

7 factors contributing to India's capex cycle revival

By Alok Agarwal, ETMarkets.com Last Updated: Oct 26, 2024, 05:42:00 PM IST

Synopsis

For most of the past decade, India's capex growth remained subdued. From 2013 to 2018, capex growth averaged around 3-4%, with infrastructure and manufacturing facing underinvestment. This slowdown was primarily due to policy uncertainties, weak demand, high corporate debt, and challenges in land acquisition and project approvals.



Indian economy is witnessing a significant resurgence in [capital expenditure](#) (capex), marking a pivotal point in the country's growth trajectory. The capex cycle, which had been sluggish for the better part of the last decade, has now picked up steam, fuelled by various structural reforms, government initiatives, and favourable

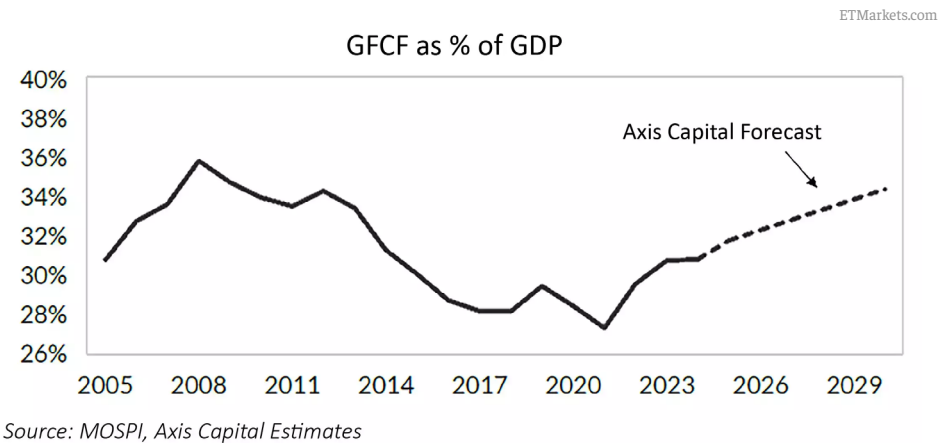
global conditions.

The capex cycle refers to the periods of increased investment by companies, governments, or both in building [infrastructure](#), expanding production capacities, or acquiring new technology. These investments usually lead to long-term growth, creating jobs, boosting demand, and spurring further investments.

Historical Context: The Decade of Stagnation

For much of the past decade, [India](#)'s capex growth was subdued. Between 2013 and 2018, the capex growth rate hovered around 3-4%, with sectors like infrastructure and manufacturing suffering from underinvestment. This was largely due to policy uncertainties, weak demand, high corporate debt, and issues with land acquisition and project approvals.

Investment or [Gross Fixed Capital Formation](#) (GFCF) to GDP ratio hit a 2-decade low of 27% during the Covid years. It's up above 30% in FY24, likely to go towards a 21st-century high of 36% over the next few years – led by house construction, power and new areas – defence, railways, and data centres. The near-term slowdown is due to unintended policy tightening, which is expected to reverse and again pivot in favour of capex.



Resurgence of the Capex Cycle

In recent years, the tide has turned, and capex spending is now on the rise

across multiple sectors.

Several key indicators and factors are contributing to this revival:

1. Government Push for Infrastructure Development & Defence

The National Infrastructure Pipeline (NIP) is an ambitious investment plan by the Indian government aimed at enhancing the country's infrastructure from FY 2020 to FY 2025. The plan involves an estimated investment of INR 111 lakh crore (approximately USD 1.5 trillion) over this five-year period.

Key sectors targeted for investment include:

Energy (24%)

Roads (18%)

Urban infrastructure (17%)

Railways (12%)

These sectors together account for about 71% of the total projected investments. The NIP aims to provide world-class infrastructure across the country, improve the quality of life for all citizens, and support India's goal of becoming a USD 5 trillion economy by 2025.

