NETRA

Early Signals Through Charts

July 2024

DSP

Economic Growth May Or May Not Result In Commensurate Equity Returns

A common misconception across markets is "strong economic growth equals equity returns, therefore buy stocks." This narrative is flawed.

The Case in Point: Brazil, with only moderate growth, delivered highest real returns for investors in the past 30 years. Conversely, China, with explosive GDP growth, has yielded negative real returns.

Why?
Stock returns depend on earnings growth. Companies that consistently create value for shareholders (above their cost of capital) deliver long-term gains, exceeding bonds. This is rarer than most people believe. In many countries and companies, events outside the control of authorities can derail or stop growth.

The Takeaway: Don't be fooled by economic growth alone. Focus on a company's earnings and the price you pay for them.

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.

The Metamorphosis of Fiscal Expenditure

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India Has Used The Global Fiscal Extravaganza The Best

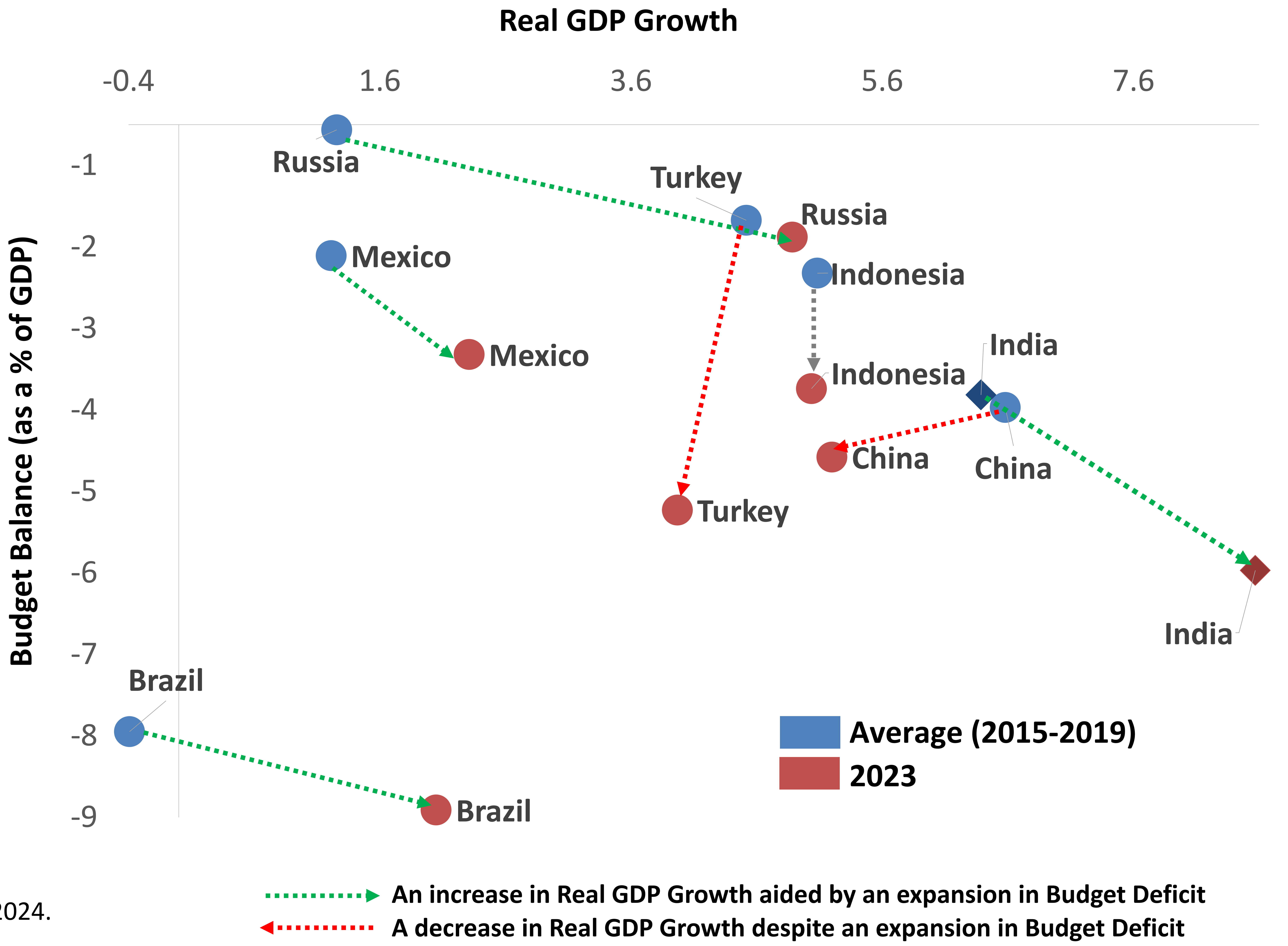
India has rightfully landed as an outlier amongst its EM Peers, leveraging its expanding budget deficit in achieving a growth higher than 8%.

After Turkey, India has made the steepest increase in its budget deficit, compared to its pre-covid average and now runs the second highest fiscal deficit among peers. This expansion in fiscal deficit has translated into economic growth, making India one of the fastest growing among the top 40 largest economies.

This fiscal extravaganza was made possible only because most other trade partners are also running very high fiscal deficits, curtailing adverse balance of payments shocks through the currency channel.

This **isn't a policy construct**.

The use of this window efficiently by the central government along with the RBI is a **case of efficient policy implementation**, which has been absent in most peers. The question is, can this continue?



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

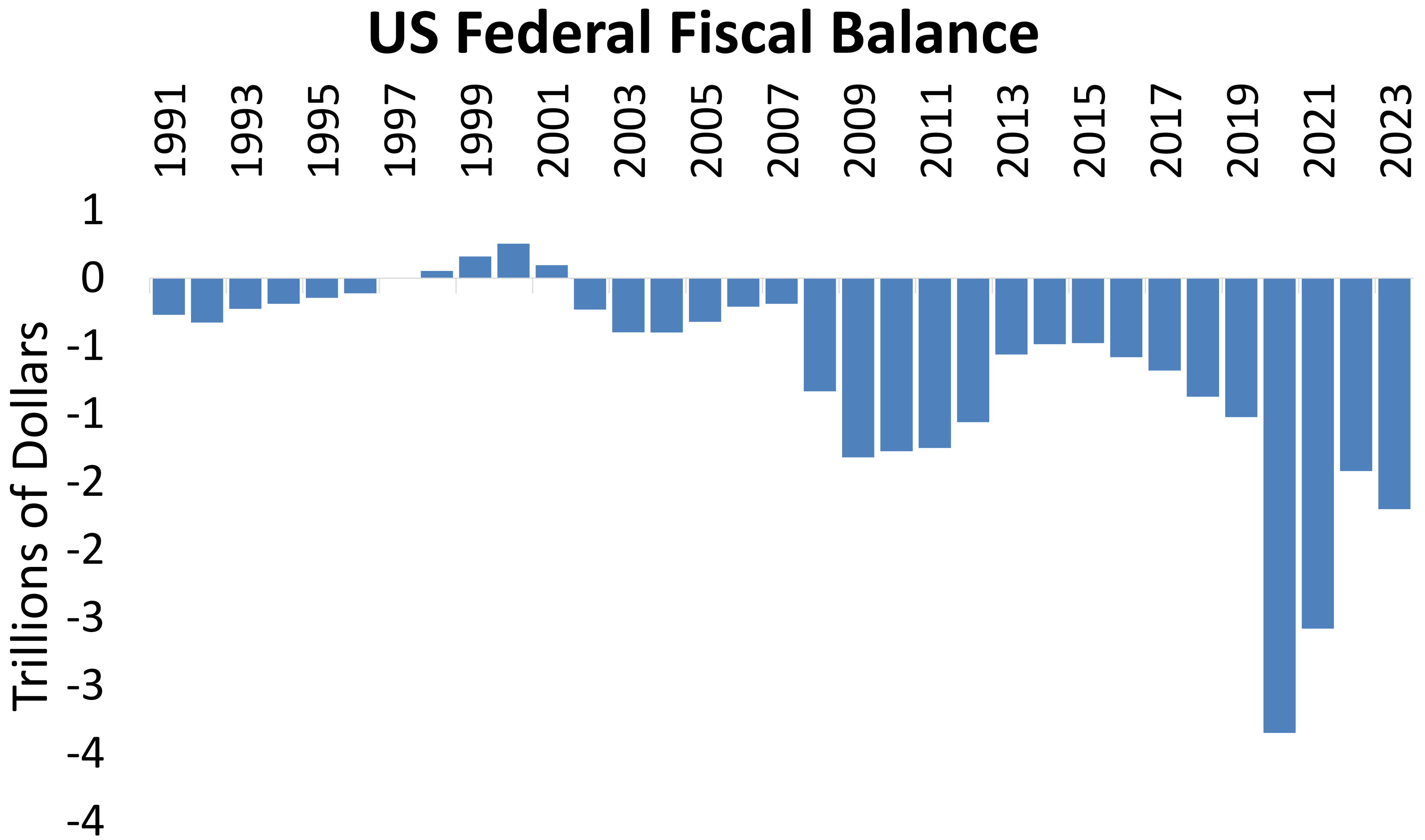
A Profligate US Has Allowed Fiscal Spending Of This Scale By GOI

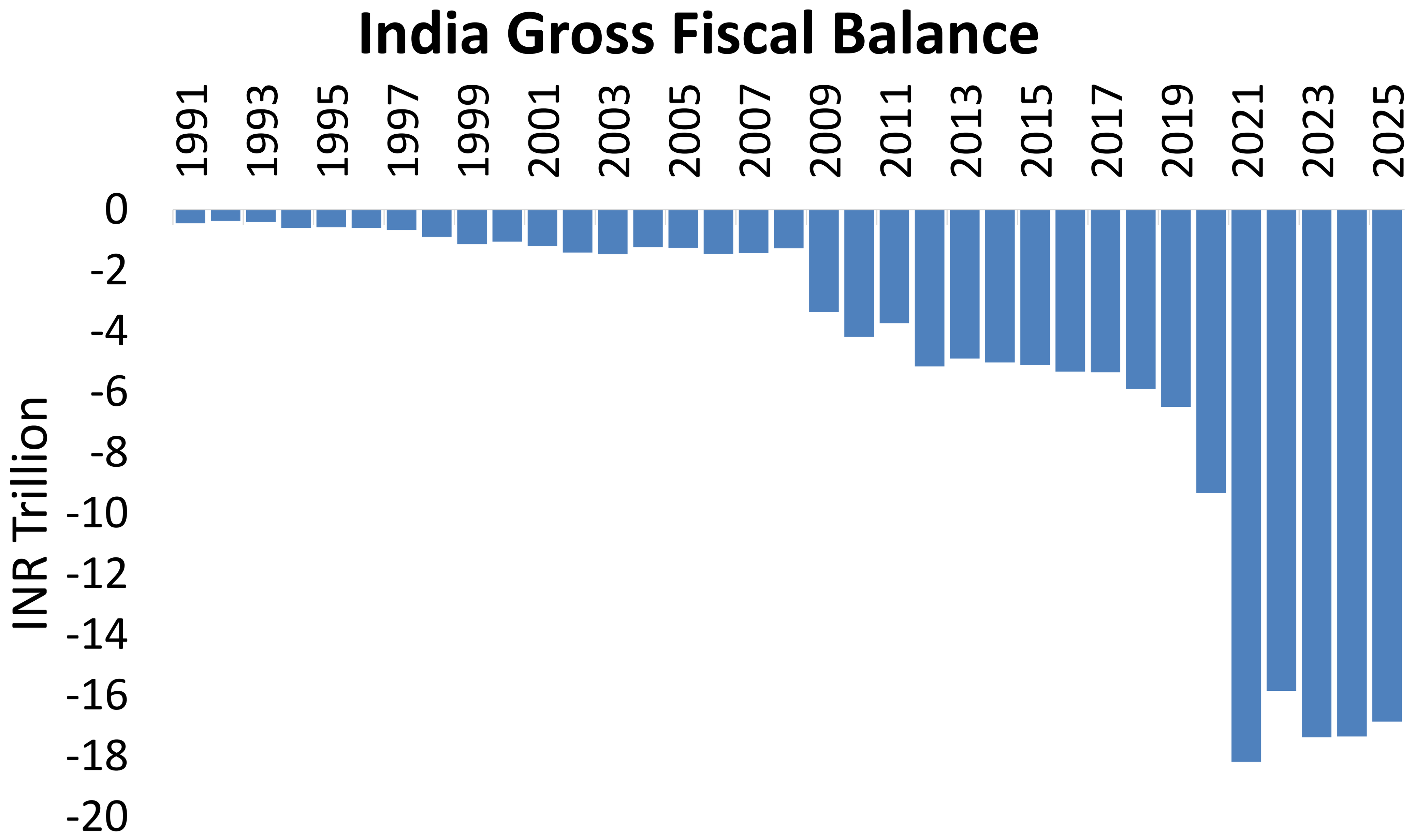
The US fiscal stimulus in the aftermath of COVID-19 through the federal government spending alone has totaled $9trn, or 41% of average real GDP. A similar number for GFC'08 was 30% of real GDP. While US GDP grew at a CAGR of 1.5% between FY08 and FY12, the growth rate was 50bps higher during the post COVID recovery.

