

*Embracing complexity to capture Alpha*

*Dear Investors,*

*The world is perhaps evolving more rapidly than we realize.*

*In America, there was a change in the presidency. The new President has been in office for less than two weeks now. The world has had an early inkling of policy changes that will affect the global movement of goods and labor.*

*Europe faces both political and economic uncertainties. Europe's biggest economic engine, Germany, experienced economic contraction for two successive years. Political uncertainty, too, is a factor since elections are due to be held in February this year. France has had political uncertainty due to developments in the wake of the snap elections called there. The United Kingdom had a change of government. After a long gap, the Labour Party came into office amidst fiscal pressures and a slowing economy. In general, Europe is facing competitiveness pressures amidst much higher energy costs caused, in part, by the transition towards renewable energy. To a large extent, these developments have affected the global economy.*

*The reopening of the Chinese economy after the Covid shutdown has not led to a spurt in economic growth rate as overcapacity and financial strains in the real estate sector have come to the fore. Due to weak aggregate demand, the economy is in deflationary mode. The absence of a significant policy stimulus to boost domestic consumption means excess capacity spills over into external markets. Chinese exports are thriving. China's trade surplus in 2024 was nearly one trillion US dollars.*

*Recent strength in the US dollar and rethinking in the Federal Reserve about the path of policy rates in America have caused emerging market currencies to weaken. Fiscal strains and low real rates relative to history have led to rapid erosion of value in some currencies compared to others. Borrowing costs for sovereigns are also rising as financial markets re-evaluate the outlook for inflation, policy rates and fiscal prudence.*

*Several stock markets worldwide are at elevated levels and do not appear unduly concerned about economic growth and earnings uncertainties. Nor have financial stability risks fazed investors even though serious concerns are re-emerging about securitization, leveraged loans, and private credit.*

*This is the global backdrop for India as it seeks to steady and sustain the growth momentum that the economy has experienced post-Covid. The passing of the era of rapid world trade growth clouds the outlook for India's export growth because, historically, India's export growth has been a high beta play on global export growth. This means domestic growth levers will be relatively more important than external ones in the coming years.*

*As European competitiveness decreases, the same can easily have been said for India. Most of the challenges cited in Europe apply to India, except that India is an aspiring nation, and the European continent has the cushion of a higher per capita income. Europe is, by and large, ageing, but India has a more youthful demographic profile. That is an advantage, but it comes with a huge responsibility.*



*India faces limitations in producing critical goods at the scale and quality required to serve the infrastructure and investment needs of an aspiring economy. The single-source concentration risk from China in several key inputs exposes India to potential supply chain disruptions, price fluctuations and currency risks. India's task is cut out. It means going all out to attract, promote and facilitate further domestic and foreign investments that India needs to become a competitive and innovative economy. It will not be easy because competition for investment is not only with other emerging economies but advanced economies, too, who are determined to keep their businesses at home. Equally, investing in and strengthening domestic supply-chain capability and resilience will be the hallmarks of strategic and long-term thinking on the part of the private sector. Alternative sources of supply, where possible, have to be located and nurtured, going beyond short-term cost considerations.*

*It will also require appropriate skilling and education for India's youth to take advantage of technological advances such as Artificial Intelligence, enabling its population to stay one step ahead of technological developments. That would minimise or even eliminate the potential adverse impact on employment and, if possible, turn it into a force for augmenting employment. It would require a departure from 'business as usual' for collaboration between academic institutions and businesses.*

*Achieving competitiveness will be an incomplete project without raising productivity in the primary sector. As we wrote in the Economic Survey 2023-24, the agriculture sector needs to be freed, empowered and emboldened to diversify away from water-dependent crops. Simultaneously, irrigation cover has to rise. Agricultural research will need a leg up. Much more can be done.*

*Above all, underpinning specific policy efforts will have to be the philosophical approach to governance. "Getting out of the way" and allowing businesses to focus on their core mission is a significant contribution that governments around the country can make to foster innovation and enhance competitiveness. But, 'get out of the way' and trust people, we must, for we have no other choice. 'Business as usual' carries a high risk of economic growth stagnation, if not economic stagnation. Yes, trust is a two-way street and the non-government actors in the economy have to vindicate the trust reposed.*

*The Indian economy is on a steady growth path. While a transitional slowdown is expected to persist for the next couple of quarters, the macroeconomic outlook appears strong in the long run. As the country aims to accelerate its economic growth rate in the coming years, it has the tailwind of strong balance sheets in the domestic corporate and financial sectors. But, globalisation is on the retreat. Hence, raising the growth average in the next two decades will require reaping the demographic dividend through a deregulation stimulus. As the Spartans apparently believed, "the more you sweat in peace, the less you bleed in war". India certainly has her work cut out.*

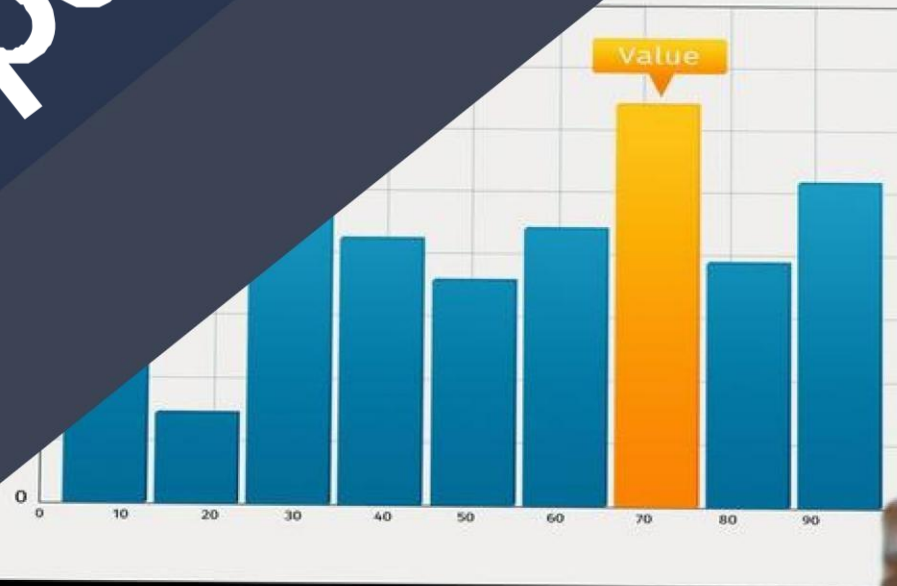
*That said, we look forward to partnering with you as we navigate this transformative chapter for both India and the global economy.*

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*Best regards,*

**Siddharth Jadeja**

# Investment Strategy Report





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KILIKA CAPITAL





# WHO WE ARE?



## ABOUT US

Kilika Capital is a research-driven investment firm specializing in **deep research** and analysis to identify high-quality financial products for sophisticated investors.

## OUR MISSION

At Kilika Capital, our sole mission is to **generate Alpha** for our investors.

## MEET OUR LEADERSHIP TEAM – THE DREAM TEAM!

At Kilika Capital, we believe that great businesses are built by exceptional people. Our team brings a mix of experience, precision, and creativity that sets us apart, but what truly defines us is our shared passion for delivering results.

### Siddharth Jadeja, CFA – The Strategist

Our managing partner, Siddharth Jadeja, is the calm, analytical anchor of Kilika Capital. A CFA charterholder and an MBA in finance, Siddharth comes with over 15 years of experience in a variety of roles ranging from credit risk, equity research, corporate banking, structured finance, and fund management at giants like HDFC Bank, Edelweiss Capital and Nuvama to name a few. He's been the brains behind countless deals, with the kind of market insights you'd bet on any day. Whether it's breaking down complex businesses or analysing sectors or structuring assets, Siddharth's expertise in credit and risk ensures our ship sails smoothly. Investors trust him, and so do we—his knack for turning numbers into actionable results thought rigorous analysis is *nothing short of magic*. Siddharth, a passionate sports enthusiast who has played cricket at the state level, brings the same unwavering discipline and never-give-up attitude to Kilika Capital.

### Smitha Iyer – The Operational Hawk

If you ever wonder who keeps our house in perfect order, meet Smitha Iyer, the head of operations and our very own perfectionist-in-chief. Chemical Engineer, an alumna of Welingkar Institute Of Business Management, Smitha is an MBA in finance with over 8 years of experience in giants like ICICI Prudential and Future Generali. She took a short break to embrace motherhood (shoutout to her little champ, Devamsh!) And returned with twice the tenacity. She hounds the AMCs, dots every *i*, and crosses every *t*—no document or process escapes her eagle eye. Sure, her insistence on perfection might leave you a little exasperated, but when you realize that clean operations mean safety, you'll be grateful she's on your side.

### Piyush Sharma – The Creative Wizard

Meet Piyush Sharma, our research lead and the youngest brain in the room—but don't let that fool you. Armed with an MBA and a flair for creativity, Piyush lives and breathes financial models. Whether it's running a Monte Carlo simulation, dissecting a mutual fund, creating a portfolio company DCF model, or rethinking how investor portfolios are structured, he's always cooking up something extraordinary. Watching Piyush and Siddharth brainstorm together is like watching a symphony of numbers—a mix of youthful enthusiasm and seasoned experience. For Piyush, Kilika Capital isn't just a job; it's a playground for pushing the boundaries of quantitative finance, a platform to challenge conventions, explore new paradigms, and redefine what's possible in a financial model. Who says spreadsheets can't be fun?

Together, we're not just a team; we're partners in your financial journey. We bring experience, attention to detail, and a touch of creative flair to everything we do. Whether it's operations, research, or strategy, rest assured—we've got your back. After all, when we win, you win. And we're in it for the long run.

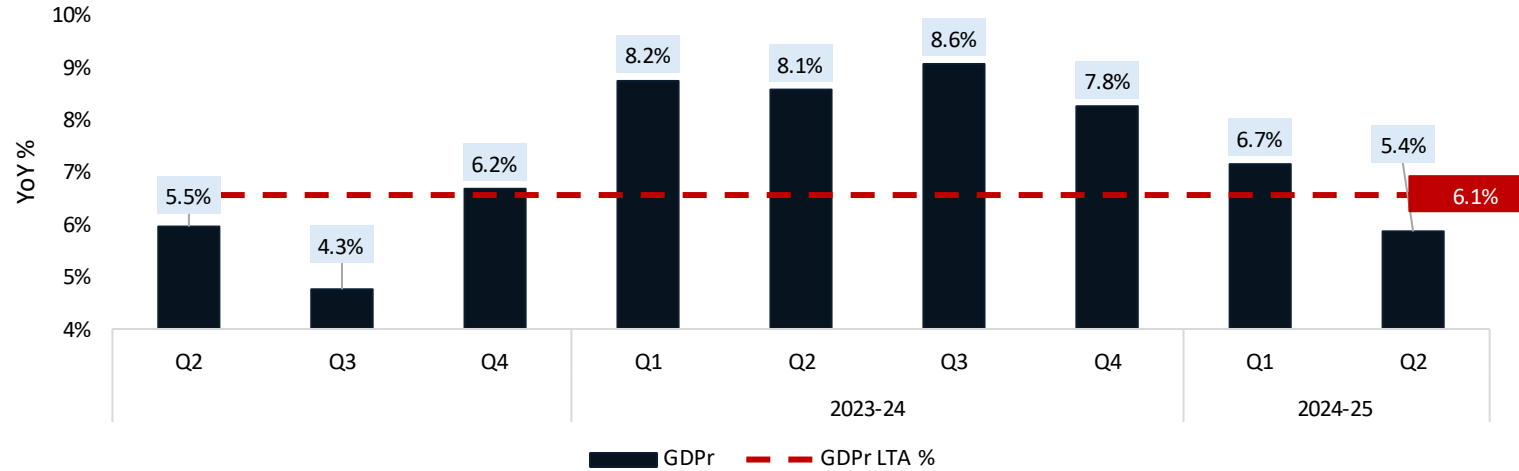
# Macro-Economic Outlook



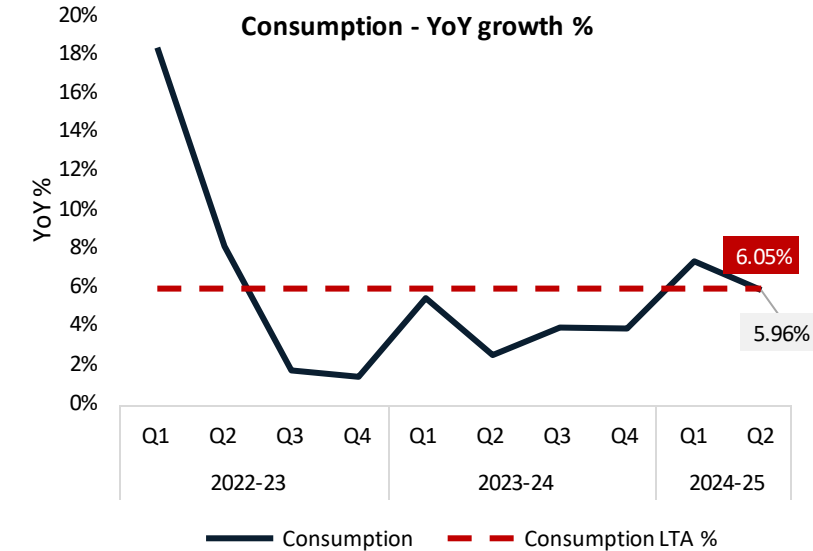
# 1. GDP (Gross Domestic Product)



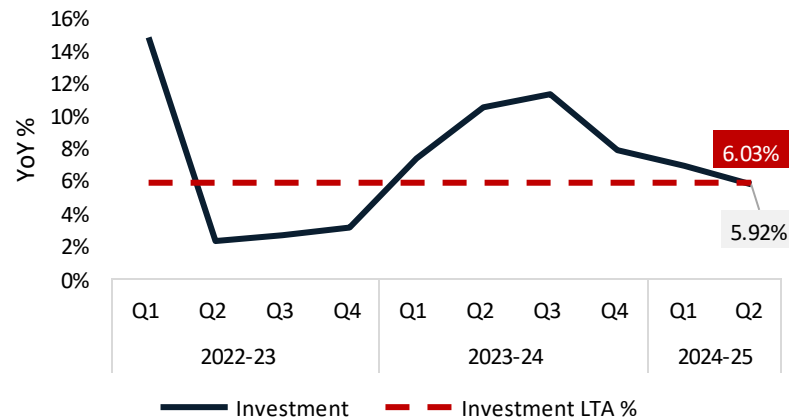
Real GDP



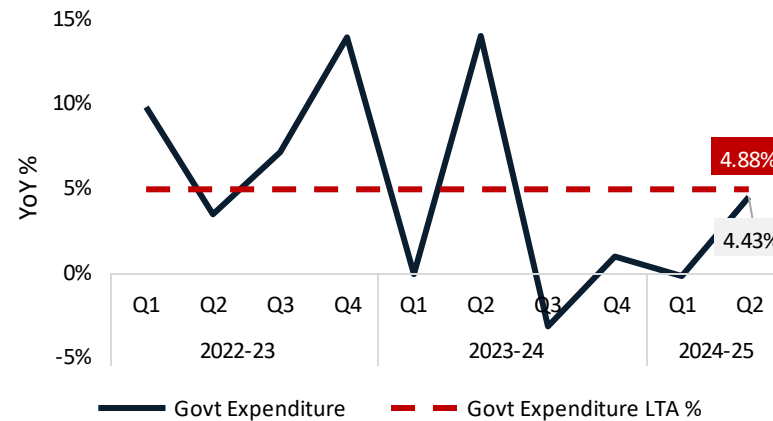
Consumption - YoY growth %



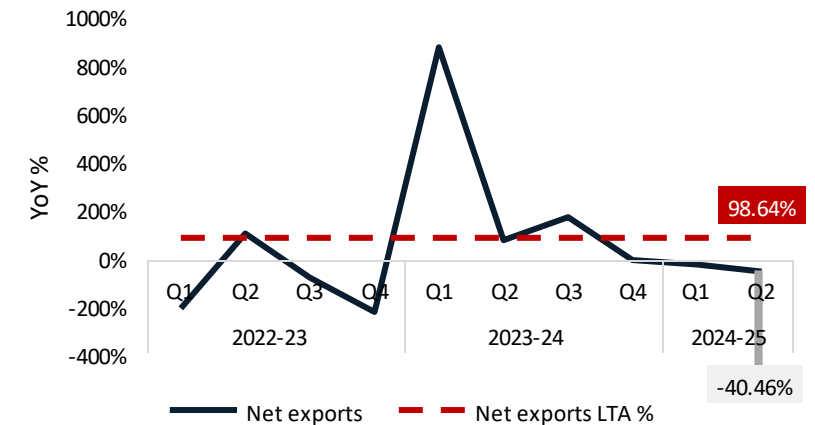
Investment - YoY growth %



Government Expenditure - YoY growth %



Net Exports - YoY growth %





## **Slowdown – Transitional or Structural?**

From the angle of **Aggregate Demand** in the economy, India's GDP at constant (2011-12) prices grew by 6.7% and 5.4% in Q1 and Q2 FY25, respectively. This implied a **real GDP growth of 6.0% in the first half of the current fiscal**.

### **Consumption**

- Private Final Consumption Expenditure (PFCE) firmed up in **H1 FY25, growing by 6.7% YoY**. Indicators such as **2-wheeler and 3-wheeler sales** and **tractor sales** signal that **rural demand** contributed to private consumption growth. This is also reflected in the January 2025 round of National Bank for Agriculture and Rural Development (NABARD's) Rural Economic Conditions and Sentiments Survey, where **78.5% of rural households reported an increase in their consumption expenditure during the last year**. The impulse from rural demand is **expected to continue in the second half of the fiscal year** with the returns from a **bumper Kharif crop** and **higher MSPs** for a **prospectively good Rabi crop**.
- On the other hand, indicators of **urban demand presented mixed trends**. According to data from the Federation of Automobile Dealers Associations (FADA), the **growth of passenger vehicle sales has slowed to 4.2 per YoY cent in April – November 2024** compared to 9.2% in the corresponding period of the previous year. **Fast-moving consumer goods (FMCG) sales in urban areas, as per Nielsen IQ, have recorded a moderate growth in H1FY25**. However, there is **steady growth of 7.7% YoY in air passenger traffic in April – November 2024**. The 7.3% YoY growth indicated by the First Advance Estimates for PFCE at constant prices for FY25 indicates a pick-up in the most recent months.

### **Private and Government Investment**

- The moderation in real GDP growth can be traced to a **softening of growth in Gross Fixed Capital Formation (GFCF) from 10.1% in H1 FY24 to 6.4% in H1 FY25**. Q1 FY25 witnessed a slowdown in capital expenditure across different levels of government on account of the **conduct of the general elections**.
- **Private sector investment growth may have remained subdued thus far in FY25 on account of the domestic political timetable, global uncertainties and overcapacities**.

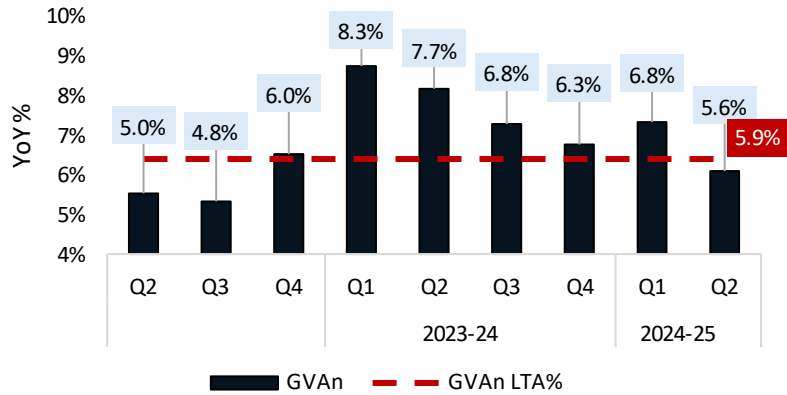
### **Net Exports**

- On the external front, **exports of goods and non-factor services at constant prices increased by 5.6% in H1 FY25, while imports increased by 0.7%**. In Q2 FY25, imports of goods and services at constant prices contracted by 2.9%, primarily driven by a **decline in commodity prices**. As a result, **net exports contributed positively to real GDP growth** in this period.

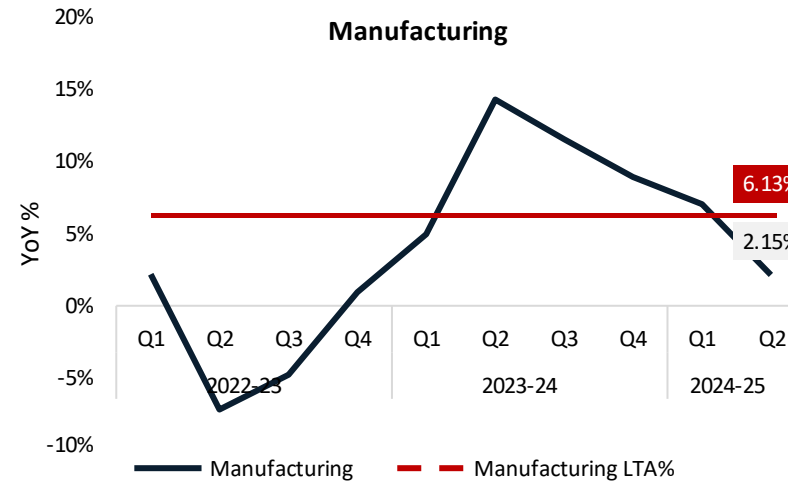
# GVA (Gross Value Added)



## Real GVA



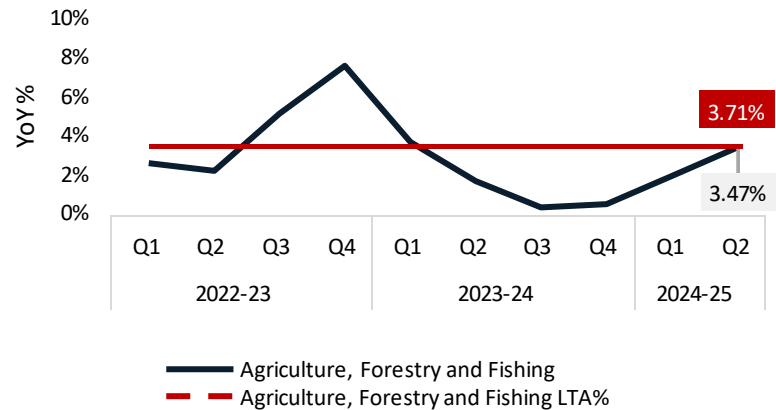
## Manufacturing



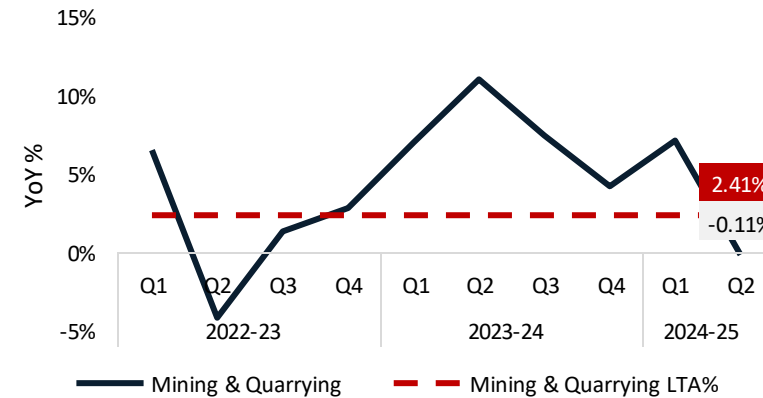
## Finance, Real Estate, Services



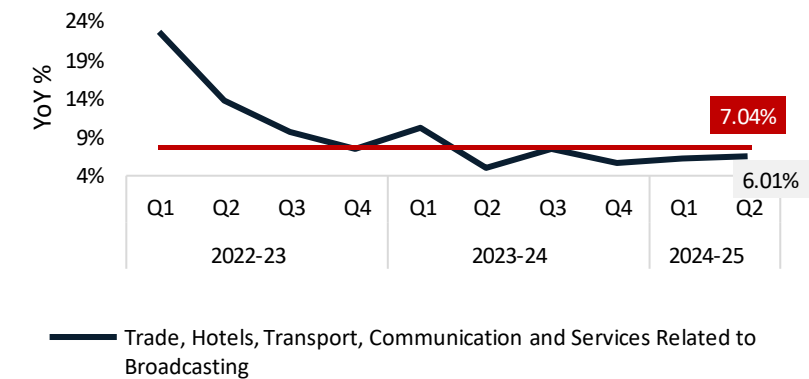
## Agriculture



## Mining



## Trade, Hotels, Transport, Communication and Services Related to Broadcasting





On the Supply side, the real GVA grew by 6.2% in H1 FY25. A strong growth momentum in Q1 FY25 was followed by a subdued performance in Q2 FY25.

### Agriculture

Agriculture growth remained steady in H1 FY25, with Q2 recording a growth rate of 3.5%, marking an improvement over the previous four quarters. **Healthy Kharif production, above-normal monsoons, and an adequate reservoir levels** supported agricultural growth. As per the first advanced estimates of agricultural production for 2024-25, total Kharif food grain production is estimated at a record 1647.05 lakh metric tonnes (LMT), higher by 5.7% compared to 2023-24 and 8.2% higher than the average food grain production in the past five years. The estimated increase is mainly on account of the rise in rice, maize, coarse grains and oilseeds output. **A normal southwest monsoon in 2024 has improved the water levels in reservoirs, ensuring sufficient water for irrigation during the rabi crop production.** As of 10 January 2025, rabi sowing of wheat and gram was 1.4% and 0.8% higher, respectively, compared to the previous year. **Improved agricultural prospects also bode well for softening of food inflation pressures over the course of the year.**

### Industrials

The industrial sector grew by 6% in H1 FY25. Q1 saw a strong growth of 8.3%, but **growth moderated in Q2 due to three key factors.** First, **manufacturing exports slowed significantly due to weak demand from destination countries, and aggressive trade and industrial policies in major trading nations.** Second, **the above average monsoon had mixed effects - while it replenished reservoirs and supported agriculture, it also disrupted sectors like mining, construction, and, to some extent, manufacturing.** Third, **the variation in the timing of festivities between September and October in the previous and current years led to a modest growth slowdown in Q2 FY25.**

**Oil companies suffered due to inventory losses and lower refining margins, while steel companies faced price pressures and lower global prices. The cement sector faced weak demand in Q2 due to heavy rains and lower selling prices. However, with the conclusion of the monsoon season and the expected pick-up in government capital expenditure, sectors such as cement, iron, and steel are expected to see a recovery. Further, mining and electricity are expected to normalise after the monsoon-related disruptions.**

### Services

The services sector continues to perform well in FY25. A **notable growth in Q1 and Q2 resulted in 7.1% growth in H1 FY25.** Across sub-categories, all the sub-sectors have performed well. The robust performance of the services sector is also reflected in high-frequency indicators (HFIs). PMI services have been in an expansionary zone during H1 FY25, supported by growth in new orders, rise in output, improvement in sales and enhanced employment generation. The hospitality sector performed well, with hotel occupancy rates in H1 FY25 similar to the previous year. Average daily rates and revenue per room increased due to higher corporate and leisure travel. Air cargo activity grew in double digits, while port traffic remained stable. Information Technology (IT) companies also performed better than the previous quarter.

