MONTHLY OUTLOOK

JULY 2020

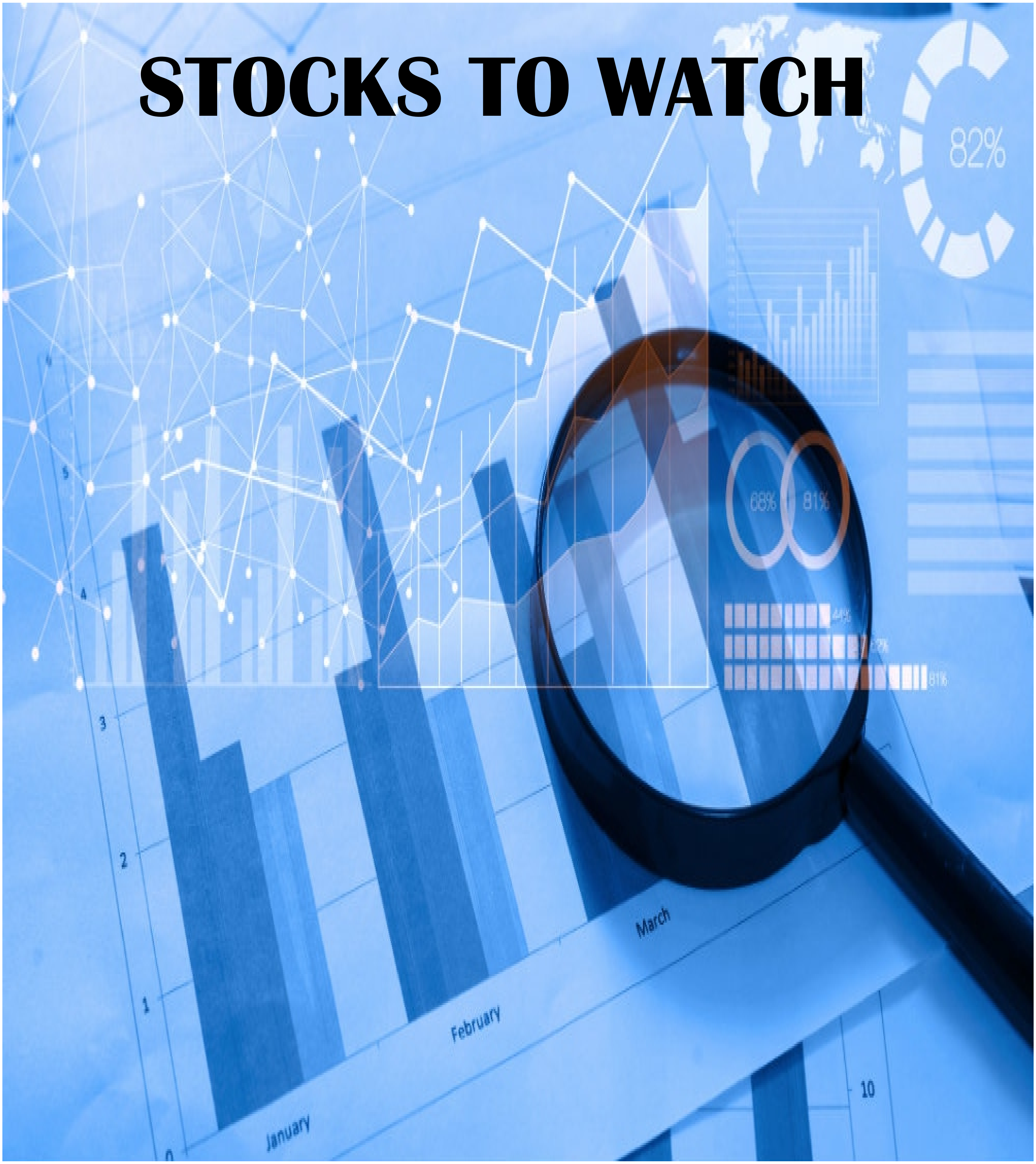
MONTHLY OUTLOOK FOR JULY 2020

The index hit hard low in Late march 2020 and there after it has bounced back sharply. The bounce back is forming a rising wedge pattern and is close to the upper end of the pattern . A throuover above upper trendline cannot be rules out to make a bull trap hence above 10690 the index can possibly test 10883 which can be the top of current ongoing rally.There after a the index will head lower to test lower trendline around 10110 . a breach below 10100 will turn the tables for bulls and the target for the wedge pattern is placed at 7600. On the downward journey the index has possible supports at 10300, 10110 , 9724. The pattern has took more then 3 months to develop so the breakout can test the targets in a month post breakdown so longs are advised to book at resistance levels on individual staocks and on rejection of 10690/10883 aggressive shorts can be opening for 10110.

