India's Comeback Story – How, Why, and Where

By Rahul Chadha, Chief Investment Officer of
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India's economy is slowing down. GDP growth for 2Q FY19/20 recorded at 4.5% – the lowest since 2013[1]. In contrast, the country hit over 8% GDP growth for FY16/17. The government is also unlikely to achieve its fiscal deficit target.

These have sparked concerns about the health of the Indian economy. While understandable, they are overblown.

> "While concerns over the health of the Indian economy are understandable, they are also overblown. India's economic fundamentals remain strong, and ongoing government reforms are continuing to unlock the country's full potential."
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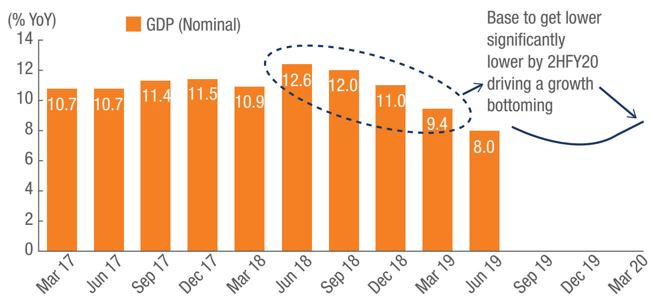
The India Story – Long-Term Growth versus Short-Term Headwinds

The Indian economy is facing a short-term slowdown. But its structural and fundamental factors should allow it to weather these near-term storms and thrive over the longer term. Its current headwinds are, as the World Bank[2] notes, mostly driven by external and cyclical factors.

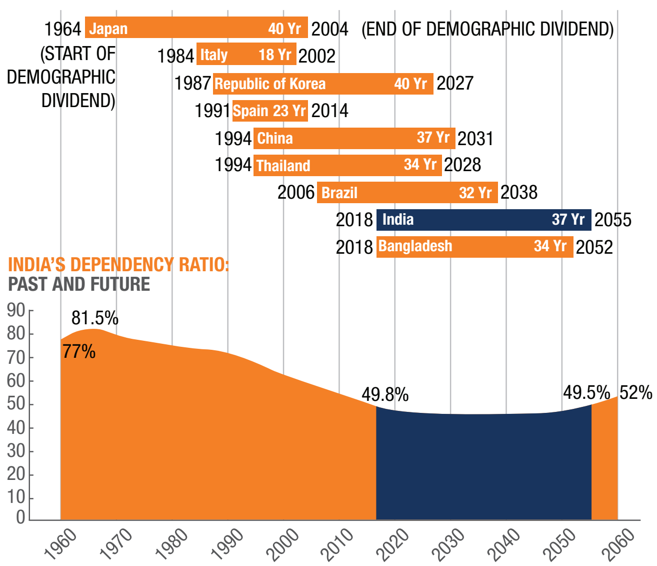
India's Nominal GDP Growth Bottoming Out



Source: Bloomberg, November 2019

Meanwhile, country-specific issues are or have already been resolved – their impact has just yet to impact economic figures. Indeed, we expect further declines before an eventual bottoming out. Subsequently, India's structural and economic fundamentals will come to the fore. These include a 37-year demographic dividend, a rising middle class, and ongoing government reforms.

Period of Demographic Dividend in Large Economies



But not all sectors will benefit equally. We will next study how these will affect each area of the market, beginning with the financial industry.

Unlocking the Potential of India's Financial Sector

Four main structural challenges have hampered the realisation of the Indian financial industry's potential. But as these are resolved, the sector (and economy) will stand poised for substantial long-term growth.

CHALLENGE #1: Disproportional State Dominance

State-owned banks hold almost 70% of sector assets[3]. Reducing this is thus a significant step toward a healthier system. This is being achieved through public-sector bank consolidation and bank licensing liberalisation. The number of state-owned banks is being cut from 27 to 12[4], while final guidelines for a new licensing regime were recently issued.

CHALLENGE #2: Persistent Asset Quality Issues

While non-performing assets (NPAs) continues to drag on the economy, the private sector has emerged mostly unscathed. The gross NPA ratio for private banks at the end of FY2019 was 3.7%[5] compared to 12.6% for public sector banks. Public sector issues are also being resolved through asset-quality reviews, capital injections, regulations[6], and write-offs[7].

