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2025 Outlook

January 2025

2024 saw Developed market equities outperform, particularly US equities, a second consecutive year of outperformance. Gold price rallied 30 % in 2024 and has risen 1.5x in the last three years. The US Dollar continued its trend of appreciation.

Heading into 2025, it seems that the markets are placing little emphasis on any significant risks to economic growth. At present there is fiscal policy support across the pacific, and the intent so far seems intact.

The key monitorable will be the direction US economic policy takes. The in-coming Trump administration's policies could cause a disruption in the growth-inflation trade-off, potentially influencing the policy direction of the US Fed and central banks worldwide. This has been the reason that despite a start to monetary easing cycle, developed market bonds experienced their fourth consecutive year of lacklustre or negative return. With inflation still above the target level, the durability and effectiveness of policy easing in the US remains in question.

If the new US administration's policy mix leads to the Fed maintaining status quo on rates, central banks globally will likely follow suit, particularly if US tariffs provoke a retaliation or currency depreciation and raising inflation in respective economies. There is an ongoing debate on whether tariffs will end on their own or be used as a tool, like sanctions, to extract concessions from other countries.

Looking ahead to 2025, the evolving US tariff regime poses risks to Chinese manufacturing investment, with exports facing potentially significant headwinds, necessitating a pivot towards stimulating stronger domestic demand, particularly consumer spending. Unlike previous stimulus packages focused on infrastructure, the most effective growth driver now may be boosting household consumption. As a result, commodity producers and machinery exporters may not see the same benefits as in previous stimuluses.

In India, we expect both monetary and fiscal policy to increase their focus on growth incrementally. Monetary policy could go slow on the macro prudential tightness and support liquidity (though we do not rule out a shallow rate cutting cycle too). Fiscal policy on the other hand, could go slow on fiscal consolidation and reduce the fiscal deficit by a mere 20-30bps vs. 80-90 bps each year in FY24 and FY25.

In the upcoming union budget 2025, we hope for some enhancement to revenue expenditure and positive changes in the income taxes. Policy support could help India's growth to recover to ~7% in FY26 from an expected 6.3% in FY25.

2025 could start with a relative out-performance in investment growth over consumption growth. That said, given the hope for policy support, consumption outlook could turn brighter through the course of 2025. Global trade outlook currently is unexciting, though India continues to gain market share in select sectors and could be the last target of US adverse policies. However, unlike 2021 and 2022, exports are unlikely to be the mainstay of India's growth.

Rupee has depreciated around 3% in 2024. Dollar strength on the back of Trump's stated policies is leading to lack of FII enthusiasm for EM nations. These problems get compounded by deterioration in India's basic balance. India's external account has shifted from comfort to caution, and the biggest reason is the sharp slowdown in net FDI due to dual factors of reduced fresh inflow and sharp jump in repatriation.

Thus, so long as investors continue to buy into the Trump trade and favour the US dollar, the rupee is likely to have a depreciation bias. With a heavy dip in FX reserves, we observe that the RBI's is allowing the rupee to adjust a bit. One would logically believe into an end for the dollar rally, and most likely with the turn of the year, but given the elevated forward book, a word of caution on rupee remains. We believe the Rupee could weaken further in line with broader dollar strength and relative movement against other currencies.

We are sanguine on the outlook for India's retail inflation. Two years of vegetable price rise would provide a strong favourable base. And it isn't like consumer demand is overheating, thus core inflation could stay under control. We have factored in a 15-20% telecom tariff hikes around mid-2025 and continued 5-6% electricity annual tariff hikes. No material rise in transportation cost is also being a big help. Thus, CPI could average under 4.5% in FY26.

In terms of monetary policy, The RBI may need to adjust its liquidity and macro prudential measures to support growth, given that credit growth has slowed and deposit growth remains sluggish. A shallow rate cutting cycle cannot be ruled out.

The recent consolidation in the Indian equity market and some moderation in valuations is a welcome change. Yet despite these corrections, valuation's richness remains- more so for the broader market. We therefore expect the current consolidation to continue entering CY2025. From a longer-term standpoint, however, the Indian equity story continues to be supported by a healthy growth and earnings upcycle. The current turbulence should bring the focus back on fundamentals. We remain of the view that increasingly the market will become more discerning and move back towards companies which have strong business models, long-term earnings growth visibility and sustainable cashflows.

Overall, the macro dynamics at present remains constructive on Indian bonds. Fixed income yields across tenors continue to provide visibility of higher prospective real returns based on estimated forward-looking inflation. Apart from portfolio diversification, absolute yields as available more so in the shorter end of the curve are extremely compelling with high carry and possible roll down. All possible matrices for valuation including real returns, short term bond spreads etc remain compelling.

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Content

Global Economy: All eyes on the US policy

The global economy ended 2024 on a mixed note. After a small bounce in the Jul-Sep 2024 quarter, European data disappointed, while growth across much of emerging market economies seemed to be holding steady, with even some China data showing tentative signs of stabilisation. Once again, the US remained the resilient outperformer.

2024 Market Recap: US Equities Shine, Gold Glows, and Commodities Falter

Developed market equities, particularly in the US, saw their second consecutive year of outperformance. Despite a correction in the final quarter, MSCI India posted a 15% return for the year, with smaller market caps performing notably better. Gold performed strongly (up 30% in 2024), the US dollar strengthened by 7%, and the spread between emerging market (EM) and developed market (DM) bonds continued to narrow. While EM government bonds delivered positive returns, developed market bonds experienced their fourth consecutive year of lacklustre or negative returns. This occurred even as the US Federal Reserve began its monetary easing cycle. With inflation still above the target level, the durability and effectiveness of this easing remain in question. Brent crude prices fell despite rising geopolitical tensions, as demand remained sluggish. After a strong three-year run, industrial metals showed lacklustre performance, as China's growth failed to meet expectations.

Chart 1:
Equity market delivers second year of outperformance

2021	2022	2023	2024
Industrial metals (73%)	Brent (10%)	BSE Small Cap (48%)	Gold (30%)
BSE Small Cap (63%)	CRB Food (9%)	BSE Midcap (46%)	BSE Small Cap (29%)
Brent (50%)	DXY (8%)	MSCI DM Equity (22%)	BSE Midcap (26%)
BSE Midcap (39%)	India NIFTY (4%)	Industrial metals (21%)	MSCI DM Equity (17%)
CRB Food (35%)	Industrial metals (3%)	MSCI India (20%)	FTSE Global Equity (16%)
CRB Commodity (30%)	MSCI India (2%)	India NIFTY (20%)	MSCI India (14%)
MSCI India (27%)	BSE Midcap (1%)	FTSE Global Equity (20%)	CRB Food (14%)
India NIFTY (24%)	Gold (0.4%)	Gold (13%)	India NIFTY (9%)
MSCI DM Equity (20%)	BSE Small Cap (-2%)	EM fixed income (9%)	Precious Metals (7%)
FTSE Global Equity (17%)	CRB Commodity (-4%)	MSCI EM Equity (7%)	EM fixed income (7%)
DXY (6%)	Precious Metals (-11%)	DM fixed income (6%)	DXY (7%)
EM fixed income (-2%)	EM fixed income (-15%)	Precious Metals (2%)	CRB Commodity (5%)
Gold (-4%)	DM fixed income (-16%)	DXY (-2%)	MSCI EM Equity (5%)
MSCI EM Equity (-5%)	MSCI DM Equity (-19%)	CRB Commodity (-8%)	DM fixed income (-2%)
DM fixed income (-5%)	FTSE Global Equity (-20%)	Brent (-10%)	Brent (-3%)
Precious Metals (-9%)	MSCI EM Equity (-22%)	CRB Food (-13%)	Industrial metals (-18%)

Source: Bloomberg, SBIFM Research; NB Barclays Global Aggregate represents developed market fixed income, EM Aggregate total return Index represents EM fixed Income

Markets Eye 2025 with Optimism

2025 promises to be an interesting year in so many ways: politically, geopolitically, economically and certainly from a policy standpoint.

Markets are looking into 2025 through an optimistic lens. Post the US election, a still robust US economy, expectations of hefty corporate tax cuts, a broad deregulatory agenda and, seemingly, a view that the worst outcomes for global trade will be avoided, have pushed US stocks higher. In Asia, China is promising looser monetary and fiscal policy to support growth on the mainland. Japan sees support from rising income and consumer spending.

As we enter 2025, the market seems to be placing little emphasis on any significant risk to growth. Policy support for growth appears intact, and consumption demand in the US is expected to remain stable and perhaps improve in China and Europe.

Table 1:
Growth expectations across key economies

Median GDP projection (%)	2023	2024E	2025E
US	2.9	2.7	2.7
Eurozone	0.4	0.8	0.8
Germany	-0.3	-0.1	0.7
UK	0.4	0.9	1.4
India	7.0	6.3	6.8
China	5.2	4.8	4.5

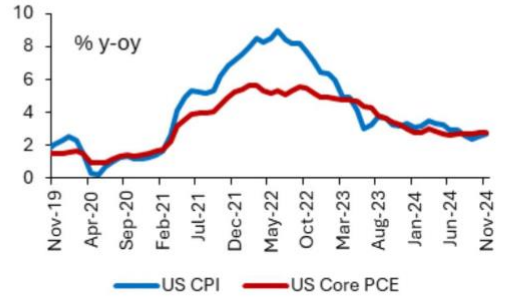
Source: Bloomberg, SBIFM Research; NB 2024 and 2025 are Bloomberg estimates; India estimates are SBIFM research estimates for the fiscal year; 2024E represents FY25 estimates, 2025E represents FY26 estimates

Disinflation Stalls and Diverges Across Global Regions

The global inflation landscape has become more complex and uncertain. Disinflation has stalled in many regions and is now less synchronized. The downward pressure from falling energy prices and supply chain improvements has weakened, while factors such as fiscal and monetary policies, labour market tightness, and productivity growth have gained prominence.

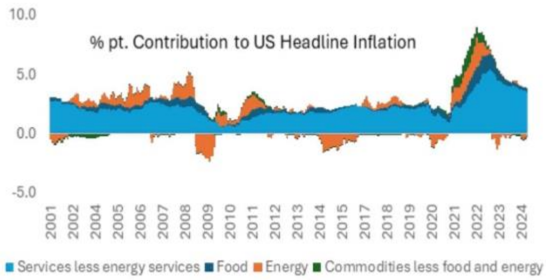
The deflation in goods prices for US consumers may have reached its limit. Inflation and consumer spending growth in the US will also be influenced not just by the size and scope of tariffs, but also by how much of the cost increase is offset by currency movements or absorbed by profit margins. Restrictive immigration may contribute to stickier services inflation in the US.

