From CIO's Desk
PGIM India Alternatives

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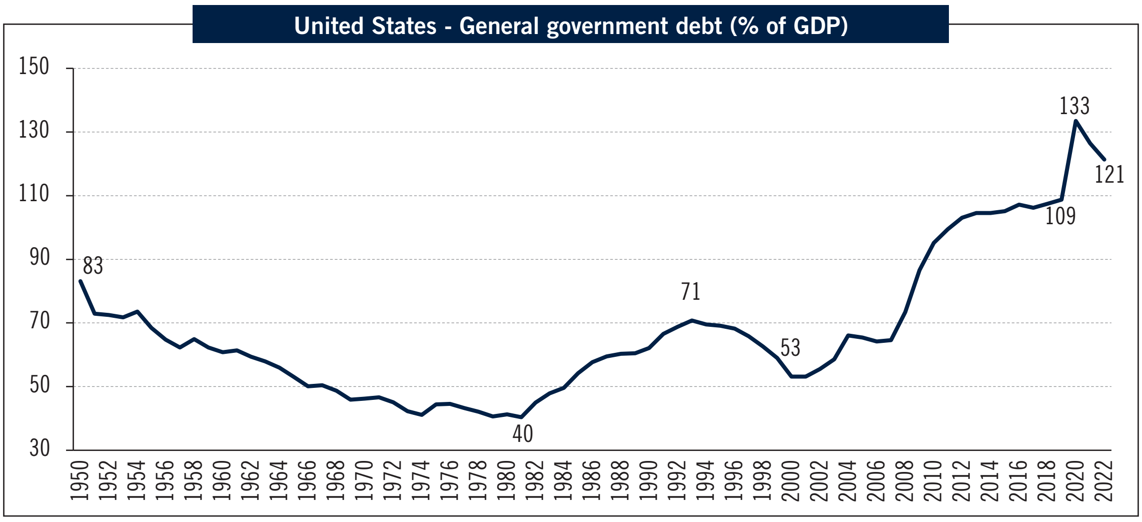
Wish you all a fantastic 2024.

The start of the year, presents a mixed bag for the global and Indian economy.

Globally, the world is inundated in debt (see Chart 1) like never before and interest rates are at the highest levels seen since the last decade. A slowing global economy and range bound crude keeps the hope alive for lower inflation prints and a subsequent cut in interest rates. The hopes are quite high for interest rate cuts into calendar year 2024.

