#DSP7Sees

7 Insights Through A New Lens| Aug 2024

Economic Growth Translating To Equity Returns, A Rarity

Economic Growth May Not Result In Commensurate Equity Returns, India An Exception

A common misconception is that strong economic growth directly translates to equity returns. Brazil, with moderate growth, delivered the highest real returns over the past 30 years, while China, despite explosive GDP growth, saw negative real returns.

Why?
Stock returns hinge on earnings growth. Companies that consistently create value above their cost of capital generate long-term gains, often outpacing bonds. This is less common than widely believed as external events in many regions can derail growth.

The Takeaway: Economic growth should be assessed alongside earnings and valuations.

Indian corporations have demonstrated consistent earnings growth, capitalizing on broader economic trends—a rare advantage among emerging markets fraught with multiple unknown risks.

30 Year Returns For Frontline Equity Indices In Local Currency & Adjusted For Inflation

Country	Real GDP Growth	Local Currency Returns	Real Returns
China	**8.6%**	0.4%	-3.0%
Philippines	4.7%	3.1%	-1.6%
Hong Kong	2.8%	2.3%	-1.0%
Malaysia	4.8%	1.7%	-0.7%
Indonesia	4.4%	9.3%	0.9%
Korea	4.3%	3.8%	0.9%
UK	2.0%	3.3%	1.0%
Australia	3.1%	4.6%	2.0%
Japan	0.8%	2.3%	2.0%
France	1.5%	4.6%	2.9%
Mexico	2.0%	11.1%	3.0%
Canada	2.3%	5.6%	3.5%
India	**6.2%**	**10.3%**	**3.6%**
United States	2.5%	8.4%	5.9%
Brazil	2.4%	15.9%	9.3%

**Countries marked in green -> Real returns higher than Real GDP growth*

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Source: Bloomberg, CMIE, DSP; Data as of June 2024.

India Has Used The Global Fiscal Extravaganza Most Constructively

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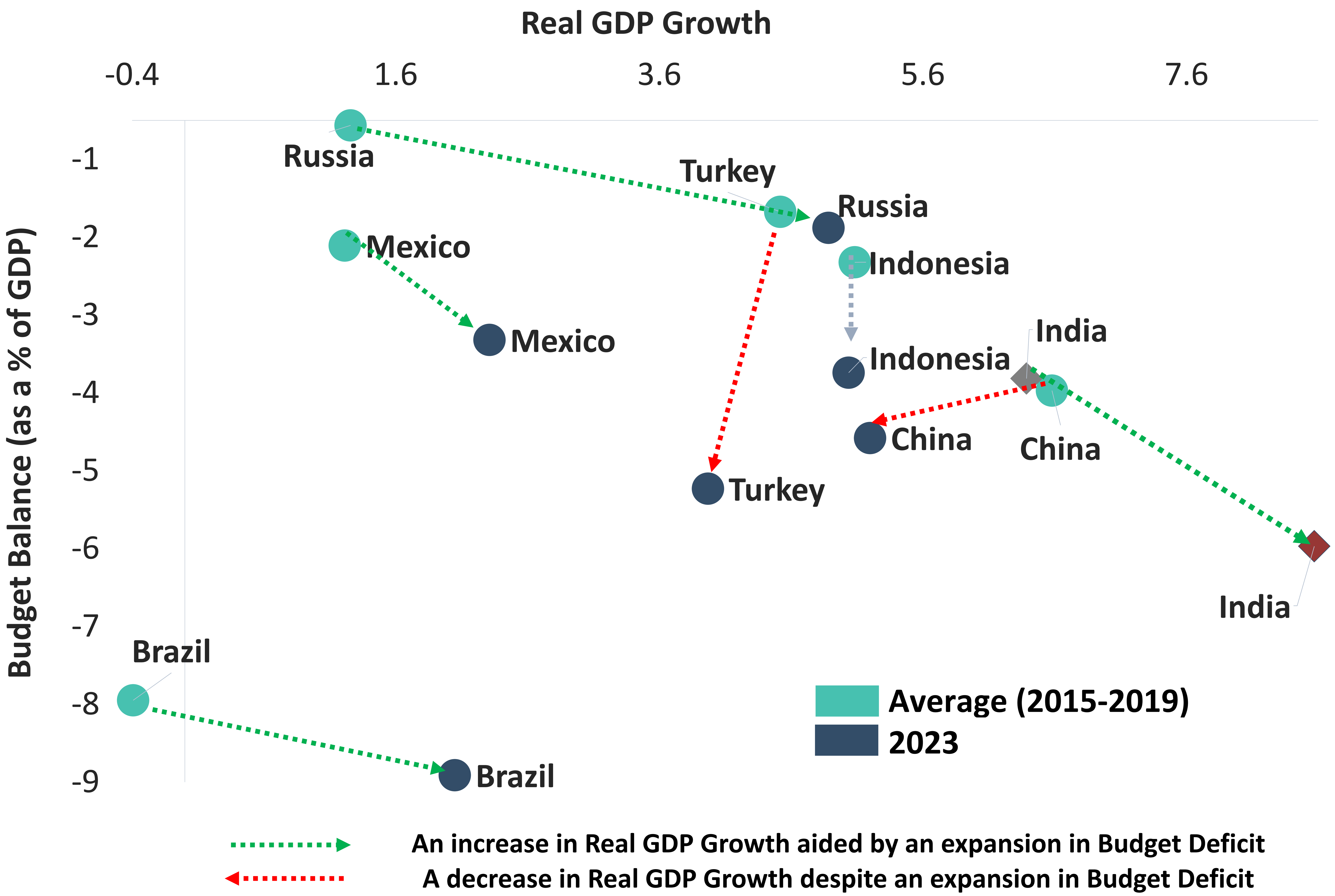
India stands out among emerging markets, leveraging its expanding budget deficit to achieve growth exceeding 8%.