Chart 2:
US CPI inflation has flatlined around 2.5-3% since June 2024



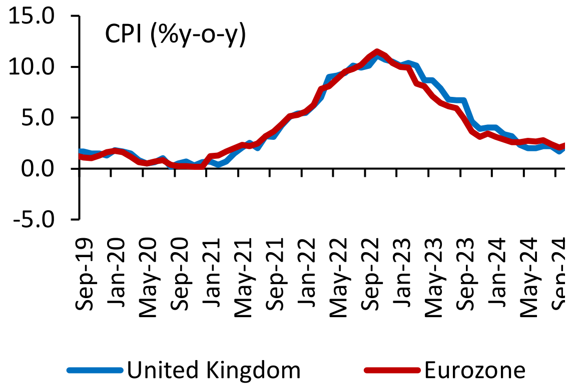
Source: Bloomberg, SBIFM Research

Chart 3:
Benefits of better supply chain, lower commodity inflation already in the price



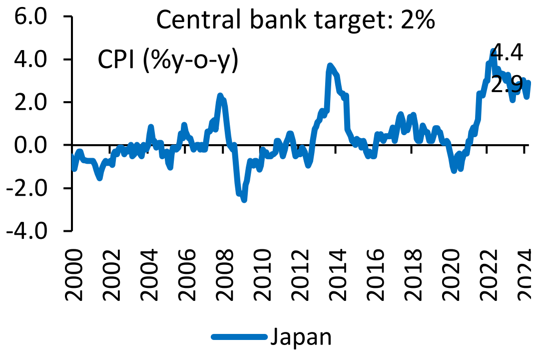
Source: Bloomberg, SBIFM Research

Chart 4:
CPI moderation has also stagnated in developed market economies



Source: Bloomberg, SBIFM Research

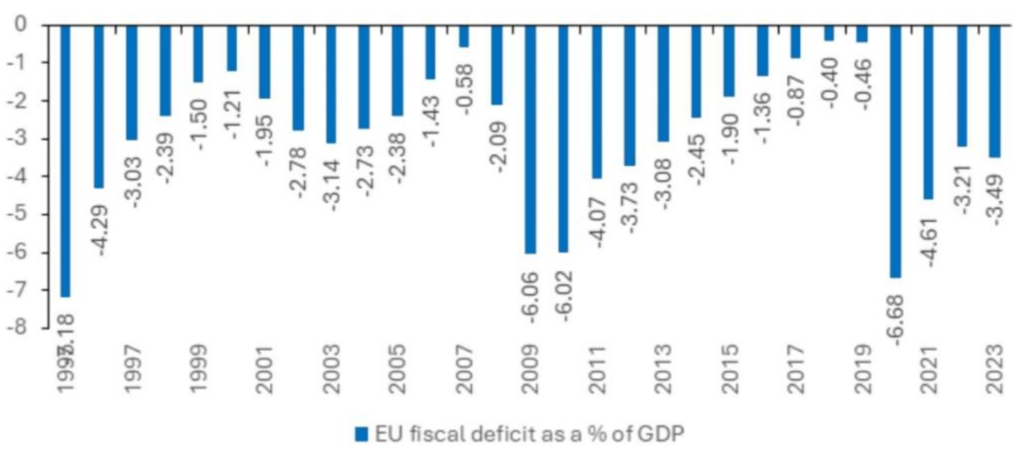
Chart 5:
Japan CPI ~3% driving monetary tightness



Source: Bloomberg, SBIFM Research

Japan's CPI inflation lingered around 3% in 2024 and may see only a modest moderation in 2025 as structural labour shortages trigger higher wage revisions. In Europe, fiscal policy remains somewhat restrictive, while gas prices have gradually risen throughout 2024, directly impacting headline inflation and firm costs. Supply increases may take longer. On a positive note, oil prices have stayed relatively stable, even amidst ongoing geopolitical instability.

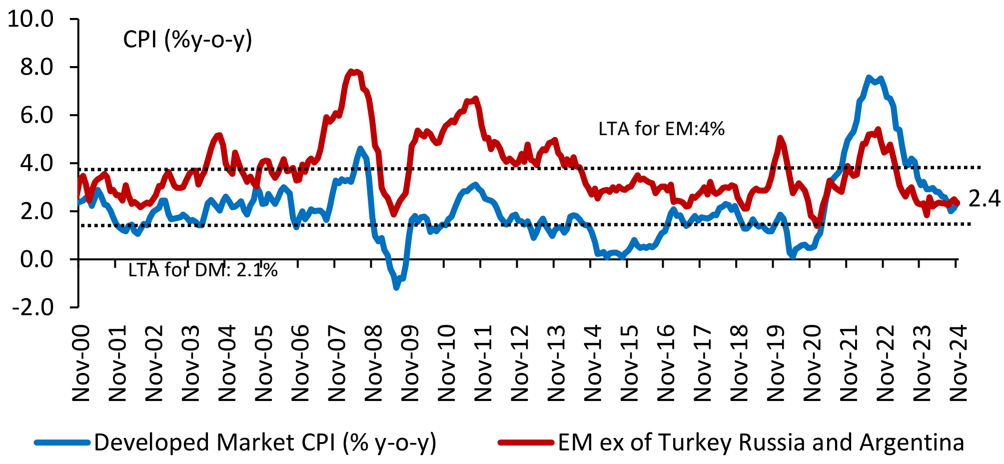
Chart 6:
Eurozone sees restrictive fiscal policies



Source: Bloomberg, SBIFM Research

Barring a few exceptions, such as Turkey, Russia and Argentina, Emerging market inflation is in line with long term trends, and rather well behaved. That said, climate change and rising volatility in global food supply and prices are a perennial risk for EM economies. Globally, food prices—especially for commodities like coffee and cocoa—are higher and food continues to have a larger weight in the CPI basket for the EM nations, further contributing to inflation.

Chart 7:
EM inflation is better behaved...



Source: Bloomberg, SBIFM Research

Chart 8:
..... though food prices are rising off late

Source: US FAO. SBIFM Research

In summary, disinflation has stalled globally, with inflation levels remaining higher than pre-pandemic levels for developed economies. Inflation trajectories are increasingly divergent across regions, and there is a high chance that inflation has settled to a new normal post COVID demanding a reassessment to the neutral rate for key economies.

Table 2:
Inflation expectations across key economies

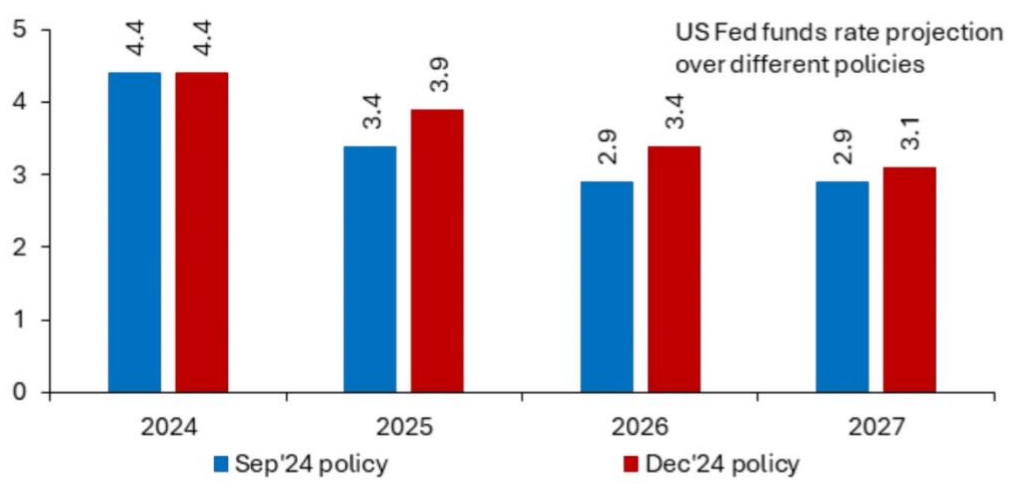
Median CPI projection %	2023	2024E	2025E
US	4.1	2.9	2.9
Eurozone	6.4	2.4	2.0
Japan	3.3	2.6	2.1
UK	7.4	2.5	2.4
India	5.4	5.0	4.3
China	0.2	0.4	0.4

Source: Bloomberg, SBIFM Research; NB 2024 and 2025 are Bloomberg estimates; India estimates are SBIFM research estimates for the fiscal year; 2024E represents FY25 estimates, 2025E represents FY26 estimates

US policies may keep Fed rates high, pushing global central banks to follow

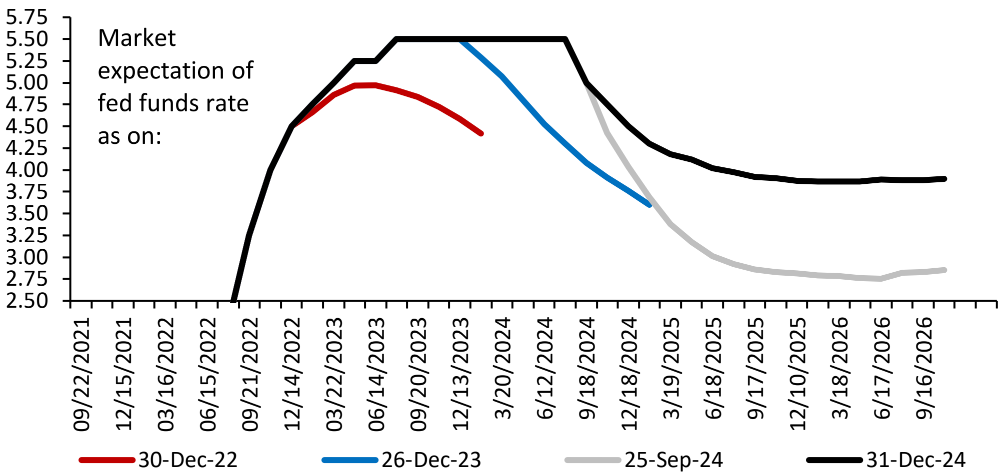
Global monetary easing cycle has begun and is expected to continue in 2025. Yet, the consequent positive reaction in fixed income assets remain elusive. US Fed has lowered the policy rate by a cumulative 100bps from 5.25-5.5% to 4.25-4.5% between September and December 2024. However, the outlook for cuts has narrowed with the projected rate cuts for 2025 being reduced from 100bps to 50bps.

Chart 9:
Projected rate cuts for 2025 reduced from 100bps to 50bps



Source: Bloomberg, SBIFM Research

Chart 10:
Market pricing for rate cuts has been more aggressive than actual monetary easing



Source: Bloomberg, SBIFM Research

Many post-election proposals, if enacted, could shift the FOMC's view on the neutral rate and the extent of necessary easing. On the policy front, the end to 2024 has just been the opposite to that of 2023. Back in December 2023, the Fed Chair added two more cuts in its 2024 guidance and the market went even more aggressive. In December 2024, the Chair took away two cuts from its guidance, but this time the market is in sync with the Fed Dot plot. Even as 2024 appears to be starting on a more realistic note in terms of expectations, there could still be negative surprises in store.

