JAKE SIEWERT

This is Exchange at Goldman Sachs where we discuss developments currently shaping markets, industries and the global economy. I'm Jake Siewert, Global Head of Corporate Communications here at the firm.

Today we're digging into the big questions behind India's economy, how markets have reacted to the prime minister's reelection back in May, why inflation has declined so dramatically and what's driving the economy's growth and much, much more. Our guest today is Prachi Mishra, the India Chief Economist for Goldman Sachs. Prachi is on a business trip here in New York this week. Prachi, welcome to the program.

PRACHI MISHRA

Thank you, Jake. A pleasure to be here.

JAKE SIEWERT

Prachi, let’s start by talking about the India elections back in May. Prime Minster Modi was reelected to a second term in office, maybe not a huge surprise, but how have markets reacted to that development? How have markets reacted to that development?

PRACHI MISHRA

Jake, markets indeed reacted positively to the election outcomes, bond deals, equity markets and the INR rallied, along with sharp increases in capital inflows. Markets were already pricing in PM Modi to come back to some extent. However, what surprised markets to the upside was the sheer magnitude of the victory. The final seat tally was 353 for the BJP-led National Democratic Alliance and 303 for the BJP alone. And just to give us some sense of these numbers, 273 is needed for a majority out of a total of 545 seats in the lower house of Parliament.

Let me emphasize three key features of these results. First, the seat tallies for the BJP and NDA were higher than back in 2014. So, in 2014, it was 336 and 282 to NDA and BJP. This time around, 353 and 303 for NDA and BJP. Second, the results were higher than any previous focus. Opinion polls, exit polls and our own sense of what the results would look like.

And finally, this is indeed the biggest victory for an incumbent government over the last five decades in the history of independent India. This clearly flies in the face of all theories of anti-incumbencies.

JAKE SIEWERT

So, Prachi, backing up, you mentioned that many investors were anticipating the prime minister's reelection, but what was the economy looking like at the beginning of the year and what were investors focused on?

PRACHI MISHRA

So, Jake, if I can recall, we did a macro tour earlier during the year with a large group of investors. And we met with key policymakers, market participants, bankers and political analysts in Mumbai, as well as Delhi, and the highlights from that tour can be summarized, I would say, in five points.

First, India's progress on growth and inflation was emphasized by all the policymakers, just to give you a sense of the numbers, GDP growth based on official statistics; GDP growth has increased from an average of 6.7 percent during 2010 to 2014 to 7.3 percent during 2015 to 2019. An average inflation has declined from 10 percent to 5 percent during the same period.

Second highlight was that despite growth being strong, overall, the investment climate was pretty weak. Third concern which was raised during the tour quite prominently was very muted monetary transmission. And fourth, on the fiscal side, slow GSD collections was one of the main challenges for the fiscal outlook. GSD is one of the major reforms introduced in the Indian economy back in July 2017.

And finally, on the political outlook, it was clear that, you know, the ruling party was coming back to power even, you know, earlier during the year in 2019. I should add that weak investment, muted monetary transmission and slow GSD collections still continue to be big challenges for the Indian economy at this point.

JAKE

So, Prachi, you mentioned the relatively, the turn around in outlook for inflation. Let's talk a little bit about inflation and monetary policy. Give us the rundown in India in the wake of June's decision by the Reserve Bank of India to reduce the policy repo rate. What are we seeing?

PRACHI MISHRA

Over the last decade and a half, inflation has emerged as a leading concern in India. Worries increased as the average headline consumer inflation increased from 3 percent to 10 percent during 2001 to 2013. As high and rising consumer inflation was during this period, the decline since then has been equally dramatic. India's inflation rate was the highest across emerging economies in 2013. Now it's actually among the lowest.

While many, including the former RBI Government Rajan expressed concern that high levels of inflation would become embedded in expectations of price setters and lead to a self-sustaining inflationary spiral, the focus now has shifted to the plight of farmers who recently marched to Delhi in large numbers to protest again low food prices and demand higher returns on the crops.

On monetary policy, RBI has cut interest rates by 75 basis points since February and we expect another cut by 25 basis points in the August meeting. The accommodative monetary policy has been driven mainly by concerns about slowing growth, and in fact, based on our Goldman India current activity indicator, as well, growth is about 1 percentage point lower than the strong 2018 base.

JAKE SIEWERT

So, I mean, obviously the bank has some more latitude with inflation so low. Why has inflation declined so dramatically and is this likely to be sustained over time?

PRACHI MISHRA

So, let's dig into the details a bit. A large share of the decline in headline inflation since 2013, about 83 percent or so can be explained by food prices.

And surprisingly in the Indian context, global food prices play a very limited role in domestic Indian food inflation, except for certain commodities like sugar and edible oils. Interestingly, even within food, the decline has been concentrated in two broad categories; cereals and vegetables. And these two categories have driven about 60 percent of the fallen food inflation since 2013.

While it's well known that the decline in Indian headline inflation was driven by food, the fact that even within food the decline has been concentrated is relatively less appreciated. And interestingly, the story is subtly different for these two commodities. So, if you look at cereals, cereals appear to be a story of active food release of buffer stocks in large quantities and high imports and response to high cereals inflation.

