India: To Decouple or Not to ,That is the Question

Expert Take

GAUTAM TRIVEDI

Domestic demand in India has surged in the past two quarters.

Last month's auto sales have rebounded when compared with September 2019. Passenger car sales rose 44.5%, trucks 17% and tractors 37%. The hospitality industry has seen explosive growth with all sub-sectors gaining, from hotels to airlines to dining out.

Real estate sales, too, have grown in spite of rising interest rates. For example, property sales in Mumbai rose 11% year-on-year last month, making it the best September in a decade.

Non-food credit for September is up 16.7% YoY. GST collections have been registering over ₹1.3 lakh crore a month for the past 12 months, signalling that the formalisation of the economy is gaining traction. In manufacturing,

India is benefiting from China +1 as major global corporations look at it as one of the destinations. Apple now manufacturing the iPhone 14 in India is a great headline!

While the year-to-date performance of various asset classes is mostly negative, the Nifty 50 (down 14% in dollar terms) has performed relatively better than the US (S&P500 down 23%, and the Nasdaq down 31%) and the MSCI Emerging Markets index (down 27%).

Hence the question: Will India de-couple from global markets assuming that the recession, which has already begun in Europe, reaches US shores? Some argue that this time it's different, i.e. India is on a different path.

In June, Jamie Dimon, chairman of JP Morgan Chase, said, "There are big storm clouds here. It's a hurricane [and] that hurricane is right out there down the road coming our way. I just don't know if it's a minor one or Superstorm Sandy."

It seems that his prophecy is coming true. I see a hurricane coming over the next few months and making landfall on the global capital markets. The final quarter of 2022 starts with a heady mix of:

- The Fed's war on inflation that's resulting in interest rates rising globally and the strengthening of the US dollar. Emerging Markets (EMs) like India are collateral damage as it is causing imported inflation. The rupee has already depreciated 11% this year, even after the RBI sold $100 billion to arrest the fall. The dollar is also hurting US corporations that have large overseas businesses. 29% of aggregate S&P 500 revenues are derived from outside of the US. For example, Microsoft warned that the rising dollar will shave 5 percentage points off its revenue next quarter.
- Commodity inflation remaining elevated. Although oil (Brent) has corrected 25% from a year high to $97/barrel, it remains expensive for most EMs. OPEC's decision to cut oil production by 2 million barrels a day will only add fuel to the fire (no pun intended). A roundtrip air ticket in economy class for my younger son from Durham, North Carolina to Mumbai this December has cost me a whopping ₹3.24 lakh or $4,000, double from last year!
- The war in Ukraine entering its ninth month and showing no signs of abating, thereby continuing its impact on inflation.
- It has dawned upon global corporations that there is no quick fix for the supply chain bottlenecks. China +1 will take several years to implement and mature. As a result, in the medium-term inflation is here to stay.

I remain bullish on India; frankly, it's the only country left standing from the original BRICS economies. But I see near-term headwinds caused by external factors. Since 1990, the S&P 500 has corrected 10% or more 26 times and each time Asian markets have corrected with it. I believe that India historically has not and will not de-couple from global markets. In fact, a correction would be positive and will attract more inflows. Today stocks that I don't like are expensive and those I like are very expensive.

The RBI is stuck between a rock and a hard place. If they raise rates too much then they risk derailing the post-Covid recovery, but if they don't, they risk the rupee falling even more.

The net $21.8 billion YTD selling by foreign investors has been more than offset by domestic mutual funds which have invested $32 billion. Flows into systematic investment plans (SIPs) have grown every month with September clocking a new high of ₹12,700 crore or $1.6 billion. Separately, retail investors have net ploughed $11 billion YTD directly into the market.

Until now there were no real investment alternatives to equities. However, with rates rising and demand for real estate reviving (ironically partly fuelled by gains made in the equity markets), investors finally have other options.

The key risk to the thesis is a sudden end to the war in Ukraine. I sincerely hope that the storm clouds result in a minor hurricane and not Superstorm Sandy or Ian!

(The author is managing partner of Nepean Capital)