श्री LAKSHMISHREE
Gateway to your Financial Goals

JULY 2020

STOCKS TO WATCH



UPL

JULY 2020

Current Market Price (Rs)	Target Price (Rs)	52 week H/L (Rs)	Mkt Cap (Rs cr)
430.60	496	709.05/240.15	32,941.82

Investment Rationale:

UPL's geographic diversification and believe that a volume growth of 29% in Q4FY20 is impressive considering a challenging market scenario UPL is likely to enjoy low cost of borrowing due to diversify currency borrowing

Company Profile

UPL Limited provides crop protection solutions. The Company is engaged in the business of agrochemicals, industrial chemicals, chemical intermediates and specialty chemicals. The Company's segments include Agro activity and Non-agro activity. The Agro activity segment includes the manufacture and marketing of conventional agrochemical products, seeds and other agricultural related products.

Financial Summary:

P/E (x)				ROE (%)				EV/EBITDA(x)				Mcap/Sales (x)			
FY19	FY20	FY21E	FY22E	FY19	FY20	FY21E	FY22E	FY19	FY20	FY21E	FY22E	FY19	FY20	FY21E	FY22E
17.6	14.4	11.9	9.7	15.3	13.1	13.5	15.4	15.2	8.6	7.8	7.1	1.5	0.9	0.9	0.8

JULY 2020

Camlin Fine Sciences

Current Market Price (Rs)	Target Price (Rs)	52 week H/L (Rs)	Mkt Cap (Rs cr)
53.55	110	89.90/33.00	655.38

Investment Rationale:

CFIN's Q4 as well as FY20 earnings performance was ahead of our expectations. Going ahead, we believe the anticipated commissioning of Dahej plant (estimated to bring in overall cost saving of 400bps) in Q2 and steady growing revenues from antioxidant blends to drive faster profitable growth for CFIN.

Company Profile - CFS is a provider of high-quality shelf life extension solutions including antioxidants, aroma ingredients and performance chemicals. With over thirty years of serving customers, we've learnt that each one has a unique need and therefore must require a unique solution. Our global expertise, local insights and technical know-how put together enables us to deliver what's required.

Financial Summary:

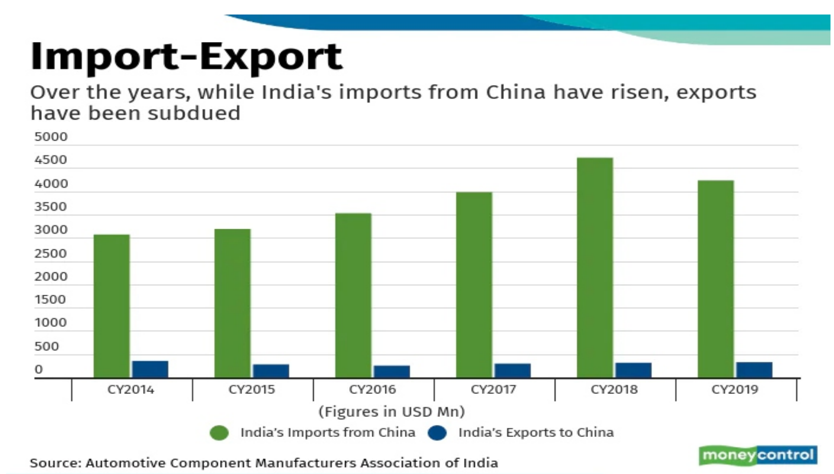
(Rs mn)	Q4FY20	Q3FY20	qoq Ch %	Q4FY19	yoy Ch %	vs. expect. %	Comments
Net Sales	2,929	2,739	6.9	2,680	9.3	26.6	No visible impact of Covid
EBITDA	343	290	18.1	214	60.0	25.6	
EBITDA margin	11.7	10.6		8.0		-9bps	
Reported PAT	27	52	-48.1	74	-63.8	-67.7	
Core PAT	144	111	30.0	104	38.2	74.1	Adjusted for forex
EPS (Rs)	1.2	0.9	30.0	0.9	38.2	74.1	

