CLSA

# India Thematic

Market outlook

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28 November 2023

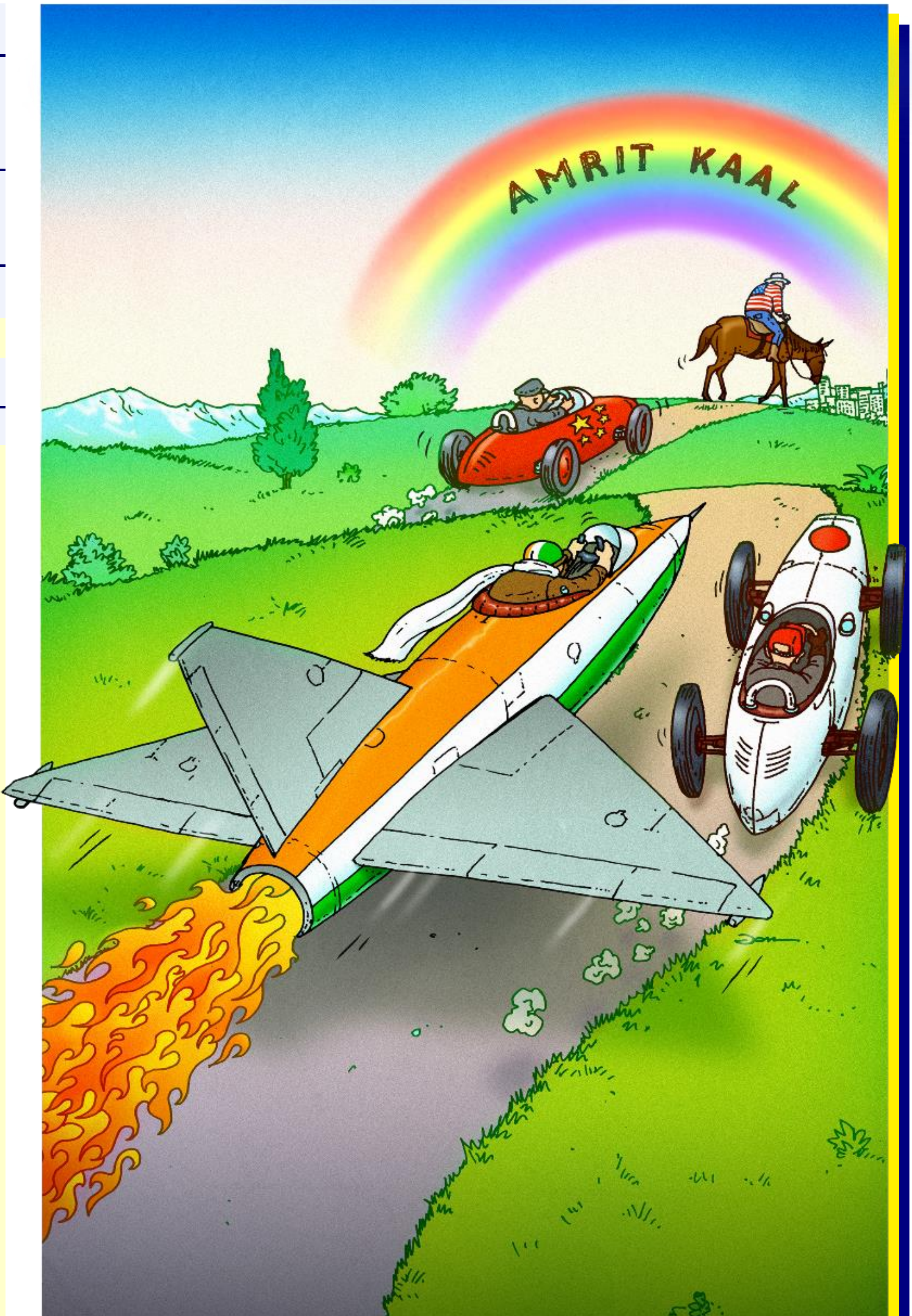
## India
## Thematics

**BUYs**

| | |
|---|---|
| Axis Bank | AXSB IB |
| Bharti Airtel | BHARTI IS |
| ICICI Bank | ICICIBC IB |
| Mahindra | MM IB |
| NTPC | NTPC IS |
| Sun Pharma | SUNP IB |
| State Bank of India | SBIN IB |

**Outperforms**

| | |
|---|---|
| Hindustan Unilever | HUVR IB |
| UltraTech | UTCEM IS |
| Tata Consultancy | TCS IB |




# The Bharat story

## On track to secure third spot among global economies

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 **For important disclosures please refer to page 67.**


We continue to recommend a defensive large-cap basket to ride out a potential market correction

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All prices quoted herein are as at close of business 22 November 2023, unless otherwise stated

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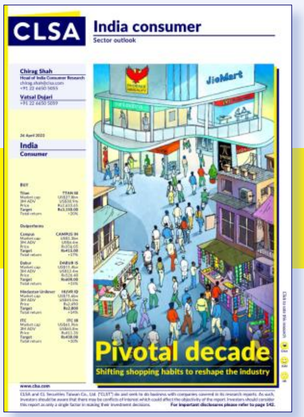
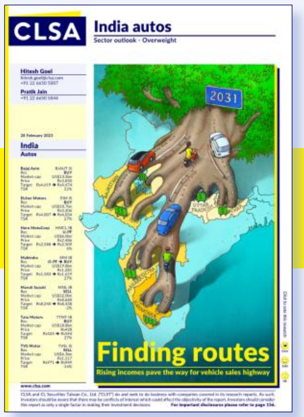
## Uncovering deeper layers



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# The Bharat story

**India's long-term growth prospects remain radiant**

India is moving up in the world: we expect searing GDP growth to propel it to the top three of the globe's largest economies, from just US$3.4tn today to larger than Japan's by 2027, hitting US$29tn by 2047 and US$45tn by 2052. A temporary slowdown until September 2024 is possible, but we view a cyclical recovery as likely in 2025. Its demographic advantage, financial deepening and a stable currency with ample forex reserves fuel our longer-term outlook. We prefer large-cap liquid stocks to maximise capital protection and mid-caps for growth opportunities.

**Ascent to the third-largest economy imminent**

India has surpassed several economies in the past 15 years and is set to become the world's third-largest economy, overtaking Japan, by 2027, even factoring in some dollar-yen normalisation. This assumes 6% real GDP potential/trend growth rate, 5.5% inflation rate, and 2.5% depreciation. If reforms scale growth up to 8%, India can actually overtake the US over the next 30 years.

**Three growth drivers**

Demographic dividend, financial deepening and forex stockpile will likely boost economic growth. A large pool of cheap labour reduces production costs and mobilises higher savings for investment. Deepening of financial services makes for more efficient allocation of resources. A forex reserves buffer protects the rupee and provides external stability, boosting investor confidence. Alternate energy should also cut down the current account deficit going ahead.

**Three burning questions**

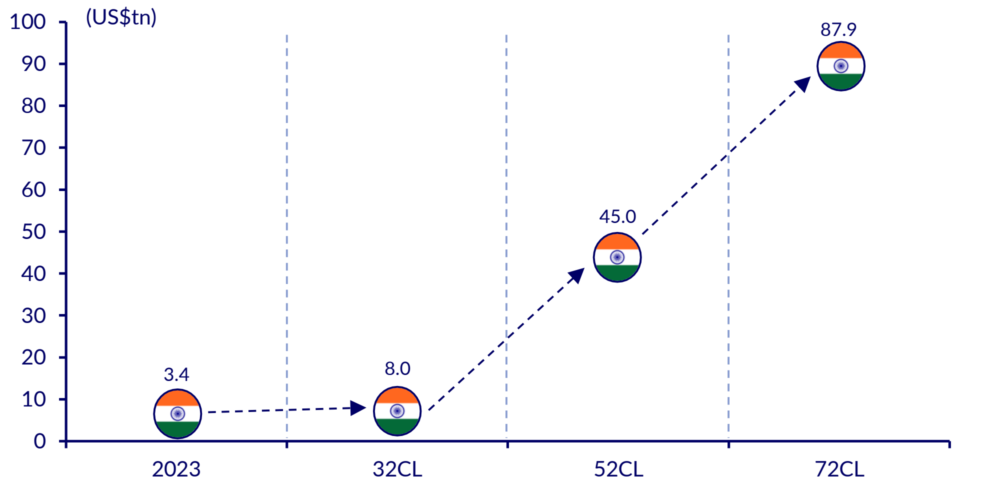
There are some critical factors to consider when assessing India's prospects. According to our analysis, the twin deficits do not pose a significant threat to its growth trajectory. Additionally, our growth projections do not account for any potential efficiency improvements from reforms. However, there is a consensus among politicians about the necessity of implementing economic reforms.

**Bharat story basket**

India is poised for growth with rising incomes, institutional accessibility and the impact of innovation and digitisation. We recommend large-cap liquid stocks and 10 picks from within our coverage offer exposure to one or more of our three highlighted market growth drivers. Our recommendation includes Axis Bank, Bharti Airtel, Hindustan Unilever, ICICI Bank, Mahindra & Mahindra, NTPC, Sun Pharma, UltraTech, TCS and SBI. All of our picks have proven track records of delivering consistent returns. We also highlight mid-cap stocks Zomato, PVR Inox, Delhivery, Prestige and Paytm as offering long-term value.

**Demographic dividend, financial maturity and rupee stability will drive growth**

**India GDP growth trajectory**




Source: CLSA

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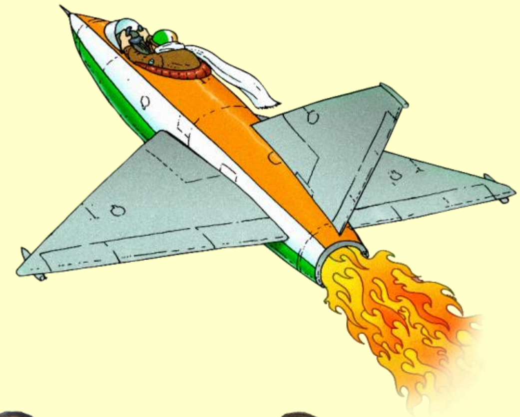

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# Roadmap to Amrit Kaal

We expect the Indian economy to expand to US$45tn in 2052

We remain optimistic about India's long-term growth prospects. Our forecast suggests the economy will reach US$29tn in 2047 from the current US$3.4tn and US$45tn by 2052, and surpass Japan's nominal US-dollar GDP by 2027. However, we expect a slowdown in growth until September 2024, followed by a cyclical recovery in 2025. The upcoming demographic dividend, financial deepening, and a relatively stable rupee with sufficient forex reserves at the Reserve Bank of India (RBI) underpin our outlook. Given the current volatility, we suggest holding on to large-cap liquid stocks for enhanced capital protection and growth opportunities. Our recommended stocks include Axis Bank, Bharti Airtel, Hindustan Unilever, ICICI Bank, TCS, SBI, M&M, NTPC, Sun Pharma, and UltraTech. Zomato, PVR Inox, Delhivery, Prestige and Paytm also offer long-term value.

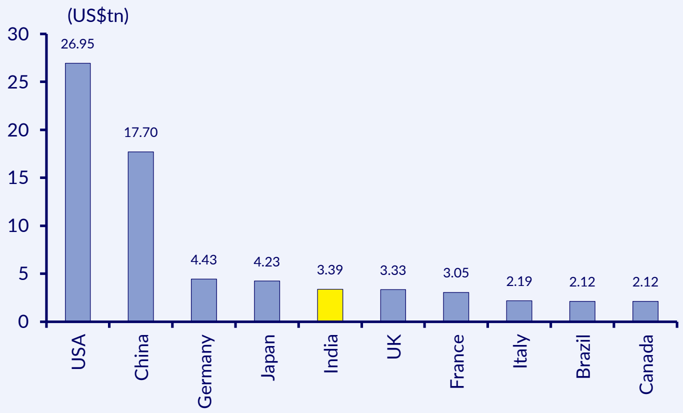


## Narrative deepens

India to emerge as the third-largest economy by 2027

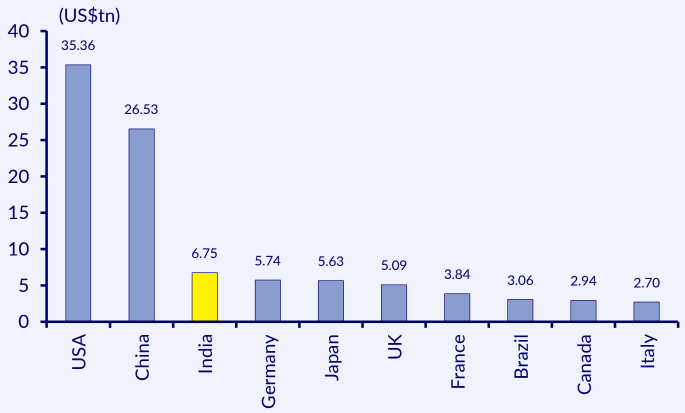
We continue to expect India to overtake Japan in nominal GDP in US dollars by 2027. China and the US will be the only economies that will be bigger than India by then. Looking beyond, we see the economy expanding from US$3.4tn today to US$29tn in 2047 and US$45tn in 2052. If big bang reforms unleash efficiencies, India could overtake the US economy in size by 2052.

**World's 10 largest economies as of 2022**




Source: IMF, CLSA

**. . . and by our projections as of 2030**




Source: IMF, CLSA

**Near-term concerns remain but cyclical recovery in 2025**

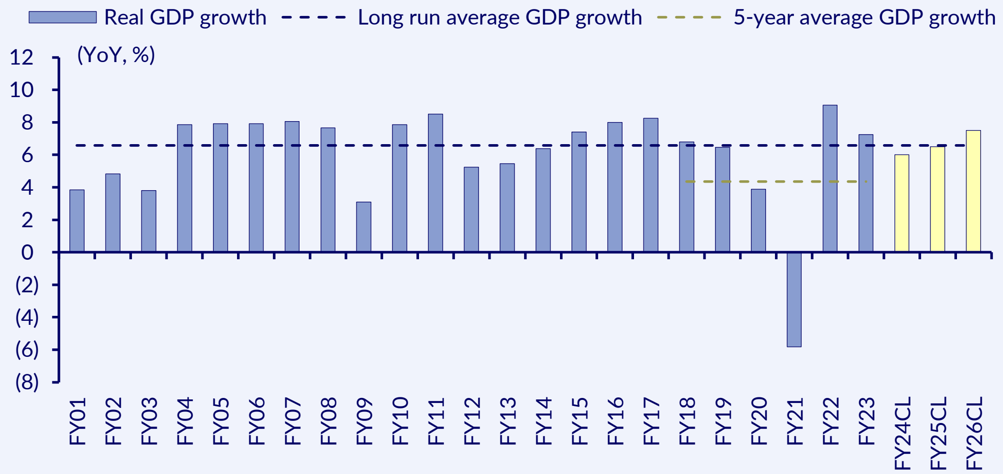
We see a cyclical recovery in 2025

We continue to see a slowdown in India's growth into September 2024. India's growth has averaged a dismal 4.4% since FY18. The Fed hike that is slowing export demand is also forcing the RBI to raise rates to protect the rupee and is hurting domestic demand. Not surprisingly, rising real policy rates pose growth risks. Rural demand is also slowing, given uneven rains due to El Niño.

We expect a cyclical recovery in 2025 and see three factors turning favourable for India: First, we see the global/RBI rate cycle turning down in 2024. Second, export demand should pick up if the US recovers, and finally, we see a rural recovery in mid-2024 as the northern rivers have sufficient water to irrigate a bumper wheat crop. This should be sustained into 2025 as El Niño (which drives rain clouds away) fades. This leads us to forecast a step up in India's growth to 7.5% in FY26 from 6.4% in FY24 and 6.5% in FY25.

Growth to improve from 2025

**India's GDP growth and long run average growth**




Note: Long term average growth excludes Covid-19 impacted years. Source: Ministry of Statistics and Programme Implementation, CLSA

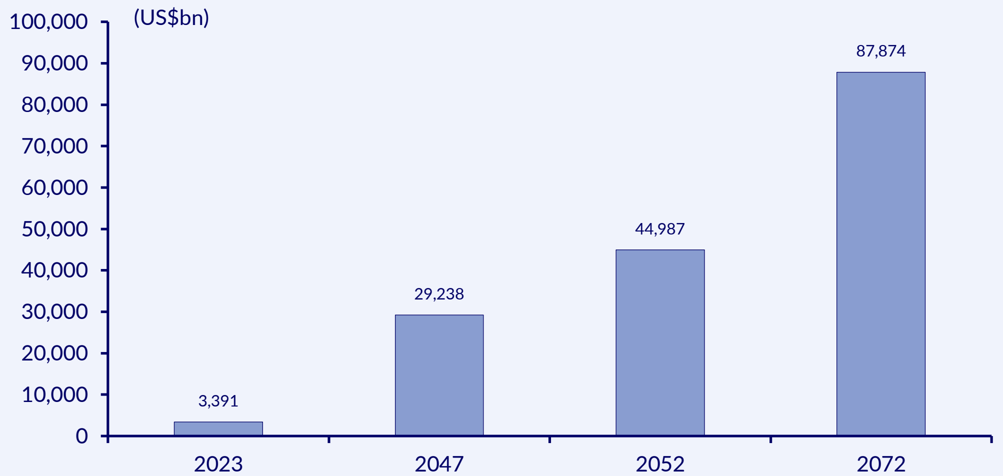
India to turn into an upper-middle-income economy

### GDP: US$29tn in 2047; US$45tn 2052; US$88tn by 2072

In the long term, India will emerge as what the World Bank classifies as an upper-middle-income economy from its current designation as a middle-income country. We see the economy expanding to US$29tn in 2047, US$45tn in 2052 and US$88tn in 2072, from US$3.4tn currently. We assume 6% real GDP growth, 5.5% inflation and 2.5% rupee depreciation in deriving these forecasts.

3% growth, 3% inflation, 1.5% depreciation in 2047-72

**India's GDP size**




Source: CLSA

## Three growth drivers

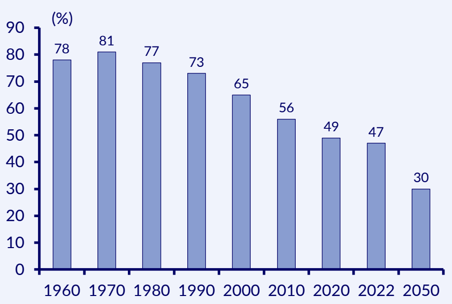
Demographic dividend, financial deepening and forex reserves to drive GDP growth

We see three macro drivers powering India's GDP: a coming demographic dividend, financial deepening and a relatively stable rupee on the RBI's forex reserves. First, the forthcoming demographic dividend should offer relatively cheap labour and mobilise savings to fund higher investment. Rising incomes and labour supply will likely boost economies of scale. This will keep price growth in check, generating further demand, which in turn will increase production, employment and incomes.

Second, we expect financial deepening to expand to ensure efficient allocation of resources. The credit/GDP measure, a proxy for financial deepening, should jump to about 120% of GDP by 2052 from 50% at present, consistent with our growth and inflation assumptions.

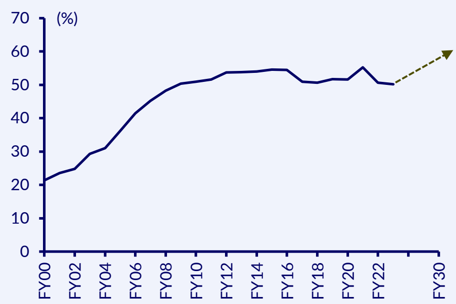
Finally, the buffer built up by the RBI's forex buying should protect the rupee and ensure external stability. The RBI has successfully built up forex reserves to weather each crisis and ensured rupee stability. All these factors will help improve penetration in terms consumption as a percentage of population and raise disposable incomes, presenting an exciting opportunity for companies, although the post-Covid 19 K-shaped recovery is dampening penetration for now.

**Age dependency ratio over the years**



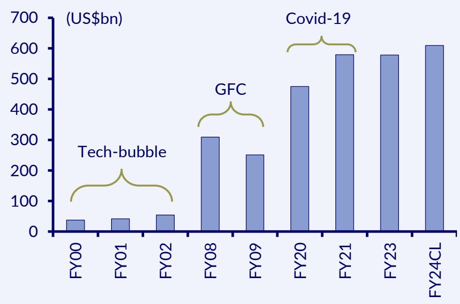

Source: UNDP, CLSA

**Bank credit to GDP over years**




Source: CLSA

**RBI's forex stockpile**




Source: CLSA, RBI

## Three burning questions

**Fiscal deficit unlikely to improve in the near future**

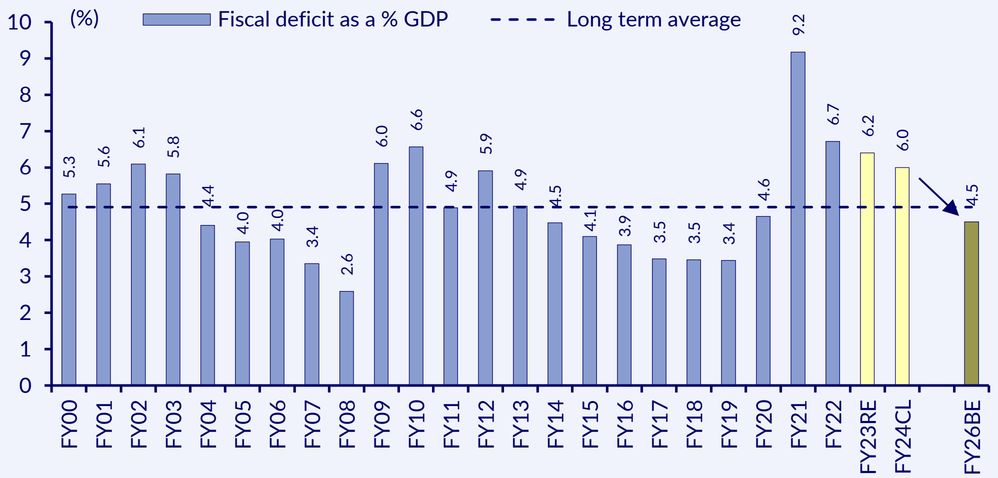
We address three burning questions about the India growth story. Our assessment is that India's twin deficits do not pose a significant risk to the country's growth prospects. Moreover, our growth projections do not take into account any potential improvements in efficiency. However, we believe that there is a widespread political consensus regarding the need for market-oriented economic reforms.

### #1 Twin deficits not really a risk

We do not see India's twin deficits (current account deficit & fiscal deficit) as a significant risk. The fiscal deficit is unlikely to improve soon, given that public investment continues to support growth in periods where private investment has slackened on excess capacity. High fiscal spending is also necessary to support the population during periods of economic strain.

**We expect fiscal deficit to remain high**

**Fiscal deficit as a % of GDP**




Source: Ministry of Finance, CLSA

Finally, in the Indian economy, the causality typically runs from growth to fiscal deficit rather than vice versa. Years of high/low growth usually result in increased/reduced tax collections to reduce/raise the fiscal deficit. Also, empirical tests tell us that one rupee of public consumption expenditure leads to a maximum of one rupee of GDP, while one rupee of public investment generates Rs2.5 of GDP; the impact of the first is immediate, while the latter takes time.

### #2 Efficiency gains look difficult

No efficiency gains in our base case projections

Second, our base case growth projections do not factor in any improvement in efficiency. We see India's growth driven by capital accumulation rather than efficiency, like China. China and India have not seen any improvement in their incremental capital output ratio (ICOR) during the past few years. Key drivers of ICOR improvement would be the development of a corporate debt market after India's inclusion in the JP Morgan Emerging Market Bond Index Diversified, the success of government reforms and a jump in investment due to the diversification of production of global companies from China even though studies show that the value add to GDP is limited for now.

China and India have seen no ICOR improvement in recent years

**ICOR for India and China**

| Economy | Investment rate (%) | Incremental Capital Output Ratio (ICOR) | Growth rate (%) |
|---|---|---|---|
| **1991-1995** | | | |
| China | 31.8 | 2.6 | 12.3 |
| India | 21.8 | 4.6 | 4.7 |
| **1996-2000** | | | |
| China | 32.5 | 4.7 | 8.6 |
| India | 22.9 | 3.6 | 6.8 |
| **2001-2005** | | | |
| China | 37.0 | 5.2 | 9.8 |
| India | 26.9 | 5.2 | 5.6 |
| **2006-2010** | | | |
| China | 40.0 | 5.0 | 11.3 |
| India | 35.2 | 5.9 | 6.9 |
| **2011-2015** | | | |
| China | 43.8 | 6.2 | 7.9 |
| India | 37.8 | 5.9 | 6.6 |
| **2016-2020** | | | |
| China | 42.5 | 8.1 | 5.7 |
| India | 34.2 | 4.7 | 6.7 |
| **2020-2023** | | | |
| China | 43.0 | 9.2 | 4.7 |
| India | 34.4 | 5.9 | 3.6 |
| **Memo** | | | |
| Korea (1981-1990) | 29.6 | 3.2 | 9.2 |
| Japan (1960-1970) | 32.6 | 3.2 | 10.2 |

Source: IMF, CLSA

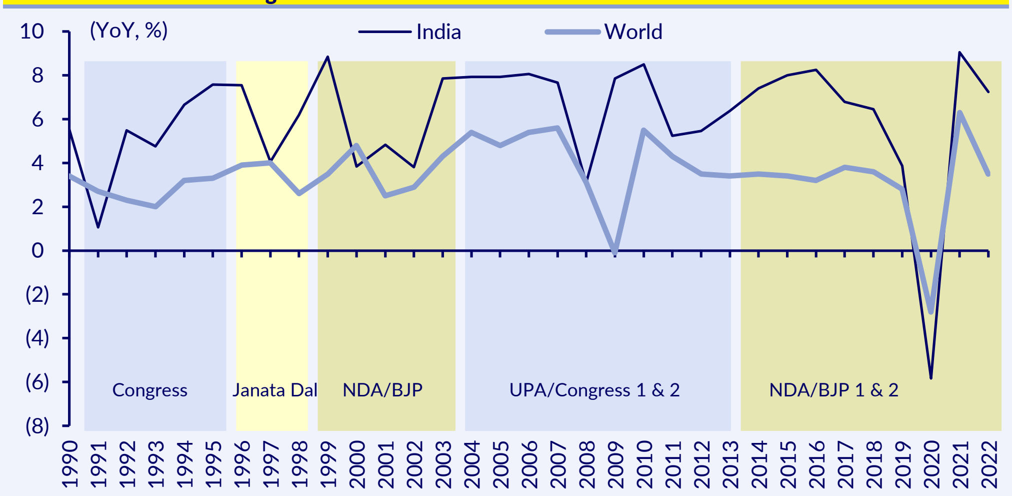
### #3 Global cycle, rather than politics, drives growth

No major difference in economic performance between governments

Finally, there is a broad political consensus about market-oriented economic reforms. We do not think a major difference in economic performance exists between governments with a simple majority and coalitions. It is really the global economic cycle that drives the Indian economy.

Political regime does not impact growth as much as the global cycle

India and world real GDP growth




Source: Bloomberg, CLSA

## Bharat story basket of large cap and mid cap long run value stocks

Stock picks focus on capital preservation while also offering opportunities for growth

Our Bharat story basket enmeshes our macro drivers, strategic sector drivers, and the immediate volatility in this market. In the near term, we build a slowdown in India's growth into September 2024, followed by a cyclical recovery in 2025. Taking cognisance of the immediate future, we recommend holding on to large-cap liquid stocks, which provide increased capital protection and opportunities to achieve growth. We continue to choose our stocks on three defensive principles: sectors that have already sold off or underperformed markets; traditional defensives; and stocks with a positive major event coming up.

We continue to recommend Axis Bank, Bharti Airtel, Hindustan Unilever, ICICI Bank, TCS, SBI, M&M, NTPC, Sun Pharma and UltraTech. Stocks like Zomato, PVR Inox, Delhivery, Prestige and Paytm also offer long-run value.

CLSA defensive stock recommendation

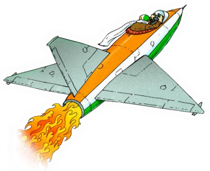
| Stock | Ticker | Market cap (US$bn) | ADTO (US$m) | Price (Rs) | Target price (Rs) | Rec | PE (x) | | PB (x) | | EV/Ebitda (x) | | ROE | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | FY24 | FY25 | FY24 | FY25 | FY24 | FY25 | FY24 | FY25 |
| Tata Consultancy | TCS IB | 154.2 | 80 | 3,529.9 | 3,550.0 | O-PF | 27.2 | 24.2 | 13.6 | 13.3 | 19.6 | 17.2 | 50.7 | 55.8 |
| ICICI Bank | ICICIBC IB | 77.9 | 165 | 922.6 | 1,225.0 | BUY | 16.5 | 14.8 | 2.8 | 2.4 | | | 18.1 | 17.5 |
| Hindustan Unilever | HUVR IB | 70.7 | 47 | 2,521.7 | 2,802.0 | O-PF | 55.5 | 50.0 | 11.5 | 11.0 | 41.8 | 37.5 | 21.0 | 22.5 |
| Bharti Airtel | BHARTI IS | 68.2 | 55 | 969.8 | 1,110.0 | BUY | 57.7 | 33.0 | 6.5 | 5.5 | 9.2 | 8.1 | 11.7 | 18.1 |
| State Bank of India | SBIN IB | 60.1 | 107 | 559.1 | 700.0 | BUY | 8.6 | 9.3 | 1.3 | 1.2 | | | 16.5 | 13.6 |
| Axis Bank | AXSB IB | 36.7 | 105 | 998.2 | 1,200.0 | BUY | 13.1 | 11.3 | 2.1 | 1.8 | | | 17.3 | 17.2 |
| Sun Pharma | SUNP IB | 34.6 | 27 | 1,204.3 | 1,340.0 | BUY | 33.1 | 27.1 | 4.7 | 4.2 | 22.0 | 19.2 | 14.8 | 16.3 |
| UltraTech | UTCEM IS | 30.2 | 32 | 8,759.9 | 9,450.0 | O-PF | 32.1 | 26.1 | 4.2 | 3.7 | 17.7 | 14.7 | 13.7 | 15.0 |
| NTPC | NTPC IS | 29.1 | 40 | 253.7 | 240.0 | BUY | 13.3 | 11.8 | 1.6 | 1.6 | 7.5 | 7.1 | 12.9 | 14.0 |
| Mahindra | MM IB | 23.3 | 47 | 1,543.3 | 1,931.0 | BUY | 18.5 | 18.1 | 3.7 | 3.2 | 13.0 | 10.9 | 21.8 | 19.1 |

Source: CLSA

CLSA other thematic stock recommendation

| Stock | Ticker | Market cap (US$bn) | ADTO (US$m) | Price (Rs) | Target price (Rs) | Rec | PE (x) | | PB (x) | | EV/Ebitda (x) | | ROE | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | FY24 | FY25 | FY24 | FY25 | FY24 | FY25 | FY24 | FY25 |
| Zomato | ZOMATO IN | 12.2 | 101.6 | 115.3 | 168.0 | BUY | 177.2 | 46.9 | 4.7 | 4.3 | 276.4 | 48.6 | 2.7 | 9.7 |
| Delhivery | DELHIVER IN | 3.5 | 4.9 | 385.7 | 493.0 | BUY | nm | nm | 3.5 | 3.6 | 498.1 | 68.0 | nm | nm |
| PVR Inox | PVRINOX IN | 2.0 | 11.7 | 1,655.1 | 2,280.0 | BUY | 84.6 | 35.2 | 2.2 | 2.1 | 11.4 | 8.7 | 2.7 | 6.1 |
| Prestige | PEPL IN | 4.3 | 9.6 | 905.7 | 1,005.0 | BUY | 60.2 | 51.1 | 3.2 | 3.0 | 14.7 | 12.2 | 5.6 | 6.1 |
| Paytm | PAYTM IN | 6.9 | 38.1 | 918.8 | 1,200.0 | BUY | nm | 366.9 | 4.8 | 4.4 | nm | 48.6 | nm | 1.2 |

Source: CLSA



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India to become the third-largest economy by 2027 . . .

. . . and overtake Japan in nominal US GDP

# Ascent to the third place imminent

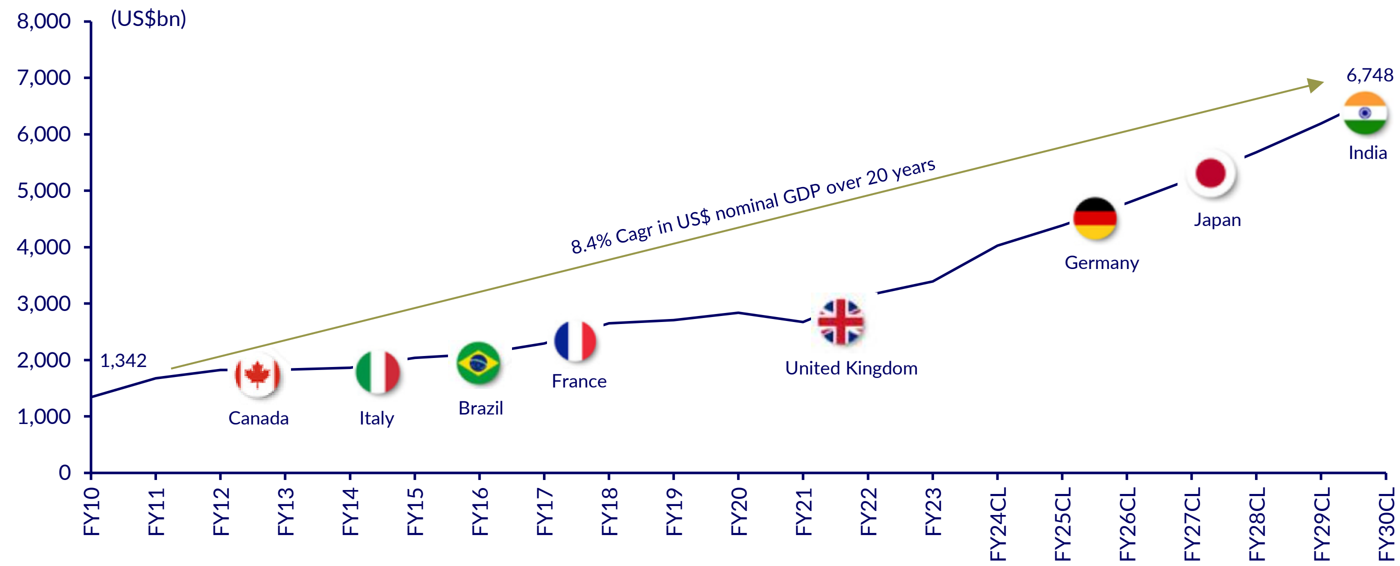
We provide a roadmap of the journey to PM Modi's *Amrit kaal* (golden era.) We continue to expect India to overtake Japan in nominal GDP in US dollars by 2027, assuming USD-JPY normalisation. We see the economy expanding to US$44.9tn in 2052 and US$29.2tn in 2047 from the current US$3.4tn.

## . . . Behind only China and the US

We expect the Indian economy to cross Japan's nominal US GDP by 2027, even after assuming some USD-JPY normalisation. Figure 1-2 shows India has pulled ahead of several economies in the past 15 years. We assume a 6% real GDP potential/trend growth rate, 5.5% inflation rate, and 2.5% depreciation, and see a fair possibility of India achieving our target by 2027. China and the US will be the only economies bigger than India by then (Figures 4-5).

