

India Update – One Set Up

We remain constructive on Indian equities despite the strong year to date performance. Underpinning this optimism is the major fall in international crude prices benefitting India on all fronts, consolidating the economic tailwind already in force. Recent elections in key states have reinforced the BJP's position resulting in a spate of positive announcements; although constraints to progress still remain, the gradual recovery in economic growth is just beginning and is expected to develop further from here. Corporate profitability is set to recover, allowing the market to move forward. Changes will take time to evolve, and we do not expect "big bang" reforms. The Rupee is enjoying a period of stability against both emerging market peers and the Dollar. The key risks remain global.

1. BJP victory in state elections of Maharashtra and Haryana
 - The BJP recently won key state elections in Maharashtra and Haryana
 - This represents 18.5% of GDP; the BJP now governs 50% of India's GDP *at the state level*
 - No meaningful state election for a year, increasing the Government's political firepower
2. Deregulation of diesel prices – "*Henceforth, like petrol, the price of diesel will be linked to the market*" (Finance Minister, Arun Jaitley)
 - The recent collapse in oil prices has facilitated the dismantling of the diesel subsidy
 - Diesel was the largest contributor to the fuel subsidy, costing US\$10bn in FY14
 - LPG and Kerosene subsidies remain in place, but changes are expected
3. Increase in domestic gas prices – reigniting exploration and production
 - The Government had earlier fixed the price for upstream gas discoveries at US\$4.2/mmbtu
 - This has been raised to US\$5.6/mmbtu, with an added premium for deep water exploration
 - The formula is based on international prices, and the level will be adjusted every six months
4. Coal sector reforms – the beginning of the end of a state monopoly
 - Currently coal can only be mined as an internal linkage or purchased from Coal India
 - India must import US\$20bn of coal p.a. despite having the fourth largest reserves globally
 - An ordinance has been issued paving the way for commercial participation in the coal sector
 - The private sector will, in due course, be able to mine and sell coal to the open market
5. Impact of lower oil prices is a positive for India, reducing inflationary impact, reducing fiscal and current account deficits, supporting the Rupee and corporate India's operating costs
 - India has a high dependency on imported crude
 - US\$1/bbl change in price impacts the current account deficit by ~US\$1.1bn
 - If oil held US\$85/bbl to March 2016, current account deficit will decline to 0.6% GDP (all else being equal)
 - A US\$10/bbl fall in oil prices lowers the current account deficit by ~0.4%
6. The bureaucracy is now actively working to facilitate a growth recovery
 - The bureaucracy is guided by signals from the top and the message is unequivocal
 - Mind set and work ethic of key functionaries is changing at all levels
 - Structural changes to private sector project approval process across key ministries is leading to a pick-up in infrastructure projects
 - More needs to be done to improve regulatory oversight, to ease funding constraints and to encourage foreign participation
 - Changes will take time to evolve but the intention and the trend is clear

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