HSBC

Asset Management

India picks up pace amid global slowdown

June 2023

Renee Chen
Senior Economist
& Investment Strategist

Key takeaways

- India's economy has recovered strongly from the Covid-19 shock, driven by buoyant consumer spending and a rebound in (contact-intensive) services
- Growth is likely to moderate in the coming quarters, given fading reopening gains, the lagged effects of policy tightening, and external headwinds, but India should remain among the fastest growing major economies
- India's macro resilience is supported by cyclical and structural tailwinds. Improved corporate and bank balance sheets support credit growth and lay the groundwork for a pickup in the investment cycle, key to its medium-term growth sustainability
- The FY24 Union Budget strikes a fine balance between growth support and fiscal consolidation, with a continued focus on capex push, keeping fiscal sustainability and overall macro-stability concerns in check
- There has been a structural shift in India's balance of payments (BOP) dynamics. Strong services exports and rising remittance inflows have helped offset the deterioration in the goods trade balance. This coupled with prospects for a structural uptrend in foreign direct investment has reduced India's medium-term external vulnerability
- A gradual disinflation trend combined with reduced BOP risks and a decent real interest rate buffer would provide RBI with more policy flexibility
- India's structural growth story remains intact, amidst improvements in productivity dynamics via rapid digitalisation, a big infrastructure push, higher FDI and structural reforms, and its favourable demographics. India presents itself as an alternative location for MNCs looking to diversify their supply chains in a multipolar world

Source: Bloomberg, HSBC Asset Management, May 2023.

The information contained in this publication is not intended as investment advice or recommendation. Non contractual document. This commentary provides a high level overview of the recent economic environment, and is for information purposes only. It is a marketing communication and does not constitute investment advice or a recommendation to any reader of this content to buy or sell investments nor should it be regarded as investment research. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination. The performance figures displayed in the document relate to the past and past performance should not be seen as an indication of future returns. Any forecast, projection or target where provided is indicative only and is not guaranteed in any way. HSBC Asset Management accepts no liability for any failure to meet such forecast, projection or target.

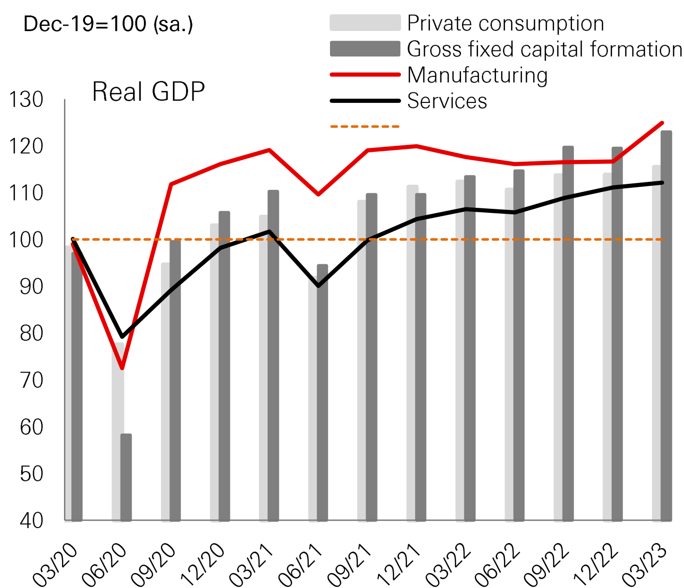
Cyclical growth likely to moderate, but stay resilient

India's economy has recovered strongly from the Covid-19 shock, led by a rebound in (contact-intensive) services. Growth is likely to moderate in the coming quarters, given fading reopening gains, depletion of household pandemic savings, the lagged effects of monetary policy tightening, the withdrawal of Covid-related fiscal relief measures, and external headwinds from a looming Western recession.

However, India is expected to remain among the fastest growing major economies of the world, with around 6.0% growth expected for FY24-25e (vs. 7.2% for FY23).[1] India is less vulnerable to slowing global demand than many of its EM peers, as exports currently make up less than a quarter of GDP. Urban consumption has been robust while rural demand is showing signs of recovery, amid an improving labour market and rising rural wages.

An El Nino phenomenon remains a risk to growth and inflation outlook, as about 60% of the rural population is employed in the agricultural sector.[1] However, structural improvements in the rural economy, including expanded roads, irrigation and water-storage capacity, digitalisation, and better credit access, etc., have reduced the monsoon dependence of agriculture. There has also been significant diversification in the rural economy with increasing contribution from non-farm sectors to rural income.