- After Turkey, India has seen the sharpest increase in its budget deficit compared to pre-COVID levels and now runs the second-highest fiscal deficit among peers.
- This fiscal expansion has driven India to become one of the fastest-growing economies among the top 40 globally.
- This fiscal strategy was effective due to other major economies, particularly the US, also running high deficits, which mitigated balance of payments shocks.
- The central government and RBI have efficiently capitalized on this window, showcasing policy execution unmatched by most peers.



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Source: IMF, Bloomberg, DSP; Data as of June 2024.

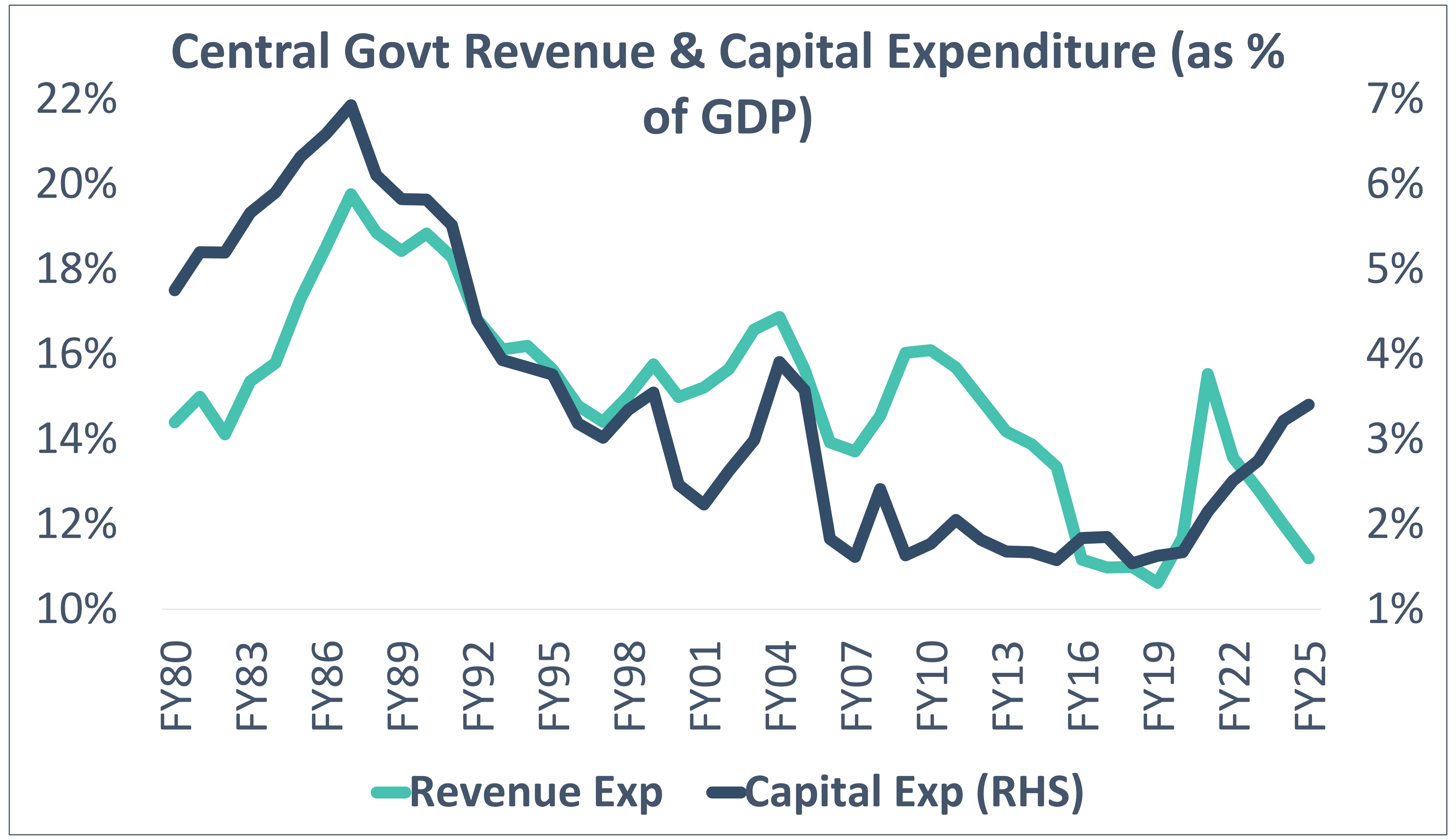
Fiscal Focus On Capital Expenditure Has Been Laser Sharp