Another interesting fact is that the sharpest decline in inflation in cereals actually are back in 2014 and '15 despite these being drought years. The story in vegetables is actually a little bit different from that in cereals. We believe that the key driver of the collapse in vegetable prices has likely been the deregulation of markets.

So, vegetables' inflation also declined sharply in 2014 and '15 and has stayed low since then, but the timing of the sharp drop in vegetables' inflation coincides with the delisting of vegetables from something called the APMC, the Agriculture Produce and Marketing Committee Act in 14 states in India. So, basically this has cut out middlemen and enable farmers to sell directly to consumers. And what does all this imply going forward? We believe that this market deregulation in vegetables is likely to bring about a more durable decline in vegetable prices.

In addition, if active food management policies continue, lower food inflation can persist even more. And unless hit by really major shocks, for example, weather shocks of greater intensity than what we saw historically in 2014 and '15, or pressure showing up in commodities other than cereals and vegetables, food inflation is likely to remain rather subdued going forward in our view.

JAKE SIEWERT

So, with China slowing down a little bit into the low 6 percent, India's growth has sort of become the world leaders amongst the large economies. Where is the growth coming from and how are changing demographics playing a role?

PRACHI MISHRA

So, Jake, average GDP growth in India over this decade has been about 7 percent. Three-fourth of that is actually attributable to consumption. And only one-fourth to investment and almost nothing is attributable to spots.

So, India has a large and growing middle class with increasing aspirations and this middle class wants to consume and save less. In fact, Indian households are moving at the margin away from savings and physical assets like gold and real estate to what's consumption and towards savings and debt in equity mutual funds.

JAKE SIEWERT

So, let's talk a little bit about tariffs. I mean, there is a lot of attention on the US-China trade dynamic, but India's government announced that it would impose higher tariffs on some products coming from the US in mid-June. The government announced some more hikes on US products. India has never been, you mentioned this, a big economy that's dependent on imports and exports, so explain a little bit of what's going on with the dynamic there is.

PRACHI MISHRA

So, indeed Indian government increased tariff rates on 28 products imported from the United States in June. This is not new. The imposition of tariffs was actually announced back in June 2018, following the US administration's decision to impose tariffs on imports of aluminum and steel from India. And the implementation of tariffs by India kept getting deferred as negotiations went on.

And, in fact, our discussions with the Ministry of Commerce back in March suggested that India is not likely to retaliate. So, the immediate trigger was the domination of preferential treatment given to the US, given by the US to Indian exports earlier this month. Our analysis suggests that quantitative implications of the recent move by India or of domination of preferential treatment are not likely to be significant.

The broader question is whether these moves can have bigger ramifications and whether the United States could, again, retaliate. There are indeed speculations that the H-1B visa allocations could be made country-specific, which could affect India in particular and Indian stocks, IT stocks in particular, did react negatively recently but recovered later once the United States ambassador to India in the recent speech signaled no such measures.

JAKE SIEWERT

00:10:29 So, let's talk a little bit about the investing landscape. Where are foreign investors finding value in India and equity and bond markets and where are domestic investors looking abroad to diversify?

PRACHI MISHRA

So, overall, there's been a complete change in sentiment among foreign investors between last year and now. Last year, there were net capital outflows from India of about 11 billion US dollars.

The first half of this year we've already seen more inflows than the net outflows last year. So, the inflows this year so far has been about 13 billion US dollars. There have been inflows into both debt and equities and we expect it to continue this year. INR should continue to outperform on expectations of positive reform momentum after the election results and any escalation of US China trade conflict because INR is less sensitive to CNY than some of the other currencies. We also see bonds to outperform swaps.

You asked about the Indian domestic investables. It's actually very large and just investor. It's actually very large, and just to give you some sense, so far this year, 33 billion dollars have flown into domestic debt and equity mutual funds in

2019, more than twice, that and foreign capital inflows. But these are mainly long-only investors. Outward foreign investment is still a relatively small phenomenon for domestic mutual funds.

JAKE SIEWERT

So, the central government in India put out a new fiscal year 2020 budget. What are the key things to note from that budget?

PRACHI MISHRA

So, Jake, first on the budget math, despite concerns about growth slowdown, government has adhered to a part of fiscal consolidation for the center. The center’s fiscal deficit is projected to decline slightly from 3.4 percent of GDP to 3.3 percent of GDP. Of course, the underlying assumptions, particularly on revenue collections are fairly ambitious. Tax compliance would have to strengthen significantly to be able to achieve the budget targets.

In addition, the budget is characterized by very low capital spending, especially in the context of, you know, large infrastructure needs in the country. In fact, capital spending takes place mostly outside the budget. Forty percent of the capital spending is done by public sector enterprises. This is really not idea from a fiscal accounting perspective, but from a growth perspective it gives a better view than focusing exclusively on the budget.

Some of the other big announcements in the budget include liquidity support for the shadow banking sector, which has been in stress recently. Additional recapitalization program for public sector banks and the announcement to issue foreign currency debt by the sovereign.

