

Riding India's growth wave



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Risks, valuations, and opportunities

Over the last two decades, India's nominal GDP growth, earnings, and equity market returns have been the highest among major global economies. The structural reforms kickstarted by the current Indian government, which came into power in 2014, have moved the economy to a higher orbit, laying the foundation for macro durability and productivity gains. These reforms have allowed domestic companies to consistently deliver superior profitability.

India is viewed as a relative safe haven in the current economic environment due to its heavy reliance on domestic consumption, and generally strong corporate governance. Today, India's macro backdrop appears more balanced as it goes through a mid-cycle slowdown, but with a supportive policy environment, we anticipate the next leg of the cycle to be driven by a combination of consumption and private sector capital expenditure (capex).

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1. Formalisation, financialization, flows



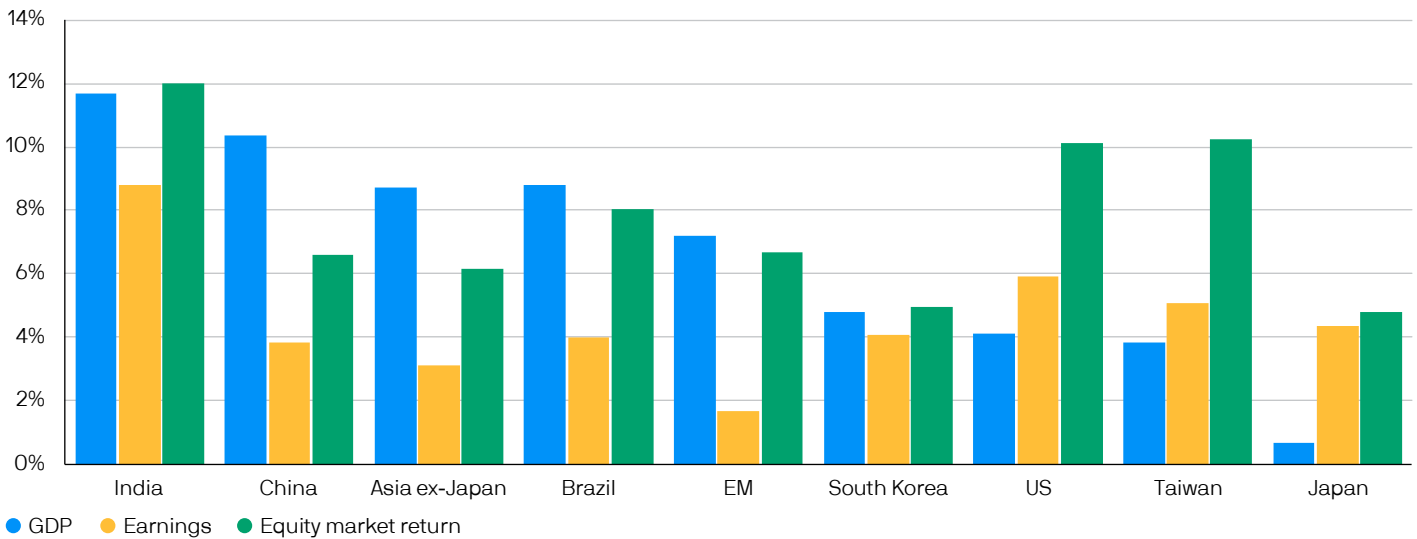
One of the government’s key structural reforms has been the launch of Aadhaar, the world’s largest biometric ID system. It was launched less than a decade ago but now covers nearly the entire ~1.4bn population, streamlining access to government services and financial transactions. This has helped bank account penetration reach over 80% in 2024 vs 35% in 2011. However, since only ~12%¹ of Indians have access to cheap formal credit, the runway for financial services growth remains huge.

Simultaneously, formalisation and digitisation have helped broaden the tax base and create scale advantages for organised players. It has specifically been driven by the creation of the Goods and Services Tax (GST) – a unified nationwide indirect tax, UPI – an instant payment system that has led to India having the largest market share in global digital payments at 46%, low cost of data leading to nearly a billion internet users, deregulation to help cut red tape, and cross-country infrastructure buildout. Formalisation has also led to financialization of savings away from traditional assets like gold and real estate, which has resulted in higher flows to financial markets.