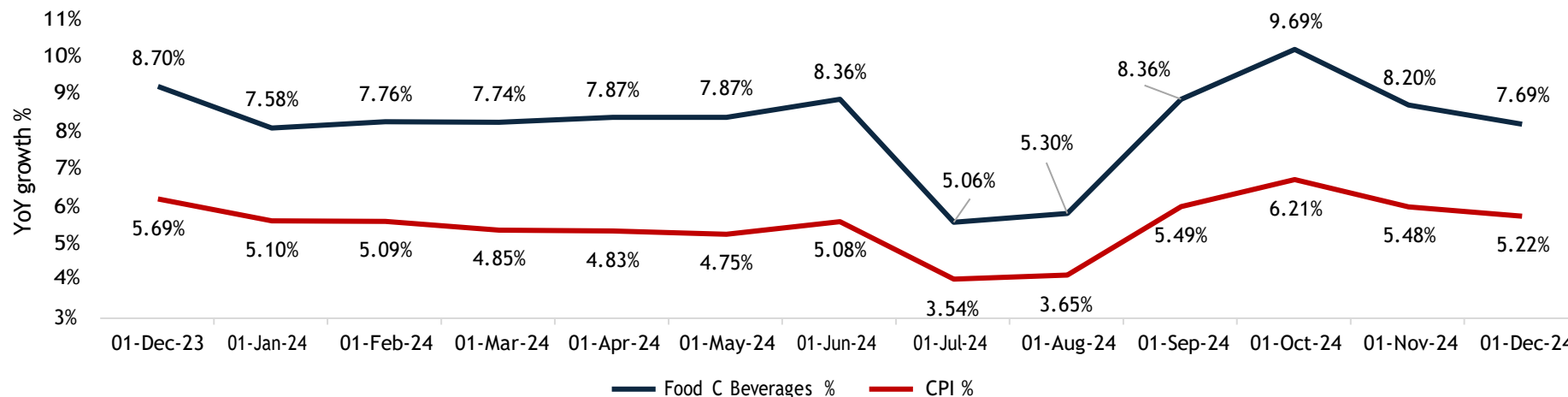
### Outlook

**The rural economy continues to show resilience, while urban consumption remains sluggish, with a recovery expected around Q2 FY 2025-26. However, global tariff movements will be a key determinant, making it a wait-and-watch scenario for now.** As per the first advance estimates released by the National Statistical Office, Ministry of Statistics & Programme Implementation (MoSPI), the **real gross domestic product (GDP) growth for FY25 and FY26 is estimated to be 6.4% and 7.1% respectively.**

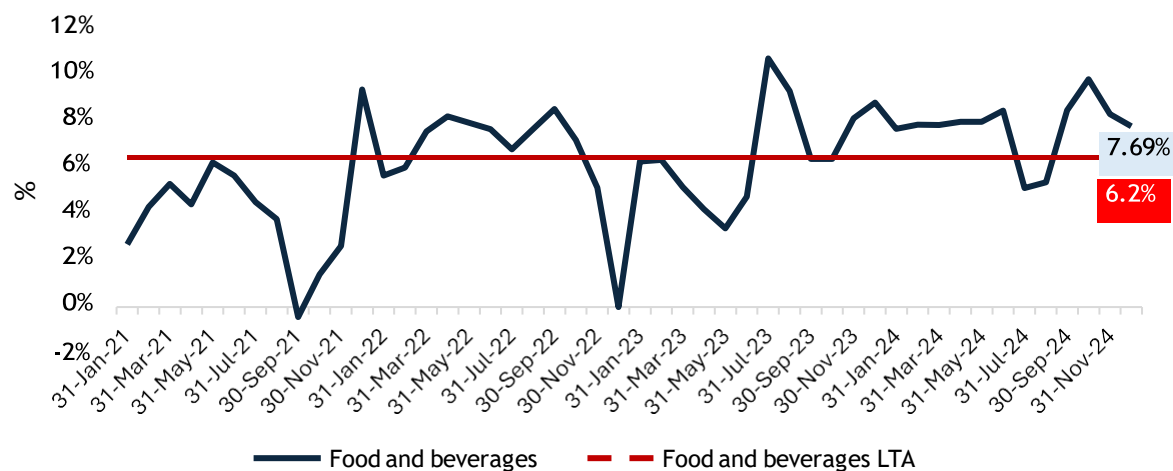
# 2. Inflation



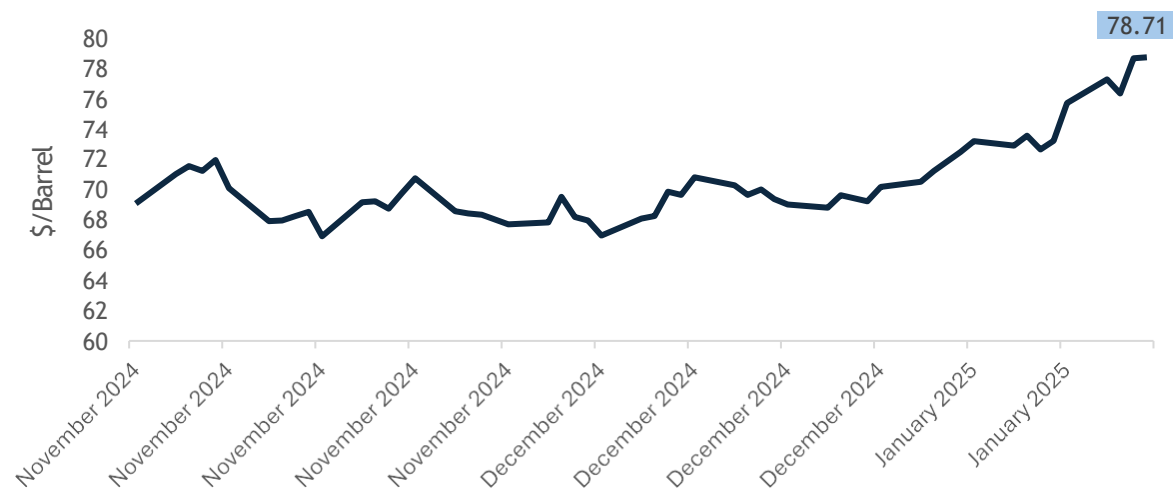
## Headline CPI and Food and Beverages Inflation



## Food s Beverages YoY %



## Crude Oil Price





## Monetary Policy at a Crossroads: Balancing Inflation Risks and an Economic Slowdown

### Inflation Overview - CPI (Consumer Price Index)

- **Retail inflation (CPI) growth rate fell to 5.22% YoY in December 2024** (from 5.5% in November and 6.2% in October), marking a 4-month low.
- **Food inflation eased to 7.69%**, with sharp reductions in vegetable prices (-26.6% MoM) led by onions, tomatoes, and potatoes.
- **Core inflation remained steady at 3.6%**, signaling stability in non-food, non-fuel categories like transport, healthcare and education.

### Food Inflation Trends

- **Vegetable prices fell sharply (-26.6%)**, bringing relief to households.
- However, **Edible oils surged by 14.6%**, reaching a 32-month high due to **global supply disruptions and high import duties**, and Milk and Meat prices saw moderate increases, reflecting sustained demand pressures.

### Food Inflation Outlook

- **Positive prospects with Rabi sowing up 0.5% YoY and strong Kharif production supported by healthy reservoir levels**, are expected to ease food inflation further in the coming months.

### Impact of Rupee Depreciation

- Since the start of the financial year, the **rupee has depreciated by approximately 4% against the dollar**, primarily due to significant FPI outflows on account of global tariff uncertainties. This **depreciation could make imported goods costlier, potentially driving up headline inflation in the coming months**. Adding to the mix, the RBI now has a new governor at the helm. It will be interesting to see his policy adoption pertaining to the central banks intervention in the forex markets.

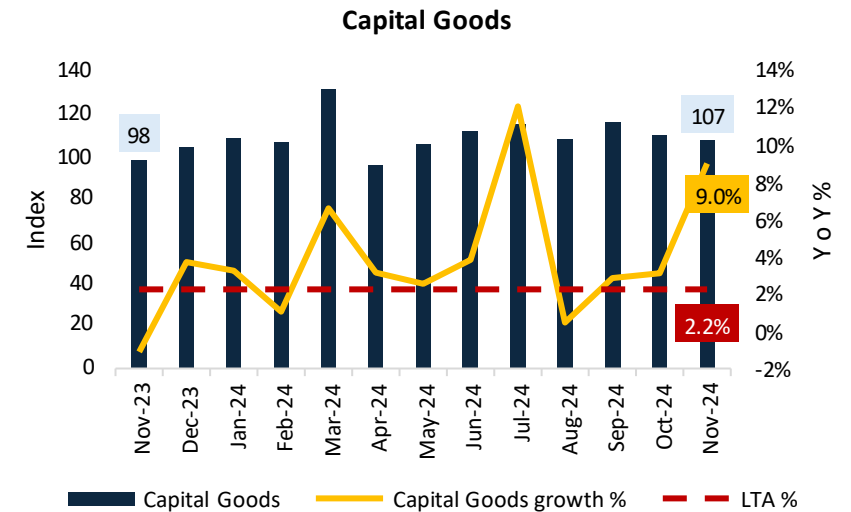
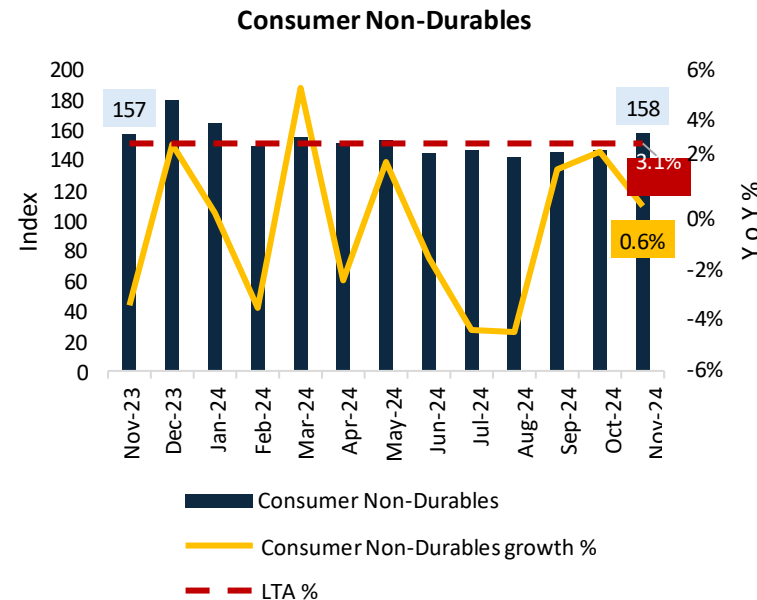
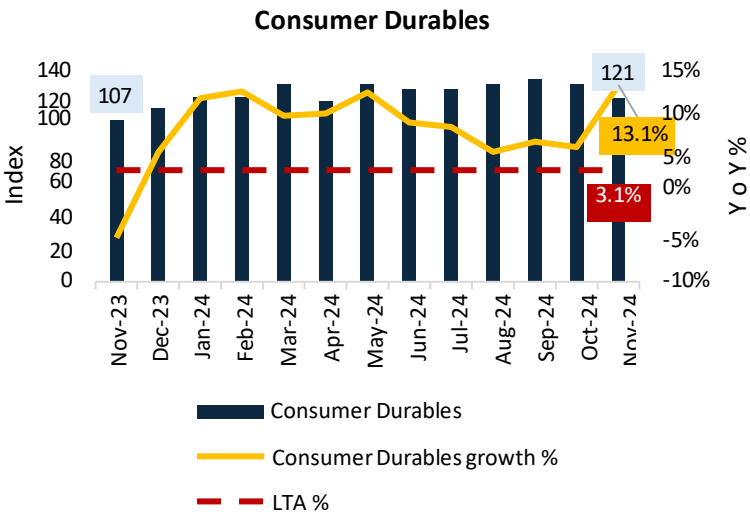
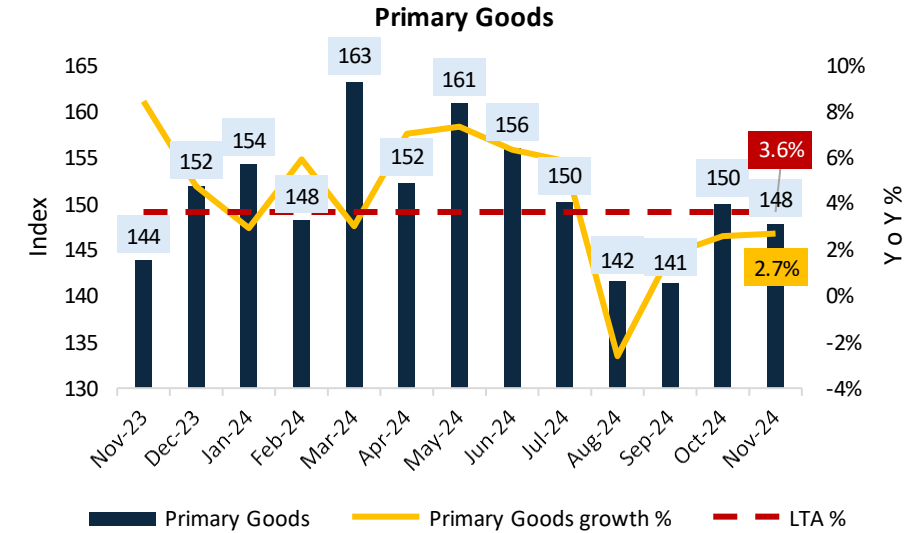
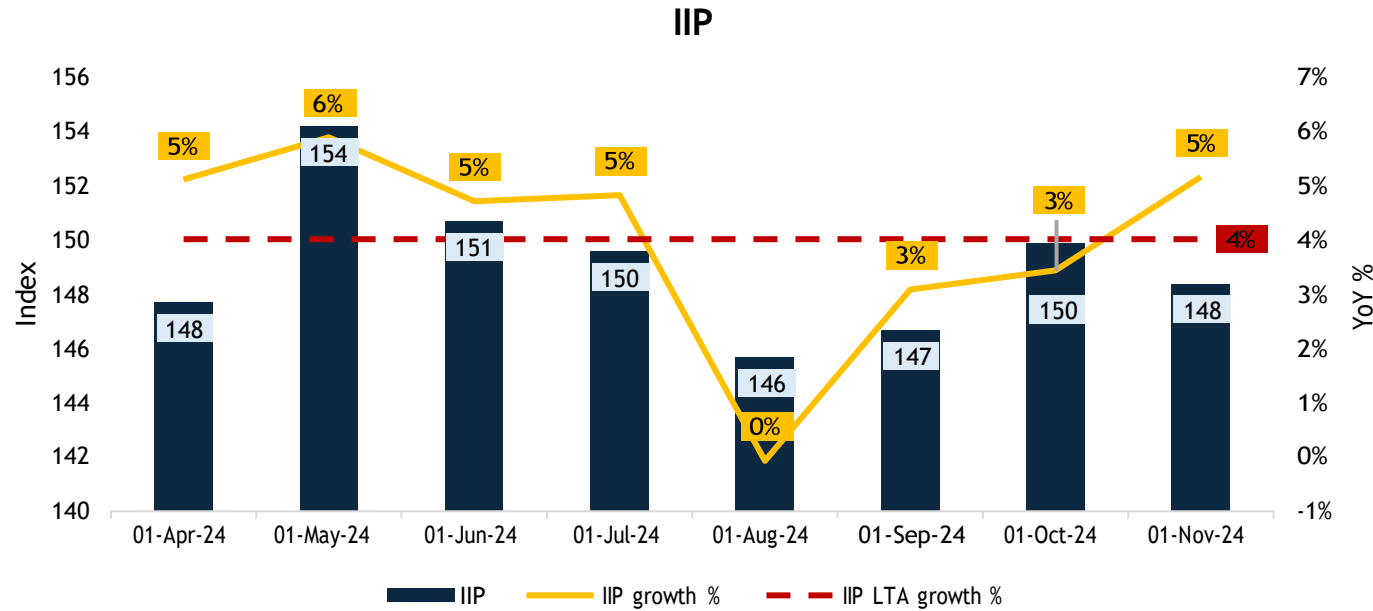
### Trade Tariffs, Sanctions & Oil Price Risk

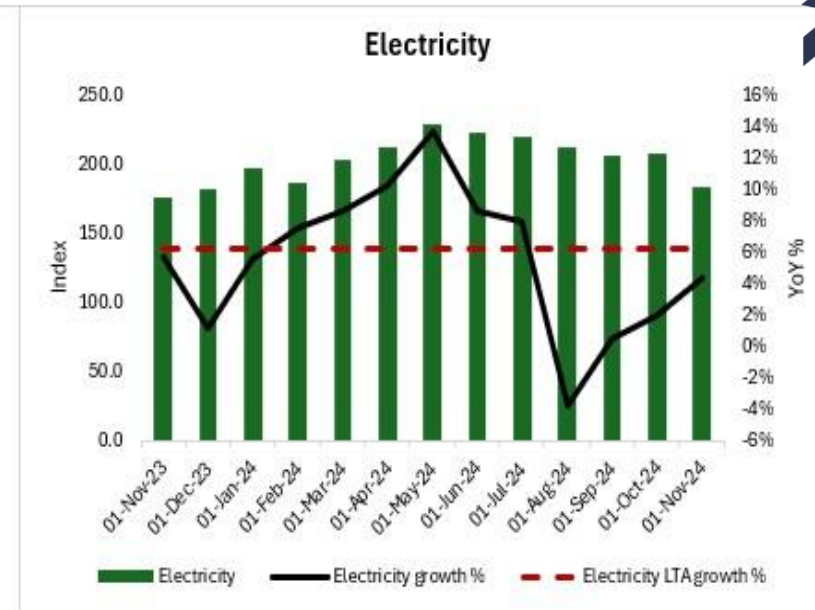
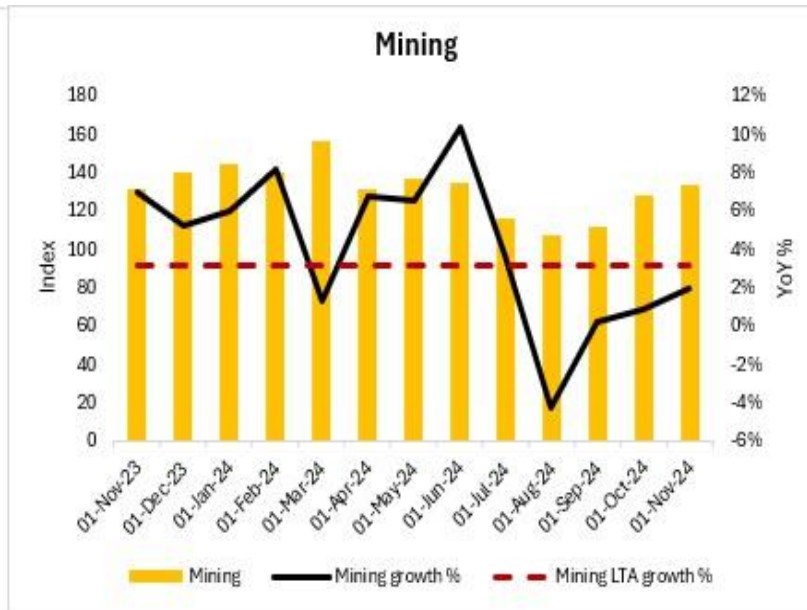
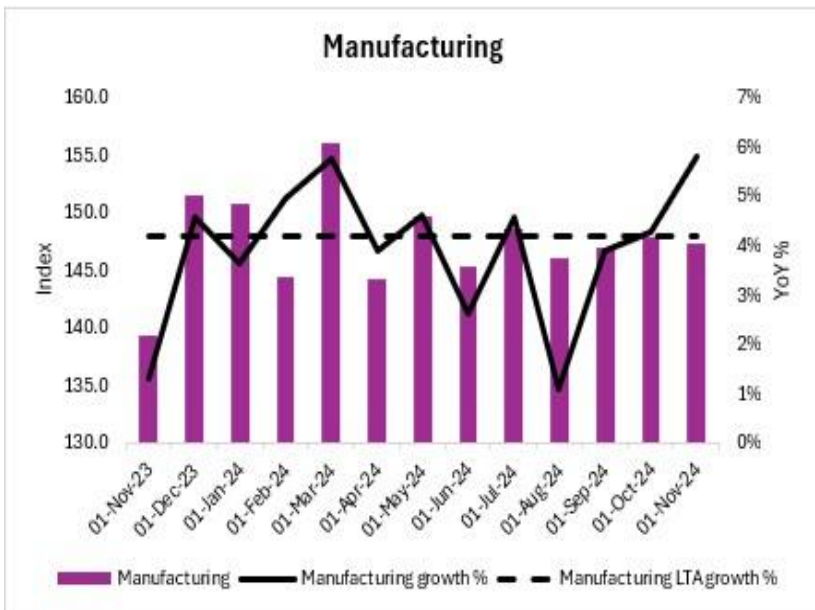
- **Oil prices climbed about 2% to a four-month high of ~80 \$/barrel**, on expectations that wider US sanctions on Russian oil would force buyers in India and China to seek other suppliers. High Oil prices could increase import costs and put pressure on inflation going forward.

### Outlook

- **The risk of rising imported inflation due to a depreciating rupee, together with potential imposition of U.S. tariffs and sanctions**, poses an upside risk to inflation, supporting the case for keeping rates unchanged. However, **weak consumption spending, particularly in urban India, and sluggish private capex** are key factors driving the economic slowdown, strengthening the argument for a rate cut to stimulate growth.
- The RBI has projected that India's CPI will progressively align towards the inflation target in FY26. In the December 2024 RBI's Monetary Policy Committee report revised its inflation projection from 4.5% to **4.8% in FY25**. Assuming a normal monsoon and no further external or policy shocks, the RBI expects headline inflation to be **4.2% in FY26**.
- The primary objective of monetary policy is to maintain price stability while also considering the goal of economic growth, as stable prices are essential for sustainable growth. **The RBI faces a challenging decision in balancing the risk of rising future inflation against a slowing economy. In the Feb 2025 meet the MPC unanimously voted to continue with the neutral monetary policy stance and remain unambiguously focussed on a durable alignment of inflation with the target, while supporting growth thereby cutting the policy Repo rate by 25bps to 6.25%.**

# 3. IIP (Index of Industrial Production)





## IIP on the Decline - Temporary or Structural?

### Industry-based IIP

- India's Index of Industrial Production (IIP) growth reached a **six-month high of 5.2% YoY in November 2024**, up from 3.66% YoY in October.
- The surge was primarily driven by growth in **manufacturing output**.
- Sectoral Contribution:
  - ❖ **Manufacturing:** Accounts for 78% of IIP, **grew 5.8% YoY** in Nov 2024 vs 1.3% YoY in Nov 2023
  - ❖ **Mining:** Contributes 14%, **grew 1.9% YoY** in Nov 2024 vs 7.0% YoY in Nov 2023
  - ❖ **Electricity:** Makes up 8%, **grew 4.4%** in Nov 2024 vs 5.8% YoY in Nov 2023.

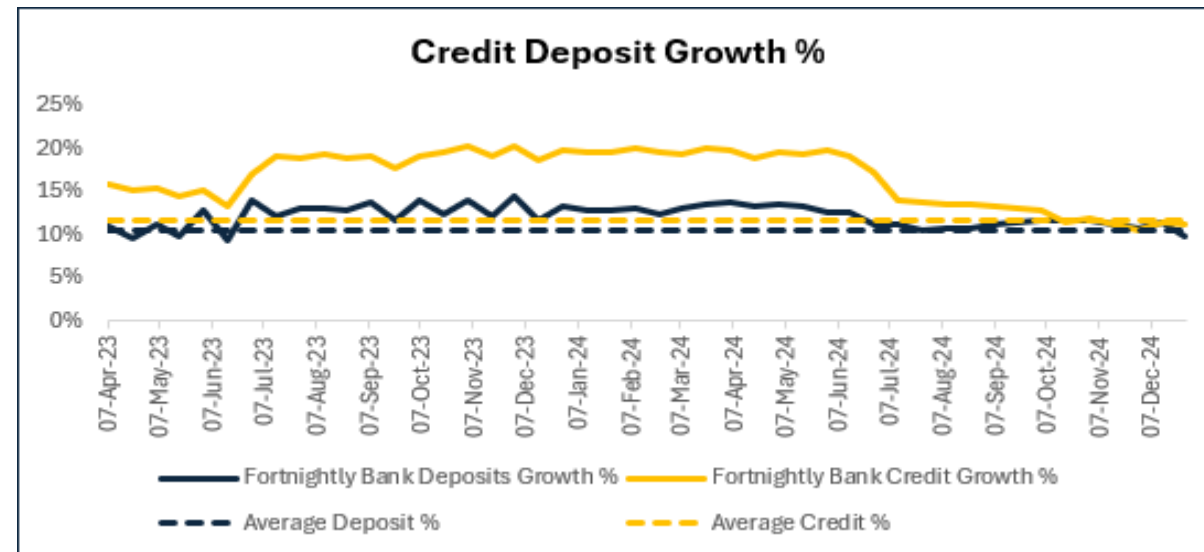
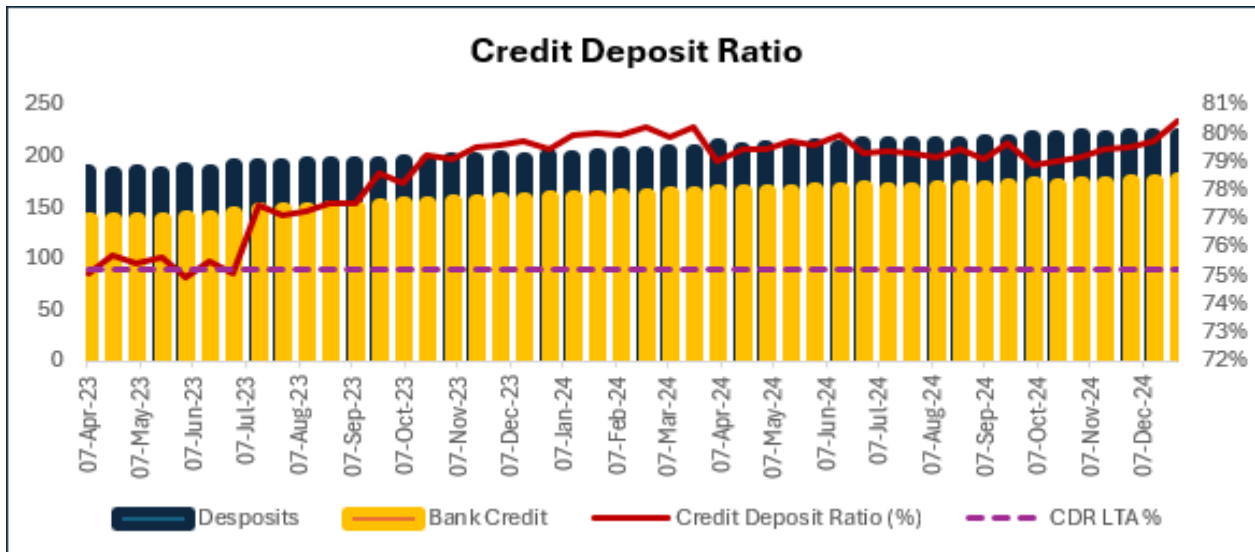
### Usage-based IIP

- In the Use-based categories, **growth was led by Consumer Durables (13.1% YoY) segment**, followed by Infrastructure (10% YoY), Capital Goods (9% YoY), Intermediate Goods (5% YoY), and Primary Goods (2.7% YoY). However, growth in the Consumer Non-Durables (0.6% YoY) segment decelerated during the month.
- Consumption-related components within the IIP exhibited mixed signals as output of **Consumer Durables witnessed a strong growth propped up by a supportive base**. However, **deceleration in growth of Consumer Non-durables output pointed towards some concern**. Given that there are signs of improvement in rural demand, the performance of consumer non-durables output remains a key monitorable going ahead.

### Outlook on IIP

- Overall, despite the November rebound, April-November, IIP growth stood at 4.1%, lower than the 6.5% recorded during the same period last year. Although IIP has been on an increasing trend since September 2024, it will be too early to term it as industrial demand revival as the uptick in Consumer Durables may have been due to the festive demand and some discretionary spending. Given the base effects related to the shifting festive dates, an average growth over Oct-Nov tends to provide a better gauge of the underlying momentum. By this yardstick, **overall industrial growth was modest (4.4% YoY in Nov 2024 vs 7.2% YoY in Nov 2023), driven by Consumer Durables on account of increased consumption during the festive season and Infra/Construction Goods driven by an increase in government capex spending, with a distinctly lacklustre performance of Primary Goods and Consumer Non-durables**.

# 4. Capex



## The Capex cycle and the Multiplier effect

### MSME Loans: Addressing Challenges and Policy Gaps

- The MSME sector, a vital pillar of India's economy, has faced funding challenges due to restrictive policies. **Loans to NBFCs for on-lending to MSMEs have been excluded from priority sector lending (PSL) classification, impacting NBFCs' ability to support MSE's.** Due to this policy change, many NBFC's that were helping MSEs with their day-to-day working capital requirements have faced financial strain due to the stoppage of funds from banks. Although the RBI reinstated PSL classification for loans up to ₹20 lakh per borrower, industry bodies have urged raising this limit to ₹1 crore to align with working capital needs. Policy adjustments to ease funding constraints for NBFCs could enhance credit flow to this essential sector clearly seems to be the need of the hour.

### Credit vs Deposit Growth: Emerging Trends

- In the second half of calendar year 2024 (H2 CY2024), **aggregate bank credit growth has moderated more sharply than the pace at which bank deposits have expanded.** A sectoral breakdown shows a **pronounced deceleration in credit off-take within the services sector, which has been trending downward over the last six to seven months.** By contrast, **credit extended to the industrial sector remains above its long-term average (LTA) and is on an upward trajectory.** However, within this segment, **credit to Micro, Small & Medium Enterprises (MSMEs)—which accounts for roughly 30% of total industrial credit—continues to trail its respective LTA.** On the retail front, **personal loans remain broadly below their long-term growth norms.**
- Specifically, **credit card outstanding (5% of personal loans), housing loans (51%), vehicle loans (11%), and other personal loans (26%)—which together make up approximately 93% of the personal loan book—are all expanding at rates below their respective LTA's.** Meanwhile, **credit flow to the agricultural sector (including rural financing) has been relatively flat since April 2023.** Overall, the divergence between moderating credit growth and relatively subdued deposit growth underscores a cautious lending environment.
- Bank lending outpaced deposit growth at the start of Q4 FY25, with credit rising 11.5% YoY as of January 10, 2025, compared to 10.8% growth in deposits. Aggregate deposits reached ₹221.5 lakh crore, while total credit stood at ₹178 lakh crore, resulting in a **Credit-to-Deposit Ratio (CDR) of 80.4%, up from 79.5% a year ago.**
- This slowdown in credit growth, previously over 20%, stems from a **higher base effect, stricter RBI measures** (e.g., higher risk weights for NBFCs and cautious lending stance to the unsecured sector), and **regulatory concerns over elevated CDR levels.** Banks are reducing exposure to unsecured loans and NBFCs while raising deposit rates to attract funds.
- Additionally, **households are increasingly shifting savings toward capital market assets, impacting deposit growth and raising funding costs for banks.** These trends underscore evolving dynamics in India's banking sector, balancing credit demand and deposit mobilization.

