Ninety One

Investing for a world of change

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India: a powerhouse in the spotlight

India, alongside China, now represents nearly half of the EM equity universe. While structural trends favour Indian equities in the long term, higher equity valuations mean a selective approach is more crucial than ever.

A bigger role in the investment universe

India's increasing prominence in the investment landscape is undeniable. Over the past two decades, the Nifty 50, India's main stock benchmark, has consistently outperformed, delivering double-digit returns compared to the single digit returns of the MSCI EM index over the same period. As investors pile into the Indian stock market, headline valuations have become elevated and a selective approach towards the companies we invest in remains as relevant as ever. However, the foundational drivers are real.

In this piece, we unpack the macro, micro, and demographic trends shaping India's economy and the growth of its stock markets over the long term and consider the risks and opportunities for investors.

A decade of economic growth

Under the administration of Narendra Modi, who has been prime minister since May 2014, India has increasingly focused on growth. Between 2014 and 2022, India's GDP per capita rose from US$5,000 to over US$7,000 — an impressive 40% increase[1].

This growth trajectory continues, with the IMF recently raising India's 2024-25 growth forecast to 7% from 6.8%, driven by improving private consumption. India has already surpassed the UK to become the world's fifth-largest economy and is set to overtake Japan and Germany within five years.

1. Source: tradingeconomics.com/India/gdp-per-capita.

For further information on investment team and indices, please see the Important information section.

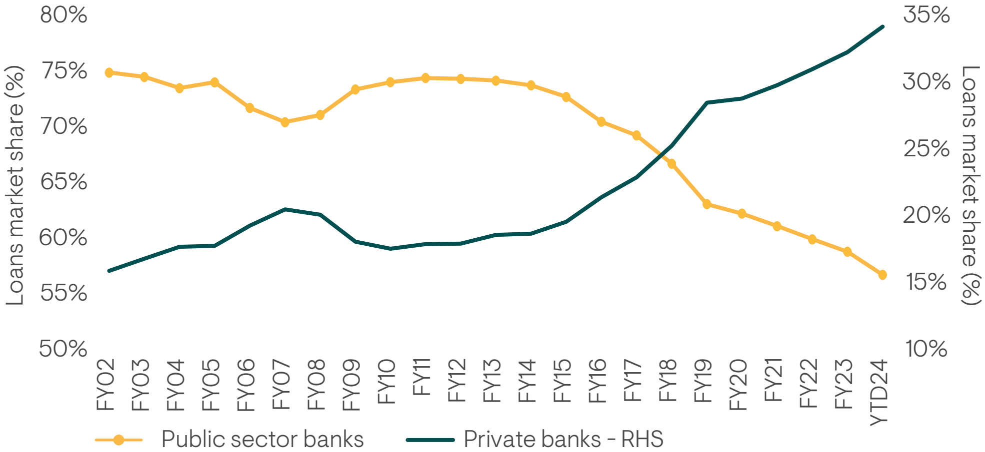
A reforming economy

India's progress over the past decade includes improvements in both soft and hard infrastructure. Streamlined regulations, better oversight, and simplified tax applications (necessary in a federal country with 28 autonomous states) have reduced red tape. This, together with capital market reforms and the easing of Foreign Direct Investment (FDI) rules, has resulted in a surge in inward investment.

Additionally, the government's policy of incentivising businesses with subsidies and tax breaks while supporting major homegrown firms to become 'national champions' has spurred local growth. There is also India's ambitious National Infrastructure Plan aiming to replace ageing infrastructure and inject US$1.4 trillion into various sub-sectors by 2025, including energy, roads, railways and other urban development.

Over the past three decades, India has gradually liberalised its financial system through market-oriented reforms. These changes have significantly reduced government involvement in state banks, paving the way for the rise of dynamic private banks, better equipped to meet the credit needs of India's growing economy.