These changes help explain the euphoria around Indian equities over the past few years, led by domestic mutual funds investing ~\$125bn since Covid, more than the cumulative amount in the preceding decade. Foreign institutional investors, on the other hand, have been reducing their active weight as valuations became expensive, signalling headroom to increase positioning as US dollar weakness leads to demand for diversification.

Exhibit 1: Nominal GDP growth, earnings and equity market returns

2005-2024, annualised



Source: FactSet, MSCI, World Bank, J.P. Morgan Asset Management. Earnings and equity market returns are represented by each market’s respective MSCI index. Nominal GDP growth, equity returns and earnings growth are calculated in local currency except for Asia ex-Japan and emerging markets, which is in US dollars. GDP for Asia ex-Japan is calculated by adding up nominal GDP in USD for all the 10 markets which are tracked by MSCI Asia ex-Japan. GDP for EM is calculated by adding up nominal GDP in USD for all the 24 markets which are tracked by MSCI EM.

Past performance is not a reliable indicator of current and future results Data are as of April 30, 2025.

¹ BofA Global Research, as of May 2025.

2. Fertile hunting ground for stock-pickers

India is a fertile hunting ground for companies given increasing market depth, relative corporate maturity, and willingness of management teams to engage with investors. Perhaps most importantly, plenty of industries and basic service sectors offer huge scope for productivity gains to capable management teams. In fact, Indian company managements are routinely the most profitable in the emerging market (EM) universe, showing consistently high return on equity, at times, even higher than the US. Minority shareholder protection ranking is amongst the top league, not just within EMs but globally.



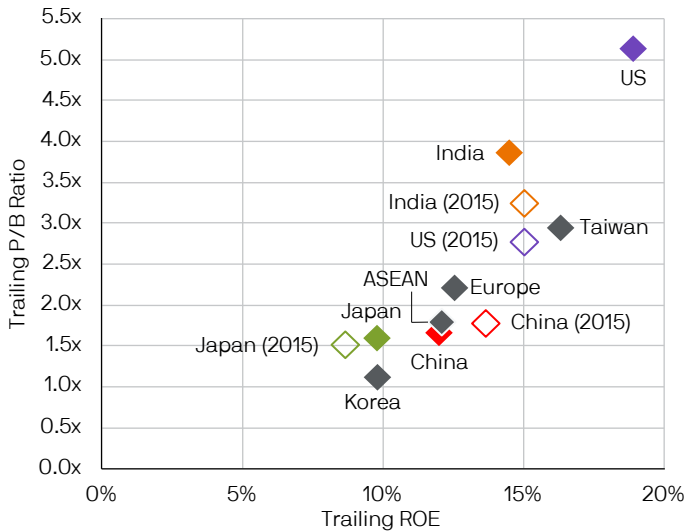
Additionally, the implementation of GST since FY18 has led to monthly tax collections doubling from launch to FY24. Besides enhancing fiscal health, GST has also levelled the playing field as unorganised players – small, unsophisticated enterprises that often operate outside of regular labour laws – come within the tax net, leading to a significant increase in the number of organised players across sectors, with scope for further consolidation.

India leapfrogging broadband internet directly to mobile internet has led to a 140x increase² in digital transactions over the eight years to April 2025, transforming multiple sectors. These companies also operate in an environment of political stability, as well as in the presence of strong independent institutions such as the central bank, securities regulator, and judiciary. Quality companies, good management and governance, and long runways for growth can provide a compelling opportunity set for investors.

