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Strong macros await revival in sluggish micros

July 21, 2025

Over the past 25 years, the general adage has been that India is a market with weak macros but excellent micros. The good news is that the macro- indicators look excellent and support any downside in the market. However, they await micros (earnings growth) to improve before we can break out from the current market consolidation. Near term market will have an eye on the latest Trump tariff deadline of August 1st. We think a time correction and likely improvement in earnings in the next couple of quarters will ease current elevated valuations of 21.5x.

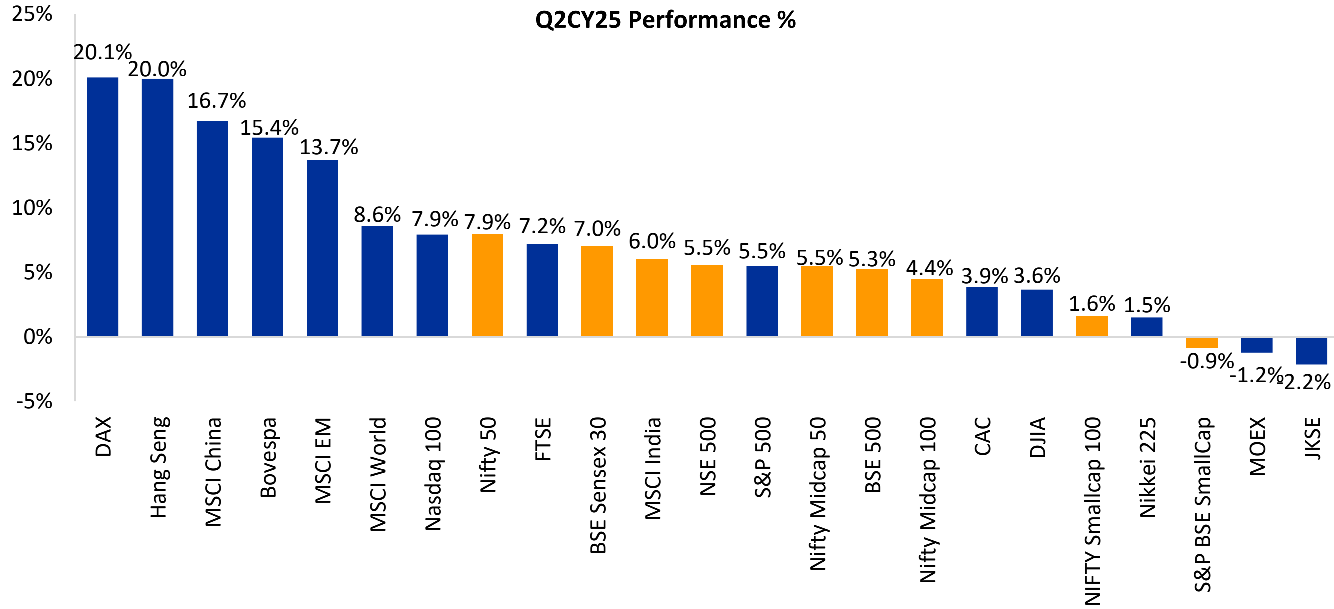
What will influence earnings?

1. **Peaking margins put pressure on topline growth: With margins at a 10-year high, the onus is on topline growth to drive earnings. Corporate revenue growth is closely linked to nominal GDP growth which is slowing given low inflation. Nominal GDP growth in FY26 can be the second lowest in the past 20 years excluding the Covid year.**
2. **Banking earnings should revive in H2FY26: Bank earnings, which drove Nifty earnings growth, have slowed in FY25 and in the current year. NIMs bottoming out in Q2FY26/Q3FY26 and thereafter start improving in the later part of FY26.**
3. **Consumption revival on the cards: 3 factors should help consumption spend (a) Better monsoons helping rural demand (b) The Rs 1 lakh crore tax cut and (c) lower EMIs as interest rates fall.**
4. **Private sector capex reviving? While Government has done most of the heavy lifting in capex, we are seeing an upturn in private capex which will nearly double from Rs 6.3 trillion in FY22 to Rs 12.3 trillion in FY26.**

Strong macros provide support to valuations

India has seen the stock market rebound strongly from its lows in the early part of the year. However, India and US which are the 2 best performing markets over past 10-20 years and trade at high valuations of 20+ PE, have been relatively under-performing in the first half of CY25.

Chart 1: India's performance continues to lag



Source: Investing.com, Valentis Research

For many years, we had a theme that India had "weak macros but excellent micros". Ironically, while India macros are in pink of health, the micros as represented by earnings growth is struggling. This underpins our expectation of a range bound consolidating market over the next few months. Strong macros will support the downside of the market but till earnings growth gets more visible (we think H2FY26 will see stronger growth) we do not see a meaningful upside. Meanwhile, the Trump administration seems determined to go ahead with higher tariffs from August 1st which could lead to some volatility in global markets which have so far been ignoring this issue, probably in the hope that the tariffs will be postponed again (for details please read our previous report www.valentisadvisors.com).

