

*Embracing complexity to capture Alpha*

*Dear Investors,*

*As we move through 2025, the markets continue to remind us of an essential truth, volatility is the price we pay for higher returns.*

*The past few months have brought a mix of economic resilience and market adjustments. India's GDP growth has softened to around 6.2%, supported by government spending and rural demand, but private sector investments remain cautious. Inflation has cooled, offering some relief, yet liquidity remains tight, the rupee continues to be supported by the RBI's persistent interventions, and global trade uncertainties are keeping investors on edge.*

*Markets, too, have been playing their part. As new investors experience their first real market correction after the pandemic, the Nifty 50 has corrected from its highs, mid and small caps have cooled after an extraordinary rally, and corporate earnings have been a mixed bag. High-end segments such as personal vehicles, hotels, durables, and jewelry, which had previously performed well, experienced a slowdown. IT firms remained stable despite the seasonally weak Q3, while industrials, telecom, pharma, and chemicals posted moderate growth. However, small- and mid-cap firms, which rely more on domestic demand, lagged behind large-caps. Consumption-focused companies faced headwinds, with FMCG volumes remaining sluggish as urban demand weakened despite a gradual rural recovery. Consumers shifted to smaller pack sizes in premium categories, and even during the festive season, retail and fast-food chains reported subdued sales. Automobile volumes remained under pressure, but the real estate sector stood out, driven by strong demand for luxury housing. Meanwhile, the electronics manufacturing services industry gained traction, supported by robust long-term growth prospects. While the market is expected to remain range-bound in the immediate future, inflows from foreign institutional investors are anticipated to turn positive by the latter half of CY 2025, providing a crucial stabilizing force. This shift in sentiment is contingent on external factors such as trade tariffs and domestic drivers like a rebound in demand.*

*In moments like these, perspective is everything. Market cycles come and go, sentiment fluctuates, and short-term news will always make headlines. If history has taught us anything, it's that fortunes are built not by predicting the next move but by staying the course with conviction and rationality.*

*As always, stay focused, stay thoughtful, and trust the process.*

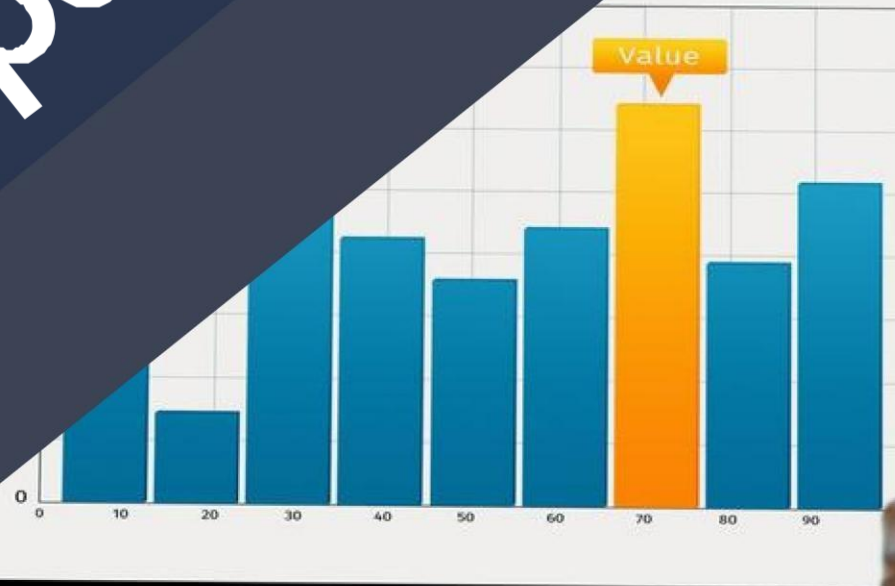
*Wishing you clarity and composure in the months ahead.*

*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

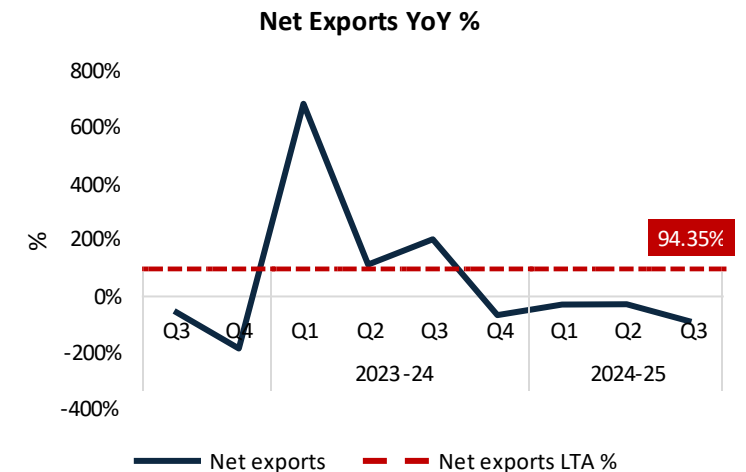
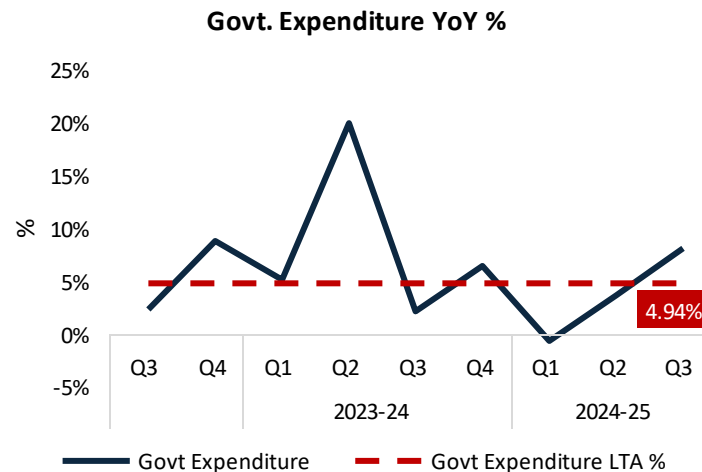
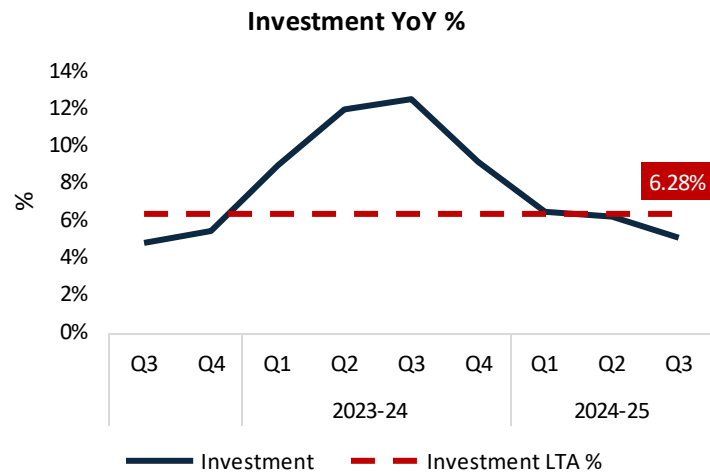
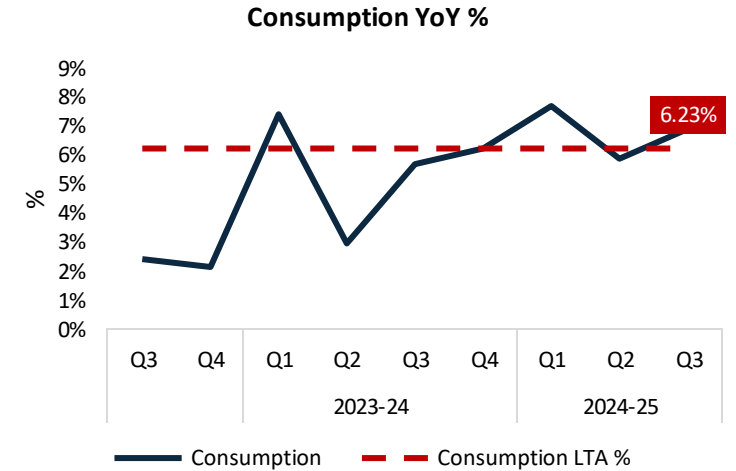
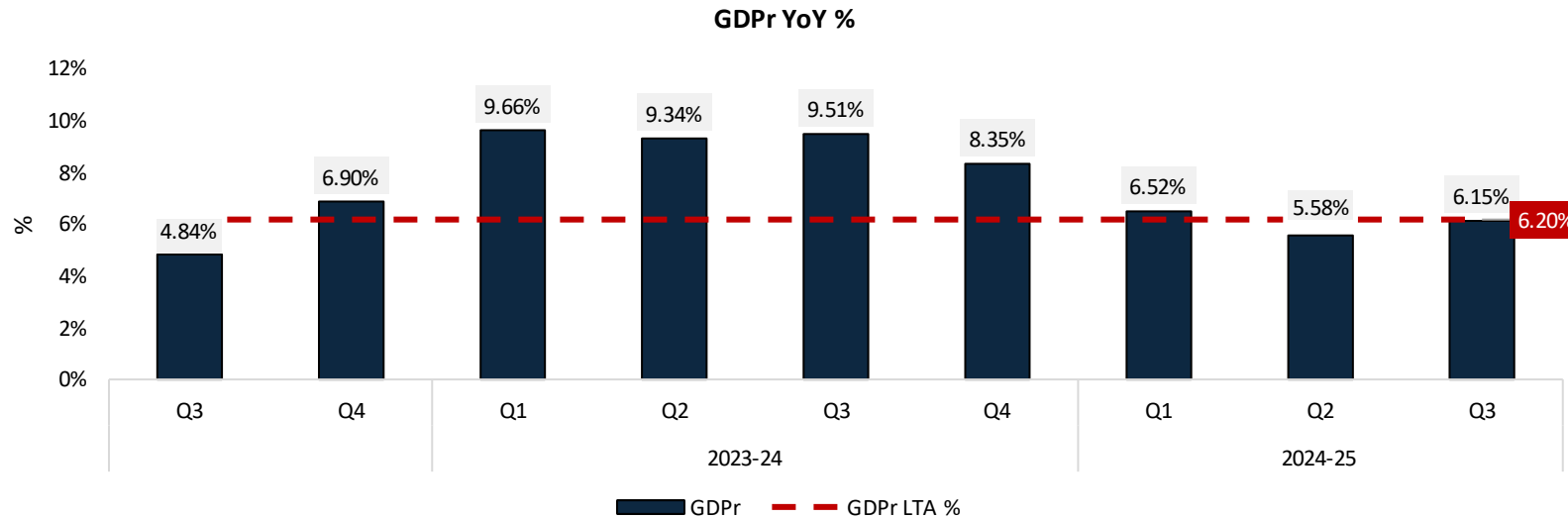
Meet Piyush Sharma, our research lead and the youngest brain in the room—but don't let that fool you. Armed with an MBA and a flair for creativity, Piyush lives and breathes financial models. Whether it's running a Monte Carlo simulation, dissecting a mutual fund, creating a portfolio company DCF model, 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



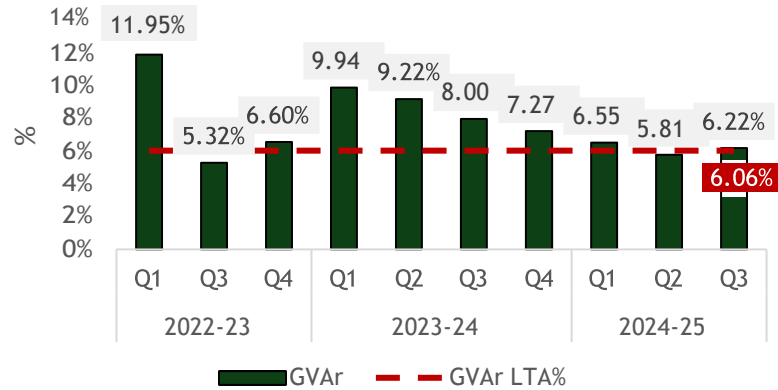
# 1. GDP (Gross Domestic Product)



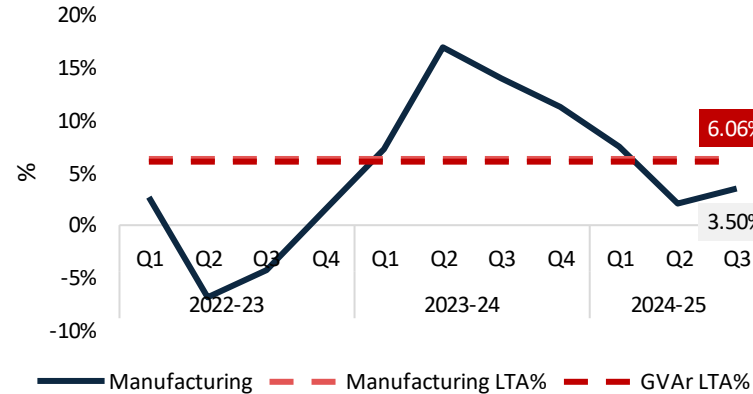
# GVA (Gross Value Added)



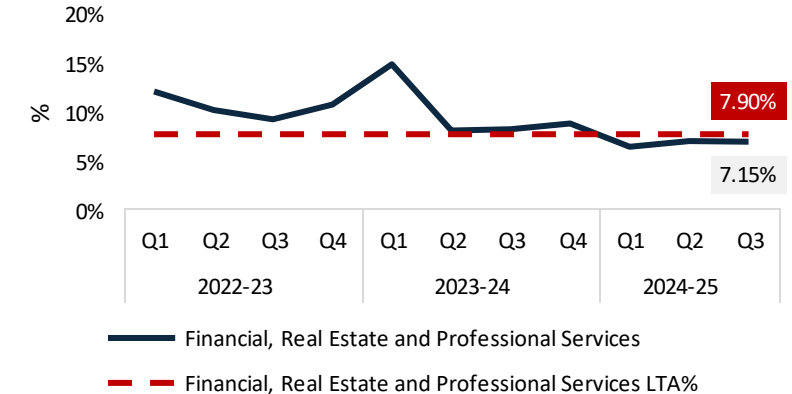
## GVAr YoY%



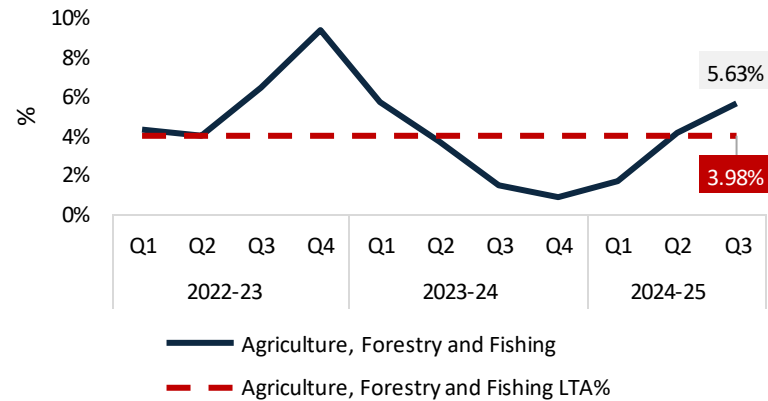
## Manufacturing YoY%



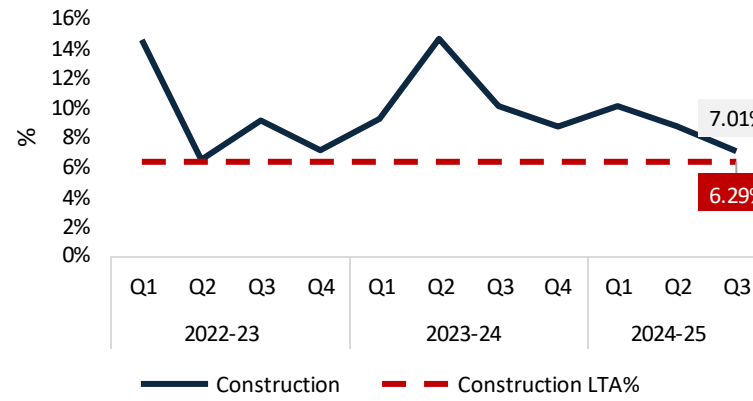
## Finance, Real Estate, Services



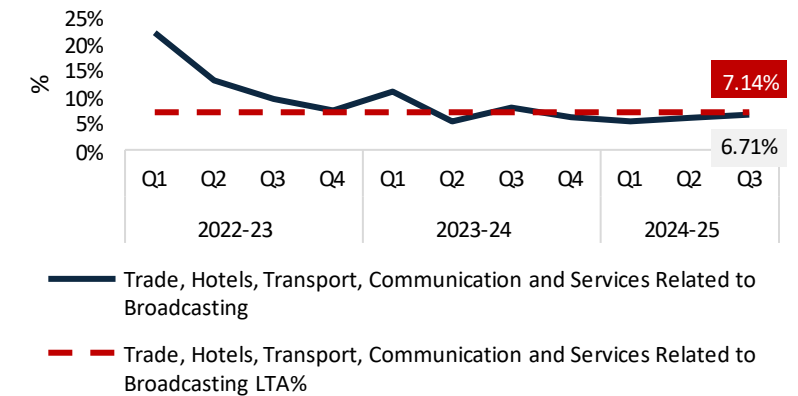
## Agriculture



## Construction



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





## Gradual Pickup in Growth Momentum

- India's economic growth engine showed some spark in the December quarter to recover from a low in the September quarter. Yet, the 6.2% GDP (Gross Domestic Product) growth reported was the slowest since Q4FY23, barring one quarter — the previous one (Q2), when it recorded 5.6% (revised estimate). The third quarter's growth rate, supported by increased government spending post elections and consumption amid festive demand, was still far from the 9.5% (revised estimate) recorded in the corresponding quarter of the previous fiscal. The CSO now expects growth to come in at 6.5% for FY 2025. While this sounds reasonable, it still implies that GDP growth ought to accelerate to over 7.6% during the current quarter. But more importantly, the 6.5% growth itself is slower than the average growth in the last decade (which was closer to 7%). Further analysis implies a sharp jump in private final consumption expenditure to 9.9% in Q4 from 6.9% currently, followed by a modest rise in gross fixed capital formation.
- Meanwhile, Gross Value Added (GVA), which measures the total value of goods and services produced in an economy, also grew 6.2% in Q3. Tepid growth in Industrial Sectors (4.5% YoY in Q3 FY 2025 vs 11.8% YoY in Q3 FY 2024) of manufacturing, mining, and electricity impacted overall GDP growth in Q3, despite high growth recorded by agriculture (5.6% YoY in Q3 FY 2025 vs 1.5% YoY in Q3 FY 2024).

| GVA Growth (% YoY)    |         |        |        |        |         |        |        |        |        |        |         |
|-----------------------|---------|--------|--------|--------|---------|--------|--------|--------|--------|--------|---------|
|                       | Q1 FY23 | Q2FY23 | Q3FY23 | Q4FY23 | Q1 FY24 | Q2FY24 | Q3FY24 | Q4FY24 | Q1FY25 | Q2FY25 | Q3 FY25 |
| Agriculture           | 4.3     | 4.0    | 6.4    | 9.4    | 5.7     | 3.7    | 1.5    | 0.9    | 1.7    | 4.1    | 5.6     |
| Industry              | 7.3     | -2.2   | 1.0    | 3.8    | 7.3     | 15.1   | 11.8   | 9.5    | 8.4    | 3.8    | 4.5     |
| Mining                | 8.3     | -3.2   | 2.6    | 4.6    | 4.1     | 4.1    | 4.7    | 0.8    | 6.8    | -0.3   | 1.4     |
| Manufacturing         | 2.7     | -6.9   | -4.3   | 1.5    | 7.3     | 17.0   | 14.0   | 11.3   | 7.5    | 2.1    | 3.5     |
| Electricity           | 17.1    | 7.8    | 9.9    | 8.6    | 4.1     | 11.7   | 10.1   | 8.8    | 10.2   | 3.0    | 5.1     |
| Construction          | 14.5    | 6.4    | 9.1    | 7.1    | 9.2     | 14.6   | 10.0   | 8.7    | 10.1   | 8.7    | 7.0     |
| Services              | 17.1    | 10.0   | 7.5    | 7.6    | 12.5    | 7.5    | 8.3    | 7.8    | 6.8    | 7.2    | 7.4     |
| Trade, etc.           | 22.2    | 13.2   | 9.7    | 7.5    | 11.0    | 5.4    | 8.0    | 6.2    | 5.4    | 6.1    | 6.7     |
| Finance, etc.         | 12.3    | 10.4   | 9.4    | 10.9   | 15.0    | 8.3    | 8.4    | 9.0    | 6.6    | 7.2    | 7.2     |
| Public Administration | 21.1    | 5.0    | 1.3    | 2.5    | 9.3     | 8.9    | 8.4    | 8.7    | 9.0    | 8.8    | 8.8     |
| GVA                   | 12.0    | 5.5    | 5.3    | 6.6    | 9.9     | 9.2    | 8.0    | 7.3    | 6.5    | 5.8    | 6.2     |