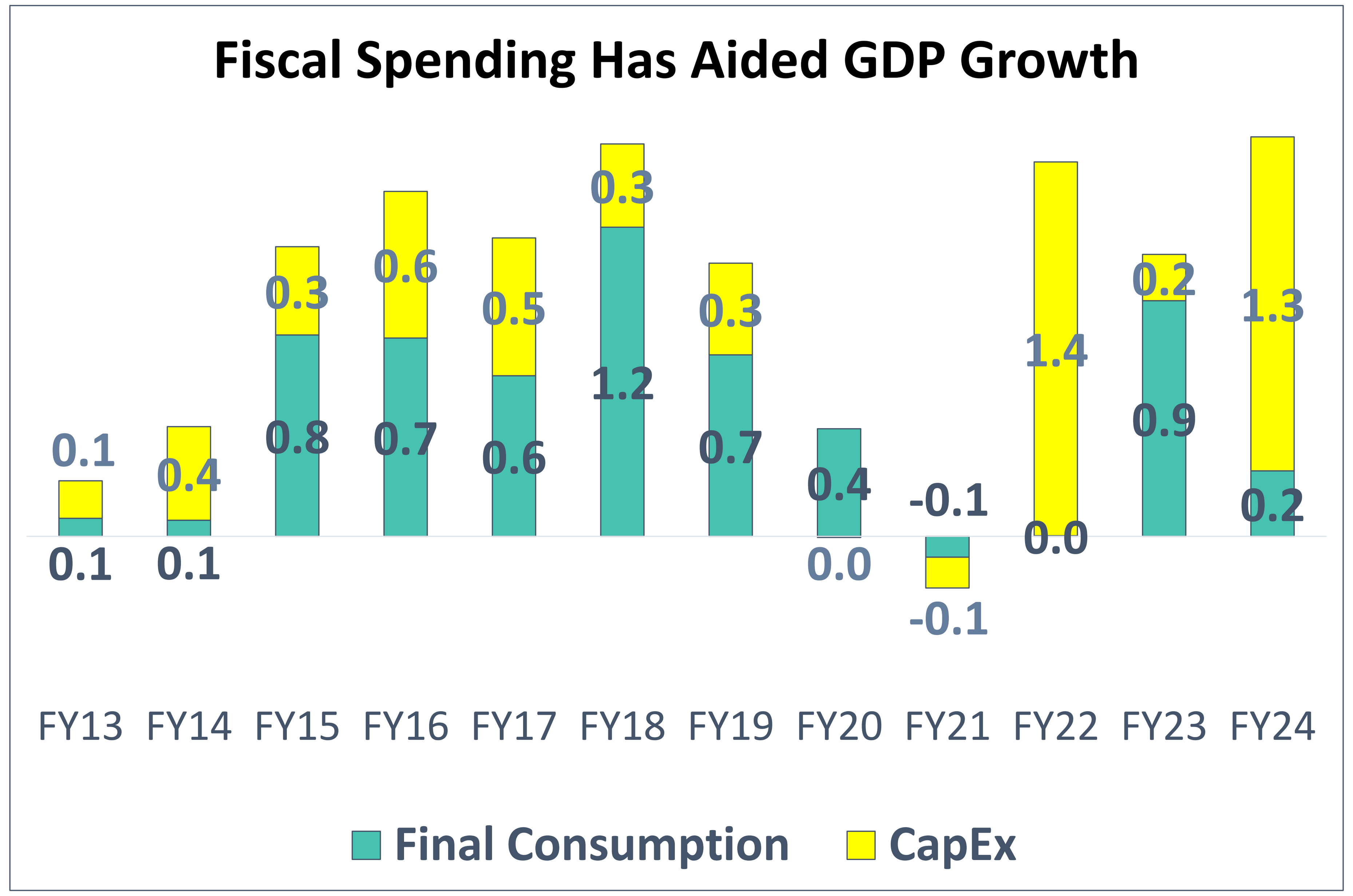
2b

India has effectively utilized post-pandemic fiscal spending (as seen in the bottom left table), with the central government allocating a third of its resources to capital expenditure, up from 13% pre-pandemic.

Instead of following pre-pandemic trends, which would have led to USD 40Bn in capital spending, the government invested USD 93Bn over the last five years, helping to revive the capex cycle.

