

## India – the transformation gains pace

### IN A NUTSHELL

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- India has become an investor favorite in 2023 while China's popularity has sunk.
  - We expect the current government to retain power in the upcoming elections, meaning that the reform and investment programs are likely to continue. We are also counting on ongoing momentum in service exports.
  - India's equities are not cheap, but we expect growing investor interest from abroad, not least because of the opening of the bond market, which could also help the currency to stabilize further.
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Over the past three years India's leading share index, the Sensex, has risen by as much as 40% in Indian rupee terms. Meanwhile, over the same period, the Emerging Markets (EM) index, MSCI EM, has lost 20%, and China's shares (MSCI China) have lost as much as 50% (all calculated in rupees).<sup>1</sup> Indian equities have therefore been outstanding performers in the EM universe. So much so that they are now trading at a valuation premium of around 70% to the average of other emerging markets. Is this a bandwagon to jump on now? To answer that we need to dig a little deeper.

For a long time, India's development into an industrial and service nation has been incremental. But in recent years the steps forward have become bigger. The foundation has been laid by the current government's reforms and an investment offensive that has done much to strengthen infrastructure in particular. Government infrastructure expenditures have risen by a full 30% on average over the past three years. It is still expected to grow by a further 11% in the current fiscal year. This ramping up of government capital expenditure should help India make better use of its big demographic advantages. The country not only has a relatively young population (on average ten years younger than China's), but it also has falling birth rates, fundamentally improving the dependency ratio between the working and non-working population. This double demographic tailwind sets India apart from most other emerging economies.

Other developments, too, are supportive. The growth in services exports is rapid, which is offsetting India's trade deficit in goods and giving the central bank and government more room for maneuver. And the opening of the bond market and inclusion of Indian government bonds in major indices should further boost foreign investor interest. There is also a growing desire in the West to avoid relying solely on China for some products. And the technology sector is expanding, driven by artificial intelligence (AI) and India's role as a global technology services provider. Finally, India has huge catch-up potential: Its per-capita income is one-fifth of China's, meaning it can generate economic momentum regardless of global economic conditions. For investors that also means India offers attractive diversification benefits in our view.

Of course, given just how well India's equity markets have performed, there is considerable scope for volatility. Identifying the perfect entry point is anything but easy. Also, in terms of the economy, India's further rise is likely to be volatile and rocky. Not least because some of the longer-term challenges persist and will take more time to resolve. For example, the education system, especially at primary level, needs to be improved. The high level of youth unemployment and still excessive bureaucracy are further difficult challenges.

At the same time, the great potential India offers in many areas is blatantly clear. The country's above-average growth is likely to reward longer-term investors. This year, two events are likely to stoke particular interest in India. First, the parliamentary elections held in April/May, in which we expect Narendra Modi to win another term. And second, the inclusion

<sup>1</sup> Source: Bloomberg Finance L.P. as of 2/16/24

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of India's local-currency government bonds in a leading global EM index starting in June. We view both of these events as positive for Indian capital markets.

## Glossary

The [BSE Sensex](#), Sensex for short, is a market-capitalization-weighted index of India's 30 most important listed companies.

[Capital expenditure \(Capex\)](#) are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment.

[Emerging markets \(EM\)](#) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

The [Indian rupee](#) is the official currency of the Republic of India.

The [MSCI China Index](#) captures large- and mid-cap representation across China H shares, B shares, Red chips, P chips and foreign listings.

The [MSCI Emerging Markets Index](#) captures large- and mid-cap representation across 23 emerging-market countries.

[Volatility](#) is the degree of variation of a trading-price series over time. It can be used as a measure of an asset's risk.

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