Modi coupled with huge liquidity in world markets will take Indian economy to unprecedented heights

Post BJP's monumental victory in 2014 Lok Sabha elections, we analyze the anticipated economic climate in India based on Mr. Narendra Modi's vision to drag India out of current economic slump.

1) **Under Modi, who has a clear mandate, all bottlenecks on investments in India will be cleared with lightning speed and infrastructure projects will take off in a big way:** India was expected to grow at the rate of 9% per annum from FY13 to FY17 on the back of cumulative infrastructure investment of USD 1tn (INR 65tn). However, in the first two years, GDP growth rate has declined to almost 5% with the lack of growth attributed to slowdown in growth of infrastructure segment. According to RBI, inadequate regulatory policies in terms of procedural delays, complex rules and regulations related to land acquisition, legal requirements and environmental obligations held the investors back from investing in India. On the other hand, we saw state of Gujarat registering growth of over 13% over the past three years with its model of development, backed by its chief minister and now prime ministerial candidate, Mr. Narendra Modi. It is no coincidence that Mr. Modi achieved in Gujarat what UPA could not achieve in India, by merely eliminating the bottlenecks related to land and environmental issues. Hence, our belief is that FDI into India, especially in the infrastructure segment, would improve significantly with BJP and Mr. Modi leading India at the Center.
2) **More than a trillion dollars expected to flow into India through FDI for infrastructure projects, such as development of Bombay-Delhi rail corridor, 100 hi tech cities and new ports:** We believe that Narendra Modi's vision to create 100 modern, smart and wireless cities will boost infrastructure investments in India. First, Mr. Modi's vision to create this kind of infrastructure backed by affordable housing is the need of the hour, as past land deals have taken prices so high that well-off middle class families cannot afford to buy houses on those lands. With minimum expected estimated cost of USD50bn per city, investments of USD 5,000bn will be required to build this network of well connected smart cities that would serve as a model for future economic development in India. A separate project, Delhi Mumbai industrial corridor, which spans 6 states with rail, road, port and air connectivity, itself promises to bring in an initial investment of USD 10bn. We estimate that huge FDI to the tune of trillions of dollars is bound to find its way into India backed by credible plans by Mr. Modi's Government to earn good risk adjusted returns on such investments.
3) **Huge FDI will lead to rupee appreciation and help lower import inflation:** RBI has tried to contain inflation by maintaining high interest rates in India but so far has not succeeded in controlling it. It should be remembered that inflation and high growth always go hand in hand but Influx of FDI in India will lead to appreciation of rupee reducing import inflation. Also, interest outgo on deposits in Indian banks of USD 1,186bn (at end of FY13) would reduce and help in controlling the increase in money supply arising from addition of interest to deposits. Lower interest rates in India would also help export intensive industries by reducing their interest payments and improving their margins and making them more competitive in international markets.

4) **Modi, with clear mandate and reformist agenda, will replicate Gujarat development model across India and create millions of jobs in Indian economy**: In 2004, Congress won the national elections and formed Government with support from Left parties, known to be opposed to reforms in private sector. It resulted in a bull run with Sensex appreciating from 4,841 in June 2004 to 20,827 in early January 2008 even though no reforms were initiated by the UPA government in this period. During this period, savings rate improved from 31.4% in 2004 to 37% in 2007. Now, we see a scenario similar to 2004 for Indian economy but with one major difference that will encourage the investors more than it did during the previous period. The national government will be headed by a pro-reform Modi with a proven good governance record in Gujarat for past 10 years, backed by a qualified analysis team of IIM and IIT graduates, who also shaped Modi's election campaign. We expect procedural delays to be eliminated after Mr. Modi's rise to the top. Our confidence is guided by Mr. Modi's model of development in Gujarat, where land sale was immediately facilitated by state government to industrial groups , like Adanis and Tatas, is expected to be adopted all over India. Power plants of Tata Power and Adani Power have bought an investment of INR 40,000cr. The Adanis have also invested about INR 20,000cr in the Mundra SEZ and port project . Tata Motors have set up Nano production plant of 250,000 cars per annum in Sanand. These examples of domestic corporate savings directed into Gujarat state were followed by retained earnings of foreign companies finding its way to Gujarat. Ford Motors has invested USD1bn in its new factory at Sanand. According to one government official, 425 companies (including foreign multinationals, like Bosch Rexroth India Ltd, Hitachi Hi-Rel Power Electronics Pvt. Ltd, Colgate Palmolive Co and Nestle India Limited) will be investing INR 6,000cr in Gujarat. If Gujarat model is adopted across India, (immediate facilitation of sale of land to private sector by Government) then 40 million jobs will be created across India boosting Indian GDP growth rate.
5) **Savings and budget deficit bound to improve with the implementation of new development model:** Under new reformist Government, we expect Government budget deficit to improve by privatization of some Government enterprises and improvement in profitability of Government enterprises. Also, improving business environment will increase corporate savings, which was the main reason for improvement in India's savings (as % of GDP) from 31.4% in 2004 to 37% in 2007. Improving business environment also means more tax collections for Government.
6) **Ample world liquidity in the world will boost investments in India; Fed's QE tapering won't affect world liquidity:** We note that world savings are forecast to reach 26% of world GDP in 2017, an all time high for last 38 years. The figure would be USD 24,447bn. In retrospect, we would like to point out that China recently offered to finance 30% of India's USD1tn of infrastructure development needs. Important conclusion to be drawn from the above numbers is that there is plenty of liquidity in the world and capital will chase avenues that offer good risk adjusted returns. Chine, a trade surplus country with excess capacity in steel and cement sector and USD 3.8tn of foreign currency reserves, realizes that very few countries offer the opportunity to realize high risk adjusted returns. There is very little scope to realize high returns in US, which is offering yields as low as 2.5% on 10 year Government bonds.

Also, most of the demand for investment in infrastructure related sectors such as, steel, cement in developed countries is for replacement demand rather than substantial new demand. In such a scenario, there are very few real investment options. Investors have long feared that QE tapering would reduce world liquidity ignoring the fact that world savings are as high as 25% of GDP and expected to improve to 26% by 2017. This proves that there is ample liquidity in world markets even with scaling back of Fed's QE program and this excess liquidity needs to be parked somewhere. For the moment, yields on 10 year Treasury notes hit their lowest (since October 2013) of 2.5% on May 15, 2014. Treasury yields go down if inflation (growth) expectations are low. Investor concerns for investing in bond markets were guided by lower inflation expectations (low growth expectations) in key developed markets, such as US, UK and Europe, and developing China prompted investors to purchase US Treasuries. For e.g. US import prices were down 0.3% in April from a year earlier, China reported weak home sales, retail sales and industrial production, Bank of England and ECB reported weaker inflation. All these measures point to weaker growth in other parts of world and India seems to be one of the few options, where investors can park their money and earn good returns.

To conclude, we anticipate a better investment demand and supply scenario in India and anticipate India's economic environment to improve dramatically in the next 5 years.

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