Figure 1: A vibrant private banking sector has gradually supplanted the public sector in the loans market

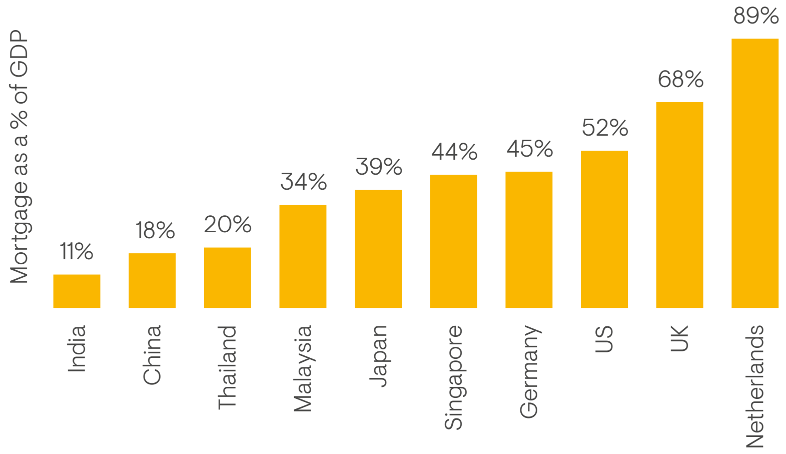


Source: Reserve Bank of India, Macquarie, data as at August 2024.

In parallel, India has also been addressing other critical areas, such as its property market. The Indian property market, once plagued by poor regulation and widespread fraud, has undergone a transformation with the introduction of the Real Estate Regulatory Authority (RERA) Act in 2016. A decade ago, buyers faced delays, poor construction standards, and even outright fraud, leading to a lost decade for the market. RERA has changed this by establishing a regulatory authority, requiring project registration, and ring-fencing sales proceeds to ensure funds are used for construction. This has driven out unscrupulous developers, boosted buyer confidence, and positioned the Indian property market for a much stronger decade ahead.

In addition, India's low mortgage penetration rate provides significant room for growth in the housing market. This is supported by a likely peak in interest rates, 8-10% salary growth enabling early repayments, and intense competition among mortgage providers.

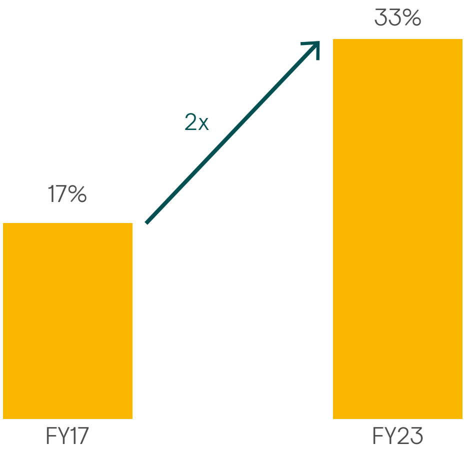
Figure 2: Low mortgage penetration leaves scope for growth



Source: HDFC Limited, IMF, data as at July 2024.

These improvements not only strengthen the property sector, but also contribute to a more stable economic environment, creating a positive backdrop for equity markets.

Figure 3: A functioning property market benefits listed developers



Source: Anarock, data as at July 2024.

These reforms are contributing to a flourishing capital expenditure cycle that is expected to remain elevated for several years. This cycle is more diversified than India's boom period from 2003-2007, and government capex spending is being caught up by the private sector.

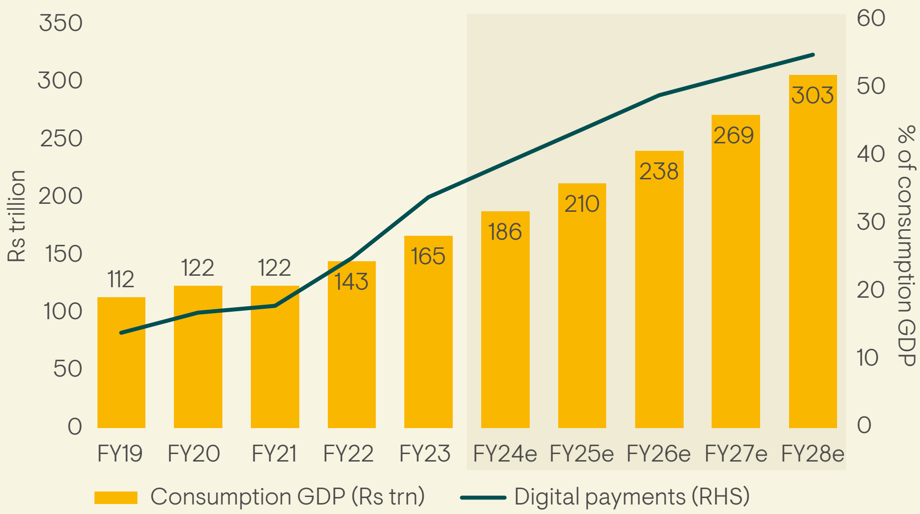
India's digital revolution

Other key game-changers that have reshaped and propelled India's economy in recent years include the rollout of Aadhaar, India's 12-digit unique identity number, which links individuals' demographic and biometric data, providing a secure and reliable identification system for 1.4 billion people. This system has enabled access to smartphones, bank accounts, and direct government payments, significantly enhancing financial inclusion.

