



MORNING BRIEFING

February 13, 2019

A Passage to India

See the [collection](#) of the individual charts linked below.

(1) EM stock prices rebounding from last year's rout. (2) Fed calls the shots for EM stocks, bonds, and currencies. (3) US stocks have significantly outperformed the rest of the world during the current bull market. (4) The rest of the world has more homegrown problems than does the US. (5) After five-year run, India's Modi is facing a spring election. (6) India's farmers and poor haven't fared well under Modi. (7) India has lots of mouths to feed, yet food prices are falling. (8) Rigging GDP growth and the jobless rate. (9) The central bank is easing just in time for elections.

Strategy: Urge To Emerge. As Joe and I noted yesterday, investing in emerging market economies (EME) is making a comeback after a miserable 2018 for this asset class. The global economy remains weak. But last year's fears that the Fed would raise interest rates to levels that might trigger an EME crisis have dissipated, especially after Fed Chairman Jerome Powell used the "pause" word in a 1/4 panel discussion.

The EM MSCI stock price index is up 6.5% ytd in local currencies and 7.2% in dollars through Monday ([Fig. 1](#)). Last year, the stock index in local currencies peaked on January 26, then fell 20.9% through October 29 on fears of a Fed-induced EM crisis. The EM MSCI currency index is up 1.5% ytd ([Fig. 2](#)). Last year, this index peaked on April 3, then fell 8.8% through September 11 as investors stopped buying and started selling their EM stocks and bonds.

The US MSCI stock price index significantly underperformed the EM MSCI stock price index during the bull market of the 2000s. China joined the World Trade Organization at the end of 2001 and subsequently led a boom in global investing in EMs, particularly in the BRICs ([Fig. 3](#)). Since the financial crisis of 2008, the US has outperformed EMs significantly, as well as all the other major global stock indexes in local currencies ([Fig. 4](#)). Since the start of the latest bull market on March 9, 2009, the US index is up a whopping 300.3%, followed by more modest gains for EM (127.1%), Japan (116.3), EMU (106.0), and UK (96.8).

We continue to favor a Stay Home investment strategy over a Go Global one. In other words, we would continue to overweight the US and underweight the rest of the world. As we wrote yesterday, an amicable trade deal between the US and China by the end of February could allow Go Global to outperform for a little while, as the prospects for the global economy would improve more than the outlook for the US economy.

However, homegrown problems in Europe, Japan, China, and other EMs suggest that their stock markets might not outperform the US's for long. Today, let's examine India's homegrown problems.

India: Shifting *Hawa*. Five years ago, Narendra Modi and his Bharatiya Janata Party (BJP) romped to

victory in India's general elections on promises of economic reforms, more jobs, streamlined government processes, and plans to root out rampant corruption. By courting the youth vote, appealing to rural voters, and utilizing social media, Modi won the most decisive mandate in India in 30 years, noted a 5/16/14 [piece](#) in *The Guardian*.

Lifted by powerful political winds that wags refer to as “*hawa*,” the Hindi word for air or wind, Modi was free to pursue his own agenda. Electing the son of a train station *chaiwala*, or tea seller, who rose to become chief minister of Gujarat was a stunning repudiation of the Congress Party and the Nehru-Gandhi dynasty that had led India since Independence.

Now facing re-election in April and May, Modi's *hawa* has shifted. A farm crisis and continued high unemployment, especially among youth, have bedeviled his administration. Changes at the top of the Reserve Bank of India over accusations of meddling and a subsequent surprising shift in the direction of interest rates have sounded alarms. There have also been allegations of fiddling with government statistics to hide slowing growth and unfavorable unemployment figures, according to a 2/7 [article](#) in the *WSJ*. A sign of the new mood: December legislative elections in three important stronghold states of the BJP showed a revival of fortunes for the opposition Congress Party led by Rahul Gandhi.

All this is on top of Modi's early missteps. A surprise demonetization plan announced suddenly on November 8, 2016—banning bank notes representing 86% of the currency in circulation in an effort to discourage the informal cash economy—is now widely seen as a failure. The move resulted in enormous disruption to the economy and exacted a big social price, as poor people with no access to credit cards or mobile payments suffered disproportionately. Yet the Reserve Bank of India revealed that most of the bank notes eventually found their way back into the financial system, as an 8/30 *NYT* [piece](#) explained.

Modi's rollout of the Goods and Services Tax (a.k.a. GST), designed to streamline the tax system, is seen as a more positive development but is still a work in progress after many miscues following its July 2017 introduction, according to an 8/28 [piece](#) by Deutsche Well.