If the new US administration's policy mix leads the Fed to maintain a status quo on rates, central banks globally will likely follow suit, particularly if US tariffs provoke retaliation or currency depreciation, raising inflation in respective economies. The USD has already strengthened against multiple currencies, driven by expectations of higher tariffs, stronger US growth, and increased inflation.

All eyes on the US policy

The Trump administration's key agendas include corporate tax cuts, deregulation, stricter immigration policies, and higher tariffs. These policies are expected to drive inflation and improve corporate profits, potentially boosting economic activity.

While Trump has shown a preference for a weaker dollar, he may use tariffs and social media to influence currency values. However, broader economic fundamentals are likely to dominate. Trump's tariffs could weaken the Chinese Yuan, which, combined with a stronger US dollar, might lead to marginal depreciation of the rupee.

While tax cuts could happen soon, the impacts of tariffs and immigration policies may be felt more quickly. Given the high inflation that contributed to Trump’s election, his administration might approach fiscal, immigration, and trade policies more cautiously to avoid further inflation. Repatriating undocumented immigrants may affect labor supply and costs in some sectors. However, the president-elect has indicated room for legal immigration, crucial to US growth.

Inflation and consumer spending will depend not only on tariffs but also on how much of the cost increase is offset by currency fluctuations or absorbed by profit margins. Restrictive immigration policies could contribute to persistent inflation.

Overall, the Trump administration's policies could lead to a deterioration in the growth-inflation trade-off, influencing Fed policy and central banks worldwide. Tariffs may also weaken the currencies of affected nations. There is ongoing debate on whether tariffs will end on their own or be used as a tool, like sanctions, to extract concessions from other countries.

China's Economic Rebound Relies on Further Policy Support for Consumer Spending

China's manufacturing investment has remained stable despite an overall subdued growth in fixed asset investment. Looking ahead to 2025, the evolving US tariff regime poses risks to Chinese manufacturing investment, with exports facing significant headwinds. It remains unclear how much China can offset this by diversifying trade beyond the US.

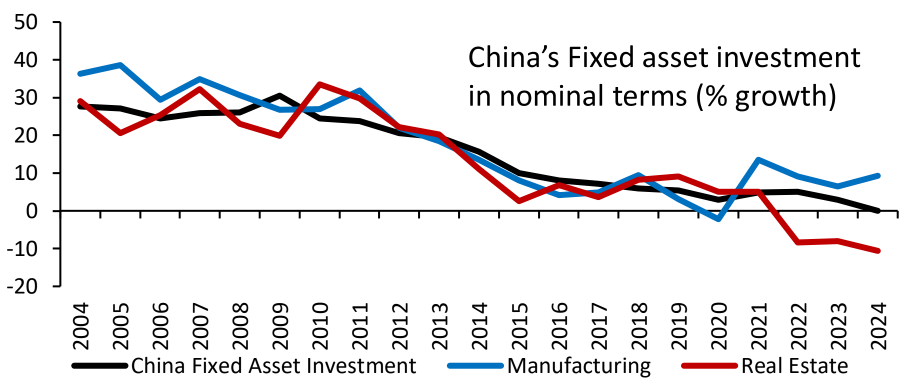
This export risk highlights the need for stronger domestic demand, particularly consumer spending. While some consumer goods sales have improved due to government trade programs, these measures don't suggest a sustained consumption recovery. Low consumer confidence, driven by poor employment prospects, raises concerns about the potential for private consumption growth without continued state support.

The December Politburo meeting called for more policy support, with the Central Economic Work Conference outlining measures like increased pensions and medical subsidies, to be implemented in 2025. Monetary easing and fiscal support, including a large local government debt swap, are expected to stabilize growth.

Unlike previous stimulus packages focused on infrastructure, the most effective growth driver now may be boosting household consumption. As a result, commodity producers and machinery exporters may not see the same benefits as in past Chinese stimulus.

Chart 11:

US trade policy could weigh down on China's manufacturing and exports which had been driving China's growth



Source: Bloomberg, SBIFM Research

Chart 12:

Property sector seems to have bottomed out- some sign of stabilisation

Source: Bloomberg, SBIFM Research

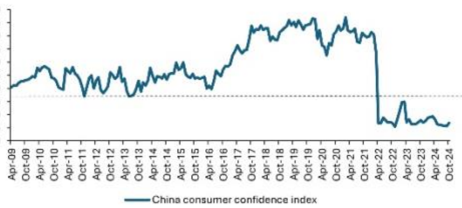
Chart 13:

Retail sales growth in China has stabilized

Source: Bloomberg, SBIFM Research

Chart 14:

Consumer confidence stays weak



Source: Bloomberg, SBIFM Research

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India: Will growth get prioritized in FY26?

In India, the economy showed signs of a moderate slowdown. The growth was dragged down by slowdown in spending around the general elections and relatively higher than typical weather anomalies this year which derailed construction activity. The high frequency indicators for October and November suggest some revival in growth. We believe rural consumption and higher government spending in the remainder of the fiscal to lift growth for 2H FY25.

Namrata Mittal
Chief Economist

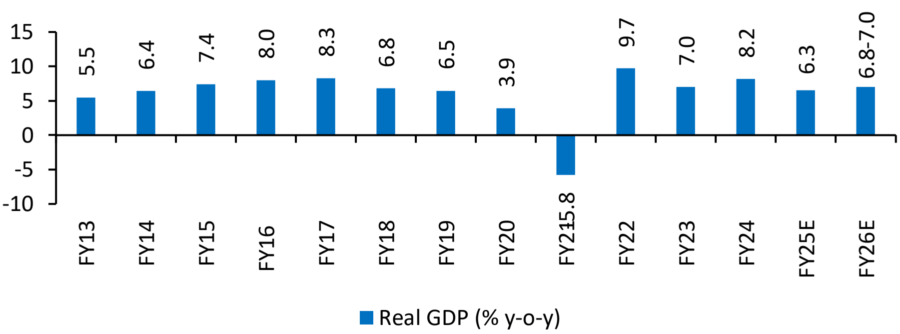
Varnika Khemani
Economist

Table 3:
Real GDP- quarterly and annual growth

	% Share in GDP (5Yr avg)	% y-o-y						% y-o-y						
		FY19	FY20	FY21	FY22	FY23	FY24	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24	Q1 FY25	Q2 FY25
Real GDP	100	6.5	3.9	-5.8	9.7	7.0	8.2	6.2	8.2	8.1	8.6	7.8	6.7	5.4
Private Consumption	57	7.1	5.2	-5.3	11.7	6.8	4.0	1.5	5.5	2.6	4.0	4.0	7.4	6.0
Govt. Consumption Spending	10	6.7	3.9	-0.8	0.0	9.0	2.5	13.9	-0.1	14.0	-3.2	0.9	-0.2	4.4
Gross Capital formation	35	11.0	-2.6	-7.4	21.1	5.5	9.4	3.3	7.5	10.7	11.5	8.0	7.1	5.9
GFCF	32.5	11.2	1.1	-7.1	17.5	6.6	9.0	3.8	8.5	11.6	9.7	6.5	7.5	5.4
Change in Stocks	0.9	27.3	-58.7	-76.4	525.4	14.5	5.9	18.2	1.2	10.2	7.5	5.0	5.6	1.3
Valuables	1.5	-9.7	-14.2	29.9	32.5	-19.1	21.2	-23.6	-21.0	-0.9	63.9	72.8	-11.4	14.4
Exports	22	11.9	-3.4	-7.0	29.6	13.4	2.6	12.4	-6.6	5.0	3.4	8.1	8.7	2.8
Imports	23	8.8	-0.8	-12.6	22.1	10.6	10.9	-0.4	15.2	11.6	8.7	8.3	4.4	-2.9

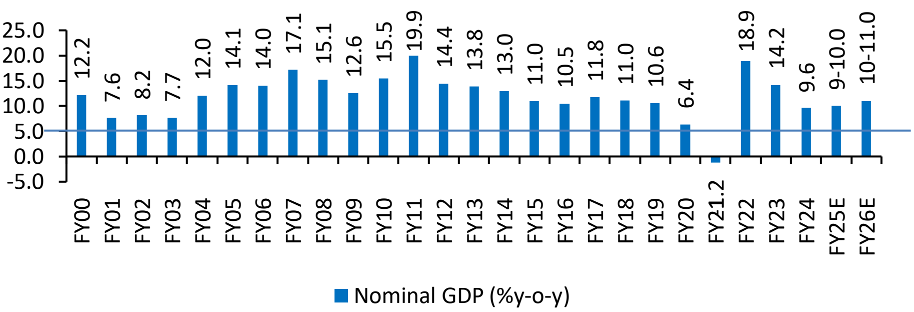
Source: CMIE, SBIFM Research, NB: Green highlights the top growth drivers in a particular financial year

Chart 15:
Policy support could help India's growth to recover to ~7% in FY26



Source: CMIE, SBIFM Research

Chart 16:
Nominal growth in FY26 could pick-up modestly to 10-11% from 9-10% in FY25.



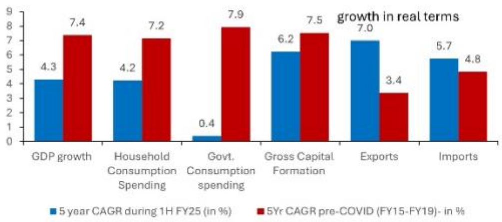
Source: CMIE, SBIFM Research

Over the last two years, fiscal policy focused on consolidation and tax buoyancy, while monetary policy prioritized inflation control and financial stability. In FY26, we expect both monetary and fiscal policy to increase their focus on growth at the margin. Monetary policy could go slow on the macro prudential tightness and support liquidity (though we do not rule out a shallow rate cutting cycle too). Fiscal policy on the other hand, could go slow on fiscal consolidation and reduce the fiscal deficit by a mere 20-30bps vs. 80-90 bps each year in FY24 and FY25. In the upcoming union budget 2025, we hope for some revival to revenue expenditure and positive changes in the income taxes. Today, the challenge is that India is supply side ready where banks can extend credit and corporate can leverage but an adequate demand thrust is missing. Policy support could help India's growth to recover to ~7% in FY26 from an expected 6.3% in FY25.

