



360 Perspectives

India: The case for a structural bull market



Executive Summary



India's economy has weathered the pandemic-era growth shock better than its peers and has the potential to successfully transition into an upper middle-income economy over the next two decades.



Ongoing policy reforms, political stability, significant infrastructure investments and technological adoption are likely to aid improvements in per-capita income, boost discretionary consumption demand and enhance corporate profitability.



We believe this superior macroeconomic backdrop sets up Indian financial market assets to perform well on a multi-year horizon.

Audrey Goh, CFA

Head, Asset Allocation and Thematic Strategy

Tay Qi Xiu

Investment Strategist

India's transition to a middle-income economy

7.1%

If one excludes FY2021¹ given the unusual nature of the Covid shock, India's GDP has grown at an annualised rate of approximately 7.1% over the past decade.

Domestic consumption has played a significant role, contributing around 60% to overall growth, while investments, vital for enhancing productive capacity and ensuring long-term growth, also made a substantial contribution of around 30%. As of the end of the March 2023 financial year, India's GDP stood at USD 3.4trn while per capita GDP has more than doubled to USD 2,600 (as per IMF estimates), vs. just USD 1010 in 2008. Consensus projects India's economy to be one of the fastest-growing major economies in the world, with an anticipated average GDP growth rate of 6.2% in the coming two years (see Fig. 2). According to the International Monetary Fund (IMF), India is expected to surpass Germany and Japan to

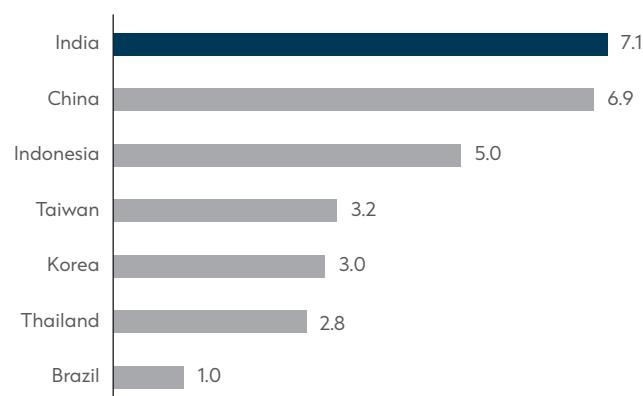
become the 3rd largest economy in the world by 2027 in nominal USD terms.

A transition into an upper middle-income economy would bring about transformative changes to the economic landscape. Living standards would improve and consumption patterns would likely change as income rises, attracting further foreign direct investments. In our view, India has the potential to successfully transition into an upper middle-income economy within the next two decades, given the following key structural macro drivers.

Fig. 1

India's GDP growth has outpaced its EM peers

2013-2022 annualized economic output growth % y/y (ex-2021)¹

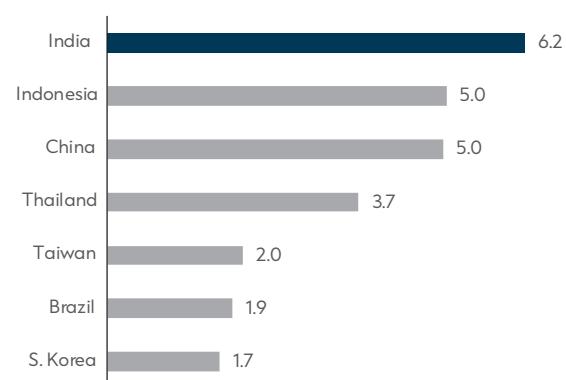


Source: Bloomberg, Standard Chartered

Fig. 2

GDP growth expected to stay ahead of EM peers

FY 2024 and FY 2025 avg. GDP growth estimates (%)



Source: Bloomberg, Standard Chartered

1 For India, fiscal year (FY) considered (1 April – 31 March cycle) instead of calendar year (CY).

Significant demographic dividend

According to the 2023 UN report, India now has one of the highest working-age population in the world. 68% of the population is part of the working-age group, defined as being within the age of 15 to 64 years, while 26% of the population is within the age of 10 to 24 years, making the population of India one of the youngest in the world. India's working-age population growth has outpaced its dependent population, which can result in increased savings potential as more people work and add to savings rather than draw on them during retirement.

