Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims and Mains focus: about the recent economic slowdown in Indian economy and why it is not affecting the stock market

News: Benchmark indices Sensex and Nifty have touched fresh highs in the last couple of months despite fresh concerns about a rise in bad loans, risks in the banking and non-banking space and the economic slowdown.

Why is Sensex peaking amid slowing growth?

Reforms such as the goods and services tax, insolvency and bankruptcy code and the recently announced corporate tax cuts suggest a positive mid-term outlook for India’s growth once banking and financial sector stress is resolved. The other equally important factor is low interest rates in developed economies that have led to fresh inflows into India. More Indians are participating in retail equity markets as a viable investment through special investment plans and mutual funds. All this, coupled with expectations that the direct tax code will be enforced in the next budget, has improved market sentiment.

Aren’t they supposed to move together?

Not always. Ideally, markets and the economy should move together as price of shares of a company should be correlated with its future earnings. Expectations of future earnings are formed from past and present earnings. Thus, during a slowdown markets should correct to reflect the current level of earnings. But several other factors influence the pricing of shares. Fresh availability of surplus liquidity at cheap rates, along with speculation of future earnings being better than today, can lead to such divergence. The convenient argument during a bull run has been “this time it is different” however, it never is.

Does this mean the Sensex is likely to correct?
There’s a greater chance it won’t correct. Growth will recover over the next few quarters and the corporate tax cuts will have a positive impact on the balance sheet of all firms. What will happen to benchmark indices depends on the budget, the monetary policy panel’s February meet, availability of liquidity, global growth and the pace of recovery.

**What if there’s a global economic recession?**

Many anticipate a global economic meltdown due to a slowdown in the US economy caused by the **US-China trade war**. The slowdown in the EU has been explained using arguments including heightened uncertainty over **Brexit**. However, the recently concluded phase 1 of the US-China trade deal and the Conservatives’ thumping majority in the UK polls reduce uncertainty. Geopolitical factors will thus be conducive to growth. The only factor that can cause a recession is a severe correction in US stock markets, which is less likely.

**So what will happen by December 2020?**

While the indices are performing well, well-governed companies are driving this show. BSE Midcap is down roughly 600 points, even as BSE Smallcap is up around 200 points. So, capital has moved away to strong companies with consistent earnings. This suggests a correction in their valuation is unlikely. The economy bottomed out in the second quarter of FY20; thus, economic indicators by next December will be positive and in line with India’s potential.