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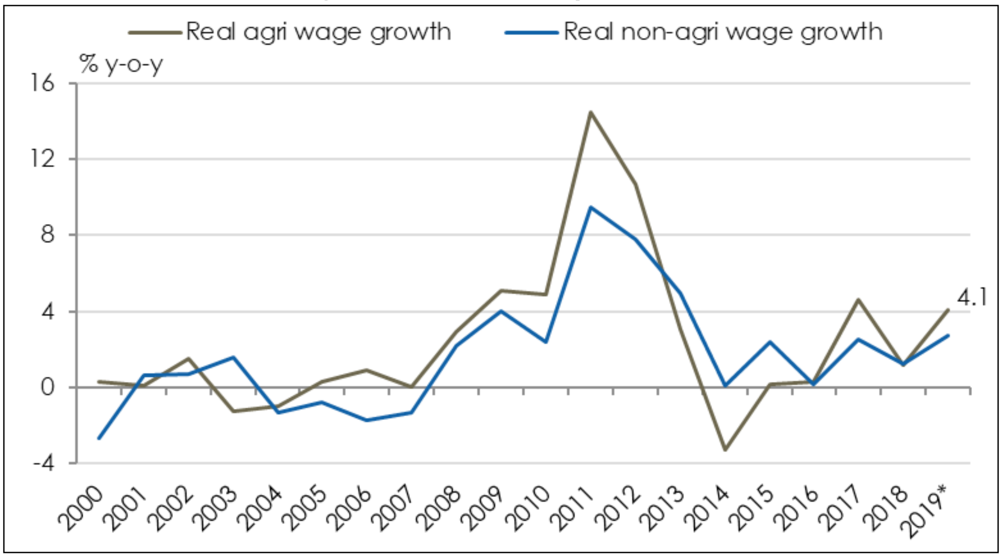
From the CIO's Desk

Bharat Slowing Down

Recent data points on discretionary demand (i.e autos) and quarterly results from large FMCG companies point towards a weakening of micro driver of earnings which creates an interesting situation even as macro factors (inflation, rates, politics) remain quite favourable for Indian equities. This could strengthen the case for wide differences in the potential returns from the various segments and sectors of the market.

Let's first try and understand why the consumption slowdown might be happening now and if that can change. What started off in autos seems to be now impacting consumer staples too with companies clearly indicating slowing rural demand as the key factor. However, if one looks at the real wage growth in rural (see chart below), it is surprising that consumption sustained for so long as real wage growth had declined substantially since 2015 due to lower farm incomes and waning impact of income support schemes earlier in the decade. Subsequent interventions in the form of MSP hikes have also failed to have any significant impact on the wage trajectory.

Chart: Rural wages have been under pressure for sometime...



Source: CMIE

One of the theories for sustained consumption has been the growth in jobs in non-agri rural segments especially construction (see table below). This along with the NBFC credit led consumption and GST led gains kept consumer staples demand robust in 2017 and 2018 despite pressure on real wages. The credit and liquidity squeeze in NBFCs over last 6 months along with impending election has reduced availability of consumer finance and might have slowed down construction activity thus impacting rural jobs. If that is true, some of it can reverse post elections with construction activity likely to pick up again. But, given the high base of 2018, staples demand might look structurally lower for some time to come if subdued food inflation (driver of agri-based income) is any indication. Discretionary consumption like autos have additional headwinds in terms of emission and safety norms to contend with in the short term as it increases vehicle ownership costs.

Estimated No. of persons engaged in non-agriculture occupations and their average income		
2016-17	**Avg monthly income (INR)**	**No. of people engaged (in lac)**
Agricultural Labour Works	3526	982
Non-Agricultural Unskilled Labour Works	4921	800
Non-Agricultural Skilled Labour Works	5082	460
MNREGA Works	1236	528
Govt. Private Jobs	10347	486
Trading, Shopkeeping, etc.	4988	249
Self Employed Profession (doctor, lawyer, etc.)	5372	43
Running a Manufacturing Microenterprise (above ₹ 25 lakh)	2927	33
Running a Service Microenterprise (above ₹ 10 lakh)	6270	23
Selling NTFP/ Forest Produce	2933	10
Running a Service Microenterprise (up to ₹ 10 lakh)	11715	4
Running a Manufacturing Microenterprise (above ₹ 25 lakh)	11752	2

Source: NAFIS 2016-17 survey

Consumption stocks (esp. staples) did very well in 2018 on the back of earnings upgrade cycle, driven by rural growth and aided by GST led cost savings, plus valuation re-rating. In the absence of topline support from rural consumption now, further earnings upgrades appear unlikely This further strengthens the case for what we had pointed out in the April newsletter i.e. a *broader market participation (vs. 2018) and the "value" and "cyclicals" segments doing well vs. "growth/defensive"* despite potentially moderate returns at the index level.

In this context, our basic investment approach remains unchanged i.e. growth at reasonable price and looking for segments that can outperform the market. More specifically, we continue to evaluate sectors and stocks that offer :

i. Value with triggers, and

ii. Potential earnings upgrade cycle vs. present expectations

Rahul Singh
Chief Investment Officer (CIO) - Equities