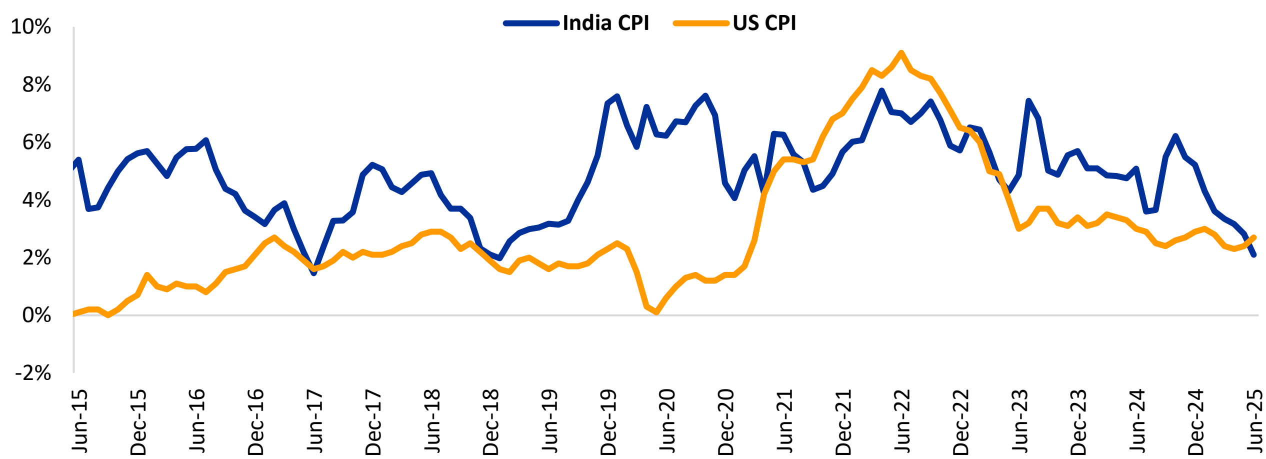
Strong macros support higher valuation

The Indian macros are providing a very stable picture of a growing economy without stress.

1. The twin deficits are under control. Fiscal deficit is being reduced every year and for a change the Government has been meeting its fiscal deficit targets e.g. for FY25, fiscal deficit ended at 4.8% slightly lower than estimates of 4.9%. For FY26, the government is budgeting further reduction to 4.4%. Meanwhile, the current account deficit continues to be under control at a deficit of 0.6% in FY25 with the Q4 ending up at a surplus.

2. Inflation in India is well under control with latest CPI data at 2.1% (June'25). This is lower than the US CPI inflation data of 2.7%. Falling oil prices globally and lower food prices are helping keep inflation in check.
3. Falling inflation has helped the RBI keep monetary policy easy and cut interest rates 100 bps over the past 6 months.
4. Real GDP growth though slower than couple of years ago, is still strong at 6.5% (2024-2025), the highest in the world.

Chart 2: India and USA Inflation trend (%)

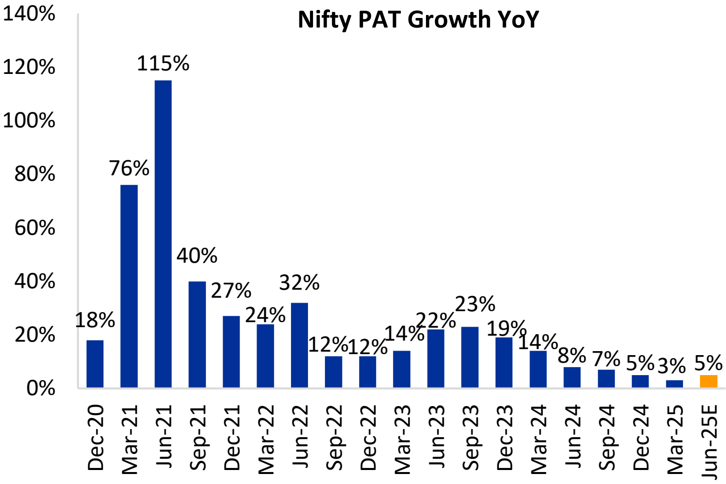


Source: Investing.com, Valentis Research

So what ails earnings growth?