Robust growth recovery

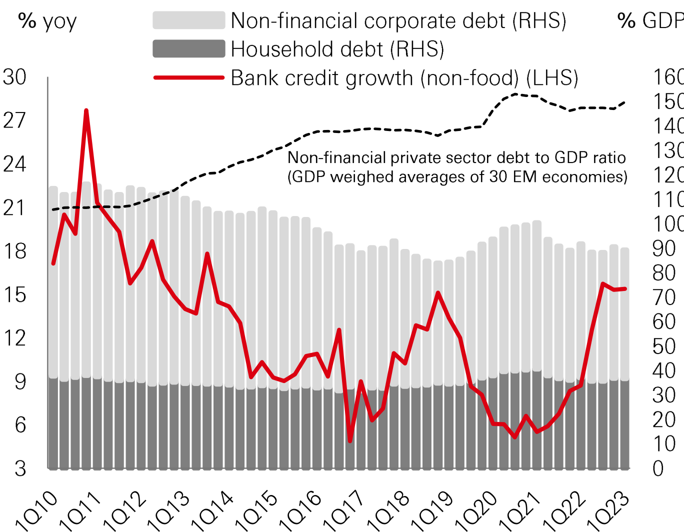


Source: CEIC, Bloomberg, HSBC AM, May 2023

Improved balance sheets support a capex cycle

The economic recovery has driven a strong pickup in credit growth in FY23. While credit growth may have peaked off due to a tapering of pent-up demand and the transmission of higher policy rates into lending rates, improvements in bank and corporate balance sheets remain supportive of the credit cycle, while the household leverage stays low. The debt-to-equity ratio of listed Indian corporates has generally trended lower since 2018.[1]

Relatively low private sector debt ratios within EM



Source: IIF, CEIC, Bloomberg, January 2023

Indian banks' asset quality has improved, following a large-scale clean-up of stressed assets since 2015, and they are well-capitalised now. The gross non-performing asset (NPA) ratio of scheduled commercial banks fell to a seven-year low of 5.0% in September 22 from 11% in March 2018, while the average capital-to-risk-weighted -assets ratio (CRAR) rose to 16% from 13.8%.[2] This bodes well for a pickup in the investment cycle, amid the fiscal thrust on infrastructure and with signs of a corporate capex revival in select sectors hinted by new project announcements. Meanwhile, the housing market recovery is backed by strong pent-up demand, high affordability and declining unsold inventory. Favourable demand-supply dynamics may help cushion the impact from higher mortgage rates.

Note 1: Source is CEIC, HSBC Asset Management as of May 2023. Note 2: Source is CEIC, Bloomberg as of January 2023. Source: CEIC, Bloomberg, HSBC Asset Management, May 2023.

Investment involves risks. Past performance is not indicative of future performance. Any forecast, projection or target contained in this presentation is for information purposes only and is not guaranteed in any way. HSBC Asset Management accepts no liability for any failure to meet such forecasts, projections or targets. The views expressed above were held at the time of preparation and are subject to change without notice. The information provided does not constitute any investment recommendation or advice. For illustrative purposes only.

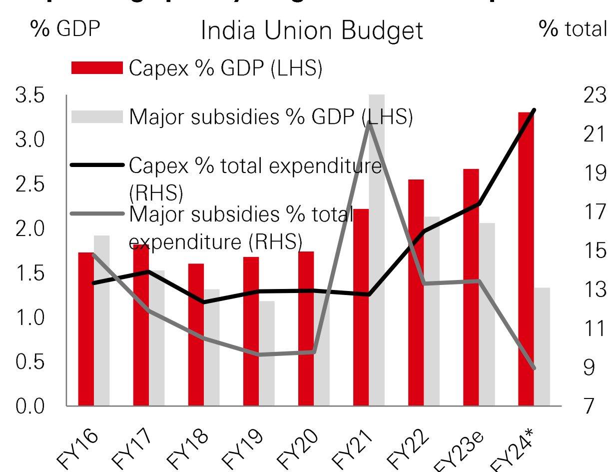
Prudent FY24 budget with capex focus

The Indian government's balance sheet remains stretched. Its gross debt-to-GDP ratio at 81.3% in Q4FY23 was high in the EM context, albeit off the FY21/22 peak (of ~90%).[3] The primary deficit was sizeable at 3.0% of GDP in FY23 vs. the 2017-19 average of 0.35%.[3] However, the FY24 Union Budget managed to strike a fine balance between (capex-led) growth support and fiscal consolidation. It targets a central-government fiscal deficit of 5.9% of GDP, down from 6.4% in FY23.[3] This reflects the government's commitment to a medium-term fiscal consolidation glide path, further lowering the deficit to 4.5% of GDP by FY26.[3]

