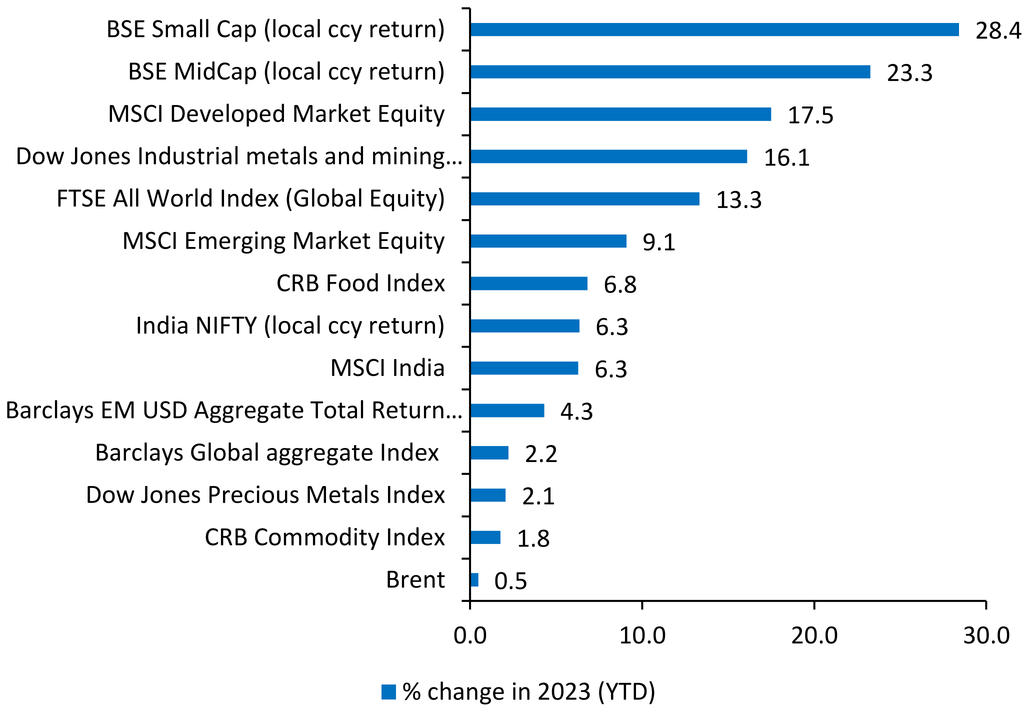
ECONOMY AND MARKETS

September 2023

SBI FUNDS MANAGEMENT LIMITED

Risk assets have performed in 2023

Risk assets performed in 2023 (YTD)

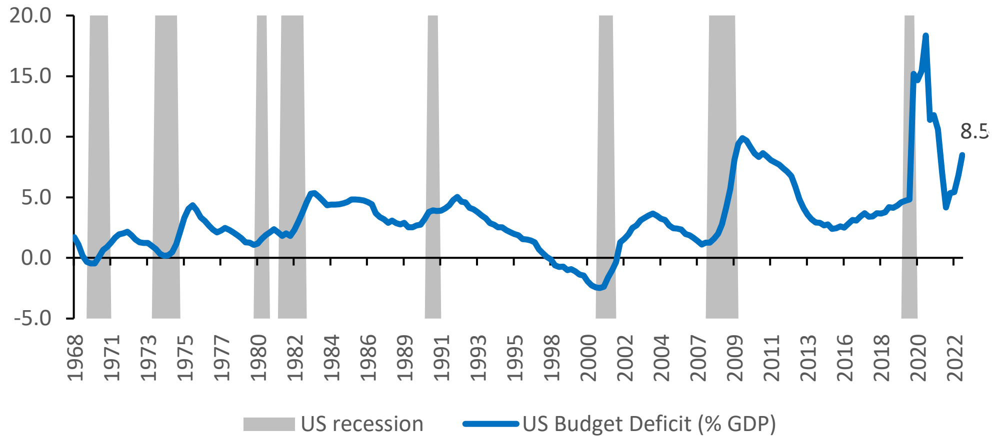


- Risk assets have done well in 2023.
- Many investors are questioning the idea of a recession in the US towards the end of 2023/ beginning 2024.
- Soft landing is the new accepted wisdom among many including US Fed.

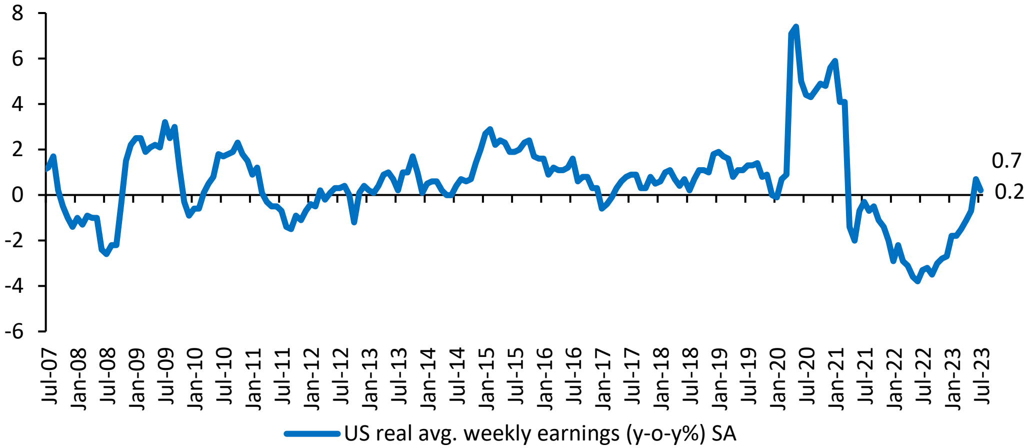
Source: Bloomberg, SBIMF Research

Expansionary fiscal policy and positive real wage explains better than expected US activity till now

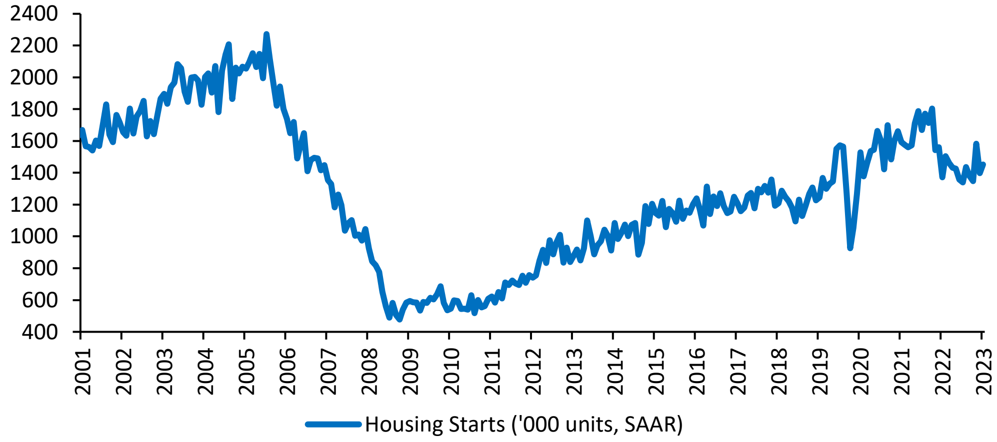
US has expansionary fiscal policy which partly offsets the monetary tightness



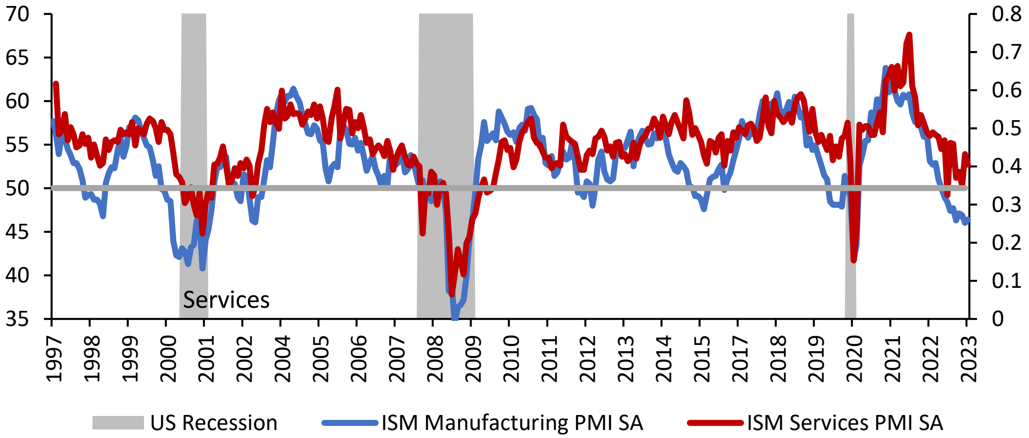
Real wage growth has turned positive as inflation cooled off since May’23- supports consumption demand



Housing start has seen some rebound



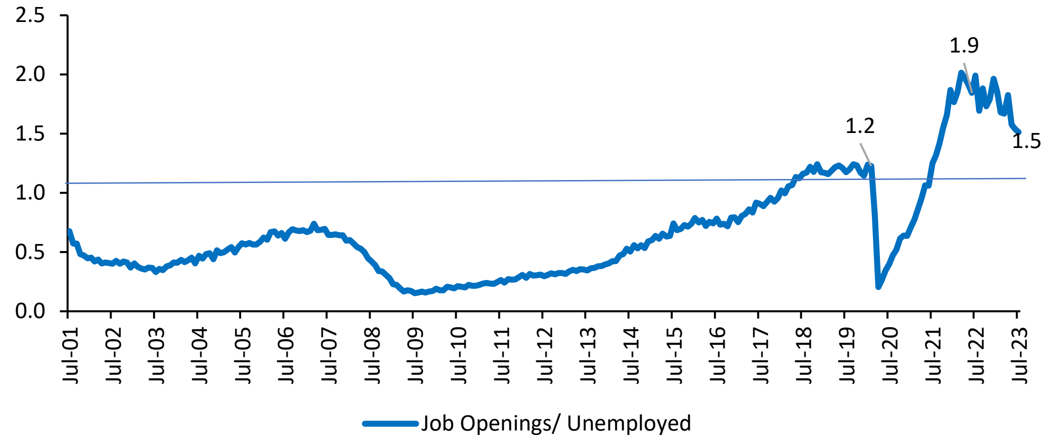
Services still in expansionary zone; sharp dichotomy in manufacturing and services



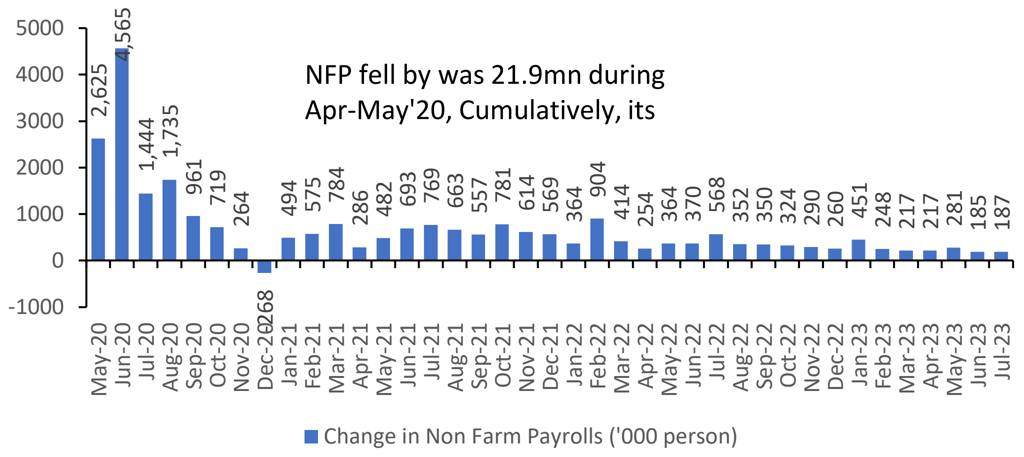
Source: FRED, Bloomberg, SBIMF Research

Labour market in the US has seen a very slow and protracted cooling

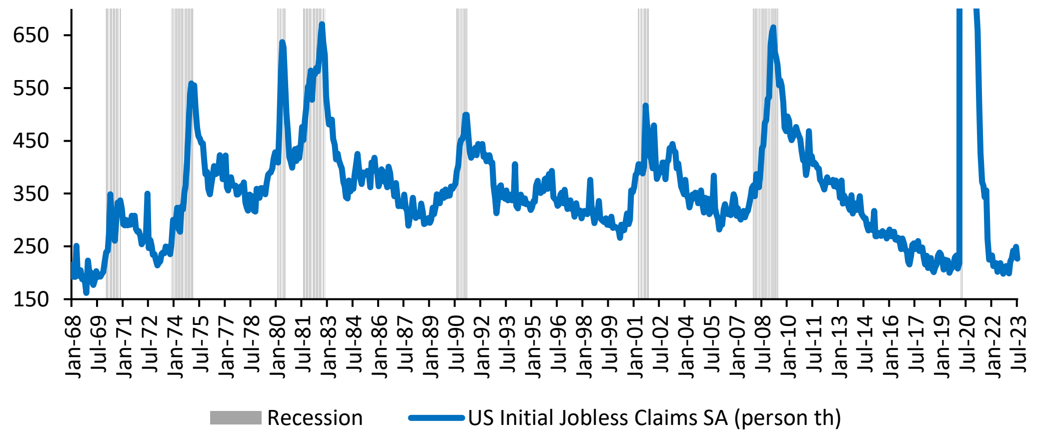
Demand for workers have subsided but remains near historic highs



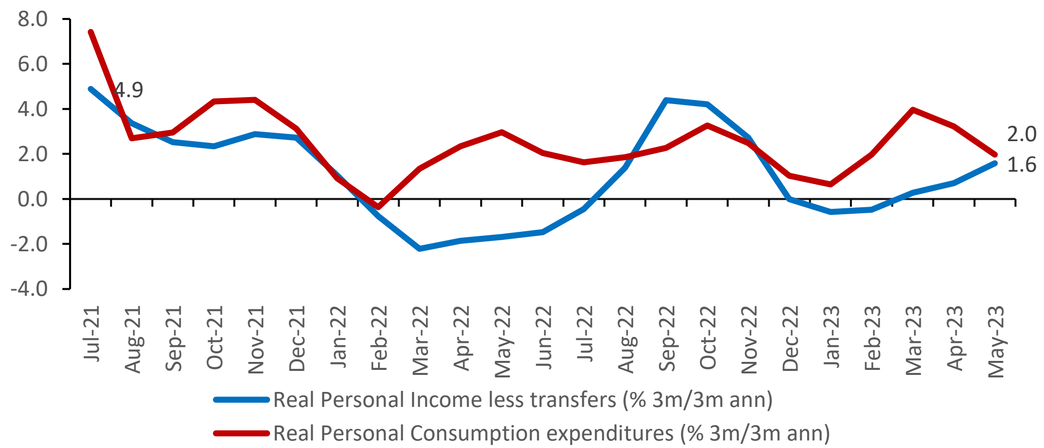
Non–farm payroll monthly accretion decreases to 187K in Jul'23



Jobless claims lower than pre-pandemic norms



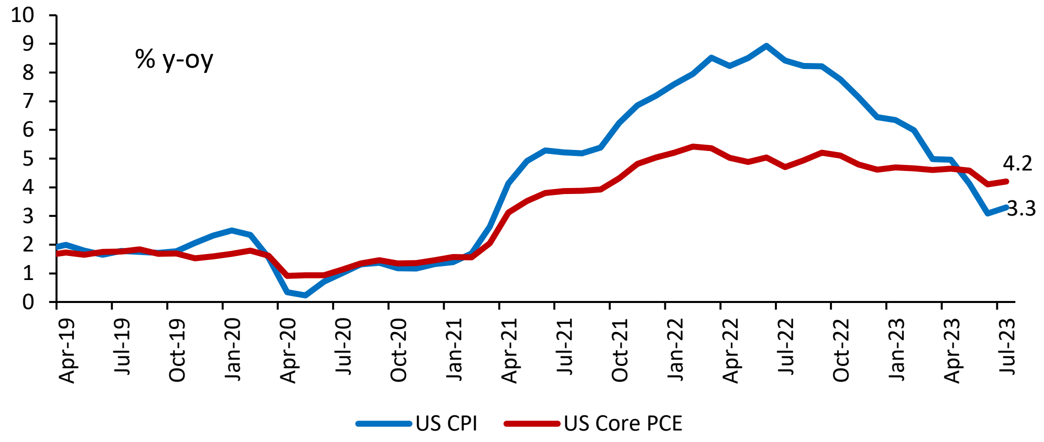
Personal income growth in positive territory aiding personal consumption



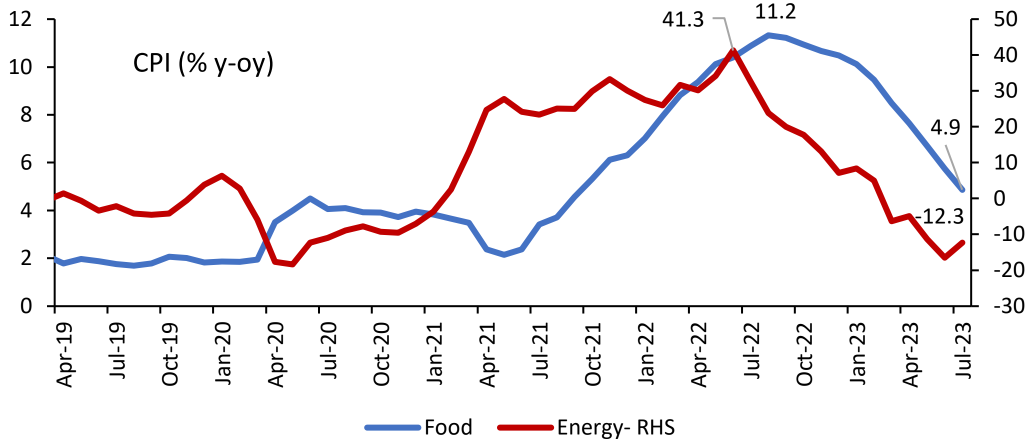
Source: FRED, Bloomberg, SBIMF Research

US disinflation aids real wage growth and drives some consumer confidence lift-up

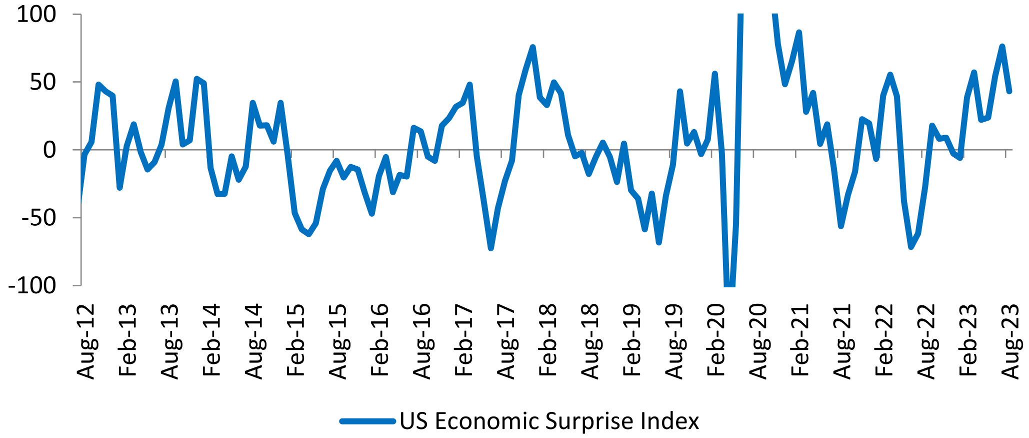
Headline inflation has cooled off to 3.3% and core at 4.2%



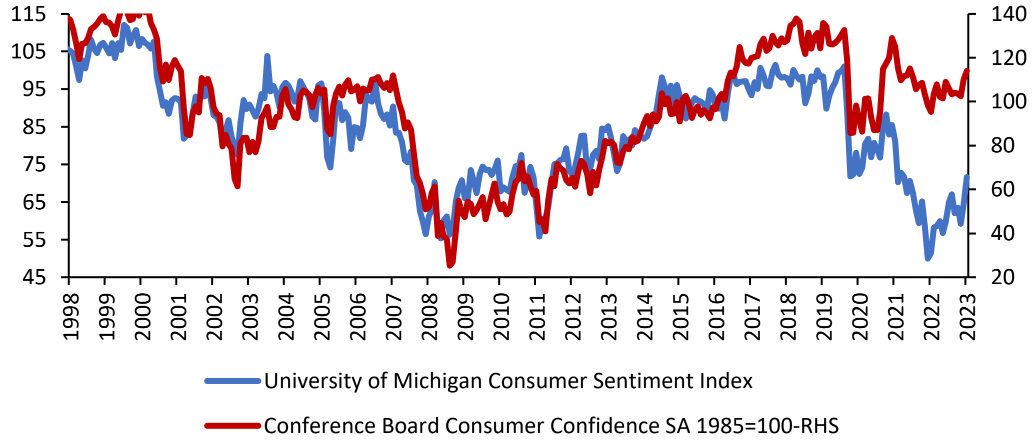
Though, food disinflation and energy deflation has likely bottomed out



US economic surprise still strong



US consumer confidence rebounds; but could fade away quickly due to depletion in excess savings



Source: Bloomberg, SBIMF Research

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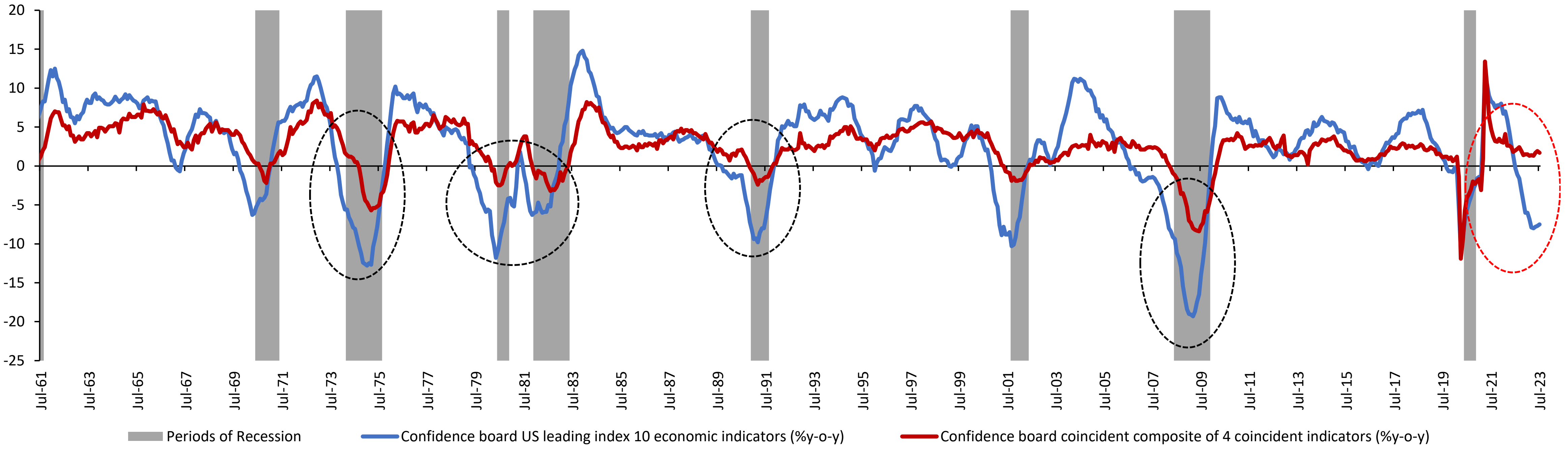
US economy activity in green despite leading indicators pointing to a strong decline for last 17 months

US growth still holds up despite leading indicators pointing to a likely decline for over a year now

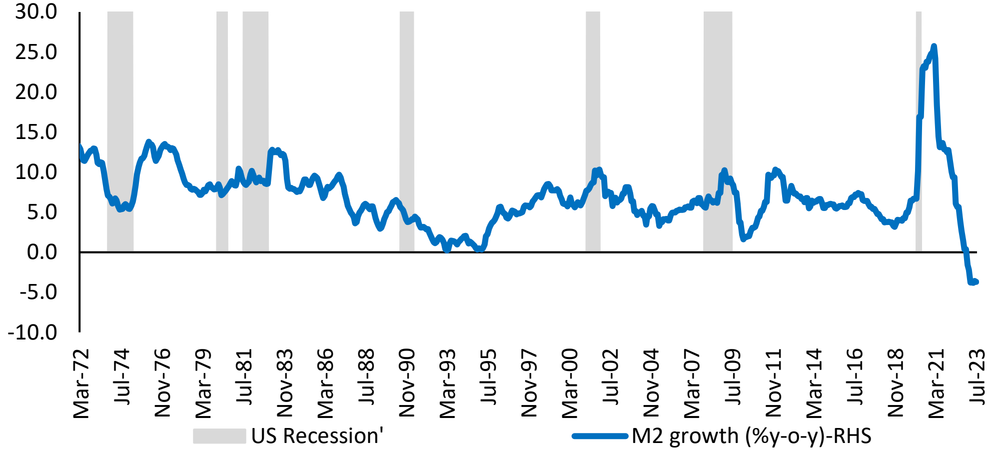


- The Leading Economic Index provides an early indication of significant turning points in the business cycle and where the economy is heading in the near term. The Coincident Economic Index provides an indication of the current state of the economy.
- In past, US coincident indicators start to decline within a few months of decline in the leading indicators,
- In the current cycle, the CFB Leading Economic Index (LEI) has been declining on a y-o-y basis for last 16 months in succession while coincident indicators have been in green.
- The deviation from the norm may be best explained by post COVID massive fiscal stimulus, leading to excess savings in US household.
- US GDP grew by 2.1% annualized in Q2 2023, above market expectations.

