

Valuations of Equities Seem Stretched: RBI

But promoters raising ownership reflects confidence in their biz: RBI economists

Our Bureau

Mumbai: Valuations of Indian equities seem stretched by most conventional yardsticks, such as price-to-earnings multiples and yield differentials with benchmark bonds, but the trend among promoters to steadily raise ownership in listed companies reflects the confidence they have in their businesses, central bank economists said in their latest report on the state of the economy.

Economists at the Reserve Bank of India (RBI) also said on Monday that monetary and credit conditions are conducive for a durable economic recovery. India's equity indices have outperformed peers so far this year as the country rebounded from the second Covid wave stronger – and more quickly – than initially anticipated. “The spectacular gains have raised concerns over overstretched valuations with a number of global financial service firms turning cautious on Indian equities,” said the RBI’s

MARKETS ON A HIGH

Difference between 10-year G-sec yield & 12-mth Sensx forward earnings yield at 2.47%

Higher than long-term average of 1.65%

Promoter holding in NSE-listed cos up 50 bps to 44.90% end-Sept from 44.42% end-June



RECOVERY PATH

Conditions conducive for a durable economic recovery, say RBI economists

But There Are Concerns Over

- 1] Uneven global growth
- 2] Commodity prices
- 3] Supply bumps
- 4] Withdrawal of monetary support in major economies

latest monthly bulletin authored by its economists.

Wall Street financial firms and leading global brokerages, such as Goldman Sachs, Morgan Stanley, Nomura, CLSA and UBS, have lately been rather circumspect about the prospects of Indian equities, broadly highlighting downside risks to investment returns due to stretched valuations and potential inflationary pressures.

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Traditional valuation gauges, such as price-to-book value ratio, price-to-earnings ratio and market capitalisation to GDP ratio, stayed above their historical averages. The yield gap, or the difference between 10-year G-sec yield and 12-month forward earnings yield of the BSE Sensex, at 2.47% has outstripped its historical long-term average of 1.65%.

Despite widespread concerns over valuations, it is noteworthy that the percentage holding of promoters in companies listed on the National Stock Exchange (NSE) increased nearly 50 basis points to 44.90% end-September from 44.42% end-June.

One basis point is 0.01%.

“Empirical research shows a positive relationship between promoter ownership and firm value,” the report said. “Steadily increasing promoters’ shareholding reflects confidence on the part of the promoters about their business prospects and comfort with ongoing valuations.”

A noticeable dip in fresh infections and rapid progress with vaccinations have brightened recovery prospects.

“The Indian economy is clearly differentiating itself from the global situation, which is marred by supply disruptions, stubborn inflation and surges of infections in various parts of the world,” the RBI report said.

Indicators of aggregate demand have improved in several areas. Mirroring improved economic activity and movement of goods transport, the first-half financial position indicates tax buoyancy helped contain the Centre’s fiscal deficit at 35% of budget estimates despite higher expenditure.

Record production of horticulture crops should bolster the availability of vegetables and fruits.

“Overall monetary and credit conditions stay conducive for a durable economic recovery to take root,” said the report.

In the credit segment of financial markets, transmission to lending and deposit rates has shown consistent improvement ever since the introduction of an external benchmark system in October 2019.

Transmission improved significantly after March 2020 due to abundant surplus liquidity, the RBI said.