GOVERNMENT OWNED BANKS (PSB)						
	FY14	FY15	FY16	FY17	FY18	FY19
GNPA	4.7%	5.0%	9.3%	11.7%	14.6%	12.6%
NIM	2.5%	2.3%	2.2%	2.1%	2.1%	2.4%
RoTA	0.5%	0.5%	-0.1%	-0.1%	-0.8%	-0.9%
PRIVATE BANKS (PVB)						
	FY14	FY15	FY16	FY17	FY18	FY19
GNPA	1.9%	2.1%	2.8%	4.1%	4.7%	3.7%
NIM	3.3%	3.4%	3.4%	3.4%	3.3%	3.8%
RoTA	1.7%	1.7%	1.5%	1.3%	1.1%	1.2%
ALL BANKS (SCB)						
	FY14	FY15	FY16	FY17	FY18	FY19
GNPA	4.1%	4.3%	7.5%	9.3%	11.2%	9.3%
NIM	2.7%	2.6%	2.6%	2.5%	2.5%	2.8%
RoTA	0.8%	0.8%	0.4%	0.4%	-0.2%	-0.1%

Source: CARE Ratings

CHALLENGE #3: The Shadow Banking Liquidity Crunch

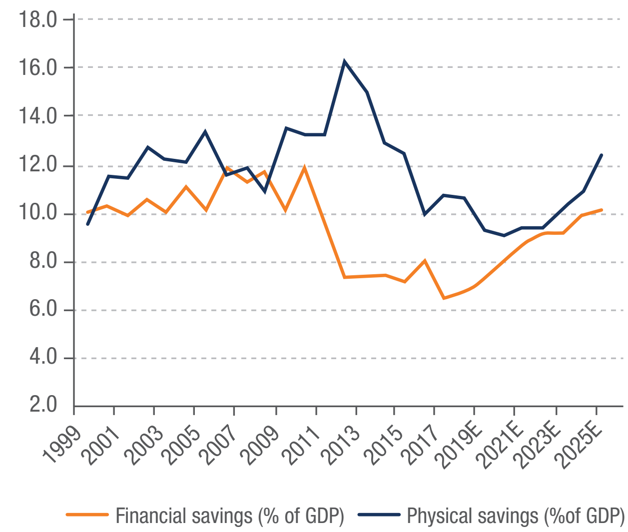
The 2018 default of India's leading infrastructure finance company created a panic about liquidity in the NBFC (Non-Bank Financial Company) subsector – responsible for over 20% of system credit. But nothing happened beyond several isolated defaults. Their diverse business models shielded them from contagion effects. Further, the affected NBFCs and concerned loans only accounted for a tiny percentage of total system credit.

CHALLENGE #4: Low Financial Inclusion

Despite having 190 million unbanked adults in 2017[8], the government's financial inclusion agenda has been highly successful. Its PMJDY initiative saw 377 million bank accounts opened from 2014 to 2019. The programme's even more ambitious successor was launched in 2020.

As financial inclusion grows, Indians' savings are also increasingly financialised[9] and less physical. This development will have a deepening effect on capital markets.

Savings are Expected to Rise Sharply Going Ahead

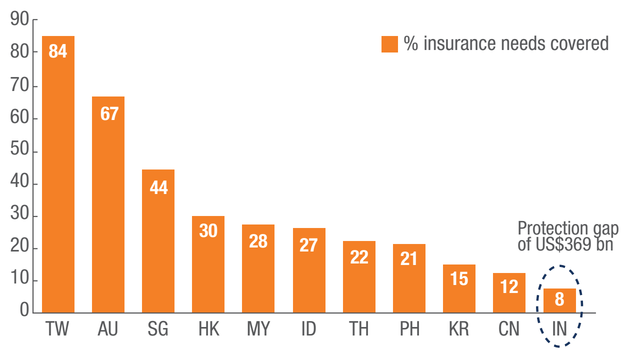


Source: RBI, Kotak, Swiss Re, JP Morgan Research, Mirae Asset Global Investments

Mirae's strategy

Mirae's strategy is heavily weighted toward the financial sector. We focus on the disproportionate beneficiaries of sectoral reforms and the recovering economy: quality private sector banks, strong NBFCs, and large insurance companies (which will gain from higher financialisation).

