Trust must be earned

India Newsletter

July 2024

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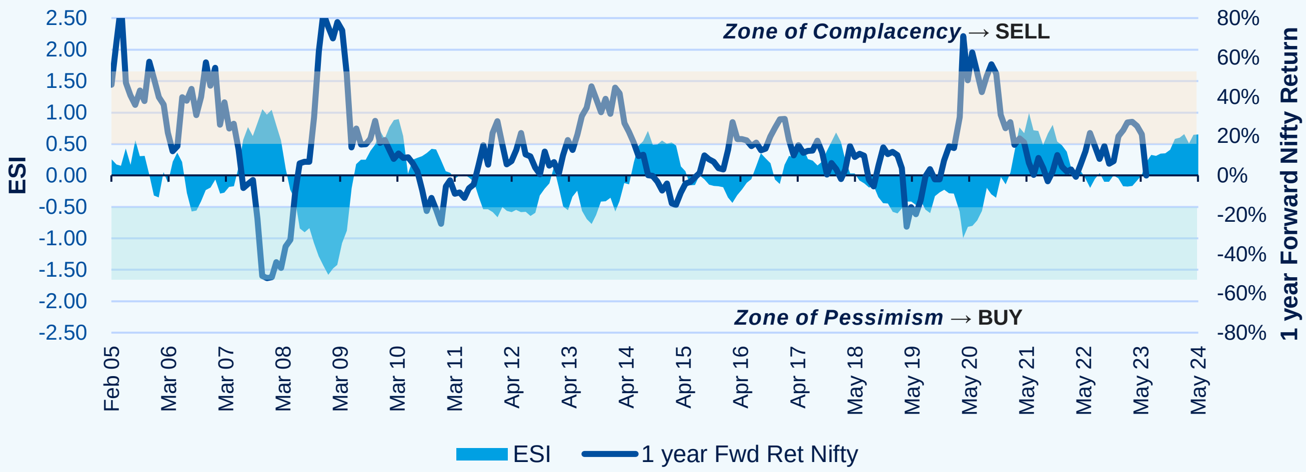
MARKET OVERVIEW: Indian equity & fixed income market insights from SBI FM's CIO Team

India market views

The outcome of 2024 General Elections was a surprise for markets. Despite the incumbent Bhartiya Janta Party (BJP)- led coalition NDA (National Democratic Alliance) was expected to form the government, BJP was short of the half-way mark thus entailing reliance on coalition partners. While it is too early to gauge how this will impact the direction of policy making, this might just be the trigger for a cool off in the overheated market sentiment. According to the SBI FM's proprietary index, market sentiment has stayed stretched, suggesting a high degree of complacency going into this event. With the eventual outcome turning out to be not as expected, there is reason to foresee moderation in sentiment, which could potentially weigh on markets in the near term.

Equity sentiment readings reflected high complacency going into the event



Source: Bloomberg, FactSet, SBI FM Research, as of 31 May 2024.

More importantly, a related change should be a shift in market preference towards quality. For over three years now, ever since 2021, quality stocks have been underperforming. With political uncertainty returning and speculative action likely to subside, at SBI FM we believe the focus should move back to bottom-up fundamentals. Quality of management, strength of balance sheets and sustainability of growth should become important again.

Fixed income

Softening of US treasury yields (UST) and resumption of FPI[1] debt flows led the initial softening of yields in the month of May.

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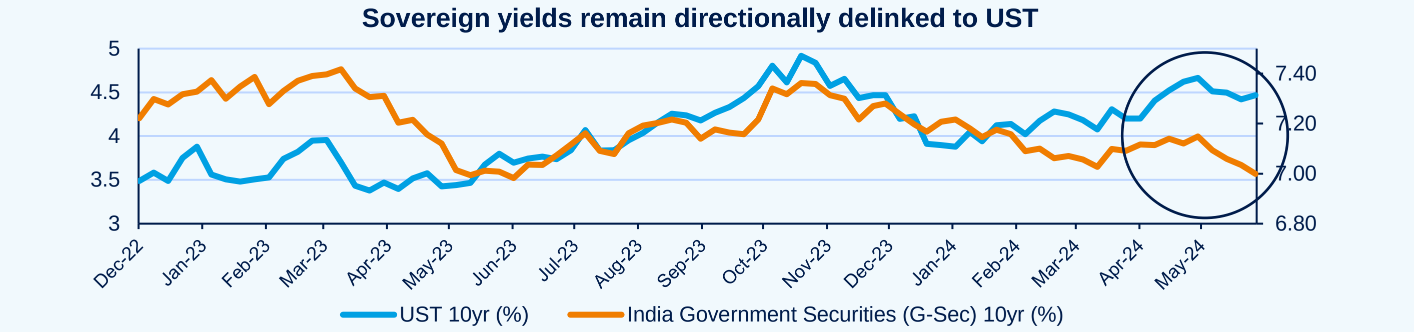
[1] *Foreign Portfolio Investment.*

Even as treasury yields moved up over the second half of the month, larger than anticipated dividend transfer by the RBI to the government enabled domestic yields to be delinked from treasuries.