The quality of spending mix will improve, with a continued infrastructure push (and the intention of increasing private capex which is key for sustainable growth) and a further reduction in the food and fertiliser subsidy bill. The budget also provides continued support for the middle class, jobs creation, climate change targets and expansion of local manufacturing supply chains in strategic segments such as electronics. The budget also aims to improve tax compliance with further efforts towards tax simplification.

Overall, fiscal policy is supportive of India's domestic demand strength and productivity gains, while keeping fiscal sustainability and overall macro stability concerns in check. The FY24 budget resisted populist temptations in a pre-election year, though there will likely be more policy pledges to support the rural economy and bottom-of-the-pyramid segment in the run-up to 2024 general elections (and state elections in the coming few months). That said, robust tax collections so far and a large RBI dividend transfer may help keep fiscal consolidation on track.

Improving quality of government expenditure

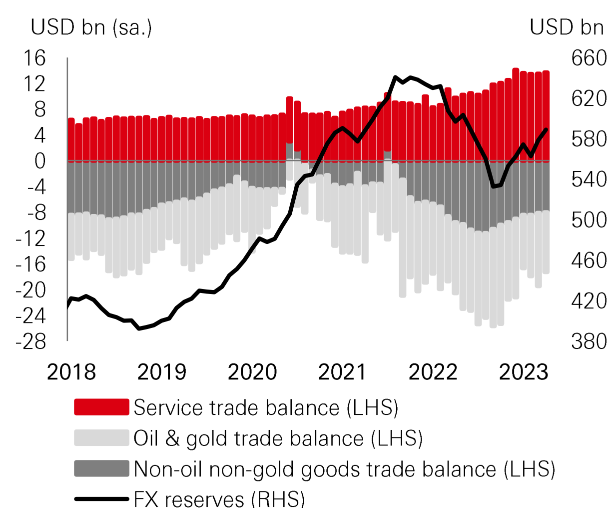


Note * budget estimates; Source: CEIC, Bloomberg, HSBC AM, May 2023

Reduced external vulnerability

Global oil/commodity prices coming off their 2022 peaks have eased pressures on India's current account (CA) balance and inflation. We expect the CA deficit to narrow to about 2% of GDP or below in FY24/FY25, a sustainable level, after widening to 2.7% in the first three quarters of FY23 from 1.2% in FY22.[4] India's goods exports would come under pressure from weaker global demand, but there could be an offset from potentially lower (or limited rises in) commodity prices.

Strong services exports; narrower goods trade deficit



Source: IIF, CEIC, Bloomberg, January 2023

There has been a structural shift in India's balance of payments (BOP) dynamics. Strong services exports and rising remittance inflows have helped offset the deterioration in the goods trade balance. Global digitalisation during the pandemic, the growing trend of remote working, and greater acceptance among multinationals (MNCs) to run operations remotely have increased demand for off-shoring and exports of services in software/IT and R&D, where India has a comparative advantage, and a wide range of other professional services (e.g. business consulting). We expect India's services exports to hold up better as compared to goods in a global downturn, even assuming some mean-reversion (stabilisation) following a service trade boom.

This coupled with prospects for a structural uptrend in foreign direct investment (FDI) in India and strong FX reserves adequacy has reduced its external vulnerability. FDI picked up significantly during the pandemic, driven mainly by a surge in computer software services, but fell in FY23, likely in part reflecting some payback effect and global push factors (e.g. tighter financial conditions). While global uncertainty clouds the cyclical FDI outlook, structural reforms and transformation improve India's prospects for FDI in the medium-to-long term (discussed later). The rise in FDI will reduce India's dependence on portfolio capital flows to fund its CA deficit.