JULY 2020

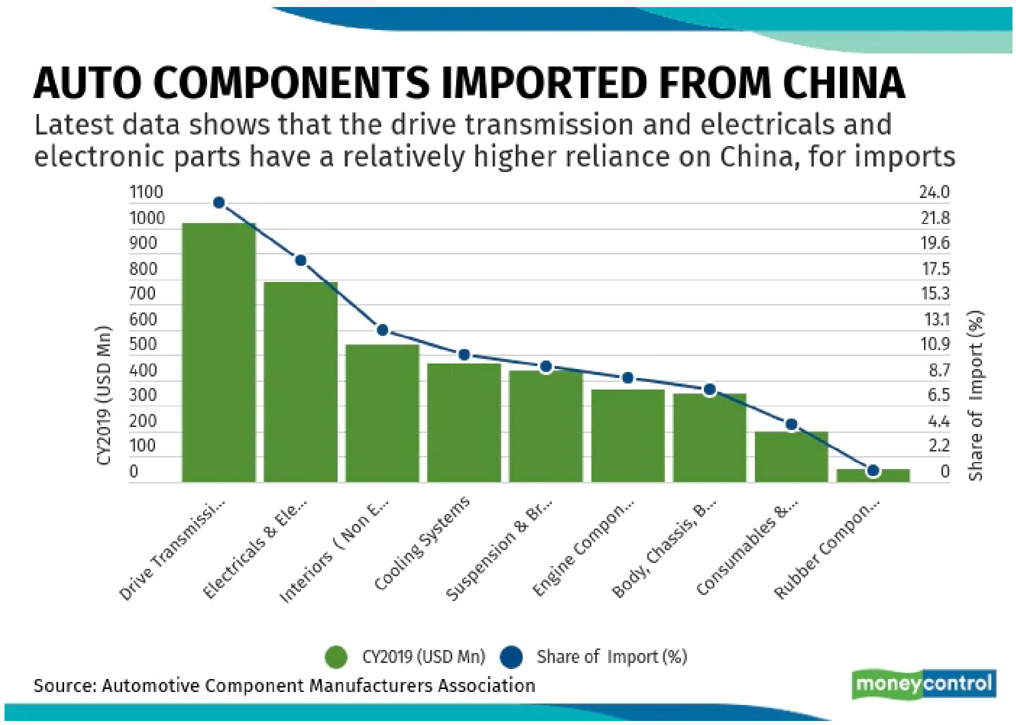
CHANGES TO WITNESS

Will the India - China stand off drive India's auto industry to Atmanirbharta?

The year 2020 seems to be one of misgivings for India's automakers. It unfolded with the coronavirus outbreak in China and a lockdown in one of its largest “motor cities” Wuhan that disrupted the industry's supply-chain. As if this wasn't enough, recent border tensions between the two nations and campaigns to boycott and ban Chinese goods in India signal more trouble for the industry.Although there has been no formal announcement by the government to ban imports from China, the industry's concerns are not unfounded given its reliance on China for components. According to data from the Automotive Component Manufacturers Association of India, about 27 percent of the total component imports of about US$17.5 billion is from China. This is excluding batteries and tyres.The worry is not the value of component imports. In fact, the Indian auto industry boasts of a high level of localisation of around 90 percent. The problem is to do with the complexity of the automotive value chain and the critical nature of the imported components is what underscores the high dependence on a region or supplies. Even if there is one missing link in production, the vehicle is not ready for sale.



The chart (Fig. 2) shows that drive transmission and steering, electrical and electronics, interiors and cooling systems in that order, are key components imported from China, although there are several other parts too. Of course, a sizeable portion of imports from China also services the aftermarket sales.

