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Why has the Indian market not continued the take-off started in 2017? Our outlook.

Restoring its position as the fastest growing major economy

GDP growth could top 7.5% in 2018—restoring India's position as the world's fastest-growing major economy- , supported by more generous government spending ahead of next year's general elections, robust household consumption and a moderate recovery in private investment –as Delhi has gambled that the extra demand created by higher spending will prod companies to invest-.

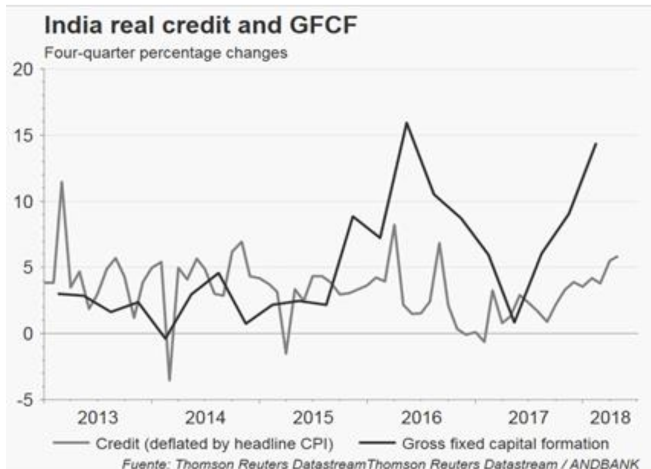
Then, why has the Indian market not continued the take-off started in 2017?

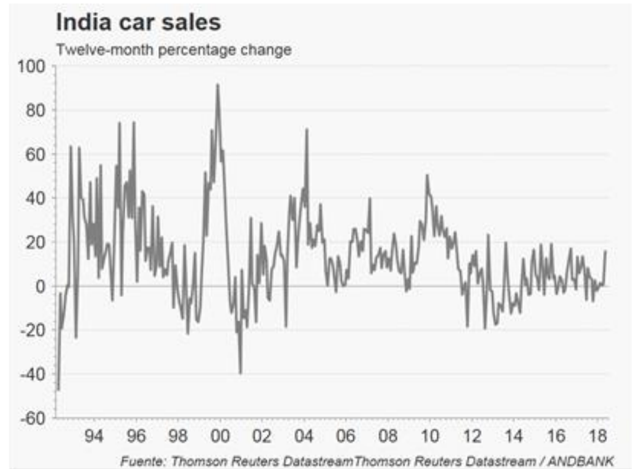
1. Several banks have missed their deadlines for resolving their debts. Most of the 12 big cases referred to the new bankruptcy courts—accounting for 25% of US$200bn worth of bad loans—have missed their 270-day resolution deadline, with bad-debt clean-up bogged down in legal disputes. If banks remain clogged up with non-performing assets, they will be unable to support the budding revival in the investment cycle.
2. Recapitalization announcement in October 2017 lifted animal spirits, but credit growth has since wobbled as banks became risk averse after a fraud scandal seen in 1Q18 helped to spread the perception that the stress within the banking sector is far from being resolved.
3. A rate hike cycle seemed imminent as higher oil import bill (that has expanded the current-account deficit), the government's decision to relax its fiscal-deficit reduction target, and a weak rupee have caused that the risk of rises in inflation has recently picked up. As such, rate hikes looks inevitable.

Our Outlook. The 6 reasons to remain constructive in this market

1. Admittedly, the Indian equities show one of the highest valuations after a stellar rally seen in 2017, preventing foreign investors from adding to much exposure at this stage. However, **India probably has the strongest fundamentals and brightest prospects among large developing economies**, what justifies higher valuations.
2. The rupee has sold off in recent weeks and although remains vulnerable to souring investor sentiment -which could bring the INR towards 70 to the US dollar-, the rupee is no longer overvalued, and this should be supportive for the equity market.
3. Base effects should buoy YoY growth rates in 2H18, meaning full year growth could top the 7.5% projected, and with it, prompting corporate sales and earnings acceleration.
4. Despite the recent sharp uptick in oil prices, India's oil deficit has so far been relatively contained. At 2.5% of GDP it is still less than half the average in 2009-14. As long as the government maintains its commitment to a market-based pricing regime for fuels, India's current account deficit is unlikely to widen significantly beyond 2.5-3% of GDP.

5. In a rare liberalizing move, the RBI in April removed a restriction that only allowed foreign investors to buy debt with maturities exceeding three years.
6. The indicators we follow, and that make up our decision tree, still draw a constructive picture for the Indian market: Encouragingly, there are early signs of a positive turn in the capex cycle (see the first chart below), the manufacturing PMI is healthy, export demand has picked up, and private consumption is robust (see chart two below).
7.





Just hope it helps.

Best

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