Chart 1: United States Government Debt Outstanding

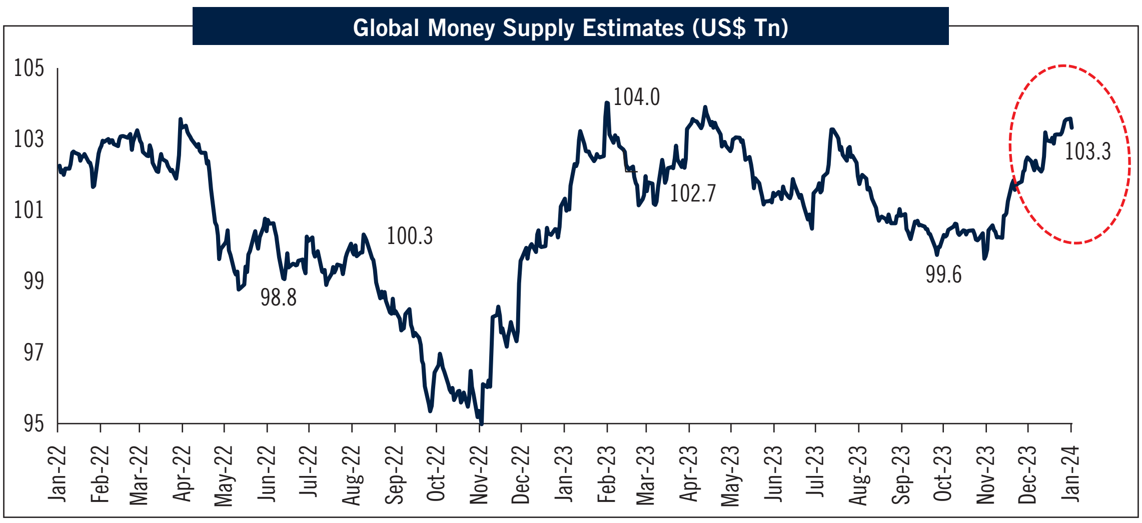


Source: Spark Capital, PGIM India

The Cold War between the US & western world and China & Russia, and actual conflicts between Ukraine and Russia and the conflict in the Middle East has broken down conventional supply chains across the world. Self-sufficiency goals of nations have taken precedence over procurement from the most efficient producing nation. This invariably builds in some inefficiencies which manifests as inflation.

The amount of money printing (see Chart 2) which has happened post Covid, will also push money supply high, which leads to increased demand and inflation.

Chart 2: Global Money Supply Estimates



Source: Spark Capital, PGIM India

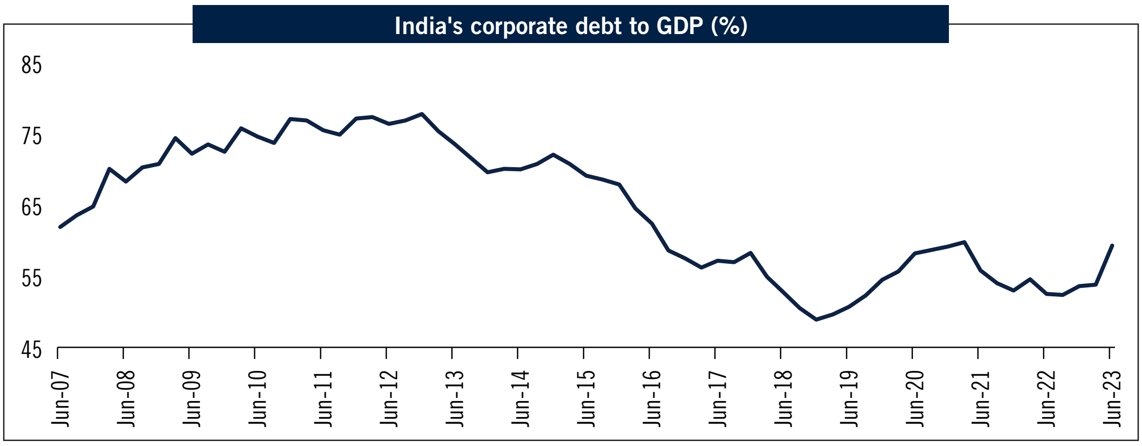
Given that inefficiencies in supply chain and higher money supply both induce inflation, it is unlikely that inflation will come off meaningfully, unless, a collapse of M2 Money supply or extended high inflation kills demand, leading to a slowing economy, inflation cooling off and rate cuts follow.

In such an uncertain environment, India seems to be well positioned both on the balance sheet and the profit growth prospects.

While evaluating the balance sheet of the country, we look at:

Corporate Balance sheets: Corporates, across market capitalisations, have cleaned up debt over the last 5-6 years. Even small & microcap (we evaluated companies up to 1000crs market cap), have got pristine balance sheet, which lend a lot of resilience to the corporate sector. The deleveraging cycle came at the cost of capacity addition, and today capacity utilisation is near to 75% across many segments (in some segments beyond 80%), which is one of the reasons to be positive on the capital expenditure (capex) cycle. Unlevered balance sheet and high capacity utilisation is a potent combination for corporate capex recovery.