Figure 1

**India GDP growth trajectory and peer economies**

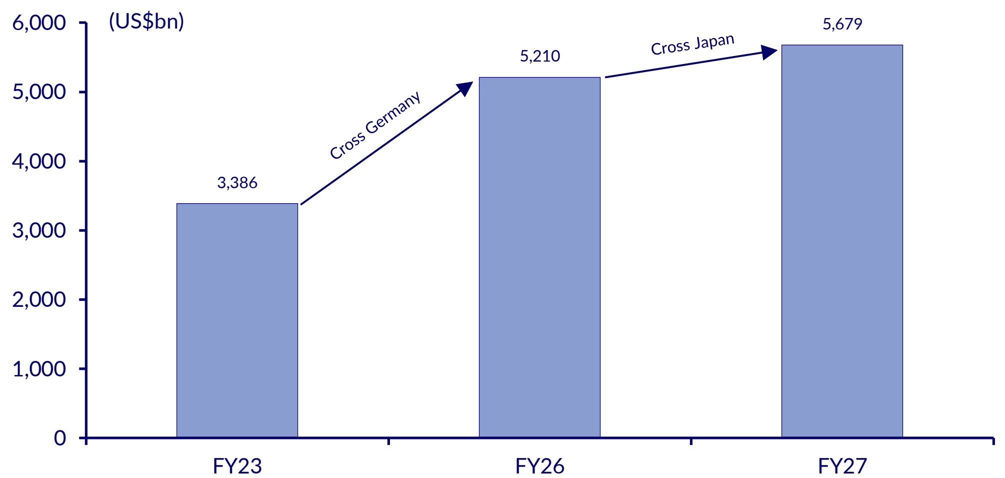



Source: Flags of the world, Bloomberg, CLSA

India is likely to cross Germany and Japan by 2027

Figure 2

**India nominal US-dollar GDP outlook**

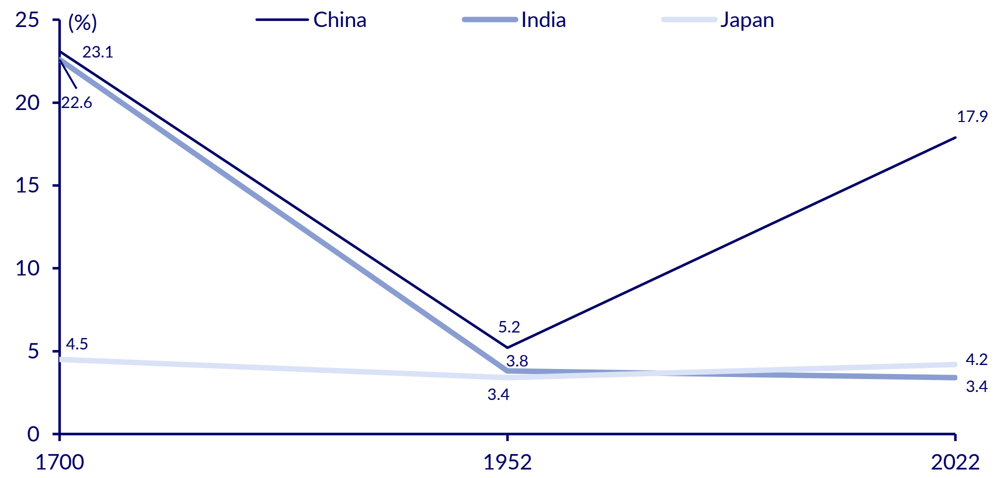



Source: Ministry of Statistics and programme implementation, CLSA

**India set to regain past glory in terms of share in world GDP**

Figure 3

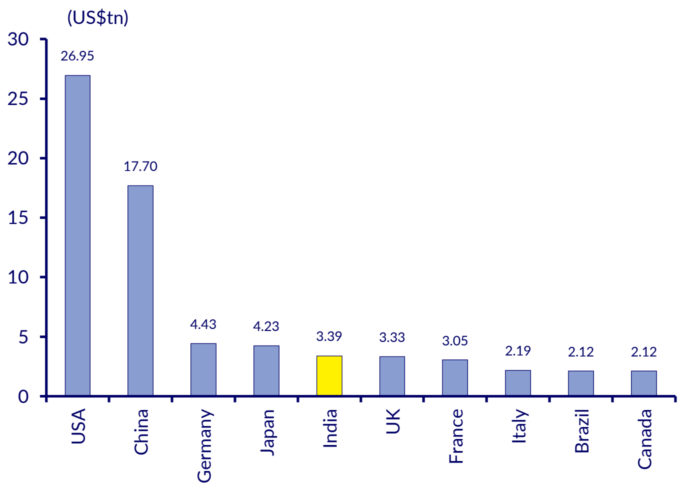
**Share of China, India and Japan in world GDP over the years**




Source: World Bank, CLSA

Figure 4

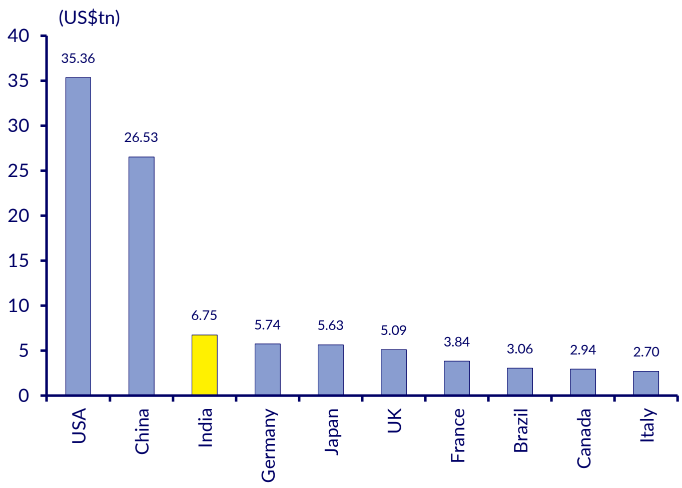
**World's 10 largest economies as of 2022**




Source: IMF, CLSA

Figure 5

**. . . and by our projections as of 2030**




Source: IMF, CLSA

**We continue to see a slowdown in India's growth in the near term**

## Near term concerns remain but cyclical recovery in FY25

In the near term, we continue to see a slowdown in India's growth into September 2024. India's growth has averaged a dismal 4.4% since FY18. After all, the Fed hike that is slowing export demand is also forcing the RBI to raise rates to protect the rupee and is hitting the domestic market. Not surprisingly, real policy rates are rising to pose growth risks.Rural demand is also slowing, given uneven rains due to *El Nino*. We estimate farmer income in the autumn *kharif* harvest to contract by 3.4% versus growth of 9.2% a year ago.

**Expect cyclical recovery in 2025**

We expect a turnaround in growth from 2HFY25 and forecast a step up in India's growth to 7.5% in FY26 from 6.4% in FY24 and 6.5% in FY25. Three factors are likely to drive this improvement:

1. **RBI rate cuts in 2024**: with the global rate cycle turning down in 2HFY25. Our economists expect the Fed from end-2024 once inflation cools down.

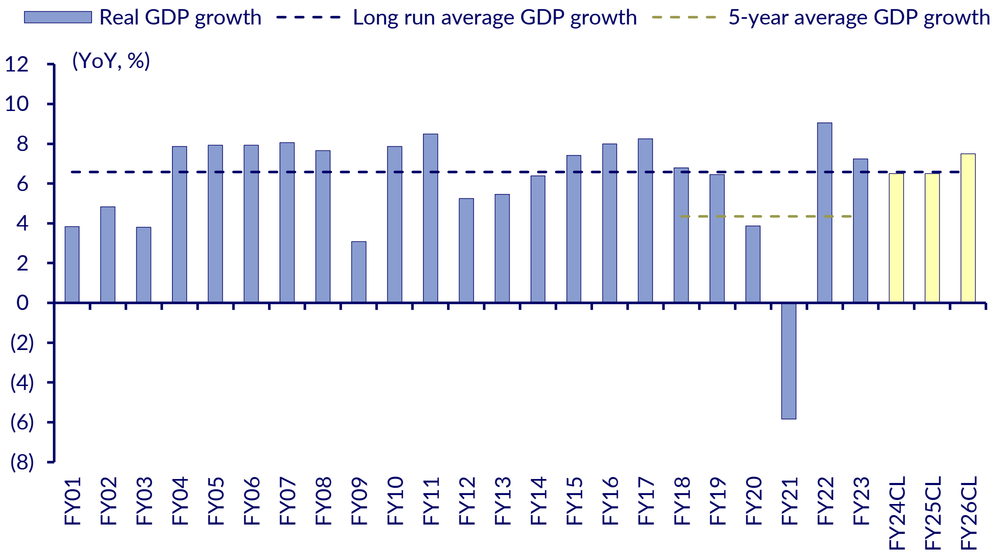
2. **Export demand should pick** up: if US recovers. Our economists expect US growth to bottom out by 2024.

3. **Rural recovery**: likely in mid-2024 as northern rivers have sufficient waters to irrigate a bumper wheat crop. This should sustain into 2025 as *El Nino* (that drives rain clouds away) should fades.

**India's potential growth about 6%**

Figure 6

**India's GDP growth and long run average growth**

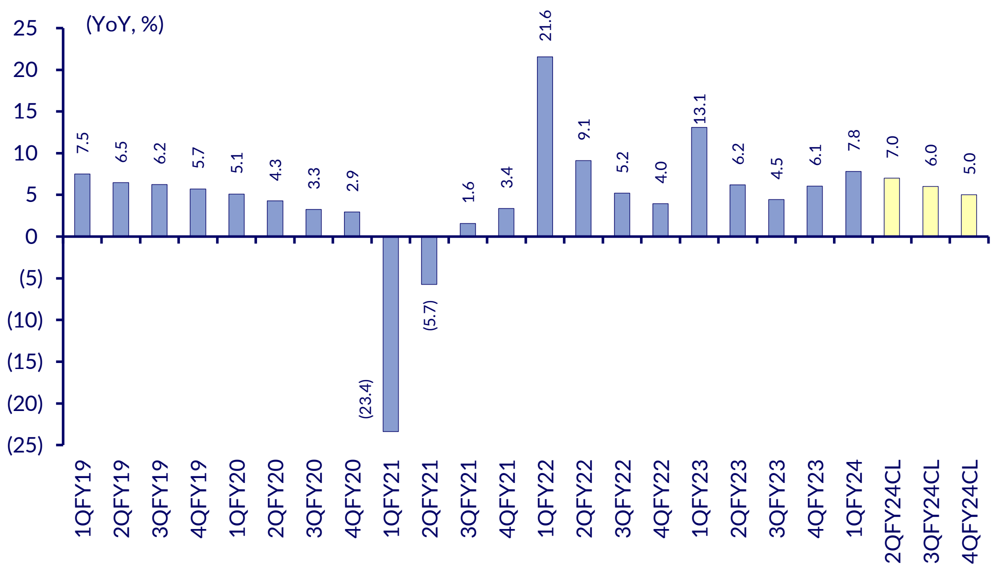



Note: Long term average growth excludes Covid-19 impacted years. Source: Ministry of Statistics and programme implementation, CLSA

**Growth to slow in 2HFY24 but rebound in 1HFY25**

Figure 7

**India's quarterly GDP growth profile**




Source: Ministry of Statistics and programme implementation, CLSA

Figure 8

**India's FY24 growth projections**

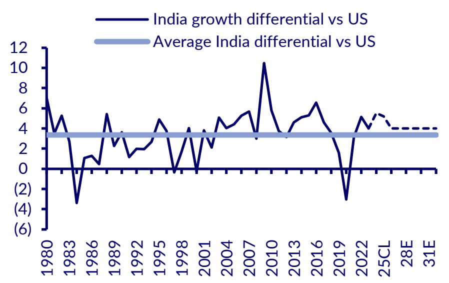
| Component | Weight | Annual | | | | | |
|---|---|---|---|---|---|---|---|
| | | FY19 | FY20 | FY21 | FY22 | FY23 | FY24CL |
| Agriculture | 14.8 | 2.1 | 6.2 | 4.1 | 3.5 | 4.0 | 2.0 |
| Industry | 23.1 | 5.0 | (2.4) | 1.0 | 10.4 | 2.4 | 4.6 |
| Mining and quarrying | 2.4 | (0.9) | (3.0) | (8.6) | 7.1 | 4.6 | 3.0 |
| Manufacturing | 18.2 | 5.4 | (3.0) | 2.9 | 11.1 | 1.3 | 5.0 |
| Electricity, gas, water supply and other utility | 2.3 | 7.9 | 2.3 | (4.3) | 9.9 | 9.0 | 4.0 |
| Services | 62.1 | 7.1 | 5.8 | (7.9) | 9.9 | 9.7 | 6.7 |
| Construction | 7.9 | 6.5 | 1.6 | (5.7) | 14.8 | 10.0 | 7.0 |
| Trade, hotels, transport and comm. services | 19.9 | 7.2 | 6.0 | (19.7) | 13.8 | 14.0 | 8.0 |
| Financial services, real estate and prof. services | 21.5 | 7.0 | 6.8 | 2.1 | 4.7 | 7.2 | 9.0 |
| Public administration and defence | 12.7 | 7.5 | 6.6 | (7.6) | 9.7 | 7.2 | 6.0 |
| **Real GVA** | **100.0** | **5.8** | **3.9** | **(4.2)** | **8.8** | **7.0** | **6.2** |
| Net Taxes | | 0.6 | (0.1) | (1.6) | 0.3 | 0.2 | 0.2 |
| **Real GDP** | | **6.5** | **3.9** | **(5.8)** | **9.1** | **7.2** | **6.4** |

Source: Ministry of Statistics and Programme Implementation, CLSA

Comparing growth across countries, we expect India to be the fastest-growing major economy over the next three years. This would keep its growth differential versus the US, Japan and EM above its historical average. India's growth differential to China will likely remain positive in the coming decade.

Figure 9

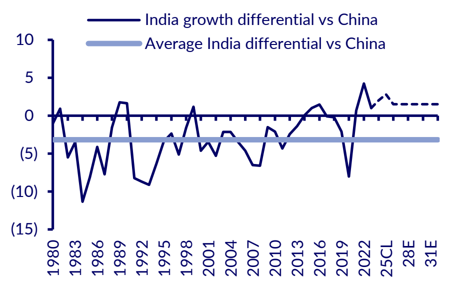
**India real growth vs US real growth**




Source: Reserve Bank of Australia, IMF, CLSA

Figure 10

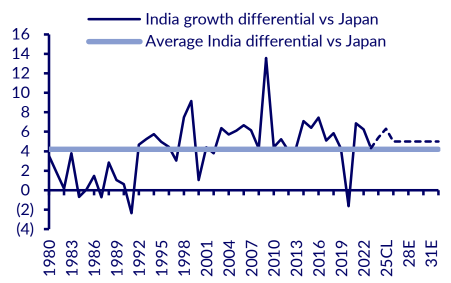
**India real growth vs China real growth**




Source: Reserve Bank of Australia, IMF, CLSA

Figure 11

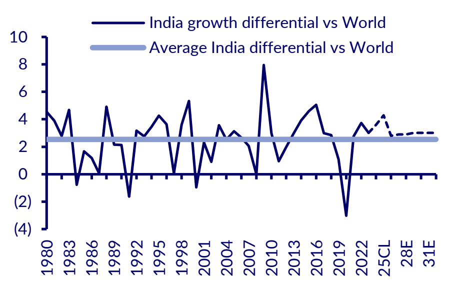
**India real growth vs Japan real growth**




Source: Reserve Bank of Australia, IMF, CLSA

Figure 12

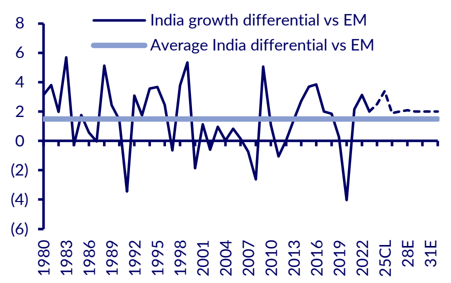
**India real growth vs world real growth**




Source: Reserve Bank of Australia, IMF, CLSA

Figure 13

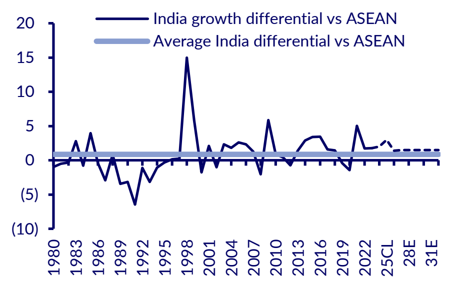
**India real growth vs EM real growth**




Source: Reserve Bank of Australia, IMF, CLSA

Figure 14

**India real growth vs Asean real growth**




Source: Reserve Bank of Australia, IMF, CLSA

**India will be the fastest-growing economy for the next three years**

Figure 15

**Real GDP growth (in local currency) for major EMs and DMs**

| Real GDP growth (YoY %, in LCU terms) | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|
| India | 7.2 | 6.4 | 6.5 | 7.5 |
| Indonesia | 5.3 | 5.1 | 5.4 | 5.6 |
| Vietnam | 8.0 | 5.0 | 6.4 | 6.8 |
| China | 3.0 | 5.0 | 4.5 | 4.7 |
| Philippines | 7.6 | 4.9 | 5.8 | 6.3 |
| Egypt | 6.7 | 4.2 | 3.6 | 5.0 |
| Turkey | 5.5 | 4.0 | 3.0 | 3.2 |
| Malaysia | 8.7 | 3.9 | 4.5 | 4.7 |
| UAE | 7.9 | 3.4 | 4.0 | 4.2 |
| Mexico | 3.9 | 3.2 | 2.1 | 1.5 |
| Brazil | 2.9 | 3.1 | 1.5 | 1.9 |
| Thailand | 2.6 | 2.9 | 3.8 | 4.2 |
| Russia | (2.1) | 2.2 | 1.1 | 1.0 |
| US | 2.1 | 2.0 | 1.0 | 2.3 |
| Japan | 1.0 | 1.7 | 1.1 | 1.2 |
| South Korea | 2.6 | 1.4 | 2.2 | 2.3 |
| Colombia | 7.3 | 1.4 | 2.0 | 2.9 |
| Peru | 2.7 | 1.1 | 2.7 | 3.1 |
| South Africa | 1.9 | 0.9 | 1.8 | 1.6 |
| Saudi Arabia | 8.7 | 0.8 | 4.0 | 4.2 |
| Taiwan | 2.4 | 0.7 | 1.9 | 2.1 |
| UK | 4.1 | 0.5 | 0.6 | 2.0 |
| Argentina | 5.0 | (2.5) | 2.8 | 3.3 |

Source: IMF, CLSA

## Lags in per capita income, human development index

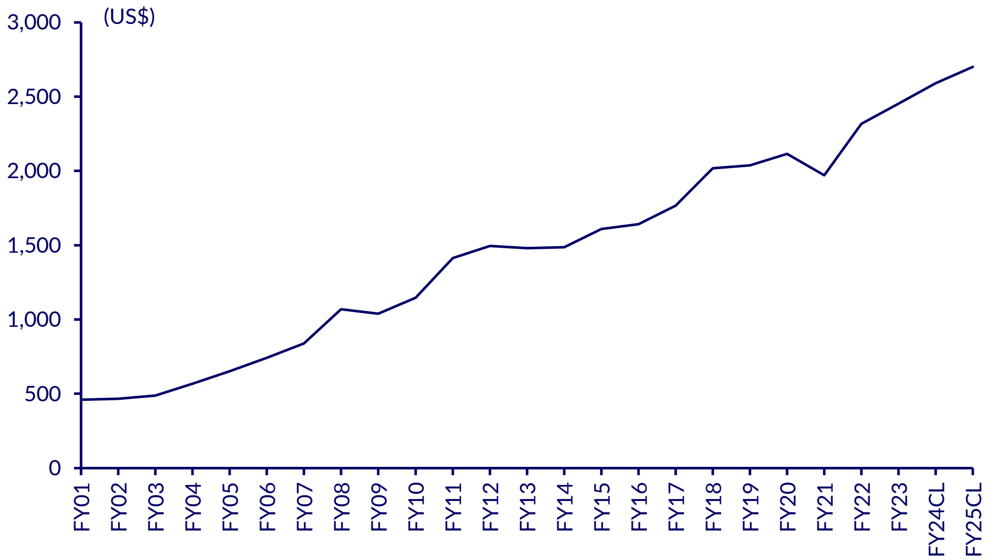
**139th in per capita income, 132nd in HDI**

We add a word of caution. While India will emerge as the third-largest economy in the next few years, per capita income still needs to grow. With less than US$2,500 per capita income, India will still rank above 100th place among countries in per capita income and the human development index.

**India's per capita income has grown to US$2500 but is still extremely low**

Figure 16

**Per capita Income of India over the years**

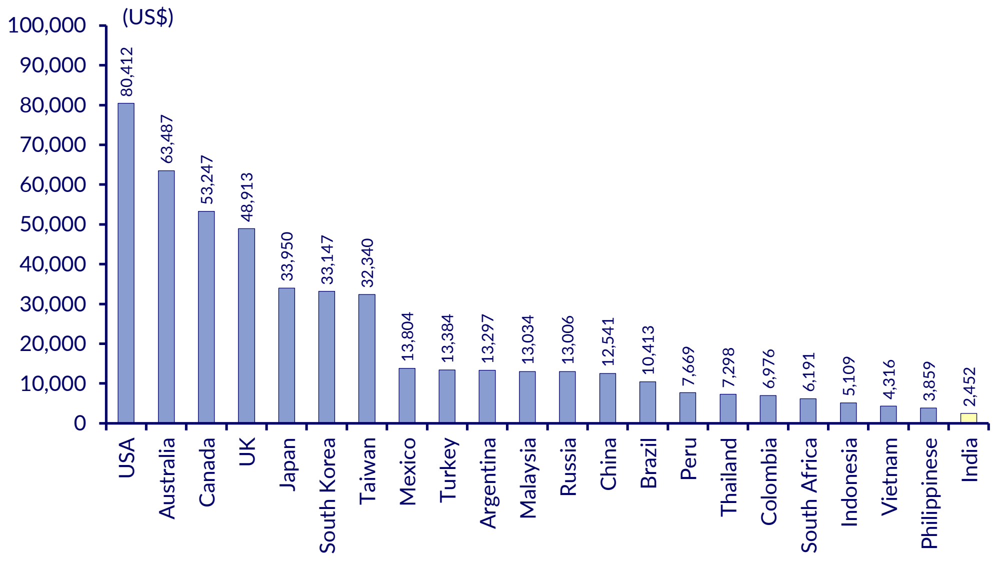



Source: Bloomberg, CLSA

**India still has the lowest per capita income across major economies**

Figure 17

**Per capita income across major economies, 2023**




Source: Bloomberg, CLSA

**India still has some way to go in terms of the Human Development Index**

Figure 18

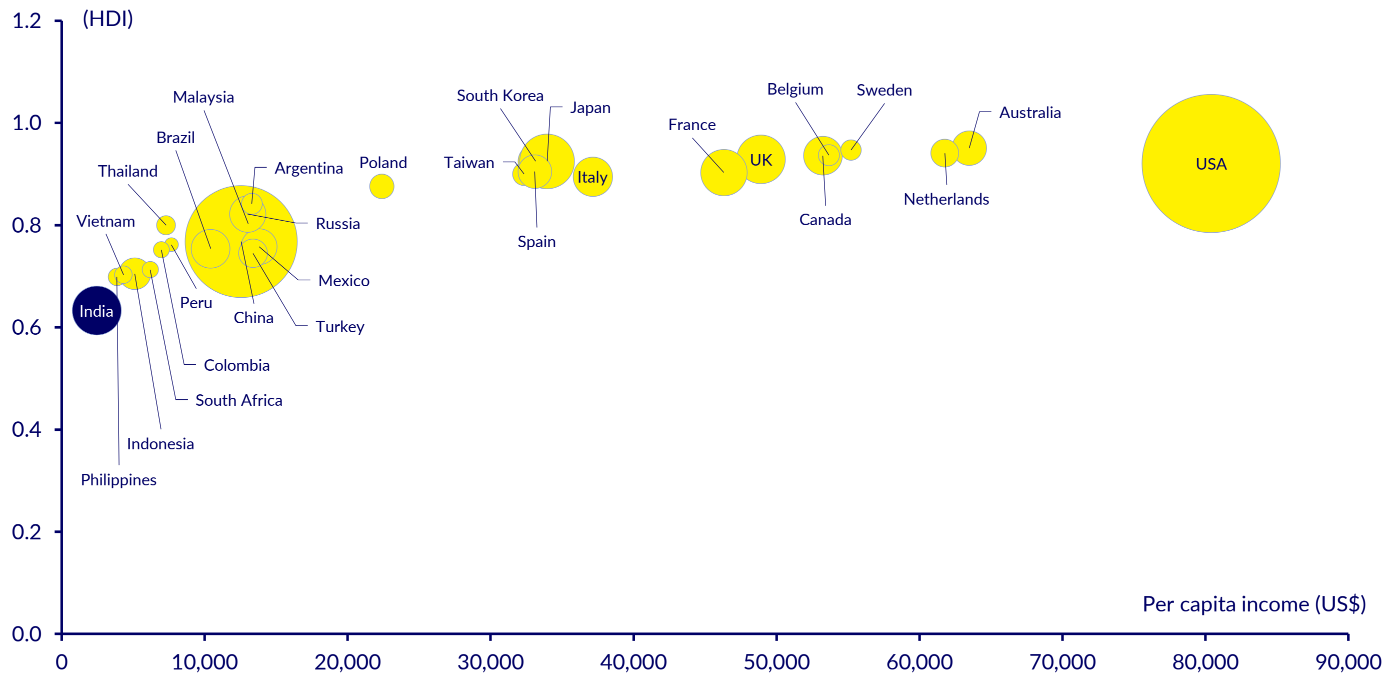
**Human development Index (HDI) value and rank across top economies**

| | HDI value | Rank of HDI |
|---|---|---|
| **Very High** | | |
| Australia | 0.951 | 5 |
| Sweden | 0.947 | 7 |
| Netherlands | 0.941 | 10 |
| Belgium | 0.937 | 13 |
| Canada | 0.936 | 15 |
| UK | 0.929 | 18 |
| South Korea | 0.925 | 19 |
| Japan | 0.925 | 19 |
| USA | 0.921 | 21 |
| Taiwan | 0.900 | 22 |
| Spain | 0.905 | 27 |
| France | 0.903 | 28 |
| Italy | 0.895 | 30 |
| Poland | 0.876 | 34 |
| Argentina | 0.842 | 47 |
| Russia | 0.822 | 52 |
| Malaysia | 0.803 | 62 |
| Thailand | 0.800 | 66 |
| **High** | | |
| China | 0.768 | 79 |
| Peru | 0.762 | 84 |
| Mexico | 0.758 | 86 |
| Brazil | 0.754 | 87 |
| Colombia | 0.752 | 88 |
| Turkey | 0.745 | 91 |
| South Africa | 0.713 | 109 |
| Indonesia | 0.705 | 114 |
| Vietnam | 0.703 | 115 |
| **Medium** | | |
| Philippines | 0.699 | 116 |
| India | 0.633 | 132 |

Source: World Bank, CLSA

Figure 19

**HDI and per capita income across markets**




Note: Size of bubble denotes GDP size. Source: Euromonitor, CLSA

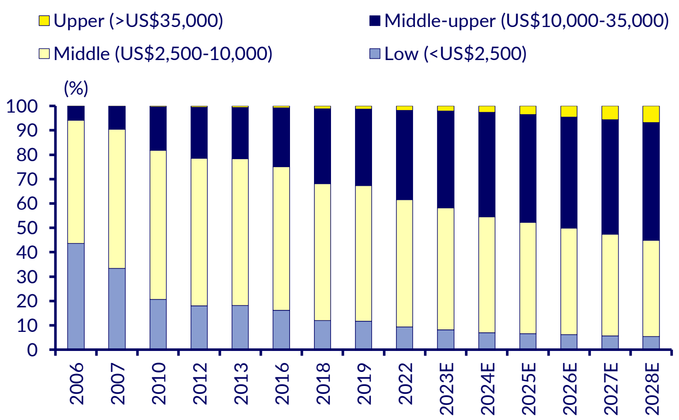
**From middle class to upper middle class country**

Will the jump in the size of the economy make life better for the average citizen? India will emerge as what the World Bank classifies as an upper-middle-class economy from a middle-class country. We see a potential trajectory for India to follow China, an aspirational consumption story.

Euromonitor estimates that, at 54%, middle income is still the bulk of its 336m households, but the middle-upper segment is rising. It is now 33% of households from 22% ten years ago. Euromonitor expects this class to grow further to 48% by 2028.

Figure 20

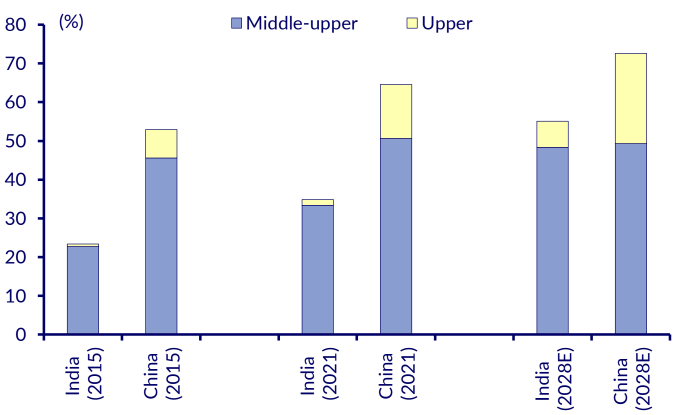
**India's households by income bracket**




Source: Euromonitor, CLSA

Figure 21

**India's middle-upper income population, versus China's**




Source: Euromonitor, CLSA

Food accounts for nearly 30% of per capita consumption of India - much higher than China and Japan due to low per capita income

Figure 22

**Per capita consumption by category (2020)**

| (US$) | China | India | Indonesia | Japan | Korea |
|---|---|---|---|---|---|
| **Total** | **4,177** | **1,141** | **2,264** | **21,006** | **13,943** |
| Food | 885 | 314 | 697 | 3,028 | 1,504 |
| Beverages | 28 | 5 | 42 | 280 | 111 |
| Alcoholic drinks | 51 | 7 | 5 | 339 | 127 |
| Tobacco | 70 | 17 | 156 | 134 | 130 |
| Clothing | 213 | 54 | 61 | 596 | 763 |
| Footwear | 52 | 15 | 21 | 95 | 86 |
| Housing related | 1,260 | 191 | 286 | 6,165 | 2,884 |
| Health related | 389 | 57 | 73 | 863 | 792 |
| Transport | 304 | 190 | 388 | 2,098 | 1,478 |
| Communications | 144 | 28 | 124 | 731 | 723 |
| Leisure and recreation | 217 | 9 | 55 | 1,571 | 996 |
| Education | 260 | 52 | 86 | 421 | 778 |
| Hotels and catering | 174 | 21 | 226 | 1,640 | 1,446 |
| Personal care | 17 | 13 | 28 | 838 | 493 |
| Others | 113 | 170 | 19 | 2,120 | 1,632 |

Source: Euromonitor, CLSA

## GDP: US$29tn in 2047; US$45tn 2052; US$88tn by 2072

Demographic dividend, financial deepening and stable rupee . . .

We see the Indian economy expanding to US$29.2trn in 2047, US$44.9tn in 2052 and US$87.8trn in 2072, from US$3.4tn currently. We see three drivers: the coming demographic dividend, financial deepening and a relatively stable rupee on sufficient RBI forex reserves.

**Base case**: We assume 6% growth, 5.5% inflation and 2.5% rupee depreciation (Figure 24). This will take India's economy to US$44.9tn by 2052.

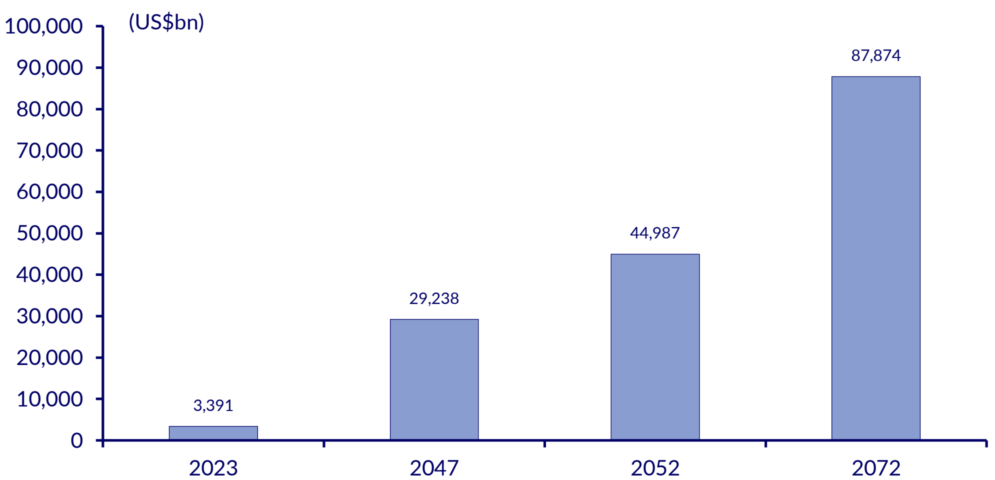
**Bear case**: This assumes 5% growth, 5.5% inflation and much higher 4% depreciation with lower capital flows limiting the build-up of forex reserves. This will keep India's economy at US$22.4tn.

**Bull case**: The Indian economy expands to US$151.4tn, with higher 8% growth, on improved efficiency, attracting higher foreign investment to prevent depreciation.

. . . to drive strong growth for India over the years

Figure 23

**India's GDP size**




Source: CLSA

**Indian economy to touch US$45trn by 2052 driven by reforms**

Figure 24

**Three cases for India economy by 2052**

| | India GDP in 2023 (US$bn) | GDP growth (%) | CPI inflation (%) | INR depreciation (%) | India GDP in 2052 (US$bn) |
|---|---|---|---|---|---|
| Base scenario | 3,391 | 6.0 | 5.5 | 2.5 | 44,987 |
| Bear scenario | 3,391 | 5.0 | 5.5 | 4.0 | 22,427 |
| Bull scenario | 3,391 | 8.0 | 5.5 | - | 151,414 |

Source: Ministry of Statistics and Programme Implementation, CLSA

**India's size to nearly equal EU's by 2052**

Figure 25

**Size of economies in 2052**

| | GDP in 2023 (US$bn) | GDP growth (%) | Inflation (%) | Currency app/ (Dep) (%) | GDP in 2052 (US$bn) |
|---|---|---|---|---|---|
| US | 25,462 | 2.0 | 2.0 | - | 82,583 |
| EU | 16,713 | 1.8 | 2.0 | - | 51,165 |
| China | 17,886 | 5.6 | 2.0 | - | 161,021 |
| India | 3,391 | 6.0 | 5.5 | (2.5) | 44,987 |
| Japan | 4,237 | 1.0 | 0.5 | - | 6,623 |
| ASEAN | 3,092 | 4.5 | 2.5 | - | 23,537 |

Source: Reserve Bank of Australia, Ministry of Statistics and Programme Implementation, CLSA

**Our base case sees India's growth funded by capital accumulation rather than higher efficiency**

## 6% growth, 5.5% inflation, 2.5% depreciation

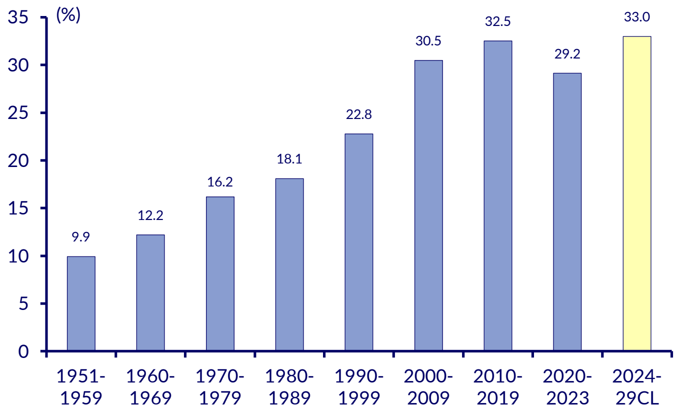
The coming demographic dividend should sustain savings to fund, say, a 33% of GDP investment rate, notwithstanding the present slowdown due to repeated macro shocks. Assuming an incremental capital output ratio (ICOR) at the long-run average of about 5.5x, we arrive at 6% real GDP growth. Our base case sees India's growth funded by capital accumulation rather than higher efficiency. Higher efficiency (lower ICOR), borne out of reforms, could increase growth to 8%.