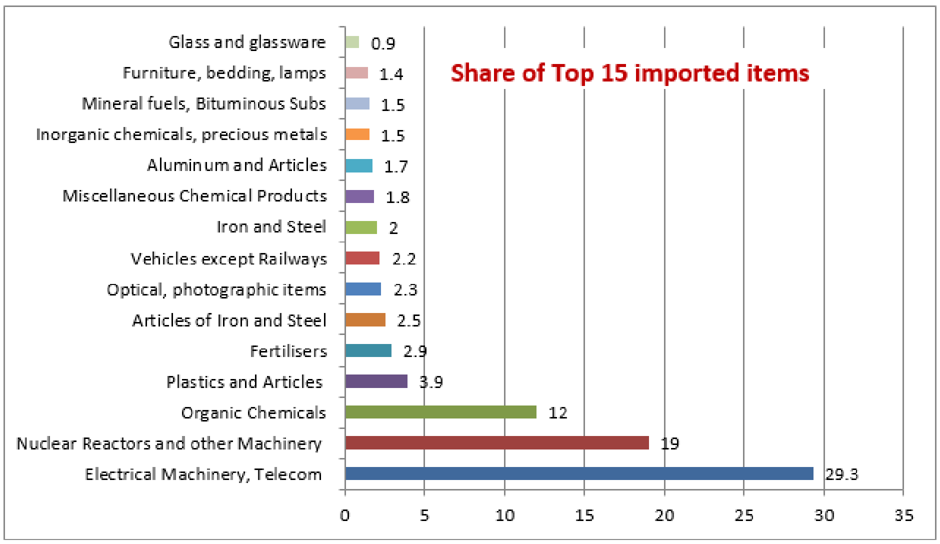


Noticeably, component imports from China have risen significantly from around the last three years (see Fig.1). This was largely due to the quick technological transition of the auto industry from BS-IV to BS-VI emission norms imposed by the government, along with other safety standards. Apart from severe cost implications that made the vehicles costlier, it gave very little time for the domestic component industry to measure up with new technology and capacity.So India's automakers who were faced with stiff deadlines for BS-VI compliance took recourse to Chinese component suppliers who were quick and cost effective and had scalability. China's auto components industry turnover of US$550 billion (2019) is nearly 10 times that of India. In a sense, our component makers missed the bus to enter the supply chain of critical parts for BS-VI vehicles.At this juncture, any moves to unduly raise import tariffs or take any non-tariff measures to thwart imports will once again disrupt the automotive supply chain and production cycles. The Wuhan lockdown experience confirms this and the industry is slowlygetting back on its feet after that disruption.In fact, automakers have learnt their lesson. They have already started scouting for alternate sources of supply. It is a trend seen in the last few months across the globe. “India's auto industry has started to de-risk itself and is working on deep localisation. The recent standoff between India and China will only hasten the same,” explains Deepak Jain, president of ACMA.This also coincides with Prime Minister Narendra Modi's Atmanirbhar Bharat Abhiyan initiative that seeks to make India self-reliant with the 'Make in India” mantra. But, as in any industry, this cannot materialise overnight. In a note to the government, ACMA indicates among other things that one way forward to reduce dependence on China is for India's component makers to grow exports to at least 5 percent of world trade compared to 1.3 percent at present. Exports of components have been lacklustre in the past three years.The need of the hour is for the auto industry and government to commit to each other to become self-reliant. “While the industry will have to deliver technologically relevant, globally price competitive products with consistent quality, Government will have to ensure ease of doing business in its true sense and to overcome disabilities of capital logistics and energy. With 9-11 percent borrowing rate, India has one of highest costs of capital, on logistics we are disadvantaged by 10-12 percent and our energy costs need to be globally competitive,” highlights the note.

Going by the past trends, there is no reason to doubt the industry's ability to cope with technological changes. The front-runners have facilities that match international standards of quality. Sundram Fasteners Ltd, Bharat Forge Ltd and Motherson Sumi Systems Ltd are a few from home ground that have made a mark in international markets too.But, these are only a handful. Most component suppliers are in the micro, small and medium enterprises segment and have their own battles to fight. Industry watchers point out that these enterprises must be incentivised by the government to grow in size, so that they build capacities of scale over time. Only then can they become globally competitive, stand the test of time and cater to automakers needs at home and outside. In this context, Ajay Srinivasan, director, CRISIL Research points out that the industry will need reasonable time and a rational approach in terms of a roadmap, which clearly defines milestones for localizing these critical components. For instance, there are way too many electronic items and sensors that are needed to be compliant with BS-VI. Then, there was the pressure of emerging technologies like electric vehicles. Some of these critical components also require huge capital investments.In other words, the automotive value chain is quite complex technologically with global supply chains at play. Any knee jerk reaction could lead to large scale disruptions impacting the industry.

For 'Boycott China' to work, think like the Chinese

Rage against China in India has been building up over a long time. Every time the Chinese supported the terrorists in Pakistan at the UN or tried to push its army into India, calls for a boycott would flash up on various social media platforms. But after a few days, these died down and life was back to normal.This time around it does not seem to go away. With 20 soldiers martyred, the anger is justifiably high. Calls for boycotting Chinese goods and investments are coming from all corners and the government seems to be acting on it. The Indian government has taken action for cutting down economic ties with China. It started with imposing restrictions on Chinese investments in Indian companies after the Chinese central bank hiked its stake in India's largest housing finance company HDFC to 1.1 percent. The government then decided to screen investments into the country and impose restrictions.But direct investments are the least of the problem. China's share in equity FDI inflows to India has been a negligible 0.5 percent between FY2000-20. However, their investments in start-ups are high.A February 2020 research report by Gateway House on Chinese Investments in India' points out that 18 out of the 30 Indian unicorns with a valuation of more than $1 billion have total Chinese investment of more than $3.6 billion. Nonetheless, there is enough money globally to back a good idea which can substitute Chinese capital.The bigger problem is commerce. Around 14 percent of India's total imports come from China. India's trade deficit with China, the lowest in five years is still estimated to have narrowed to $48.7 billion during the last financial year. That's compared to a near zero deficit in FY2000. For every dollar of exports from India, the country imports around $4 worth of goods from China.The government has to correct this anomaly irrespective of what is happening at the borders. The Boycott China' moment has only made the matter urgent.The question is whether we will be able to replace imports from China with either imports from other countries or manufacture them domestically. To answer that let us look at what India imports from China.The chart below shows the dominance of top 3 industries in total imports from China.



(Figures in %, Source : Motilal Oswal India Strategy report)

Among the list given above the biggest concern is telecom and solar panels (clubbed under electrical machinery). China supplies around 80 percent of solar cells and modules to India and has been the biggest reason for the low cost of solar power in the country. Substituting these will be a big challenge as they are the lowest cost suppliers globally. As for telecom, many companies in India and abroad are moving away from Chinese suppliers on fears of spyware associated with the equipment. Most of the products are available globally and at a competitive price.