Note 3: Source is India government sites, Reserve Bank of India, CEIC, May 2023. Note 4: HSBC Asset Management, May 2023. Source: CEIC, Bloomberg, HSBC Asset Management, May 2023.

Investment involves risks. Past performance is not indicative of future performance. Any forecast, projection or target contained in this presentation is for information purposes only and is not guaranteed in any way. HSBC Asset Management accepts no liability for any failure to meet such forecasts, projections or targets. The views expressed above were held at the time of preparation and are subject to change without notice. The information provided does not constitute any investment recommendation or advice. For illustrative purposes only.

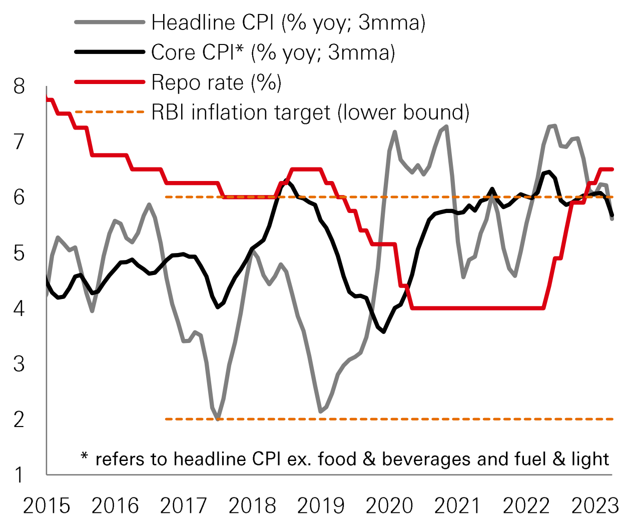
Moderating inflation provides policy room for RBI

Headline CPI inflation fell to 4.7% yoy in April from 7.4% in September 2022, with price moderation across food, fuel and core measures.[5] The trend reflects the base effect, easing supply-side shocks on goods prices and transport costs, and the lagged impact from monetary tightening.

We expect inflation to remain within the RBI's tolerance band (4% medium-term target+/-2%), averaging ~5% in FY24. Lower input cost pass-through and weaker domestic demand should help tame core inflation, as inflation expectations have been kept anchored, despite some uncertainty over drug price hikes, housing inflation, and wages Lower farm input costs and government supply-side measures may help keep food price inflation in check.

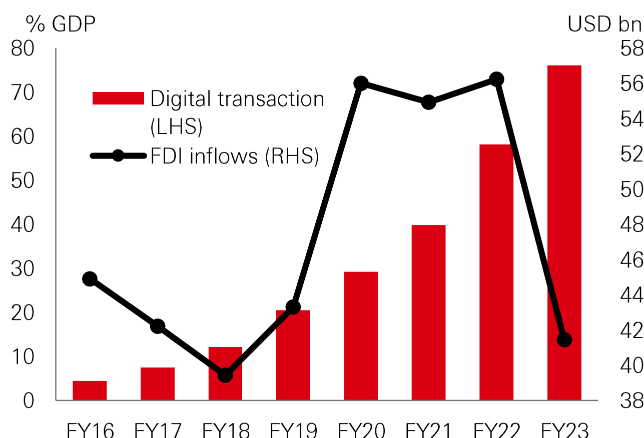
A gradual disinflation trend combined with reduced BOP risks - helped also by our expectation of Fed policy pivot at the turn of the year – and a decent real interest rate buffer would allow the RBI to focus more on domestic growth and stability considerations. RBI stood pat at its April meeting and indicated continued data dependence. We think a policy pause is likely in the coming months, with the potential for rate cuts (unwinding of the cumulative 250bp hikes) in H2FY24 if disinflation gains further traction.

A gradual disinflation trend provides policy room



Source: CEIC, Bloomberg, HSBC AM, May 2023

Rapid digitalisation; strong FDI inflows during Covid



Source: Morgan Stanley Research, CEIC, HSBC AM, May 2023

Structural growth story remains intact

Overall, India is well positioned to navigate global head-winds, backed by its robust domestic demand, improved macro stability, and favourable structural growth story. We believe a turnaround in the (private) manufacturing capex cycle is key to India's medium-term growth potential.