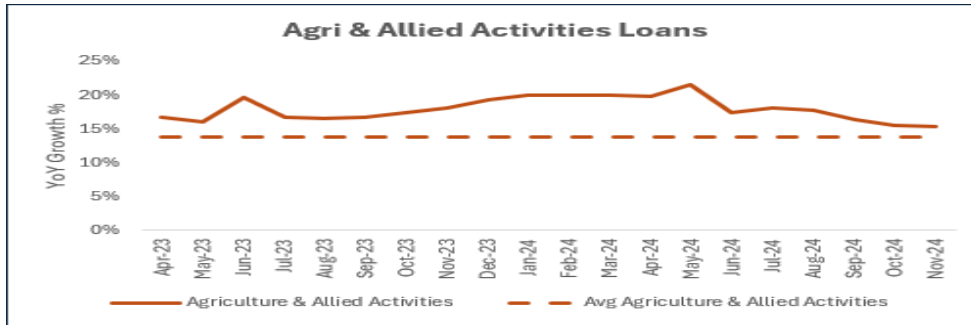
### QIPs hit a record high in 2024

- QIPs allow companies already listed on stock exchanges to raise funds from domestic markets to finance key projects. But even as **fundraising via QIPs reached record levels in 2024,** private capital expenditure remained sluggish, forcing the government to spend huge amounts, especially on infrastructure.
- As of 28 December, **Indian companies had raised 1,37,560 crore (11.4% of the capital raised) across 95 QIPs in CY 2024,** as compared to ₹54,350 crore from 45 issues a year earlier.
- Fundraising through **QIPs is likely to continue in the current year,** mainly driven by **frothy valuations, tight money supply in the credit markets, and strong investor interest in the equity markets.**

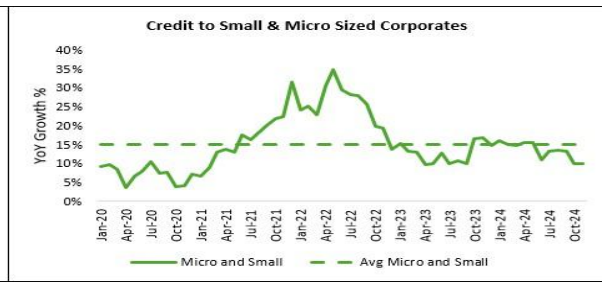
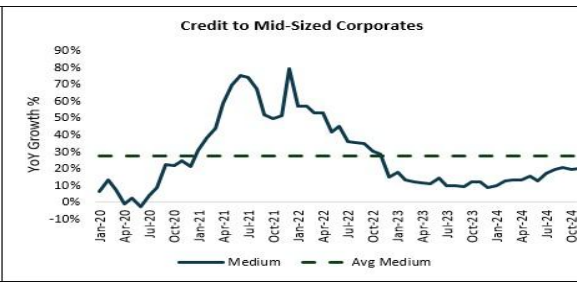
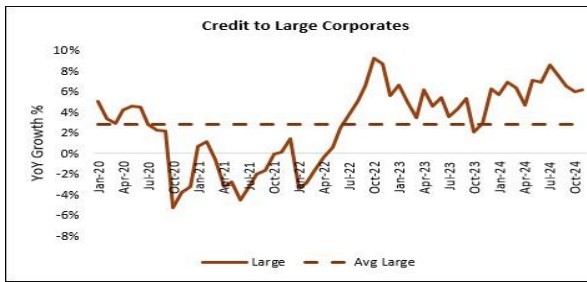
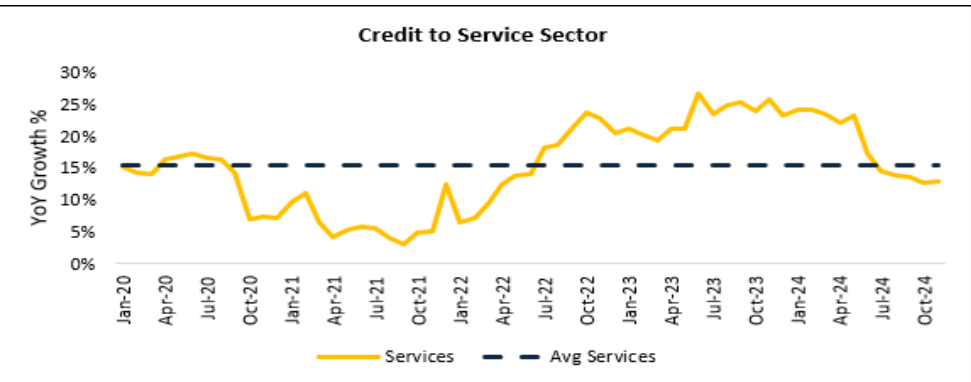
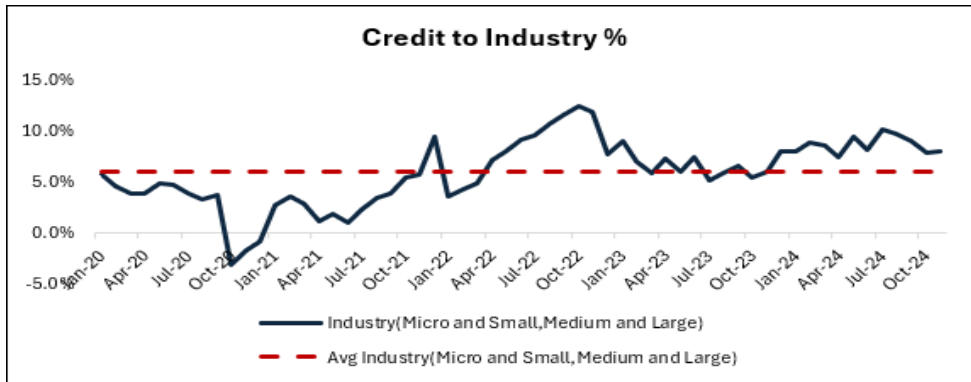
## Credit to Consumer



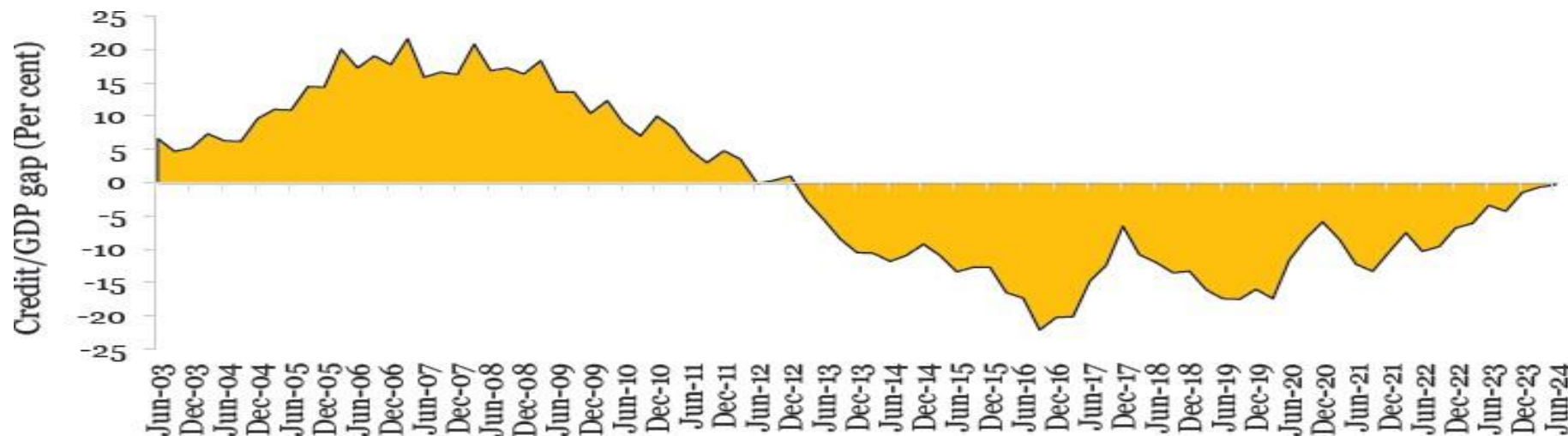
## Credit to Agri



## Credit to Industry



## Credit-GDP<sub>n</sub> Gap

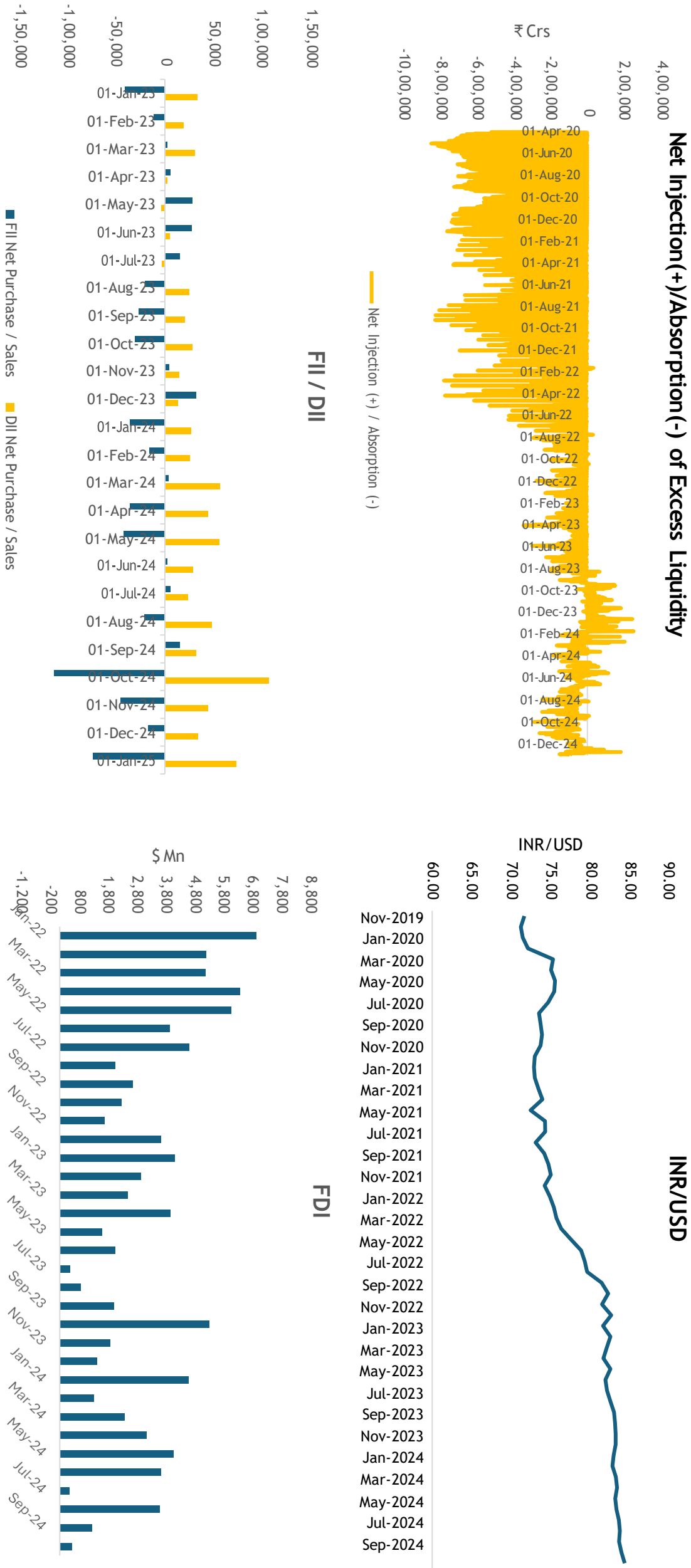


Source: Bank of International Settlements (BIS)

### Credit/GDP ratio:

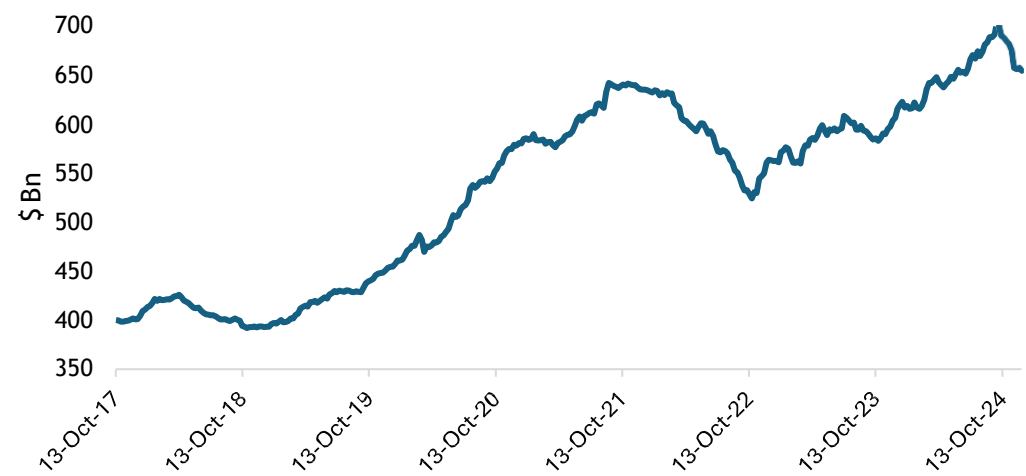
- The credit/GDP ratio is a good statistic to evaluate where an economy stands in the financial cycle. If the ratio is significantly greater than its trend value, it may indicate a build-up of stress in the lending sector. On the other hand, if the ratio is lower compared to its trend, it indicates ample room for growth. In the case of India, there was a **positive credit/GDP gap (i.e., the difference between the credit-GDP ratio and its long-term trend) between 2006 and 2012, indicating excessive credit growth**. This also coincided with the **investment boom over that period. A bust followed this in the credit cycle; higher NPAs impaired the banking sector's lending ability, leading to a significant slowdown in credit growth**.
- After tiding over this situation and the recovery from the COVID-19 pandemic, an upward trend in the credit/GDP ratio is observed, with the gap steadily closing. **With credit growth outpacing nominal GDP growth for two successive years, the credit-GDP gap narrowed to (-) 0.3% in Q1 of FY25 from (-) 10.3% in Q1 of FY23**.
- Therefore, despite the double-digit growth in bank credit post-April 2022, the credit-to-GDP ratio is below the trend line, indicating that the recent growth in bank credit is sustainable.
- These emerging trends mark the dawn of a new era for India's financial sector. However, they also bring regulatory challenges and potential risks that cannot be overlooked. One critical risk to guard against is the **dominance of financial markets in shaping policy and macroeconomic outcomes**, a phenomenon known as '**financialisation**'. The consequences of financialisation are evident in advanced economies, where it has led to **unprecedented levels of public and private sector debt** — some visible to regulators and some not. **Economic growth in such contexts becomes overly reliant on rising asset prices to offset leverage, exacerbating inequality and asset market considerations that may overly influence public policies, particularly regulatory ones**. As India strives to align its financial system with its economic aspirations for 2047, she should **strive to maintain the fine balance between financial sector development and growth on the one hand and financialisation on the other**. It means that the country has to chart its path with respect to its context, considering the levels of financial savings in households, its investment needs, and levels of financial literacy. Ensuring that incentives in the sector are consistent with national growth aspirations is a policy imperative.

# 5. Liquidity

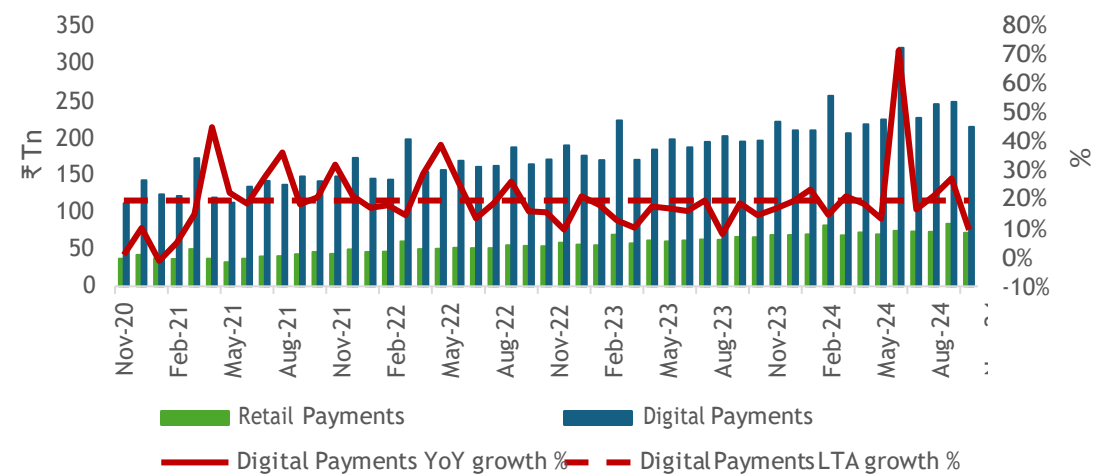




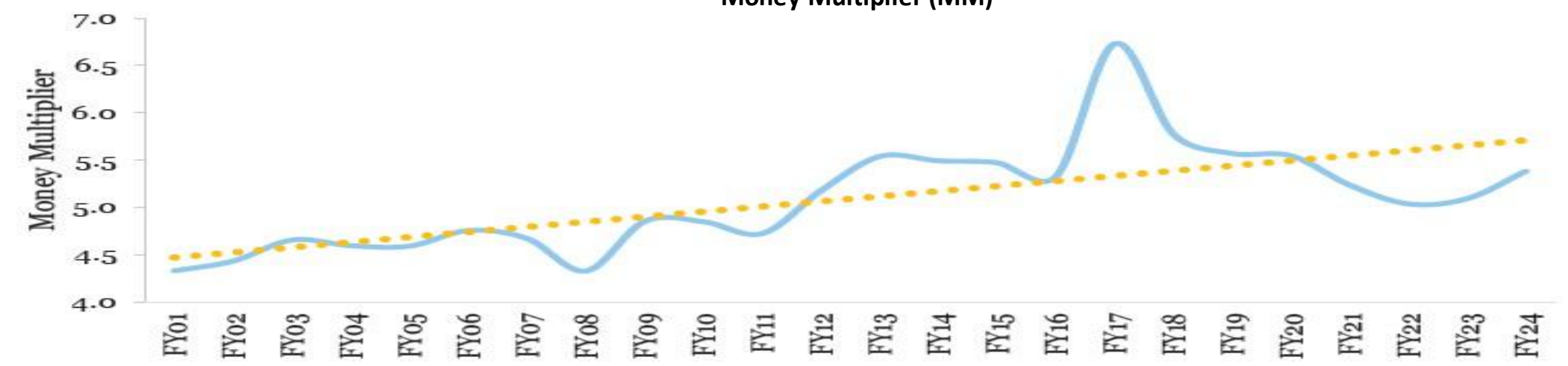
Foreign Exchange Reserves (USD Bn)



Payments



Money Multiplier (MM)





## Setting the Context: Understanding India's Liquidity Crunch: Causes, Impact, And Solutions

It's a regular workday morning. You visit a bank to withdraw cash, only to find that it's struggling to fulfill large withdrawals. Or perhaps, as a business owner, you seek a loan but encounter tight funding conditions and elevated borrowing costs. These are clear indicators of a liquidity crunch—when the financial system faces a shortage of readily available cash.

India is currently experiencing one of its most severe liquidity shortages in over a decade.

### The Role of Liquidity in Banking:

Liquidity is the cornerstone of banking operations, enabling financial institutions to lend, process transactions, and meet withdrawal demands. Banks typically manage liquidity through four key mechanisms:

- **Maintaining Cash Reserves:** Banks hold a portion of deposits as cash to address sudden withdrawal spikes.
- **Investing in Liquid Assets:** Some funds are allocated to easily accessible investments, such as government securities, which can be quickly converted to cash.
- **Interbank Borrowing:** If liquidity falls short, banks borrow from each other in the interbank market at the repo rate set by the Reserve Bank of India (RBI).
- **RBI Borrowing via the MSF:** If interbank liquidity is insufficient, banks access funds through the RBI's Marginal Standing Facility (MSF), which carries a slightly higher rate than the repo rate.

When liquidity contracts, banks reduce lending and raise interest rates to attract deposits, making credit less accessible and increasing economic uncertainty.

### The Current Liquidity Deficit:

India's daily interbank liquidity deficit has surged from approximately ₹1 lakh crore in early January to over ₹3 lakh crore—the most severe shortfall since 2010. But what has triggered this sharp liquidity crunch?

### Key Factors Draining Liquidity:

- **RBI's Forex Market Interventions:** To stabilize the rupee, the RBI has been actively selling US dollars, reducing forex reserves from \$700 billion in October to \$623 billion by mid-January. This effort to curb rupee depreciation has also withdrawn a significant amount of liquidity from the financial system.
- **Government's "Just-in-Time" Payments Model:** The government has shifted from advance fund transfers to a need-based disbursement model, leaving substantial cash locked in government accounts rather than circulating in the banking system.
- **HDFC-HDFC Bank Merger:** The merger's impact on loan maturities of the HFC has intensified competition for deposits, further straining liquidity.
- **Shift from Fixed Deposits to Market Investments:** More individuals are moving savings from fixed deposits to mutual funds, reducing the volume of bank deposits.
- **Rise of Digital Payments:** The rapid adoption of UPI and RTGS has made liquidity flows more unpredictable, challenging traditional banking models.
- **RBI's Tightened Liquidity Measures:** The central bank has raised liquidity coverage ratio (LCR) requirements, locking up nearly ₹4 lakh crore in government bonds that could otherwise be used for lending.

As a result, overall liquidity—including government cash balances—has dropped to a deficit.



### The RBI's Response to the Liquidity Crunch:

To address the crisis, the RBI has implemented several liquidity-enhancing measures:

- **Reduction in the Cash Reserve Ratio (CRR) and Policy Repo:** The CRR was cut from 4.5% to 4%, releasing ₹1.13 lakh crore into the banking system, and Repo rate was cut by 25bps to 6.25%
- **Expansion of Short-Term Liquidity Operations:** Daily repo operations were increased from ₹50,000 crore to ₹2 lakh crore.
- **Open Market Operations (OMO):** The RBI committed to purchasing ₹60,000 crore worth of government bonds to infuse liquidity.
- **Introduction of a 56-Day Variable Rate Repo Auction:** This program provides banks with longer-term liquidity support.
- **\$5 Billion Dollar-Rupee Swap Auction:** This mechanism allows banks to trade their dollar holdings for rupees.

Collectively, these measures are expected to inject liquidity into the banking system – (60k crs via OMO, 30k crs via market purchases of Gilt, 44k crs via Fx Swaps, 50k crs via long term Repo). Most of these would have already been done. **However, given that the liquidity deficit has already exceeded ₹3 lakh crore, these interventions may not fully bridge the gap structurally, especially if the rupee-dollar exchange rate does not stabilize soon and the RBI has to constantly intervene to maintain exchange rate stability. On the other hand, excessive liquidity infusion could fuel inflation and asset bubbles, making liquidity management a delicate balancing act for the RBI.**



## Tight Liquidity Conditions

### Liquidity Conditions

- **Liquidity in the banking system remained tight with the RBI infusing liquidity via OMO and VRR routes.** Liquidity deficit in the banking system exceeded ~₹3 trillion in January 2025. The bond repurchase programme will allow the government to reduce its liabilities and improve its fiscal position. By repurchasing outstanding bonds before maturity, the government lowers its total debt burden. The process involves using government funds to buy back bonds, which are then retired, reducing the overall outstanding debt. This approach enables the government to strengthen its debt profile by targeting higher-cost or shorter-term bonds for buyback. The previous CRR reduction released ₹1.16 trillion, but limited scope for further cuts. **The liquidity infusion by the RBI in the last couple of weeks has brought down the deficit sharply – from a peak of over ₹3 trillion in the last week of January to ~₹600bn in the last two days.**
- **Money Multiplier:** Examining the trend in various measures of money supply in the economy, viz., different aggregates that reflect varying degrees of liquidity, it is seen that the monetary base, viz. the most liquid form of money, **M0, recorded a year-on-year (YoY) growth of 3.6% as of 3 January 2025, compared to 6.3% a year ago.** The **growth in M3**, excluding the impact of the merger of a non-bank with a bank (with effect from 1 July 2023), was **9.3% (YoY) as of 27 December 2024, compared to 11% a year ago.** Component-wise, aggregate deposits were the most significant component and contributed most to the expansion of M3. Amongst sources, bank credit to the commercial sector was a major contributor to the increase in M3. **As of 27 December 2024, MM4, i.e., the ratio of M3 to M0, stood at 5.7 against 5.5 a year ago.** Adjusted for reverse repo amounts, analytically akin to banks' deposits with the central bank, the adjusted MM was lower at **5.6 as of 27 December 2024.** A country's MM is influenced by two main factors: - **the amount of cash individuals (and businesses) hold and the reserves that banks maintain.** When individuals keep more cash, the banking system cannot create money, resulting in a lower multiplier. In this case, cash in hand acts as a leakage from the banking system. Similarly, the reserves that banks hold with the central bank also count as a leakage, further decreasing the MM. In India's case, banks hold a portion of their deposits as reserves with the RBI, known as CRR. A higher MM indicates that the banking system is generating a greater money supply from the money provided by the central bank. In India, recent efforts to promote financial inclusion have encouraged people to hold less cash in hand relative to their deposits, which partly explains the increase in the MM. **MM has been on an upward trend over the years.** It declined during the COVID-19 pandemic as increased economic uncertainty caused individuals to increase their cash holdings, resulting in a fall. However, after FY22, it has resumed its upward trajectory, **reflecting enhanced liquidity generation in the economy.**
- **FPIs withdrew ₹64,156 crore (\$7.44 billion) so far in January 2025 due to rupee depreciation and a general 'risk off' sentiment on account of tariff uncertainties.** This has led to heightened demand of US treasuries as a safe haven asset.
- **Net FDI dropped sharply to \$0.5 billion (Apr-Nov 2024) from \$8.5 billion in the same period in 2023.**
- **Forex interventions drained \$14 billion from reserves (Dec 2024 - Jan 2025). Rupee depreciation continues due to strengthening USD, weighing on Foreign Portfolio returns.**
- **UPI-enabled transactions growing at 20% monthly**, with an average of 40 transactions/user. Average transaction size: ₹1,125, lower than ₹4,000 for traditional credit cards.
- **Gold prices reached a 3-month high at \$2,755.19/oz due to geopolitical uncertainty.** Gold being a safe haven asset and a hedge against inflation.
- **Banks have relied heavily on short-term Certificates of Deposit (CDs),** which reached 2012 levels, **heightening rollover risk** and additionally **increased their cost of borrowing thus negatively affecting their NIM's.** However, the **Banking sector balance sheet in India remains robust and ready for a new credit up cycle.**

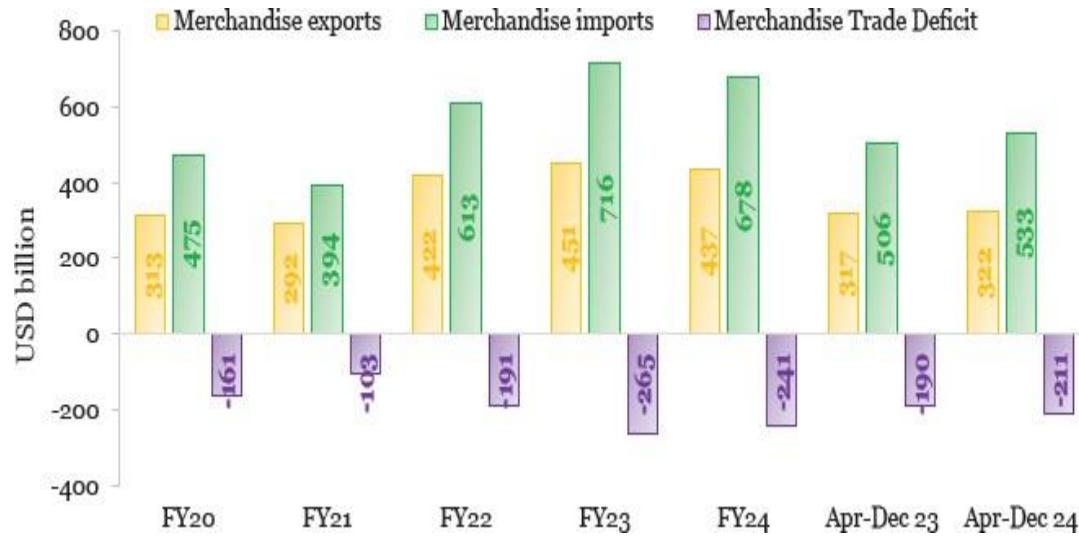
### Outlook

- **The current macroeconomic landscape closely resembles the 2013 taper tantrum, characterized by tightening liquidity, rising U.S. Interest rates, and sustained FPI outflows.** However, we anticipate a further price or time correction by H2 of CY2025, which should bring valuations into attractive zones and encourage FPI's to build long positions in the domestic equity markets.
- **Urban demand is expected to gain momentum in H2 of CY2025, complementing the ongoing recovery in rural demand.** This, in turn, should drive higher corporate volumes, attracting further capital inflows into equities.
- **The anticipated FPI inflows are likely to stabilize the exchange rate, thereby reducing pressure on the RBI in managing volatility and creating room for liquidity expansion in the banking system.**

