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Insigneo Weekly Dispatch

Rise of the Bengal Tiger: The Case for India

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Rise of the Bengal Tiger: The Case for India

> The long-term potential for India is clear: a large population, which is producing a growing, young and tech-savvy workforce, should lead to high income and consumption growth over the long-term.

> As oil prices continue to stagnate, one of India's main input costs remains relatively low, increasing the country's medium-term growth potential.

> The Reserve Bank of India embarked on a cycle of monetary easing in February of this year, possibly creating a dynamic that could propel growth higher in the near term.

> The Indian equity market is not for everyone, as it comes with its fair share of potential risks. However, long-term drivers stemming from favorable population and education growth dynamics, coupled with more tangible catalysts such as relatively low oil prices and a favorable economic backdrop, could make this country a reasonable alternative destination for investors with the appropriate risk profiles.

U.S. equity markets still represent some of the best long-term investment opportunities for a globally diversified portfolio. However, given the recent outperformance of U.S. equities, investors have been looking for alternative markets in which to deploy new capital, and rightly so. With this in mind, we have been highlighting different regions that we consider attractive, such as Europe, Latin America, and Asia. Within Asia, a country that we find particularly appealing for investors with a long-term horizon and a moderately high tolerance for risk is India.

With an estimated population of close to 1.5 billion people, India ranks as the most populous country in the world, surpassing China, and accounting for nearly 20% of the world's population. It is unlikely that India will relinquish its top rank any time soon, as its population is expected to grow to close to 1.7 billion by 2050. Historically, a densely populated country has equated to low levels of literacy and high levels of rural living. This is true in India. With literacy levels close to 80% and relatively low levels of urbanization, India ranks below the average for both metrics in developing countries. However, the country's literacy levels already surpass those of most countries in South Asia, and urbanization levels are expected to surpass 50% by 2050. This is important, because as more people move from rural to urban areas, education levels tend to increase, driving incomes higher, which leads to increased consumption. China experienced a similar dynamic in the recent past, and we have all seen how this country has developed over time.

Apart from a growing population with increasing levels of education, India has an additional advantage, which is the young age of its people. With a median age of 28.7 years, India's population is significantly lower than that of most developed countries with median populations ages higher than 40 years. Given its relatively young population, growing education levels are trending towards highly skilled labor industries such as technology and communications. By some estimates, India's tech-oriented workforce currently numbers between 6 and 7 million people, compared to other tech-oriented emerging markets economies such as Vietnam and Poland, with similar industry populations standing near 1.3 million and 500,000, respectively. According to LinkedIn's Workforce Report, tech-related jobs in the country have grown on average, close to 15% per year over the past five years. With the current number of technology-oriented jobs accounting for only 2% of total jobs in the country, and the country's educational institutions continuing to produce millions of technology-oriented graduates every year, the runway for growth is long. Cities like Bengaluru, Hyderabad, Pune and Chennai are already strong technology hubs in the country, housing some of the largest campuses outside of the U.S. for industry leaders like Google, Amazon, and Microsoft. **The long-term potential for India is clear: a large population, which is producing a growing, young and tech-savvy workforce, should lead to high income and consumption growth over the long-term.** But what about the mid- and short-term horizons?

Some of the dynamics associated with rising levels of education within a growing population base are already starting to express themselves. As a result of increased consumption, the country already enjoys the third largest retail market on the planet, with ecommerce experiencing very high levels of growth, powered by companies such as Instakart and Amazon India. However, consumption is not only manifesting itself in terms of retail spending, but also in terms of a more pressing need, energy demand. According to CIA World Factbook, the vast majority of India's electricity, 75% of it to be precise, stems from fossil fuel sources, primarily oil and coal. At the same time, other sources of energy demand, such as transportation, are also consuming vast amounts of oil. Data from the Energy Information Administration shows that as of 2024, India was consuming approximately 5 million barrels of oil per day, or approximately 5% of global consumption, making it the third largest consumer on the planet, trailing only the United States and China. In fact, according to the International Energy Agency (IEA), Indian consumption growth is currently the single largest driver of global oil demand growth and expected to account for as much as one third of global demand growth by 2030. Why is this important? **Because as oil prices continue to stagnate, one of India's main input costs remains relatively low, increasing the country's growth potential over the medium-term.**

There are also dynamics at play that could propel growth higher in the short-term, the most important being the fact that the Reserve Bank of India (RBI) embarked on a monetary easing cycle in February of this year, representing the first interest rate cuts since 2020. From February through early June, the RBI has meaningfully reduced the country's repo rate by a full 100 basis points, from 6.5% down to 5.5%, where it currently stands. At the same time, the RBI reduced the Cash Reserve Ratio by 100 basis points, effectively injecting more liquidity into the economy to support loan and mortgage growth. Although the RBI recently changed its tone on the easing cycle from one of “accommodative” monetary policy to a more “neutral” stance, RBI governor Sanjay Malhotra left the door open for more rate cuts if inflation proves to be below projections. Inflation has been cooling over the past three years from levels close to 7.5% in the Fall of 2022, to its current level of 2.8%. At the same time, GDP growth has improved over the same period, moving from 5.9% to its current level of 7.4%. The RBI appears to be on track to deliver on its 6.5% GDP growth forecast for next year. As a result, the country’s traditionally strong technology and banking sectors are expected to continue to benefit from increased economic growth, coupled with low inflation.

To be fair, although economic growth potential appears to remain strong, risks do abound. Relatively high unemployment rates between 5.5% and 6% could create potential headwinds for the economy. Additionally, there is a high level of geopolitical risk stemming from the recent flare-up between India and Pakistan over the long-disputed region of Kashmir. Although this dispute dates as far back as the 1940’s, flare-ups like the one seen last month remain a possibility, adding another dimension of risk to potential investments in this country. At the same time, Indian equity markets trade at valuations that tend to be higher than most developing markets, which could make it vulnerable to general market pullbacks. However, at its current valuation near 22.3x forward earnings, India’s Nifty 50 index is trading towards the bottom half of its 5-year valuation range, and more than 25% off the highs seen in 2021.

After considering the potential risks and returns from investing in India, investors with the appropriate risk profiles that want to consider getting exposure to the Indian equity markets are best served doing so through diversified investment vehicles such as mutual funds or ETFs. Given the relatively low breadth and depth of Indian equity indices like the Sensex or Nifty 50, a diversified approach would be best suited to attain the desired exposure. ETFs such as the iShares MSCI India ETF (INDA) and the Franklin FTSE India ETF (FLIN), as well as their UCIT counterparts, could provide relatively higher levels of diversification.

The Indian equity market is not for everyone, as it comes with its fair share of potential risks. However, long-term drivers stemming from favorable population and education growth dynamics, coupled with more tangible catalysts such as relatively low oil prices and a favorable economic backdrop, could make this country a reasonable alternative destination for investors with the appropriate risk profiles. ■

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