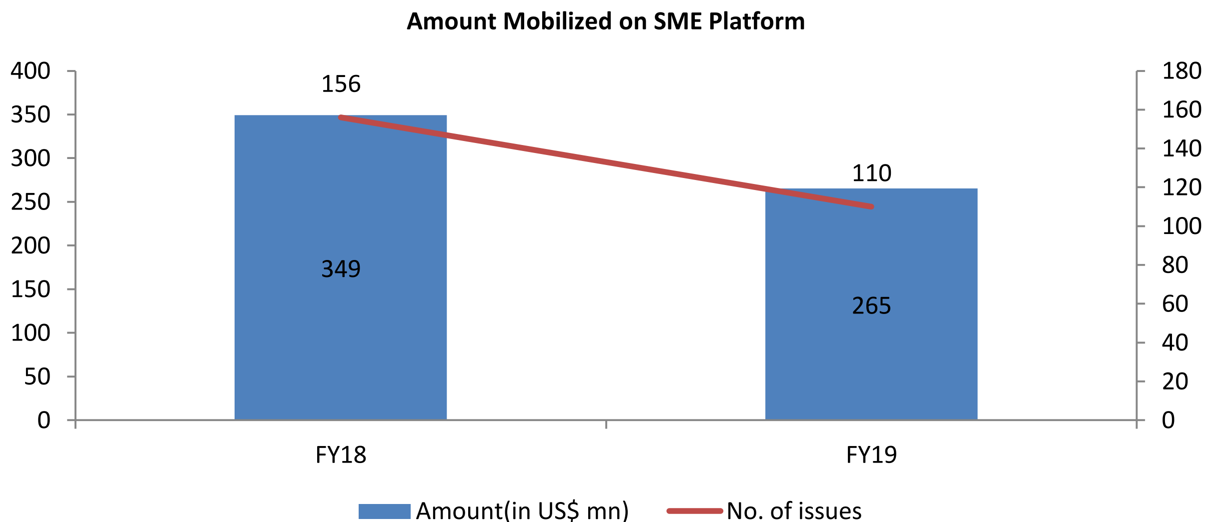
All offers for sale have been included under the head of IPOs/FPOs

The primary market resource mobilization is inclusive of amount raised on the SME platform

Source: SEBI

SME Platform

The SME platform also witnessed a drop in FY19 as against FY18 both in terms of the number of companies accessing and the amount raised through IPOs. In FY19, 110 companies were listed in the SME platform raising a total amount of US$ 265.5 mn as compared to US$ 345.7 mn raised through 156 issues in FY18.



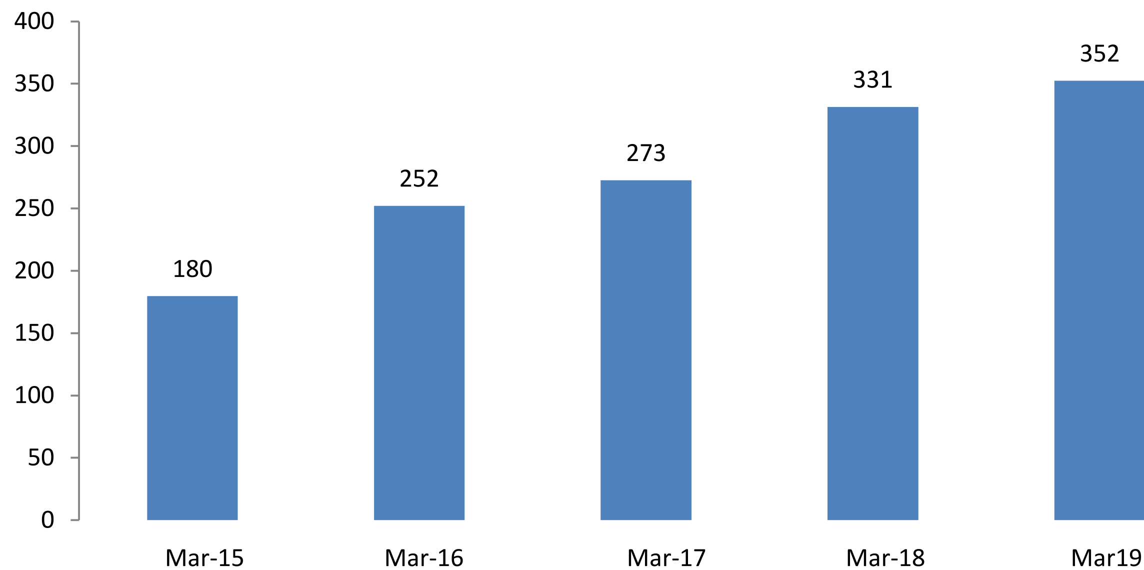
Source: SEBI

Asset Management Industry

As of 31st March 2019, the Assets under management (AUM) of the mutual fund industry stood at ~US$ 352 bn. Inflows in India's mutual fund schemes via the Systematic Investment Plan (SIP) route reached US$ 10.43 bn during FY18 from US$ 6.55 bn during FY17, which further increased to US$ 13.34 bn in FY19. The average AUM has further increased to ~ US$ 367 bn at the end of August, 2019.