Investment Set to Outperform Consumption in FY26

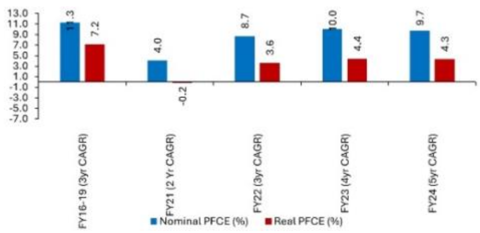
A year has now become too long a time frame in the investment world. But we think that 2025 could start with a relative out-performance in investment growth over consumption growth. In the very near future, a sharp thrust to consumption demand is lacking. We are worried that recent clampdown on household credit could weigh down the credit led consumption growth in India. Urban sector wage growth and hiring also seems to be moderating, and urban consumer sentiments has weakened in 2024. That said, given the hope for policy support (mostly fiscal), consumption outlook could turn brighter through the course of 2025.

Chart 17:
Consumption demand has been weak post COVID



Source: CMIE, SBIFM Research

Chart 18:
Volume growth in consumption has been weaker



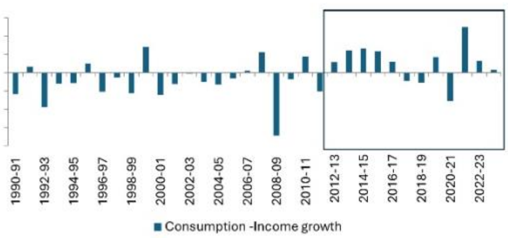
Source: CMIE, SBIFM Research

Leveraged consumption on the rise in last 12 years…

Chart 19: Consumer spending weak

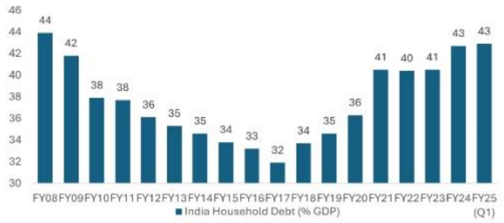
Source: Ace Equity, SBIFM Research; NB: Consumer spending is derived by looking at net sales of consumer-oriented sectors in the listed space. Sectors included are Auto, alcoholic beverages, Consumer durables, Jewellery, Ecommerce/ App aggregator, Edible oil, FMCG, Healthcare, Hotel & Restaurants, Leather, paint, Printing and stationary, Quick Service Restaurants, Apparels, Real estate, Retail, Telecom, Tobacco products

Chart 20: Consumption growth outpaces income growth



Source: CMIE, SBIFM Research

Chart 21:
Household debt to GDP near 2007 peak



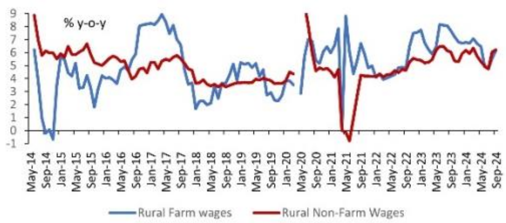
Source: CMIE, SBIFM Research

Chart 22:
Urban salary growth is weakening

Source: CMIE, SBIFM Research

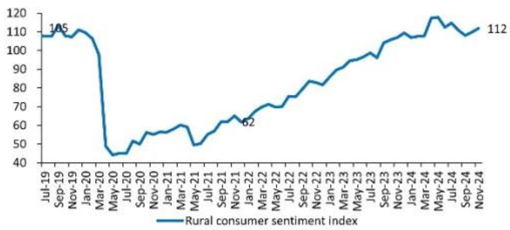
Rural economy is looking better than the urban with a tad better wage growth. Rural prospects also get some support from the combined effect of a) stabilizing price pressures b) some positive rub off from welfare schemes c) positive flow of income owing to pick-up in construction and infrastructure activities. In 2024, the Agri exports had been low. This had impacted the realized income of farmers despite a healthy output this Kharif season. As of now, Rabi prospects are looking good as gauged from the reservoir levels, sowing trends and the relaxation of exports.

Chart 23:
But some uptick in rural wages



Source: CMIE, SBIFM Research

Chart 24:
Rural sentiments are recovering at margin

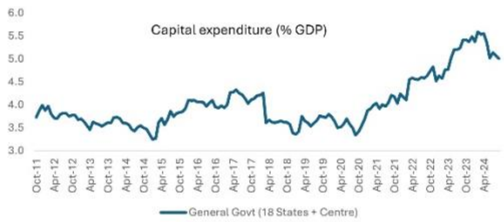


Source: CMIE, SBIFM Research

Looking at the demographic profile of Indian households, the lower income class continues to be supported from rising welfare spends (particularly at the state levels) and the plethora of social security protections (free food grain, MGNREGA, LPG subsidy, free electricity by states, medical insurance under Ayushman Bharat, housing subsidy and so forth). The Upper income community is reaping the positive wealth effect from equity market and real estate gains, which could continue to support their spending leisure activities and investment in real estate and jewellery. It is the middle class which continues to reel under the pressure of muted wage growth, no government benefits and reduced purchasing power under rising prices. Currently, per various surveys, this class forms at least one- third of Indian households and is the primary driver of mass consumption. In this regard, a favourable tax adjustment to personal the income taxes or GST rates could catalyse consumption growth in India.

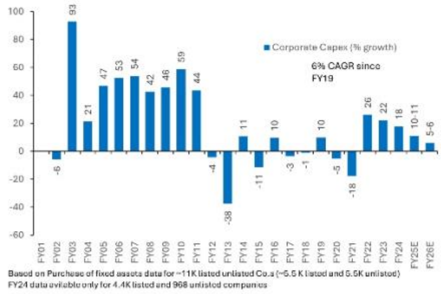
Government's capex (centre and state combined) had grown at a ~30% CAGR during FY22-24, driving up government capex to GDP (via budgetary support) all the way up from ~4% of GDP to ~6% of GDP by end FY24. The government capex thrust has likely plateaued, and overall budgetary capex spend may at best grow in line with India's nominal growth (while state could even cut down to fund welfare schemes).

Chart 25: Government capex to GDP



Source: CMIE, SBIFM Research

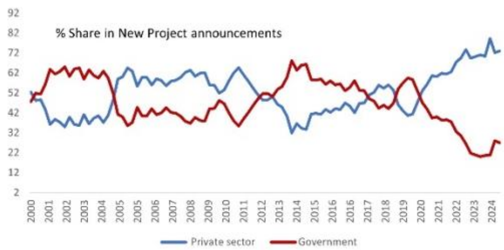
Chart 26: Corporate capex growth



Source: Ace Equity, SBIFM Research

As per the CMIE's new project announcement, the share of private sector in the new projects announced had taken over the government sector projects. In our analysis of ~10K listed unlisted companies, corporate capex (both public and private sector), had grown at a 15% CAGR in the last four years (FY22-FY25). However, now along with moderating government momentum, and a healthy capacity addition in multiple sectors, corporate capex (public and private combined) is also likely to moderate to mid-single digits in FY26 and FY27. Some of the capex-oriented sectors, such as commodity space (metals, cement, Oil & Gas & Sugar), chemicals and cap goods, capex is flattening out on a high base.

Chart 27:
New projects envisaged by private sector surpasses government projects



Source: CMIE, SBIFM Research

Chart 28:
RBI's tracking of private corporate capex intentions gives a positive read

Source: RBI, SBIFM Research

Within corporates, it is largely power (renewables and transmission capex) and the auto sector (both auto and auto anc. ex of CV space) that are driving an incremental capex growth in coming years. The power sector is witnessing significant capacity addition in the renewable and transmission space. As per the ordering awareness, the annual capex in transmission is likely to jump from Rs. 120bn per annum to Rs. 450 bn per annum from FY26 onwards for the next several years. Similarly, as per the order awards sitting in the books of several companies, annual capacity addition is likely to jump from 15-16 MW to 45 MW starting FY26. Hence there is a threefold jump in renewable capex starting FY26.

The auto sector is running at full capacity. The two-wheeler industry has seen a healthy capacity utilization. Tyers, which is a capex intensive business, has seen a behavioral change in capex creation. Instead of lumpy capex, the sector has seen efficient utilization of resources and has been undertaking very methodical and regular capex in the last five to seven years.

Bearings has seen a portfolio expansion and has forayed into exports along with other products like automotive and industrial space. Hence the segment sees both export and replacement demand driving the capex is the respective companies. Forging and casting has seen the Indian companies has gained export market share from European businesses. Battery is another area of capacity creation. On the other hand, the sales have been weak in the commercial vehicle space. The under-utilization of CV capacity is driving a muted capex in the CV companies and the related ancillary space.

There could be an upside surprise in the textile sector. The telecom sector also seems to be promising for tangible asset creation in fiber and electronics space.

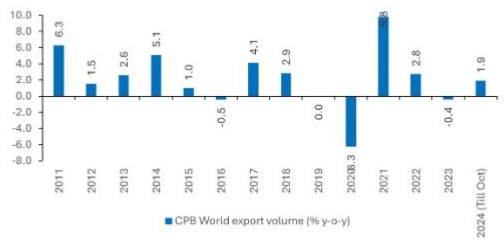
Looking at the real estate, 1H FY25 saw only ~30% of the FY25 launch guidance, due to slower approvals on account of elections. Launched are likely to pick up in coming quarters. Also, limited unsold inventory keeps us positive on the continued upcycle in the real estate.

Hence, while both consumption and investment growth lacks animal spirit, the outlook for capex is modestly positive and a tad better over consumption in the near-term

Global trade cycle remains wobbly

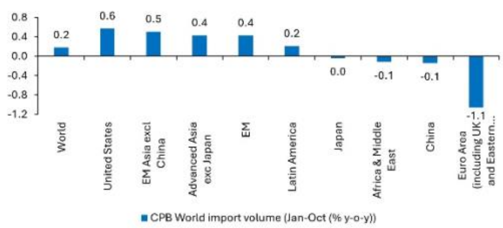
The WTO projects global trade volume growth to be around 2.7% in 2024. Asian exports and North American imports grew faster than anticipated in the first half of 2024, while European trade flows continued to decline, dampening global trade growth. Much of 2024's global export growth was driven by US demand and electronics trade.

Chart 29:
WTO projects global trade volume growth to be around 2.7% in 2024



Source: Bloomberg, SBIFM Research

Chart 30:
Much of 2024's export volume growth was driven by US demand



Source: CPB World Trade Monitor, SBIFM Research

In the near term, exports could stay supported as businesses frontload orders ahead of potential US tariffs. But beyond the near term, US policy around trade lends great deal of uncertainty to global trade outlook. While China is vacating some space in low-value-added products and India could be last on Trump's tariff radar, competition remains intense. As a result, relying on exports as a primary growth engine is becoming more challenging.