The shifting political winds appear to be dampening investor enthusiasm along with trade concerns. The MSCI India Share Price Index trails most of the pack so far in Q1, down 0.1% (in local currency) through Monday. In contrast, MSCI EM Asia is up 7.3% and MSCI EM has risen 6.5%. In US dollar terms, the India Share Price index ranks dead last this year, down 1.8% in Q1 to date.

I asked Sandra Ward, our contributing editor, to examine the Modi approach to governing. Here is her report:

(1) *Rising unemployment*. A jobs report by the National Sample Survey Office leaked to the press in late January set off a firestorm by putting India's unemployment rate at 6.1% for the year ended March 2018, a 45-year high. The government dismisses the report as an unfinalized draft but has delayed revealing official results, which were scheduled to be released in December. Two officials in the National Statistical Commission, including the chairman, resigned in protest over the delay, according to a 2/1 [story](#) in the *WSJ*. They also accused the government of recalculating GDP figures.

India's unemployment figures long have been viewed skeptically by economists and investors because the way the data are calculated results in unusually low levels. For the past 40 years, unemployment has mostly ranged between 2.0%-3.0% before rising above 5.0% in 2015, according to a 9/25 [report](#) titled *State of Working India* by the Centre for Sustainable Employment (CSE) at Azim Premji University. The CSE reported that youth unemployment is at 16% and that job growth is becoming disconnected from economic growth. A 10% increase in GDP growth now results in job growth of less

than 1.0%.

(2) *Faster GDP?* Vying with China for the title of “fastest-growing major economy,” Modi’s government changed the base and method of calculating India’s GDP in 2015 to boost growth. The new methodology was applied to historical results last year but showed GDP growing faster under the previous government and was tweaked again.

GDP growth in Q3-2018 registered 7.1%, down from a nine-quarter high of 8.2% in Q2-2018. A sharp slowdown in manufacturing growth and a contraction in mining were blamed ([Fig. 5](#)). Sentiment suffered owing to higher oil prices, a weak rupee, and tight liquidity. While the figure disappointed, it beat China’s 6.5% growth.

The latest government figures show industrial production rebounded in December, by 2.4% y/y, after hitting a 17-month low in November, largely on the back of a 2.7% rise in manufacturing—which pales next to the 8.7% rate of growth produced in 2017 ([Fig. 6](#)).

(3) *Fed up farmers.* Indian farmers voted overwhelmingly for Modi in 2014, and he promised to double farmers’ incomes when he took office, a 3/29/15 CNBC [piece](#) points out. But amid record harvests, farmers are finding themselves squeezed between falling prices for their crops and higher costs for oil and fertilizer and other items. Heavily indebted, they are committing suicide in alarming numbers.

More than a dozen major farm protests took place in India in 2018, according to an 11/30 *Business Standard* [article](#). In one instance, on November 29, 100,000 farmers from across India rallied in Delhi to demand higher minimum support prices and debt relief in the form of loan waivers. The December elections in Rajasthan, Madhya Pradesh, and Chhattisgarh that unseated the incumbent BJP candidates were largely seen as a referendum on the farmers’ crisis. The new Congress party leaders in those states moved swiftly to forgive billions in farm loans, according to a 12/19 *Outlook* [article](#).

Food represents 40% of India’s CPI, which hit a 19-month low of 2.0% y/y in December on continued deflation in food prices. The Wholesale Price Index fell to an eight-month low of 3.8% y/y in December, but that figure belies the deflationary trends in the food subgroup over the past six months ([Fig. 7](#)).

With more than 50% of India’s population tied to agricultural work and agriculture’s share of GDP only 15.5%, there is a serious disconnect. As India Macro Advisors noted in its 1/14 analysis of the inflation index: “While low inflation is a cause for celebration for urban consumers, inflation this low and largely on account of falling food prices is a matter of concern for a country like India. As a large percentage of the population is dependent on farming, lower food prices mean a lower rural income. And a lower rural purchasing power could affect aggregate demand and growth which had already moderated in Q2 of FY19.”

(4) *Wooing voters.* In the interim budget announced February 1, Modi extended a hand to farmers. He offered those with less than two hectares (about five acres) of land annual cash payments of 6,000 rupees (\$85). An estimated 120 million households qualify, according to a 2/1 AP [piece](#). In other giveaways, workers in the informal sector—rickshaw drivers, maids, and tea sellers among others—will receive a monthly pension of 3,000 rupees, or \$40, on retirement at age 60. The budget doubles income-tax exemptions for those earning up to 500,000 rupees (\$7,142) a year from the existing 250,000 rupees (\$3,571).