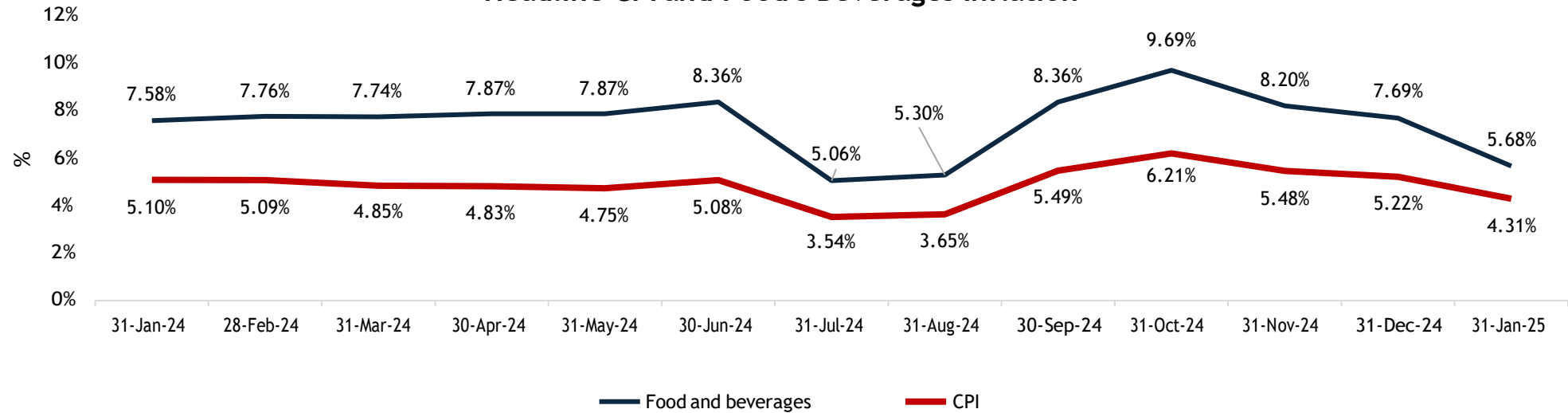
## Outlook

- 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 estimates released by the government agencies, the real GDP growth for FY 2025 and FY 2026 is estimated to be 6.5% and 7.1% respectively.
- The recovery in the Private Consumption growth was due to festival spending, majorly led by rural economy on the back of good kharif harvest. As indicated by Nielsen IQ survey, FMCG volume growth was robust at 9.9% for rural sector while it was at 5.0% for urban sector in Q3FY25. Government spending grew by 8.3% from 3.8%. However, the worry comes from Gross Fixed Capital Formation (GFCF) or the investment demand that grew by 5.7% YoY in Q3FY25 but contracted by 2.5% on a QoQ basis, marginally down from 5.8% YoY in Q2 and has been in the sub-6% range in the last four quarters.
- We expect the FY25 GDP figure to be lower than CSO's (Central Statistics Office) estimate by around 20-30 bps (basis points) in FY 2025 and 6.5% in FY 2026. Further, the outlook remains heavily clouded with downside risks amid global trade uncertainties surrounding merchandise exports and commodity prices, due to the impending tariffs, which would in turn affect corporate margins.
- Consumption boosting measures include – (i) a good rabi crop harvest, and this should help sustain the agricultural growth and consequently rural consumption. Further, with (ii) inflation expected to drop further in FY26, it should provide a boost to real wage growth and hence push consumption demand. The (iii) Union Budget has provided a boost to consumption by reducing the tax burden. However, this may fail to have a significant impact as only ~2% of India's population pay taxes. (iv) Easing of monetary policy has started and we expect another 50 bps drop in the repo rate in FY 2026. This should be reflected in the EBLR linked loans and may provide some support to consumption and growth.
- We expect Centre and State capex to pick up in FY26, but the worry on Private Sector Capex may continue due to lack of visibility of demand.

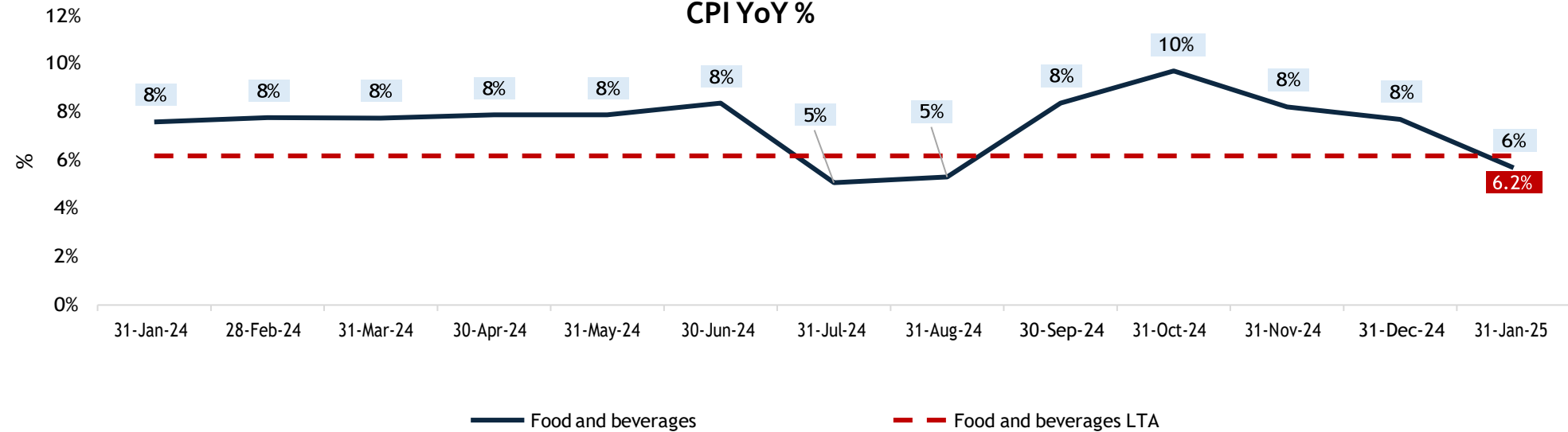
# 2. Inflation



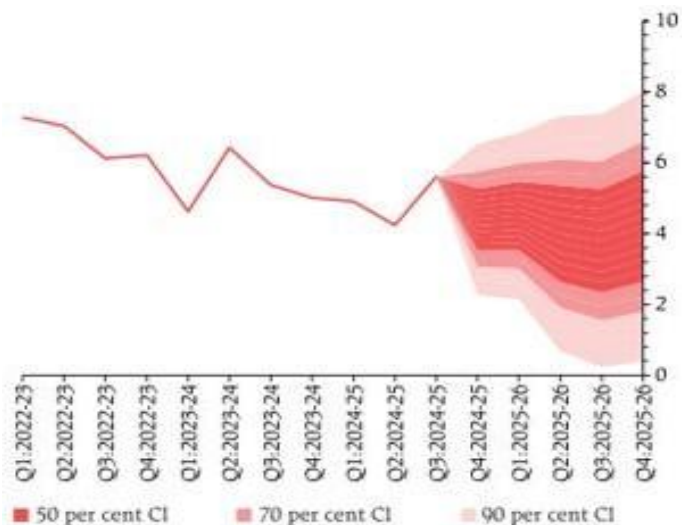
### Headline CPI and Food s Beverages Inflation



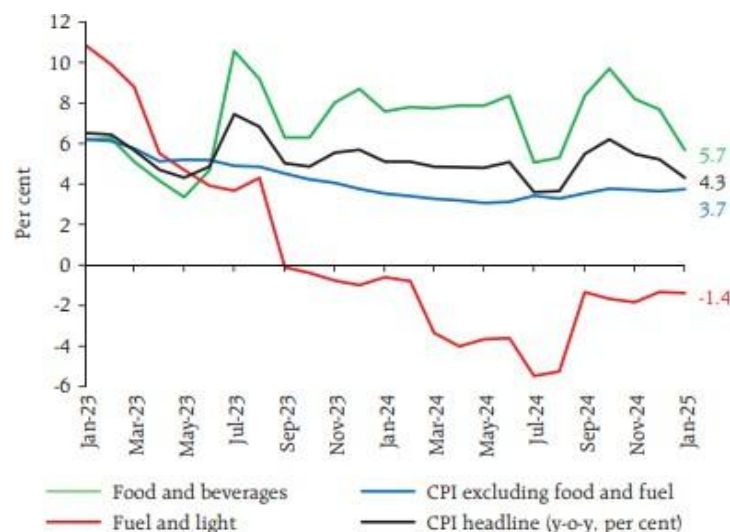
### CPI YoY %



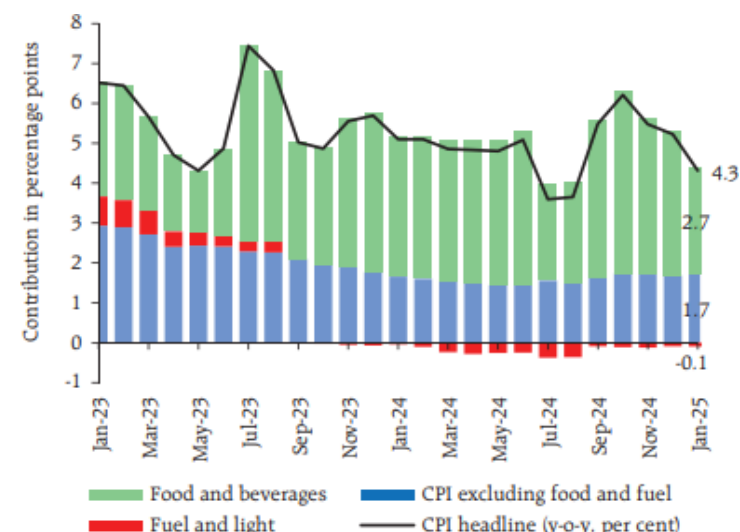
Quarterly Projections of CPI



CPI Inflation YoY %



Contributions



## Inflation Under Control With a Caveat

- The headline CPI inflation for January 2025 stood at 4.31% YoY, marking a decline of 91 bps from December 2024, the lowest since August 2024. Food inflation dropped sharply to 6.02% YoY, down 237 bps, driven by a decline in vegetables, eggs, pulses, and cereals. Rural inflation fell to 4.64%, while urban inflation declined to 3.87%. Housing inflation rose marginally to 2.76%, while education and health inflation moderated to 3.83% and 3.97%, respectively. Transport & communication inflation stood at 2.76%, whereas fuel & light remained in deflation at -1.38%. High inflation was observed in coconut oil (54.2%) and potato (49.6%), while jeera (-32.25%) and ginger (-30.92%) saw the steepest deflation. The overall disinflationary trend reflects easing supply-side pressures and softening food prices.

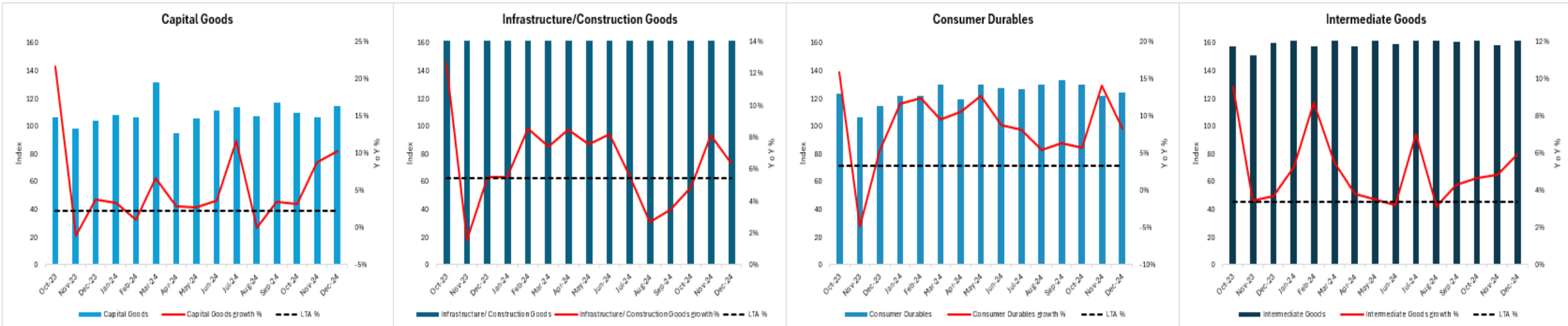
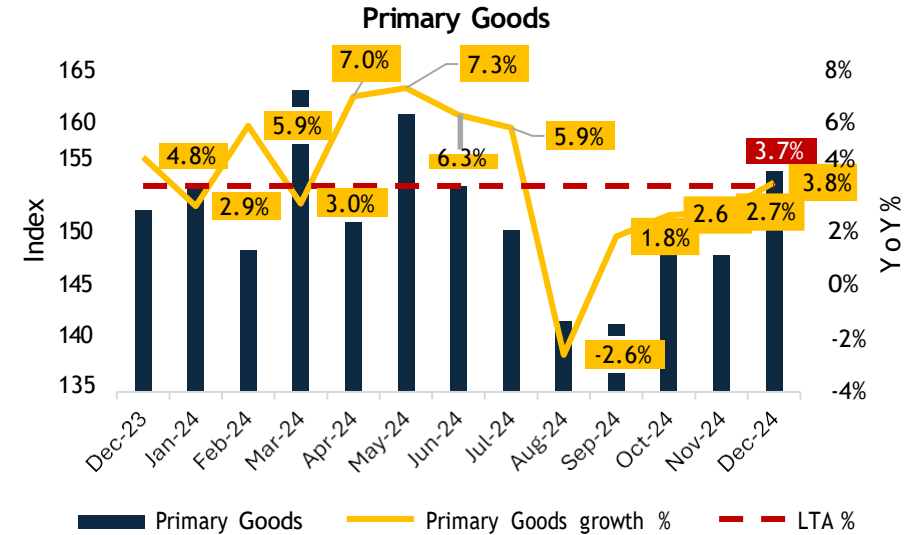
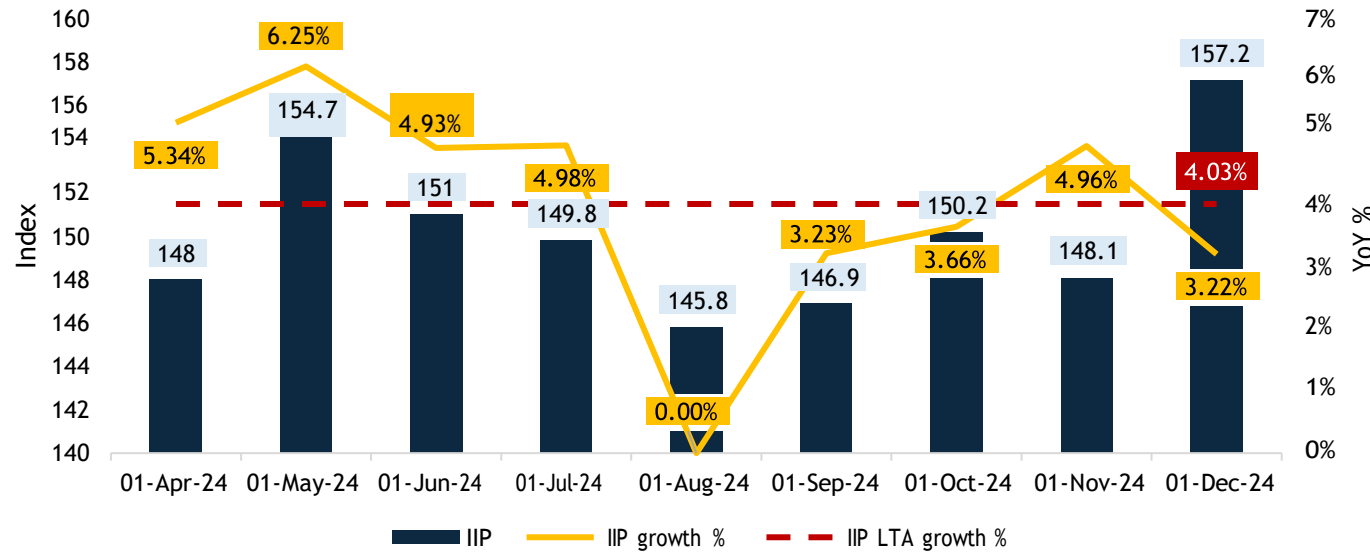
### Outlook:

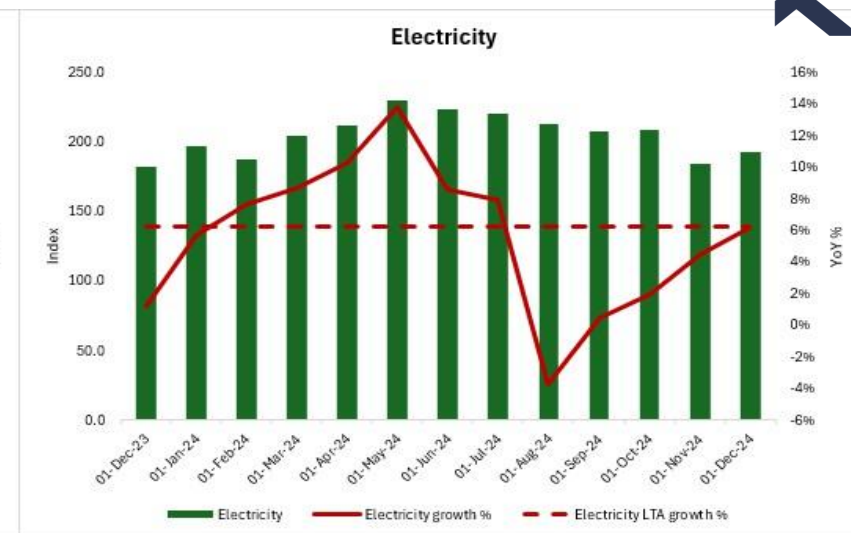
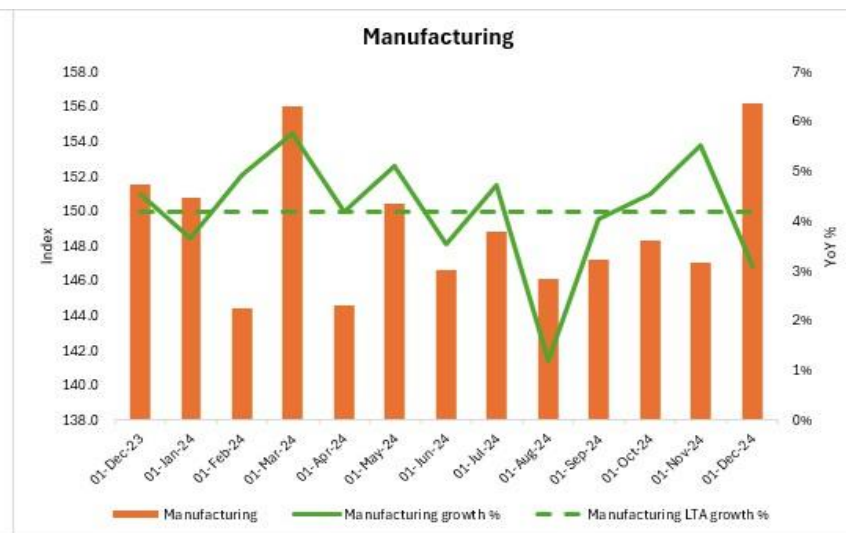
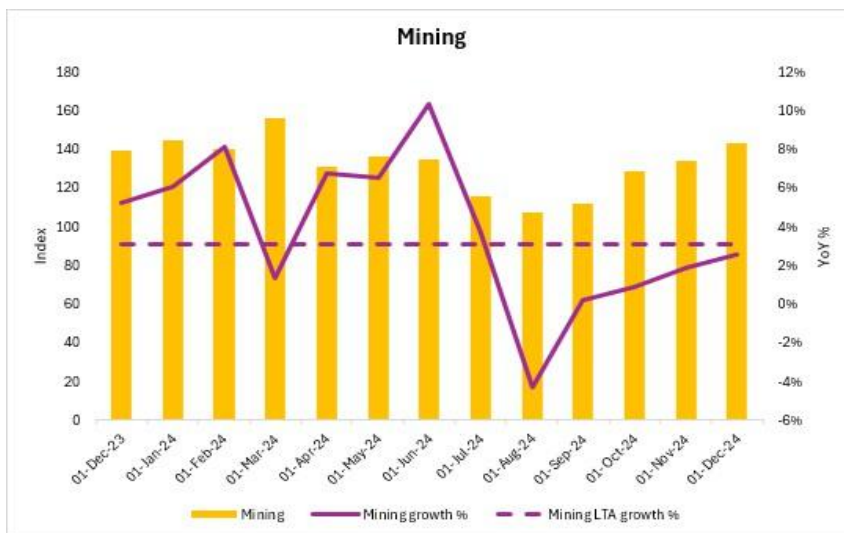
- CPI inflation for the current financial year is projected at 4.8% with Q4 at 4.4%. Assuming a normal monsoon, CPI inflation for the financial year 2025-26 is projected at 4.2% with Q1 at 4.5%; Q2 at 4.0%; Q3 at 3.8%; and Q4 at 4.2%. However, with imported Inflation yet to play out with the impending tariffs, the risks are evenly balanced.