Table 4:
Indian economy is relative insulated and will not be as affect by a slowdown in US imports on account of tariffs

Share in US imports (%)	2018	2022	2023	2024 (1H)
Mexico	13	14	15	16
China	22	17	14	13
Canada	12	13	14	13
Japan	6	5	5	5
Korea, Republic of	3	4	4	4
Viet Nam	2	4	4	4
India	2	3	3	3
European Union (27)	17	17	19	19

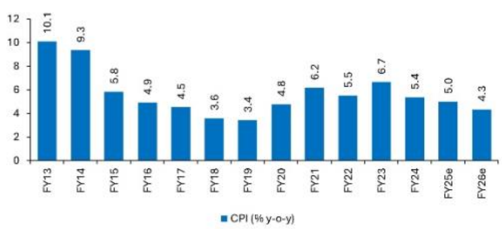
Source: ITC Trademap, SBIFM Research

Vegetable led disinflation in FY26

We expect CPI inflation to average at 4.3% in FY26 vs. a likely outcome of 5% in FY25, 5.4% in FY24 and 6.7% in FY23. Hence retail price pressures are moderating. We are sanguine on India's retail inflation. Two years of vegetable price rise would provide a strong favorable base. And it isn't like consumer demand is overheating, thus the core would stay under control (a modest rise built in estimates). No material rise in transportation cost is also a big help. CPI could average under 4.5% in FY26.

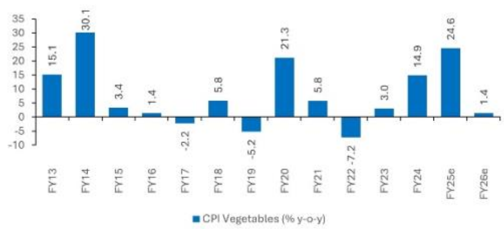
The entire disinflation is driven by vegetables. Ex of vegetables, CPI may rather rise a tad to 4.5% in FY26 vs. 3.7% in FY25 as the favorable base effect fades away in core and fuel.

Chart 31: CPI inflation to moderate



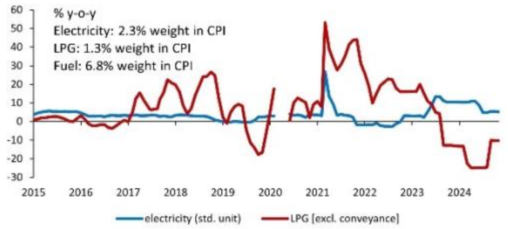
Source: CMIE, SBIFM Research

Chart 32: Vegetables offer high base



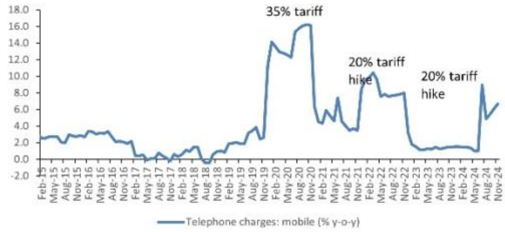
Source: CMIE, SBIFM Research

Chart 33:
Fuel inflation has been helped by multiple subsidies on LPG prices; Electricity may continue to see 5-6% tariff hikes



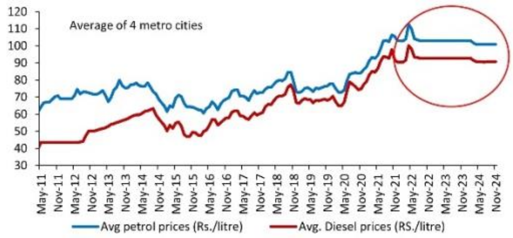
Source: CMIE, SBIFM Research

Chart 34:
Telecom tariff hikes are expected by mid-2025; though it is expected to be lesser in magnitude than the previous two hikes



Source: CMIE, SBIFM Research

Chart 35:
Petrol, diesel prices are flat- keeping core inflation contained



Source: CMIE, SBIFM Research

Chart 36:
Contained commodity prices would keep CPI goods inflation in check

Source: CMIE, SBIFM Research

Increasingly, we have been on the camp to believe that vegetable inflation was supply led- influenced by the dual factor of weather disturbances and government interferences. We suspect that as there is no major state election in 2025, government interference would reduce in 2025. Though, weather would always be a surprise element.

We continue to expect an elevated cereal inflation owing to the 5-7% MSP floor being put by the government. Further, FY25 was the year when export ban had kept a lid on the cereal inflation. Relaxation of export controls along with an expected 5-7% MSP hike could keep cereal inflation elevated at around 7-8% vs. around 8% this year too.

We do not sense the consumer demand to be robust enough to drive up core inflation. Though a low base could lead to marginally higher core inflation in FY26. Petrol diesel prices could stay range bound as broader global thesis expects crude prices to stay contained.

Even though rabi prospects look good, food prices vulnerability to weather have risen and hence that continues to be a risk to food inflation outlook.

Fuel inflation has been helped by multiple subsidies on LPG prices implemented by various states. While much of that may be in the base, we do not expect the subsidies to go away anytime soon. Electricity may continue to see 5-6% tariff hikes.

Telecom tariff hikes are expected by mid-2025. It is expected to be less in magnitude vs. the previous two 20% weighted average hikes in 2022 and 2024, which impacted the headline CPI by 20bps.

Rate cuts aren't an ideal answer to India's macro situation

Recent global developments of dollar strength, FII outlook and weakening rupee has clouded the prospects of policy rate cuts in India. Anyways, given that the current Repo rate (at 6.5%) is significantly lower than previous peaks of above 8% and growth just appears to be moderating, not crashing, rate cut, if at all could be very shallow (say 50bps) and would be highly data dependent.

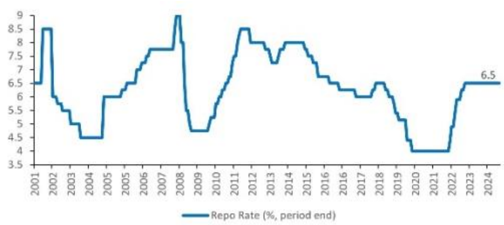
But rate cut isn't really a true answer to India's current macro situation.

Bank credit has moderated from ~16% in FY24 (adjusted for HDFC merger) to 11% now and there is a struggle for deposits. RBI has delivered 50bps of CRR cut (from 4.5% to 4%) in its December policy. While the market seems to anticipate the next action as being a Repo rate cut, a move to further ease the banking system liquidity and reduced regulatory tightness is the greater need of the hour to address India specific macro dynamics.

Interest rate works its way to growth via cost of funds channel. But today, the lack of industrial credit growth is not because the cost of funds is high but because of the lack of adequate topline growth in businesses or because of availability of other sources of funds- equity issuances being a case in point. That said, industrial credit offtake is picking up in India.

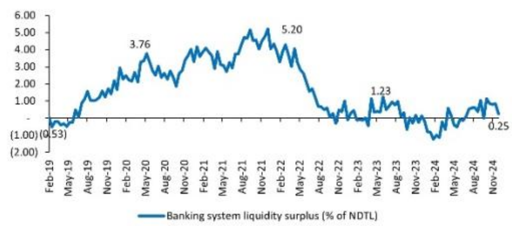
As industrial credit off-take begins to pick up, the RBI may need to consider other measures to ensure adequate liquidity within the banking system, rather than relying solely on interest rate adjustments.

Chart 37:
Repo rate unchanged since April 2023 policy at 6.50%



Source: RBI, SBIFM Research

Chart 38:
Banking system liquidity needs to be addressed



Source: RBI, SBIFM Research

Table 5:

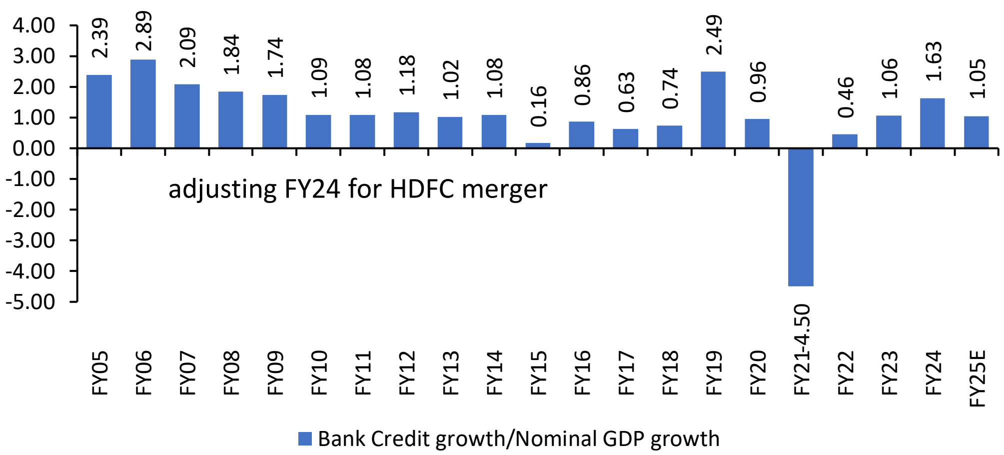
Bank credit growth in current financial year mostly on account of personal loans and loans to NBFC

CAGR (%)	2009-11	2017-19	2022-24	2025 (y-o-y)
Bank Credit	**18**	**15**	**11**	**12**
Non-Food Credit	**18**	**15**	**11**	**12**
Agriculture and allied activities	19	8	10	15
Industry	22	2	6	8
Micro & small	13	2	9	10
Medium	0	-1	8	20
Large	26	3	5	6
Services	18	15	14	13
Personal Loans	10	18	16	13
Consumer durables	4	-28	13	7
Housing (Including priority sector housing)	12	16	16	12
Advances to individuals against share, bonds, etc.	10	1	8	16
Credit card outstanding	-13	31	19	17

Source: RBI, SBIFM Research

Chart 39:

India's credit multiplier can improve



Source: CMIE, SBIFM Research

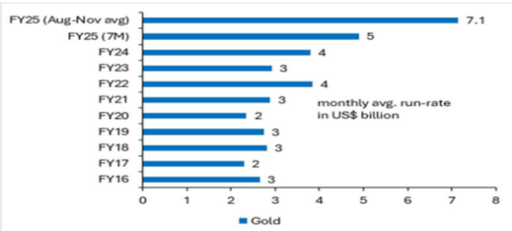
Plunge in Net FDI Inflows strains India's External Account- increasing the FII dependency

A dichotomy in the external accounts has emerged. The current account deficit remains modest (aided by healthy services exports, contained crude priced and a healthy flow of remittances), but capital inflows have fallen considerably. One of the most adverse developments for India is sharp fall in net FDI inflow and hence a deterioration of basic balance.

Fresh FDI inflow has moderated sharply while repatriation of existing investment continues to happen. Net FDI inflow between Oct -Apr 2024 is at a paltry US$ 2 bn. This has deteriorated the basic balance for India. Most likely, repatriation should abate after two back-to-back years of high outflow. That said, the fresh inflow also fails to show up.