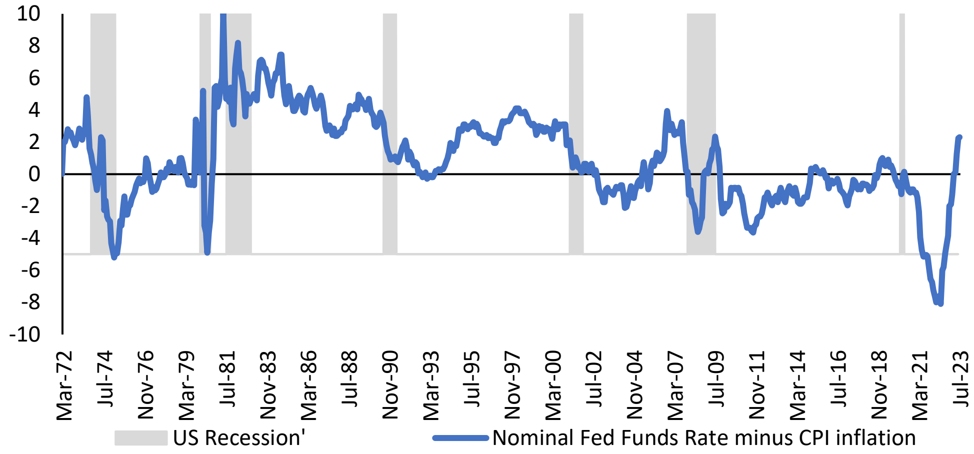
Source: Bloomberg, SBIMF Research

We stay cautious on US growth owing to continued tightness in monetary and credit conditions

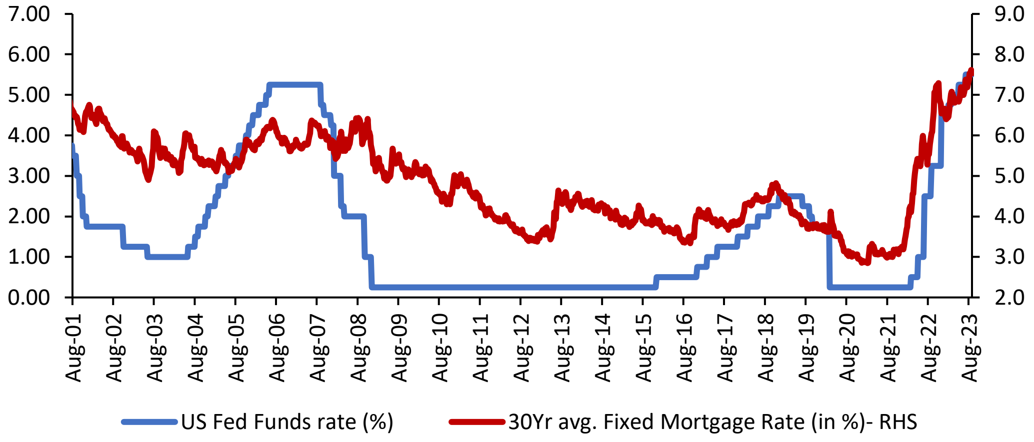
Money supply continues to contract



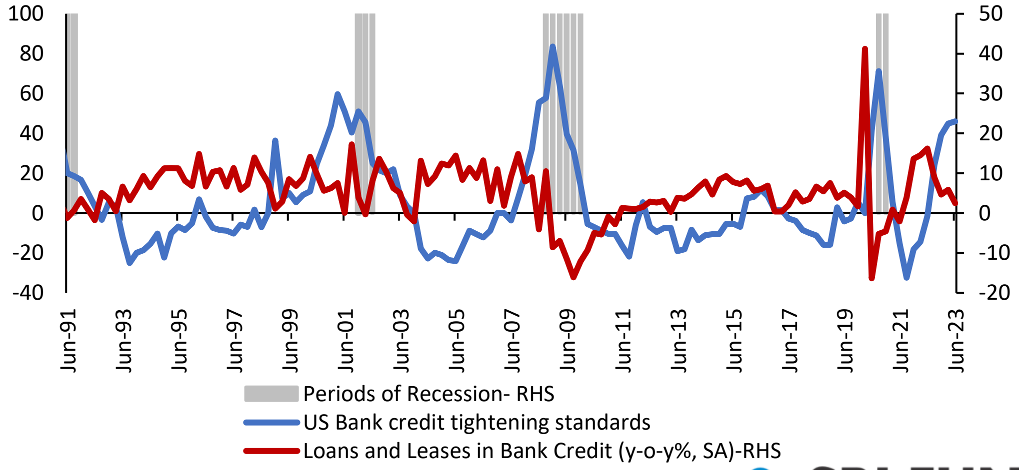
Real rates have just turned neutral- could turn restrictive very rapidly



Cost of funds is rising; mortgage rates at its highest in over two decades



Tightening of credit conditions in the US could weigh on the economy



Source: FRED, Bloomberg, SBIMF Research

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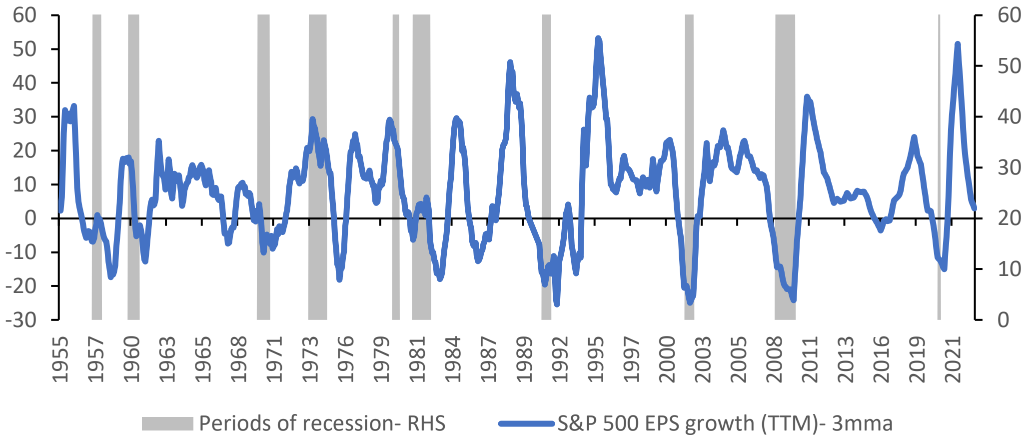
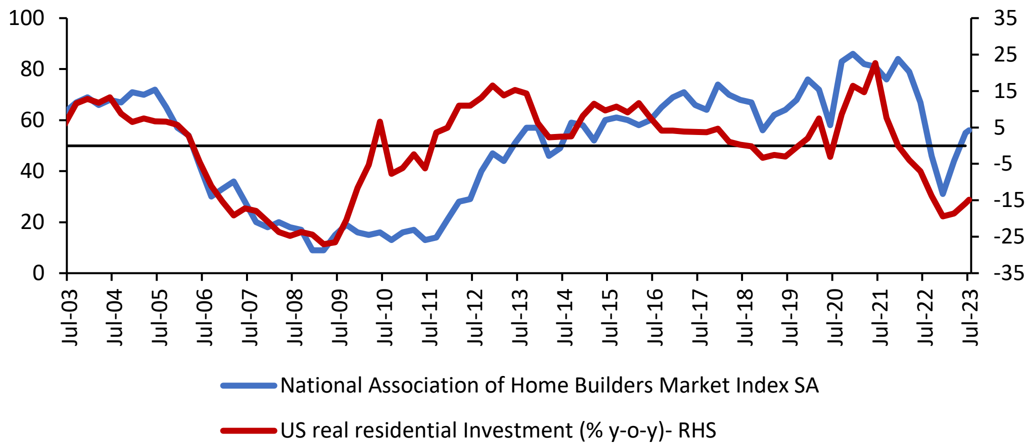
Near term aside, US economy is headed for a weakening in growth momentum

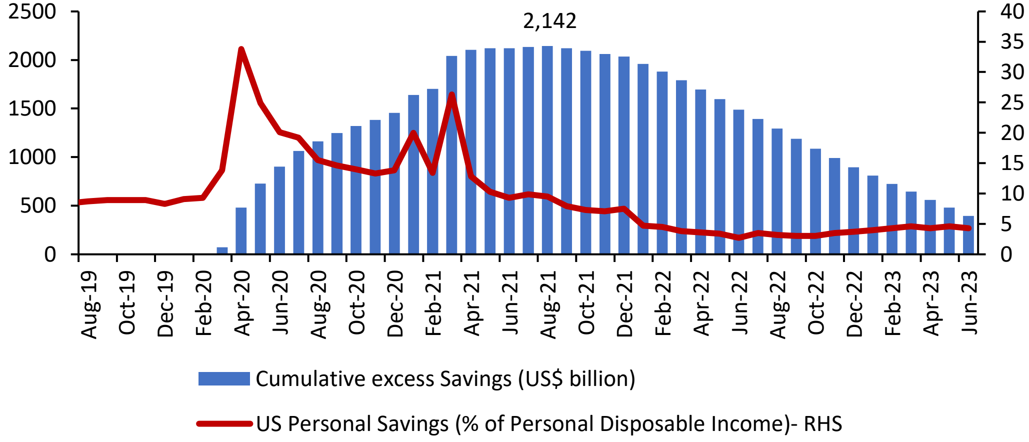
S&P Earnings growth has moderated from 13% at start of the year to 3% by June end



Despite some pick-up in sentiments, investments are weak



Personal savings rate has dropped to 4%, will need to restore as excess savings dry-up



- In 2H 2023, the coming months could deliver (i) decent US growth, (ii) more Chinese stimulus, (iii) a weaker US dollar- all this pointing to continued momentum in risk assets. But history suggests caution is still warranted.
- Given that the underlying problems of higher rates and declining manufacturing output globally, tightening credit standards, contracting money supply growth and depleting excess savings in the US, it is too soon to move away from the recession front.
- Real rates have finally turned positive in the US only now, at 2%, its highest since GFC. And given where valuations are today, they cannot sustain earnings downgrade.

Source: Bloomberg, FRED, SBIMF Research

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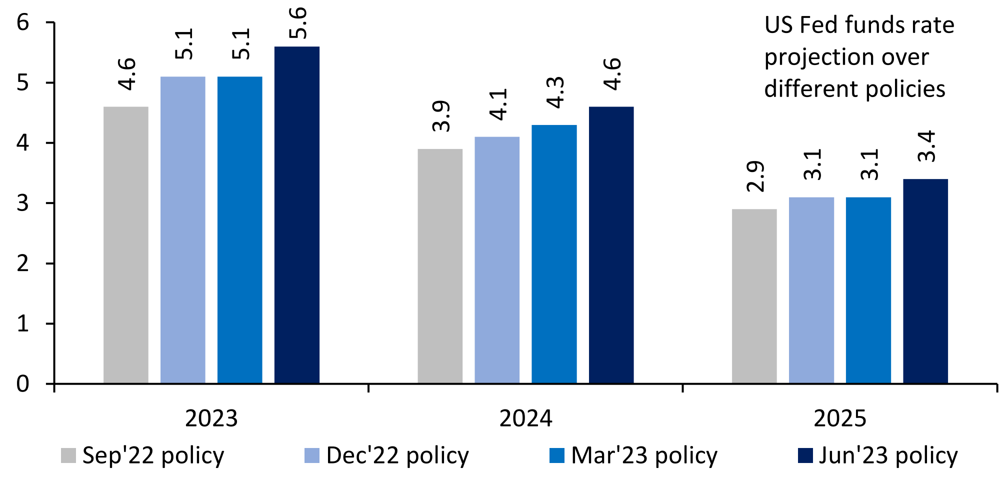
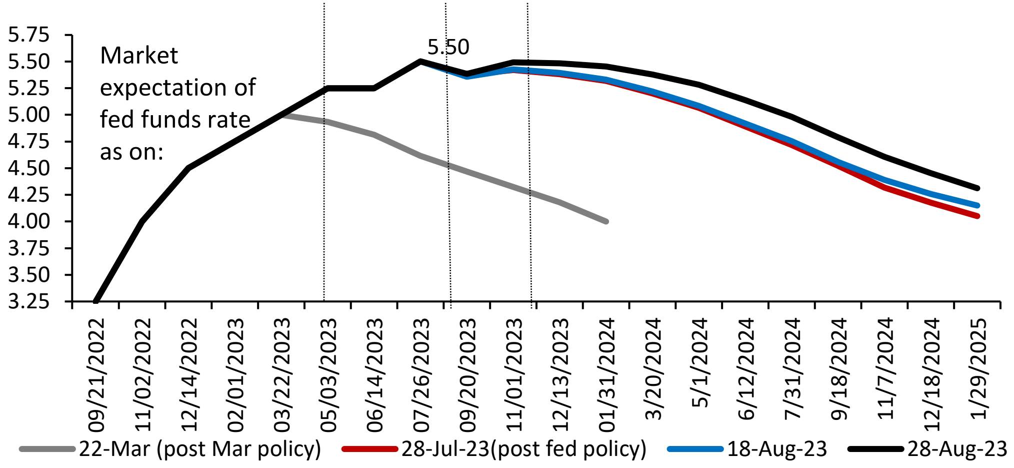
Jackson Hole symposium underscored the possibility of more rate hike(s)

Fed guides for one more rate hike this year (June policy projections)



The market expectations now move towards higher for longer- expect a pause in 2023

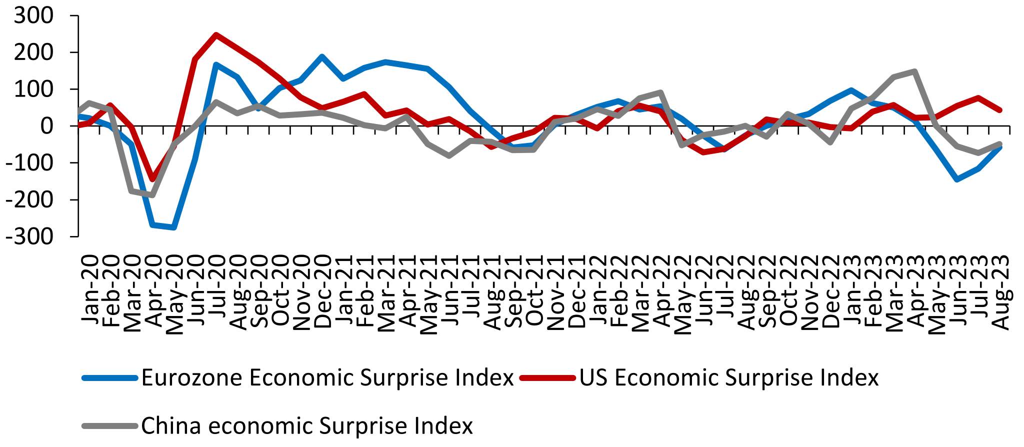


- The latest Fed policy delivered the expected 25bps hike, did not deliver any surprises and stays data dependent.
- Fed dot plot guides for one more hike this year. The median projection of Fed funds rate is unchanged at 5.6% as per June policy.
- Jackson Hole symposium underscored the possibility of more rate hikes.
- Market expectations move towards the “higher for longer” narrative. They continue to price in a pause in rate hikes in 2023 and a cut in policy rates only by mid 2024.

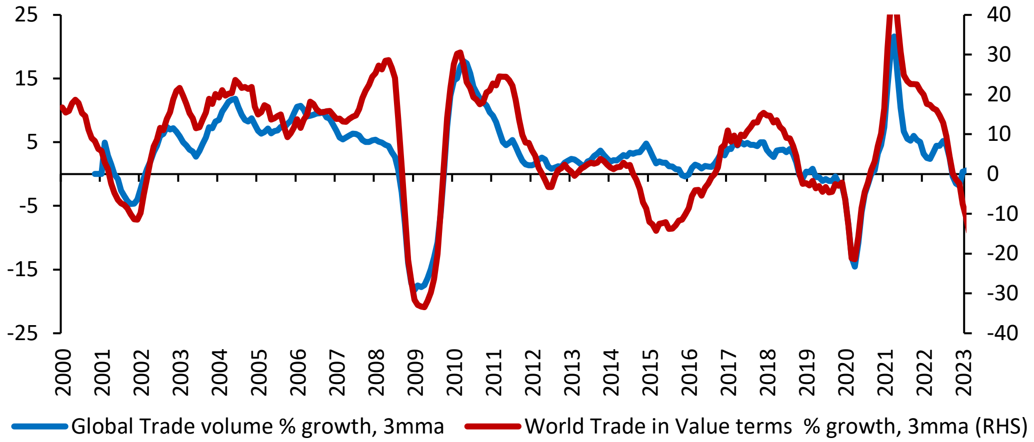
Source: Bloomberg, SBIMF Research

Outside of the US, activity is weak in China and Eurozone; manufacturing weaker than services

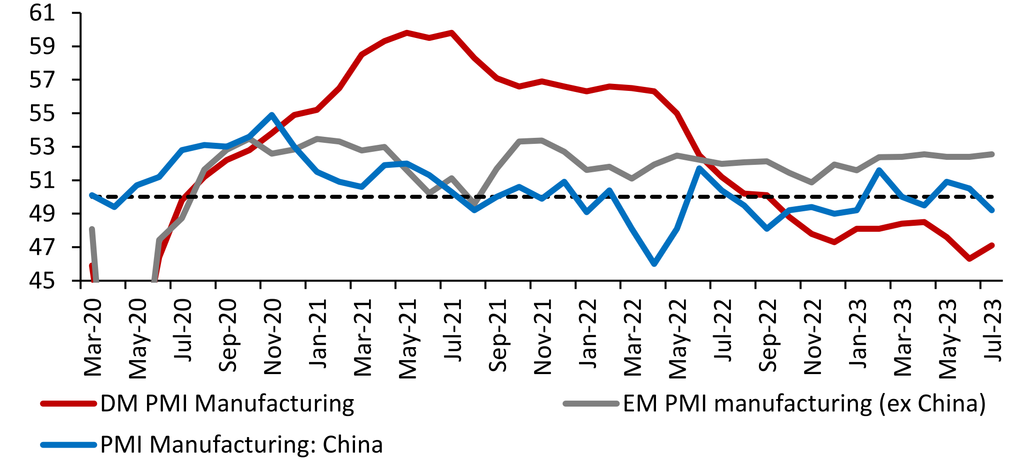
US economic activity surprises on the upside, while Eurozone and China underwhelms expectation



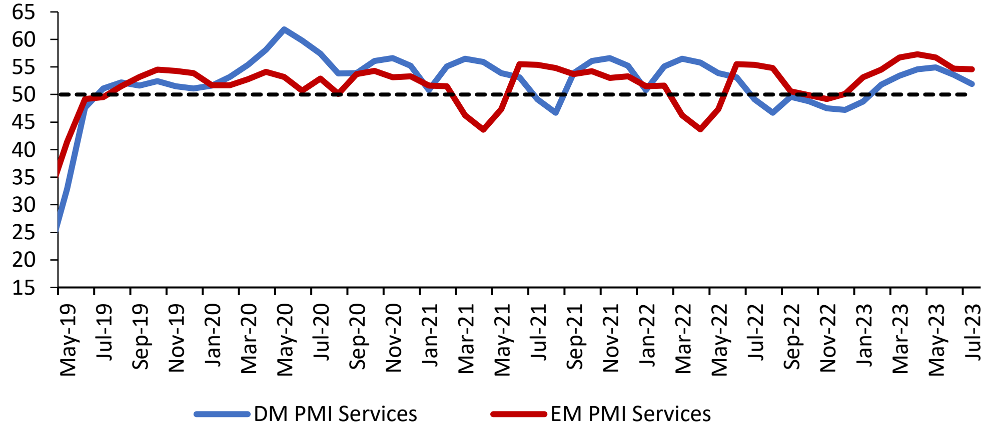
Global trade is slowing down rapidly



Manufacturing activity in developed market is weakening; holds up for emerging market economies



PMI services continues to be in expansionary zone for developed and emerging market economies; moderates m-o-m



Source: Bloomberg, SBIMF Research

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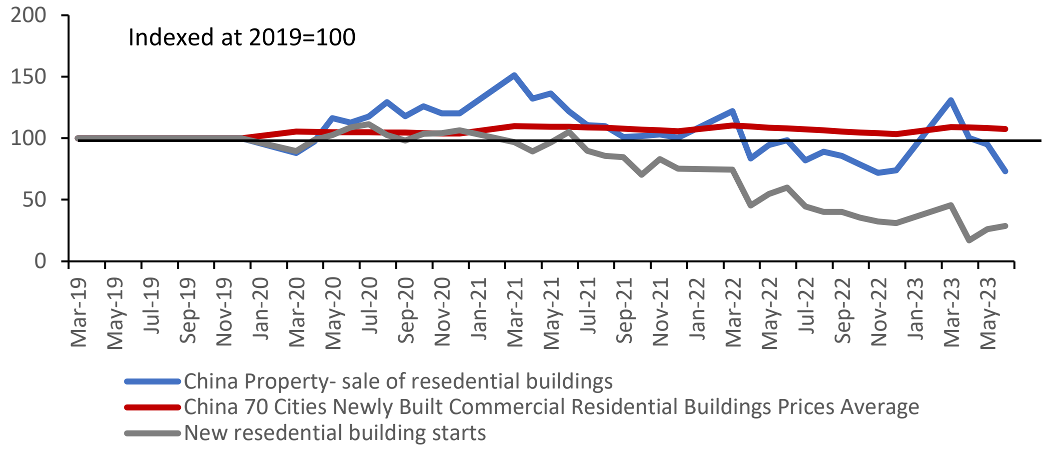
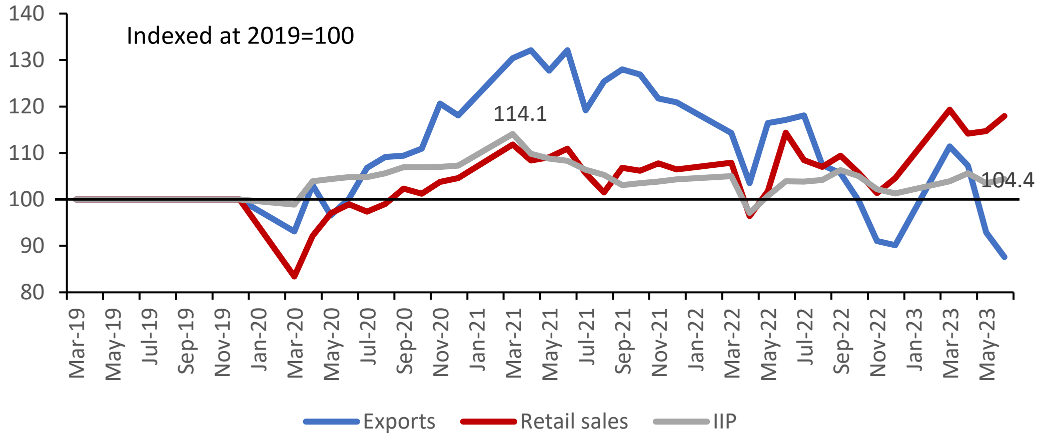
China: Severe property sector trouble is slowing down growth momentum

Property sector weakness goes from sales to prices to construction



Underutilization of manufacturing sector capacity as export weakens

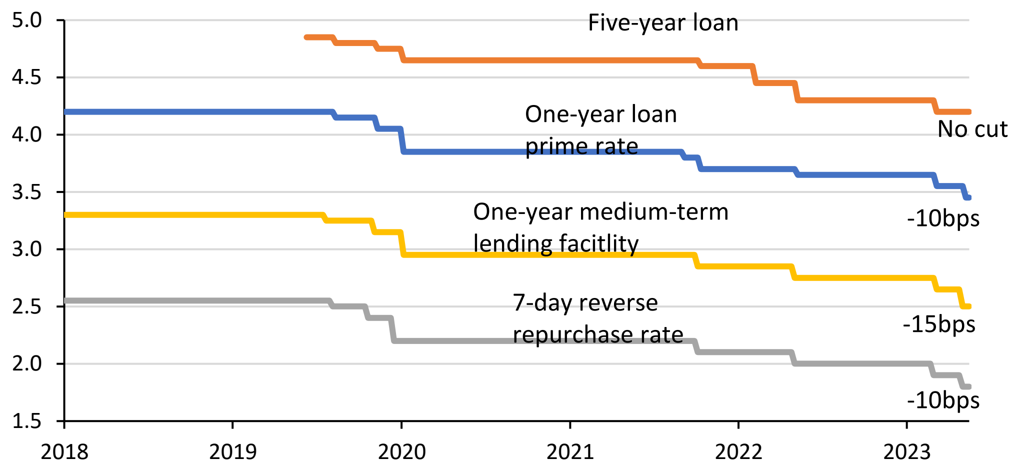


- China’s economic momentum cannot recover without the stabilization in the property sector.
- Fiscal measures have been less than enthusiastic.
- Moral hazard issues in bailing out local government financing vehicles and real estate developers and hence left as a last resort.
- Policy makers want banks to sacrifice margins to support economy
- Politburo targets to reduce reliance on property sector and prioritize industrial policy. Tech company crackdowns abetting.

Source: Bloomberg, SBIMF Research

China: Efficacy of monetary policy measures reduces at the margin

PBOC monetary policy rate cuts in August did not translate into simultaneous cuts in bank lending rate



Likely Possibilities for China

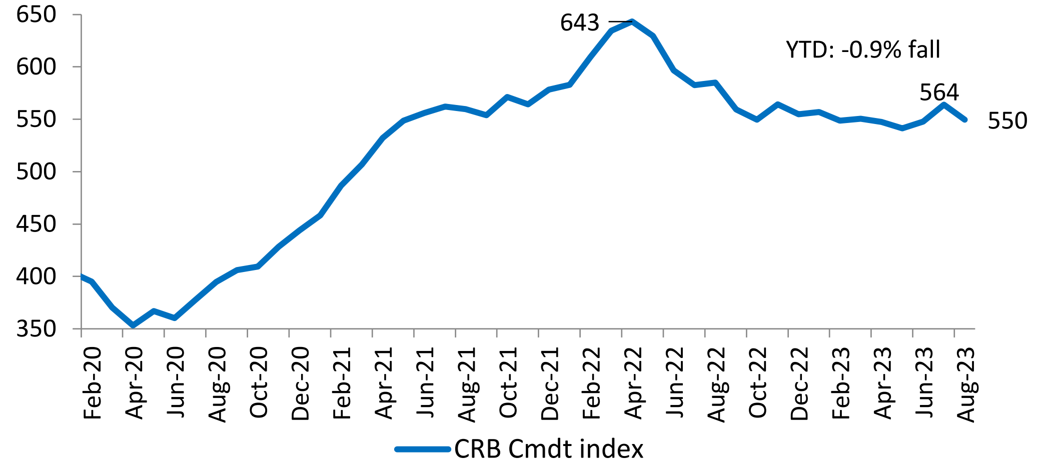
Case 1: Major fiscal stimulus: Some rebound in growth and Chinese assets
Case 2: Just enough stimulus to prevent growth slowdown: does not generate any global comfort
Case 3: Govt. fails to follow through its promises: Sell-off in Chinese assets

- PBOC cut the policy seven-day reverse repo and one-year medium-term lending facility rates by -10bp and -15bp, respectively.
- Banks did not cut rates as expected. The one-year lending rate was lowered by only 10bps, and the five-year lending rate was kept unchanged.
- China’s commercial banks’ wafer-thin net interest margins, limit the scope for further monetary easing to boost growth.
- Property sector at further risk as the five-year lending rate was unchanged and is primarily used to price mortgage loans.

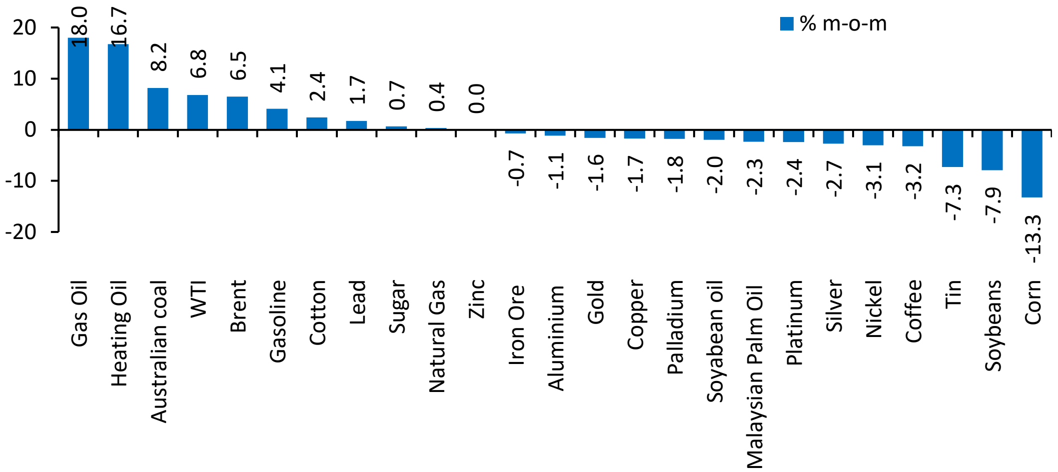
Source: Bloomberg, SBIMF Research

Global commodity index moderates in August 2023

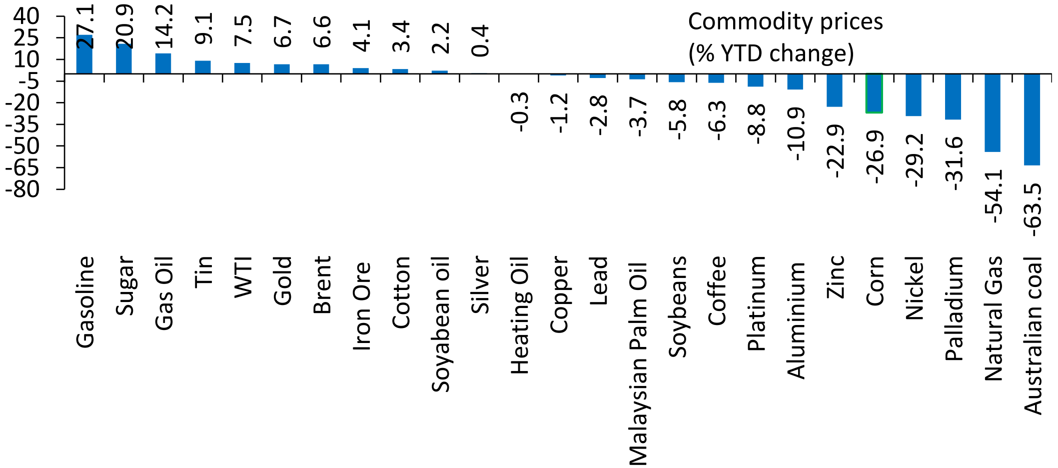
Bloomberg commodity index sees a -2.5% sequential downtick in August 2023



Sequential fall driven mainly by select food and metal prices; select energy prices remain elevated



On a YTD basis, coal, natural gas and select metals have seen a sharp moderation



- Global commodities moderate in August. Overall Bloomberg commodity Index is marginally down by ~1% YTD.
- This moderation is mainly due to the m-o-m fall in select food and metal prices, while energy prices saw an uptick.
- There are some renewed supply concerns out of Russia and Ukraine (discontinuation of Russia and Ukraine black sea grain deal) that could drive up global wheat prices.