As for the other products, almost all have been produced in India but have stopped because of cheap imports from China. An analysis by Acuite Ratings and Research Ltd says that India's trade deficit with China can be reduced by $8.4 billion or 17.3 percent of the overall deficit in the current fiscal year alone. This reduction is possible by the domestic industry without any additional capital investment.Imports from China have declined by 15 percent since FY18 on account of imposition of anti-dumping duties on some products. A similar imposition of duties can have a double benefit for the country. It will help reduce imports as well as promote domestic manufacturing.However, these will be stopgap arrangements as was seen in the recent past. China sold goods to India through other countries which do not attract duties in India or have a trade agreement with India.Here is where there is a big challenge for the Narendra Modi government. In order to bring the cost of production in India in line with that of China, it will need to bring down the cost structure and improve the way businesses operate in the country. Implementation of GST has been a big help to remove the multi-layered tax system. Similarly, the lowering of corporate tax has made India an attractive destination.But apart from these the operational issues still persist. Cost of land and electricity is still high compared to global standards, let alone China. Labour laws need to be amended to attract investments and lower cost.The best example of the high-cost structure in India is the chemical industry. Almost all the products imported from China can easily be manufactured and have been manufactured in India. But the high-cost structure including taxes on raw material, logistics and operational costs have made them unviable. Further, China offers incentives for exports which makes Indian manufacturing unviable.Apart from these, other factors like under-invoicing by traders and companies have led to increased imports. A check on such practices will help most of the smaller consumable items which were earlier manufactured by MSME sector.China thinks and acts like a business house when it comes to exporting its products across the globe and attracting investments. It not only offers world class facilities but also promotes companies to use China as the manufacturing hub by providing incentives. Compare that with the hide-bound and often corrupt bureaucratic machinery in India that looks for reasons to create hurdles.Cancellation of projects given to Chinese companies is good for optics but it does not address the core problem of high-cost structure. Chinese companies were able to win the projects because of the lower cost of equipment they source from their country which are subsidised by their government. Indian companies, on the other hand, have to pay very high taxes to buy and use the equipment.Cost and availability of finance in another reason why Indian companies are not competitive when compared to their Chinese counterparts.While there is wisdom in attacking China where it hurts, unless the country addresses the core issue, we may just replace another supplier instead of China. Most countries across the globe are looking at alternatives to China as a supplier to their goods. India is ideally positioned to capitalise on this situation, but it would need a holistic approach to solve the problem.The issue is not of imports from China, the issue is of making India competitive. The Indian government will need to adopt the same measures that have made China a manufacturing giant.

Bringing Cooperative banks under RBI supervision is a good move , but it is not enough

In areas that fall under the joint authority of the central and state governments – think electricity, for instance - the will to reform has typically been weak. Cooperative banking is also one such area. For long, it had been dually regulated by the Reserve Bank of India and the state registrar of societies. Hijacked by vested political interests, this sector had also escaped reforms for long despite repeated frauds and failures.But the writing on the wall was up after the failure of the Punjab and Maharashtra Cooperative Bank. The government moved an amendment to the Banking Regulation Act, 1949, to give the central bank more powers to supervise urban cooperative banks. The bill couldn't be discussed in Parliament owing to the COVID-19 outbreak. Now, the Centre is planning to promulgate an ordinance on the same issue.While the ordinance awaits the assent of the President, a look at the amendment bill shows the government's intent. It is a welcome move and a first step towards cleaning up the cooperative banking sector, which has acquired sizeable proportions. There are around 1540 urban cooperative banks with deposits of at least Rs 5 lakh crore catering to 86 million customers.The Bill proposes that RBI be given powers to supersede the board of directors of cooperative banks after consultation with the concerned state government. Earlier, it could issue such directions only to multi-state cooperative banks – which are only about 50 compared to around 1500 single state cooperative banks.The Bill also proposed weeding out a lot of clauses in section 56 of the Banking Regulation Act which exempted cooperative banks from RBI rules. Cutting out these clauses will ensure that urban cooperative banks will be treated on par with commercial banks.Also, importantly, the bill proposes that cooperative banks be allowed to issue paid-up share capital and other securities subject to RBI supervision. This can change the whole ownership structure of banks and allow the central bank to fix mergers for failing banks quickly. It will also allow urban cooperative banks to raise capital from a variety of sources, grow, hire professional managements and handle risk. Moreover, As the R Gandhi committee had suggested a few years ago, urban cooperative banks voluntarily wanting to convert into small finance banks should be allowed to do so if they fulfil the central bank's criteria.Thus, the proposed ordinance, if it follows the script of the Bill, is yet another important step in strengthening the Indian financial system which has faced a multiple balance sheet crisis in recent years. The road ahead is rocky too as the COVID-19 pandemic and decelerating economic activity lead to a further pile up of non-performing assets.

What more needs to be done?

The government should quickly bring about a law for resolutions of distressed financial corporations. This will benefit the financial system at large and cooperative banks too if the Resolution Corporation is allowed to wind up these lenders without involving other regulators under cooperative societies' laws.Two, the RBI also issued a discussion paper for governance in banks. The paper focused on strengthening the board of a bank, its appointment processes, and its oversight on the bank's management and in areas such as risk management, audit and vigilance. These governance practices should be made applicable to cooperative banks as well.Third, all these will work only if the central bank is able to beef up its supervisory capacity. It has often given the excuse of dual control when it comes to supervising cooperative banks. But the RBI's record when it comes to private sector banks and NBFCs has hardly been stellar. To be sure, the government has done well to bring cooperative lenders under RBI control, since the alternative is worse. But the central bank also needs to quickly get its own house in order.