(5) *New central bank chief, new outlook.* The Reserve Bank of India (RBI), under its new governor, Shaktikanta Das, cut its key lending rate by 0.25% to 6.25% on February 7. The policymakers cited a global economic slowdown and tame inflation as reasons for the action ([Fig. 8](#)).

In its latest, 2/7 [statement](#), the central bank also said it was shifting its monetary stance to “neutral” from a “calibrated tightening.” The timing of the moves has raised questions about the central bank’s independence, particularly with the general election just weeks away. The easing and change in outlook also come just months after former governor Urjit Patel resigned the post suddenly, following months of pressure from the government to relax lending standards and to provide some of its surplus reserves to fund the fiscal deficit, according to a 12/10 *WSJ* [story](#).

The latest inflation figures raise the probability of another 0.25% rate cut at the RBI’s April monetary policy meeting, according to a 2/7 [article](#) in *The Week*. In its statement, the RBI maintained its commitment to targeting headline inflation of 4.0%, plus or minus 2.0%.

There’s a new mood in India. Whether voters are in the mood for more Modi remains to be seen.

CALENDARS

US. Wed: Headline & Core CPI 1.5%/2.1% y/y, Treasury Budget -\$12.0b, MBA Mortgage Applications, Atlanta Fed Business Inflation Expectations, EIA Petroleum Status Report, Mester. **Thurs:** Retail Sales Total, Less Autos, Less Autos & Gas, and Control Group 0.1%/0.0%/0.4%/0.4%, Business Inventories 0.2%, Jobless Claims 225k, PPI-FD Total, Core, and Core Less Trade Services 0.2%/0.2%/0.2%, EIA Natural Gas Report, Harker. (Econoday estimates)

Global. Wed: Eurozone Industrial Production -0.4% m/m/-3.3% y/y, UK Headline & Core CPI 2.0%/1.9% y/y, Japan GDP (saar) 1.4% q/q. **Thurs:** Eurozone GDP 0.2% q/q/1.2% y/y, Eurozone Employment, Germany GDP 0.1% q/q/0.8% y/y, China Trade Balance \$32.0b. (DailyFX estimates)

STRATEGY INDICATORS

S&P/Russell LargeCaps & SMidCaps ([link](#)): All of these price indexes are up so far in 2019, and only the SmallCaps are still in a correction. Here’s how they rank ytd through Monday’s close, along with their percentage changes since SMidCap’s record highs in late August and LargeCap’s on September 20: Russell SmallCap 2000 (12.6% ytd, -12.7% from record high), S&P MidCap 400 (12.1, -9.1), S&P SmallCap 600 (11.6, -14.1), Russell LargeCap 1000 (8.7, -7.4), and S&P LargeCap 500 (8.1, -7.5). LargeCap’s forward EPS is now 2.3% below its record high of \$175.48 in late October, while MidCap’s and SmallCap’s are now 2.2% and 5.5% below their mid-October highs, respectively. LargeCap’s forward EPS is the most below its record high since June 2016, while MidCap and SmallCap have not been this far below since April 2016 and December 2010, respectively. The yearly change in forward earnings remains healthy compared to the past due to the boost from the Tax Cuts and Jobs Act (TCJA), but is tumbling now as y/y comparisons become more difficult. In the latest week, the rate of change in LargeCap’s forward earnings fell to a 23-month low of 8.0% y/y from 9.4%. That’s down from 23.2% in mid-September, which was the highest since January 2011 and compares to a six-year low of -1.8% in October 2015. MidCap’s y/y change was down to a 23-month low of 9.4% from 10.9%, which compares to 24.1% in mid-September (the highest since April 2011) and a six-year low of -1.3% in December 2015. SmallCap’s dropped to a 13-month low of 14.5% from 16.4%, which is down from an eight-year high of 35.3% in early October and compares to a six-year low of 0.3% in December 2015. Analysts had been expecting double-digit percentage earnings growth in 2019, but those forecasts have been dropping since October. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.7%, 4.4%, 11.8%), MidCap (21.7, 6.1, 11.8), and SmallCap (21.8, 10.8, 15.9).