A large and young working-age population also increases productivity, attracts investments, and ensures a more sustainable long-term economic growth

Over the next 10 years, India is expected to increase its working-age population by 101 million, accounting for about 23% of the total increase in the global working-age population. This is likely to keep the savings and investment ratio high in this decade.

A gradual shift to a multi-polar world likely to benefit India

The Covid-19 pandemic and rising geopolitical tensions highlighted the need for companies to diversify their supply chains and reduce dependence on a single supplier or country. With a young and large working-age population, India is well-positioned to benefit from shifts in global supply chains. India has tailored many policy decisions to attract greater foreign direct investments into its manufacturing sector, such as the "Made in India" initiative.

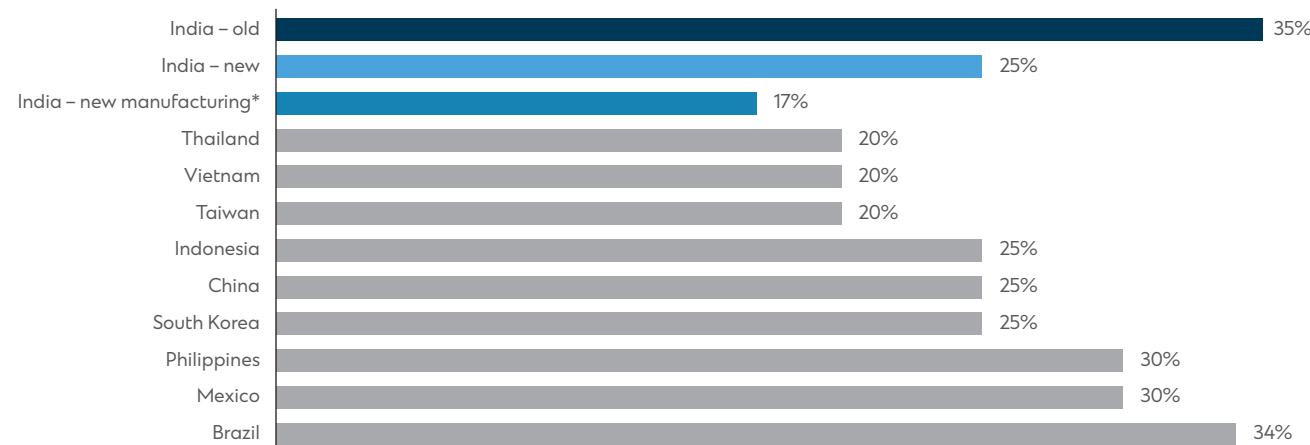
Policy reforms focused on improving competitiveness

Over the past few years, the government has announced numerous structural reforms to increase India's growth rate and improve the ease of doing business. Reforms included the Goods and Services tax (GST), the Insolvency and Bankruptcy Code (IBC), the adoption of the Inflation-Targeting Framework by the RBI and corporate tax cuts (see Fig. 3). During the pandemic, the government also focused on pushing capex-led growth and complemented it with structural incentives like the production-linked incentive (PLI) schemes for manufacturing sectors. Changes were also made to labour laws and solutions concerning land acquisition were introduced. These reforms are likely to help improve the competitiveness of India's domestic industry.

Fig. 3

For manufacturers, India's corporate tax rate remains the most competitive among market peers

Corporate tax-rates (%)



Source: Ministry of Finance (India), World Bank, CMIE. *For new manufacturing companies commencing operations before March 2024.

Policy boost to manufacturing sector

The government has undertaken numerous initiatives to revive the manufacturing sector in India. In addition to the implementation of GST and corporate tax cut, including a 15% tax rate for manufacturing units, the government announced the production-linked incentive (PLI) scheme. This aims to offer industry-specific incentives to raise value-add and create an ecosystem to lower imports and make exports highly competitive. The PLI schemes are expected to lead to investments of USD 58bn over the next five years across 660 entities (both Indian and Global) backed by an additional USD 33bn in government incentives over next 5-6 years (equivalent to 1.4% of government expenditure). On average, companies could receive approximately 7.2% of incremental revenue annually as incentives over the next five years. Overall, PLIs not only have the potential to generate incremental revenue, but also the ability to boost job creation and support domestic consumption, which remains the largest contributor to GDP growth.