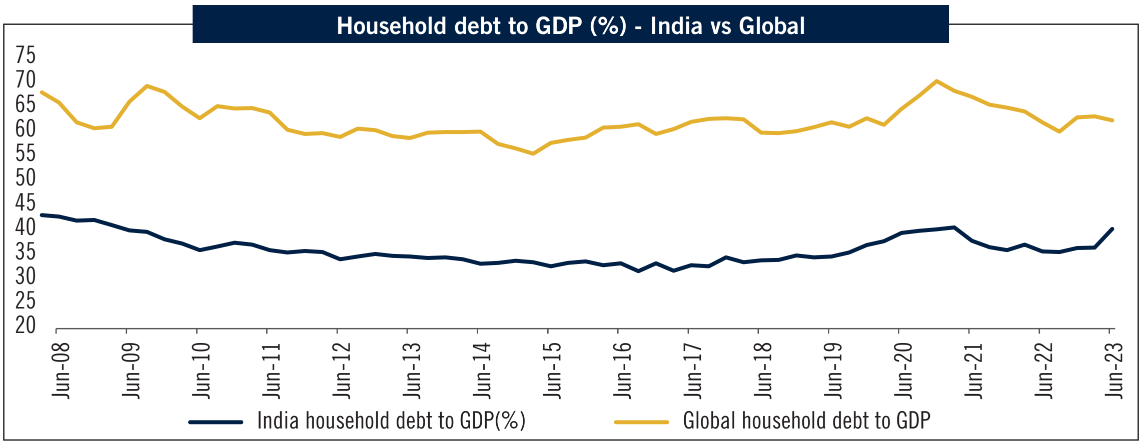
Chart 3: India's corporate debt to GDP ratio has eased



Source: Nuvama, PGIM India

Personal balance sheets: Indians have generally been savers and debt on personal balance sheets have generally been restricted to housing debt, vehicle loan or credit cards. Off late the RBI has sounded caution, on the growth of unsecured personal debt, but as a percentage of savings, debt on personal balance sheet is comfortable.

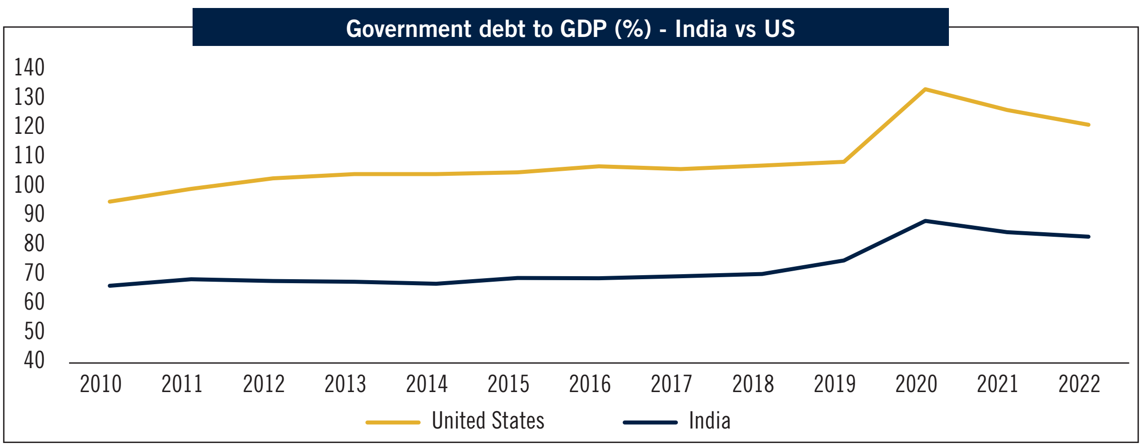
Chart 4: India's household debt to GDP is low compared to global levels



Source: Nuvama, PGIM India

Government Balance sheet: The central government has been prudent while managing their fiscal deficit and highlighted towards a path of fiscal prudence. Higher tax buoyancy, strong forex reserves, reasonably stable crude and currency have all aided in the government's fiscal discipline. A higher crude price and some fiscal relaxation (given this is an election year), could be the risks one can foresee. India's government debt as a proportion of GDP appears to be comfortable as compared to many of the global peers.