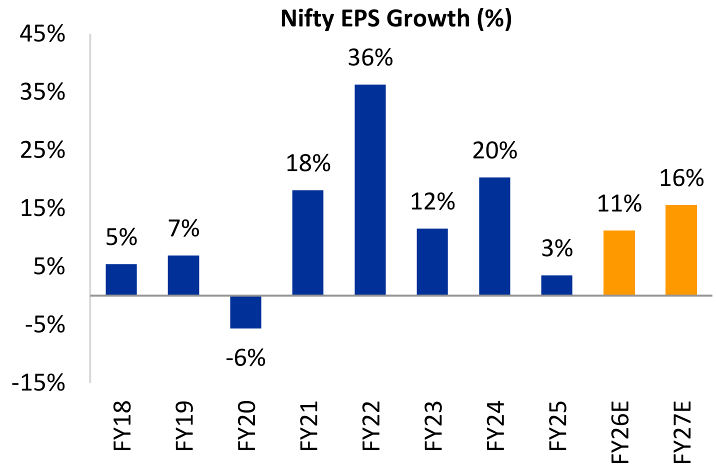
FY25 saw earnings growth at 3%, the weakest in the post-Covid period. Consensus expectations are that the next 2 years could see double-digit earnings growth, which will be good for markets. However, Q1FY26 is again looking very weak with expectations of only 5% of earnings growth. Thus, we will need a strong second half to meet our double-digit earnings growth forecast.

Chart 3: PAT growth is expected to be low in single digit



Source: MOSL, Valentis Research

Chart 4: Annual EPS Growth



Source: Kotak IE, Valentis Research

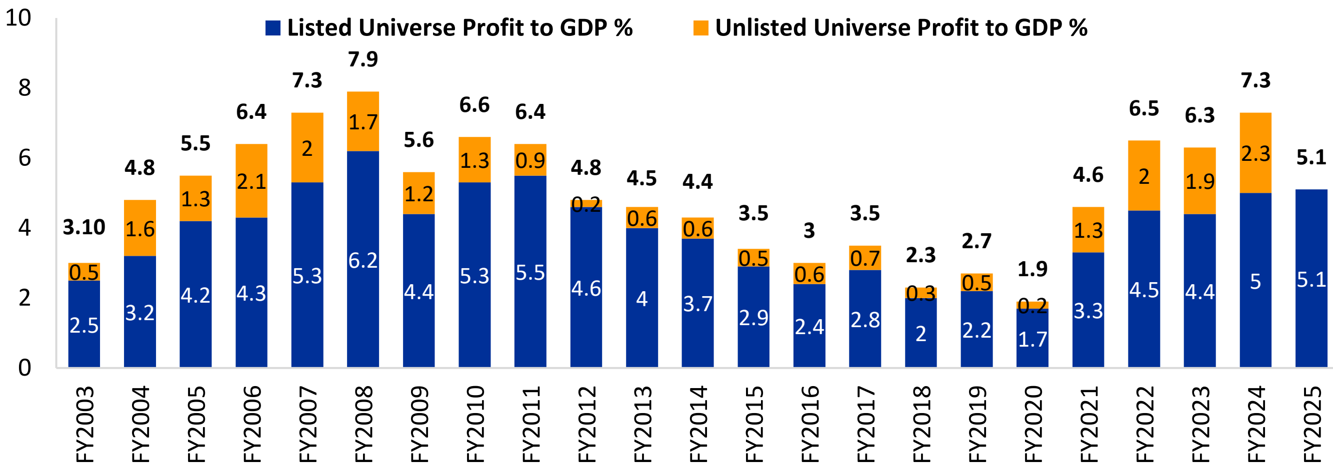
Q1FY26 will again be a weak set of earnings

Overall, Q1FY26 Nifty earnings are likely to be weak, with growth expected at only 5% YoY. Excluding metals and oil marketing companies, earnings growth drops closer to 4%. A significant drag comes from the private banking sector, which is expected to report its second consecutive quarter of declining earnings since March 2020. Meanwhile, the PSU banking sector is likely to report moderate earnings growth of 5%, the lowest in 20 quarters. The auto sector is projected to see a year-on-year decline of 10%. Pharma sector is expected to report 11% year-on-year growth, marking a moderation after eight consecutive quarters of 15%+ earnings growth. The chemical sector is expected to record 10% year-on-year earnings growth, marking its second consecutive quarter of growth after seven quarters of decline.

Is corporate earning to GDP peaking?

India’s listed corporate earnings to GDP in FY25 is at 5.1% which is higher than a long-term average 3.9% but still lower than the peak of 6.2%. In fact, there is reason to believe that this number can trend higher in future as larger companies gain market share over smaller, unlisted players.

