India Insights

India in lockdown: Bracing for the coronavirus impact

April 2020

Summary

- *India's 21-day lockdown is seen as an extraordinary move with substantial economic costs attached to it, but it has been deemed necessary by the government to limit the spread of coronavirus and avert a large-scale health crisis*
- *In a surprise emergency move on March 27, the RBI cut the policy repo rate by 75bps to 4.40% and announced measures to improve liquidity, monetary transmission and credit flows*
- *Economic losses from containment efforts are expected despite mitigating factors such as lower oil prices, policy actions, and India's relatively limited integration into global value chains*
- *Even with the anticipated economic fallout, we believe sharp discounts have been priced into earnings forecasts and risky asset prices*

In the spotlight

India in lockdown: Bracing for the coronavirus impact

As the coronavirus (COVID-19) pandemic continues its rapid spread across the world, India with its large population, dense urban areas, unorganized labour force and constrained public healthcare, is seen facing a daunting challenge in the weeks and months ahead.

India currently has less than 2500 confirmed cases (as of April 3) with 72 deaths. A majority of the infections seem to be imported i.e found amongst people with travel histories, and others who've had close contact with them, with little evidence of community transmission thus far. However, due to the limited amount of testing being done at present these numbers could be substantially under reported and could potentially shoot up as testing picks up.

Intensified efforts, indeterminate impact

- Taking its cues from other governments and global central banks, India has made a number of moves to protect public health and cushion the impact of the containment measures on the economy. While Indian authorities have been rolling out various containment measures since the beginning of February, stricter measures were put in place from early March as the number of infections continued to rise. At first India cancelled all incoming international flights from March 22 till April 14, which was then followed up with an unexpected 21-day national lockdown from midnight on March 25, which is the largest of its kind given country's population

HSBC

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Intensified efforts

A shutdown of this magnitude is seen as an extraordinary move with substantial economic costs attached to it, but necessary to limit the community spread of the virus and avert a large-scale public health crisis

- Even at a time when a large proportion of the global population is under some form of lockdown, a shutdown of this magnitude is seen as an extraordinary move with substantial economic costs attached to it. But the nation-wide lockdown was deemed necessary by the government as it attempts to limit the community spread of the virus and avert a large-scale public health crisis
- The lockdown brings a significant portion of economy to a standstill for a duration of three weeks, barring certain essential sectors and activities such as food supply, pharmaceuticals, storage, telecom, electricity, banking and capital markets. This is unprecedented in the Indian context - even during the demonetisation exercise in November 2016, when much of the currency in circulation was banned, economic activity still continued
- Following the lockdown, the government swiftly announced a $23bn (around 0.9% of GDP) package to support the parts of the economy most impacted by the move. This package includes 1) heavily subsidised food for 800 million individuals for period of three months 2) direct cash transfer into banks accounts of 200 million women beneficiaries, 50 million rural workers, 87 million farmers and 30 million senior citizens 3) employment support through payment of retirement fund contribution for three months for 8 million low wage workers in smaller firms. While these support measures may seem inadequate in context of the expected economic contraction, government has clarified that there will be other industry specific packages announced in due course
- Shortly after, the central bank came in with a larger than expected 75 bps rate reduction, substantial liquidity injections and a host of other support measures *(see details on pages 5 & 6).* These measures will likely help improve financial system liquidity; facilitate monetary transmission and credit flow to the economy; provide relief to borrowers and ensure continuity of viable businesses; and reduce the tail risks of funding and credit market stress. The Reserve Bank of India (RBI) has also reiterated that it is open to further conventional and non-conventional tools to achieve its objectives

Indeterminate impact

Even after the lockdown period ends, the "fear factor" may still result in below-normal activity for a few more months, as there will likely be a lingering impact of COVID-19 related precautions on both private consumption and corporate capex