Another leap forward came with the launch of the instant payment system UPI, developed by the National Payments Corporation of India. Since its introduction in 2016, UPI has become the backbone of the country's e-commerce and fintech ecosystem, establishing India as a global leader in real-time payments and fuelling the rise of a new generation of fintech entrepreneurs.

Of course, this progress would not have been possible without widespread smartphone penetration. The country has made huge strides, aided by the collapse of telephony tariffs. Adoption is now widespread, with over 500 million users, but considerable potential remains for further growth.

Figure 4: India now has the largest volume of real-time digital payments worldwide



Source: CLSA, data as at July 2024.

Favourable demographics

India has a large, youthful, and well-educated population which could accelerate economic growth, providing their skills can be harnessed. One of the country's key advantages is its pool of millions of skilled IT professionals, many of whom are now returning after seeking opportunities abroad. This is fuelled by the availability of capital to invest in innovative ideas, driving disruption and growth across the Indian economy, especially in e-commerce and fintech.

More broadly, as the world faces a shortage of workers, India stands out with its abundant labour force. With global manufacturing moving away from China, India is well-positioned to seize this opportunity. Unlike in the past, India is actively pursuing this chance through its government's Production Linked Incentive (PLI) schemes, which aim to boost investment in various manufacturing sectors. The government is backing these schemes with a substantial investment of Rs 1.97 trillion (about US$24 billion), offering incentives based on incremental domestic sales to attract and stimulate growth in the manufacturing industry.

Equity market performance

The dynamics listed above are evident in India's stock exchanges. In recent years, the Securities and Exchange Board of India (SEBI) relaxed foreign ownership limits, which increased the attractiveness of the Indian market to international investors. As a result, the combined market capitalisation of companies listed on the National Stock Exchange and Bombay Stock Exchange has grown by US$1 trillion in under three years, solidifying India's position in the MSCI Emerging Markets Index.

Earlier this year, India's weight in the index reached its highest point ever. Together with China, both countries represent nearly half of the EM index universe. Globally, India is now the fourth largest equity market by market capitalisation behind the US, China and Japan. Three Indian companies - Reliance Industries, ICICI Bank and Infosys – are now among the top 10 constituents in the EM index.

The dynamism extends to a surge in initial public offerings. In 2023, India saw 241 IPOs, the highest number in over 20 years. The momentum continues in 2024, with 57 IPOs launched since March, raising almost US$178 billion[2].

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2. Source: www.msci.com. MSCI country spotlight as of May 2024.
For further information on indices, please see the Important information section.

However, this growth is not without risks. While India's inflation is stable, and the economy continues to expand, we believe the likelihood of increased volatility is higher than it was six to 12 months ago. The new coalition government is also mindful of the market's rapid growth: tax changes unveiled in the July budget, including a higher levy on equity investments, aims to limit over-exuberance, while lowering taxes for foreign companies to attract more investment.

Additionally, the government has allocated billions of dollars for job creation in a budget designed to solidify the coalition and regain voter support. The new political landscape suggests that implementing reforms in the markets for land, labour, and capital may face some obstacles. We will be monitoring this closely.

Selectivity is key

Given the recent out-performance of the Indian stock market and elevated valuations, bottom-up security selection is crucial. Identifying investments that can capitalise on growth will be key.

India's market is both large and highly liquid, with over 850 stocks trading at an average daily value of more than US$1 million. It is also notable for its diversity and low concentration compared to other emerging markets.

Active management and, specifically, bottom-up fundamental research have potential to generate alpha in emerging markets like India. It allows investors to build an in-depth understanding of each company's potential, business fundamentals, governance structures, supply chains and sustainability credentials.

In summary

India's market reforms position it as a compelling investment destination, offering investors a distinctive proposition within an increasingly diversified emerging market opportunity set.

While the country's outlook is promising, it is not without risks and therefore requires active navigation as an investor. Success will likely hinge on identifying companies poised to benefit from structural trends. The mix of opportunities and challenges underscores the importance of selectivity, making India an attractive but nuanced investment destination for years to come.

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