AUM of Equity Schemes increased to US$ 128.4 bn by FY19 vs US$ 116.4 bn in FY18. The growth in the beyond top- 30 cities, with help of alternative investments and regulation norms, are expected to shape the mutual fund industry in the coming years.

Mutual Fund AUM (in US$ bn)

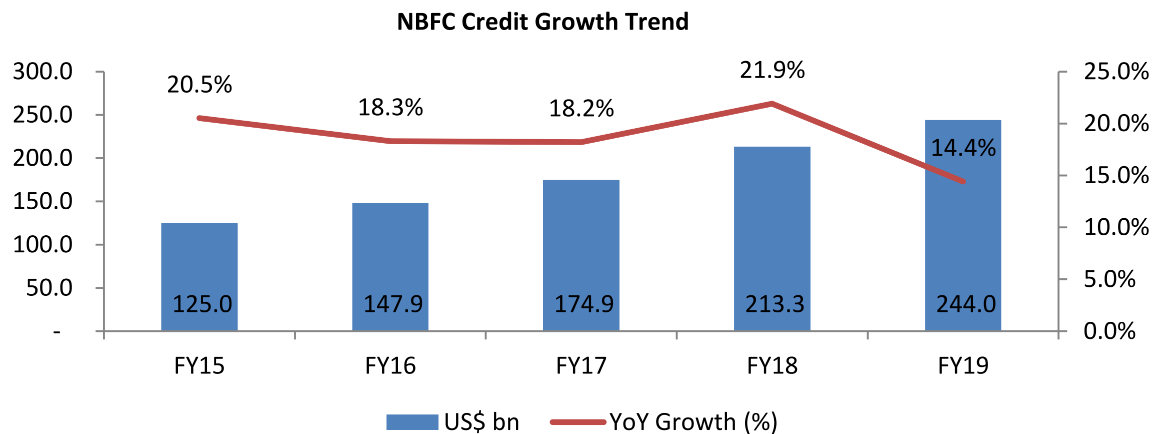


Source: IBEF/ AMFI

NBFC Sector- A Unique Story of the Indian Economy

India's NBFC sector continues to remain at the forefront in driving new credit disbursals for the country's underserved retail and MSME market. Over the last five years, the NBFC lending book has grown at nearly 18% YOY driven by a deep understanding of target customer segments, use of technology advances, lean cost structures and differentiated business models to reach credit-starved segments.

After witnessing healthy growth over the past few years, non-bank credit growth slowed down in the second half of FY19 due to the tight liquidity conditions that engulfed the sector. Consequently, Non Bank Financial Companies (NBFCs) which were gaining market share from banks across major asset classes in the past could not do so in FY19. As shown below, the growth rate of top 30 listed NBFCs, slowed down in FY19 compared to earlier years.



Sources Company Annual Reports

Despite recording robust growth, the NBFC market share is mainly dominated by large players, while many small players have struggled to profitably expand their operations. Moreover, recently, the sector has taken a beating in the stock market with defaults and liquidity challenges, specifically related to one large NBFC. Although the problem seems isolated, it has concerned regulators due to the risk of contagion effect and the overall governance in the sector. Given the sector is fairly large now to impact the overall economy, this certainly entails some potential implications, including new compliance measures by the regulator, lending slowdown and potential consolidation by larger players.

The Indian economy has been on a positive trajectory in the amount of formal credit deployed, supplemented by rising consumer disposable income and ease of access to credit. Credit off-take has grown by 11% over the last 10 years, led by public and private sector banks. However, despite overall credit growth, India still remains under-penetrated in retail and MSME lending.