Rapid digitalisation and India's big infrastructure push are helping to lift productivity. The digital infrastructure "India Stack" brings together digital payments and identification to expand financial inclusion. It has also been used as a platform to foster innovation, expand markets, and improve public expenditure efficiency and services. Policies such as 'Make in India' and the Production-linked incentive (PLI) schemes, which incentivise domestic production in strategic industries such as semiconductor and display, mobile devices, pharma, food processing and autos, etc. help facilitate digitalisation.

PLIs aim at enhancing India's manufacturing competitiveness and exports, attracting FDI, and promoting (skilled) jobs, though challenges remain that require continued policy and reform efforts. India presents itself as an alternative location for MNCs looking to diversify their supply chains (e.g. the China+1 and friend-shoring opportunity), given its comparatively low production costs, huge domestic market (amid a fast growing middle class), and the government's reform agenda improving India's ease of doing business and deepening its integration into global value chains. There is also a growing trend of outsourcing labour demand and offshoring to India, making it "the office of the world."

Structural reforms in areas such as real estate, banking, insolvency and bankruptcy, tax (e.g. corporate tax rate cuts and the goods & service tax, GST), direct-subsidy transfers, and sector deregulation are starting to bear fruit, though progress in the relatively more contentious reforms (e.g. labour and divestment/ privatization) is slow and may be further delayed due to a busy political calendar over the next 12 months. Further improvements in education, health, (higher-paying, skilled) job creation and other favourable socio-economic policies will help India reap its demographic dividend, particularly its large young workforce. Successful structural transformation and improving productivity dynamics could lead to a higher savings rate (driven by higher export income, improving corporate profitability and higher household income and saving), which will ultimately help finance a higher level of investments.

Note 5: Source is CEIC as of May 2023. Source: CEIC, Bloomberg, HSBC Asset Management, May 2023.

Investment involves risks. Past performance is not indicative of future performance. Any forecast, projection or target contained in this presentation is for information purposes only and is not guaranteed in any way. HSBC Asset Management accepts no liability for any failure to meet such forecasts, projections or targets. The views expressed above were held at the time of preparation and are subject to change without notice. The information provided does not constitute any investment recommendation or advice. For illustrative purposes only.

Important information

The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested. Past performance contained in this document is not a reliable indicator of future performance whilst any forecasts, projections and simulations contained herein should not be relied upon as an indication of future results. Where overseas investments are held the rate of currency exchange may cause the value of such investments to go down as well as up. Investments in emerging markets are by their nature higher risk and potentially more volatile than those inherent in some established markets. Economies in Emerging Markets generally are heavily dependent upon international trade and, accordingly, have been and may continue to be affected adversely by trade barriers, exchange controls, managed adjustments in relative currency values and other protectionist measures imposed or negotiated by the countries with which they trade. These economies also have been and may continue to be affected adversely by economic conditions in the countries in which they trade. Mutual fund investments are subject to market risks, read all scheme related documents carefully.

The contents of this document may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose. All non-authorised reproduction or use of this document will be the responsibility of the user and may lead to legal proceedings. The material contained in this document is for general information purposes only and does not constitute advice or a recommendation to buy or sell investments. Some of the statements contained in this document may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors. We do not undertake any obligation to update the forward-looking statements contained herein, or to update the reasons why actual results could differ from those projected in the forward-looking statements. This document has no contractual value and is not by any means intended as a solicitation, nor a recommendation for the purchase or sale of any financial instrument in any jurisdiction in which such an offer is not lawful. The views and opinions expressed herein are those of HSBC Asset Management and are subject to change at any time. These views may not necessarily indicate current portfolios' composition. Individual portfolios managed by HSBC Asset Management primarily reflect individual clients' objectives, risk preferences, time horizon, and market liquidity.

We accept no responsibility for the accuracy and/or completeness of any third party information obtained from sources we believe to be reliable but which have not been independently verified.

Investment involves risk. Past performance is not indicative of future performance. Please refer to the offering document for further details including the risk factors. This document has not been reviewed by the Securities and Futures Commission.

HSBC Asset Management is the brand name for the asset management business of HSBC Group. The above communication is distributed in Hong Kong by HSBC Global Asset Management (Hong Kong) Limited.

This document should not be regarded as investment research. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination. This document is purely for marketing purposes. This document is not a contractually binding document nor are we required to provide this to you by any legislative provision.

Copyright © HSBC Global Asset Management (Hong Kong) Limited 2023. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of HSBC Global Asset Management (Hong Kong) Limited.