Exhibit 2: Profitability and performance of global equities

Return on equity (ROE) and valuations

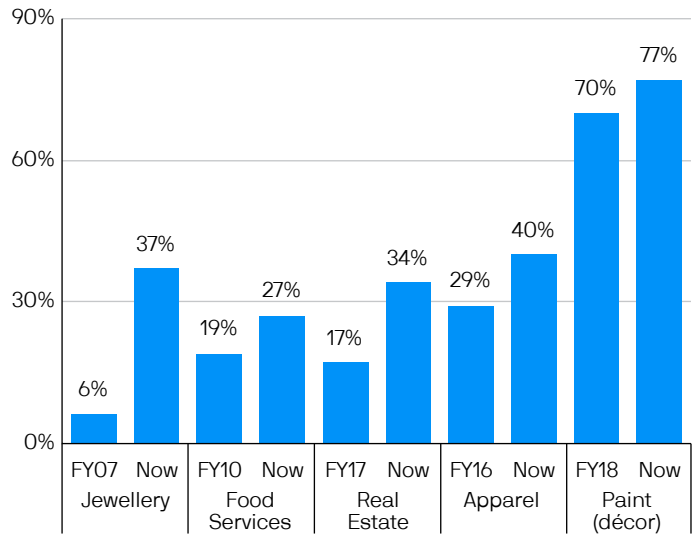
Trailing 12-month



Source: FactSet, MSCI, J.P. Morgan Asset Management. Data are based on respective MSCI data, except US, which is represented by the S&P 500 Index. Filled diamonds represent latest data while unfilled diamonds represent historical comparisons. *Guide to the Markets – Asia*. Data reflect most recently available as of 30/06/25.

Exhibit 3: Significant increase in share of organised players across industries, especially post Covid

A long runway ahead for consolidation



Source: Bank of America. Data as of May 2025.

² BofA Global Research, as of May 2025.

3. A mid-cycle slowdown meets monetary and regulatory easing

After several years of an infrastructure-led business cycle expansion, economic and corporate earnings growth are seeing a mid-cycle slowdown. This is largely due to a cut-back in government spending after the 2024 general elections and tighter policy by Reserve Bank of India (RBI), as inflation ticked up. Fortunately, India is fairly insulated from any impact of tariffs as the country derives just 2% of its GDP from US exports with over 75% of geographic revenue exposure of MSCI India to domestic consumption.



Given this background, the RBI and the securities regulator have front-loaded multiple market-friendly measures, including 100 basis points of rate cuts in 2025 to 5.5%, alongside over \$90bn of liquidity injection, to revive growth and kickstart a new cycle. With inflation down to the lower end of the 2-6% target range, the RBI seems to have fired most of the shots in its arsenal to drive credit growth, which seems closer to bottoming out at its current rate of ~9.8%. While the recovery is yet to be visible in economic indicators, the second half of the financial year looks more promising as the macroeconomic environment shows signs of balance, led by tight fiscal management, front-loading of government capex, regulatory easing, and income tax relief to households.

4. Capital expenditure versus consumption: Which one will lead the next leg of the economic cycle?



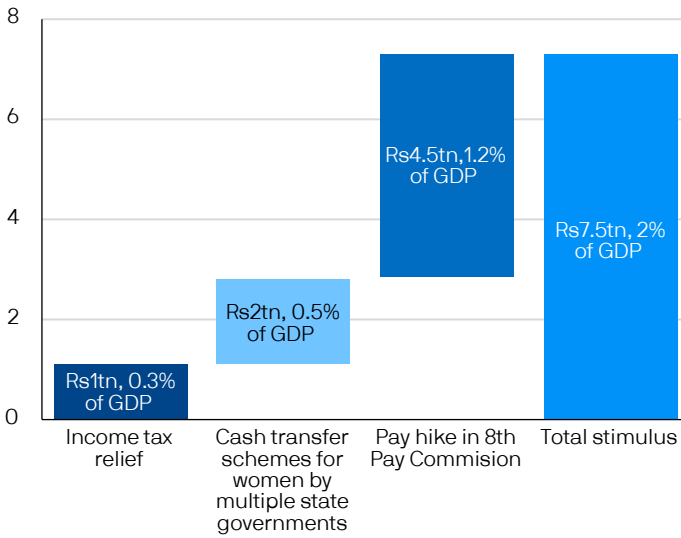
While we remain confident that corporate earnings and the economy have bottomed out, we need to see some combination of growth in private sector capex and consumption to justify elevated equity market valuations. Central and state governments have done a large part of the heavy lifting when it comes to infrastructure growth in the country over the last decade, with 28km of roads constructed daily, nine airports built every year and a fourfold increase in the metro rail network. Government and government owned companies form a little under 25% of the Gross Fixed Capital Formation (GFCF) as of 2024, while private sector corporates, which have mostly remained on the sidelines, form ~36%.³ The government, for its part, is maintaining the capex intensity. Despite capacity utilisation increasing steadily in the two years following Covid, healthy balance sheets with leverage at a 15-year low, a strong banking system, and robust capital markets, the private sector remains hesitant due to demand uncertainty.