Reasons for growth of NBFCs

- **Deep understanding of the customer segment**: Given their operations in unorganized and under-served segments of the economy, NBFCs have created a niche for themselves through a deep understanding of needs of their customer segments and ensuring last-mile delivery of products and services.
- **Customized product offerings**: Several NBFCs have focused on a limited line (or often mono-line set of products) to serve the target customer segment. Armed with a thorough comprehension of their target segment, NBFCs have customized product offerings to address unique characteristics of the customer segment and focus on meeting the right needs. Additionally, several NBFCs are also adopting non-standard pricing models for product lines, in-line with the customer profile and inherent risk of lending.
- **Wider and effective reach**: NBFCs are now reaching out to Tier-2, Tier-3 and Tier-4 markets, distributing the loan across several customer touch-points. Furthermore, they are also building a connected channel experience, that provides an omni-channel, seamless experience with 24/7 sales and service. With the consumer of today evolving and accessing digital media like never before, NBFCs have embarked on new and better ways to engage with the customer.
- **Leveraging technology advances for improved efficiency and enhanced experience**: The use of technology is helping NBFCs customize credit assessment models and optimize business processes, thereby reducing the time to market and helping improve customer experience. Select NBFCs are also investing in data analytics and artificial intelligence to build robust relationships with their target customer segments.
- **Co-lending arrangements**: NBFCs have been tying up with multiple alternative lenders with digital platforms and commercial banks as well, which has been adding to their targeted customer base.

- **Robust risk management**: Given their focus on lending to the sub-prime customer segment, and regulatory disadvantage (SARFEASI, DRT and capital adequacy requirements) in comparison to commercial bank lenders, NBFCs are ensuring enhanced governance through a pro-active, robust and agile risk management model.

Reasons for recent NBFC crisis

- **Leveraging an off-the-roll sales force with no direct ownership:** The absence of direct sales agents on NBFC payrolls has had a downward spiraling effect on the quality of sourcing. In addition to resulting in minimal accountability, the situation has also been exacerbated by agents looking to exploit gaps and loopholes with the existing underwriting model to on-board new customers.
- **Gaps in the underwriting model:** Given the focus on lending to the under-served segment, an approach to effective underwriting has required NBFC lenders to form personal relations with prospects and taking a credit call based on local context. The decline in asset quality for select NBFCs has stemmed from cases where underwriters are inexperienced, or with limited understanding of the local situation and dynamics that drive the demand for credit.
- **Misalignment in product offerings with customer needs:** Small NBFCs, in an effort to capture share, have expanded into new geographic locations and diversified their product portfolio. This has resulted in aggressive investment, increased cost of acquisition and operations.
- **Asset-liability mismatch:** Lot of Indian NBFCs had been lending towards long term loans with short term borrowing and this had caused a negative asset liability mismatch, which means the cash inflow was not sufficient to match the cash outflows. This led to decline in the refining ability of the NBFCs and eventually their growth was impacted. However, NBFCs in India have now become cautious post this event and are approaching more prudent business practices.

Conclusion

India's development trajectory is critically intertwined with the investments in social infrastructure. To reap the benefits of demographic dividend, the government is committed to improve the outcomes in education and skill developments, and to provide employment and affordable healthcare to all. Scaling up development programs for improving connectivity, providing housing, and bridging gender gaps in socio- economic indicators is of paramount importance for sustainable development. India's march towards achieving Social Development Goals (SDGs) is firmly anchored in investing in human capital and inclusive growth.

Overall investment rebounded in FY19 with fixed investments growing by 12.2% as compared to 7.6% in FY18, moreover the investment to GDP ratio is estimated to have improved to 32.9% compared to 30-31% over last 5 years. The pick-up might have brought with it a healthy change in the investment spending mix, though official data on this will only be available in early 2020. Spending (by the Centre and the states) on construction of rural roads, highways, and affordable housing drove public investments, but private investment looked up only in select sectors such as auto, cement and steel, where capacity utilization increased.

The financial services sector had a tough time over the last one year, particularly the NBFC sector, which had lower access to liquidity. This had a material impact on the overall consumption and growth of the economy. While problem still persists in the sector, there is a sense of improvement and hence the last mile credit which is provided by NBFC should be back on track and help the recovery in growth in India.

For FY20, sustaining the momentum in overall investments will be a tough task without support from private investments. With continuously improving capacity utilization and the end of the de-leveraging phase for the corporate sector, conditions are ripe for a revival of private corporate investments. We believe the recent tax mega reforms carried out by the Govt. of India should attract large scale investments and propel the growth. And in couple of quarters, India's growth engine should fire all the cylinders.

Note:

Financial Year (FY) is period of one year starting 1st April and ending 31st March e.g. FY19 means one year ending on 31st March 2019.