Market cap to GDP ratio at 115%; highest since 2008

Combined m-cap of all listed firms has doubled since last March to ₹226.5 trillion

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The Indian equity market continues to race ahead of macroeconomic fundamentals. While the Indian economy recorded its worst performance in 70 years last fiscal, the market capitalisation of listed equities has grown to an all-time high. This has resulted in India’s market cap to gross domestic product (GDP) ratio touching a 13-year high of 115 per cent.

This is the highest level for the ratio since December 2008, when it reached a record high of 150 per cent. In comparison, the ratio hit an 11-year low of 56.8 per cent at the end of March last year, and was close to 100 per cent at the end of March this year.

The combined market cap of all listed companies has doubled since last March from ₹113.5 trillion to ₹226.5 trillion. In contrast, India’s GDP at current prices shrank by three per cent in FY21 to around ₹197 trillion from around ₹203 trillion a year ago. (See the adjoining chart)

The analysis is based on quarterly GDP at current prices on a trailing four quarters basis and the combined market cap of all BSE listed companies at the end of every quarter since March 2005.

India’s current market cap to GDP ratio is higher than historically, raising concerns about the stock valuations on Dalal Street. In the last 15 years, the ratio has hovered around 79 per cent on average with 150 per cent being the highest, reached at the end of December 2008, and 52.4 per cent being the lowest point, touched at the end of March 2020.

“It’s tough to correlate the market cap of listed securities to India’s GDP, but the markets are expensive and look overheated at current levels. One can even deduce this from traditional valuation parameters such as price-to-earnings (P/E) multiple and price-to-book value ratio,” says G Chokkalingam, founder and managing director of Equinomics Research and Advisory Services.

According to him, the recent rise in the market cap has been driven by the rally in mid- and small-cap stocks, rather than large-caps. The BSE MidCap index has risen about 25 per cent since the beginning of 2021, while BSE SmallCap index is up 33 per cent year-to-date. In contrast, the benchmark BSE Sensex is up 9.4 per cent.

Others, however, dismiss the ratio and say that there is no direct link between the market cap or stock prices and a country’s GDP.

“The market cap to GDP ratio doesn’t tell us much. Market capitalisation or asset prices depend on the level of money supply rather than the GDP. There has been a rapid rise in money supply to GDP across the world led by developed markets, and that has fuelled a rally in asset prices, including equities. The result is a higher market cap to GDP ratio,” says Dhananjay Sinha, MD and chief strategist at JM Financial Institutional Securities.

He says the market cap may continue to race ahead of GDP till money supply remains benign and inflation low.

Analysts also point out that while India’s GDP and corporate revenues declined in FY21, corporate profits reached an all-time high thanks to the macroeconomic changes brought about by the pandemic. Gains from lower commodity prices and sharp decline in interest rate helped the corporate profit to GDP ratio hit a decadal high in FY21 of around 2.7 per cent. This, the analysts say, also fueled the rally on the Street.

At the global level, India has the highest market cap to GDP ratio among the BRICS (Brazil, Russia, India, China, and South Africa) countries with the exception of South Africa.

The ratio is 81 per cent in China, 73 per cent in Brazil and 52 per cent in Russia. In Indonesia, a country with per capita income similar to India’s, the ratio is around 47 per cent.