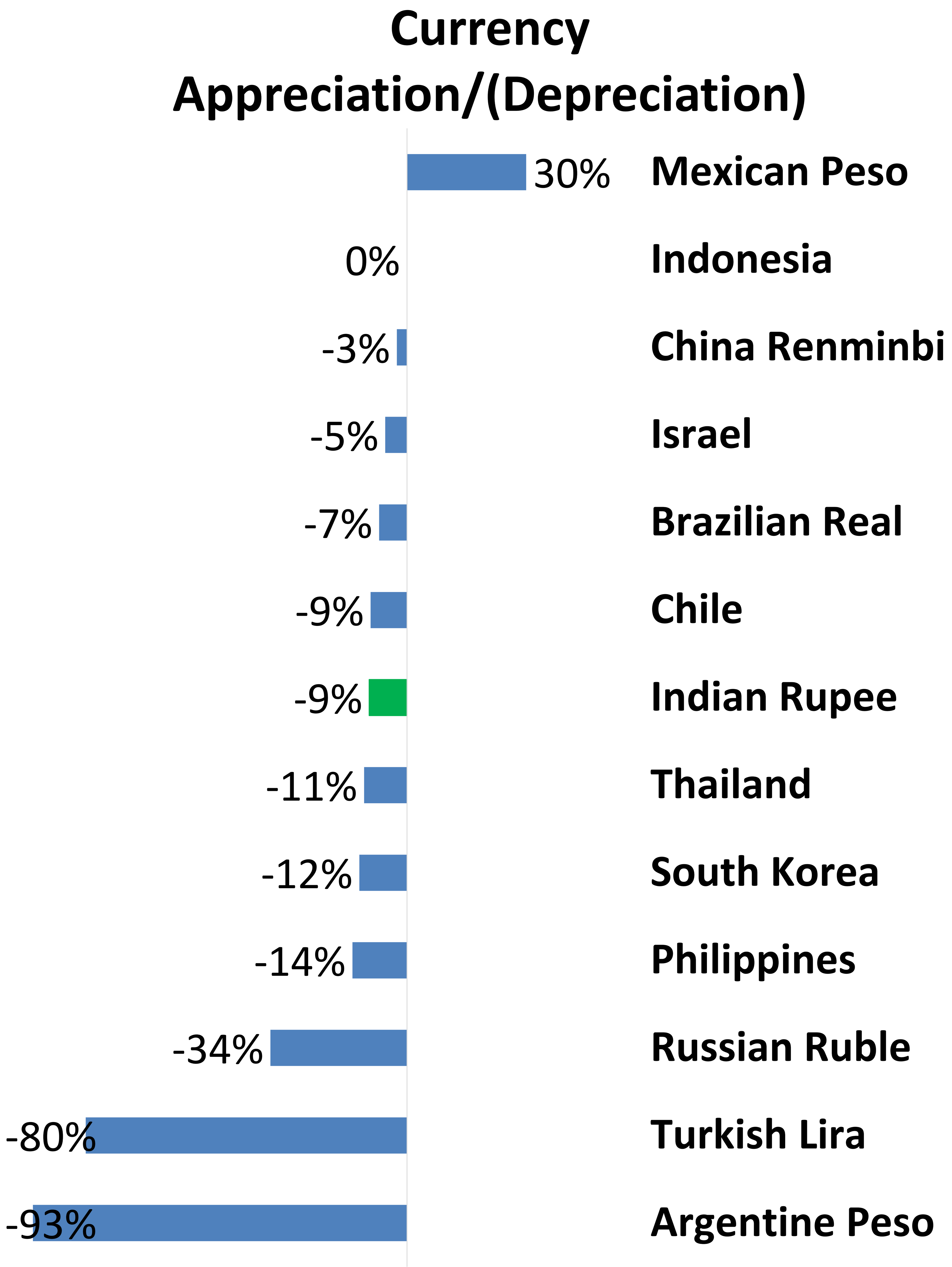
The size and scale of stimulus allowed other governments, including India, to run similarly large deficits and prop up the economy.

However, this policy decision has its shelf life. With most economic indicators back to pre-covid levels in US, the need for this extra spending is over. The continuation of extra fiscal expenditure in US has allowed other nations to also provide additional fiscal support without worrying about their currencies.

This fiscal ability may get challenged as and when US changes its policy. That policy change can happen due to financial market volatility or a policy making decision.







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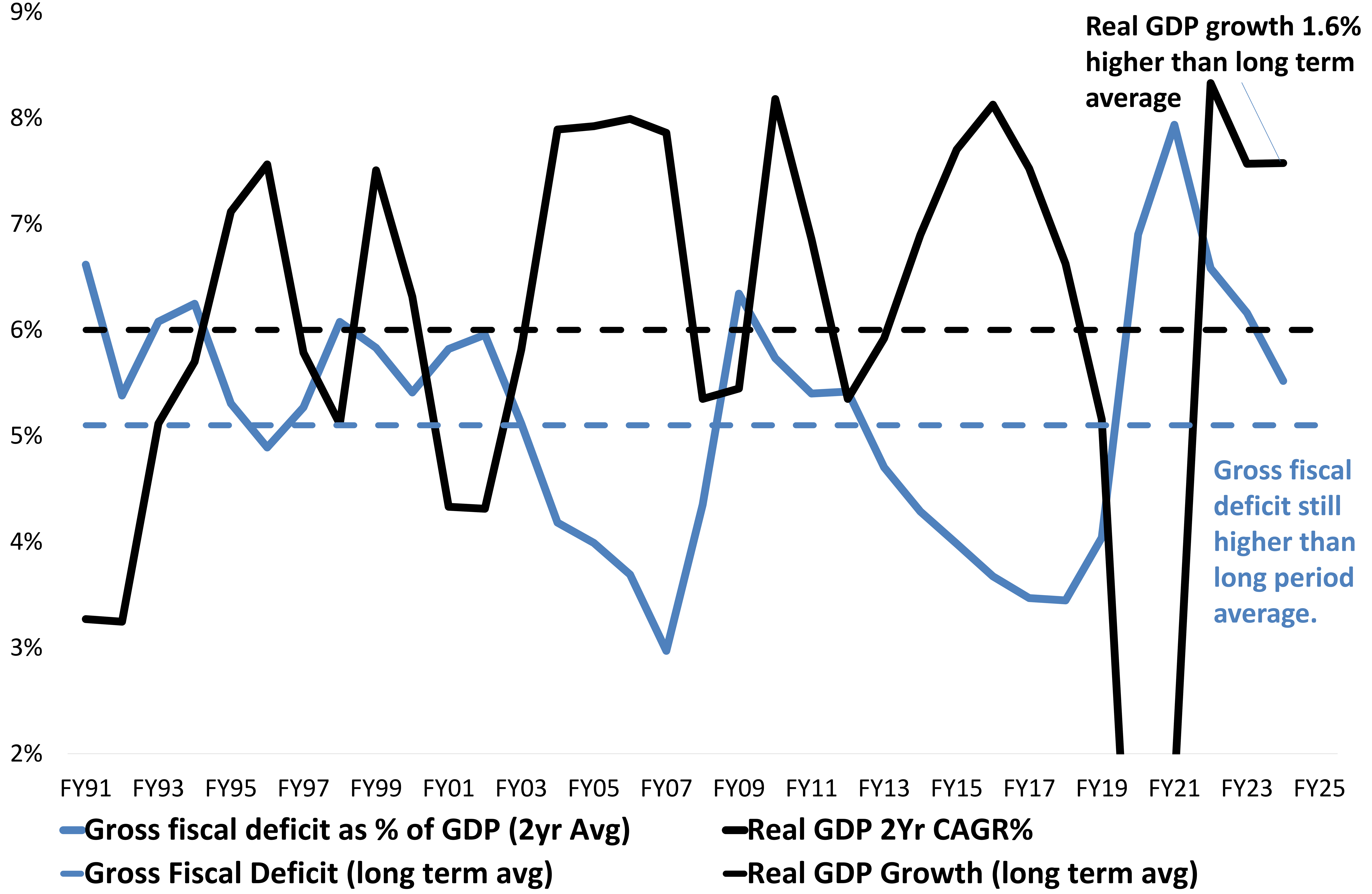
Source: Govt Docs, CMIE, DSP; Data as of June 2024.

Countercyclical Fiscal Policy Turning Procyclical?

In the 21st century, India faced two major economic shocks. The 2008 Global Financial Crisis (GFC) caused GDP growth to drop from 8% to 5.5%, while the 2020 pandemic-induced recession led to a 6.1% contraction in FY21. Both events triggered significant countercyclical stimuli from the Indian government and RBI.

Post GFC, the stimulus withdrawal was slow and led to twin balance sheet problems when a flare up in oil prices broke India's BOP. A similar contributing factor was inability of running a wide fiscal deficit because US and other trade partners were also more circumspect and fiscally tight.

From FY25 onwards, the gliding path of fiscal spending could turn procyclical. This means government spending may slow as the economy exits its post pandemic growth spurt phase. The central government's revenue expenditure growth has slowed, and capital expenditure growth is also tapering. This means that government expenditure growth could be a drag on GDP for the next few years.



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

Declining Subsidy Bill Has Helped Improve The Quality of Expenditure

In India, subsidies such as Food, Fertilizer, and Fuel (FFF) are included in Direct Benefit Transfer (DBT). Other subsidies include MNREGS, Crop Insurance, PM Kisan, and interest subvention on farm loans.