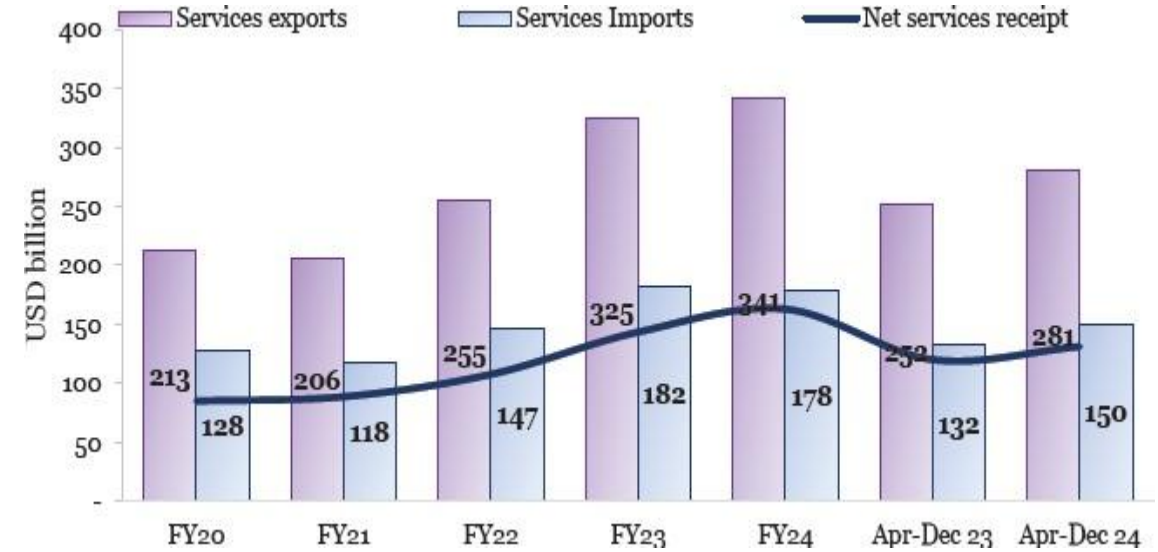
# 6. Trade



## Merchandise Trade



## Services Trade

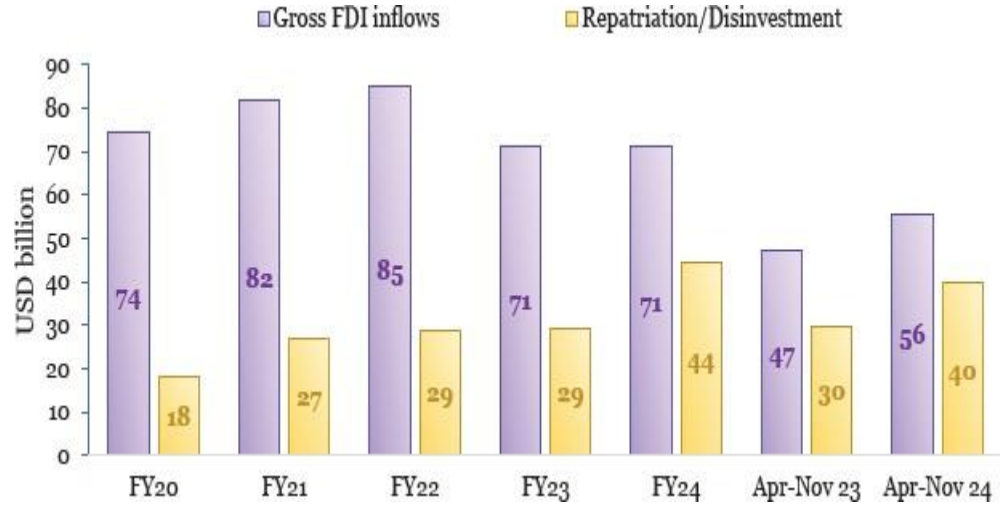


## Current Account Deficit (CAD)

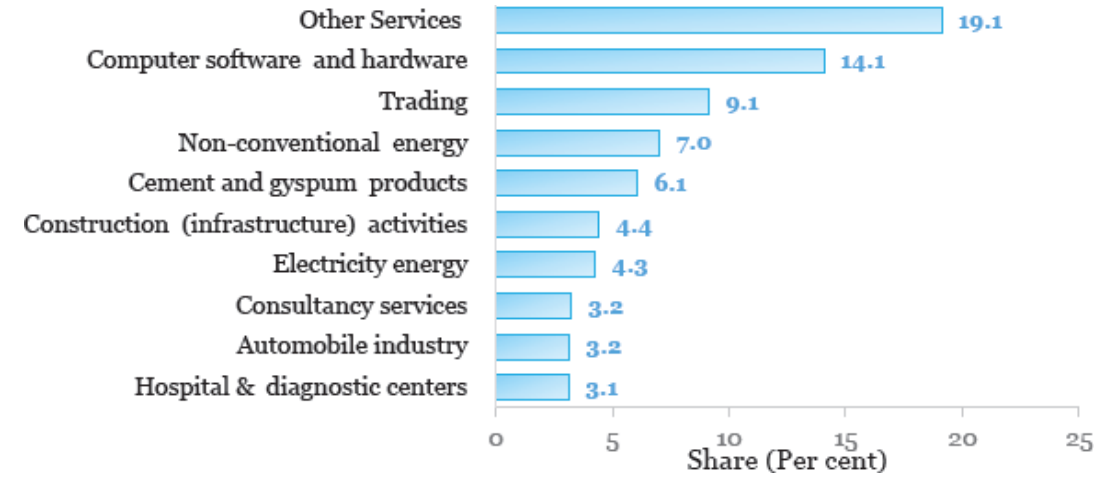




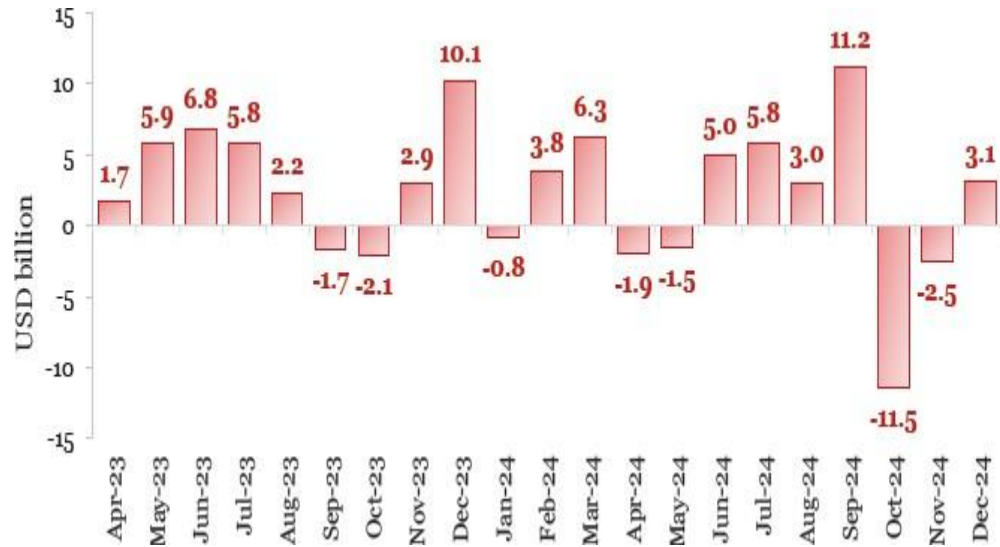
## FDI Flows



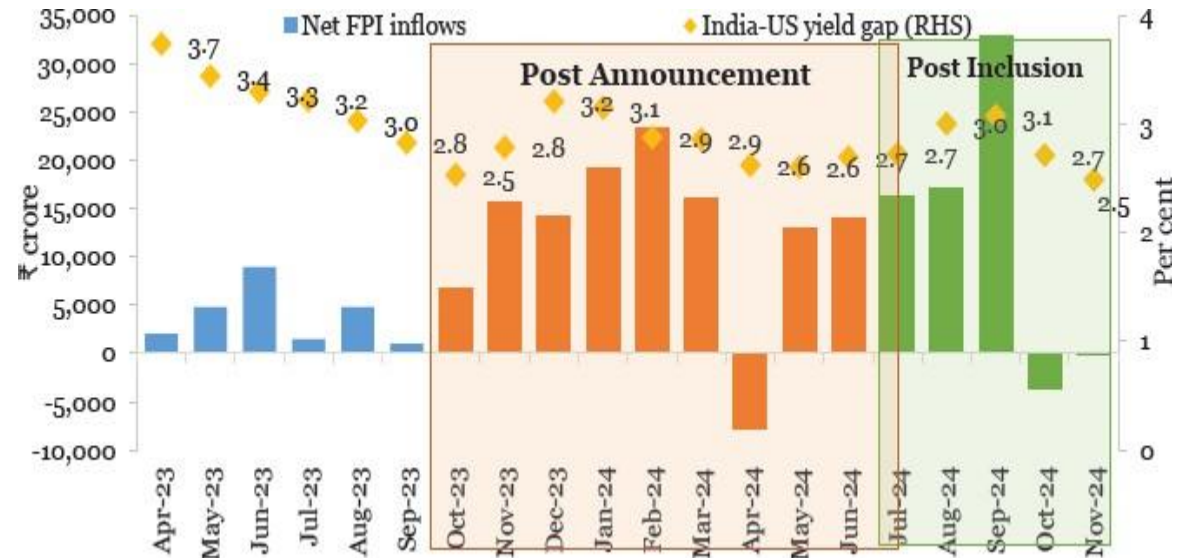
## FDI Sectoral Share



## Equity FPI Flows



## Debt FPI Flows



## India's Trade Performance – silver lining with a caveat



### Overall Trade Deficit

- India's total exports (merchandise + services) have shown positive momentum in the first nine months of FY25, reaching USD 602.6 billion, witnessing a YoY growth of 6%. This increase demonstrates the resilience of exports, which have been building on a steady upward trend in recent years despite global economic challenges. **Total imports during April-December 2024 reached USD 682.2 billion, registering a YoY growth of 6.9%.** This positive import growth indicates a steady demand for goods in the Indian market, supporting domestic consumption and production needs. A more significant increase in overall imports compared to exports led to a **rise in the overall trade deficit from USD 69.7 billion during April-December 2023 to USD 79.5 billion** in the corresponding period of FY25.

### Merchandise Exports

- During April-December 2024, **non-petroleum exports were up by 7.1%.** Over the same period, **non-petroleum and non-gems and jewellery exports rose by 9.1%.** Specific sectors like **drugs and pharmaceuticals, electronic goods, engineering goods, and chemicals** saw an increase in exports, growing by 6.4%, 28.6%, 9.9%, and 5%, respectively, during April-December 2024 on a YoY basis. **Textile exports also saw a YoY increase of 7.6% during the same period.** Rising inflationary pressures on cereals, pulses, and edible oils limited the exports of agricultural and allied products. Overall, merchandise exports registered a modest growth of 1.6% (YoY basis) primarily attributed to a decline in the value of petroleum product exports due to a fall in international commodity prices.

### Merchandise Imports

- Merchandise imports grew by 5.2% during April-December 2024.** This increase was largely due to a rise in non-oil, non-gold imports, which reached USD 352.1 billion in the first nine months of FY25 compared to USD 340.5 billion during the same period last year, indicating a rebound in domestic consumption despite the inflationary impact. Gold imports increased due to higher international prices, driven by frontloading ahead of festival spending and demand for safe-haven assets. Among the major non-oil, non-gold imports, non-ferrous metals, machine tools, machinery, electrical & non-electrical goods, and transport equipment witnessed remarkable growth in the first nine months of FY25, reflecting growing demand for capital goods. Electronic goods also maintained consistent momentum, signalling a rise in discretionary consumer spending. Additionally, imports of pulses and cotton rose to support domestic production and control inflation.

### Merchandise Trade Deficit

- The faster pace of increase in merchandise imports compared to exports contributed to the **widening of the merchandise trade deficit to USD 210.8 billion in April-December 2024, compared to USD 189.7 billion in the same period last year.**

### Service Sector Exports

- Services sector exports have demonstrated resilience, while merchandise exports have witnessed moderation in recent months. They **grew at 11.6% in the first nine months of FY25 amidst unfavourable geopolitical conditions.** The rise in services exports contributed to an **increase in net services receipts from USD 120.1 billion in the first nine months of FY24 to USD 131.3 billion during the corresponding period of FY25.**
- Services exports from India have shown a multi-sectoral presence in global exports, with notable contributions across several sectors. **India's share in global services exports has more than doubled, reaching around 4.3% in 2023 from 1.9% in 2005.** In 'Telecommunications, Computer, & Information Services', India commands 10.2% of the global exports market (ranking 2nd largest exporter in the world), reflecting its strong position in IT outsourcing, software development, and digital services. The 'Other Business Services sector' also plays a crucial role, with India holding 7.2% of the world share (ranking 3rd largest exporter in the world), **driven by its expertise in professional and consulting services.** 'Travel' and 'Transport' services represent areas where India holds a relatively smaller share in global exports, at 2.1% and 2.2%, respectively, likely facing competition from other worldwide tourism and logistics hubs. There are opportunities for further growth, especially in enhancing international tourism infrastructure and global transport networks. India's financial services sector lags behind the global average, highlighting the **potential for growth in global banking, insurance, and investment services.** On the other hand, with a global share of 3.4% in 'Personal, Cultural, & Recreational' services and 3.5% in 'Construction services,' India ranks 6th and 8th, respectively, demonstrating its competitive edge in cultural exports and international infrastructure projects. **India remains a global leader in IT and business services, but there is considerable untapped potential in travel, transport, and financial services.** As the country becomes a hub for Global Capability Centres and continues to innovate, focusing on skill development and strategic policy interventions will be key to sustaining this momentum. Strengthening emerging sectors and improving global competitiveness will ensure India remains a dominant player in the services sector in the times to come.



### Balance Of Payments (BOP)

- Against the backdrop of uncertainties in the external trade and investment environment, India's Balance of Payments (BoP) position has remained stable, led by resilient services exports and benign crude oil prices.

### Current Account

- India's **current account deficit (CAD) moderated slightly to 1.2% of GDP in Q2 of FY25 against 1.3% of the GDP recorded in Q2 of FY24**. The recent rise in the CAD can be attributed to an **increase in the merchandise trade deficit, which rose to USD 75.3 billion in Q2 of FY25 from USD 64.5 billion in the corresponding quarter of the previous year**. The **rising net services receipts and increase in private transfer receipts cushioned the expansion in the merchandise trade deficit**. Net service receipts increased to USD 44.5 billion in Q2 of FY25 from USD 39.9 billion in the corresponding quarter in FY24. Private transfers, mainly driven by remittances by Indians employed overseas, formed the bulk of **net transfers, growing steadily from USD 28.1 billion in Q2 of FY24 to USD 31.9 billion in Q2 of FY25**. This growth reflects the continued **strength of India's diaspora** and robust remittance inflows despite global economic uncertainties.

### Capital & Financial Account

- The Capital and Financial Account is a vital segment of the BoP, serving as the primary mechanism for financing the CAD and strengthening foreign exchange reserves. **Over the period from Q1 of FY23 to Q2 of FY25**, India has generally recorded surpluses in the capital account, largely driven by **robust inflows from FDI, FPI, and external loans**. These inflows have supported the country's external position and contributed to building foreign exchange reserves. However, post H2 FY2024-25, FPI's have been net sellers in the market.

### FDI

- FDI recorded a revival in FY25, with gross FDI inflows increasing from USD 47.2 billion in the first eight months of FY24 to USD 55.6 billion in the same period of FY25, a YoY growth of 17.9%. India remains a strong destination for FDI, ranking high in greenfield project announcements and international project finance deals. However, the country has to pay heed to numbers. As per the data published by RBI, **net FDI to India during the first eight months of FY25 stood at USD 0.48 billion compared to USD 8.5 billion in the corresponding period of FY24**. Similarly, for FY23, the figure stood at USD 19.8 billion. For **FY24 as a whole, the net FDI was USD 10.1 billion**. **The last two financial years have indeed seen much larger repatriation from India**. The amounts were USD 29.3 billion and USD 44.5 billion, respectively, in FY23 and FY24. In the current year, up to November, the repatriation amount is USD 39.6 billion. At this rate, the full-year figure might exceed last year's figure. To a large extent, this is a success story as foreigners take profits. Second, much of it was sold to portfolio investors. In other words, the large portfolio inflows in FY24 were the other side of the coin of large repatriation. **At a gross level, FY23 and FY24 have seen a decline in gross FDI, including earnings retained in India. This has broken the steadily rising trend seen since FY14. The period between FY13 and FY22 witnessed ultra-low interest rates and quantitative easing policies in the developed world. The cost of funds was much lower. Interest rates in developed countries rose sharply in 2022 and 2023. The Federal Funds Rate topped 5%. Other Asian countries such as Thailand, Malaysia and Indonesia also witnessed declines in inward FDI in 2023, according to UNCTAD.**
- However, **India runs a CAD, and its investment needs are much larger considering the size of its economy**. Supplementing domestic savings with reasonably large foreign savings expands the scope for capital formation. **If, for various reasons, capital flows are going to be problematic, it raises questions as to the level of sustainable CAD for India**. It may not be 2.5% to 3% as before, but it is much lower. It used to be said that a country can run as large a CAD as the Rest of the World (RoW) is willing to finance. If the RoW is unwilling or unable to do so for various reasons, then the size of the CAD will have to be lower. **Developed countries, too, are wooing investments, and India is not competing with other emerging economies alone**. So, India has two options. One, **we must pull out all the stops wooing FDI and making itself more attractive for foreign investors**. India has been doing so. For example, most sectors in the country are open for foreign investors under the automatic route. The large amount of repatriations, as witnessed in the data, also suggests that it is easy to transfer the returns on investment made in India. However, **there is room to improve tax certainty and tax stability in matters such as APA (Advance Pricing Agreement)**. India has simplified many of its laws, rules and regulations over the years leading to a regime shift in terms of the ease of doing business compared to yester years. At the same time, all **statutory and regulatory authorities must bear in mind that international investors benchmark countries cross-sectionally and not longitudinally**. That will determine the success of the government's goal to make global companies produce in India for the world, making India a part of the global supply chain. The second option is to **make the available and existing investments deliver more**. In other words, **if the investment rate cannot be increased because of capital constraints, then investment efficiency has to go up**. That is where deregulation and 'Ease of Doing Business' come into play. That is why the main theme of the Economic Survey was about deregulation. Therein lies the clue to improving India's investment efficiency.



## FPI

- Factors such as **concerns about slowing earnings growth, high valuations, rising geopolitical tensions, and recent developments in China** led FPIs to withdraw significant funds from Indian equities in October and November 2024. FPI flows in the domestic equity markets have been volatile since December 2024.
- **The inclusion of Indian Government Bonds (IGB) in some global bond indices recently has significantly supported debt inflows.** Since the investor sentiment/perception of the trajectory of Fed rates and the interest rate differentials are the key drivers of FPI flows in India, it will be interesting to analyse the trends in FPI debt flows and the yield differential between India and the US. The chart labelled Debt FPI Flows compares the FPI debt flows and the yield gap between India and US10 year yields, which shows that a **widening yield differential in India's favour leads to higher inflows (November 2023 to March 2024) and vice-versa. India's strong growth fundamentals and range-bound inflation also made it a preferred choice amongst foreign investors despite the narrowing yield differentials seen from May to July 2024.** The increase in demand for India's G-Secs is also set to have a positive externality in terms of **lowering the borrowing costs for the government as the yields soften due to heightened demand and limited supply dynamics.** The preliminary impact of this is already visible in the Indian 10Y G-Sec yields. The inclusion of Indian bonds in global indices signals a growing appetite amongst foreign investors to include Indian government securities in their investment portfolios, trust in India's growth prospects, and financial stability in the Indian markets.

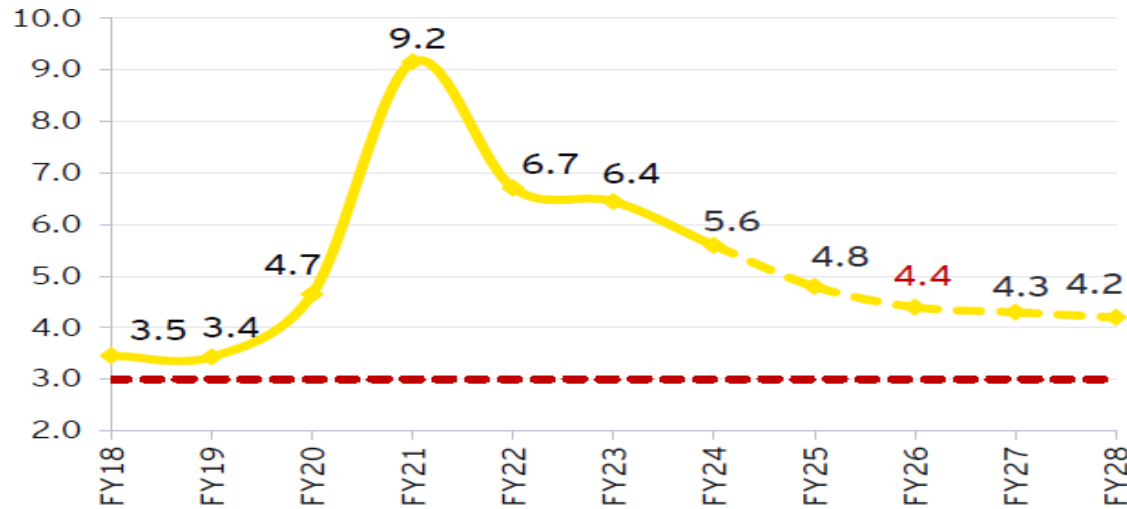
## Outlook

- India's external sector has performed well amidst unfavourable geopolitical conditions. On the current account front, though merchandise exports have displayed moderate growth owing to a slowdown in external demand, merchandise imports have shown remarkable growth supported by strong domestic demand. Increased net services receipts and growing remittances have cushioned the rise in the merchandise trade deficit. On the capital front, the economy has been witnessing net positive capital inflows. Gross FDI inflows have shown a higher growth in the first eight months of FY25 compared to the corresponding period of the previous year. However, a surge in repatriation has reined in the expansion in net FDI. FPI inflows have shown volatility in the first nine months of FY25, showing mixed trends. India's current account deficit (CAD) moderated slightly to 1.2% of GDP in Q2 of FY25 against 1.3% of the GDP recorded in Q2 of FY24, and is projected to be within 1.1%-1.2% of GDP in FY 2026. However, the impending US tariffs are a certainly a headwind not only to India but also to global economic growth and will be tracked closely in the days to come.
- While it is logical to expect that there will be another 25bps rate cut in April (since a single 25bps rate cut does not move the needle in any meaningful way), the MPC does not want to commit to this. Hence the MPC is not suggesting that yesterday's rate cut is the start of a rate-cutting cycle. And so the MPC has maintained its neutral stance which does not lock itself into either a loosening or tightening action for the next policy. This is principally because of the evolving external environment – which can on one side constrain growth or also spur inflation or even cause both, with large trade tariffs in the play. Much will depend on how the domestic growth data and the global environment evolve over the next couple of months.
- Global trade dynamics have changed significantly in recent years, shifting from globalisation to rising trade protectionism, accompanied by increased uncertainty. This calls for a new strategic trade roadmap for India. To remain competitive and enhance its participation in global supply chains, India must continue reducing trade costs and improving facilitation to boost export competitiveness. Much remains to be done to enhance trade competitiveness. The good news is that doing so is entirely in our hands. On its part, the industry must continue to invest in quality. The state produces governance, and the private sector produces goods and services. If both these actors focus on quality and efficiency, then despite the trade tensions and protectionism that are likely to come in the way of expanding global trade, India can increase its share in overseas markets and generate resources to sustain a higher level of capital formation. Then, it will be possible for us not just to dream of but actually realise higher economic growth rates on a sustained basis.

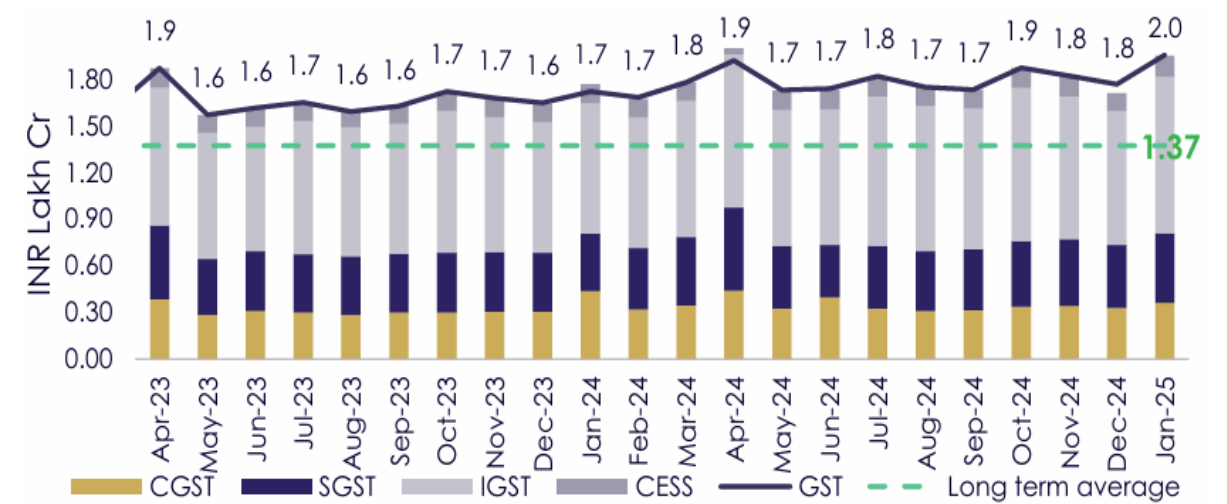
# 7. Fiscal Situation



GOI's Fiscal Debt / GDP - Glide Path



GST Collection - rises 12.3% YoY in Jan 2025



GOI's Fiscal Position

|                              | FY23  | FY24  | YoY (%) | FY25RE | YoY (%) | FY26 BE | YoY (%) |
|------------------------------|-------|-------|---------|--------|---------|---------|---------|
| Direct tax revenues          | 16.6  | 19.6  | 17.9    | 22.4   | 14.4    | 25.2    | 12.7    |
| Indirect tax revenues        | 13.9  | 15.1  | 8.5     | 16.2   | 7.1     | 17.5    | 8.3     |
| Gross Tax revenues           | 30.5  | 34.7  | 13.6    | 38.5   | 11.2    | 42.7    | 10.8    |
| Net Tax revenues [A]         | 21.0  | 23.3  | 10.9    | 25.6   | 9.9     | 28.4    | 11.0    |
| Non-tax revenues [B]         | 2.9   | 4.0   | 40.8    | 5.3    | 32.2    | 5.8     | 9.8     |
| Disinvestmt & Others [C]     | 0.7   | 0.6   | -17.2   | 0.6    | -1.3    | 0.8     | 28.8    |
| Total Revenue [A+B+C]        | 25    | 28    | 13.6    | 31     | 12.8    | 35      | 11      |
| Capital Exp [D]              | 7.4   | 9.5   | 28.2    | 10.2   | 7.4     | 11.2    | 10.1    |
| Revenue Exp [E]              | 34.5  | 34.9  | 1.2     | 37.0   | 5.8     | 39.4    | 6.7     |
| Total Expenditure [D+E]      | 41.9  | 44.4  | 6.0     | 47.2   | 6.1     | 50.7    | 7.4     |
| Fiscal Deficit               | -17.4 | -16.5 | NA      | -15.7  | NA      | -15.7   | NA      |
| Nominal GDP                  | 272.4 | 295.4 | 8.4     | 324.1  | 9.7     | 357.0   | 10.1    |
| Fiscal deficit as (%) of GDI | 6.4   | 5.6   |         | 4.8    |         | 4.4     |         |

GOI's Fiscal Position - as a % of GDP

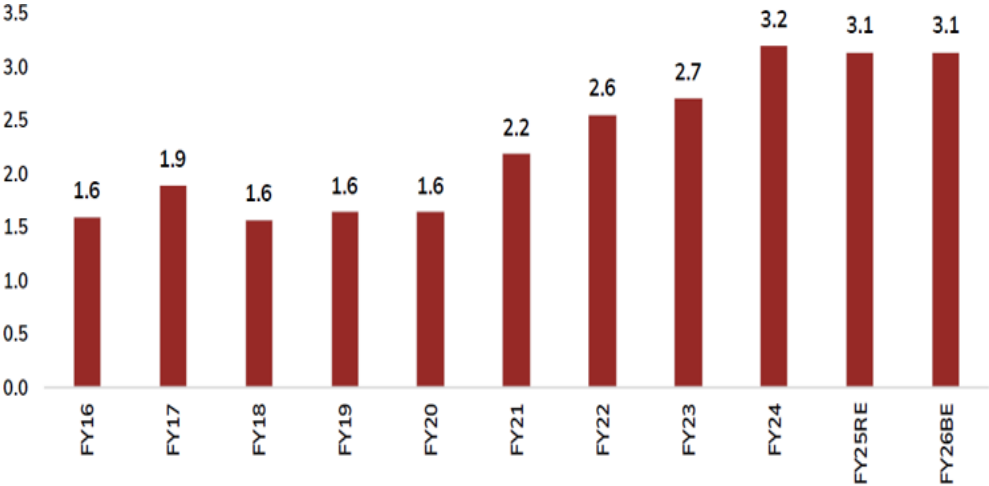
|                          | FY23 | FY24 | FY25RE | FY26 BE |
|--------------------------|------|------|--------|---------|
| Direct tax revenues      | 6.1  | 6.6  | 6.9    | 7.1     |
| Indirect tax revenues    | 5.1  | 5.1  | 5.0    | 4.9     |
| Gross Tax revenues       | 11.2 | 11.7 | 11.9   | 12.0    |
| Net Tax revenues [A]     | 7.7  | 7.9  | 7.9    | 7.9     |
| Non-tax revenues [B]     | 1.0  | 1.4  | 1.6    | 1.6     |
| Disinvestmt & Others [C] | 0.3  | 0.2  | 0.2    | 0.2     |
| Total Revenue [A+B+C]    | 9.0  | 9.4  | 9.7    | 9.8     |
| Capital Exp [D]          | 2.7  | 3.2  | 3.1    | 3.1     |
| Revenue Exp [E]          | 12.7 | 11.8 | 11.4   | 11.0    |
| Total Expenditure [D+E]  | 15.4 | 15.0 | 14.6   | 14.2    |
| Fiscal Deficit           | 6.4  | 5.6  | 4.8    | 4.4     |

