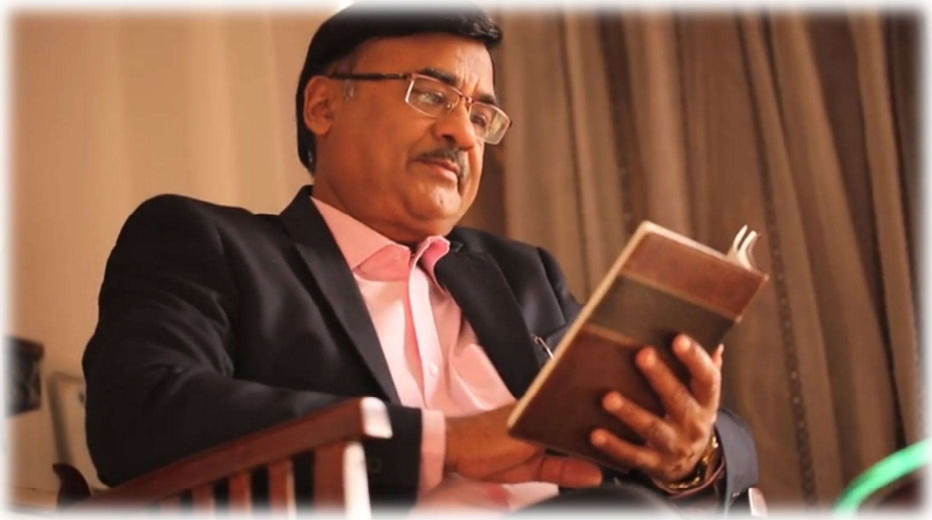

Dr. Ashok Ajmera (FCA), CMD & CEO

Dr. Ashok Ajmera's column as on August 31, 2019

GDP slowdown reflects struggling economy; more steps needed to boost credit growth to kick start investment led spending..

The Indian benchmark indices witnessed third consecutive monthly fall, but on a weekly basis both Sensex and Nifty closed with gains of around 2 percent. The Nifty50 fell 5.6 percent in July, and 1.12 percent in June 2019.

On a monthly basis, the S&P BSE Sensex fell 0.4 percent while the Nifty50 was down by 0.85 percent. However, on a weekly basis, Nifty50 gained 1.79 percent, and the S&P BSE Sensex rose 1.72 percent in August.

Indian GDP expanded at lower-than-expected 5% year on year in the April-June quarter, the slowest in over six years, driven by weak investment growth and sluggish demand. In the March quarter, Indian economy expanded 5.8%. Economists in a Reuters poll had expected GDP to grow at 5.7% in the June quarter. The manufacturing sector grew at just 0.6% while 'Agriculture, Forestry and Fishing' sector at 2%. The 'Mining and Quarrying', 'Construction' and 'Financial, Real Estate and Professional Services' grew at 2.7%, 5.7% and 5.9%, respectively, during this period. Weak global cues and persistent selling by foreign investors (FIIs) capped the upside. FIIs have pulled out nearly Rs. 15,000 crore from the cash segment of India markets in August 2019.

Mega merger of Public Sector Banks

The government on Friday announced a mega plan to merge 10 public sector banks into four as part of plans to create fewer and stronger global-sized lenders as it looks to boost economic growth from a five-year low:

Merger 1: Punjab National Bank, Oriental Bank of Commerce and United Bank of India will combine to form the nation's second-largest lender

Merger 2: Canara Bank and Syndicate Bank will merge to form 4th largest PSB

Merger 3: Union Bank of India will amalgamate with Andhra Bank and Corporation Bank to form 5th largest PSB

Merger 4: Indian Bank will merge with Allahabad Bank to form 7th largest PSB

The exercise, seen together with the previous two rounds of bank consolidation, will bring down the number of public sector banks to 12 from 27 in 2017. This, the government feels, will make bank balance sheet stronger with greater capacity to lend. The above merger will result in Banks with enhanced capacity to increase credit, with a strong presence and global reach

The finance minister also unveiled governance reforms in public sector banks, saying their boards will be given autonomy and enabled to do succession planning.