Protection Gap is Large in India



The Evolution of the Indian Consumption Narrative

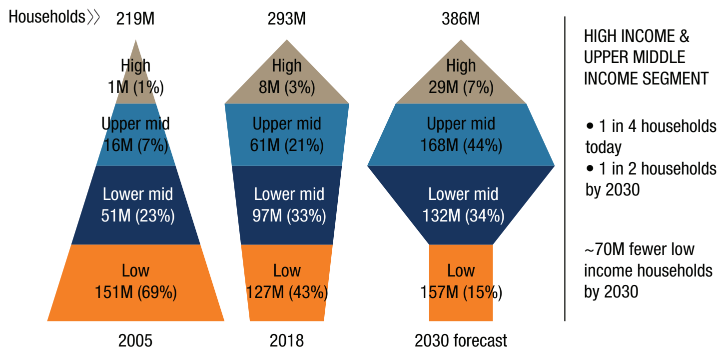
Domestic consumption already accounts for 60% of GDP. Trends within the consumption narrative thus play a huge role in the direction of the economy. Each of the following five trends will have positive implications for specific sectors such as consumer durables, consumer discretionary, real estate, and healthcare. Mirae Asset's strategy is to carefully research and pick out the winners within those sectors.

TREND#1

Rising Incomes Concentrated Around the Middle Class

India is becoming a middle-class economy. From 2018 to 2030, India is expected to add about 140 million middle-class and 21 million high-income households while lifting 25 million households out of poverty.

India Households Growth



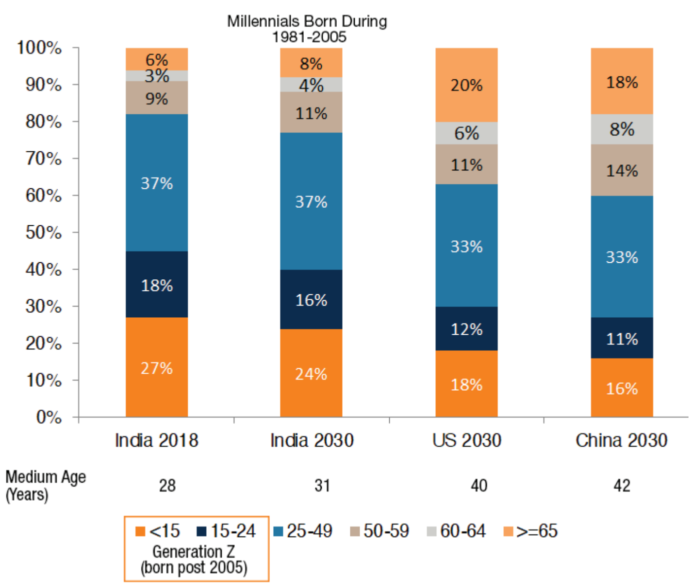
This growing wealth will lead to a premiumisation effect – the increased consumption of higher-quality goods, which will be reflected in higher spending on more nutritious food, better healthcare, modern appliances, and discretionary outlay.

TREND#2

The Continued Prevalence of a Younger, Tech-Savvy Demographic

With its demographic dividend expected to last till 2055, India will be dominated by a young and tech-savvy generation. By 2030, millennials and Generation Z will comprise 77% of the total population. Generation Z will itself consist of 370 million people – 'digital natives' who will be accustomed to and even prefer technology-enabled consumption models.

Population by Age Cohort



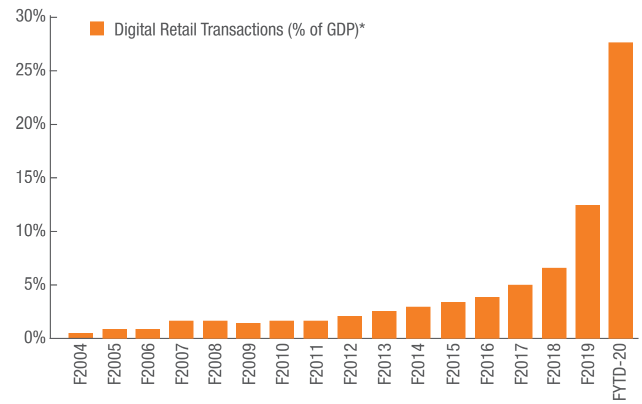
Source: Euromonitor

TREND#3

Digital Influence on Consumer Habits

The Internet's reach is becoming increasingly democratised. By 2030, an estimated 1.1 billion Indians will be online, supported by falling prices of data and smartphones. This premiumisation effect will thus influence the consumption patterns of even the lower-income classes.

