Why the Indian economy is ‘buzzing with energy and optimism’

Even as tariffs and other shocks are expected to rattle the global economy in 2025, India will likely remain insulated. Thanks to a strong push in manufacturing and infrastructure, the Indian economy is “buzzing with energy and optimism,” says James Reynolds of Goldman Sachs Asset Management.

“With domestic consumption accounting for 70% of its GDP, India has historically been viewed as more vulnerable to high inflation,” says Reynolds , global head of direct lending. “However, India has in recent years performed better than various developed and emerging economies in relation to its inflation targets, largely a result of a stronger government, central bank, and improving financial system.”

To get the pulse of the Indian economy, Reynolds, Stephanie Hui, head of private and growth equity in Asia Pacific for Goldman Sachs Asset Management, and Hiren Dasani, co-head of emerging markets equity for Goldman Sachs Asset Management, led a tour of clients and investors through three cities. The four-day tour included discussions with top corporate executives, up-and-coming start-up founders, and policymakers.

We spoke with Hui, Dasani, and Reynolds about the prospects for India’s economy, the thrust in infrastructure and manufacturing, and the private equity sector’s view of India.

**Tell us a little more about the investor tour, and the overall mood you encountered.**

**Hiren Dasani:** It was 22 investors representing $4 four trillion in assets under management as of November 2024 . The clients had come all over from all over the world: about 50% from the Americas, I would say, and about 25% from the EMEA region, and the remaining from the Asia-Pacific region. A very large proportion of the clients were public pension funds from the US and some of the largest family offices as well.

I think the mood was very optimistic from a medium-term perspective, and that was evident from the meetings we did with corporate leaders. There’s a sense that India may be becoming more competitive on manufacturing. Historically, services was the main driver of consumption, but now manufacturing competitiveness has been more pronounced, especially in a world where many large corporations are looking to diversify their supply chain. “China plus one” is a theme that a lot of corporates like.

**What has led to this boost in manufacturing competitiveness?**

**Hiren Dasani:** Some of this is related to production-linked incentive schemes, which India has rolled out over the years. There are tax incentives if a company sets up new production capacity in India, with certain production targets: up to 5-6% of the value of the output for a certain number of initial years.

Over and above that, I’d say there are more structural reforms like investments in renewable energy, which makes energy costs more competitive, and in logistics infrastructure.

**Stephanie Hui:**The diversification of supply chains has been a key driver of India’s growth prospect. Prior to Covid, people were happy basically sourcing primarily from China for manufactured goods. However, with the disruptions from Covid and geopolitics, business leaders have increasingly sought diversification. Historically, India was more costly, but people are now saying that, if you need diversification, there’s more tolerance for higher costs and more patience for India to get up the learning curve.

Unlike some smaller manufacturing markets, India has a large home base. So that the procurement power is such that, when you get to scale, it will likely become price competitive. I believe that's the reason why there's optimism that, if they can do dial up manufacturing, it may benefit India but may also benefit other international companies trying to risk manage. They had already, long ago, started sourcing IT services, so this is a continuation on that spectrum.

**How is the Indian government’s strong capex focus on infrastructure contributing to this story?**

**James Reynolds:** The government has significantly ramped up its capital expenditure on infrastructure, allocating a record 11 trillion rupees ($134 billion) on infrastructure spend for the fiscal year ending March 2025. In recent years, it has launched several large-scale projects in areas such as energy, urban development, transportation, digital infrastructure which includes expansion of highways, development of new airports, creation of smart cities, and investment in renewable energy.

**Hiren Dasani:**We met one of the largest infrastructure companies in India, which has been involved in railway electrification, bullet train projects, airport buildouts, and so forth. And in all of them, they were highlighting that the pace of execution has picked up quite a bit. So just to give you some numbers: Data center capacity is likely to grow by a factor of six or seven in the next five years, we believe. And while India has built metro rail systems in 17 cities in the last 50 years, more than 20 cities at present are developing metro rail networks.

**Why are many Indian companies today focusing on vertical integration?**

**Hiren Dasani:**This is more true of startups, really. In developed countries, a startup founder gets many things on a platter, because the physical infrastructure and the overall ecosystem (including supply chain networks and pools of talented human resources) are typically better developed. So the founder can just focus on one thing and doing that extremely well. But in an emerging market like India, where the broader ecosystem is not that well developed, you might spend more time and resources in developing that ecosystem. Which leads you to be a little more vertically integrated.