Chart 5: India Inc. – corporate profit to GDP ratio trend



Note: FY25 earnings from unlisted companies are yet to be available
Source: MOSL, Capitaline, Valentis Research

6 factors that will impact earnings

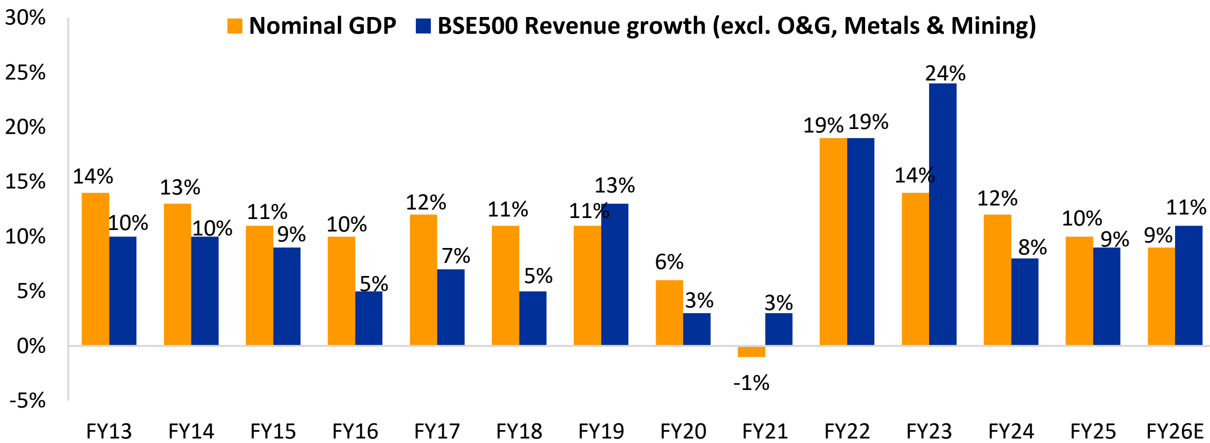
We have tried to look at trends that will drive earnings, both negatively and positively.

#1: Low inflation is dragging down revenue growth

Low inflation is good for our economy and has resulted in an easy monetary policy as well as lower interest rates. Lower interest rates help higher valuations in the market. However, lower inflation also means lower nominal GDP growth. There is a strong linkage between nominal GDP growth and revenue growth.

While real GDP growth in India will be robust in FY26, we see nominal GDP growth at 9% being amongst the lowest over past 20 years given likely GDP deflator of under 3%. Over the past 20 years, FY20 was the only year which saw a lower nominal GDP growth excluding Covid-impacted FY21.

Chart 6: Nominal GDP vs. BSE500 cos. revenue growth

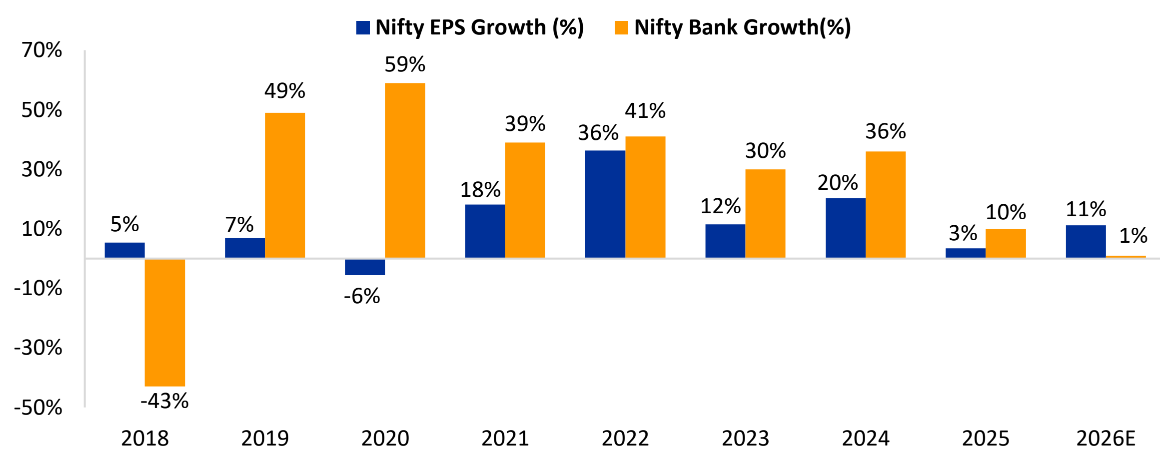


Source: RBI, AceEquity, Valentis Research

#2: Banks dragging down overall earnings

The banking sector has a significant impact on overall earnings growth given that it accounts for over a third of the index. Over the past few years, a revival in bank earnings led by lower provisions and rising NIMs helped overall earnings growth. However, with interest rates falling NIMs are coming under pressure and bank earnings are lacklustre. This is dragging down overall earnings growth.