# 3. IIP (Index of Industrial Production)



IIP - Industry





## IIP Growth Slows – Cyclical Softness or Structural Shift

### Industry-based IIP

- India's Index of Industrial Production (IIP) growth slowed to 3.22% YoY in December 2024 from 4.96% in November 2024.
- The deceleration was primarily led by a moderation in manufacturing output.

### Sectoral Contribution:

- Manufacturing: Accounts for 78% of IIP, grew 3.10% YoY in Dec 2024 vs 4.55% YoY in Dec 2023.
- Mining: Contributes 14%, grew 2.58% YoY in Dec 2024 vs 5.2% YoY in Dec 2023.
- Electricity: Makes up 8%, grew 6.17% in Dec 2024 vs 1.23% YoY in Dec 2023.
- Within Manufacturing, 16 out of 23 industry groups recorded positive growth.
  - Top-performing sectors within Manufacturing:
    - ❖ Manufacture of Electrical Equipment (+40.1% YoY)
    - ❖ Manufacture of Basic Metals (+6.7% YoY)
    - ❖ Manufacture of Coke & Refined Petroleum Products (+3.9% YoY)
    - ❖ Growth in these segments was driven by increased production in Steel Products, Electrical Components, Diesel, and Aviation Fuel.
  - Worst-performing sectors within Manufacturing:
    - ❖ Manufacture of food products (-5.5%)
    - ❖ Manufacture of pharmaceuticals, medicinal chemical and botanical products (-9.5%)

### Usage-based IIP

- Growth in Capital Goods (10.3% YoY) and Infrastructure/Construction Goods (6.3% YoY) provided key support.
- Consumer Durables recorded strong growth (8.3% YoY), while Consumer Non-Durables contracted (-7.6% YoY), indicating demand-side weakness in essential goods.
- Primary Goods (3.8% YoY) and Intermediate Goods (5.9% YoY) showed moderate expansion.

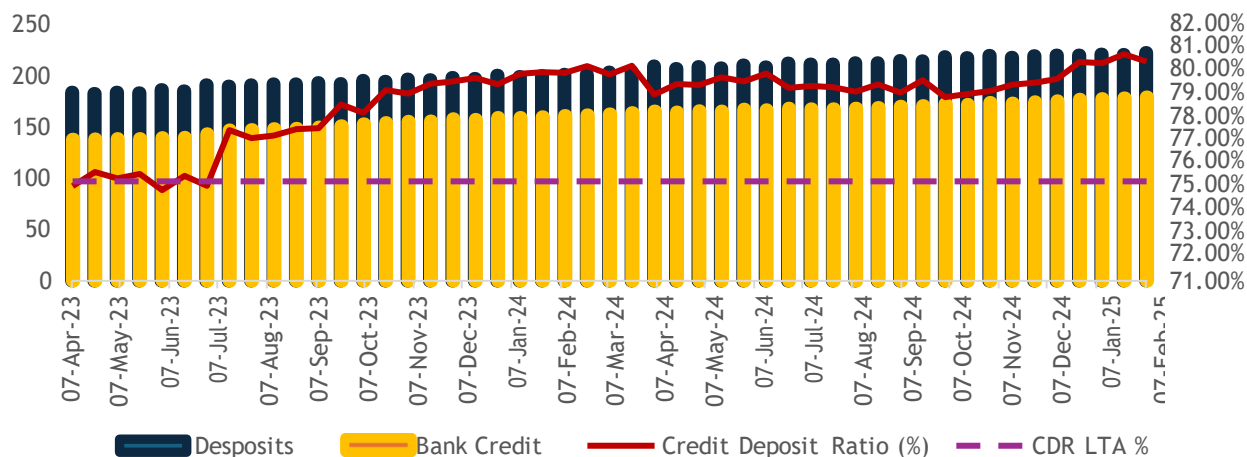
### Outlook on IIP

- The slowdown in IIP growth in December suggests a temporary pullback after strong festive demand.
- While capital goods and infrastructure-related production remain resilient, weak Consumer Non-Durables point to potential demand-side pressures.
- The sustainability of industrial growth will depend on government capital expenditure, consumer demand recovery, and global economic conditions.

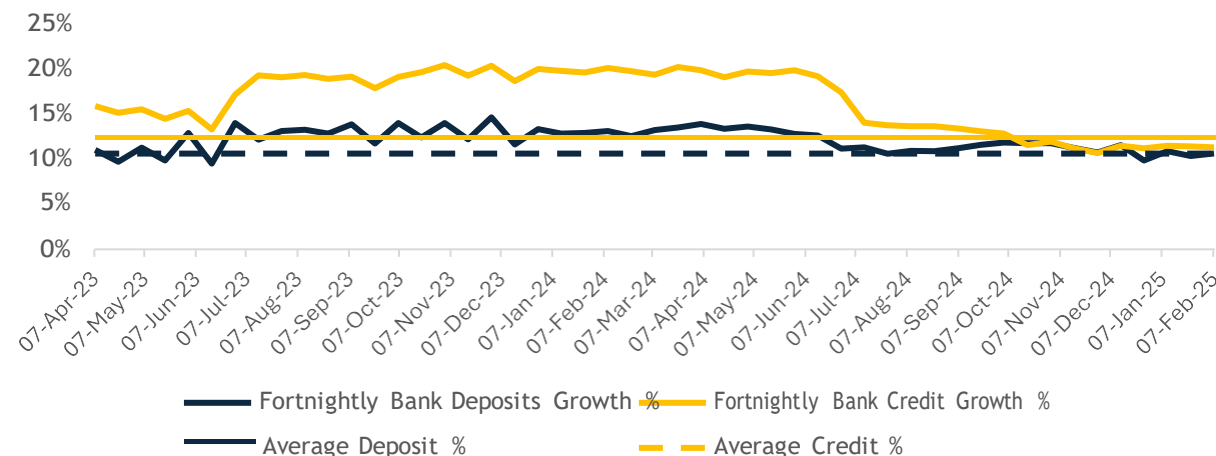
# 4. Capex



## Credit Deposit Ratio



## Credit Deposit Growth %



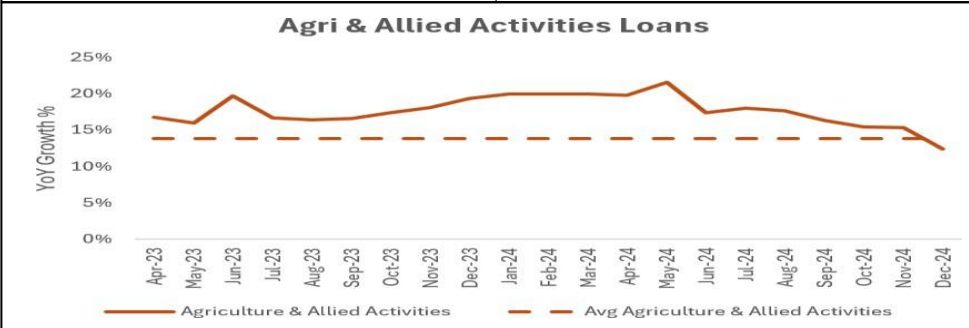
## Credit Upcycle in Play

- Aggregate bank credit and deposits registered growth of 12.5% and 10.6%, respectively, as on January 24, 2025. The Credit Deposit Ratio (CD ratio) for the banking system at the end of January 2025 was at 80.44%, still above the LTA of 75.28%, 2024. Bank liquidity buffers are sufficient. Though the net interest margin (NIM) moderated, return on assets (RoA) and return on equity (RoE) remain robust. The system-level parameters for NBFCs too look healthy. Despite a tough Q3 FY2025 with higher credit costs, weak loan growth, and NIM pressure, loan growth is expected to improve from H2 FY2026, driven by a recovery in unsecured lending and private capex. PSU banks outperformed private banks due to lower credit costs, while private banks struggled with rising credit costs, especially in the unsecured segment. Asset quality issues remain concentrated in mid- and small-sized banks, but liquidity improvements and RBI rate cuts should support margins and loan growth ahead.
- The credit industry has witnessed a notable deceleration in consumer lending, as reflected in the muted 15.6% YoY growth in credit card outstanding in December 2024, significantly below its long-term average (LTA) of 23.3%. Housing loans, the largest segment in consumer credit, have remained below LTA for six consecutive months, while vehicle and personal loans have also trended below LTA for 6-7 months, highlighting sluggish demand and cautious lending. The slowdown is attributed to tighter underwriting standards, rising delinquencies in unsecured retail loans, and high interest rates dampening discretionary borrowing.
- Additionally, credit growth in the agricultural and rural sectors declined compared to the previous month, reflecting seasonal demand variations. However, credit to the industrial sector remains on a positive trajectory, with large-cap companies witnessing 5.1% growth, exceeding LTA, supported by improved corporate earnings in Q3 as compared to Q2, and capital expenditure revival. Conversely, Medium Small and Micro enterprises continue to struggle, with credit growth further declining below LTA in December, reflecting liquidity challenges and tighter lending norms amid macroeconomic uncertainties.
- The RBI has reduced the risk weights on bank loans to NBFCs by 25 percentage points, reversing its earlier hike in November 2023. This move aims to boost credit flow to NBFCs, improving liquidity and enhancing lending. With risk weights now aligned with external ratings, banks need to set aside less capital, lowering borrowing costs for NBFCs and making credit more accessible. Bank lending to NBFCs had dropped to a four-year low due to higher risk weights and tighter credit conditions, but this rollback is expected to revive loan growth. The decision also supports financial stability by easing capital requirements for banks, improving their capital ratios, and strengthening their balance sheets. The deferment of other regulatory measures, including liquidity and provisioning norms, further adds to the sector's relief. The reduction in risk-weighted assets will aid banks' profitability and risk management, leading to improved credit availability in the economy via the NBFCs and MF's. This policy shift is expected to drive growth in the financial sector and support economic expansion.

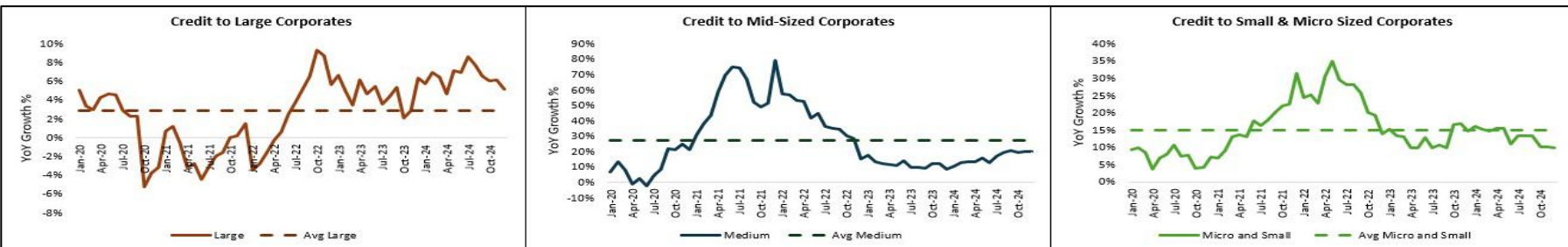
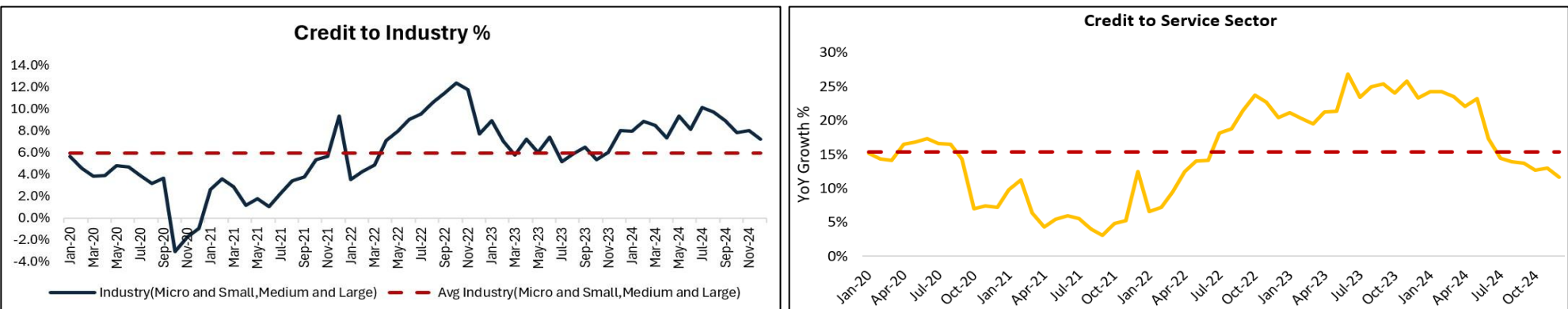
## Credit to Consumer



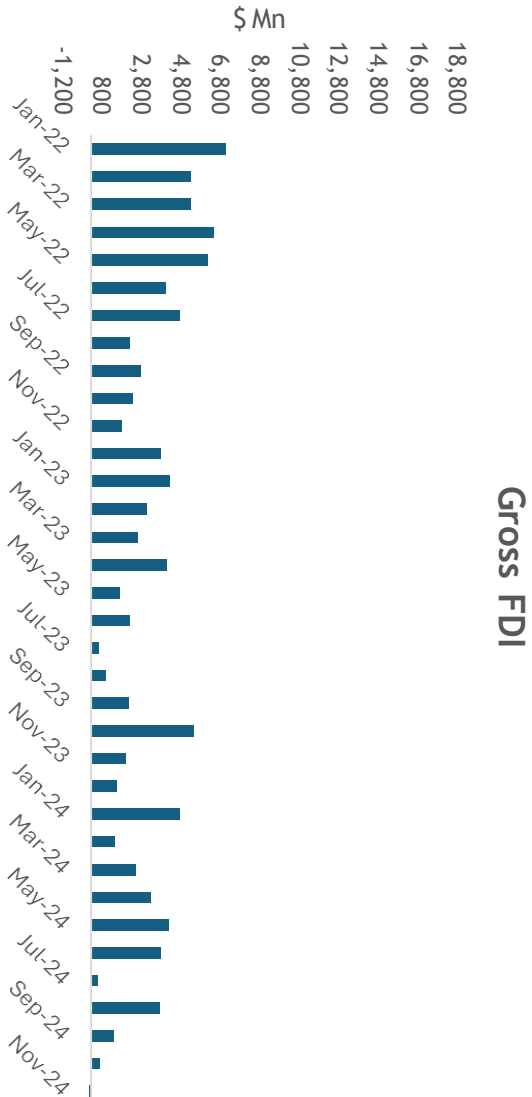
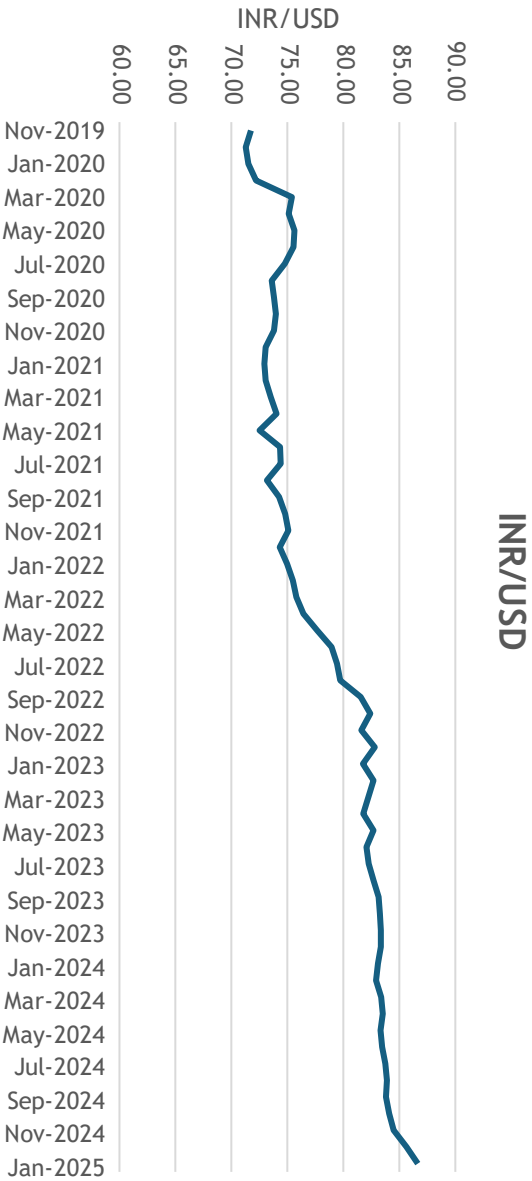
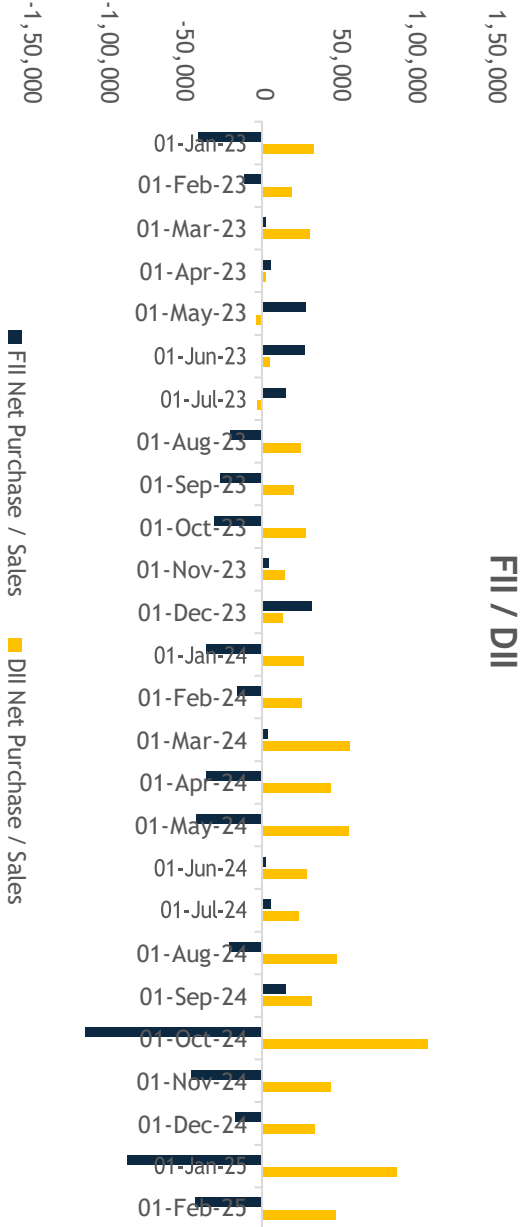
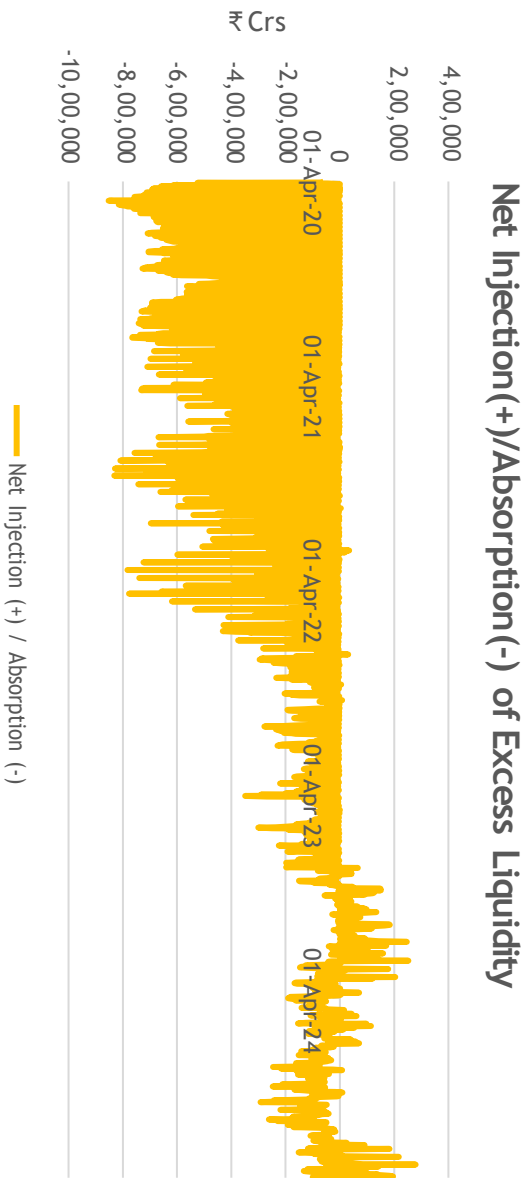
## Credit to Agri



