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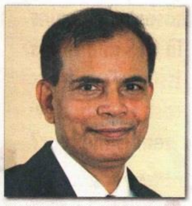
WEEKLY INTERVIEW

Budget unlikely to be a populist one

Sharp corrections are part and parcel of a bull market, says ***Nirakar Pradhan****, chief investment officer of Future Generali Life Insurance. In an interview with* ***Bijoy Sankar Saikia****, he says the market is likely to remain buoyant amid expectations of a pro-reform budget. Excerpts:*



Is the Delhi election verdict a bad signal for the stock market? Do things look shaky on the policy front?

The Delhi election verdict is not a bad signal for the stock market; rather it shows the strength of our democracy. With a motive to implement good governance, any political party, however small it may be, can garner voters' attention. As Delhi sends only three members to the Rajya Sabha, the outcome does not pose a challenge for BJP in achieving majority in the Upper House over the next two-three years.

On the policy front, we believe the government will continue to strive to make India one of the most attractive investment destinations. We don't expect many populist measures in the Union budget (next election in Bihar is still 8-9 months away), rather a pragmatic approach by the finance minister, keeping in mind our difficult fiscal deficit situation.

The market is waiting for some major drivers to give it the next big lift, which it expects to come from the Union budget. But the government is also constrained in terms of big reform moves. How do you read the situation?

Even though the government doesn't have majority in the Rajya Sabha, it has found a way, so far, to get things done inside or outside Parliament. One of the biggest tax reforms in the form of GST has been introduced and is likely to be passed in the budget session. The insurance amendment bill is also likely to see the light of the day soon as are land acquisition and labour reform bills.

However, more than new laws, the market will be keenly looking for implementation of key policies, be it 'make in India', Swachh Bharat Abhiyaan or direct benefit transfer, all of which can be big success stories if implemented properly.

What are your key expectations from the budget? Do you think the government will have enough money to go in for big-ticket investments?

Subsidy management will be a key area to watch out for. With a sharp fall in global crude prices presenting a benign platform, this probably is the time to set a target on capping subsidy as a percentage of GDP. These savings because of lower subsidy outgo can be used to increase plan expenditure, which is the need of the hour to revive the capex cycle.

At the same time the budget should aim at kick-starting private investment by extending incentives for projects under 'make in India', 'smart cities', REITs and InvITs. On the corporate tax front, clarity on GAAR, retrospective taxation and timelines on the implementation of GST will help investor sentiment. Like the previous budget, some change in the personal tax structure is expected to increase disposable income and higher consumption.

The market has also corrected quite a bit over the past two weeks. What would you attribute this correction to?

January was quite good for our market with more than 6 per cent return by Sensex/Nifty. After hitting an all-time high of near 9,000, Nifty corrected almost 5 per cent over the past two weeks. This can be attributed to weak Q3 corporate earnings and uncertainty in Greece after an anti-austerity party won the election. Sharp corrections are part and parcel of a bull market and we feel the market will resume the uptrend soon.

How should equity investors position themselves ahead of the budget?

The Union budget is a key event for the equity market. With expectations of a pro-reform budget, the market is likely to remain buoyant going into the event. The budget is expected to have large allocation towards roads, ports, airports, incentivise low-cost housing, address supply side issues plaguing food inflation and increase allocation towards agriculture and warehousing. Keeping this in mind, investment should be made in sectors like infrastructure, capital goods, cement, home finance, agriculture and logistics.

What according to you are the key downside risks, if any, to keep an eye on as far as the stock market is concerned?

Key downside risks come more from the global arena, rather than the domestic economy. As they say, in the stock market you should always be ready for the unknown, and that unknown can come from Europe. The outcome of Greek bailout talks could determine the volatility in global markets. The other risk arises out of global commodity prices, which have been benign over the past six months. We are a net importer of commodities and any flare-up in commodity prices, especially crude, may create fiscal problems for the country.

Recent economic data points have left economists and investors fairly confused on the macro front. What's your reading of the situation? Do you think it is a good signal going out to overseas investors?

A change in base year and the calculation method have put the GDP growth rate in top gear at 7.5 per cent for FY15. However, rather than being gung-ho about this, we would wait and watch for similar improvements in high frequency monthly data points like IIP, core sector growth and auto sales before concluding that we are out of the woods as far as growth is concerned.

For overseas investors, I think the change in the calculation methodology from factor cost to the internationally recognised market prices would be a welcome step. Moreover, rather than looking at numbers only, we should be watching the trend of GDP growth, which is positive (higher growth year-on-year) as per both the old and new methods.

Going by Q3 results, profit recovery for India Inc still remains a distant dream. What would you make out of the latest quarter earnings numbers?

Latest quarter earnings numbers have not been good, particularly public sector banks, capital goods, FMCG and metal sectors offered big disappointments. This indicates that ground-level improvement is yet to take place, resulting in earnings improvement. It led to an average earnings growth of not more than 10 per cent for the Nifty companies in FY15.

Having said this, we expect the average earnings growth of Nifty companies to rebound in FY16 to more than 15 per cent primarily because of the revival of capex cycle, lower interest rates, benefit of falling crude prices in raw material costs and higher capacity utilisation.

The government's PSU disinvestment agenda has been running way behind for this financial year. Do you think the situation is going out of hand?

The government's budget target of nearly Rs 58,000 crore from disinvestment is unlikely to be met unless the divestment of ONGC, PSU ETF/Suuti comes along within the next month. However, even if the government is unable to meet its divestment target, we expect it to meet the budgeted fiscal deficit target of 4.1 per cent on the back of a cut in plan expenditure and lower petroleum subsidy.

Insurers being long-term investors, where have you been putting your money of late and which are the sectors you have been avoiding?

With the growth eclipse behind us, and interest rates coming down, capex revival is in sight. We like the sectors that will directly benefit due to growth revival and resumption of capex cycle. So we like banking, auto, cement, capital goods and infrastructure with a medium to long-term view.

We have been avoiding the metals sector, as global commodity prices are likely to remain under pressure on the back of tepid global growth outlook. Similarly, the real estate sector is not on our radar as many companies have stretched balance sheets. Also, we expect financial assets like equity, bonds to be more attractive for investors compared with physical assets like real estate and gold going ahead.

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