Parle-G success shows in tough times consumer choose comfort foods

Through the lockdown enforced by the Covid 19 pandemic, the Rs 35000 crore biscuit market in India has been a somewhat surprising gainer. Numbers indicate that led by the likes of Parle Product's Parle G and Monaco, Britannia's Good Day and Marie as well ITC's Sunfeast, biscuit sales have soared over the last three months.This marks a sharp turnaround from a time less than a year ago when sales of biscuits, particularly the cheaper ones, were in decline with Varun Berry, managing director, Britannia Ltd, pointing to a serious demand slowdown in India claiming that “even for a Rs 5 product if the consumer is thinking twice before buying it, then there is some serious issue in the economy." Around the same time, Parle considered laying off nearly 10% of its workforce following a hike in the GST rate on biscuits from 12% to 18%. Credit Suisse in fact, predicted that based on those estimates, FY20 would be the slowest year of growth for FMCG in 15 years. Higher taxes though were only the immediate dampener on sales of low-priced biscuits particularly in rural markets. The decline had been coming for a while as rising affluence led to increasing consumption of higher-priced biscuits and cookies. In a report released in March 2019, BlueWeave Consulting had said “Cookies segment is estimated to be the fastest growing product type of India biscuit market during the forecast period 2019-2025. ”Yet, come the pandemic, it was the humble low-priced lowest-priced biscuits that led the demand turnaround. The reasons were obvious.In the first place, home finances across the board are under severe strain as jobs are lost, salaries are slashed and many small and medium enterprises are witnessing a demand meltdown which could put them out of business soon. At such times, spending priorities change as customers focus on their core needs and value for money becomes the mantra for all purchases.Demand for low-priced biscuits was also boosted by the thousands of free food camps set up by the government as well as NGOs and individuals where an inexpensive and easy to stock product like a pack of biscuits worked well.But beyond these immediate triggers, this sudden reversal of fortunes for the biscuit industry shows that in bad times people fall back on trusted and established products. In a recent 12-market study by Edelman on the critical role of brands, 54% of the respondents said they were not paying attention to new products at present unless they are designed to help with their pandemic-related life challenges.It could get worse for companies if the severity of the economic crisis with its consequent impact on people's confidence and buying power, drives consumers to alter their spending patterns in fundamental and even permanent ways. Already some elements of the lockdown lifestyle like work-from-home are becoming institutionalized. Anecdotal evidence suggests many more people are baking at home (in the US, stores are reporting shortages of yeast) or sourcing products from smaller, unbranded neighbourhood bakeries. The fact is, consumers aren't just worried about the pandemic but also by the seeming absence of an end in sight to its many woes.Of course, because of the lockdown, people did stock up on all varieties of biscuits with sales of the more expensive brands from companies like ITC and Britannia also growing. With the lifting of most curbs, it isn't clear though if that trend will sustain. In any case, Parle has said that 80-90% of its sales came from the low-cost favourite, Parle-G, which in turn gave the company's market share a sizable boost.How that translates into higher profits for Parle, is another intriguing element of the unfolding story. Parle whose brand Parle-G is obviously the best known in the segment and was once voted as the world's largest selling biscuit, is one of those rare market leaders in India that chooses to stay unlisted even after 90 years in the business. It isn't clear however, what it has gained from this leadership. Despite sales topping Rs 9000 crore in 2018-19, net profit at Rs 410 crore was disappointing. By contrast, its arch-rival Britannia Industries posted net profit of Rs 1484 crore on sales of Rs 10986 crore in 2019-20.

Will the boom in sales spur improved profitability at Parle Products?

Yes Bank interest default a warning on what rising NPAs could do

As Yes Bank falls short of regulatory capital requirements, the Reserve Bank of India told the lender not to pay interest on its upper tier-II bonds which was due on June 29. While Yes Bank's troubles are mostly of its own making, this episode serves as yet another reminder of the pitfalls that the Indian financial system faces thanks to decelerating economic activity. Public sector banks will bear the brunt.It is inevitable that non-performing assets (NPAs) will rise as the COVID-19 moratorium ends. While the unlocking of the economy is revealing some green shoots, the current financial year looks like a washout with some economists forecasting India's GDP to shrink by as much as 7 percent. This will naturally lead to more bank loans slipping into NPAs.Investment bank Jefferies, for instance, predicts that in FY21, the aggregate slippages for the banks it covers will be 1.8 times those seen in FY20. Bank of America forecast last month that the NPA ratios of state-owned banks could rise by as much as 4 percentage points by the end of this financial year.The expected sharp rise in NPAs brings two interlinked issues to the fore. One is the need to augment bank capital. Second, we need to conclusively address the bad loan issue so that lending gains traction and supports the economic recovery.This rise in bad assets will lock in capital. While many banks have increased their provision coverage, and indeed, provided extra for COVID-19 related issues, it is inadequate. Rating agency Fitch, for instance, believes Indian lenders to have “only moderate-to-small buffers above the regulatory minimum.”“There is a substantial risk of (PSU banks') limited capital buffers being further eroded even under moderate stress. In comparison, private banks' common equity Tier 1 ratio is around 400bp higher than the state banks' average, which makes their capitalisation more resilient yet vulnerable to severe stress," said the ratings agency last month.Note that this rise will come even as India banks have been sitting on a festering pile of bad assets in sectors such as power, commercial real estate and MSMEs for several years now. Thus banks' capital adequacy will come under severe pressure and they will have to be recapitalised as quickly as possible. Credit Suisse has estimated that public sector banks need $13 billion of capital in FY21 and the overall banking system around $20 billion.