GOI's Fiscal Position - growth rates

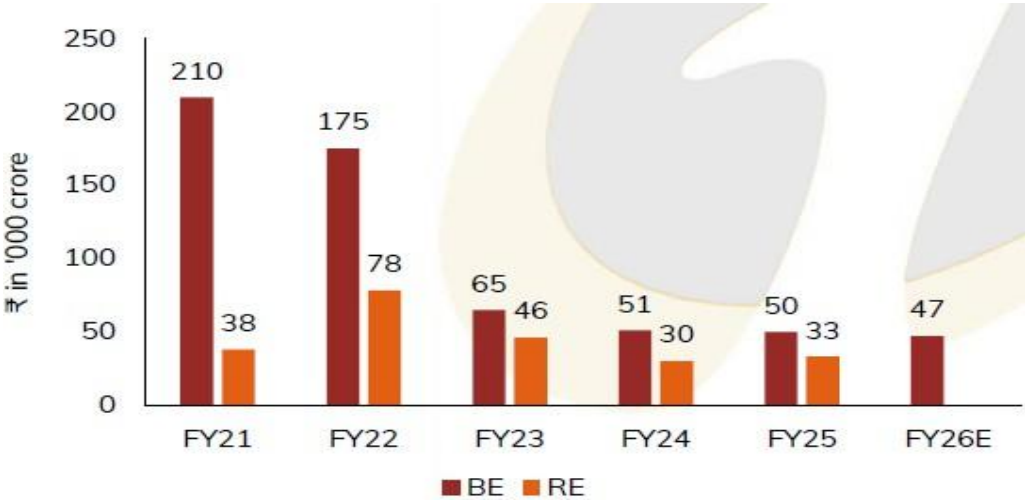
|                         | FY21        | FY22        | FY23        | FY24        | FY25RE      | FY26BE      |
|-------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| GDP                     | 1,97,46,000 | 2,36,64,637 | 2,72,40,712 | 2,95,35,667 | 3,24,00,627 | 3,59,64,696 |
| Gross Tax Revenue       | 10.3%       | 11.4%       | 11.2%       | 11.7%       | 11.9%       | 12.0%       |
| Corporate Tax           | 2.3%        | 3.0%        | 3.0%        | 3.1%        | 3.0%        | 3.0%        |
| Income Tax              | 2.5%        | 2.9%        | 3.1%        | 3.5%        | 3.9%        | 4.0%        |
| GST                     | 2.8%        | 3.0%        | 3.1%        | 3.2%        | 3.3%        | 3.3%        |
| Others (Excise+Customs) | 2.7%        | 2.5%        | 2.0%        | 1.9%        | 1.7%        | 1.6%        |
| Total Exp               | 17.8%       | 16.0%       | 15.4%       | 15.0%       | 14.6%       | 14.2%       |
| Capital                 | 2.2%        | 2.5%        | 2.7%        | 3.2%        | 3.1%        | 3.1%        |
| Revenue                 | 15.6%       | 13.5%       | 12.7%       | 11.8%       | 11.4%       | 11.0%       |
| Growth in Capex         |             | 39.1%       | 24.8%       | 28.2%       | 7.4%        | 10.1%       |
| Growth in RevEx         |             | 3.8%        | 7.9%        | 1.2%        | 5.8%        | 6.7%        |
| Fiscal deficit(%)       | 9.2%        | 6.7%        | 6.4%        | 5.6%        | 4.8%        | 4.4%        |
| Subsidies               |             |             |             |             |             |             |
| Fertiliser              | 0.65%       | 0.65%       | 0.83%       | 0.59%       | 0.53%       | 0.47%       |
| Food                    | 2.74%       | 1.22%       | 1.05%       | 0.67%       | 0.61%       | 0.57%       |
| Petroleum               | 0.19%       | 0.01%       | 0.03%       | 0.04%       | 0.05%       | 0.03%       |
| Interest                | 3.4%        | 3.4%        | 3.5%        | 3.7%        | 3.5%        | 3.9%        |
| Gross Borrowing         | 6.9%        | 4.8%        | 5.2%        | 5.2%        | 4.3%        | 4.2%        |



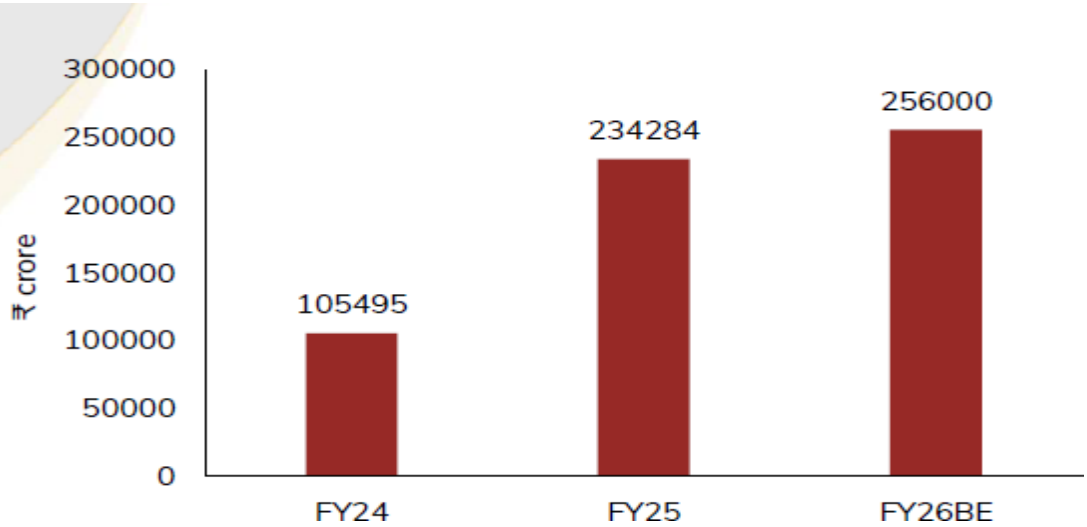
### Capex as a % of GDP



### Disinvestment Target



### Payout from the RBI



### GOI's Debt / GDP

| Years     | Gol's Revenue Deficit/Fiscal Deficit ratio | Centre            | Combined (IMF) |
|-----------|--------------------------------------------|-------------------|----------------|
|           |                                            | Debt to GDP ratio |                |
| FY15      | 71.6                                       | 50.1              | 67.1           |
| FY16      | 64.3                                       | 50.1              | 69.0           |
| FY17      | 59.1                                       | 48.3              | 68.9           |
| FY18      | 75.1                                       | 48.2              | 69.7           |
| FY19      | 70.0                                       | 48.1              | 70.4           |
| FY20      | 71.4                                       | 50.7              | 75.0           |
| FY21      | 79.7                                       | 60.7              | 88.4           |
| FY22      | 65.1                                       | 57.4              | 83.5           |
| FY23      | 61.6                                       | 56.5              | 81.7           |
| FY24      | 46.2                                       | 57.5              | 83.0           |
| FY25 (RE) | 38.9                                       | 56.1              | 83.1           |
| FY26 (BE) | 33.4                                       | 55.1              | 82.6           |



## Fiscal Discipline

### Key Budget Highlights

- **On the fiscal deficit front, Government exhibited disciplined path with deficit target revised down for FY25RE at 4.8% versus earlier estimate of 4.9% and to 4.4% for FY26BE, as against market expectation of ~4.5%.**
- The subsidy allocation has remained unchanged for broader heads. **Government has kept a strict vigil on its subsidy allocation which for FY26E is estimates at ₹ 3.8 lakh crore, flat on YoY basis, however down as a % of GDP basis to 1.1% of GDP in FY26E vs. 1.2% in FY25E.** Government has also broadly maintained allocation towards its flagship DBT schemes namely Mahatma Gandhi National Rural Employment Guarantee Program (MGNREGA) and Pradhan Mantri Kisan Samman Nidhi (PM-Kisan).
- **The major focus of the budget has been to revv up consumption via income tax reliefs; Exemption on personal income tax upto Rs 12,00,000 and addition of new tax slab will lead to higher income in the hands of middle-income group. Further the government has increase allocations under various scheme to improve rural economy.** This will boost consumer sentiments in the urban and rural demand in India, which is likely to lead to an uptick in the consumer demand going ahead (likely from Q1FY26).
- **Capex intensity has been maintained despite capex spending growing at a CAGR of 20% over FY22-FY26BE. The Government has budgeted growth at 10.1% YoY in FY26BE to ₹ 11.21 lakh crore. The capex to GDP is pegged flat at 3.1% in FY26BE vs. 3.1% in FY25RE.** Allocation in key segments like Roads and Railways has been flat over FY25-26 whereas, Defence and Housing (PM Awaas Yojna) has seen allocation rising double digit ~13% and ~19% respectively thereby creating a high base. Implicitly in our view the run-rate of monthly capex spent will average at ₹ 97,000 crore from Q4FY25-FY26E vs. ₹ 76,000 crore spent in 9MFY25.

### 3 Cornerstones of Budget 2025

- The Government in Budget 2025-26 has tried to balance the three cornerstones of the economy in their order of preference: a) **Income Tax relief to the public at large in order to address the consumption moderation, b) Maintain Fiscal discipline thereby containing macro variables and c) Allocation to capex, albeit some moderation.** We believe revving up consumption in the near term would provide additional triggers for both central and private capex to revive in the medium to long term.

### Fiscal Discipline

- Government continued on its fiscal glide path with fiscal deficit target revised down for FY25RE at 4.8% versus earlier estimate of 4.9% and to 4.4% for FY26, as against market expectation of ~4.5%. **While the fiscal deficit in absolute terms in FY26 remain at similar level of FY25 at ₹15.7 lakh crore, gross market borrowing has been increased to ₹14.8 lakh crore versus ₹14.0 lakh crore in FY25.**
- **Nominal GDP growth estimates for FY26 has been marginally increased to 10.1% as compared to 9.7% in FY25.**
- **Gross tax revenue growth forecast is lowered for FY26 at 10.8% as against 11.2% in FY25 with expectation of some improvement in corporate tax collection while similar growth of 10.9% is assumed for GST. Income tax growth risen from 2.5% of GDP in FY21 to 4.0% in FY26E.**



### Capex

- Growth in Capex has been resumed to a normalized level of 10.1% in FY26 as compared to 7.4% in FY25. Capex growth likely to moderate to 10.1% in FY26BE on high base of average 30% from FY22 to FY24 but will recover from an election hit year low growth of 7.4%. **Capex intensity has been maintained despite capex spending growing at a CAGR of 20% over FY22-FY26BE. The Government has budgeted growth at 10.1% YoY in FY26BE to ₹ 11.21 lakh crore.** The capex to GDP is pegged flat at 3.1% in FY26BE which is same as FY25RE. Allocation in key segments like Roads and Railways has been flat over FY25-26 whereas, Defence and Housing (PM Awaas Yojna) has seen allocation rising double digit ~13% and ~19% respectively thereby creating a high base. **The tendering & ordering activity in Q1FY25 was muted on account of elections/code of conduct. The same picked up pace in Q2 & Q3 of FY25, however there still remains ₹3 trillion to be spent. The same implies that the remaining 2 months of FY25E will witness hectic activity in terms of new tenders and ordering activity.**

### Disinvestment

- FY26BE disinvestment target continue to remain in-line with budget at ₹ 47,000 crore.

### Dividends

- **Dividend from RBI & financial institutions for FY25 at ₹2,34,284 crore**, aiding non-tax revenues. Earmarked contribution of ₹2,56,000 crore, attributable to anticipation of continued higher payout from RBI, amid aggressive intervention in currency markets.

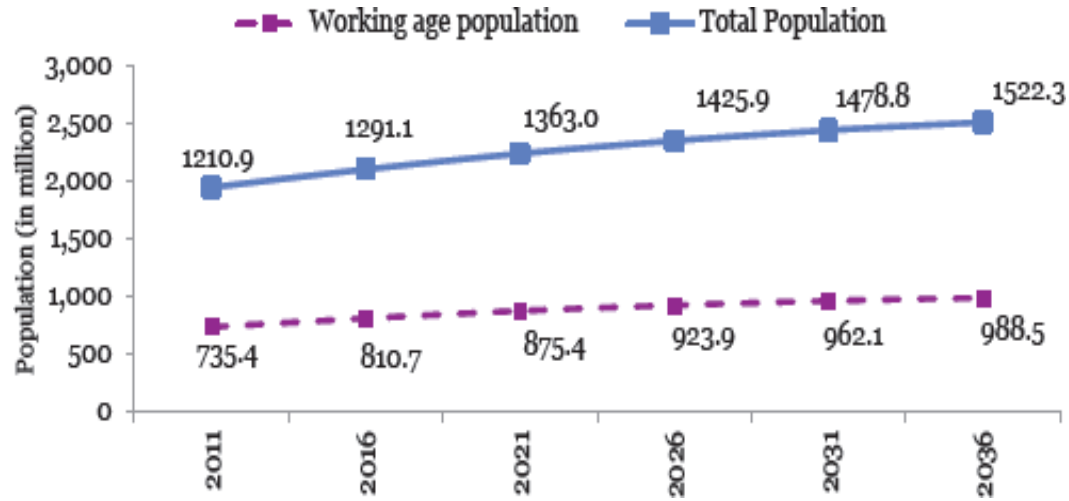
### Personal Income Tax

- **Government has announced biggest ever overhaul in personal income tax structure thereby increasing the tax-exempt income from ₹ 7 lakh to ₹ 12 lakh in Union Budget 2025-26. This tax relief, is expected to increase disposable income in the range of ₹ 30,000 to 1,10,000 pa in the hands of tax-payer.** For the financial year 2022-23, around 34 million individuals filed tax returns reporting income above Rs 5.5 lakhs (we don't have the exact number of people with incomes above ₹7 lakhs). And in the last two years, the number would have increased by ~10-15%. **So, ballpark of around 40 million people can potentially benefit from the higher tax exemption. The government expects this higher exemption to cost the exchequer ₹1000bn or 0.3% of GDP. So, if we assume, around 30 million people benefit from this higher exemption, it translates to ~₹33k per person.** For reference, India's per capita GDP is ₹2.4 lakhs. So both at an individual level and in aggregate, this is a material benefit. **So, this should boost consumption and in turn GDP growth and eventually trickle down to other sectors of the economy through the multiplier effect.** It should result in some upgrade to FY26 GDP growth estimate (which in FY25 has fallen to the lowest since the pandemic) as well as for some of the consumer goods companies – possibly the consumer durables companies as the quantum of savings is the sweet spot for them. Of course, for that people have to go and spend the money in a shopping mall or on an e-commerce platform rather than listening to their financial advisors and starting an SIP or paying down their debt. For we might run into the paradox of thrift in that case.

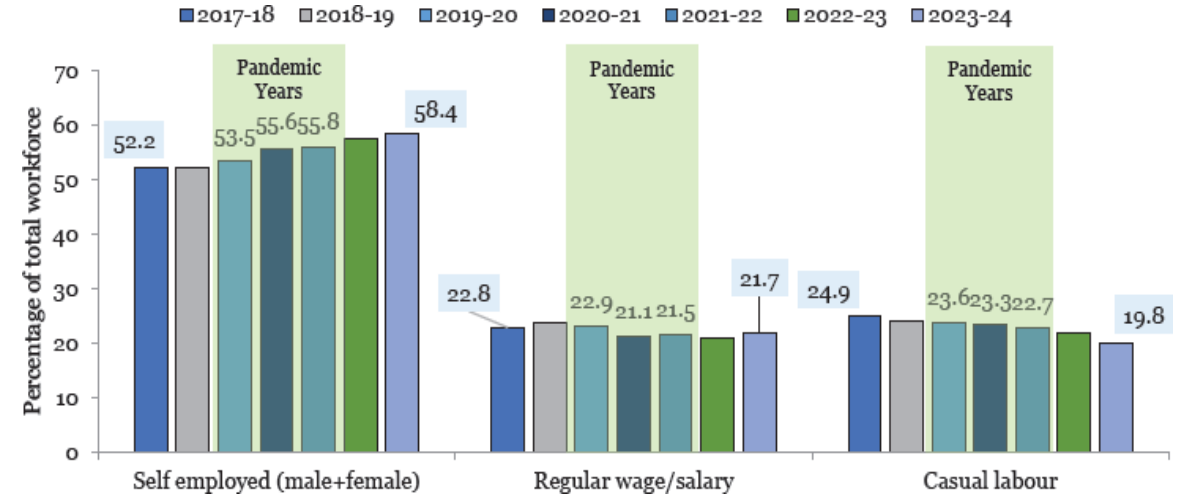
# 8. Employment



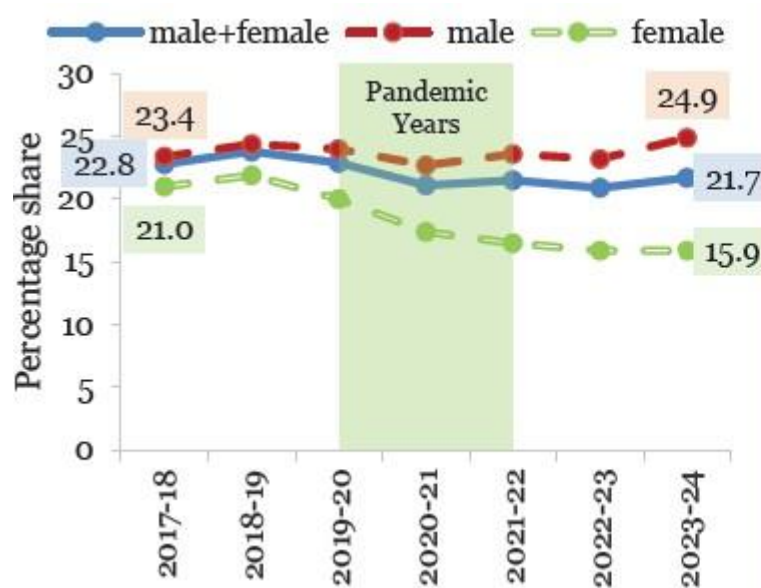
## Working Age Population s Total Population



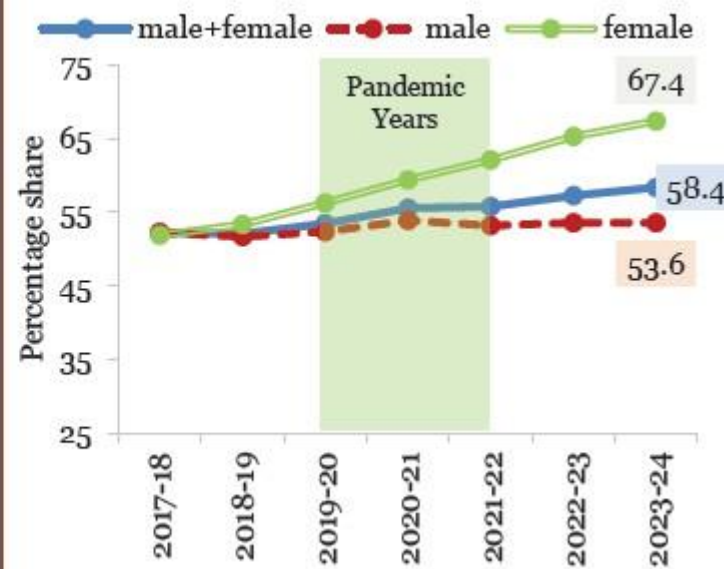
## Trend in Employment



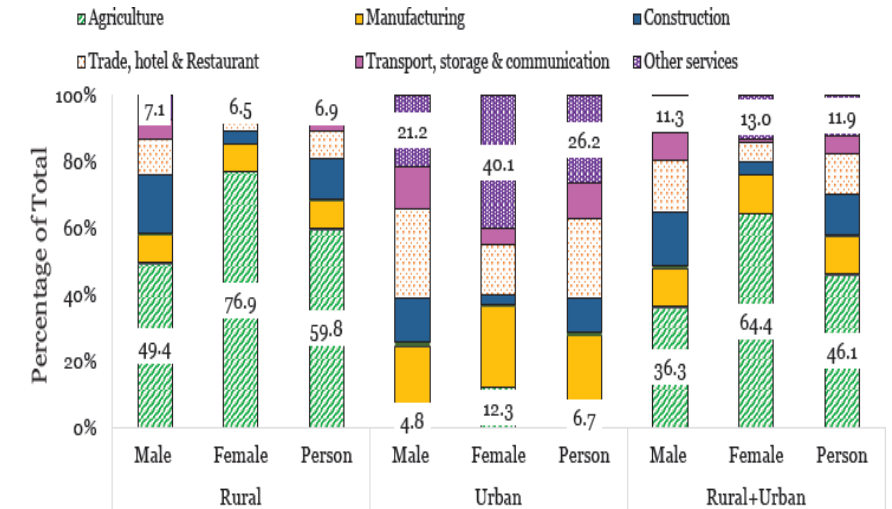
## Share of workforce in regular wage/salaried job



## Share of workforce self employed

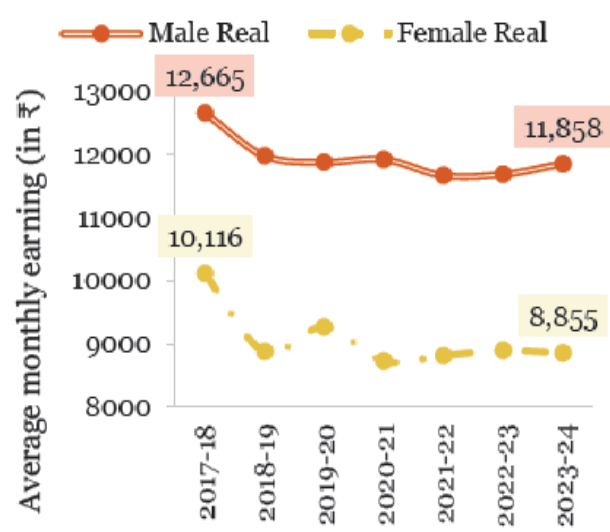
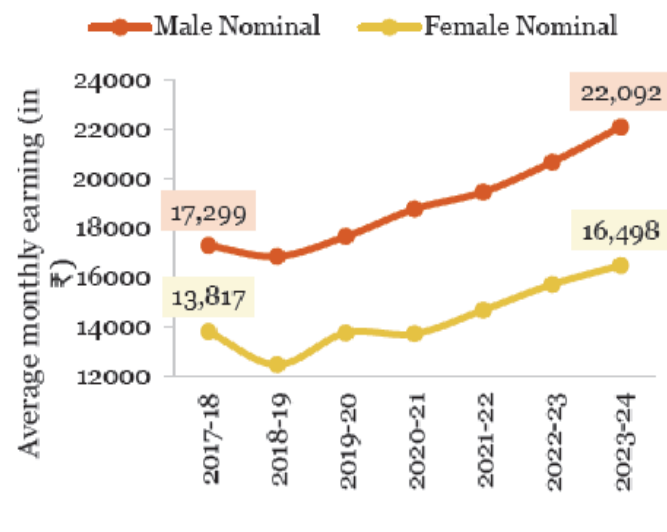


## Distribution of workers

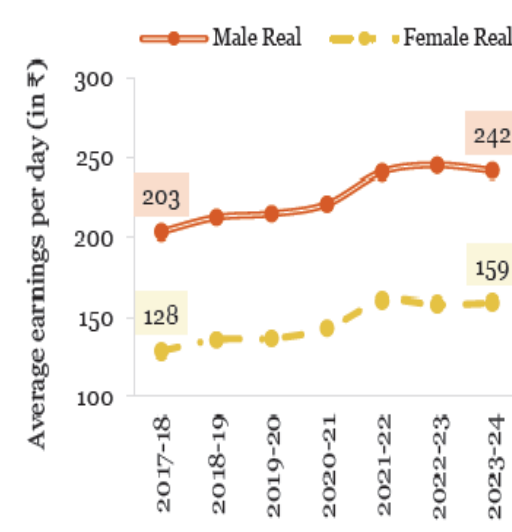
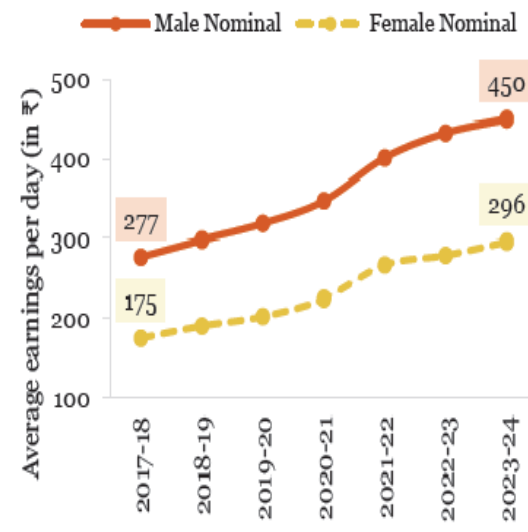




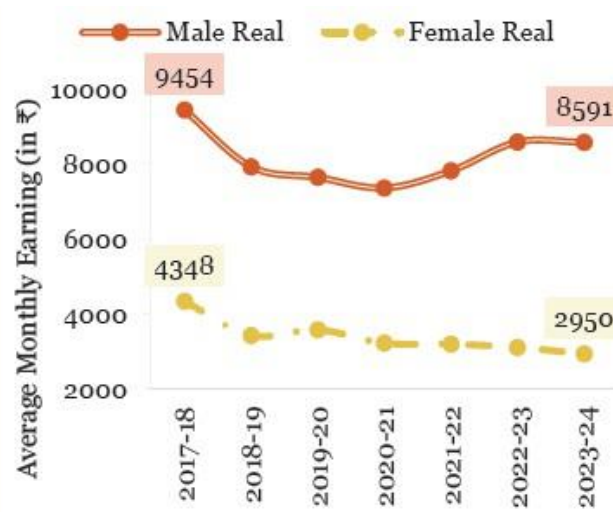
## Nominal and Real Wages - Salaried



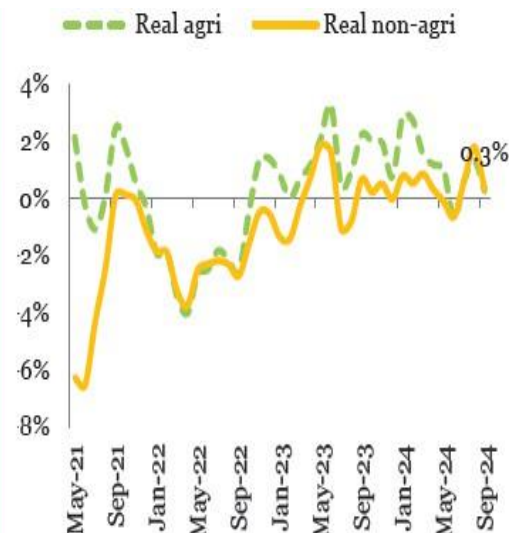
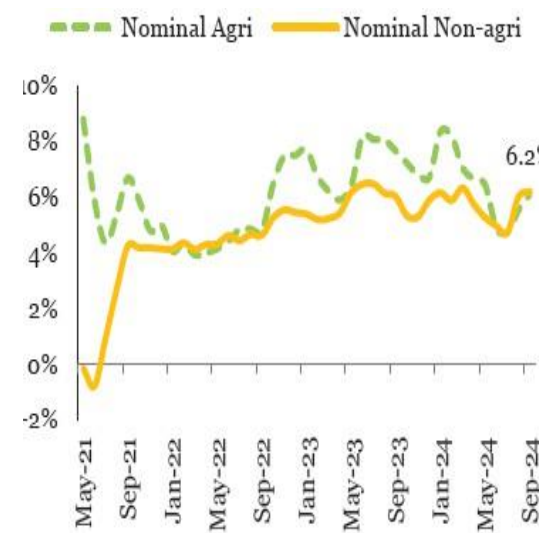
## Nominal and Real Wages - Casual Labour



## Nominal and Real Wages - Self Employed



## Nominal and Real Wages - Rural





As the crucial link between growth and prosperity, the **quantity and quality of employment** in an economy determines how **economic growth sustainably** percolates the masses. With around **26% of the population in the age group 10-24 years, India stands at the cusp of a once-in-a-lifetime demographic opportunity**. As one of the youngest nations globally, India's economic success depends on integrating its growing workforce into productive and meaningful roles, ensuring inclusive and long-term growth.

In 2014, India was ranked as the tenth-largest economy in the world. In under a decade, India surpassed the UK to reach the fourth position. **She is poised to be the third largest economy by 2030, after the USA and China. By 2030, she will have a growing working-age population and healthy manufacturing sector**. The country's demographic trend highlights the growing potential for a demographic dividend. The currently young population, with a **median age of around 28 years, compared to the ageing population of developed countries, is the key driver of the growth potential**.

#### Non-farm Jobs

- The Economic Survey highlighted that the **Indian economy must generate, on average, 78.5 lakh non-farm jobs annually until 2030 to productively engage its growing working population**. Creating quality jobs remains an ongoing endeavour and a well-recognised national priority, pivotal to ensuring inclusive and sustainable economic growth. Further, the ambitions and aspirations of the workforce align with the **need to generate employment opportunities to leverage the country's demographic dividend and to accelerate the structural transformation from farm to non-farm jobs**.

#### Unemployment Rate

- The 2023-24 annual Periodic Labour Force Survey (PLFS) report by the National Statistical Organisation (NSO) highlights a significant post-pandemic recovery in employment trends across India. **The all-India annual unemployment rate (UR) for individuals aged 15 years and above (usual status) has steadily declined from 6% in 2017-18 to 3.2% in 2023-24**. This recovery has been accompanied by an **increase in the labour force participation rate (LFPR) and the worker-to-population ratio (WPR)**.

