

2024 may pave the path for a decadal breakout of Indian economy and markets

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2023 has been a dream year for many investors. Markets climbed series of wall(s) of worries from four rate hikes over four months, stubborn inflation, heightened odds of global recession, collapse of three mid-sized US banks (including the third largest banking failure in history), extension of the Ukraine war, and breakout of a new war in Israel, volatility in crude oil, slower demand environment, and uncertainties of weather gods. Almost none of these were envisaged when the year began.

Outlook 2024

One must do a reality check on what is changing in the world – slowly, steadily, and permanently. The easy money period is gone; capital is costlier. The world is fragmented with broken supply chain(s), fractured socioeconomics, simmering conflicts and deep polarisation. The existing economic frameworks, capital market rule-sets, and the global powers-be are under serious challenge. 2024 on this backdrop is a landmark year for India – which can set up a path for a decadal breakout for a muddle-through economy.

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With key growth vectors like scale, favourable demography, at-inflection GDP per capita, favourable factor costs, rising digital density, historically stable macro environment (GDP growth, currency, fiscal, FX reserves, inflation) and policy – India is growth-ready for a visibly long period.

Elections

Elections, till they get factored in, do create uncertainty and are always unpredictable in outcomes like box-office. The narrative post recent state elections has certainly turned positive. The markets are factoring in continuity in the policy environment and the economy is readying itself to commit enough resources towards growth capex. Any outcome other than majority rule for the existing regime – can dampen the spirits. If history is a cue – any such situations are screaming opportunities to log in to the India story.

Macros

GDP growth is expected to remain in the band of 6.5-7.5 percent driven mainly through domestic consumption and sustained government investments. Increased digitisation, higher compliances, lower base effects and sustained capex cycle should continue keeping these numbers buoyant. Currency can be a vital cog, where a five-decade lowest inflation and interest rate differential against developed economies, backed by better capital flows into the economy can surprise with a firm rupee.

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Corporate earnings

After sluggish sales growth in the first half of the current fiscal, improving base demand, softer input cost regime, and focus on efficiencies are set to reflect in earnings growth of estimated 15-17 percent CAGR over the next 24-month period. While the initial part of growth would be in financials, industrial should catch up in the latter half. Companies focused on domestic franchises with localised supply chains would benefit. Businesses dependent on higher export contribution will continue to weigh under near-term challenges from slower global growth.

Flows

India has come off from times when markets were enslaved to international flows. Post Covid, India equities have lived their moment of truth with a stellar performance against the tide of \$60 billion+ outflows while registering the new highs. Domestic flows have provided a counterbalance with an annual flow of more than \$30 billion+ (2/3rd of through systematic investment plan (SIP) and balance through pension insurance flows).

Domestic investor allocations to equities (only 5 percent of household assets) would follow its outperformance against other asset classes. Any resurgence in FII flows to add to their current India exposure (tiny overweight today) can have cascading effects on market performance.

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Valuations

With the recent earnings performance, Nifty is now 20.0x 1-year forward - higher than the past 10-year average, but relative to EM (excluding China) the premium at 63 percent is in line with the historical average. Also, on PEG (price/earnings-to-growth) basis, Indian markets appear reasonable. Valuations are slaves of fundamentals, sentiments, and relative attractiveness against peer-set opportunities.

As things stand with the recent run, the pendulum is at high velocity on growth expectations, their sustainability, extended performance expectations, and recency effects of flows to the asset class performance. India will remain a premium value destination due to its well-spread opportunity basket, a developed world capital market architecture, proactive regulators, and superior ROE (return on equity) profiles for most of the investible universe.

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If we see through the prism of earnings yield to bond yield – at -2.82 the medium-term upside does seem dragged – the interest rate trajectory would remain a critical peg to watch out for while the earnings expectations improve slowly. The last 3-4 months have widened the gap

in favour of large caps certainly. The markets, from here on, should reward stock-pickers ahead of the market timers.

Trends to watch out for:

Capex: A consensus trade – India's capex (GFCF) to GDP is still 500-600 bps lower than the previous peak seen around 2010. All three elements of the capex cycle (Housing, corporate & govt capex) are now firing thereby limiting the impact of any potential global slowdown should have.

Housing is in a virtuous cycle (strong pent-up demand, above-average affordability, and 12-year low unsold inventory). Corporate capex too is poised for growth with low leverage, a decade-high utilisation, and ready access to credit from a well-capitalised banking system.

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Consumption: After a dull calendar year 2023 a base effect should be visible in most of the consumption, especially in the discretionary basket – like home improvement and consumer durables – as the finished stock of real estate comes into the possession zone. A rising proportion of young consumers would reflect on higher aspirational consumption (food, fashion, dining, leisure and hospitality, etc) and sustained growth in consumer credit. One needs to watch out for employment numbers though.

Government policies: Focus on enhancing growth enablers: 1) More power to women – policy, execution, 2) Rural resurgence is a priority. Health and education would see increased allocation. 3) Public-infra standards (like UPI) in power, EV charging, telecom (6G) and renewables. 4) Increased focus on localisation in the supply chain – Defence, railways, electronics, communication, etc. 5) Last mile access of public utilities – power, water, roads, connectivity

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How does one play this?

Irrespective of markets, parameters like business model sustenance, business return profile, and medium-term cash flow growth are critical components of security selection. Well-defined risks, frequent monitoring and early flag-off for mitigation remain essential to avoid any accidents – particularly when global uncertainty is the only constant. While we remain in an uncertain world, India remains blessed with a few megatrends through this volatility. Some of the opportunities in plain sight are –

Digitisation: Government-induced, cross-sectoral, population-scale sachet size public owned facilitators, increased digital adaption in B2B, B2C, B2G, G2C, data networks

Financialisation: Increased compliance, faster digital adaption, emerging asset opportunities, and digital finance

Formalisation: Increased regulatory vigil and compliance, increased representation of formal economy at marketplace, consolidated industry structures

Premiumisation: Affordable aspiration, fashion, QSR, leisure, premium durables

Urbanisation: Real estate, urban infra, home improvement, durables/appliances

Manufacturing Renaissance: At-scale businesses, favourable policy incentives, China+1/Europe+1 opportunity spaces

Capex Recovery: Government infra, private company capex - at utilisations start reaching 70 percent+ thresholds



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