Strong Growth in Digital Retail Transactions



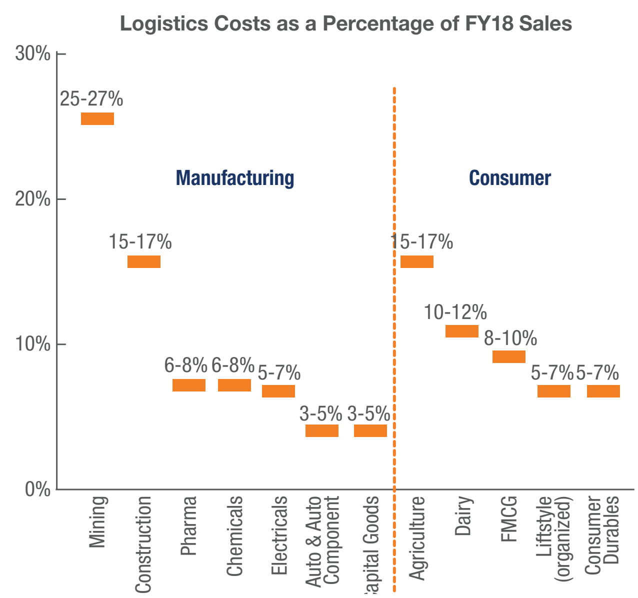
Source: As of Oct 2019, Morgan Stanley Research

TREND#4

Greater Urbanisation and a Shrinking Urban-Rural Divide

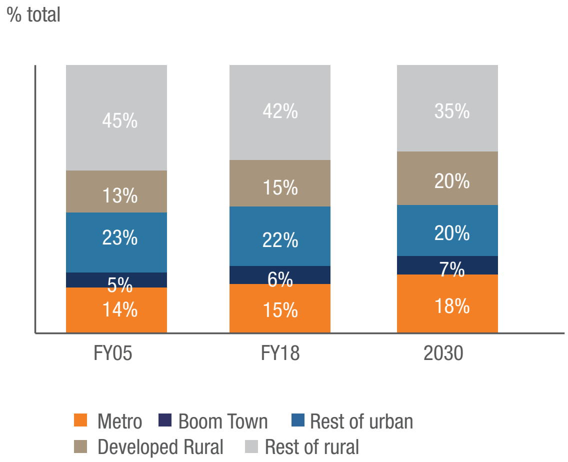
India's vast rural population creates massive long-term growth potential. By 2030, 40% of the population will be urban residents, primarily driven by the government's ambitious infrastructure development projects. These moves will also aid industries with high logistical costs, such as mining, construction, agriculture, and FMCGs.

Sectors with High Logistics Costs to See Gains



Source: KPMG, BofA Merrill Lynch, June 2019

Consumer Expenditure in India across city types



Source: PRICE Projections based on ICE 360o Surveys (2014, 2016, 2018)

The gap between rural and urban population will also continue to shrink. From 2018 to 2030, per-capita consumption is forecast to grow by 3.5x for urban dwellers and 4.3x for rural ones. But the true potential of India's rural population will be unlocked once the long-term catalyst of large-scale infrastructure development takes effect.

TREND#5

Increased Demand for Quality Healthcare Services

Rising incomes and premiumisation trends among the middle class and expanded access (the National Health Protection Scheme provides US$7,000/year to over 100 million families) will combine to boost healthcare demand. The growing incidences of lifestyle diseases will support the longer-term trend.

Your Vehicle for Investing in India's Established and Future Sector Leaders

Once the Indian economy blows past its short-term headwinds, all signs point toward it continuing its path of steady long-term growth. But not all companies will benefit equally. Certain businesses will gain disproportionately. These are the companies the Mirae Asset India Sector Leader Equity Fund methodically identifies and invests in. For investors looking to leverage India's long-term economic trajectory, our fund could be the perfect choice.

[1]Reuters, as of 29 November 2019.
[2]World Bank Group, as of Fall 2019.
[3]Business Standard, as of 13 Oct 2019.
[4]DB Research, Imagine 2030.
[5]UNFPA, as of 31 Jan 2020.
[6]The Economic Times, as of 22 Jul 2019.
[7]World Economic Forum, Insight Report, January 2019.
[8]Bain & Company, as of 8 January 2019.
[9]Reuters, as of 28 August 2019.