Chart 5: India's government debt is at comfortable levels



Source: Nuvama, Spark Capital, PGIM India

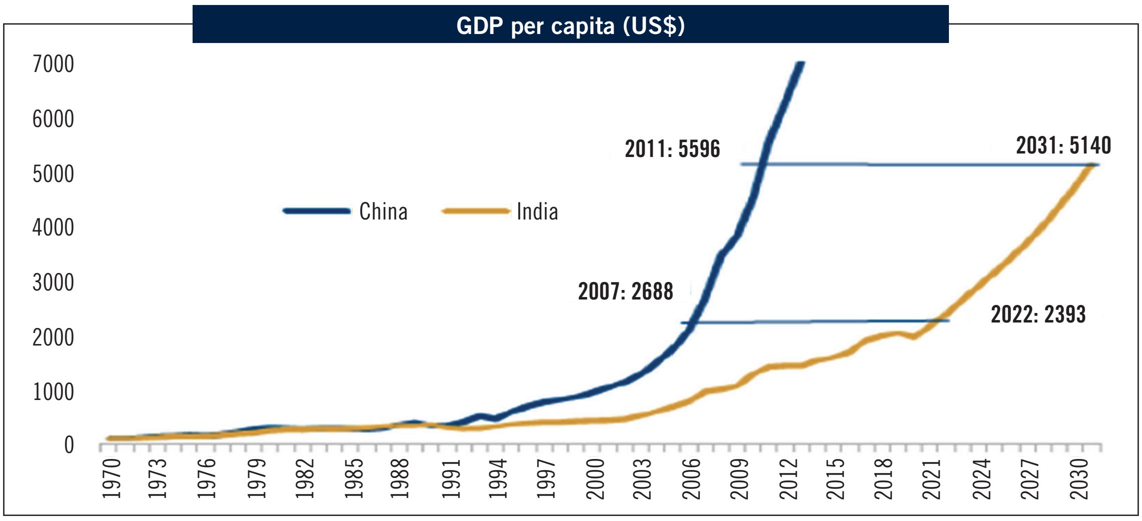
Banking balance sheets: The banking system has come out of an asset quality cycle and today most banks have good asset quality with adequate provisioning. The banking system is very well capitalised and the Central bank has been prudent in keeping hawk's eye on any kind of excesses across the Financial sector.

With this in mind, we identified four trends, which we believe shall play out over the next 5 years and longer. We discuss the trends, which we believe have long term potency in India.

Discretionary Consumption: India is a young population and the per capita GDP has crossed the $2,000 mark and stands at approximately $2,200. Globally, a young population and a per capita GDP rising beyond $2,000, has invariably triggered a hockey stick pattern in the rise in discretionary consumption. Whether it is travel, tourism, hotels, liquor, jewellery, personal grooming, electronics, consumer durables, real estate, two and four wheelers, etc., all these segments tend to do well over long periods of time. India will likely produce the largest Middle class over the decade providing a big boost to the consumption theme, in our view.

Let me share an anecdote to highlight how even in consumer staple segment like tooth paste, discretion is available for the paying customer. My first visit to a departmental store in Hong Kong introduced me to 16 different kinds of Colgate tooth pastes. India's journey of discretionary consumption will likely be the journey from 6-7 different tooth pastes to the 16+ over the decade as people go up the value proposition ladder.