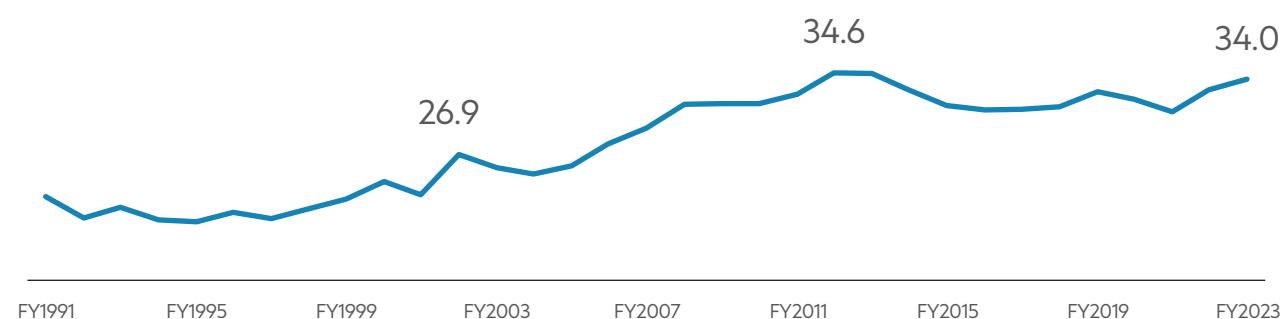
Investment cycle revival to broaden to the private sector

India's fixed investments have recovered quickly post the pandemic, with the investment rate now back to FY 2012 high of 34% of GDP (see Fig. 4). Most of the pick-up in investments has been driven by increased government capex through large-scale infrastructure investments in expressways, railways, renewables, electrification, urban metros, airports, and irrigation (see Fig. 5). We are seeing initial signs of a revival in private capex driven by deleveraged corporate balance sheets and improved bank lending to investments amid a broad-based pick-up in capacity utilisation. Further, the government's policy initiatives to boost manufacturing is expected to attract investments in key sectors like auto, steel, renewable, pharmaceuticals, textile, and electronics over the coming years. A sustained recovery in private capex would more than offset the government's slower capex growth as the government sticks to its fiscal consolidation path (fiscal deficit to fall from 5.9% of GDP in FY 2024 to below 4.5% by FY 2026).

Fig. 4

Fixed investments, which are vital for enhancing productive capacity and ensuring long-term sustainable growth, have recovered to historic highs of 2012-2013

Fixed investments to GDP (%)