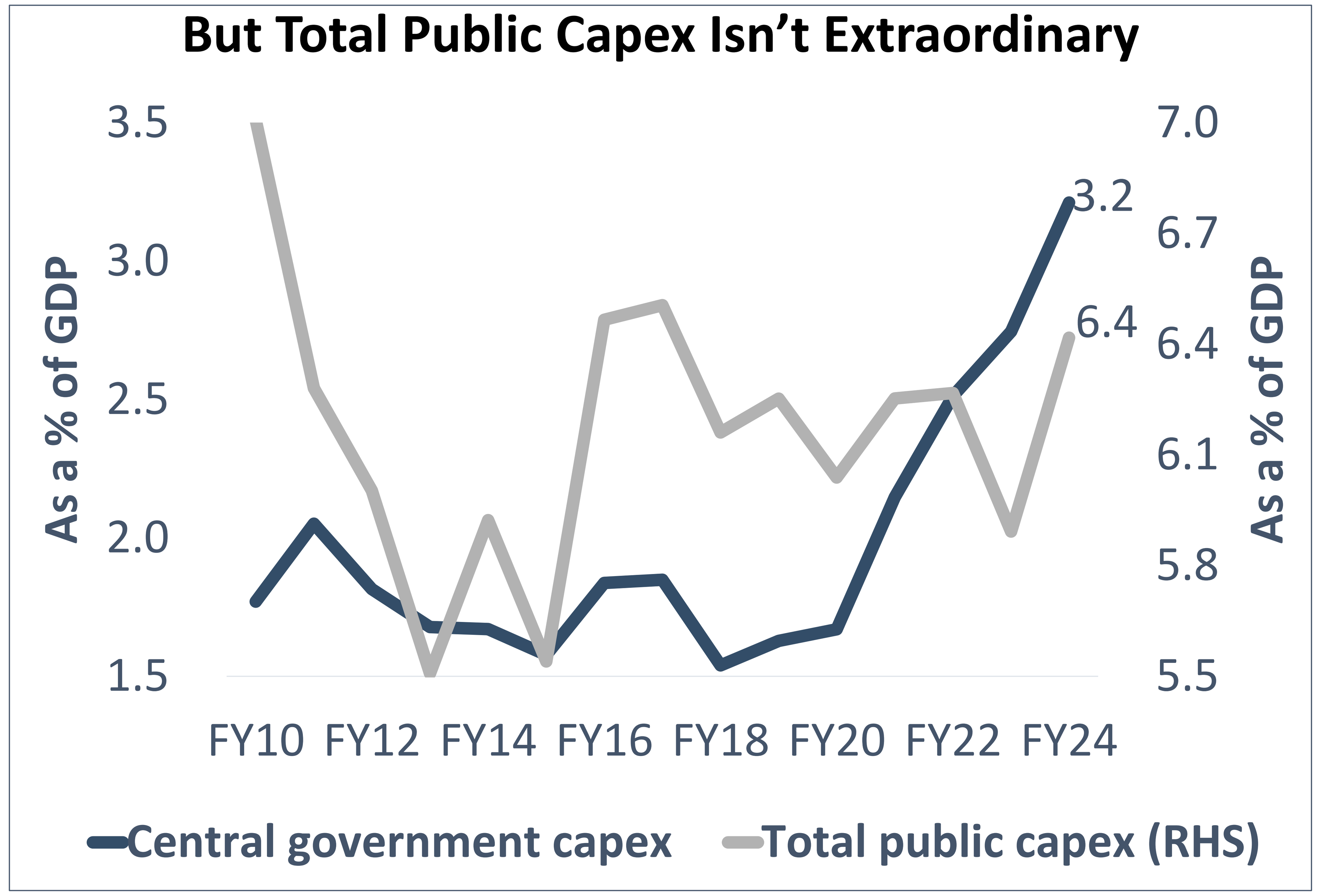
This spending has efficiently translated into economic growth. However, despite the government's strong capex push, the private sector has not been crowded out, as aggregate public capex (center + states + PSUs) remains around average levels.





GOI Has Focused Its Spending on CapEx

FY20 to FY25 Incremental Total Numbers	Expenditure Post COVID (FY21 to FY25e) USD Mn	Run Rate Nos Basis Prior Trend USD Mn	Expenditure as % of additional resources mobilized post COVID	Pre-Covid 10-Yr Avg Expenditure as % of Total Expenditure
Rev Ex	**156,354**	**253,235**	**54.3%**	**87%**
Cap Ex	**92,968**	**39,704**	**32.3%**	**13%**



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Source: Govt Docs, CMIE, MOSL Research Estimates, Nuvama Research, DSP; Data as of June 2024.

DSP Capex Tracker – This Isn't Like The Early 2000s, Yet!

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2003-2011 was rightfully 'India Growth Story' marked by robust govt capex and buoyed by private sector investment at the same time.

	Units	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	8 Year CAGR (FY03 - FY11)
New Investments	USD Bn	61.6	109.3	126.9	292.1	545.0	658.0	587.3	516.8	572.3	32%
Central Govt Capex	USD Bn	15.4	23.8	25.3	15.0	15.2	29.5	19.4	23.8	34.4	11%
Cement Volumes	YoY, %				12.3	9.1	8.1	7.3	10.5	4.5	8.6
Import of engineering goods	USD Bn	10.9	14.8	21.1	33.4	43.1	66.6	69.4	60.9	72.2	27%
Industrial credit	USD Bn	61.1	68.4	95.0	124.2	154.4	213.9	226.5	277.5	352.4	24%
IIP Capital Goods	YoY, %	10.6	13.6	21.9	18.1	23.3	48.5	11.3	1.0	14.8	18.10
Housing loans	USD Bn			29.8	41.8	51.1	64.9	60.0	63.7	76.9	17%
Investment Projects Completed	USD Bn	13.5	14.3	22.9	26.3	42.5	56.8	65.4	83.5	78.0	25%

Capex cycle, post covid has been largely driven by govt action and remains constrained to it, with little private sector initiative. Private sector needs to takeover the mantle.

	Units	FY19	FY20	FY21	FY22	FY23	FY24	5 Year CAGR (FY19-FY24)
New Investments	USD Bn	272.1	277.3	153.1	321.4	490.9	366.5	6%
Central Govt Capex	USD Bn	44.0	47.3	57.5	79.7	91.8	114.7	21%
Cement Volumes	YoY, %	13.3	-0.9	-10.8	20.8	8.7	8.9	6.7
Import of engineering goods	USD Bn	101.1	97.0	76.2	100.7	125.9	127.8	5%
Industrial credit	USD Bn	405.9	414.8	409.2	427.6	417.8	441.0	2%
IIP Capital Goods	YoY, %	2.7	-13.9	-18.6	16.9	13.1	6.3	1.06
Housing loans	USD Bn	168.3	191.7	204.1	233.7	247.1	328.2	14%
Investment Projects Completed	USD Bn	93.6	76.4	47.2	88.5	85.6	110.6	3%

Source: CMIE, DSP; Data as of July 2024.

