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New Year, a harbinger of change

India's financial services sector appears to be on the cusp of transformation

The year 2015 was mixed for India as optimism turned to caution, with some beginning to wonder if we were missing the opportunity that made everyone optimistic in the first place! Even as there are incipient signs of recovery, two successive droughts and lukewarm demand even after rate cuts are weighing on the broad equity indices. As we step into 2016 though, India continues to look like an oasis in a global desert struggling for growth.

The world economy's return to growth not only remains elusive but 2016 could perhaps see the slowest growth since the 2008 financial crisis. The basket of developed nations is likely to grow at 2.2 per cent in 2016 though this could dip, as some of the countries are likely to be buffeted by recession. Despite the Fed's rate hike, the recovery in the US still remains tentative.

The BRICS block, once expected to lead global economic growth, seems to have moved out of the Goldilocks zone. The block is expected to log a growth of 2.7 per cent in 2016, but take away India's estimated growth of 7.5 per cent and the average drops to just 1.5 per cent. This is in stark contrast to a decade ago when the average growth was an impressive 8 per cent.

The sustained downtrend in commodity prices, led by oil, is the biggest positive for the Indian economy given the composition of our imports. From the peak net oil imports of $108 billion for the 12 months ended December 2012, the import bill is already down to $61 billion for the 12 months ended November 2015. With oil prices predicted to slide further, the net oil import bill could further slide to $38 billion by December 2016. The resultant cut in oil subsidies has given the government the much needed breathing space. How India will use this windfall and which sectors are beneficiaries of this commodity deflation will be one key theme of 2016.

India's financial services sector looks set to break new ground in 2016. The big push to financial inclusion and the positive real rates in the economy are both good signs for the sector. The introduction of 'direct benefit transfer' for payment of subsidies and the success of Jan Dhan Yojana will ensure that a sizeable section of the population will now join the formal banking system.

In addition, 2016 will mark the launch of payment banks and small banks. Together, these new entrants have the potential to remarkably scale up financial inclusion in the country. So far, licences have been given to 11 payment banks and 10 small banks. Payment banks are expected to leverage the mass ownership of mobile phones in India and bring banking onto this device. The payment banks will target India's thriving cash economy by reaching out to migrant labourers, low-income households and small businesses, offering savings accounts and remittance/payment services with economical transaction costs.

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As far as traditional banking is concerned, the New Year is likely to be interesting as PSU banks start the process to clean up their books. The RBI has set a deadline of 2017 for banks to clean up their bad loans, which are pegged at 10 per cent of the total loan book, so that there is room for fresh lending when the economy picks up steam.

The year 2016 is expected to witness slow domestic recovery in a generally recessionary world. As such, we should not expect any positive earnings surprises. Equity markets are likely to provide returns in line with earnings growth though some sectors and individual stocks may well outperform. Other factors that could drive the overall multiples in the market could be the quantum of foreign flows which in turn is dependent on global conditions and the pace of domestic reforms. Given that India has faced two droughts on the trot, the strength of the south west monsoon could also be important. That said, the first forecast for the season is encouraging, as monsoon-favouring La Nina is expected to make a comeback in 2016.

As far as debt markets are concerned, a benign inflation regime, slowing growth globally and a positive real rate of return after several years, should provide scope for further rate cuts and spur bonds and bond funds. We should expect continued interest in bonds from both foreign investors and domestic investors.

A recovering economy, an economy that is more banked and a positive real rate will also move money from physical assets to financial assets.

The Indian financial sector appears to be on the cusp of transformation, where technology will be the key enabler. As a large chunk of hitherto unbanked population starts to join the mainstream, there is a big opportunity for financial services companies to expand the market. And so, 2016 could be the harbinger of that change! •

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