Our 5.5% inflation target is placed at growth-maximising threshold levels. Several empirical studies place India's growth-maximising CPI inflation around 6%

Again, 2.5% depreciation is taken at long-run levels. Complacency led the RBI to stop buying forex reserves 12 years ago. This, in turn, increased depreciation to 5.2% in 2013-20. With RBI Governor Das reverting to the Jalan-Reddy policy of building forex reserves, we forecast 2.5% depreciation over time.

Figure 26

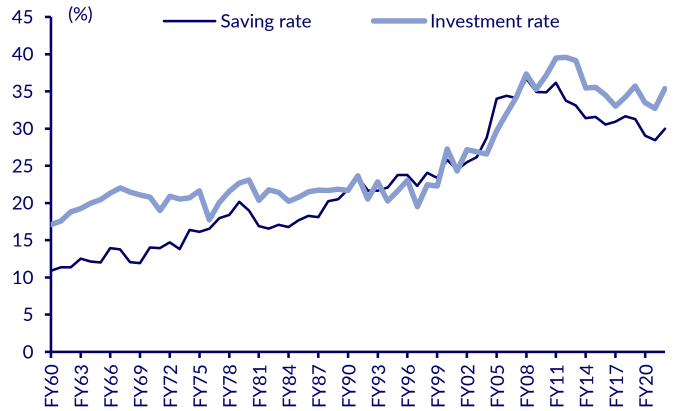
**Gross saving rate**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 27

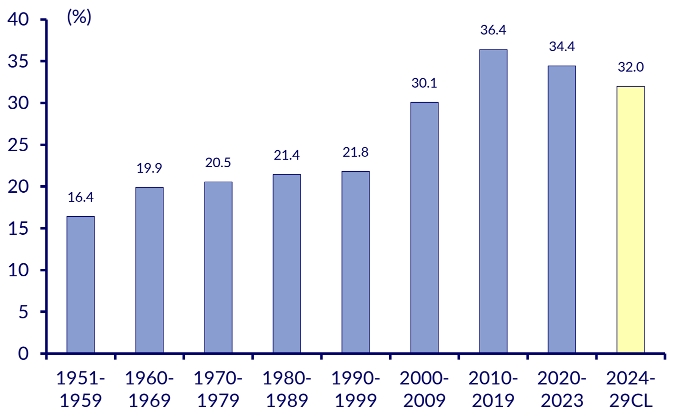
**Saving and investment rate over the years**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 28

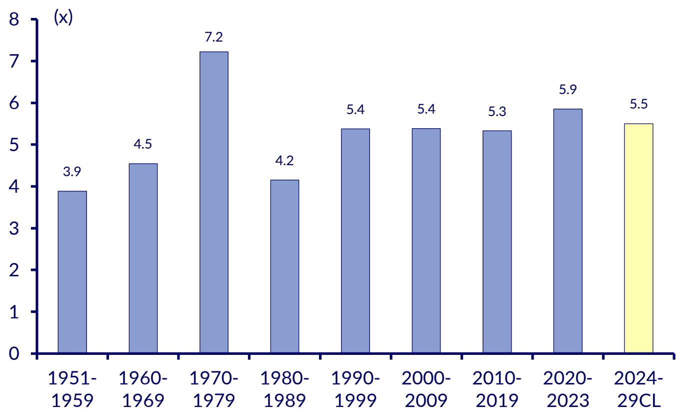
**Investment rate**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 29

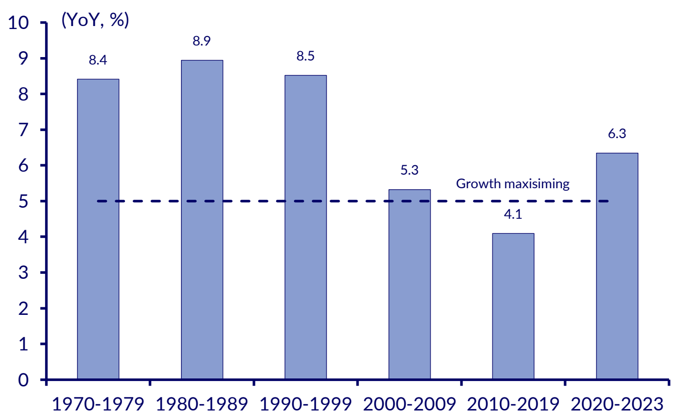
**Investment capital output ratio (ICOR)**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 30

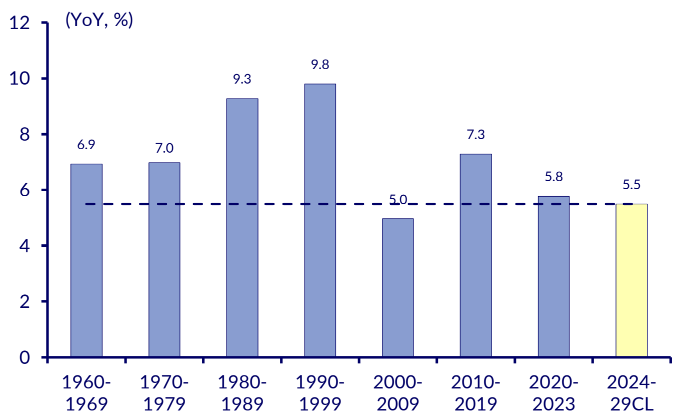
**WPI inflation**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 31

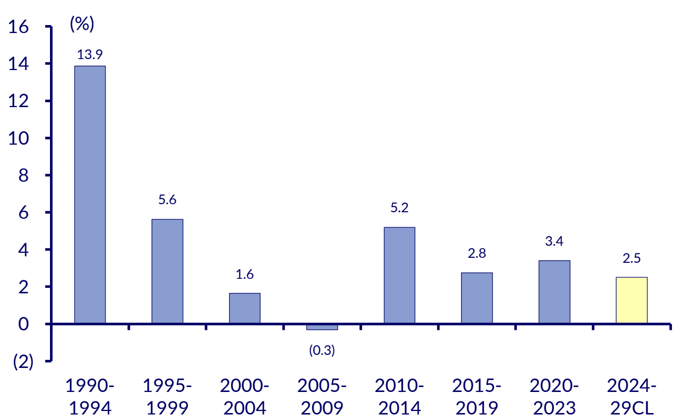
**CPI inflation**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 32

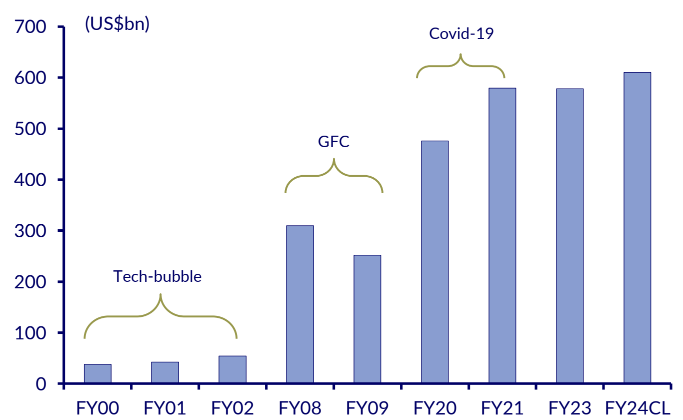
**Rupee depreciation**




Source: Bloomberg, CLSA

Figure 33

**RBI forex reserves**




Source: RBI, CLSA

## What's changing? The long view

Liberalisation is gaining political acceptance

India gained independence from the British Raj in 1947. A combination of the success of Soviet planning and a mistrust of colonialism led to the adoption of a "mixed" economy in which both the public and private sectors co-exist. Given the lack of private capital, the state decided to take over the commanding heights of the economy to build the temples of modern India: dams, steel plants etc. Rising public investment initially led to a step up in growth as well (Figure 34).

So, what went wrong? The state could not fund investments at the rate it began due to paucity of funds. Rising fiscal deficits, increasingly funded by printing of money by the RBI to fund the fiscal spending, led to a spurt in inflation. This increased the cost of borrowing for most investment projects and high inflation impacted rural demand, reducing spending power for rural population.

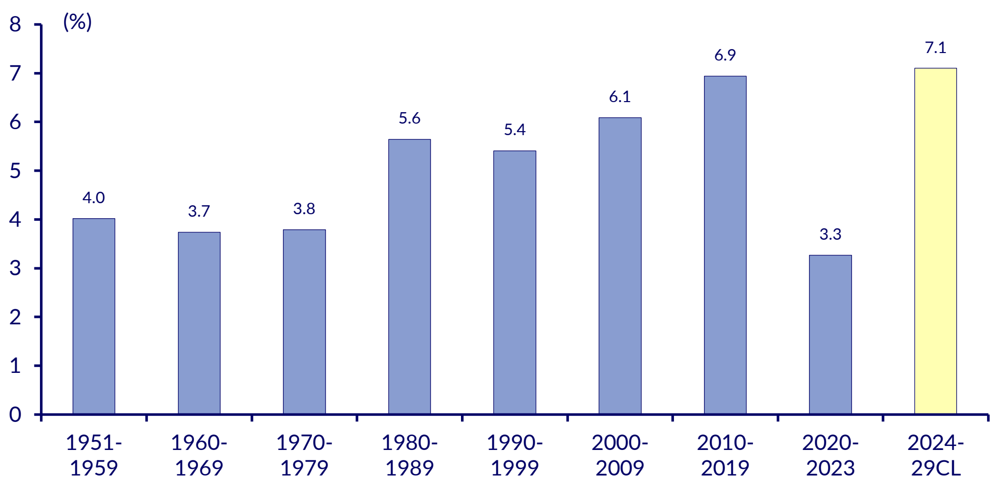
Further, indiscriminate expansion of the planned economy - often by nationalisation - led to rising inefficiency. As a result, the ICOR began to rise. Finally, an autarkic policy of import substitution, coupled with equating a strong rupee as political strength, deprived the RBI of forex reserves and landed India at the IMF for a loan in the early 1970s, 1980s and 1990s.

The first timid steps towards reform began with the Rajiv Gandhi government. As the 1991 IMF loan came with conditions, India had to embark on a programme of liberalisation that has come to gain political acceptance.

Real GDP growth potential about 6%

Figure 34

**Real GDP growth Cagr**




Source: Ministry of Statistics and Programme Implementation, CLSA

Studies show that India saw a structural break by the 2000s to a higher growth path. Growth has risen to 6.5% since 1990s from 4.9% in 1970s-1999, driven by:

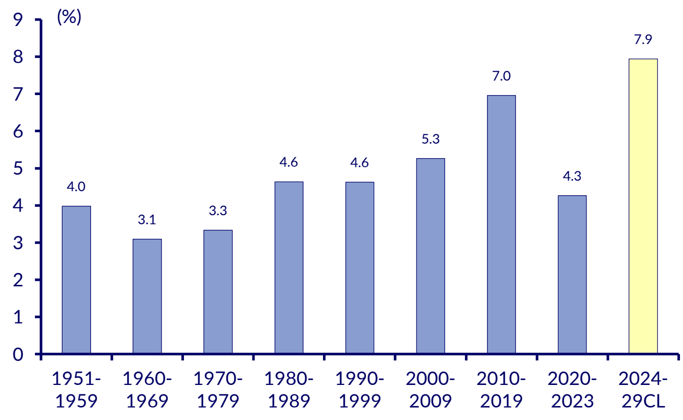
a) A consumption boom on structural reduction of rates with reforms reducing cash reserve ratio (CRR)/statutory liquidity ratio (SLR) requirements;

b) A renewed investment boom, sparked by government initiatives to improve infrastructure;

c) Stepped up outsourcing.

Figure 35

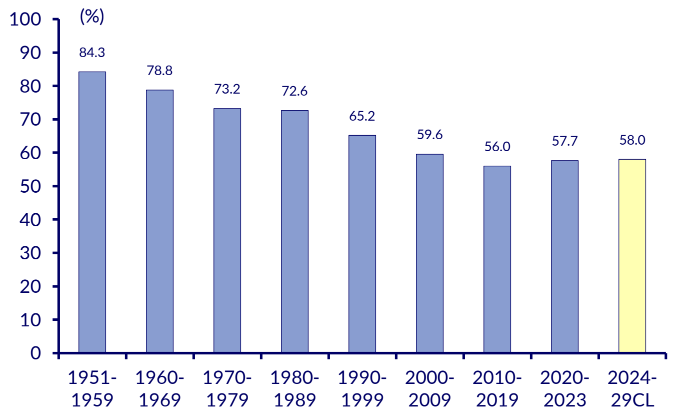
**Consumption growth**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 36

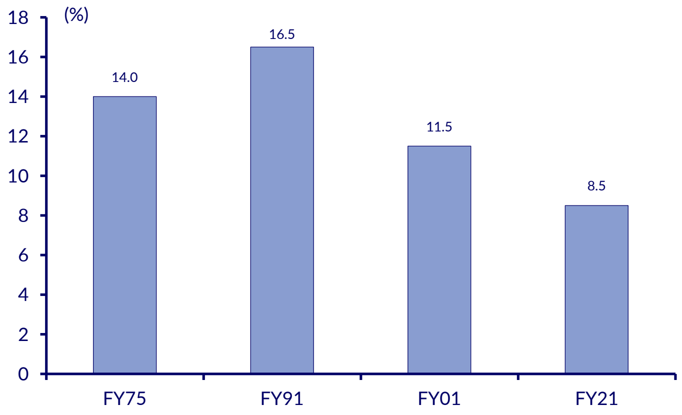
**Consumption as a proportion of GDP**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 37

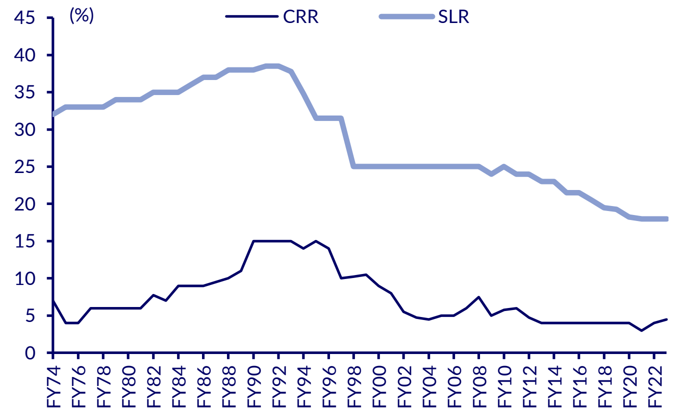
**Lending rates**




Source: RBI, CLSA

Figure 38

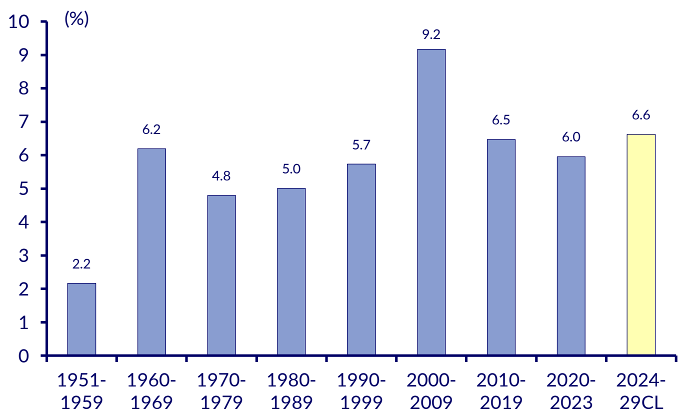
**CRR and SLR**




Source: RBI, CLSA

Figure 39

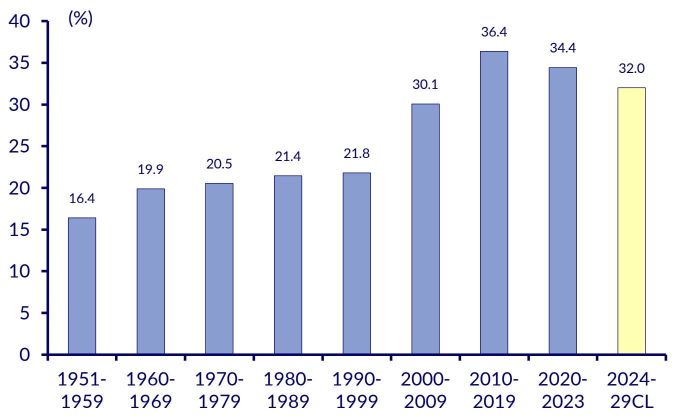
**Gross capital formation**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 40

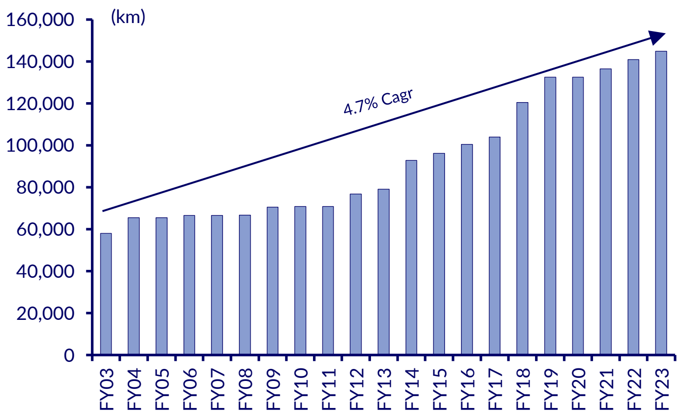
**Gross capital formation as a proportion of GDP**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 41

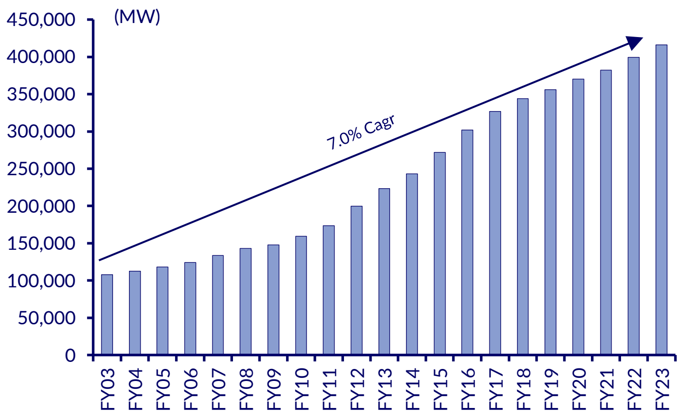
**Road network**




Source: Ministry of Railways, CLSA

Figure 42

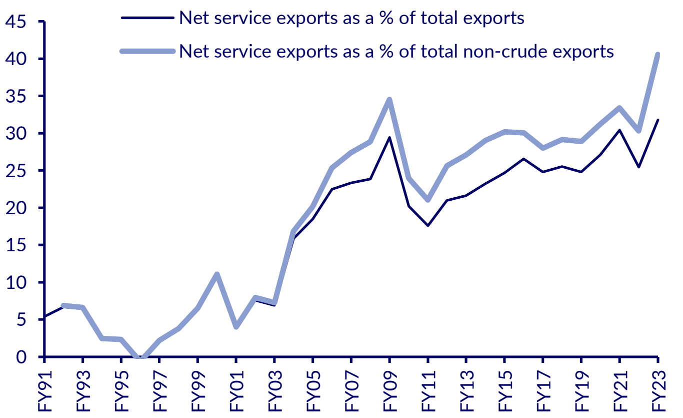
**Total power capacity**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 43

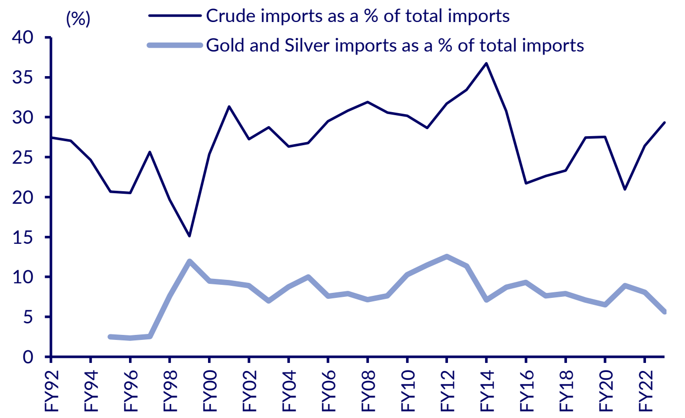
**Service exports**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 44

**Crude and gems imports**



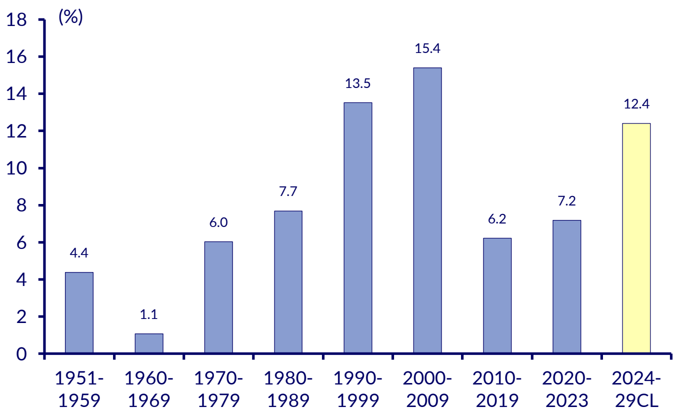

Source: Ministry of Statistics and Programme Implementation, CLSA

India's emergence as a BRIC economy coincided with the global upcycle of 2005-07. This drove up growth not just in India but across the world. As a consequence of the opening up of the economy, we have seen imports climb, reaping comparative advantages of scale. This has also been accompanied by an increase in exports.

The Great Financial Crisis, however, resulted in a drop in growth across BRICs. This, in turn, has led to questions about the sustainability of growth and the possibility of penetration that this report addresses.

Figure 45

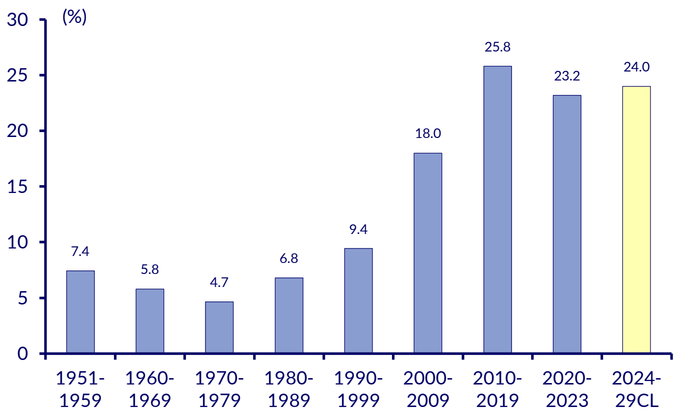
**Imports growth**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 46

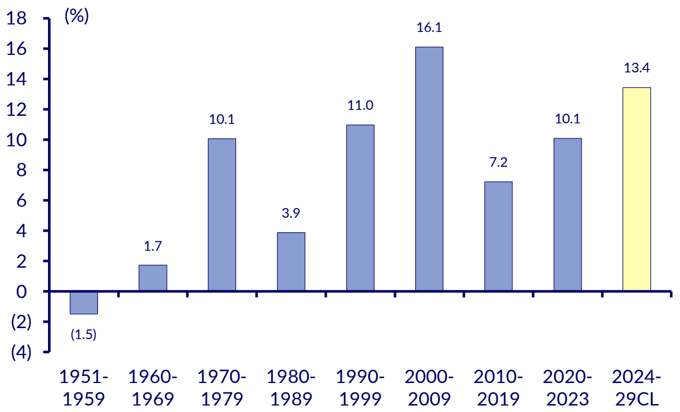
**Imports as a proportion of GDP**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 47

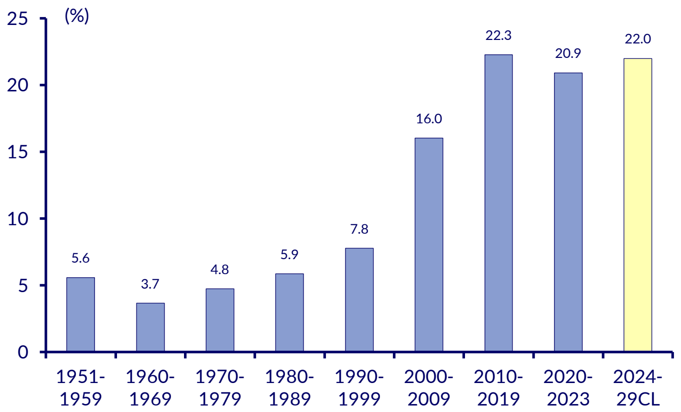
**Exports growth**



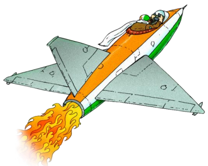

Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 48

**Exports as a proportion of GDP**




Source: Ministry of Statistics and Programme Implementation, CLSA



# Three growth drivers

**Demographic dividend, financial maturity, rupee stability to drive growth**

The upcoming demographic dividend, financial deepening and a relatively stable rupee on sufficient RBI forex reserves should drive India's growth. In our base case, we have not factored in any major government reforms - we believe those could potentially take India's GDP to 3x our base case.

**The coming demographic dividend** should offer relatively cheap labour, on one hand, and, mobilise savings to fund higher investment, on the other. Rising incomes and labour supply will likely boost economies of scale to hold the price line to generate further demand to raise production, employment and incomes.

**Financial deepening**: We expect financial deepening to expand to ensure efficient allocation of resources. The credit/GDP measure, a proxy for financial deepening, should jump to about 120% of GDP by 2052 from 50% at present, consistent with our growth and inflation assumptions.

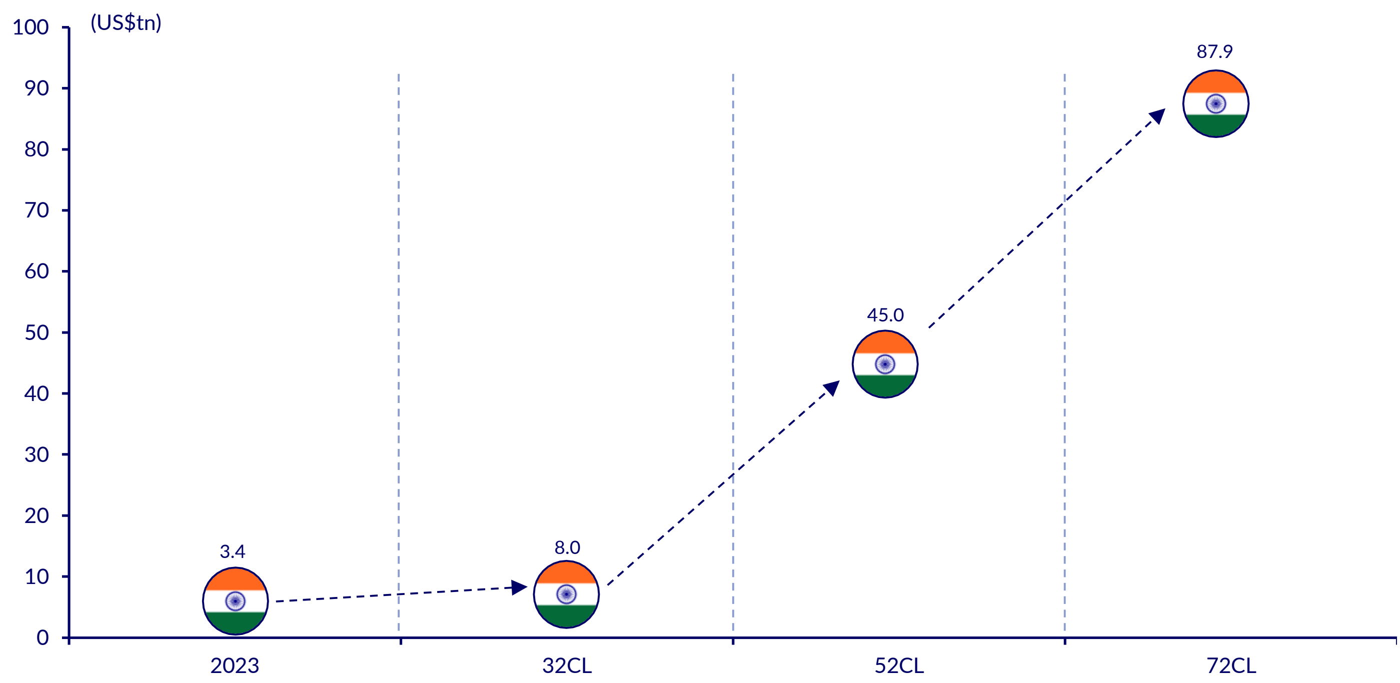
**High forex reserves**: The buffer being built up by the RBI's FX buying should protect the rupee and ensure external stability, in our view. RBI has successfully built up FX reserves to weather each crisis and ensured relative rupee stability.

**. . . these should drive consumption**

All these factors will help improve penetration in terms of consumption as a percentage of population - notwithstanding the present lull due to the post-Covid 19 K-shaped recovery - and raise disposable incomes to power premiumisation, presenting an exciting opportunity for companies.

*Click to rate this research*
Great
Solid
Meh

Figure 49
**India's GDP growth outlook**




Source: CLSA

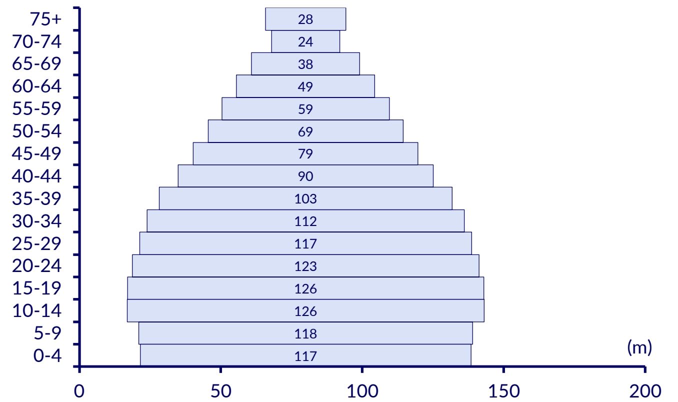
Young population will aid India's growth story

## Demographic dividend

We believe that India will reap the benefit of the coming demographic dividend. The dependency ratio (children and elderly/total population) has consistently fallen to 47% from 73% in the 1990s. It will likely fall further to 30% in 2050.

Figure 50

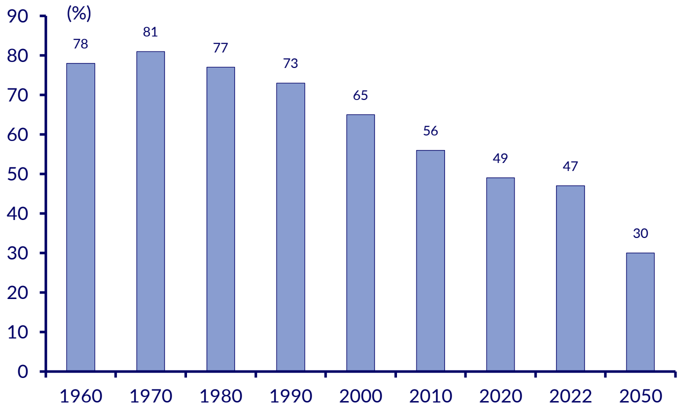
**India population pyramid - 2020**




Source: UNDP, CLSA

Figure 51

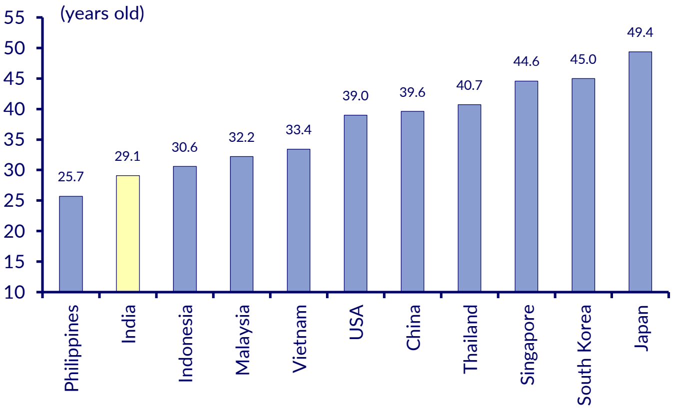
**India's dependency ratio**




Source: World Bank, CLSA

Figure 52

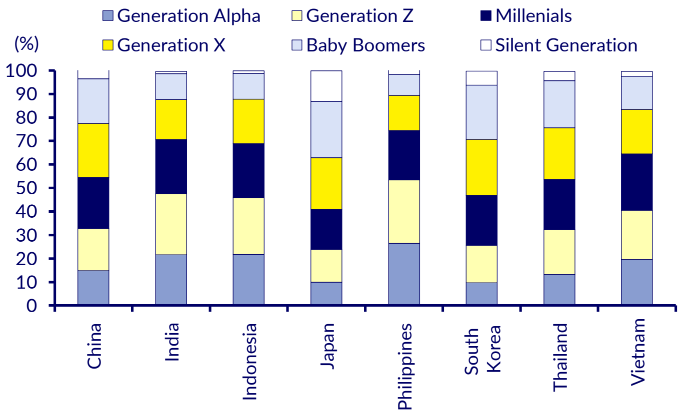
**Median age across economies**




Source: UNDP, CLSA

Figure 53

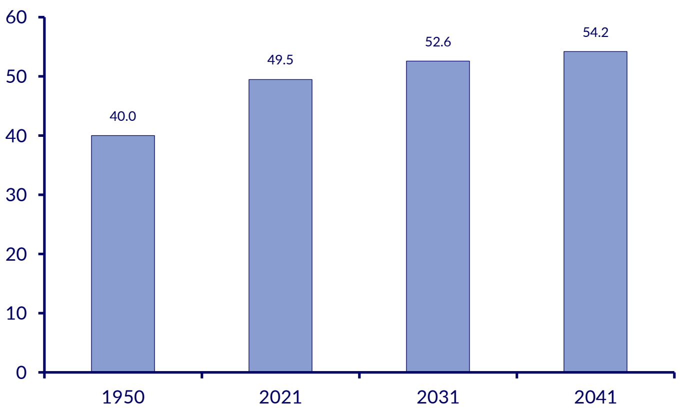
**Population by generation**




Source: CLSA

Figure 54

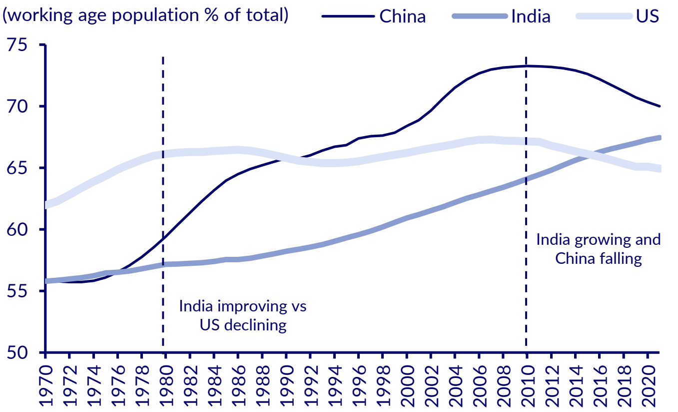
**Working age population projection for India**




Source: UNDP, CLSA

Figure 55

**India's working age population in comparison to China and the US**



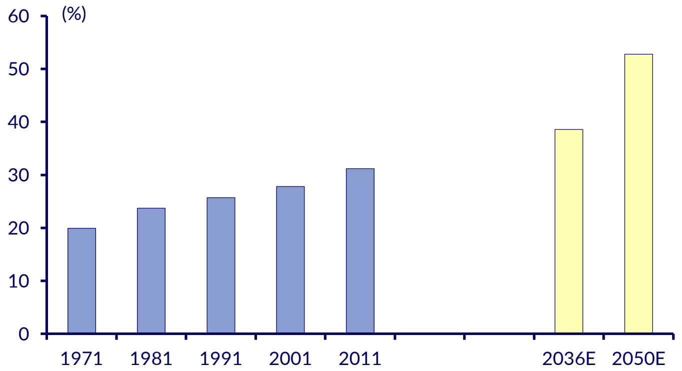

Source: UNDP, CLSA

**Urbanisation will help change lifestyles**

**Urban aspirations changing lifestyles**. Urban aspirations are an integral part of India's young. Urbanisation rate has also steadily risen from 31% in 2010 to 35% in 2021. Progressive urbanisation is inducing a consumer culture, especially as India is set to reap the benefits of demographic dividend over the next 30 years. The shift in urban diets to higher-value horticulture and dairy farming is also raising rural incomes to push rural India towards urban consumption..