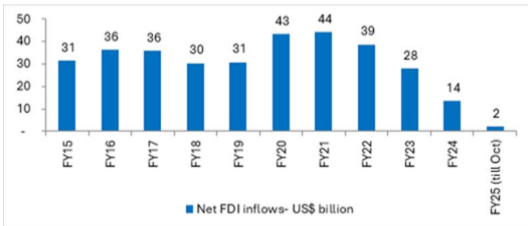
ECB has also remained negligible after the interest rate differential has narrowed down. This makes external account dependent on FII. After a surge in gold imports during Aug- Nov this year, one can hope for a more normalized gold import bill next year. Even as we expect CAD to be a mere 1.2% of GDP, the challenge is that even that reliable source of funding remains out of sight. On a positive note, FII trends should improve somewhere through the course of 2024 as the dollar story fades away, but this is not a very reliable source of capital inflow. And hence external account vulnerability has opened for FY26.

Chart 40: Gold import rose in FY25



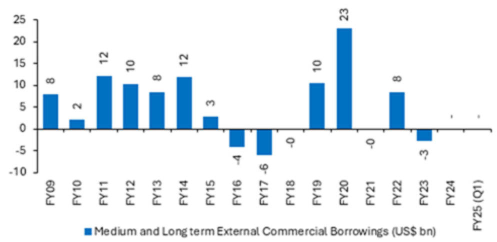
Source: CMIE, SBIFM Research

Chart 41: Net FDI inflow weak



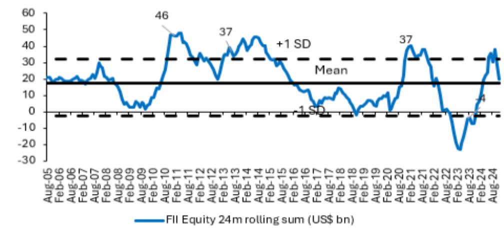
Source: CMIE, SBIFM Research

Chart 42: ECB inflows has dropped



Source: CMIE, SBIFM Research

Chart 43: FPI outflow may abate in 2025

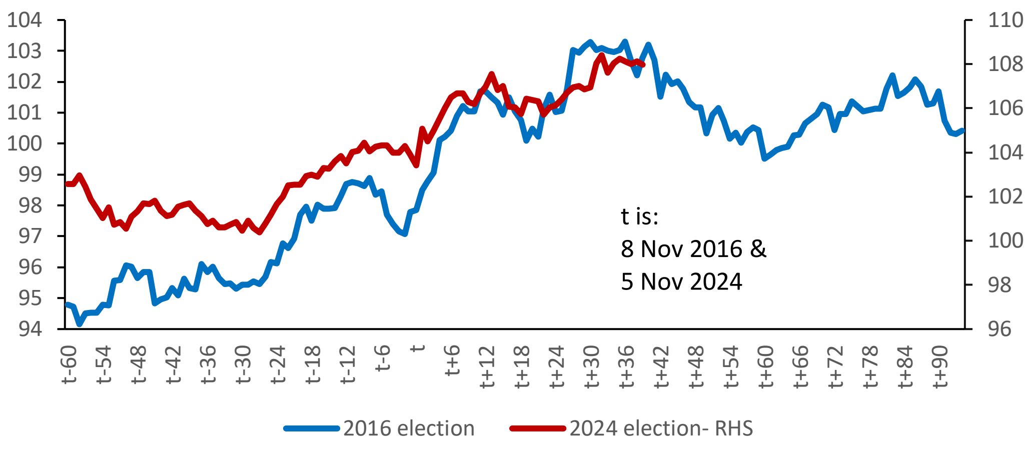


Source: CMIE, SBIFM Research

FX reserves have fallen since early October and domestic liquidity conditions have tightened. While modest inflows into equity markets returned in late November, uncertainty in the global backdrop could linger on. This makes liquidity situation prone to tightness and builds the case of RBI OMO. Consequently, the Rupee remains biased towards depreciation. The depreciation pressure on the Rupee is turning higher than earlier anticipated. Additionally, Trump's tariffs raise the possibility of a weaker Chinese Yuan (RMB), which, combined with a relatively strong US dollar, could increase rupee depreciation at the margin. We have always believed that Rupee has a stronger correlation to RMB than Dollar moves owing to a direct impact on export competitiveness. Though we do think that FY26 could be the year of two halves and most of the depreciation could fructify in first half. Rupee could trend to 87/US$ in FY26.

Chart 44:

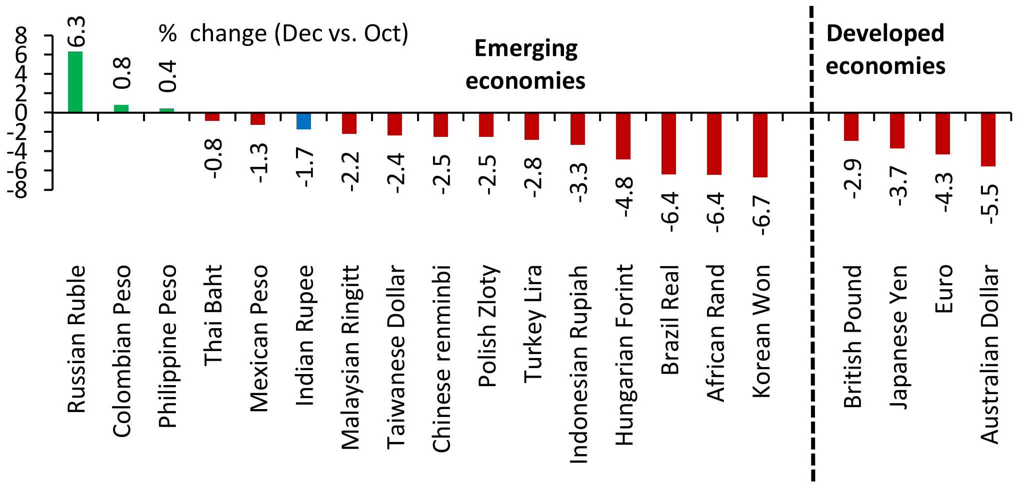
Dollar, so far, rhyming the moves of 2016



Source: Bloomberg, SBIFM Research

Chart 45:

Movement in Key currencies during October- Nov: Rupee has been the best performing currency



Source: Bloomberg, SBIFM Research

Equity Outlook

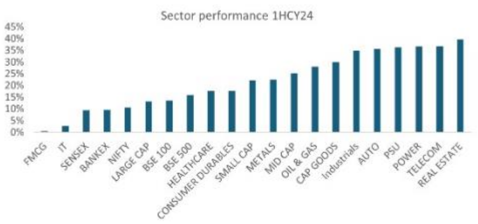
Gaurav Mehta
CIO, Alternatives

CY24 was a year of two very different halves for Indian equities. While the first half was characterized by unbridled optimism, the second half saw some normalization in market sentiment. There was a marked change in market complexion in the latter part of the year. Sector wise, cyclical sectors such as Real Estate, Power, Autos, Industrials, Metals, PSUs and Capital Goods amongst others saw strong outperformance in the first half of the year while defensive sectors such as Information Technology, Healthcare and Consumers underperformed significantly. In the second half, however, there was a significant role reversal with defensive sectors topping the charts as cyclical sectors significantly underperformed.

A similar dynamic was at play from a style standpoint too. While Value stocks did very well in the first half, and Quality stocks underperformed, the second half saw a comeback for Quality as Value took a backseat. For the year, momentum stayed a consistent performer and the best performing style. A continued normalization in market excesses, however, could pose a risk to Momentum stocks in 2025.

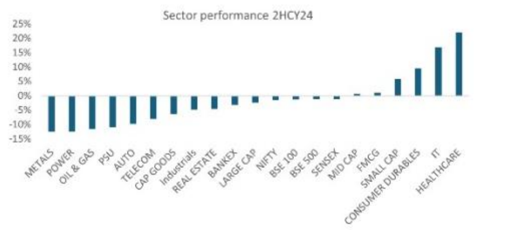
Also, market breadth started to deteriorate as the year progressed as evinced in a declining proportion of BSE500 stocks outperforming the BSE500 index.

Chart 46:
Cyclical sectors outperformed significantly in 1HCY24



Source: Bloomberg, SBIFM Research

Chart 47:
While defensive sectors did well in the second half



Source: Bloomberg, SBIFM Research

Value stocks outperformed in the first half only to falter in the second…

Chart 48:
Value Quintile Performances, 1HCY24

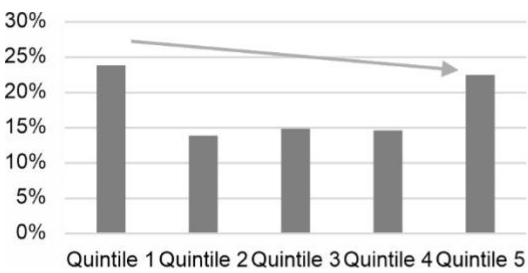


Chart 49:
Value Quintile Performances, 2HCY24

…while Quality stocks outperformed in the second half after underperforming in the first

Chart 50:
Quality Quintile Performances, 1HCY24

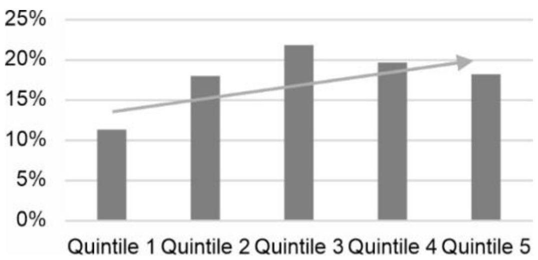


Chart 51:
Quality Quintile Performances, 2HCY24

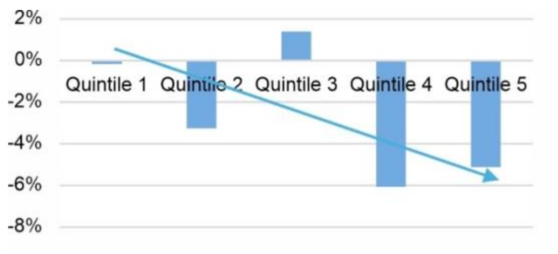
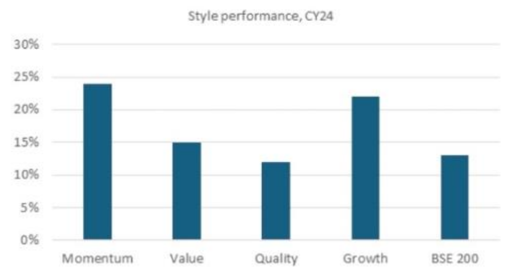


Chart 52:
Momentum was the best performing style in CY24



Source: Bloomberg, FactSet, SBIFM Research

Chart 53:
Breadth has started to narrow as proportion stocks outperforming BSE500 decline