#### Employment Trends

- **The proportion of self-employed workers in the workforce has risen from 52.2% in 2017-18 to 58.4% in 2023-24**. This shift reflects growing entrepreneurial activity and a preference for flexible work arrangements. While the **share of workers (male and female) in regular/salaried jobs decreased from 22.8% to 21.7% during the same period**, the trend has stabilised since 2020-21, with employment levels either holding steady or showing gradual improvement. The **decline in casual workers, from 24.9% to 19.8%**, also indicates a shift toward more structured forms of self-employment. These changes suggest an evolving workforce that embraces flexibility and independence in response to industry transformations and individual preferences. While the **proportion of women in regular wage/salaried employment decreased, more women engage in self-employment or contribute to household enterprises**, especially in rural areas. For instance, in rural India, women's participation in regular wage jobs fell from 10.5% in 2017-18 to 7.8% in 2023-24, coinciding with an increase in women working as "own account workers/ employers" or "helpers in household enterprises. In urban areas, salaried employment for women decreased from 52.1% to 49.4%. The bulk of the drop occurred in 2020-21, when it dropped to 50.1% from 54.2% the year before. This was accompanied by a rise in entrepreneurial ventures and flexible work roles.
- According to the PLFS 2023-24, **the agriculture sector remains dominant in employment, with its share rising from 44.1% in 2017-18 to 46.1% in 2023-24. The share of industry and services sectors saw declines in employment share, with manufacturing falling from 12.1% to 11.4%, and services from 31.1% to 29.7% during the same period**.
- From the gender perspective, the **Female Labour Force Participation Rate (FLFPR) has been rising for seven years, i.e., from 23.3% in 2017-18 to 41.7% in 2023-24**, driven mainly by the rising participation of rural women. The notable rise in the **FLFPR is the primary driver of the overall improvement in the labour market indicators**.



### Trends in Wages

- While the **average monthly earnings for regular wage/salaried workers and self-employed workers** grew at a CAGR of 5% during the period 2018-19 to 2023-24, the **daily wage of casual workers increased at a CAGR of 9% during the same period**. Earnings for self employed workers showcased a dynamic trajectory, with a brief dip from 2017-18 to 2020-21, followed by a **significant rebound post-pandemic**. Nominal wages have shown good growth across all categories, outpacing growth in real wages. **Rural wages rose at above-4% every month, YoY**. On average, the nominal wage rate in agriculture grew by 5.7% for men and 7% for women. In non-agricultural activities, nominal wage growth was slightly lower for men, at 5.5%, but higher for women, at 7.9% during the same period.

### Employment in Factories

- The Annual Survey of Industries (ASI) results for the FY2362 highlight the manufacturing sector's resilience, showing a **more than 7% increase in employment over the previous year**. This translates into an addition of over **22 lakh jobs in FY'23 over FY'19 (pre-pandemic level)**, **underscoring the sector's robust post pandemic recovery**. During the pandemic in FY 21, the sector lost approximately 5 lakh jobs. The growth of the sector in FY 23 indicates a strong rebound of the sector as economic conditions improved. In terms of the share of employment, **large factories continue to employ about 80% of the total workers**. Seven industry groups in the sector contribute to around 54% of the total employment. These are food products, textiles, basic metals, wearing apparel, motor vehicles, trailers and semi-trailers, machinery and equipment N.E.C., and chemicals and chemical products. Other than these leading industries, industry groups representing computer, electronic and optical products and the manufacture of furniture have seen strong growth in employment compared to the pre-pandemic level with around 50% growth in (Total Persons Engaged) TPE. This indicates a positive shift towards electronics manufacturing in India.

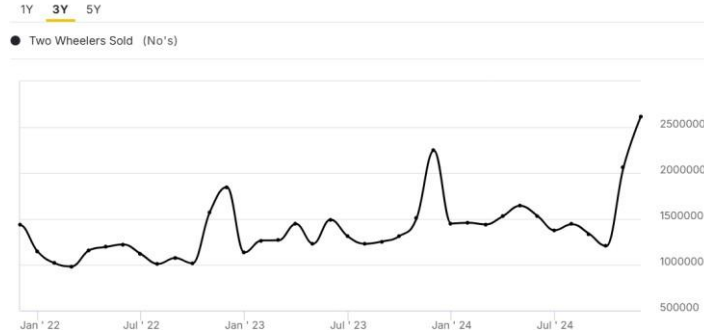
### Outlook

In conclusion, India has seen good growth in employment in recent years, as highlighted by labour market indicators that show strong signs of post-pandemic recovery and increased formalisation of the economy. This growth can be attributed to notable achievements in entrepreneurship, formalisation, skill development, and the transformation of the regulatory framework.

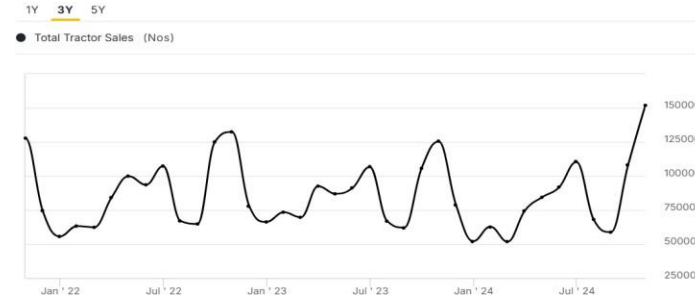
# 9. Demand Indicators



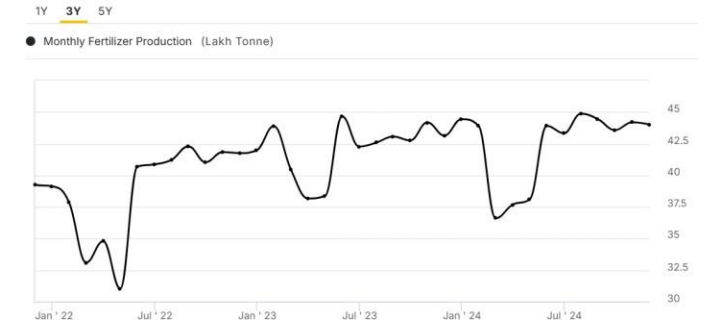
TWO WHEELERS SOLD (No's)



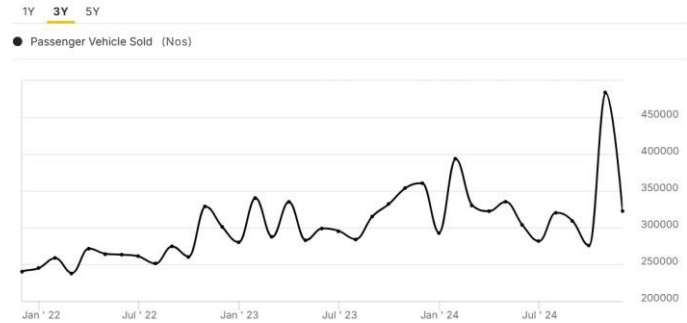
TOTAL TRACTOR SALES (Nos)



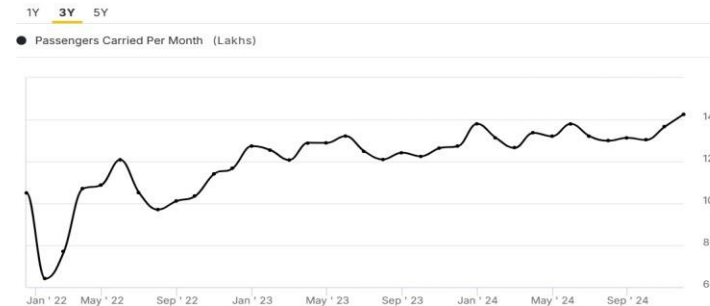
MONTHLY FERTILIZER PRODUCTION (Lakh Tonne)



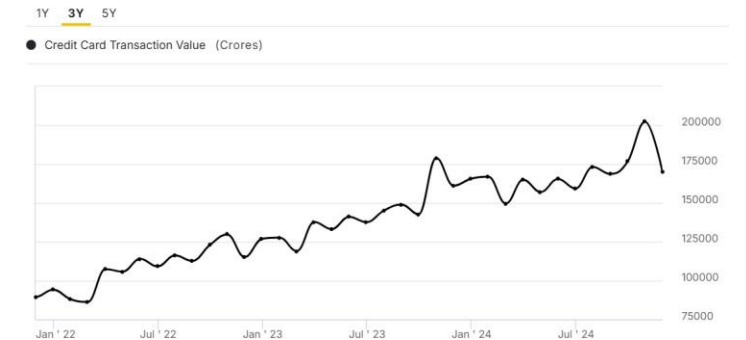
PASSENGER VEHICLE SOLD (Nos)



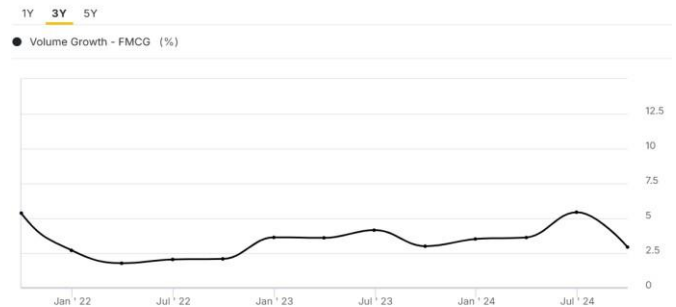
PASSENGERS CARRIED PER MONTH (Lakhs)



CREDIT CARD TRANSACTION VALUE (Crores)



VOLUME GROWTH - FMCG (%)



## Select Consumer Demand Indicators

### Rural Demand

Sales of two-wheelers, tractors, and fertilizers have experienced a significant upward trend, largely driven by favorable monsoon conditions and an increase in harvest yields. This improvement has led to a rise in disposable income in rural areas, enhancing purchasing power and boosting demand for these essential products.

### Urban Demand

Passenger Vehicles and Credit card transactions experienced a downtick just after the festive season.

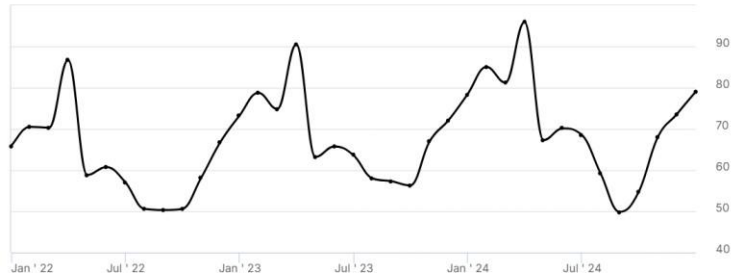
At the beginning of Q3 FY2024-25, overall consumer demand experienced a notable surge, rebounding from a period of sluggish growth reflected in Q2, which was highlighted in the quarterly GDP figures. As we move forward, it will be crucial to monitor whether this positive momentum can be sustained beyond the festival season.



#### COAL PRODUCTION (Mil Tonnes)

1Y 3Y 5Y

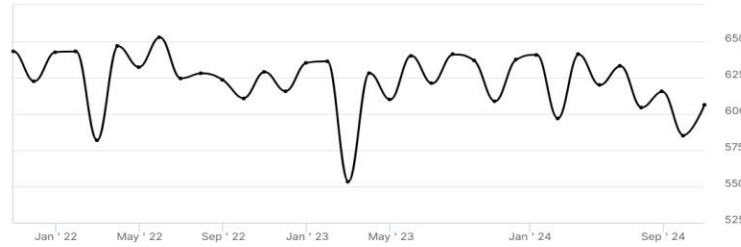
● Coal Production (Mil Tonnes)



#### CRUDE OIL PRODUCTION (ThsBar/day)

1Y 3Y 5Y

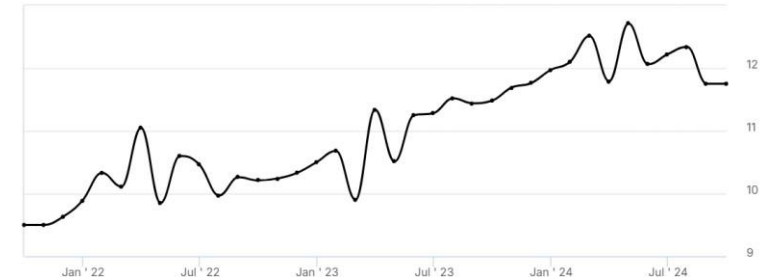
● Crude Oil Production (ThsBar/day)



#### CRUDE STEEL PRODUCTION (Mil Tonnes)

1Y 3Y 5Y

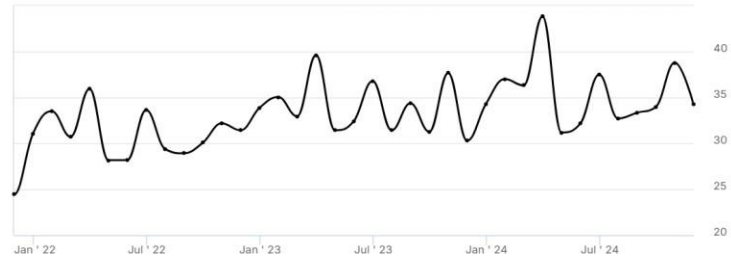
● Crude Steel Production (Mil Tonnes)



#### CEMENT PRODUCTION (Mil Tonnes)

1Y 3Y 5Y

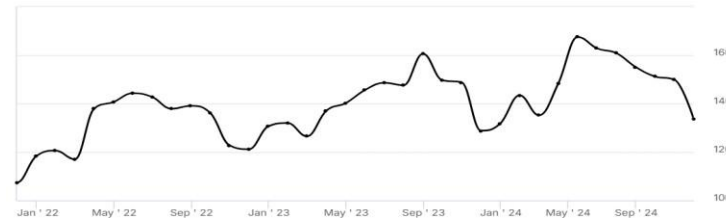
● Cement Production (Mil Tonnes)



#### ELECTRICITY GENERATION (Bil Units)

1Y 3Y 5Y

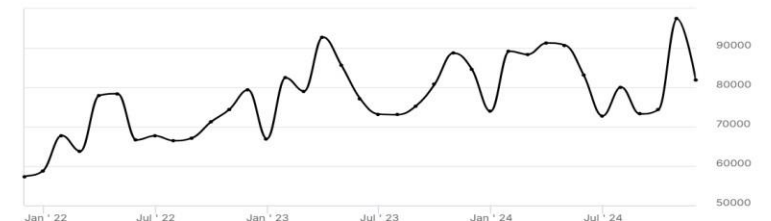
● Electricity Generation (Bil Units)



#### COMMERCIAL VEHICLE SOLD (Nos)

1Y 3Y 5Y

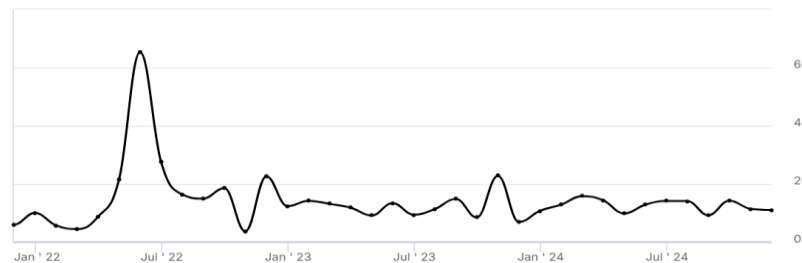
● Commercial Vehicle Sold (Nos)



#### FREIGHT INDEX - YOY GROWTH (%)

1Y 3Y 5Y

● Freight Index - YoY Growth (%)



### Select Industrial Demand Indicators

- **Crude oil production and electricity generation have shown muted performance** over the past two quarters of FY 2024-25.
- Similarly, **Coal production, Cement output, Commercial Vehicle sales, and the Freight Index have remained relatively flat, indicating a period of stagnation** in these key sectors.
- The tendering & ordering activity in Q1FY25 was muted on account of elections/code of conduct. The same picked up pace in Q2 & Q3 of FY25, however there **still remains ₹3 trillion to be spent**. The same implies that the remaining 2 months of FY25E will witness hectic activity in terms of new tenders and ordering activity.
- With the Union Budget and the RBI policy meeting behind us, the government has provided **fiscal stimulus to boost consumption** and the RBI has delivered **monetary stimulus by reducing the policy repo rate**—both measures aimed at spurring economic growth. These steps are expected to drive a short-term uptick in consumption and capital expenditure. However, whether this **expansionary approach will translate into sustained growth in consumption and gross fixed capital formation remains to be seen**.



Macro-Economic Heatmap

|                     | Jun-24 | Jul-24 | Aug-24 | Sep-24 | Oct-24 | Nov-24 | Dec-24 | Jan-25 |
|---------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| ↓ GDP               | Good   | Good   | Good   | Ok     | Bad    | Bad    | Bad    | Bad    |
| → Inflation         | Good   | Good   | Good   | Ok     | Ok     | Ok     | Ok     | Ok     |
| ↓ Industry          | Good   | Good   | Good   | Ok     | Bad    | Bad    | Bad    | Bad    |
| → Capex             | Good   | Good   | Good   | Good   | Good   | Ok     | Ok     | Ok     |
| ↓ Liquidity         | Good   | Ok     | Good   | Ok     | Ok     | Bad    | Bad    | Bad    |
| ↑ Trade             | Good   | Good   | Good   | Good   | Good   | Good   | Good   | Good   |
| ↑ Fiscal Situation  | Good   | Good   | Good   | Good   | Good   | Good   | Good   | Good   |
| → Employment        | Good   | Bad    | Bad    | Ok     | Ok     | Ok     | Ok     | Ok     |
| ↓ Demand Indicators | Bad    | Bad    | Bad    | Bad    | Bad    | Bad    | Bad    | Bad    |
| ↓ Equity            | Ok     | Bad    | Bad    | Bad    | Bad    | Bad    | Bad    | Bad    |
| ↑ Debt              | Good   | Good   | Good   | Good   | Good   | Good   | Good   | Good   |

Key:

|   |      |
|---|------|
| ↑ | Good |
| ↓ | Good |
| → | Ok   |
| ↓ | Bad  |
| ↑ | Bad  |

Cautious Optimism

The domestic economy is exhibiting clear signs of a slowdown, with disappointing figures emerging across various economic indicators, including economic growth, consumer demand, and industrial performance. While there is a deficit in the core liquidity, persistent foreign outflows could prompt the Reserve Bank of India (RBI) to intervene in the foreign exchange market, potentially affecting short-term liquidity, interest rates, and inflation. Despite a boost from the festive season in India, it remains uncertain whether this momentum will be sustained. We will be closely monitoring the situation to determine whether this slowdown is a transient fluctuation or indicative of deeper structural issues within the economy. At the moment we remain cautious, in a wait-and-watch mode.



# Equity Outlook



# Market Cap Risk-Return Profile/ PE-Multiples



| Year | Nifty 50 Return % |     |      |     |      |      |     |     |      |        |        |        |        |
|------|-------------------|-----|------|-----|------|------|-----|-----|------|--------|--------|--------|--------|
|      | Jan               | Feb | Mar  | Apr | May  | Jun  | Jul | Aug | Sep  | Oct    | Nov    | Dec    | CY     |
| 2025 | -1%               |     |      |     |      |      |     |     |      |        |        |        | -0.58% |
| 2024 | 0%                | 1%  | 2%   | 1%  | -1%  | 7%   | 4%  | 1%  | 2%   | -6.22% | -0.31% | -2.02% | 8.6%   |
| 2023 | -2%               | -2% | 0%   | 4%  | 3%   | 4%   | 3%  | -3% | 2%   | -3%    | 6%     | 8%     | 20.0%  |
| 2022 | 0%                | -3% | 4%   | -2% | -3%  | -5%  | 9%  | 4%  | -4%  | 5%     | 4%     | -3%    | 4.3%   |
| 2021 | -2%               | 7%  | 1%   | 0%  | 7%   | 1%   | 0%  | 9%  | 3%   | 0%     | -4%    | 2%     | 24.1%  |
| 2020 | -2%               | -6% | -23% | 15% | -3%  | 8%   | 7%  | 3%  | -1%  | 4%     | 11%    | 8%     | 14.9%  |
| 2019 | 0%                | 0%  | 8%   | 1%  | 1%   | -1%  | -6% | -1% | 4%   | 4%     | 2%     | 1%     | 12.0%  |
| 2018 | 5%                | -5% | -4%  | 6%  | 0%   | 0%   | 6%  | 3%  | -6%  | -5%    | 5%     | 0%     | 3.2%   |
| 2017 | 5%                | 4%  | 3%   | 1%  | 3%   | -1%  | 6%  | -2% | -1%  | 6%     | -1%    | 3%     | 28.7%  |
| 2016 | -5%               | -8% | 11%  | 1%  | 4%   | 2%   | 4%  | 2%  | -2%  | 0%     | -5%    | 0%     | 3.0%   |
| 2015 | 6%                | 1%  | -5%  | -4% | 3%   | -1%  | 2%  | -7% | 0%   | 1%     | -2%    | 0%     | -4.1%  |
| 2014 | -3%               | 3%  | 7%   | 0%  | 8%   | 5%   | 1%  | 3%  | 0%   | 4%     | 3%     | -4%    | 31.4%  |
| 2013 | 2%                | -6% | 0%   | 4%  | 1%   | -2%  | -2% | -5% | 5%   | 10%    | -2%    | 2%     | 6.8%   |
| 2012 | 12%               | 4%  | -2%  | -1% | -6%  | 7%   | -1% | 1%  | 8%   | -1%    | 5%     | 0%     | 27.7%  |
| 2011 | -10%              | -3% | 9%   | -1% | -3%  | 2%   | -3% | -9% | -1%  | 8%     | -9%    | -4%    | -24.6% |
| 2010 | -6%               | 1%  | 7%   | 1%  | -4%  | 4%   | 1%  | 1%  | 12%  | 0%     | -3%    | 5%     | 18.0%  |
| 2009 | -3%               | -4% | 9%   | 15% | 28%  | -4%  | 8%  | 1%  | 9%   | -7%    | 7%     | 3%     | 75.8%  |
| 2008 | -16%              | 2%  | -9%  | 9%  | -6%  | -17% | 7%  | 1%  | -10% | -26%   | -5%    | 7%     | -51.8% |
| 2007 | 3%                | -8% | 2%   | 7%  | 5%   | 1%   | 5%  | -1% | 12%  | 18%    | -2%    | 7%     | 54.8%  |
| 2006 | 6%                | 2%  | 11%  | 5%  | -14% | 2%   | 0%  | 9%  | 5%   | 4%     | 6%     | 0%     | 39.8%  |
| 2005 | -1%               | 2%  | -3%  | -7% | 10%  | 6%   | 4%  | 3%  | 9%   | -9%    | 12%    | 7%     | 36.3%  |
| 2004 | -4%               | -1% | -2%  | 1%  | -17% | 1%   | 8%  | 0%  | 7%   | 2%     | 10%    | 6%     | 10.7%  |
| 2003 | -5%               | 2%  | -8%  | -5% | 8%   | 13%  | 5%  | 14% | 4%   | 10%    | 4%     | 16%    | 71.9%  |
| 2002 | 2%                | 6%  | -1%  | -4% | -5%  | 3%   | -9% | 5%  | -5%  | -1%    | 10%    | 4%     | 3.2%   |
| 2001 | 9%                | -1% | -15% | -2% | 4%   | -5%  | -3% | -2% | -13% | 6%     | 10%    | -1%    | -16.2% |
| 2000 | 4%                | 7%  | -8%  | -8% | -2%  | 7%   | -9% | 5%  | -9%  | -8%    | 8%     | 0%     | -14.7% |

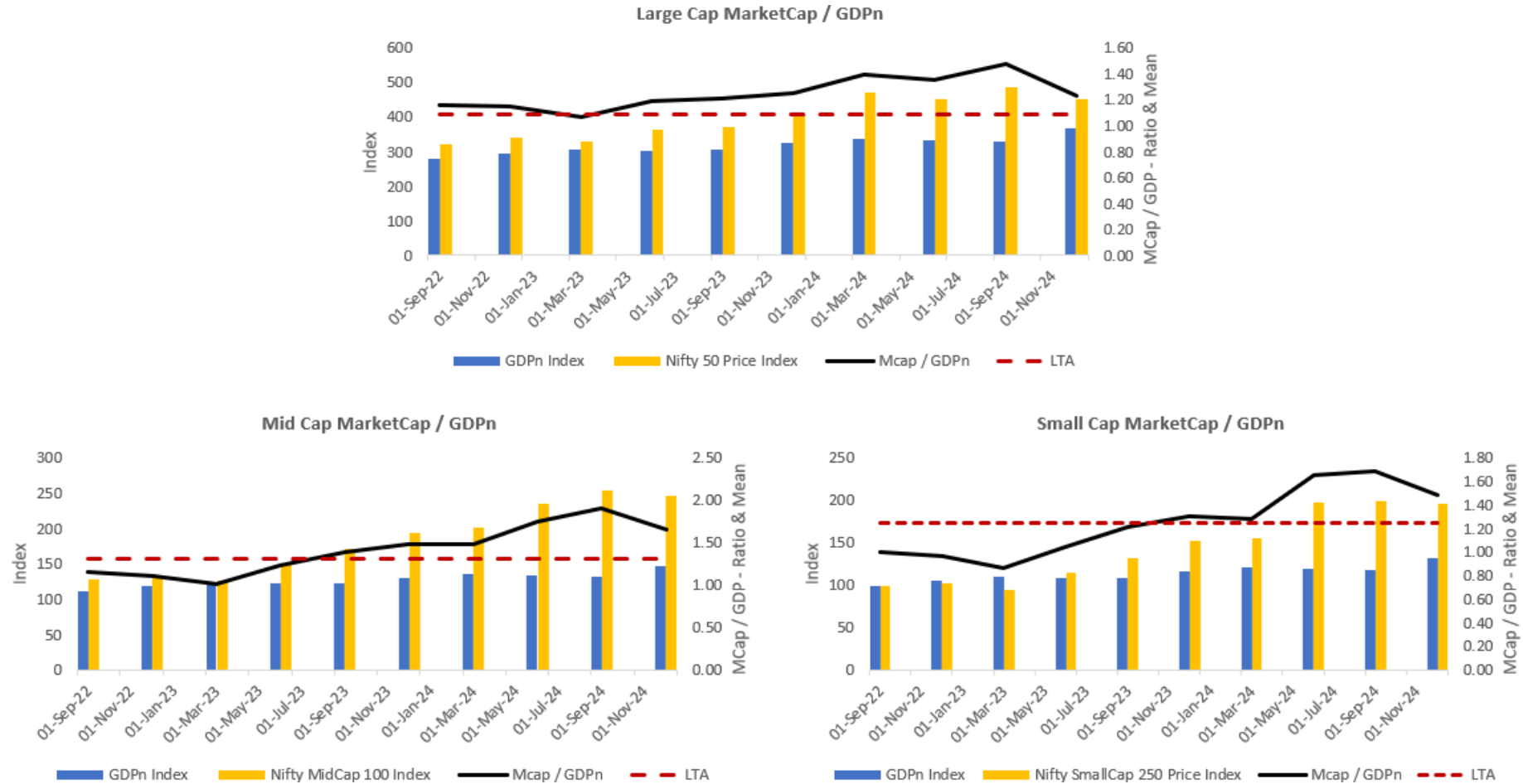
| Risk-return Measures             | Nifty 50 | Nifty Mid Cap 150 | Nifty Small Cap 100 |
|----------------------------------|----------|-------------------|---------------------|
| CAGR Return %                    | 12.1%    | 15.6%             | 17.0%               |
| Standard Deviation               | 21.8%    | 26.5%             | 30.5%               |
| Avg Months with +ve return / yr  | 7        | 7                 | 6                   |
| Avg Months with -ve return / yr  | 5        | 4                 | 5                   |
| Avg Months with >6% decline / yr | 1        | 1                 | 1                   |
| No of Years                      | 25       | 19                | 11                  |

## Tempered Down Expectations

- From Oct 2024 till Jan 2025, the Nifty 50 Index has declined ~9%, sparking caution among investors. **Historically, the Nifty 50 has given a CAGR of ~12% over the past ~25 years**, with an average of only 1 month in a year where returns have declined by 6% or more (this number is the same for mid and small caps). Furthermore, advances and declines in a single month were at an average of 7 and 5 respectively in a single year for large caps, thus tending towards a CAGR of ~12% over a long-time horizon. **Similarly Mid Caps registered a CAGR of ~16% over the past ~19 years and Small Caps registered a CAGR of ~17% over the past ~11 years**. As we start CY 2025 with a modest -1% return in Jan 2025 for Nifty 50, thus exhibiting mean reversion from the past year. However Mid and Small Caps have given a return of ~24% each in CY 2024 which followed 44% and 56% return respectively in CY 2023. Hence, **we expect returns in Mid and Small Cap Indices to be subdued in CY 2025 with reversion to their long-term mean**.
- The scatterplot shows the tradeoff between risk and return for the 3 Market Cap indices, with increasingly higher returns at the cost of higher risk as we move down the Market Cap spectrum.
- As per TTM PE valuations Mid Cap and Small Cap seem to be Overvalued and Large Caps Fairly-valued.

| Market Cap | Current PE | Long Term Average PE | Premium / (Discount) | Valuation     |
|------------|------------|----------------------|----------------------|---------------|
| Large Cap  | 21.08      | 23.98                | -12%                 | Fairly Valued |
| Mid Cap    | 37.32      | 32.18                | 16%                  | Overvalued    |
| Small Cap  | 30.05      | 24.87                | 21%                  | Overvalued    |

# Buffett Indicator



The present lofty valuations are evidenced in the **high premiums exhibited in their Mcap/GDP ratios where Large Caps, Mid Caps and Small Caps are currently trading at premiums of approx 10%, 13%, and 10% respectively** (as per Buffet Indicator), as on 31<sup>st</sup> Jan 2025.

# Budget Impact on Sectors



## Auto Sector

- Finance minister proposes to **exempt import duty on Capital Equipment's used for manufacturing Lithium-Ion Batteries used in Electric Vehicles**. This will **promote manufacturing Li-On batteries in India and is positive for players setting up such plants in India**. This is particularly positive for Exide Industries and Amara Raja Energy and Mobility which are executing sizeable capex in this field.
- The government has **increased the allocation for the Production-Linked Incentive (PLI) scheme for the automobile sector to ₹2,818 crore for FY26E, up from ₹ 347 crore for FY25RE**. This is **beneficial for companies investing in capital expenditures in the new energy sector, including Electric and Hydrogen-Powered Vehicles**. This is positive for all domestic OEM's.
- The government has **raised the allocation for the PM E-DRIVE scheme to ₹4,000 crore in FY26E, up from ₹1,871 crore**. This increase is **beneficial for domestic two-wheeler and three-wheeler original equipment manufacturers (OEMs)**. Positive for Bajaj Auto among others.

