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Private Bankers

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It's not India's decade, it's India's century," says McKinsey's CEO

It's been a few weeks since I last wrote to you about India, despite being an investment with a structural vocation in our mandates. This is because nothing that could alter the drivers that led us to enter this market has changed. Therefore, our structural conviction remains intact for this market.

Nevertheless, and given the requests by some collaborators to update our vision regarding this market, let me to summarize the most relevant recent events, as well as our assessment.

Macro & Inflation. Outlook.

The government continues to forecast bullish growth of 8.0-8.5% in the 2022-23 fiscal year, but that now looks much too optimistic in our opinion. We are inclined to think that GDP growth will be closer to 7.2% this fiscal year, and then will moderate to 6.5% for FY2024 and 2025. For inflation, projections are of a decline to 6.8% this year, declining to 5.2% and 4.75% in the subsequent years.

The Consumer Price Index (CPI) for July decreased to 6.71% compared to 7.01% the previous month. Core inflation remained stable at 6.25%. The Industrial Production Index (PI) for June moderated to 12.3%.

Forecasts are still for bullish growth.

Capital Flows.

According to the latest RBI data, the foreign exchange reserve position narrowed marginally to USD 561.05 Bn during the month. The USD appreciated by 0.24% during the month and closed at Rs 79.46/USD from Rs 79.27/USD last month. Foreign investors were net buyers of Indian equities worth USD 6.26 Bn and net buyers of fixed income worth USD 0.54 Bn. Meanwhile, domestic investors were net sellers of US$0.81Bn equities during the month.

Outlook for Indian assets remains structurally positive in our view. As a summary of favourable arguments for equities in India, we would highlight the following:

1. India is the country with the highest growth (7.5% growth expected for India in 2022 according to the main institutions).
2. India has joined the “USD 3 Tn” club (surpassing UK) with a per capita income similar to that of China in 2007.
3. Inflation is under control compared to developed economies, as it is an agricultural country, so the food component is under control, while commodity prices are moderate.
4. Although the stock market has recovered due to the correction in global commodity prices, which has led to some moderation in inflation expectations, shares in Indian market continue to trade within reasonable valuation levels.
5. This decrease in global inflation could reduce the current pace of interest rates hikes in the West, and thus reducing funding costs in foreign currency for EM’s companies.
6. While the coming months may remain volatile for equity markets in India due to global factors, such as the war in Ukraine, domestic earnings are expected to continue to rise as the underlying domestic demand remains robust and this will lead to valuations remaining reasonable.
7. The Indian economy's fundamentals and long-term growth potential remain strong and we see any correction as an attractive long-term opportunity.
8. A very healthy banking system with net NPAs below 2% and leverage levels also low, with net corporate debt/EBITDA at lowest level in 15 years.
9. According to McKinsey CEO: It is not India's decade but India's century.

Why can India's valuations remain higher than the rest of the EMs?

Valuations in these markets are basically based on ROEs and sustainability of growth. Indian companies are clearly outperforming the rest of peers in terms of ROE and growth, and as a result, valuations will remain higher as long as this continues. India's historical premium is the key to evaluating valuations.

Strength of the currency. A significant asset

On the monetary front, the RBI's monetary policy committee (MPC) decided to hike interest rates by 50 bps, which is favourable for the currency.

Main risks

Interest rates increases well above the consensus is the main risk. If they continue to rise, high growth companies with high valuations will be affected. We must be very attentive to the Interest rate-inflation relationship. What are the expectations of monetary policy and interest rates? Increase of 205 bps during 2022, similar to the FED, with RBI withdrawing liquidity (QT). A 40-50bps hike was expected at the last meeting (and the central bank delivered that rate hike), and we expect rates to reach over 6% in 2023 (depending on inflation data). We don't see a rate cut until inflation is at 4%.

Preferred sectors

Consumption, banking and financial services, consumer durables, basic products. IT is also emerging in the country, which is key for global businesses.

How is India living with the geopolitical situation?

The policy chosen by India is a strategic autonomy. The country is part of the association between a set of states, known as Quad (the Quadrilateral Security Dialogue, is a group of four countries: the United States, Australia, India, and Japan), despite having military dependence on Russia (70% of military equipment) and despite China remaining an important trading partner.

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