## Credit to Industry

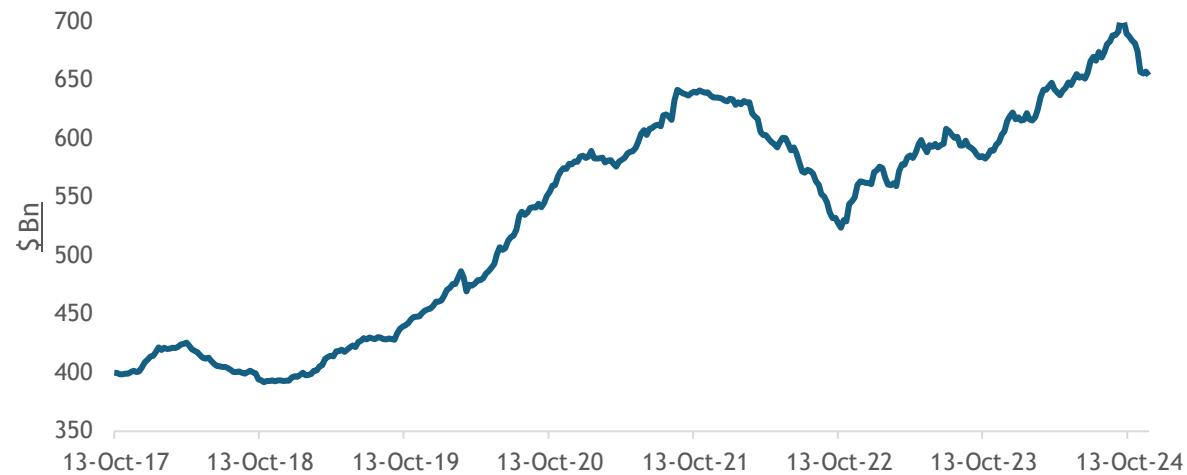


# 5. Liquidity

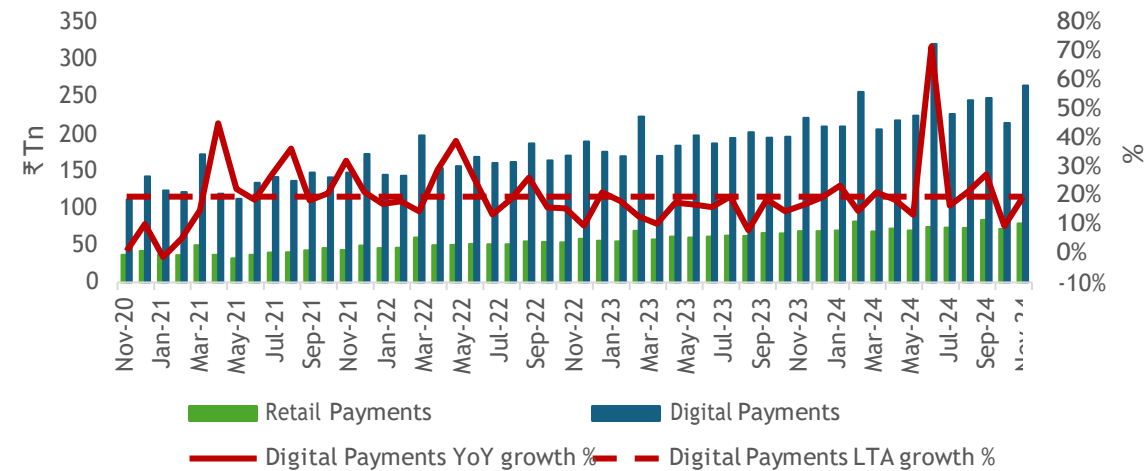




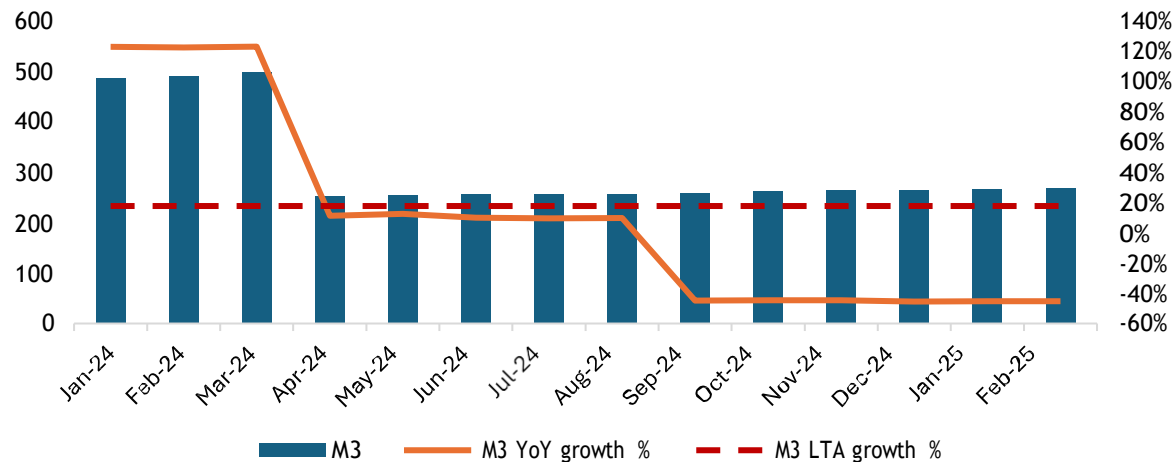
### Foreign Exchange Reserves (USD Bn)



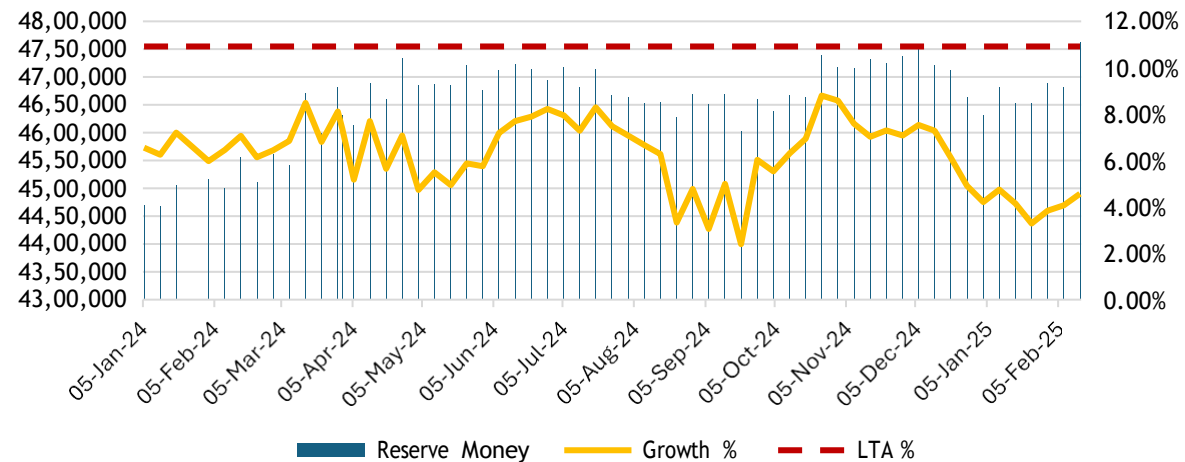
### Payments



### Money Supply



### Reserve Money (M0)





## 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 ₹1.7 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 \$440x billion by mid-February. 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%
- **Open Market Operations (OMO):** The RBI purchased ₹388.15 bn 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 – (100 crs via OMO, 38.8 crs via market purchases of Gilts, 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 ~₹1 trillion in February 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.
- **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 6.5% as of 7 February 2025, compared to 5.9% 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 **9.6% (YoY) as of 24 January 2025, 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 14 February 2025, MM, i.e., the ratio of M3 to M0, stood at 5.66 against 10.91 a year ago.** 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 \$8.39 billion so far in February 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 heaven asset.
- **Net FDI dropped sharply to \$1.18 billion (Apr-Dec 2024) from \$7.84 billion in the same period in 2023.**
- **Rupee depreciation continues due to strengthening USD, weighing on Foreign Portfolio returns.**
- UPI-enabled transactions growing at 20% monthly, with an average volume increased by 39.3% YoY. Average transaction size increased by 27.5% YoY.
- **Gold prices reached a 3-month high at \$2,912/oz due to geopolitical uncertainty.** Gold being a safe heaven 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.**

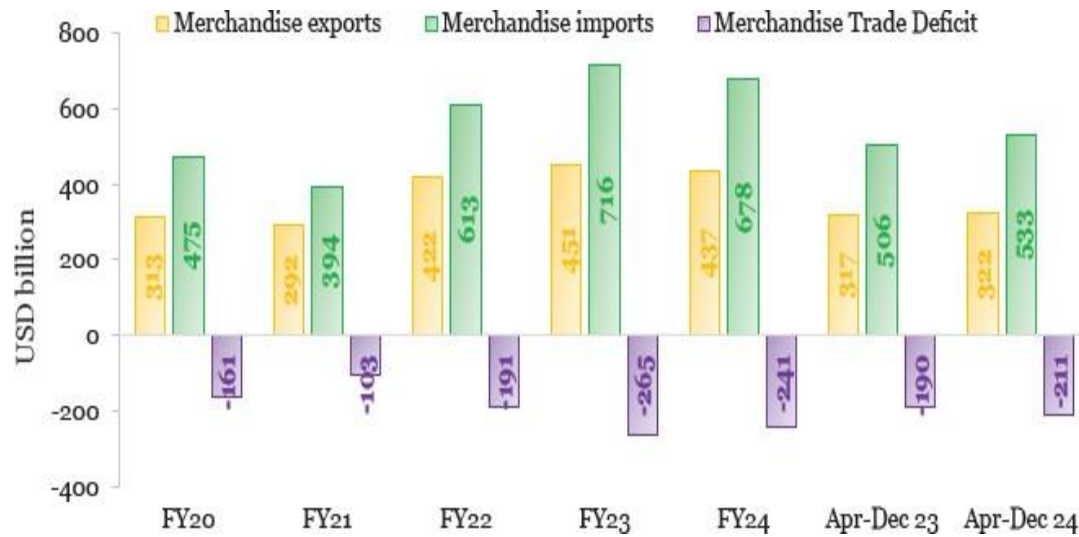
### Outlook

- 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.

