Disclaimer :- This was originally published on 4th October 2022 and is part of our Q2FY23 letter. Link to the letter [here]()

Has India decoupled?

We can never be de-coupled as while we may be more resilient on growth, we are connected financially and hence vulnerable to external risks.

The India market has been broadly resilient as earnings expectations have not significantly changed.

- Real GDP is expected to grow 7%+ in FY 23 in contrast to recessionary conditions elsewhere.The NIFTY 50 Earnings are still expected to grow ~11% in FY 23.[4]
- Bank Balance sheets are clean. Credit growth is at a 9 year high. HDFC Bank's CEO is said tohave said that "growth is pouring out of ears[5]" in a road show.
- India should be a beneficiary of "friend-shoring". For example, SRF (a leader in SpecialtyChemicals) has announced over a doubling of cap ex in the next five years vs the previous five.
- High-capacity utilizations, currently at ~73%, will start a new Cap-ex cycle.
- Global IT spending has headwinds but should not collapse.
- The recent weakness in the Indian Rupee vs the USD is not a reflection of the weakness in theeconomy, but more a rush to safety of the USD. The INR has appreciated against the Euro, Yen, and the Pound during this period.

Cost of Capital in India – basis inflation/interest rates today – does not need to be significantlyrepriced.

- Our inflation trajectory and long-term bond yields are not very far from long term averages a stark contrast to the developed world.
- India's nuanced use of stimulus during Covid means we are not facing the same inflationary issues as the West.
- India is the only large country where aggregate debt burdens as % of GDP have not expanded since 2008 – when developed world Central Bankers turned on the printing presses.

Cost of Capital in India does not need to be repriced significantly vs the developed world				
	India	**US**	**UK**	**Eurozone**
Avg 10 Yr G Sec Yields FY 12-22	7.30%	2.10%	1.40%	0.40%
10 Yr G Secs yield 3 months ago	7.40%	3.00%	2.20%	1.30%
10 Yr G Secs yield today	7.30%	3.80%	4.00%	2.10%
Avg CPI Inflation 2012-2022	5.80%	2.10%	2.00%	1.40%
CPI inflation today	7.00%	8.30%	9.90%	9.10%
Increase in Central Bank Balance sheets (Covid to today)	16%	114%	90%	55%
Increase in Aggregate Debt/GDP 2008 - 2022	-6%	49%	54%	147%
Source: Bloomberg; Debt/GDP data sourced from Kotak MF presentation				

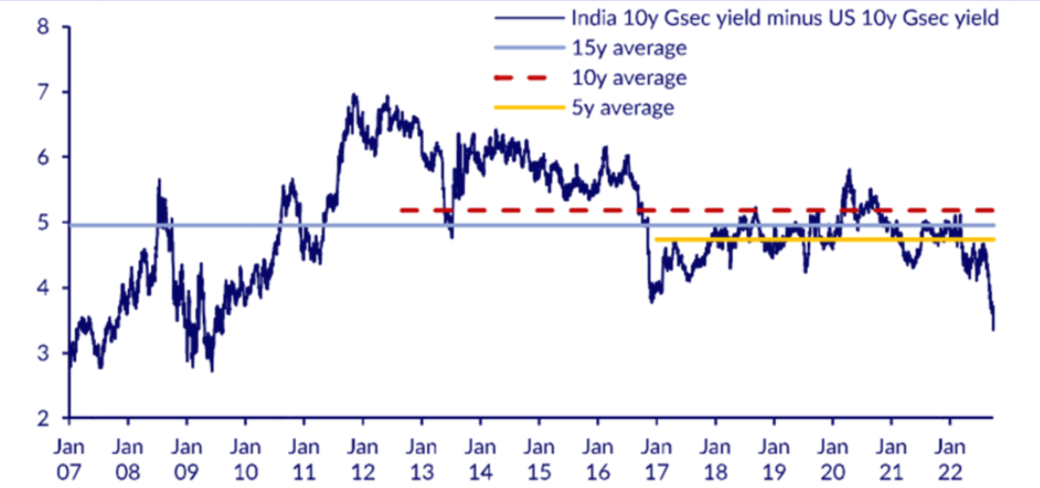
[4] Source: Bloomberg consensus estimates

[5] Macquarie report, 5 Sep 2022

However, one cannot make a case for "de-coupling" as we are vulnerable to external risks.

- India's exports/IT Services are ~20% of GDP. A recession in the developed world will impact us through linkages.
- If developed world interest rates continue to rise, it will have an adverse impact on our currency/bond yields as well. 10 Year G-Sec differentials vs the US at 3.3% are the lowest theyhave been in 13 years[6]. A further rise in US interest rates will result in more Rupee depreciation or higher bond yields in India as well. This will result in greater head winds to growth and inflation.
- If Oil stays above USD 100/barrel for an extended time, our Balance of payments becomes stressed.
- We cannot be insulated from any event that creates a systemic risk.

Differential between US and Indian 10-yr government bond yields is at a 13-yr low



Source: CLSA

[6] Source: CLSA