- On macro front, similar to other economies India too will have to grapple with growth slowdown, and the extent of further fiscal stimulus by the government will be crucial considering its own weak finances
- While the lockdown is in place, non-essential consumption, especially of services, will likely be the worst hit, particularly for low income households. Household consumption expenditure on services has been rising over time and currently accounts for ~50% of total consumption and ~30% of GDP. The risk of possible job losses and reduced income levels will likely compound the sentiment-driven demand shock. There are heightened concerns about the disproportionate impact on a large swathe of the labour force who are either self-employed or casual labourers in the unorganised sector and lack any sort of safety net
- More broadly the global pandemic is seen impacting India via supply-chain disruptions, and a demand shock amidst increased risk of a global recession. There could also be second-round effects through tightening financial market conditions. Economic losses are expected despite mitigating factors such as lower oil prices (a rare positive in this environment), policy actions, and India's relatively limited integration into global value chains
- The exact macro impact will depend on the severity and duration of the global pandemic, how strictly and for how long the social distancing policies are implemented, as well as policy responses and their effectiveness in addressing the potential economic fallout. Having said that, it stands to reason that growth in the first half of the financial year (FY2021) is likely to be flat to negative, and depending on how the situation evolves we could see a recovery in the second half
- However, we see the risk that even after the lockdown period ends, the "fear factor" may still result in below-normal activity for a few more months, as there will likely be a lingering impact of COVID-19 related precautions on both private consumption and corporate capex. Some activities, particularly services, will likely be permanent lost, and it will take longer for the economy to return to the pre-pandemic levels. Overall, the long anticipated cyclical recovery has been delayed by the COVID-19 outbreak

Source: HSBC Global Asset Management as of April 2020

In the following pages we will take a deeper look at how recent events and policy measures are impacting Indian equity and fixed income markets:

Equity market

Towards the end of March, there was a rebound in both Indian and global equities, as governments across the world rolled out fiscal and monetary stimulus packages to combat an economic downturn.

- Indian equities have dropped sharply in the first quarter of 2020, with the NIFTY Index (INR) down 22.9% (as of 31 March) and the MSCI India Index (INR) down 21.5%. Compared with the broader universe of emerging markets (MSCI EM) equities, Indian equities (MSCI India) underperformed by 9.1% in USD terms on a MTD basis (as of 31 March). One-year forward P/E for MSCI India remains at around 16x
- From the 2020 peak on 17 January to the trough on 23 March, MSCI India (INR) has suffered a loss of 38%. The fall has largely been in line with the general direction of global markets. MSCI India (INR) recorded a single-day loss of 13% on Monday, 23 March, as India began to lockdown of various parts of the country the weekend prior to contain the spread of COVID-19. The rest of the week saw a rebound in both Indian and global equities, as governments across the world rolled out fiscal and monetary stimulus packages to combat an economic downturn
- Within MSCI India (INR), real estate, consumer discretionary and financials are the worst performing sectors, while consumer staples, communication services and information technology are the best performers. The pattern is largely in line with the conventional wisdom that during times of great uncertainty, defensives would outperform cyclicals
- In the single month of March 2020, the Indian equity market saw USD8.2 billion of net foreign investment outflows, almost negating the entirety of the foreign investment inflows accumulated over the previous five months that amounted to USD8.3 billion. At the same time domestic institutional investors were net buyers to the tune of USD3.8 billion in the month of March
- Despite the relief measure announced by the government, it is certain that the lockdown will have a substantial impact - corporate investment will likely also be affected with delayed capex plans, as many companies face cash flow shortage, squeezed corporate profits, sourcing (e.g. imported inputs), and uncertain near-term demand outlook. This could create a vicious cycle of lower corporate capex and weaker consumer demand. Halting of production during the lockdown period will lead to supply chain disruptions and adversely affect industrial production. Meanwhile, the banking sector could face higher risk of defaults in both corporate and retail loans, with gross nonperforming assets (NPAs) likely to rise
- Following the sell off, valuations are now in an attractive range in terms of PE and earnings yield vs. bond yields. Key factors to monitor going forward are the duration and extent of the COVID-19 related fallout and the measures the government can take within its constrained fiscal space. The fiscal stimulus announced so far has been modest at best compared to what has been announced globally so more measures targeting specific industries would be needed

Source: Bloomberg, MSCI, data as of 31 March 2020

Sector positioning

Sector	Weighting
Financials	Overweight
Real Estate	Overweight
Communication Services	Overweight
Utilities	Overweight
Industrials	Neutral
Information Technology	Neutral
Consumer Discretionary	Underweight
Materials	Underweight
Consumer Staples	Underweight
Healthcare	Underweight
Energy	Underweight

Source: HSBC Global Asset Management as of end-March 2020
Note- above information reflects the sector positioning of HSBC Global Asset Management's flagship offshore Indian equity product.