Figure 56

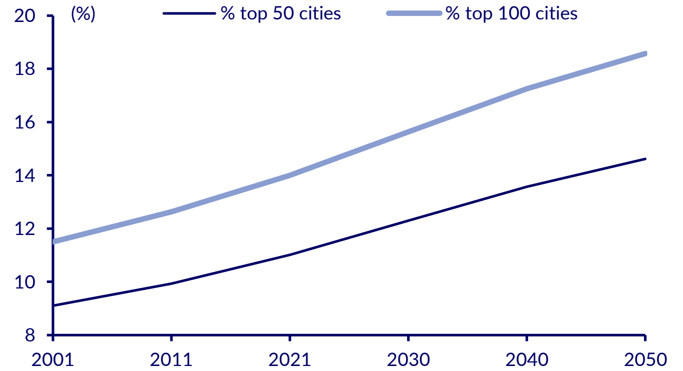
**India urbanisation trend (urban population as a % of total)**




Source: UNDP, CLSA

Figure 57

**Share of top 50/100 cities in population**




Source: World Bank, CLSA

**India to harness the demographic dividend like Asia**

Will India harness the demographic dividend like Asia or dissipate it like Latin America? We believe in the former. Although most of the young will come from India's poorer states, migration to wealthier states will enable them to get employment and send back remittances. This also requires an inclusive society that allows internal mobility.

Figure 58

**Population across states and age groups**

| | 0-19 years | | | | 20-59 years | | | | 60 years and above | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **States** | **2011** | **2021** | **2031** | **2041** | **2011** | **2021** | **2031** | **2041** | **2011** | **2021** | **2031** | **2041** |
| **India** | **40.9** | **34.5** | **28.8** | **25.2** | **50.5** | **55.8** | **58.8** | **58.9** | **8.6** | **9.7** | **12.4** | **15.9** |
| Andhra Pradesh | 34.8 | 28.4 | 24.4 | 21.4 | 55.1 | 59.6 | 60.2 | 58.6 | 10.1 | 12 | 15.4 | 20 |
| Assam | 42.7 | 35.4 | 29.1 | 26.8 | 50.6 | 56.7 | 60.1 | 58.8 | 6.7 | 7.9 | 10.9 | 14.4 |
| Bihar | 49.4 | 43.5 | 35.1 | 30.1 | 43.2 | 48.9 | 55.9 | 58.3 | 7.4 | 7.7 | 9.1 | 11.6 |
| Chhattisgarh | 42.3 | 36 | 30.5 | 27.2 | 49.9 | 55 | 58 | 58.5 | 7.9 | 8.9 | 11.6 | 14.4 |
| Delhi | 37.2 | 29.2 | 23.5 | 20.2 | 56 | 61.1 | 61.9 | 58.5 | 6.8 | 9.7 | 14.6 | 21.2 |
| Gujarat | 38.7 | 33.2 | 28.6 | 25.1 | 53.3 | 56.8 | 58.2 | 57.9 | 8 | 9.9 | 13.2 | 17 |
| Haryana | 40.3 | 33.5 | 28.4 | 24.9 | 51 | 57.1 | 59.5 | 59.3 | 8.7 | 9.5 | 12.1 | 15.8 |
| Himachal Pradesh | 35.3 | 29 | 24.5 | 22 | 54.5 | 58.8 | 59.3 | 56.9 | 10.3 | 12.2 | 16.1 | 21.1 |
| Jammu & Kashmir | 43.7 | 33.8 | 24.5 | 23 | 48.9 | 57.1 | 62.9 | 59.8 | 7.4 | 9.1 | 12.6 | 17.2 |
| Jharkhand | 45.9 | 38.8 | 31 | 28 | 46.9 | 52.8 | 58.5 | 58.7 | 7.2 | 8.4 | 10.6 | 13.4 |
| Karnataka | 35.8 | 29.8 | 25 | 21.7 | 54.7 | 59 | 60.5 | 59.3 | 9.5 | 11.1 | 14.5 | 19 |
| Kerala | 31.3 | 27.6 | 24.9 | 23.3 | 56.2 | 56.2 | 54.7 | 52.8 | 12.6 | 16.2 | 20.5 | 23.9 |
| Madhya Pradesh | 43.8 | 38 | 31.8 | 27.3 | 48.4 | 53.7 | 57.6 | 59.3 | 7.9 | 8.3 | 10.6 | 13.4 |
| Maharashtra | 36.2 | 29.5 | 24.1 | 21.2 | 53.9 | 59 | 60.9 | 59 | 9.9 | 11.5 | 14.9 | 19.7 |
| Odisha | 38.2 | 32.6 | 28.3 | 26.1 | 52.3 | 56.7 | 58.2 | 57.3 | 9.5 | 10.8 | 13.4 | 16.6 |
| Punjab | 35.8 | 28.2 | 23.8 | 21 | 53.9 | 59.5 | 60.2 | 58.4 | 10.4 | 12.3 | 16 | 20.6 |
| Rajasthan | 45.5 | 38.3 | 31.5 | 27.3 | 47.1 | 53.4 | 58 | 59.5 | 7.5 | 8.2 | 10.4 | 13.3 |
| Tamil Nadu | 32.3 | 27 | 23.2 | 20.6 | 57.3 | 59.7 | 59.2 | 56.9 | 10.4 | 13.3 | 17.6 | 22.6 |
| Telangana | 37 | 30 | 26 | 23 | 53.8 | 59.4 | 60.5 | 58.8 | 9.2 | 10.6 | 13.5 | 18.2 |
| Uttar Pradesh | 47.6 | 39.4 | 32.6 | 27.7 | 44.6 | 52.7 | 57.9 | 60.3 | 7.8 | 7.9 | 9.5 | 12 |
| Uttarakhand | 42.2 | 35.2 | 29.4 | 24.1 | 48.8 | 55.1 | 58.6 | 60.6 | 9 | 9.7 | 12.1 | 15.3 |
| West Bengal | 37.1 | 29.1 | 24.2 | 21.9 | 54.4 | 59.8 | 60.6 | 58.4 | 8.5 | 11.1 | 15.2 | 19.7 |

Source: Government of India, Economic Survey, CLSA

States with high GDP seeing higher migration of workers

Figure 59

**States with GDP, population and migration as a % of total**

| | GDP share (%) | Population share (%) | Net Migration share (%) |
|---|---|---|---|
| Maharashtra | 15.7 | 9.3 | 7.7 |
| Uttar Pradesh | 9.2 | 16.5 | (6.1) |
| Tamil Nadu | 9.1 | 6.0 | - |
| Gujarat | 8.2 | 5.0 | 8.3 |
| West Bengal | 7.5 | 7.5 | (1.0) |
| Karnataka | 6.2 | 5.1 | 3.5 |
| Rajasthan | 5.5 | 5.7 | (2.6) |
| Andhra Pradesh | 4.9 | 4.1 | (1.0) |
| Madhya Pradesh | 4.6 | 6.0 | (1.3) |
| Delhi | 4.3 | 1.4 | 30.7 |
| Kerala | 4.2 | 2.8 | (2.9) |
| Telangana | 4.2 | 2.9 | na |
| Haryana | 4.1 | 2.1 | 11.8 |
| Bihar | 3.7 | 8.6 | (10.2) |
| Punjab | 3.4 | 2.3 | 7.7 |
| Odisha | 2.9 | 3.5 | (2.6) |
| Chhattisgarh | 2.0 | 2.1 | 2.2 |
| Jharkhand | 1.8 | 2.7 | - |
| Assam | 1.7 | 2.6 | (1.6) |
| Uttarakhand | 1.3 | 0.8 | 6.4 |
| Jammu & Kashmir | 0.9 | 1.0 | (2.9) |
| Himachal Pradesh | 0.9 | 0.6 | 1.2 |
| Goa | 0.5 | 0.1 | 24.3 |
| Chandigarh | 0.3 | 0.1 | na |
| Tripura | 0.3 | 0.3 | 1.0 |
| Meghalaya | 0.2 | 0.3 | 1.9 |
| Puducherry | 0.2 | 0.1 | na |
| Nagaland | 0.2 | 0.2 | 4.8 |
| Manipur | 0.2 | 0.2 | (5.1) |
| Arunachal Pradesh | 0.1 | 0.1 | 11.2 |
| Sikkim | 0.1 | 0.1 | 12.5 |
| Mizoram | 0.1 | 0.1 | 3.5 |

Source: Census, CLSA

India following a services led model of growth and employment

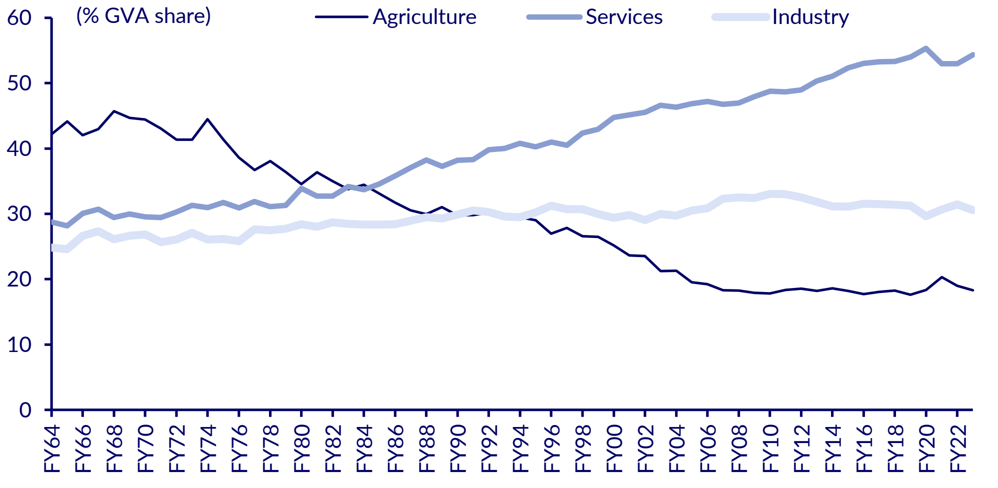
**Services-led growth, employment**. Can India generate sufficient jobs without large scale manufacturing? We think that the Indian economy is charting a new paradigm of services-led growth. Conventional wisdom has industry generating forward linkages to services. In the Indian case, we see services radiating forward linkages to industry/infrastructure.

Empirical studies find that the employment elasticity of industry and services are similar. It is true employment is largely informal and unorganised. Agriculture is still the main employer for households but its share in the overall gross value added (GVA) has been falling. On the other hand, services have seen a rise in employment and contribution to GVA with most of the jobs being formal. Increase in women participation, particularly in the rural areas, would help raise per capita consumption for India and widen the labour force.

**Services share has been rising and agriculture has been falling**

Figure 60

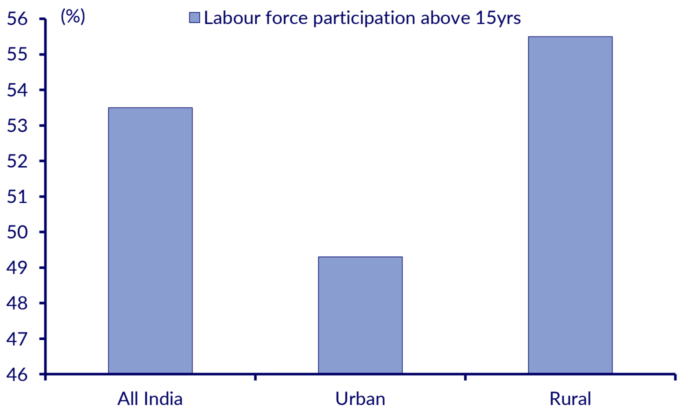
**Share of agriculture, services and manufacturing in GVA**




Source: Ministry of Statistics and Programme Implementation, CLSA

Figure 61

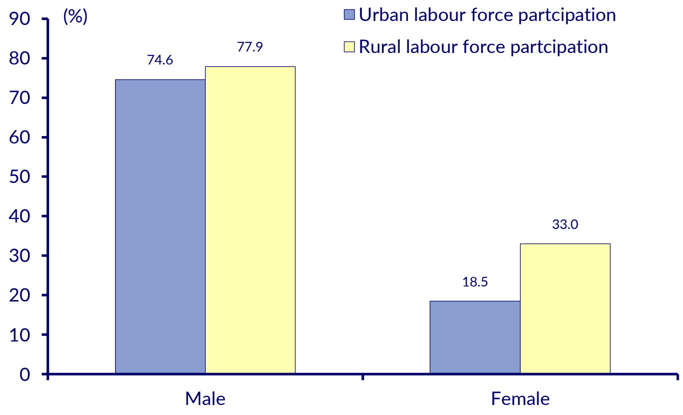
**Labour force participation rate**




Source: Government, CLSA

Figure 62

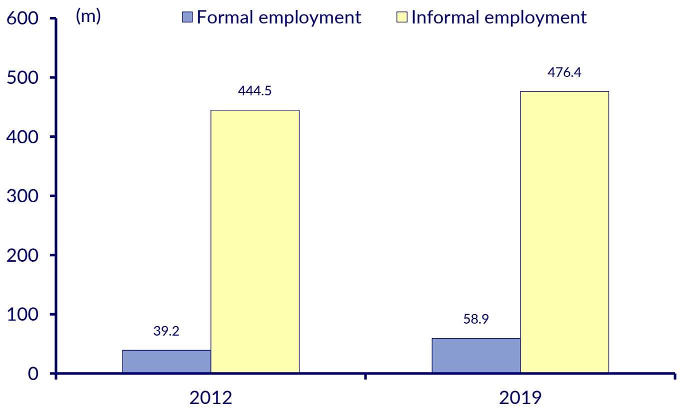
**Urban and rural labour force participation**




Source: Government, CLSA

Figure 63

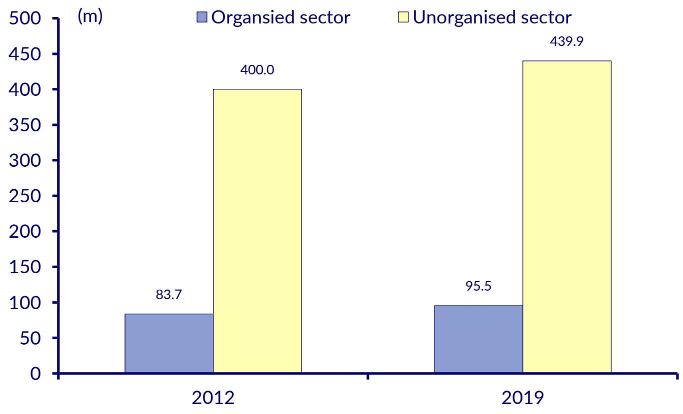
**Formal and informal employment**




Source: Government, CLSA

Figure 64

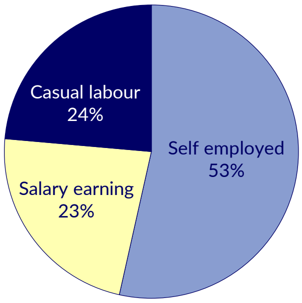
**Organised and unorganised employment**




Source: Government, CLSA

Figure 65

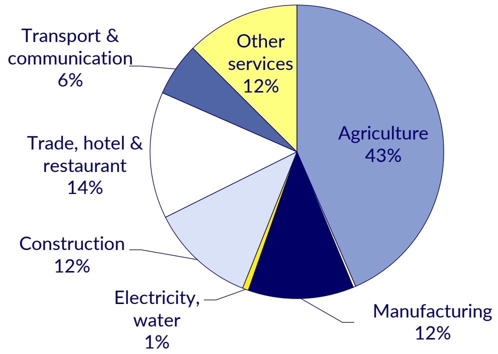
**Labour force employment by type**




Source: Government, CLSA

Figure 66

**Labour force employment by sector**




Source: Government, CLSA

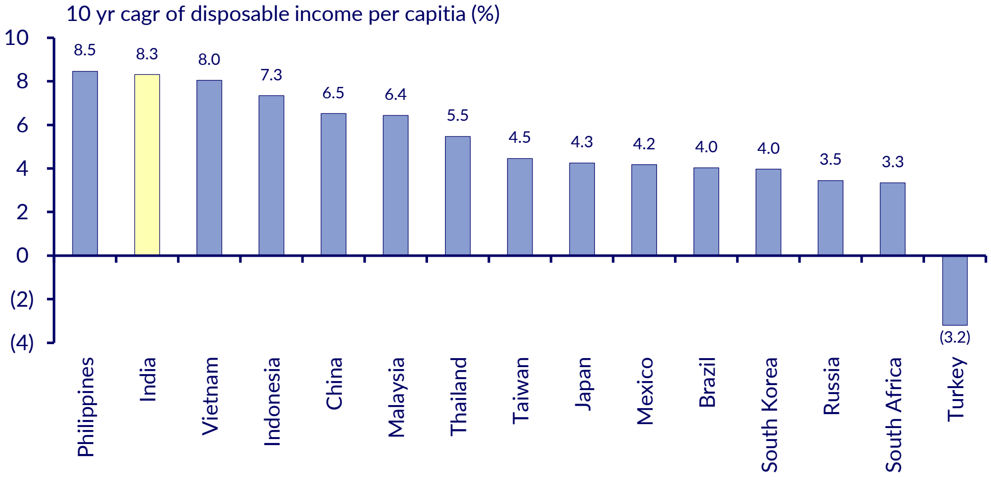
**Low penetration levels imply high potential to acquire customers**

**Penetration opportunity**. Under penetration can be seen in most segments, providing room for companies to acquire customers, especially when disposable income growth for India is expected to be one of the highest globally. Key sectors that should benefit from this are autos and consumer durables; financials have seen some gain, but there is scope for more expansion. As incomes rise, premiumisation is emerging as a theme as well, powered by the post-Covid-19 K-shaped recovery right now.

**Disposable incomes in India have increased in the last 10 years**

Figure 67

**Disposable income growth across countries**

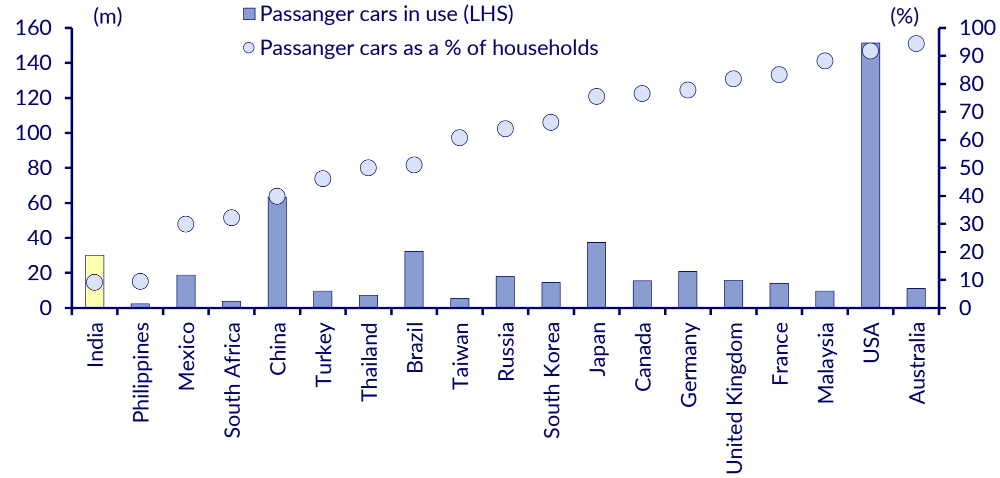



Source: IMF, Euromonitor, CLSA

**Under penetration in passenger cars**

Figure 68

**Passenger car in use and as a % of household**

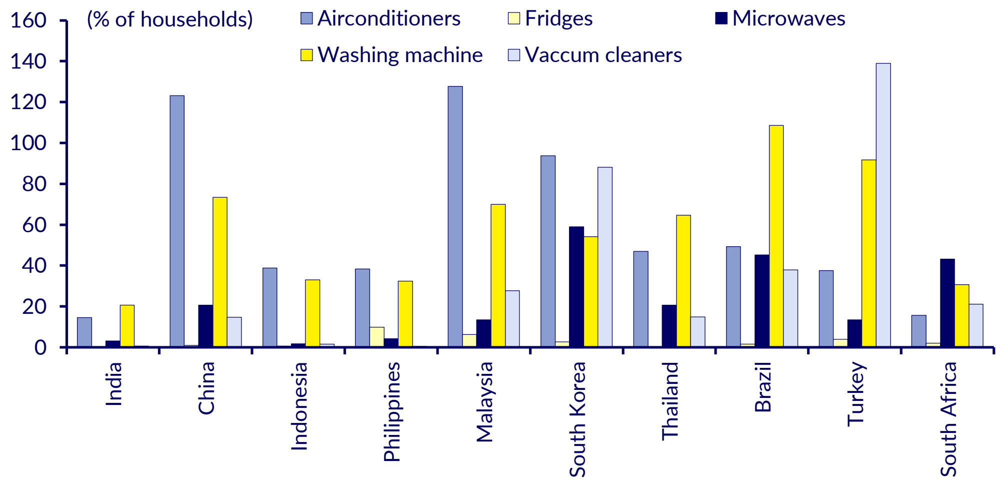



Source: Euromonitor, SIAM, CLSA

**Under-ownership in appliances**

Figure 69

**Appliances by proportion of households**

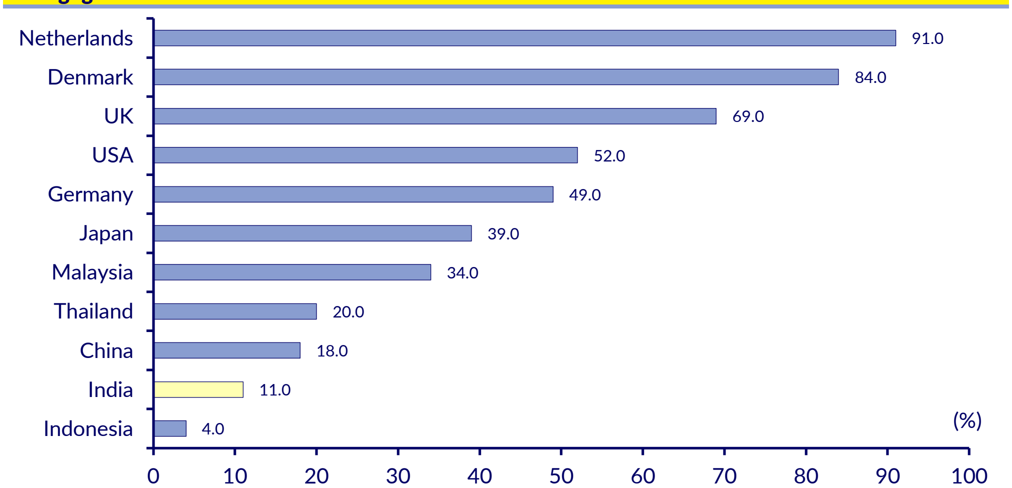



Source: Euromonitor, CLSA

**Mortgage credit is low**

Figure 70

**Mortgage as a % of GDP**

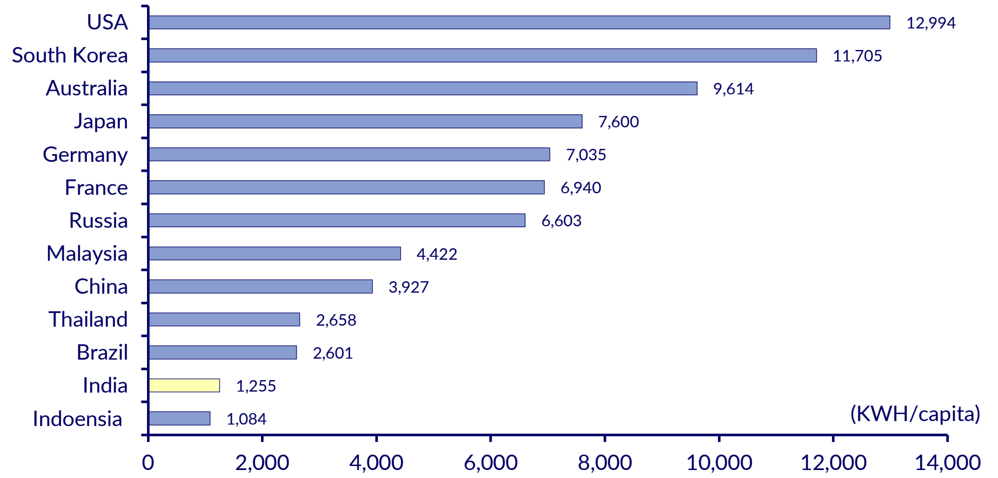



Source: HDFC, CLSA

**Electricity consumption per capita is one of the lowest**

Figure 71

**Electricity consumption as a % of GDP**

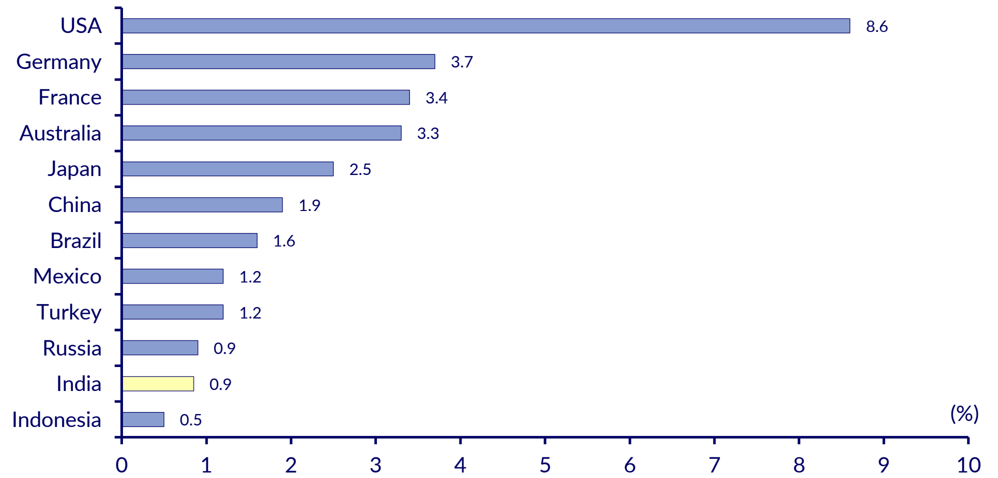



Source: IEA, CLSA

**General insurance premium has room to grow**

Figure 72

**General insurance premium as a % of GDP**

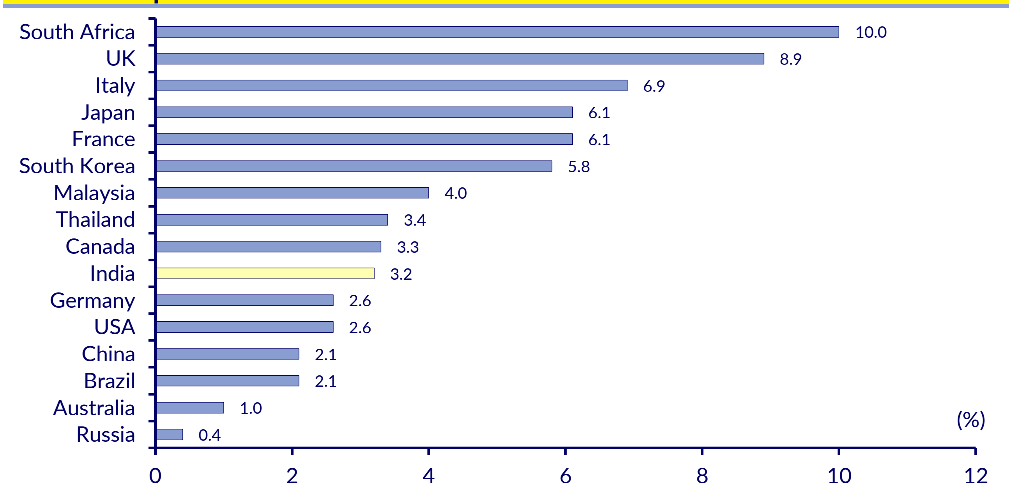



Source: ICICI Lombard, HDFC Life, CLSA

**Life insurance penetration is low**

Figure 73

**Life insurance premium as a % of GDP**




Source: ICICI Lombard, HDFC Life, CLSA

Credit to GDP has room to improve

## Financial deepening . . .

We see financial deepening to improve allocative efficiency to promote growth. This is especially important as India is a bank economy rather than a capital-market-based economy. Further, financial inclusion is freeing the deprived sections of society from usury.

### . . . improves allocative efficiency

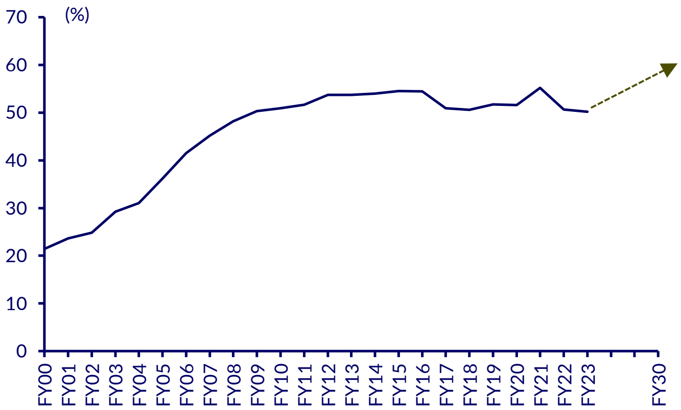
We believe financial deepening will improve allocative efficiency to promote growth. Bank credit, a standard measure of financial deepening, should climb to 60% of GDP by FY30 from 50% currently. This assumes a 13% growth assuming 6% real GDP growth, 5.5% inflation and credit elasticity of growth of 1.2x, *ie*,

Credit growth = 1.2 * real GDP growth rate + 5.5% inflation

India's bank credit to GDP ratio is still very low as compared to its BRIC peers. It is also well below that of Japan, although the two economies are coming close in terms of size.