**Stephanie Hui:** I’d also add that there’s support from the government to move upstream. I’ll use an anecdote here. Historically, Indian manufacturing companies have imported major parts, primarily from China, and assembled locally. The software may have been Indian, but the hardware was primarily sourced from outside. But what we’re seeing right now is, for some products, a cap on the percentage of components coming from outside the country, versus being manufactured domestically. The government uses tax and other incentives to drive this change.

The example that was quoted on our trip was HVAC systems: heating, ventilation, and air conditioning systems that people use. Historically you could import most of the parts, but now some of the copper tubing and hardware pieces have to be sourced domestically.

**What were the big takeaways for private credit?**

**James Reynolds:** Total outstanding private sector lending increased approximately 5x over the last 13 years to $2.5 trillion at the end of 2023 — and we may just be at the beginning. There has been a strong thesis supporting growth of the sector in India. Sponsors have remained bullish on the long-term potential of India, which will likely continue to drive M&A activity. That could result in greater financing needs, particularly offshore financing, as regulations restrict ability of onshore lenders to finance acquisitions.

Second, we believe companies need to continue investing to meet the growing global and domestic demand. With India’s nominal GDP expected to grow to $7 trillion by 2030, the total incremental demand for private credit is expected to be another $2.6 trillion. Excluding the 60% that was historically provided by banks, this implies an additional $1 trillion to be financed by the bond market and non-bank market and represents a large opportunity for private credit lenders.

**What did you see and hear on the private equity side of things?**

**Stephanie Hui:**In this region, obviously China has historically been the primary destination for private equity, but in recent years, there has been more of a diversification, with increased flow to Japan, India, and Australia. Of these three markets, many investors feel Japan is a more developed market. India's exciting as a developing market, but that also comes with developing market risks. There’s a tremendous will to try to understand the Indian market.

The major theme we have seen is what we call IT services to the world, because the skilled labor cost in India is about a fifth or sixth of what it is in the US. Here, PE players may start with an Indian company, but when they exit eventually, given many of IT clients are US and European companies, they can exit as international players.

If you look at the private equity space, there are some sizable and successful exits from India. You see proper exits coming through.

The other focus is on capital markets, because India’s capital markets are very vibrant and have grown quite substantially in terms of value over the last two years in particular. The flip side of this is that everybody's asking the question: Is India too expensive now? For some of the consumer market deals, you were seeing companies trading at a premium of 25-30x EBITDA. Along with the US, India is possibly the most highly priced market in the world. The question that comes through is: Is it well-priced? Is it a time to exit versus a time to enter? And where do you get good value?

**James Reynolds:**While there has been a consistent debate as to whether the Indian stock market is too expensive, we believe valuations in India are in general still very healthy. This is driving families and founders to look for an alternative source of capital that is less dilutive than equity.

**Hiren Dasani:** I'll just add one point on the valuation, and this is not so much from the tour — but the way we’ve tried to frame valuations in public markets is that there’s a stronger-for-longer nature of growth in India today. It’s much less volatile, much more structural, domestic-consumption-driven growth rather than global cyclically driven growth. Also, more benign as inflation leads to a lower cost of capital. So all of this, we believe, bring valuations to where they are.

If you look at the luxury hotel sector, when the US economy went from $3.6 trillion to $7.3 trillion between 1983 and 1994, the number of hotels of a particular chain went up by seven times. In Europe, similarly, when GDP went from $3.7 trillion to $7.1 trillion, the number of hotels of another chain went up by a factor of four. India is at a similar stage of economic development in terms of absolute GDP and, on many measures, per capita GDP as well. We believe a lot of discretionary spending will grow exponentially over time, and that’s what leads to these kinds of valuations in the market.

**What constraints, if any, do you see in the economy?**

**Stephanie Hui:**There are some discussions about labor force participation. In the south of India, there seems to be more female participation in the labor force, and you see an improvement of GDP per capita there, versus in the north. The other topic is: Obviously it's an English-speaking workforce, and particularly in IT services, that's very helpful. But there's also a lot of debate about the efficiency of the workforce, versus China, particularly in manufacturing. India's manufacturing productivity is lower. And in lifting people en masse from poverty, manufacturing tends to be the important sector to do so.

**James Reynolds:** The biggest potential impediment to India’s growth would be its ability to control the pace of infrastructure development as gaps in connectivity and logistics often can have a big impact on business operations, costs, and quality of life. We believe India’s ability to prioritize large-scale infrastructure projects and urban development and increase public-private partnerships to expedite infrastructure development would be key.

There is also a delicate balance between job productivity and job creation that the country will need to achieve. While digitalization has helped improved productivity, the lack of sufficient job opportunities has the potential to lead to longer term socio-economic instability albeit the effect of this has been somewhat offset by the slower urbanization in India.

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