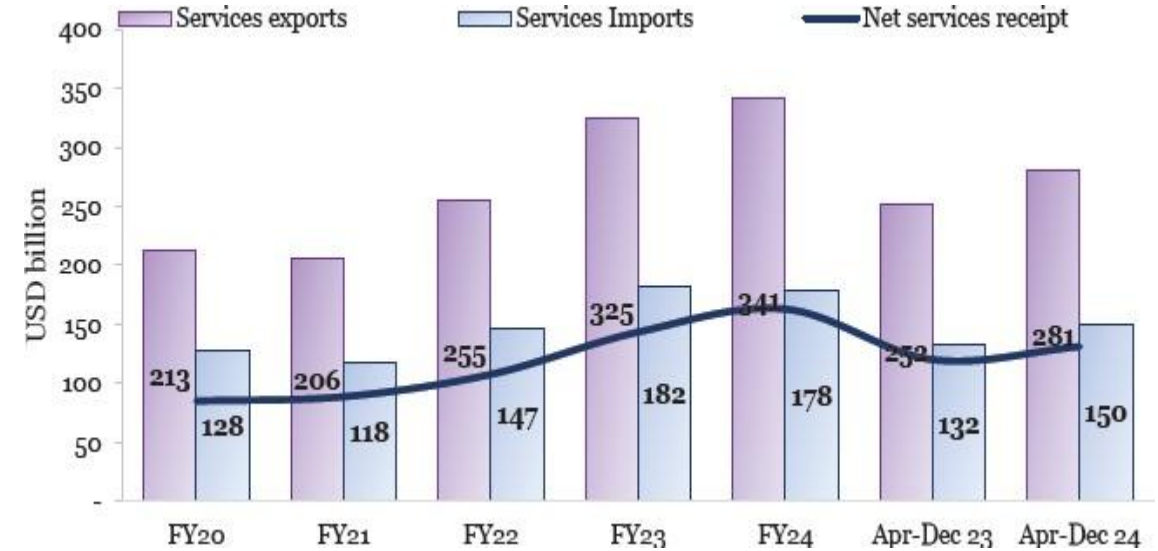
# 6. Trade



## Merchandise Trade



## Services Trade

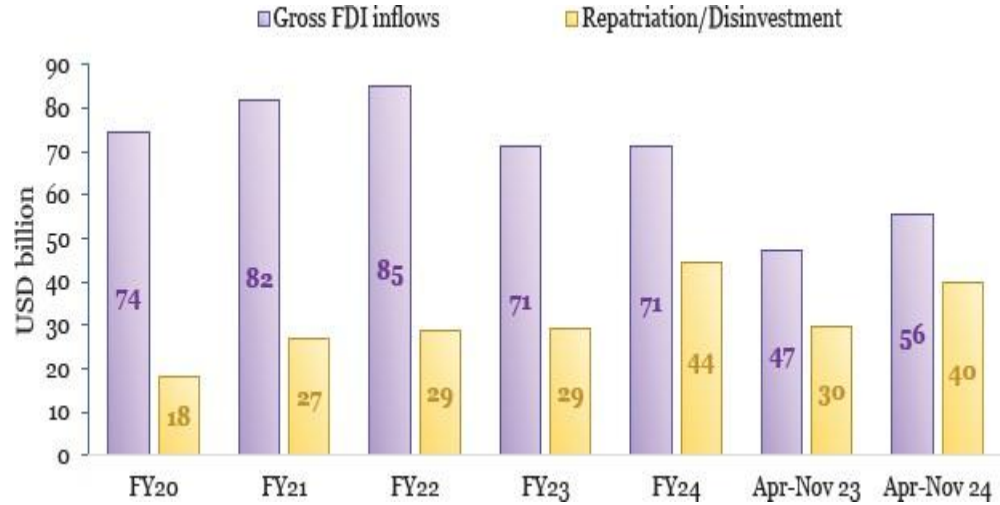


## Current Account Deficit (CAD)

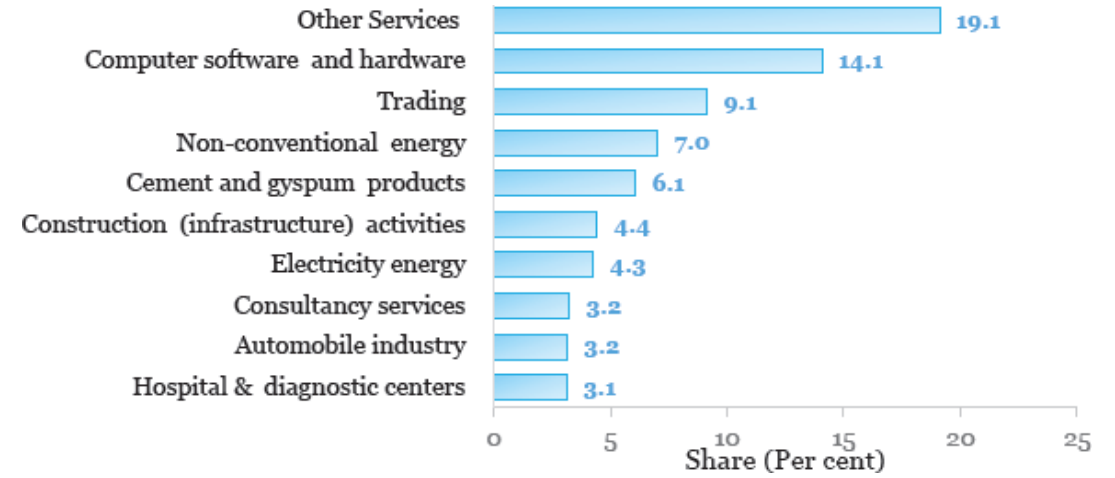




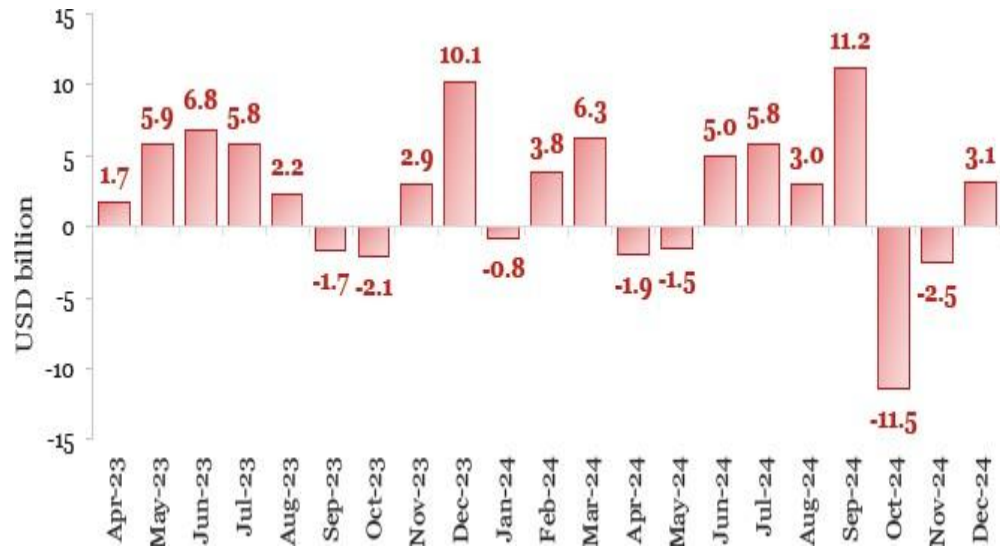
## FDI Flows



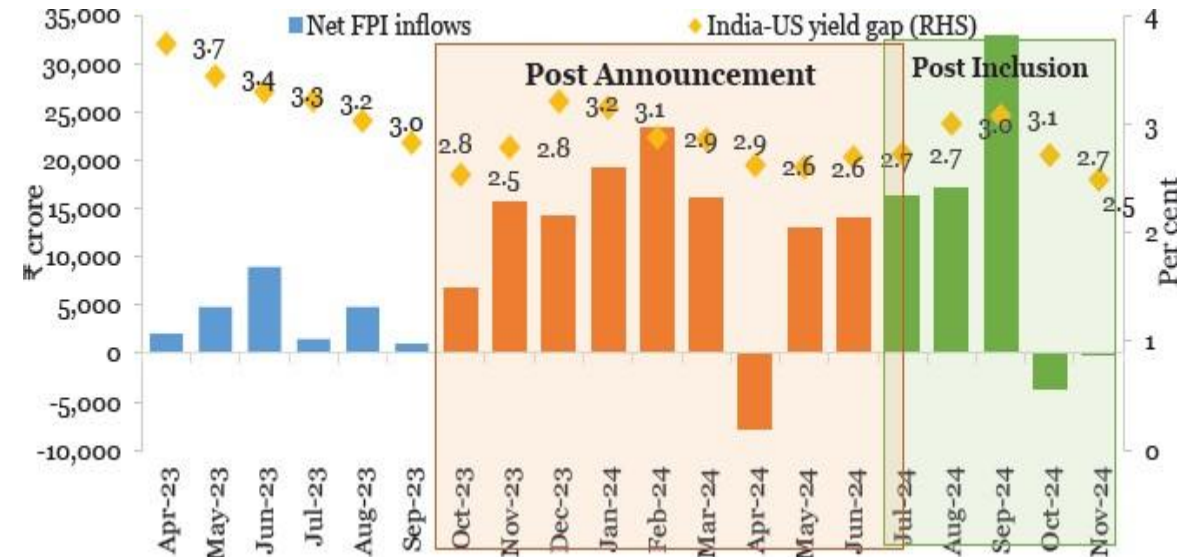
## FDI Sectoral Share



## 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 jewelry 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, signaling 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 **unfavorable 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 analyze 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.

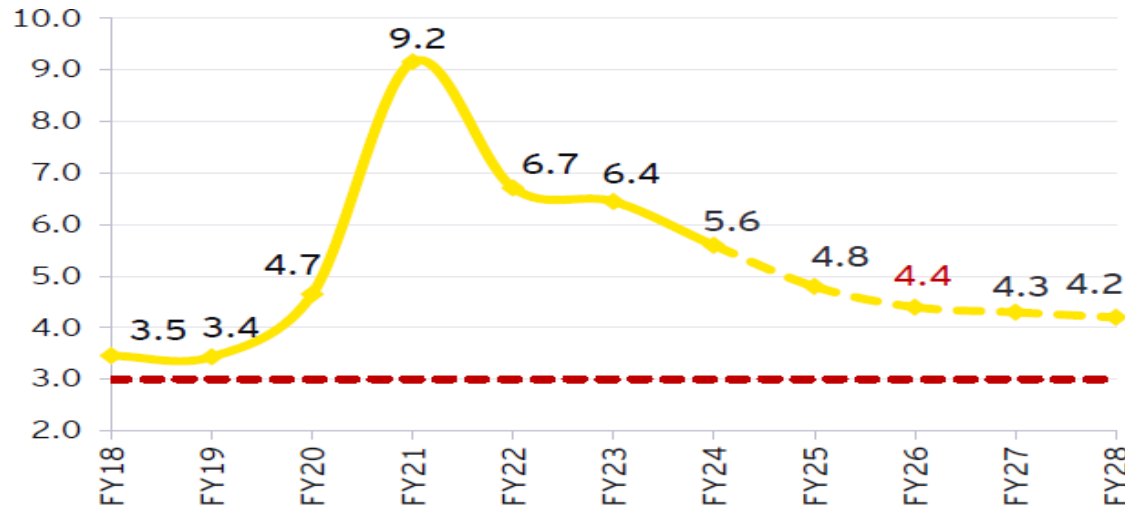
## Outlook

- India's external sector has performed well amidst unfavorable 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 globalization 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.

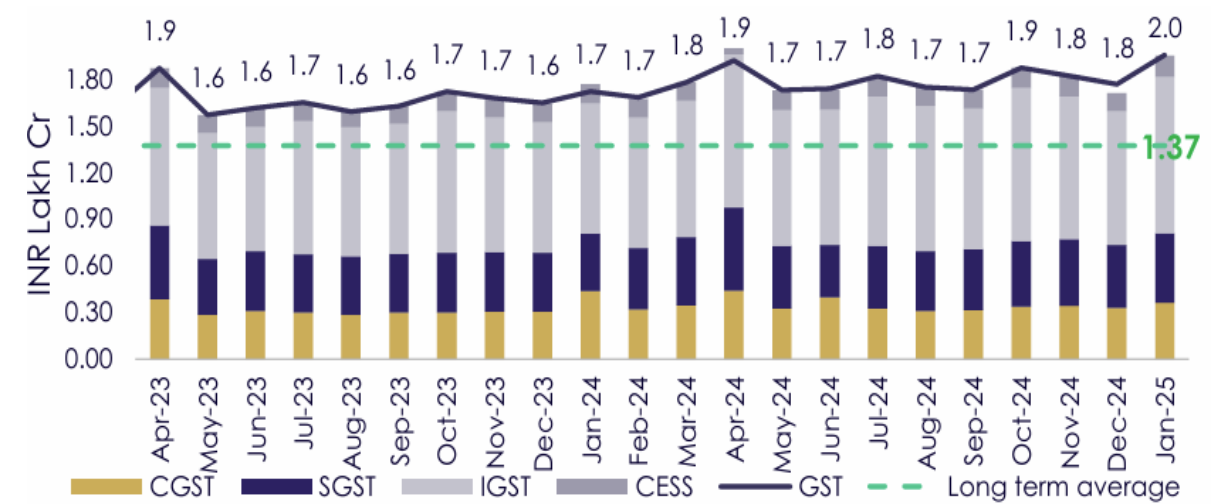
# 7. Fiscal Situation



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

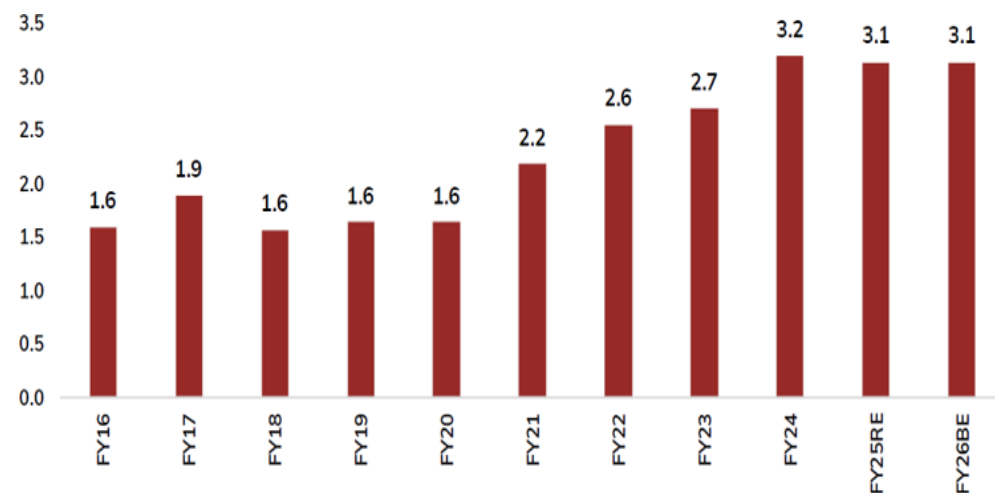
|                          | FY23 | FY24 | FY25RE | FY26 BE |
|--------------------------|------|------|--------|---------|
| Direct tax revenues      | 6.1  | 6.6  | 6.9    | 7.1     |
| Indirect tax revenues    | 5.1  | 5.1  | 5.0    | 4.9     |
| Gross Tax revenues       | 11.2 | 11.7 | 11.9   | 12.0    |
| 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

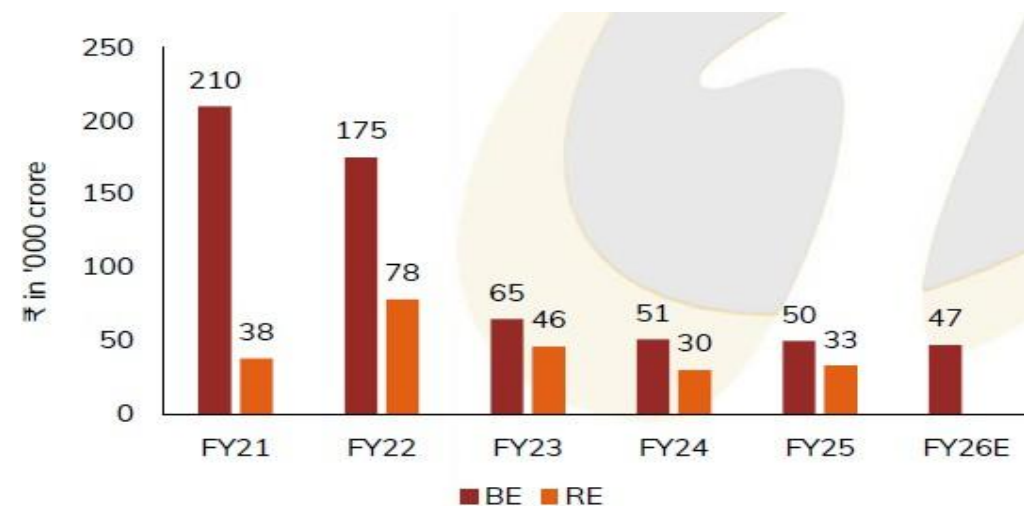
|                         | FY21        | FY22        | FY23        | FY24        | FY25RE     | FY26BE     |
|-------------------------|-------------|-------------|-------------|-------------|------------|------------|
| GDP                     | 1,97,46,000 | 2,36,64,637 | 2,72,40,712 | 2,95,35,667 | 324,00,627 | 359,64,696 |
| 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%       |



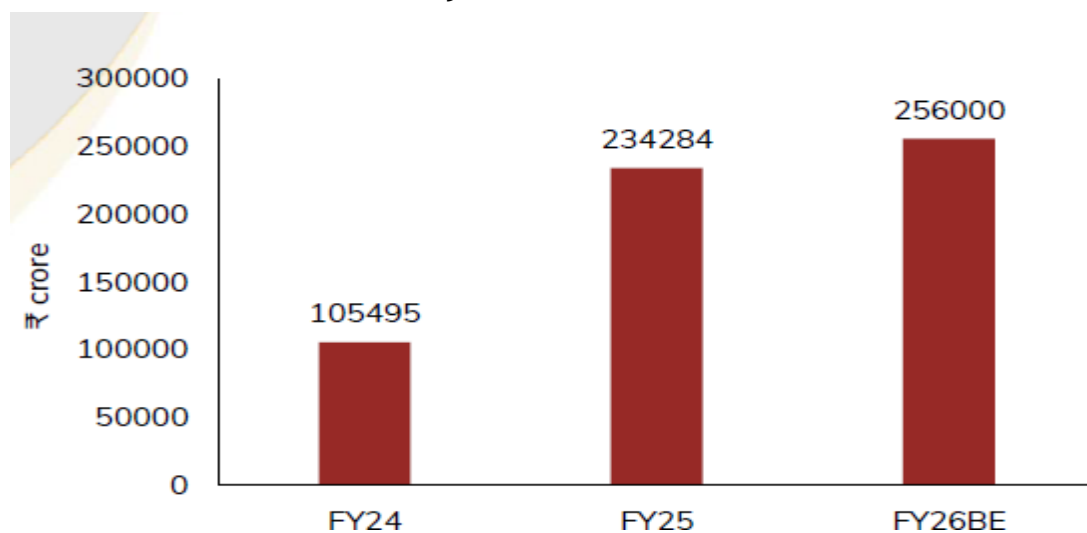
### Capex as a % of GDP



### 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.

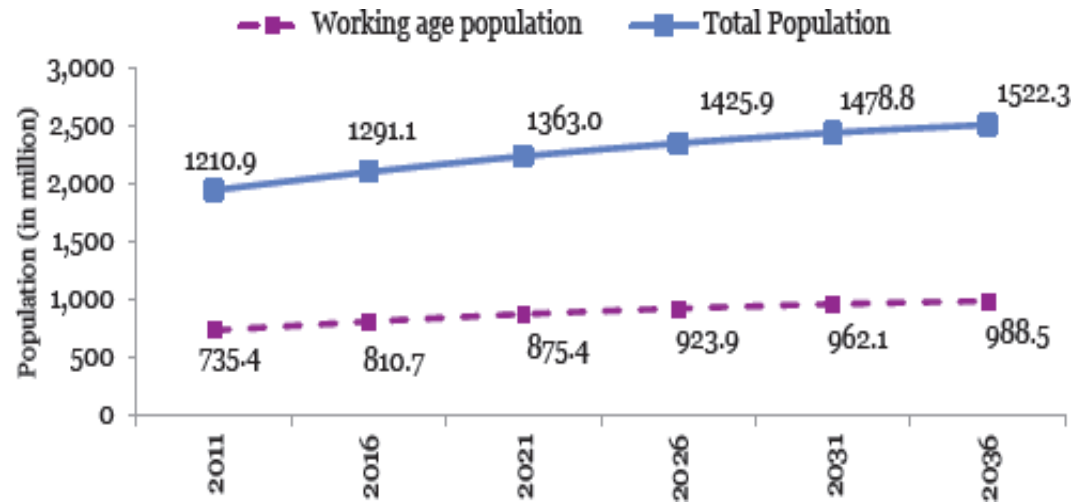
### Personal Income Tax

- **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.

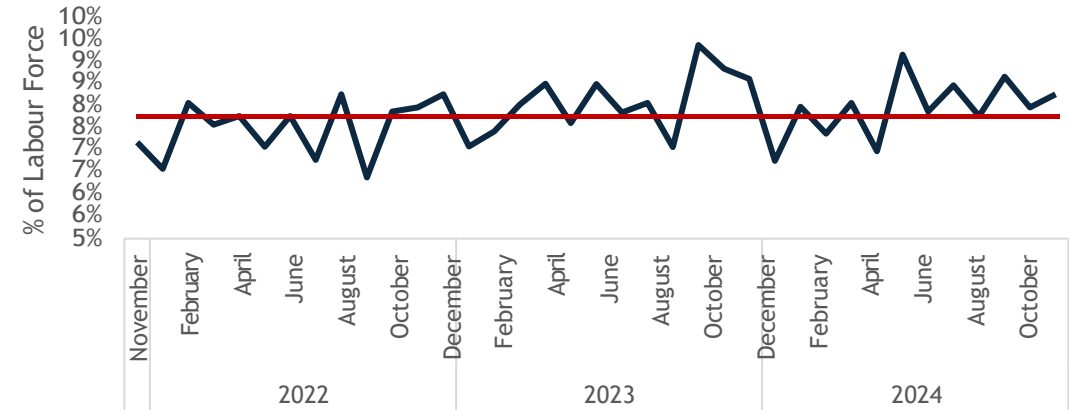
# 8. Employment



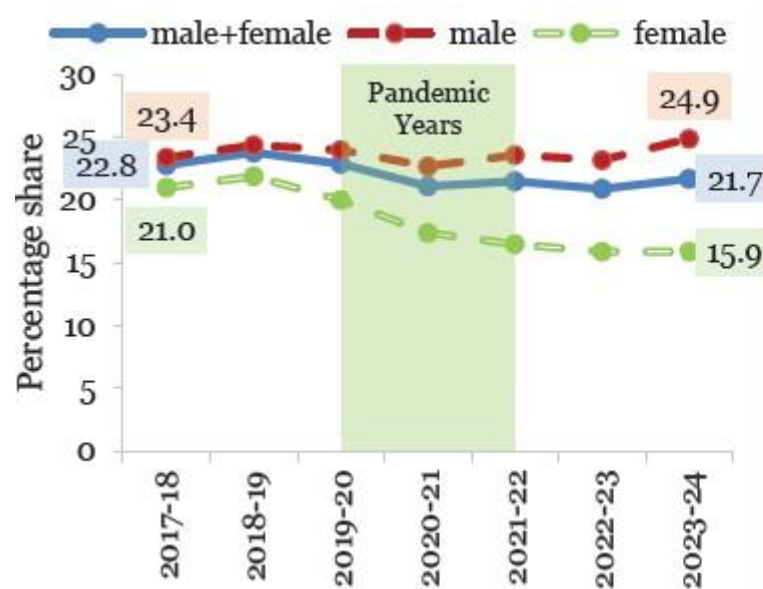
## Working Age Population s Total Population



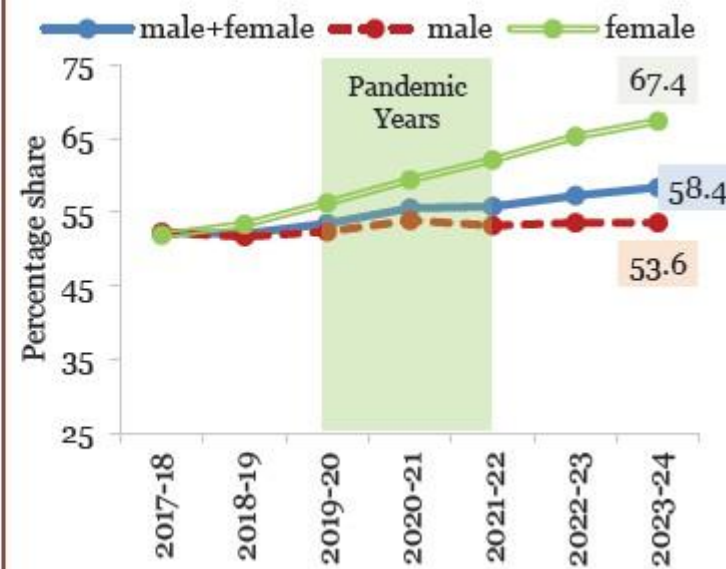
## Unemployment Rate



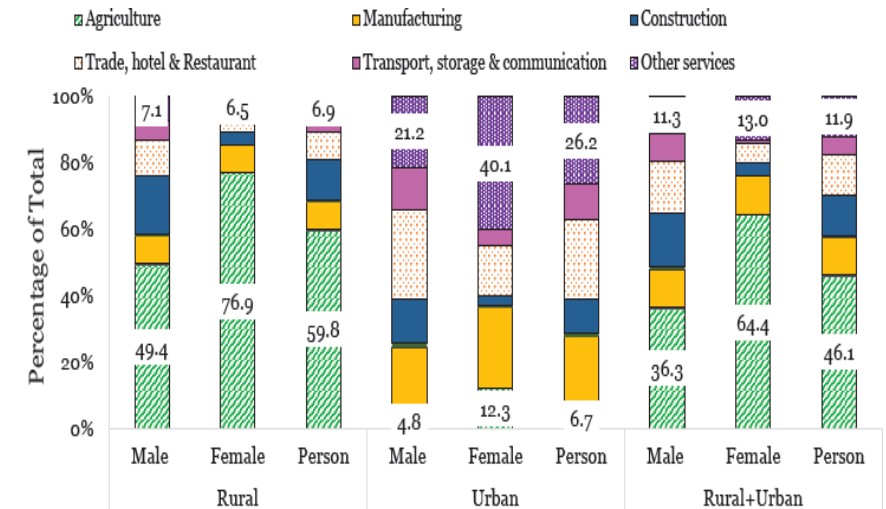
## Share of workforce in regular wage/salaried job