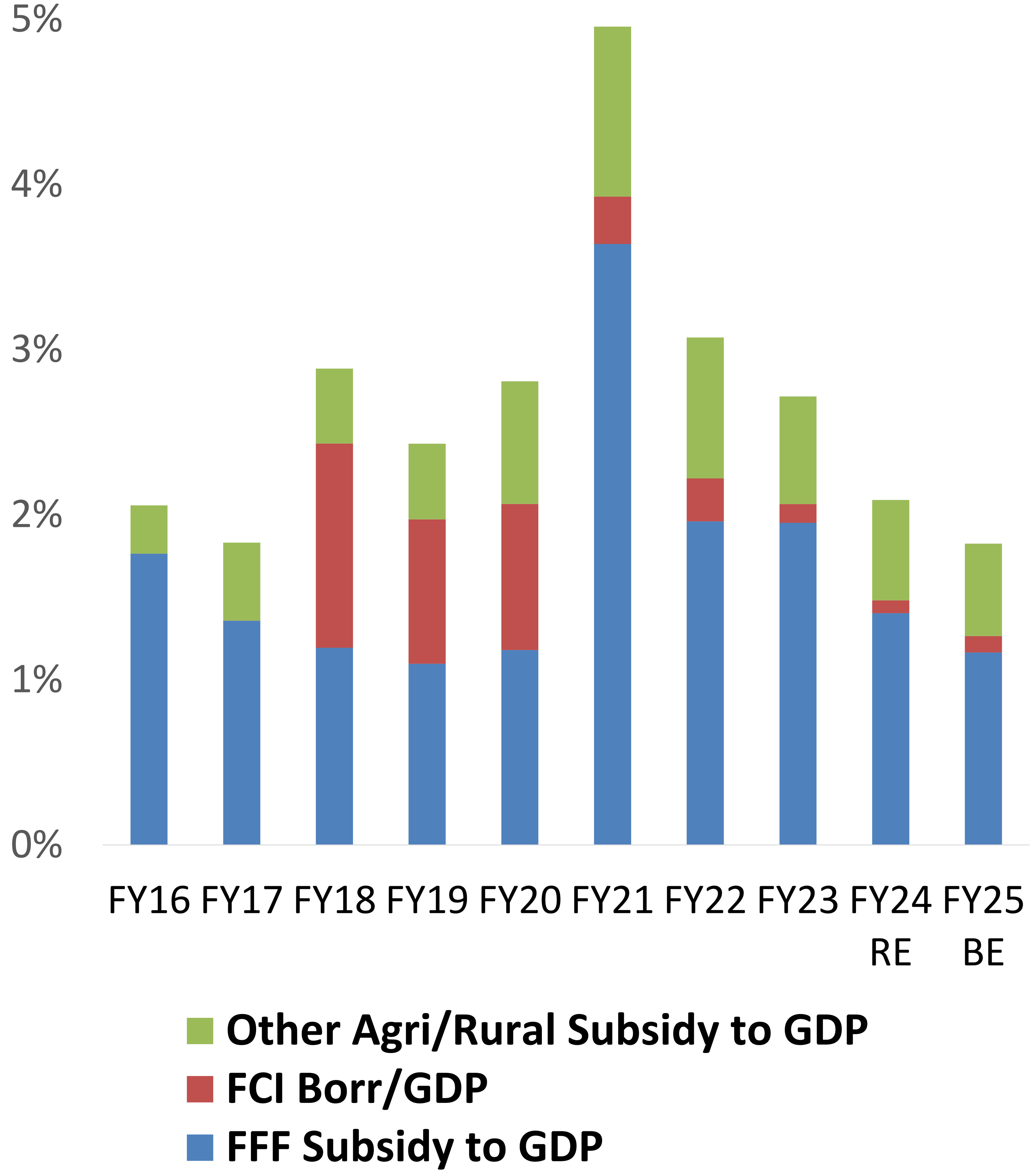
Spending has transitioned from FFF to income-generating avenues like crop insurance, credit subvention, and asset & employment creation like MNREGS.

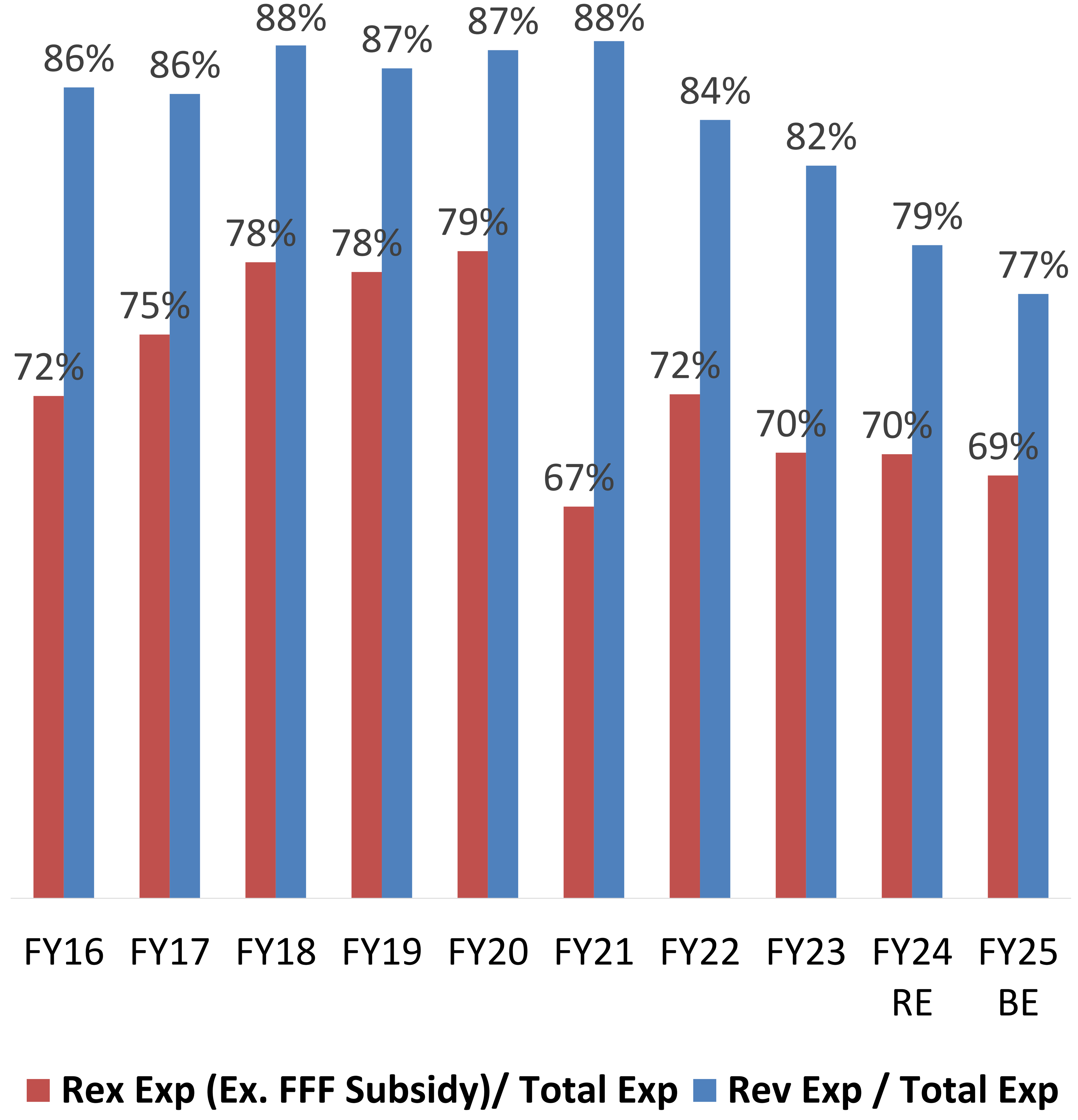
Food subsidy spending off the balance sheet through FCI has largely moved to on-balance sheet, with FCI spending restricted to temporary borrowing.

Post-pandemic, overall subsidy spending has significantly decreased due to moderation in subsidy payments and GDP improvement.

This reduction has allowed for increased focus on capital expenditure. The Government of India has effectively utilized the post-pandemic period of increased fiscal deficit and expenditure, with a clear emphasis on capital expenditure.

India Central Govt. Subsidy Spend as a % of GDP – A steady decline & shift towards income generating subsidies. FFF subsidy (including FCI borrowing) at the lowest in 10 years.





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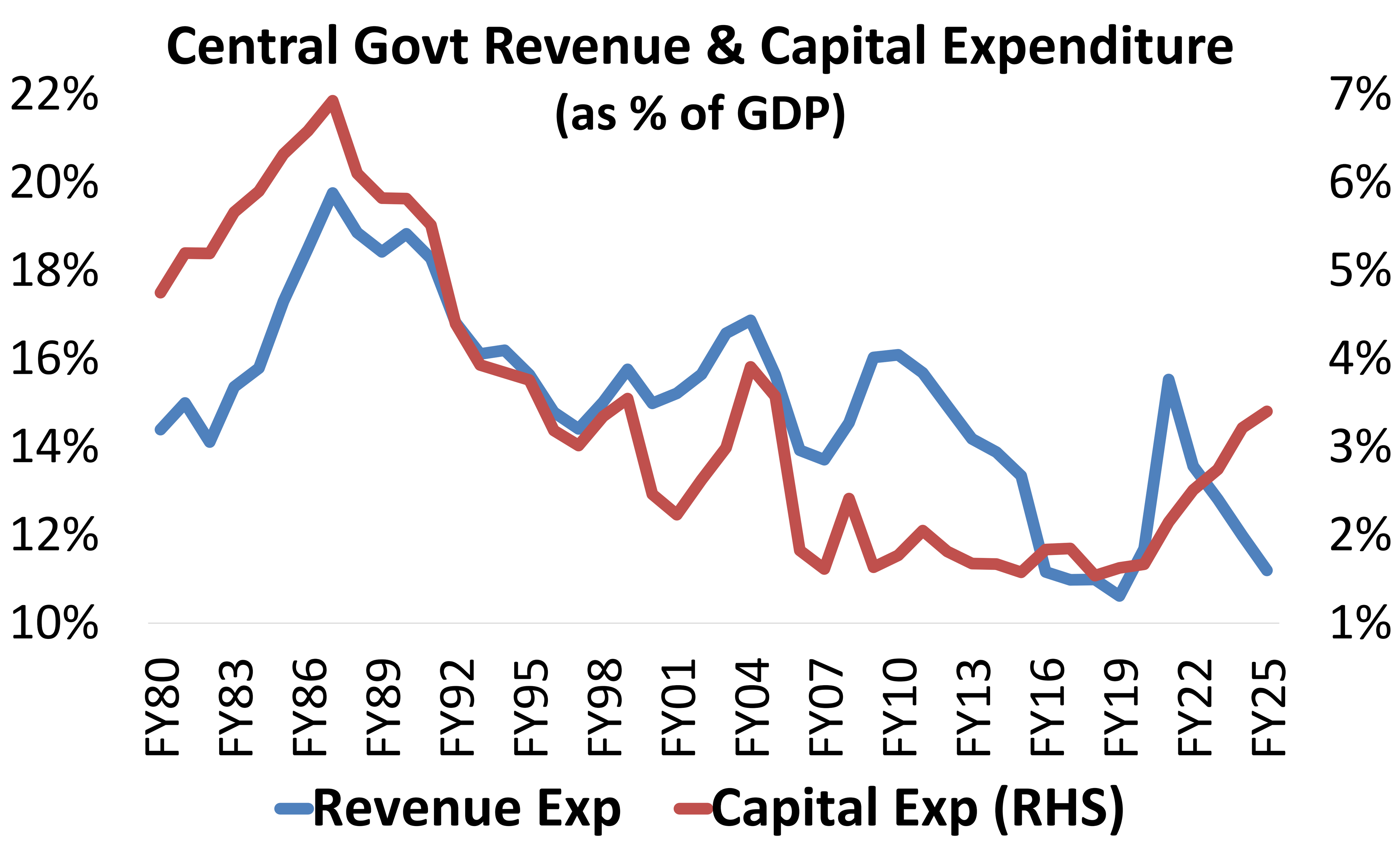
Source: Anitha Rangan, Equirus Securities, DSP, Data as of June 2024

