

May 29, 2023

# India Equity Strategy and Economics

## How India Has Transformed in Less than a Decade

This India is different from what it was in 2013. In a short span of 10 years, India has gained positions in the world order with significant positive consequences for the macro and market outlook. We present a snapshot of these changes and their implications.

We run into significant skepticism about India, particularly with overseas investors, who say that India has not delivered its potential (despite its being the second-fastest-growing economy and among the top-performing stock markets over the past 25 years) and that equity valuations are too rich. However, such a view ignores the significant changes that have taken place in India, especially since 2014. We highlight the 10 big changes, mostly because of India's policy choices, and their implications for its economy and market.

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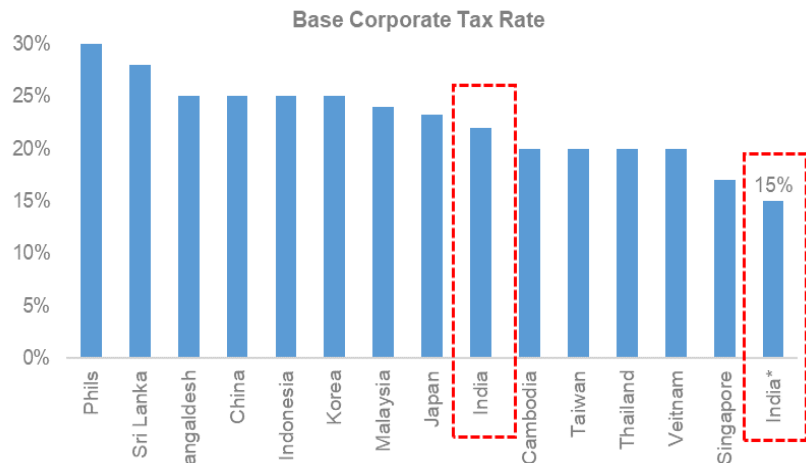
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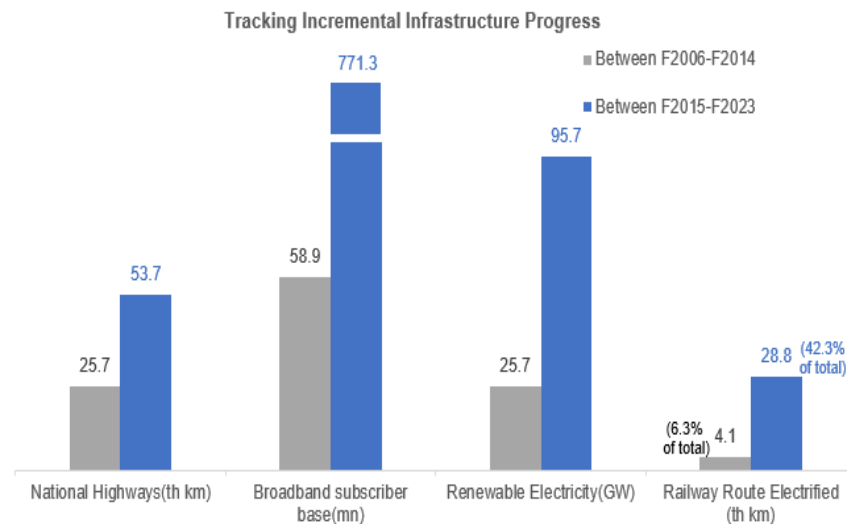
## Ten Big Changes

## 1) Supply-side Policy Reforms

### India's Corporate Tax at Par with Peers



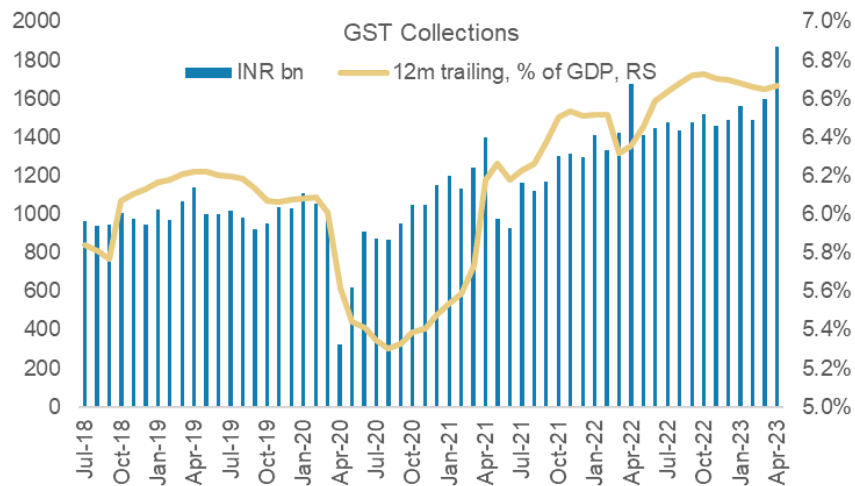
### Infrastructure Has Picked up Pace in the Last Eight Years



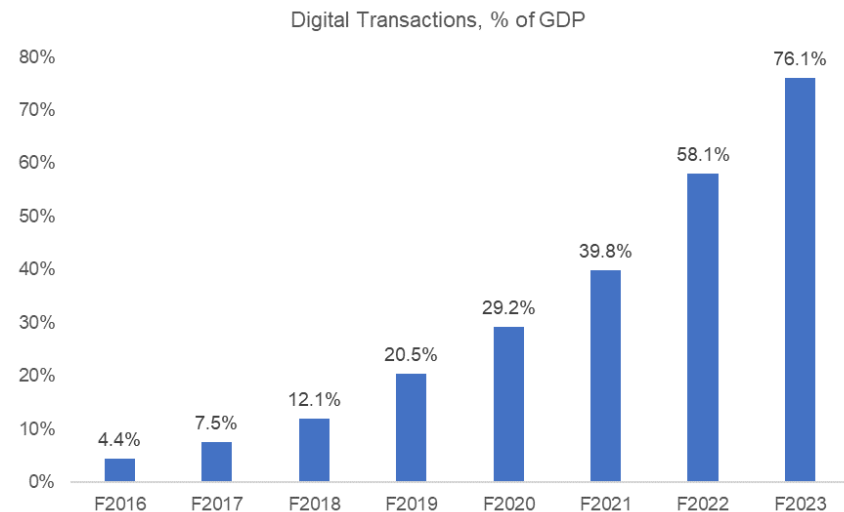
Source: World Bank, CMIE, TRAI, Ministry of Road, Transport & Highways, Morgan Stanley Research \* for new manufacturing companies with operations commencing before Mar-24

## 2) Formalization of the Economy

### GST Collections on an Upward Trend



### Digital Transactions, % of GDP



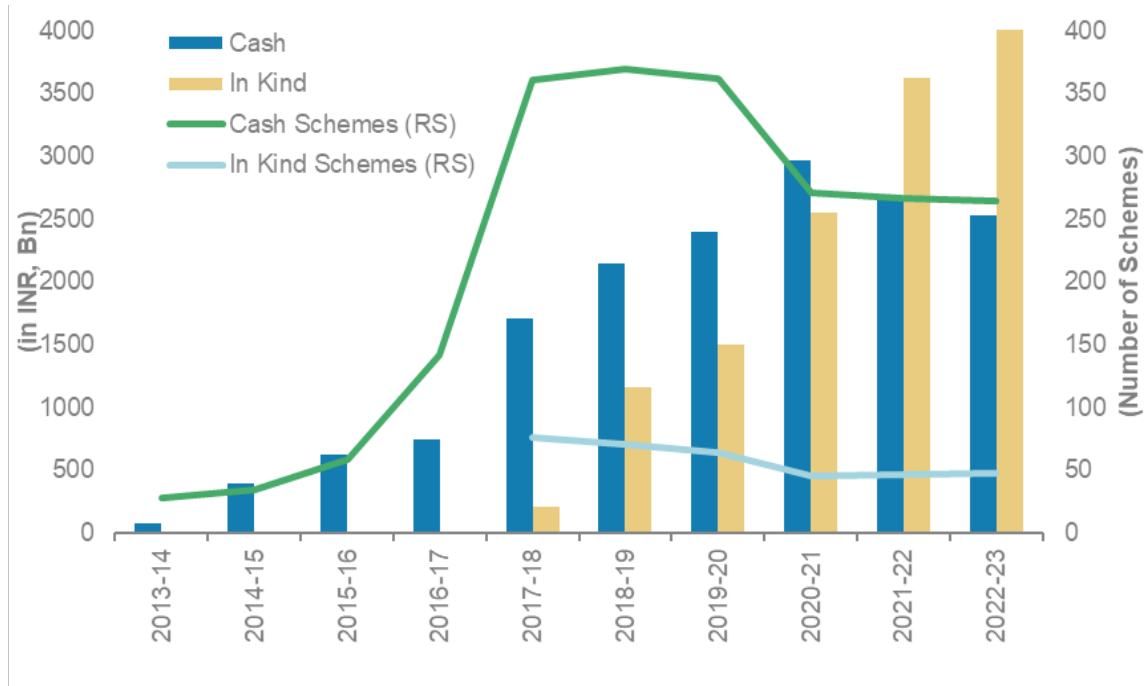
Source: Ministry of Finance, RBI, Morgan Stanley Research.

### 3) Real Estate (Regulation and Development) Act



Source: JLL, Morgan Stanley Research.