Chart 7 – Banks to drag down the overall Nifty earnings growth

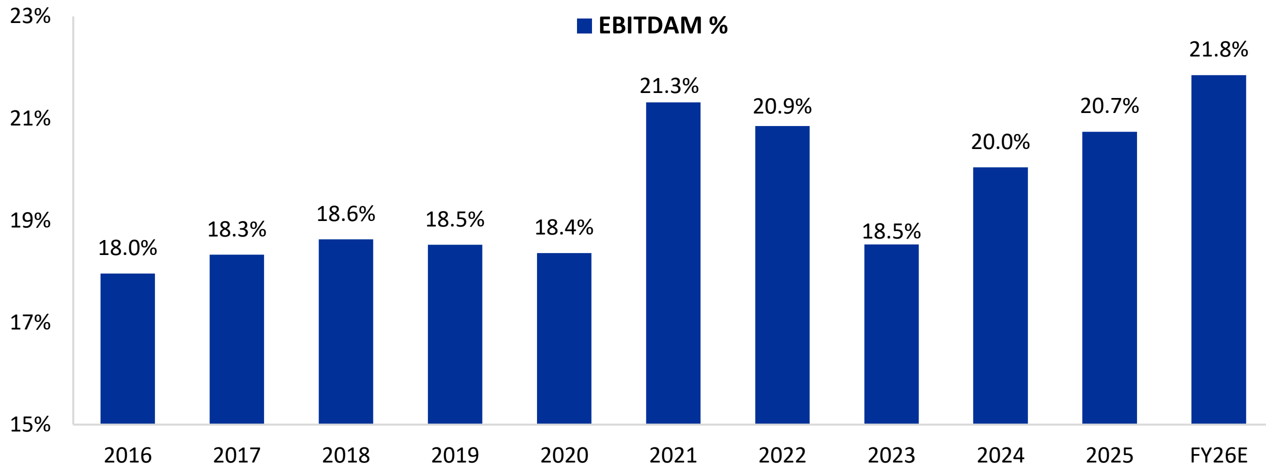


Source: AceEquity, Valentis Research

#3: Margins peaking? Onus on revenue growth

Analysts are forecasting FY26 EBITDA margins at 21.8%, which will be the highest in a decade. While margins may not fall materially, we think margin increase from here will be difficult. Thus bulk of earnings growth will have to be accounted by increased revenue growth.

Chart 8: FY26E margins at 21.8% are at a 10-year high



Source: Investec, Valentis Research

#4: Trump tariffs can be a mixed bag

We see a greater probability of Trump going ahead with his tariff plans from August 1st. This has the risk of raising inflation in the USA as tariffs seem to average well above the 10% rate currently. Moreover, this could trigger a slow-down in the USA and impact growth across the world including India.

So, while tariffs are overall negative in terms of a slowing global economy, the more specific impact on India depends on the contours of an Indo-US trade pact, if any. The key to watch is the tariffs on Indian goods relative to that on other countries it competes with. We think a tariff of around 15% may relatively be good for India given that most competitors are currently at 20-30% tariffs.

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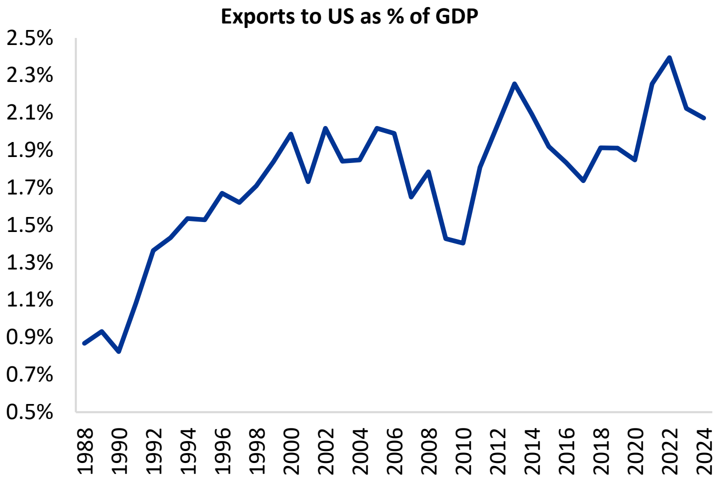
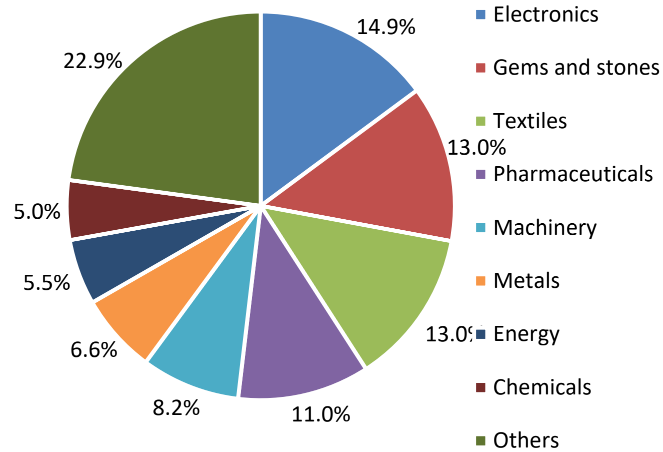
Chart 9: US exports as % of GDP is low for India