Chart 6: GDP per capita rising beyond $2,000 marks an inflection point

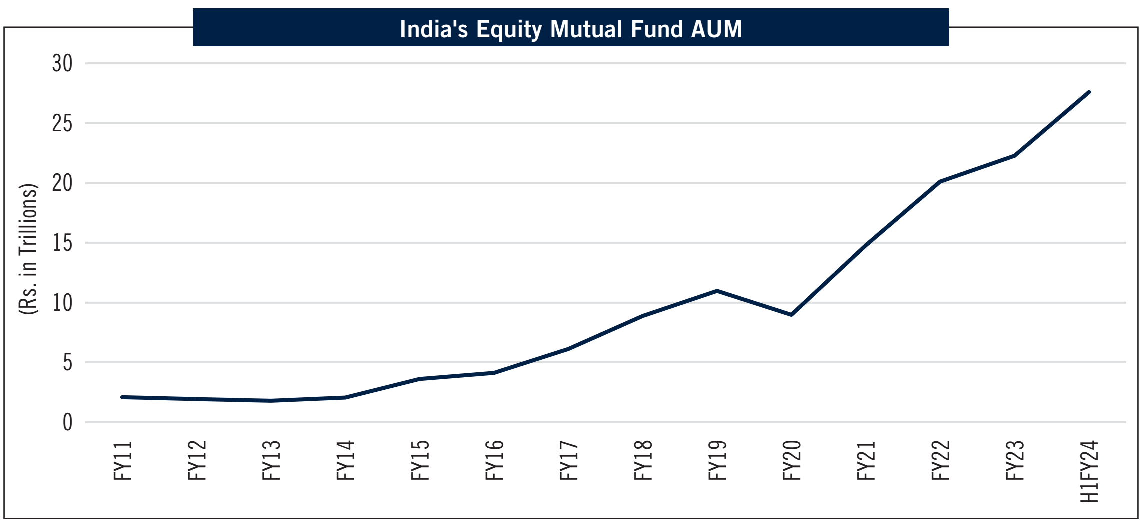


Source: CEIC, Morgan Stanley Research estimates

A sub-segment of discretionary consumption will be Healthcare. COVID-19 has increased health awareness among people. People are now pre-empting doctor's requirements, by getting themselves tested for simple blood tests to an ECG. People are more conscious about healthy living and healthy diet. Over the long term, hospitals, diagnostic chains and any economy system related to healthy lifestyle is likely to do well in our view.

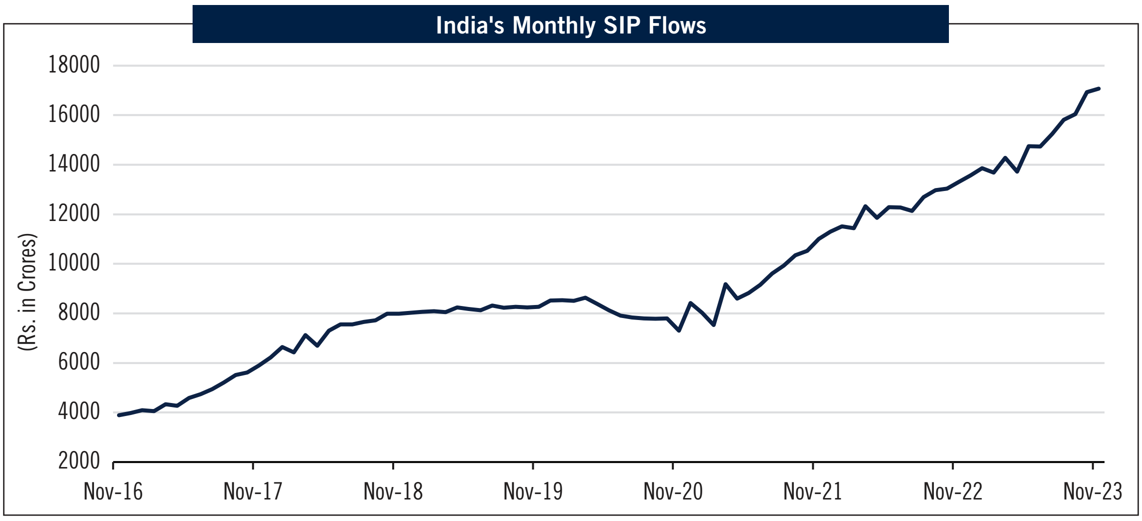
Financialisation: The journey of financialisation is best reflected in the growth in the Mutual Fund industry AUM and monthly SIP numbers of around $2bn monthly. There is a clear indication of cheap and idle money moving out of the banking system and chasing returns, either through MFs (debt, hybrid or equity), PMS, AIFs or even direct equity. This will reflect positively over the full value chain of companies, which participate in this financialisation story, whether rating agencies, asset management companies, exchanges, wealth management platforms or the back-end enablers. We believe, this trend of financialisation may play out structurally over the next decade.

