

# INDIA REWIND

**India Rewind** is a monthly update from DSP's Investment desk. It separates the alpha from the noise and aims to deliver key insights to readers, packed within a 2-minute reading time.

## “Indian ER&D: Emerging as a Force to be Reckoned With“

In the realm of Indian Engineering R&D services, an unprecedented surge in demand is currently underway, and it is predominantly driven by the sweeping transition towards digital engineering. Within this robust growth environment, three distinct growth drivers have emerged as pivotal factors. Three key growth drivers are identified as: i) Digital adoption leading to the introduction of new products and platforms, resulting in long-term contract wins, ii) More companies are advancing in offshoring, expanding the potential market and iii) a global scarcity of specialized digital skills is driving increased offshoring to India. As these trends continue to unfold, it is anticipated that India's share in offshoring will ascend to ~34% by FY31E, a significant increase from the ~24% recorded in FY21, with service providers poised to capture an even more substantial share of ~50%, up from ~42% in FY21.

**Digital Engineering Revolution:** Industries across the board are embracing digital engineering to become digitally driven enterprises. This includes increased investments in electric and autonomous vehicles in the automotive sector, digital health solutions in healthcare, smart factories in manufacturing, 5G and network virtualization in telecommunications, and a focus on OTT platforms in media. These shifts reflect a broader trend of industries adapting to the digital age.

Indian service providers have excellent capabilities across key growth themes. Vendor capabilities span entire product life development, allowing strong participation rates, which will power growth. Further, smart deal structuring and concerted efforts to proactively shape large deals will provide further tailwinds. Growth for companies in the medium term will depend on exposure to growth themes and execution skills. We remain optimistic about the sector's long term growth potential.

**India's inclusion in the JPM GBI-EM Global Diversified Index is set for June 28, 2024.** The allocation to India in the index is expected to gradually reach the 10% cap, with a monthly scaling of 1%. This move is anticipated to attract substantial inflows, estimated at over US\$40 billion, into India's fixed income markets over the next eighteen months, with the majority of these flows front-loaded as investors prepare for the transition.

**Flows, valuations and earnings:** In YTD23, MSCI India Index US\$ returned ~7.1% vs. MSCI EM ~(-0.4%) and MSCI DM ~9.6%. After strong foreign inflows through most part of the year, September saw a reversal with ~US\$2bn selling, but overall FII bought US\$4bn in 3Q (~15bn YTD) (the largest inflow within Asia). DIIs bought US\$5bn in 3Q (+\$16bn YTD). Amid weak markets globally, India is one of the few markets in the region with positive returns (~+2%) in 3Q (+7% YTD). India's resilient 3Q performance was primarily driven by earnings (Forward EPS: ~+9% in 3Q), and flat CY23 EPS revisions (vs. ~5% cuts in the MXAPJ region), while valuation compressed, and FX weakened vs. USD. Brent crude rose another ~3% last week, crossing \$95/bbl. Correlation between Indian markets and Oil has declined sharply, but remains slightly positive. Historically Indian market/Oil correlations have turned more negative at higher levels of oil prices (US\$100-120 range). In India monsoon season concludes with a cumulative rainfall ~6% below seasonal average. This has led to FMCG sector to experience a dip in performance during the 3Q, after leading in 2Q amid concerns over monsoons.

**Chart of the Month: ER&D offshoring penetration to increase to ~12% by FY31E from ~9% in FY21. Share of digital ER&D spends to rise to ~66% by FY31E from ~36% in FY21.**