Source: IMF, World Bank, Niryat, Valentis Research

Chart 10: Composition of India exports to US



Source: Kotak IE, Valentis Research

#5: Consumption spend should improve

We think 3 factors will drive consumption spend over the next few months:

1. Better monsoons have led to better sowing of crops. Some of this could be due to early sowing relative to last year since monsoons arrived ahead of the normal schedule. But with monsoons looking normal, we think agriculture growth will be strong this year leading to higher rural income.
2. Urban consumption will be supported by the tax break of around Rs 1 lakh crores given in the budget in February 2025.
3. Lower interest rates and easy monetary conditions will lead to lower EMIs helping urban consumption.

Table 1: Kharif Sowing

Kharif sowing as on 4/7/2025			
mn hectare	2025	2024	% Change
Paddy	6.93	6.45	7.4%
Pulses	4.26	3.15	35.2%
Coarse cereals	7.72	6.38	21.0%
Oilseeds	10.83	9.49	14.0%
Sugarcane	5.52	5.49	0.5%
Jute & Mesta	0.55	0.56	-2.7%
Cotton	7.95	7.86	1.2%
Total	43.75	39.38	11.1%

Source: PIB, Philip Capital, Valentis Research

Table 2: Rainfall distribution

Subdivision-wise rainfall distribution (mm) (1/6/25 - 13/7/25)			
Area	Actual	Normal	% Dep
East & North East India	390.9	513.2	-24%
North West India	199.4	154	29%
Central India	402.6	294.1	37%
South Peninsula	221.3	241.8	-8%
Country	302.6	275.7	10%

Source: IMD, Philip Capital, Valentis Research

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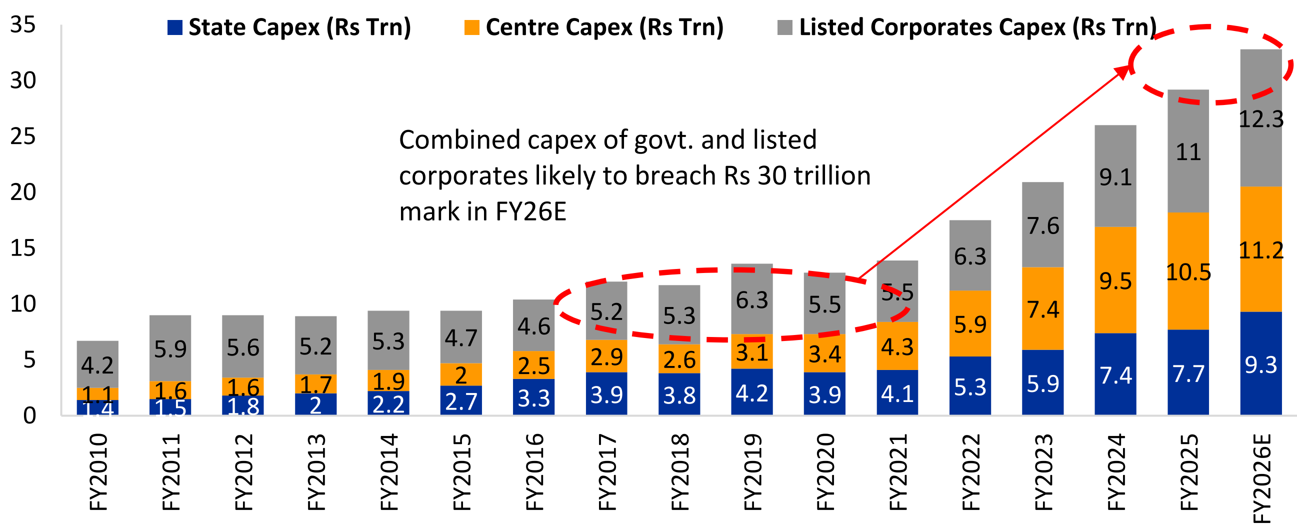
#6: Capex is better than consensus believes

The consensus view is that the Government has done most of the heavy lifting on capex and private sector capex has been missing. The good news is that Government has continued to accelerate capex spend and has rightly front loaded its capex for the year.