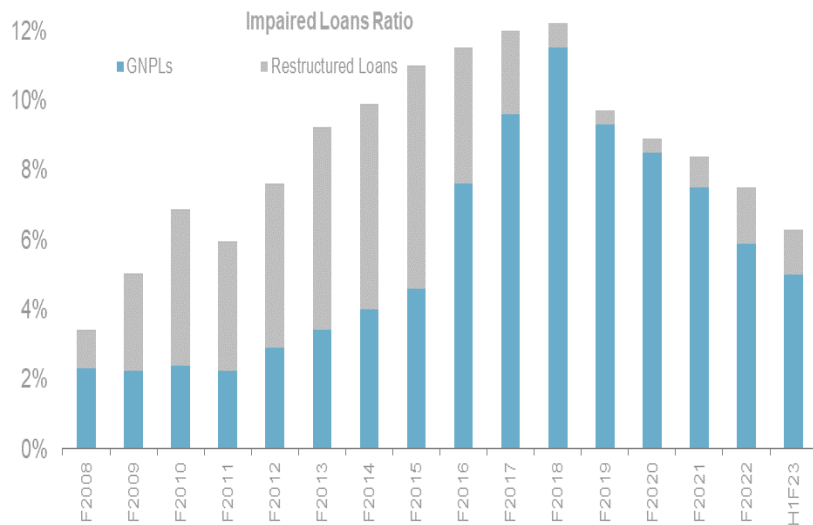
## 4) Social Transfers: Direct to Beneficiary



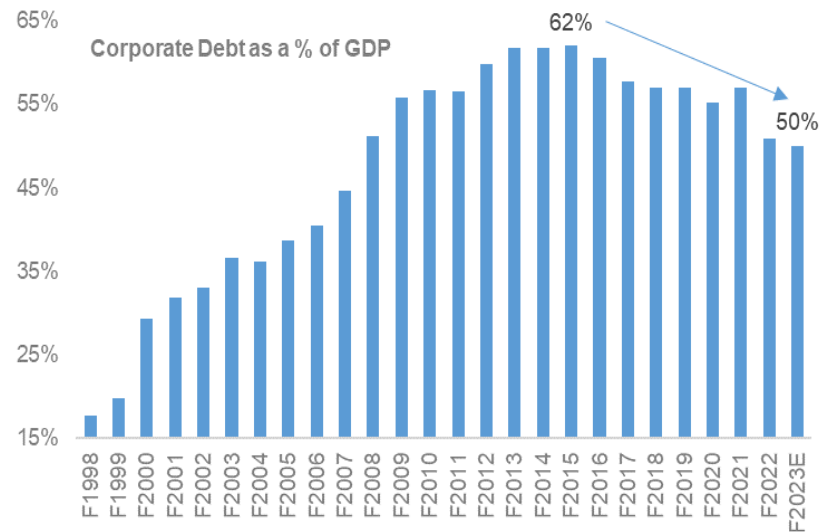
Source: DBT website, Morgan Stanley Research.

## 5) Insolvency and Bankruptcy Code

### Impaired Loan Ratio at 12-year Low



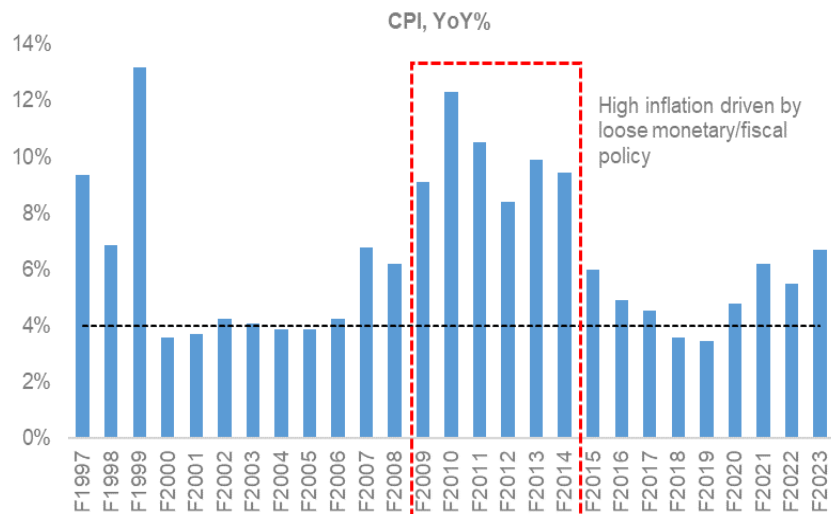
### Corporate Debt, % of GDP to Moderate to 50% in F2023e



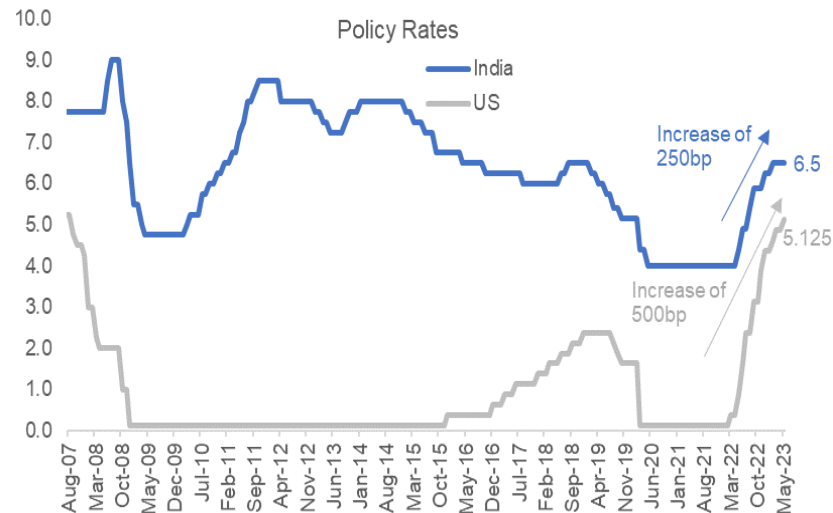
Source: CEIC, RBI, Morgan Stanley Research, Morgan Stanley Research Estimates

## 6) Flexible Inflation Targeting

### Flexible Inflation Targeting Regime Has Allowed...



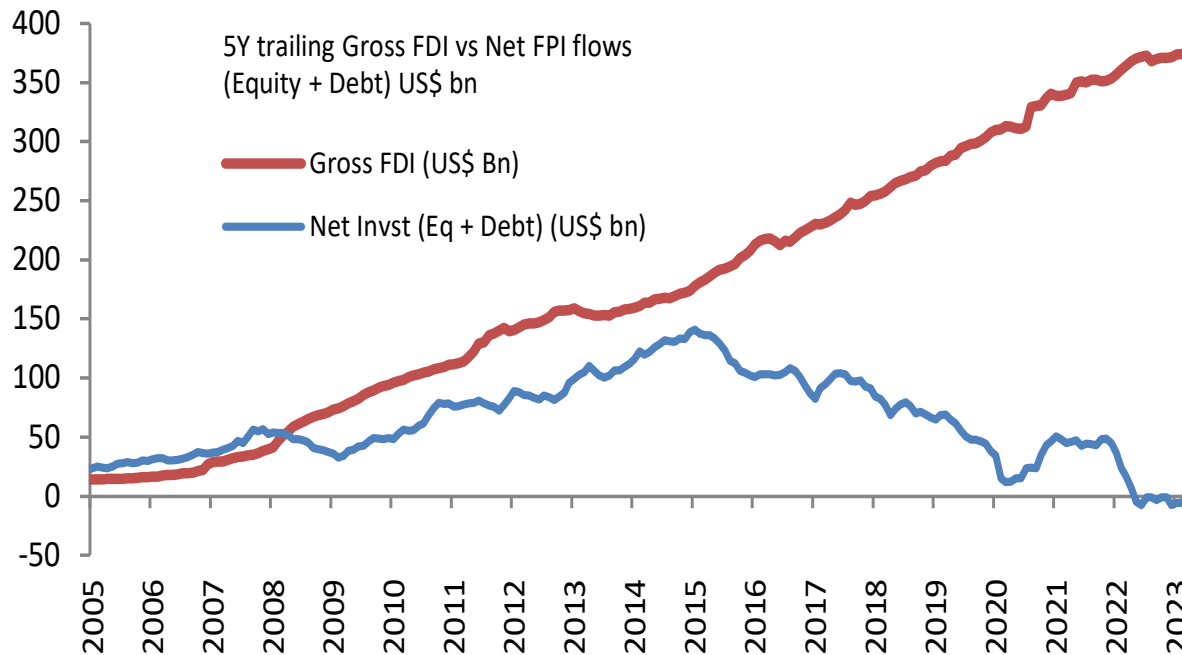
### ...Decoupling of Fed and RBI Policy Rate Hike Cycle