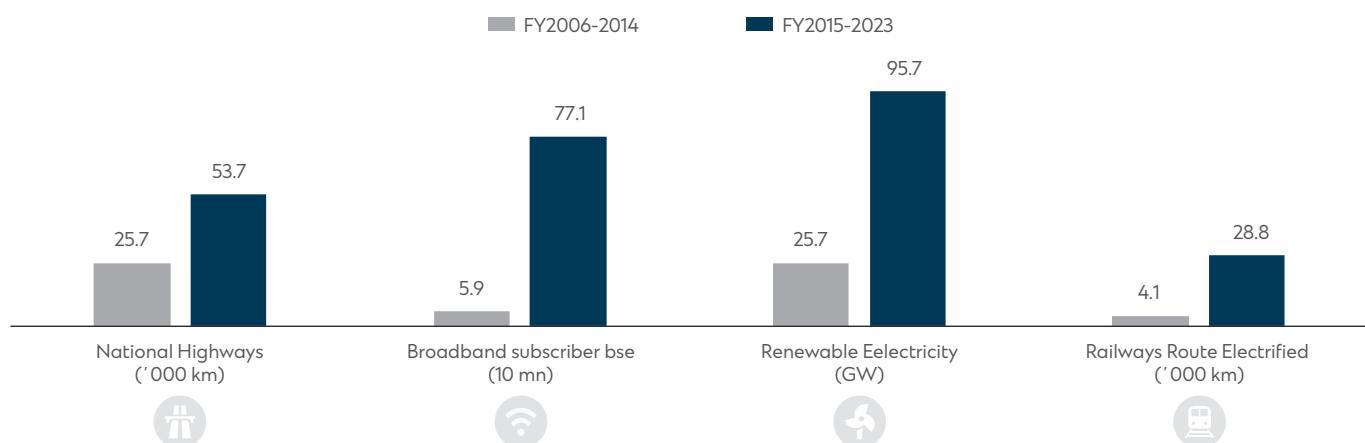


Source: National Statistics Office (India), RBI

Fig. 5

Infrastructure has received a strong boost from the government's focus over the past eight years

Pace of infrastructure projects



Source: Ministry of Road, Transportation & Highways (India), RBI, TRAI



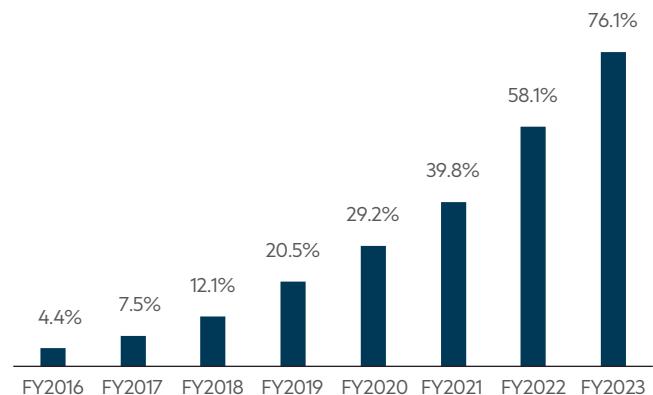
Efficiency gains from improved digital infrastructure

India is set to reap the rewards of decade-long investments in digital infrastructure. The IndiaStack – India's digital transaction-led, low-cost, large volume and small ticket size system – has reached economies of scale (see Fig. 6). This is likely to change the way Indians invest, spend, lend, and make payments over the coming decade, leading to efficiency gains. It also helps ensure timely and direct delivery of public welfare policies. Further, the digital infrastructure has aided growth of new private sector companies and start-ups in the financial sector and has the potential to deepen financial inclusion through ease of access to banking, credit, and financial assets.

Fig. 6

Digital transactions have risen at a significant pace since FY 2016

Digital transactions % GDP



Source: Ministry of Finance (India), RBI, TRAI

Fig. 7

India's financial market assets are expected to benefit structurally from a favourable macroeconomic backdrop over the next few years

Our long-term (7yr) capital market expectations for Indian financial market assets

Asset classes	Sub-asset class	Return (annualised return in INR)	Vol.
Equities	India Large Cap	8.0%	30.1%
	India Mid/Small Cap	7.6%	34.1%
Fixed Income	India Short Term	7.1%	2.0%
	India Mid/Long Term India Composite	7.2%	2.7%
	Bonds	7.2%	4.0%
Commodity	INR Gold	4.8%	14.4%
Cash	India Cash	6.5%	1.2%

Source: Standard Chartered

Outside of structural drivers, we are of the view that India's key macro-economic parameters are on a sound and sustainable trend:

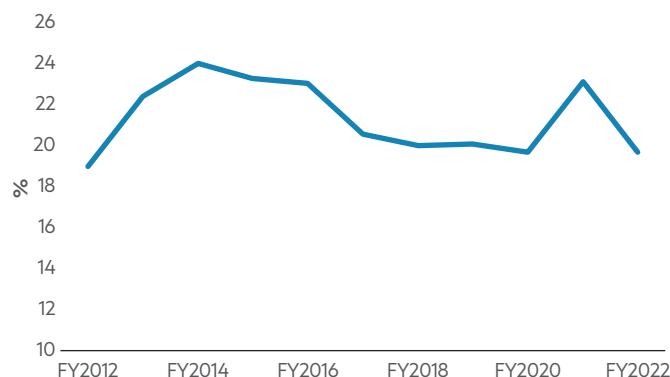
1. India's external debt-to-GDP remains low at 18.4% for FY 2023, tracking below its 10-year average of 21.6%.
2. Credit growth has risen to a decade high of 15% y/y for FY 2023. India's corporate balance sheet post the painful de-leveraging cycle of 2010-2020 and stable asset quality is likely to be supportive for growth and domestic consumption.
3. Capacity utilization has risen to 74% in Q3 FY 2023, above the long-term trend.
4. More supportive external conditions have narrowed the current account deficit (now estimated at about 2% of GDP in FY 2024 and within its long-term trend).