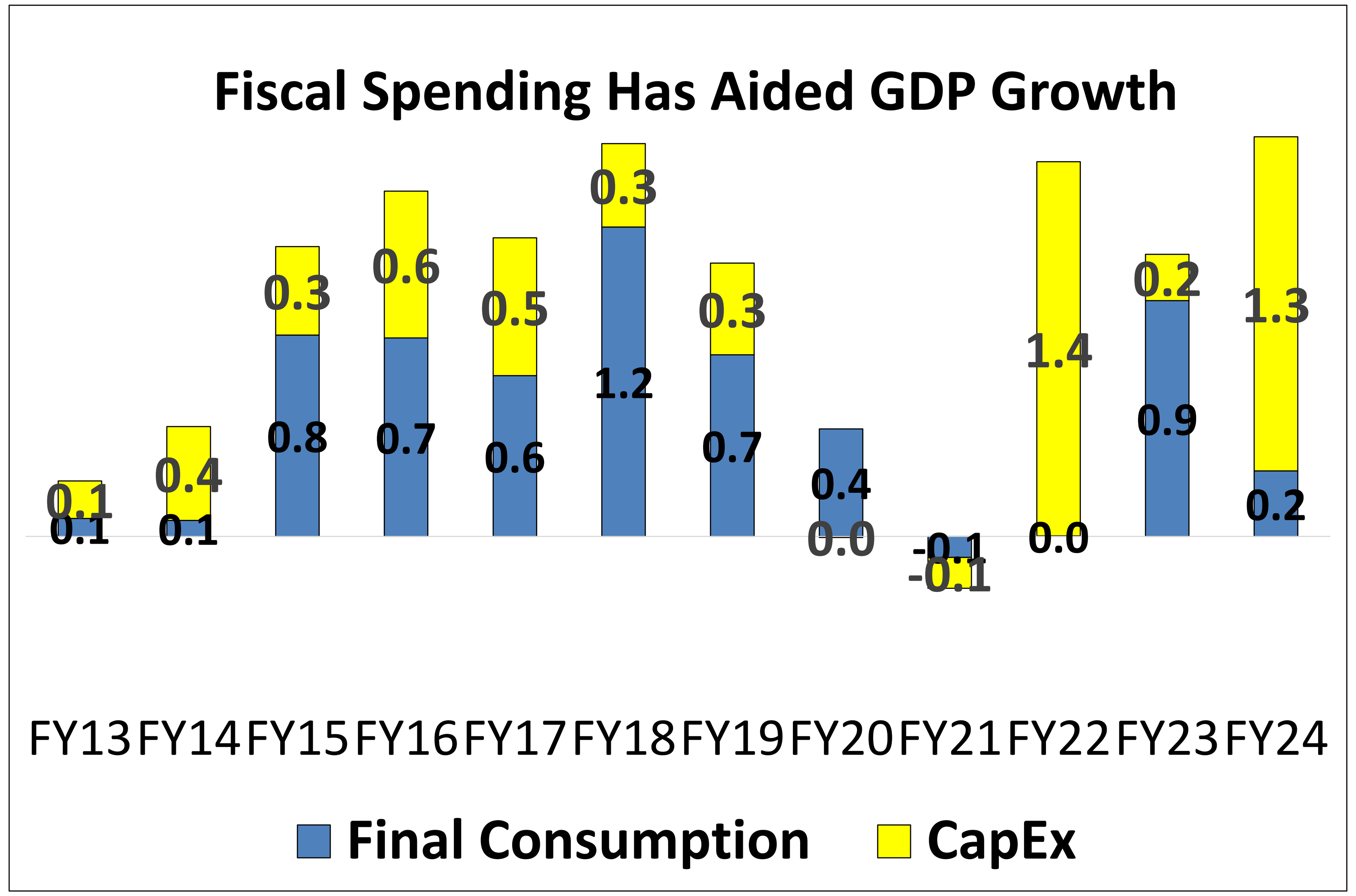
Fiscal Focus On CapEx Has Been Laser Sharp, But Isn't Extraordinary

India, has used the post pandemic fiscal spending spree quite judiciously. As seen in the table (bottom left), the central government spent a third of resources mobilized through revenues and fiscal borrowing on capital expenditure. This one-third used to be just about 13.8% prior to pandemic. In absolute terms, had the GOI followed the pre-pandemic expenditure trend it would have spent Rs. 3.31 Lakh Crore on capital expenditure over the last 5 years. Instead, it spent Rs. 7.75 Lakh Crore. This has helped revive the moribund capex cycle to some degree.

Government spend has also entirely translated into economic growth due to efficiency of government expenditure.

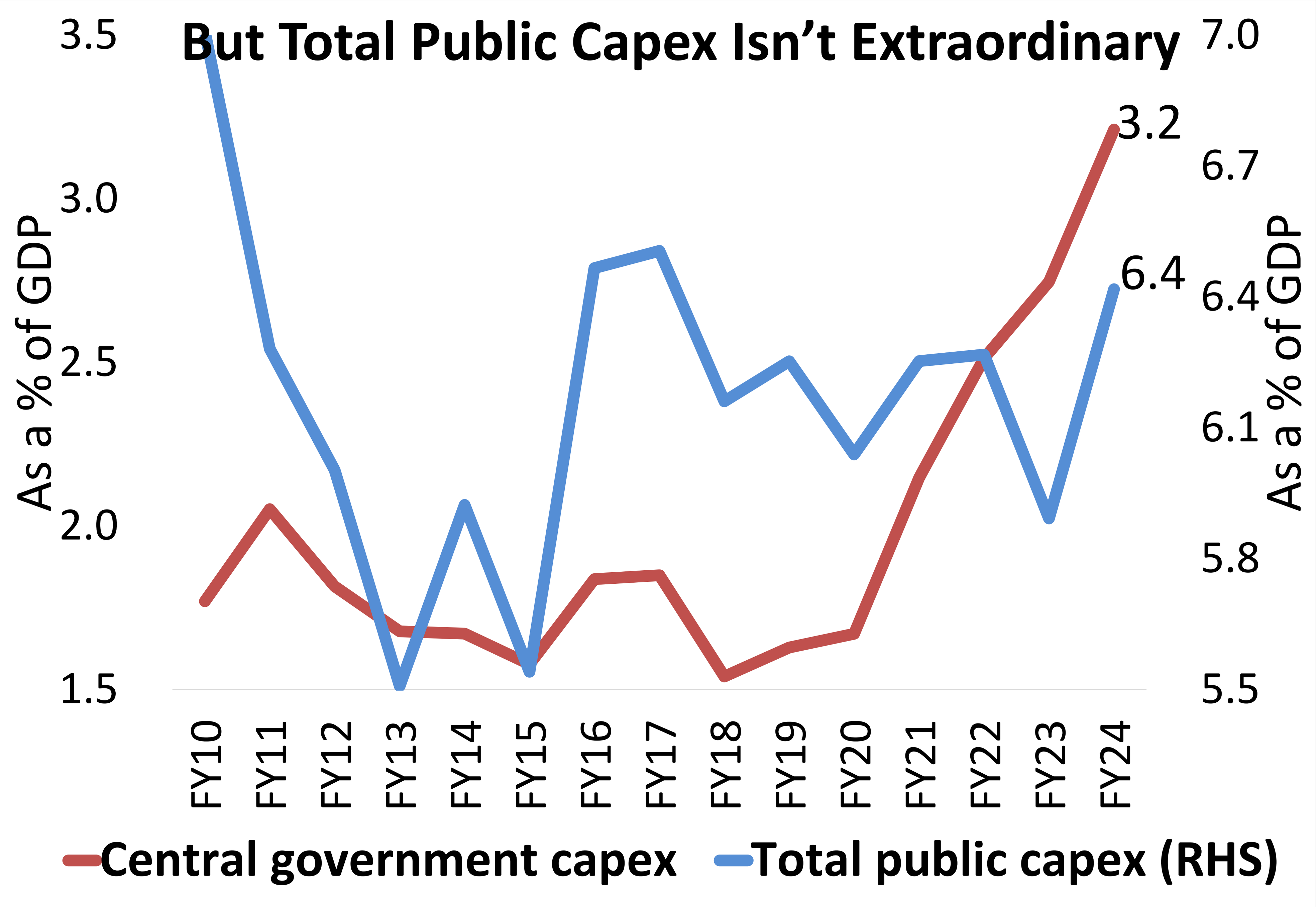
But, despite big government capex push, private sector is not getting crowded in so far. This is because while Centre has pushed capex aggressively, the aggregate public capex (center + states + PSUs) is about average.





GOI Has Focused Its Spending on CapEx

FY20 to FY25 Incremental Total Numbers	Expenditure Post COVID (FY21 to FY25e) INR Cr	Run Rate Nos Basis Prior Trend INR Cr	Expenditure as % of additional resources mobilized post COVID	Pre-Covid 10-Yr Avg Expenditure as % of Total Expenditure
Rev Ex	**13,04,053**	**21,12,070**	**54.3%**	**87.9%**
Cap Ex	**7,75,385**	**3,31,148**	**32.3%**	**13.8%**



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

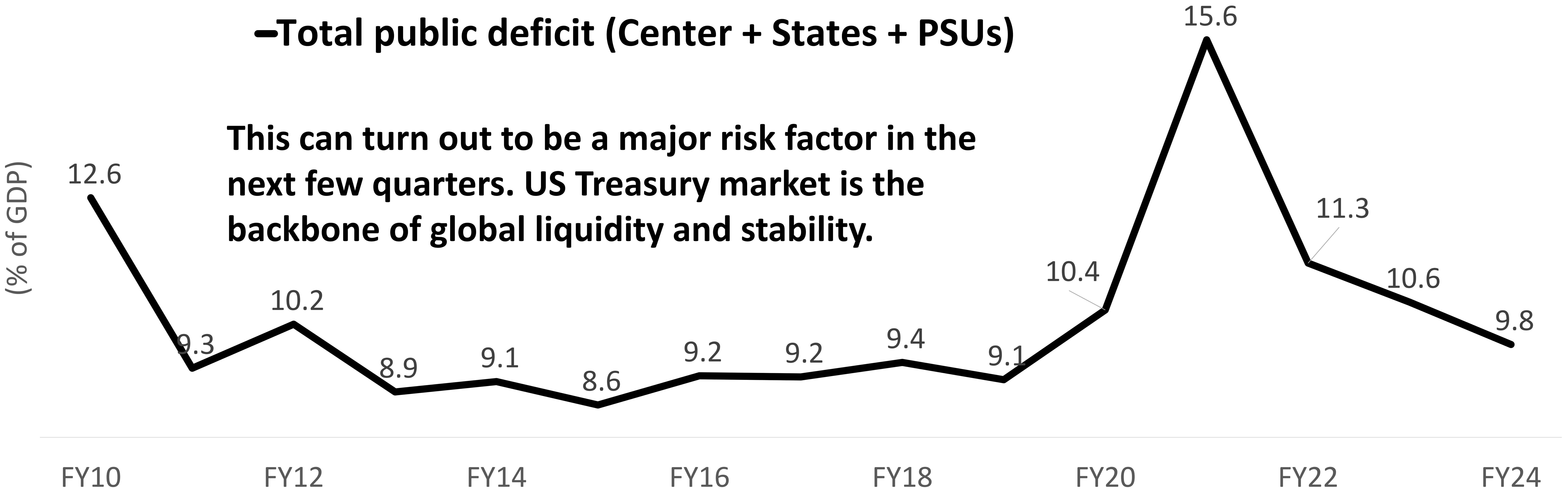
Is There Enough Fiscal Spending For The Cycle To Continue? May Be Not