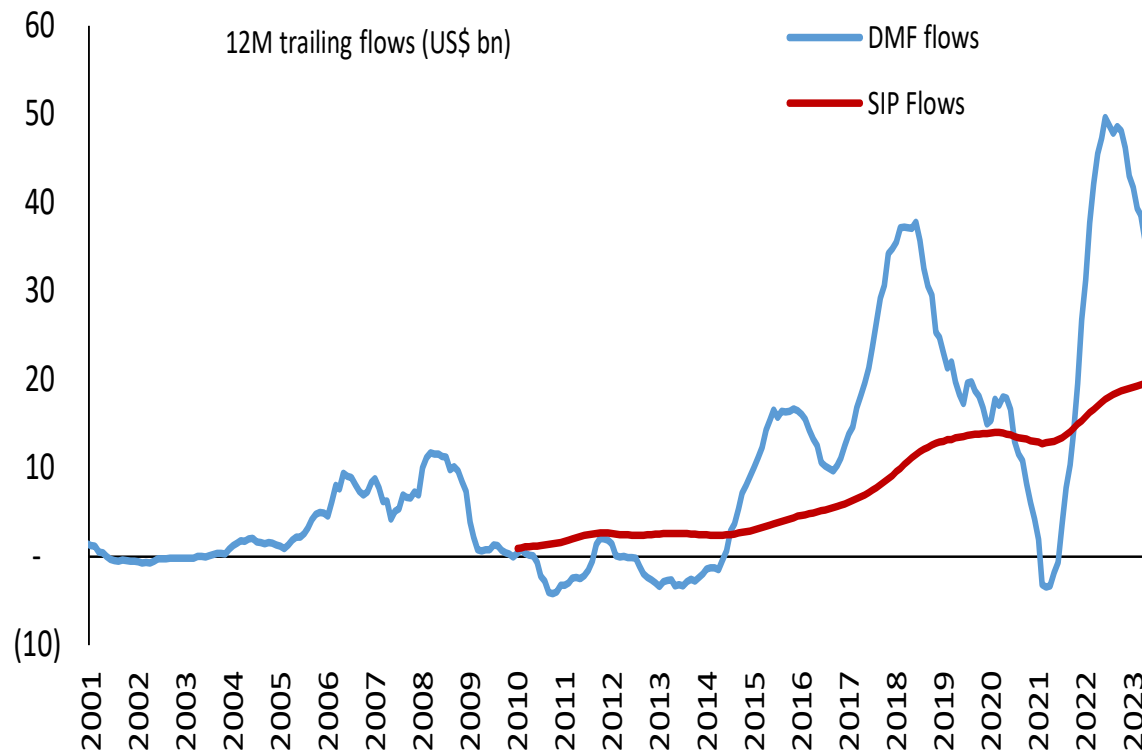
Source: Haver Analytics, CEIC, Morgan Stanley Research.



## 7) Focus on FDI

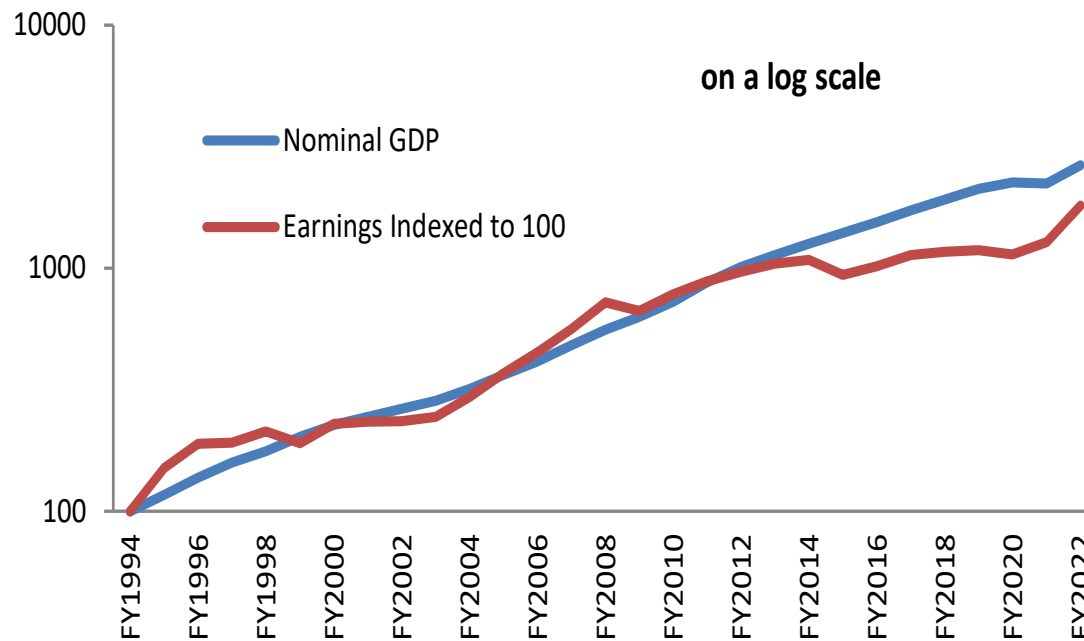


## 8) India's 401(K) Moment



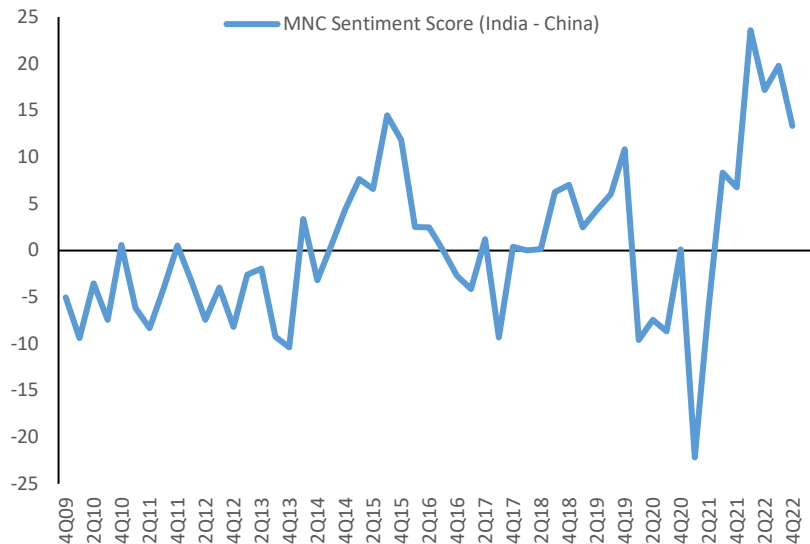
Source: CDSL, SEBI, Morgan Stanley Research

## 9) Government Support for Corporate Profits

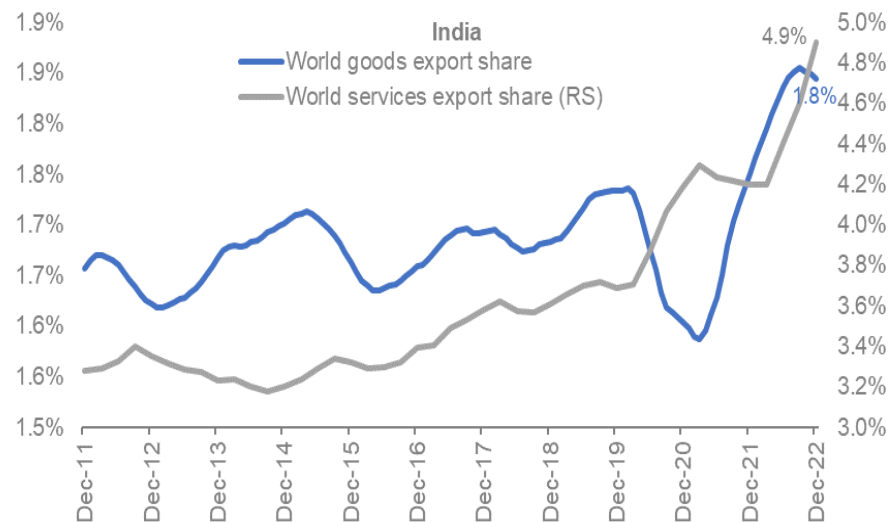


## 10) MNC Sentiment at Multiyear High

India's Outperformance vs. China on Sentiment



Offshoring Boom: India's Service Export Market Share Accelerates



Source: Refinitiv, Alphawise, Haver Analytics, Morgan Stanley Research

## The 10 Big Changes

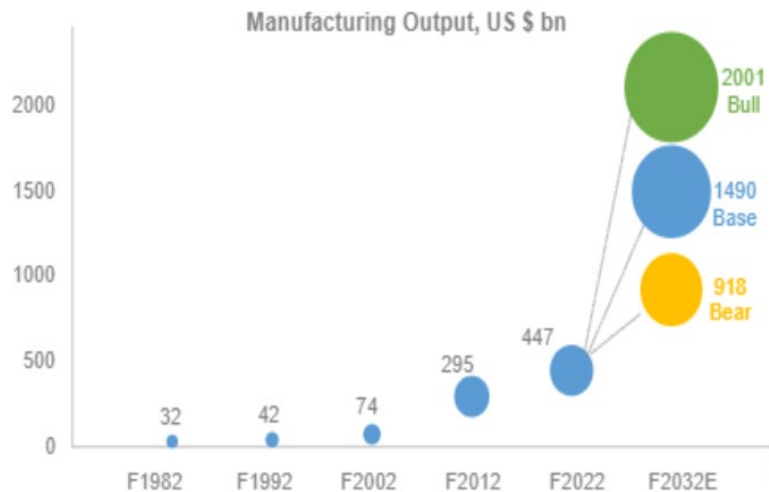
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- 1. Supply-side Policy Reforms**
- 2. Formalisation of the Economy**
- 3. Real Estate (Regulation and Development) Act**
- 4. Digitalizing Social Transfers**
- 5. Insolvency and Bankruptcy Code**
- 6. Flexible Inflation Targeting**
- 7. Focus on FDI**
- 8. India's 401(k) Moment**
- 9. Government Support for Corporate Profits**
- 10. MNC Sentiment at Multiyear High**

