

## India Market Update & Outlook: CoVid-19 Pandemic

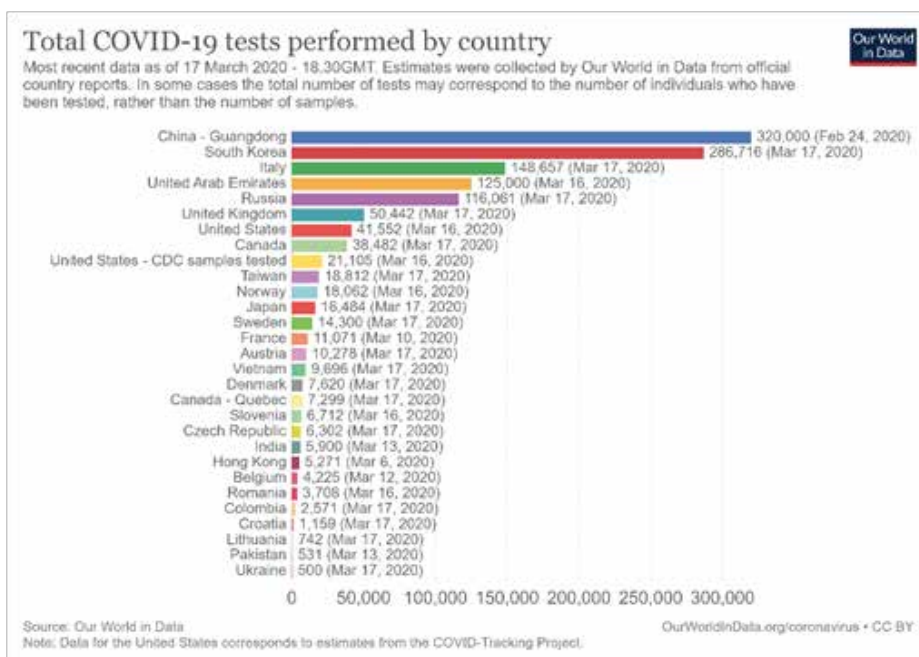


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### India Market Update: CoVid-19's Arrival

Global markets have recently been under duress as investors grapple with the COVID-19 escalation in different parts of the world and try to assess the economic damage to these economies caused by an unprecedented lockdown and business shutdown in large parts of these regions. In the past month, the NIFTY Index has lost a third of its value - as the index's volatility nears a 12-year high. COVID-19 cases have recently risen to 169 after 18 new cases were reported from different parts of the country<sup>1</sup> causing foreign fund outflows<sup>2</sup> and sapping domestic investor sentiment. Although the number of reported cases has been few with even fewer fatalities, this may be a reflection of the country's limited testing when compared to other major economies. Indian and global health officials believe infection rates may be much higher than recorded - as only a small number of tests have been conducted so far (see graph below). National testing is limited but testing at major international airports is said to be extensive, which could prove a useful targeting of limited resources. We continue to expect global and Indian equity markets to remain volatile until new infection cases peak in places like the US, EU and India. Market participants will also closely assess how governments like India will respond to the COVID-19 impact with corresponding fiscal stimulus policies, which Delhi has yet to announce.



<sup>1</sup><https://www.mohfw.gov.in/>

<sup>2</sup><https://www.nseindia.com/all-reports>

### Healthcare Policy Response: Initial Delayed testing and social-distancing but catching up to the rest of Asia

Originally considered draconian, the aggressive social-distancing measures are now widely accepted to curtail the proliferation of new infection cases. India is gradually joining global testing/lockdown efforts in line with the West but lagging Asia's other large and higher-income economies. India is around 3x more densely populated than China and has widespread rural congestion. Population density, coupled with the country's socio-economic structure, imply higher risks of rapid spread. Public health risks in India are clear, present and significant dangers, as senior officials and experts now acknowledge.

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**Monetary policy: RBI likely to continue cutting rates; adding liquidity; intervening to support INR**

As the country faces its lowest GDP growth rate since the GFC in 2008-2009, the government has been responding aggressively – stimulating the economy through a widened fiscal deficit and loosened monetary policies in order to inject ample liquidity into the market.

The Reserve Bank of India (RBI) recently announced a currency swap and measures to boost liquidity however refrained from following its global central bank peers with emergency rate cuts. Although RBI Governor Shaktikanta Das' explanation that the RBI has many other levers to pull to inject liquidity into the economy, market participants were disappointed that the central banker did not act as aggressively with an emergency benchmark interest rate cut in light of rising global recession fears. The readthrough is that the RBI is continuing its assessment of the COVID-19 and that further monetary easing – including conventional rate cuts and unconventional policies can be expected shortly.

Earlier in March the Reserve Bank India (RBI) stepped in to prevent the total collapse of Yes Bank, a private sector financial institutional that has been troubled for a while. The rescue highlights the correlation between India's non-performing loan (NPL) - burdened banking system and its near-term decelerating economy. Though some private banks and shadow banks are likely to continue to face challenges, the banking system as a whole should be supported by RBI liquidity injections and longer-term bank funding, as well as state ownership of many of the largest banks.

The RBI has also intervened to ease heavy downward pressure on the INR, as liquidity injections/rate cuts naturally lead to FX depreciation in the current environment of equity selling and dollar buying on the part of foreign institutional investors. On the other hand, the general external balance of payments position is manageable - the oil price collapse should help improve the current account, trade and fiscal deficits. Plus, record high FX reserves which peaked at almost half a trillion dollars in early March should permit the RBI to smooth the path of the depreciation and excessive volatility. The INR has actually held up fairly well when compared to other emerging market currencies.

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**Fiscal policy: Space for stimulus may be limited – overall public manageable; but deficits are large**

India has consistently run sizable fiscal deficits at both the federal and state levels for generations. At present, the headline numbers suggest a federal deficit in the low-mid single digits and a gross general government deficit including state budgets (but not parastatals) in the high single digits. Further rises in the explicitly measured fiscal deficit and debt stock are very likely if the economy slows further due to the pandemic.

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**Economic Outlook: A less abrupt but probably more drawn out deceleration than in China or the West**

The coronavirus shock comes on top of the cumulation of credit losses in the banking and corporate sectors. These factors, together with the government's major policy shifts such as the implementation of the GST federal VAT, have contributed to declines in growth and inflation. We expect a gradual and shallow recovery once the coronavirus escalation period has ended, as the recent liquidity injections and fiscal stimulus measures work their way through the economy.

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## **Oil Price Collapse: Eventual but not immediate relief for India**

The collapse in the price of oil should be a major supporting factor for India is a major importer of oil. However even here caution is warranted: The collapse in the oil price owes to two major factors - a collapse in demand and a glut of supply that is being exacerbated by the Saudi-Russia oil price war against US shale oil. A sharp decline in oil certainly increases the purchasing power of Indian consumers, however since many are already practicing social distancing and with many food and beverage outlets closed, we don't expect any near-term boost to consumption spending. At present, the collapse in oil price is contributing to a severe tightening in global financial conditions and could pose a challenge for India. All these issues suggest the sharp drop in oil should bring eventual but not immediate relief to India.

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## **Financial Markets: Currency and Equity likely to continue to be significantly more exposed than Bonds**

Further pressure on the India complex, INR and equities in particular, seems likely as global markets continue to adjust to the risk of a severe global downturn. The bond market should be somewhat more insulated than the currency or stock markets, given the still relatively tight quotas on non-resident investment and our expectations for further rate cuts and unsterilized liquidity injections.

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### **Source**

Invesco, internal

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