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Flash Note
October 24, 2019

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India: +8.3% YTD (lagged a little behind), but the future remains constructive

Politics gives way to economic decisions

There is another important election. Now in Maharastra –India's richest state-, where the ruling BJP is poised to repeat the stellar performance showed in April's national elections, helped by an alliance with the right–wing Shiv Sena party, after implementing an Hindu nationalist agenda. Indian PM Modi has spent the first nine months of his second term prioritizing politics, (i.e repealing the 70-year old law that granted the Muslim-majority state of Kashmir internal autonomy in order to fire up nationalist voters), but with the GDP growth now at its six-year lows the economy has become the first priority for Modi. We believe (and we are already seeing it), that the time has come for the great economic decisions that can boost the market.

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180º turn in economic policy demonstrates the government's ability to react

Back in July, with GDP growth falling to 5%, the finance minister Sitharaman inexplicably decided to raise taxes (in order to fix the deficit). Right after that, and as markets slumped, the government changed his mind, starting with a substantial cut in corporate taxes (from 30% to 22%), leaving India's corporate tax in a very competitive position at regional level, only surpassed by HK, Singapore, Taiwan and Cambodia. In September's trade meeting in Houston, Modi also tried to get the attention of international producers and lauded India's revised 15% tax rate for new manufacturing firms. The government followed by scrapping higher taxes on capital gains, dropped a surcharge on foreign investors, eased foreign investment rules and announced a plan to consolidate 12 state banks. With India close to signing a new trade agreement with the US and agreeing to join the Regional Comprehensive Economic Partnership—set to create the world's biggest free-trade zone—Modi is keen to show that India is open to the world. The message is clear: This government is friendly, not hostile, to capital.

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More liberalizing reforms are coming

Even PM Modi's advisors seem to be surprised by the transformation and the sense that further liberalizing reforms will follow. Talks are for a middle-class income tax cut aimed at reviving sagging

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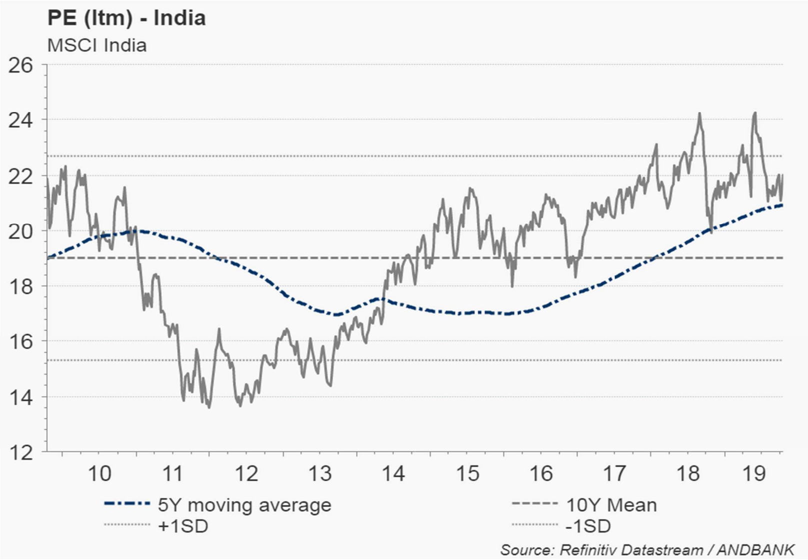
More liberalizing reforms are coming: Middle class income tax cut, land and labor reform, privatizations.

consumption. Another "possibility" is a renewed push to ease outdated land and labor laws (unfinished business for Modi). There are also reports pointing that privatization is back on the agenda (the state carrier Air India will be put back on the market, but this time without the onerous restrictions that put off buyers the first time). The government is also preparing to ask parliament to approve the sale of its entire shareholding in four big public companies (including Bharat Petroleum, sixth largest company by sales). One of the motivations for selling off state assets is to help fill the fiscal hole, especially if we consider that the structural reforms always take a few years to reach the desired results. The government has been able to verify this after the implementation of the GST reform and the new bankruptcy code, whose positive effects have not yet begun to be felt. Corporate tax cuts will improve corporate profitability, helping companies to keep labor, but companies only start investing when consumer demand picks up. It will be a year or two before a new wave of direct investments materializes. Meanwhile, the recent failure of a small bank (Punjab and Maharashtra Co-operative Bank), forced the RBI to release a communiqué denying there was a systemic threat to the banking system, what has weighed a little on investor sentiment. It is important to emphasize that the credit crunch we have seen in the shadow banking sector (vital source of small loans) continues to weight heavily. Non-bank financial companies still cannot get any money from banks, which have been repairing their balance sheets for two years. The only risk lies on looser fiscal policy pushing up interest rates. If bond investors take fright, the rupee could also come under pressure.



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