Ocean Dial March 2016 Investor trip to India
"Disrupting the status quo"

The current narrative that questions India's reform agenda fails to consider the motivation behind the Prime Minister and the RBI Governor. Whilst independent of each other, their purpose is to disrupt the *status quo* rather than encourage its recovery. Much of the impatience that is now being vocalised, is in part due to the visible signs of stress in the economy, and the fourth consecutive year of earnings downgrades in the equity markets. Investors foresaw "big bang reform" centred on reviving the investment cycle, thereby facilitating a recovery in earnings to initiate the next bull market for equities. Similarly, corporate India has clamoured (in vain) for looser monetary policy to ease stressed balance sheets and revive lending. Instead, the recent macroeconomic stability that has resulted from fiscal prudence, inflation targeting (high real interest rates), and lower commodity prices, has been used to reset the operating environment for business, with crony capitalism as the main target:

- Forcing PSU banks to recognise the true extent of NPAs
- Government operations documented online, subsidies streamlined into recipients' bank accounts, and a draconian clampdown on savings in the shadow economy

The result of this disruption has created short term pain for growth as the economy adjusts to a cleaner and more transparent operating environment. Indeed, 95% of India's capex in the last 10 years came from five sectors, all of which were reliant on Government patronage, including real estate which is responsible for one third of jobs outside of agriculture. This game is now over and the impact has been most severe in rural India where wage growth has fallen from a consistent 15-20% range under the Congress Party to barely 5%. Within the confines of adhering to a fiscal deficit target, Government policy is following a two pronged approach – build economic momentum through an expansive road and rail programme (where the multiplier effect can kick-in faster), and create a more conducive business environment for FDI and domestic companies – in order to "crowd-in" private sector investment:

- State spending on land acquisition for infrastructure; FY14 US$800m, FY15 US$900m, FY16 US$2.2bn
- Amendment to arbitration law; 12 month time limit (previously unlimited) for speedier dispute resolution
- Road construction
    - FY15 4,500km, FY16 target 6,000km (will be met), FY17 target 10,000km
    - Total highway network 100,000km, of which only 24,000km are 4-6 lanes. 3 year target to upgrade 50,000km to this, and build 10,000km of new highways
    - Main focus of non-highway roads is to connect remote villages to rural towns
- Railway reforms
    - India's logistic costs ~13% versus global average of 8%
    - Five year budget of US$128bn; spent US$16bn in FY16 (US$10bn in FY15 which was the norm)
    - Priority is track laying so freight and passenger rail get independent lines to unclog the system
    - FDI; GE, Alstom, Bombardier to set up plants in India to supply coaches and locomotives
    - Independent rail regulator set up (originally part of the Government) to ensure fairer arbitration

FDI commitments have picked up and business leaders point towards the creation of a more suitable environment for investing. Confidence in the Government and RBI's ability to execute strategic planning is growing. Beyond progress in road and rail connectivity:

- 213m new bank accounts, LPG subsidies now paid directly, kerosene underway with food being piloted
- 23 banking licences issued in two years (only two were issued in previous 21 years)
- 1,000 day deadline to electrify 18,500 villages set last year. Year 1; 6,500 connected (5,500 target)

The economy is still adjusting to the clampdown on crony capitalism (as well as recovering from two consecutive poor Monsoons). The stress is especially pronounced in rural India where the downturn has been more prolonged than in recent cycles. Alongside global uncertainty, the extended slowdown has resulted in more reasonable valuations in the stock market. The benefits of the reform agenda will be felt in due course, and the pace and direction of travel is encouraging, especially considering that corruption at the upper levels of Government have declined considerably. Moreover, we are hopeful of more progress on legislative reform in this parliamentary session. As such, it is clear that a platform is being built for a longer term, more sustainable and inclusive recovery that will facilitate India's transition into a modern economy.