On the other hand, India's household consumption nearly doubled in the past decade to \$2.2tn⁴ in 2023, stronger than the US and China. Current consumption growth is led by rural India, which is on the road to recovery due to better farm output and real wage growth as food inflation moderates. Urban consumption, while currently lagging due to weak salary growth and stretched household balance sheets, is expected to recover in the coming quarters driven by a combination of reduced personal income tax for middle-class households and a significant pay boost for government employees and pensioners under the eight pay commission. Along with the ongoing social welfare spending by the government, this should lead to a consumption stimulus equivalent to 2% of GDP.

³ Jefferies, as of January 2025.

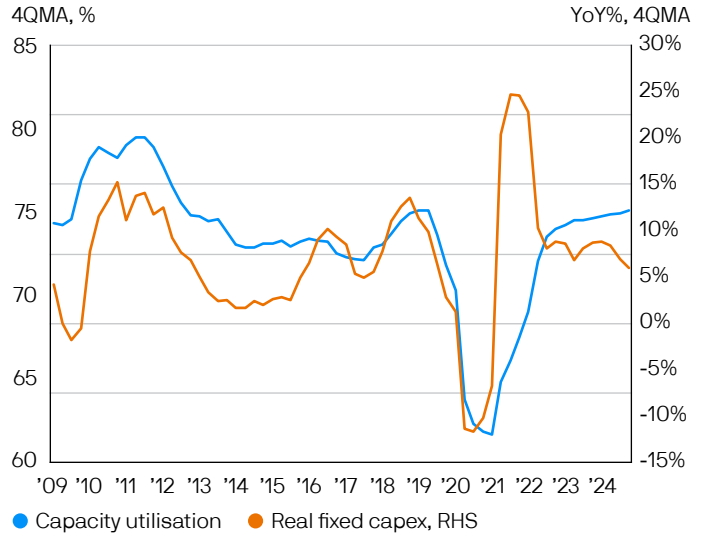
⁴ UBS, as of June 2025.

Exhibit 4: Consumption stimulus of Rs7.5tn (around 2% of GDP)



Source: UBS estimate. Data as of June 2025.

Exhibit 5: But handover from public to private capital expenditure not yet kicking in as capacity utilisation stuck

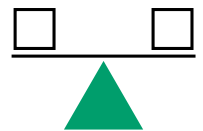


Source: RBI, CEIC, UBS. Data as of December 2024.

5. Risks, valuations, and opportunities

Over the past five years, multiple expansion has been a significant driver of returns for Indian equities, particularly for small and mid-cap stocks, with signs of retail investor exuberance. Even since the recent correction from the September 2024 peak, valuations remain high, driven by strong investment flows and anticipated growth recovery following monetary easing.

Despite this, domestic mutual funds hold 6%⁵ cash on average (as of April 2025), the highest level seen since 2020, indicating potential for increased investment flows. Furthermore, softening inflation will likely support discretionary spending while rate cuts will help ease household debt, which has been steadily increasing since Covid.



Conclusion

India's economic transformation – driven by structural reforms and a supportive policy environment – has positioned the country as a compelling investment destination. The combination of formalisation, financialization, and robust flows has strengthened the equity market, while high-quality companies offer fertile ground for stock-pickers. Despite the current mid-cycle slowdown, monetary and regulatory easing measures are expected to revive growth and kickstart a new cycle as the India economy enters a Goldilocks phase.

The interplay between capex and consumption dynamics will be crucial in driving the next leg of economic growth. As valuations remain elevated, the investment landscape offers opportunities for stock-pickers willing to navigate the complexities of the market and benefit from India's noteworthy resilience against a backdrop of global uncertainty. With a solid foundation built on deregulation and pending reforms, we believe India is poised to sustain impressive GDP growth, making it an attractive option for investors seeking diversification and long-term returns.

⁵ Goldman Sachs – Top 200 equity mutual funds in India

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