Rising crude, falling rupee, fiscal slippage & poll-heavy calendar are key challenges

*Rise in core inflation and increasing upward risk to overall CPI would keep RBI slightly hawkish, said **Anurag Jain**, chief investment officer, Canara-HSBC Oriental Bank of Commerce Life Insurance Company, in an interview with **Sangeetha G**. The current level of crude and current account deficit will be manageable. But if crude prices keep on rising then it will be a cause of concern, he said. Excerpts:*

How has been the market movement in the past few weeks in the backdrop of Indian as well as global political and economic developments?

We expect the equity market in 2018 to be volatile and range-bound due to macro-economic headwinds and an election heavy calendar. After the sub-prime crisis, with coordinated government and central bank action, interest rates had been kept exceptionally low. It is normalising now and volatility is also back. The US 10-year bond yields have topped 3 per cent and the Indian 10-year treasury yields have touched 8 per cent. Uncertain global geo-political situation is impacting crude prices, which would have an adverse impact on India's growth. But what is heartening is that corporate results are coming out better than expectations and that would drive their performance.

In a relative context to the region and similar economies, Indian equities have behaved with reasonable stability. Some part of correction has also played out through the currency. Benchmarks after correction have recovered close to previous highs, though mid-caps continue to remain under pressure.

How do you evaluate FY18 and Q4 performance of different sectors?

The market has been awaiting earnings recovery for a long. For the last two quarters, from Q3FY18 onwards, we have seen recovery in growth and companies outperforming expectations on growth. In Q4FY18 also, we are witnessing that playing out. But while growth of firms is improving beyond doubt, there are looming concerns over macros. These are not insurmountable, but are concerns nevertheless. Rising crude, depreciating currency, fiscal slippage, higher interest rate, worsening asset quality and a poll-heavy calendar are key challenges.

So far, the market has taken them in its stride and we expect growth momentum and the market to sustain for some time before adverse macros start to hurt.

What would be the impact of US-N Korea tango and scrapping of Iran nuclear deal on the global economy?

Tensions between US and North Korea seem to have eased for now. N Korea is not very significant to impact world GDP. Tensions with Iran, however, impact the global crude prices that have adverse impact on global growth and inflation. This has led to 10-year bond yields topping 3 per cent in the US, crude and commodity prices being higher, currencies have re-adjusted and most markets have corrected. All the asset classes have moved to adjust for this development. There has been reallocation of flows towards developed markets. At the same time, earnings growth in US and India has continued and has, in fact, gained strength. We are far more sanguine in our global outlook now than we were at the beginning of the year.

What are the chances of oil moving up further and triggering inflation across the globe?

Rise of crude oil prices in the recent months has been quite sharp. Crude is now trading around $80 a barrel, this level was last seen in 2014. Crude prices have firmed up due to better than expected global growth recovery, reduced US rig count and the prevailing geo-political tensions. Sustainability of crude at these elevated levels will be an important question for both global and domestic growth and inflation.

The rupee depreciation brings in further challenge on the external account. We are no experts on crude, but other oil producing countries can make up for any supply shortage and it also triggers higher shale oil output. Increasingly, co-relation between economic growth and oil demand is weakening on account of energy conserving and renewable technologies. Hence, oil prices should not have a runaway movement.

How is India feeling the heat of inflation? Will we see a change in RBI policy in the coming quarters due to inflation?

After a softening trend of inflation in Q4FY18, April witnessed a reversal in overall inflation, both in wholesale and retail prices. Core inflation has also increased and with currency depreciation and rise in crude and commodity prices globally, inflation is expected to remain at elevated level. Rise in core inflation and increasing upward risk to overall CPI would, however, keep RBI slightly hawkish. We have seen interest rates bottoming out and from here on trajectory are likely to be upward at a gradual pace. Moderately high inflation is good for equities as it leads to faster earning growth for companies and current levels of consumer prices, though high, are not alarming to impact growth adversely.

Rising oil prices will also widen the current account deficit. Will the deficit return to earlier levels of concern?

Sustainability of crude at these high levels as well as rupee depreciation will be important questions for the macro economy. Every $1 per barrel rise in crude has an adverse impact of $1.5 billion on the economy. As an economy, though India gets negatively impacted due to higher crude, it also gets benefited with higher remittances and revival in exports. At the current level of crude, current account deficit will be manageable. But if crude keeps on rising, it will be a cause of concern.

Metal prices are also surging. Which sectors stand to lose due to the rising commodity prices?

Metal prices have been surging for the last few quarters. But unlike crude, where we are largely dependent on imports; India is a large producer of most metals as well as exporter of some. Thus on the economy as a whole, rebound in metal prices is a positive. This also helps banks in resolving metal NPAs and over the time can help in reviving corporate capex as well. Extensive users of metals are primarily auto, consumer durables and infrastructure. The material costs are increasing in these sectors, some of which is already reflected in the margins of companies. In the Indian context where growth in these sectors and especially in the auto is robust due to low penetration and reasonable demand, the ability to pass on higher costs to users/consumers will moderate the impact.

Which are the sectors an investor has to be cautious about in FY19?

Some of the micro indicators that are driving expectations of better earnings growth and are showing firm uptrend are urban and rural consumption, consumer confidence index, strong CV and tractor sales.

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