## Share of workforce self employed

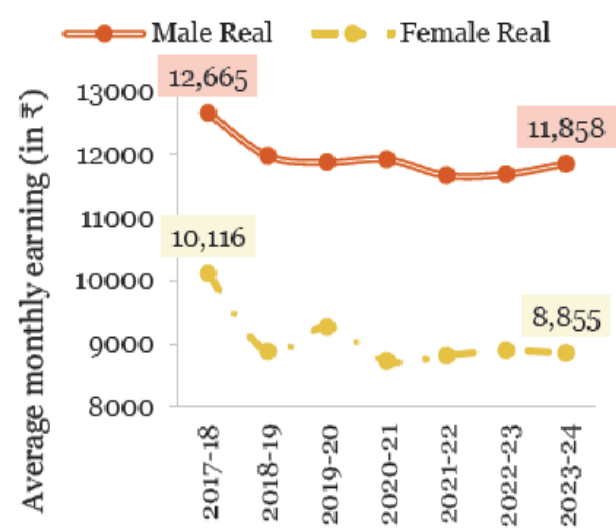
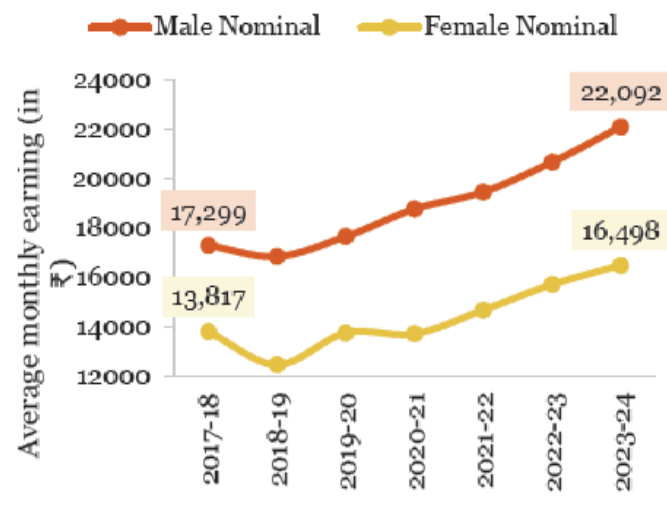


## Distribution of workers

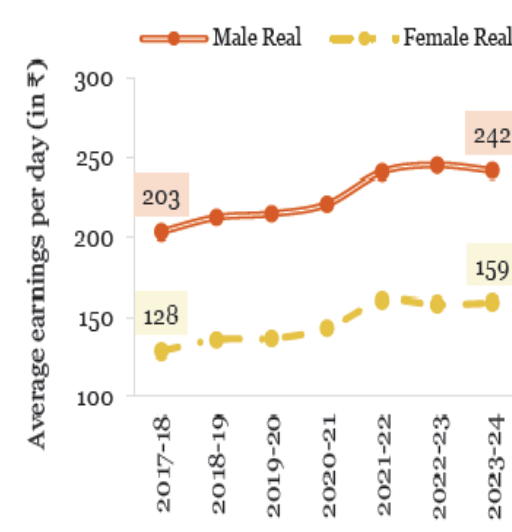
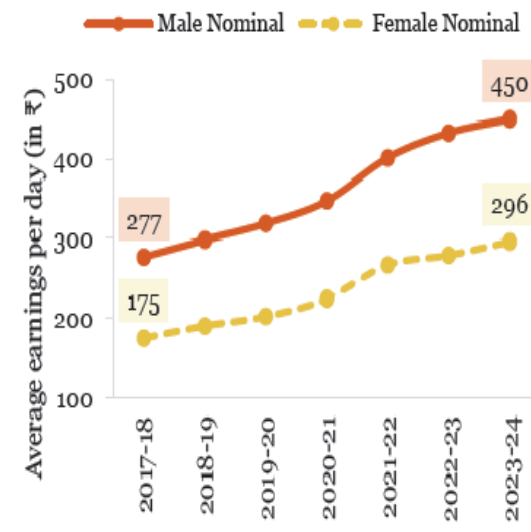




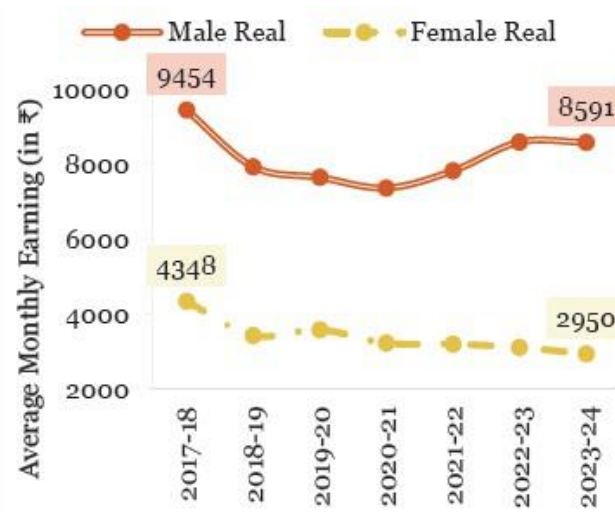
## Nominal and Real Wages - Salaried



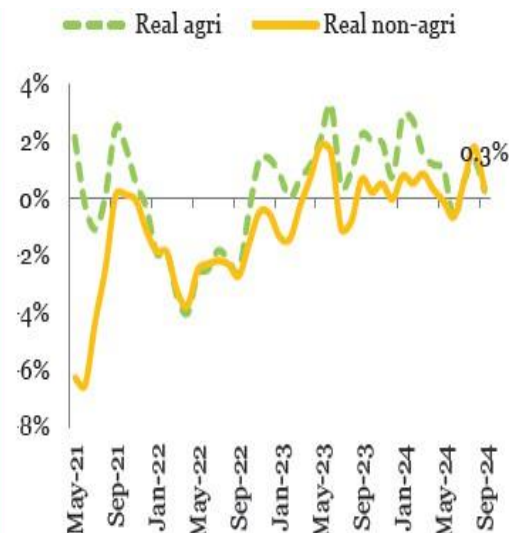
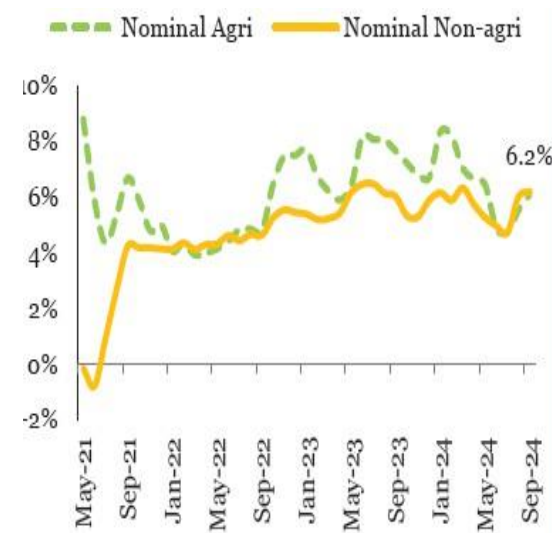
## Nominal and Real Wages - Casual Labour



## 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.

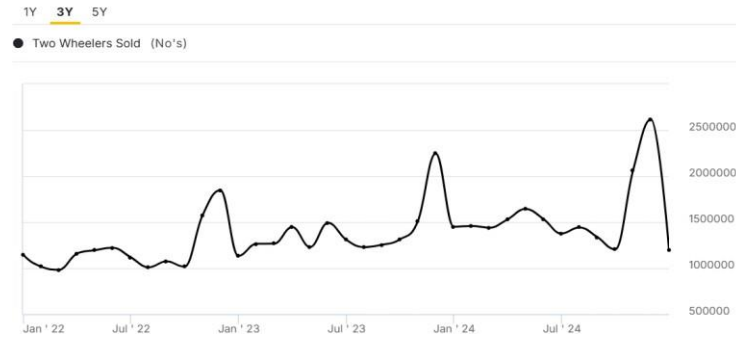
### Outlook

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.

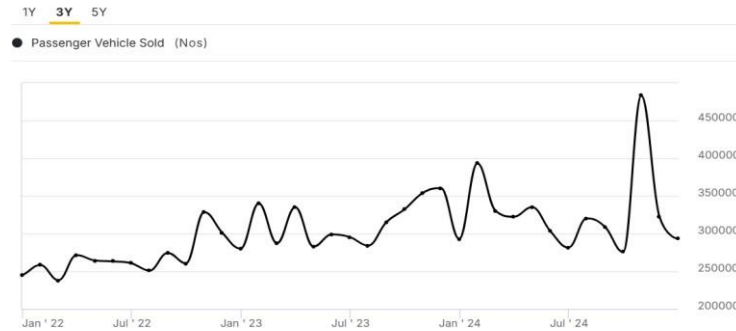
# 9. Demand Indicators



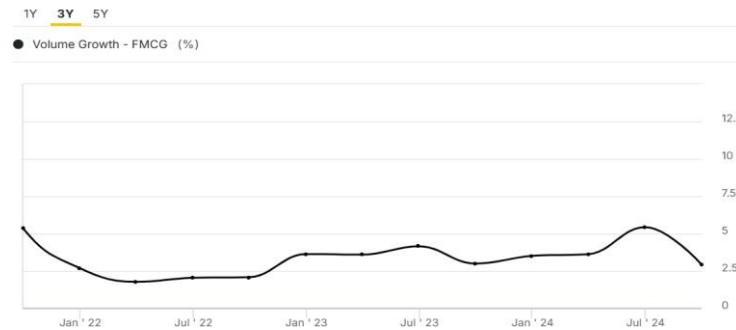
TWO WHEELERS SOLD (No's)



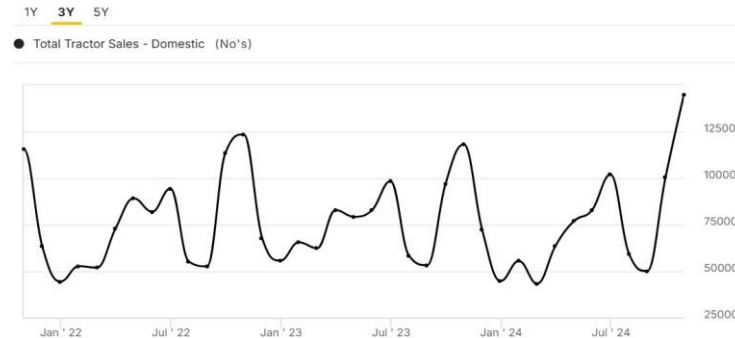
PASSENGER VEHICLE SOLD (Nos)



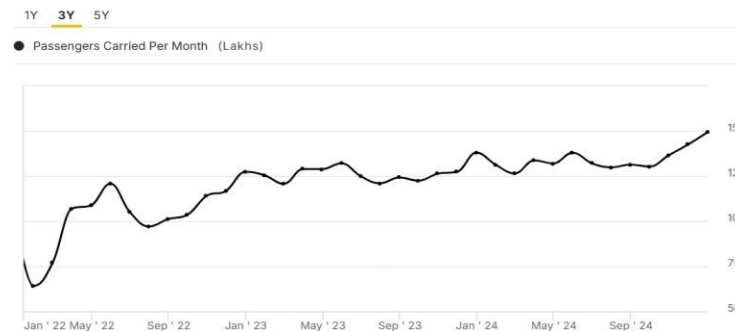
VOLUME GROWTH - FMCG (%)



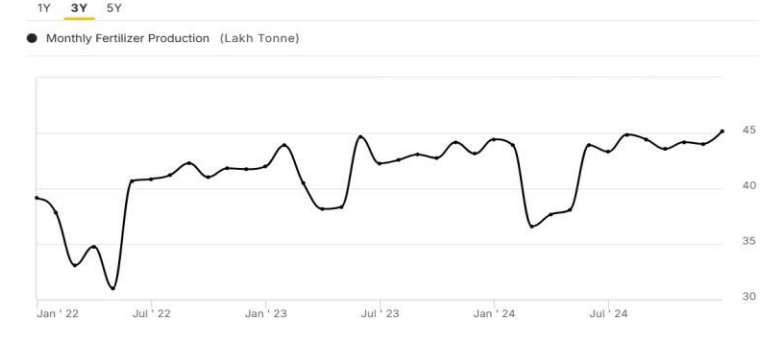
TOTAL TRACTOR SALES - DOMESTIC (No's)



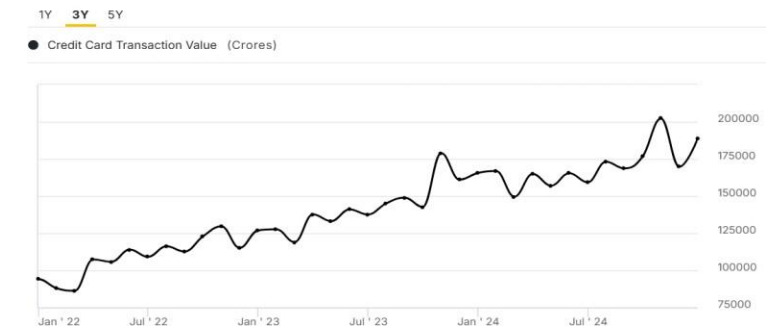
PASSENGERS CARRIED PER MONTH (Lakhs)



MONTHLY FERTILIZER PRODUCTION (Lakh Tonne)



CREDIT CARD TRANSACTION VALUE (Crores)



## Select Consumer Demand Indicators

### Rural Demand

Sales of 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. However, Two-Wheeler Sales experienced a fall in the month of December.

### Urban Demand

Sales of Passenger Vehicles, FMCG Volume growth, and Credit card transactions experienced a downtick just after the festive season, whereas Airline passenger traffic experienced an uptick.

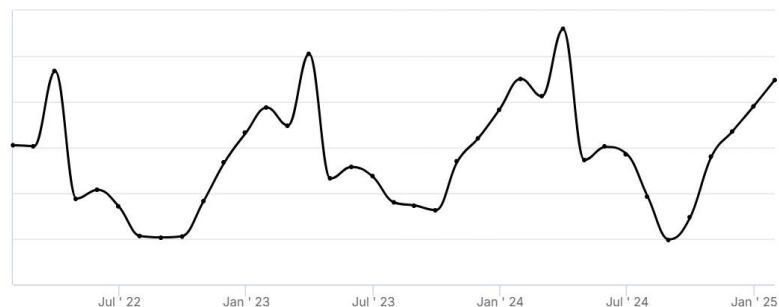
At the beginning of Q3 FY2024-25, overall consumer demand experienced a notable surge, rebounding from a period of sluggish growth reflected in Q2, which was highlighted in the quarterly GDP figures. As we move forward, it will be crucial to monitor the momentum of these high frequency indicators beyond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



COAL PRODUCTION (Mil Tonnes)

1Y 3Y 5Y

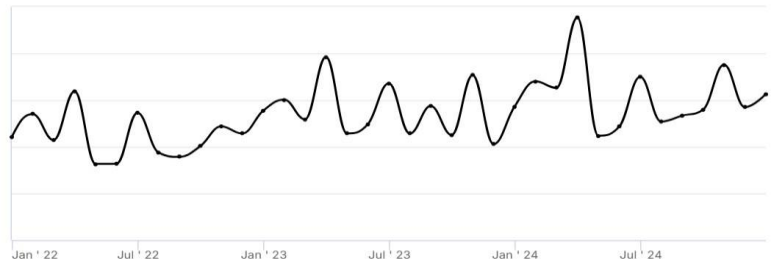
● Coal Production (Mil Tonnes)



CEMENT PRODUCTION (Mil Tonnes)

1Y 3Y 5Y

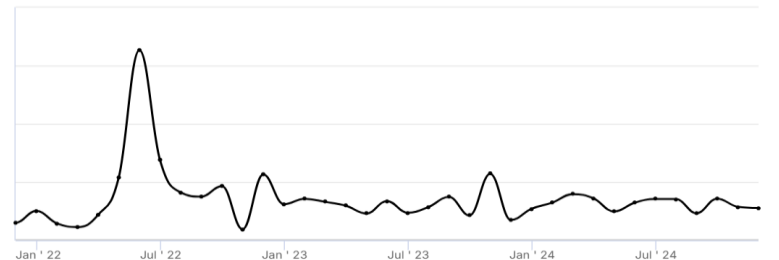
● Cement Production (Mil Tonnes)



FREIGHT INDEX - YOY GROWTH (%)

1Y 3Y 5Y

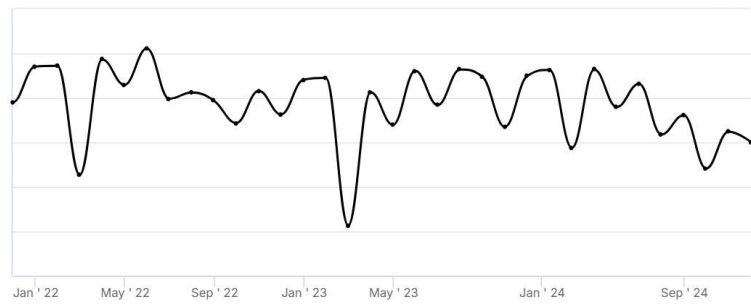
● Freight Index - YoY Growth (%)



CRUDE OIL PRODUCTION (ThsBar/day)

1Y 3Y 5Y

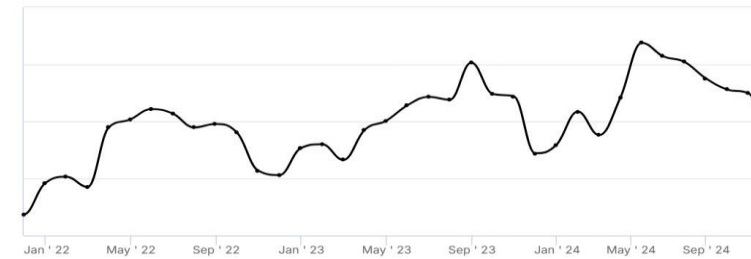
● Crude Oil Production (ThsBar/day)



ELECTRICITY GENERATION (Bil Units)

1Y 3Y 5Y

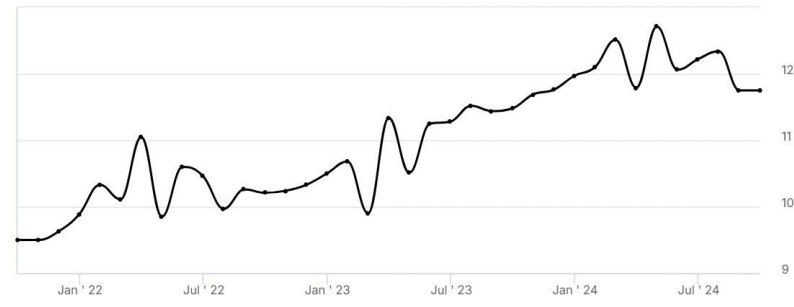
● Electricity Generation (Bil Units)



CRUDE STEEL PRODUCTION (Mil Tonnes)