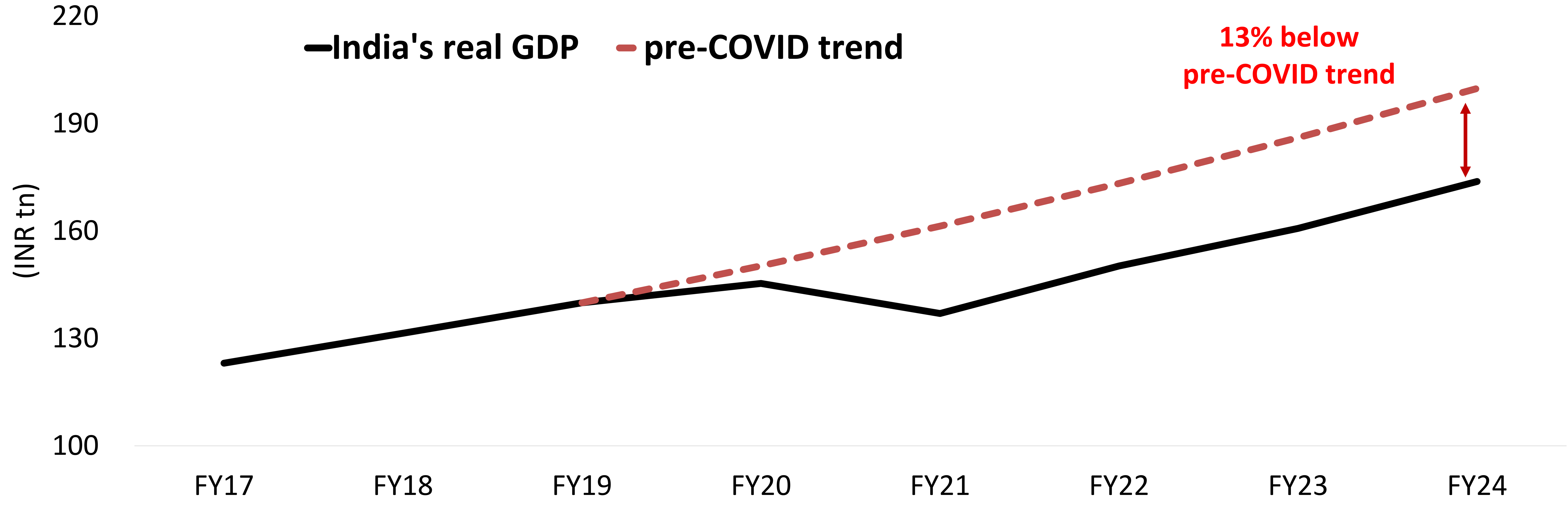
Economy is yet to get back to pre-covid trend line while fiscal consolidation has happened at a rapid speed. The aggregate fiscal deficit (including off balance sheet items) is now nearing pre-covid levels. This means that extra fiscal expenditure is likely to become insignificant. Given that Nominal GDP growth is slowing, exports are weak and domestic consumption is also muted, this constitutes a procyclical fiscal policy.

Countercyclical Fiscal Policy: Government policy that works against the ongoing economic boom or recession trend, aiming to stabilize the economy.

Procyclical Fiscal Policy: Government increases public spending and reduces taxes during an economic boom or reduce spending and increase taxes during a recession. Essentially, it moves in tandem with the overall state of the economy.

Of course, fiscal prudence is good for macroeconomic stability, but the negative side is that demand remains insufficient and therefore sustained revival in capex becomes difficult.





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Source: Kapil Gupta, Nuvama Research, CMIE, DSP; Data as of June 2024.

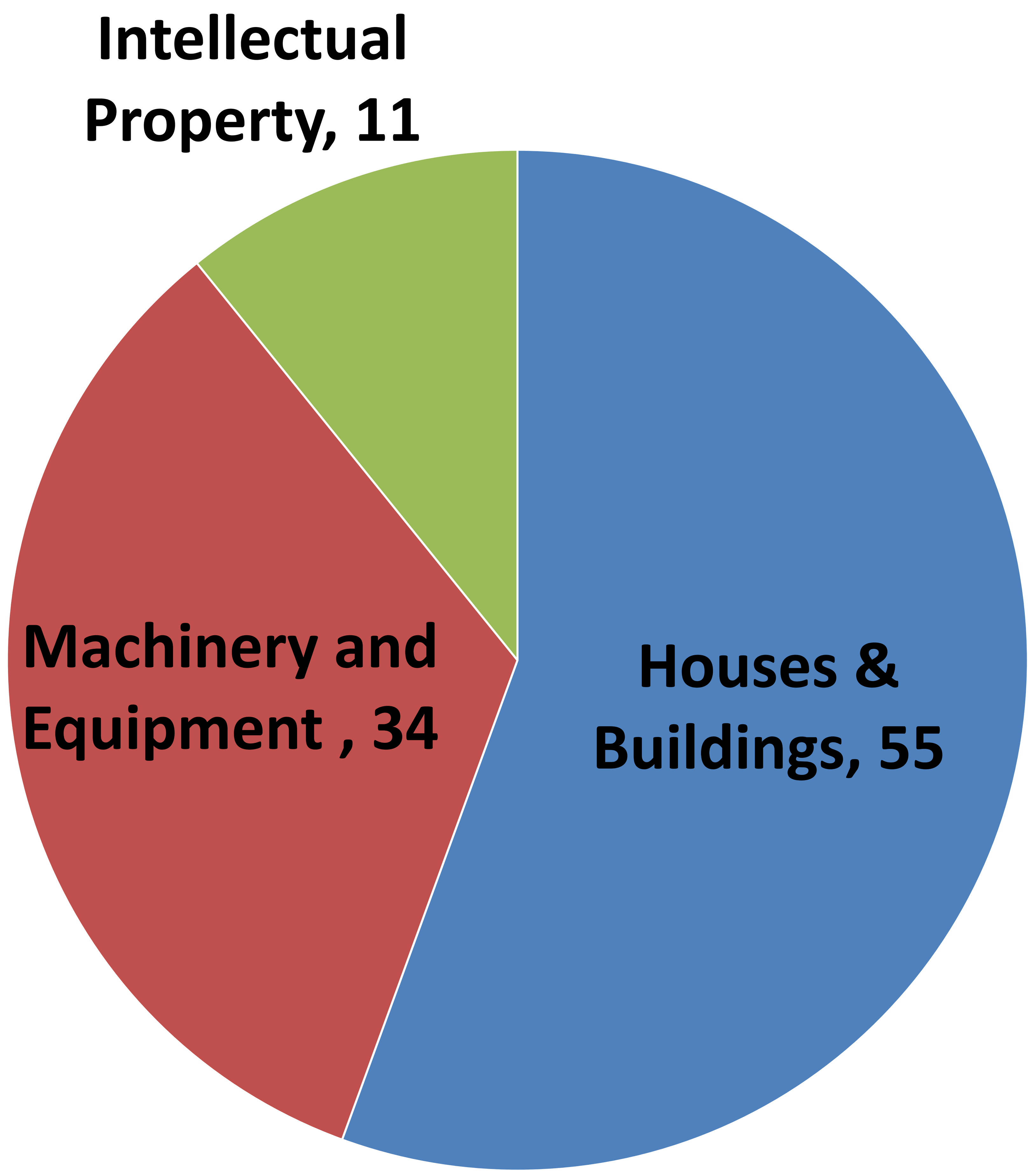
Household Physical Savings On The Upswing But Shallower Than Previous Cycle

If there is one number that greatly influences the economic growth of the country, it is the houses and building construction across the country. The gross fixed capital formation, or investments, done during the year comprises of three major heads shown in the pie chart.

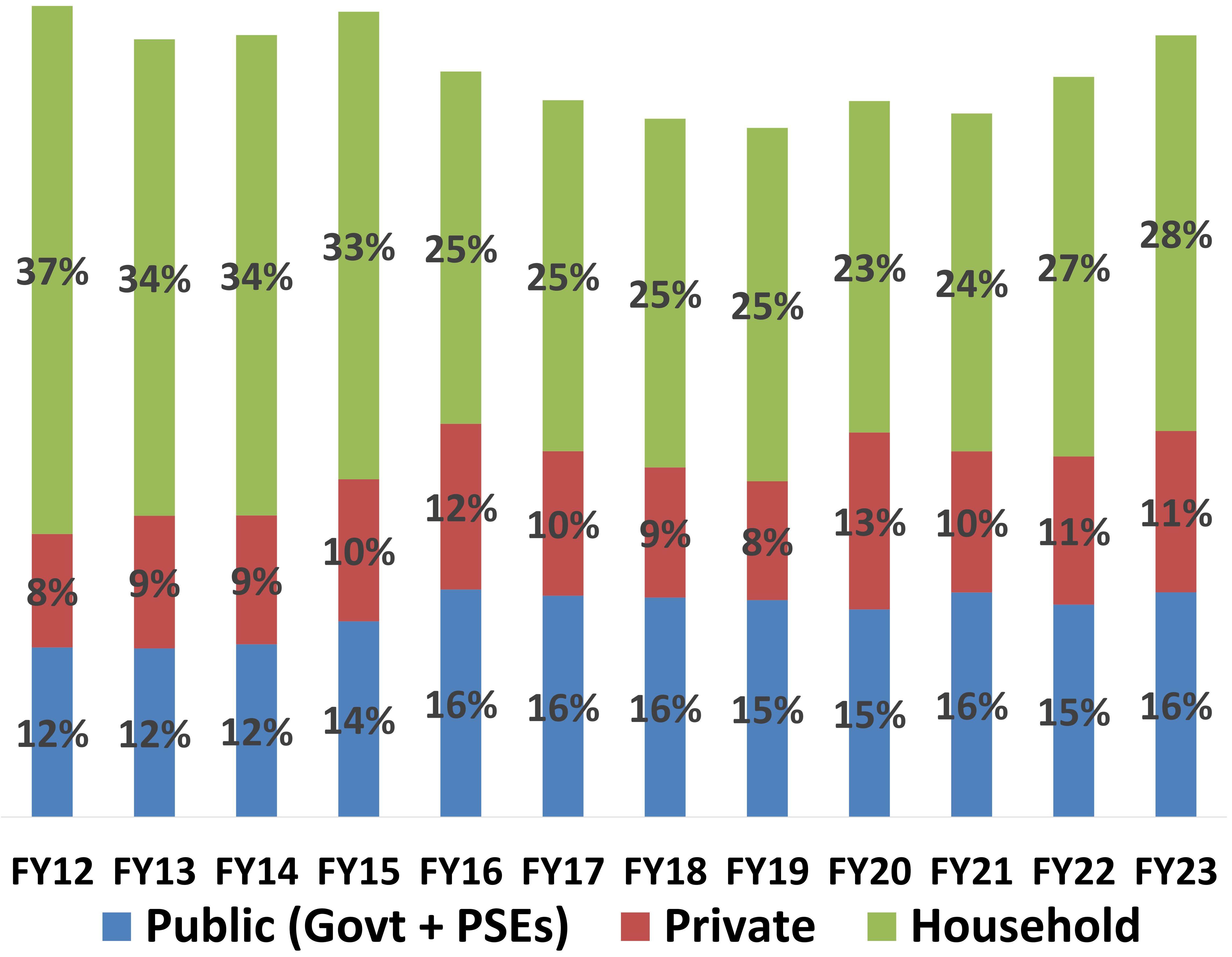
At 55%, the share of houses and building construction (called Dwellings, Other buildings & Structures in economic jargon) is the largest contributor. Of this 55%, nearly half comes only from households (*including people building houses*) building construction. This number used to be even bigger, with two-third share coming from households.