Source: Bloomberg, SBI FM Research, as of 31 May 2024.

Fiscal consolidation and good demand - supply balance have been the key factors supporting a softer bias in government security yields. Compulsions of electoral and coalition dynamics may potentially lead to additional spending, however, in the context of buoyant revenue picture (including RBI dividend) the government could still have enough leeway to budget additional spending without disrupting the borrowing numbers.

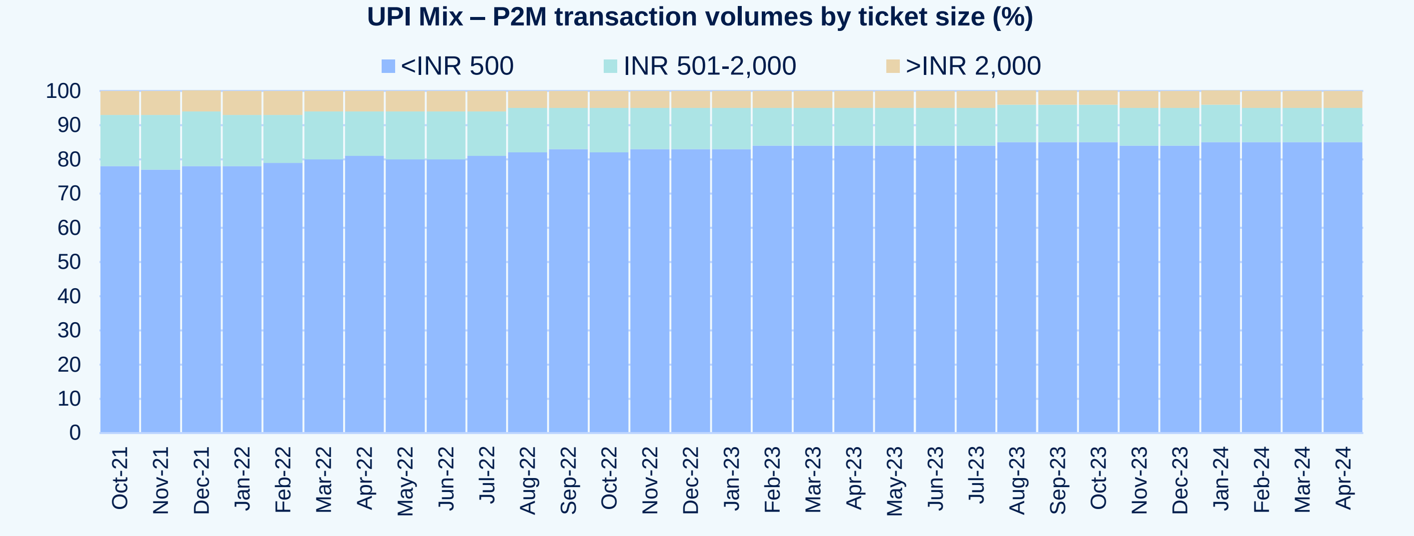
With FY25[2] GDP growth estimates being around 7%, the central bank (Reserve Bank of India) has sufficient leeway to sequence policy actions to sustainably meet the inflation mandate. Further, the outlook on liquidity dynamics improves materially with the expected pick-up in government spending, seasonal reduction in CIC (currency in circulation) and anticipated inflows on account of index flows over coming months.

With visibility emerging on the liquidity dynamics, the elevated levels at the front end of the curve should settle lower over the coming months. This should enable better risk- reward equation for incremental investments at the shorter segment (up to 5y) of the curve.

DID YOU KNOW? What stood out to us this month

India accounts for nearly 46% of the world's digital transactions.

Unified Payment Interface (UPI), a homegrown, instant real-time retail payment platform, is at the heart of this digital revolution in India. UPI is one of the most modern payment systems that processes over 420 million transactions per day. This trend is primarily driven by significant growth in person-to-merchant (P2M) transactions and, in the process, promotes financial inclusion by empowering the unbanked and helps formalise the economy. 85% of the P2M transactions are lower than INR 500[3], highlighting a shift in consumer behaviour away from traditional cash transactions.



Source: NCPI, Reserve Bank of India, SBI FM, May 2024. The chart shows the year-on-year growth (Y-o-Y).