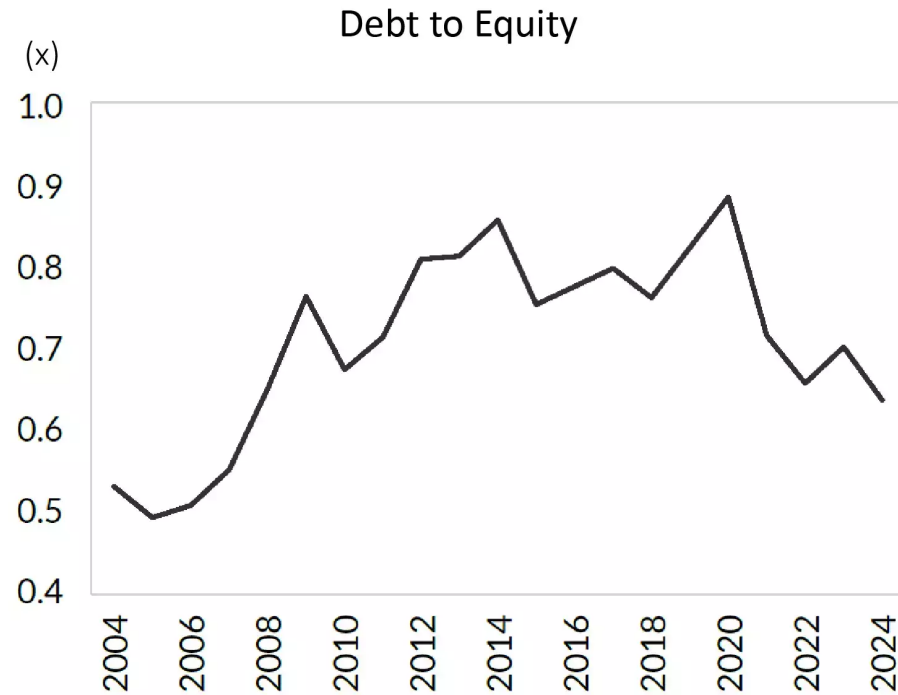
Defence

It's one of the largest ticket items in the Budget, but almost all used to be spent on O&M (Operations and Maintenance) and imports. With a focus on indigenisation, the domestic capex allocation has increased substantially.

Cumulatively over the next 5 years, it can reach \$130 billion, which is like 3% of GDP – the visibility for the next 5-10 years is extremely high with the whole value chain being ignited and created. It sounds similar to the auto sector of the 90s. We do see a long runway of growth, of course with speed bumps on the way.

2. Private Sector Participation

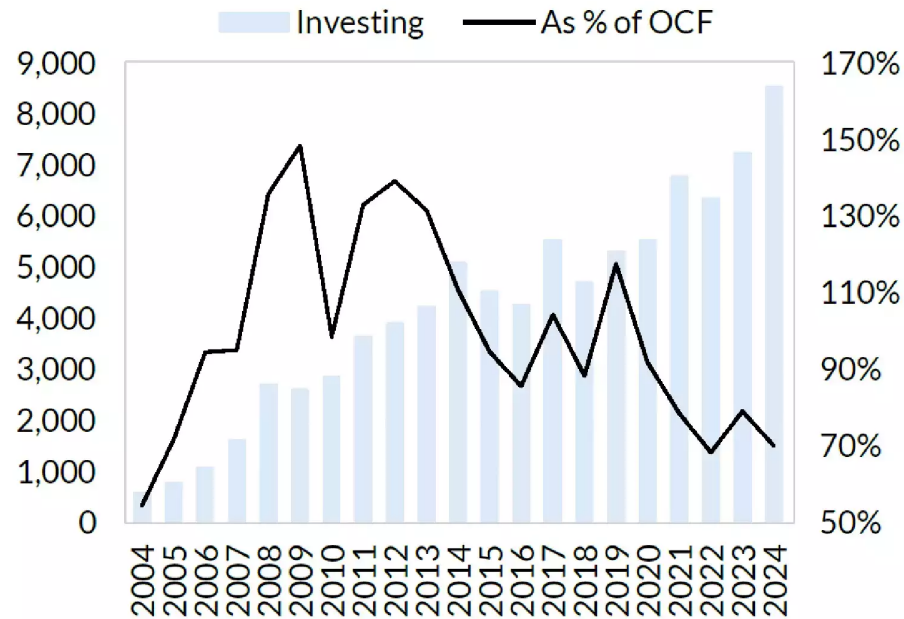
Corporate India is also ramping up investments. After years of deleveraging, companies now have stronger balance sheets (with the lowest leverage in 16 years) and are more willing to invest in expanding capacities. The private sector's capex growth surged to 16% in FY23, the highest in nearly a decade. Industries such as steel, cement, and automobiles are leading the charge, driven by strong domestic demand and export opportunities.



Source: Refinitiv, Axis Capital

Over the last five years, the Operating Cash Flow (OCF) of BSE 200 companies (ex-Fin) has grown at a 22% CAGR. During this time, the CAGR for investments was only 10%. This growth number has been significantly less than the OCF growth. However, it is still better than 4% CAGR in investments in FY12–19. Just 70% of OCF was invested in FY24, half of the 140% was invested in FY12 and the lowest amount since 2004.

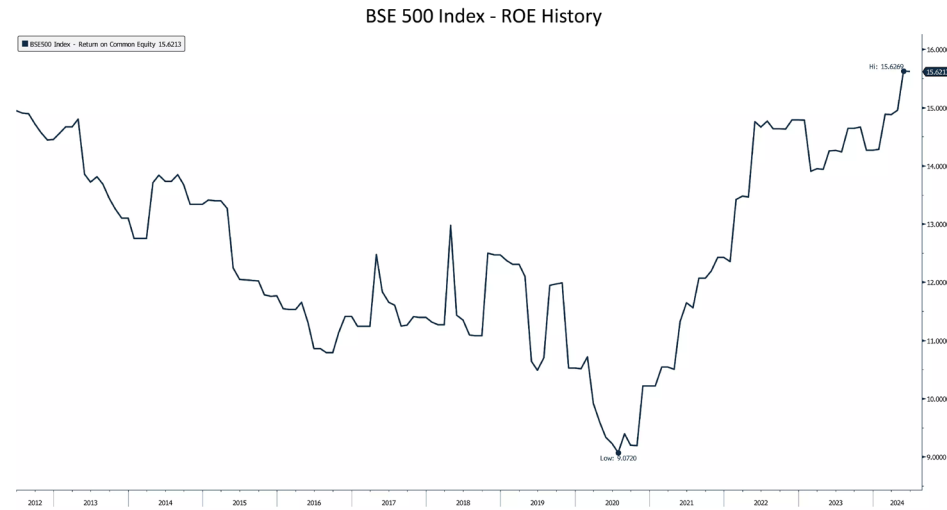
Investing Cash Flow as % of OCF at 20-Year Low