***Average YoY%**
****6 Year CAGR (FY05 – FY11)**

For each row, best to worst

India's Consumption Growth, Outpacing Most of its Global Peers

- India's 7%+ GDP growth is largely driven by household consumption, which makes up 60% of the GDP.
- This is a key factor in India's economic trajectory, with household consumption growing from USD 200 billion to USD 2 trillion over the past 30 years, reflecting a 7.2% CAGR.
- While China's growth has been investment-driven, and the U.S. maintains strong domestic consumption at 70% of GDP, India's consumption growth story stands out.
- To sustain its growth and attract both domestic and foreign investment, India must continue to build on this consumption strength.

Households Final Consumption Expenditure (US$ Bn)

1990	1995	2000	2005	2010	2015	2020	2022	2023	33 Year CAGR
3809	4963	6767	8769	10260	12297	14206	17512	18571	11.7%
1608	2925	2666	2648	3275	4178	5611	6686	6967	7.2%
998	1444	1102	1642	2090	2479	2733	2366	2260	5.0%
726	876	1097	1610	1874	1877	1952	2084	2142	4.9%
701	856	735	1195	1587	1779	1634	2044	2119	4.3%
333	338	566	905	1464	1318	1598	1911	2065	3.9%
253	336	406	637	922	1241	1408	1484	1628	3.2%
215	230	299	471	917	900	941	1163	1182	2.6%
180	211	239	396	785	758	769	1100	1007	2.5%
170	206	120	382	635	718	693	824	856	0.8%

China India Russia France United Kingdom
Canada Australia Japan Germany United States

Source: World Development Indicators, DSP; Data as of July 2024.

Business Consulting Exports – A New Source Of Strength For India's BOP

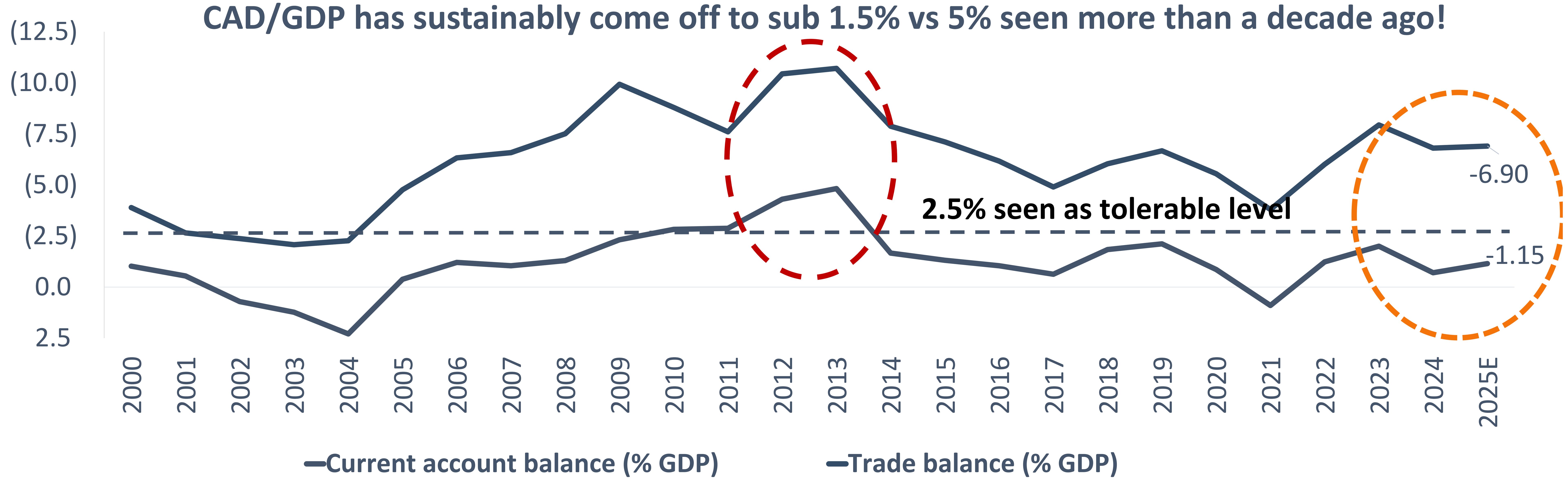
India's reduced Current Account Deficit (CAD) remains vulnerable to global economic shifts, standing at 0.65% of GDP in FY24, its lowest in over a decade (excluding the COVID-19 surplus).

Service exports, led by software services, netted \$163Bn in FY24 with a 5-year CAGR of 14.7%. Notably, business services grew significantly, with a 5-year CAGR of 86%, driven by the GCC sector's use of affordable skilled labor.

Business consulting services, one of the fastest-growing segments globally, have created a substantial tailwind for India's balance of payments (BOP).

Moreover, India's debt market inflows, supported by inclusion in global bond indices, along with strong growth in business consulting exports, offer a substantial buffer against global balance of payments shocks.