Source: Bloomberg, SBIMF Research

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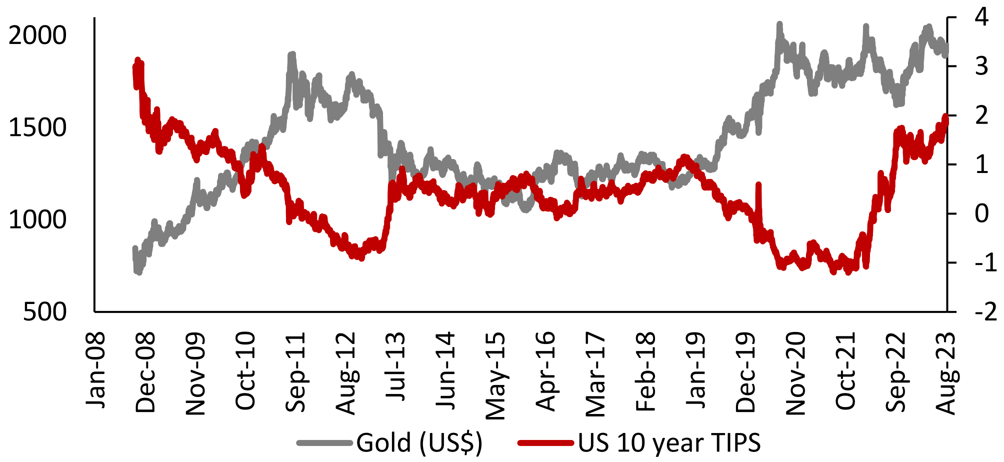
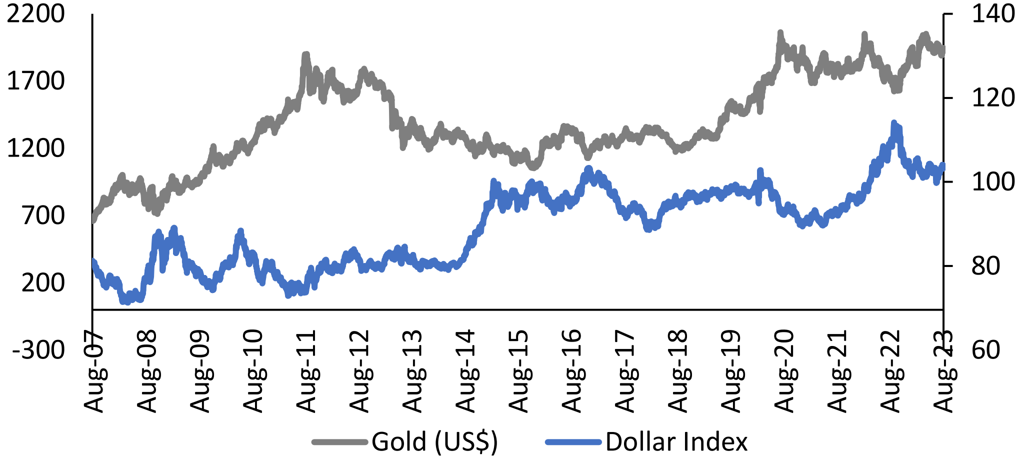
Gold outlook contingent on US real yields

High US real yields have put a lid on Gold prices so far



While dollar softness has been a tailwind



Source: Bloomberg, SBIFM Research

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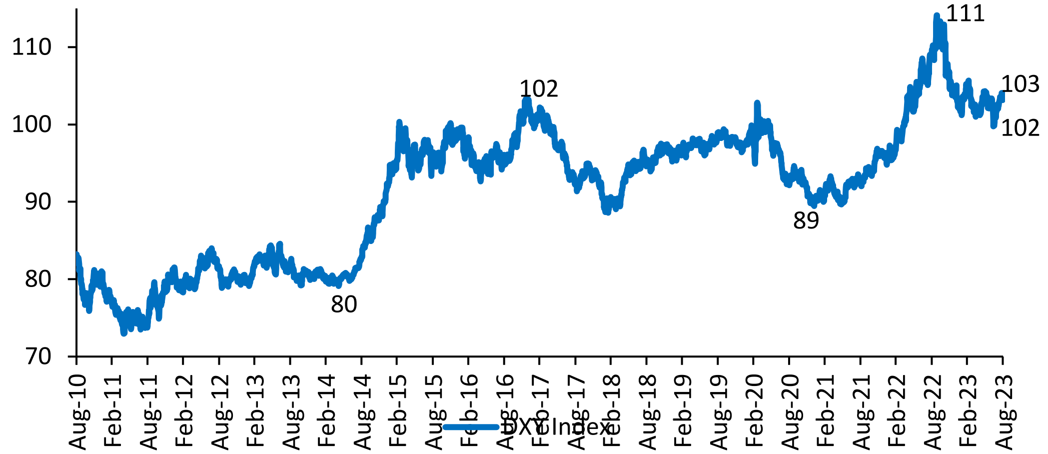
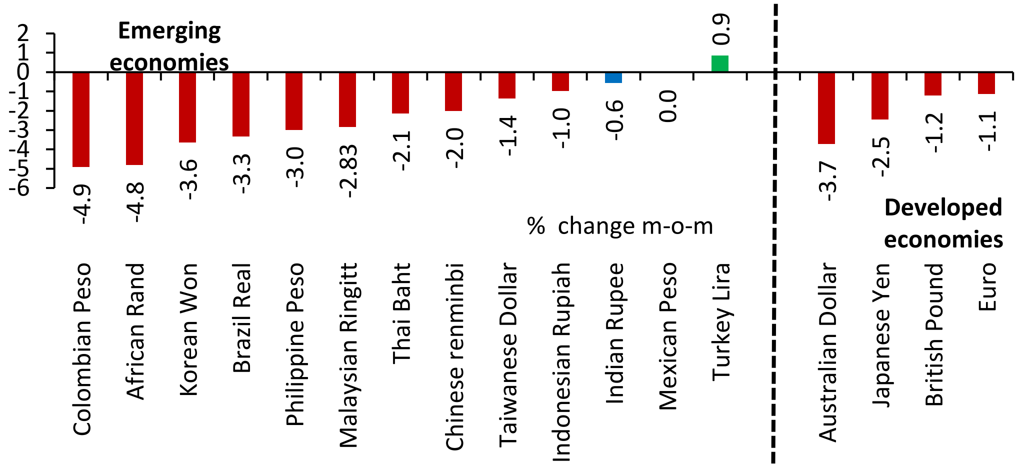
USD strengthens at the margin in August

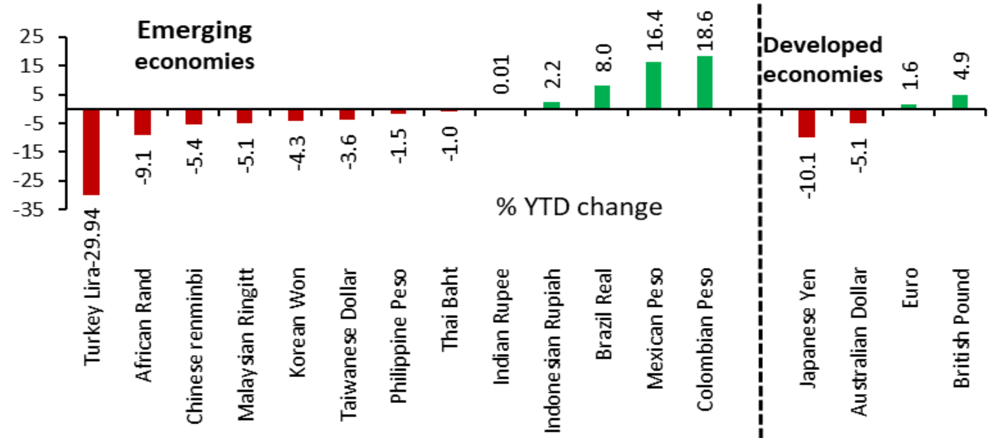
DXY index increases by 1.6% m-o-m in Aug’23



Strengthening of the dollar index drives depreciation across emerging and developing market currencies during the month



YTD Indian rupee broadly flat at INR 82.7/US$ by end Aug’23



- DXY strengthen in August (1.6% rise m-o-m).
- The end of the Fed’s hiking cycle and further signs of inflation ebbing could help to soften the USD.
- Stronger evidence that a softer landing for global growth, including the US economy must materialize to see the USD’s range bound behavior finish and renewed weakness emerge.

Near-term risks aside, expect INR to appreciate 6-12 months down the line to INR 80/US$

Source: Bloomberg, SBIMF Research

INDIA ECONOMIC ACTIVITY

High frequency indicators suggest a continued demand momentum in India

Index value for every month compares to corresponding month in the prior year	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23
Macro indicators														
Bank credit deflated by WPI	96	99	102	105	108	110	109	110	112	114	117	119	123	116
GST Deflated by WPI manufacturing	146	120	121	120	112	107	112	110	109	106	114	115	114	113
Consumption of petroleum products	118	109	115	108	106	114	103	104	107	109	101	113	105	102
Electricity generation	118	104	103	114	103	114	114	118	114	105	104	105	109	112
Urban Consumption demand														
Domestic air traffic	348	198	155	149	130	113	115	197	157	122	151	159	199	269
Domestic sale of passenger Cars	109	110	123	222	136	129	93	108	106	88	111	97	88	77
Naukri Job Speak Index	122	121	106	113	97	143	104	102	98	105	95	100	97	81
Payments via digital means	178	166	158	161	147	146	147	150	144	141	138	137	140	na
Urban Consumer sentiment Index	148	138	139	147	148	150	154	150	156	155	154	143	144	134
Rural Consumption demand														
Domestic Tractor sales	89	88	99	119	104	104	119	116	112	110	87	98	99	100
Real rural wage	95	96	96	96	97	99	101	96	96	96	na	na	na	na
Domestic sale of two-wheelers	124	110	116	113	102	116	103	104	108	108	115	117	102	93
Consumer sentiment - rural	141	137	132	129	135	129	133	135	134	132	133	137	140	131
Business indicators														
Cargo traffic - rails	111	108	108	109	101	105	103	104	104	104	103	102	98	102
Cement production	120	101	102	112	96	129	109	105	107	100	112	115	109	na
Steel consumption	106	114	114	112	111	113	116	108	115	115	108	109	114	na
Sale of CV	200	134	134	134	111	111	111	107	107	107	95	95	95	na
Bank industrial credit deflated by WPI	93	96	99	102	105	107	104	104	103	104	108	110	112	na
External Sector indicator														
Cargo traffic - ports	114	115	108	115	104	102	110	112	112	102	110	103	100	104
Merchandise exports	130	108	111	105	88	110	97	102	100	94	87	90	81	84
Services exports	133	125	130	135	124	131	120	129	129	113	107	108	103	112
Non-oil non-gold imports	138	141	139	121	105	109	104	96	96	95	88	99	85	90
Government														
State government: Capital expenditure	93	124	144	79	88	150	112	128	148	116	221	174	162	na
Central government : capital expenditure	140	198	101	158	276	187	36	160	47	137	99	317	163	na
Centre Revex ex of interest payments	86	72	94	119	149	118	88	113	104	103	115	78	106	na
State Revex ex of Interest Payments	120	117	116	114	107	117	99	110	114	113	110	117	99	na

Weak data to stronger data →

Source: CMIE Economic Outlook, CEIC, SBIMF Research; NB: Bank credit data adjusted for HDFC merger, Payment via digital means includes credit card, debit card, wallet and UPI payments

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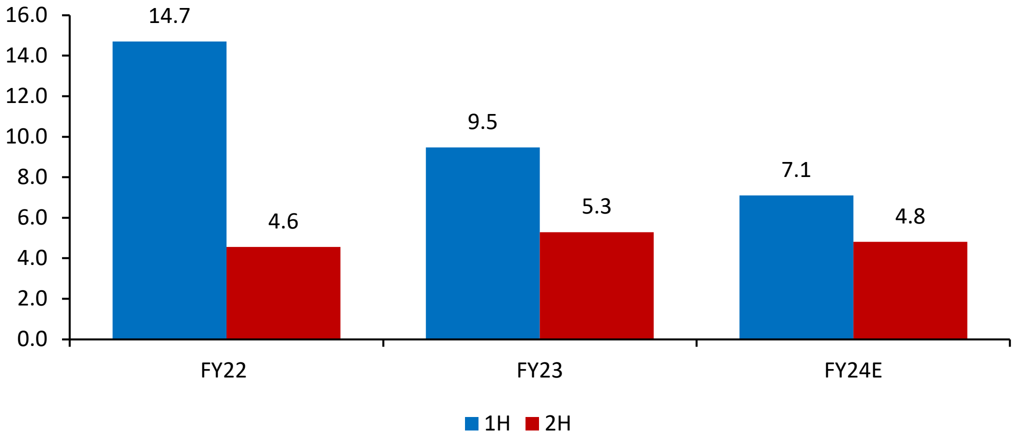
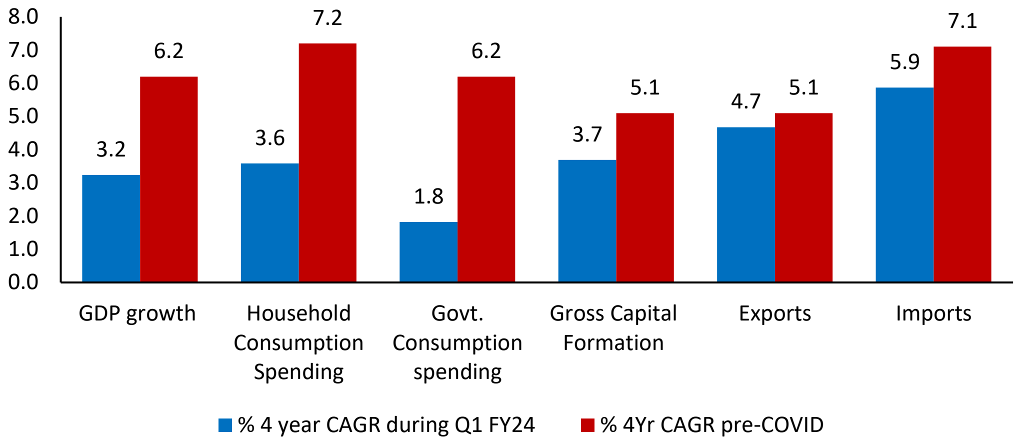
Anomaly in 1H vs. 2H y-o-y GDP growth prints warrants emphasis on CAGR results

GDP prints depict some anomalous behaviour on account of which the 1H growth exceeds 2H growth prints….



…hence, we focus on CAGR- Q1 FY24 growth CAGR vs. Q4 FY23, there is marginal moderation in every component of demand



- GDP prints depict some anomalous behavior owing to which 1H growth exceeds 2H. This anomaly hasn't corrected itself three years past COVID. Hence, one should instead focus on growth CAGRs since COVID.
- Looking at 4-year CAGR in various demand components, consumption is the weakest link in demand. Real household spending has grown at just 3.6% CAGR significantly below 7% trend in 4 years pre-COVID.
- Govt. revenue spending is low but that has just 10% weight in overall GDP. Investment is catching up.
- Exports has seen a significant growth in FY22 and FY23 and it was modest pre-COVID. Hence despite its recent moderation, it most closely aligned to pre-COVID trend.
- Overall, comparing Q1 FY24 growth CAGR with Q4 FY23, there is marginal moderation in every component of demand. Hence in truest sense, demand is moderating.

India Q1 FY24 Real GDP growth in line with expectation

Q1 FY24 real GDP growth at 7.8% y-o-y vs. 6.1% in the previous quarter

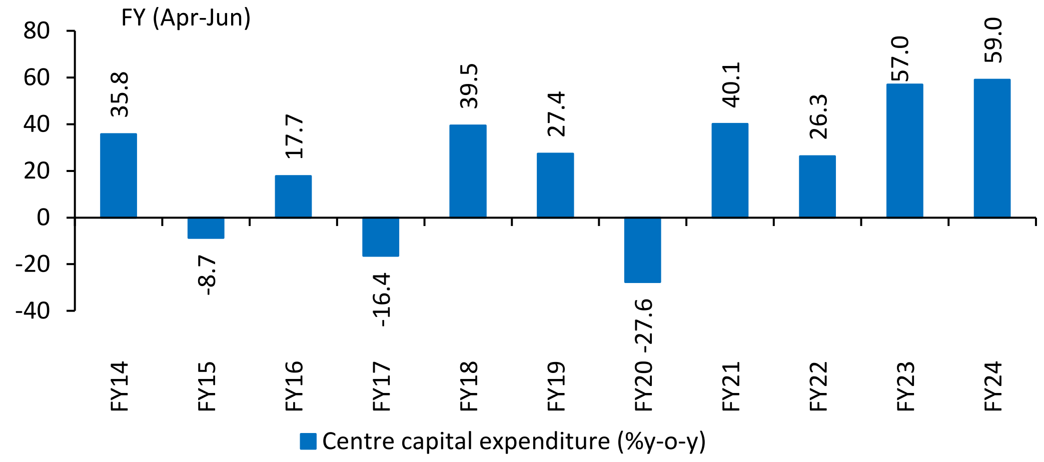
	% Share in real GDP (in FY23)	% y-o-y		% 2yr CAGR	%3yr CAGR	% y-o-y					%3yr CAGR	%4yr CAGR
		FY22	FY23	FY22	FY23	Q1 FY23	Q2 FY23	Q3 FY23	Q4 FY23	Q1 FY24	Q4 FY23	Q1 FY24
Real GDP	100	9.1	7.2	1.3	3.3	13.1	6.2	4.5	6.1	7.8	4.5	3.2
Private Consmption	59	11.2	7.5	2.7	4.3	19.8	8.3	2.2	2.8	6.0	4.7	3.6
Government Spending	10	6.6	0.1	2.8	1.9	1.8	-4.1	-0.6	2.3	-0.7	12.2	1.8
Gross Capital formation	36	17.9	9.6	4.2	6.0	20.8	6.5	5.2	7.8	7.1	8.9	3.7
GFCF	33.9	14.6	11.4	3.1	0.0	20.4	9.6	8.0	8.9	8.0	9.2	4.1
Change in Stocks	0.8	NA*	2.7	7.0	0.0	7.5	-2.6	-0.1	5.9	3.9	8.4	4.4
Valuables	1.4	34.0	-18.9	30.2	0.0	58.7	-19.5	-38.0	-23.4	-21.0	-1.7	-10.9
Exports	23	29.3	13.6	8.4	10.1	22.4	19.6	12.2	11.1	11.9	12.5	4.7
Imports	26	21.8	17.1	2.6	7.2	6.7	33.6	23.1	10.7	4.9	7.8	5.9

- Q1 FY24 GDP growth came in at 7.8% vs. 6.1% in the previous quarter. Q1 GDP print is 20bps lower than RBI expectation (8.0%) and in line with market expectation.
- Nominal GDP growth dropped meaningfully to 8% y-o-y led by a deflator which grew 0.2% y-o-y. Nominal GDP is likely to stay in single digit for full year.
- On a y-o-y basis real consumption grew by 6%, GFCF by 8% and exports volume by 12%, sharper than import volume growth. However, sentiments gauged from earnings or other high frequency data do not resonate this trend. Hence, we look at the trend on a 4yr CAGR basis.
- Household consumption recovery has been very slow. Growth on a 4-year CAGR basis has ticked closer to 3.6%, below ~7% pre-COVID growth trends. Moderating inflationary pressures and improving real income should drive some recovery in FY24 household spending.
- Exports remain closely aligned to pre COVID levels despite recent moderation. A part of export growth also gets explained by robust services export. Real surplus in services exports offsets ~75% of real deficit in goods export (vs. ~50% during FY18-FY20).
- Investment activity is improving aided by real estate revival and pick-up in government capex, while private corporate capex also show improving trends.
- On the supply side, financial services show a robust growth followed by manufacturing activity.

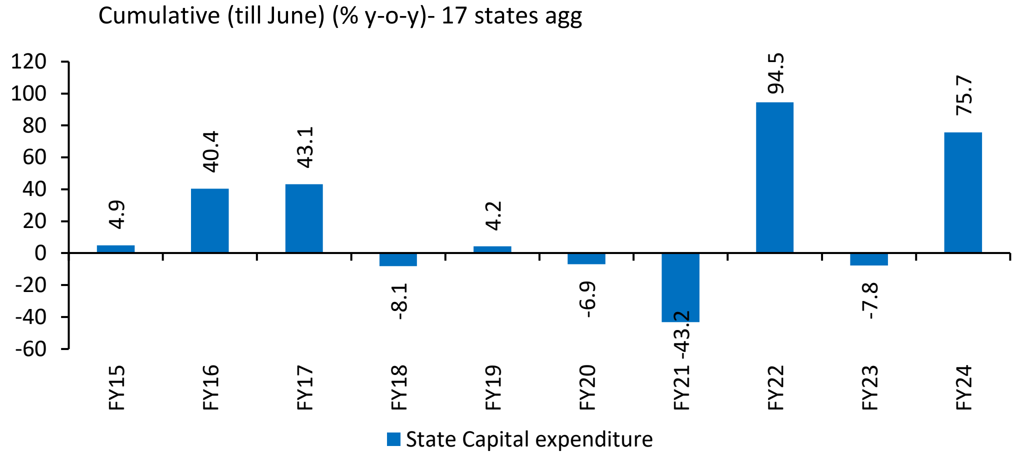
Source: CMIE Economic Outlook, SBIMF Research; NB: * Change in Stock turned from negative to positive in FY22

Healthy government expenditure in April-June aids construction activity

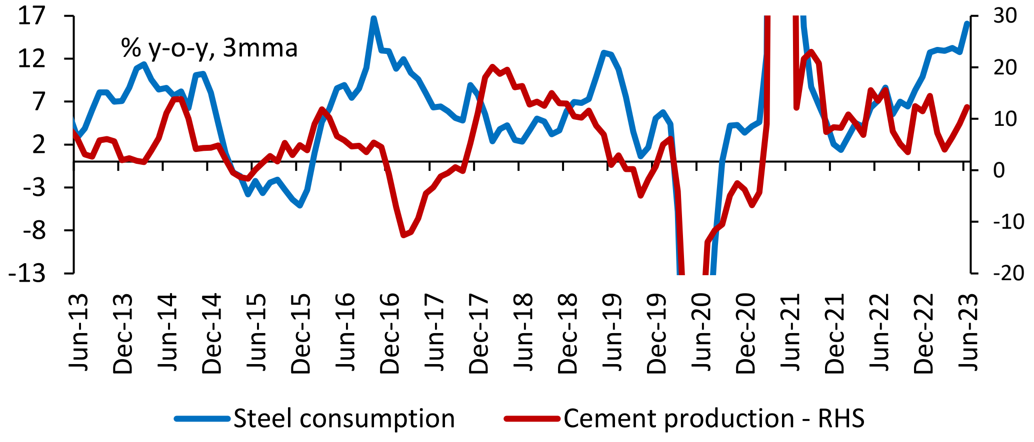
Centre's capex grows at a healthy pace



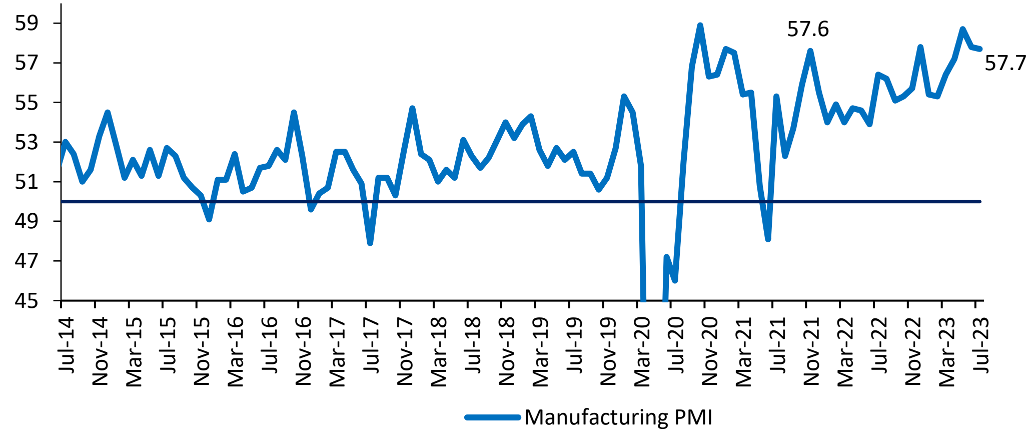
States Capex has been a strong bright spot in 2023



Cement production and steel consumption are resilient



Manufacturing PMI in expansionary zone



Source: CMIE Economic Outlook, CEIC, SBIMF Research

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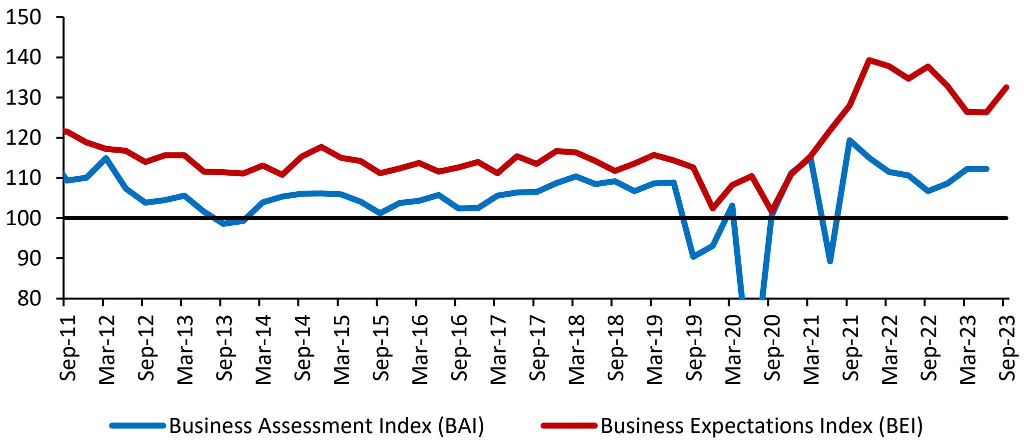
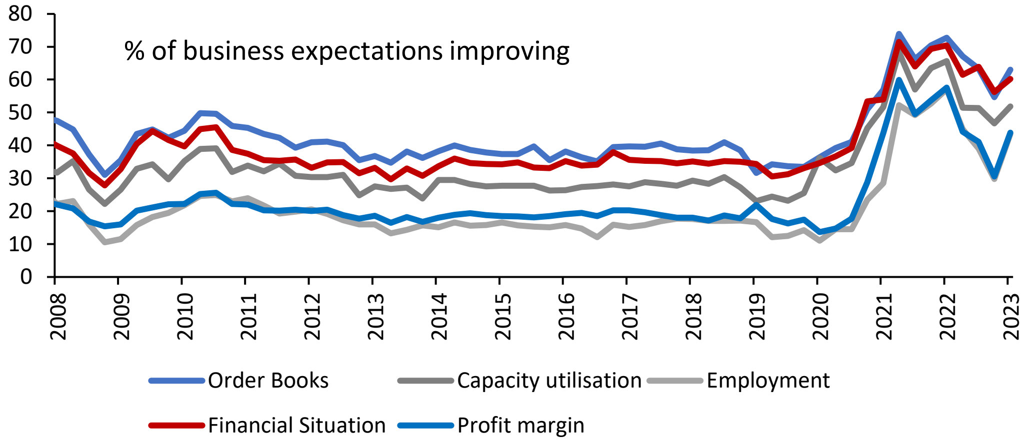
Business confidence stay positive despite headwinds to exports

Business sentiments stay robust; business expectations sees an upward revision



Manufacturing expectations improve



Source: CMIE Economic Outlook, RBI, SBIMF Research; Aggregate bank credit figure adjusted for HDFC merger

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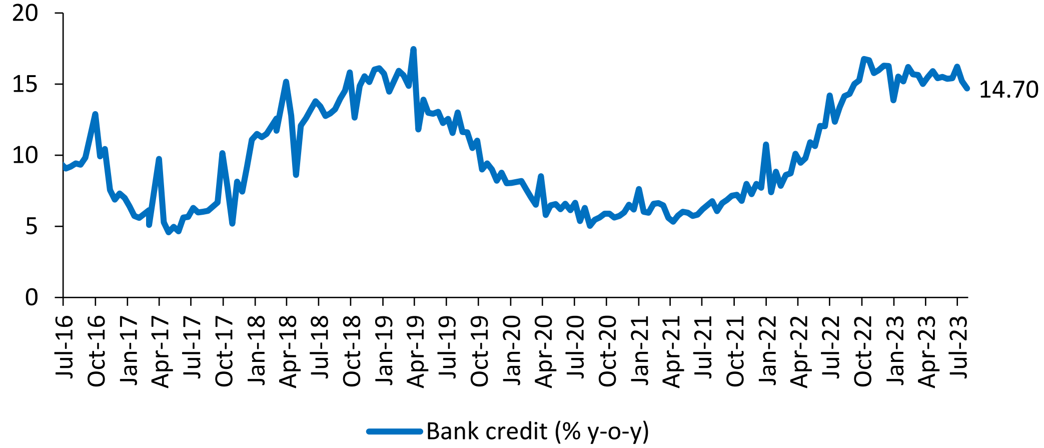
Overall bank credit growth continues to be robust