Where will this money come from?

Earnings are not going to lead to capital accumulation. Banks are still making losses and business is yet to pick up after COVID-19 partly due to lenders' risk aversion. For state-owned banks, their promoter, the government, is strapped for cash. With economic growth plummeting and revenues falling short of estimates, the government didn't even talk about bank recapitalisation even though its much touted Rs 20-lakh crore economic package leant heavily on bank lending. Thirdly, it is difficult for the average bank to raise money from the market given the state of balance sheets and the uncertainty over the NPA pile up.

So what are we left with?

After nearly a decade of the bad loans problems, resolution is nowhere in sight. The insolvency and bankruptcy code has had some notable successes but the judicial infrastructure is inadequate to cope with the influx of cases even before COVID-19 struck. Desperate times call for desperate measures and perhaps, it is time to set up a bad bank. In this country, we have endlessly debated the main issues around a bad bank such as pricing of bad assets, protection for bankers against unnecessary vigilance cases, who will capitalise the bad bank and so on. These issues can be worked upon. But bear in mind that a lot could go wrong too. Even after a bad bank is set up, bankers might still be risk averse and not willing to lend. Thus, a comprehensive policy is needed which will encompass the design of a bad bank, a recapitalisation package and also incentive structures for bankers.Only then will we see bank credit pick up enough to support growth without wrecking the financial system. The government has reportedly nixed the idea of the bad bank proposed by the Indian Banks Association. It is time for a rethink.

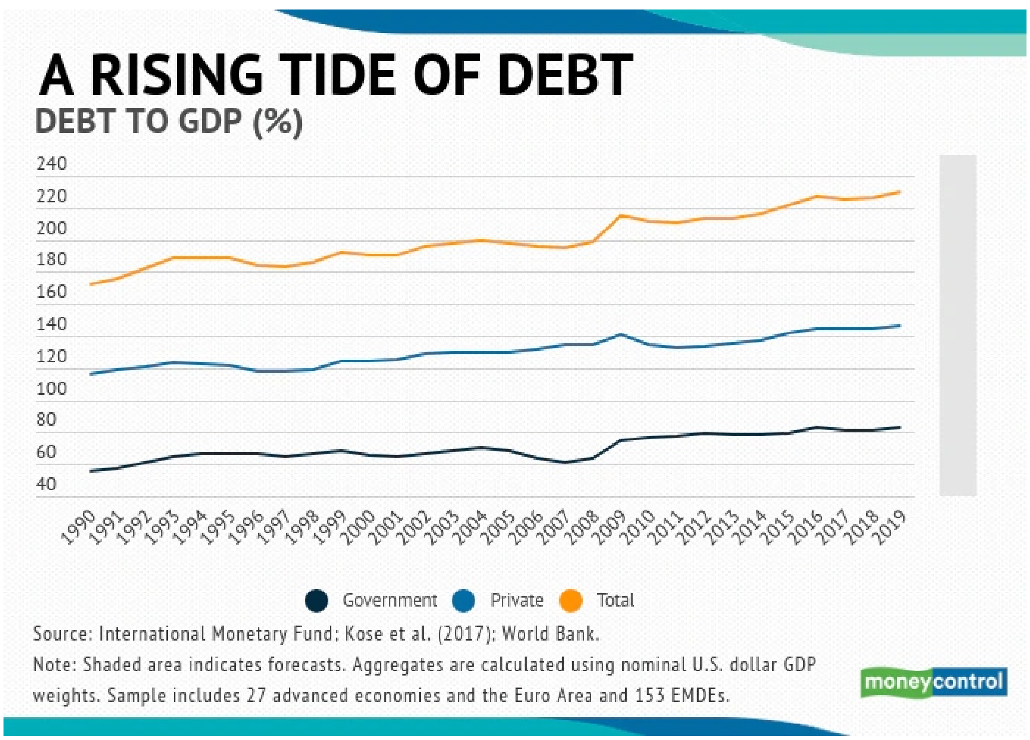
YES BANK

The link between low growth, and high stock prices, increasing debt and trade wars.