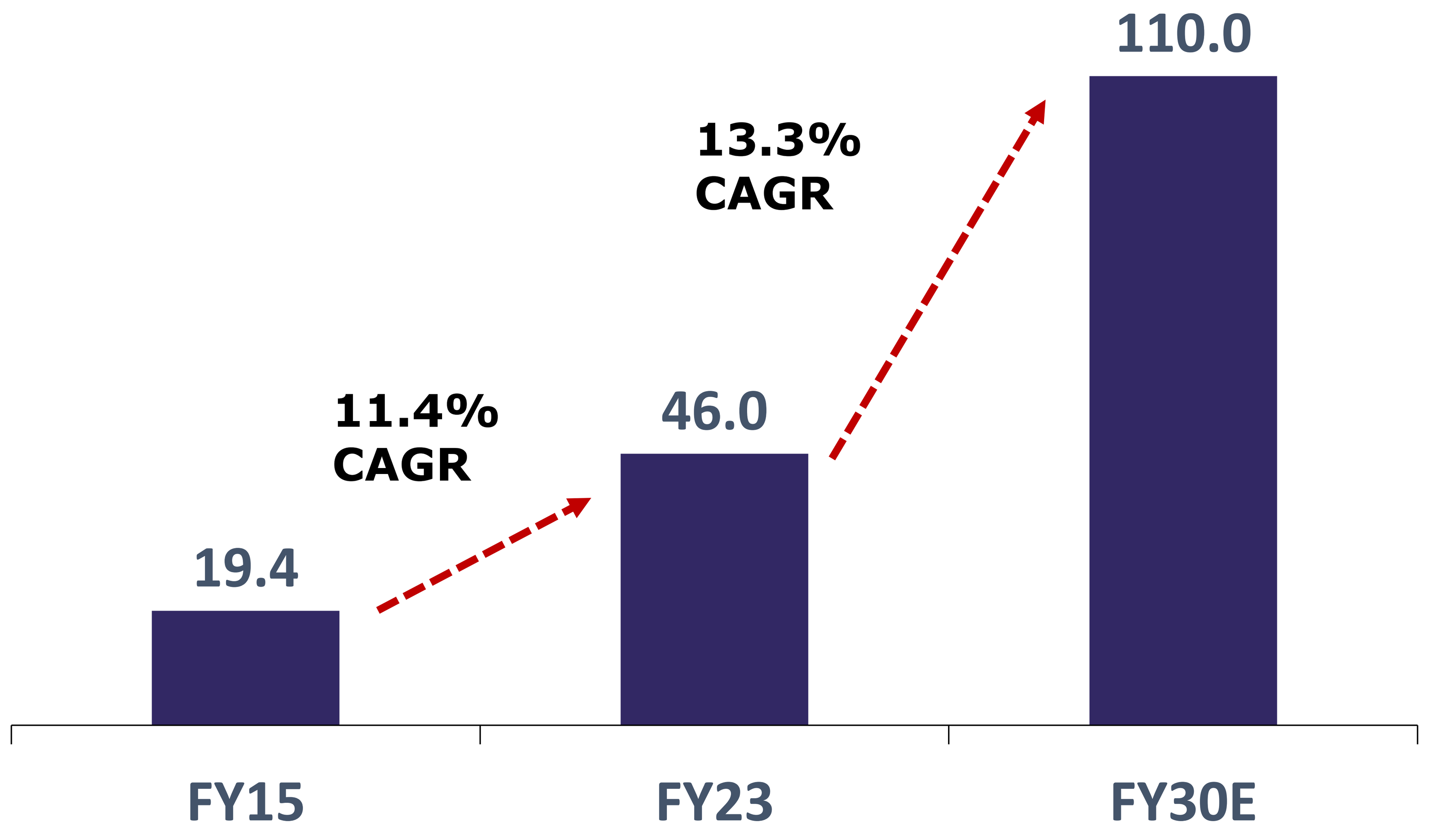
CAD/GDP has sustainably come off to sub 1.5% vs 5% seen more than a decade ago!



Share Of Business Consulting Services Gained 7pp In Last 5 Years

	FY04	FY08	FY19	FY20	FY21	FY22	FY23	FY24
Services	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Travel	19%	13%	14%	14%	4%	4%	8%	10%
Transportation	12%	11%	9%	10%	11%	13%	11%	9%
Software services	48%	45%	40%	44%	49%	48%	45%	47%
Business services	**0%**	**19%**	**19%**	**21%**	**24%**	**23%**	**25%**	**26%**
Others	22%	13%	18%	11%	13%	12%	11%	9%

Indian GCC market size (USD bn)