Sector focus

Consumer staples:

- Against the backdrop of the 21-day nationwide lockdown, companies that provide essential products, packaged foods and other grocery items could see a boost to their revenues in the near-term. A large grocery retailer with a chain of hypermarkets and supermarkets has outperformed both the consumer staples sector and the broader market and has delivered 15% year-to-date, while the broader market is down . The company has seen strong sales growth and should continue to deliver even in the wake of the coronavirus situation
- Overall, the consumer staples sector is down 7.7% year-to-date, which is an outperformance of 24% against the broader market is down sharply. When compared with other sectors, the consumer staples sector has high valuations relative to earnings growth. Bottom-up stock selection remains key
- Leading grocery retailers are set to benefit from increasing market penetration over the longer term, given that organised retail currently only makes up 2-3% of the entire market

Financials:

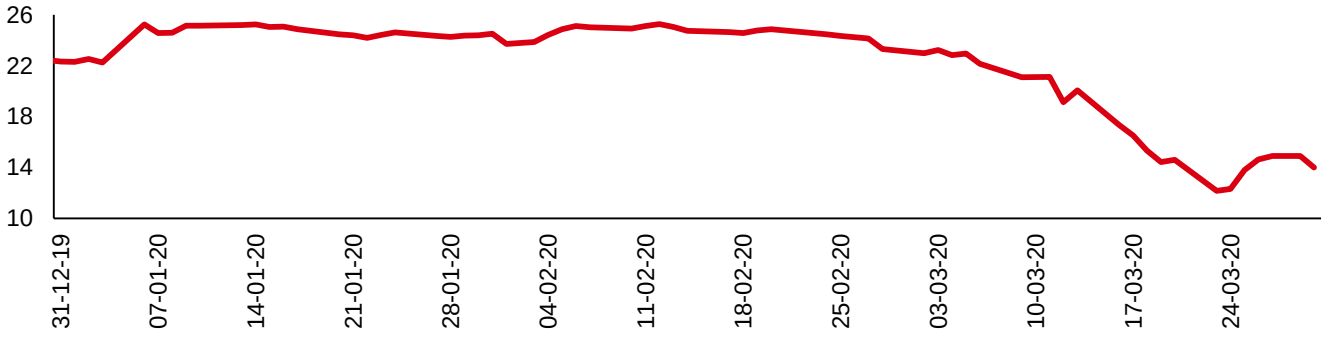
- On 27 March, the RBI announced measures to address the stress caused by COVID-19 : targeted long-term repo operations, cut in cash reserve ratio and relaxation of borrowing measures under the marginal standing facility should pump INR 3.74 trillion (~USD 50 billion) of liquidity into the system. Allowing lenders to defer interest payments and the moratorium on term loans for three months should also benefit the financial industry, particularly in helping address the liquidity and funding issues of non banking financial companies
- Large banks with strong deposit franchises and solid capital positions should be equipped to weather the volatility. Select banks are seeing accelerated NPA recognition and recovering ROEs. Diversified loan books, increasing market share (of large private sector banks) and strong liquidity are other positive factors that can help these banks amidst a challenging period
- This year's volatility has brought down the valuations of the banking sector, and P/E levels have become more attractive. The sector is now trading at 14.0x forward P/E (as of 30 March) versus 22.3x at the beginning of the year

Communication services:

- Spending on communication services is not expected to be materially impacted from the coronavirus situation, and could in fact see a pick-up amidst the nationwide lockdown and work-from-home protocol. Telecom companies are also expected to benefit from industry consolidation – which in turn is leading to less competition intensity as well as price recovery

Valuations of banking stocks are compelling

NIFTY Bank Index: Forward P/E (x)



Source: Bloomberg as of 30 March 2020.

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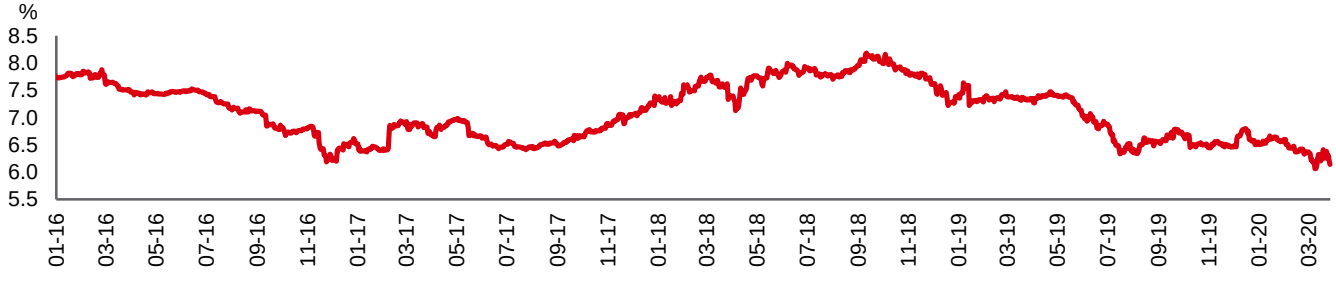
Fixed income

