"Don't expect fireworks in the next three months"

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Though earnings growth will be slow, certain segments like consumer staples will bounce back fairly quickly post-demonetisation, Suresh Soni tells ***Sanket Dhanorkar****.*

What do you think of the demonetisation exercise?
As a country we have almost all the drivers needed for strong growth—entrepreneurial culture, a growing middle class, a smoothly functioning banking sector and capital market and a stable democracy. Over the years what we did not have was an effective rule of law and that bogged us down. Unless a law is implemented properly, it does not create effective deterrence against errant behaviour and there is not enough incentive for people to behave properly. We have been very slow to punish corrupt practices. The only people who pay taxes are people from whom it is collected at source, the salaried class. The rest essentially ends up evading it to a large extent. If you want to change that behaviour, strong deterrence is needed. Nobody likes paying taxes. A strong information system can ensure evaders don't go scot free. The government has sent out a strong message that there is a downside to keeping unaccounted for money. It is a good start, but it has to be followed up with strengthening our systems so that there can be checks on the flow of money and effective deterrence by bringing the errant to book. Unless you do that, you can't raise the tax-to-GDP ratio.

What would be the impact of this drive?
We are expecting a higher impact than what official estimates suggest. At present, effective currency in circulation is only 25% of what you had before in high denominations. This is not allowing the economy to function properly. People are hoarding whatever new cash they have and there could be a demand slowdown as purchases are postponed. It will take a few months for the currency in circulation to improve enough for the economy to get back on track. Even as we drive towards a cashless economy, we need enough cash to bring back normalcy. From an investment behaviour perspective, it takes away the inclination to hold gold and property. People will look for other investment avenues. The incremental money will move more towards financial assets than physical assets. That will be healthy for the economy.

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Which sectorswill recover quickly?
For the past few years, the markets have begun each year on an optimistic note, and then adjusted downwards as the year progressed. Even before this event, earnings growth was being tempered down to around 5-7%. Now we are likely to see even slower growth. My expectation is real estate and gold will be very slow to recover. Consumer staples should bounce back quickly as these are relatively low-ticket items. Consumer durables and automobiles should also recover in reasonable time. The drivers that were in place for consumption before this event—Seventh Pay Commission, healthy monsoon etc—coupled with a possible healing touch in the Budget, should speed up the recovery.

Do you expect a Budget sweetener?
With the furore this move has created in the Parliament, we have to see whether the GST stays on track or gets delayed. Another issue is whether the system will be able to adjust quickly to so many changes in a short time. Some tax concessions may be warranted like raising minimum tax exemption limit. It will create a feel-good sentiment and bring back some demand. The other thrust should be on creating better data capture to facilitate improved tax compliance. The two have to go hand-in-hand. You can't dole out tax concessions without improving tax administration. More incentives would be needed to move towards cashless, digital transactions.

What is your outlook on bond markets given the RBI stance in its recent monetary policy?
While the RBI move was surprising, one can see the logic behind it. Much of the money that has come into the banking system is transitional. It would want to find out how much of it stays and how much moves out. Given that there are other factors such as possibility of a Fed rate hike, higher metal and oil prices and capital outflows, it does make a case for caution. The bond market was building an argument for ample liquidity, low growth post-demonetisation and hence an urgent need for rate cut. RBI has flipped that argument around. It has pushed the rate cut argument by at least two months, if not more. Till then, the bond market should stabilise around current levels. There is no immediate trigger for a broad rally.

What are the right investment avenues now?
Interest rates are still attractive. Fixed income options in mutual funds still give reasonable return. As the growth outlook has been pushed forward a bit, it is an opportunity for investors to enter from a medium-term perspective. But do not expect any fireworks in the next three months. This is a temporary weak phase, and we should be on the growth path in the next 12 months. Equities remain a good opportunity. In the bond space, we have seen a disproportionate rally in government bonds. The medium term segment of corporate bonds provides more value at this juncture.

How far are we from simplifying KYC procedures for mutual fund investors?
This simplification of KYC procedures is extremely important for making this a mass product. Mutual funds are the lowest cost intermediation vehicle in the country. While there are ongoing efforts in this direction and the intent is right, there are some wrinkles in the implementation. The C-KYC for instance is a step in the right direction but needs to be polished further.

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