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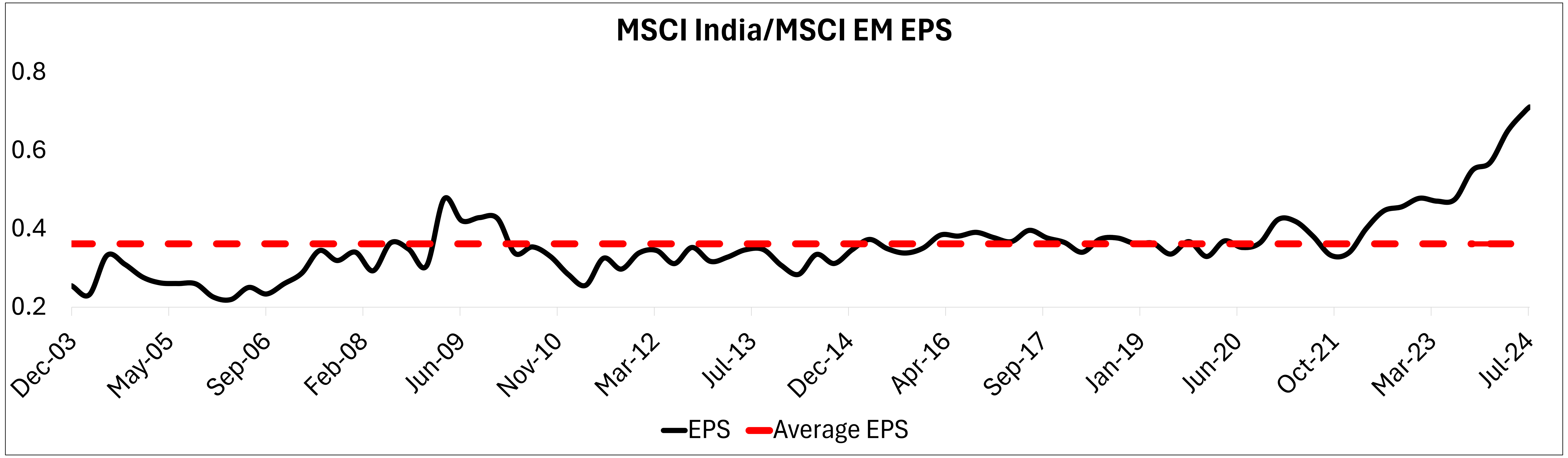
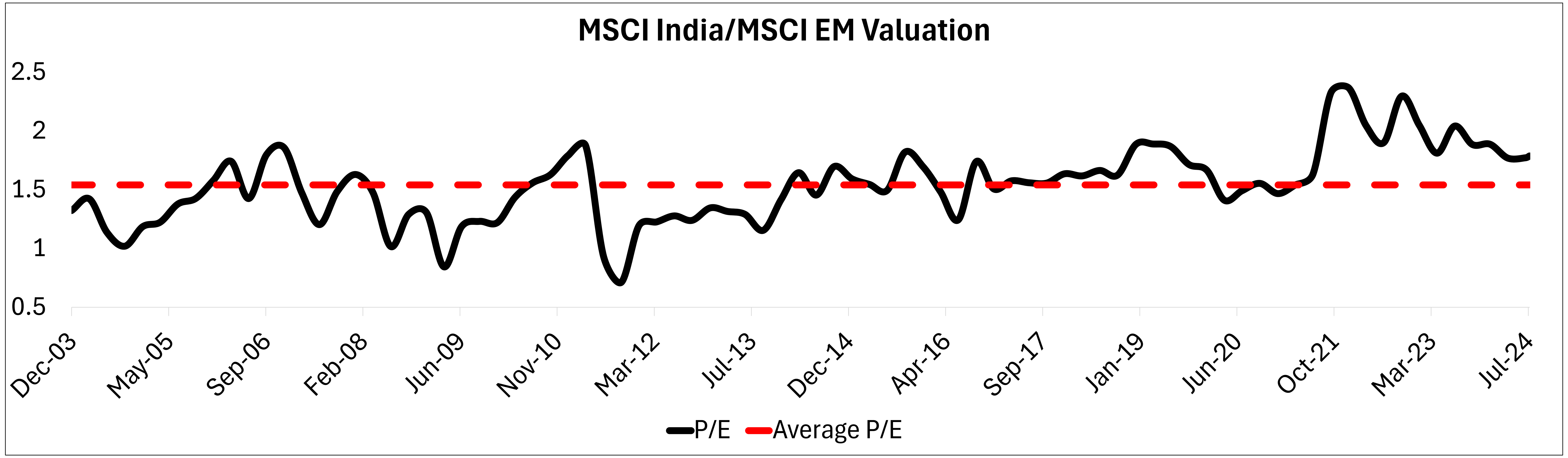
Source: Madhavi Arora, Emkay Research, : RBI, Nasscom, Zinnov, FT Fdi Markets, DSP; Data as of June 2024.

Can Earnings Dominance Lead To EM Dominance?

- Since the COVID-19 pandemic, India has seen one of its most significant bull runs, driven by strong earnings growth.
- The 12-month forward earnings estimate for India has risen by 13% YTD, and over the past three years, India's earnings growth have been far superior compared to its emerging market peers, now exceeding double the 20-year average.
- This growth has sparked valuation concerns, though they remain below the previous peak of 2.4 times, despite being above the 20-year average of 1.5 times.
- India's weight in the emerging market index has doubled from 10% in June 2021 to 20% in July 2024.
- As China underperforms, India is emerging as a top contender in the Emerging Market Index, competing with Taiwan for the leading position.



One of the main drivers of India's relative outperformance is superior earnings growth



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Source: DSP, Bloomberg, Data as of July 2024. Indices taken are Net Total return USD indices.

Where Is The Money Allocated?

India has historically struggled to attract foreign flows, despite outperforming its peers. Our latest analysis dives into where Foreign Institutional Investors (FIIs) are currently allocating capital, focusing on their overweight or underweight positions relative to the MSCI India index.

- Financials continue to attract strong FII interest, while Healthcare is seeing renewed attention, marking its first overweight position since the COVID-19 pandemic.
- In contrast, FIIs are pulling back from cyclical sectors like Industrials and Utilities, likely booking profits after recent gains.
- Consumer Staples, although underweight, are nearing their lowest underweight level since June 2016, which was followed by a 26%* forward 12 month returns.

