INDIA HAS THE POTENTIAL TO GROW AT 8-9% UNDER NARENDRA MODI, SAYS KEVIN GIBSON, CIO, EASTSPRING INVESTMENTS

Kevin Gibson, chief investment officer at Eastspring Investments, the Asia asset management arm of Prudential plc, said he would like to see India growing at its potential growth rate of 8-9 per cent by the end of Prime Minister Narendra Modi's current term, and expects the Reserve Bank of India to ease rates towards the end of this year, if inflation eases further. In a wide-ranging chat with ET, Gibson said India is one of the most diversified emerging markets which provide foreign *investors with enough opportunities to rotate investments within the country. Edited excerpts:*

Indian markets are currently trading at their life highs. How do you expect markets to behave and what's your Index target?

We need to be mindful that India is significantly up from the distressed levels seen in August last year. Since 2008, earnings have continued to grow, albeit at a varied pace. Markets are now trading close to historical averages and things on ground may need to improve fast to further catalyse valuations. Long term, we expect markets to rise in line with corporate earnings while the consensus earnings growth numbers — at mid to late teens for the next three years —appear to be encouraging.

The recent macro-economic indicators suggest that the worst is behind us, and growth has started to pick up. What are your economic growth expectations?

As I said, there are not many levers to push growth aggressively. Recovery may be U-shaped as course correction may take its own time. That said, things are moving in that direction. We have seen healthy industrial production numbers after a long time. Also, the inflation trajectory seems downwards. All this can help India emerge out of a stagflation kind of an era, which had strangled the country for a few years. I would like to see India growing at its potential 8-9 per cent by the end of PM Modi's current term.

The Reserve Bank of India is likely to hold rates in the September credit policy. What's your take on the interest rate scenario, given the inflationary situation?

It's clear that for the central bank, inflation took precedence over growth in deciding the rates trajectory. Inflation is the single-largest factor that's keeping the RBI from easing rates. Headline inflation is now within the RBI's target inflation of 8 per cent for this year. If inflation softens further, as expected, RBI may ease rates towards the end of this year. At the same time, it seeks support from the government to tackle the supply side and the fiscal situation. Of course, RBI cannot directly influence food inflation, but its policies can have an indirect effect on inflation expectations. The inflation expectations are running high and that also needs to moderate. It has been embedded in the mindset for too long and RBI needs to work towards changing that.

Steady corporate earnings, improving industrial output, easing inflationary situation and a stable domestic currency are giving a ray of hope to economic recovery. Would you agree?

There's no doubt in my mind that the worst is over. The external equation has turned around while measures to contain gold imports worked well. The sentiment got a further boost after elections: all this is making things easier for the RBI. I read reports that RBI was buying dollars to keep the rupee from appreciating — this is a remarkable development from where India was in the middle of last year. This also helps RBI accumulate reserves which further becomes a source of stability. If monsoon indeed remains deficient, it may moderate rural demand outlook, but I do not see a big spike in inflation.

Foreign institutional investors have invested over $13 billion into Indian equities this year. Do you think higher FII flows are sustainable after the slowdown in August investments?

Foreign flows have been encouraging and we expect that momentum to continue for India. At a time when the scare around global liquidity squeeze is still on, India has enough domestic catalysts to keep the investors coming back. India may be at an inflection point and continue attract foreign capital. Plus, India is one of the most diversified emerging markets which provide foreign investors with enough opportunities to rotate investments within the country in periods of varying risk perception.

The cyclical stocks have come under pressure after their disappointing first quarter earnings (Q1 FY15). Is the hope rally fading?

Things on ground are yet to improve notably, but markets always run ahead of time... they lead. There is enough operational leverage in the system which could facilitate smart earnings recovery when growth returns.