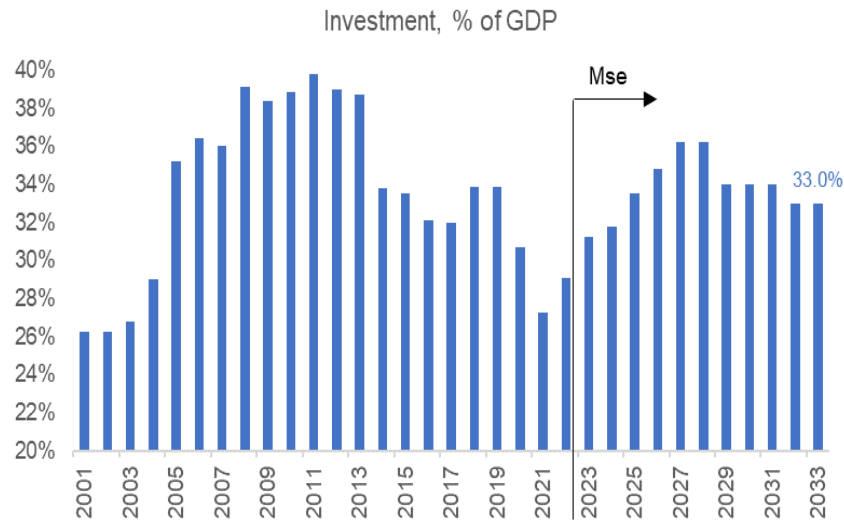
## Macroeconomic Implications

# 1) Manufacturing and Capex, % of GDP to Rise Steadily

Manufacturing Output, US\$ bn

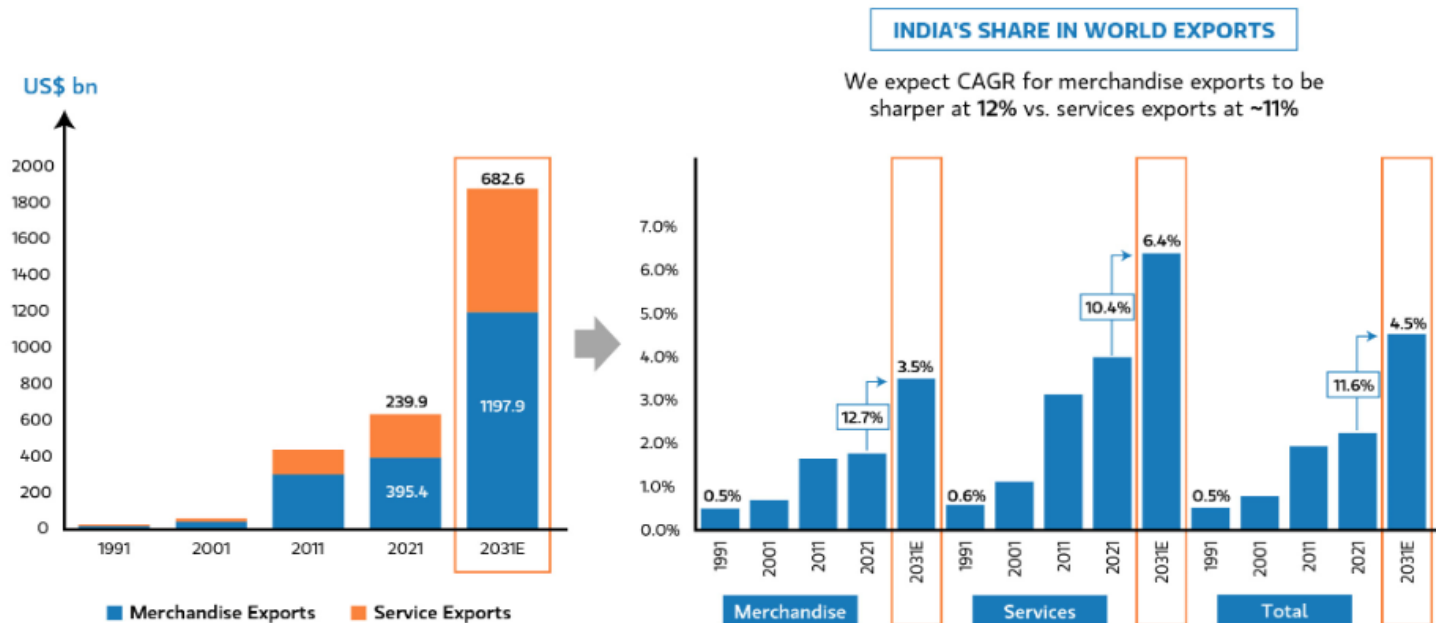


Investment, % of GDP



Source: CEIC, RBI, Morgan Stanley Research, Morgan Stanley Research Estimates

## 2) Export Market Share to More than Double to 4.5% by 2031



Source: WTO, Morgan Stanley Research Estimates

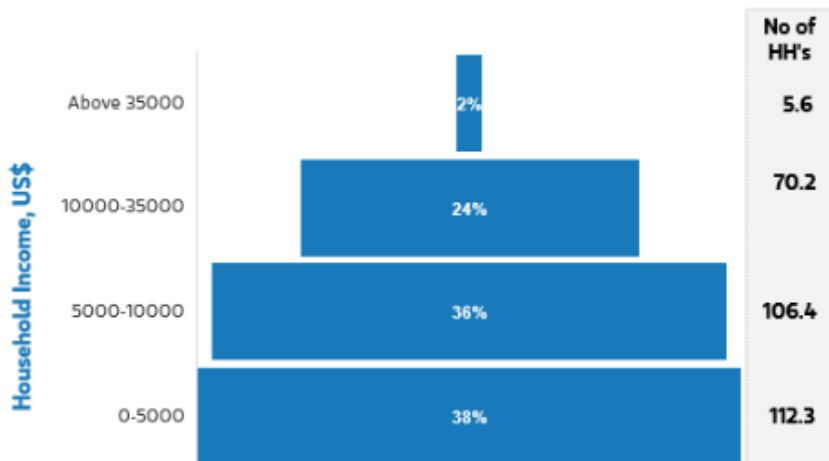


### 3) Major Shift in Consumption Basket

#### 2021 Households by Income Distribution

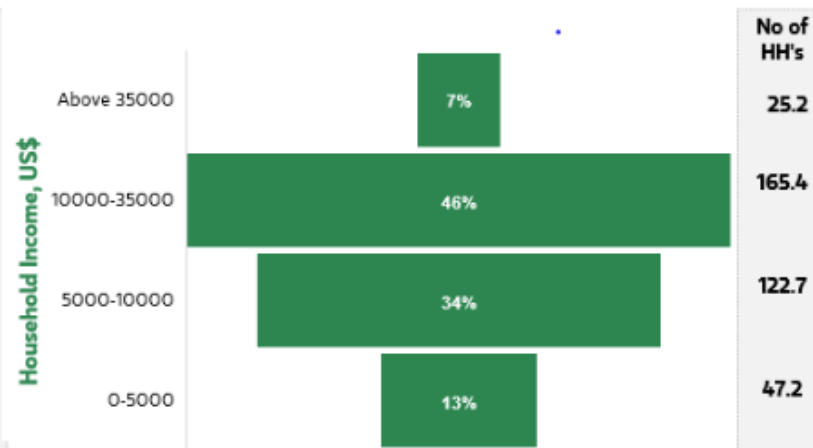
Households:  
GDP per capita:

294.8mn  
\$2278



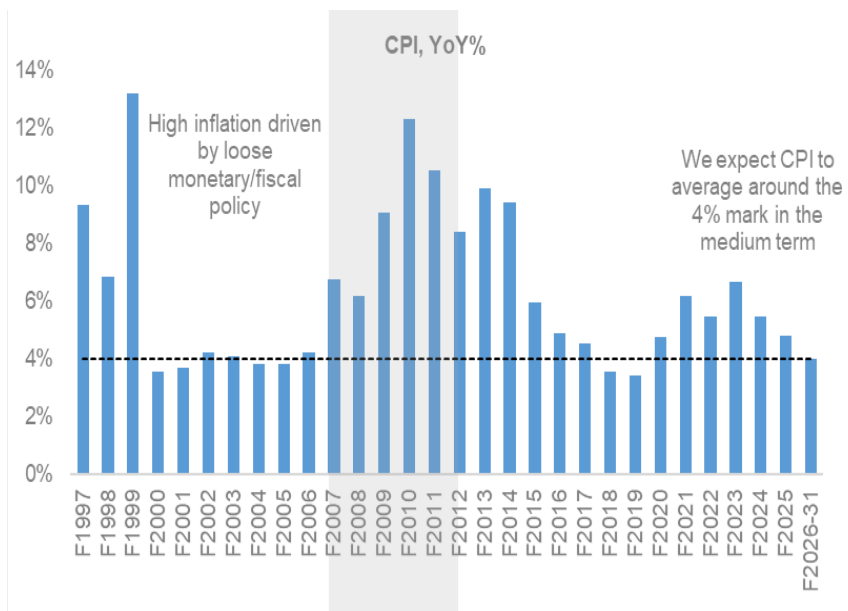
#### 2021 Households by Income Distribution