We expect the RBI (and the government) to not lift their foot off the accelerator until the economy begins to revive

On the positive side, the sharp fall in crude prices should lower India's import bill and aid its current account, although oil prices are coming off their lows as talks between Saudi Arabia and Russia advance.

- In a surprise emergency move on 27 March, the RBI cut the policy repo rate by 75bps to 4.40% while stating that it's the central bank's priority to minimise the impact of COVID-19 on the domestic economy. The RBI also announced measures to improve liquidity, monetary transmission and credit flows – including introducing targeted long term repo operations of up to 3-year tenor and totaling up to INR 1 trillion, cutting the Cash Reserve Ratio (CRR) by 100bps to 3% for one year as well as permitting banks to extend a 3-month re-payment moratorium for all term loans outstanding without a change in asset classification, amongst other measures
- While the RBI's actions along with government measures are aimed at providing much needed stimulus to stabilise the economy and bring it back on the growth path, the key risk at this point is COVID-19 and its intensity and duration. We however expect the RBI (and the government) to not lift their foot off the accelerator until the economy begins to revive. While January/February inflation was 30bps above RBI's earlier estimates, the RBI expects food prices would soften as the harvest has been healthy thus far. In addition, the plunge in crude prices should work towards easing both fuel and core inflation pressures, depending on the level of pass-through to retail prices
- In another positive development, starting April 1, foreign investors have full access to certain government securities, without the imposition of foreign portfolio investor (FPI) limits, under the Fully Accessible Route (FAR). The securities include 5-year, 10-year, and 30-year new issuances in FY2020/2021 and five existing government securities in the 5-year, 10-year and 30-year tenors, making up an outstanding amount of INR 4.34 trillion (USD 57 billion). This move is an important step towards the potential inclusion of domestic Indian bonds in major global bond indices
- The Indian fixed income market is predominantly domestically oriented and has only <4% holding from foreign portfolio investors. This gives the Indian fixed income market a unique combination of desirable characteristics - reasonably high yields and lower correlation to the broader emerging market sentiment
- Our India fixed income strategy continues to be overweight INR government bonds with a predominant positioning in the 5-12yr part of the curve as well as high quality corporate bonds in the 1-3yr part of the curve – these are expected to continue to benefit from the RBI's accommodative stance, adequate system liquidity and long term repo operations (apart from the cut in the CRR and Open Market Operation (OMO) purchases undertaken by RBI). In light of increasing volatility in financial markets fueled by coronavirus fears, in recent weeks, we have extended portfolio duration by trimming some shorter-dated government bonds while continuing to remain slightly underweight duration against the market. The overall quality of the portfolio remains high, with a combination of government and quasi-sovereign bonds as well as high quality corporate bonds
- With the coronavirus pandemic remaining front and centre, we expect ongoing pressure on capital flows and the INR. While we could likely see weak economic data in the coming months, we believe sharp discounts have been priced into earnings forecasts and risky asset prices. The INR has already weakened to historic levels against the dollar, hitting a record low of 76.275 against the dollar on 23 March, hurt by outflows from foreign investors; foreign investors' net outflows amounted to nearly USD 15billion (INR 594billion for equity markets and INR 528billion for debt markets). On the positive side, the sharp fall in crude prices should lower India's import bill and aid its current account, although oil prices are coming off their lows as talks between Saudi Arabia and Russia advance.. We expect the INR to track moves in the dollar and global markets, while remaining sensitive to risk-on/risk-off sentiment

Yields look attractive vis-à-vis policy rates and inflation



Source: Bloomberg, HSBC Global Asset Management, Bloomberg data as of 27 March 2020