In addition, Bank boards will be given flexibility to fix sitting fee of independent directors, she said, adding that non-official directors will perform role analogous to independent directors. The sanctioning power of Board's MCBs is also doubled.

"To make management accountable to board, board committee of nationalised banks to appraise performance of general manager and above including managing director," she said.

Post consolidation, boards will be given flexibility to introduce chief general manager level as per business needs. They will also recruit chief risk officer at market-linked compensation to attract best talent.

Banks recapitalisation

According to FM at the Press meet, 10 PSBs will get a total of Rs. 55,250 crore. Here is the breakup: Punjab National Bank – Rs. 16,000 crore, Union Bank of India – Rs. 11,700 crore, Bank of Baroda – Rs. 7,000 crore, Canara Bank – Rs. 6,500 crore, Indian Bank – Rs. 2,500 crore, Indian Overseas Bank – Rs. 3,800 crore, Central Bank of India – Rs. 3,300 crore, UCO Bank – Rs. 2,100 crore, United Bank of India – Rs. 1,600 crore and Punjab & Sind Bank – Rs. 750 crore.

We believe the above merger plan, banks recapitalisation and reforms in PSB's would strengthen the Indian Banking system and augur credit growth which is the need of the hour. However, we are bit concerned that during the integration process, the credit growth of the Banks being merged should not get dented. The Government and Bank's managements should ensure that the credit off take is smooth and is not hampered during the merger process.

Global markets

US equity markets ended on a flat note as investors turned cautious ahead as a fresh round of US tariffs on Chinese imports to be levied will come into effect from Sunday. Additionally, equity markets will be closed on Labor Day holiday. Investors have been cautious in last two months due to escalations in the US-China trade war and the inversion of a key part of the US yield curve which is often a recessionary signal.

However, on Thursday, the United States and China had given hopeful signs on trade on Thursday as they discussed the next round of in-person negotiations in September.

The Dow Jones Industrial Average rose 41.03 points, or 0.16%, to 26,403.28, the S&P 500 gained 1.88 points, or 0.06%, to 2,926.46 and the Nasdaq Composite dropped 10.51 points, or 0.13%, to 7,962.88.

Ajcon's view

Last 2 months witnessed heavy selling by FPIs owing to Union Budget 2019-20 proposals. Proposals like surcharge on high income generating groups, increased threshold of minority shareholding from 25 per cent to 35 per cent and no specific announcement to revive consumption triggered the fall in equities as it failed to cheers investors and FPIs. Furthermore, weak global cues and expectation of another muted quarter dragged the markets down.

However, recently, to improve sentiments and tackle economy slowdown, the government introduced various measures to boost the consumer and investor sentiments. From the rolling back of high taxes on foreign investors to tweak in FDI norms and on August 30, Finance Minister Nirmala Sitharaman unveiled mega merger plan to help India become a $5 trillion economy and kick start investment cycle.

At Ajcon, we believe the government with full majority will now have to focus on to boost consumption in the economy, focus on boosting investment led spending, fasten implementation of policy measures and create an environment to boost employment in the economy. However, on a long term basis, Indian equity markets are in a structural bull run as the benefits of implementation of GST, Insolvency and Bankruptcy code, digitization and a stable government coming back to power would augur well for the economy in the long run.

We believe investors should look at building long term portfolio in companies which have weathered the storm in different market cycles, suited to changing dynamics of the economy as business models are changing in new age economy and delivered decent financial performance. The strategy at present should be invest in phased manner only in companies which have a robust business model, strong earnings and cashflow visibility, low debt, no pledge of promoter holdings and backed by quality management especially on the corporate governance front.

Dr. Ashok Ajmera, FCA

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