Source: Refinitiv, Axis Capital

3. Better Capital Efficiency: BSE 500 Index ROE at 12-Year High

With companies being able to use capital more efficiently already, they feel better incentivised to take capex, if the demand is projected to be good.



4. Production Linked Incentive (PLI) Schemes

The Indian government has rolled out several PLI schemes to incentivise domestic manufacturing across sectors such as electronics, pharmaceuticals, textiles, and automobiles. These schemes aim to attract investment to the tune of Rs 2 lakh crore by 2026, further driving the capex cycle. Data shows that PLI-induced investments have already exceeded Rs 1.5 lakh crore, with sectors like electronics and pharmaceuticals seeing the most traction (*Source: <https://pib.gov.in/>*).

5. Rising Capacity Utilisation

According to the Reserve Bank of India (RBI), the capacity utilisation rate in Indian industries rose to 74.5% in the second quarter of FY24, indicating that companies are approaching full utilisation of existing capacities and will need to expand to meet rising demand. Historical data suggests that when capacity utilisation crosses 75%, companies typically initiate new investment cycles. At the end of FY24, the number stood at 76.8%, the highest in 11 years.

6. FDI Inflows

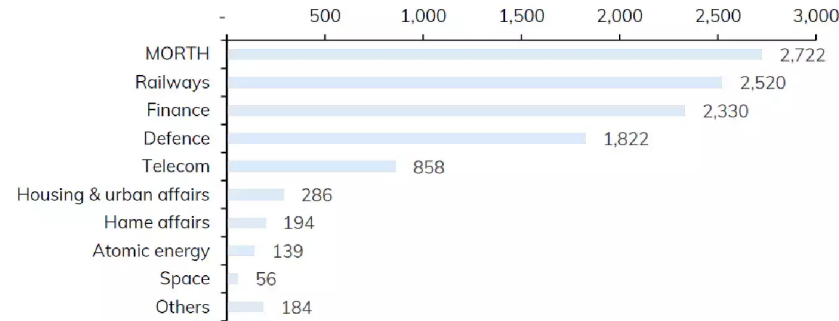
Foreign direct investment (FDI) has been another catalyst for India's capex revival. According to the Department for Promotion of Industry and Internal Trade (DPIIT), FDI inflows into India reached a record \$83 billion in FY23, driven by investments in sectors such as infrastructure, retail, and technology. The influx of foreign capital is helping boost India's infrastructure and manufacturing capacities, further propelling the capex cycle.

7. Energy Transition and Green Investments

India's commitment to reducing carbon emissions and transitioning to renewable energy is driving massive investments in green infrastructure. The country aims to install 450 GW of renewable energy by 2030. Investments in solar, wind, and hybrid energy projects, alongside electric vehicle (EV) infrastructure, are expected to drive capex growth in the coming years.

Capex budget for FY25

Distribution of Capex by Major Ministries (INR bn)



Source: Budget Documents, I-Sec Research

Note: MORTH - Ministry of Road Transport and Highways

Implications for India's Economy

The revival in the capex cycle is expected to have a profound impact on India's economic growth. Historically, a pickup in capex has led to higher GDP growth, as it creates a multiplier effect by generating demand across sectors. Here are some of the potential outcomes:

1. Job Creation:

Capex-driven investments, particularly in infrastructure and manufacturing, are expected to create millions of jobs over the next decade. According to NIP projections, infrastructure projects alone could generate 25 million direct and indirect jobs by 2025.

2. Boost to GDP Growth:

Analysts expect India's GDP growth to accelerate as a result of the capex boom. According to the IMF (International Monetary Fund), India's GDP is projected to grow at 7% in FY25, with capex investments contributing significantly to this growth.

3. Strengthening India's Global Competitiveness:

As India builds out its infrastructure and expands its manufacturing base, it is positioning itself as a global manufacturing hub. With rising FDI and participation in global supply chains, India could significantly enhance its export competitiveness, reducing its dependence on imports and improving its trade balance.

Risks to the Capex Cycle

While the capex cycle is gaining momentum, there are risks that could slow down its progress. High interest rates, inflationary pressures, and geopolitical tensions could deter future investments. Additionally, delays in project approvals, land acquisition, and regulatory hurdles continue to pose challenges.

Conclusion

The pickup in [India's capex cycle](#) is a crucial element of the country's growth story. Backed by strong government initiatives, private sector participation, and foreign investments, the next decade could witness significant infrastructure development, capacity expansion, and green investments. While there are challenges to navigate, the overall outlook remains optimistic, positioning India for sustained growth.

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