

Nifty 50 - A Little Shifty

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About the disparity between the stock market indices and the failure of Nifty to act as a barometer for the Indian Economy.

There's no two ways to say it - the Indian economy has taken a beating in the recent past. Inflation-adjusted GDP has grown at a staggeringly slow 5% in the Q1FY20, and the country's economic growth has refused to pick up even in Q2FY20, staying at about 5%.

Another signal of the economy's fate is that Moody's Investor Service has cut India's 2019 GDP growth forecast to 5.6%. The agency predicts growth rates to rise to approximately 6.6% in 2020 and 6.7% in 2021, but they believe that the rate of growth will never be as high again. The economic slowdown can be primarily attributed to shrinking employment rates that only add to the burden of waning levels of consumption. Of course, there will always be a myriad of factors that push an economy into a recession, but this time around the blame for India's economic situation belongs to these two factors.

While it has been established that India is facing a recession, the question is about whether it is cyclical or structural in nature. A cyclical recession is one that occurs over the short-to-medium time period and is largely attributed to fluctuations in the business cycle. A recession of this nature would ideally be resolved through interim fiscal and monetary measures coupled with a temporary recapitalisation of credit markets and other regulatory changes. A structural recession, on the other hand, is a beast of a different nature. Recessions that arise due to structural issues generally last for long time periods. These slowdowns are driven by either disruptive technologies and/or changes in consumer behaviour. Although industry experts initially believed our current slowdown to be cyclical in nature - a dreadful combination of low demand and excess capacity - some analysts have now started to fear that this recession may in fact be a structural one.

Another heavily emphasized factor for the economic downturn is the auto industry. Although this article does not aim to breakdown the many facets of the auto sector slowdown, it is necessary for readers to grasp the bare-bones of it to assimilate our main point. Now, the Indian auto industry has faced slowdowns before, most recently in the mid-1990s. This time around, however, the slowdown has lasted longer. The liability for the prolongation of this particular crisis lies on the mixture of a drop in private investment and a banking crisis that has made access to credit elusive. It would be premature to assume that the introduction of disruptive technologies like Ola and Uber, to name a few, is responsible for the complete drop in consumer demand. The

auto industry does not merely consist of light consumer vehicles(LCVs), when in fact a large chunk of the demand within the sector comes from heavy consumer vehicles (HCVs). The NBFC banking crisis has made it troublesome for farmers to get lines of credit to purchase heavy vehicles such as tractors etc. Thus, the drop in demand from the HCV side has contributed equally to the total drop in demand that has sent shockwaves through the auto sector.

At this point, we've clearly outlined the many reasons the Indian economy is headed for a nasty turn in the next few quarters and established that we are, indeed, facing an economic recession. Therefore, by extending the logic described, it follows to ask if the Indian stock market must also have taken quite a hit? Strangely enough, the answer is no.

It seems intuitive that stock market indices should mirror the economy's plight, and this intuition isn't baseless. Stock market indices were created to reflect the behaviour and performance of the companies under them. In the Indian context, we look at Nifty50. Nifty50 comprises of 50 stocks in the market and is calculated using the Free Float Market Capitalisation methodology. All jargon aside, if the market's future expectations seem bleak, investors would choose to withdraw funds from the market and thus, cause the market indice to take a plunge. This logical prediction could not be further from the reality of the situation. As the Indian economy has plunged into a slowdown, Nifty50 has been rising steadily. As of December 18th 2019, Nifty50 has achieved a high of 12,221.65, while Nifty MidSmallCap 400 had achieved a measly 5787.4 till December 2nd, 2019.

To summarise and elaborate and twisted explanation of the two indices, one can say that Nifty 50 comprises of the largest companies in the country in terms of market capitalisation whereas Nifty MidSmallCap 400 consists of 400 companies that are considered small and mid cap. The true story of the Indian markets would indubitably be narrated by the behaviour of Nifty MidSmallCap 400. But the reason Nifty50 has experienced a period of growth could rationally be the surge of investment into blue chip companies that make up the index. Traditional avenues for investment such as gold and real estate have become less desirable. Wealthy individuals in India have generally never shown a high propensity to invest in the stock market which may be due to their inherent risk-averseness. But, if other sources to invest have dwindled down and their only option was the stock market, they are much more likely to place their money in blue-chip stocks that have historically given returns with little to no risk. At the same time, Nifty MidSmallCap 400 did not experience this injection of wealth. It fluctuated given the performance of the small and mid cap companies in the country, thus betraying the true situation of the economy.

The disparity between the two indices tells us something crucial about the standard stock market index as a barometer for our economy : the behaviour of an index should no longer be used to diagnose and predict the condition of the economy. If anything is to be used, it must be oil prices and in turn, exports of the country as these numbers allow individuals to evaluate the real demand and supply of an economy and not be deceived by the herd mentality.