360.5mn  
\$5242

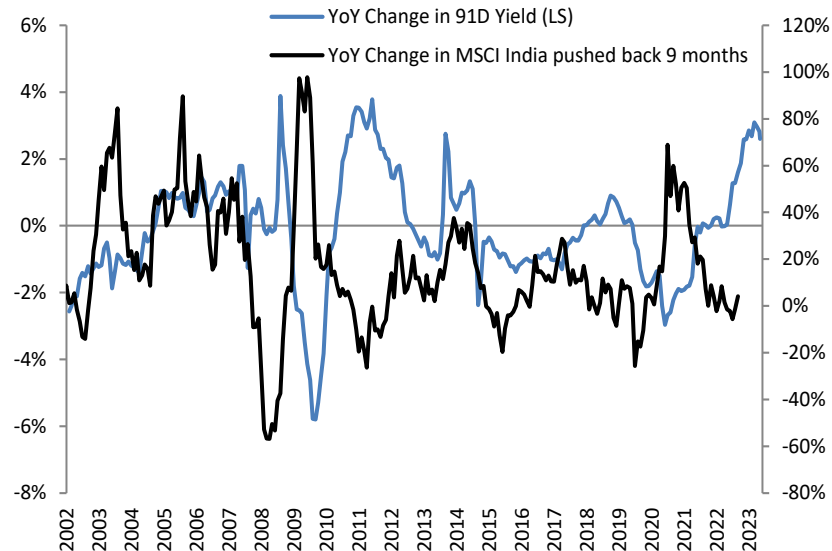


## 4) Lower Volatility in Inflation and Shallower Interest Rate Cycles

Price Stability in the Medium-term

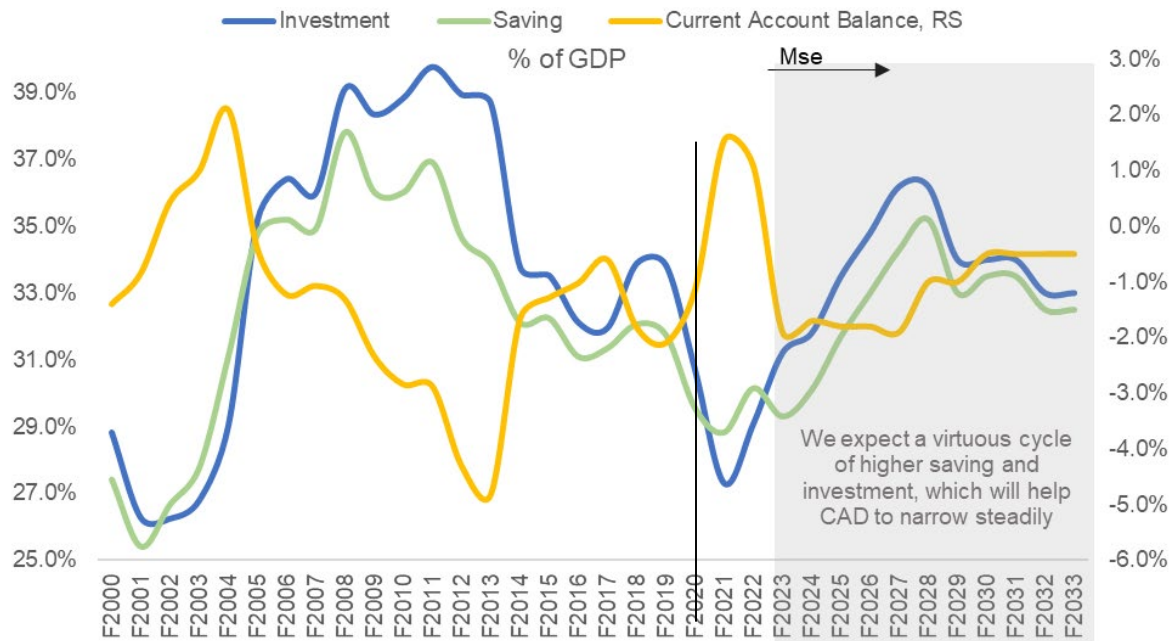


Short rates may have peaked



Source: Bloomberg, CEIC, RIMES, MSCI, Morgan Stanley Research, Morgan Stanley Research Estimates

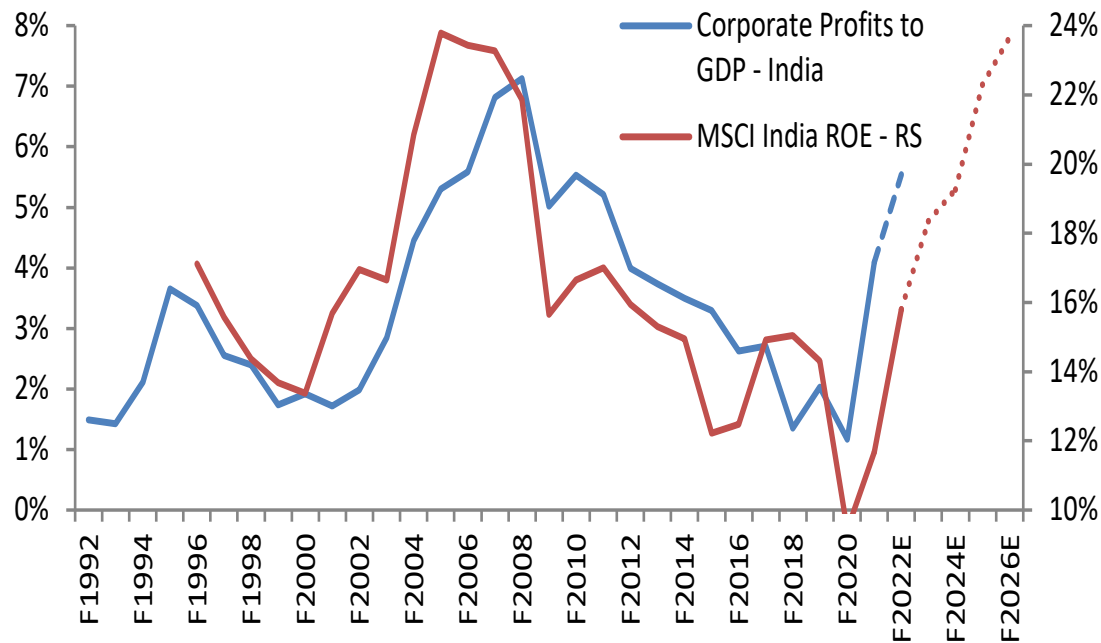
## 5) Benign Trend in Current Account Deficit