Overweight/Underweight (bps) relative to the MSCI India index									
Period	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Information Technology	Materials	Utilities
Mar-15	-169	-222	-502	1045	-19	22	-16	-325	83
Mar-16	-182	-132	-449	834	20	-50	190	-397	90
Mar-17	-89	-207	-364	1286	-208	-19	-309	-234	121
Mar-18	-82	-285	-538	1389	-108	10	-346	-169	85
Mar-19	-130	-342	-613	1624	-82	75	-416	-214	-29
Mar-20	-82	-372	-417	1369	2	64	-375	-185	65
Mar-21	-137	-354	-281	1334	-123	149	-326	-336	71
Mar-22	-127	-277	-221	1051	-28	52	-165	-249	-87
Mar-23	-168	-253	-331	1183	0	125	-361	-216	-40
Mar-24	-162	-152	-256	672	27	9	-158	-133	34
Jun-24	-161	-138	-226	716	26	-1	-174	-149	-17

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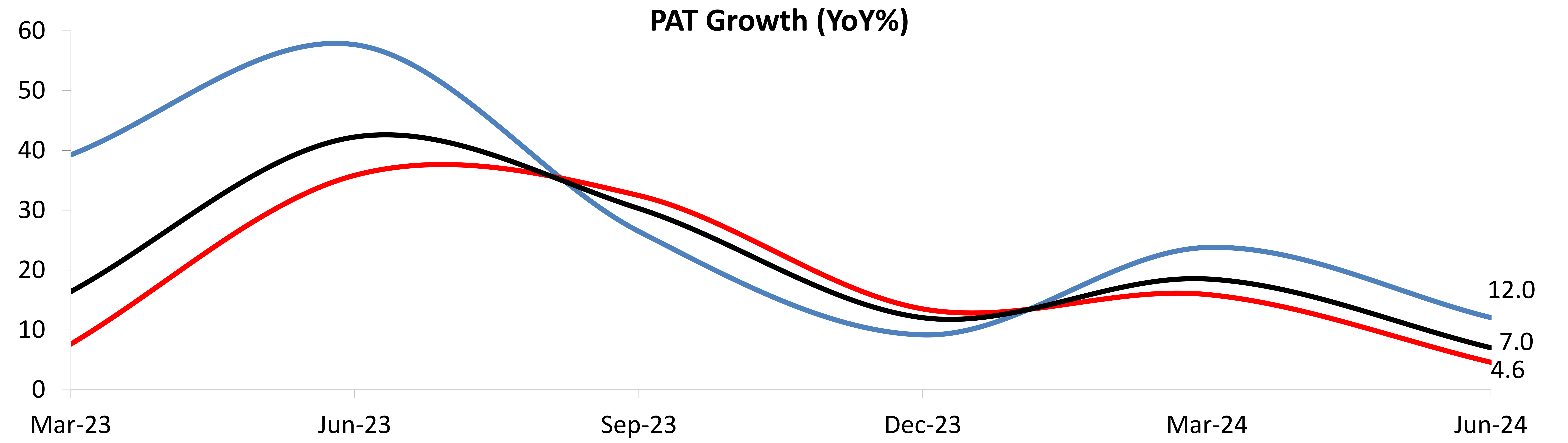
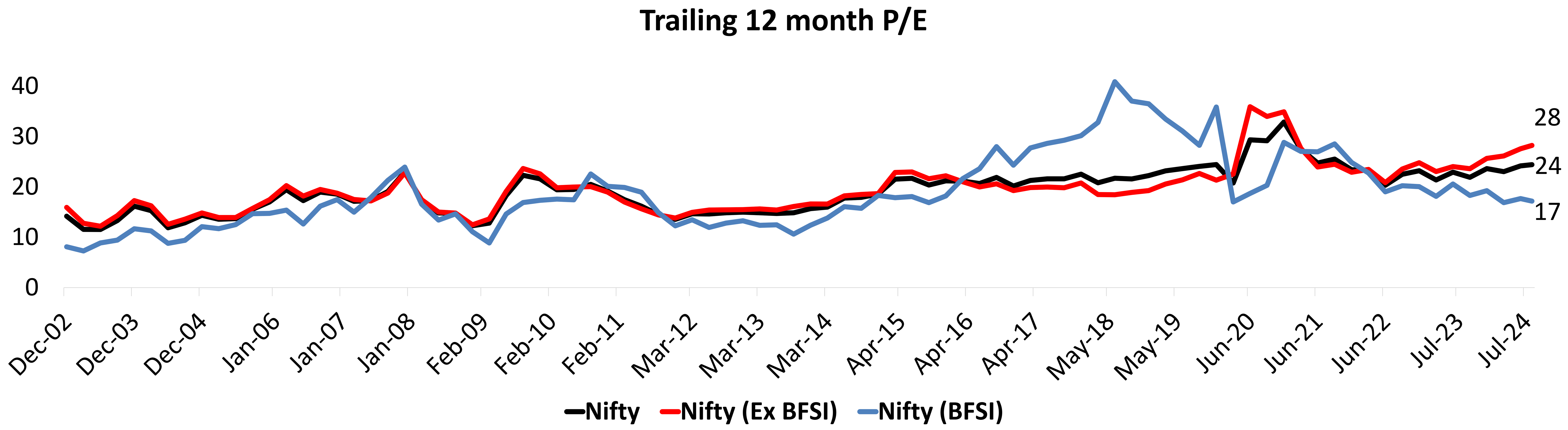
Source: Citi Research, DSP. Data as of Aug 2024. BPS – Basis Points. *This return is of MSCI India Consumer Staples Gross Total Return USD Index.

Is BFSI Sector Well Positioned?

- Nifty 50's earnings are currently driven by the BFSI sector, revealing a sharp divergence in growth.
- In the June quarter, BFSI posted a 12% PAT growth, while non-BFSI companies saw just 4.6% growth.
- This trend is likely to persist as more companies report earnings, underscoring the Nifty index's reliance on BFSI.
- From a valuation standpoint, BFSI is particularly attractive, trading below both the Nifty P/E ratio and its five-year average of 22.
- In contrast, Nifty ex-BFSI trades at a 44% premium over Nifty BFSI, well above its five-year average premium of 5%.





Source: Ambit Capital Research, DSP. Data as of July 2024.

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