ET EXCLUSIVE Q&A

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We have 12 months rolling (Sensex) target. Our base target is 26000 and bull target is 30000. Target has to be seen in the context of return from global market. As India is the 8th largest market, the return in next one year is 70-80% in correlation with global market

NITIN SONAWANE

Indian Economy may Recover Sharply in Next 6-8 Months

India has a good chance of outperforming other emerging markets in the next one year as the economy is on the verge of strong recovery, said Ridham Desai, Managing Director, Morgan Stanley India. In an interview with **R Sriram & Rajesh Mascarenhas**, he said India's relative dividend yield is best in terms of valuation in the past eight years, while our fiscal and monetary policy in terms of flexibility is superior among all emerging markets. Edited excerpts:

How much foreign investors have actually taken notice of India's fiscal prudence?
It's not only one matric which foreign investors have taken note of, it's a whole package – fiscal prudence, greater transparency, more stability in the tax structure, better environment, turnaround in projects and top of it good monetary policy have made the change. I won't be surprised if this year's (FY16) public savings number would be positive. This could be a big change and the importance of this change cannot be under emphasised. The government has also cut down the consumption spending and has increased the investment spending. These measures will set the stage for better growth. This may have taken two years, but it's a major achievement, partly backed by the lower crude oil prices.

What surprised me in terms of growth is the government's tremendous achievement in power sector, in terms of production growth in Coal India, increase in plant load factors, growth in electricity, new connections in rural India, capex that Power Grid is undertaking, growth in renewable energy. There is an improvement in industry demand. Look at coal production, steel production, cement production, lot of these sectors are now standing at multi-month high. Power and roads have already kicked off. Cement demand has gone up because real estate has picked up. Bottomline is that the economy has changed. We are recovering, but not all sectors. See the earnings of March quarter, we did not have many negative surprises. On corporate banks, we are going to get best earnings in six or seven quarters. We can see the double-digit growth from next quarter.

Railways also happening, but slower-than-anticipated. Private capex may come little later, but currently the lead is coming from the government capex.

What RBI and government together achieved was shift in savings behaviour. If you look at five years ago, household was investing in real estate and gold that has totally come back into financial savings. Equity savings is at all-time high, deposit growth is five-year high. Rebalancing in savings will help trigger the next growth cycle. Global investors have realised these changes and you could have seen the result in foreign direct investments.

Crude price has bounced back sharply. Will this have a major impact on the economy?
Up to certain levels, falling oil price is good for India, but after that it is not necessarily beneficial for various reasons. First of all, it signals for a weak global growth. Second, India gets large remittance from the Middle East, which would be impacted. When oil declined from \$110 to \$40 per barrel, we saved almost \$70 billion, but when oil declined from \$40 to \$25, we saved only \$15 billion. So, net benefit to the economy if crude falls below certain levels neutralises or sometimes turns negative. The government has done a smart move when oil prices were falling. They have not passed the savings of \$70 billion to consumers. Hence, the government has the flexibility. If oil prices go up, the government can react and cut taxes and make sure that economy is not affected. But in our view, oil prices are unlikely to cross over \$60.

M&A ACTIVITY TO PICK UP

I think you can see a major pick up in M&A in the next few months as the restructuring for debt-heavy companies is inevitable

Do you think the current rally has any fundamental elements to it?
It's a global rally across all countries and nothing India-specific. There may be various explanations for the rally, but the fact is that everyone oversold equities in the past few months and now they are back.

Is your Sensex target for Dec achievable?
We have 12 months rolling target. Our base target is 26000 and bull target is 30000. Target has to be seen in the context of return from global market. You cannot look at these target in isolation. We don't expect constructive return from global markets and many of the emerging markets in the next one year. On most markets, we have downside for the next one year, but on India we have upside. As India is the eighth-largest equity market, the return in next one year is 70-80% in correlation with global market, though this correlation has come down. Last year, we went wrong in Sensex target because of rupee and government fiscal tightening, which was much more than anticipated.

Do you think India will outperform emerging markets in next one year?
India has a good chance of outperforming other EMs in the next one year. If you see the number of EM outflow, India's outflow is relatively lower. Four things are driving this logic. We have distinct shift in current account from FPI to FDI, that lends a greater amount of micro stability. Second, Indian companies are paying more dividends. If you look at India's relative dividend yield, this is the best in terms of valuation in the last eight years. While India looks rich in PE and PB, it doesn't look rich in dividend yield. Third, fiscal and monetary policy in terms of flexibility is currently best among EMs. Fourth factor is in terms of trade, which is the best in past two decade. Big picture view is that the commodity super cycle is over.

Any sectors you are very bullish on?
We are bullish on discretionary consumption sector like auto, media and retail because there has been a big recovery in jobs market over the past 6 months. Also, fall in inflation has boosted the real wages especially in urban India. The pay commission pay-out will happen in the next 12 month. There has been moderation in interest rate, which has been reflected in the retail loan growth. If the monsoon is good, the spending will go up. What we have seen in the last six months is that there has been a strong pick up in consumption infrastructure. There may be sharp recovery in Indian economy in the next 6-8 months. The only bigger risk is that global economy may drag us down as quarter of India's economy is exported.

What is your take on public sector banks?
Corporate debt cycle has peaked. That doesn't mean that worst is over for PSU banks because they may not have realised the problems in the balance sheet. For the next 12 months, they may report weak earnings. But the short-term risk for public sector banks is they are left with very little capital. Even if the economy turns, they will not be able to provide capital to the system. I think you can see a major pick up in M&A in the next few months as the restructuring for debt-heavy companies is inevitable. I think the deleverage process has started. This year, earnings will grow double-digit, but debt will not grow.