Overall bank credit growth is resilient



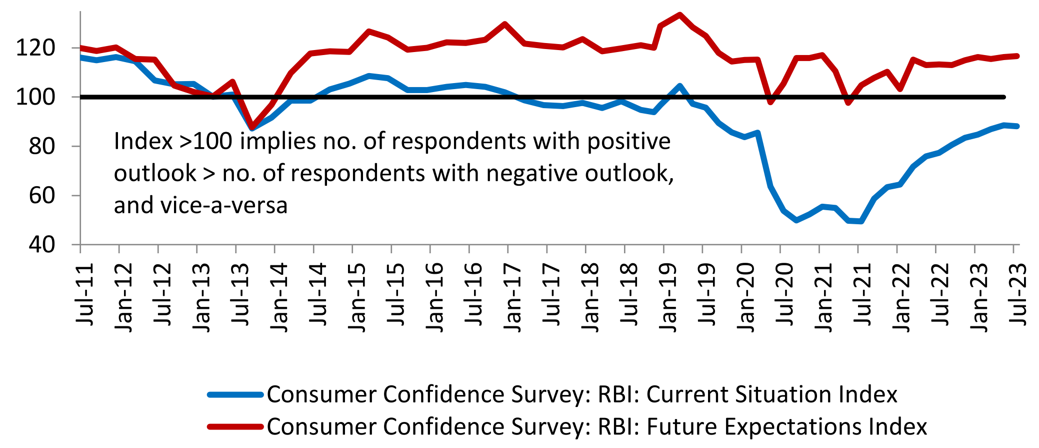
Bank credit data is strong- driven by services and personal loans sector

	Incremental Credit in FY23 (Rs.Billion)	% y-o-y growth FY23	Incremental Credit in Jun'23 YTD (Rs.Billion)	% y-o-y growth Jun'23
Bank Credit	17,839	15	7,165	18
Non-Food Credit	18,190	15	2,138	14
Agriculture and allied activities	2,255	15	1,098	20
Industry	1,807	6	874	8
Micro & small	662	12	272	13
Medium	275	12	101	13
Large	869	4	501	6
Services	5,966	20	2,765	27
NBFCs	3,087	30	930	35
Personal Loans	6,982	21	1,758	21
Consumer durables	30	17	14	17
Housing (Including priority sector)	2,520	15	635	15
Vehicle loans	993	25	231	23

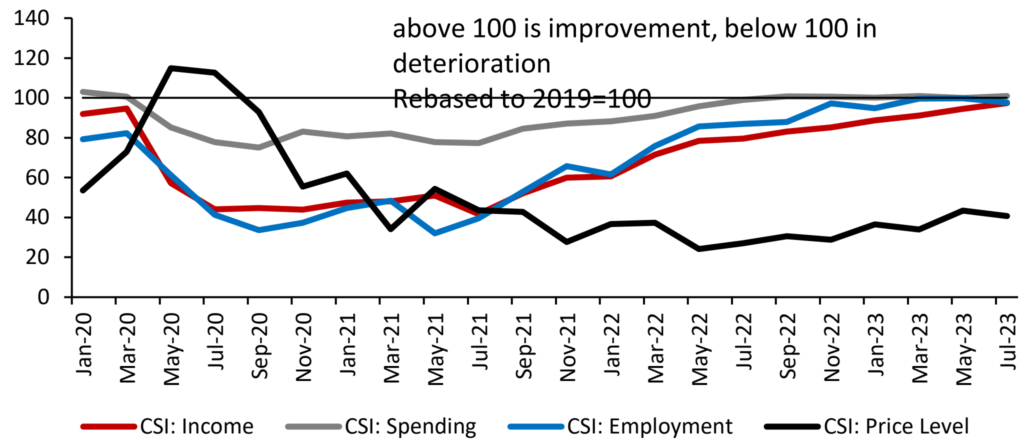
Source: CMIE Economic Outlook, RBI, SBIMF Research; Aggregate bank credit figure adjusted for HDFC merger

Consumption high frequency indicators weaken at the margin

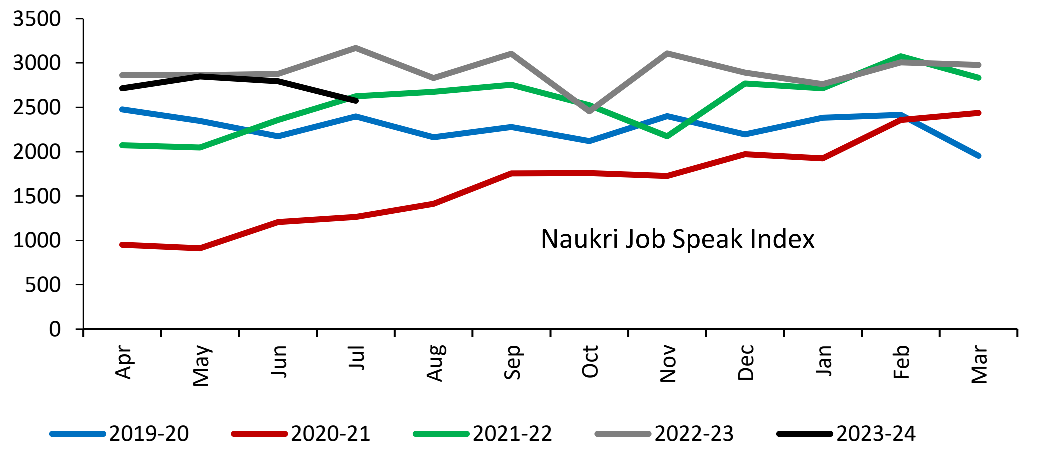
Current consumer sentiment has flatlined in a pessimistic zone



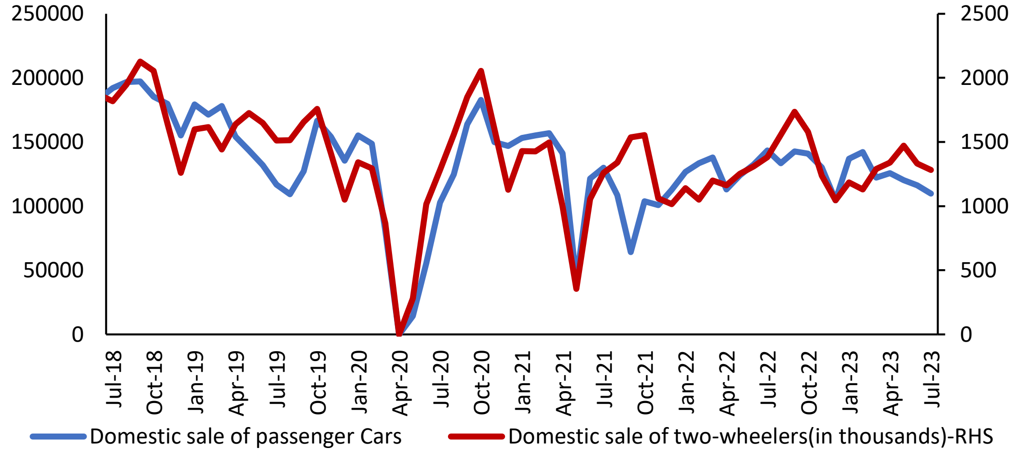
Current price levels are a pain point for consumers; overall income situation and spending is gradually improving



Urban job hiring moderates sharply on a y-o-y basis



Slowdown in auto sales (2W and passenger vehicles)



Source: RBI, CMIE Economic Outlook, CEIC, SBIMF Research

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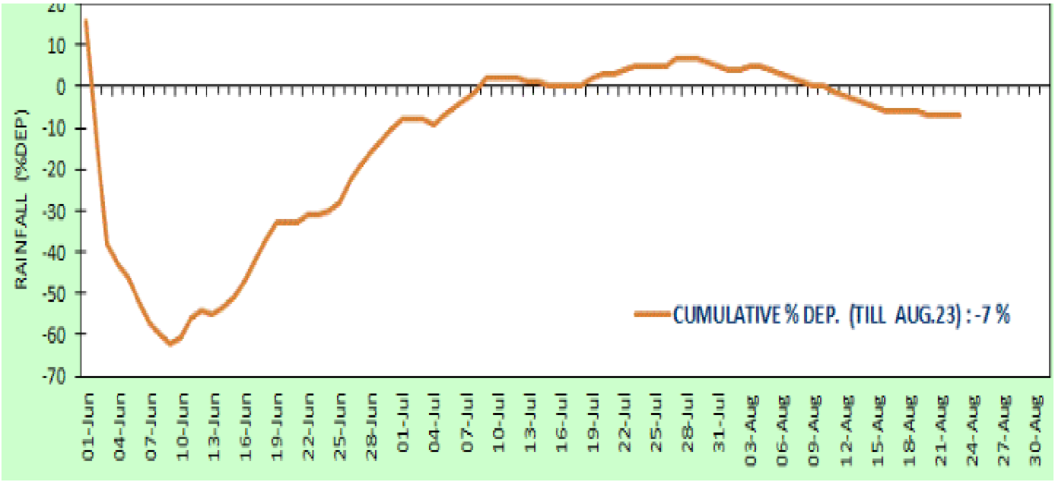
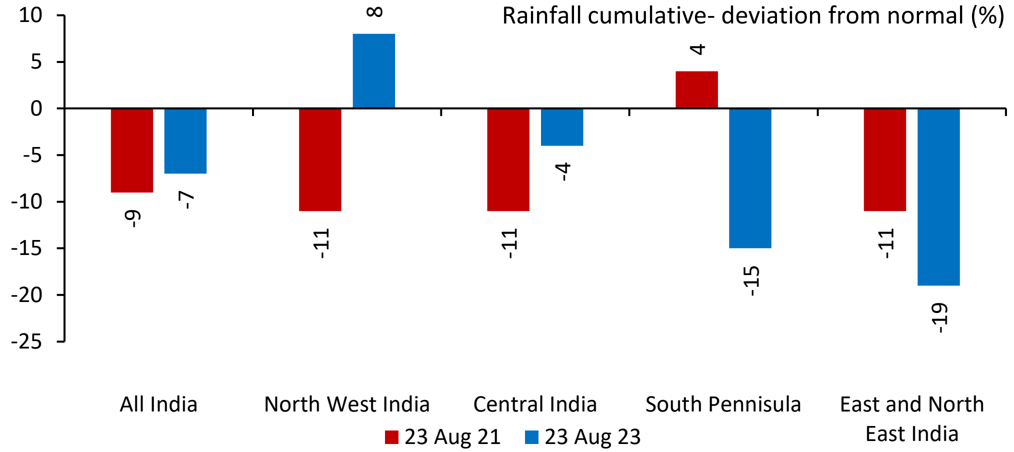
Weather related risks could be a potential dampener to agricultural income

Cumulative monsoon rains are trailing at 7% below normal as of 23rd August 2023



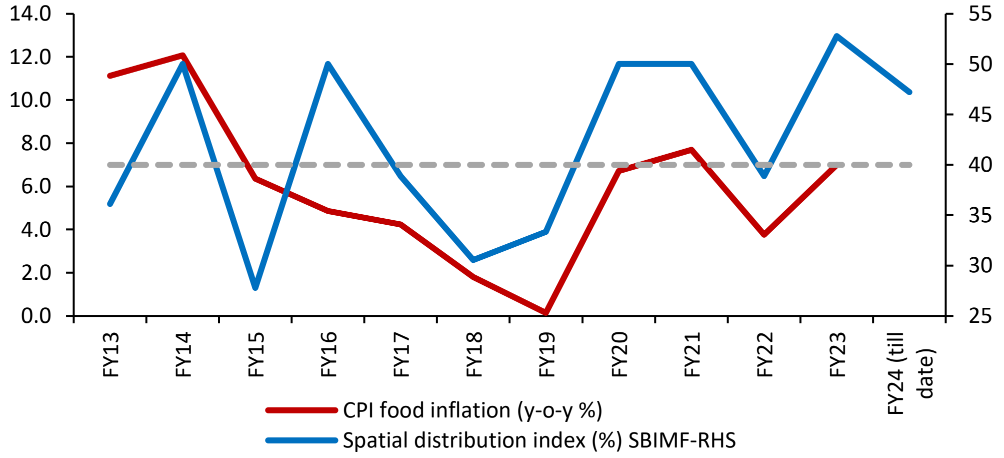
Rainfall distribution is skewed- with excess rainfall in Northwest India and deficient rainfall in South, East and Northeast India



Slow start to monsoon- Pulses and rice crop sowing underwhelms

as on 18th August 2023	% y-o-y	Actual area sown as a % of normal area
All crops	0.1	93.7
Rice	4.3	92.4
Cereals	1.6	90.3
Pulses	-9.2	82.2
Oilseeds	-1.7	99.8
Sugarcane	1.3	114.8
Cotton	-1.9	94.7

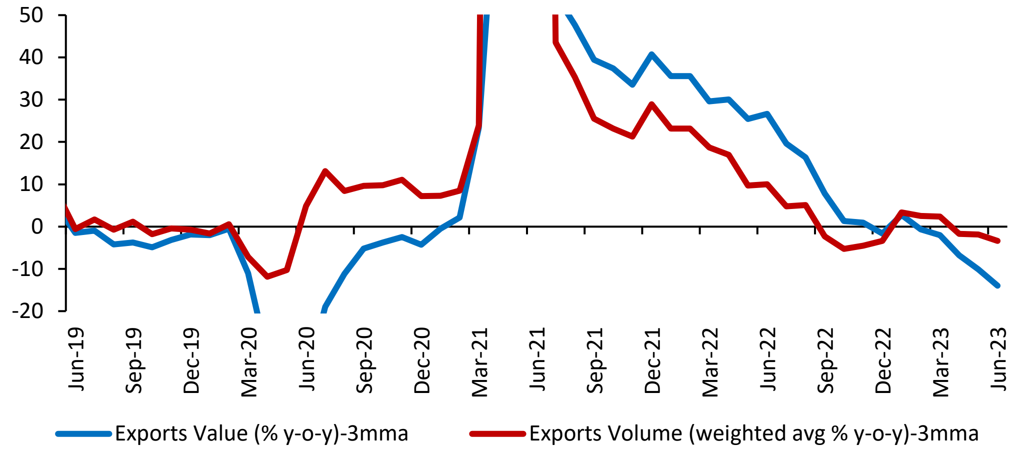
Dispersion in spatial distribution casts continued worry on food prices in the near term at least



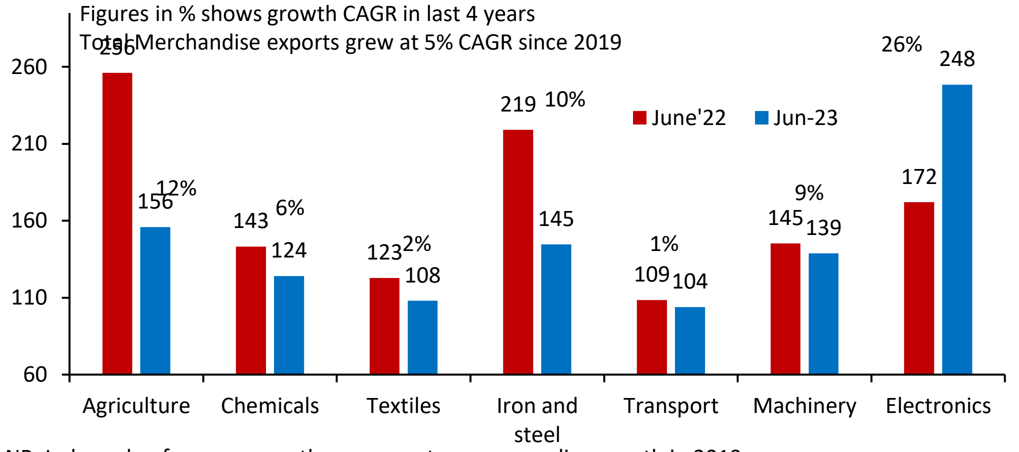
Source: IMD, CMIE Economic Outlook, CEIC, SBIMF Research ; NB: A value for 50% for the spatial distribution index means that rainfall in half of the 36 subdivisions are either above or below 20% normal

Cautious outlook on external sector

Goods export growth is contracting in volume and value terms



All major sector export volumes see a slowdown; only electronics exports are healthy

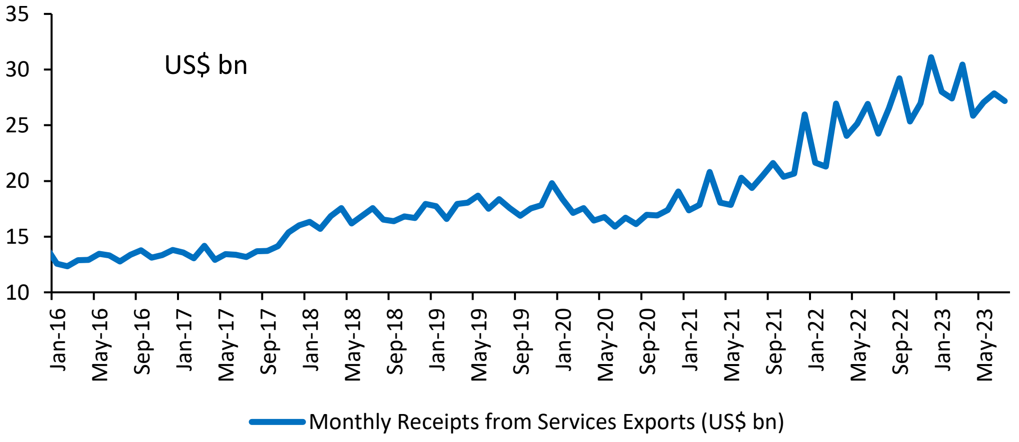


NB: Index value for every month compares to corresponding month in 2019

Broad based slowdown across all sector export volumes

	% pt contribution in Jun'23	Value Growth				Volume growth			
		Mar-23	Apr-23	May-23	Jun-23	Mar-23	Apr-23	May-23	Jun-23
Non-POL exports*	-13	-5	-11	-5	-13	1	-10	3	-6
Gems and jewellery*	-4	-27	-30	-12	-36	-33	-39	-23	-50
Iron and Steel	-2	-28	-26	-32	-34	-24	-15	-19	-25
Textiles*	-1	-19	-22	-12	-12	-8	-12	-2	-4
Chemicals (Organic)	-3	-6	-18	-13	-27	-4	-9	3	-2
Electronic goods*	2	57	26	74	55	63	29	97	47
Agricultural goods	-4	7	-14	-14	-28	-1	-32	-29	-39
Engineering goods*	-3	-7	-7	-4	-16	-6	0	-3	-12

Services exports are flattening



Source: CEIC, CMIE Economic Outlook, SBIMF Research

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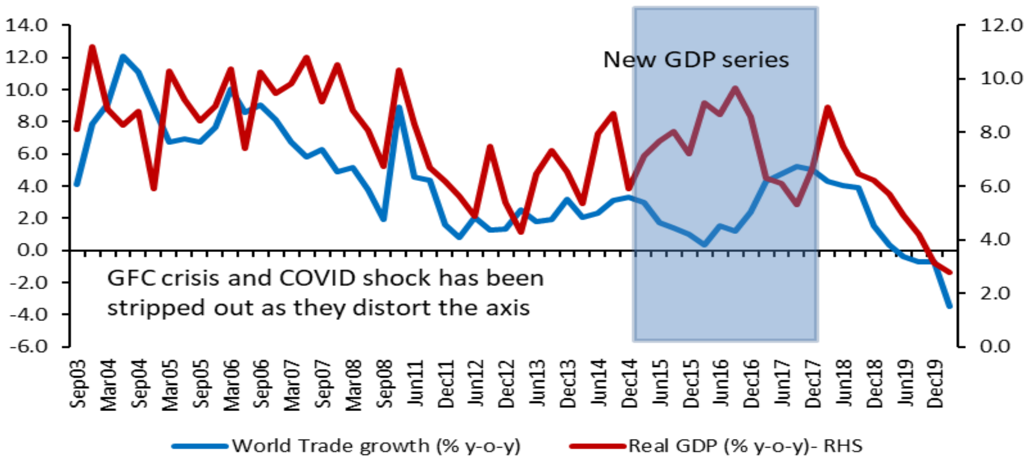
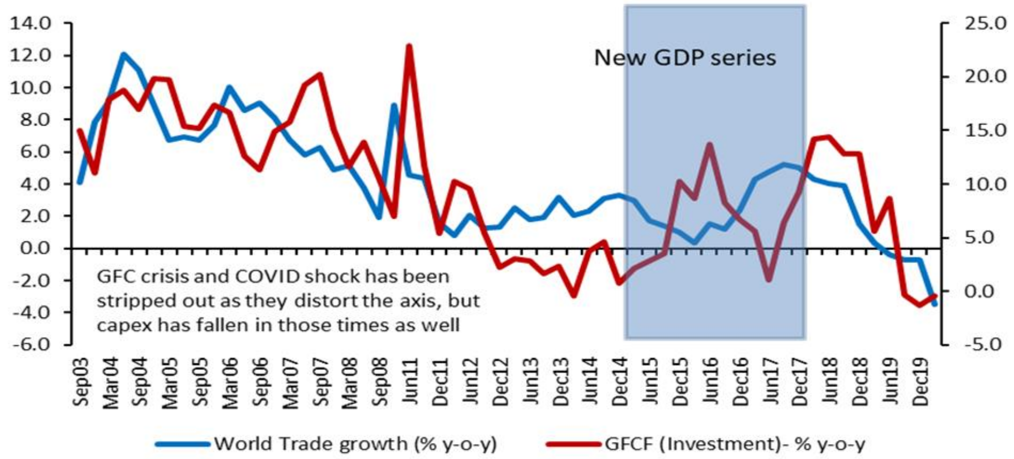
Global headwinds aside, we are constructive on medium term outlook

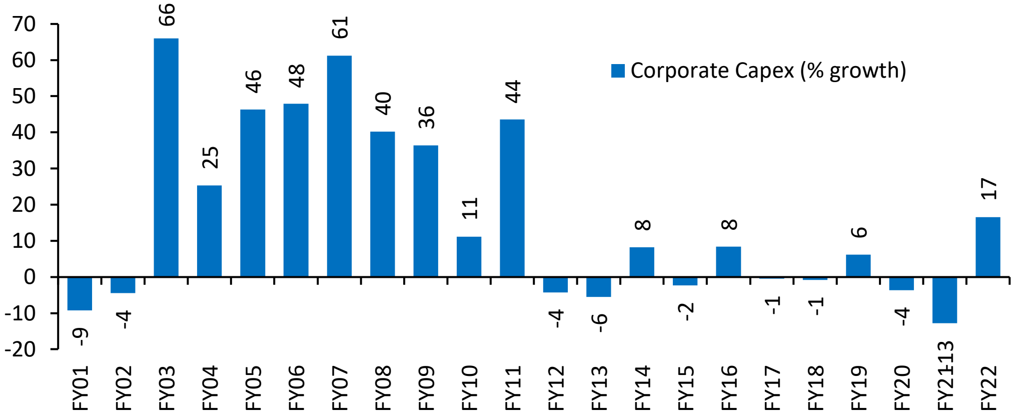
India's GDP moderates with moderating global trade



India's capex cycle has very strong linkage to global trade cycle

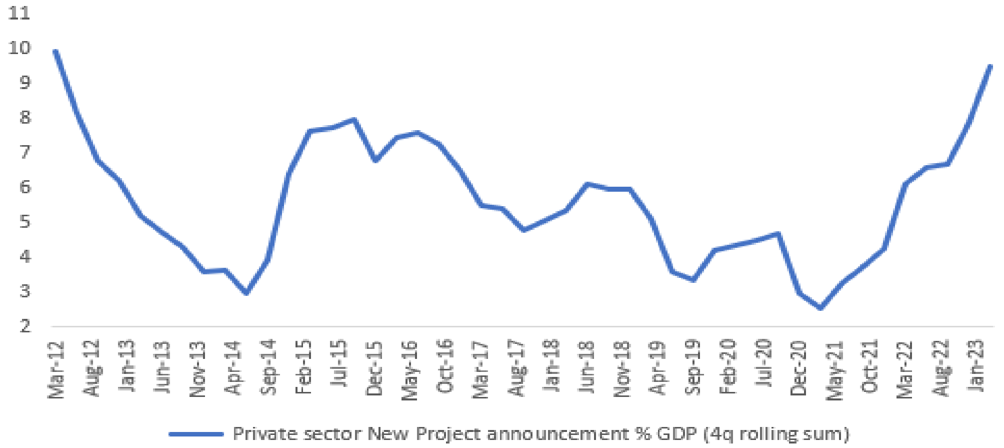


Long period of underinvestment in India- Total Corporate Capex grew 17% in FY22



Based on ~9K listed unlisted companies

Private sector project announcement as % of GDP is the highest since 2012



Source: CMIE Economic Outlook, Ace equity, SBIMF Research; NB: Private sector project announcement from CMIE

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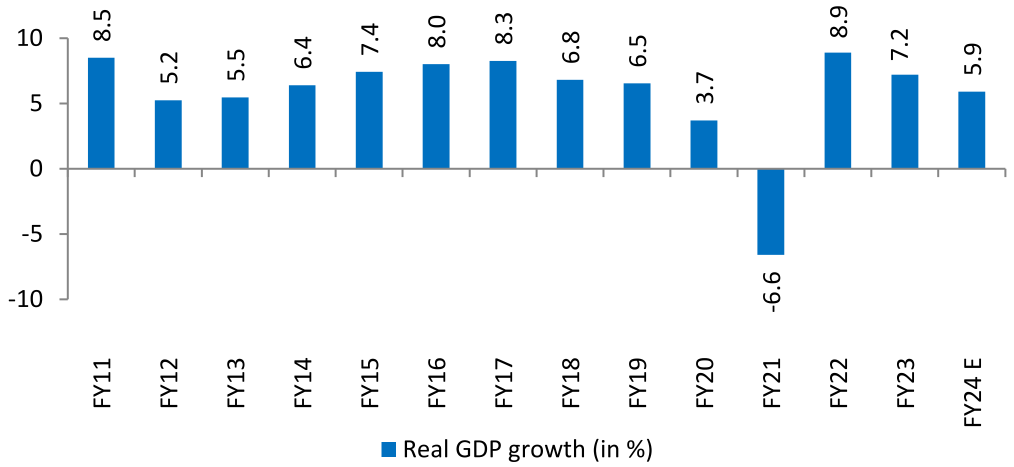
External headwinds to FY24 growth; domestic demand to drive growth in coming quarters

Real GDP growth for FY24 to be sub 6% y-o-y vs. 7.2% in FY23



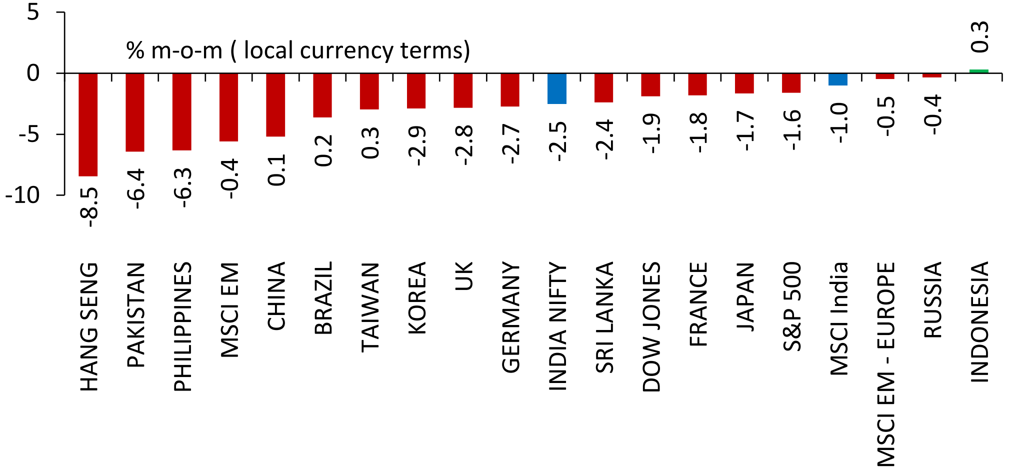
- Exports was the mainstay of demand driving industry contribution. Investments has been volatile but holding up aided by central govt infrastructure push and pickup in corporate capex. State govt. spend picked up in the last quarter. Household consumption recovery has been very slow.
- FY24 growth drivers to see a shift. Goods exports is likely to take a backseat while services exports maintain healthy momentum.
- Global growth headwinds could lead to some temporary pause in corporate capex cycle, though we are hopeful of revival in state capex after three years of lull since COVID.
- Growth risks appear significantly underappreciated. We believe combination of weaker global growth and tight domestic and global financial conditions could further impair the growth drivers viz. exports, investment and discretionary consumption.
- RBI's projection of 6.5% fructifies on a base of 7.2%. Last year ~7% growth had a strong contribution from pent up demand/ reopening. Downside risk to government (7%) and RBI (6.5%) projection on account of headwinds to industrial and construction activity.
- Hence, we stay a tad bearish on growth and lean towards sub 6% print for FY24. **Growth could moderate significantly in 2H FY24.**

