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Earnings, Elections and Economy

Monthly Newsletter: December 2024 Edition

Recap

November proved to be a highly eventful month for the markets and their participants, marked by:

a) The release of Q2 results by majority of listed companies.

b) The Presidential Election in the USA, the world's largest economy and democracy.

c) Elections in one of India's most significant states: Maharashtra

d) Heightened geopolitical tensions, with ongoing wars witnessing periods of rapid escalation followed by partial stabilization.

e) Continued Foreign Institutional Investor (FII) outflows from Emerging Markets, including India, leading to notable corrections in stock prices.

We delve into each of these developments in detail below, analyzing their potential implications for the economy and markets going forward.

Earnings

The Q2FY25 earnings season continued through November, with negative surprises outweighing positive ones by a notable margin. Results from BSE-500 Index companies reflected persistent weakness, with revenue growth of 8% YoY, a 171 bps YoY decline in EBITDA margins, and a 73 bps sequential contraction. Notably, small-cap companies significantly underperformed, reporting a 28% YoY drop in profits, compared to flat-to-marginal positive PAT growth in large-cap and mid-cap segments (Source: Kotak Securities).

Weak earnings, combined with ongoing FII selling, led to sharp corrections in poorly performing stocks, with some falling 20% to 40% from recent peaks. Even companies with stable performance were not immune, with some quality stocks experiencing single-day declines of 5% to 10%.

Looking ahead, overall economic activity is expected to gain momentum in the second half of FY25, supported by increased government spending. General Elections in Q1FY25 and a prolonged monsoon had suppressed H1FY25 spending, with central government capex averaging INR 600 billion per month in Q1FY25 compared to INR 928 billion in Q1FY24. However, a sharp increase in September capex to INR 1,140 billion suggests an upward trend, which is likely to continue in H2FY25.

Earnings momentum should improve in H2FY25, though recovery is expected to be gradual and uneven. Government capex will play a pivotal role in driving economic revival, although potential trade policy shifts, such as tariffs from the incoming Trump administration, could present temporary headwinds.

Elections

The world’s largest economy elected its new government in a closely contested race, with the Republican Party, led by President Trump, achieving a decisive victory and securing a comfortable majority in both houses of Congress. U.S. markets responded positively, with broader indices rising approximately 5% in November. Market participants are optimistic that a stable and strong government will guide the U.S. economy from its current recessionary phase to robust growth over the next four years.

The election results also strengthened the U.S. Dollar, which appreciated against major global currencies. FIIs reallocated funds from Emerging Markets (EMs), including India, to the U.S., triggering continued sell-offs in EMs.

President Trump has consistently emphasized tariffs as a key tool for addressing trade imbalances, domestic issues, and geopolitical challenges. With his administration set to take office on January 20, 2025, global markets are watching closely, anticipating both opportunities and risks. **While adverse policy moves could impact specific sectors or countries, the consensus is that Indian markets may remain resilient, potentially benefiting if higher tariffs are imposed on other economies**.

On the domestic front, Maharashtra and Jharkhand held elections in the second half of November. The ruling NDA government secured a comfortable win in Maharashtra, adding to its earlier victory in Haryana. These wins have bolstered the central government's position, particularly after its lukewarm performance in the June 2024 Lok Sabha elections. The Indian markets reacted positively to these state election outcomes, continuing their upward trajectory**. With no major state elections scheduled until 2027, the central government is expected to shift its focus toward governance and driving economic growth**.

Economy

The Q2FY25 GDP numbers, released last Friday, fell short of expectations. Against a consensus forecast of 6.4%, real GDP grew by just 5.4% during the quarter. This slower growth is likely to impact the full-year GDP projection for FY25, with estimates now ranging between 6.3% and 6.6%, down from earlier expectations of 7%. Historically, election years tend to see a moderation in GDP growth due to reduced government spending and the higher base effect from pre-election period.

The markets had largely anticipated weak GDP figures, given the underwhelming performance of a significant portion of listed companies during Q2FY25. Attention is now focused on the Reserve Bank of India (RBI), with expectations that the Governor may consider rate cuts in the upcoming Monetary Policy Committee (MPC) meetings over the next four months to support economic recovery.

While a single quarter of subdued GDP growth is not cause for alarm, it will be crucial to monitor key indicators in the coming months, including the pace of government spending, non-food and non-personal credit offtake, and private capital expenditure trends.

Conclusion

With no significant domestic uncertainties expected in the coming quarters and the likelihood of geopolitical tensions easing as the Trump administration takes charge, the primary focus will be on corporate earnings, which are anticipated to show gradual improvement. FII selling slowed considerably in November, dropping to INR 460 billion compared to INR 1,114 billion in October. With U.S. markets performing strongly, FII outflows are expected to moderate further in the near term.

We believe that CY2025 will be a year of consolidation, setting the stage for the next phase of extraordinary growth in the Indian economy. It's time to prepare for the exciting wave of progress ahead!

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