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[2] *In India, the fiscal year starts on 1 April and ends on 31 March. FY25: from April 2024 to March 2025.*
[3] *500 INR = 5.60 EUR as of 26 June 2024.*

HOT TOPIC: India, coalition government era returns – will the elephant keep dancing?

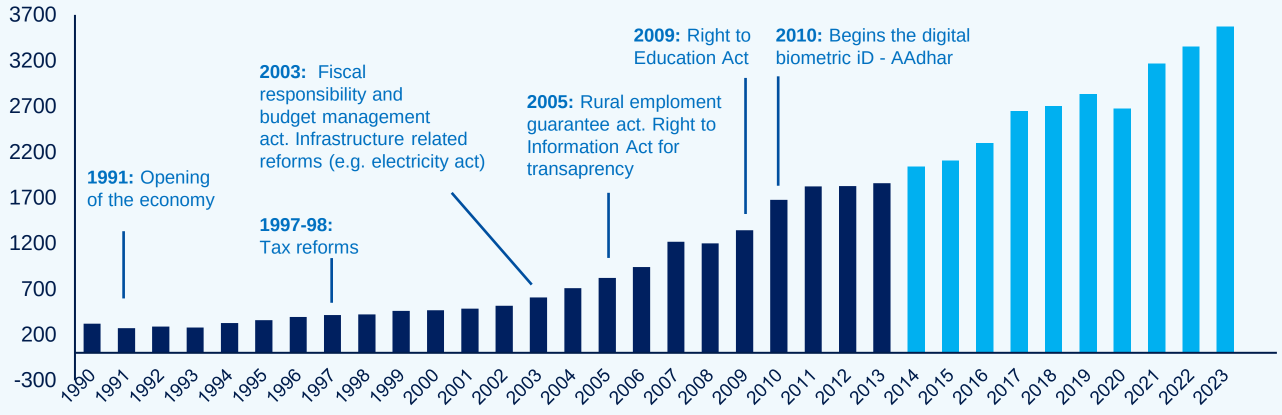
India, the largest democratic nation in the world, concluded its mammoth General Election with **over 969 million eligible voters[4].** Over 2,360 registered political parties participated, with multiple candidates contesting for 543 seats in the Lower House of Parliament, the Lok Sabha[5]. Most exit polls predicted the incumbent BJP-led NDA government would return for a third consecutive term, with a massive majority of over 360 seats[6]. However, the election results were surprising. The **BJP fell short of a majority on its own** and became dependent on other political parties to run the government.

The questions that kept the markets on its edge was - will the coalition government impact the reforms and policy directions of India? Can India continue to be the fastest-growing large economy? Looking at the historical data and based on SBI FM's experience, **we expect reforms to continue and India to remain the fastest-growing large economy.** Our belief stems from (a) the track record of coalition governments in India, (b) stable macroeconomic conditions, and (c) expected strong recovery in corporate earnings, setting the stage for a multi-decadal earnings expansion cycle.

Track record of coalition governments in reforms and growth

In India, from 1989 to 2014, none of the political parties had a majority on their own and were dependent on alliances with other political parties to form the government. However, since there has been a near consensus on economic policies across the political spectrum, **some of the boldest reforms in India have been implemented by coalition governments** with various political parties at the helm[7]. This time it shouldn't be different.

Indian GDP growth and reforms during coalition governments - 1989 to 2014



Source: IMF: WEO Database, April 2024, SBI FM Research.

Stable macro conditions

India's macro fundamentals remain strong. Real GDP growth was 8.2% for FY24[8] and is projected to be around 7% for FY25. Fixed investment and positive net exports are key drivers of growth, private consumption is also gradually improving but is still softer than pre-COVID levels.

It must be noted that the **growth rate of Indian IT and business services exports doubled over FY20-23**, as the increasing acceptance of 'work from anywhere' and sticky labour inflation brought more jobs to India. The 'talent + innovation' arbitrage is driving diversified functions to India, creating sustainable buoyancy for IT and business services exports. NASSCOM[9] data indicates 280,000 Global Capability Center (GCC) employee additions in FY23 compared to 380,000 added over FY17-22. As a result, **India's current account as a percentage of GDP has stayed under 2% since FY14**. Net services receipts now help fund two-thirds of the goods trade deficit post-COVID, compared to one-third a decade ago.