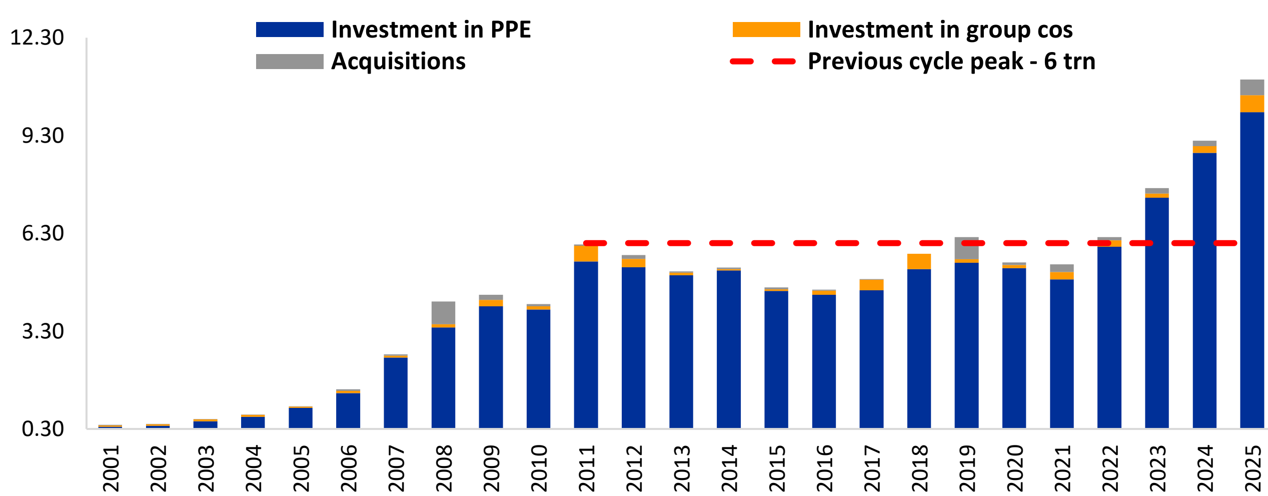
- But the even better news is that the private sector capex has accelerated over the past 2 years. We still do not see anything like the animal spirits we saw in FY2004-07 phase. But even a more gradual recovery will help the economy and earnings. Listed corporate capex will practically double from FY22 to FY26. Listed corporate capex as % of Nominal GDP has moved up from 2.7% in FY22 to 3.3% in FY25.

Chart 11: Listed corporate capex can double in 4 years



Source: Isec, Valentis Research

Chart 12: Listed Corporate Capex breaches Rs. 11 trn mark



Source: Isec, Valentis Research

Portfolio Performance and outlook

1. During the quarter our portfolio performed in line with the benchmark indices as the small and mid-caps also recovered from their lows.
2. Going forward we have tried to maintain a portfolio with high earnings growth of 21% while keeping valuations below the market at a PE of 16x. We think this will help us achieve a good return in the portfolio despite the likely volatility in the markets.
3. Our focus is on domestic stocks and avoiding stocks that can be hurt badly if the tariffs in USA are back to a high level. The good news is that nearly 80% of our portfolio has very minimal exposure to USA exports

US exports as % sales	Weightage	No. of stocks
Nil	74%	13
>0-10%	4%	1
10-20%	0%	0
20-40%	8%	2
40-50%	6%	1
Above 50%	0%	0

4. The high US export companies are in the pharma sector where tariffs are currently not applicable. It is likely that the much talked about pharma tariffs will be implemented over next few months. We believe the tariffs on generics will not be onerous.
5. During the quarter, we continued to add to the chemical sector. Our view is that de-stocking in the sector is behind us, and this should help decent earnings growth in the sector. Meanwhile, we cut weight on a consumer stock where valuations had become challenging and added to our cash positions in order to benefit from any tariff-led correction in the market.
6. We believe investors should keep return expectations tempered during the year and look at this year as a year of consolidation where we build our portfolio for the next few years. We will continue to invest additional money in a staggered manner while being aggressive on any significant dips in the market.