FX reserves are also strong, estimated by the IMF to cover more than seven months of imports and close to twice the external short-term debt. Both point to lower external vulnerability and hence more contained INR volatility in the medium-term.

Fig. 8

Indian banks' bad debt ratio has dropped to a near 8-year low, allowing credit growth to resume

Scheduled commercial banks non-performing loans as a percentage of total gross loans

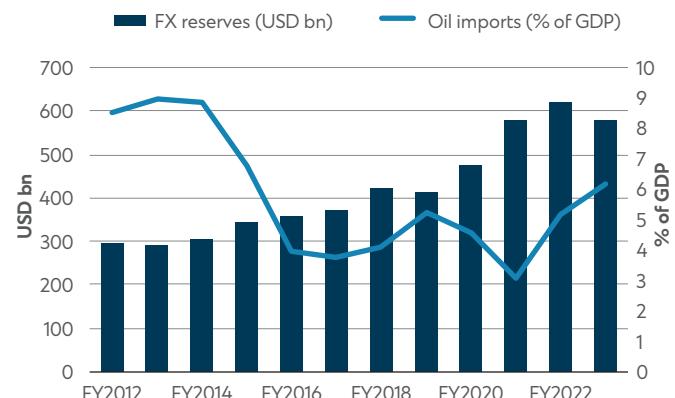


Source: Reserve Bank of India, Standard Chartered

Fig. 9

The crude oil import burden remains below the peak of FY 2012-2014

FX reserves (USD bn), Oil imports as % of GDP (RHS)



Source: Bloomberg, Standard Chartered

A structural bull case for Indian assets

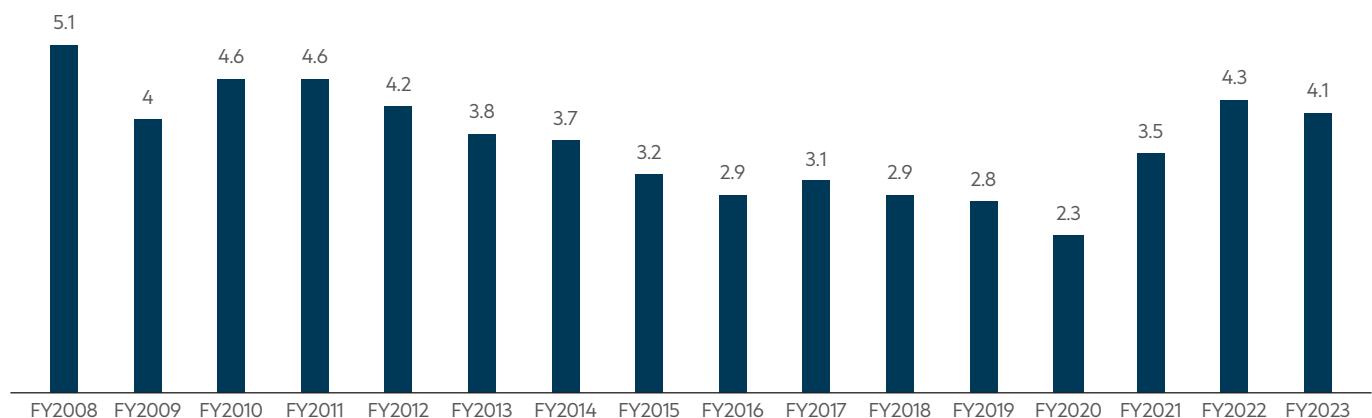
In our view, India's macroeconomic backdrop sets Indian financial market assets up to perform well on a multi-year horizon – what we see to be a “structural bull case”.