CPI inflation moderated to 4.8% in April 2024 from 4.9% in March and is expected to remain benign in 2024, with favourable weather projections. **CPI inflation is anticipated to glide towards 4% through 2024**, with the India Meteorological Department (IMD) predicting a normal monsoon as a positive factor. Agricultural income improved marginally this Rabi

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[4] compared to 400 million in the European Union election and 160 million in the United States of America.
[5] Source: The Mint, 19 March 2024, "What makes India's Lok Sabha polls the world's largest 'electoral movement'? 2024 election in numbers".
[6] Source: The Economic Times, 2 June 2024, "Lok Sabha Elections 2024: Exit Polls".
[7] These include economic liberalisation (1991), tax reforms (1997-98), implementation of fiscal responsibility and budget reforms (2003), infrastructure reforms (2000-2003), e-commerce initiatives, connecting rural India, the right to employment (2005), the right to education (2009), and the initiation of Aadhar, the digital biometric ID for every citizen (2010). In fact, the Goods and Services Tax (GST) was also planned by a coalition government.
[8] In India, the fiscal year starts on April 1 and ends on March 31. FY24: from April 2023 to March 2024.
[9] National Association of Software and Service Companies, is an Indian non-profit trade associations that primarily serves the Indian technology industry.

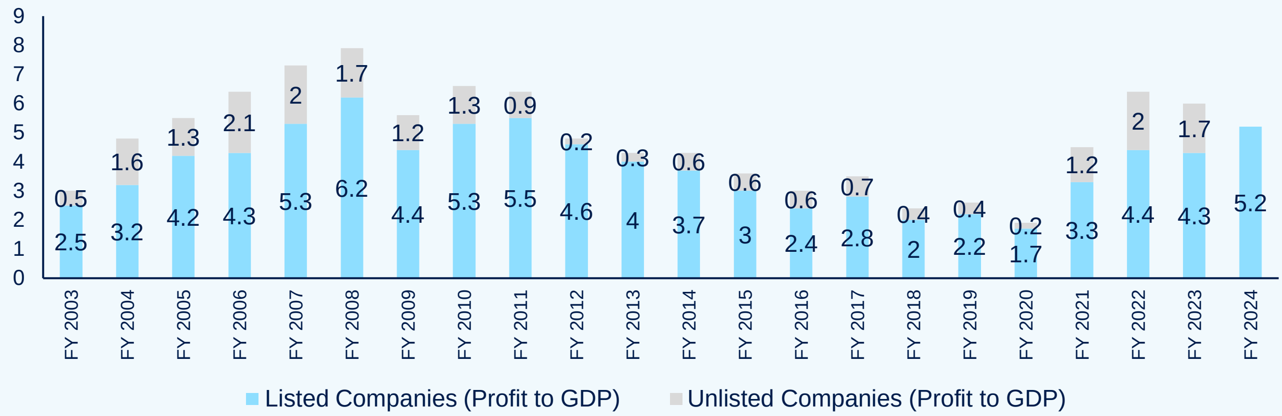
(spring) season, with rural wage growth in real terms turning positive. Infrastructure and real estate activities are likely to contribute to job creation and better cash flow for rural households.

Recovery in earnings

Q4 FY24[10] earnings outcomes were better than expected. NIFTY[11] reported 6.6% growth in sales, with EBITDA and PAT growth at 11% and 12% year-on-year, respectively. However, the top line of Indian companies are repeatedly dragged down by moderating global growth, impacting sectors such as IT, chemicals, metals, and oil & gas. Conversely, some domestic sectors like auto, financials, infrastructure, and consumer discretionary have posted very strong revenues. After growing at a 22% CAGR since FY20, the likely EPS trend would mostly align with nominal growth, necessitating an increase in revenue growth.

Additionally, corporate profits as a proportion of GDP in India have reversed the downtrend of the past decade and have been increasing over the past three years. This suggests we might be **in the early stages of an earnings expansion cycle**, which augurs well for long-term investors.

Corporate profit to GDP: revision of downward trend - early stages of earnings expansion



Source: Capitaline, SBI FM Research data for each financial year (April to March), compiled from available listed and unlisted companies. FY25 earnings data for unlisted companies is not yet available.

Further, over the last decade, **Indian corporates have deleveraged**. Corporate debt-to-GDP has dropped significantly from 71% in 2012 to 52% in mid-2022. During this time, corporates in other key nations increased their leverage, with debt positions reaching near multi-year highs. This, coupled with government incentives to invest, strong balance sheets, and improved capacity utilisation, corporates are now in a strong position for multi-decadal earnings expansion cycle.

At SBI FM, we focus on rigorous on-the-ground research and bottom-up stock selection as key to generating differentiated alpha in a growing market like India.

Important information

Date of first use: 30 June 2024.

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[10] *From January 2024 to March 2024.*
[11] *National Stock Exchange of India Limited (NSE)'s index.*