Source: RBI, CEIC, Morgan Stanley Research, Morgan Stanley Research Estimates

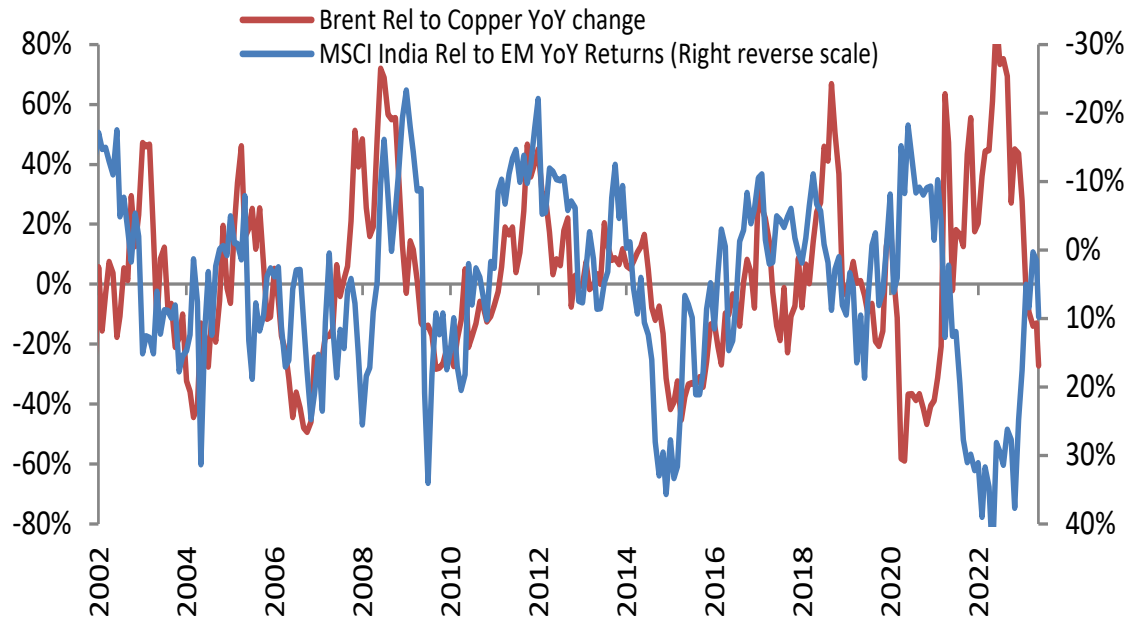
## Stock Market Implications

## 1) Profit Boom



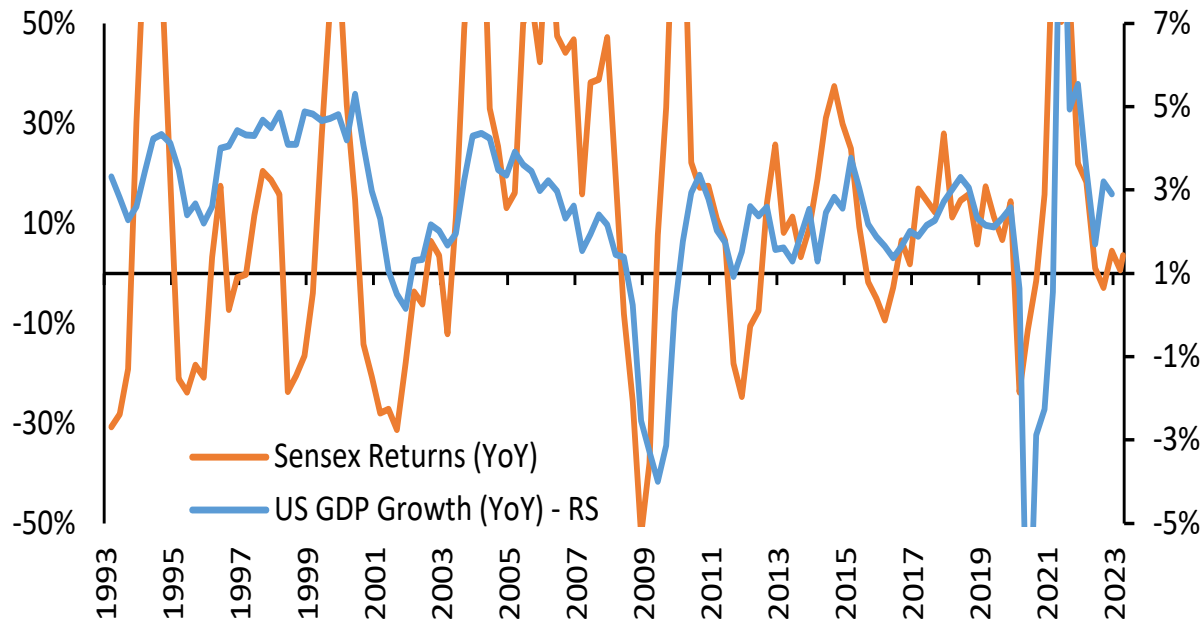
Source: CMIE, RIMES, IBES, Worldscope, MSCI, Morgan Stanley Research (e)

## 2) Breakdown in Correlation with Global Oil Prices

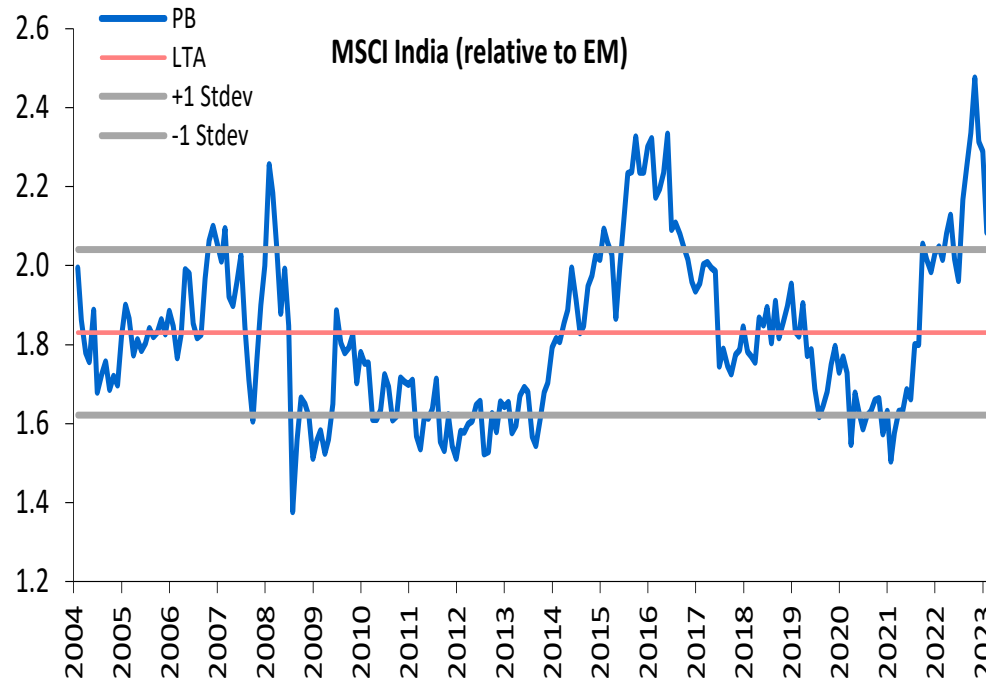


Source: RIMES, MSCI, Bloomberg, Morgan Stanley Research

### 3) Likely Breakdown in Correlation with US Recessions



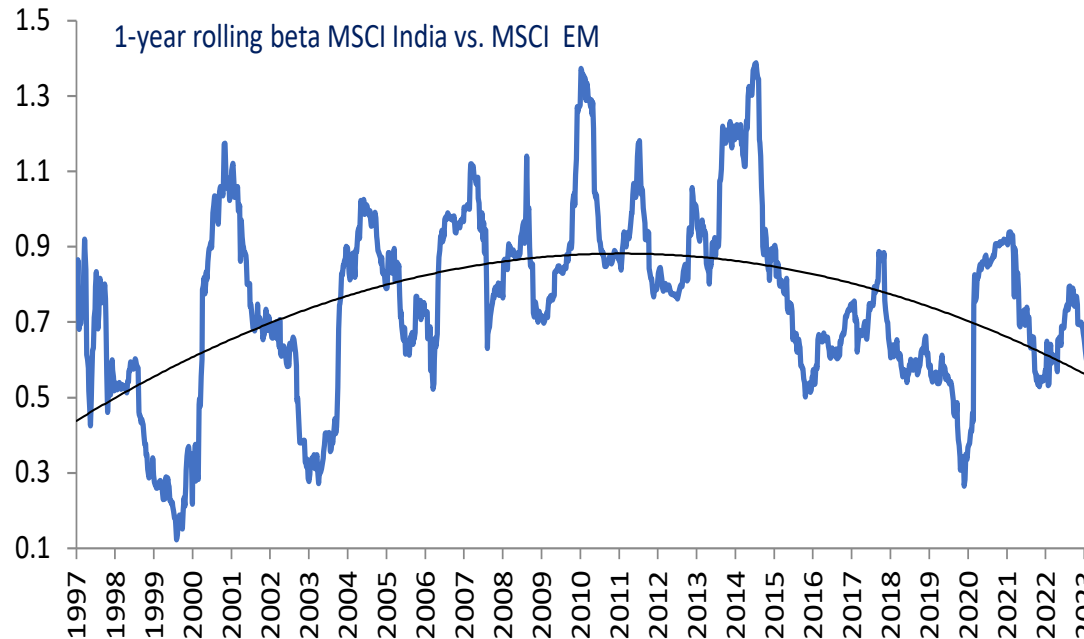
## 4) Indian Equities Re-rate: MSCI India P/B Relative to MSCI EM



Source: RIMES, MSCI, Morgan Stanley Research



## 5) Indian Stocks Have Become Defensive: India's Low Beta



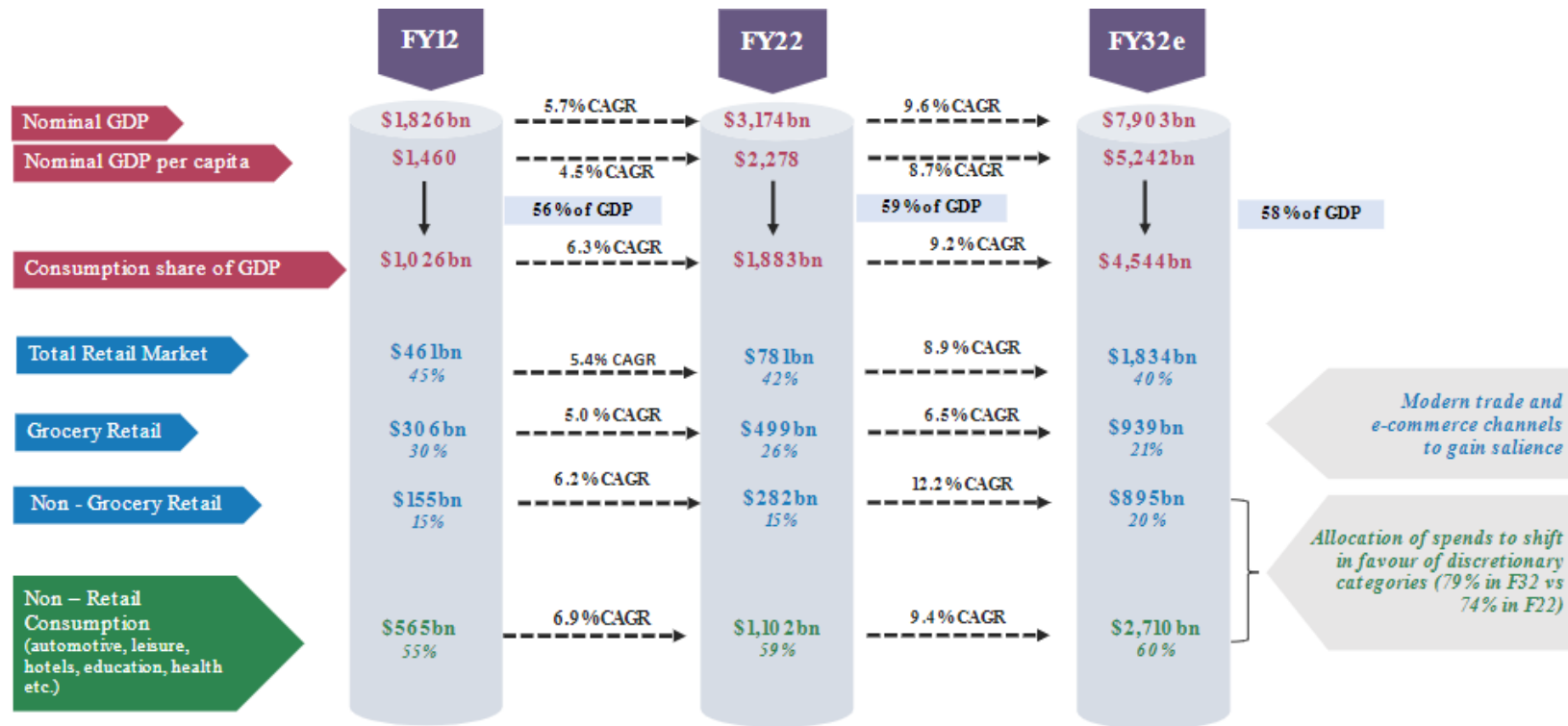
Source: RIMES, MSCI, Morgan Stanley Research