This effect is not just because of the pandemic. That the rich save more is hardly a surprise and it is the reason why economists say that any stimulus programme should be directed to the poor, who are much more likely to spend it. Numerous studies and research papers have shown that inequality within most countries has been going up. And the well-off consume a smaller proportion of their income and save a larger proportion. In the jargon of economics, their marginal propensity to consume is low. Could it then be that the increase in savings of the rich as a result of rising inequality has found its way to the asset markets, thus keeping asset prices high?Economists Atif Mian, Amir Sufi and Ludwig Straub of Princeton, Chicago Booth and Harvard respectively have said that the 'savings glut of the rich' lowers aggregate demand in the economy and limits the size of the market. And if aggregate demand is low, why set up new capacities? This is the reason why investment has stagnated in a highly unequal society such as the United States. With investment demand in the doldrums, the only way to grow the economy is by increasing debt, by encouraging the poor to borrow more, so that consumption demand is supported. That is precisely what led to the sub-prime crisis in the US and to the Global Financial Crisis.But if most of the increase in economic growth is captured by the rich, it has another effect---the savings glut of the rich is invested in the markets, in equities, in debt and in property. The upshot: higher asset prices. It's well known that the relatively rich own the lion's share of equities. It's very likely then that it is higher inequality that is supporting asset prices.But that's not the end of it. While the savings glut leads to higher asset prices, at the same time it limits consumption demand, thus inhibiting growth. The result is the divorce between the asset markets and the economy that we have been seeing for a long time. What's more, rising asset markets in turn increase inequality, because it is the rich who benefit the most from them and the vicious circle continues.Loose monetary policy has also done its bit to boost the asset markets. With central banks in the developed world keeping interest rates very low, investors move into riskier assets in search of higher returns. This fuels the rise of the equity markets and to fund flows into emerging market debt.All these trends have, of course, will be exacerbated by the pandemic.There's more to it. A recently published book 'Trade Wars are Class Wars' by Michael Pettis, professor at Peking University and Matthew C Klein, economics commentator at Barrons, shows how rising inequality is also leading to trade wars. With inequality limiting the size of the domestic market, countries naturally want to export as much as possible in order to increase revenues, while they would like to limit imports. Here's an extract from the book:'Businesses across the world use international competition as an excuse to push for lower wages, weaker environmental and safety regulations, preferential tax regimes, and regressive transfers. Squeezing ordinary households has, apparently, been much easier than increasing productivity, investing in infrastructure, and improving health and education. This is unsustainable, however, because depressing wages must lead to some combination of lower consumption, which reduces total spending in the global economy, and higher indebtedness, which is ultimately self-limiting and self-defeating. It is not just a coincidence that throughout modern history, high levels of income inequality have coincided with soaring levels of debt. Companies everywhere fight for larger shares of a global market even as they collaborate to suppress the size of their domestic markets. This is the very definition of 'beggar thy neighbour'. Because 'competitiveness' has become a euphemism for pushing wages down, either directly or through currency depreciation and weaker social safety nets, the fetish of competitiveness has generated a global spending shortage. Trade wars are an almost inevitable consequence of globalization as it has been practiced.' Simply put, a conflict over the share of the pie within a country becomes a conflict between nations. What are the implications of this line of thinking? If inequality continues to be as high as it is now, then the trends we are seeing now will continue. In other words, economies will stagnate while asset prices will rise, debt will increase and so will trade wars and geopolitical tensions. Such a system may in the short run bring fleeting returns for investors, but it increases the risk of a backlash and rising social tensions. It is a system clearly undesirable for any society and for the world.

Global economic growth in recent decades has relied on a rising tide of debt

The accompanying chart shows how the global economy has been powered by increasing amounts of debt. It shows the debt/GDP ratios both of governments and the private sector, as well as the total debt/GDP ratio globally. What is crystal clear is that debt/GDP went up sharply after the Global Financial Crisis as seen from the jump in the ratio in 2009. But the ratio not only remained high, it also increased even after that crisis was long past. The COVID-19 crisis has led to another wave of government debt and the debt/GDP ratio is unlikely to be scaled back anytime soon.



Many economists and international institutions such as the International Monetary Fund, the World Bank and the Bank for International Settlements have been warning about the global build-up of debt.In September last year David Levy, chairman of the Jerome Levy Forecasting Centre in the US, published a paper on the US economy with the insightful headline, Bubble or Nothing.' The paper essentially said two things:

Private sector balance sheets grew faster than income over many decades; thus, aggregate debt grew faster than aggregate income, and aggregate assets grew faster than aggregate income.

This disproportionate balance sheet expansion changed financial parameters in the economy, mathematically making financial activity increasingly hazardous and compelling riskier behaviour.

Levy also presciently said, "The present cycle is almost certain to end badly. Although there are signs that balance sheet ratios are undergoing an extended, secular topping process, they remain extreme and will produce serious financial instability during the next recession. There is no nice, neat solution to the Big Balance Sheet Economy dilemma, no blueprint for a politically acceptable resolution."

To be sure, the pandemic is the reason for the current recession. But the fact is that recent global growth has been due to a rising tide of debt and all it needed was a trigger to sink the economy. The epidemic provided that trigger. At the same time, as the headline of the Levy paper suggests, serial bubbles are needed to keep the global economic system afloat. And each bursting of a bubble results in even higher debt. Simply put, the COVID-19 crisis, with its massive bailouts, will sharpen the contradictions of the system.The Levy paper concluded by saying, "In 2019, there appears to be diminishing potential to keep blowing bubbles. The Big Balance Sheet Economy is flirting with its limits, and the global financial backdrop has become extremely fragile.

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