Figure 74

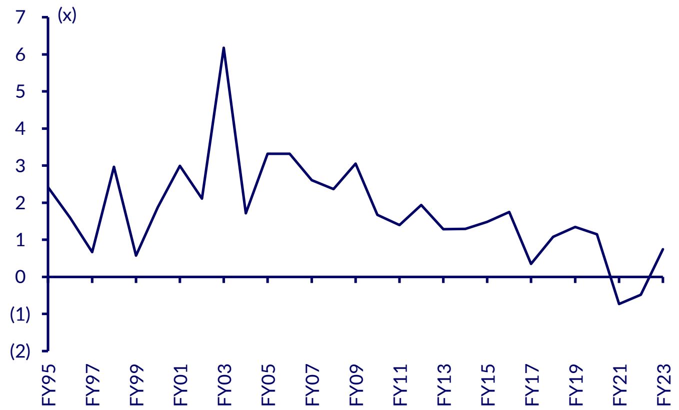
**Bank credit to GDP**




Source: RBI, CLSA

Figure 75

**Credit elasticity of growth**

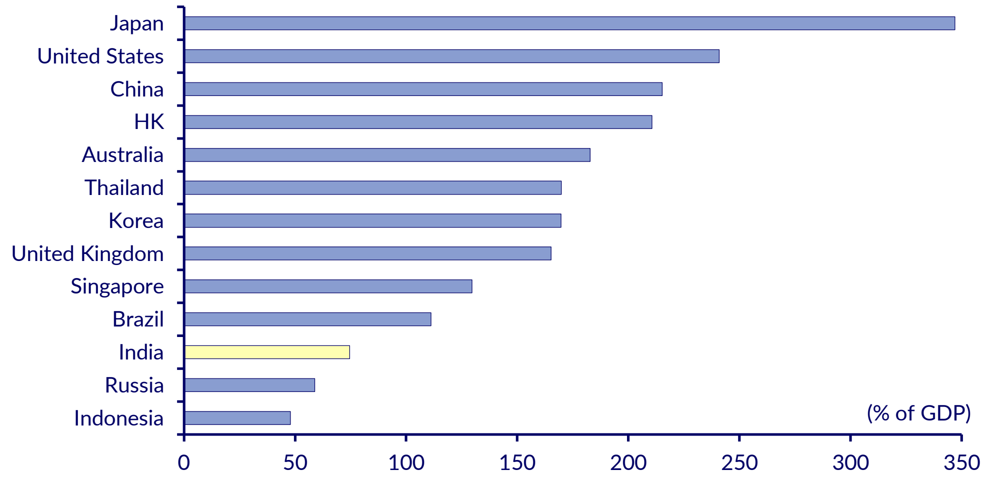



Source: RBI, CLSA

Credit by financial sector share is low in India

Figure 76

**Credit provided by financial sector as a % of GDP**




Source: Euromonitor, CLSA

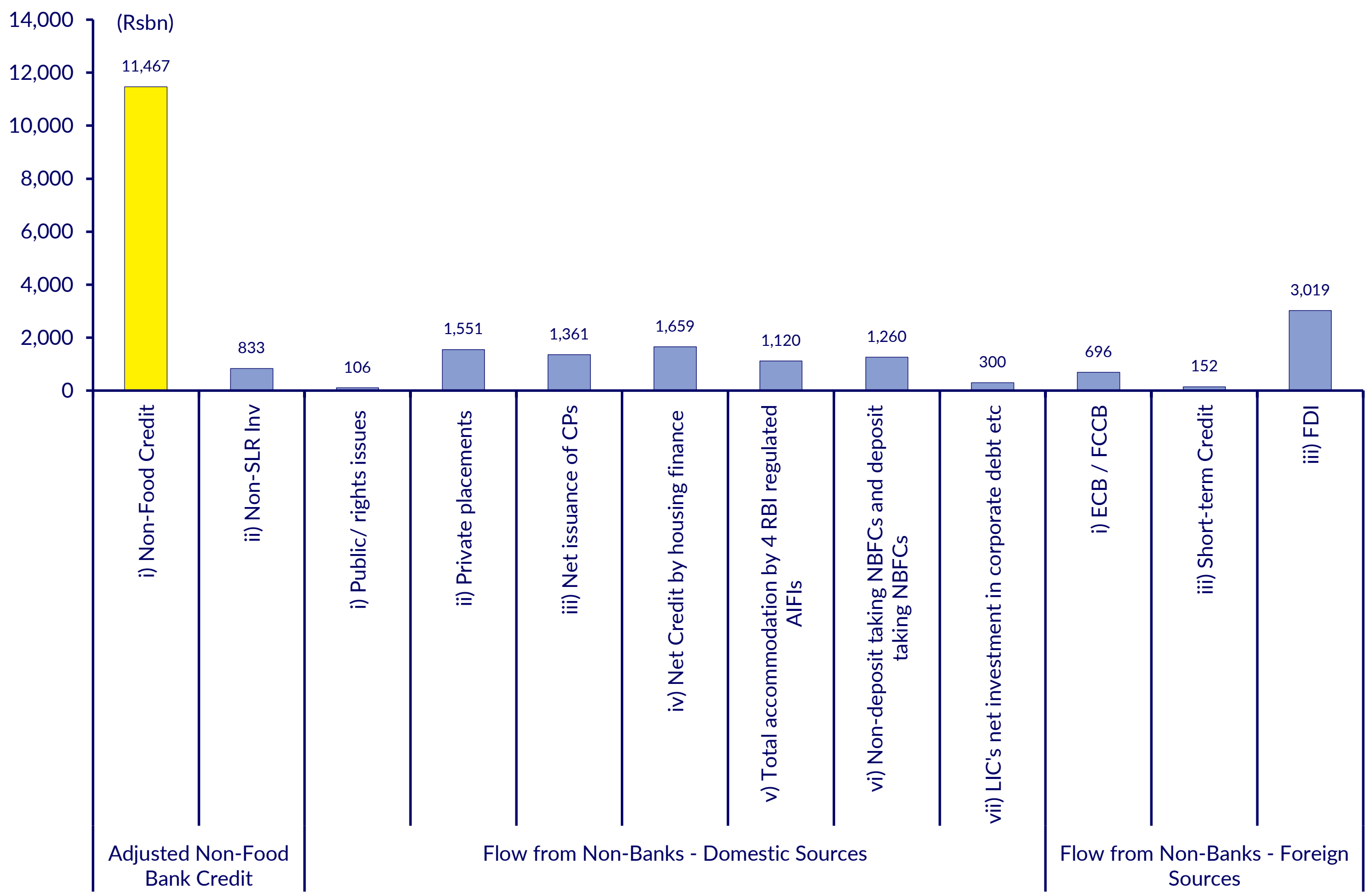
Financial deepening is important

## India is a bank based economy

Financial deepening is all the more important in a bank-based economy like India. In which banks rather than capital markets raise resources for growth. Bank funding is currently 6.4% of GDP, compared to primary equity markets that have raised just 0.8% of GDP.

Figure 77

**Flow of resources to commercial sector in India (FY19)**




Source: RBI, SEBI, BSE, NSE, Merchant Banks, LIC and NHB

Bank credit remains the most consistent source of economic funding. Primary equity market financing is, by and large, restricted to boom years. In addition, bond financing is constricted by the absence of a mature debt market. Finally, foreign direct investment (FDI) generally flows only into the financial and service sectors. We believe the RBI will maintain the banks' dominant role at the centre of the payments network, even if it means restricting fintech growth. Learning from the past, it is trying to pro-actively contain non-performing asset risks.

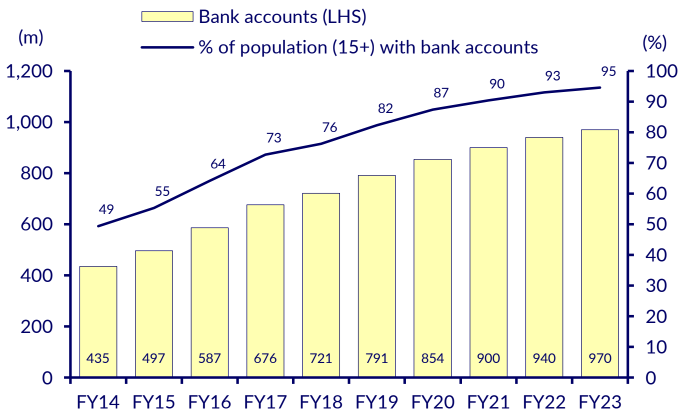
Micro finance, Jan Dhan accounts, fintech

## Financial inclusion is taking banking to the last mile

The government and the RBI have intensified financial deepening for over 50 years. The government has nationalised several banks since 1969 to extend branch banking in rural India. The RBI began focusing on microfinance in the past 15-20 years, including creating self-help groups. This was buttressed by the appointment of *bank bandhus* who open deposit accounts for the disadvantaged sections, and the *Jan Dhan Scheme* that offers no-frills accounts with parallel life insurance.

Figure 78

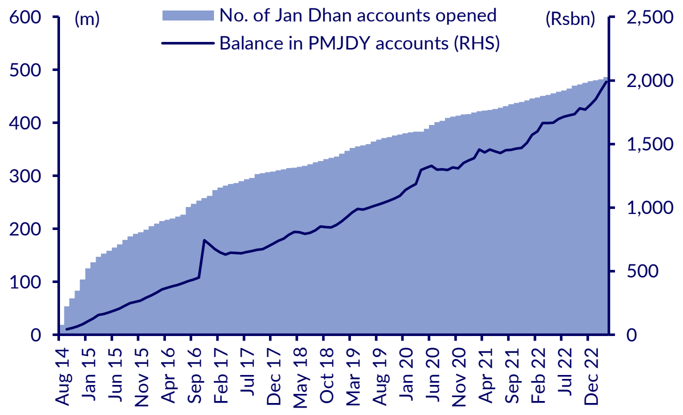
**Bank accounts as a % of population**




Source: RBI, CLSA

Figure 79

**Jan Dhan bank accounts**

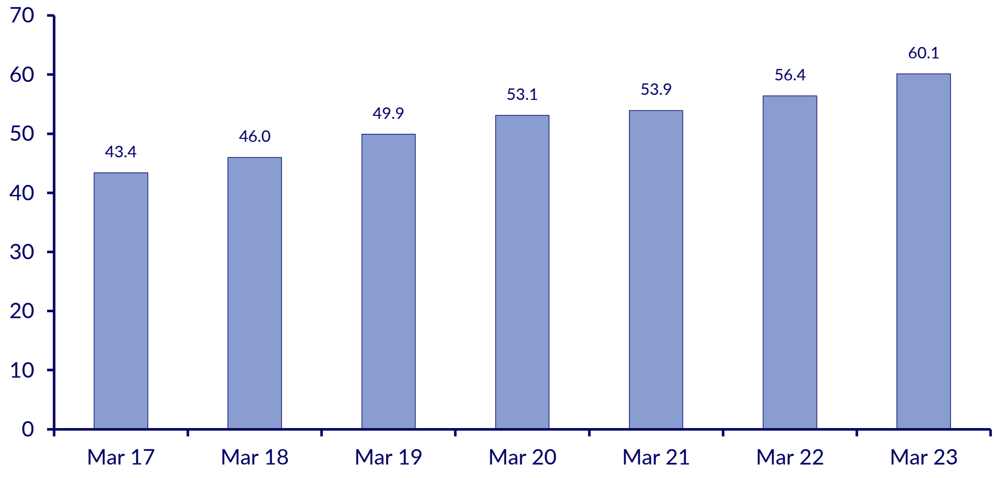



Source: Ministry of Finance, CLSA

**Financial inclusion is improving**

Figure 80

**RBI's financial inclusion index**




Source: RBI, CLSA

**Favourable demographics has contributed to India's success story**

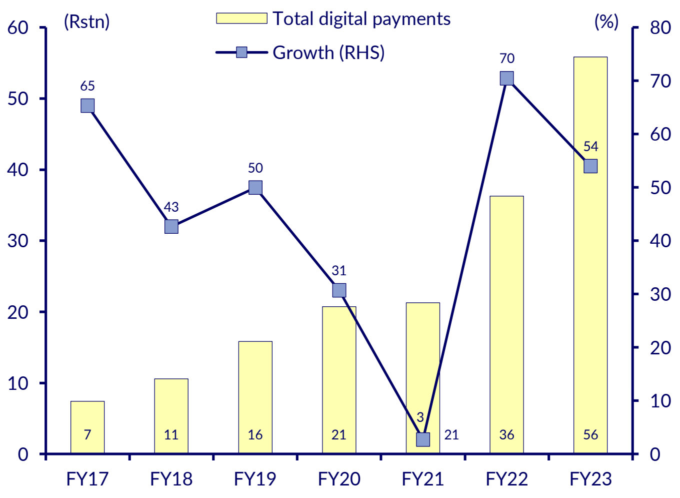
According to our financial analysts, India is evolving as one of the largest fintech markets. While many factors like favourable demographics, rising mobile penetration, and availability of engineering talent pool have contributed to the success story, the role of the government/industry bodies in developing the India Stack is unique; it forms the bedrock of fast-paced fintech evolution. The first two layers, presenceless/paperless (Aadhaar) and cashless (UPI), have aided the rapid financial inclusion and digitisation of payments. The upcoming two layers, consent (Account aggregator (AA)) and credit (open credit enablement network - OCEN), have the potential to further drive significant innovations by democratising lending. Finally, the RBI's e-Rupee will also aid last mile connectivity.

**India's digital payments to cross 30% of private consumption from 15% in FY21**

Our analysts estimate that digital payments (debit cards + credit cards + UPI P2M) by consumers to merchants increased from 5% of consumption spending equivalent in FY16 to +15% in FY21 and are likely to reach 20% in FY22. While consumption witnessed a 9-10% Cagr over FY16-21 (adjusting for the Covid dip), digital payments driven by UPI saw a Cagr of over 40%, leading to a higher share of consumption spending. With increased use cases of digital payments and likely high growth in online consumption, we expect digital payments to increase to 30%, equivalent to private consumption and +20% of GDP. This implies a growth of 27% cagr in digital payments over FY21-26CL.

Figure 81

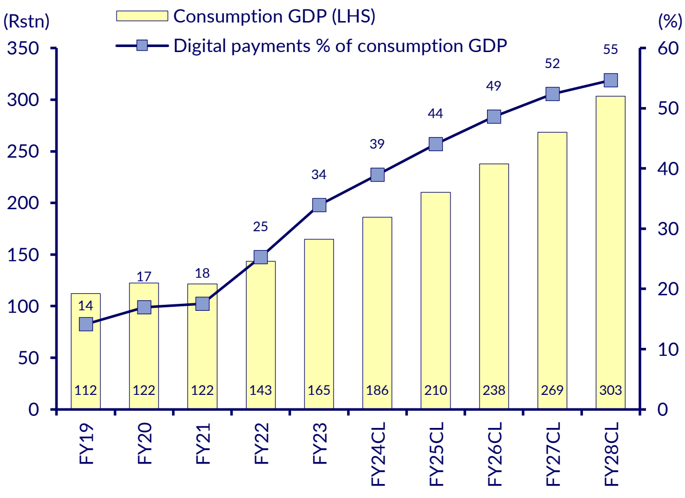
**Digital payment growth**




Source: RBI, CLSA

Figure 82

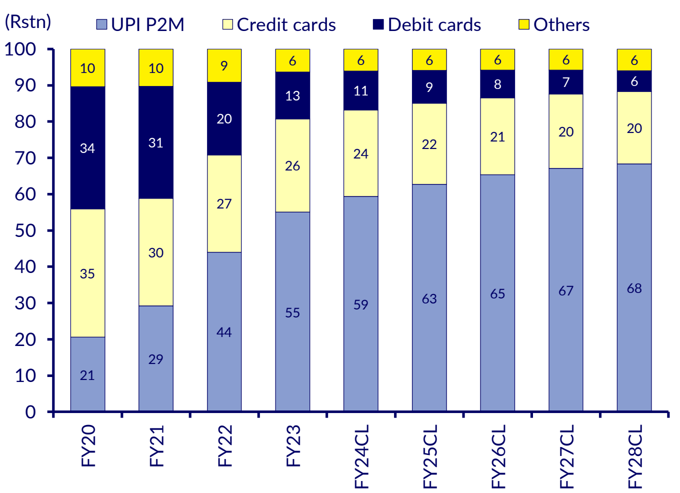
**Digital payments as a % of consumption**




Source: RBI, CLSA

Figure 83

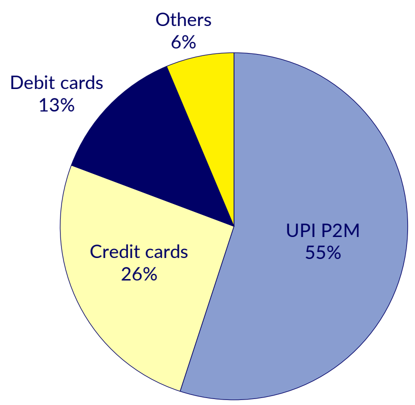
**Mix of digital payments**




Source: RBI, CLSA

Figure 84

**Transaction value by method**




Source: RBI, CLSA

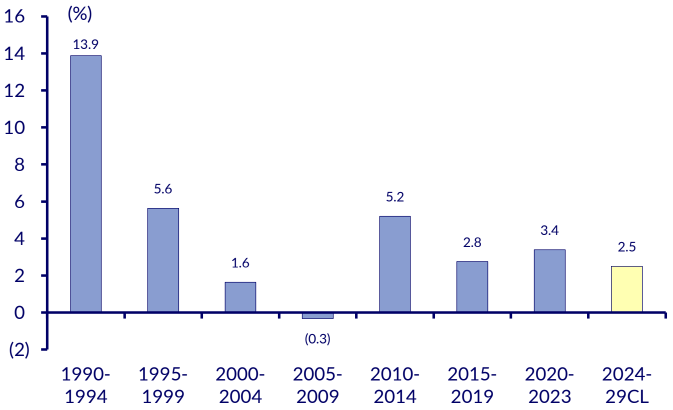
Rupee to trade in a stable range

## High forex reserves stabilising rupee

A rapid build-up of forex reserves of over 6% of GDP by RBI Governor Shaktikanta Das has sparked off a virtuous cycle in the rupee. This is stabilising the currency to step up forex flows. We assess forex reserves are at the US$600bn adequate level. The RBI will likely still buy forex as the US dollar weakens to guard against contagion. On balance, we see depreciation slowing to an average of 2% a year from 5.1% in FY13-20 with higher forex reserves fending off speculative attacks.

Figure 85

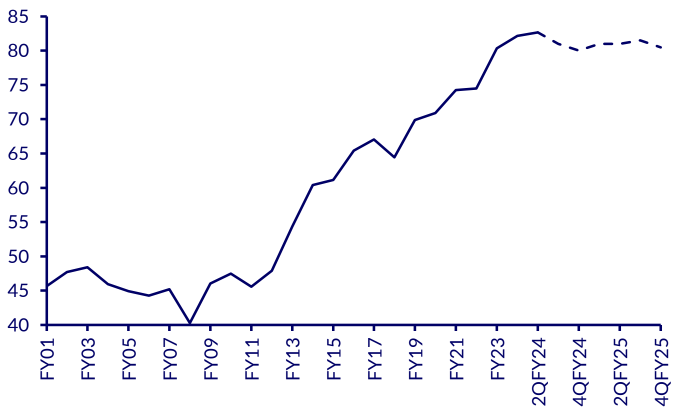
**Rupee depreciation**




Source: Bloomberg, CLSA

Figure 86

**INR/USD**




Source: Bloomberg, CLSA

**RBI is building high forex reserves to stabilise rupee expectations**

The RBI has certainly fully seized the opportunity offered by the surge in global liquidity, the fall in oil prices in 2020, the collapse in domestic import demand due to the Covid-19 shock, and the jump in capital inflows. Even after selling almost US$100bn during 2021, RBI's forex reserves are a comfortable US$600bn that we deem adequate.

**Forex reserves are insurance cover against contagion**

This begs the question, why are forex reserves so important? Because the rupee is vulnerable to speculative attacks given India's chronic and often large current account deficit. It is natural that investors want to ensure that their investments are not eroded by high depreciation. High forex reserves provide RBI with the comfort to fund any outflow without any runaway depreciation. Experience tells us that bullet issuances of foreign currency deposits with a government/RBI exchange rate guarantee - Resurgent India Bonds (1998), India Millennium Deposits (2001) and FCNRB deposits with swap subsidy (2013) - to boost forex reserves were all successful in containing the rupee crises.

**Building forex reserves is now an official forex policy**

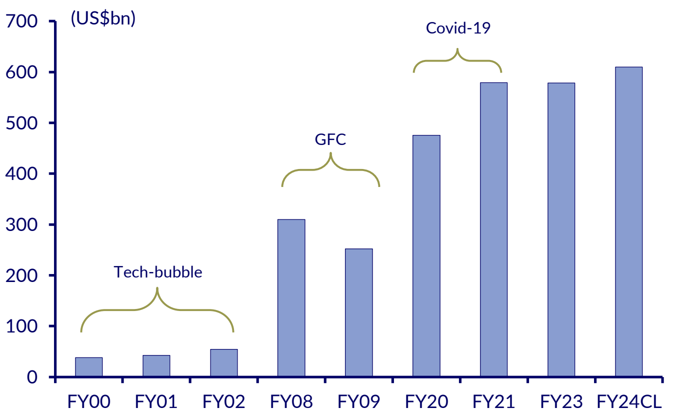
In fact, the RBI has shifted to an explicit policy of building forex reserves from the earlier "official" policy of intervening to smoothen rupee volatility: ". . . Sustained accretion to foreign exchange reserves has improved reserve adequacy . . . Sound external sector indicators augur well for limiting the impact of spillovers of possible global shocks and financial stability concerns as investors and markets are credibly assured of the buffer against potential contagion... Under uncertain global economic environment, EMEs typically remain at the receiving end. In order to mitigate global spillovers, they have no recourse but to build their own forex reserve buffers, even though at the cost of being included in currency manipulators list or monitoring list of the US Treasury . . ."

**Virtuous rupee cycle to push up FPI investments to 1% of GDP**

Against this backdrop, we see a virtuous cycle of the rupee that should drive up FPI inflows into India to 1% of GDP from 0.3% in the past 10 years.

Figure 87

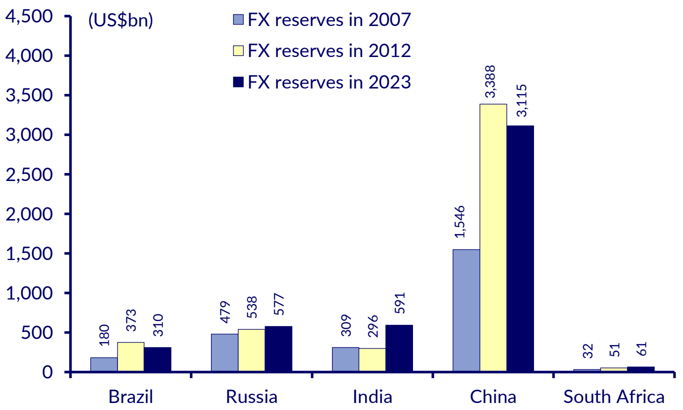
**RBI forex reserves**




Source: RBI, CLSA

Figure 88

**BRIC forex reserves**




Source: Bloomberg, CLSA

**Little currency manipulator risk**

We are not surprised that the RBI is building up forex reserves to strengthen external stability despite being put on the US currency manipulator watch list. It is unlikely that the RBI will ever satisfy the three criteria for currency manipulator: a bilateral trade surplus with the US of more than US$20bn, a current account surplus of at least 3% of GDP and net purchases of foreign currency of 2.5% of GDP over 12 months.

**Oil prices, FPI flows and the rupee often co-move together**

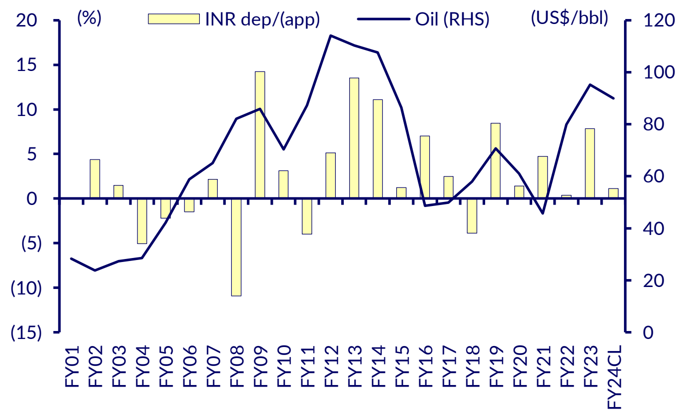
## Oil prices not necessarily a risk to rupee

Will higher-than-expected oil prices hurt the currency? Not necessarily. As Figures 89-90 show, the risk-on/-off trends that drive up/pull down oil prices also typically bring in/drive out FPI flows to emerging markets like India. It is really at extremes in oil prices that investors shift to/from India as a major oil importer.

In any case, the development of alternate sources of energy and the switch to electrical vehicles should reduce the oil import bill and the current account deficit. We assess the impact of the shift from fossil fuel vehicles (ICEs) to electric vehicles (EVs) on government finances. Our oil auto analysts forecast the shift to EVs would lead to savings in fuel consumption (c.US$119bn) for the consumer in FY24-32.

Figure 89

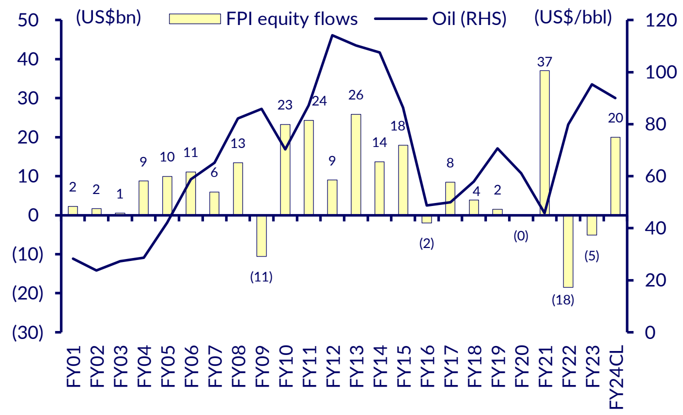
**Oil prices and rupee**




Source: CLSA, Bloomberg

Figure 90

**Oil prices and FPI equity flows**




Source: CLSA, Bloomberg

High import cover, FPI cover, short-term debt cover

**Forex reserves fortifying BoP indicators**

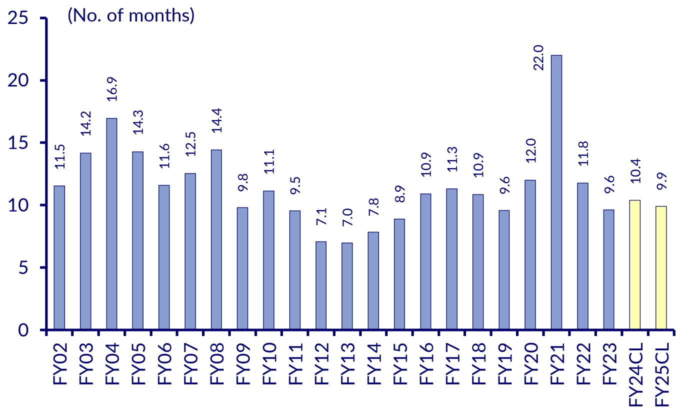
**Import cover**: India's foreign exchange reserves have risen to about 10 months of FY24 imports from a cover ratio of seven months recorded during the 2013 taper. It had shot up in FY21-22 due to the Covid-19 shock. Experience suggests that the rupee depreciates if the import cover falls below eight months (Figures 91-92).

**External debt cover**: FX reserves/short-term external debt of 1-year residual maturity have climbed to 2.1x from 1.7x in 2013, well above the 1x Greenspan-Guidotti rule (Figures 93-94).

**FPI cover**. FPI investments/forex reserves (including forwards) are still contained at about 100% (up from 74% in FY12) despite the jump in equity prices (Figures 95-96).

Figure 91

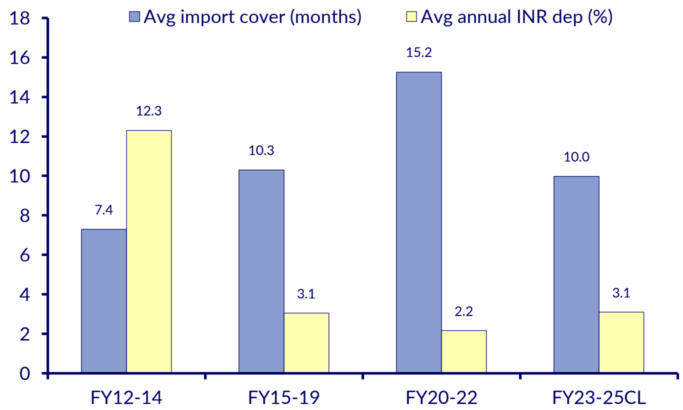
**Import cover**




Source: RBI, CLSA

Figure 92

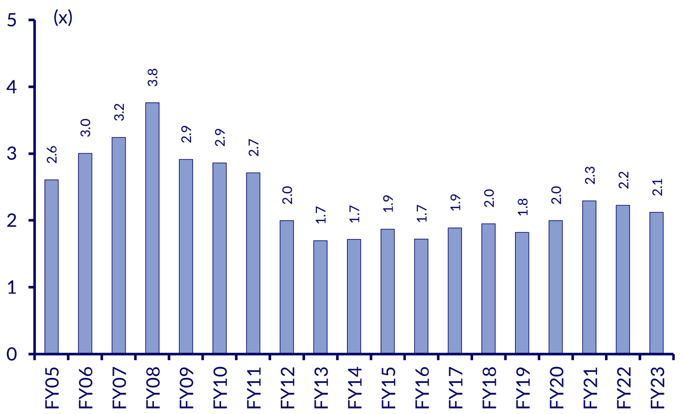
**Import cover and rupee change**




Source: RBI, CLSA

Figure 93

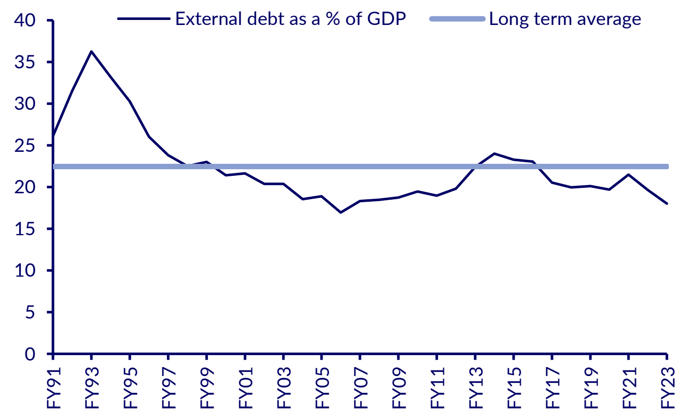
**Short-term external debt cover**




Source: RBI, Ministry of Economic Affairs, CLSA

Figure 94

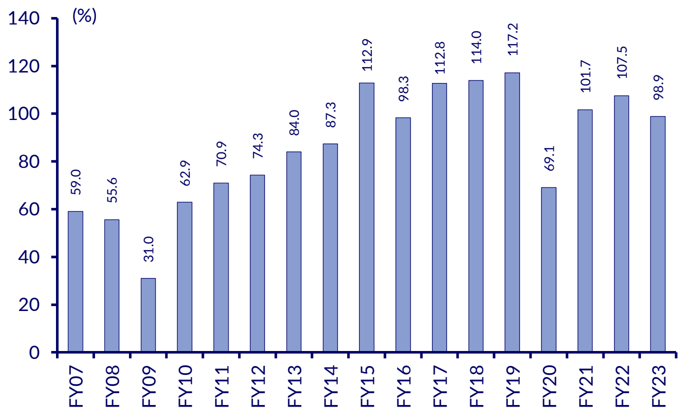
**External debt as a % of GDP**




Source: RBI, Ministry of Economic Affairs, CLSA

Figure 95

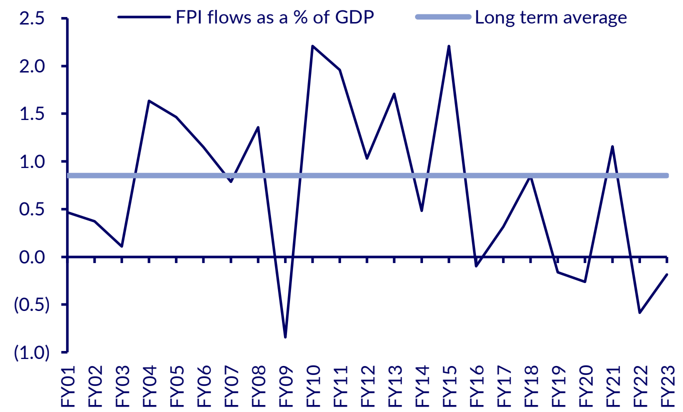
**FPI cover**




Source: RBI, Bloomberg, CLSA

Figure 96

**FPI flows as a % of GDP**




Source: RBI, Bloomberg, CLSA

**Rupee will continue to outperform EM peers resulting in a step up in FPI flows and cheaper project finance**

**Stable rupee to step up forex flows, project finance**

**Stable currency**: Large depreciations of 2011, 2013 and 2018 are history, in our view. Not surprisingly, the rupee (0.2% depreciation) has held on against peers during the Covid-19 shock (Figure 97). Fed easing is likely to cause US dollar depreciation in FY25, which will aid rupee.

**Step up in forex flows**: We expect FPI flows to rise to 1% of GDP on a stable rupee from 0.3% during FY14-20 (Figure 98).

**Cheaper project finance**: as Indian corporates will be able to raise long-term money far cheaper.

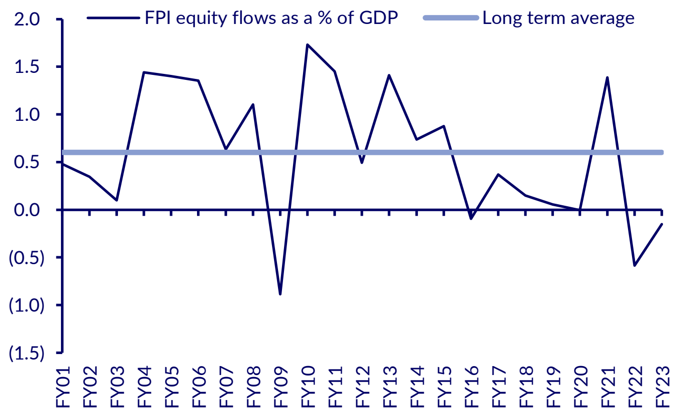
Figure 97

**Depreciation (appreciation) by select currencies, March 2020 - March 2022**


Source: CLSA, Bloomberg

Figure 98

**FII equity flows as a % of GDP**




Source: CLSA, Bloomberg

**Adequate import, FPI, short-term external debt cover**

**RBI will keep buying forex reserves: US$600bn adequate**

We expect RBI Governor Das to continue to build forex reserves to guard against contagion in an uncertain world. The RBI should continue to buy forex reserves when the US dollar weakens.

This begs the question, how much of forex reserves should the RBI target? We prefer to pitch "adequate" forex reserves at US$600bn based on the following criteria:

**10 months import cover**: This works out to US$590bn, estimated by taking imports at 20% of GDP, at a normalised growth of 10% nominal GDP growth in FY21-22.

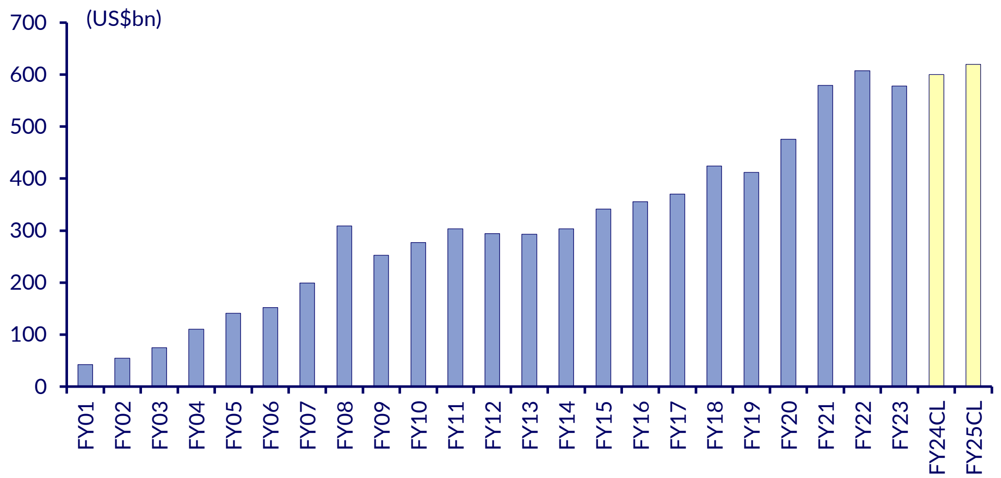
**0.8x FPI investments/forex reserves**: This works out to about US$560bn now at 0.8x.