## Banking & MSME's

- **Kisan Credit Cards (KCC) facilitate short term loans for ~7.7 crore farmers, fishermen, and dairy farmers**. Increase in loan limit under Modified Interest Subvention Scheme from ₹3 lakh to ₹5 lakh for loans taken through the KCC.
- **Customised credit cards with a ₹ 5 lakh limit for micro enterprises** registered on Udyam portal. In the first year, 10 lakh such cards targeted to be issued.
- **Public Sector Banks will develop 'Grameen Credit Score' framework to serve credit needs of SHG members and people in rural areas**.
- **Proposed to increase FDI limit for insurance sector from 74% to 100%**. This enhanced limit will be available for companies which invest entire premium in India.
- **Increase in investment and turnover limits for classification of all MSMEs by 2.5 and 2 times respectively to include more number of small businesses**.
- **Enhancement in credit guarantee cover for MSME to improve access to credit:**
  - a) For Micro and Small Enterprises, from ₹5 crore to ₹10 crore, leading to additional credit of ₹1.5 lakh crore in the next 5 years
  - b) For Startups, from ₹10 crore to ₹20 crore, with the guarantee fee being moderated to 1 per cent for loans in 27 focus sectors important for Atmanirbhar Bharat
  - c) For well-run exporter MSMEs, for term loans up to ₹20 crore.



### Capital Goods / Power

- **Nuclear power projects, with aspirations of 100GW of nuclear power projects by FY47 from 8.2 GW in FY25. The government proposes to bring in private participation in the nuclear power projects.** NTPC, L&T, BHEL will be key beneficiaries. Additionally, the government has provided for an outlay of ₹20000 crore for Small Modular Reactors (SMR). At least 5 indigenously developed SMRs will be operationalized by 2033.
- **Reforms in the power distribution, inter state transmission capacity augmentation will bring in reduction in transmission and distribution losses, attract private participation in the power distribution space thus improve the entire power generation, transmission and distribution ecosystem.** This will also enable increase in smart meter adoption thus smart meter manufacturing companies like HPL electric will benefit.
- **The urban challenge fund of ₹1 trillion will be set up for Cities as growth hubs creative redevelopment of cities, water and sanitation along with increase in overall outlay for Jal Jeevan Mission.** This is expected to bring in EPC opportunities for players like L&T, VA Tech Wabag, KEC International and Kalpataru Projects International, EMS Ltd.
- Under make in India mission the **government aims to improve domestic value addition and build ecosystem for solar PV cells, EV batteries, wind turbines, very high voltage transmission equipment and grid scale batteries. Custom duties have also been reduced on solar cells.** The development of local supply chain will create opportunities across industrial players like Reliance, Tata group, Adani group, L&T, Jindal group, among others.

### Consumer staples

- **Exemption on personal income tax upto ₹12,00,000 and addition of new tax slab will lead to higher income in the hands of middle-income group. Further the government has increase allocations under various scheme to improve rural economy. This will boost consumer sentiments in the urban and rural demand in India, which lead to uptick in the consumer demand going ahead (likely from Q1FY26).**
- **Uptick in consumer demand will result in the urban FMCG volume growth to gradually recover which touched the low of 2% in Q3FY25.** Rural FMCG volume growth stood ahead of urban volume growth at mid-single digit. With good support in the budget, we expect rural volume growth to further improve in the quarters ahead. This Positive for all the consumer staple companies, which might see good recovery in the volume growth in FY26.
- **Demand for premium consumer goods will go up in FY2026** and hence it will be positive for companies such as HUL, Marico, Nestle India and Tata Consumer Products who are riding on premiumisation strategy. Also **demand for premium and luxury liquor will increase** which will benefit companies such as Allied Blenders & Distillers and Radico Khaitan.
- There was **no increase on cess or tax rate on cigarettes** in the union budget. No increase in tax rate cigarette will help legal/branded cigarette companies to increase it market share in the near term. We expect ITC cigarette sales volume to continue to grow at 3-5%.
- **Basic custom duty on synthetic flavouring essences and mixtures of odoriferous substances used in food and drinks industries reduced from 100% to 20%.** This will be positive for food and beverages companies such as Varun Beverages, Dabur India, Nestle India and Tata Consumer Products.
- **Basic custom duty on Sorbitol reduced from 30% to 20% in the Union Budget. Sorbitol is one of the key inputs in the manufacturing of toothpaste. Reduction in the custom duty on Sorbitol is positive for toothpaste manufacturing companies** such as Colgate Palmolive India, Dabur India and HUL.



## Consumer discretionary

### a) Tourism & Hospitality

- Tax exemption on the personal income tax will maintain the momentum in the domestic tourism and will help room demand to remain high in the near term.
- **Integrated development of tourist circuits around specific theme (Swadesh Darshan) has been increased by 5x to ₹1900crore** compared to last year.
- **Modified Udaan scheme will be launched to enhance regional connectivity to 120 new destinations and carry 4 crore passengers in the next 10 years.**
- **Top 50 tourist destination sites in the country will be developed in partnership with states. Hotels in those destinations will be included in the infrastructure HML.**
- **Medical Tourism and Heal in India will be promoted in partnership with the private sector along with capacity building and easier visa norms.**
- A special focus on destinations related to the life and times of Lord Buddha.
- Overall, we believe **hotel sector will continue to benefit from sustained momentum in the domestic tourism and government focus on improving infrastructure and development of tourist places to drive tourism in India.** It is positive for hotel companies such as Indian Hotels Company, Lemon Tree Hotels, Chalet Hotels and Samhi Hotels etc.

### b) Lifestyle fashion, footwear and QSR

- **Increase in consumers wallet would lead to recovery in the consumption of branded apparel and footwear space in FY26.** This will help same-store-sales growth of branded apparels and retail companies to recover from lows in the quarters ahead. Fast fashion demand will remain high in the tier 2 and tier 3 town and will benefit the fast fashion companies such as Trent, V2 Retail and Vishal Megamart who are expanding footprints in the tier 2 and tier 3 towns.
- **QSR sector was reeling under the pressure of food inflation resulting in lower consumption. Increase wallet will lead to higher spends on food consumption in restaurant and food courts, which will help average daily sales to gradually pick up.** This will be positive for QSR companies such as Jubilant Foodworks, Devyani International and Restaurant Brand Asia.
- **Government plans new policy for leather and non-leather footwear sector with focus on increasing the domestic production of non-leather footwear along with providing required support to leather footwear segment largely to drive export sales.** Positive for footwear companies such as Bata India, Campus and Relaxo Footwear.

### c) Jewellery and luxury watches

- **Jewellery industry will benefit from no increase in custom duty on gold and silver in the budget. Further exemption on the personal tax will help the ticket size of jewellery segment to increase in the upcoming wedding and festive season.** This will be positive for Titan.
- **Demand for luxury watches will remain strong helping watch makers to clock in better volumes.** It is Positive for the company like Titan and Ethos.



### Consumer Durables

- The rationalisation in personal income tax slabs shall leave more money in the hands of middle-class consumers which shall aid discretionary spending and thus consumer durable companies. **Discretionary home appliances companies (Room air-conditioners, lighting & fixtures, fans, refrigerators, washing machines) which are urban centric could find growth impetus in the recent sluggish scenario.** Companies like Havells, Crompton, Bluestar, Voltas and Whirlpool to be key beneficiaries.

### Electronic manufacturing services (EMS)

- **To address inverted duty structure, BCD on interactive flat panel displays to be increased from 10% to 20%. This is in line with government's Make in India initiative and shall support import substitution. Besides, custom duty on open cells for LCD and LED television has been reduced to 5% and Inputs/parts of open cells used for manufacturing television is exempted from current 2.5% making the manufacturing of TV more affordable.** Dixon is a major player in this segment and shall benefit from the same.
- **The government has fully exempted customs duty on 28 capital goods for use in the manufacture of lithium-ion battery production of mobile phones. Additionally, the BCD on key components used to manufacture PCBA, camera modules, connectors, USB cables, and fingerprint sensors has also been reduced from 2.5% to zero.** Dixon tends to be key beneficiary.

### Infrastructure

- In the Union Budget 2025, the extension of the Jal Jeevan Mission (JJM) until 2028 was announced with an enhanced total outlay, aiming to achieve 100% coverage of potable tap water connections across rural households. JJM has been allocated ₹ 67,000 crore, marking a significant increase from the revised estimates of ₹ 22,694 crore in 2024-25.
- **The ministry of road transport and highways (MoRTH) saw its allocations of ₹ 2.72 lakh crore for 2025-26, which is largely unchanged from the previous year. The flattish allocation is largely due to likely to focus of government on BOT methods, as well as focussing on other sources including asset monetisation.**

### Metals and Mining

- The Union Budget has proposed a **full exemption of basic custom duties (BCD) on cobalt powder and waste, the scrap of lithium-ion battery, lead, zinc and 12 other critical minerals. This will reduce the procurement cost, which will benefits metal recycling companies.**
- **With the goal of providing 100% coverage of potable tap water to rural India, the government has extended the Jal Jeevan Mission until 2028. It has increased allocation from ~₹22,505 crores in Revised Budget 2024-25 to ~₹66,770 crores for 2025-26. This will benefits pipe manufacturers.** Also beneficial for players such as NCC, PNC Infra and KNR who have a presence in the water segment.
- **Government has also raised the budget allocation for Specialty steel under the Production Linked Incentive scheme to ~₹305 crores, up from ~₹55 crores in revised budget 2024-25. This scheme aims to boost the production of specialty steel grades and is positive for players such as Vardhman Speciality Steel.** This is favorable for JSW Steel and SAIL, which is venturing into the manufacturing of cold rolled grained oriented steel, a high value steel essential for production power transformers.
- For the National Critical Mineral Mission, the government has allocated ~₹410 crores in the Budget 2025-26. This focuses on enhancing domestic production, recycling of critical minerals, and overseas acquisition of critical mineral assets. This will be beneficial for mining companies such as Coal India, NMDC etc. which are currently expanding in this space.
- Government has also allocated ~₹300 crores for Coal/Lignite gasification scheme in the Budget 2025-26. Coal India is a key beneficiary given this scheme aims to achieve ~100 MT of coal gasification target by 2030.



### Defence, Space & Ship-building

| Rs Crore                    | FY24            | FY25RE          | FY26BE          | YoY (%)      |
|-----------------------------|-----------------|-----------------|-----------------|--------------|
| Aircrafts & Aero-Engines    | 40,278          | 46,592          | 48,614          | 4.3%         |
| Naval Fleet                 | 23,800          | 25,605          | 24,391          | -4.7%        |
| Heavy & medium vehicles     | 4,638           | 4,093           | 3,651           | -10.8%       |
| Naval Dockyards             | 6,830           | 5,418           | 4,500           | -16.9%       |
| Other Equipments            | 62,198          | 46,589          | 63,099          | 35.4%        |
| Others                      | 19,484          | 31,203          | 35,745          | 14.6%        |
| <b>Total Capital Outlay</b> | <b>1,57,228</b> | <b>1,59,500</b> | <b>1,80,000</b> | <b>12.9%</b> |

- The total capital expenditure for defense in FY26E is set at ₹1.8 lakh crore, reflecting an approximate 13% YoY increase compared to FY25RE.
- For R&D (Research & Development) in defence sector, capital outlay allocated is at ₹14924 crore for FY26E, ~9% YoY increase over FY25RE.
- Capital outlay for space sector is at ₹6104 crore (29% increase over FY25RE). This aligns with the goal of expanding the space economy by fivefold over the next decade.
- A credit note scheme for ship recycling has been introduced in Indian shipyards to reduce costs and promote domestic manufacturing. Shipbuilding clusters will also be established, focusing on improved infrastructure, skill development, and advanced technology.
- A ₹25,000 crore Maritime Development Fund will be established for long-term financing and increased competition, with the government contributing up to 49% and the rest sourced from ports and private sector participants.
- A ten-year exemption from basic customs duty has been introduced for materials used in shipbuilding and ship-breaking to promote MRO activities. Additionally, the export timeframe for imported railway goods for repair has been extended.
- These announcements support the government's goal to boost India's share in the global shipbuilding market, where it currently holds less than 1%.



### Logistics

- India Post to be transformed into large public logistics organization. India Post, with its 1.5 lakh rural post offices, supported by the India Post Payments Bank and a network of 2.4 lakh daak sevaks, will be repositioned to drive the rural economy forward. The transformation will see India Post evolve into a major public logistics entity, addressing the growing needs of Vishwakarmas, emerging entrepreneurs, women, self-help groups, MSMEs, and larger businesses.

### Oil and Gas

- OMCs may continue to struggle as the budget does not provide the anticipated stimulus. For FY25, the government has revised the LPG loss subsidy upward to ₹14,700 crores as compared to the ₹11,925 crores announced in the previous budget. However, inspite of the upward revision, OMCs are likely to take a hit in profitability as under-recovery stood in excess of ₹30,000 crores for 9MFY25. To add to the pain, the FY26 budget has allocated ₹12,100 crores for LPG subsidiary, far lower than the anticipated value. This shall have a significant negative impact on the profitability of OMCs.
- GAIL, Petronet LNG and end users likely to benefit from reduced custom duty on LPG. The Custom Duty on Liquified Petroleum Gas (LPG), Liquified Propane and Liquified Butane has been revised downwards from the existing 15% to 5%, applicable from 1st May, 2025. This move is set to benefit GAIL and Petronet LNG, thereby lowering the net cost of consumption for the end users.

### Pharma & chemicals

#### a) Agro-chem

- PM Dhan-Dhaanya Krishi Yojana, covering 100 districts with low productivity, to enhance productivity and crop diversity among others benefitting 1.7 crore farmers is likely to benefit domestic agrochem players.

#### b) BCD exemption on import Lifesaving cancer drug/API

- Proposal to **fully exempt Basic Custom Duty on 36 life saving drugs for cancer and rare diseases and concessional customs duty of 5% on 6 lifesaving medicines is expected to benefit pharma players importing and distributing these drugs.** Full exemption and concessional duty on the bulk drugs(API's) for manufacture of 36 lifesaving drugs for cancer and rare diseases is likely to benefit domestic formulation manufactures of these drugs.

#### c) Focus on Healthcare

- Medical tourism and Heal in India to be aided by capacity building with the private partners and easing visa norm to benefit private hospitals.
- **Increase in allocation for Aayushman Bharat(PMJAY) from ₹7,605 crore to ₹9,406 crore implying ~24% growth is expected to be beneficial for hospitals.**



### Real Estate

- Tax relief on the annual value of self-occupied properties claimed as nil increased to two properties from one.
- Annual limit for TDS on rent increased to ₹ 6 lakh from ₹ 2.4 lakh.
- Special Window for Affordable and Mid-Income Housing (SWAMIH) Fund 2 will be established as a blended finance facility with contribution from the Government, banks and private investors. This fund of ₹ 15,000 crore will aim for expeditious completion of another 1 lakh units.

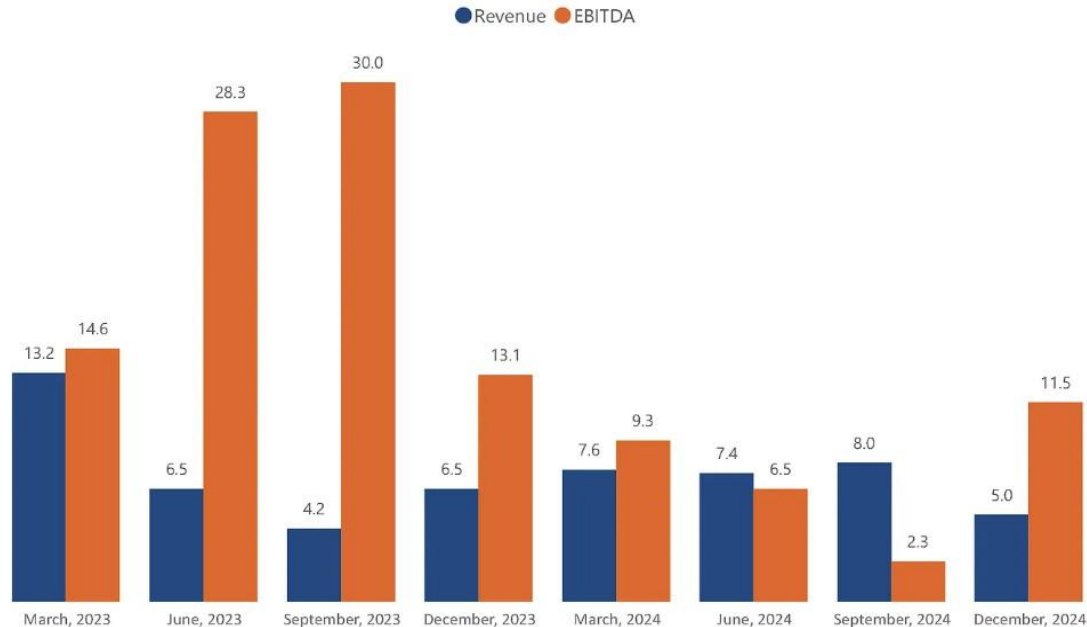
### Textiles

- Government has proposed 5-year mission which will facilitate significant improvements in productivity and sustainability of cotton farming, and promote extra-long staple cotton varieties. This will result in consistent supply of quality cotton to the domestic textile players. Positive for textile companies such as KPR Mills, Arvind, Welspun India and Gokaldas Exports etc.
- Government has increased the allocation of production linked incentives (PLI) scheme for textile to ₹1,148crore from ₹45 crore in the earlier years. Positive for textile companies.

# Corporate Earnings



## Corporate Performance (YoY%)



## Below Expectations

- The early results so far seem to suggest that this quarter might be slightly better for corporate profitability compared to the last quarter as margins seem to have expanded. **Overall revenue growth is currently tracking only 5% growth YoY which is the second-lowest growth in the last few years. However, EBITDA growth is currently tracking 12% growth YoY, the highest growth since the December quarter of 2023.**
- This is broadly in sync with top-down data which is also suggesting that the December quarter was stronger for the economy compared to the extremely weak growth reported during the September quarter. However, as on the 1<sup>st</sup> week of Feb when this review was written, a significant majority of the companies are yet to report so these numbers can change.
- Corporate India's underwhelming performance so far led to an ~11% correction in Nifty 50 from September highs. The market currently seems to be in a risk off sentiment with heavy FPI outflows since September this year. **Geopolitical risks, domestic urban consumption slowdowns, slower than expected US Fed rate cuts, falling rupee, and Trump's trade policy uncertainty are the major headwinds to the market currently.**

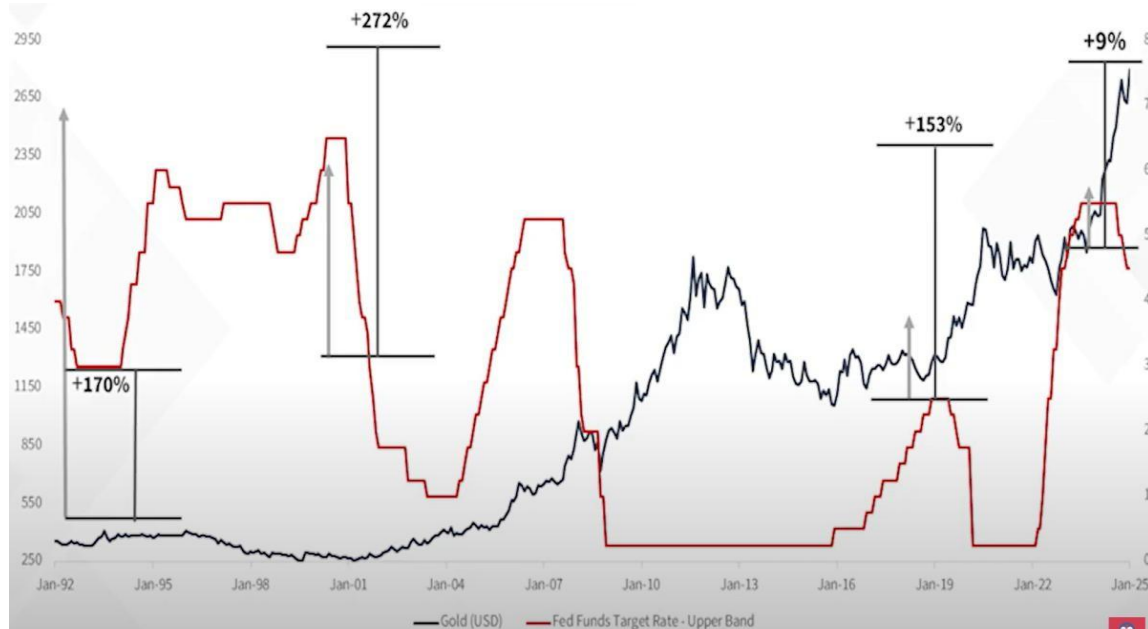
## NIFTY 50

| INR Trillion          | FY20-23 CAGR | FY24  | FY25E | FY26E | Growth |       |
|-----------------------|--------------|-------|-------|-------|--------|-------|
|                       |              |       |       |       | FY25E  | FY26E |
| M-CAP                 | 27.0%        | 187.8 | -     | -     |        |       |
| EPS                   | 19.0%        | 1005  | 1033  | 1177  | 4.4%   | 14.7% |
| EPS ( Q1 FY25)        |              |       | 255   |       |        |       |
| EPS ( Q2 FY25)        |              |       | 254   |       |        |       |
| EPS 2H FY 25 Expected |              |       | 524   |       |        |       |

## Looking Forward

- First 6 months of FY 2024-25, Nifty 50 EPS has touched 509. In H2 FY 2024-25 EPS is expected to be 524 (~4% expected growth in total). However, **EPS is expected to grow ~15% to 1,177 in FY 2025-26. If this number is achieved, then this presents limited downside to the market from a valuation point of view.**

# Gold



## China Continues Making Covert Gold Purchases In London

Jan. 28, 2025 5:53 AM ET | SPDR® Gold Shares ETF (GLD), IAU, IGT:CA, GLDM, SGOL, BAR, IAUM, OUNZ, AAAU, XAUUSD:CUR | DBP, GLTR, JJP... | 4 Comments



Jan Nieuwenhuijs

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### INVESTMENT

## China to allow insurance funds to buy gold

China will allow insurance funds to buy gold for medium and long-term asset allocations

Xiuhao Chen, Reuters News

February 7, 2025

- China continues to buy Gold to diversify their massive FX reserves, as part of their 'de-dollarization' program.
- Additionally, the **Chinese government has allowed the Chinese insurance companies which are managing ~₹4.3 Trillion to buy upto 1% in Gold as an asset class**, this in turn would lead to **incremental demand of ₹43 Billion**.
- **Whenever the US Fed has cut interest rates in the past, Gold prices have rallied. Going forward the US Fed is looking to cut interest rates, albeit not at the same pace as originally expected. This will provide further momentum to rising Gold prices.**

# Strategy



## Tailwinds

- Robust **structural long term economic growth**.
- **Political Stability** with BJP and allies forming majority at the Center as well as in Maharashtra and Delhi.
- **Consumption boost** in the Budget.

## Headwinds

- **Subdued earnings** due to **slowing consumer demand**.
- **Elevated valuations**, especially in the Mid Cap and Small Cap space.
- **Geopolitical uncertainty** with Israel-Palestine and Russia-Ukraine conflicts lingering on.
- **Foreign flows redirecting towards US** and general risk off sentiment due to a **slower than expected rate cut cycle** in the US, and **falling rupee**, leading to heightened market volatility.
- Uncertainty over **Trump's impending trade policies**.

## Outlook

- **Heightened Volatility with a Downward Bias / Risk Off Sentiment**

## Suggested Strategy

### ➤ *Underweight Equity*

| <i>Category</i>  | <i>Stance</i>      |
|------------------|--------------------|
| <i>Large Cap</i> | <i>Neutral</i>     |
| <i>Mid Cap</i>   | <i>Underweight</i> |
| <i>Small Cap</i> | <i>Underweight</i> |

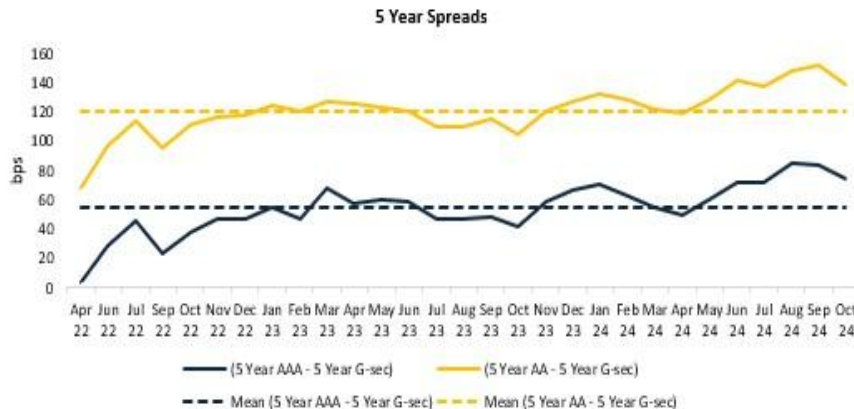
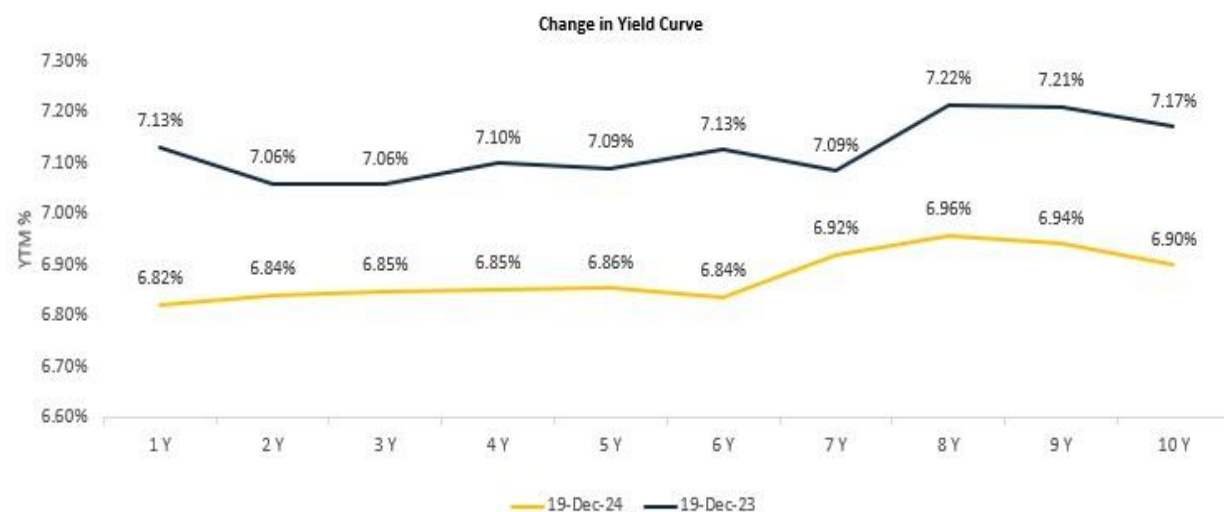
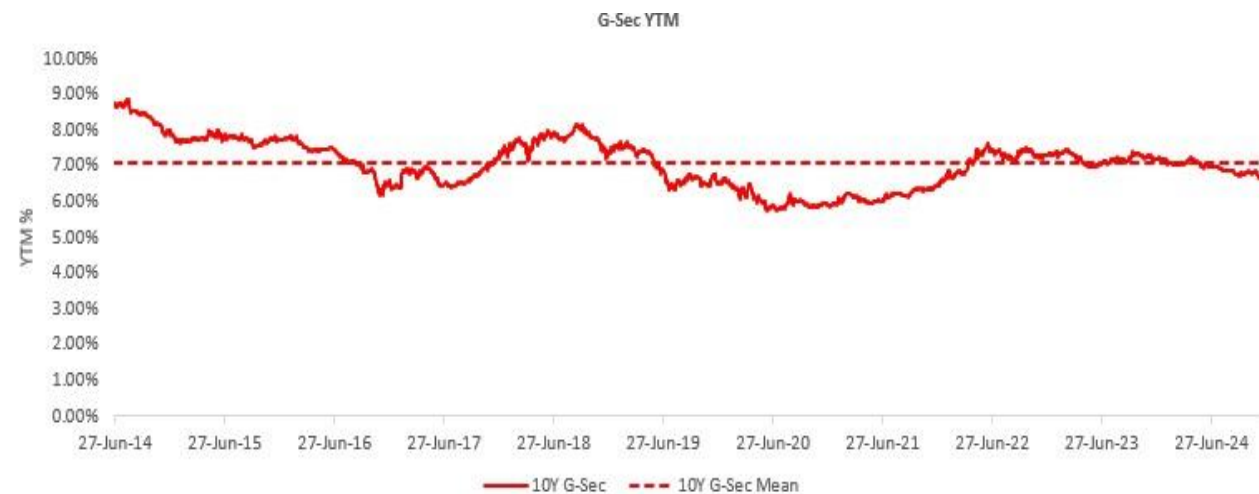
### ➤ *Marginally Overweight Gold*



# Debt Outlook



# Yields & Spreads



The **spreads** between high quality and high yield papers have **mean reverted**, however **still remain above the long run average**, hence investors should be **selective while choosing high yielding papers to gain proportionate risk premium**. **Cooling yields at the long end of the yield curve** are providing impetus to returns from a duration strategy.