Source: CMIE Economic Outlook, SBIMF Research

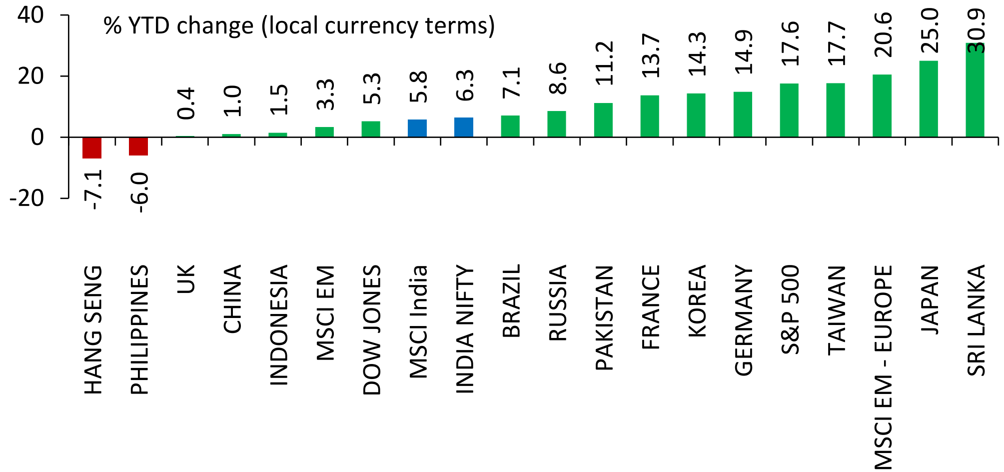
EQUITY MARKET

Global equity market snapshot: August 2023

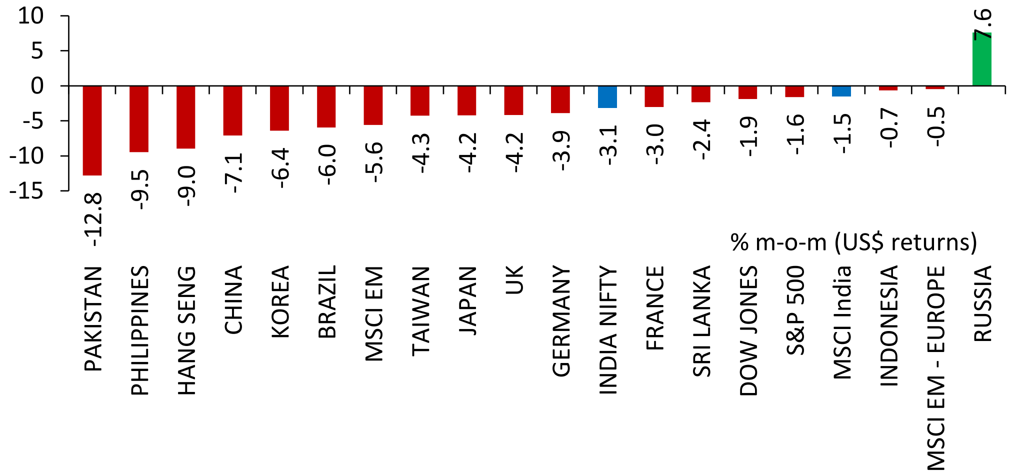
Performance in August 2023 (local currency returns)



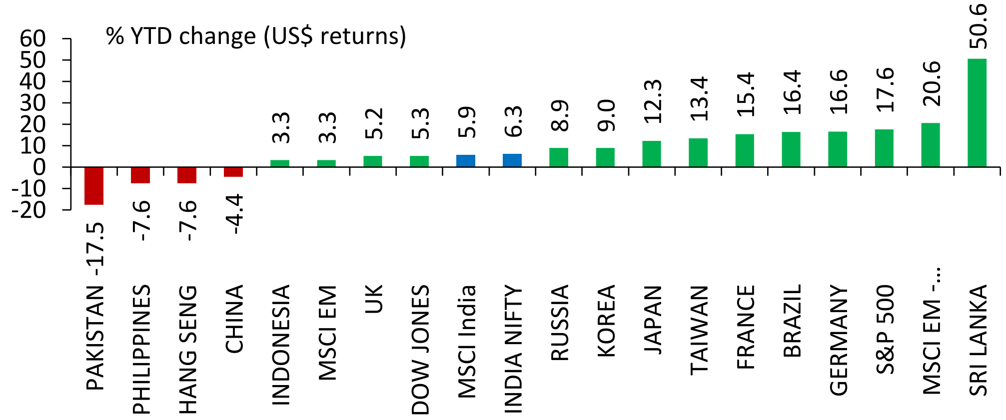
YTD performance (local currency returns)



Performance in August 2023 (US$ returns)



YTD performance (US$ returns)



Source: Bloomberg, SBIMF Research

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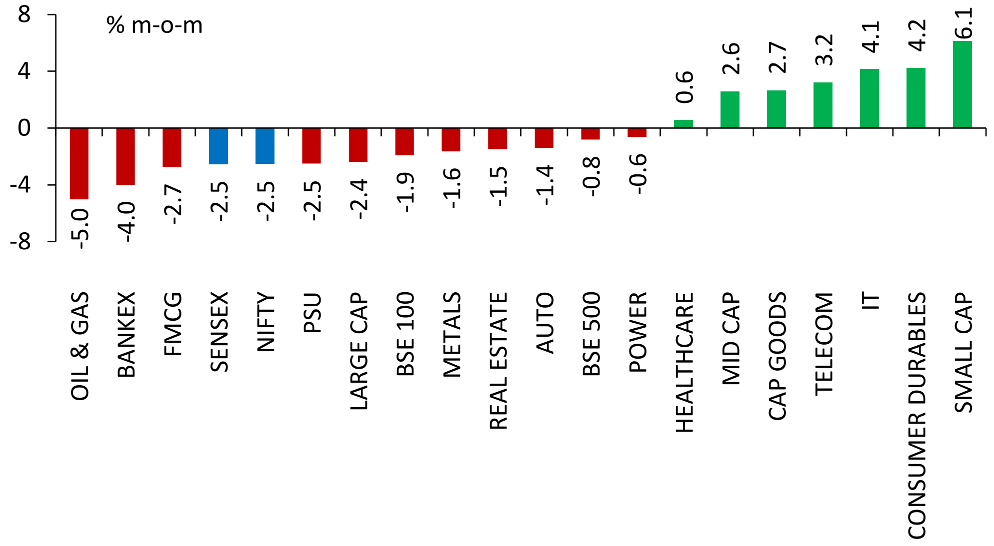
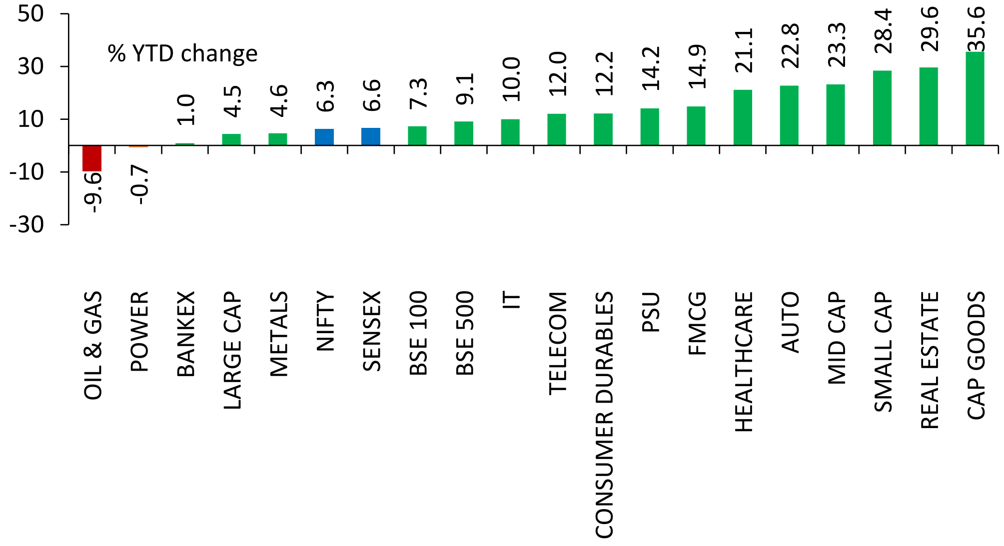
Indian equity market snapshot: August 2023

Indian equity market performance in August 2023 (local currency returns)



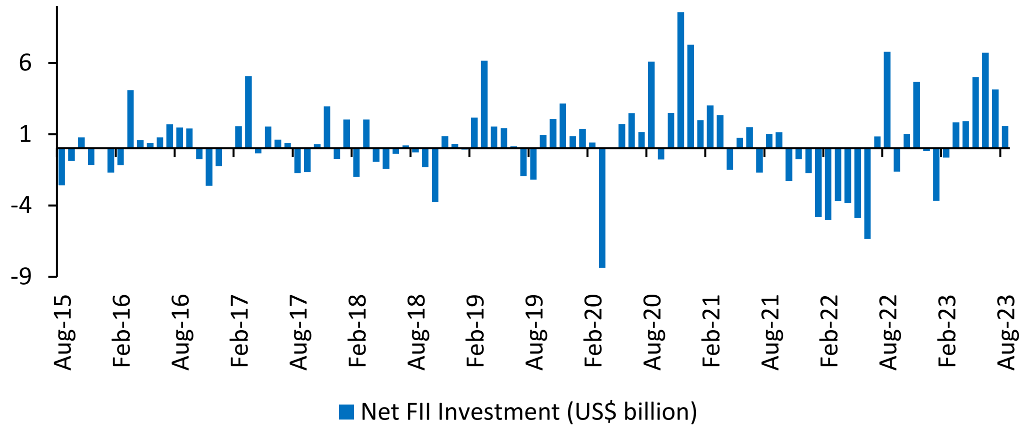
YTD performance (local currency returns)



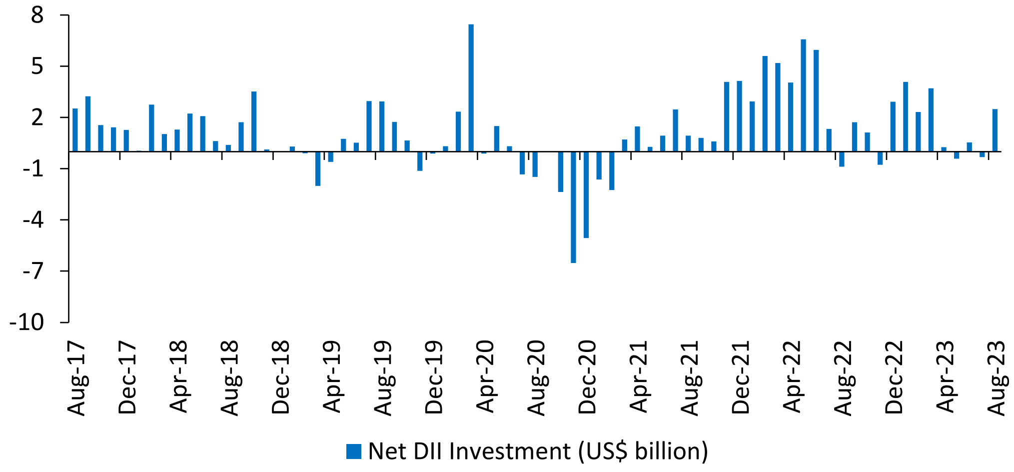
- Nifty and Sensex decreased m-o-m in August by 2.5% each. Among sectors, consumer durables, IT, telecom and healthcare delivered positive returns on a m-o-m basis. Apart from these sectors, all sectors delivered negative sequential returns led by oil & Gas (-5%), and bankex (-4%).
- Small cap (6.1%) outperformed mid cap (2.6%) and large cap (-2.4%) in August.
- On YTD basis, Nifty and Sensex increased by 6.3% and 6.6%, respectively. Among sectors, Power, and Oil & Gas, are the only underperformers. Apart from these, all other sectors have outperformed on a YTD basis led by Cap goods (36%), auto (23%) and real estate (30%).

Liquidity: FIIs are net purchasers for sixth month in succession

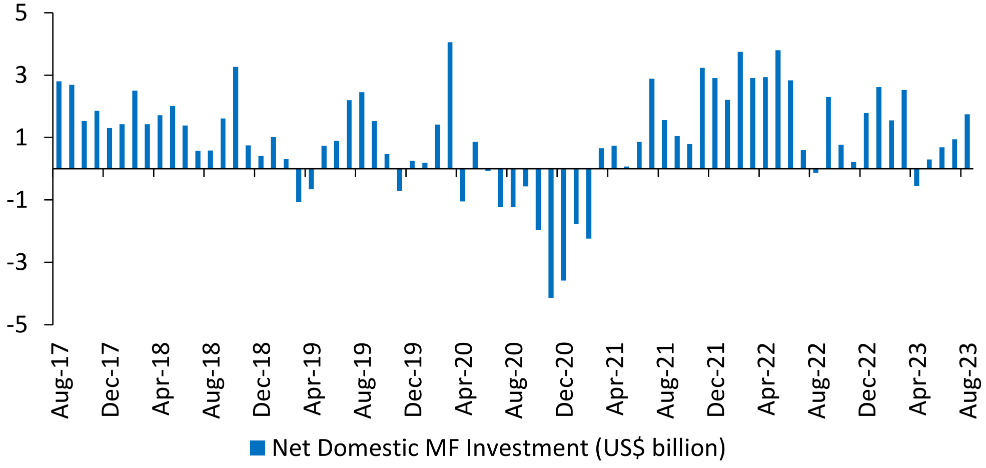
FIIs bought ~USD 1.5 billion in Aug'23 in equity segment vs. USD 4 billion buying in Jul'23



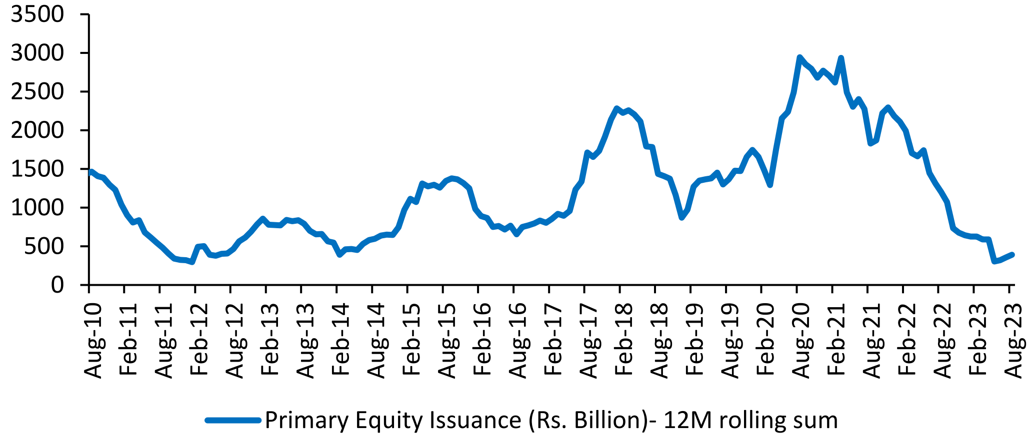
DIIs are net buyers (purchase of USD 2.5 billion in Aug'23 vs. sale of USD 0.3 billion in Jul'23)



Mutual funds bought USD 0.1.8 billion in Aug'23 vs. purchase of 0.9 billion in Jul'23



Primary market supply improves at the margin in August 2023



Source: Bloomberg, SBIMF Research

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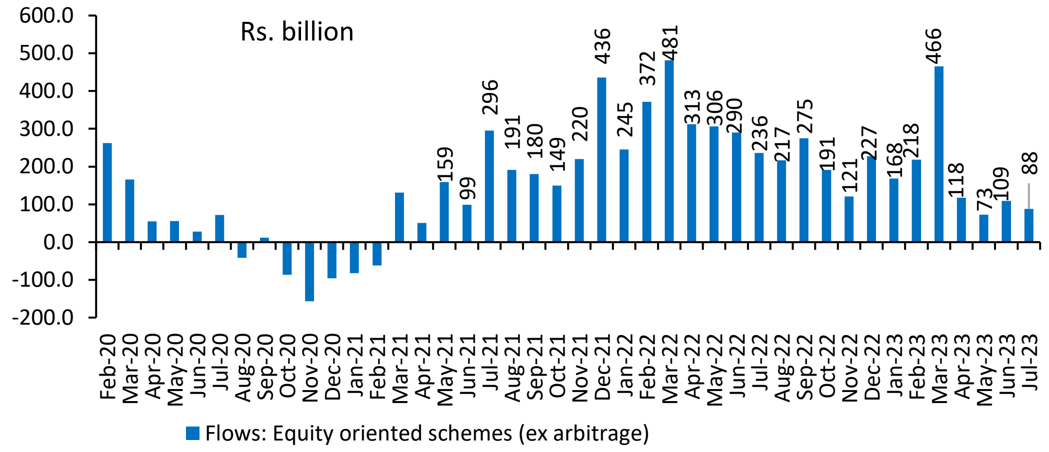
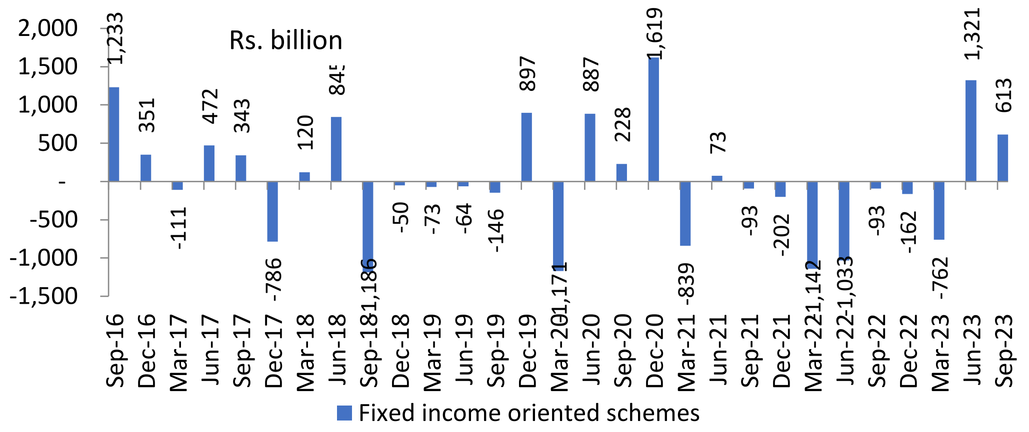
MF flows: moderation in non-SIP equity inflows

Equity inflows are moderating

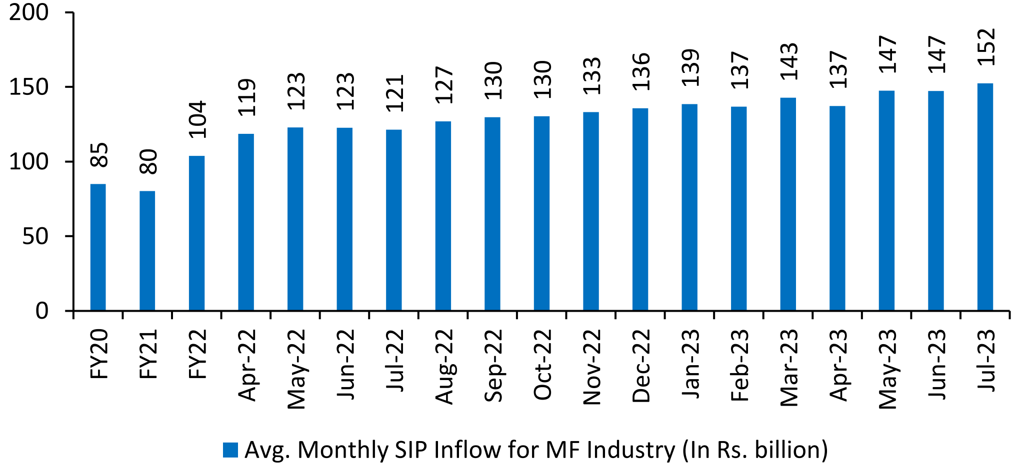


Debt inflow rebounded after seven successive quarters of outflow

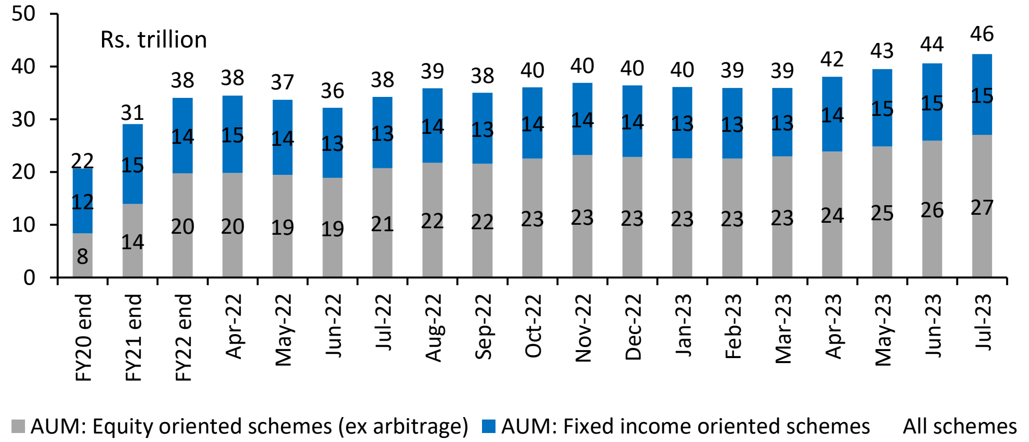


Data till Julv'23 for Q2 FY24

Monthly SIP inflow increases m-o-m in July



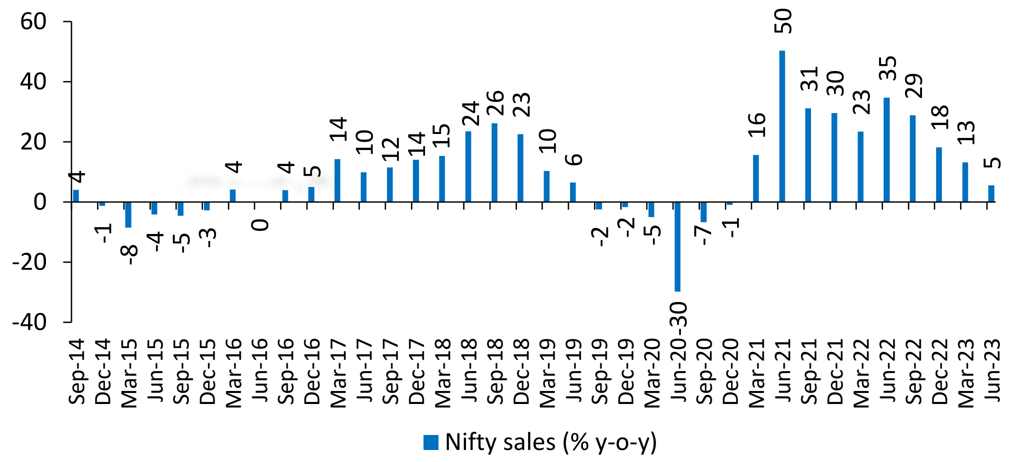
Debt and equity AUM increase m-o-m



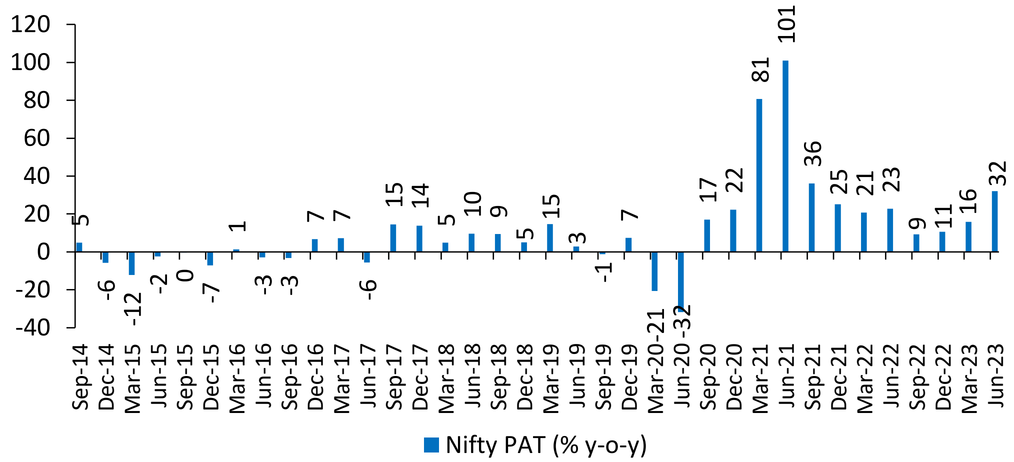
Source: CMIE Economic Outlook, Association of Mutual Funds of India(AMFI), SBIMF Research

Q1 FY24 earnings: Sharp improvement in EBITDA and PAT margins aided by falling input costs

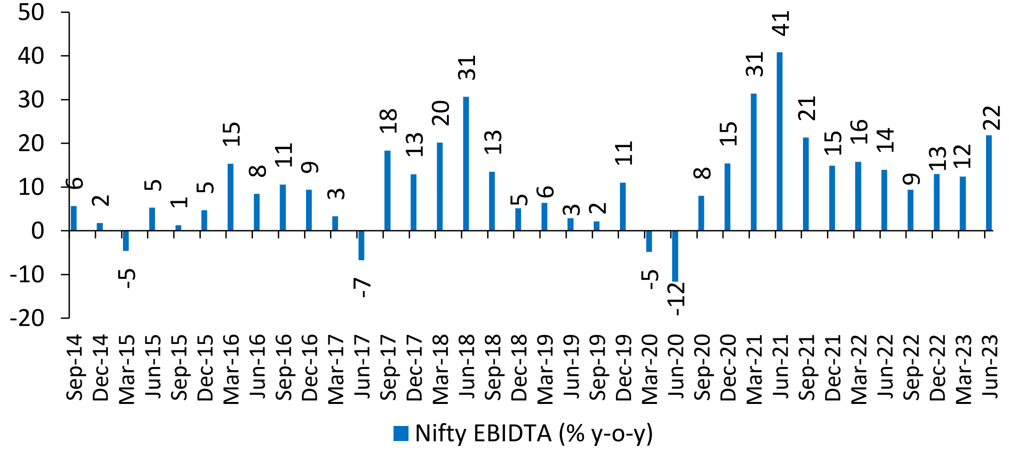
Q1 FY24 NIFTY sales growth in line with expectations



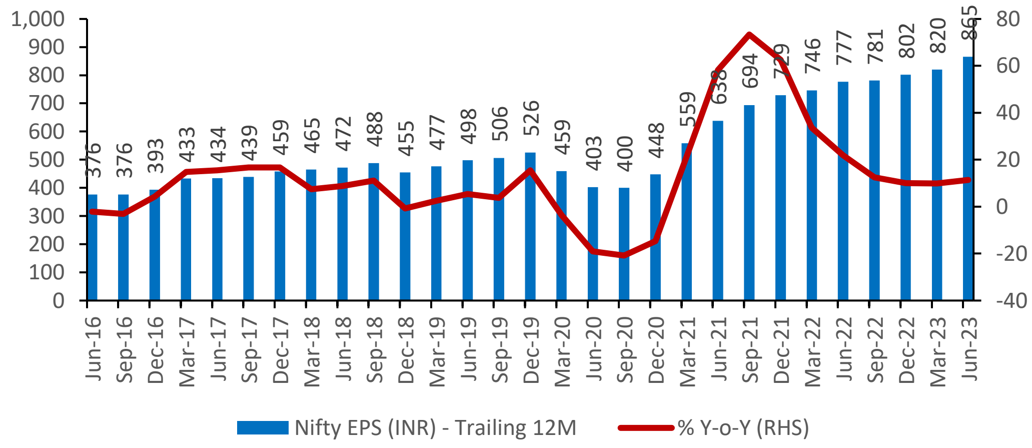
Profit growth improved in Q1FY24 vs. Q4FY23; PAT growth above expectations



EBITDA growth improved as input costs see some relief



EPS growth moderates to mid-teens growth



Source: MOSL, SBIMF Research; NB: Results released for all 50 NIFTY companies, EPS growth is adjusted for Axis bank losses for FY23

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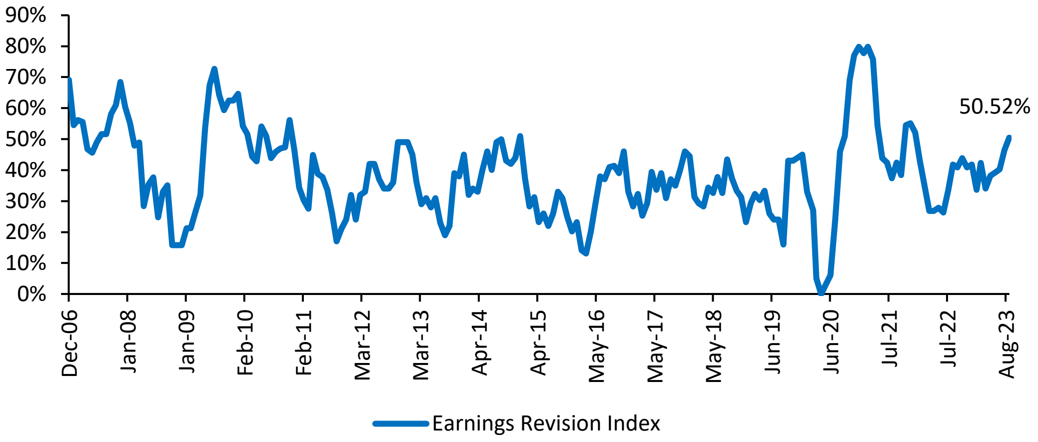
Q1 FY24 earnings' review

- Earnings results for Q1 FY24 is completed. While we are witnessing a consistent moderation in topline, EBITDA and PAT picked up aided by falling cost and healthy other income.
- Exports oriented sectors and export segment of businesses in most sectors reported a weak revenue and a cautious outlook. Specialty chemical and textile companies, on an average, posted a drop in top line mainly aided by falling volumes and partly by realization. Bearings and forging exports revenue growth across the board declined due to lower demand in Europe/ US. Higher localization trend, higher content per vehicle and strong demand from after-market segment are likely to continue. Industrial and core segments expected to do well backed by demand.
- Aided by pick-up in real estate and government infrastructure orders, cement companies are reporting double digit volume growth. A healthy momentum can be seen for other building materials companies too
- Banks registered lower GNPAs, and lower provisions led to strong earnings growth across the board. Most NBFCs reported a contraction in NIMs while Banks posted a marginal expansion. Healthy advances, deposits and PAT growth aided improvement in ROAs/ROEs.
- Healthcare: Diagnostics reported tepid growth in volumes and realization. Hospitals posted an improvement in Average Revenue Per Occupied Beds to early-double digits on a y-o-y basis. Pharma showed a rebound in generics volumes with good growth outlook going forward driven by better pricing trends in the US.
- Consumer Staples reported considerable gross margin expansion across companies after 7 quarters of decline while consumer discretionary was a mixed bag.
- Auto-OEM, PC and 2W players saw muted volume growth with slight increase in realization. Battery – the lead acid demand remained steady aided by domestic demand. Tyers clocked steady volume growth aided by recovery in OEM and replacement demand. Gross margins improved y-o-y due to raw material tailwinds.
- IT – Constant currency revenue growth stood at mid to high single digits. This is the third consecutive quarter of net headcount reduction.
- Unseasonal rains impacted demand across sectors such as Auto, Cement, Building materials, Discretionary, FMEG, and Staples. Decline in raw material prices resulted in gross margin expansion. B2B segments reported strong volume growth y-o-y due to higher government capex and lower commodity prices. Domestic consumption trends remain a mixed bag with entry-level consumption yet to show evidence of demand recovery. The volume growth in the exports segment remained subdued for the quarter, and there are no indications of near-term recovery. Further, pharma companies are experiencing stable pricing trends for their base business in the US.
- Despite a modestly better than expected PAT for Q1 FY24, earnings do not see any material upgrades. FYTD Earnings projection is broadly flat.