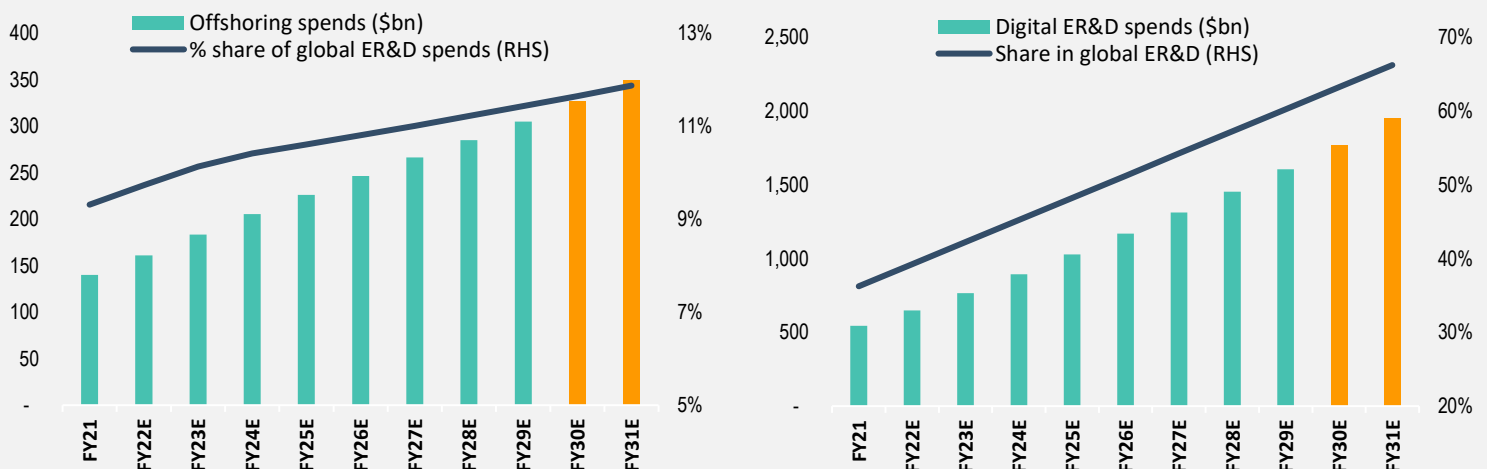


Chart Source: JP Morgan Research, Info Sources: Internal, Bloomberg, UBS Research, Goldman Sachs, FII - Foreign Institutional Investor, DII - Domestic Institutional Investor, FY - Financial Year, CY - Calendar Year; YoY is Year over Year, YTD - Year to date, EM- Emerging Markets, DM- Developed Markets, 2YF - Two Year Forward, ER&D; Engineering research and development,



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## India at a Glance

|  | FY17 | FY18 | FY19 | FY20 | FY21  | FY22 | FY23 | FY24E |
|--|------|------|------|------|-------|------|------|-------|
| <b>Economic Activity and Employment</b>  |      |      |      |      |       |      |      |       |
| GDP, USD bn                              | 2295 | 2651 | 2701 | 2871 | 2668  | 3176 | 3390 | 3713  |
| GDP per capita, USD                      | 1767 | 2018 | 2036 | 2141 | 1969  | 2321 | 2451 | 2658  |
| Real GDP growth, %                       | 8.3  | 6.8  | 6.5  | 4.0  | -6.6  | 8.7  | 7.2  | 6.2   |
| <b>Prices, interest rates and money</b>  |      |      |      |      |       |      |      |       |
| CPI inflation, % y/y (average)           | 4.5  | 3.6  | 3.4  | 4.8  | 6.2   | 5.5  | 6.7  | 5.4   |
| Repo rate, % (year-end)                  | 6.25 | 6.0  | 6.25 | 4.4  | 4.0   | 4.0  | 6.50 | 6.0   |
| 10 year bond yield, % (year-end)         | 6.7  | 7.4  | 7.4  | 6.1  | 6.2   | 6.8  | 7.3  | 7.0   |
| USDINR (year-end)                        | 64.8 | 65.0 | 69.2 | 75.4 | 73.5  | 75.8 | 82.3 | 83.0  |
| <b>Fiscal accounts</b>                   |      |      |      |      |       |      |      |       |
| General government budget balance, % GDP | -7.0 | -5.9 | -5.9 | -7.8 | -13.9 | -9.5 | -9.4 | -9.0  |
| <b>Balance of payments</b>               |      |      |      |      |       |      |      |       |
| Trade balance, USD bn                    | -112 | -160 | -180 | -158 | -102  | -189 | -266 | -250  |
| Exports, USD bn                          | 280  | 309  | 337  | 320  | 296   | 429  | 456  | 403   |
| Imports, USD bn                          | 393  | 469  | 518  | 478  | 398   | 619  | 720  | 668   |
| Current account balance, USD bn          | -14  | -49  | -57  | -25  | 24    | -39  | -69  | -55   |
| Foreign direct investment (net), USD bn  | 35.6 | 30.3 | 30.7 | 43.0 | 44.0  | 38.6 | 35   | 38    |
| Total FX reserves, USD bn                | 370  | 425  | 413  | 478  | 577   | 607  | 578  | 608   |
| Total external debt, % GDP               | 20.5 | 20.0 | 20.1 | 19.5 | 21.4  | 19.1 | 18   | 15    |
| <b>Credit ratings</b>                    |      |      |      |      |       |      |      |       |
| Moody's                                  | Baa3 | Baa2 | Baa2 | Baa2 | Baa3  | Baa3 | Baa3 | Baa3  |
| S&P                                      | BBB- | BBB- | BBB- | BBB- | BBB-  | BBB- | BBB- | BBB-  |
| Fitch                                    | BBB- | BBB- | BBB- | BBB- | BBB-  | BBB- | BBB- | BBB-  |

Source: CEIC, Haver, UBS estimates; Note: Data is for FY ending March, E - Estimates

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