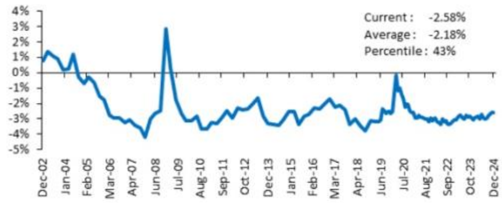
Source: Bloomberg, FactSet, SBIFM Research

We believe this shift in market complexion towards a more defensive positioning has been brought about by a combination of expensive starting valuations, stretched market sentiment earlier this year and slowdown in near term corporate earnings. The recent consolidation has been a welcome change with some moderation in headline index valuations as measured by earnings yield spread over bond yields as also some easing in equity market sentiment readings

on our proprietary measure. Yet on both counts we are not yet at levels denoting complete normalization of excesses. More importantly, broader market valuations stay significantly more elevated versus large cap indices, as measured through BSE500 market cap relative to Sensex market cap. **We therefore expect the current consolidation to continue entering CY2025.**

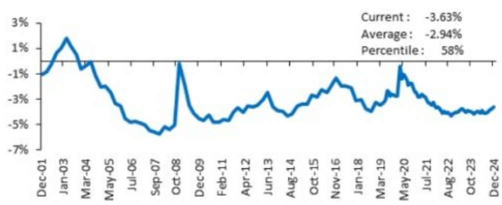
Large cap valuations have moderated on account of falling yields and market correction, not cheap yet

Chart 54:
Sensex trailing earnings yield minus bond yield (%)



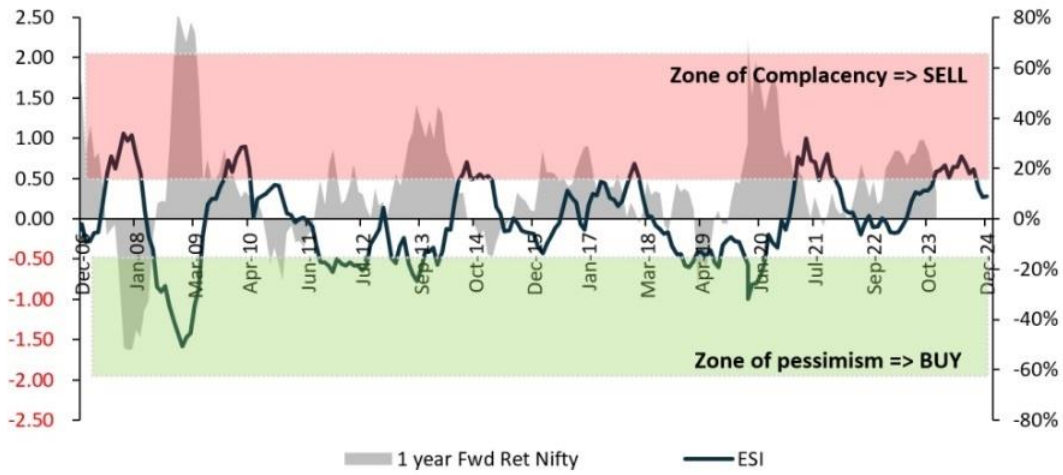
Source: Bloomberg, SBIFM Research

Chart 55:
Sensex cyclically adjusted earnings yield minus bond yield



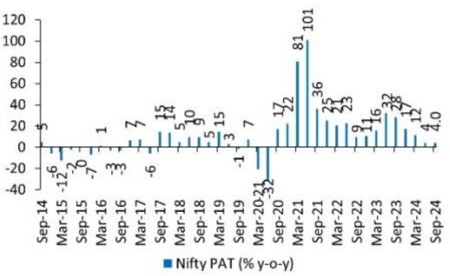
Source: Bloomberg, SBIFM Research

Chart 56:
Equity Market Sentiment has eased some, not neutral yet



Source: Bloomberg, FactSet, SBIFM Research; Note: ESI stands for Equity Sentiment Index

Chart 57:
Slowdown in earnings print…



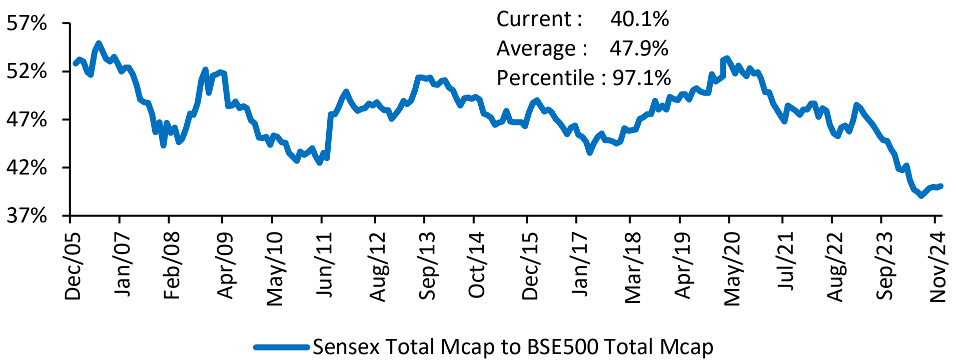
Source: FactSet, MOSL, Bloomberg, SBIFM Research. Earnings revisions index measures the breadth of earnings revisions in BSE100 Index.

Chart 58:
…as well as downgrades in earning expectations

Source: FactSet, MOSL, Bloomberg, SBIFM Research. Earnings revisions measures the breadth of earnings revisions in BSE100 Index.

Chart 59:

Valuations down the market cap spectrum stay significantly stretched relative to large cap indexes

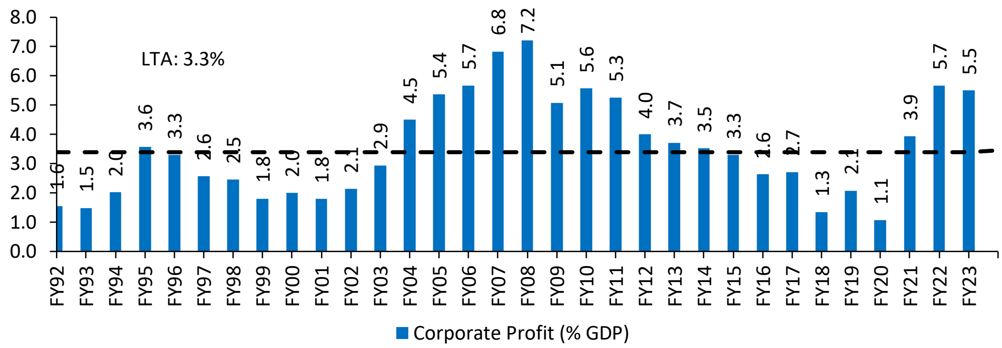


Source: Bloomberg, SBIFM Research.

From a longer-term standpoint, however, the Indian equity story continues to be underpinned by earnings upcycle, short term slowdown notwithstanding. India's corporate profits as a proportion of GDP have reverted higher over the past 4 years after secularly declining for 12 years between 2008-2020. We believe a revival in manufacturing, rising per capita GDP and an eventual recovery in the global economy on the other side of the current slowdown should be tailwinds to continue supporting a constructive earnings growth outlook over the mid-long term.

Chart 60:

Longer-term earnings trend stays encouraging with a reversion higher in profits to GDP ratio



FY92-FY23 data is based on a sample of ~30,000 listed unlisted companies in CMIE (includes both financial

The current turbulence, however, should bring the focus back on fundamentals. We remain of the view that increasingly the market will become more discerning and move back towards companies which have strong business models, long-term earnings growth visibility and sustainable cashflows. We therefore expect 2025 to be a year of significant deviation from the trend as markets become very selective amidst narrowing market breadth, as against the undiscriminating and broad-based up move of the past few years.

Fixed Income Outlook

Rajeev Radhakrishnan
CIO - Fixed Income

CY24 witnessed recurring bouts of volatility in global markets driven by the gyrations in US treasury yields. The year started with a dovish tilt by the Fed chair in the Dec 23 FOMC that led markets to price in about 150bps of rate cuts in CY24. However stronger data over Q1 led to yields moving up to around 4.7% by April 24, which subsequently moved lower to 3.61% in September as the FED initiated the rate cuts with a 50bps move following signs of labour market weakness. Subsequent data and the change in the US administration have led markets to price out the possibility of significant large cuts moving into CY25. The benchmark US 10Y has moved up almost 100bps since the FED initiated the first cut and closed the year at 4.56%. The other significant factor that has emerged is the broader trend of steeper yield curves. This has been more pronounced since the prospect of Trump 2.0 as the markets start to factor in lower taxes, higher tariff, above trend line inflation and higher fiscal deficits for longer.

Chart 61:
Volatility in UST remained a recurring feature in CY24

Source: CMIE, SBIFM Research

Chart 62:
..Even as the curve steepens on fiscal fears

Source: CMIE, SBIFM Research

With respect to the domestic markets, the broader consensus at the beginning of the year was that the RBI would ease policy rates at least in H2CY24. However, over the year even as the policy rate stayed unchanged at 6.50%, the benchmark sovereign yields moved lower by around 40 bps even as liquidity dynamics tightened materially in the last quarter. The sovereign curve continued to be supported by tailwinds in terms of fiscal consolidation, well matched demand supply dynamics, potential higher LCR requirements and steady inflows in terms of bond index flows. This largely offset the headwinds posed by higher global yields, sticky inflation and no change in RBI policy actions and even a shift in currency dynamics towards the last quarter.

Table 6:

Market levels over CY24- Duration outperforms, AAA curve inverts further

G sec	**31-Dec-23**	**31-Dec-24**	**Change**
3-year G Sec	7.08%	6.72%	-0.36%
5-year G Sec	7.13%	6.72%	-0.41%
7-year G Sec	7.13%	6.79%	-0.34%
10-year G Sec	7.18%	6.76%	-0.42%
15-year G Sec	7.29%	6.87%	-0.42%
30-year G Sec	7.42%	7.00%	-0.42%
slope 3x30y	0.34%	0.28%	
SDL			
10-12Y	7.64%	7.15%	-0.49%
AAA- PFC			
1Y AAA	7.84%	7.78%	-0.06%
2Y AAA	7.72%	7.50%	-0.22%
3Y AAA	7.69%	7.52%	-0.17%
5Y AAA	7.68%	7.45%	-0.23%
10Y AAA	7.65%	7.25%	-0.40%
Slope 1x10y	-0.19%	-0.53%	
INR/USD	83.1695	85.605	-2.93%
DXY	101.333	108.487	7.06%
UST	3.88%	4.56%	0.68%
Brent	77.04	74.64	-3.12%
OIS Swaps			
1Y	6.64%	6.51%	-0.13%
3Y	6.25%	6.22%	-0.03%
5Y	6.19%	6.20%	0.01%

Even as the RBI has shifted to a neutral stance and signalled a possible directional shift through a CRR cut, the prospects for the market over the coming year would be hostage to multiple uncertain factors. This sets the stage for continued volatility even as directionally over the coming months at least over H1, one should see a downward shift in yields from current levels.