Data watch

Indicator	Latest data	Consensus data	Previous data	Analysis
Industrial Production (IP) (% YoY)	2.0 (Jan)	0.5	0.1 (Dec)	The rise in IP growth was consistent with strong January PMI and led by improvements in manufacturing and electricity output. Intermediate goods IP maintained a robust momentum, but on a sequential basis, capital goods and consumer durables also recovered. However, the near-term growth outlook worsens due to the COVID-19 pandemic and social distancing policies such as the 21-day national lockdown from 25 March deemed necessary to slow the virus transmission. The lockdown brings a significant portion of economic activity to a standstill, although certain essential activities and services are allowed, and is likely to come at a substantial economic cost despite some mitigating factors such as lower oil prices, aggressive policy actions, and India's relatively limited integration into global value chains. The informal sector workers and micro, small & medium enterprises will likely be among the worst hit by the shocks.
Local passenger vehicle (PV) sales (units)	251,516 (Feb) (-7.6% YoY)	NA	262,714 (Jan) (-6.2% YoY)	Weak economic activity and challenge to clear up BS-IV inventories in view of transition to BS-VI emission norms remained headwinds. The COVID-19 pandemic is set to hit the auto sector via demand and supply shocks (including the temporary supply chain disruption in China) with a nationwide lockdown for 21 days.
Exports (USD) (% YoY)	2.9 (Feb)	NA	-1.7 (Jan)	The pickup in total and oil import growth partly reflected lower base effects, but on a sequential basis, oil imports fell in both price and volume terms. Gold imports contracted YoY as elevated gold prices continues to damp demand. Non-oil imports ex. gold improved further. Looking ahead, India's trade outlook faces challenges from the COVID-19 induced demand and supply shocks amid the risks of a global recession and further weakness in domestic activities.
Imports (USD) (% YoY)	2.5 (Feb)	NA	-0.7 (Jan)	
Trade Balance (USD)	-9.9bn (Feb)	-11.4bn	-15.2bn (Jan)	
Inflation (% YoY) - CPI - WPI	6.58 2.26 (Feb)	6.72 2.43	7.59 3.10 (Jan)	The moderation in CPI inflation was driven by lower food (especially vegetable) prices and supported by lower transport fuel prices and relatively steady core inflation, though the core disinflation could be partly a pay-back after three months of sharp increase driven by policy actions leading to a rise in telecom tariffs and drug costs, etc. Inflation is likely to decelerate further amid lower oil and commodity prices and subdued demand due to the COVID-19's growth impact.
Repo rate (%) Reverse repo rate (%) Marginal standing facility (MSF) rate (%)	4.40 4.00 4.65 (27 Mar)	4.65 4.40 4.90	5.15 4.90 5.40 (6 Feb)	In an unscheduled meeting, the RBI unveiled a comprehensive set of measures to help mitigate the economic fallout of the lockdown. These include large rate cuts with a widening of the corridor and lower floor rate; liquidity infusion via the Targeted Long Term Repo Operations (TLTRO) (to support the bond market), cash reserve ratio cut (by 100bp to 3%) and marginal standing facility; as well as regulatory forbearance to help banks and borrowers, etc. These measures may help to improve financial system liquidity, facilitate monetary transmission and credit flows to the economy, provide relief to borrowers and ensure continuity of viable businesses; and reduce the tail risks of funding and credit market stress. These may also help the recovery once the COVID-19 pandemic is behind us. However, more easing may be needed if economic disruptions persist or are more severe than expected.
GDP (% YoY) Gross value-added (GVA) (% YoY)	4.7 (Oct-Dec) 4.5 (Oct-Dec)	4.7 4.4	5.1 (Jul-Sep) 4.8 (Jul-Sep)	GDP weakness was driven by a continued slowdown in investment and sluggish trade, while slower GVA was led by the manufacturing sector. Growth is likely to slow sharply in Q4FY20 and Q1FY21 amid a fragile financial sector and due to the COVID-19 shock and lockdown policies which will likely impact ~60% of GDP.
Current Account Deficit (CAD)	USD1.4b -0.2% GDP (Oct-Dec)	NA	USD6.5b -0.9% GDP (Jul-Sep)	The narrower CAD was driven by a smaller goods trade deficit and larger services trade surplus. The goods trade outlook suggests further CAD improvements likely despite high external uncertainties.

Indicates improved data on month-on-month/quarter-on-quarter/year-on-year basis

Indicates worsened data on month-on-month/quarter-on-quarter/year-on-year basis

Indicates no change in data on month-on-month/quarter-on-quarter/year-on-year basis

Source: Bloomberg, HSBC Global Asset Management, as of March 2020

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Expiry date: End of Quarter