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Cautious optimism

Markets are riding on hopes of quick economic revival, but it is best to temper expectations

The Indian stock market has proved to be among the most resilient in 2020, closing the year with sizeable gains. It would however be difficult to replicate this performance in 2021 as current price levels seem to have already factored in a strong recovery in the economy as well as corporate earnings in 2021 and 2022. This not only limits further increase in stock prices but also any disappointment or setbacks can bring forth a flood of profit-taking. The Indian stock market was among the best performers from the bottom touched in March 2020, when panic triggered by the economic consequences of the Covid-19 pandemic dragged stocks sharply lower. While stocks were initially lifted due to the humongous stimulus funding announced by all countries, Indian equities were particularly favoured by foreign portfolio investors last year and their net purchases amounting to ₹1,68,000 crore of Indian stocks was largely instrumental in taking the benchmarks beyond pre-Covid-peaks. The benchmark indices have managed to gain 15 per cent last year while the mid- and small-cap indices have managed higher gains, as the rally became more broad-based in the last quarter of 2020.

Besides FPIs, Indian stocks also witnessed good demand from domestic retail investors and HNIs who increased their activities in Indian stocks, due to the surplus time on their hands caused by work-from-home and the lockdown. While the rally appeared incongruous in the second quarter of 2020, when economic activity was at a standstill and GDP contracted sharply, the optimism displayed in stock prices was vindicated by the subsequent recovery in economic activity. Corporate earnings, after a severe contraction in the June 2020 quarter, recorded remarkable recovery in September quarter, thanks to cost controls, lower interest cost and taxes. However it is a little worrying that the market is currently pricing-in a sharp recovery in earnings growth in FY22 and FY23. Given that the consensus forward estimate of earnings has always been too optimistic calling for a downgrade at a later date, it is not right to justify current prices based on future growth estimates. The buying has also been concentrated in healthcare and IT stocks with both these indices gaining over 50 per cent in 2020. The rush towards stocks that have a sustained record of high earnings growth and return on equity, has resulted in excessive valuation.

While liquidity could continue to be supportive, volatility cannot be ruled out. There are other uncertainties, such as the time it will take for the pandemic to die down sufficiently to allow economic activity to reach pre-Covid levels; Biden's proposed corporate and income tax rate hikes; the hidden stress in the banking sector; and lack of public and private capital expenditure. Investors should moderate their expectations from stocks this year, even as they continue to invest for the long-term.

A hurried gamble: On vaccines and transparency

Opacity in communication is dangerous when there is high vaccine hesitancy

The stage is set for the **biggest vaccine rollout in India's history** with the **Drugs Controller General of India formally approving two vaccines** for restricted use under emergency conditions: Covishield by the Serum Institute of India (SII), and Covaxin by Bharat Biotech. Though other vaccine candidates are in the fray too, these two set a precedent for how future COVID-19 vaccines will be evaluated and administered. India has been long known as a manufacturer of vaccines but less so as one that can develop from scratch, test and then provide it to the world. The pandemic offers an unprecedented opportunity to establish those credentials, but already a key step — of establishing the vaccine's efficacy in the Indian population before rollout — has been side-stepped. A **double-blinded phase-3 trial** — where some volunteers get the vaccine and some do not and the rate of disease in both arms is compared to determine the vaccine's ability — is among the foundations of evidence-based medicine. The SII because of its agreement with AstraZeneca has furnished **data from a phase-3 trial in the U.K.** and Brazil, but nothing publicly on how protective the vaccine was in **1,600 Indian volunteers**. All of the leading vaccine candidates — **Pfizer**, **Moderna** and AstraZeneca itself — made public at least partial results of the vaccine's abilities in their own populations before these were given a go-ahead by the respective regulators. Bharat Biotech, which is conducting such a phase-3 trial in India, is yet to furnish similar data because it has not been able to finish recruiting the **required number of volunteers**. The Indian data furnished by the companies only attest to the vaccine's safety and its evoking some immune response. However, this pandemic has revealed multiple instances of therapies and interventions — from **convalescent plasma therapy** to a slew of antivirals — that seemed to work well under idealised lab conditions but did not measurably protect in real-world hospital conditions.

The concern from approving an untested vaccine is that it makes it nearly impossible to conduct a proper phase-3 trial. It will be unethical to expect volunteers to participate in a trial where there is only a 50% chance of being administered the actual vaccine, when they have the option of the real dose elsewhere. Both SII and Bharat Biotech, given the pace of recruitment and potential pool of volunteers, would have been able to generate much more data within mere weeks. So, it is hard to imagine why an emergency use authorisation of these vaccines was hurried through. Opacity marks the government's communication strategy in a country where distrust of vaccines remains in spite of years of vaccination programmes and elimination of grave diseases. The government neglects this at the country's peril.

A tortuous recovery: On record GST inflows

Record GST inflows in December augur well, but the economy is still in a flux

For a fiscally strapped government, scrambling to arrest the economy's recessionary decline, the GST collections in the last month of 2020, of **over ₹1.15 lakh crore**, come as welcome tidings. With **revenue receipts at just 40% of the Budget target** in the first eight months of 2020-21, the government would hope that December's indirect tax inflow, the highest since the indirect tax regime's launch in July 2017, shall sustain over the last quarter of the year. GST inflows have now stayed above ₹1-lakh crore for three months in a row, averaging ₹1.05-lakh crore through **October** and **November**, before the December spike. After two quarters of a sharp shrinkage in the economy following the COVID-19 lockdown last March, this also infuses hope that the third quarter might see India's headline growth rate resurfacing from subterranean depths. The Finance Ministry has stressed that the 12% year-on-year buoyancy in GST's December kitty, the highest growth rate recorded in 21 months, reflects 'rapid post-pandemic economic recovery', bolstered by improvements in compliance following a recent **crackdown on indirect tax evaders**. It is important to discern how much of an impact stricter oversight and better compliance had on these revenues so as to distil what came from normal economic activity in November, which is what December revenues largely account for. Moreover, November included the fag end of India's festive season so the numbers may moderate in the months to come, even though growth rates may stay high due to a low base effect as it gets close to a year after the lockdown.

But **new GST rules**, effective January 1, are expected to tighten GST compliance further so that part of the revenue booster should persist. Second, the GST on imports grew a robust 27% in November, even though overall merchandise imports contracted 13.33%. With December recording a 7.6% surge in imports, growing for the first time since February 2020, GST on imports should rise further in the coming month. Similarly, car sales surged for the fifth month in a row in December, which should not only boost the GST receipts in January but also bring in precious compensation cess. Whatever trajectory revenues take from here, pain points persist and some key niggling issues seem to be aggravating further. Core sectors recorded yet another contraction in November, with cement and steel slipping back after a minor uptick. New investments in the October to December 2020 quarter declined a whopping 88% from a year ago, as per the Centre for Monitoring Indian Economy (CMIE). Employment levels declined significantly in October, followed by almost 35 lakh job losses in November and continue to deteriorate through December, CMIE reckons. The Centre needs to address some of these challenges — in the coming Union Budget or outside — to recover lost ground faster.