

India: Getting too big to ignore



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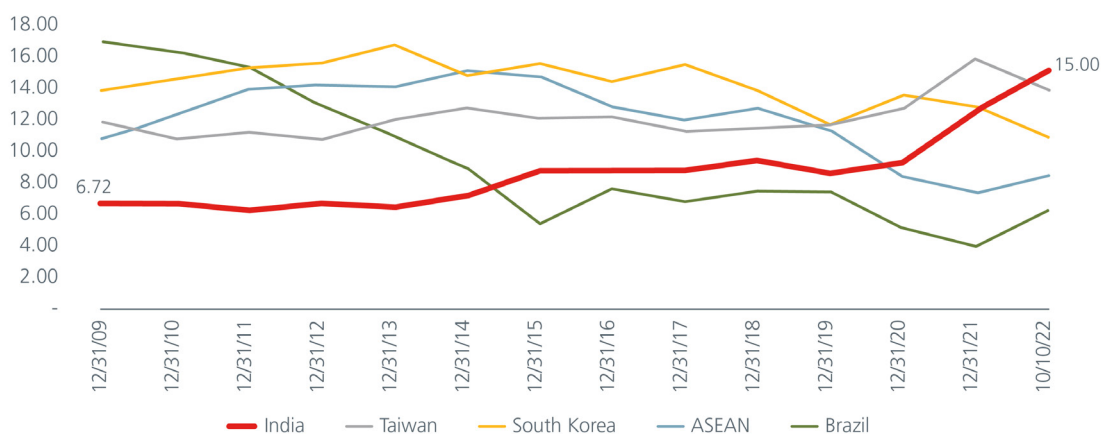
India makes up more than 15% of the MSCI Emerging Market Index. With the India economy expected to drive one fifth of global growth this decade, investors can no longer ignore the opportunities that will arise from India's demographic dividend, rising affluence and unique sector strengths.

The Indian economy has recovered strongly from the COVID pandemic. The IMF forecasts that India's economy will expand 6.1% this year — one of the fastest rates of any

major economy — and 6.8% in 2024. India is expected to contribute 15% of 2023's global economic expansion and drive one fifth of global growth this decade.

While India is striving to realise its economic potential, its equity market is also making big strides. India accounts for more than 15% of the MSCI Emerging Market (EM) Index, up from 6.7% in 2009. It ranks second in terms of weight within the MSCI EM Index, next only to China¹. For investors, India is quickly becoming a market that is too large to ignore. Fig. 1.

Fig 1: Country weights in MSCI EM Index (%)



Source: Eastspring Investments (Singapore) Limited. Macquarie Research, November 2022.

Source: ¹Macquarie Research. November 2022.

Fig 2: EM funds' exposure to India has room to rise



Source: BofA Global Research, BofA Asia Quantitative Strategy, MSCI, FTSE, FactSet, 13F Filings, Benchmark Indices, Country Stock Exchanges. March 2023.

INDIA AND CHINA: NOT MUTUALLY EXCLUSIVE

The Sensex Index outperformed the China A-share and H-share market by 18.1% and 12.5% respectively in 2022². Some investors believe that this strong performance was because foreign investors were reducing their exposures in China last year, given its slowing economy and embattled property sector. As such, there are concerns that the optimism over China’s economic re-opening this year may result in foreign investor outflows from India.

In reality, in 2022, India suffered the largest foreign investor outflows it has seen in the last 12 years. It was rising domestic inflows (which tend to be stickier) that helped sustain the equity market. We believe that as global investor risk sentiment improves towards the Emerging Markets (EMs), both India and China will benefit from foreign investor inflows. While

EM funds have recently increased their exposures to India, the average weight remains at multi-year lows. There is significant room for exposures to rise. Fig. 2.

In our opinion, global investors need not choose between the China and India equity markets. These markets offer opportunities in different sectors and can have complementary roles in portfolios.

For example, the MSCI India Index is skewed towards Private Sector Banks and Information Technology services which are largely dependent on US corporate tech spending. On the other hand, MSCI China has a greater representation of E-commerce and Gaming platforms, as well as state-owned banks and energy companies. Fig. 3. shows that the Consumer Discretionary sector is 28% of the MSCI China Index but just 8% of the MSCI India Index. We had highlighted previously

Fig 3: Sector breakdown for India and China

MSCI Sector Weight (%)	India	China
Consumer Discretionary	7.86	28.24
Communication Services	3.24	17.96
Consumer Staples	8.06	5.50
Energy	12.24	2.31
Financials	23.90	16.87
Health Care	4.70	6.26
Industrials	4.83	5.66
Information Technology	18.47	6.08
Materials	10.16	3.87
Real Estate	0.61	4.60
Utilities	5.93	2.66
Variance*	47.4	68.2

*Variance is the sum of square of the difference between each value and mean. In this context, the lower the variance, the more diversified the index.

Source: Eastspring Investments (Singapore) Limited. Left Chart: MSCI. Data as at 14 February 2023.

that the MSCI India Index is one of the most diverse in Asia, and among emerging markets.

Given such different sector exposures, it is not surprising that the 5-year correlation between both markets is one of the lowest compared to the other Asian markets. Fig. 4.