1Y 3Y 5Y

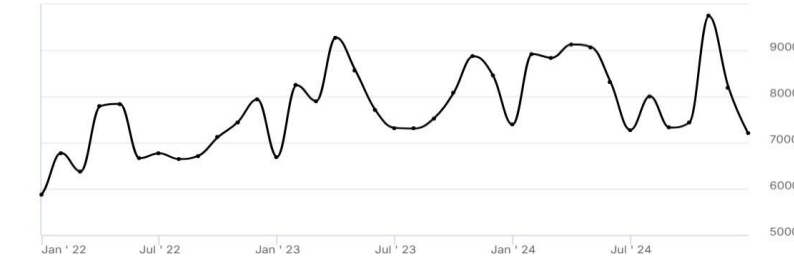
● Crude Steel Production (Mil Tonnes)



COMMERCIAL VEHICLE SOLD (Nos)

1Y 3Y 5Y

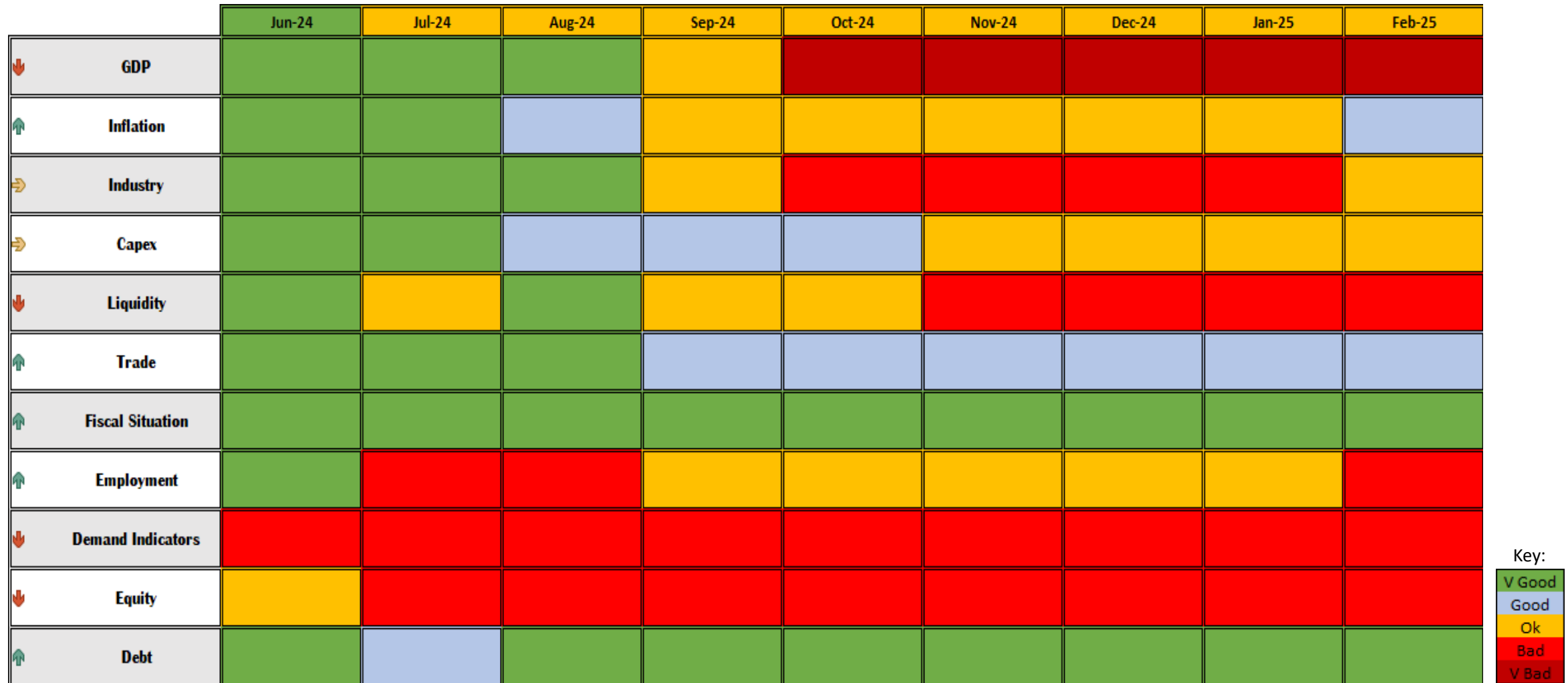
● Commercial Vehicle Sold (Nos)



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 Q1 and Q2 FY25 was muted on account of elections/code of conduct. The same picked up pace in Q3 of FY25, however there **still remains ~₹3 trillion to be spent**. The same implies that the remaining month 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**.

# Economic Heatmap



## Cautious Optimism

The domestic economy is clearly in 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, the fiscal and monetary policy boost to consumption, it remains uncertain whether the momentum witnessed in Q3 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%               | -6% |      |     |      |      |     |     |      |        |        |        | -6.38% |
| 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% |

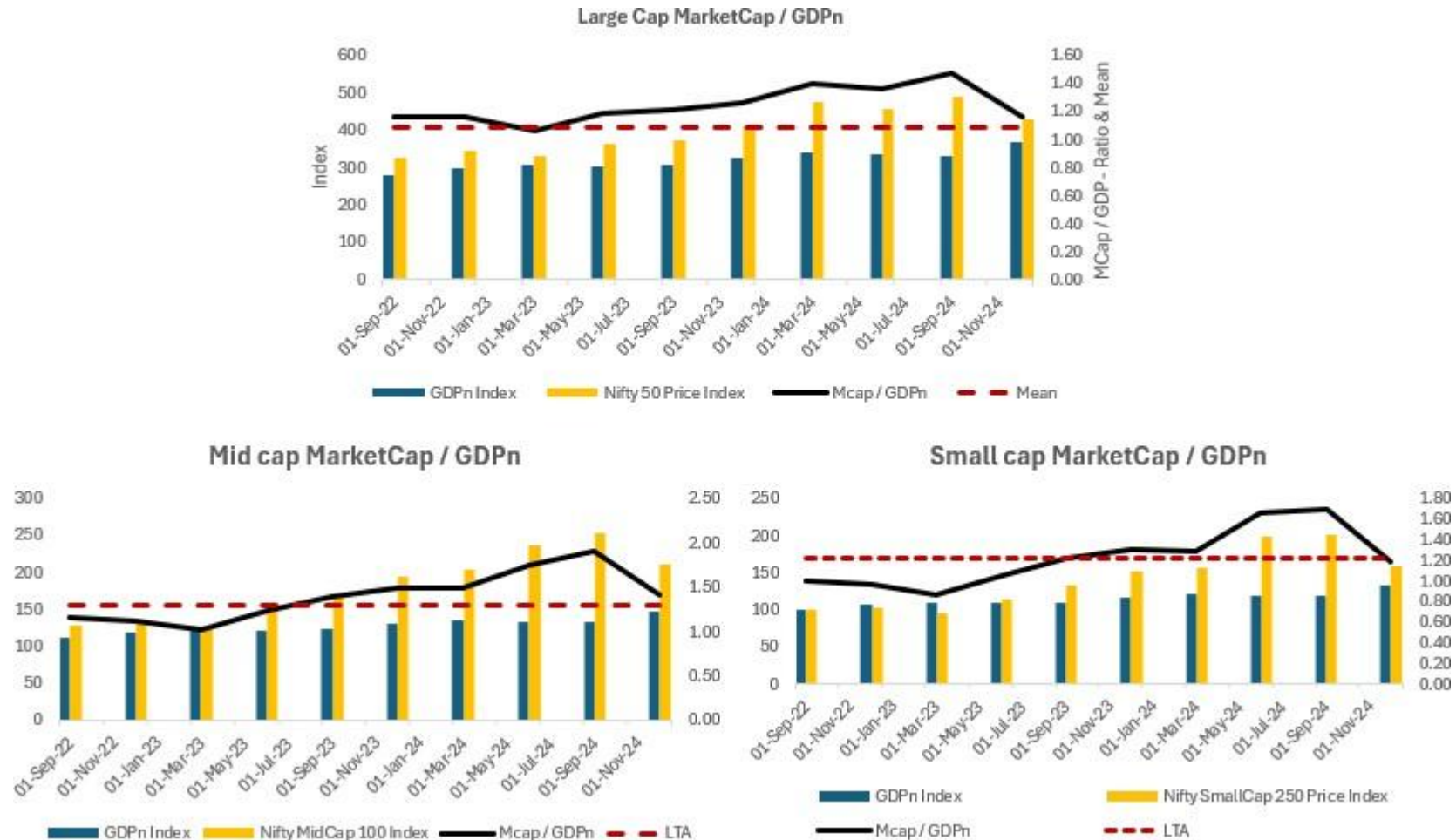
| Risk-return Measures             | Nifty 50 | Nifty Mid Cap 150 | Nifty Small Cap 100 |
|----------------------------------|----------|-------------------|---------------------|
| CAGR Return %                    | 11.3%    | 14.0%             | 13.8%               |
| Standard Deviation               | 21.8%    | 26.5%             | 30.7%               |
| 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        | 2                 | 1                   |
| No of Years                      | 25       | 19                | 11                  |

## Tempered Down Expectations

- From Oct 2024 till Feb 2025, the Nifty 50 Index has declined ~13%, sparking caution among investors. Historically, the Nifty 50 has given a CAGR of ~11% 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 almost 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 ~11% over a long-time horizon. Similarly Mid Caps registered a CAGR of ~14% over the past ~19 years and Small Caps registered a CAGR of ~14% over the past ~11 years. As we start CY 2025 with a modest -1% return in Jan 2025 and -4% return in Feb 2025 for Nifty 50, thus exhibiting mean reversion from the past two years. We expect muted returns in the Large Cap segment, atleast in the first 9 months of this calendar year. 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 9M of CY 2025 with reversion to their long-term mean.
- The Risk-Return Matrix 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  | 20.26      | 23.96                | -15%                 | Fairly Valued |
| Mid Cap    | 33.92      | 32.25                | 5%                   | Overvalued    |
| Small Cap  | 27.31      | 25.00                | 9%                   | Overvalued    |

# Buffett Indicator

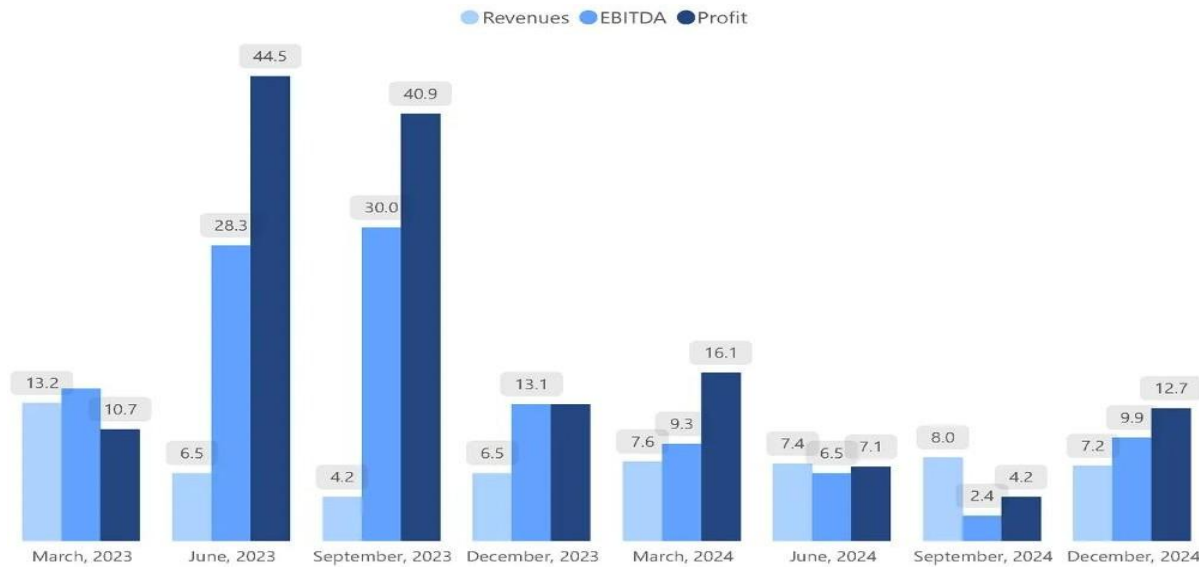


The present lofty valuations are further evidenced in the **high premiums exhibited in their Mcap/GDP ratios where Large Caps and Mid Caps are currently trading at premiums of approx 6% & 9%, whereas Small Caps are currently trading at Discount of approx 3%** (as per Buffet Indicator), as on 28<sup>th</sup> Feb 2025.

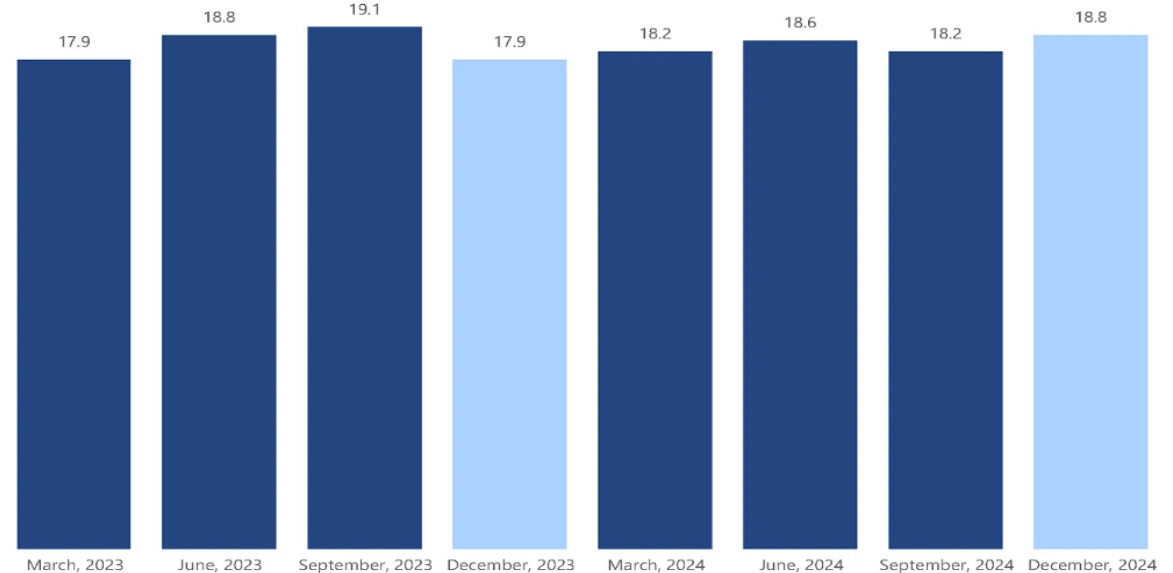
# Corporate Earnings



Quarterly Corporate Performance YoY %



Quarterly EBITDA Margin %

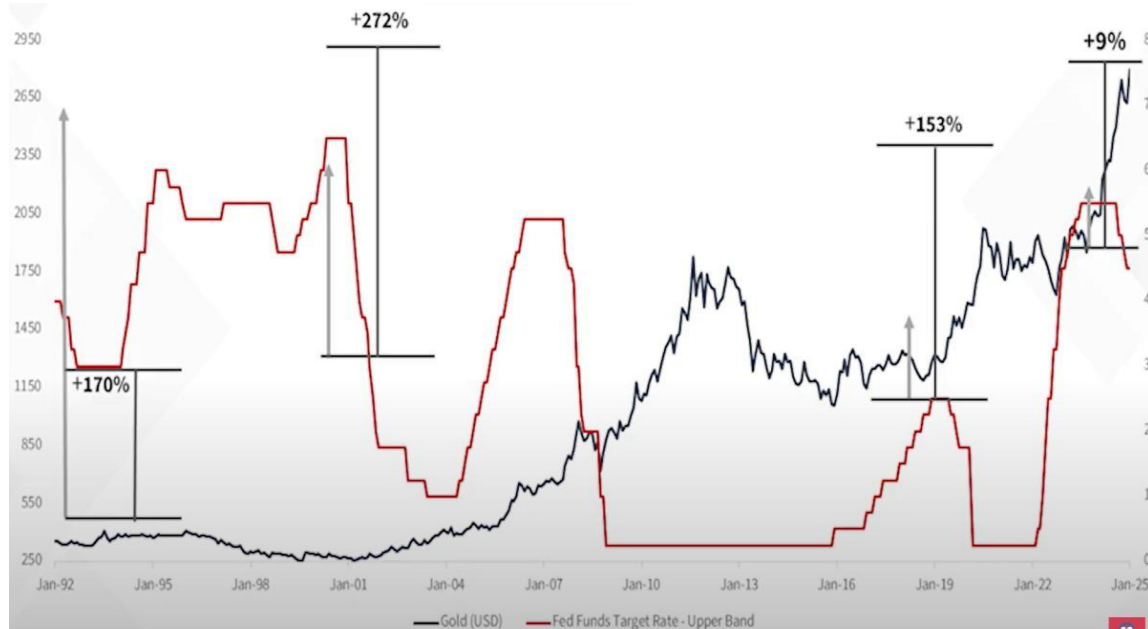


## Wait & Watch Strategy with a hint of Optimism

- The 3Q reporting season has come to an end and it was a **better quarter for corporate profitability compared to the last few quarters**. Based on a sample of over 4000 quarterly results (excluding Insurance and Investment Trusts), **reported profits grew at a 3-quarter high rate of 13% YoY during the quarter**. This was driven by a 4-quarter high growth of 10% in operating profits (EBITDA). Revenue growth was, however, a modest 7%, broadly the same growth rate as in the preceding few quarters (indeed modestly lower if one were to nitpick).
- So **Margin expansion was a key driver of profit growth during the quarter**. EBITDA margins expanded almost 100bps on a YoY basis during the quarter after having declined in the preceding two quarters. And comes on top of a 100bps margin expansion during the December quarter of the previous year.
- However, while overall profits rose, a **significant portion of the growth came from just a few large firms, masking weaker performance in broader markets**. The profit-after-tax growth for BSE500 companies (excluding oil marketing firms) slowed to 8%, down from 21% in FY24. Revenue growth remained weak at 8%, marking the seventh straight quarter of sub-10% growth.
- The most concerning trend was the demand slowdown, which has now spread from export-driven industries to domestic consumption. High-end segments such as personal vehicles, hotels, durables, and jewelry, which previously performed well, saw a slowdown. IT firms stabilized despite seasonally weak Q3, while industrials, telecom, pharma, and chemicals showed moderate growth. However, small- and mid-cap firms, more dependent on domestic demand, underperformed large-caps.
- Consumption firms struggled, with FMCG volumes remaining weak as urban demand softened despite a gradual rural recovery. Consumers opted for smaller packs in premium categories, and even during the festive season, retail and fast-food chains saw muted sales. Automobile volumes remained under pressure, while real estate stood out with strong luxury housing demand. Electronics manufacturing services gained momentum, with long-term growth prospects looking strong.
- Markets saw a sharp correction, with benchmark indices declining around 13% from record highs, and small- and mid-caps falling more. Despite this, valuations remain expensive. **Analysts expect earnings growth to improve in FY26 (4.4% FY25 expected EPS growth and 14.7% FY26 expected EPS growth for Nifty 50)**, but weak demand may lead to disappointment.
- The banking sector reported mixed results due to slowing loan growth, though lower credit costs supported profitability. Deposit mobilization remains a challenge, with system liquidity in deficit despite recent central bank measures. Lenders continue to face stress in unsecured retail loans, particularly in personal loans, credit cards, and microfinance.
- However, the overall improvement in profitability is broadly in sync with data suggesting that the December quarter was stronger for the economy compared to the September quarter. And we have got validation for this from the December quarter GDP data released on 28th Feb. If anything, the fact that the interest coverage ratio has continued to improve suggests that corporates are not yet borrowing in a meaningful way and thus corporate investment cycle has most likely continued to remain muted. Sometimes, too much of a good thing is also not that good. Currently it's a clear wait and watch strategy with a hint of Optimism.