**2x short-term debt cover**: This works out to US$580bn adjusting short-term external debt of 1-year residual maturity.

**Based on the above scenarios, forex reserves should increase to US$600bn in FY24 and US$620bn in FY25**

Figure 99

**Forex reserves**

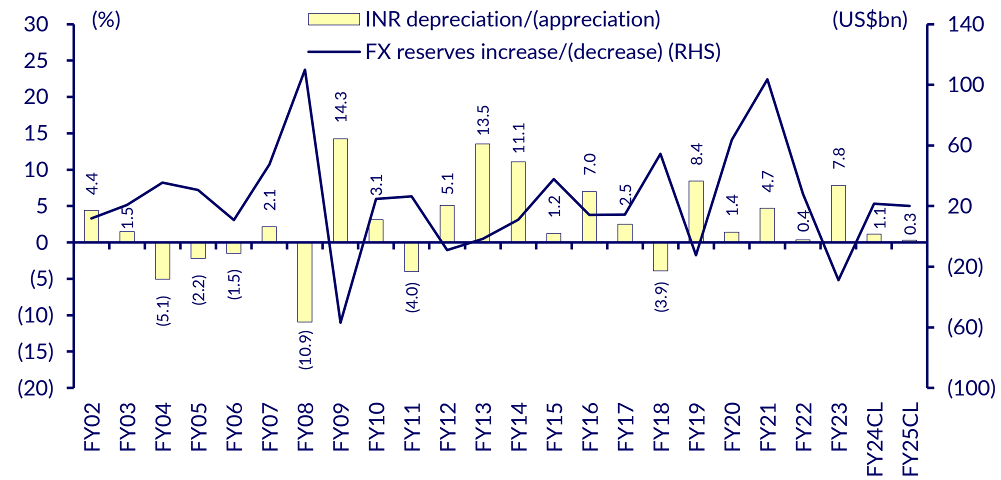



Source: RBI, CLSA

**Rupee depreciation and forex increase have a negative 67% correlation**

Figure 100

**Rupee depreciation/(appreciation) and change in forex reserves**




Source: RBI, CLSA

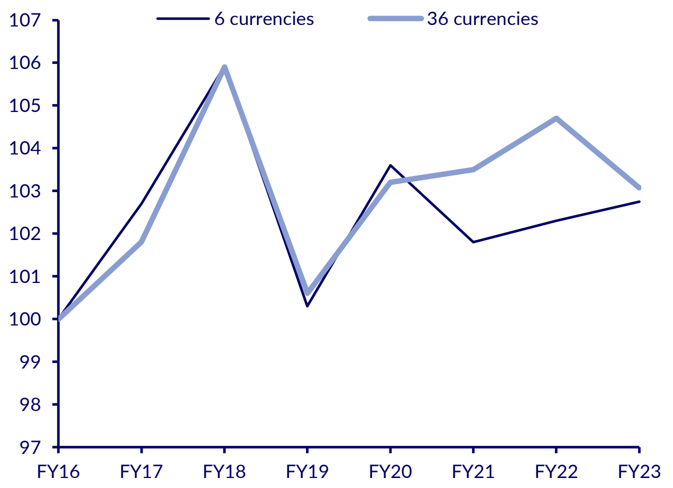
## RBI will not want rupee appreciation

**RBI has a policy preference for weaker rupee to support textile exports**

The RBI has a policy preference for a weaker rupee. Although appreciation attracts capital, the cotton export industry is a major employer. As it is, the rupee's real effective exchange rate is still relatively strong given weak export demand (Figures 101-102). Further, rupee appreciation will also lead to mark-to-market hits on the RBI balance sheet. At present, the RBI's revaluation reserves cover 20% appreciation. Finally, a policy of appreciating rupee at the cost of building forex reserves in 2009-11 landed the Indian economy into a series of forex crises for eight years.

Figure 101

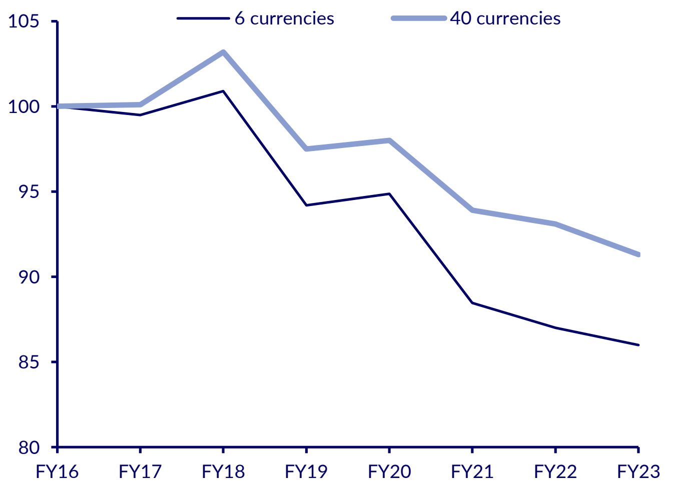
**Rupee real effective exchange rate**




Note: Index base year is FY05. Index is based on CPI inflation. Source: CLSA, Centre for Monitoring Indian Economy (CMIE)

Figure 102

**Rupee nominal effective exchange rate**




Note: Index base year is FY05. Source: CLSA, CMIE

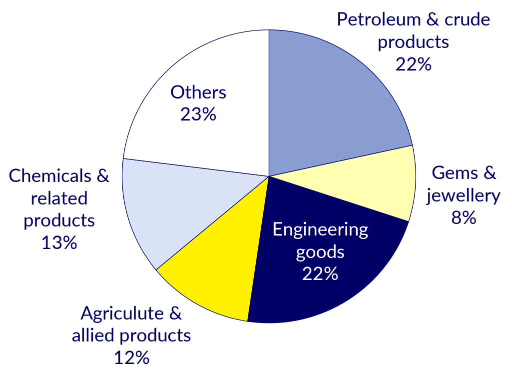
**Relationship between rupee and export performance is weak because of India's large diverse export basket**

## RBI will not want large-scale depreciation either

We think that the RBI will not favour large-scale depreciation as that will hurt capital flows that are the mainstay of funding a chronic current account deficit. Most studies do not show much relationship between a weaker rupee and export performance. This is largely because India has a fairly diversified trade basket (Figures 103-106). Similarly, it can be seen that most of the increase in exports in the past 20 years came from innovations and diversification (Figure 104).

Figure 103

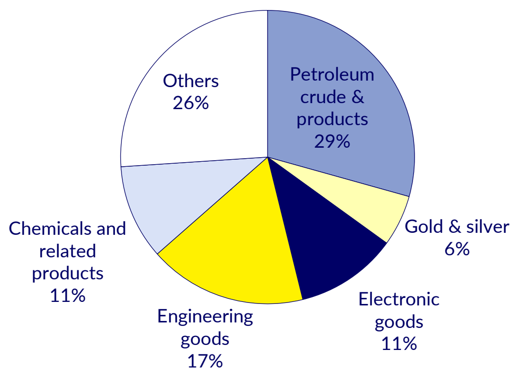
**India exports by sector**




Source: CLSA, CMIE

Figure 104

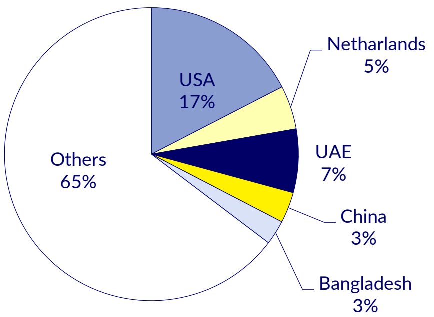
**India imports by sector**




Source: CLSA, CMIE

Figure 105

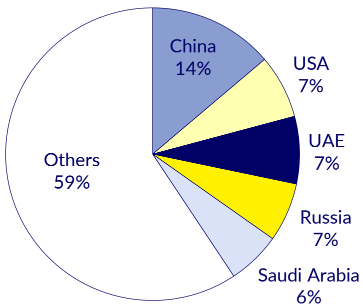
**India's exports by destination market**




Source: CLSA, CMIE

Figure 106

**India imports by market of origin**




Source: CLSA, CMIE

**Increase in exports over the past 20 years have come from innovation and diversification**

Figure 107

**Increase in exports reflect new products**

| FY01 | | FY10 | | FY20 | |
|---|---|---|---|---|---|
| **Commodity** | **Export as a % of GDP** | **Commodity** | **Export as a % of GDP** | **Commodity** | **Export as a % of GDP** |
| Gems & jewellery | 2.0 | Engineering goods | 2.4 | Engineering goods | 2.6 |
| Agricultural & allied products | 0.6 | Gems & jewellery | 2.2 | Chemicals & related products | 1.6 |
| Textiles | 0.6 | Petroleum & crude products | 2.1 | Petroleum & crude products | 1.4 |
| Engineering goods | 0.5 | Agricultural & allied products | 1.3 | Gems & jewellery | 1.2 |
| Readymade garments | 0.4 | Chemicals & related products | 1.3 | Agricultural & allied products | 1.2 |
| **Total** | **4.0** | **Total** | **9.3** | **Total** | **8.1** |

Source: CLSA, RBI

**Present forex reserves policy is sufficient, even without import compression**

**Import substitution not assumed; icing on the cake if it happens.** Can our rupee virtuous cycle hold without reduction in imports by developing production of electronics and/or reducing dependence on oil by promoting alternate sources of energy? We think a steady RBI policy of forex purchases is sufficient as Governor Das has already built a buffer.

Click to rate this research
Great
Solid
Meh

# Three burning questions

**Twin deficits no great risk, efficiency gains possible and the global cycle rather than politics drives growth**

In this chapter, we aim to answer three critical questions regarding India's growth story. Firstly, we do not consider India's twin deficits as a significant risk. Secondly, our growth projections do not account for any advancements in efficiency. Lastly, we believe there is a widespread political agreement on the need for economic reforms.

## #1. Twin deficits not really a risk

**Persistence of India's twin deficits is not a major risk**

We do not see the persistence of India's twin deficits (current account deficit and fiscal deficit) as a major risk. Most studies show that that a fiscal deficit of 4-5% of GDP is sustainable given 11% nominal income growth. While it is true that the Centre's fiscal deficit has jumped to 6.7% in FY20-23, due to the Covid-19 shock, the fiscal deficit has averaged 4.9% since 2000. Similarly, the current account deficit is fundable till 2-2.5% of GDP. It has averaged 1.3% since 2000 with an average capital account surplus of 3.1% of GDP.

## High fiscal deficits are unavoidable

We do not see India's fiscal deficit improving in the near future. While the government has a target of 4.5% fiscal deficit by FY26, we see the below factors weighing on the fiscal position:

1. **Public investment typically crowds in private investment:** Public investment, for example, is supporting growth in the past few years when private investment has slackened due to excess capacity. As the economy approaches potential, private investment will pick up as well.

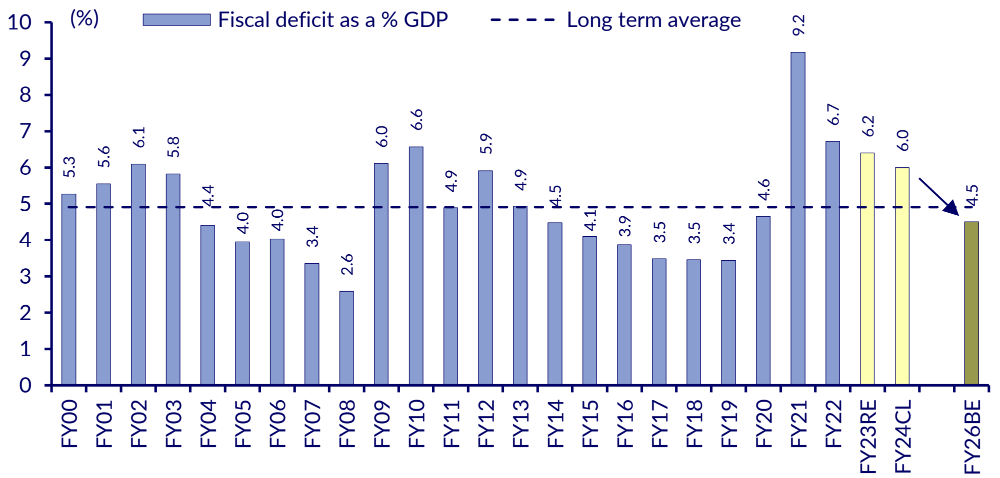
2. **Buffer against shocks:** High fiscal spending is necessary to support the population during times of economic strain. Prime Minister Narendra Modi, for example, has recently extended the monthly provision of free 5kg of rice/wheat scheme for almost 60% of the population for five years.

3. **Democracy tax:** Finally, there is the so-called democracy tax. The government has to also take the lead in reducing inter-regional disparities across states.

**We expect fiscal deficit to remain high**

Figure 108

**Fiscal deficit as a % of GDP**




Source: Ministry of Finance, CLSA

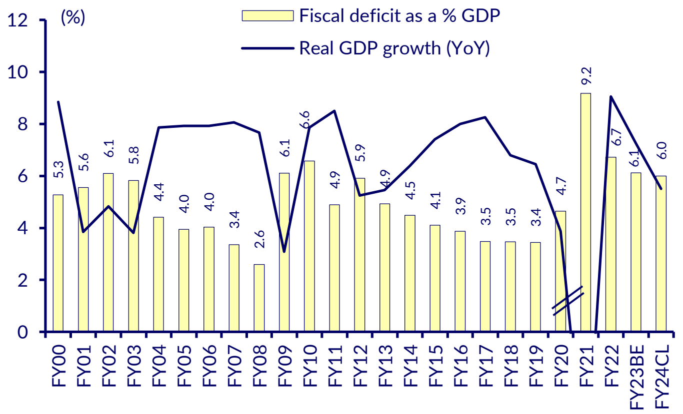
High fiscal deficit is not a growth risk

## Fiscal deficits are counter-cyclical

We do not see a high fiscal deficit as a growth risk. In the Indian economy, the causality typically runs from growth to the fiscal deficit than *vice versa*. It is typically a global shock that impacts growth and tax collections, resulting in a high fiscal deficit. Years of high growth typically result in high tax collections to reduce the fiscal deficit. The tax to GDP ratio itself is pro-cyclical.

Figure 109

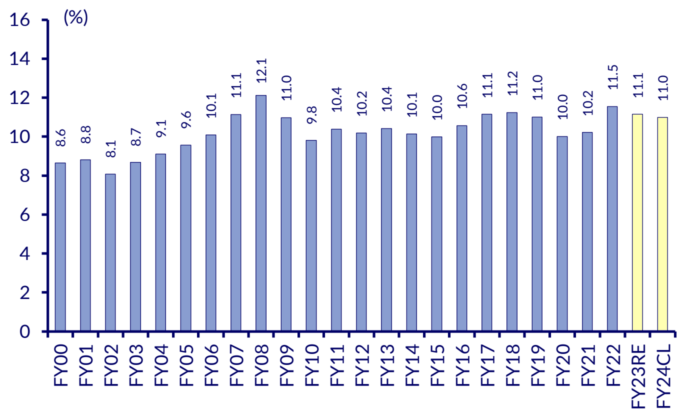
**Fiscal deficit as a % of GDP and real GDP growth**




Source: Ministry of Finance, CLSA

Figure 110

**Tax collections as a % of GDP**




Source: Ministry of Finance, CLSA

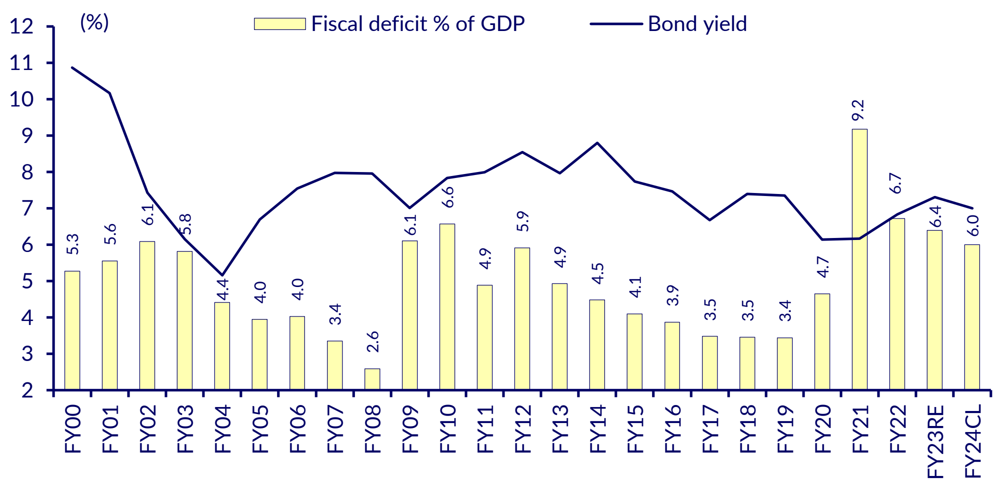
Slowdown creates space for reducing loan demand and brings down bond yields even during periods of high fiscal deficit

**High fiscal deficits co-exist with low yields**. This begs the question, wont a high fiscal deficit impact growth by raising government borrowing and crowding out investment? In reality, periods of high deficit are often associated with lower than average bond yields. This is because the slowdown that impacts tax collections to drive up the fiscal deficit also pulls down loan demand to create the space for funding additional borrowing. In the current context, for example, yields remain relatively soft despite high fiscal deficits due to the RBI's ability to buy government bonds via open market operations, due to lower forex flows, or, low loan demand.

High fiscal deficit leads to lower bond yields due to lower loan demand, RBI OMO on weak FX flows

Figure 111

**Fiscal deficit as a % of GDP and bond yields**




Source: Bloomberg, CLSA

Figure 112

**India Gsec market: Demand and supply**

| Rsbn | Item | FY24CL | Russia hold US$30bn | Rs2,000 note | Oil stress case |
|---|---|---|---|---|---|
| **A.** | **Supply** | **18,423** | **18,423** | **18,423** | **18,423** |
| A.1 | Central borrowing | 12,300 | 12,300 | 12,300 | 12,300 |
| A.2 | States | 6,123 | 6,123 | 6,123 | 6,123 |
| **B.** | **Market demand** | **15,068** | **17,528** | **18,668** | **15,068** |
| B.1 | Banks | 5,068 | 5,068 | 8,668 | 5,068 |
| B.1.1 | Deposit growth | 22,426 | 22,426 | 26,026 | 22,426 |
| B.1.2 | CRR | 1,009 | 1,009 | 1,009 | 1,009 |
| B.1.3 | Credit offtake | 16,513 | 16,513 | 16,513 | 16,513 |
| B.1.4 | Potential G-sec investments | 4,904 | 4,904 | 4,904 | 4,904 |
| B.2 | Non-banks | 10,000 | 10,000 | 10,000 | 10,000 |
| B.3 | Russian Oil imports | | 2,460 | | |
| **C.** | **RBI support (A-B)** | **3,355** | **895** | **(245)** | **3,355** |
| D. | RBI OMO for reserve money | 4,837 | 2,377 | 4,428 | 10,988 |
| E. | Gap between RBI support and RBI OMO (C-D) | (1,482) | (1,482) | (4,673) | (7,633) |

Source: RBI, CLSA

**Indian G-sec market reasonably balanced despite high fiscal deficits**

Figure 113

**Determinants of RBI liquidity**

We estimate money demand at:
M3 growth = 1.2x real GDP growth rate + inflation
Where, 1.2 is the income elasticity of money demand
M3 growth = 1.2*6.0+5.0 = 12.2%
Thus, we expect the **RBI to target about 12% M3 growth (=Rs26,601bn/US$324bn)**

We calculate our money multiplier as follows:
Money multiplier = (1+ currency deposit ratio)/(currency deposit ratio + reserve ratio)
Reserve ratio = 0.045
Currency deposit ratio = 0.17
Money multiplier = 1+0.17/0.17+0.45 = 5.5x
**Money multiplier of 5.5x** translates into **RBI reserve money requirement of Rs4,837bn/US$59bn**

Our balance of payments forecasts place **RBI FX intervention sales at Nil**
This means that the **RBI has to infuse Rs4,837bn/US$59bn by OMO**.

Source: RBI, CLSA

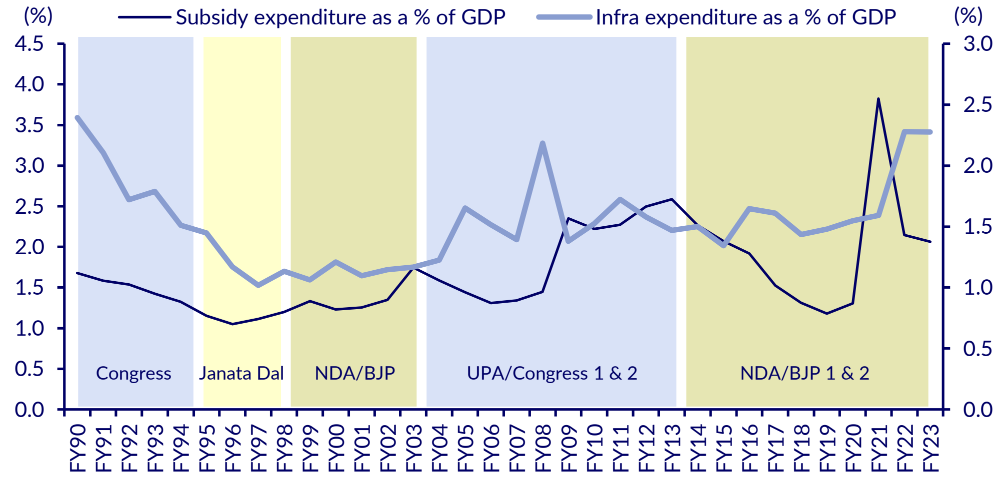
**Public consumption vs investment expenditure:** Finally, we turn to the debate over the quality of fiscal spend. Empirical tests tell us that one rupee of public consumption expenditure leads to a maximum of one rupee of GDP, while one rupee of public investment generates Rs2.5 of GDP. At the same time, the impact of the first is immediate while the latter takes time.

The policy choice is thus contextual depending on what the Indian economy really needs irrespective of political preferences. Although the previous United Progressive Alliance (UPA) laid an emphasis on the demand side, the economy saw an investment boom. While the present National Democratic Alliance (NDA) government is perceived to be supply siders, it has taken also several welfare measures.

UPA has traditionally been a demand sider and BJP have been supply siders

Figure 114

**Spending focus over different governments**




Source: Ministry of Finance, CLSA

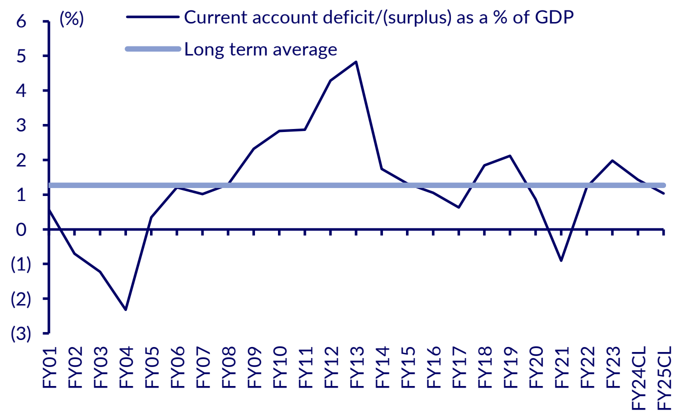
Current account deficit is not a worry

## 2-2.5% of GDP current account deficits fundable

We would not worry about the current account deficit up to 2-2.5% of GDP. Empirical studies show that India can afford to run a current account deficit (CAD) of 2-2.5% of GDP to clock 6-7% growth. CAD has averaged 1.3% of GDP in 2000-22 and 1.1% of GDP in 2016-23.

Figure 115

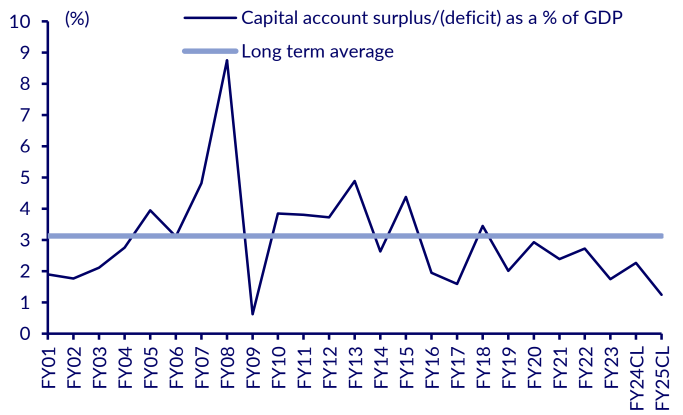
**Current account deficit**




Source: RBI, CLSA

Figure 116

**Capital account surplus**




Source: RBI, CLSA

India can afford a current account deficit of 2-2.5% of GDP

**India should run a current account deficit**. An emerging market like India should actually run a current account deficit to borrow from the rest of the world to grow faster. Higher growth should allow the economy to attract foreign capital to fund higher growth. A current account surplus would push India's savings into funding growth abroad.

FII flows should ensure a capital account surplus to fund the CAD

**FPI inflows will ensure capital account surplus**. FPI inflows in equity and debt should drive capital account surplus. Historically, FPI flows have averaged 1% of GDP. These flows will help fund the current account deficit and allow foreign investments in Indian assets.

High ICOR will make India the second-largest economy by 2052

## #2 Efficiency gains look difficult

We have not factored in any efficiency gains in our base case projections. If these gains materialise, they can drive nominal US GDP to US$150trn higher than the US by 2052. We see India's growth driven by capital accumulation rather than efficiency, like China. Figure 117 shows that China and India have not seen any improvement in their incremental capital output ratio (ICOR) during the past few years. In contrast, Asian tigers had improved during their high growth years.

China and India have seen no ICOR improvement in recent years

Figure 117

**ICOR for India and China**

| Economy | Investment rate (%) | Incremental Capital Output Ratio (ICOR) | Growth rate (%) |
|---|---|---|---|
| 1991-1995 | | | |
| China | 31.8 | 2.6 | 12.3 |
| India | 21.8 | 4.6 | 4.7 |
| 1996-2000 | | | |
| China | 32.5 | 4.7 | 8.6 |
| India | 22.9 | 3.6 | 6.8 |
| 2001-2005 | | | |
| China | 37.0 | 5.2 | 9.8 |
| India | 26.9 | 5.2 | 5.6 |
| 2006-2010 | | | |
| China | 40.0 | 5.0 | 11.3 |
| India | 35.2 | 5.9 | 6.9 |
| 2011-2015 | | | |
| China | 43.8 | 6.2 | 7.9 |
| India | 37.8 | 5.9 | 6.6 |
| 2016-2020 | | | |
| China | 42.5 | 8.1 | 5.7 |
| India | 34.2 | 4.7 | 6.7 |
| 2020-2023 | | | |
| China | 43.0 | 9.2 | 4.7 |
| India | 34.4 | 5.9 | 3.6 |
| Memo | | | |
| Korea (1981-1990) | 29.6 | 3.2 | 9.2 |
| Japan (1960-1970) | 32.6 | 3.2 | 10.2 |

Source: IMF, CLSA

A robust bond market, successful government reforms and outsourcing are the key drivers of ICOR

A robust bond market, successful government reforms and outsourcing are the key drivers of ICOR:

1. **Development of a corporate debt market after India's inclusion in the JP Morgan Emerging Market Bond Index Diversified**: The inclusion of Indian government paper will also facilitate foreign portfolio investment in corporate bonds. After all, many corporate funds reportedly did not consider India as it was off benchmark. FPI investment in Indian debt is limited: US$31bn in government debt and US$12bn in Indian corporate debt. At the same time, we think the FPI interest in corporate debt and the parallel development of the Indian corporate debt market will take time.

2. **Success of government reforms**: We have not priced in any jump in efficiency due to a major big bang government reform. Indian government reforms tend to be gradual to avoid the risk of reversal. That said, Figure 131 details the various reforms measures by the Indian government.
3. **China plus one strategy**: We have also not built in any jump in investment due to the diversification of production of global companies from China. It is a moot point if the ecosystem can shift at any time in the near future. Although we are seeing the emergency of companies that are setting up assembly plants, a study shows that the value add to GDP is limited.

**FII participation in corporate bond market:** The development of a corporate bond market has been a holy grail of the RBI. Indian industry has been constrained by the lack of project finance. FIIs have utilised only 38% of their available limit in Gsecs. Widening the corporate bond market will reduce the burden of banks to fund large scale infra projects.

**FIIs have utilised only 38% of their available limit in G-secs**

Figure 118

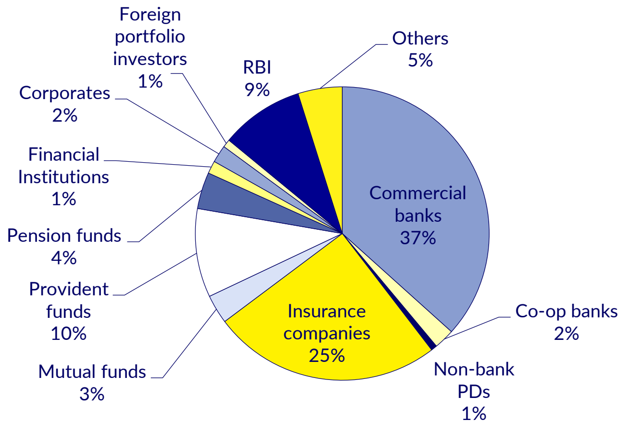
**FII debt utilisation levels**

| | Investment (US$bn) | Limit available (US$bn) | % of limit used |
|---|---|---|---|
| Central Government securities | 8.6 | 40.7 | 21.2 |
| State Government securities | 0.1 | 12.1 | 0.8 |
| Corporate bonds | 12.6 | 68.8 | 18.3 |
| Fully Accessible Route (FAR) | 11.5 | na | na |
| **Total holding (incl. FAR)** | **32.9** | **121.6** | **27.0** |
| **G-Secs holding (incl. FAR)** | **20.2** | **52.8** | **38.3** |

Source: NSDL, CLSA. Note: FAR has no limits

Figure 119

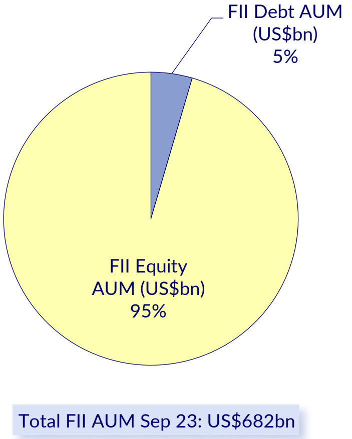
**Breakdown of Gsec ownership**




Source: RBI, CLSA

Figure 120

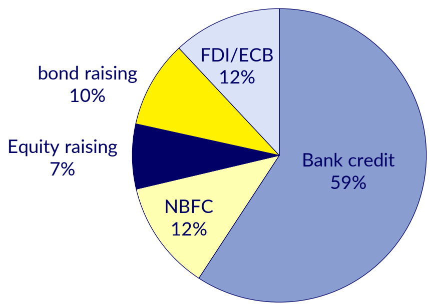
**FII investments in India**




Source: NSDL, CLSA

Figure 121

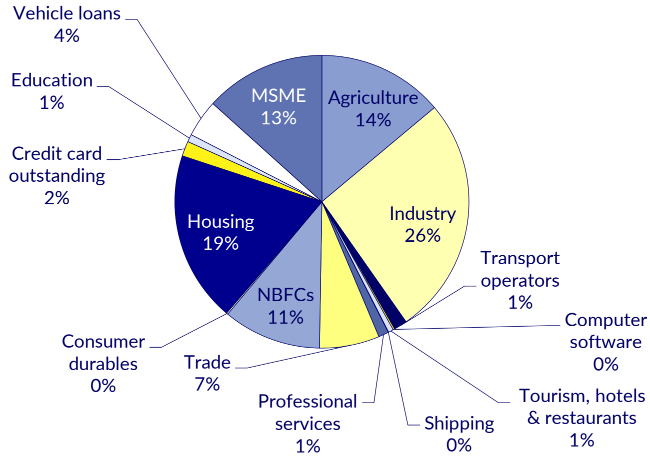
**Sources of financing**




Source: RBI, CLSA

Figure 122

**Bank loan book breakdown**




Source: NSDL, CLSA

**PLI schemes, easing import restrictions are key measures to improve localisation of manufacturing**

**Localisation push:** We have not modelled in India's efforts to reduce import dependency and becoming a self-sufficient (*Atma Nirbhar*/Make in India) economy. In recent years, India has been a large net importer of electronics (accounts for a sizeable portion of its import bill). To drive local production, the government has introduced several schemes, including the production-linked incentives (PLI) scheme (US$27bn incentives), 100% FDI in electronics manufacturing and partial incentives on capex (SPECS scheme). GST has led to lower lead and turn-around times and gradually reduced warehouse intensity, leading to both time and cost savings across industries.