Changing Global landscape

Even as there is a clear possibility of divergence in policy action by various central banks, contingent on specific macroeconomic factors, the direction of policy rates by the FED clearly will have a bearing on capital flows into EM's. Incremental data clearly validates the view that the US economy faces no significant growth concerns at present even as inflation remains slightly above target. Recent rate cuts to the extent of 100bps and the projected cuts by the FED would possibly address the immediate issue of higher real rates that may negatively impact economic activity. A data dependent approach as assessed currently clearly has set up the market for ongoing volatility as market expectations would get repriced on every data set. Fiscal policy direction remains an "known unknown" risk that is difficult to quantify currently.

This would possibly continue to keep currency under pressure, thereby impeding the full transmission of policy changes into market rates. While the policy rate need not be hostage to currency dynamics, with various other tools available to address the same, the timing and sequencing of possible rate actions clearly could be hostage to the same. To the extent that growth slowdown is seen as temporary and inflation remains above target, the risk of rate cuts getting pushed back remains a key risk.

Higher global rates and wider spreads on overseas borrowings could keep recourse to domestic borrowings higher. To the extent that domestic liquidity remains tight, bond spreads are unlikely to tighten in such a scenario.

Fiscal and Demand supply dynamics:

Fiscal consolidation alongside a strong demand-supply equation for sovereign securities has been a tailwind for the bond markets and more specifically the sovereign curve over the last year. We do not foresee material changes in this basic thesis in the near future. However, there remains 2 broader challenges that could play out over the year. The direction of fiscal consolidation clearly remains while the pace could slow down over coming years. Apart from addressing the challenges to consumption and overall growth, fiscal consolidation trajectory beyond 4.5% FD is currently not known. At the same time, the stated policy intent is to incrementally reduce public debt /GDP with specifics being unknown. Recent improvements in tax buoyancy, if sustained, should enable reduction in debt metrics over time. Incremental data on government finances clearly exhibit higher reliance on Personal Income Taxes, with muted growth in other sub heads of revenue.

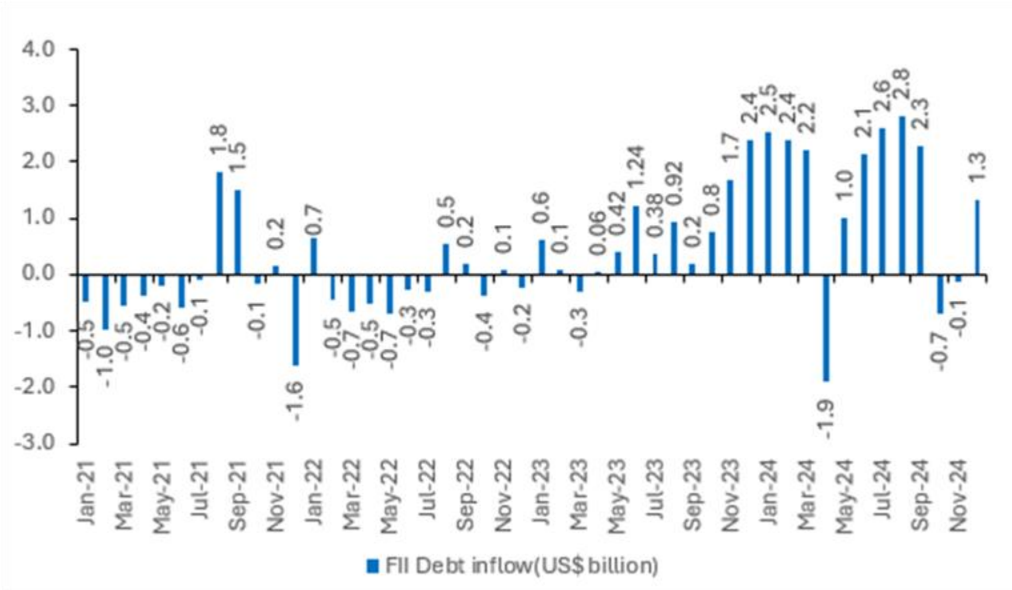
Overall while the broader, long-term fiscal metrics remain positive, relative to most other developed and EM jurisdictions, near term challenges cannot be overlooked. Hence incremental surprises on tax revenue Vs estimates as seen in recent years is unlikely.

Table 7: Government tax collection trends

% growth	CAGR (FY22-FY24)	7M FY25
Gross Tax Revenue	20	11
Income Tax	28	20
Corporate Tax	26	1
Custom	20	6
Excise duties	-8	1
GST (for Centre)	21	12
Total Direct Tax	27	11
Total Indirect Tax	13	9

Incremental demand from offshore investors was another defining feature of the demand equation for sovereign bonds in CY24. In the near-term some inflows basis the index weighting is expected that should not materially move the needle with respect to market trends. In the background of higher US treasury yields and broader dollar strength, expectations on higher flows into EM local currency domestic bonds going into CY25 should be tempered.

Chart 63:
Debt flows led by FAR (fully accessible route) G Sec flows



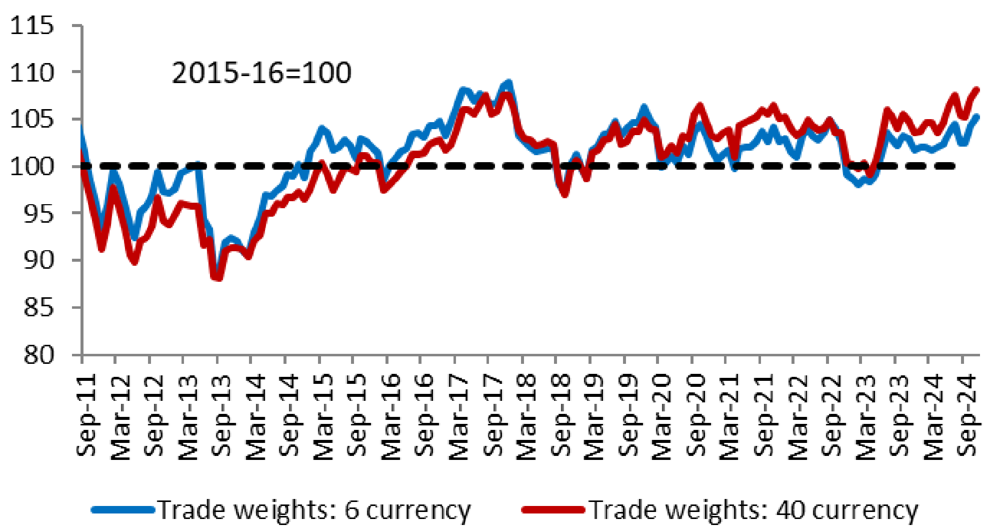
RBI actions:

The shift in the policy stance by RBI to Neutral in October, followed by the CRR cut in December clearly indicates the direction of Monetary policy based on current growth- inflation mix. To the extent that economic growth faces certain challenges even as headline CPI stays above target with muted core inflation, the stance allows adequate flexibility. Considering the current estimates on growth and inflation, broader consensus is for a shallow easing cycle, not likely to exceed 50 bps. There remains no immediate compulsion to ease, barring the lags in transmission and likely uncertainty. At the same time, the timing of policy action will be a subjective assessment, which can possibly be pushed back if overall currency market dynamics remain not conducive. We anticipate that in view of the longer lags in transmission as well as the challenging global landscape, there remains a high possibility of a front-loaded action rather than a staggered cut as the available space opens up. While the February review remains a close call with headline CPI staying higher, over the coming months as the forward projections converge around 4% on CPI, the space available is likely to be used.

RBI's operating framework with respect to liquidity has clearly been compromised by the "impossible Trinity" and the lack of market-based instruments to deal with sterilization of forex market interventions. With an open capital account (more so with FAR route for G sec flows), and independent monetary policy, managing a fixed or targeted exchange rate is a losing battle. With only 2 out of the 3 variables that can possibly be controlled, the central bank needs to let go of the third. The sensitivity towards currency levels has meant large-scale interventions on both sides leading to large swings in rupee liquidity. The recent CRR cut has clearly been triggered by FX interventions to prevent depreciation, leading to a large drawdown in core liquidity.

The constraints of an EM market with a recurring current account deficit imply reliance on capital flows imperative to fund the CAD. Volatility in capital flows will continue to impact on the exchange rate, domestic liquidity and eventually market rates. In this context, the recent RBI approach to tolerate a gradual currency weakness is possibly one way to address the overvaluation as indicated by Real effective exchange rate metric. Hopefully the Union budget would provide leeway to issue MSS bonds/ Bills that would enable RBI to effectively absorb rupee liquidity created through forex intervention through a market-based instrument. This would also possibly avoid excessive variation in the overnight rates based on forex intervention on both sides.

Chart 64:
Rupee remains overvalued on REER basis



More than policy cuts, the CRR cut clearly addresses the immediate and possibly ongoing issue that would need to be addressed. Tightening interbank and core liquidity on account of constraints on the Fx front clearly would have a larger and long-lasting impact on the economy. Apart from the availability and cost of funding, uncertainty with respect to liquidity would have a larger impact on growth. In this context the provision of durable liquidity through other routes including OMO purchases and possibly more longer-term fine-tuning operations through repos may be warranted.

Much has been debated around the changes in the RBI MPC and likely policy pivots. However, significant policy shifts on the monetary policy angle are unlikely. Operational shifts with respect to currency and liquidity management could be possible even as there could be little leeway with respect to provisioning requirements that sought to address systemic or financial stability risks.

Overall, the macro dynamics as present remains constructive on bonds, even as considerable uncertainties continue that may possibly lead to near term volatility. The case for fixed income investments remains compelling given the following. Even as there remains a possible duration play in the near term, given expectations on a policy easing cycle, overall considerations of portfolio accrual may dominate in the year ahead.

- Fixed income yields across tenors continue to provide visibility of higher prospective real returns based on estimated forward-looking inflation.

- Apart from portfolio diversification, absolute yields as available more so in the shorter end of the curve are extremely compelling with high carry and possible roll down.
- All possible matrices for valuation including real returns, short term bond spreads etc. remain compelling.
- Over the last quarter, changes in RBI stance and CRR cut clearly opens up the scope for a directional change in terms of a possible rate cut in CY25, even as the same could be a shallow one.
- Broader trend of fiscal consolidation has not changed even with near term challenges and unlike most global jurisdictions, the overall fiscal direction in India remains positive.