

Navigating risks - red flags every HNI should watch in India

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Heading into 2024, India is expected to post a robust GDP growth of over 6.5% in the current financial year, bolstered by a strong uptick in economically imperative sectors such as construction, manufacturing, real estate, financial services, trade, and transport. In this scenario, many market players believe that India is poised to overtake China as the chosen foreign investment destination, while also emerging as the third largest economy, on a global scale, by 2027. To achieve this ambitious target, India will need to surpass major global economies like Japan and Germany and attain a GDP in excess of USD 5 trillion. With the ruling government keen on furthering major development-focused initiatives such as Make in India, Digital India and Aatma Nirbhar Bharat, while also enhancing the ease of doing business in the country, the domestic economy is expected to maintain its glittering growth story in the decades ahead, thereby unveiling a host of investment opportunities which are currently germinating in India. These emerging possibilities are presenting UHNI investors with myriad opportunities to create long-term wealth. However, as with everything in life, the way forward is paved with both roses and thorns.

Red flags to note

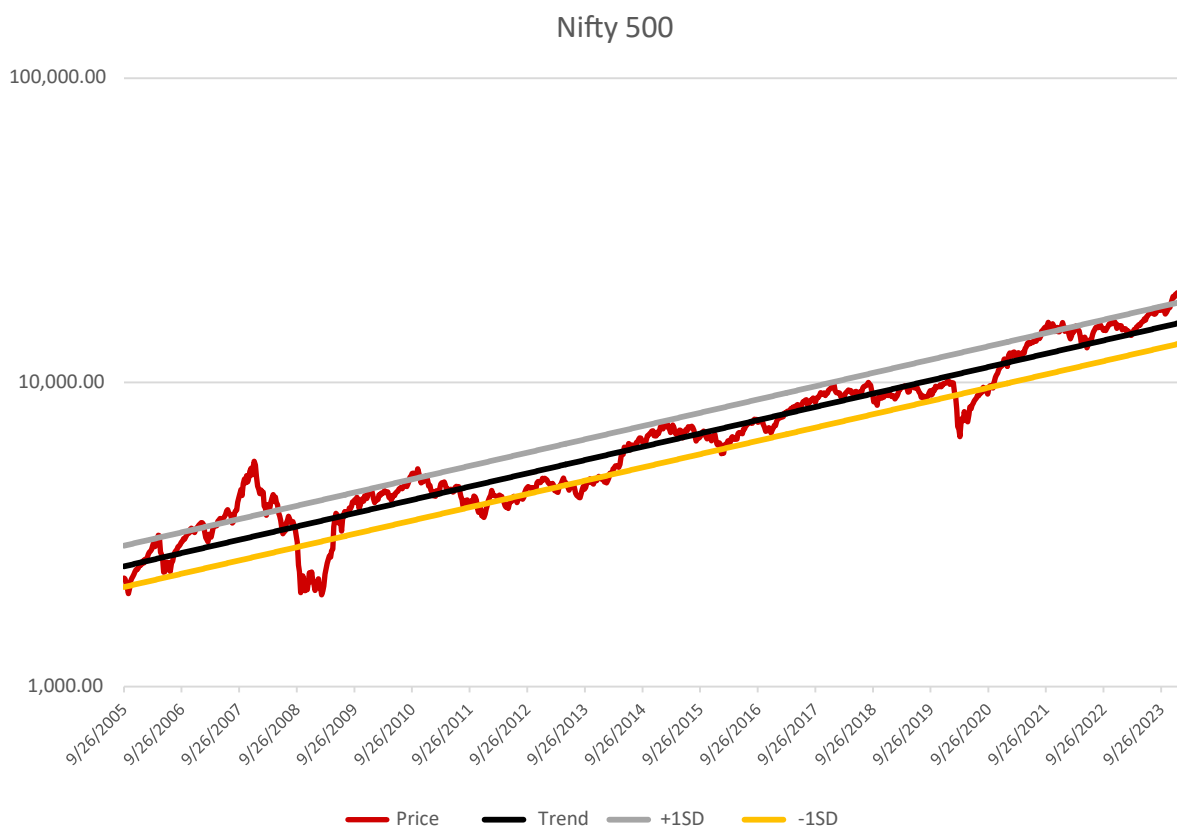
In the backdrop of India's robust economic narrative, it becomes imperative for UHNI investors to exercise keen vigilance over potential red flags that may emerge in the dynamic landscape. While the country presents an array of investment opportunities, a strategic approach is vital to building resilient, long-term portfolios. Investors must be astutely aware of specific warning signs that could pose challenges amidst the opportunities, ensuring their ability to navigate market risks effectively. By proactively identifying and addressing these red flags, individuals can not only safeguard their investments but also position themselves to optimally capitalise on the vast potential offered by India's flourishing economy. So, what are these red flags that you must maintain an eye on?