## The 10 Implications

- 1. Manufacturing and capex as % of GDP to increase steadily:** We expect a new cycle in manufacturing and capex, as we estimate the share of both to rise in GDP by approximately 5ppt by 2031.
  - 2. Export market share to double:** We estimate that India's export market share will rise to 4.5% by 2031, nearly 2x from 2021 levels, with broad-based gains across goods and services exports.
  - 3. Major shift in consumption basket:** As India's per capita income increases from US\$2,200 currently to about US\$5,200 by F2032, this will have major implications for change in the consumption basket, with an impetus to discretionary consumption.
  - 4. Lower volatility in inflation and shallower interest rate cycles:** We expect inflation to remain benign and less volatile, which would imply shallower rate cycles. Shallower rate cycles could also imply more benign equity market cycles.
  - 5. Benign trend in current account deficit:** We believe India's structural transformation will feed into the saving-investment dynamics, implying gains for its external balance sheet, with a progressively narrower trend in the CAD.
  - 6. A profit boom:** The share of profits in GDP has doubled from all-time lows hit in 2020 and are set to rise further – maybe even double from here – leading to strong absolute and relative earnings. This explains India's apparently rich headline equity valuations. Triggered by supply-side reforms by the government, we expect a major rise in investments, a moderation in the CAD and an increase in credit to GDP to support the coming profit growth.
  - 7. Lower correlation with oil prices:** Lower share of foreign portfolio (FPI) in current account funding has reduced the stock market's negative return correlation with oil prices, especially when oil prices rise due to supply disruption.
  - 8. Lower correlation with US recession:** As India's reliance on global capital market flows has reduced, the market's sensitivity to a US recession and US Fed rate changes also seems to be fading.
  - 9. Valuation re-rating:** This reflects persistent domestic demand for stocks and higher growth for longer. India is trading at a premium to long-term history, albeit well off highs and in line with recent history.
  - 10. India's beta to EM has fallen to 0.6:** This is a consequence of improved macro stability and reduction in dependence on global capital market flows to fund the CAD.
- Key Risks:** A global recession, a fragmented general election outcome in 2024, sharp rise in commodity prices due to supply outages and shortages in skilled labor supply.

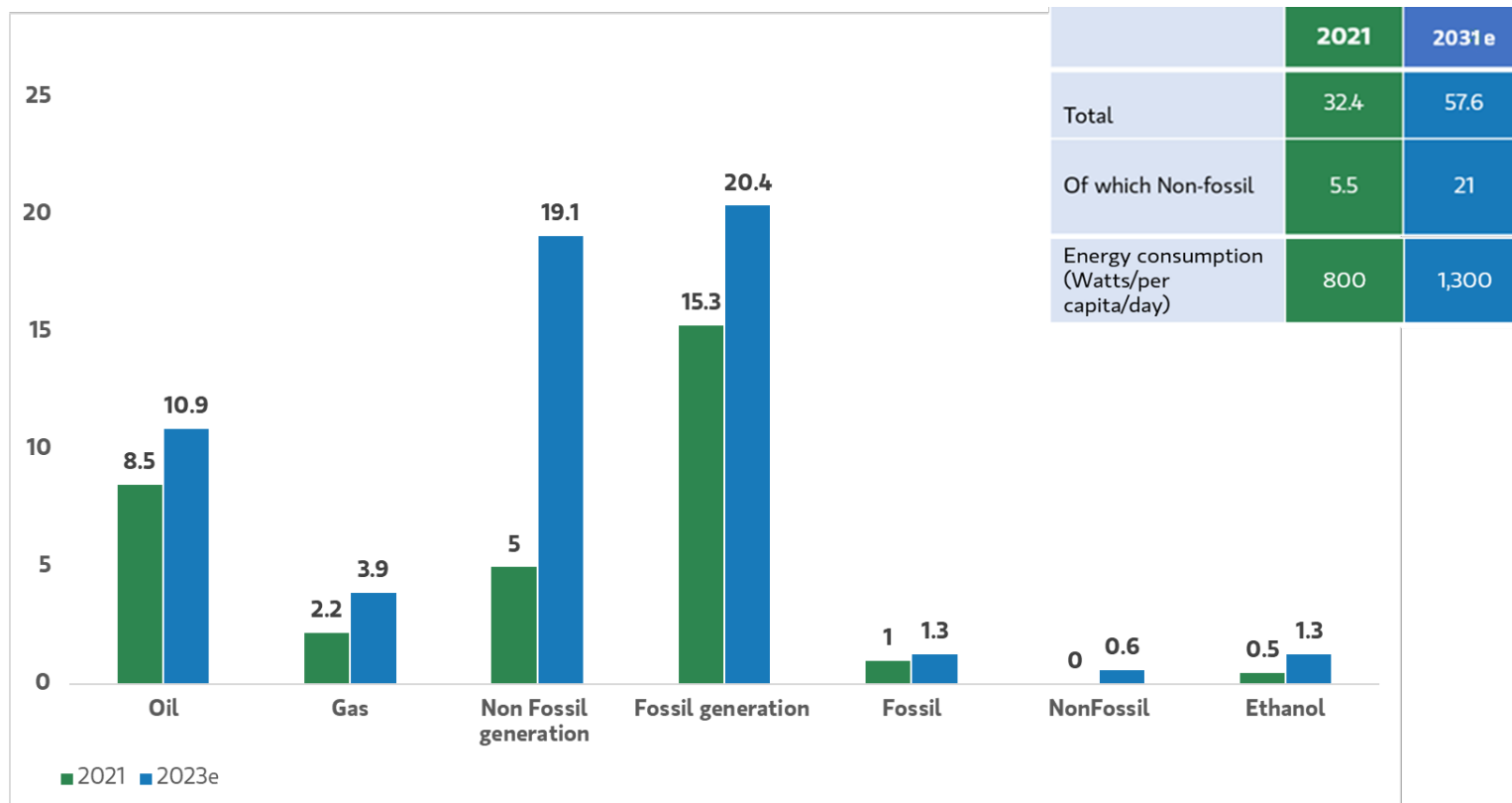
## Sector Implications

## A Discretionary Spending Boom Is on the Horizon



Source: Morgan Stanley Research Estimates

## India's Energy Boom



Source: Morgan Stanley Research Estimates

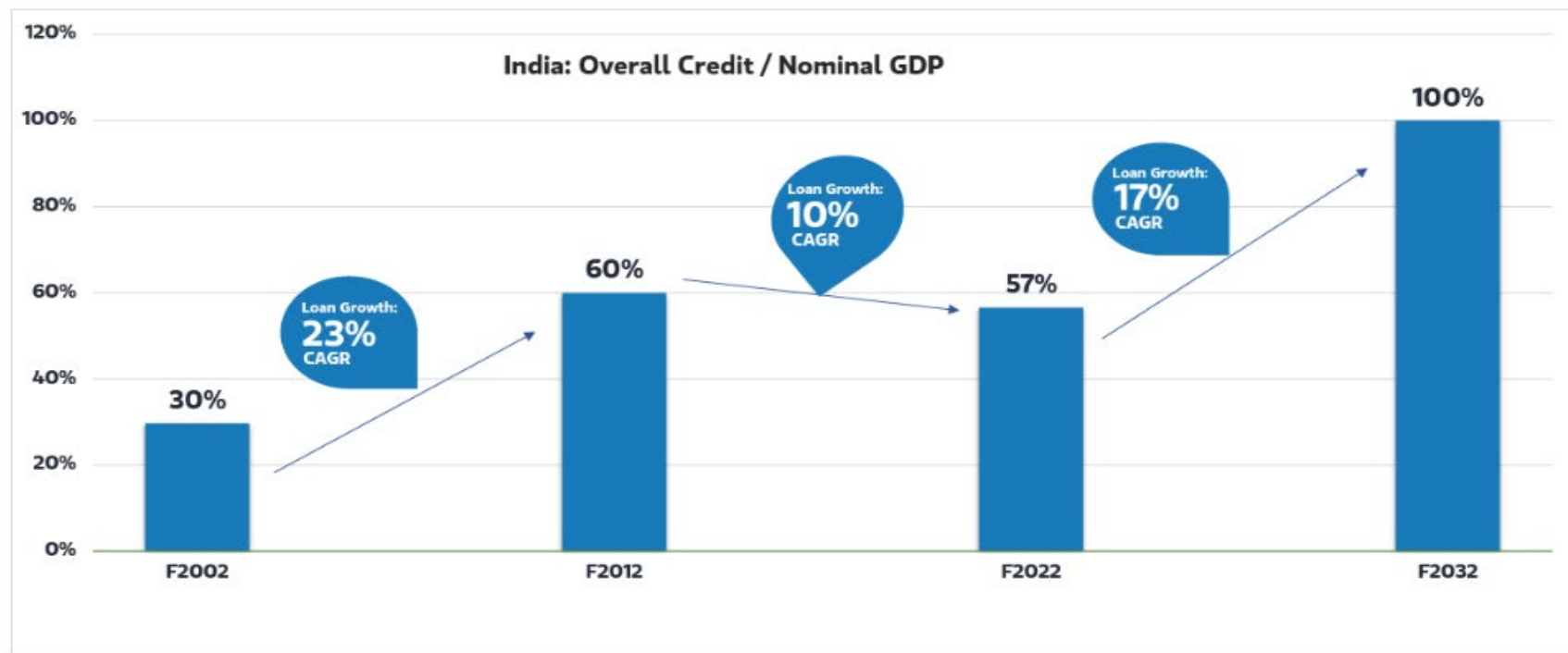
## India Stack: Disruptive Growth in the Pipeline