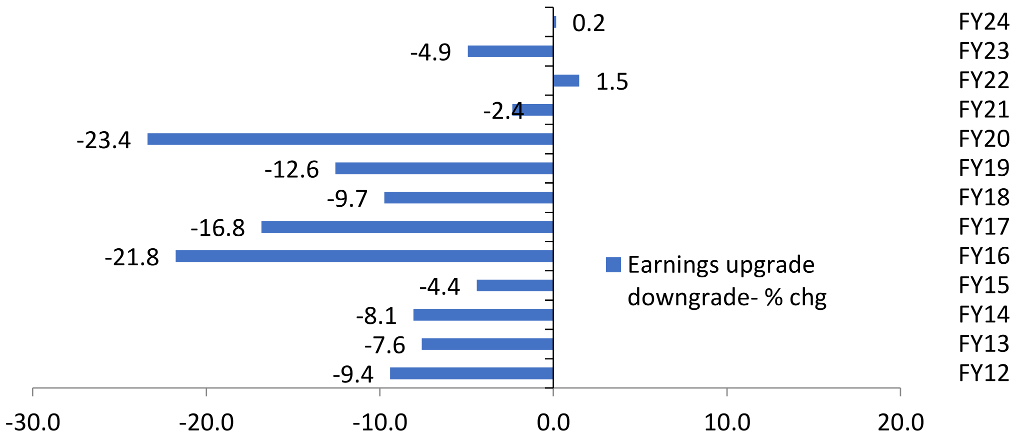
Source: MOSL, SBIMF Research

Earnings revisions has marginally moved up

Earnings Upgrades to downgrades ratio has moved up



Financial Year to Date, EPS projection is broadly unchanged

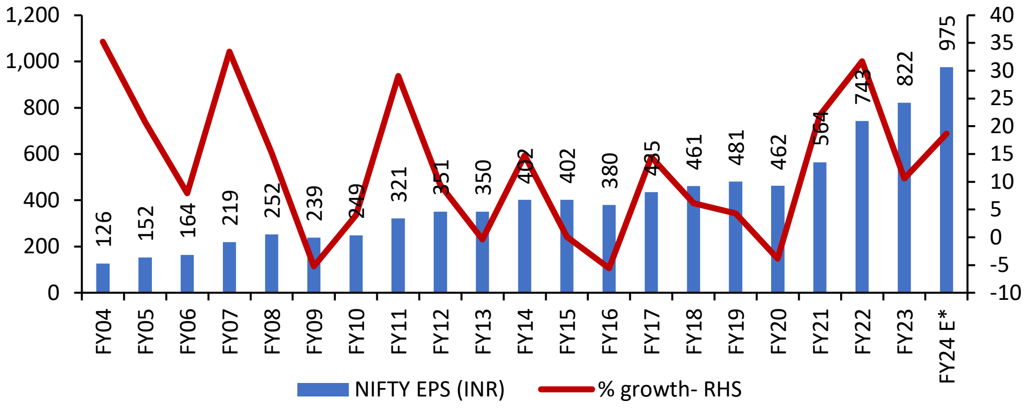


- Earnings revisions for FY24 have fallen with IT, Materials, Communication Services witnessing downward revisions. Energy, Industrials, Healthcare & Consumer Discretionary saw upward revisions.
- Post a healthy Q1 FY24 earnings outcome, there are nearly an equal proportion of the companies to see an upgrade vs. downgrade. Overall, aggregate EPS outlook for FY24 stays flat FYTD. FY24 NIFTY EPS is projected to grow by 24%. But adjusting for Axis banks loss in FY23, FY24 EPS growth outlook is in mid-teens.
- Moderating Nominal GDP growth is a headwind to topline and consequently earnings.

Source: Bloomberg, FactSet, SBIMF Research; NB: *data for communication services can't be calculated due to negative number in the base year, Earnings Revision Index: There has been a revision in methodology of calculating Earnings' Revision Index. Earlier,12 month forward estimate number of all BSE 100 constituents as of the current month-end &3 months back were taken. Now, new version considers FY23 consensus EPS for the current date and weighted format for history(1 month, 2 month & 3 months back with 1 month having the highest weight).

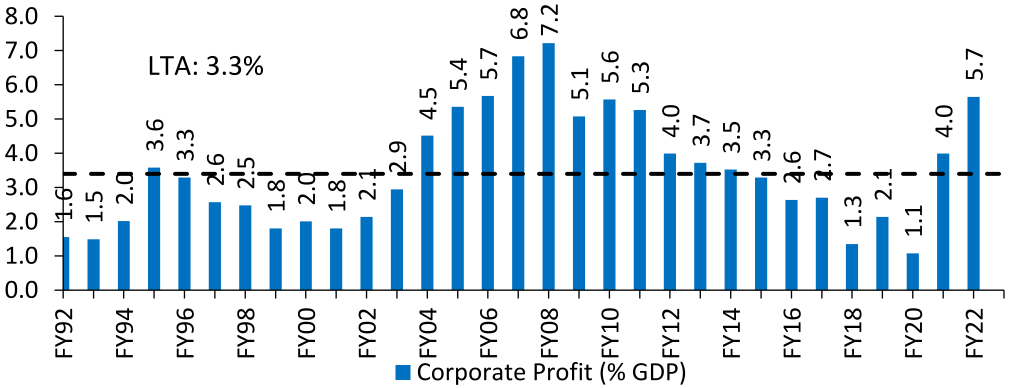
Domestic support to earnings as the outlook for global cyclicals weakens

Near-term headwinds to earnings while medium term prospects look decent



EPS growth is adjusted for Axis bank losses for FY23

Earnings have recovered from ultra-lows of FY17-FY20



FY92-FY22 data is based on a sample of ~30,000 listed unlisted companies in CMIE (includes both financial and non financial companies)

Sectoral breakup of NIFTY earnings outlook

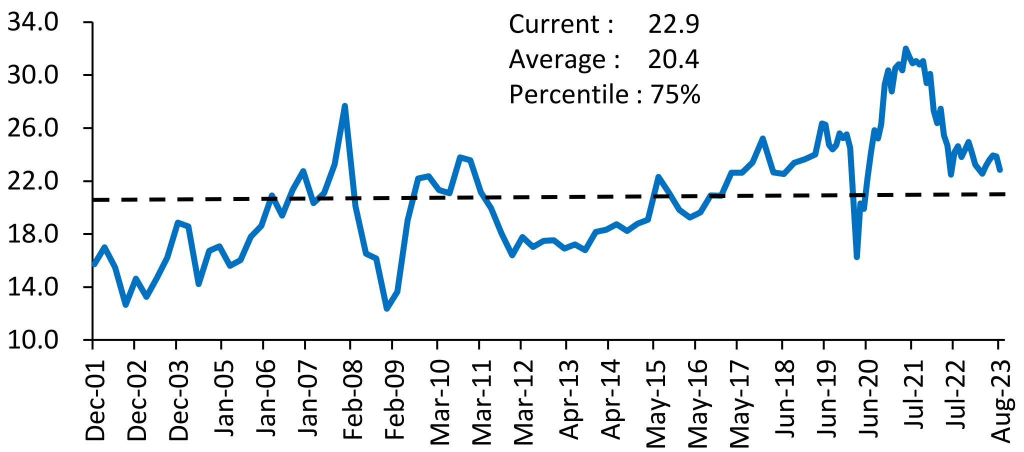
		EPS Change					
	No. of Cos.	FY20-21	FY21-22	FY22-23	FY23-24	FY24-25	FY22-25 (CAGR)
Nifty		20.0%	35.7%	5.9%	24.3%	14.8%	14.7%
Consumer Discretionary	7	20.7%	-33.4%	186.5%	53.2%	15.9%	72.0%
Financials	11	13.8%	27.3%	23.1%	32.4%	15.4%	23.5%
Energy	4	56.9%	11.4%	8.1%	29.4%	5.3%	13.8%
Industrials	3	22.9%	-30.1%	-0.9%	15.8%	24.1%	12.5%
Health Care	5	5.9%	51.7%	23.6%	-0.8%	15.6%	12.3%
Consumer Staples	5	-5.0%	-3.9%	5.6%	16.7%	12.6%	11.5%
Information Technology	6	9.6%	37.1%	13.3%	4.7%	13.2%	10.3%
Utilities	2	18.0%	-9.7%	6.0%	-1.8%	8.5%	4.1%
Materials	7	55.2%	222.9%	-54.7%	24.6%	26.8%	-10.6%
Communication Services	1		NA*		52.3%	60.0%	NA*

- Consensus expects 14.7% EPS growth CAGR for the Nifty over FY22-FY25.
- There are downside risks to FY24 EPS projections mainly emanating from extent of global slowdown. A sever contraction in global economic activity could drive downgrades in IT and other global cyclicals.
- Near-term headwinds aside, we are constrictive on medium-term earnings trajectory deriving comfort from our growth expectation for India and return of pricing power for many sectors.

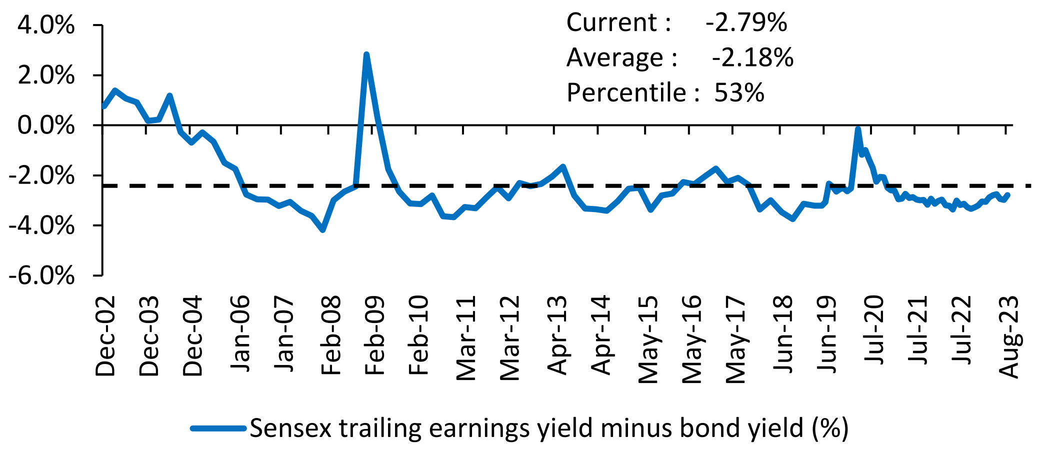
Source: CMIE Economic Outlook, Bloomberg, SBIMF Research; *FY24 earnings estimates are SBIMF,** EPS change is unadjusted to externalities, : *data for communication services can't be calculated due to negative number in the base year, Earnings Revision Index: There has been a revision in methodology of calculating Earnings' Revision Index. Earlier,12 month forward estimate number of all BSE 100 constituents as of the current month-end &3 months back were taken. Now, new version considers FY23 consensus EPS for the current date and weighted format for history(1 month, 2 month & 3 months back with 1 month having the highest weight).

Equity valuations remain expensive

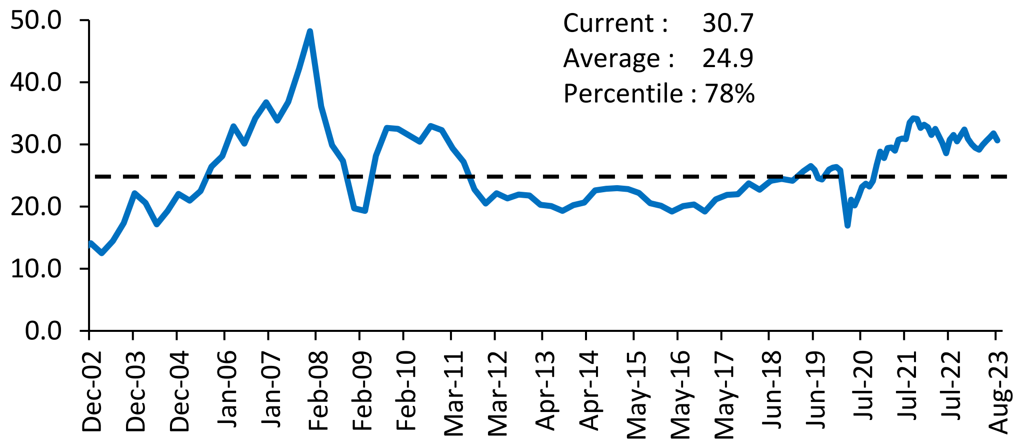
Sensex trailing PE ratio stood at 22.9 in Aug'23 vs. 23.9 in Jul'23



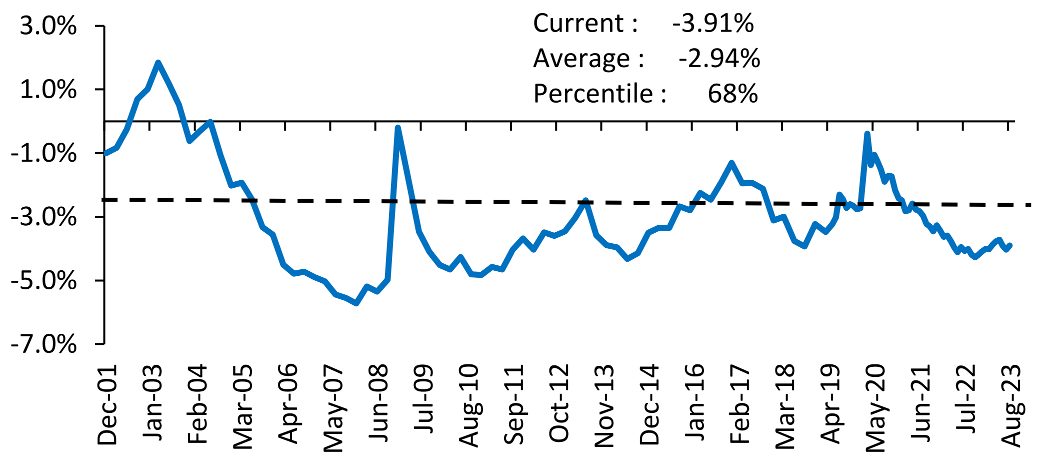
Earnings yield to bond yield spread is moderately expensive



Shiller PE ratio stood at 30.70 in Aug'23 vs. 31.8 in Jul'23



Shiller earnings yield to bond yield spread moderately expensive



Source: Bloomberg, SBIMF Research

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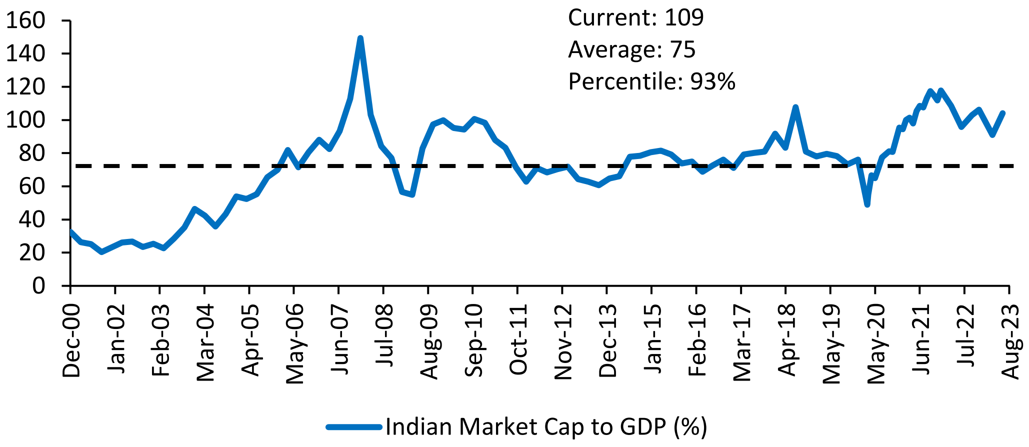
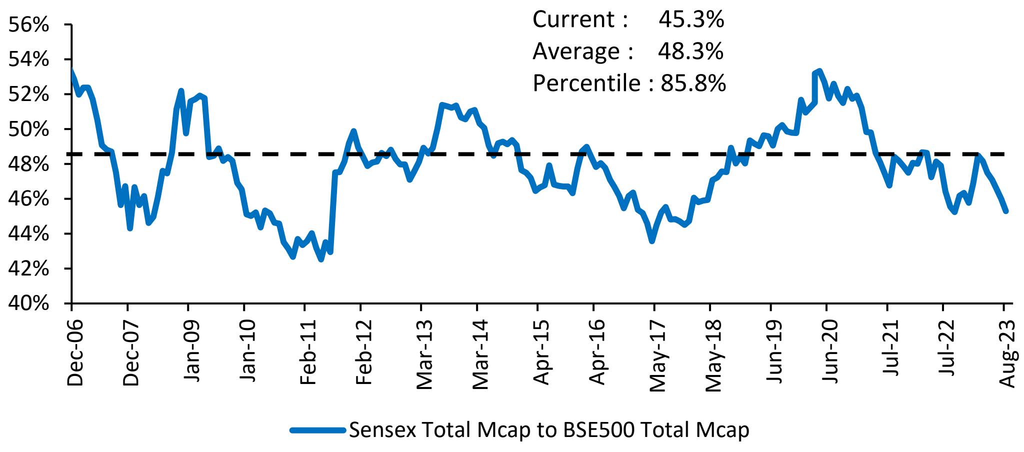
Polarization has reversed

Market capitalization/GDP expensive vs. history at 93rd percentile reading



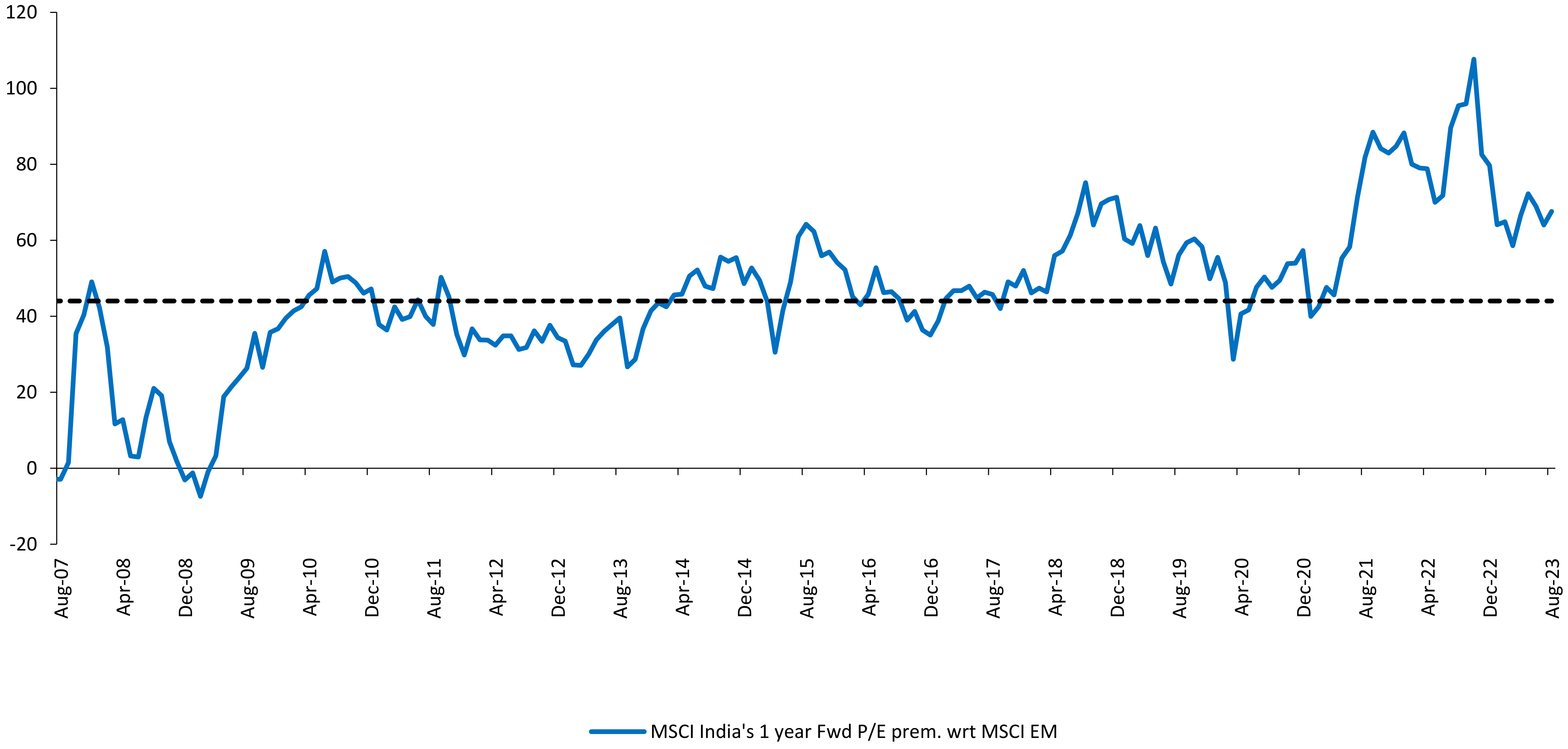
Mid caps and small caps: Market polarization reversed



- Market polarization has reversed, with broader markets outperforming the frontline large cap indexes.
- The ratio is now back to historical averages, suggesting the risk-reward is more balanced now.

MSCI India's valuation premium relative to EM improves marginally

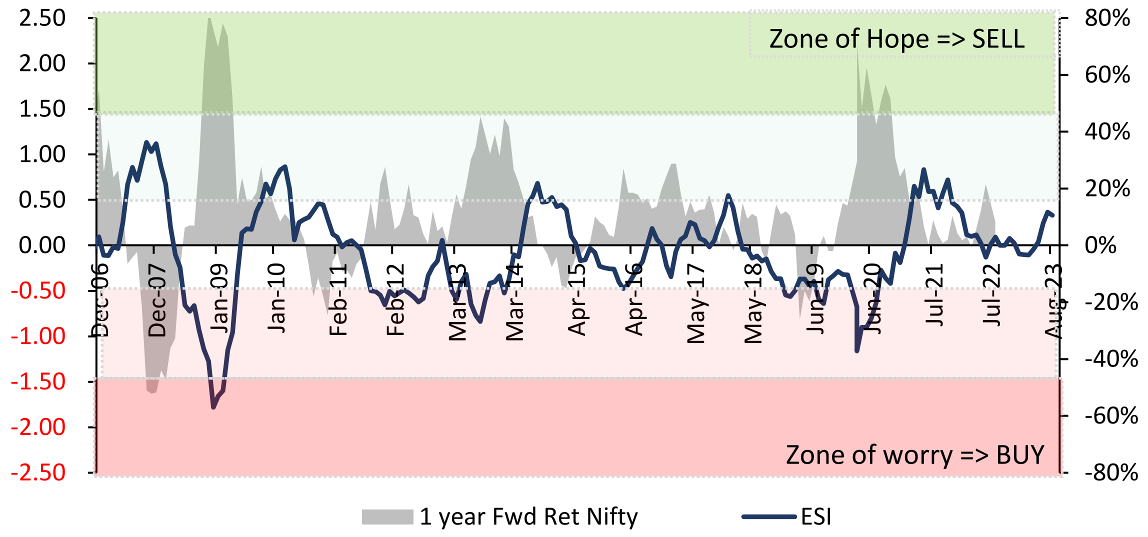
India's P/E premium to world has moderated from its peak in Oct'22; global multiples remain vulnerable to higher rates, weaker growth and potentially rising Equity risk premium



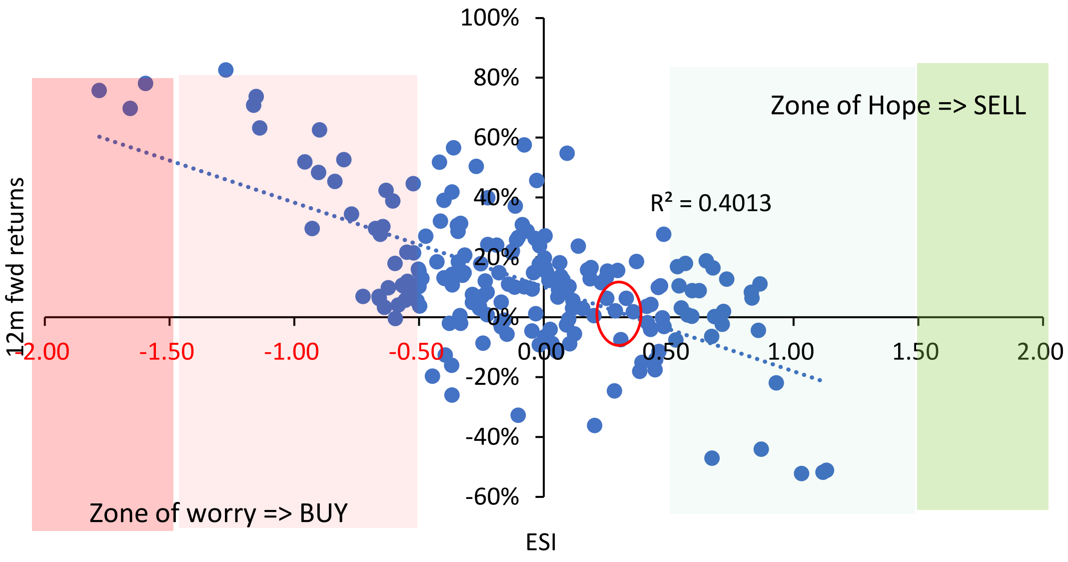
Source: Bloomberg, SBIMF Research

Equity market sentiment remains near the Zone of Hope

Equity sentiment index remains near the Zone of Hope



Equity sentiment index has moved up



- The sentiment measure works as a contrarian indicator. The action from the past few months suggests optimism coming back and brought the indicator further up.