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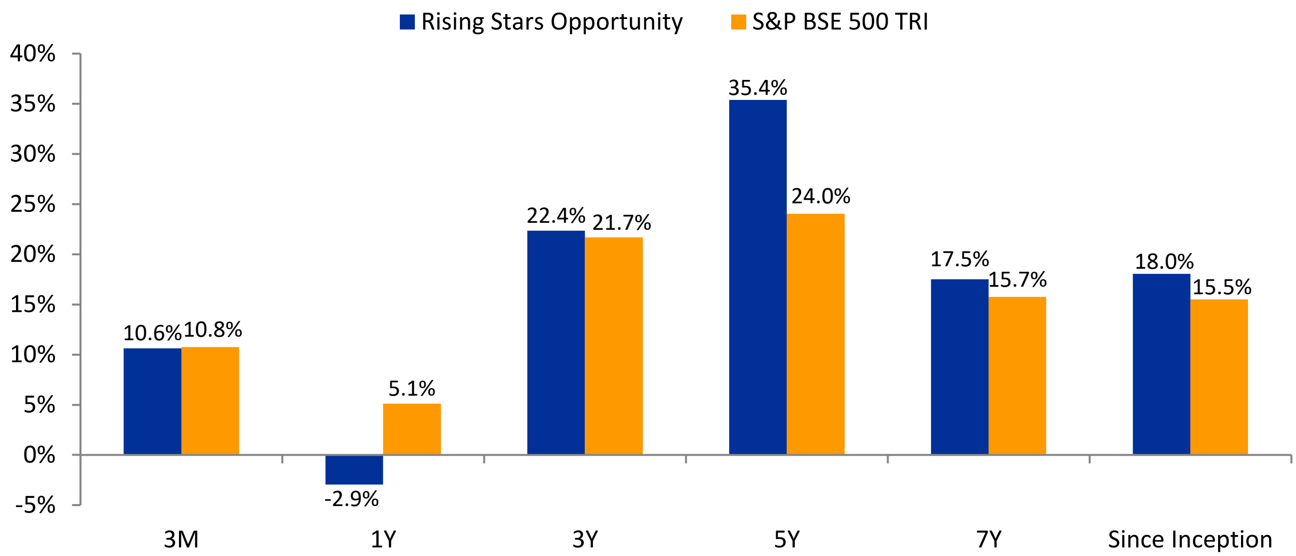
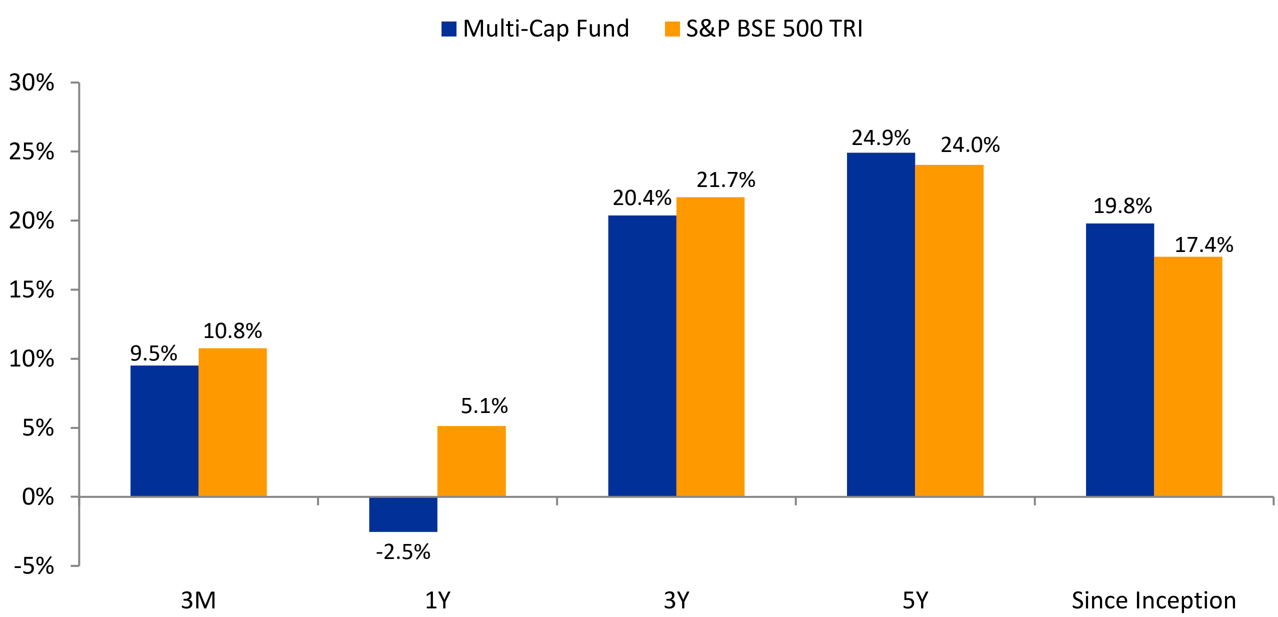
Valentis Rising Stars Opportunity Fund Performance (as on June 30, 2025)



Valentis Multi-Cap Fund Performance (as on June 30, 2025)



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