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Demonetisation will delay demand recovery by at least a quarter: Ajay Bodke

Interview With CEO & Chief Portfolio Manager: PMS, Prabhudas Lilladher

Ajay Bodke, CEO & Chief Portfolio Manager: PMS, Prabhudas Lilladher, shares his views with Pranati Deva in the backdrop of the government's demonetisation move and the surprise outcome of the US Presidential elections. Excerpts:

MARKET OUTLOOK

Although the risk-off trade post Donald Trump's election has impacted all the Emerging Markets (EMs) indiscriminately, we believe that once semblance of sanity returns investors will start focusing more closely on those economies that withstand the tremors of this mighty global asset reshuffle.

Many EM economies whose GDP relies most on net exports and whose reliance on domestic consumption is insignificant would be the worst sufferers. Conversely, EMs like India would benefit as its economy mainly relies on domestic consumption (constituting nearly 70% of its GDP) underpinned by young demographics, rising affluence and aspiration levels, rapid financial inclusion and spread of digital technologies.

It is these domestic-focused economies that large foreign investments would eventually gravitate to after dust has settled provided the macro-fundamentals are rock solid. India fits the bill perfectly with its economy

reckoned to be one of the fastest growing among large economies, record low current account deficit, government's strict adherence to its medium-term fiscal consolidation path and bold pursuance of tough-to-achieve structural reforms, strong forex reserves, softening consumer inflation pointing towards lower interest rates that would fuel aggregate demand both in consumption & investments and aid corporate profitability.

It is such times of uncertainty and asset price dislocations that, on hindsight, turn out to be excellent entry points for investors, and we urge investors to increase allocations to Indian equities with a medium-term perspective.

SECTOR PREFERENCES

We believe banking sector would be a net gainer, consumer discretionary sectors would suffer a delay in recovery, while consumer staples will be less impacted. Consumption discretionary focused sectors like automobiles, durables, consumer finance, paints & home improvement, cement would witness slow off-take. Consumer staples segments in FMCG especially essential goods would be less impacted. Sectors like Pharmaceuticals and IT would be the least impacted. Some shedding of overweight positions is seen in consumer focused sectors. Pharmaceutical sector would gain as worries recede. IT still presents a mixed picture.

VIEWS ON BANKING SECTOR

With banks witnessing a surge in deposits, the system will be flush with liquidity exerting a downward pressure on both deposit and lending rates. It would also prove to be disinflationary as demand would get crimped in the beginning due to strict currency withdrawal limits. As a sector Banks would benefit with their incremental cost of funds coming down and softening of yields benefiting their investment portfolio in bonds. They would have to closely monitor delays in payments from borrowers due to cash crunch and potential tick-up in NPAs. Banks, in general, would be better positioned to weather this change as compared to NBFCs especially those that deal in cash collections of their repayments and cash disbursals.

DEMONETISATION

The surprise demonetisation move took markets by surprise. After witnessing a tepid earnings growth for the last few years, markets were looking forward to a return to robust earnings jump in 2H FY17. The optimism stemmed from consumption-focused sectors riding on cash infusion in the economy due to the VII Pay Commission award to Central government employees and OROP to defence personnel (serving & retired) as well as a boost to rural consumption after a near-normal monsoon leading to bumper kharif harvest after two successive years of drought. The currency crunch in the wake of demonetisation and adjustments warranted due to shocks to supply chains and necessity to incorporate tweaks in the mode of conducting business would delay the demand recovery by at least a quarter.

MONETARY POLICY EXPECTATION

We believe there is ample scope for RBI to reduce rates over the next six months as the gap between consumer inflation (4.2%) and repo rate (6.25%) currently at 2.05% is far greater than RBI indicated real neutral rate of 1.25%. In view of a bumper kharif harvest, good reservoir levels and heavy precipitation aiding groundwater tables presaging good Rabi season, low food inflation and benign outlook for global crude prices we expect RBI to aggressively lower rates. However, the RBI may hold on to rates in its December 2016 policy to gauge the exact impact of the demonetisation move on the system and act in its subsequent policy.