India - the narrative is strong but enjoy in moderation

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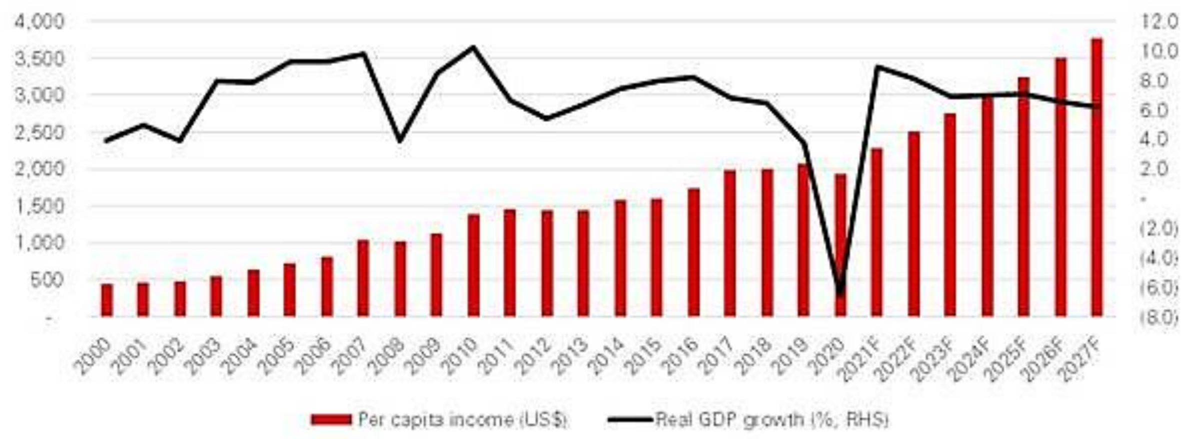
The strong performance of Indian stock indices (Nifty up ~14%) in the last 4 months to new all-time highs has put the focus back on the India growth story. FIIs have invested close to US$18bn during the period after $6bn of net selling in FY23. While Equity markets are prone to bouts of optimism and pessimism, Indian economy remains on a steadier and sustainable growth path which is likely to yield reasonable returns for equity investors over the medium to long term in our view.



Source: IMF

We see multiple drivers to India growth story coming together this decade driven by Infrastructure development, revival of Indian real estate cycle and finally growth in manufacturing supported by the two former points and other secular drivers. These together have the potential to drive a virtuous cycle of income and consumption growth and lead to economic outcomes that investors expect India to deliver.

The Indian central government continues to provide strong budgetary support to improve domestic infrastructure and has announced the National Infrastructure plan with potential to attract Rs 100 trillion of investments. Focus is multi-pronged with boosting capacity and modernization of traditional infrastructure like roads, railways, power and also newer areas like Urban infrastructure, creation of multi-modal logistics infrastructure, renewable energy, smart metering etc. The government is working on ensuring basic amenities like clean drinking water and electricity are available to all citizens which will help drive significant improvement in quality of life.

After a prolong slump through much of last decade, the Indian residential real estate cycle is showing signs of strong revival. This similar to infrastructure development has a strong multiplier effect for the overall economy in our view. Both these drivers can help attract workforce away from agriculture to jobs in construction and manufacturing.

We are positive on the medium-term growth prospects of Indian manufacturing space also aided by global supply chain shift away from China, more localization of Defence manufacturing and the boost from green energy revolution. Increasing size of the domestic market along with low manufacturing cost is also forcing global companies to consider India as a manufacturing base for their global supply chain. Development of a strong manufacturing ecosystem in multiple sectors and becoming part of the global supply chain similar to what India has done in Pharmaceuticals is likely to remain a big theme for the next decade. We are witnessing encouraging signs in this regard in sectors like Electronics, Chemicals and auto components.

The government is playing a strong enabling role in this respect with its Production Linked Incentive (PLI) scheme by incentivizing manufacturers in several industries including those mentioned above as well as for green energy (Electric vehicles, batteries and green hydrogen) and kick starting the virtuous cycle of ecosystem development.

In our view, strong growth in manufacturing and construction remains critical for India to gainfully employ its young population and reap the benefits of demographic dividend.
However, the growth path is likely to be undulating with both local and global challenges. Government needs to walk a tight rope to ensure that the fiscal deficit declines even as it tries to invest more in infrastructure, Defence and social development. This is required to ensure interest rates remain at a reasonable level to help attract private investment. While geo-political pressures have moderated, the global economic picture is far from clear. The general expectation seems to be that a mild recession in US and EU in late 2023/early 2024 is a possibility. So, some turbulence for the global financial markets will need to be considered.

Finally, valuations of the Nifty and broader market are capturing some of these positives in the near term. While valuations have moved up, given the expectations of a higher growth environment, the broad market may continue to outperform, thereby rewarding good stock selection. We therefore advise investors to continue to invest gradually or systematically a part of their long-term financial savings to capture the potential opportunities emerging from an expanding economy.

Source: Bloomberg, IMF, Data as on 31 July 2023 required to inform themselves about, and to observe, any such restrictions. If any person chooses to access this document from a jurisdiction other than India, then such person do so at his/her own risk and HSBC and its group companies will not be liable for any breach of local law or regulation that such person commits as a result of doing so.

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