Source: Bloomberg, FactSet, SBIMF Research; ESI = Equity sentiment Index

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Equity Outlook: Stick to investment discipline amidst volatile market

- Equity has been rising for fourth month in succession leading investors to question the recession thesis for the US.
- NIFTY has risen 6% YTD and rally down the capitalization curve is much stronger (mid and small cap depict 23-28% rise YTD).
- FIIs have been buying Indian equities for 6 months in succession.
- In the near-term risks assets could stay supported with recession risks getting prices out by a) positivity in US data, b) expansionary fiscal policy in the US and c) Healthy US balance sheet structure. However, caution is still warranted.
- Under the backdrop of higher rates and declining manufacturing output globally, tightening credit standards, contracting money supply growth and depleting excess savings in the US- risk on the recession front remain. Real rates have finally turned positive in the US only now, at 2%, its highest since GFC.
- China faces severe property sector troubles. This is slowing economic growth and generating stress in pockets of the financial sector, while policymakers face ideological and technical constraints to providing more fiscal policy support. While equities are weak in China and RMB has depreciated, they do not portend deep troubles yet.
- In India, Q1 FY24 GDP growth was at 7.8% y-o-y and earnings outcome was marginally better than expected. Following aspects stood out in India's growth context. Exports warrant a cautious outlook, government capex has jumped leading to robust order inflow for construction companies, improvement in real estate launches, and consumption demand is weak. With construction and capex picking up in India- its second order effects should also lead to job creation and consumption demand improvement. However, this has not translated into an earnings upgrade in India.
- We stay cautious on Indian equities.
- To sum up, diversification across assets and within equity portfolios should work well in this environment. We continue to think of 2023 as a year of adjustment even as longer-term trends continue to favor an investment led earnings cycle in India.

Source: SBIMF Research

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FIXED INCOME MARKET

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Global Bond Market Snapshot

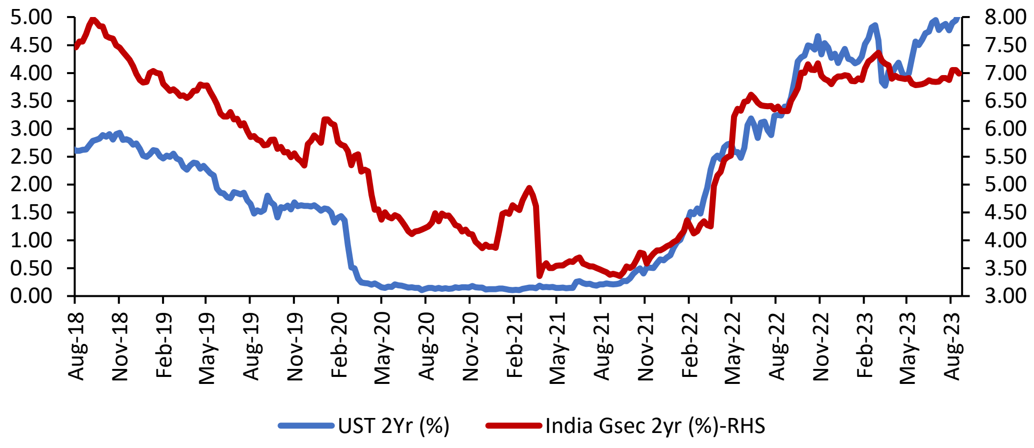
The rise in US bond yields in August much sharper than other developed market economies. Higher US treasury supply, and possibility of more hikes explains the rise. Emerging market yields also rise in August due to renewed food inflation concerns.

10 Year G-sec Yield (% month end)	2022 end	May-23	June-23	July-23	Aug-23	m-o-m change (in bps)	YTD change (in bps)
Developed market							
US	3.87	3.64	3.87	3.97	4.10	14	22
Germany	2.57	2.28	2.43	2.52	2.50	1	-7
Italy	4.72	4.08	4.10	4.12	4.14	4	-57
Japan	0.42	0.44	0.40	0.61	0.65	4	23
Spain	3.66	3.33	3.42	3.53	3.51	-1	-15
Switzerland	1.62	0.89	1.00	1.03	0.95	-6	-66
UK	3.67	4.18	4.44	4.34	4.38	7	70
Emerging Market							
Brazil	12.69	11.57	10.86	10.92	11.03	22	-166
China	2.84	2.71	2.64	2.66	2.58	-8	-26
India	7.33	6.99	7.12	7.18	7.17	-0.5	-16
Indonesia	6.92	6.36	6.24	6.23	6.36	13	-55
South Korea	3.74	3.52	3.66	3.73	3.86	9	12
Malaysia	4.09	3.71	3.84	3.83	3.84	1	-25
Thailand	2.64	5.40	5.40	5.40	5.40	0	0
Mexico	9.04	0.49	0.49	2.60	2.76	16	12
Poland	6.86	2.49	2.56	8.91	9.32	50	28
Colombia	13.01	8.80	8.69	5.45	5.63	20	-124
Hungary	8.98	6.04	5.76	10.37	10.61	44	-240

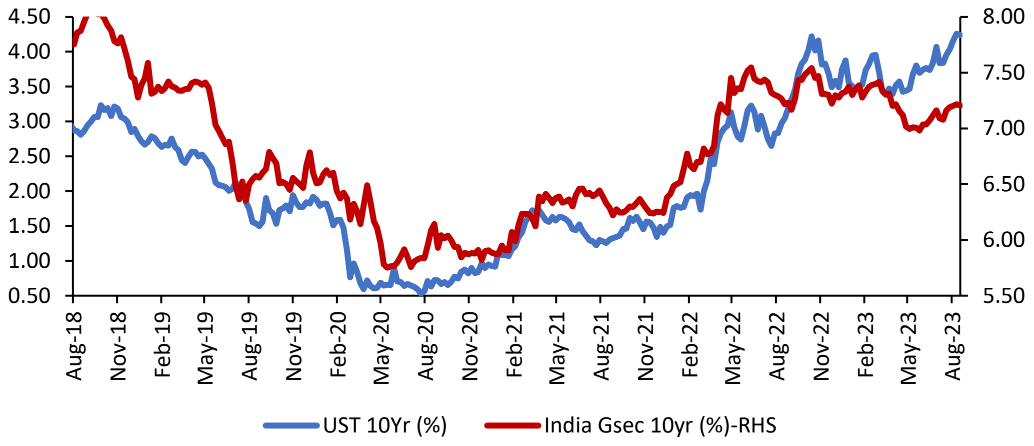
Source: Bloomberg, SBIMF Research

India bonds yields are contained despite a sharp rise in US yields

US treasury yield curve (2yr) saw a sharp upward turn in June, India G-Sec (2yr) remained range bound



Similar trend seen for 10yr yield curve as well



Source: Bloomberg, SBIMF Research

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India Rates Snapshot: Yields broadly flat across long term tenures

Slight rise in short term yields, while longer term yields remain broadly flat in Aug'2023

	Jun-23	Jul-23	Aug-23	m-o-m (in bps)	YTD Change (in bps)
Repo rate	6.50	6.50	6.50	0	25
3M T-Bill	6.76	6.72	6.82	10	51
3-year G-Sec	7.03	7.11	7.16	5	8
5-year G-Sec	7.08	7.16	7.16	0.2	-7
10-year G-Sec	7.12	7.18	7.17	-0.5	-16
3 Yr Corp Bond*	7.61	7.67	7.71	3	6
5 Yr Corp Bond*	7.67	7.70	7.65	-5	-3
10 Yr Corp Bond*	7.63	7.65	7.64	-4	-8
1 Yr IRS	6.74	6.87	6.97	10	23
5 Yr IRS	6.31	6.51	6.58	6	13
Overnight MIBOR Rate	6.90	6.60	6.69	9	9
10-year SDL	7.40	7.40	7.43	3	-18
INR/USD	82.04	82.25	82.79	-0.6^	-0.06^
Crude oil Indian Basket**	74.93	80.10	86.37	7.5^	10.6^

- Rupee depreciated by ~0.6% to INR 82.79/$ in Aug'23 (vs. 82.25 a month ago).
- Oil prices increased by ~7.5% in Aug'23 vs. Jul'23 to ~US$ 86.4/bbl level.
- Rise in shorter end likely explained by RBI's measure to suck out excess liquidity from the system
- Indian long end is range bound compared to the move in US Treasury- explained by local macro and demand supply factors.

Source: Bloomberg, PPAC, RBI, CEIC, SBIMF Research; NB: *Corporate bond rate is for AAA rated bonds, **Crude oil price is average $/barrel for the month and INR, remaining data are % month end, ^INR and Oil price changes are % change, + denotes appreciation in rupee, -ve denotes depreciation

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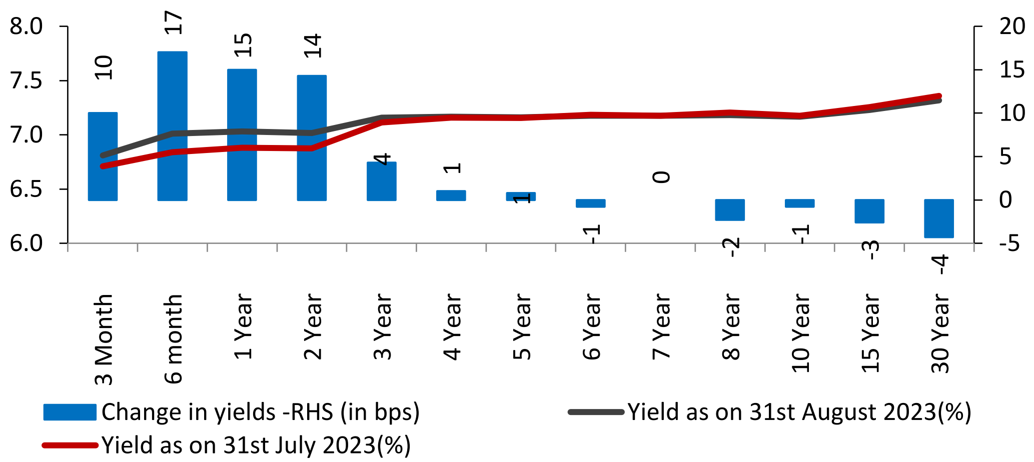
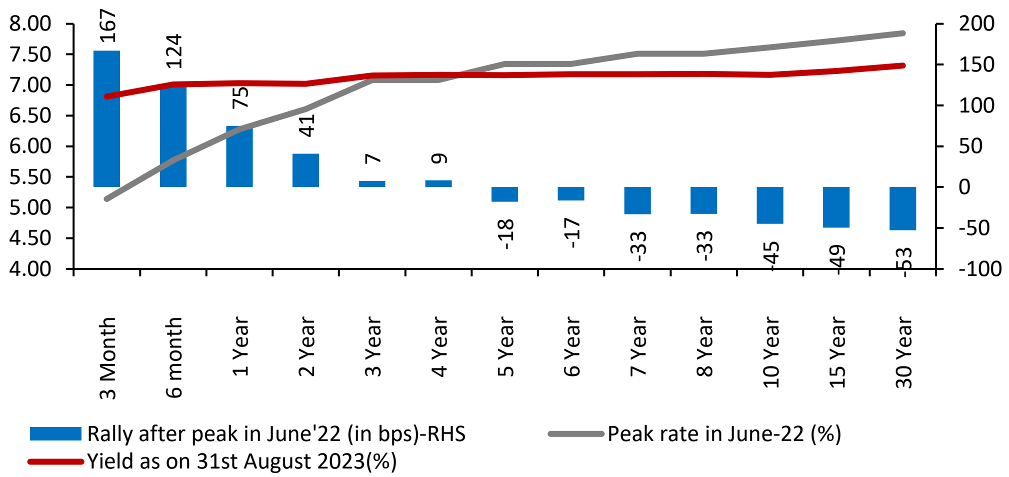
Indian G-sec yield curve significantly flattened

Indian G-sec short term yields have recorded a rise in August over the past month; long term broadly unchanged

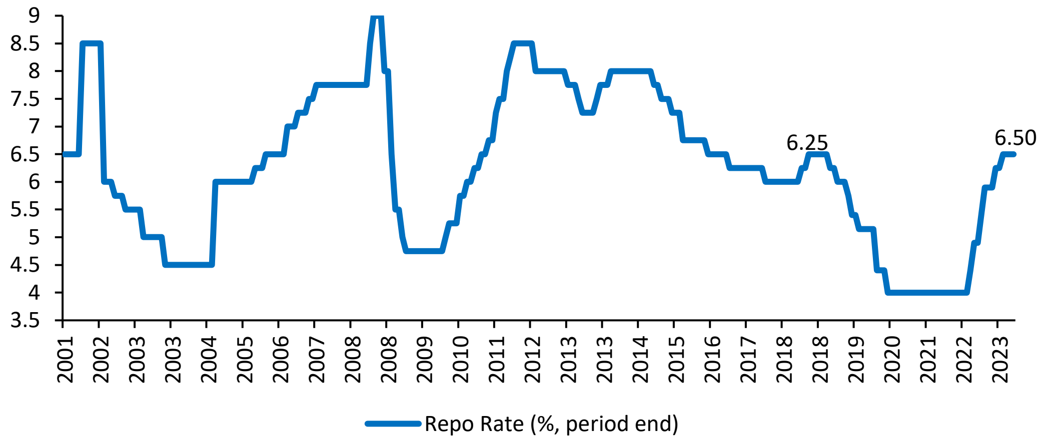


Compared to a year ago, longer end yields are lower by ~50bps



India's monetary policy likely headed for a long pause

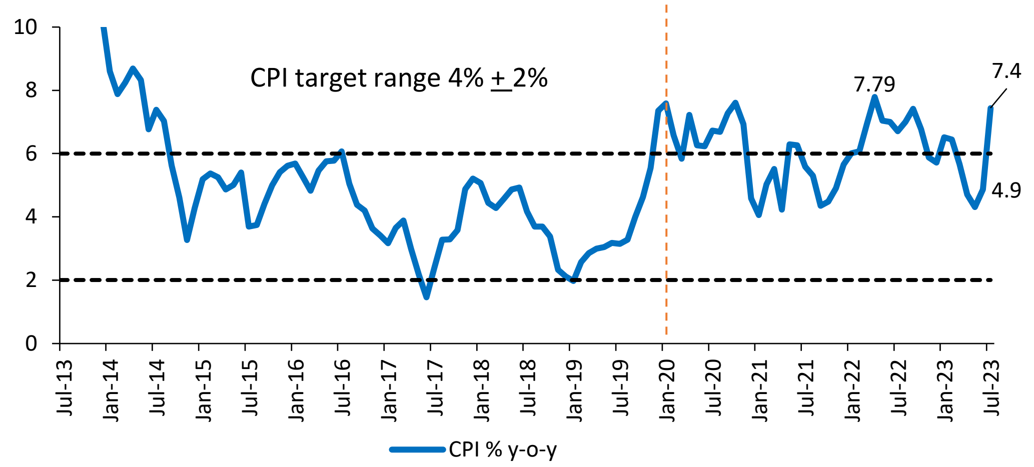
Repo rate unchanged since April 2023 policy at 6.50%



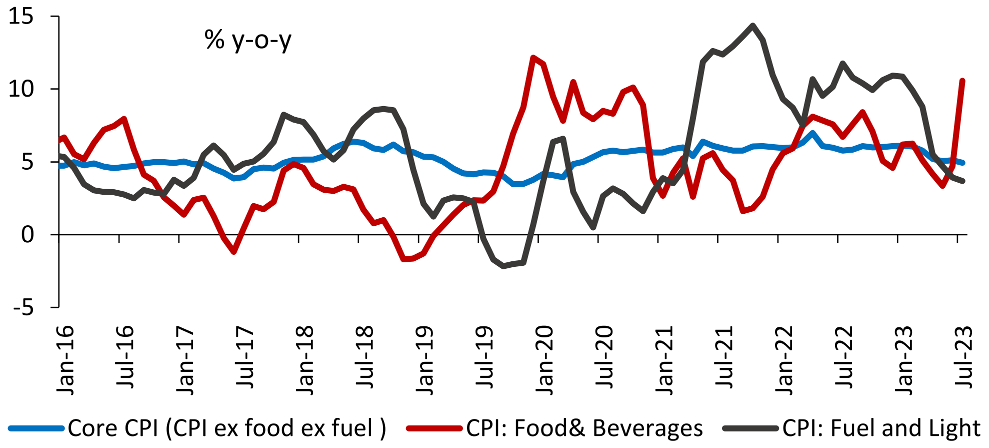
- In the August MPC meeting, RBI left policy rates unchanged (with a unanimous vote by all MPC members) and retained the policy stance of withdrawal of accommodation (with a vote of 5:1 in favour of the stance).
- Introduction of a temporary Incremental CRR of 10% on incremental NDTL to suck out excess liquidity.
- The objective was to align liquidity conditions with the stance and lift overnight rates closer to the repo rate.
- The transmission of the same to other segments of the curve may not be similar, with incremental supply and macro data and positioning likely to influence the same.
- As the minutes of the meeting highlighted, there is a subtle indication that perhaps the RBI may overlook the short-lived elevated inflation prints. However, its transmission to higher inflation expectations could be a problem.
- The lag effect of earlier actions and the cumulative monetary tightening should enable policy rates to stay on hold incrementally unless there are material upside surprises to inflation.

Domestic inflation edging higher due to food inflation; core and fuel inflation contained

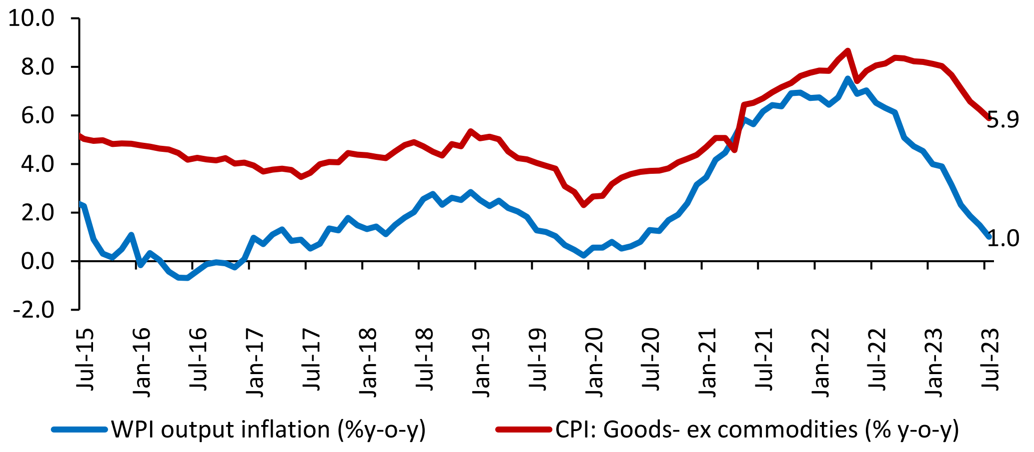
July CPI inflation is significantly high at 7.4%; The rise was primarily led by higher vegetable prices



Food inflation sees an uptick in June and July owing to erratic weather conditions; fuel and core remain benign



Household goods inflation likely to ease in coming months

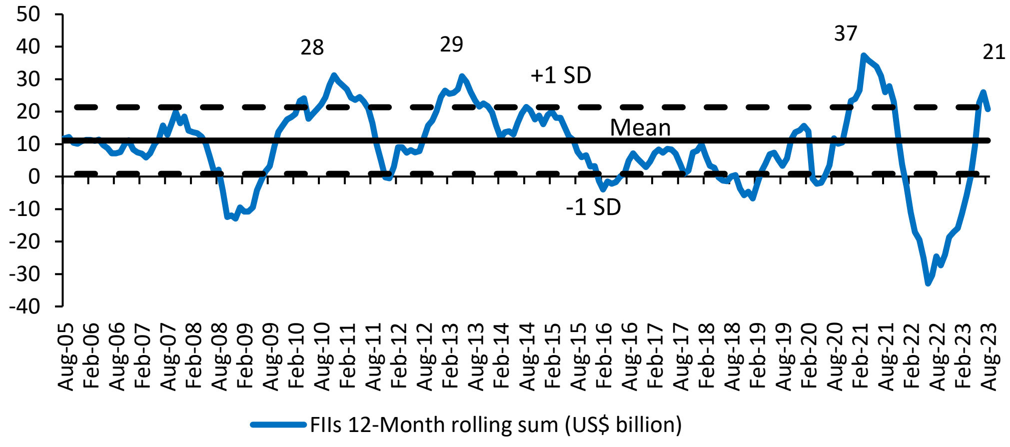


- Weather related factors has led to concern on food inflation. Compared to last year, there are multiple food items ranging from cereals to pulses, milk, spices and vegetables which has seen upward pressure to prices.
- Government has taken series of measures from open market sales of food stocks to export restriction, higher export duties and multiple other measures to ease supply shocks.
- Apart from that, fuel prices are being cut and there are hopes for further cuts in the coming months. This could help to take certain amount of pressures. That said, weather concerns are meaningful and keep us vigilant on food inflation and consequently food inflation.

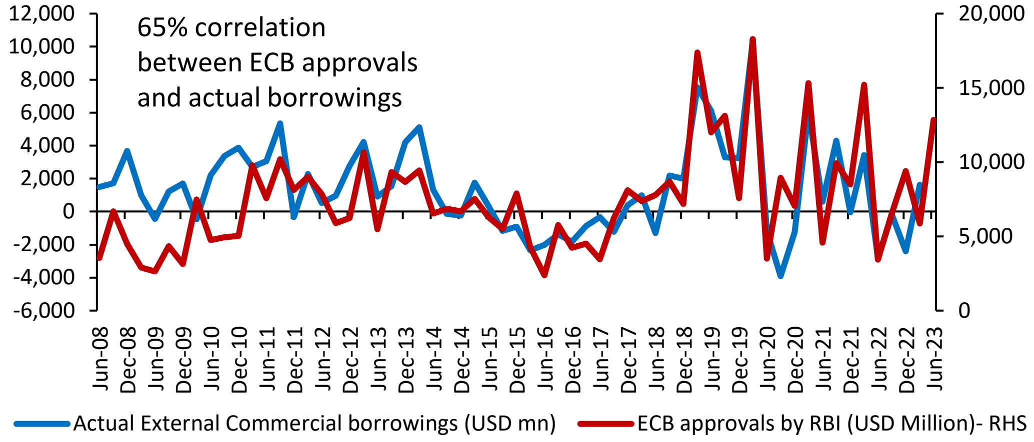
Source: CMIE Economic Outlook, SBIMF Research; NB: WPI Output inflation is internally calculated by looking at weighted avg,. Inflation of final manufactured goods in India

India’s external account dynamics looks favorable in FY24

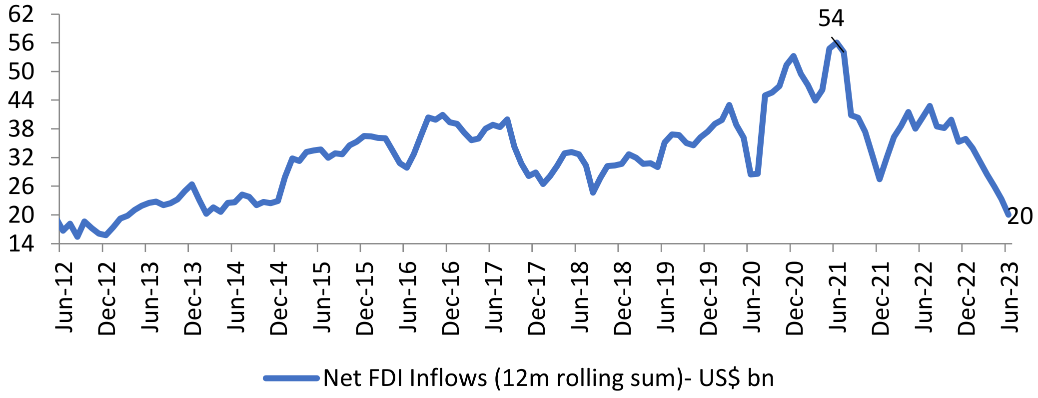
Sharp surge in FPI inflows into Indian equities; August is the fourth consecutive month for over US$5bn of net inflows



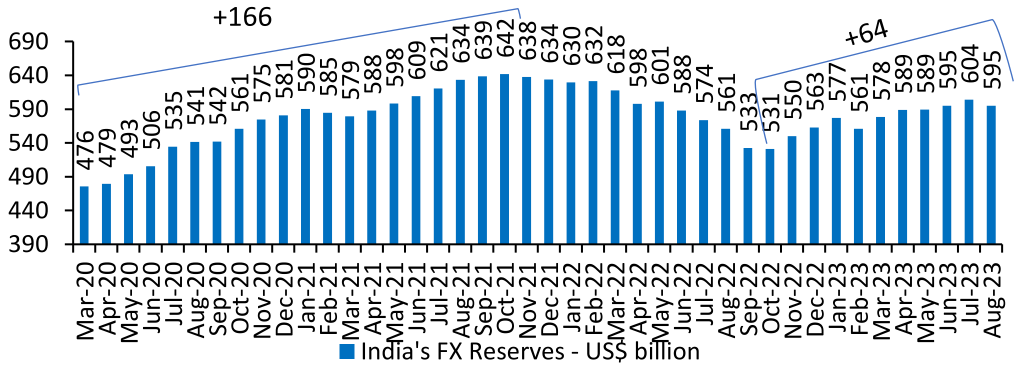
Net ECB inflow turned positive in Jan-Mar’23 after 3 quarters of outflow; approval data suggests a likely positive print in Q1FY24



FDI inflows are concerning despite ECB and FPI turning positive; 12m rolling sum basis, net FDI inflow has declined by ~50% y-o-y



FX reserves have also increased FYTD; though m-o-m moderation on account of valuation changes



Current account deficit expected to be tepid at -1.4% of GDP and BoP surplus likely to be US$15bn in Q1FY24

Source: RBI, CMIE Economic Outlook, Bloomberg, SBIMF Research; NB: FX reserves as on 18th Aug’23

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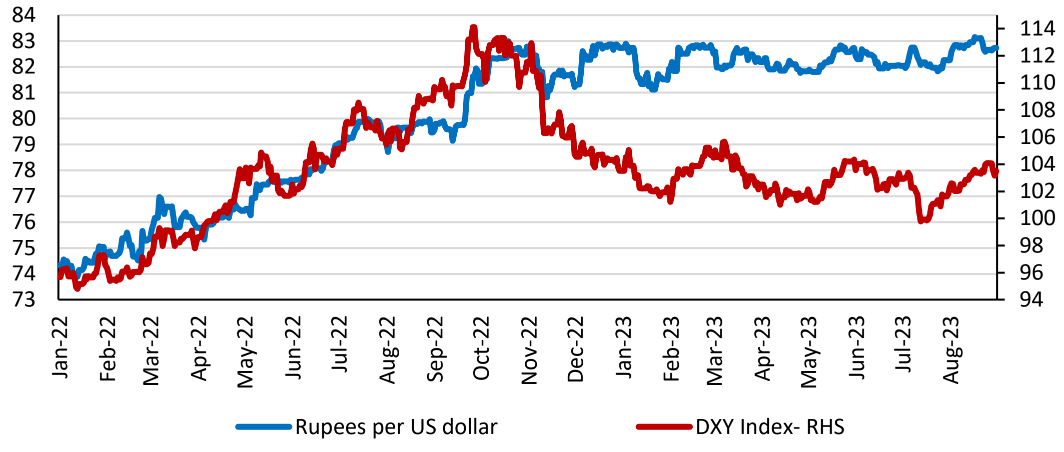
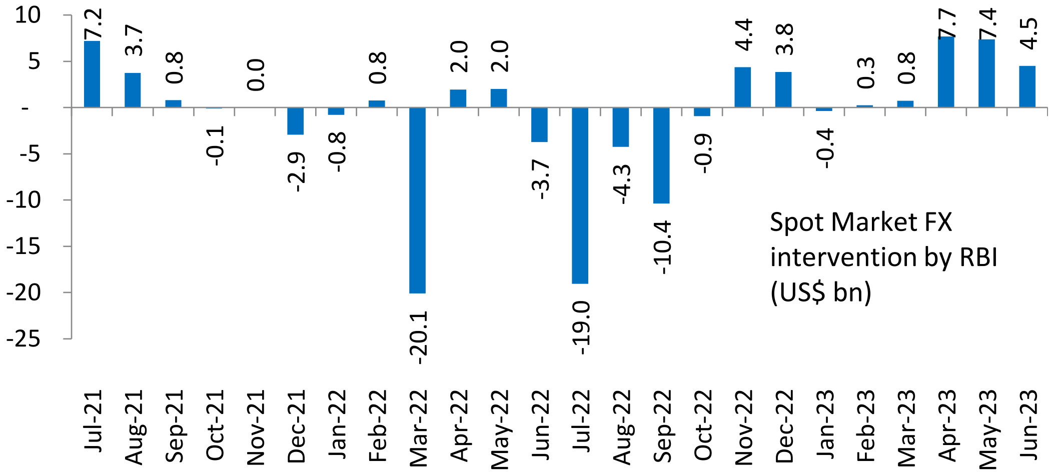
RBI shows a depreciation bias