# Debt Market Outlook



## Monetary Policy Feb 2025:

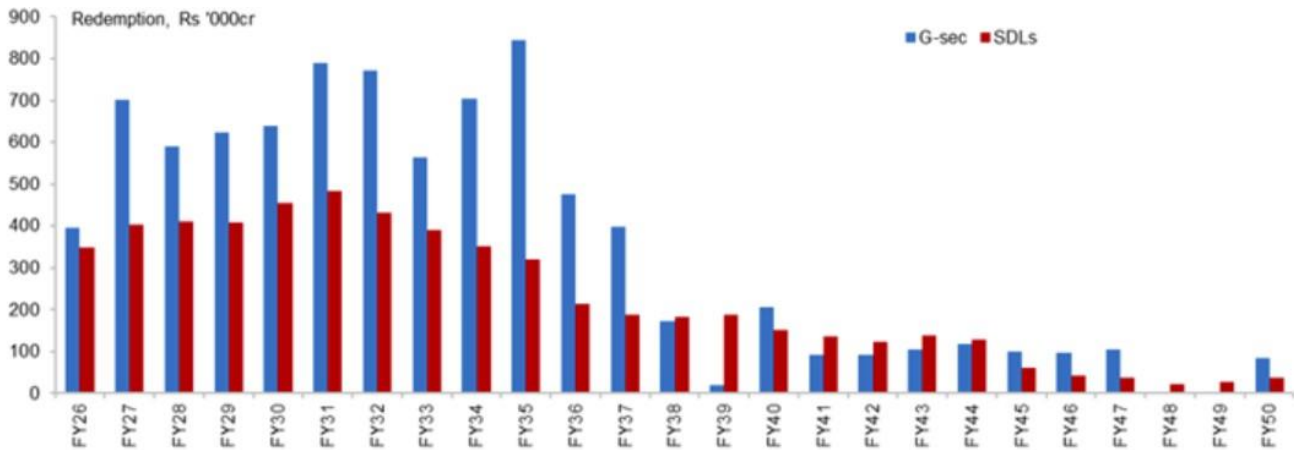
- **The MPC delivered a 25 bps cut as widely expected in an equally widely anticipated policy**, since this was new Governor Malhotra's first. To that extent, market participants were keenly looking out for some indication on the Governor's line of thinking, while always appreciating the importance of institutional continuity.
- **The Governor noted the flexibility embedded in the mandate when responding to evolving growth-inflation dynamics.** To that extent, if market needed clearer signals that an actual durable attainment of the exact 4% target is not required for monetary easing, then that was delivered.
- The commentary on regulatory front, looks to be a consideration of not unduly burdening the system even as one looks to not compromise on stability. Indeed, the Governor clarified in the press conference that the **Liquidity Coverage Ratio (LCR) guideline revisions will not be applied at least till March 2026. No timeline was given for Expected Credit Loss (ECL) norms.**
- The Governor also **committed to provide 'sufficient system liquidity' and continuing to monitor evolving conditions and 'proactively take appropriate measures to ensure orderly liquidity conditions'**. With the number of measures taken thus far, and the Governor's assurance even in the press conference that RBI will remain proactive, the market does have overall comfort that RBI will likely be more proactive than before. However, participants are left guessing whether 'sufficient' and 'orderly' mean surplus liquidity conditions or not. This point is important since sustained transmission may require a surplus liquidity environment.
- Bond market experts continued with their preferred statement in terms of '**constraint optimisation**' when evaluating macro policy. The constraint from a hawkish external environment was clear in the stance being retained even as optimisation was attempted with a rate cut. **With CPI expected to average 4.2% for the next financial year, an April or at worst June cut is also very much on the table provided the global environment allows for it.**
- **Market's near term disappointment is with respect to the absence of new liquidity measures.** Estimates indicate that the cumulative measures undertaken thus far may still fall short of making **core liquidity turn positive, given ongoing seasonal currency in circulation increases as well as continued dollar sales by RBI.** The assurance on further measures as needed, including on durable liquidity injections, would have helped.
- That said, the absence of 'here and now' new measures does **create a window of uncertainty during what is peak busy season on credit levying maximum pressure on lenders' resources.** Further, the important distinction between 'sufficient' liquidity and 'surplus' liquidity remains as yet unclarified. **This may keep deposit rates under pressure for now. However, from next quarter as credit 'lean' season begins and core liquidity improves further, including from an expected hefty RBI dividend, the transmission process can commence in a more broad-based fashion. Drawing from this scenario, we will look for RBI announcing new 'liquidity bridging' measures between now and May.**
- Apart from the **next rate cut expectation being still alive, RBI bond purchases continue**, and the government has **recently reiterated fiscal discipline. We continue with our preference for government bonds in running duration.** An important outcome from the RBI policy was also the **announcement of the bond forward guidelines that will incrementally strengthen demand for long term government bonds.**



**Constraint Optimisation:**

We have favored long duration government bond exposures. This view was enabled by our assessment of **structural tailwinds to India bonds led by revised current account dynamics** and a credible fiscal and monetary policy framework. Policy developments since then have if anything reaffirmed that view, with the latest case in point being the **continued fiscal consolidation** in the just concluded Union Budget and the **adoption of an institutionalized framework targeting debt to GDP from FY 27 onwards**. Alongside, monetary policy remains credible and sporadic inflationary pressures are coming off. This should set up a clean runway for long duration bonds from a macro-economic standpoint.

As can be seen in the chart the period of high annual maturity runs till FY 35. From FY 36 onwards maturities begin declining again. Thus, even **from a risk management standpoint, the government can now afford to start bringing down the average maturity of borrowings**.



Note: 1) Weighted average maturity calculated based on G-sec borrowing up to 24 January 2025 and SDL borrowing up to 21 January 2025. 2) Redemption data as on 27 January 2025 for G-sec and based on borrowing up to 21 January 2025 for SDLs.

The **government has done a remarkable job of re-establishing fiscal credibility through measured and focused actions** over the past few years. The recent Union Budget was yet another affirmation of this credibility. Associated with this, however, also have to be endeavors to optimise benefits from this credibility. One of the obvious ones is that **so long as the government is confident about adhering to broad fiscal frameworks, it can afford to worry less about refinancing future debt maturities**.

Keeping refinancing conservatism in mind, the government can afford to bring down the average maturity of issuances going forward. Interest payment to GDP has risen appreciably over the post pandemic period. This has correspondingly cut fiscal flexibilities. While the major driver to bringing this down will be reducing debt to GDP (the framework for which the center has already presented), some small incremental gain can also be made from optimising cost of borrowing. Indeed, if the government were to behave like a private commercial issuer, then the confidence that macro policies are progressively aligning India towards a lower perceived risk destination should argue for lower propensity to lock away incremental long term borrowings at current rates.

Additionally, the 5-10 year segment will likely see robust demand over the next couple of years owing to rate cuts and possibly large OMOs from RBI (the latter to compensate for weaker balance of payment surplus, annual currency in circulation drain, and the need to ensure abundantly surplus liquidity to transmit upcoming rate cuts). Thus stepping up issuances in the vicinity of the 10 year segment also addresses upcoming demand, just as enhancing issuances at long end has done over the past few years.



### **Investor Standpoint:**

Reasons as to why we think the long end of the government bond curve, notwithstanding recent underperformance, still looks very good:

1. The **underlying macro reason (strong structural fiscal situation) for owning long tenor bonds remains intact.**
2. The average tenor of issuance has been increased meaningfully over the past few years. This has been to cut roll over risks on large maturities lined up for the next few years as well as to respond to the strong rise in participation of the long term investor class. However, as we have shown above, **the maturity 'hump' declines by FY 35, thereby allowing the government to start reducing average maturity of borrowings. This will also address some possible change in incremental demand pattern and will help optimise cost of borrowing as well.**
3. Most importantly, **real money investors shouldn't necessarily worry about some widening of term spreads so long as yields are generally falling.** This is basis the obvious point that the **long end carries much higher duration and can deliver better absolute returns even with some widening of term spreads. Thus so long as the view on rates is bullish, it makes sense to own higher duration. Put another way, for fear of some curve steepening, investors may end up compromising severely on average duration which may hurt performance over the medium term.**

The problem in the past few months has been that the **rise in term spreads has been sharp over a short span of time, driven both by weaker incremental demand from long term investors as well as RBI largely buying 5 – 10 years under OMOs. Thus, while yields in the mid duration segment have declined, the long end has remained largely stagnant. As this stagnation reverses, the duration benefit of the long end will reassert itself in performance even accounting for some further widening of term spreads.** Additionally, if, as seems logical basis the reasoning presented above, government / RBI were to tweak some supply away from the long end, then the performance could be even more pronounced since then term spreads may have no reason to widen further. An additional trigger here could be the advent of public sector insurance into the bond forward market.

Finally, and **most fundamentally, long duration government bonds still look to us as one of the best macro trades on India's rising relevance on size, its macro-stability narrative, and the likely continued discovery of Indian bonds by offshore investors over the next few years.** Given this, the demand-supply dynamics presented here as well as potential issuance offsets discussed above are meant more as a short term analysis and do not take away from the attractiveness of long duration over the medium term.

### **Suggested Strategy:**

- ❖ *Investors should remain vigilant, balancing near-term curve volatility against opportunities in both the short and long ends of the yield curve. A Bullet strategy with allocation to longer duration 10yr+ GSec/AAA bonds. This strategy has a 2 pronged advantage, in anticipation of bull flattening of the 1-10Y or 1-15Y yield curve– (i) cutting out reinvestment risk thus locking in a TMF (Target Maturity Fund) at a higher yields (ii) Increased duration benefit at the longer end of the yield curve.*
- ❖ *Overweight Debt but Liquidity to be tracked very closely.*

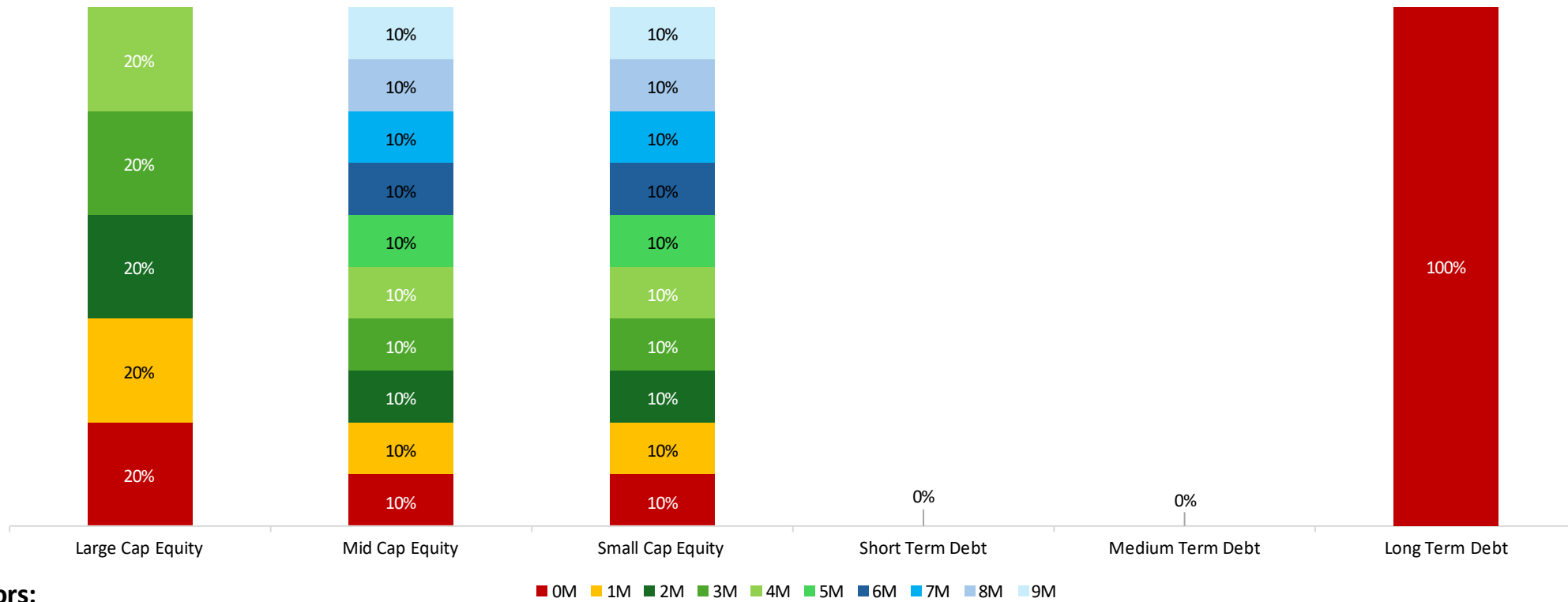
# Deployment Strategy



# Deployment



Stages of Deployment



## Indicators:

### Indicators signaling over heated market conditions –

- VIX at 14-15 levels
- Market Cap/GDP for Large Cap, Mid Cap, and Small Cap Indices well below their LTA's
- Consumption and Investment subdued for now
- TTM PE for Mid Cap and Small Cap Indices still above their LTA
- FIIs have been net sellers since Oct due to depreciating rupee and un/less profitable carry
- Liquidity

### Indicators signaling fair valuation -

- Services Exports and Imports signaling a possible reversal in domestic demand
- TTM PE for Large Cap Index below its LTA
- DII activity

## Deployment Strategy:

### *Staggered Deployment over the next 10 months -*

- Large Cap – 20% immediate deployment and 20% in each month in the next 4 months
- Mid Cap – 10% immediate deployment and 10% in each month in the next 9 months
- Small Cap - 10% immediate deployment and 10% in each month in the next 9 months
- Long Term Debt - 100% immediate deployment (Duration strategy)

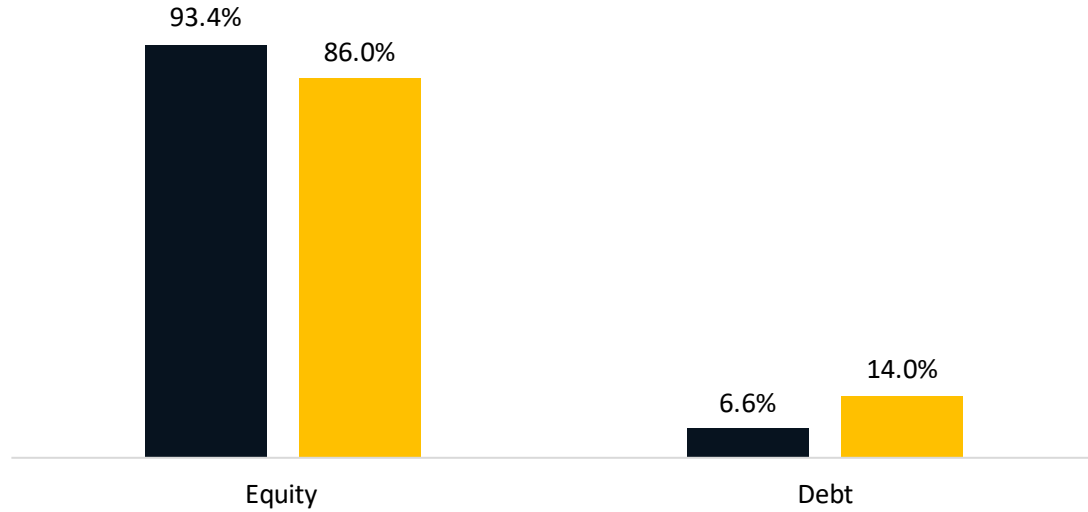
# Optimus Prime Model Portfolio





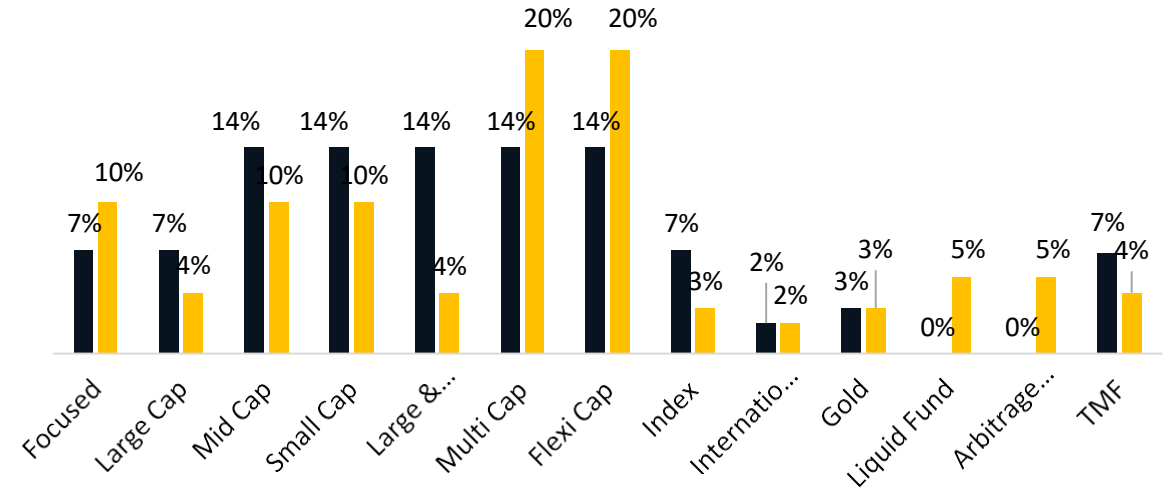
### Asset Allocation

■ SAA ■ TAA

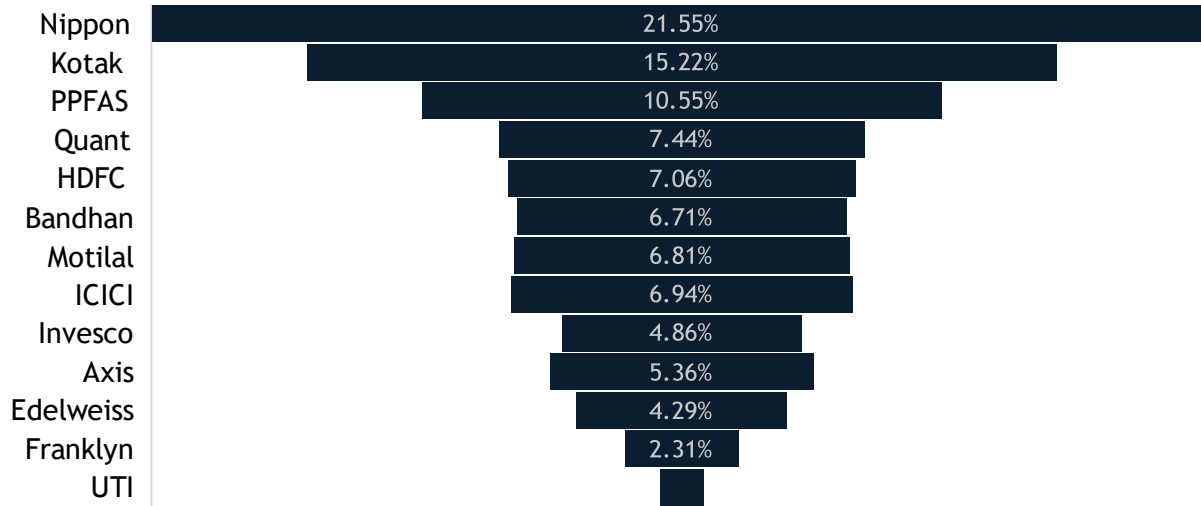


### Category Allocation

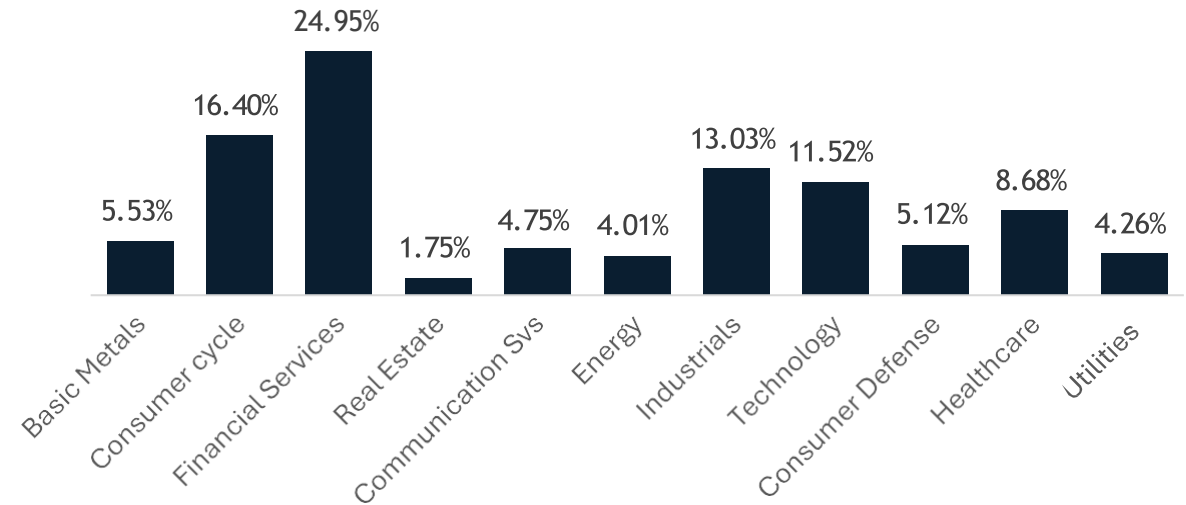
■ SAA ■ TAA



### Fund House Concentration



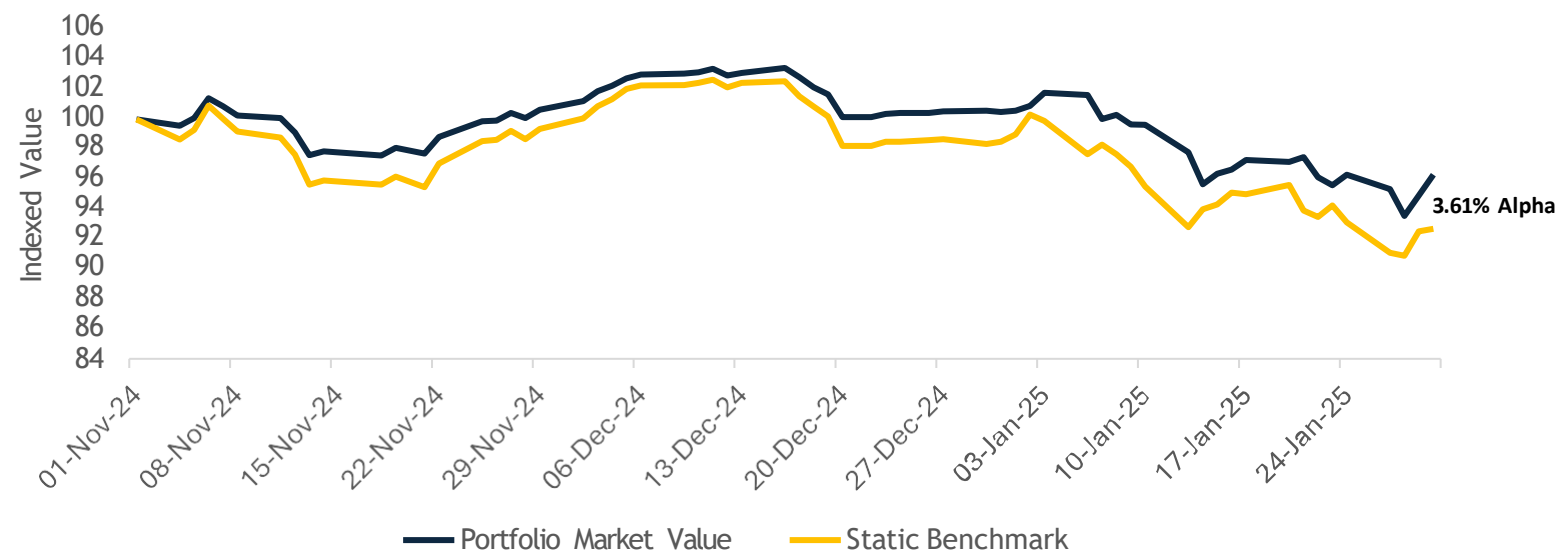
### Sectoral Allocation



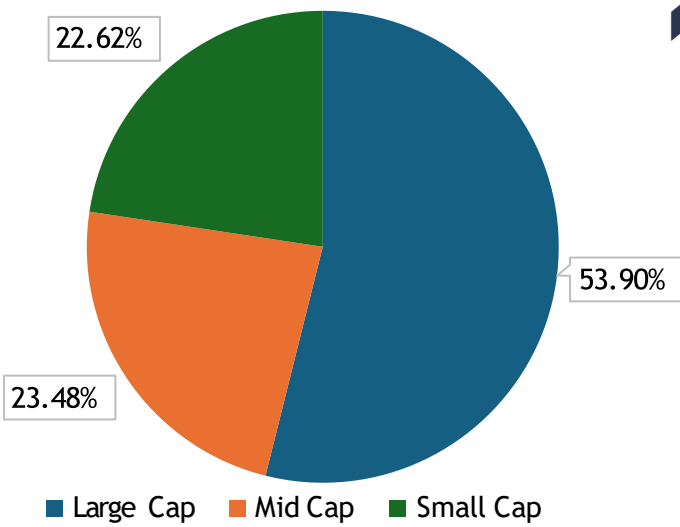
**\*SAA - Strategic Asset Allocation & TAA - Tactical Asset Allocation**, Commodity and International Allocation considered as Equity Allocation, Arbitrage Funds & Liquid Funds Allocation considered as Debt Allocation, and is temporarily parked for the short term and will be deployed opportunistically, Portfolio Inception date - 1st November 2024, Portfolio values are as on 23rd December 2024, Returns under 1 year are absolute and returns over 1 year are annualized. The benchmark indices for each fund are carefully selected to align with their respective investment objectives. The benchmark weights remain static as per the SAA. The constituent benchmarks and their respective weights are: NSE 500 India TR INR - 36.00%, NSE 100 India TR INR - 11.80%, NSE Midcap 150 TR INR - 15.60%, NSE Smallcap 250 TR INR - 15.60%, NSE 200 India TR INR - 13.60%, NSE 50 TR INR - 0.80%, NIFTY 11-15 YR G-SEC INDEX - 6.60% All returns are pre-tax and pre exit load if applicable in the Model Portfolio. Optimus Prime Model Portfolio is an Aggressive portfolio strategy



Portfolio Vs Benchmark



Portfolio Market Cap Mix



Portfolio Performance Analytics

| Analytics                       | Portfolio    | Benchmark |
|---------------------------------|--------------|-----------|
| Absolute Return %               | -3.71%       | -7.33%    |
| Standard Deviation (annualized) | 12.55%       | 15.76%    |
| Beta                            | 0.75         |           |
| <b>Alpha</b>                    | <b>3.61%</b> |           |
| Information Ratio               | 4.08         |           |
| Downside Capture                | 50.70        |           |

Debt Portfolio Analytics

| Debt Measures         | Jan-25        |
|-----------------------|---------------|
| Average MoD           | 5.05          |
| Average Maturity      | 6.78 yrs      |
| Average Coupon        | NA            |
| <b>Average YTM</b>    | <b>7.21 %</b> |
|                       |               |
| Average Credit Rating | Nov-24        |
| <b>AAA</b>            | <b>100%</b>   |
| AA                    | 0%            |
| A                     | 0%            |

*\*SAA - Strategic Asset Allocation & TAA - Tactical Asset Allocation, Commodity and International Allocation considered as Equity Allocation, Arbitrage Funds & Liquid Funds Allocation considered as Debt Allocation, and is temporarily parked for the short term and will be deployed opportunistically, Portfolio Inception date - 1st November 2024, Portfolio values are as on 23rd December 2024, Returns under 1 year are absolute and returns over 1 year are annualized. The benchmark indices for each fund are carefully selected to align with their respective investment objectives. The benchmark weights remain static as per the SAA. The constituent benchmarks and their respective weights are: NSE 500 India TR INR - 36.00%, NSE 100 India TR INR - 11.80%, NSE Midcap 150 TR INR - 15.60%, NSE Smallcap 250 TR INR - 15.60%, NSE 200 India TR INR - 13.60%, NSE 50 TR INR - 0.80%, NIFTY 11-15 YR G-SEC INDEX - 6.60%.*



## **Current Investment Portfolio Stance: *Conservative***

In our latest meeting, the investment advisory committee decided to continue with its **Conservative Approach**. It was unanimously decided that the portfolios would feature **significantly reduced exposure to Mid and Small Cap equities (~8-G% underweight) as the committee adopted an underweight position in equity (7.4% underweight)**. Our conservative decision reflects a general 'risk off' sentiment and market uncertainties - The impending US tariff structure under the new regime, weak domestic demand leading to muted corporate earnings, tight core liquidity in the banking system mainly on account of RBI invention in the forex markets due to a depreciating rupee.

The committee anticipates **high volatility and a low-return environment** following Trump's new tariff structures. There has been a **noticeable shift of capital towards the US, highlighting a flight to perceived safer assets**. Amid frequent and substantial capital outflows, RBI's intervention to manage currency fluctuations remains persistent. This approach aims to ensure that even with muted returns in the short term, individuals achieve real-term profits.

As we witness a **lower growth trajectory in urban demand indicators**, it would be prudent to **lower equity return expectations in 2025**. That said, we remain **optimistic about India's long-term growth story**.

Albeit a very short timeframe, this strategy has paid off so far. The current conservative stance has proven effective in navigating the current market volatility, with the portfolio continuing to generate **Alpha in January (3.61%)** despite a challenging market environment, with a **Beta of 0.75** and **Information Ratio of 4.08** representative of a high risk-adjusted performance in comparison to its benchmark, and a **downside capture of ~51%** indicating that the portfolio superior performance in comparison to the benchmark during negative return periods, effectively outperforming it in down markets.

The committee has agreed to **maintain this strategy until the domestic demand situation improves** and there is some clarity on the new **tariff structure**. The Asset Allocation stance would be then **revaluated based on new market dynamics**.

The focus currently remains on **preserving capital** and **generating consistent Alpha** amid challenging conditions.

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# THANK YOU

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