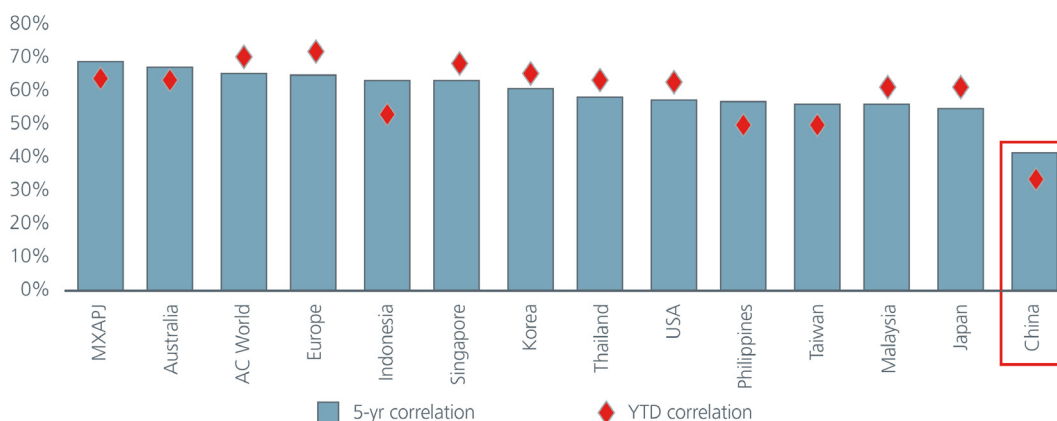
TAILWINDS FOR INDIA

We believe that the correlation between the China and India equity markets will remain low because besides offering different exposures, each economy is at a different stage of growth. India has become the world’s most populous nation and the United Nations forecasts that India’s population will continue to grow until 2050. India is expected to provide more than a sixth of the increase of the world’s working-age

population (15- to 64-year-olds) between now and 2050. This will give India a significant demographic dividend, if sufficient jobs can be created for its young workforce.

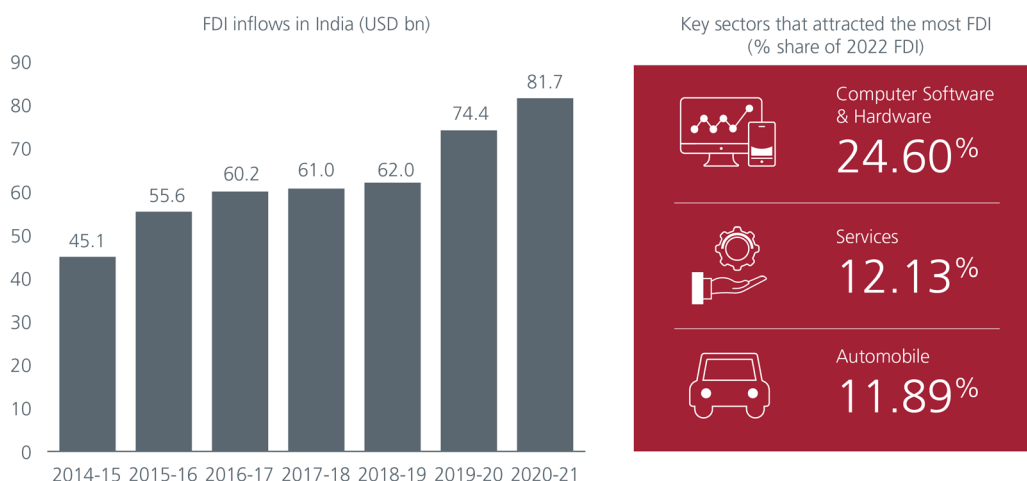
Policy direction also differs. Rising US-China tensions have led China to focus on boosting domestic consumption and increasing self-sufficiency in key sectors. Meanwhile, India is enjoying strong Foreign Direct Investment (FDI) inflows as it presents itself as an alternative location for companies looking to diversify their supply chains. India registered its highest-ever total FDI inflows of USD84.8 bn in FY2021-22. Fig. 5. The production-linked incentive (PLI) schemes which incentivises foreign manufacturers to start production in India and domestic manufacturers to expand their production have helped attract global companies to set up manufacturing bases in India. Unlike earlier schemes,

Fig 4: MSCI India return correlations with other markets



Source: Factset, MSCI, Goldman Sachs Global Investment Research, November 2022. The information provided herein are subject to change at the discretion of the Investment Manager without prior notice.

Fig 5: FDI inflows to India



Source: LHS: Central Statistics Office, Reserve Bank of India. RHS: Ministry of Commerce and Industry, March 2023.

PLI is much more targeted, focusing on selected sectors and incentives are disbursed based on capital expenditure and production targets.

The recent banking sector volatility in the US and Europe could result in tighter lending standards and a further slowdown in the developed economies. India is less vulnerable to slowing global demand as exports currently make up less than 20% of GDP. On the other hand, demand for one of India's key exports – Information Technology services - is expected to be relatively resilient. It has been observed that tech spending has increasingly decoupled from negative macro events over the decades. Relative to GDP growth, global IT services spend dipped 3x in 2009 during the Global Financial Crisis, 0.8x in 2020 and 0.3x in 2022 during the COVID-19 pandemic³. Given higher technology wage inflation in the developed economies, India remains an attractive outsourcing destination.

This has important implications for consumer spending and economic growth as the IT sector is an important job creator for India. The rising affluence of the India consumer presents a structural opportunity for investors. India's per capita spend on Fast Moving Consumer Goods (FMCG) stands at USD46 – Indonesia's and China's spend is 2x and 3x higher respectively⁴.

In the 2023-2024 budget, India's capital spending outlay was increased by 33% to Rs10 tr (USD122.3 bn), lending a boost to infrastructure development. With research suggesting that the multiplier for capital expenditure stands at 2.45 for India, this is likely to have a positive impact on economic growth over the longer term. Sectors linked to the capex upcycle such as Financials, Industrials, Cement and Steel may benefit.

RESILIENT INDIA

As India seeks to ride its multiple tailwinds, there are also challenges, such as the country's high unemployment and sticky inflation. Nevertheless, despite these challenges, the resilience of the market and its growing weight in the MSCI Emerging Markets Index reflect the appeal of India's structural story.

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