Stretched valuations

Firstly, India's booming economic narrative is currently fringed with concerns about stretched valuations in the stock market. According to CLSA¹, Indian valuations are currently amongst the highest in the world with the Nifty's Price-to-Earnings (P/E) ratio at 20.2x, a level historically associated with reversals. This makes India vulnerable to corrections, especially considering the global trend of markets trading below their historical average valuations. Going ahead, potential shifts in investment narratives of other emerging markets could divert flows away from India, amplifying risks. Additionally, the hard-landing scenario in the US may prompt a migration from equities to bonds, impacting equity valuations.

Exhibit 1 : Nifty 500 trend



Rising public debt due to increased government capex

Despite India's robust economic growth, driven partly by government capital spending, there are concerns about a slowdown if government expenditure decreases to manage the fiscal deficit. The government has been actively increasing capital expenditure, reaching a record high provision of INR 10 trillion in the current financial year². However, a projected slowdown in the YoY expansion of capex growth could impact economic activity and GDP growth. The upcoming post-election Budget is expected to play a crucial role in determining the trajectory of government spending and its effects on the economy.

¹<https://www.livemint.com/market/stock-market-news/stretched-valuations-could-weigh-on-indian-stock-market-returns-in-2024-cautions-clsa-11704696289320.html>

²https://www.business-standard.com/budget/news/budget-2024-25-govt-likely-to-do-heavy-lifting-capex-to-increase-124012100256_1.html



Slowdown in PFCE

Another point of concern is the slowdown in private final consumption, a key driver of India's consumption-driven economy. Private Final Consumption Expenditure (PFCE) is a holistic indicator of consumption trends in the country as it captures the final consumption expenditure by households. Its disconcerting to note that its growth has nearly halved to 3.13% in the Jul-Sep quarter of FY24 from 5.97% in the Apr-Jun quarter, raising worries about its impact on India's GDP, even as reports now expect growth figures to further slip to 5.2% for the full financial year³, from 7.5% in FY23. To put this in the context of GDP, the PFCE to GDP ratio at current prices during 2020-21 and 2021-22 was 61.3% and 61.1%, respectively⁴.



Global financial dynamics

External factors wield considerable influence on India's financial landscape with global market risks serving as a potent force. The prospect of higher interest rates in the United States, driven by inflation or a possible recession holds implications for the flow of capital across borders. If the US Federal Reserve opts for an interest rate hike to counter inflationary pressures or slashes the rate to address economic downturns, it could lead to changes in investment patterns. Even if interest rates remain unchanged, the current roll off of the FED balance sheet may add to liquidity risks arising in the global financial system. These factors may impact India's financial market and capital flows considering that FII's own 20% of NSE 500 market cap as of September 2023. Further, the hard landing scenario may prompt a migration of funds from emerging economies to safe haven economies/equities to bonds while a soft landing may probably be a positive for the equity markets



Geopolitical tensions

Increasing instances of geopolitical skirmishes will further contribute to the uncertainties surrounding India's economic outlook. The ongoing conflicts between Ukraine and Russia, as well as those involving Israel and Hamas, have introduced geopolitical risk factors that are reverberating throughout the global financial system, including India. Another factor to consider is the attack on ships by Houthi rebels backed by Iran. This could potentially impact sea trade and cause crude oil price to move up, thereby putting pressure on Indian imports of crude oil.

Given their potential to disrupt global trade, impact commodity prices, and instigate shifts in investor sentiment they definitely need to be on our radar.

While these red flags do not, in any way, take away from India's magnificent growth story, they do serve a cautionary tale. Mild or major skirmishes across these factors could have a significant impact on investor portfolios and therefore, must be considered in portfolio decision making.

³<https://www.moneycontrol.com/news/business/economy/mc-graphixstory-economic-revival-hinges-on-consumption-growth-12080781.html>

⁴[https://pib.gov.in/PressReleasePage.aspx?PRID=1903091#:~:text=Private%20Final%20Consumption%20Expenditure%20\(PFCE,and%2061.1%20per%20cent%20respectively.](https://pib.gov.in/PressReleasePage.aspx?PRID=1903091#:~:text=Private%20Final%20Consumption%20Expenditure%20(PFCE,and%2061.1%20per%20cent%20respectively.)

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