- 1 **A high rate of economic growth, with well-managed inflation and external stability risks.** Stable governance, policymaking, and an investment-focused growth trajectory are also expected to be beneficial.
- 2 **A sustainable corporate profit cycle.** India's corporate profit cycle remains the strongest since the 2004-08 cycle. The benchmark Nifty index EPS grew at an average 20% between FY 2021 and FY2023 and is expected to grow by a further 18.7% and 16.6% in FY 2024 and 2025 respectively.
- 3 **Fiscal consolidation and quality of spend.** The government's shift in the quality of spending towards capex and cuts in subsidies towards pre-pandemic levels is likely to raise the investment rate, which is key to sustaining growth.

Fig.10

India's corporate profit share of GDP has recovered closer to pre-pandemic levels

NSE 500 index profit as % of India's GDP



Source: NSE, Bloomberg, Standard Chartered

Equities

are best positioned to benefit from India's structural growth

Indian equities remain poised to benefit from several strong multi-year structural drivers.

These drivers include:

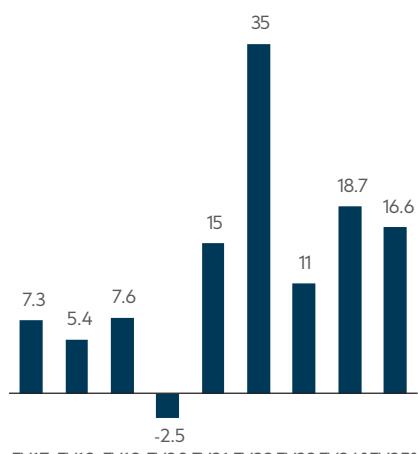
1. a diversified economy with robust domestic macro fundamentals that would be supportive of earnings;
2. healthy corporate balance sheets and strong financial sector health that would ensure more sustainable earnings growth;
3. a decline in foreign exchange risks and, thus, volatility in earnings due to a more stable domestic currency;
4. a sustained corporate earnings growth cycle driven by increased formalization, improving capacity utilization and efficiency gains from technological advancements;
5. lower reliance on foreign investor inflows due to improvements in domestic financial inclusion, which has resulted in more sustained domestic flows.

We expect the current equity cycle to be analogous to the 2003-2008 bull cycle when output growth rose sharply (see Fig. 12), inflation stayed stable and improvements in productivity drove a rise in investments. During that period, higher investments did not lead to a widening of the current account deficit as the rise in savings was led by improvement in public savings (fiscal consolidation) and private corporate savings.

Fig. 11

Indian equities earnings growth expectations remain robust

Consensus EPS growth estimates for Indian equities (%)



Source: Bloomberg, Standard Chartered

Fig. 12

Comparison of 2003-08 equity market cycle vs the current cycle: 2021-2025

Metric	2003-08	2021-25E*
Average annual GDP growth	8.9%	7.2%**
Average CPI	4.9%	5.6%
Average annual EPS growth	25%	19.3%
Average PE premium over EMs	1.3x	1.7x***
Average 12-month forward PE	19.5x	24.2x***
Peak market-cap to GDP	1.49x	1.1x***
Cumulative FII flows	USD 57bn	USD 14bn***
MSCI India return (CAGR)	44%	26%***