At the peak of previous CAPEX cycle, households were the primary driver, ably supported by the private sector through strong trend in gross block addition. In the current cycle, the pace of growth for houses and buildings has picked up but remains far below the cyclical peak seen in previous cycle. Moreover, the private sector is yet to pick up its capital expenditure. Meanwhile, public CapEx has increased to help revive the cycle.

% Share by Assets in Gross Fixed Capital Formation (Investments) Average for FY11 to FY23



Household Sector Has Seen It's Share Fall From One Third to Nearly One Fourth In Overall GFCF



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

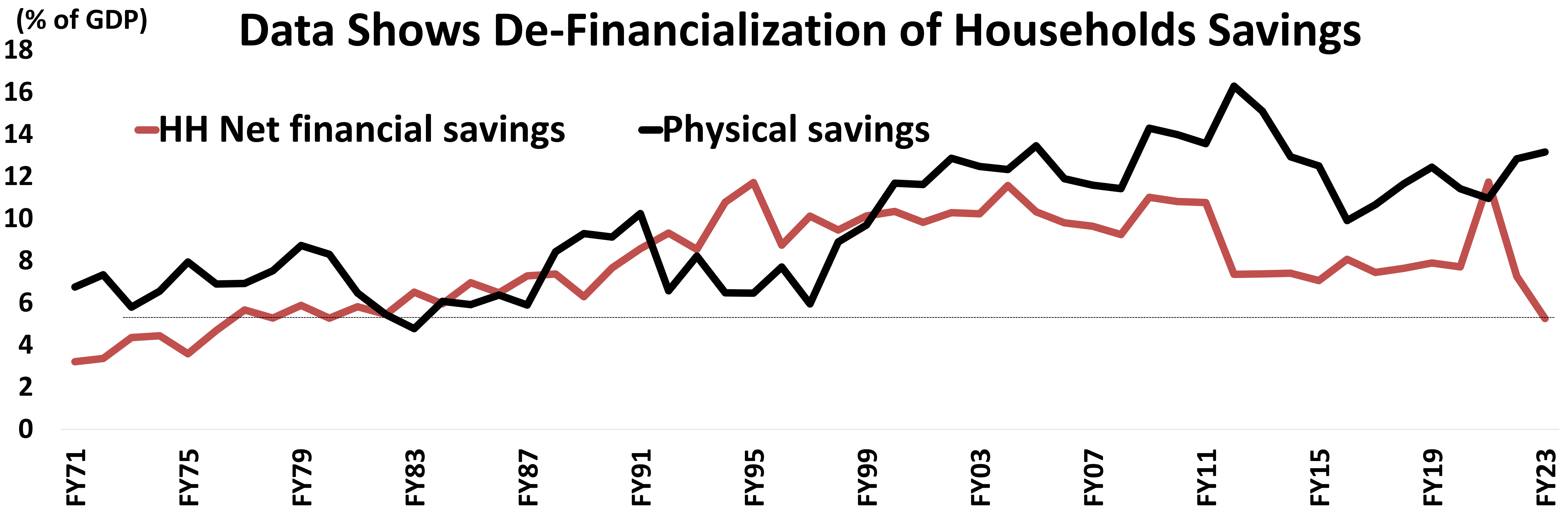
Household Balance Sheets Are Stretched?

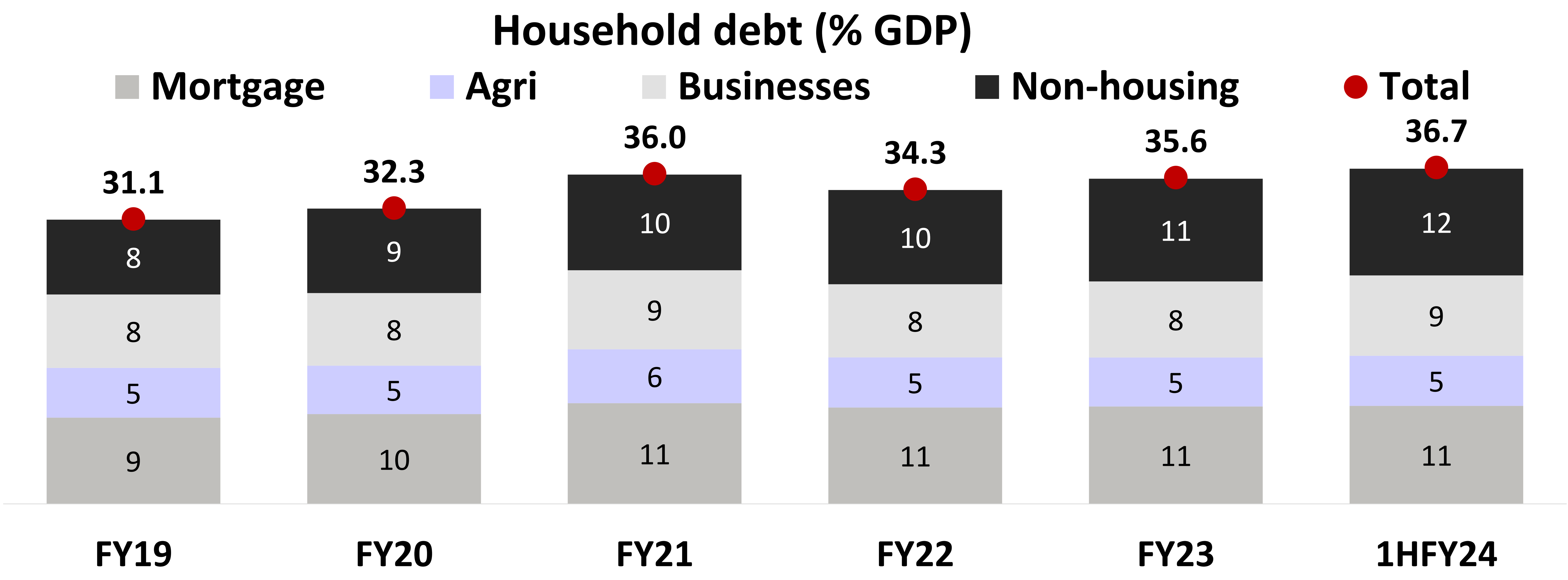
Household net financial savings (NFS) collapsed to 47-year low of 5.3% of GDP in FY23, as consumption growth outpaced income growth and households prefer physical assets (primarily residential real estate) over financial assets.

HH physical savings were at a decade high of 13.2% of GDP in FY23, accounting for more than 70% of household total savings, highlighting the de-financialization of HH savings. It is likely that HHNFS may have picked up slightly in FY24, but HH total savings remain low.

At the same time, household debt has risen sharply during the past two years. HH debt is estimated to have risen to all-time high of ~37% of GDP in 1HFY24, beating the previous high of 36% in FY21. More importantly, the share of non-housing personal loans (i.e., consumption loans) has risen the most during the past few years.

This means that the debt fueled household revival could be derailed in case of poor wages & salaries growth, and high real rates. This is a key risk for the longevity of the Capex cycle.





Source: Nikhil Gupta, Motilal Oswal Research, DSP; Data as of June 2024.

Fast Paced Wages & Salaries Growth Could Slow

IT & Financial Services wages surged 14% & 17% post-pandemic, exceeding the overall 14% growth for BSE500 firms (top 3 sectors account for ⅔ of wage bill). Strong wage growth in these sectors (plus autos in FY24) fueled urban consumption and luxury retail.

However, IT is losing steam, falling below its 14% long-term average. While Financial Services remains resilient, signs point to slower wage growth in FY25.

On balance, most other sectors are struggling to see material wage bill growth. For many urban markets, the CPI inflation (as per RBI's latest financial stability report) is nearing double digit numbers and an average wages & salary increase of 10% is completely offset by inflation. This can be a headwind for discretionary consumption and the expected recovery in private consumption.

Household balance sheets are stretched due to an uptick in leverage. In case of slower growth in wages & salaries, private consumption may take longer to revive.

Wage bill Growth by Sectorfor BSE 500 Firms (yoy,%)	Wage Share (FY24)	FY24	FY23	FY22	FY21	FY20	FY19	FY18	FY17	FY16	FY15	FY14
Information Technology	30%	8%	21%	23%	7%	12%	16%	6%	14%	18%	18%	25%
Financial Services	27%	28%	8%	12%	19%	18%	28%	10%	9%	10%	11%	15%
Automobile and Auto Comps	8%	22%	13%	11%	-5%	-5%	13%	14%	8%	9%	18%	19%
Oil, Gas & Consumable Fuels	7%	-3%	13%	6%	2%	0%	2%	14%	24%	2%	4%	15%
Healthcare	5%	11%	12%	10%	13%	10%	12%	12%	20%	13%	34%	26%
Metals & Mining	5%	9%	2%	18%	9%	-1%	8%	3%	-1%	-10%	8%	15%
Construction	3%	11%	23%	19%	5%	29%	15%	11%	5%	11%	13%	28%
Capital Goods	3%	12%	11%	12%	-6%	4%	4%	12%	5%	-4%	2%	8%
Services	3%	17%	22%	21%	-1%	25%	24%	20%	14%	21%	79%	8%
FMCG	2%	9%	12%	8%	10%	5%	8%	7%	5%	11%	11%	11%
Power	1%	3%	3%	10%	4%	4%	13%	13%	-3%	-2%	3%	25%
Construction Materials	1%	4%	12%	10%	-2%	8%	21%	27%	27%	5%	14%	10%
Chemicals	1%	1%	11%	17%	8%	21%	15%	11%	8%	8%	10%	7%
Consumer Durables	1%	17%	18%	16%	-1%	10%	13%	14%	8%	9%	15%	16%
Consumer Services	1%	17%	27%	32%	-17%	13%	16%	19%	14%	18%	21%	19%
Telecommunication	1%	14%	12%	3%	8%	-3%	6%	-5%	-3%	-1%	12%	7%
Textiles	0%	-3%	9%	19%	-4%	6%	11%	4%	10%	-1%	19%	57%
Media, Ent & Publication	0%	16%	14%	6%	-9%	-1%	54%	16%	19%	-10%	20%	10%
Realty	0%	19%	35%	12%	-13%	7%	7%	8%	17%	5%	21%	11%
Diversified	0%	16%	15%	2%	10%	10%	3%	19%	17%	9%	6%	9%
Forest Materials	0%	33%	-17%	15%	-7%	9%	-33%	-35%	-1%	5%	23%	2%
Total	100%	14%	14%	15%	7%	9%	15%	10%	11%	8%	13%	18%