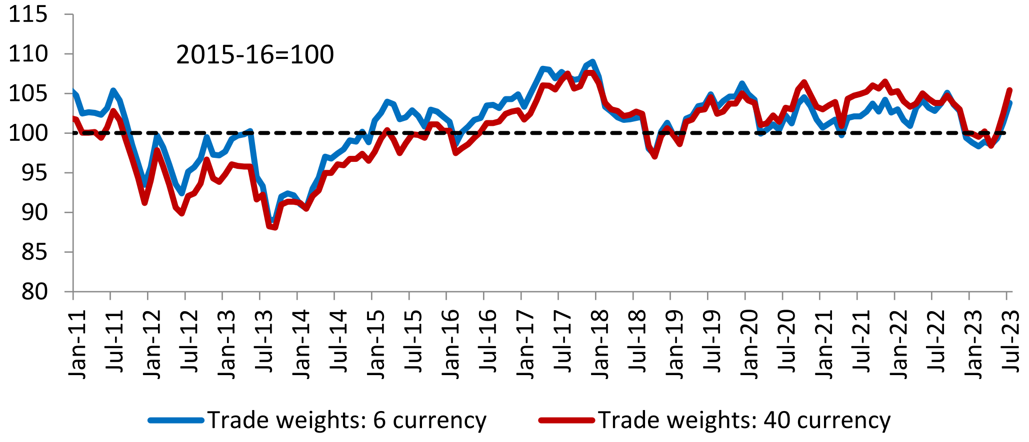
Rupee trades in a very tight range of 81.2-83.1/ US$ YTD despite weaker dollar



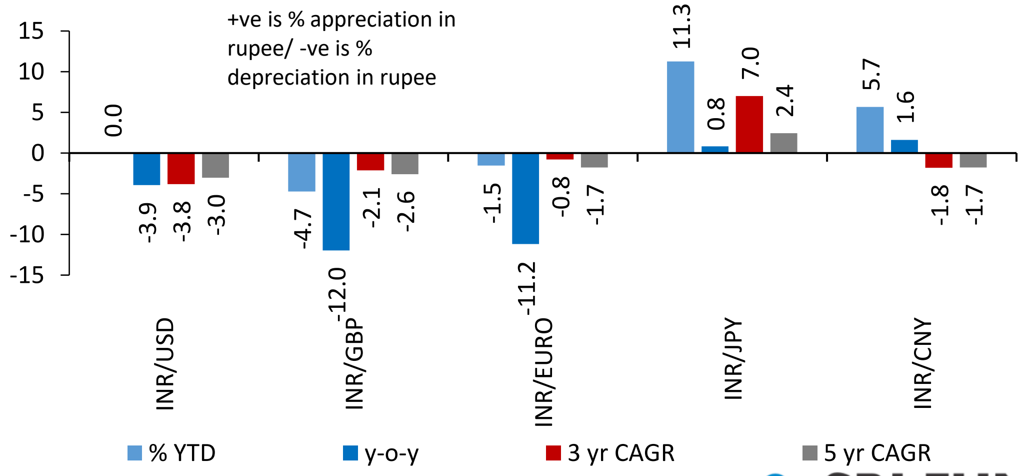
RBI's intervention keeps rupee anchored



Rupee looked marginally over valued based on REER until July- would have likely corrected in August



INR volatile vs. other currencies; Rupee appreciated 6% vs CNY and 11% vs Yen YTD while it depreciated vs Euro and Pound



Source: Bloomberg, SBIMF Research

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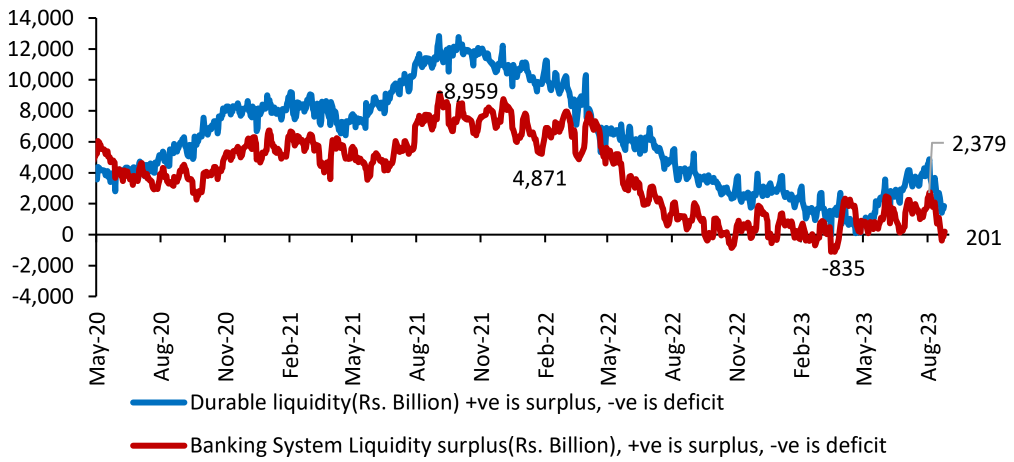
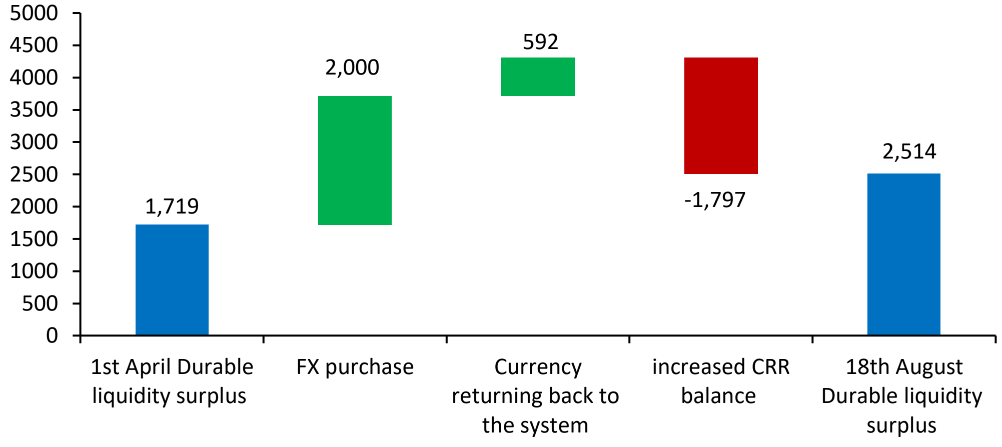
Near-term banking system liquidity to stay near neutral; likely to tighten in 2H FY24

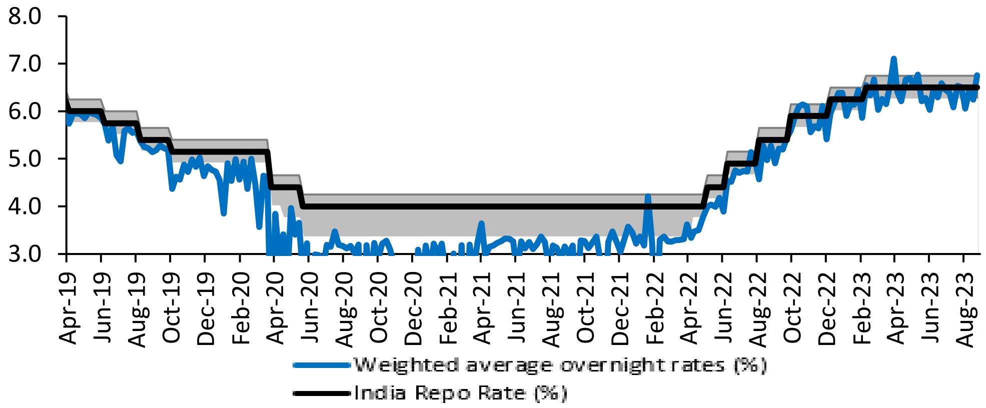
Durable liquidity at INR 2.4 trillion; Banking system liquidity near neutral level



Durable liquidity increase FYTD is mostly attributed to RBI's FX purchase, temporarily offset by increased CRR balance

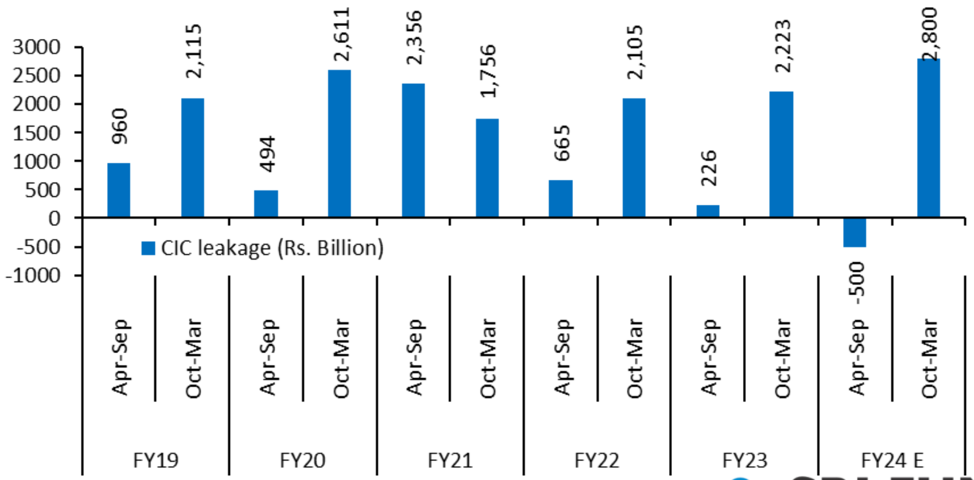


Overnight rates hover around Repo rate



Note: The shaded area represents the policy corrridor- where upper end represents MSF and lower end represent

Liquidity likely to tighten in 2H FY24 with an increase in CIC leakage



Source: RBI, SBIMF Research; NB: Durable liquidity, CIC, CRR balance as of 18st August, Banking system liquidity and overnight rates as on 25th August 2023, FX purchase is our estimate

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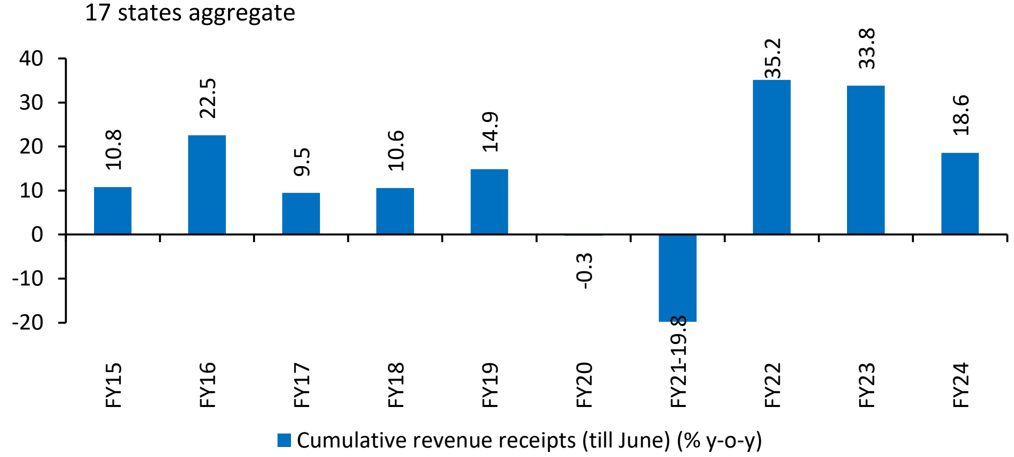
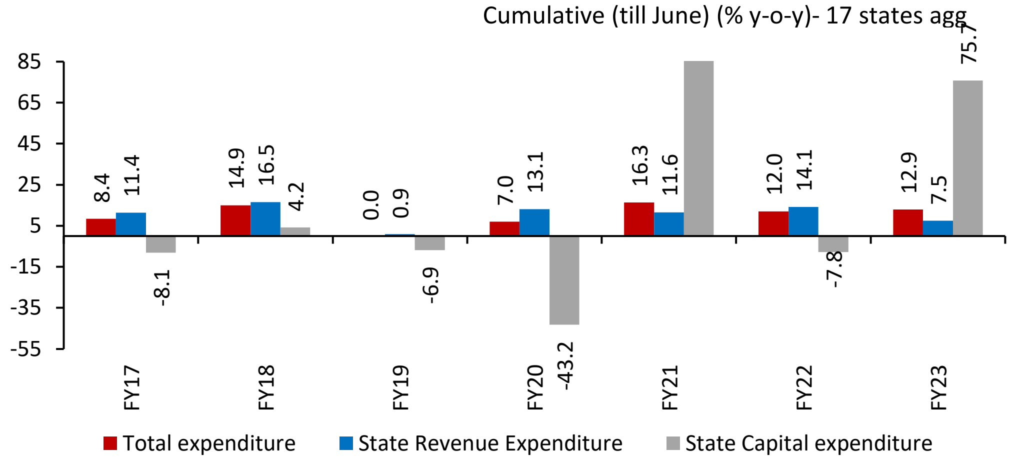
Q1 FY24 State government finances are healthy; Gross SDL supply likely to be ~INR 9 trillion in FY24

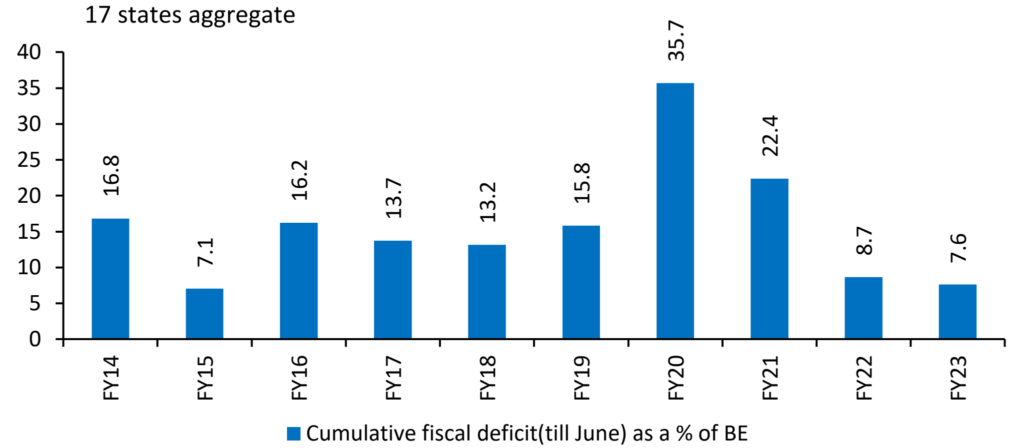
States' receipts are healthy and in line with Budgeted targets (based on study of 17 states)….



State expenditure grows by 13% y-o-y from Apr-Jun (vs. a trend of 10% in last 5 years and 12% last year)



States combined fiscal deficit at a mere 8% of BE in Q1 and in revenue surplus partly aided by aggressive tax devolution from the Centre

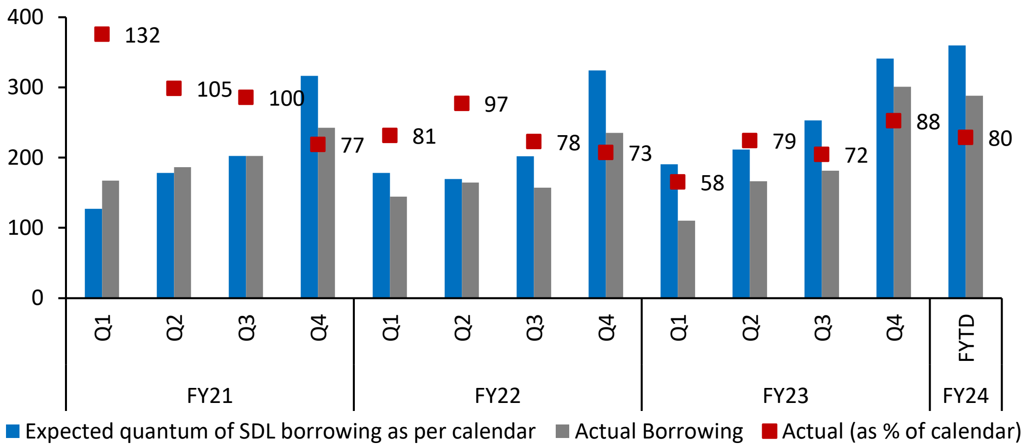


- 17 states combined show a fiscal deficit of mere 8% of BE. 7 out of 17 states are in a fiscal surplus.
- At an aggregate 17 states are posting a revenue surplus.
- States receipts are healthy with overall revenue receipts growing. Overall tax revenue is growing at a healthy 24% with own tax revenue growing at 16% and tax devolution from Centre by 58%.
- State expenditure is growing by 13% y-o-y (vs. a trend of 10% in last 5 years and 15% last year). Capex is growing at 76% y-o-y.
- Gross market borrowings of INR 9.8trillion could largely go through.

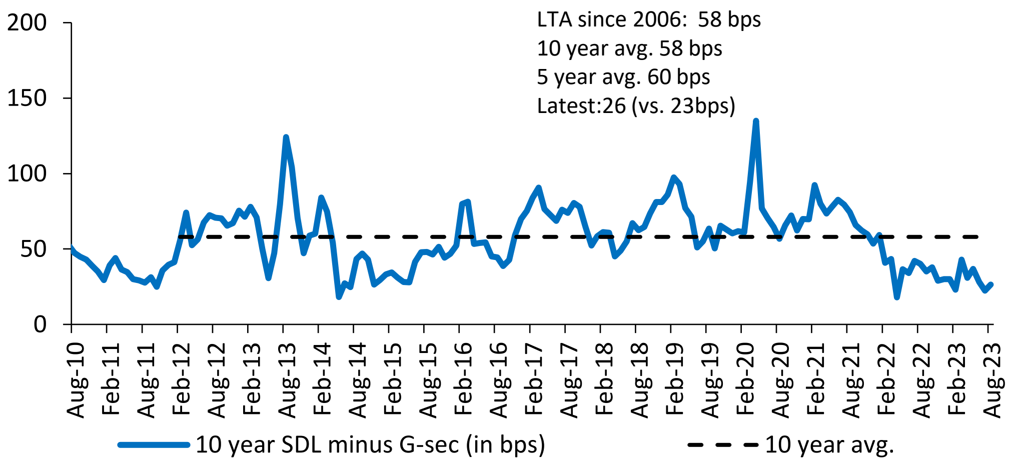
Source: CEIC, CAG, SBIMF Research

FYTD SDL borrowing at 80% of the indicated calendar amount

SDL issuances FYTD at 80% of their indicated calendar amount (29% y-o-y)



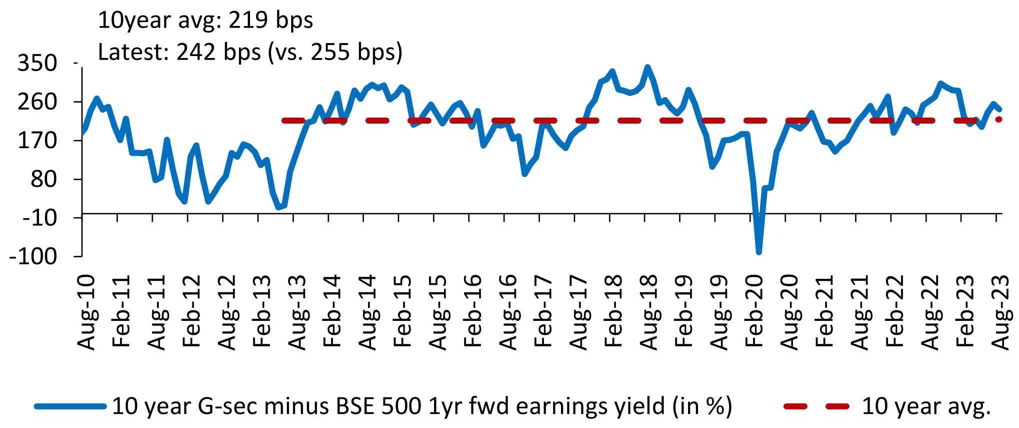
Spreads broadly flat in August compared to a month ago despite healthy SDL demand, perhaps aided by improved liquidity



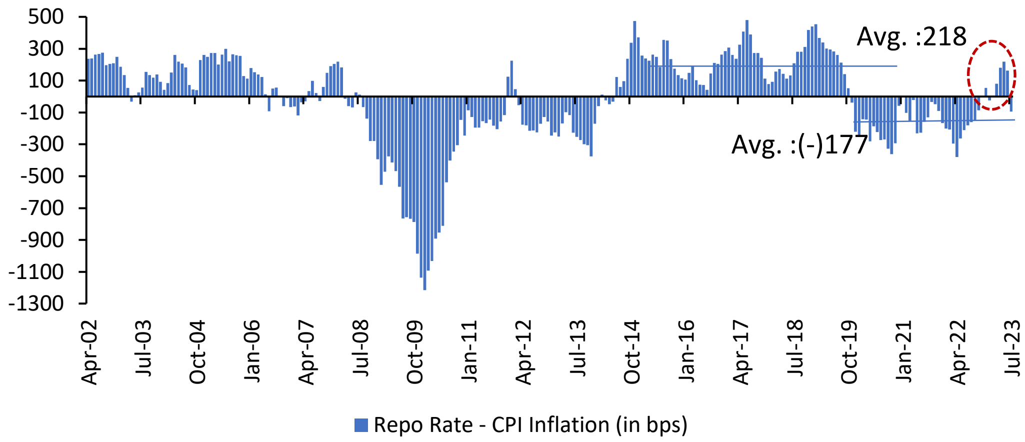
Source: RBI, Bloomberg, SBIMF Research

Indian G-sec valuations neutral given the near-term outlook of long pause by RBI

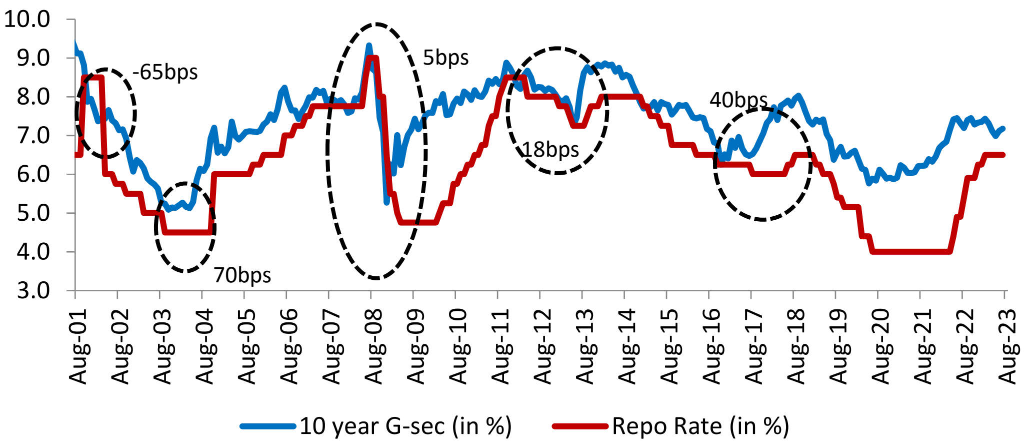
G-sec spread vs. equity neutral



Real returns deteriorated post July CPI, likely to improve by Q4 FY24 as inflation likely moderates to 5% levels



While near-term outlook stays of an unchanged Repo rate, G-sec spread can compress when there is a greater clarity on rate cuts



- Bond yields tend to move in advance of policy rate cuts
- G-sec yields have fallen by 40-60bps across the curve in last six months as rate hiking cycle matures and likely comes to a pause.
- Valuation appears neutral when compared to its own long-term history (irrespective of monetary cycle stage) and when compared to equity earnings yield.
- However, spreads tends to compress ahead of and during monetary easing.
- Valuation still favors staying invested in Indian fixed income

Source: Bloomberg, RBI, SBIMF Research

FIIs bought ~US$ 3 billion in Indian fixed income between Apr'23-Aug'23

India witnessed Debt inflows in August'23

EM FII Debt inflow US$ million	2021	2022	Jun-23	Jul-23	Aug-23
India	(1,525)	(2,012)	1,237	379	899
Mexico	(12,668)	3,949	1,747	298	446
Ukraine	283	(1,096)	198	(21)	(68)
Indonesia	(4,906)	(7,070)	1,073	591	(486)
Thailand	6,550	6,227	(269)	958	(1,057)
South Africa	(13,276)	(15,812)	(79)	(692)	(1,891)
China	1,32,282	(1,46,410)	(69,585)	(58,014)	(46,994)
Brazil	(14,913)	18,473	(5,678)	-	-
Poland	(7,089)	6,940	899	-	-
Bulgaria	273	1,053	4	-	-
Malaysia	2,976	(732)	338	1,655	-
Czech Republic	1,279	(14,477)	-	-	-
Philippines	3,900	6,334	(654)	-	-

FII flows in India are muted despite healthy inflation adjusted returns

Real rates	10 Year Gsec Yield (% mth end, Jul'23)	CPI Inflation JuLY'2023	Real Rate (%, 10 year G-Sec Yield minus CPI)	12M FX forward premium (in %) - July 2023	10 year G-sec yield adjusted for 12m fwd premium (in %) - July 2023
South Africa	11.5	4.7	6.8	9.4	3.0
Brazil	10.8	4.0	6.8	5.2	6.1
Mexico	8.8	4.8	4.0	12.2	-3.4
Indonesia	6.2	3.1	3.1	6.3	0.1
China	2.7	-0.3	3.0	2.2	0.5
Thailand	2.6	0.4	2.2	2.0	0.5
Malaysia	3.8	2.0	1.8	2.9	0.8
South Korea	3.8	2.3	1.5	2.8	0.7
Phillippines	5.4	4.7	0.7	6.4	-1.0
India	7.2	7.4	-0.3	1.8	5.2
Taiwan	0.5	1.9	-1.4	1.0	-0.5
Colombia	10.2	11.8	-1.6	13.2	-1.9
Poland	5.4	10.8	-5.4	7.0	-1.0
Hungary	7.3	17.6	-10.3	12.7	-5.1
Turkey	18.8	47.8	-29.1	57.0	-45.0

Increase in withholding tax from 5%-20% from July 01 and lack of visible progress in Index inclusion remain hurdles even as macro and currency backdrop remains favourable.

Source: CEIC, Bloomberg, RBI, SBIMF Research; NB: '-' implies data not available for the respective country

Debt Outlook: Near term cautiousness on duration

- US 10-year treasury yields rose by almost 55bps m-o-m by mid Aug to reach 4.3%.It is now closer to 4.10 levels. Jackson Hole Symposium underscored the possibility of more rate hikes. Increase in US treasury bond supply and better than expected US growth are other factors to explain UST rise. At the current levels, US fixed income outlook looks neutral in the near-term.
- Indian bond yields have traded in a narrow range and has just moved up by 20bps from its May's lows.
- Recent months have seen food inflation concerns. CPI inflation could stay above 6% upper target for next new months. RBI MPC has opined to closely watch the evolving inflation trends and perhaps watch out the impact of various supply side measures taken by the central government.
- August MPC kept repo rates unchanged. Emphasis was on liquidity through the introduction of Incremental CRR to drain out excess liquidity on account of ban of 2000 rupee notes- and align the overnight rates closer to the Repo rate (in line with their policy stance).
- Global developments and food inflation concerns has pushed out the monetary easing possibility in India.
- In the wake of depreciation pressure on Chinese currency, domestic policy makers may also lean towards a weaker rupee. That said, overall external account fundamentals are healthy.
- In the very near-term, owing to pushing out of rate cuts possibilities, and better than expected US growth, we run a slightly cautious stance on duration and would look for an opportune time to build it back.
- Higher corporate bond and SDL supply are getting absorbed, leaving the spreads benign. As liquidity moderates in 2H FY24, spreads could get retested.

Source: Bloomberg, SBIFM Research

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