Chart 7: Indian Equity Mutual Fund's AUM grew at 28% CAGR in last 10 years



Source: Nuvama, PGIM India

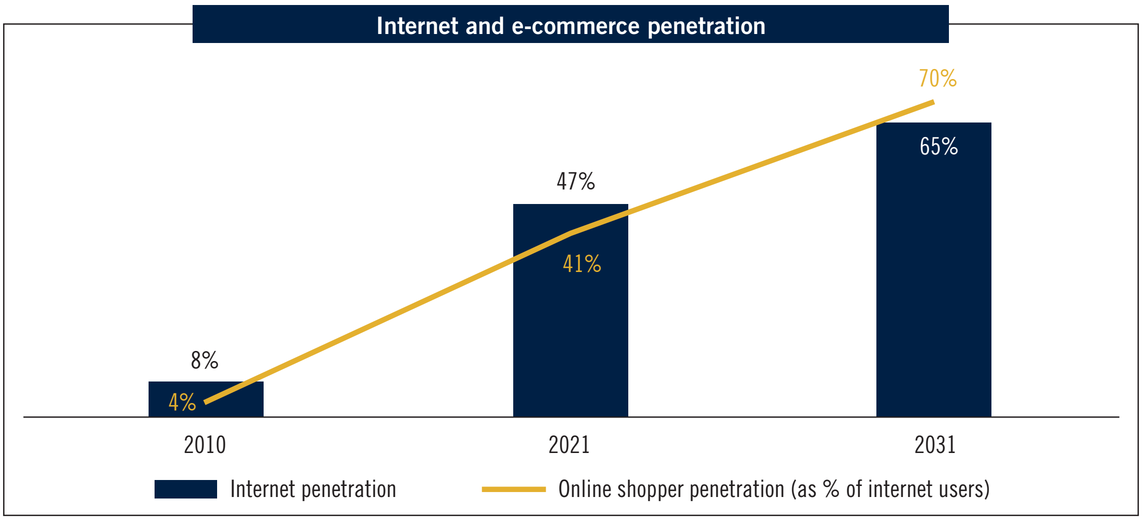
Chart 8: Monthly SIP Flows in India have been scaling new highs



Source: Nuvama, PGIM India

Digitization and technology: This trend may be the most disruptive over the decade. Conventional distribution channels are getting challenged. It may see small and midcap companies with good products and services doing well, in our view. Enablers like low cost and internet availability, Aadhar seeding, UPI backbone and now with ONDC taking shape, the markets will open up for companies across products and services. The country is also a reservoir of very interesting technology-based businesses in the unlisted space, and has one of the highest number of unicorns, scientists and technocrats globally. The combination of the above enablers and potential growth, should see very interesting small and midcap companies emerge and potentially become large caps over the decade.