Figure 123

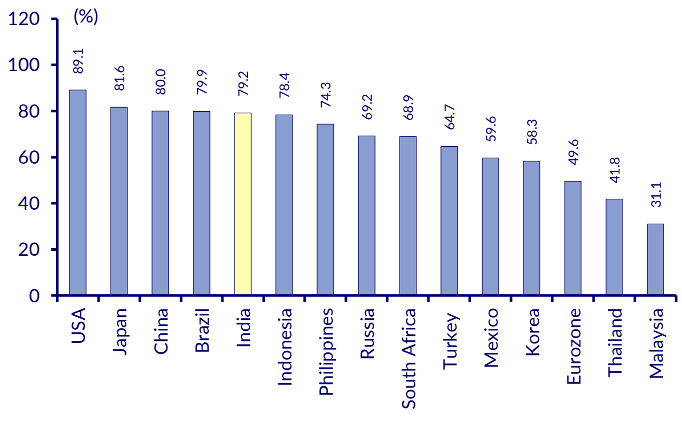
**Key reforms launched by the government**

| Name of reform | Launched year | Aim |
|---|---|---|
| Production-Linked incentive scheme (PLI) | 2020 | Scale up domestic manufacturing capability, import substitution and employment generation |
| Goods and Service Tax (GST) | 2017 | Improved tax buoyancy and logistics |
| National infrastructure pipeline (NIP) | 2020 | US$1.4tn capex plan to build highways, renewable capacity amongst others |
| Unified Payment systems (UPI) | 2016 | Real-time seamless transfer of funds that helps transfer funds through mobile phone apps. This facility has reduced working capital burden for most MSMEs |
| Open network for digital commerce (ONDC) | 2022 | An initiative to promote open networks for all aspects of exchange of goods and services over digital or electronic networks to drive inclusivity and access for consumers |
| Energy transition | 2022 | Government has pushed for net zero by 2070 by investing in renewable energy such as hydro and PSS battery |
| Ayushman Bharat scheme | 2020 | Health insurance scheme to provide insurance cover to poor families |
| Jan-Dhan Aadhaar | 2015 | Linking Aadhaar with mobile and bank account to transfer welfare beneficiaries and prevent leaks |
| Real Estate Regulation Act (RERA) | 2016 | To reduce project delays and fraud and protect home buyers |

Source: Government, CLSA

Figure 124

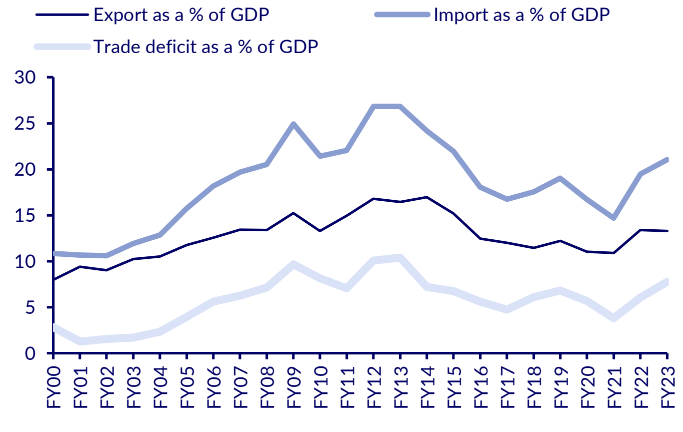
**Domestic demand as a % of GDP**




Source: World Bank, CLSA

Figure 125

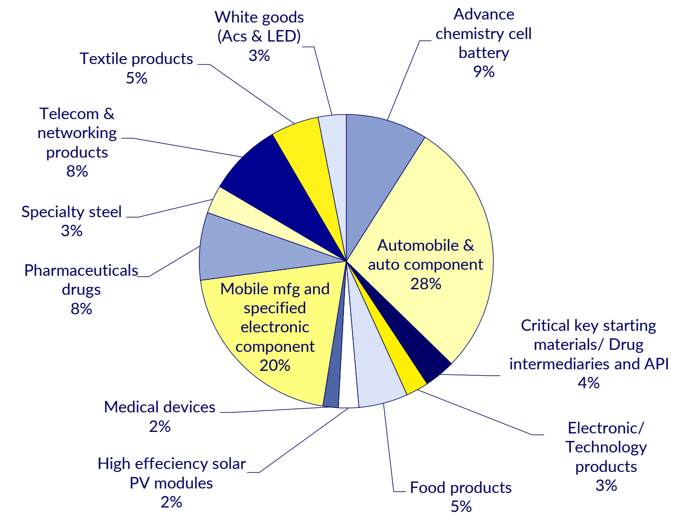
**Import, export and trade deficit as a % of GDP**




Source: Ministry of Commerce, CLSA

Figure 126

**PLI scheme sector breakdown**




Source: Government, CLSA

Figure 127

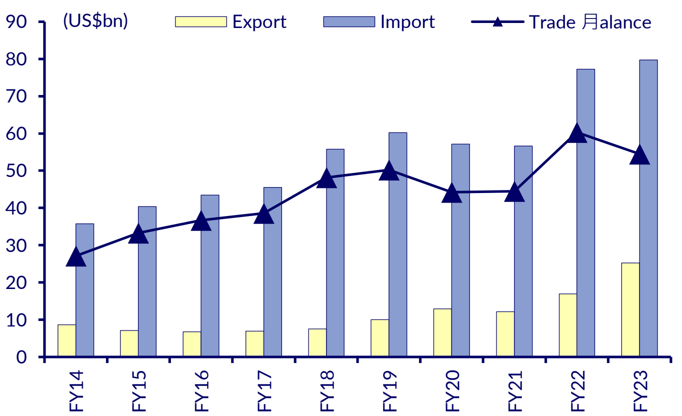
**PLI scheme potential**

| Sector | No. of companies/ applicants approved | Potential/actual employment generation | Scheme outlay (Rsbn) |
|---|---|---|---|
| Semiconductor | 3 | 135,000 | 760 |
| Automobile and components | 75 | 750,000 | 519 |
| Electronics manufacturing | 32 | 28,636 | 400 |
| Renewable energy | 18 | 719,500 | 240 |
| Pharmaceuticals | 55 | 100,000 | 219 |
| Medical devices | 21 | 6,411 | 184 |
| Telecom | 42 | 44,000 | 122 |
| Food processing | 60 | 250,000 | 109 |
| Textile | 61 | 240,134 | 107 |
| IT hardware | 14 | 144,000 | 73 |
| Metal and mining | 30 | 70,000 | 63 |
| White goods | 42 | 44,000 | 63 |
| **Total** | **453** | **2,531,681** | **2,859** |

Source: Ministry of Commerce, CLSA

Figure 128

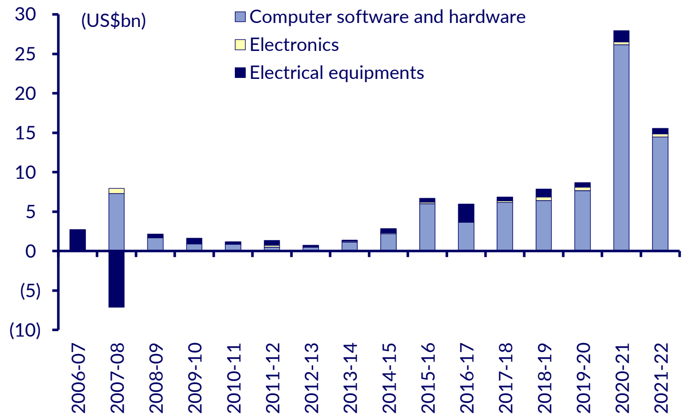
**Domestic demand as a % of GDP**




Source: Ministry of Commerce, CLSA

Figure 129

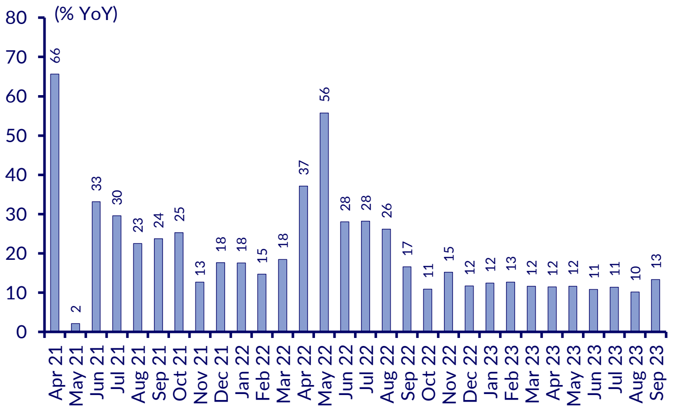
**FDI flows in electronics sector**




Source: Ministry of Commerce, CLSA

Figure 130

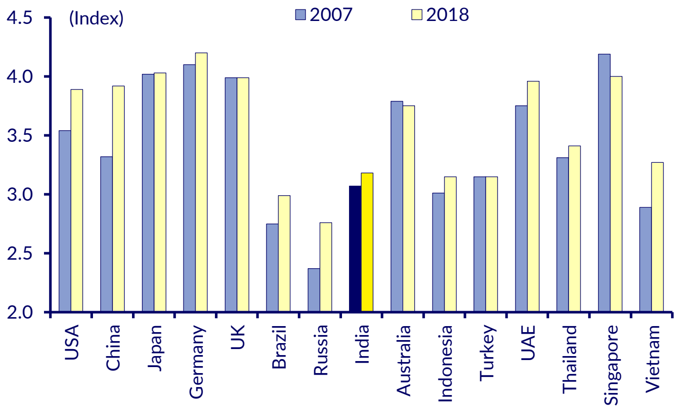
**GST collections growth**




Source: Ministry of Commerce, CLSA

Figure 131

**Logistics performance index**




Source: Ministry of Commerce, CLSA

**Most government regimes face economic cycles**

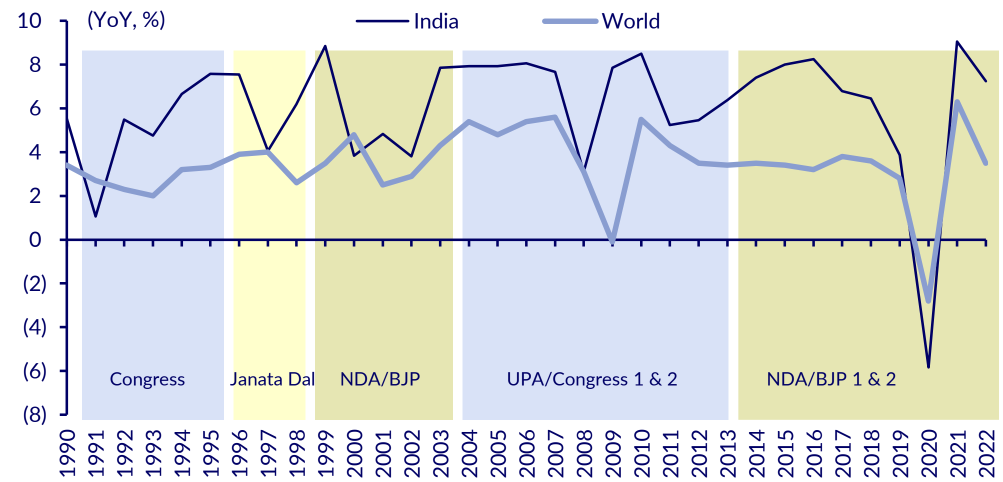
## #3 Global cycle - not politics - drives growth

We believe the Indian economic cycle is largely driven by the global cycle rather than the economic policies of any particular government. Fig 132 shows that most regimes have seen ups and downs driven by global upturns and downturns. In most cases, the policy response to global shocks follows a routine playbook authored 30-odd years ago and perfected over the years.

**Political regime does not impact growth**

Figure 132

**India and world real GDP growth**




Source: Bloomberg, CLSA

There is also a broad political consensus on economic policy across mainstream political parties. In many cases, support or opposition to a particular policy is guided by whether the political party sits on the Treasury benches or in the Opposition.

**Global and India cycles are highly correlated**

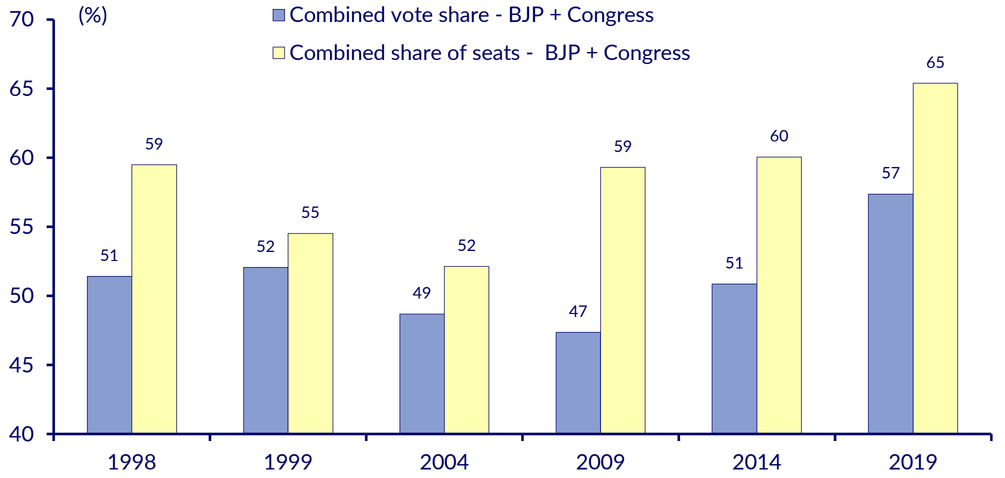
We do not see a major difference in economic performance between governments with a simple majority and coalitions. It is really the global economic cycle that drives the Indian economy.

In any case, India is typically a political coalition if we take the States into account. Figures 133-135 show that the two national parties - BJP and Congress - get about 50% of the vote. The balance goes to regional parties that are driven by ideological, regional or linguistic preferences.

More than half of the total votes in national elections go to the two major ruling parties

Figure 133

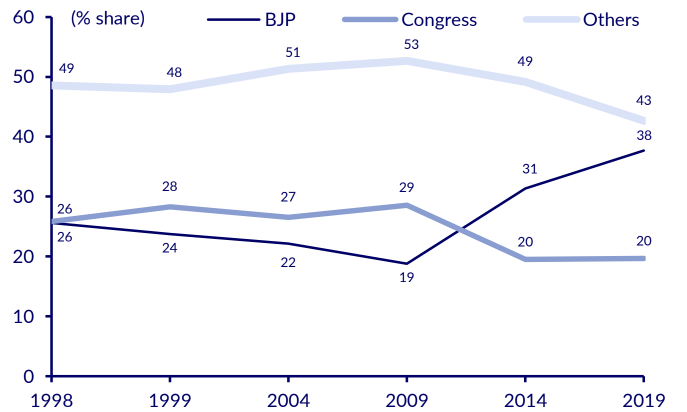
**Vote and seat share of BJP and Congress in national elections**




Source: Election commission of India, CLSA

Figure 134

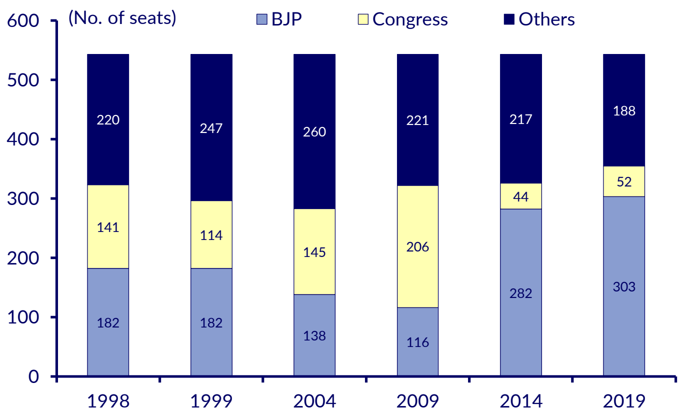
**Vote share across elections**




Source: Election commission of India, CLSA

Figure 135

**No of seats won across elections**




Source: Election commission of India, CLSA

# Bharat story basket

We recommend holding on to large-cap liquid stocks

Our Bharat story basket enmeshes our macro drivers, strategic sector drivers and the immediate volatility in the Indian market. Demand will rise due to rising affordability as incomes rise above subsistence levels, institutional accessibility due to financial deepening and the impact of innovation/digitisation. We recommend holding on to large-cap liquid stocks, which provide an enhanced level of capital protection as well as opportunities to achieve growth. Our stock recommendations are broadly unchanged from our report a year ago: Axis Bank, Bharti Airtel, Hindustan Unilever, ICICI Bank, M&M, NTPC, SBI, Sun Pharma, TCS and UltraTech remain names offering liquidity and long-term growth with exposure to our three macro drivers. Stocks like Zomato, PVR Inox, Delhivery, Prestige and Paytm offer long-run value.

Stocks like Zomato, PVR Inox. Delhivery, Prestige and Paytm also offer longer term growth potential



## Macro drivers: Demographics, financial deepening, stable rupee

We advise investors to invest in the following macro themes:

**Demographic dividend**: This should support a step up in consumption, urbanisation as well as investment;

**Financial deepening**: This should support financials as well as discretionary demand, including real estate;

**Stable rupee**: A stable pace of depreciation should support outsourcing companies as well as step up FPI portfolio flows in general.

## Market size drivers: Income, access and innovation

Demand in India will continue to rise

We remain bullish about India's long term story, and expect demand to rise due to:

- Income effect
- Institutional accessibility and
- Spread of digitisation/innovation

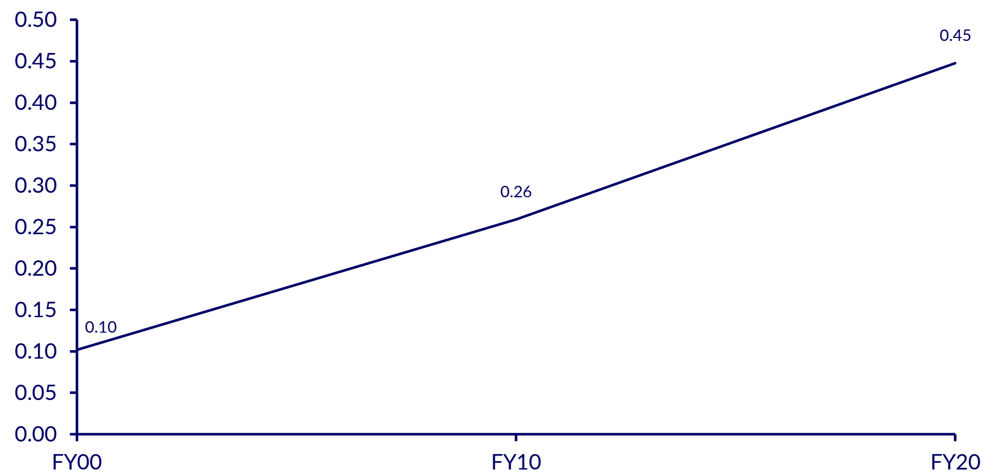
Steady improvement in affordability over the recent decades

**Income effect:** Drives the customer base by raising affordability. Figure 136 highlights that there has been a steady improvement in affordability over the recent decades.

Affordability for cars has been increasing

Figure 136

**Affordability: Per capita income/price of entry level car**



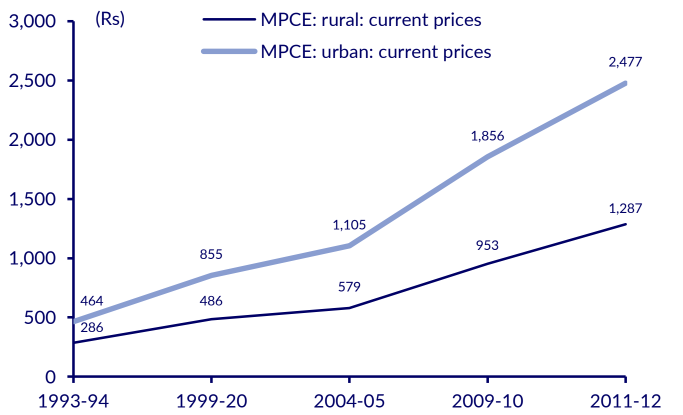

Source: RBI, CLSA

**Mass penetration as incomes rise above subsistence levels**

As incomes rise above the subsistence level, the public start to buy consumer articles (Fig 137-138). This powers mass penetration: eg, shift to cigarettes from bidis, toothpaste from twigs, jewellery buying from unorganised to organised sector. Finally, as incomes rise, higher affordability pushes consumers to upgrade as well as replace faster. This is the new premiumisation story.

Figure 137

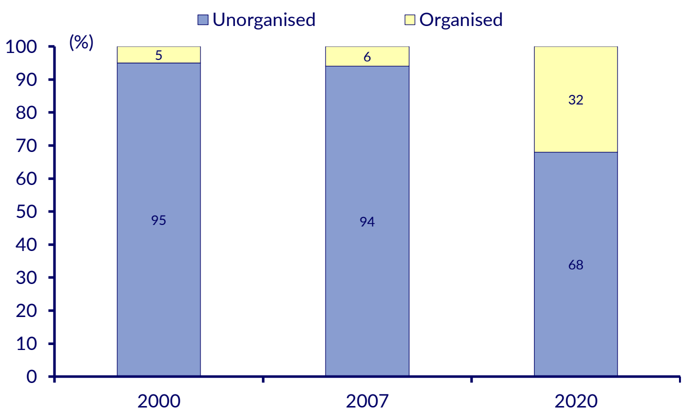
**Growth in Monthly Per Capita Consumer Expenditure (MPCE) since 1993-94**




Source: Ministry of Statistics and Programme Implementation, NSS Survey 2011-12

Figure 138

**Organised and unorganised jewellery market breakup**



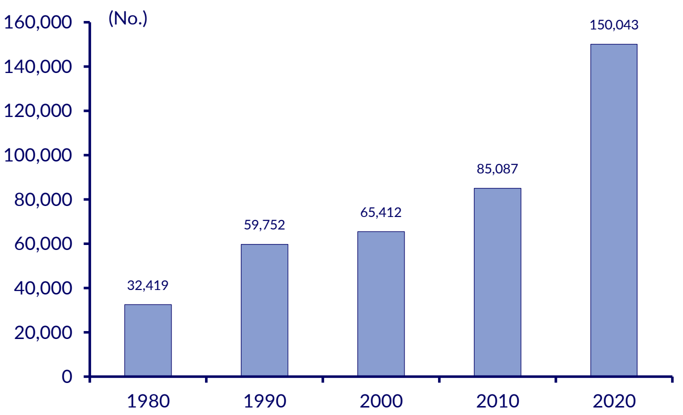

Source: Joyalukkas India Ltd DRHP

**The advent of e-transaction has added a new dimension to the spread of financial deepening**

**Institutional accessibility** is the second driver. A classic example is the expansion in deposits/credit due to financial deepening after nationalisation (Figure 139 and 140). This was driven by a twin shift to the money economy from barter as well as formal sources of finance from money lenders. This has been further deepened by financial inclusion through self-help groups and micro financial institutions. The advent of e-transaction has added a new dimension to the spread of financial deepening.

Figure 139

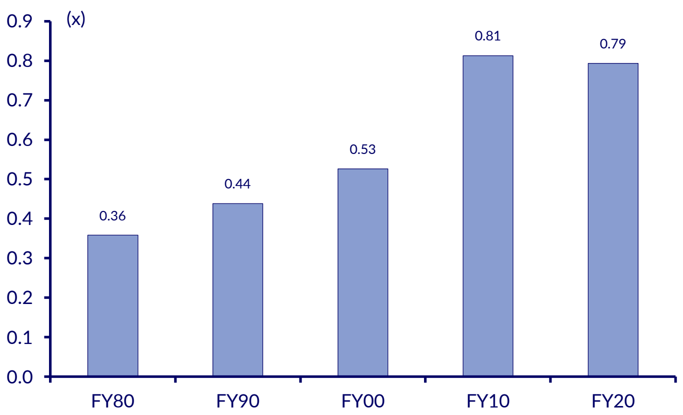
**Number of branches of scheduled commercial banks**




Source: RBI, CLSA

Figure 140

**M3/GDP**




Source: RBI, CLSA

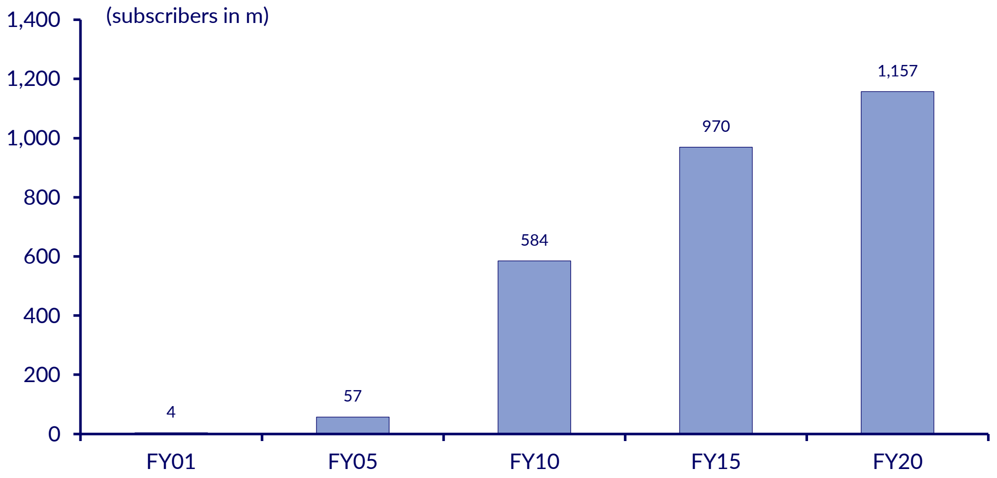
**Fast paced diffusion of technology offers a new product suite**

**Innovation impact:** Rapid fire diffusion of technology offers a new product suite for the Indian population in terms of cell phones and associated uses as well as mobile dining.

**Mobile phones have penetrated across the entire population**

Figure 141

**India mobile subscriber historical trend**




Source: TRAI, CLSA

## Income effect impacts

We see beauty and personal care as a standout sub-segment of consumer benefiting from income effect, while consumer durables will also improve. We also like autos, property and cement.

### Consumer sector: Beauty and personal care

**Beauty and personal care in India offers expansion opportunity in terms of increasing user aspirations and premiumisation**

India's beauty and personal care (BPC) category offers expansion opportunities in terms of increasing user aspirations and premiumisation. The BPC category, sized at US$14.5bn, is a combination of some highly penetrated categories (about 61%, like soaps, oral care, etc). In contrast, other categories (like colour cosmetics, shampoo, shower gel, etc) are fairly nascent and have the potential to grow at a fast pace. We expect BPC to grow at a 10% Cagr to US$39bn by FY32. Unlike in the past when decadal growth was due to factors like penetration, per capita usage and premiumisation, we see usage expansion in conventional categories (8% Cagr) in the next decade, while emerging segments to witness penetration-led growth (14% Cagr). Overall penetration will steadily expand from 66% to 72%.

### Consumer durables

**Favourable demographics and supportive government policies are driving multi-year demand in India's consumer durables**

India has the lowest penetration rates for consumer electronics globally due to low disposable income and limited access to basic necessities. However, favourable demographics and supportive government policies are driving substantial multi-year demand for consumer durables. Cross-country analysis of per-capita income and penetration levels of key categories indicate a strong growth trajectory over the next decade. We expect 4-11% market Cagrs for the four major appliance categories over the next 20 years. Favourable government policies are likely to support both demand and supply growth domestically.

### Autos

**Indian auto industry will benefit from low penetration and rising income levels**

The Indian auto industry has strong growth potential over the next 15 years as penetration levels remain low compared to other advanced nations while income levels are rising along with the need for personal mobility. However, growth will be driven by electric variants rather than conventional fuel vehicles as the government pushes for cleaner fuel vehicles through favourable policies and subsidies to achieve its net zero emissions target by 2070. We expect the domestic two-wheeler industry to grow at a Cagr of 8.1% over FY23-36. We estimate penetration levels (per person) to improve from around 12% currently to 22% in FY36, at which point the market should saturate. The passenger vehicle industry has a strong growth potential, with penetration at just 25 vehicles per 1,000 people (much lower than advanced nations worldwide). With increasing penetration in the rural markets, higher income levels and requirement for personal mobility, the industry can still grow at an estimated Cagr of around 11% over the next 30 years when we expect penetration levels to reach 210 (still lower than levels in USA and Europe currently).

**Housing demand in metros and tier 1 cities will be driven by growing talent pool and talent migration to urban regions**

### Property

We estimate housing demand in metros and tier 1 cities to grow 2.3x and 3x over the next 10 years, driven by a growing talent pool and talent migration to urban regions. We estimate the number of graduates in science, technology, engineering and mathematics (STEM) fields and post-graduates passing out annually to grow from 3.1mn in 2019-20 to 5.3mn in 2031-32. Most listed developers have their operations concentrated in metros, and we believe they will grow faster than the industry growth (9% Cagr) due to industry consolidation. Among the key markets, we like NCR, Bangalore and Hyderabad markets due to strong growth in the service economy.

**Tailwinds from a pick-up in housing demand and infrastructure build-out is likely to lead cement demand**

### Cement

India is the second-largest cement consumer globally but has one of the lowest per capita cement consumption globally. Tailwinds from a pick-up in housing demand and infrastructure build-out are likely to lead to cement demand growing ahead of GDP. Analysing China's demand growth in periods when China's per capita GDP or cement consumption is similar to India's (as of FY22) indicates demand growth can sustain at a high single-digit Cagr for a decade. That said, after two consecutive years of strong demand, we are likely to see a deceleration next year, as generally has been the case in the year after the general elections.

## Sectors impacted by demand due to institutional accessibility

Private banks and non-banking financial companies (NBFCs) still remain attractive investment options in India, given the low penetration of retail and micro, small and medium enterprises (MSME) credit in the country.

**Digital payments is now equivalent to one-third of consumption GDP**

### Financials

Private banks and NBFCs continue to be a play on the under-penetration of retail and MSME credit in India. Despite a high 16% Cagr in retail credit, secured credit is availed by only 12-15mn households and unsecured credit by 30-50mn households (ex MFI). We expect retail credit to grow at 13-15% through FY30F, and even after that, overall household/mortgage debt to GDP will remain low at 31%/14% in FY30F. On the payments side, digital payments are now equivalent to one-third of the consumption GDP, and we expect it to reach half of the consumption GDP by FY27. On deposits, Aadhar-enabled Jandhan has brought a big penetration increase in savings deposits (savings accounts by number is 1.4x of the population). However, growth in savings account (SA) deposits will depend upon the savings rate, which has been on a decline.

## Sectors impacted by demand due to spread of innovation

Online food delivery has evolved significantly recently and has huge potential to expand. We also like the telecom sector with the upcoming 5G era driving India's industrial internet opportunity.

### Online food delivery

**Online food delivery has evolved in recent times**

Of the heterogeneous categories we cover in our consumer coverage, online food delivery has evolved recently. With a large part of food consumption remaining unorganised/in-home consumption, the online food delivery segment can move out of the home and gain a share in the food services market. According to our assessment, India's meal consumption market size is US$642bn for FY22, where the food services market share is around 7%. Within the food services segment, sized at US$46bn, the food delivery segment is sized at US$6bn, about 14% of the overall food services market. We see 21% Cagr for the food delivery segment (to US$41bn), with a contribution to the food services market expanding to about 20% by FY32. Share of online food delivery in the overall food consumption market to be around 4% by FY32 (vs 1% now).

### Telecom

**India mobile data penetration will still rise 10ppt, reaching 983m subscribers by FY26CL**

India Telecom is at the start of the 5G wave. The 4G wave led to 4G subscribers jumping sixfold to 833m, and data usage soared to the highest worldwide at 22-27GB/sub/month. With highly affordable tariffs, rising smartphone penetration, and accelerated digitisation of the economy, India's mobile data penetration will still grow 10ppt, reaching 983m subscribers by FY26CL. 5G is a catalyst for final sector consolidation as Reliance Jio and Bharti Airtel are gaining share with 5G ramp-ups while Vodafone Idea is yet to roll 5G with pending fundraising. Both 5G operators are also launching 5G FWA (fixed wireless access broadband), with RJio targeting 100m homes. Besides, the 5G era, like in China, will also drive India's industrial internet opportunity.

## Sectors impacted by demand due to other factors

Indian power utilities are expected to experience decadal growth due to favourable demographics, electrification, rising temperatures, and energy transition. Technology services exports are also anticipated to grow, and Indian pharma firms are gradually reducing their dependence on the US market by increasing their share of India-branded markets.

### Utilities

**Indian power utilities is one of the few "decadal growth utilities" globally**

Favourable demographics, electrification, cooling demand from rising temperatures and energy transition shall make Indian power utilities one of the few "decadal growth utilities" globally. We expect demand-supply favouring independent power producers (IPPs) and India's Net Zero pledge shall make 'green' IPPs an island of 'high growth utilities'. Rising global rates, elevated market valuations/oil, and likely global recession keep our strategists cautious about India's return. In that context, we like India's regulated utilities offering decadal defensive growth at value multiples. The key issues to watch in the next decade are: higher electrification of energy needs, acceleration of energy transition towards renewables (RE)/green hydrogen, potential initiation of reforms post-2024 elections, double-digit EPS growth, and ROE/dividend increases.

Indian technology services exports are likely to witness 9% Cagr over FY23-32 to US$416bn

### Information Technology

We project Indian technology services exports to witness a 9% Cagr over FY23-32 to US$416bn driven by both generic technology adoption (specifically industrial IoT, besides digital) and market share gains by Indian companies. This could translate into a 1.6x increase in direct employee headcount in the industry, assuming a modest 1.6% productivity increase over this period.

Share of India branded markets is gradually going up in the overall revenue mix of India Pharma companies

### Healthcare

The US market will likely grow in the mid-single digits in the mid-to-long term. Despite some indications of stability in the current pricing environment, we believe it is likely to see price erosion in the long term as newer entrants display aggressive strategies. We expect the Indian market to enjoy a 10% Cagr over the mid-to-long-term, and the share of India-branded markets is gradually going up in the overall revenue mix of Indian pharma firms, thereby reducing the dependence on the US market and ensuring consistency in earnings with better profitability margins.

India will emerge as an upper-middle-class economy

## Stock strategies: Thematic basket

We believe India will emerge as an upper-middle-class economy from a middle-class country; we expect the economy to expand to US$44.1tn in 2052 and US$25tn in 2047 from the present US$3.3tn. However, in the near term, we have built in a slowdown in India's growth into September 2024, followed by a cyclical recovery in 2025.

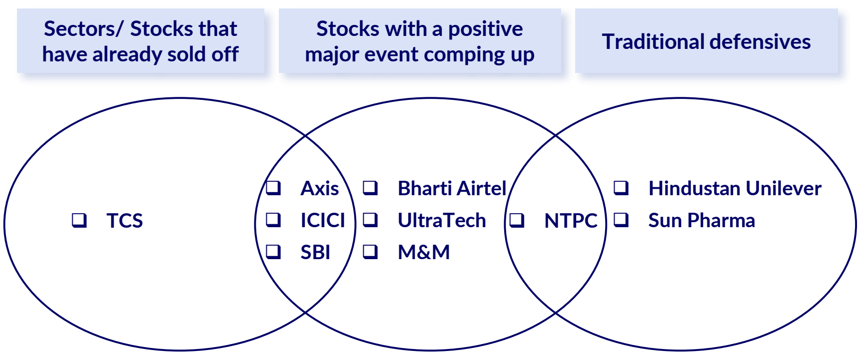
We recommend holding on to large-cap liquid stocks

Taking cognisance of the immediate future, we recommend holding on to large-cap liquid stocks, which provide increased capital protection and opportunities to achieve growth. Our stock recommendations include Axis Bank, Bharti Airtel, Hindustan Unilever, ICICI Bank, TCS, SBI, M&M, NTPC, Sun Pharma and UltraTech. Stocks like Zomato, Delhivery, Godrej and PayTm also provide longer-term growth potential across sectors.

We pick stocks that are defensive in nature and offer growth potential

Figure 142

**Our three defensive principles**




Source: CLSA

We continue to choose our stocks based on three defensive principles:

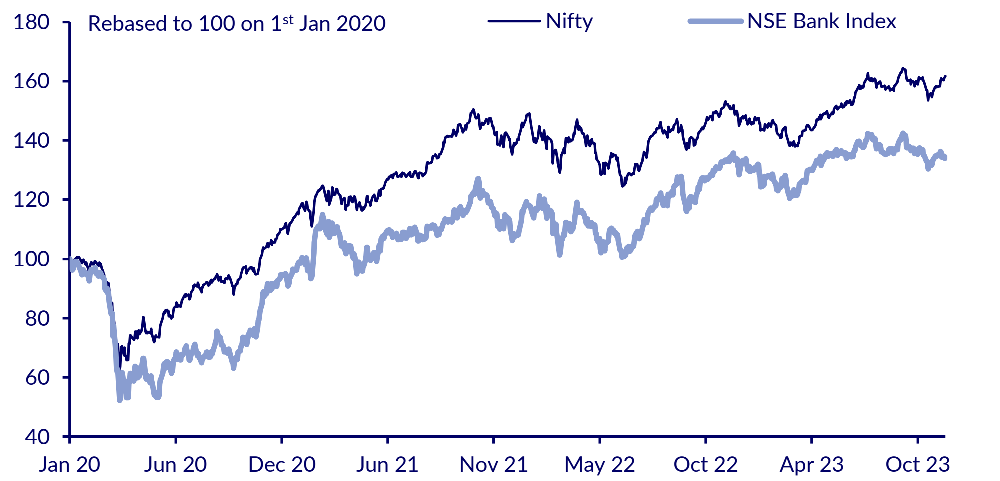
Sectors that have already sold off or underperformed markets

1. **Underperformance:** Sectors that have already sold off or underperformed markets: Major bank stocks have underperformed in fear of asset quality issues. Bank Nifty has (34% up since the Covid-19 pandemic) underperformed the Nifty (62% up since the pandemic). FPI investment in bank stocks is also at a low of 33% compared to 40% in January 2020. This guides our choice of Axis Bank, ICICI Bank and SBI, as well as TCS from the IT sector.

