India's capex cycle sets the stage for a $10 trillion economy

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SECTIONS

India's capex cycle sets the stage for a $10 trillion economy

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Synopsis

Most of this will require a sizeably higher dose of capital investments from every constituent in the economy. Gross fixed capital formation (GFCF) forms around 30% of India's GDP at $790 billion. Public and private capex are stronger, while infrastructure and industrial capex were flat over the last decade. India has witnessed a sluggish investment cycle for the past 10 years since peaking in FY11, following the recovery from the Global Financial Crisis (GFC).

India has moved from a $300 billion economy to $3 trillion in 30 years. The vision is to become a $10 trillion economy by 2031. This transformative journey is backed by multiple growth vectors like broader demand from consumption with adequate support from the lower cost of capital and a proactive policy stance from the government.

Agencies
Higher multiplier (2.5x) of government infrastructure spending along with boosting the economy, accelerating investments in cement, metals and capital goods.

Capex a Vital Cog

Most of this will require a sizeably higher dose of capital investments from every constituent in the economy. Gross fixed capital formation (GFCF) forms around 30% of India's GDP at $790 billion. Public and private capex are stronger, while infrastructure and industrial capex were flat over the last decade. India has witnessed a sluggish investment cycle for the past 10 years since peaking in FY11, following the recovery from the Global Financial Crisis (GFC).

This was characterised by the absence of large-scale capex in sectors such as power and metals.

Of the $790-billion total GFCF, around $325-350 billion is in large-scale organised capex on industries ($200 billion) and infrastructure ($125 billion) that are identifiable capital investment opportunities.

Green Shoots Visible

Post-Covid demand recovery, higher commodity prices, and better pricing power driven by industry consolidation are among the key drivers. Industry utilisation is at a trigger point (73.4%, highest in the last 12 quarters) for the top five players in most of the core sectors - cement, metals, power, and refining - making a strong case for corporate capex.

Order inflows based on recent data suggest a healthy three-year CAGR of 11-12%. Short-cycle revenues of machinery and consumables, and capital goods imports suggest that the investment cycle build is strengthening. India recorded $186 million orders calendar year-to-date from Japanese tool manufacturers - a seven-year high. Bond issuances have picked up by 9% CAGR since FY19 (April-August), indicating that corporates are accessing the credit market for funding needs.

What is different this time?

Diversity of demand: India is witnessing multiple tailwinds in terms of higher consumption, at inflexion GDP per capita of $2200+, better factor cost dynamics (on personnel, money, material), post-pandemic resumption of the economy, emerging opportunities to plug in the business value migration opportunities from the global supply chains like China+1/Europe+1.

Prudence towards capital allocation: The higher size of the economy makes this capex cycle interesting. It is also outcome-centric, efficiency-focused and prudent in allocations. Thus, the economy offers a good local anchor for every asset creation that targets a concurrent opportunity to play the global supply chain value migration.

In the past cycles, commodity inflation and negative real interest rates had led to leveraged corporate capex upcycles. This was also accompanied by crony capitalism, reckless investments, and substandard underwriting. Now, it is replaced with a focus on economic profits, prudent underwriting, cash generation and cash reserves for the corporates.

India at the Centre: While the Russia-Ukraine conflict did affect supply chains in general and commodity costs specifically, it has accelerated trends such as alternatives to the existing overdependence on a single geography. India with its scale established industrial base, and a knowledge-based service economy that respects intellectual property is well poised to participate in this space.

The post-pandemic urgency of localisation has further increased the relevance of some of the large MNCs to leverage their Indian subsidiaries in the global supply chains (R&D, products, solutions). Global engineering companies such as Cummins and

ABB
NSE 0.28 % also indicate strong momentum for capex in their end markets.

Further, most of these investments are now focused on exploiting the India factor cost advantage unlike global acquisitions in the last cycle. The top 10 groups are set to invest over $150 billion in multiple sectors within India. The banking system is in better health in terms of systems, capital adequacy and ready access to buoyant local capital or long-term-oriented global capital to fund this growth.

Better Policy Support: The government is playing its part with a policy framework that is incentivising productive capital formation, catalysing new investments with a proactive pro-business and pro-reforms stance. It is also signing multiple bilateral trade deals with large markets like Australia, UAE and many more.

The government's revenue collections and capex during April-August have been robust. India's policy push through schemes bringing in synchronisation among ministries through policies such as the Production-Linked Incentive and National Logistics Policy is likely to attract investments in the manufacturing sector. The pace of clearances for new projects has picked up since CY19 and remains strong to date in CY22.

There is a focus on directed budgetary allocations towards outcome-focused infrastructure projects. Investments in social infrastructure are expected to accelerate with better finances of the government machinery with better revenue generation on the back of a strong digitisation drive. We expect the government to further bolster its 'Make in India' agenda with higher localisation in sectors like defence and railways.

Diverse Opportunities: The breadth of this investment cycle can be larger and more sustainable, despite scepticism about its size. This is contrary to the narrow power sector-driven cycle last time, which drove cronyism and an eventual sharp pullback.

Sectoral leadership can be driven by:

- Manufacturing (significant government push as well and conducive geopolitics).

- Public spending on key sectors (road, rail, water, defence and urban infrastructure).

- Energy transition (renewables, storage, EVs and hydrogen), real estate, metallurgy, logistics (warehousing), data centres and ESG-related investments.

- Higher multiplier (2.5x) of government infrastructure spending along with boosting the economy, accelerating investments in cement, metals and capital goods.

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