Economy & Market Update

INVESTMENT Sprouts
GROW YOUR WEALTH

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The Indian stock market has been under constant pressure since the end of September 2024 after having reached its peak on 26 September 2024.

What's causing this turmoil and driving down the value of your investment portfolio?

The selling of Indian stocks by foreign portfolio investors (FPIs) in 2024 was the second highest in a decade. Announcement of stimulus measures by China, rich valuations, rising US bond yields and muted Q2 corporate earnings has created a risk-off sentiment since Oct 2024.

Let us look at these factors in details to understand their implication on our portfolios in the coming months.

HEIGHTENED GEOPOLITICAL RISK

Higher US Bond Yields

The escalating geopolitical tension is driving US Treasury bond yields up north as investors look up to it as safe heaven. A higher US yield means money flowing from emerging markets including India to the US. Also, the US Fed has been slow in cutting rates due to high inflationary pressure. The US job growth accelerated in Dec 2024 while unemployment rate fell to 4.1%. A firm labour market is further going to delay any probable rate cut by the Fed in the near term.

Depreciating INR

Higher US yield implies the demand for dollar denominated investments will further help the USD strengthen its position in the global economy. No wonder, the INR has been on a downward spiral since November 2024, going past 86.5/$ at times. A depreciating INR doesn't bode well for the Indian market.

CHINESE WHISPERS

In September 2024, China announced a series of economic stimulus measures to bring it's economy back on tracks which has been struggling since the pandemic days. These measures, primarily targeted at China's monetary policy, included lowering existing mortgage rates for home owners, lowering interest rates to make borrowing cheaper. China has been unable to spur private consumption since COVID-19 and these measures were aimed at reviving retail consumption.

The announcement of such measures obviously led to a market rally with the Shanghai Composite surging 4.4% and the blue-chip CSI300 index surging 3% respectively in September 2024. The sudden outperformance of Chinese stocks resulted in heavy sell-off by FPIs (Foreign Portfolio Investors) bringing down the Indian stock indices by nearly 1.5% on 30 September 2024. The FPI selling pressure continued through October as it was an opportune time to book profits in India and divert the money to Chinese stocks.

Does the rise of Chinese stocks pose a threat to Indian equities? Not at the moment because the Chinese rally couldn't be sustained for long. China needs to do much more to revive domestic consumption and its property sector than the current monetary and fiscal stimulus measures.

FPI SELL-OFF

If the Chinese market couldn't sustain its attractiveness inspite of the stimulus announcements, why are FPIs continuing to sell Indian equities?

FPI sell-off in Q3 (Oct'24 – Dec'24) was triggered by a mix of factors but the weak Q2 (July'24 - Sept'24) performance of corporates that were published in Oct 2024 was a major blow to foreign investors' sentiment. The lack of valuation comfort in Indian markets, especially compared to other emerging markets (EMs), is causing the risk-off sentiment.

DOUBLE WHAMMY

Slowing Growth

Q2 estimates show the economy grew at a significantly lower rate of 5.4%, the lowest in seven quarters, much lower than RBI's October'24 estimate of 7%. Except agriculture and trade and hotels, every sector grew at a slower pace in Q2 than in Q1 (Apr'24-June'24). Manufacturing growth in Q2 fell to a dismal 2.2% from 7% in Q1.

One of the main culprits for lower Q2 growth is sharply lower government capex. This coupled with failure of corporates to invest and slowing private consumption expenditure seem to have pulled down Q2 growth.

Inflation

Meanwhile CPI (Consumer Price Index), the inflation indicator, hit a 14-month high of 6.21% in October surpassing RBI's target range of 4-6%. The increase was driven by rising food inflation of 10.87%. Food prices carry about 46% weight on the country's CPI.

Inflation is already biting into urban consumption demand, corporates' earnings and capex.

CONSUMPTION ON SLOW TRACK

The seeds of moderation in urban demand were sown in the 2nd half of 2023-24, with a slowdown in urban wage growth. September '24 quarter numbers showed that private consumption growth weakened to 6% from 7.5% as urban demand slumped, fixed investment growth slowed to 5.4% from 7.5% and government consumption recovered to 4.4% growth from 0.2% contraction in June '24 due to elections.

The ongoing global uncertainty is weighing in, impacting overall consumption and tax collection (GST).

CREDIT CRUNCH

Loan credit is essential to drive business growth of corporates, MSMEs and consumption demand of retail customers. In November 2024, RBI introduced stricter lending norms for unsecured loans as it suspected some of it was potentially entering the stock market. More than the cost of credit, it is the availability of it that is worrisome. Banks' loan growth is down to 11.5% from more than 20% as RBI tightened lending norms to curb imprudence and promote financial stability in the midst of lagging deposit growth.

Even if inflation falls to 4% target, loans have to grow at least 18% for the economy to grow at 8%. Slower consumer demand, risk aversion to unsecured loans and a tepid deposit growth is likely to keep credit growth on a slow burner in the next few quarters.

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PE CORRECTION

Nifty's current PE ratio is below its 10-year average but valuations are still above Asian & emerging market peers. The premium valuations in the wake of slowing earnings growth have been a reason for foreign investors selling Indian stocks since the end of September 2024.

US is the only other market globally that is more expensive than India. Global investors are betting on the US to outperform most markets in 2025.

Most Indian sectors and themes are expensive compared to their recent historical averages. Banking, auto, consumption are some sectors where valuations have corrected significantly while FMCG, IT, metals and commodities are some sectors that are currently overvalued.