JAKE SIEWERT

So, you're in New York, you're talking to investors. You've been traveling around a little bit and what kind of questions are you getting about India from

Goldman's clients and what are they interested in in terms of the macro economic outlook?

PRACHI MISHRA

So, Jake, the big question which all our Goldman clients in London, in the United States, as well as in Asia, in Hong Kong and Singapore and domestic investors in India are asking is that, look, now that we have a strong majority by the government in the Parliament, do they really have an appetite for radical structural reforms, particularly in the area such as land, labor, export promotion and privatization.

They're asking how likely is an accelerated reform scenario, which can really put India on a growth trajectory, higher growth trajectory close to double digits. And this is something we are watching on closely in terms of any big policy announcements going forward.

JAKE SIEWERT

So, India's economy has always been notoriously a little difficult to analyze and you recently put out a report comparing the new and old methodology you use to measure GDP growth. Talk about what led to that research and what your take-aways were.

PRACHI MISHRA

So, just to give some context, a new Indian GDP series that updated the base year from 2004, '05 to 2011, '12, was introduced in June 2015 and this revision in the base year was combined with significant modifications to data sources and methodology. And in addition, a back series from 2004, '05 to 2011, '12 under the new base was released very recently end of last year.

So, with several institutions involved in this process and a lack of sufficient communication, the GDP data have led to enormous confusion among market participants' media, as well as the public, therefore, what we do in this report is try to clear some of this confusion. So, we present ten stylized facts about Indian GDP data in two broad areas.

One, comparison between old and new GDP series and second, discuss some general issues with statistics and methodology of the construction of Indian GDP. I'll not go into much details here, just to point out one key finding; we did an internal survey of Goldman economists which work on different countries and based on the survey, what we find is that India's clearly an outlier in three key aspects of GDP measurement.

First, the high frequency of revisions, second, the use of surveys and, third, the lack of an official seasonally adjusted quarterly series. Overall, we believe that the ongoing GDP debate in India is better viewed as a statistical discourse than a political one. There are significant challenges in measuring economic activity in a country with a sizable informal economy and a large services sector.

We believe that there is an urgent need for more frequent official service that can actually capture informal activity and while GDP still remains a benchmark, it needs to be combined with other high frequency sources to derive more accurate estimates of the size and growth of the Indian macro economy.

JAKE SIEWERT

So, let's talk quickly about how India looks in the broader EM context. I mean, fairly or not, it often gets lumped in with other emerging markets. How do you think about India in that context?

PRACHI MISHRA

So, Jake, if we compare India to other emerging economies, India fares well and has actually shown significant progress compared to say 2013 in terms of growth, inflation, as well as current account. One indicator, however, which stands out, is India's fiscal performance.

The consolidated fiscal deficit of India, which includes the central government and the states has been consistently reported at around 6 and a half to 7 percent for most of this decade. It stands out as the second highest across emerging markets, Brazil, which went through a fiscal crisis being the highest. And if we include borrowing by public sector entities, which I talked about, India's fiscal deficit would be much higher by another 2 to 2 and a half percent of GDP.

JAKE SIEWERT

So, before we wrap up, give us a little ... you're relatively new at Goldman. Explain how you got here and your own background.

PRACHI MISHRA

Thank you, Jake. I think, you know, I was born and brought up in Eastern India. I first migrated to Delhi to study and then I came to New York for graduate school where I got my PhD in Economics from Columbia University. Since then, for most of my career, I have been working at the International Monetary Fund in Washington, D.C. We've worked across different departments. I also worked for three years at the Central Bank of India.

JAKE SIEWERT

Is that what brought you back from D.C. to India?

PRACHI MISHRA

Actually, interestingly, that brought me back from D.C. to India, but then I came back to D.C. to the fund. And Goldman actually recruited me from Washington, D.C.

JAKE SIEWERT

Okay. So, it's nice to have you back in New York. What do you like when you visit New York, having lived here a long time?

PRACHI MISHRA

Of course, you know, I've lived here a long time. Actually, I've lived here for five years, but Goldman is a totally, you know, new experience, so I think what I like about New York is number one, you know, having, you know, having my workplace in New York, where I actually studied and lived several years ago. And, you know, Goldman, overall, has been a fascinating experience so far. I think very great culture, you know, great colleagues, so I'm looking forward to all the adventures.

JAKE SIEWERT

And when you are traveling, what do you miss most about India?

PRACHI MISHRA

Food and family.

PRACHI MISHRA

I do not miss the traffic and the number of people and the pollution.

JAKE SIEWERT

Understood. Prachi, thank you very much for joining us today.

PRACHI MISHRA

My pleasure, Jake.

JAKE SIEWERT

That concludes this episode of Exchanges at Goldman Sachs. Thanks for listening and if you enjoyed this show, we hope you subscribe on Apple podcast and leave a rating or a comment. And for more from Goldman Sachs' experts, as well as influential policymakers, academics and investors on market-moving topics, be sure to check out our newest podcast, Top of Mind at Goldman Sachs, hosted by Allison Nathan, a senior strategist in the firm's research division. Thank you.