S&P 500 Growth vs Value ([link](#)): The S&P 500 Value index is up 8.3% ytd through Monday’s close,

slightly ahead of the 7.9% gain for its Growth counterpart. However, Growth has risen 15.6% since the bottom on December 24, ahead of the 14.8% gain for Value. Both of these indexes are out of a correction now: Growth is now 8.6% below its October 1 record high, while Value is 9.5% below its record high on January 26. Since the election in late 2016, Growth's 35.9% gain is more than double the 16.3% increase logged by Value. Looking at the fundamentals, Growth is expected to deliver higher revenue growth (STRG) and earnings growth (STEG) than Value over the next 12 months. Specifically, 7.7% STRG and 7.5% STEG are projected for Growth, respectively, vs 4.2% and 5.0% for Value. Prior to the selloff in February 2018, Growth's P/E of 21.8 on January 26, 2018 was its highest since May 2002, while Value's 16.6 on January 3, 2018 was its highest since April 2002. Through Monday, Growth's P/E was back up to 20.1 from its 50-month low of 15.9 on December 24, and Value's 13.1 was up from a six-year low of 11.5 on January 3. Regarding NERI, Growth's was negative in January for a second month after 19 straight positive readings, as it fell to a 24-month low of -4.3% from -3.2%; that compares to a record high of 22.3% in March 2018 and a five-year low of -16.2% in April 2015. However, Value's NERI was negative in January for a third month and at a 33-month low as it fell to -6.8% from -4.6%; that compares to a record high of 21.2% in March 2018 and five-year low of -20.3% in April 2015. The TCJA sharply boosted the consensus forward earnings estimates and the forward profit margin for both Growth and Value, but Growth's margin is falling now. Growth's forward profit margin of 15.7% is up from 14.4% prior to the TCJA's passage, but down from its record high of 16.7% during mid-September. Value's forward profit margin of 10.3% is down from a record high of 10.5% in December, but up from 9.1% prior to the TCJA.

S&P 500 Q4 Earnings Season Monitor ([link](#)): With nearly 70% of the S&P 500 companies finished reporting earnings and revenues for Q4-2018, y/y revenue and earnings growth remains strong, but the surprise metrics have weakened relative to Q3's results due to Q4's trading turmoil and slowing growth in China. Of the 345 companies in the S&P 500 that have reported through mid-day Tuesday, just 72% exceeded industry analysts' earnings estimates. Collectively, the reporters have exceeded forecasts by an average of 3.8% and averaged a y/y earnings gain of 14.9%. If those results hold through the end of the quarter, it would mark the smallest earnings beat since Q4-2016 and the slowest y/y growth since Q3-2017. On the revenue side, just 61% of companies beat their Q4 sales estimates so far, with results coming in 0.9% above forecast and 7.9% higher than a year earlier; that marks the smallest revenue beat since Q1-2017. Revenue growth is the slowest in five quarters. Earnings growth is positive y/y for 73% of companies, vs a higher 87% at the same point in Q3, and Q4 revenues have risen y/y for 76% vs a higher 83% during Q3. Looking at earnings during the same point in the Q3-2018 reporting period, a higher percentage of companies (78%) in the S&P 500 had beaten consensus earnings estimates by a greater 7.0%, and earnings were up a higher 28.1% y/y. With respect to revenues at this point in the Q3 season, a lower 60% had exceeded revenue forecasts by a higher 1.6%, and sales rose a greater 9.5% y/y. The results for Q4 are still subject to change as more companies report, but the slowdown in revenue and earnings growth from Q3 is readily apparent. Q4-2018 should mark the tenth straight quarter of positive y/y earnings growth and the 11th of positive revenue growth.

US ECONOMIC INDICATORS

NFIB Small Business Optimism Index ([link](#)): "Business operations are still very strong, but small business owners' expectations about the future are shaky," said NFIB President and CEO Juanita D. Duggan. "One thing small businesses make clear to us is their dislike for uncertainty, and while they are continuing to create jobs and increase compensation at a frenetic pace, the political climate is affecting how they view the future." These concerns have pushed the group's Uncertainty Index up 7 points to 86—the highest since March 2017—and the fifth highest reading in the survey's 45-year history. The NFIB's Small Business Optimism Index (SBOI) fell for the fifth month since reaching a record high of 108.8 in August, slipping to 101.2 at the start of this year—the lowest since November 2016. Last month, seven of the 10 components of the SBOI fell, while three rose. The biggest negative contribution

came from companies expecting business conditions to improve, which sank to 6% in January, the lowest percentage since October 2016 and down from a post-election peak of 50%. Sales expectations (to 16% from 23%) and plans to increase inventories (1 from 8) rounded out to the top three negative contributors. Hiring plans (18 from 23) and job openings (35 from 39) eased last month—though remained strong. Not all measures of optimism declined: earnings trends (-5 from -7), capital spending plans (26 from 25), and expected credit conditions (-5 from -6) improved slightly.