Sector Index	Current P/E (Times)	10-Year Avg P/E
Nifty 50	21.79	24.40
Nifty Auto	22.29	55.47
Nifty Bank	13.68	26.14
Nifty Commodities	18.09	15.26
Nifty Energy	16.07	13.32
Nifty Financial Services	16.30	24.20
Nifty FMCG	46.36	40.53
Nifty Infrastructure	24.16	28.64
Nifty IT	34.03	23.85
Nifty Metal	20.67	16.63
Nifty Pharma	37.04	39.86
Nifty PSE	12.35	10.45
Nifty Services Sector	21.58	24.25
Nifty India Consumption	46.77	53.39
Nifty Realty	54.42	122.52
Nifty MNC *	37.25	103.39
Nifty PSU Bank **	7.44	19.62
Nifty Consumer Durables	87.48	NA
Nifty Healthcare Index	42.41	NA
Nifty India Manufacturing	29.30	NA
Nifty Oil & Gas	12.87	NA
Nifty Private Bank	14.62	NA

Index	2024 Returns	PE Ratio (trailing)	Estimated P/E Ratio
EMERGING MARKETS			
Brazil [BOVESPA]	-10.36	7.52	7.43
China [SSEC]	12.67	12.00	10.87
Hong Kong [HSI]	17.67	9.81	6.76
India [Nifty]	8.80	21.79	22.81
India [Sensex]	8.17	22.66	22.59
Indonesia [Bursa]	-2.65	12.97	–
South Africa [Jalsh]	9.37	12.46	11.87
Taiwan [TWII]	28.47	22.63	20.98
DEVELOPED MARKETS			
US [Dow Jones]	12.96	24.85	20.70
US [Nasdaq]	29.81	31.33	31.54
US [S&P 500]	23.84	27.88	24.82
France [CAC 40]	-2.36	15.56	13.96
Germany [DAX]	18.85	16.77	14.28
Japan [Nikkei 225]	19.22	18.84	19.34
UK [FTSE 100]	5.70	15.53	11.99

Source: LSEG, ETIG
* 9-yr average
** 6-yr average

While there are many reasons for the current wariness among investors, not all is lost. There are also many positive indicators to derive comfort from.

POSITIVE CUES

GST Collection

The 7.3% GST collection in Dec 2024 amounting to INR 1.77 lakh crore, is in line with a bit of slowdown in GDP. Overall GST collection during Apr'24 – Dec'24 stood at INR 16.33 lakh crore, up 9.1% against the corresponding period last year. India's GST collections are set for a strong finish this fiscal year, driven by rural economic resurgence and efforts against tax evasion. GST collection is a sound indicator of business activity by individuals and institutions.

Service Activity

India's services activity surged to a four-month high of 59.3 in December 2024 from 58.4 in November 2024 as strong demand drove business expansion and output growth. Forward looking indicators such as new business and future activity suggested that the strong performance will likely continue in the near future.

Sector-wise, finance and insurance recorded the largest increase in new orders and business activity. While employment growth slowed from November, it remained the strongest since data collection began in 2005.

FPI allure in IPOs

While FPIs were net sellers of Indian equities in the secondary market amid rich valuations, sluggish demand and slowing GDP growth, FPIs pumped in a record INR 1.22 lakh crore ($14.5billion) into the primary market (IPOs). This has more than offset their exit from the secondary market to the tune of INR 1.21 lakh crore ($14.37 billion), resulting in a net inflow of INR 426.9 crore ($124 million) for the CY 2024.

A record 90 companies raised over INR 1.6lakh crore through IPOs during 2024. Strong FPI participation in the Indian IPO party is indicative of their conviction in the India growth story over the long term.

OUTLOOK FOR 2025

The latest Financial Stability Report (FSR) released by RBI at the end of 2024 has projected a GDP growth rate of 6.6% for FY25, driven by a revival in rural consumption, a pickup in government consumption and investments, and strong services export. While the corporate earnings for Q2 were muted, the situation hasn't improved much for Q3 earnings season as evident from corporate earnings published so far in Jan'25.

The risk-off sentiment is likely to continue in the first half of 2025 as global markets will take few months to adjust to the policy changes once Trump takes charge. In such a scenario, it is advisable to go with sectors and stocks that are likely to be more resilient, provide valuation comfort and have stable growth potential.

While healthcare and IT are likely to benefit from a dollar strengthening, consumer durables and retail can work as defensives once retail inflation subsides and consumption demand revives. The upcoming Union Budget is likely to focus on raising capital expenditure, manufacturing activity, job creation, relief in personal income tax while adhering to fiscal consolidation.

The return expectations should be moderated as the equity market momentum seen since COVID-19 until Sept'24 is unlikely to continue. However, the long-term fundamentals and growth drivers of the Indian economy remain intact. Growth is likely to pick up pace as these factors start playing out in the second half of 2025 once the current turbulence settles down.

Wishing you and your family a safe and happy 2025 ahead!

Warm Regards,

Kajal Kiran

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Sources:
1. ETIG 2. NSE India 3. Moneycontrol 4. Reuters 5. Bloomberg 6. LSEG 7. RBI

AUTHOR'S PROFILE

Kajal Kiran, Director, Investment Sprouts holds a B.E in Computer Science & Engg. along with MBA in Systems & Finance from T.A Pai Management Institute, Manipal. Sha has also completed all the three levels of the CFA Exam. She has over 20 yrs of experience across industries ranging from financial services to consumer durables. Having worked with organisations of repute like DSP Merrill Lynch, DSP Blackrock, Franklin Templeton, Bajaj Allianz General Insurance, Times of Money (Times of India Group) and AMFI (Association of Mutual Funds in India), she brings rich industry expertise and deep insights to the table.

You can view her complete profile here.

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