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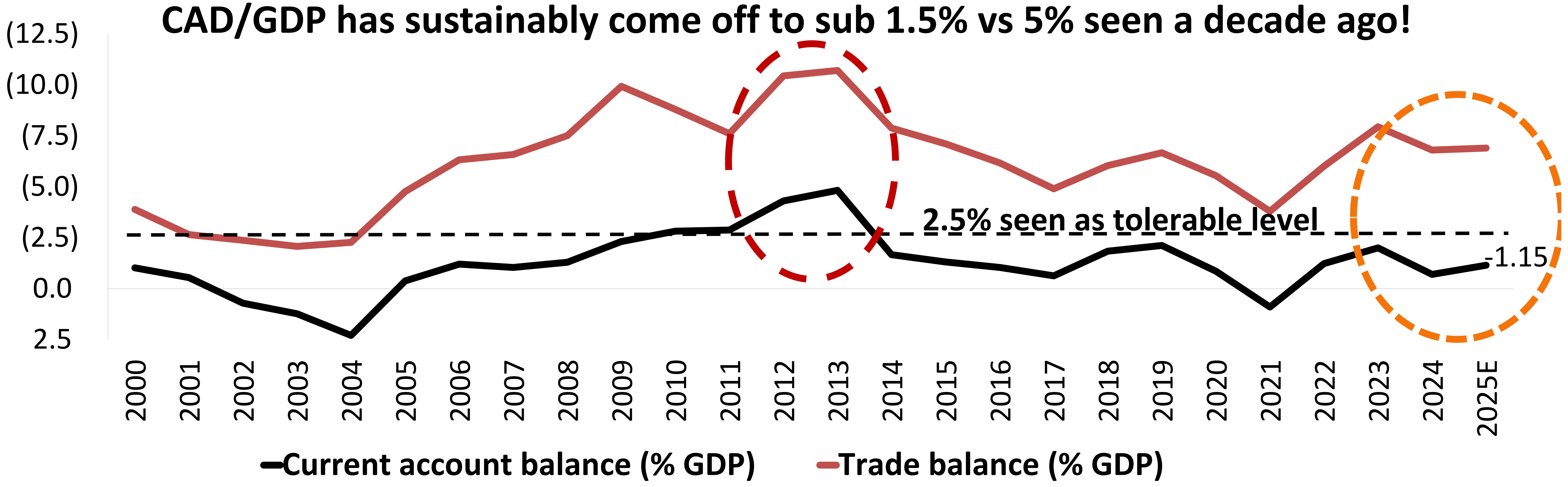
Source: Capitaline, DSP; Data as of June 2024.

Services Exports Have Been The Biggest Source Of Strength For India's BOP

The resilience in global demand is clearly reflected in the robust performance of goods and service exports. While the significantly reduced current account deficit remains susceptible to global economic fluctuations, we can take this moment to appreciate the progress made.

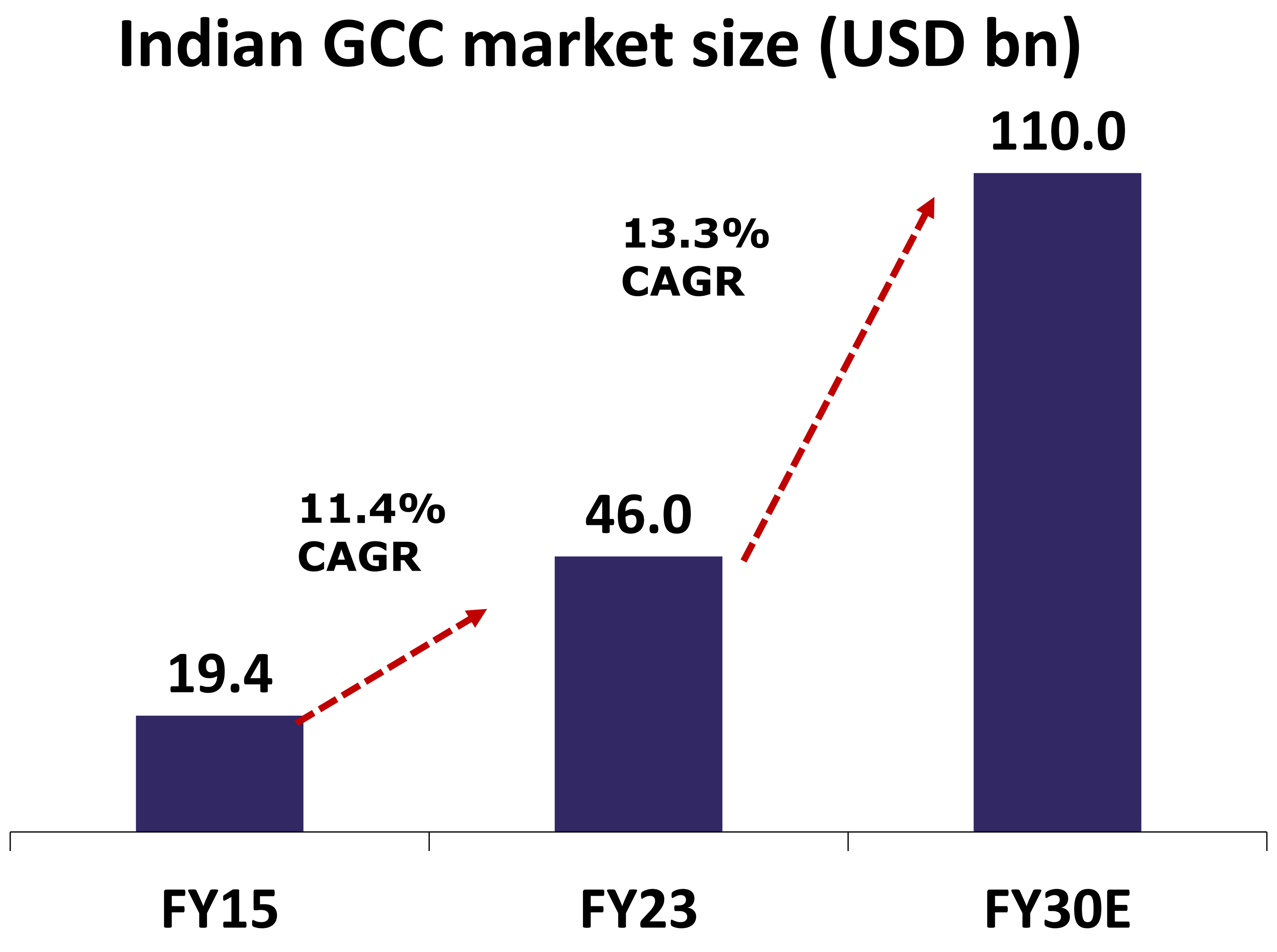
Service exports have consistently been in the spotlight, with software services leading the charge. However, business services have shown remarkable growth, particularly through the challenges posed by the COVID-19 pandemic.

The GCC sector, benefiting from relatively inexpensive skilled labor, has structurally supported India's current account, further enhancing the potential for growth in service exports. The business consulting services exports have grown at one of the fastest pace for any services industry in the world, creating a huge tailwind for India's BOP.



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%



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

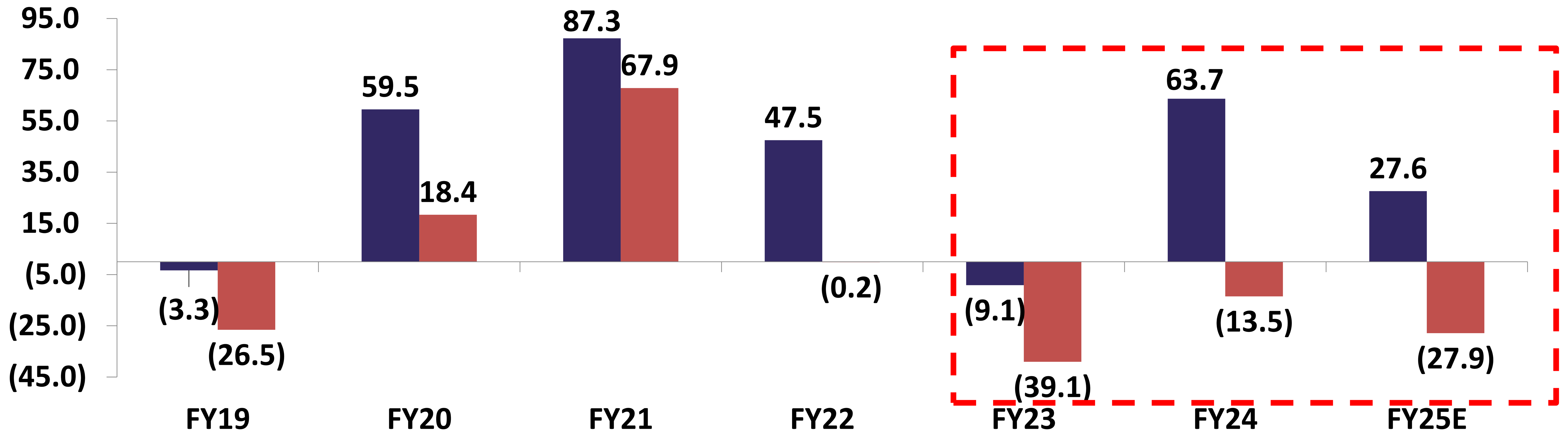
But Lack Of FDI Flows Keeps BoP Vulnerable To Shocks

The last significant positive Basic Balance of Payments (BoP), which includes CAD and FDI, was in 2021. During that year, we experienced a current account surplus due to an exceptionally low trade deficit and peak FDI levels ($44Bn), which reached 1.64% of GDP. In stark contrast, current FDI stands at just 0.27% of GDP ($10Bn), the lowest since records began.

