

# ASIA MACRO STRATEGY

## India Risk and Policy Response

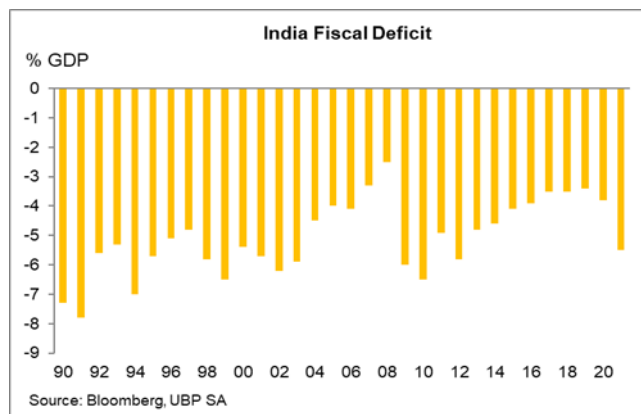
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India's total infected cases (979) and fatality rate (25) remain low but it has been escalating. According to the World Health Organisation (WHO), this can become overwhelming, if uncontrolled.

The 21-day nationwide lockdown and economic sudden stop may cause a drop in gross domestic growth (GDP) growth to 1-2% year-on-year (yoy) in the second quarter of 2020 (2Q20). Given India's large services/consumption-driven economy, about 60% of GDP will not be operational. If the lockdown period is prolonged, India's GDP may dip into negative territory.

### Fiscal Limitation

The key concern is that India's healthcare infrastructure may not be able to handle a large-scale infection.



Fiscal ammunition is also limited given India's prolonged deficit position. This year's budget shortfall was initially targeted to widen to 3.8% of GDP to fund Modi's bold corporate tax cuts implemented late last year. With the

urgent need for emergency measures, the fiscal deficit is set to rise to at least 5-6% of GDP in the coming year.

Last week's announcement of a modest \$23bn rescue package accounts for a mere 0.8% of GDP. Immediate measures have been aimed at providing basic necessities (such as food supply and free cooking gas for three months) to poor and low income-earners.

Millions of workers still rely on daily wages of \$2/day so an economic hard stop may immediately impact their daily life. Also, India's large informal economy means that many workers are not covered by the unemployment insurance schemes.

We expect limited fiscal capacity to support small- and medium-sized enterprises and the hard-hit sectors, as can be seen in the measures swiftly implemented in China, US and Europe that have tried to keep business activities afloat pending better news on virus containment.

### Swift Monetary Response

India's weak fiscal position has increased pressure on the monetary side. The Reserve Bank of India's (RBI's) swift response last Friday reflected a reversal of its previous prudent stance and has put priority on growth over inflation which has been boosted by high food inflation (and likely to worsen in view of the lockdown's disruption to the supply chain).

The central bank conducted unscheduled policy easing, cutting repo rate by 75 basis points (bps) to 4.4%, slashing CRR (cash reserves requirement) by 100bps to release INR1.37trn of liquidity, rolling out targeted LTRO (long-term repo operations) to buy IG corporate bonds, CP and NCDs



totalling INR1 trillion, and expanding collateralised liquidity adjustment facility (worth another INR1.37trn).

Total liquidity provision amounted to about INR3.74trn (\$50bn) should help to temporarily cushion liquidity tightness and backstop credit market. But they are set to expand should corporates' cash flow positions be further disrupted by a prolonged lockdown.

In addition, RBI has followed the playbook used in other countries with the announcement of regulatory forbearance – deferment of interest payment on working capital loans especially for retail and small businesses.

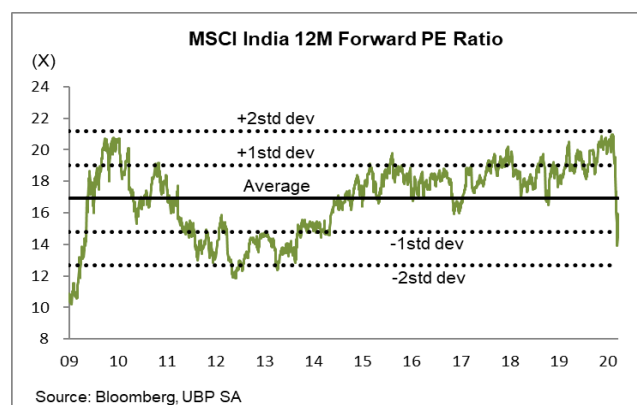
INR depreciation may potentially constrain RBI's rate easing.

So far, the collapse of oil prices has helped somewhat underpin the Indian currencies while the current account has improved on weak import demand.

The brighter spot is India's sound foreign exchange (FX) reserves position (\$470bn as of March 20) which can help RBI to provide FX interventions amid interest rate easing. However, FX reserves have peaked at \$487bn in early March and are depleted by about \$17bn over the past few weeks thanks to FX operations and capital outflows.

### Investment Implications

The stock market index, MSCI India, is down 30% from Jan 17's peak. 12-month forward price/earnings (P/E) ratio has dropped to 15.9x (from 20.5x in Jan) and price/book (PB) ratio is down to 2.1x (from 3.0x). The worst hit sectors are financials, realty, energy (oil), retail/tourism, while the relatively more resilient sectors are healthcare/pharmaceuticals.

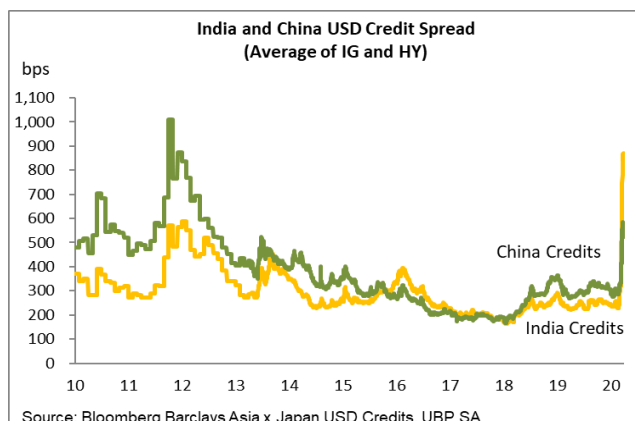


Given the high economic uncertainty on virus containment, we advise sticking to quality names with near-term revenue disruptions but with solid long-term business perspectives.

On USD credits, India's average corporate bond spread – investment grade (IG) and high-yield (HY) average – has surged to 822 bps, a 500bps jump over the past three weeks. India is now trading wide of China's credit spreads for the first time since 2018 (China is 2-3 notches higher in average credit rating).

Our fixed income team recommends that, on the back of RBI's liquidity easing, selective non-banking financial companies (NBFCs) with strong profitability, solid

capitalisation and good track record should provide buffer to weather the pending downturn.



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