Source: NSE, Bloomberg, Standard Chartered

* For 2021-25E, FY2021-23 includes reported data while FY2024-25 uses consensus

**We exclude FY2021 given data was skewed by the pandemic-led contraction

***FY2021-23 only

Fixed income

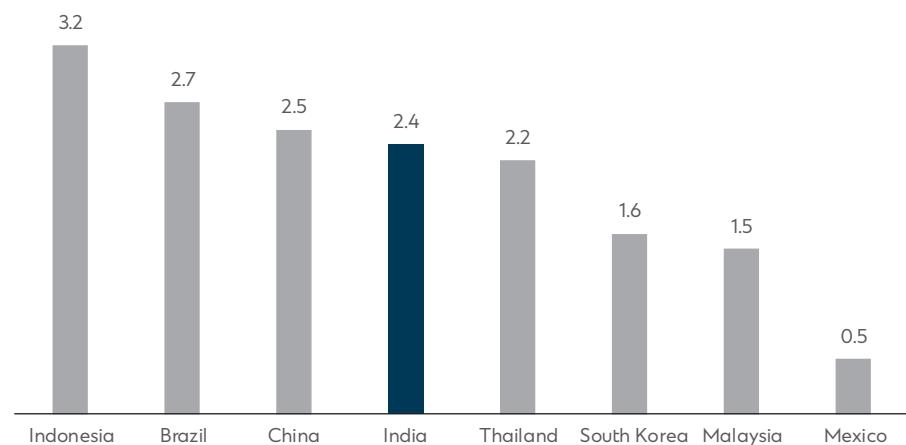
to continue to offer a stable yield

India's government bond yields have risen from pre-pandemic lows as monetary policy turned less accommodative. Yields are currently trading closer to their 10-year average. Real (inflation-adjusted) bond yields appear attractive compared to other EMs. Given the focus on investment-led growth and containing inflation, domestic bond yields are likely to remain well anchored for the next few years. A stable inflation and currency outlook are additional support factors for bond investors. The RBI's strong FX reserves (~USD 600bn), a level deemed more than adequate by the IMF relative to imports and external debt, should also help manage INR volatility.

Fig. 13

Real yields for Indian bonds higher than most EMs'

10-year government bond real (i.e. Adjusted for inflation) yields (%)

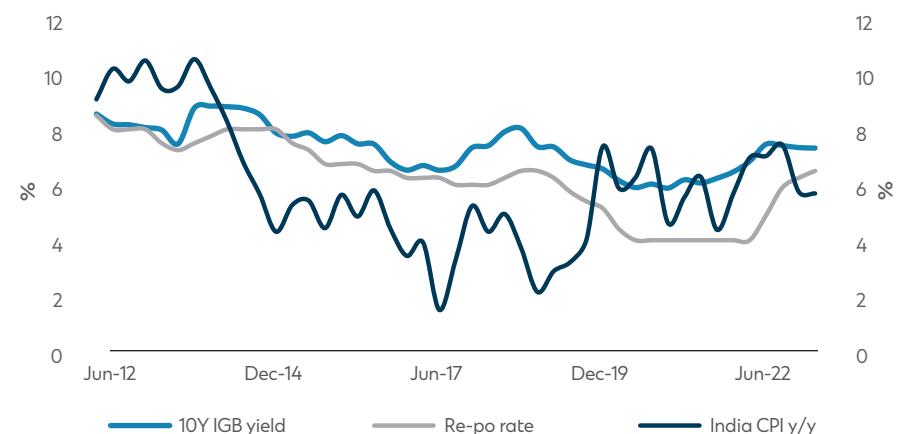


Source: Bloomberg, Standard Chartered

Fig. 14

Indian bond yields, policy rate and domestic inflation have trended lower post RBI's adoption of its Inflation Targeting Framework in 2013

CPI y/y (%), RBI re-po rate (%), 10Y IGB yield (%)