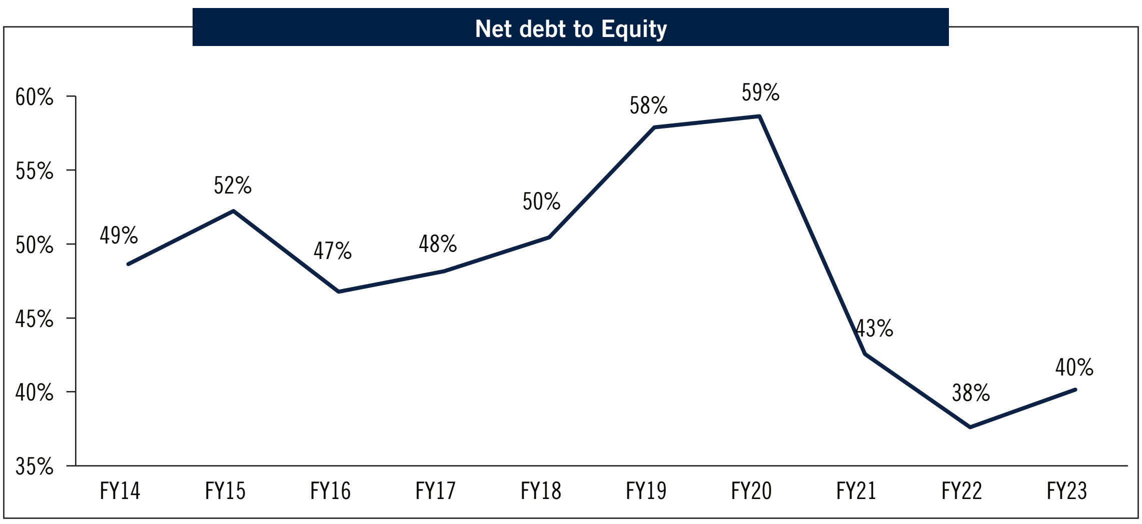
Chart 9: Rising internet and e-commerce penetration presents growth potential for India



Source: Morgan Stanley

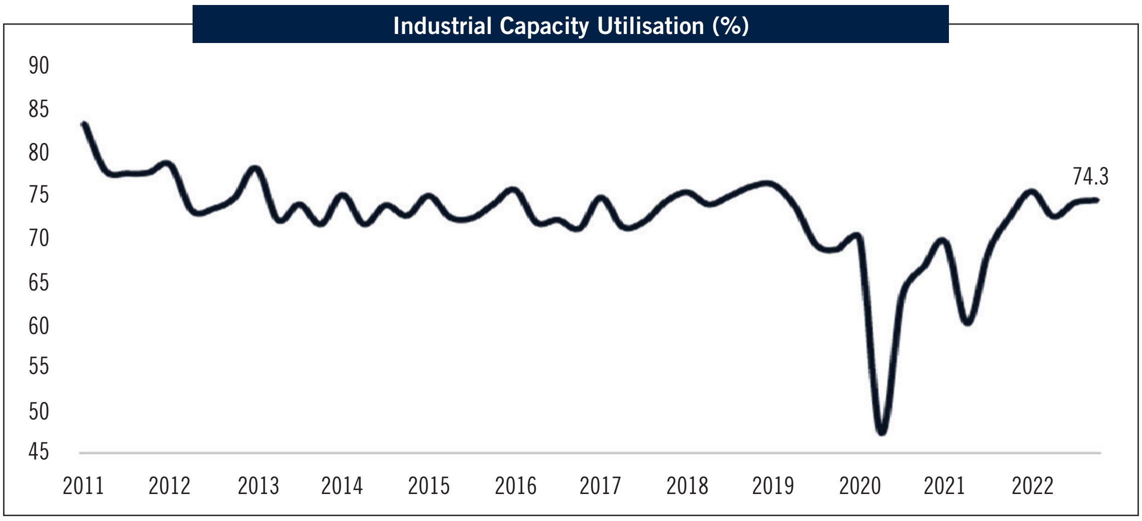
Private sector capex: As highlighted at the start of the note, Corporate India is sitting on a clean balance sheet and rising capacity utilisation. This is incentivising promoters and corporates across sectors to set up capacity. Capex is happening across electronics, auto and auto ancillary, power, consumer durables, pharma, cement, chemicals, textiles etc. Interestingly, this time capex is measured and largely funded through internal cashflows. Increased demand, may lead to increased capacity utilisation, potentially leading to a strong operating leverage playing out and an associated upswing in profitability for Corporate India. The beneficiaries may be both, the companies which execute the orders and companies, which have set up capacities to meet higher demand.

Chart 10: Corporate India's balance sheet has strengthened



Source: Spark Capital, PGIM India

Chart 11: Corporate India's capacity utilisation has surpassed the pre-pandemic level



Source: Spark Capital, PGIM India

These 4 trends, given their potency and long term nature, may lead to businesses doing well over a period of time.

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