JOLTS ([link](#)): Job openings surged to a new record high as 2018 came to a close. Openings rose six of the final seven months of last year, by 676,000, to a record 7.335 million. Meanwhile, hirings reversed some of November's decline, rebounding 95,000 to 5.907 million last month—just shy of October's 5.928 million record high. Separations fell for the fourth straight month—by a total of 234,000 to 5.545 million—since reaching a record high of 5.779 million in August. The latest hiring and separations data yielded an employment advance of 362,000 in December, 140,000 above December's payroll increase of 222,000—overstating the increase for the third month. Those quitting their jobs slid 166,000 during the four months ending December to 3.482 million. December's private industry job-opening (5.0%) rate reached a new record high, while the quit rate was at 2.6% for the third month, just below its cyclical high of 2.7%. The total hire rate (4.3) is in a volatile flat trend around its cyclical high. December's ratio of unemployed workers per job opening was below 1.00 for the 10th month—at 0.86—barely budging from August's record low of 0.85.

GLOBAL ECONOMIC INDICATORS

Global Leading Indicators ([link](#)): In December, the OECD's composite leading indicators (CLIs)—designed to anticipate turning points in economic activity relative to trend six to nine months ahead—continued to point to an easing of growth momentum in most major economies, with the OECD's CLI (99.2) sinking to its lowest level since October 2009. Easing growth momentum remains the assessment for the US (99.4), Canada (99.0), UK (98.5), and the Eurozone (99.3) as a whole—including Germany (99.5), France (98.9), and Italy (99.2). Meanwhile, Japan's CLI (99.8) is still anticipating stable growth momentum. Among the major emerging economies, signs of growth regaining momentum have emerged in Brazil's CLI (102.3), while stable growth momentum remains the assessment for India (100.7). Meanwhile, Russia's CLI (99.9) continues to show an easing in growth momentum with similar signs emerging in China's (99.0) industrial sector—reflecting a slowdown in production of motor vehicles. (Note: Due to the US government shutdown, December estimates were made for US Census Bureau reports on Durable Goods Manufacturers' Shipments & New Orders and Residential Building. All other indicators used in constructing the CLI for the United States were available and incorporated in December's assessment.)

UK GDP ([link](#)): Economic growth in the UK for all of 2018 was the weakest since 2012, ending the year on a down note. Real GDP contracted 0.4% in December, with services, construction, and manufacturing all declining—the latter for a sixth consecutive month, sinking into recession territory. For the quarter, real GDP rose only 0.7% (saar), less than one-third Q3's 2.5% pace. Real GDP expanded 1.4% during 2018—matching 2012's pace; the last time it had a worse year was 2009 (-4.2%). In 2018, net trade was a drag on growth, while the latest ONS figures show that business investment fell in all four quarters for the first time since the last recession in 2009, as concerns over Britain's future trading relationship with the EU led companies to put their investment plans on pause. Meanwhile, household consumption continued to expand last year, though at a slower pace. Last week, Bank of England Governor Carney warned the “fog of Brexit” is weighing heavily on business investment decisions, while households are starting to spend less. “Given the dynamics of the negotiations, we are now assuming uncertainty remains elevated for a while and that financial conditions stay tighter for longer.”

UK Industrial Production ([link](#)): December data show industrial output hasn't posted a gain in six

months, while manufacturing production fell for the sixth consecutive month. Headline production contracted 0.4% m/m and 1.7% during the five months through December. Meanwhile, manufacturing production fell 0.7% in December and 1.9% the last half of 2018. Looking at the main industrial groupings, here's a tally for December and the six months through December: Consumer durable (-1.0% & -1.2%), capital (-0.9 & -2.4), intermediate (-0.7 & -1.3), and consumer nondurable (-0.6 & -2.4). January's IHS Markit M-PMI shows the manufacturing sector slowed to a three-month low of 52.8, down from 54.2 in December—its second-weakest reading since July 2016 (the first survey month following the EU referendum result). Both output and orders growth slowed last month, while employment fell for only the second time in the past 30 months. Meanwhile, Brexit preparations led to a sharp increase in both purchasing activity and stockpiling at warehouses.

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