Source: Bloomberg, Standard Chartered

Private markets

to provide long-term alpha

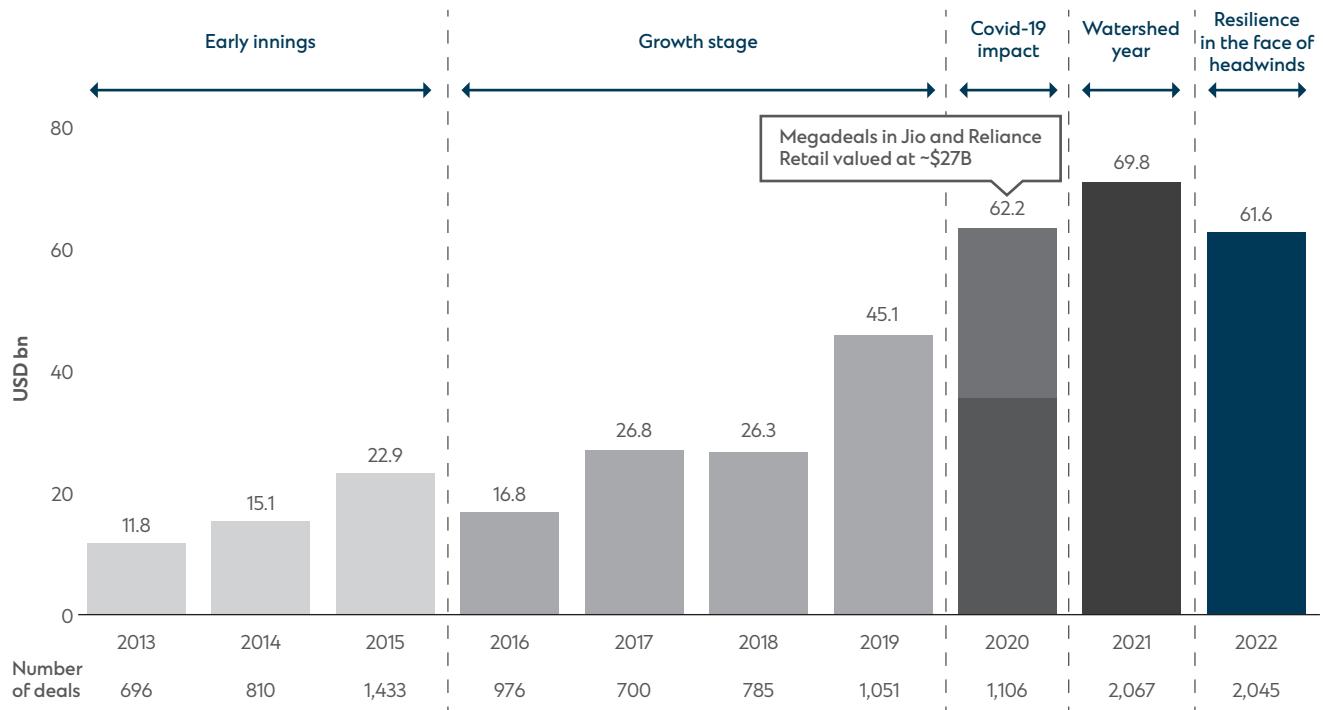
India's private markets have evolved significantly over the past decade, with investments increasing five-fold and the investor base rising four-fold. The industry has received support from a favourable regulatory landscape, notable strides in digital infrastructure and deepening maturity of founders. In 2022, India's private markets demonstrated resilience in the face of global headwinds, with investments amounting to USD 61.6bn despite a significant contraction in the region. India's share of PE-VC investments in Asia-Pacific has also rose to about 20%, from 15% only a few years ago.

In our view, private markets interest is likely to remain strong, supported by a positive economic outlook and structural enablers such as large consumption opportunity and best-in class digital infrastructure. We expect sustained demand from major PE/VC capital in India's Healthcare, Manufacturing, Tech, NBFCs, Fintech and ESG-aligned investments like EV and Green energy. Together, this suggests the asset class is likely to offer potential for long-term alpha over listed assets.

Fig. 15

India PE-VC activity rose over 5x over the last decade

Annual PE-VC Investments in India (USD bn)



Source: Bain and Company

Conclusion

In our view, Indian assets present a multi-year structural opportunity as the economy transitions to an upper middle-income economy.

Long-standing policy reforms, political stability, significant infrastructure investments and technological advancements are likely to aid improvements in per-capita income, boost discretionary consumption demand and enhance corporate profitability. India's superior macro fundamentals, low foreign investor positioning and stable currency outlook are additional tailwinds for Indian assets.



What are the key risks to the positive outlook?



The current global macroeconomic backdrop remains a key risk to the positive outlook. A protracted global growth slowdown could weigh on India's manufacturing and services exports, impact growth and increase macro stability concerns.



Delay in private investments pick-up could de-rail the positive momentum, as government capex support is likely to wane in the coming years.



While the political landscape remains stable in India, any signs of reduced political stability following elections would risk triggering asset class volatility.



A further spike in regional and global geopolitical tensions that result in a jump in energy and other commodity prices risks creating fiscal stress and inflicting downside risks on India's growth.

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