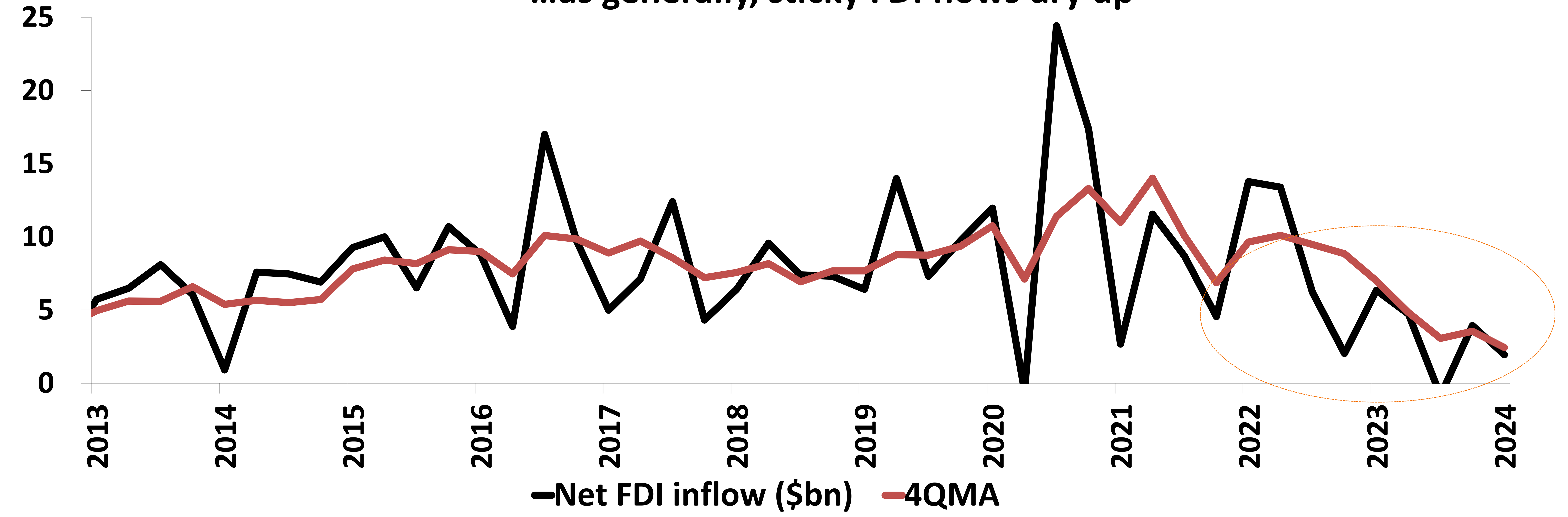
While the CAD has narrowed in 2024, the sharp drop in FDI has more than offset this gain, pushing the Basic BoP into negative territory.

Despite the decline in FDI, India has fared better than its Asian peers, retaining its position as the world's leading destination for greenfield investments (new ventures). However, relative to size of the Indian economy the Net FDI coming into the country is still contracting, rather than increasing steadily. This could be addressed by a sharp focus on creating manufacturing excellence and attracting FDI in manufacturing and other capital-intensive industries.

Despite structural Current account improvement, basic BoP stays negative…



…as generally, sticky FDI flows dry up



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Source: Madhavi Arora, Emkay Research, : RBI, FdI Markets, DSP; Data as of June 2024.

Core Inflation at Multi-Year Lows, Real Rates Can Hurt Growth

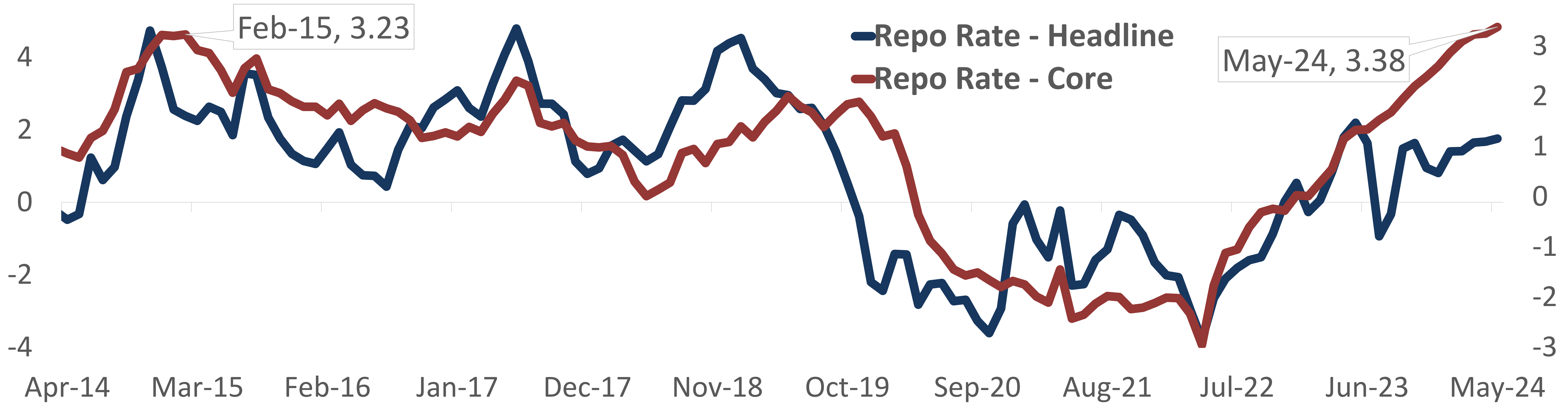
Real Rate (calculated as a difference between the Repo Rate and Core Inflation) is at it's highest at 3.38% (vs 3.23% in Feb'15, when Repo rate was 100bps higher than what it is today). Considering the pre-covid average of this difference, 338bps is a long way from 154bps.

The core number, is on a disinflationary spree, marking the steepest fall of 312 bps fall in 17 months (vs 285 bps in 18 months in 2018-19).

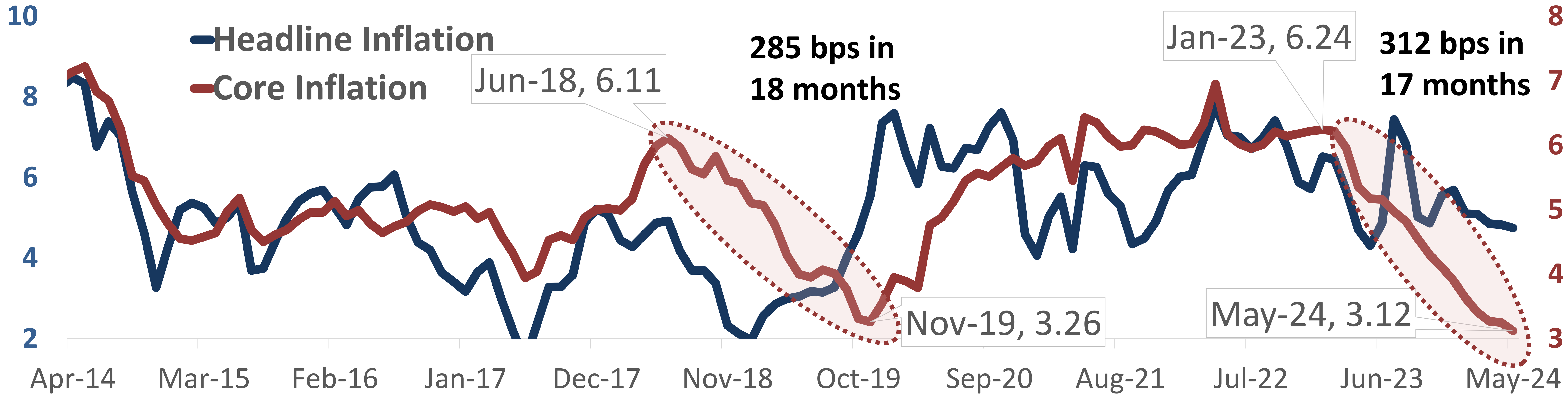
Global monetary policy rate has yet to turn with US Fed still non-committal for a rate cut. Most central banks, including India, have suggested that they find little reason to fix what's not broken. This means central banks would deliver rate cuts only when they see signs of economic trouble. This makes the current monetary policy environment a drag on growth, globally and in India.

With the possibility of fiscal extravaganza ending and monetary policy changes in the slow lane, the risks to global and domestic growth have increased.

India's Real Interest Rate Are High



Inflation Is In The Slow-lane



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Source: CMIE. Data as of 31st May 2024

Are You Still Looking For The Best Fund?

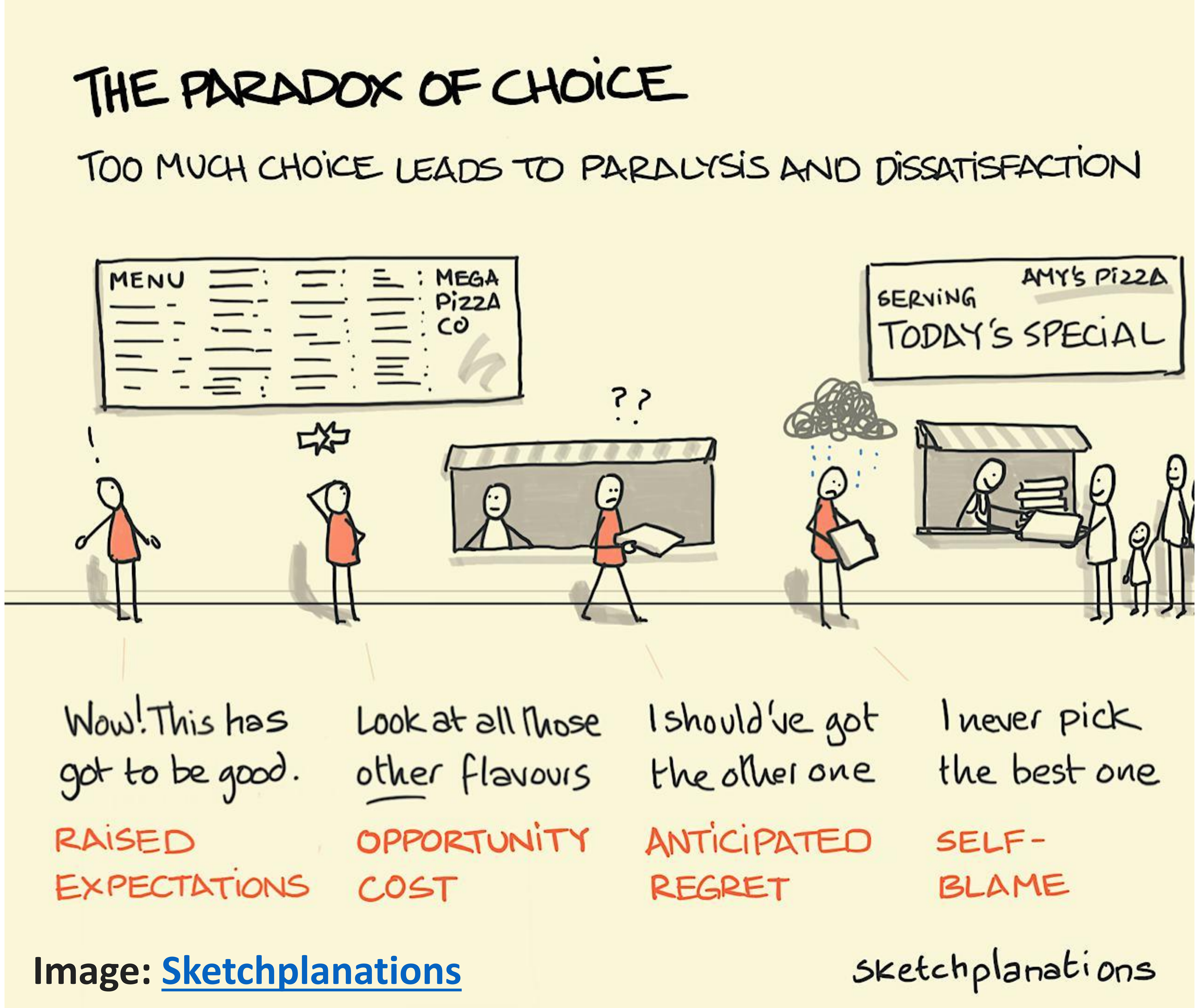

Image: [Sketchplanations]()

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