**Bank Nifty has underperformed Nifty by about 28ppt since Jan-2020**

Figure 143

**Bank Nifty vs Nifty performance since January 2020**

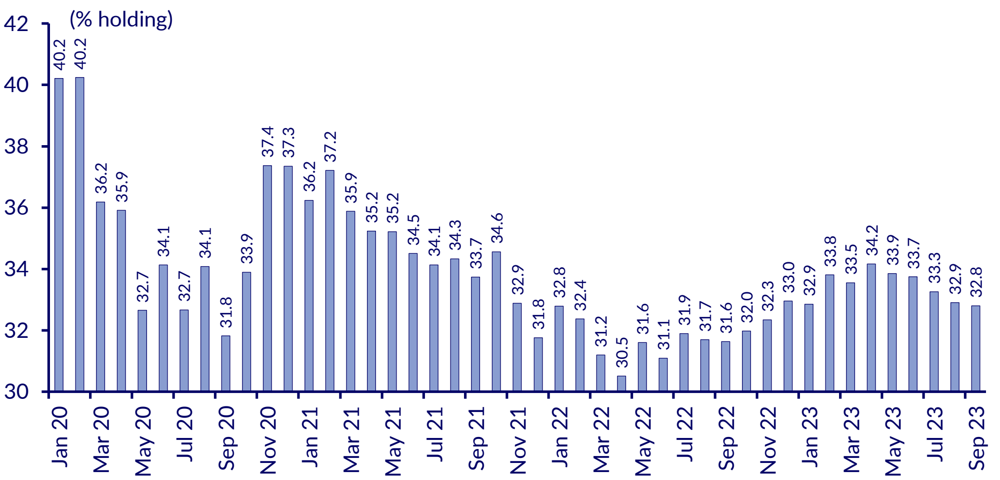



Source: Bloomberg, CLSA

**FPI investment in bank stocks is at a low of 33%**

Figure 144

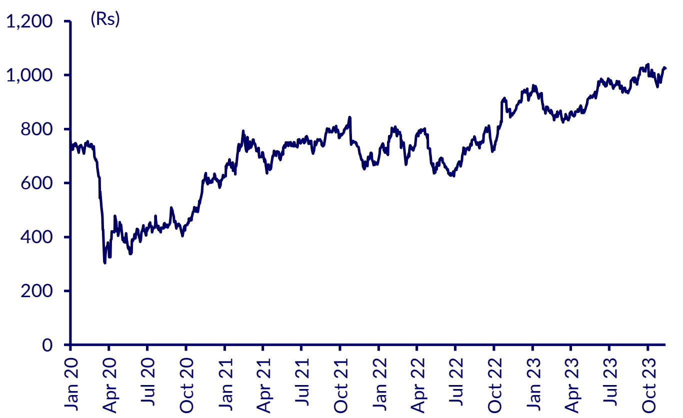
**FII holding in financials**




Source: CLSA

Figure 145

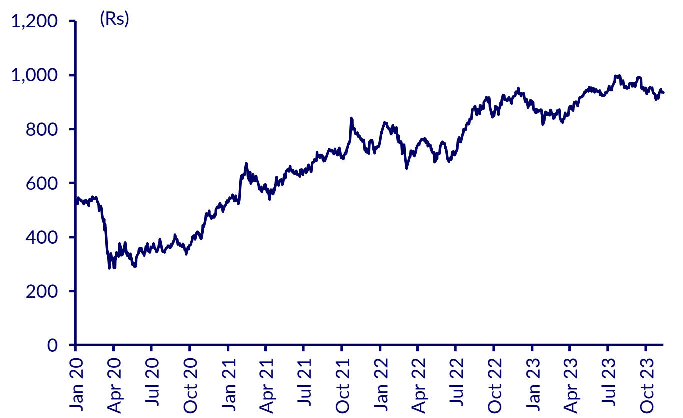
**Axis Bank stock price since January 2020**




Source: Bloomberg, CLSA

Figure 146

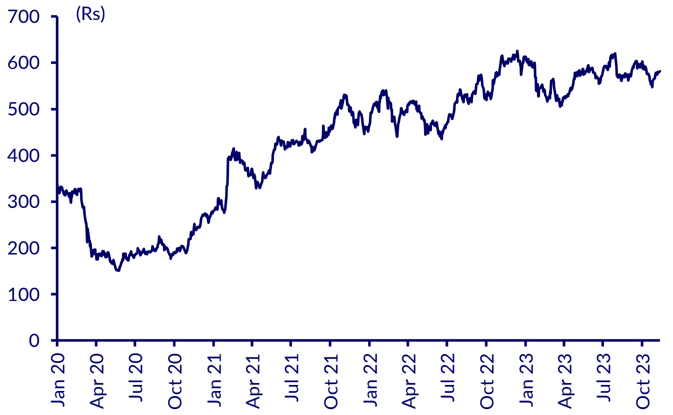
**ICICI Bank stock price since January 2020**




Source: Bloomberg, CLSA

Figure 147

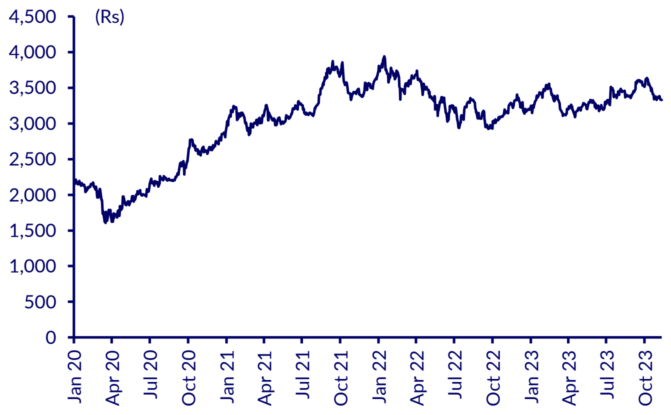
**SBI stock price since January 2020**




Source: Bloomberg, CLSA

Figure 148

**TCS stock price**



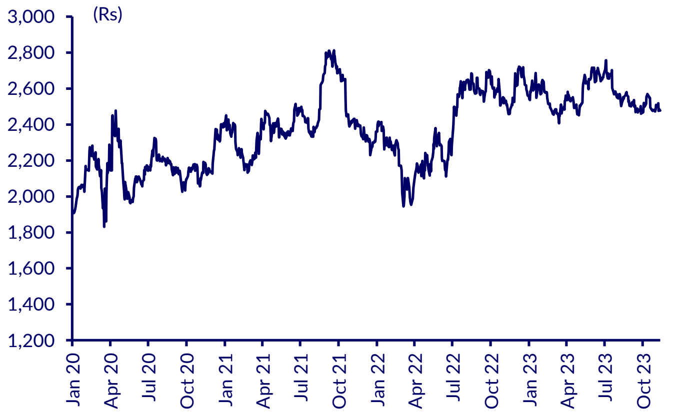

Source: Bloomberg, CLSA

**Consumer staples and pharma stocks typically outperform during bear markets**

2. Traditional defensives: For example, consumer staples and pharma sectors typically outperform during bear markets. This guides our choice of Hindustan Unilever and Sun Pharma.

Figure 149

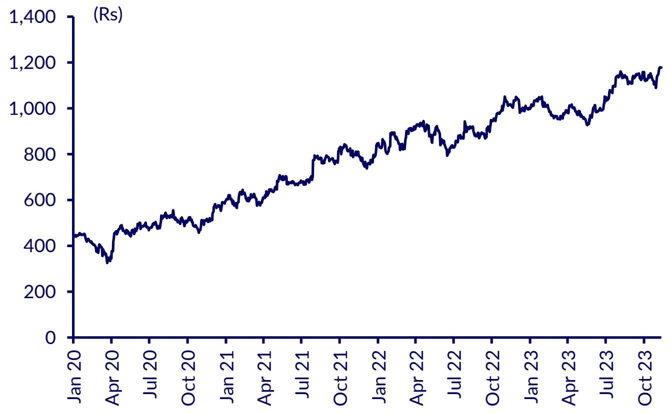
**Hindustan Unilever stock price**




Source: Bloomberg, CLSA

Figure 150

**Sun Pharma stock price**



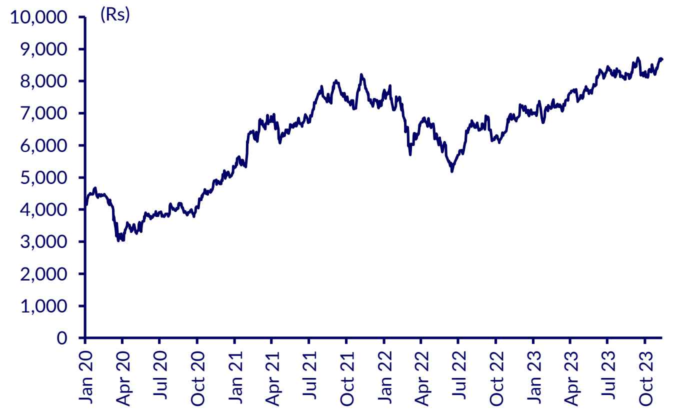

Source: Bloomberg, CLSA

**Positive events coming up for Bharti Airtel and UltraTech**

3. **Stocks with positive events coming up** are Bharti Airtel (5G ramp up) and UltraTech (pre-election pick up in cement demand). Further, both are characterised by a clean balance sheet that aligns well with our defensive strategy of capital preservation. Our expectation of a rural recovery in mid-2024 drives our choice of M&M. NTPC in the power sector is also a beneficiary of India's ambition of attaining net zero of greenhouse gas emissions by FY70.

Figure 151

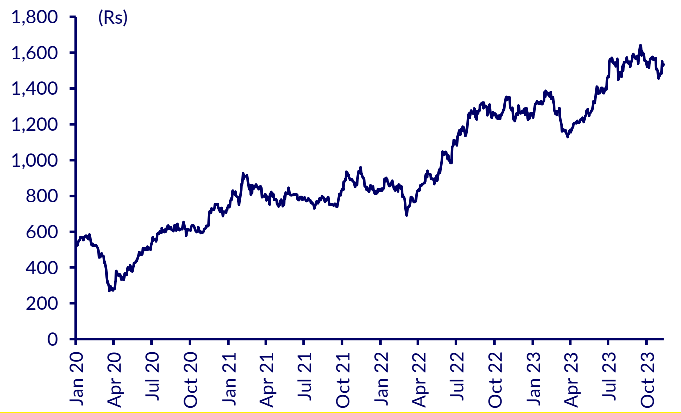
**UltraTech stock price**




Source: Bloomberg, CLSA

Figure 152

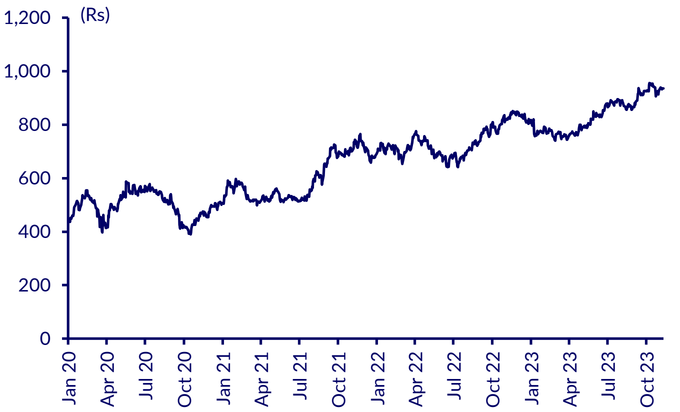
**M&M stock price since January 2020**




Source: Bloomberg, CLSA

Figure 153

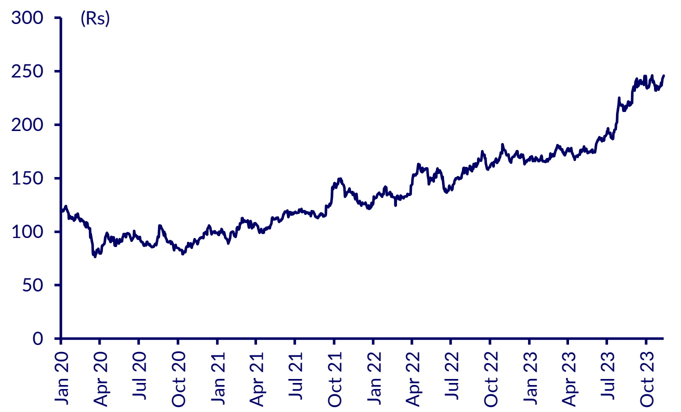
**Bharti Airtel stock price**




Source: Bloomberg, CLSA

Figure 154

**NTPC stock price since January 2020**




Source: Bloomberg, CLSA

**Axis Bank asset quality continues to improve**

**Axis Bank:** Axis Bank has been delivering well on its target of delivering loan growth 400-600bp faster than the industry. It has also managed its net interest margin well in the past two quarters, reporting a decline of only 10bp vs 35-50bp for peers like ICICI and Kotak. Asset quality continues to improve with the gross nonperforming loan (GNPL) ratio down 75bp over the past year. In the near term, the expense ratio will remain elevated but we should see a decline from 2HFY25. That should offset any NIM pressure from a rate-cut environment. The stock trades at 1.8x PB/11x PE (FY25), which is inexpensive, in our view.

**Transition to 5G offers upside to Bharti's mobile and India home broadband and enterprise offerings**

**Bharti Airtel:** Bharti Airtel is our top telco sector pick. India mobile's rising average revenue per user (Arpu), data penetration and share gains underline Bharti Airtel's growth. Bharti's 5G ramp-up offers upsides to mobile as well as home broadband and enterprise offerings. Besides strong growth, we estimate Bharti's consolidated pre-tax ROCE to rise to 19% and have US$10bn annual cash flows by FY26CL.

**We see an acceleration in growth for Hindustan Unilever in FY25 and FY26**

**Hindustan Unilever:** Hindustan Unilever remains our preferred large-cap pick in staples. It is the Beauty and Personal care (BPC) market leader. However, Hindustan Unilever's BPC growth has decelerated sharply due to increased competition from challenger D2C brands, new products from existing competitors and price-driven competitors that have used commodity price fluctuations to gain share. With renewed management focus, led by the new CEO, and demand bottoming out over the next quarter, we expect an acceleration in growth in FY25 and FY26.

**ICICI Bank is among our top picks in India financials**

**ICICI Bank:** ICICI Bank is among our top picks in India financials. It has emerged stronger after a bad corporate cycle over 2015-18 followed by Covid-19. Not only has the balance sheet been cleaned up, ICICIB has 1.5% of additional contingency provisions. Its market share in high-yielding segments like personal loans and MSME loans is low and there is scope to grow these portfolios without diluting profitability. NIMs are 50bp above pre-Covid levels, and any decline in NIM would only imply mean reversion. With a de-rating over the past year, the stock trades at only 2x FY25 PB for a best-in-class ROE of 18%.

**TCS buyback could provide support to the stock**

**TCS:** Consulting and IT services firm TCS's latest 2QFY24 results saw a modest margin and profits beat and strong deal wins (highest in last six quarters). It has approved a tender buyback of 170bn shares at Rs4,150 per share, representing 1.12% of the total paid-up equity share capital as on FY23. This could provide support to the stock and revive investor interest.

**SBI can deliver low-teens loan growth, which is better than most of its SoE peers**

**SBI:** SBI is a proxy play on the credit cycle in India. Despite a 20%+ market share, SBI can deliver low-teens loan growth, which is better than most of its SoE peers. The bank's domestic loan-deposit ratio is only 64%, implying there's scope to grow even if deposits remain tight. Over the past two years, SBI has nearly halved its GNPL ratio to 2.5% while improving its provision coverage ratio from 70% to 75%. In a steady-state, SBI will deliver 13% ROE, for which, a PB multiple of 1.2x is inexpensive.

**We estimate solid growth for M&M in SUV business led by strong order booking**

**M&M:** M&M is one of our top picks in the sector. We are bullish as the stock is undervalued; management has addressed capital allocation concerns related to subsidiaries, while the core business is in solid shape. We estimate solid growth for M&M in the SUV business, led by strong order booking, and expansion in margin in both automotive and tractor businesses, led by a decline in commodity costs.

**NTPCs thermal and hydro assets fall under regulated regime, which ensures a 15.5-16.5% RoE**

**NTPC:** NTPC, India's biggest power generator with over 24% market share is integral to the country's ambition of achieving net zero by FY70 while providing much-needed energy security to the masses. NTPC's thermal and hydro assets of 74GW fall under the regulated regime, which ensures a 15.5-16.5% ROE on its regulated equity investments apart from offering incentives, making it the a defensive growth play in uncertain times. We see continued re-rating of NTPC that started in 2021 as it began leading the energy transition in India.

**Sun Pharma is likely to maintain double-digit growth**

**Sun Pharma:** Sun Pharma has a diversified portfolio both in terms of geography as well as product categories. Its US sales should enjoy a 9% Cagr, with specialty outpacing generics. India business to maintain double-digit growth with field force expansion and market share gains. Strong core business and specialty portfolio ramp-up make us positive on Sun Pharma. It is our top pick in healthcare.

**UltraTech is best placed to benefit from a cement upcycle given its capacity and market leadership**

**UltraTech:** UltraTech is best placed to benefit from a sustained strength in cement demand given its capacity and market leadership. Cement demand is in an upcycle in our view, and UltraTech, given its strong expansion pipeline, is best placed to benefit. With capacity expansion at a much lower rate than industry benchmark, we see ROCEs improving structurally.

Figure 155

**CLSA defensive stocks recommendation**

| Stock | Ticker | Market cap (US$bn) | ADTO (US$m) | Price (Rs) | Target price (Rs) | Rec | PE (x) | | PB (x) | | EV/Ebitda (x) | | ROE | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | FY24 | FY25 | FY24 | FY25 | FY24 | FY25 | FY24 | FY25 |
| Tata Consultancy | TCS IB | 154.2 | 80 | 3,529.9 | 3,550.0 | O-PF | 27.2 | 24.2 | 13.6 | 13.3 | 19.6 | 17.2 | 50.7 | 55.8 |
| ICICI Bank | ICICIBC IB | 77.9 | 165 | 922.6 | 1,225.0 | BUY | 16.5 | 14.8 | 2.8 | 2.4 | | | 18.1 | 17.5 |
| Hindustan Unilever | HUVR IB | 70.7 | 47 | 2,521.7 | 2,802.0 | O-PF | 55.5 | 50.0 | 11.5 | 11.0 | 41.8 | 37.5 | 21.0 | 22.5 |
| Bharti Airtel | BHARTI IS | 68.2 | 55 | 969.8 | 1,110.0 | BUY | 57.7 | 33.0 | 6.5 | 5.5 | 9.2 | 8.1 | 11.7 | 18.1 |
| State Bank of India | SBIN IB | 60.1 | 107 | 559.1 | 700.0 | BUY | 8.6 | 9.3 | 1.3 | 1.2 | | | 16.5 | 13.6 |
| Axis Bank | AXSB IB | 36.7 | 105 | 998.2 | 1,200.0 | BUY | 13.1 | 11.3 | 2.1 | 1.8 | | | 17.3 | 17.2 |
| Sun Pharma | SUNP IB | 34.6 | 27 | 1,204.3 | 1,340.0 | BUY | 33.1 | 27.1 | 4.7 | 4.2 | 22.0 | 19.2 | 14.8 | 16.3 |
| UltraTech | UTCEM IS | 30.2 | 32 | 8,759.9 | 9,450.0 | O-PF | 32.1 | 26.1 | 4.2 | 3.7 | 17.7 | 14.7 | 13.7 | 15.0 |
| NTPC | NTPC IS | 29.1 | 40 | 253.7 | 240.0 | BUY | 13.3 | 11.8 | 1.6 | 1.6 | 7.5 | 7.1 | 12.9 | 14.0 |
| Mahindra | MM IB | 23.3 | 47 | 1,543.3 | 1,931.0 | BUY | 18.5 | 18.1 | 3.7 | 3.2 | 13.0 | 10.9 | 21.8 | 19.1 |

Source: CLSA

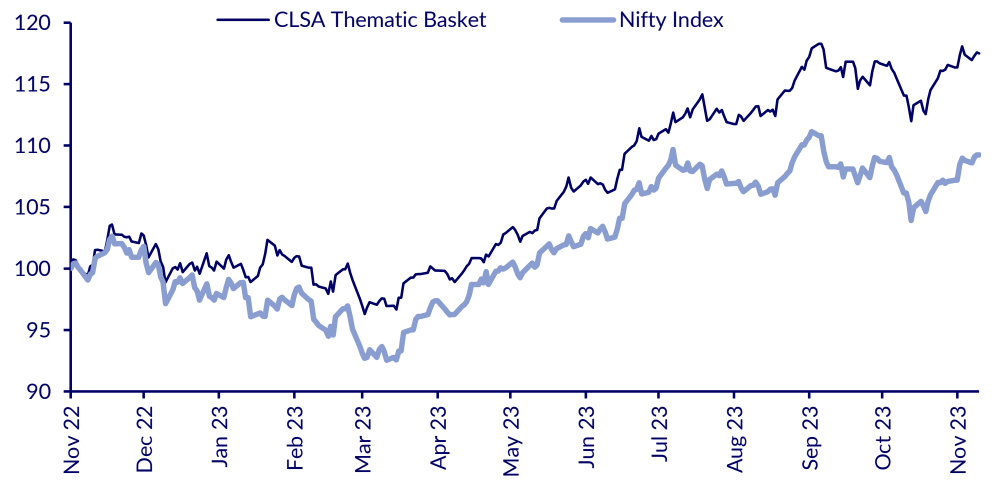
**Our basket of stocks is up 18% since Nov-22**

While we continue to recommend a defensive large-cap basket to weather a correction in the near term, our basket is up 18%, while Nifty has risen by 9%, since introduction in 14 November 2022 in our *Surviving the Fed* report.

**Thematic Basket has outperformed the Nifty 50 benchmark by about 8ppt**

Figure 156

**Our basket has outperformed the benchmark Nifty 50 since inception on 14th November 2022**

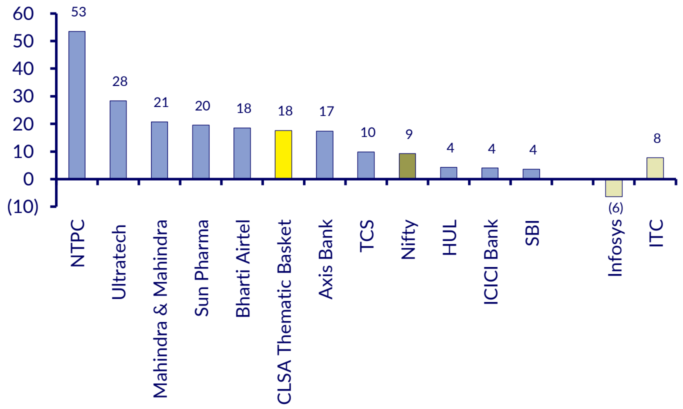



Note: Indices rebased to 100. Source: Bloomberg, CLSA


**Our *Surviving the Fed* report introduced our Thematic stocks basket**

Figure 157

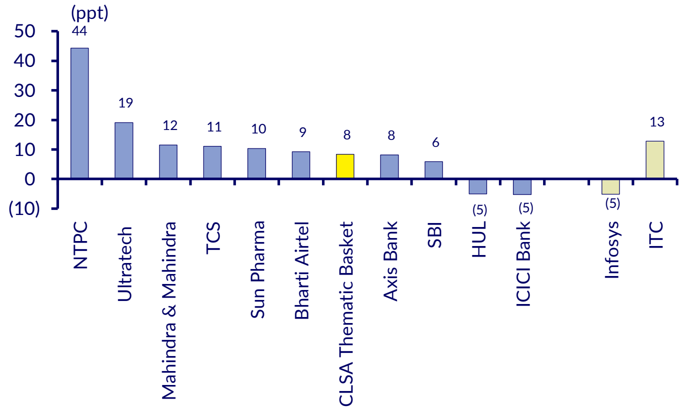
**Bharat basket total returns, absolute**




Note: Performance includes dividend returns. Replaced Infosys with TCS on 9th Jan 2023, Replaced SBI with TCS on 9th Feb 2023.
Source: Bloomberg, CLSA

Figure 158

**Bharat basket total returns relative to Nifty**




Note: Performance includes dividend returns. Replaced Infosys with TCS on 9th Jan 2023, Replaced SBI with TCS on 9th Feb 2023.
Source: Bloomberg, CLSA

**We also recommend other stocks which provide longer term growth potential across sectors**

We also recommend a few other stocks that can provide longer-term growth potential across sectors. Zomato, a prominent player in the online food delivery and restaurant discovery space, taps into the growing trend of digital dining. Delhivery, a logistics and supply chain solutions provider, is crucial in facilitating ecommerce growth, positioning itself as an infrastructure play. Paytm, a digital payments and financial services platform, adds a fintech dimension, aligning with India's evolving digital economy. PVR Inox is a compelling play on discretionary consumption in India. Prestige Estates has been one of the top three developers in terms of presales for the last 5-6 years.

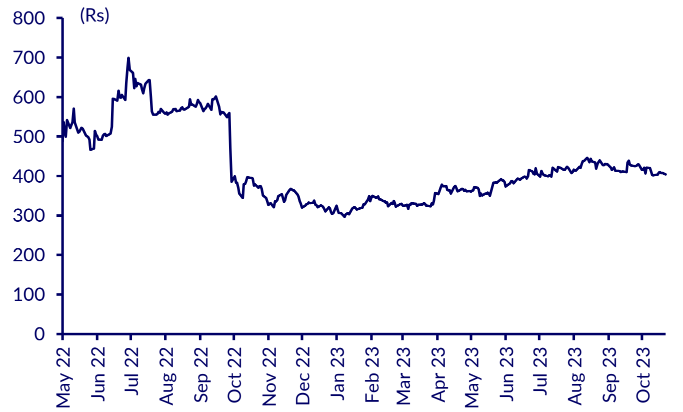
Figure 159

**Zomato stock price**


Source: Bloomberg, CLSA

Figure 160

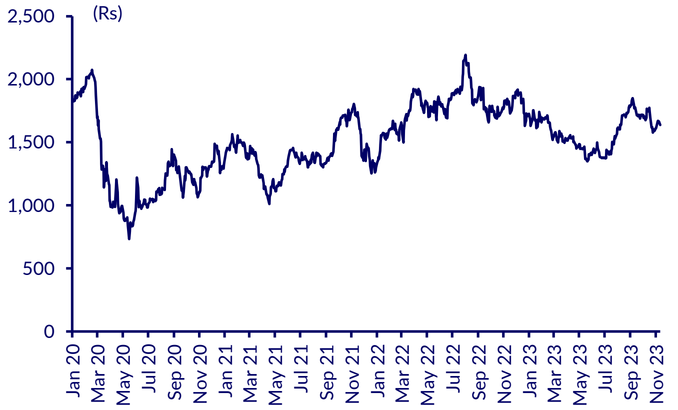
**Delhivery stock price**




Source: Bloomberg, CLSA

Figure 161

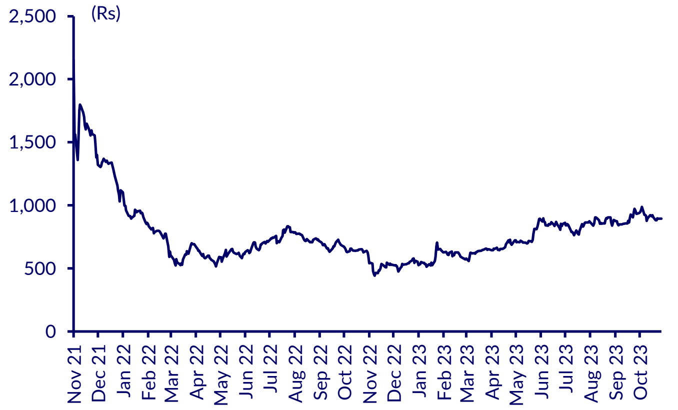
**PVR Inox stock price**




Source: Bloomberg, CLSA

Figure 162

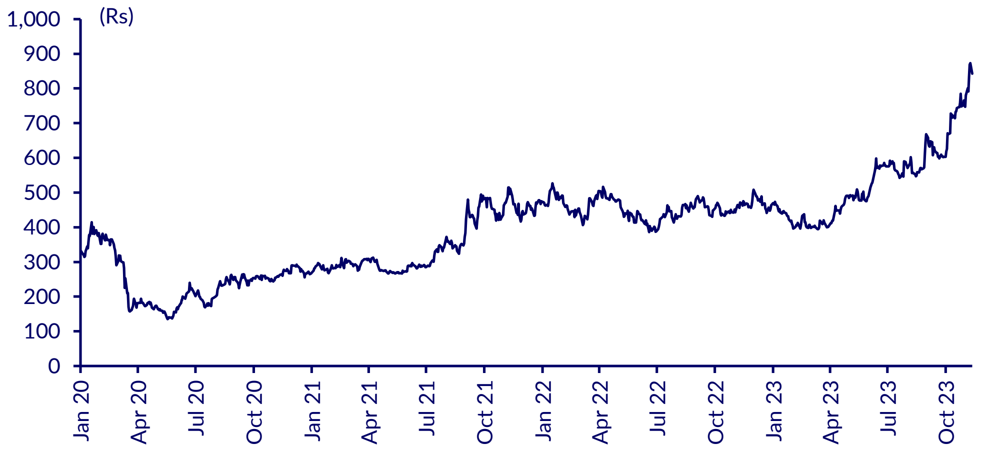
**Paytm stock price**




Source: Bloomberg, CLSA

Figure 163

**Prestige Estates stock price**




Source: Bloomberg, CLSA

**Zomato is our top consumer pick**

**Zomato:** Zomato is our top consumer pick. We believe it has a significant upside from its growing monthly transacting customer (MTC) base for its food delivery business and the quick commerce business, Blinkit. We also see ordering frequency increase steadily for food delivery as Zomato's loyalty program drives increased use. For Blinkit, we see an improvement in profitability driven by higher customer additions and coverage density and forecast the business to break even at an Ebitda level in FY25. We believe continued improvement in the MTC base, higher order frequency and move towards contribution profitability will increase investor confidence, especially in quick commerce.

**Paytm is focussing on balancing growth and profitability**

**Paytm**: Paytm is a good turnaround story, from focusing on just growth to balancing growth and profitability. GMV growth in payments remains strong at 40% and will likely continue at 30% over the medium term. Over the past three years, Paytm went from making nothing on payments to now making a 13-15bp net take rate on its payments business. Moreover, cashbacks and promotional expenses are down from 30bp of GMV in FY20 to 3bp. Loan distribution has scaled up well and now equals 80-85% of the net revenue in the payments business. Over the next 2-3 years, lending revenue will equal payments revenue. While employee cost continues to grow rapidly, other opex is under control. This gives the business operating leverage and a sharp improvement in Ebitda over the next two years.

**PVR Inox remains a compelling play on discretionary consumption**

**PVR Inox:** PVR Inox is India's leading multiplex chain with over 1,700 screens. It is seeing rising admissions and occupancy led by immense content in Bollywood (Hindi), regional and Hollywood films. Multiplexes in India do not face structural risk from streaming services and the stock remains a compelling play on discretionary consumption.

**India's logistics segment is rapidly shifting in favour of organised players**

**Delhivery:** It is the largest third-party player in the express logistics segment and is poised to benefit from strong growth in ecommerce shipments in India over the next decade. India's logistics segment is highly unorganised and is rapidly shifting in favour of organised players, which should benefit Delhivery.

**Prestige aims a 15-20% Cagr over the mid-term**

**Prestige Estates:** Prestige Estates has been one of the top three developers in terms of presales for the last 5-6 years. It is set to clock presales of over Rs200bn in FY24, the highest ever by any developer in India. It also aims a 15-20% Cagr over the mid-term driven by expansion in newer markets like Mumbai and NCR. Its rental income should also scale up sharply from around Rs5bn to Rs35bn over the next 5-6 years, driven by a capex of Rs160bn, which internal accruals will partly fund. Despite such a high scale of operations, it is trading at a 50% discount to peers (in terms of EV/presales, EV/cash Ebitda) with a similar scale, such as Macrotech, Godrej Properties and DLF, which we believe is unwarranted.

Figure 164

**CLSA other thematic stock recommendation**

| Stock | Ticker | Market cap (US$bn) | ADTO (US$m) | Price (Rs) | Target price (Rs) | Rec | PE (x) | | PB (x) | | EV/Ebitda (x) | | ROE | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | FY24 | FY25 | FY24 | FY25 | FY24 | FY25 | FY24 | FY25 |
| Zomato | ZOMATO IN | 12.2 | 101.6 | 115.3 | 168.0 | BUY | 177.2 | 46.9 | 4.7 | 4.3 | 276.4 | 48.6 | 2.7 | 9.7 |
| Delhivery | DELHIVER IN | 3.5 | 4.9 | 385.7 | 493.0 | BUY | nm | nm | 3.5 | 3.6 | 498.1 | 68.0 | nm | nm |
| PVR Inox | PVRINOX IN | 2.0 | 11.7 | 1,655.1 | 2,280.0 | BUY | 84.6 | 35.2 | 2.2 | 2.1 | 11.4 | 8.7 | 2.7 | 6.1 |
| Prestige | PEPL IN | 4.3 | 9.6 | 905.7 | 1,005.0 | BUY | 60.2 | 51.1 | 3.2 | 3.0 | 14.7 | 12.2 | 5.6 | 6.1 |
| Paytm | PAYTM IN | 6.9 | 38.1 | 918.8 | 1,200.0 | BUY | nm | 366.9 | 4.8 | 4.4 | nm | 48.6 | nm | 1.2 |

Source: CLSA

Figure 165

**Stock recommendation at a glance**

| | Macro drivers | | | Sector drivers | | | Other factors | | |
|---|---|---|---|---|---|---|---|---|---|
| | Demographics | Financial deepening | Stable INR | Income effect | Institutional access | Innovation | Valuations | Defensive play | Trigger |
| **Large caps** | | | | | | | | | |
| Axis | Y | Y | | Y | Y | | Y | | |
| ICICI Bank | Y | Y | | Y | Y | | Y | | |
| HUL | Y | | | Y | | | Y | Y | |
| Bharti | Y | | | Y | | Y | | | Y |
| TCS | | | Y | | | | | | |
| SBI | Y | Y | | Y | Y | | Y | | |
| M&M | Y | Y | | Y | Y | Y | | | Y |
| NTPC | Y | | | Y | | Y | | Y | Y |
| Sun Pharma | | | Y | Y | | Y | | Y | |
| UltraTech | Y | Y | | Y | Y | | | | Y |
| **Mid caps** | | | | | | | | | |
| PayTM | Y | Y | | Y | Y | Y | | | |
| Delhivery | Y | Y | | Y | Y | Y | | | |
| Zomato | Y | Y | | Y | Y | Y | | | |
| PVR Inox | Y | Y | | Y | Y | | | | |
| Prestige | Y | Y | | Y | Y | | | | |

Source: CLSA

## Companies mentioned

Axis Bank (AXSB IB - RS1,025.6 - BUY)
Bharti Airtel (BHARTI IS - RS947.3 - BUY)
Delhivery (DELHIVER IN - RS399.8 - BUY)
HDFC Life Insurance (HDFCLIFE IN - RS665.0 - O-PF)
Hindustan Unilever (HUVR IB - RS2,489.2 - O-PF)
ICICI Bank (ICICIBC IB - RS935.6 - BUY)
ICICI Lombard (ICICIGI IN - RS1,439.0 - BUY)
JP Morgan Asset Management (N-R)
Mahindra (MM IB - RS1,571.0 - BUY)
NTPC (NTPC IS - RS252.3 - BUY)
Paytm (PAYTM IN - RS905.4 - BUY)
Prestige Estates (PEPL IN - RS878.0 - BUY)
PVR Inox (PVRINOX IN - RS1,660.8 - BUY)
State Bank of India (SBIN IB - RS584.4 - BUY)
Sun Pharma (SUNP IB - RS1,189.8 - BUY)
Tata Consultancy (TCS IB - RS3,498.0 - O-PF)
UltraTech (UTCEM IS - RS8,775.0 - O-PF)
Zomato (ZOMATO IN - RS122.2 - BUY)



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