Goldman Sachs Global Research

We met with key government officials in the Ministry of Finance, RBI, and other ministries, along with political analysts and market participants in Delhi and Mumbai earlier this week to assess the state of the Indian economy.

- *The long-term positive macro story is still largely intact*
- We met with a number of technocrats in place in key ministries who seem well in command of their brief. We heard no complacency as yet on the need for reforms.
- Quiet progress on longer-term structural reforms in some areas (National Infra Fund, reducing energy subsidies, direct transfer of subsidies).
- Significant progress on increasing coal production and dealing with transport/environment clearance bottlenecks.
- Recognition that the MAT was an 'own goal' and committed to defusing the problem.
- Feeling that corruption levels are diminishing and ease of doing business is improving.
- Strong conviction that some big-ticket reforms will in fact occur, especially GST, where we heard widespread agreement that if passed, this would have significant positive impact.
- *Near-term progress has been slower than expected*
- Passing reform legislation through Parliament is proving an obstacle (the opposition is focusing on polarizing issues like land reform, and retain control of the Upper House)
- Lack of progress in addressing balance sheet problems for PSU banks and corporates, limiting appetite for private investments
- General sense that onshore monetary conditions are tight and, in our view, over-optimism about near term RBI easing
- Rural incomes/spending under stress due to weak commodity prices and lower government spending, with no obvious near term relief
- Upcoming state elections may dampen the government's willingness to push less popular reforms
- Lack of capacity in the wider government to take decisions and execute projects
- No near-term reform catalyst until the next Parliamentary session in July.
- *Growth - we see downside risks to near-term domestic demand, but long-term potential solid*
- *Inflation - we see heightened uncertainty around RBI's inflation forecasts due to weak monsoon forecasts, higher oil, weaker INR, and potential rise in crop support prices (MSP)*
- *RBI – we maintain our call of RBI on hold; 25bp cut possible but more seems unlikely*
- *Rates – risks skewed towards higher in near-term given over-optimistic market expectations of rate cuts. We like curve steepeners.*
- *INR - short term flow risk given aforementioned points, but fundamentals (BOP surplus, carry) still supportive.*

- *Equities - risk of a more prolonged corrective phase until earnings momentum recovers, but longer term (1yr+) bull case firmly intact.*

- We have been strategically positive on Indian equities but expected the market to remain range bound in the near term post the budget (See India: Range-bound n/t but positive thesis remains intact, Mar 2, 2015). The markets have traded weaker relative to our expectations over the past two months and given the downside risks to growth, heightened uncertainty around inflation outlook and slower than expected progress on reforms, we see risk of a more prolonged corrective phase.
- While market valuations have come down to more reasonable levels of 16.5x forward P/E (0.4 s.d. above the 10-year mean) from 18x in early March, earnings remain lackluster so far and we believe a recovery in earnings momentum is the key for equities to make a sustained move higher.
- We see our longer-term positive view on Indian equities firmly intact and remain overweight India in a regional context with NIFTY 12-month target of 9700. We continue to advocate a focus on targeted themes within the market and favor areas with relatively better earnings visibility. Our preferred sectors include Info Tech (both software and internet), autos and industrials.