Source: India Data Hub, Bloomberg

# 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

## The Modern Era Gold Rush

- 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.**
- **Amid global uncertainties surrounding U.S. tariffs, Gold has experienced a strong rally as a safe-haven asset.**

# 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> |

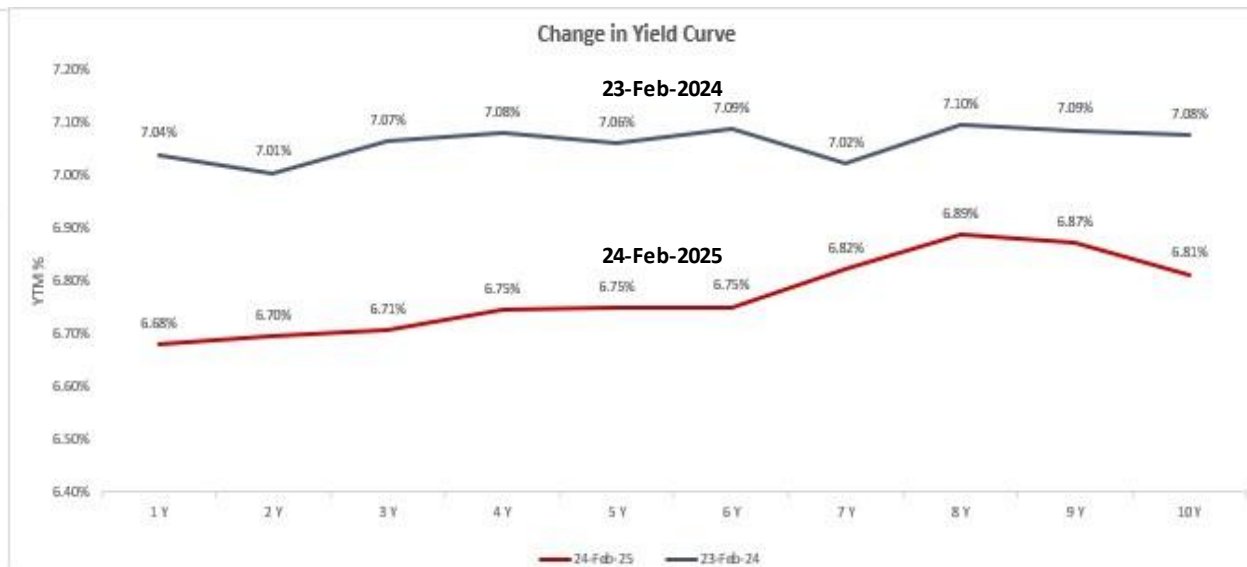
### ➤ *Neutral Gold*



# 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:

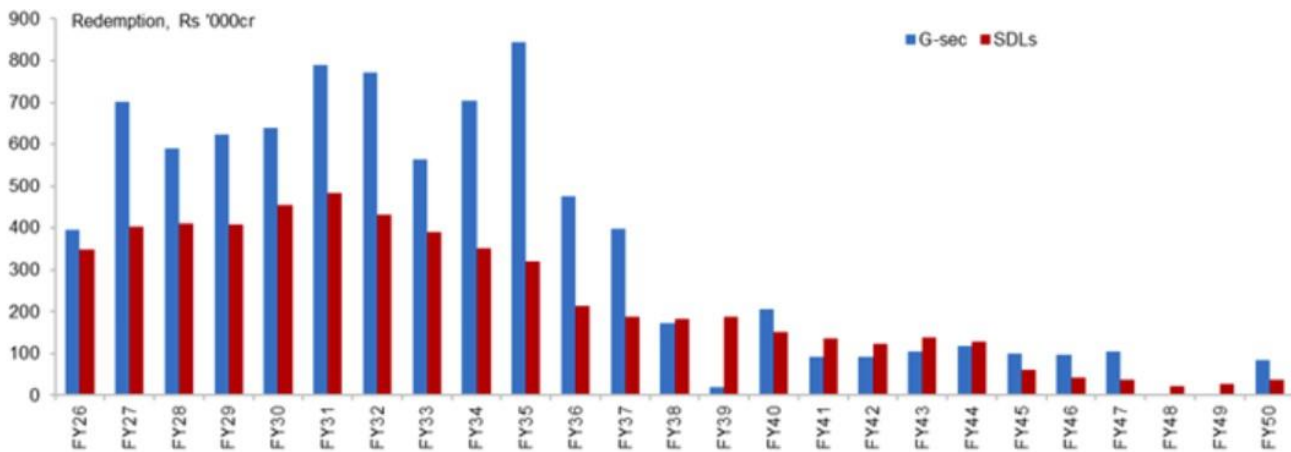
- **The MPC delivered a 25 bps cut as widely expected in an equally widely anticipated policy**, since this was new Governor Malhotra's first. To that extent, market participants were keenly looking out for some indication on the Governor's line of thinking, while always appreciating the importance of 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.*

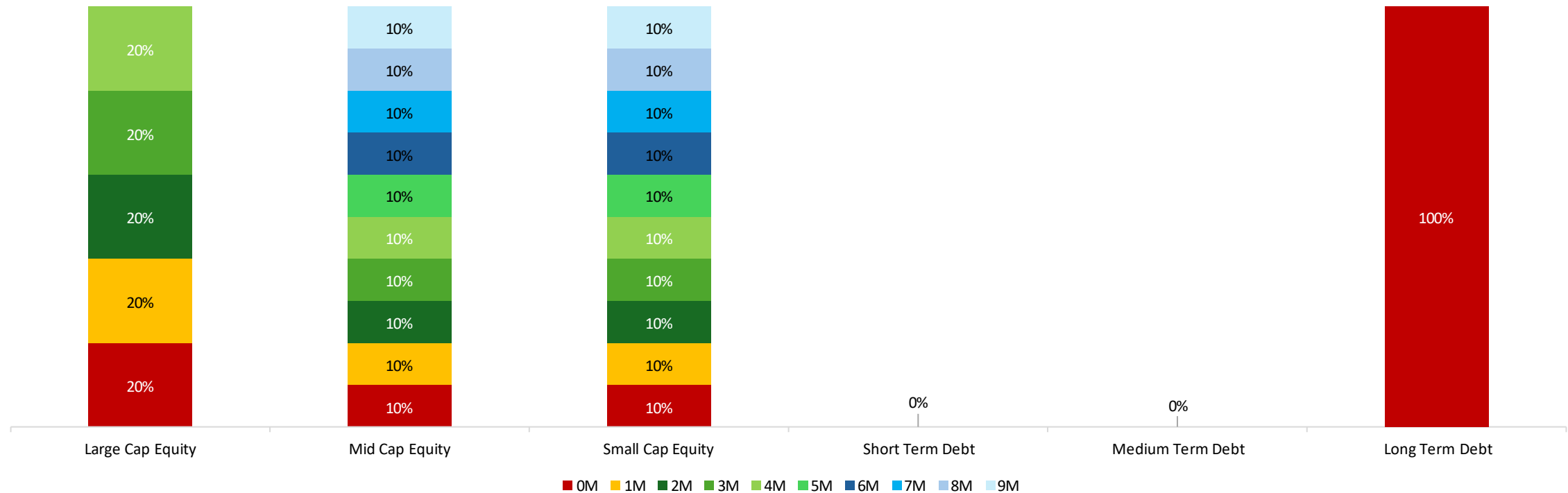
# Deployment Strategy



# Deployment



Stages of Deployment



## Indicators:

### Indicators signaling over heated market conditions –

- VIX at 14-15 levels
- Market Cap/GDP for Large Cap and Mid 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
- FII's 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 and Market Cap/GDP for Small Cap Is above the 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)

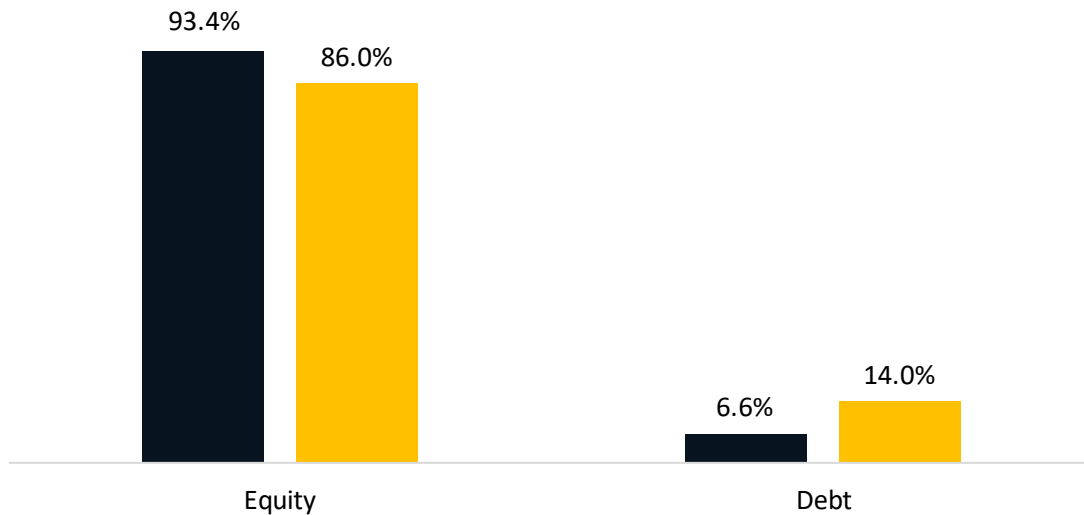
# Optimus Prime Model Portfolio





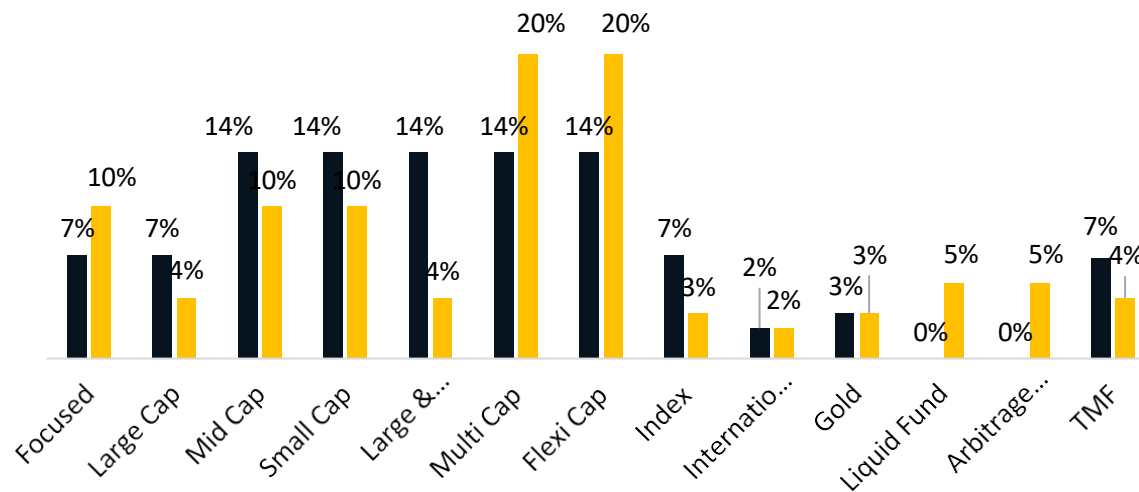
### Asset Allocation

■ SAA ■ TAA

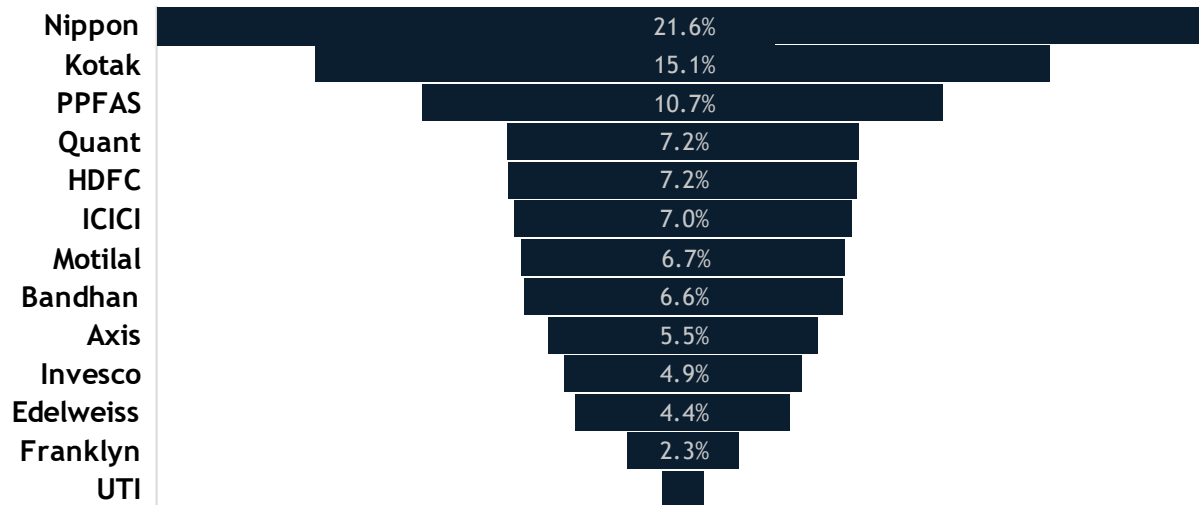


### Category Allocation

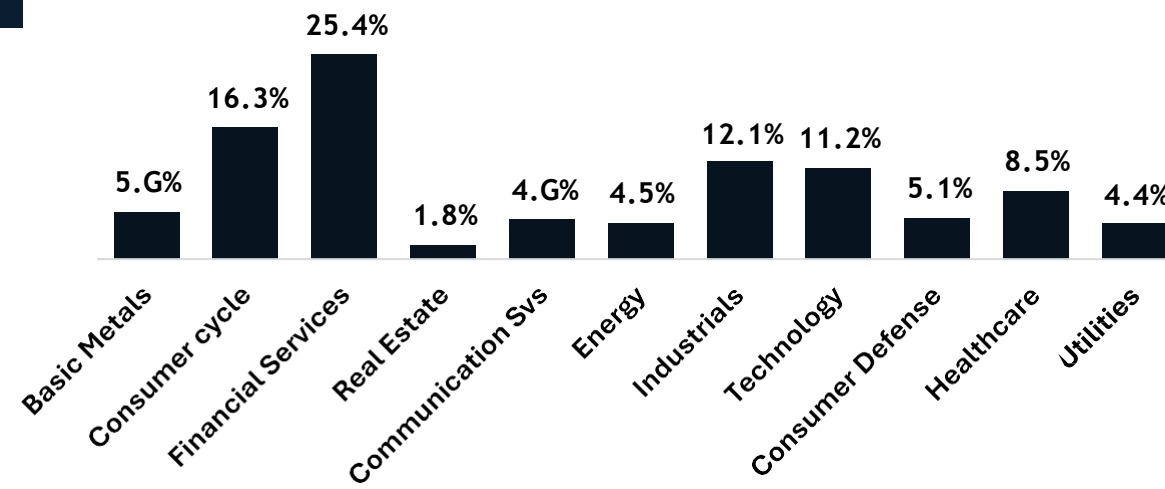
■ SAA ■ TAA



### Fund House Concentration



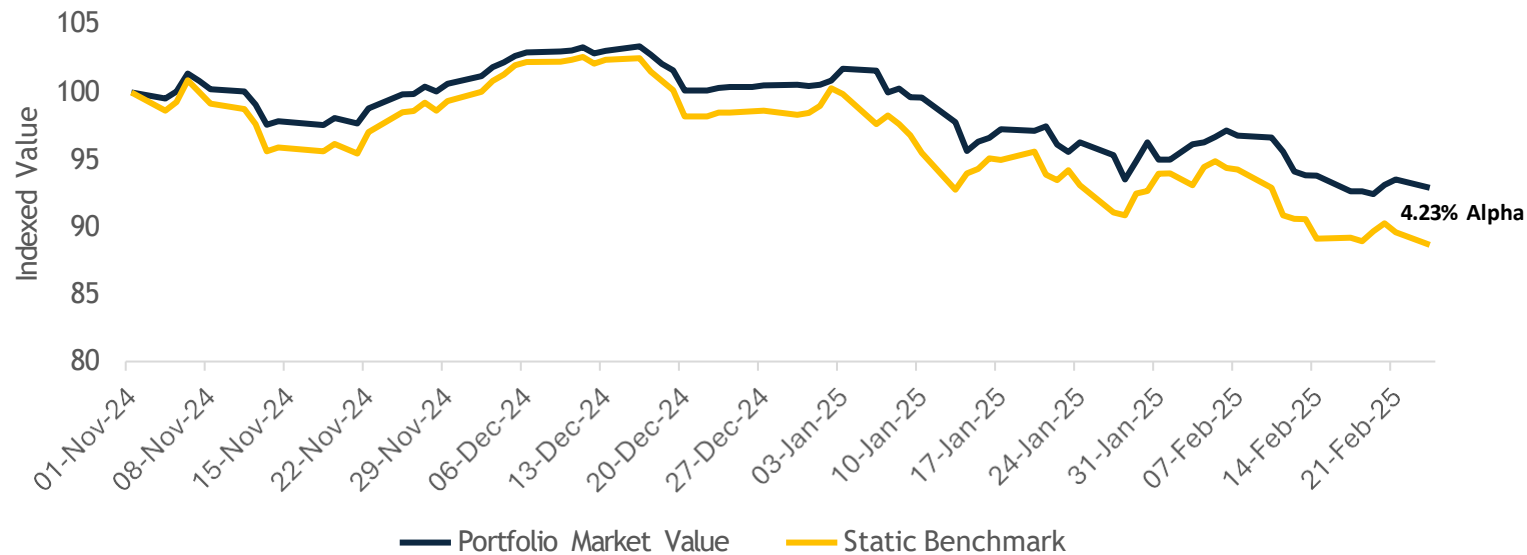
### Sectoral Allocation



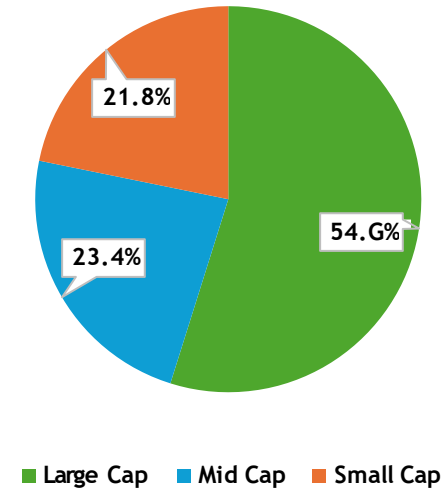
**\*SAA - Strategic Asset Allocation & TAA - Tactical Asset Allocation**, Commodity and International Allocation considered as Equity Allocation, Arbitrage Funds & Liquid Funds Allocation considered as Debt Allocation, and is temporarily parked for the short term and will be deployed opportunistically, 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 %               | -7.09%       | -11.32%   |
| Standard Deviation (annualized) | 12.55%       | 15.76%    |
| Beta                            | 0.76         |           |
| <b>Alpha</b>                    | <b>4.23%</b> |           |
| Information Ratio               | 4.35         |           |
| Downside Capture                | 62.61        |           |

Debt Portfolio Analytics

| Debt Measures      | Jan-25       |
|--------------------|--------------|
| Average MoD        | 5.2          |
| Average Maturity   | 7 yrs        |
| Average Coupon     | NA           |
| <b>Average YTM</b> | <b>7.2 %</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%. All returns are pre-tax unless specifically mentioned.



## **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 (~10-11% 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 intervention 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 CY 2025**. That said, we remain **optimistic about India's long-term growth story**.

Albeit a very short timeframe, our 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 (4.23%)** despite a challenging market environment, with a **Beta of 0.76** and **Information Ratio of 4.35** representative of a high risk-adjusted performance in comparison to its benchmark, and a **downside capture of 62.61%**, 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.

## Disclaimer



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# THANK YOU

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