CATEGORIES	RIDE HAILING	FOOD	ELECTRONICS	GROCERY	TRAVEL	BEAUTY	HEALTHCARE	FASHION
No. of SKUs/Fill rate	Yellow	Red	Yellow	Light Green	Red	Light Green	Green	Light Green
Standardization of products	Red	Light Green	Red	Yellow	Dark Green	Yellow	Red	Dark Green
Genuineness of supplier	Yellow	Light Green	Red	Light Green	Light Green	Red	Yellow	Red
Complexity of buying process	Red	Red	Yellow	Red	Yellow	Light Green	Yellow	Light Green
% Return	Yellow	Yellow	Light Green	Red	Red	Light Green	Yellow	Dark Green
Average ticket size	Red	Red	Light Green	Yellow	Light Green	Yellow	Yellow	Light Green
OVERALL	Red	Red	Yellow	Yellow	Yellow	Light Green	Light Green	Dark Green



*Decreasing potential for disruption by introduction of ONDC*

## Financial Services: Unprecedented Growth Likely



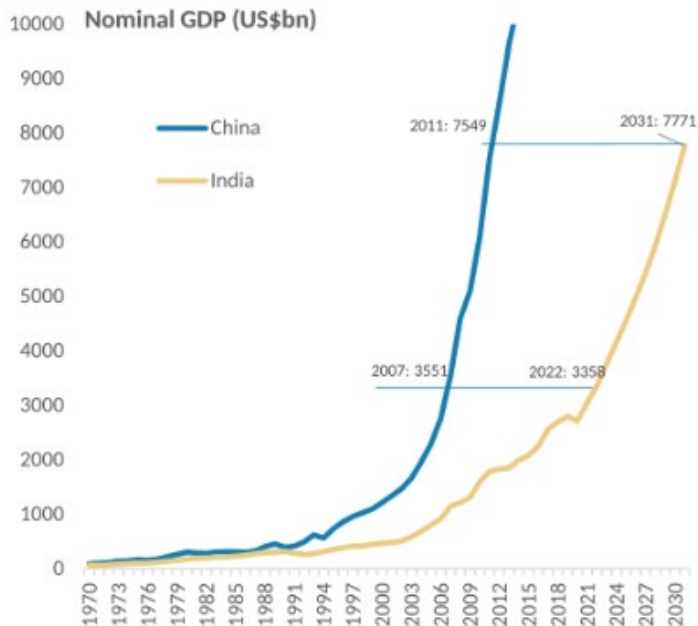
Source: RBI, Morgan Stanley Research estimates. Note: Overall Credit includes banks, NBFCs and HFCs. For NBFCs + HFCs, numbers are based upon bottom-up reported numbers for major listed entities and regulatory reporting

## Conclusion

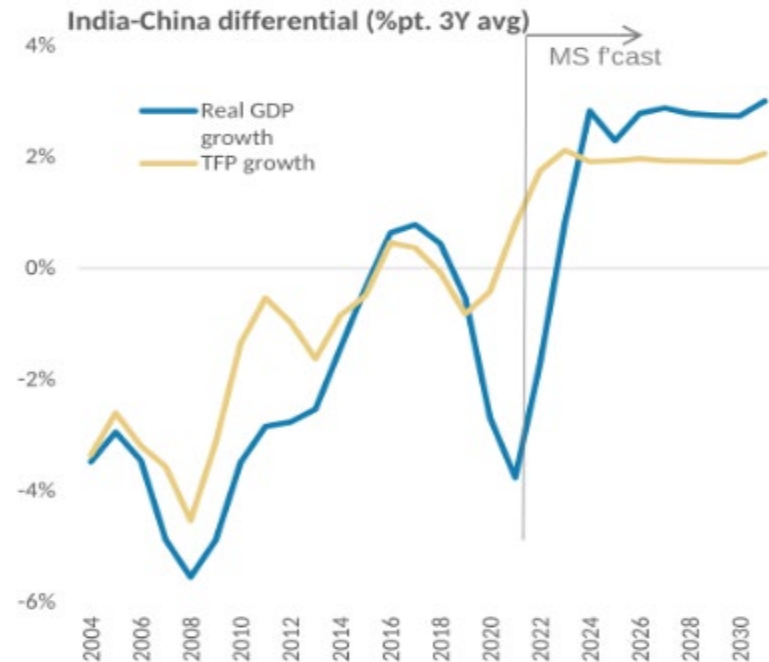


## India Will Emerge as a Key Driver for Asia and Global Growth

### India's Next Decade will Resemble China in 2007-11

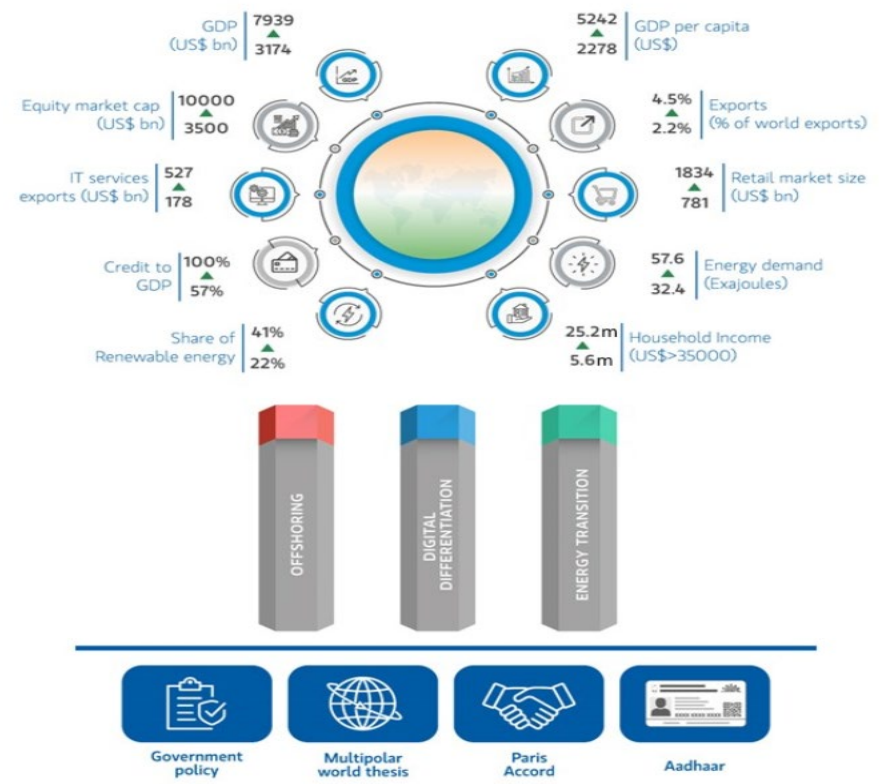


### GDP and Productivity Growth Differentials will Swing in India's Favour



Source: CEIC, Haver, Morgan Stanley Research, Morgan Stanley Research Estimates

**THE NEW INDIA WILL DRIVE A FIFTH OF GLOBAL GROWTH THROUGH THE END OF THIS DECADE**



Source: Morgan Stanley Research

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STOCK RATING CATEGORY	COVERAGE UNIVERSE		INVESTMENT BANKING CLIENTS (IBC)			OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC)	
	COUNT	% OF TOTAL	COUNT	% OF TOTAL IBC	% OF RATING CATEGORY	COUNT	% OF TOTAL OTHER MISC
Overweight/Buy	1357	37%	269	42%	20%	599	39%
Equal-weight/Hold	1660	45%	307	47%	18%	721	47%
Not-Rated/Hold	5	0%	1	0%	20%	1	0%
Underweight/Sell	639	17%	70	11%	11%	228	15%
<b>TOTAL</b>	<b>3,661</b>		<b>647</b>			<b>1549</b>	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

## Disclosure section (cont.)

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

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Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

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