

# EM COUNTRY FOCUS

## INDIA: LONG-TERM VIEWS FROM A FIXED INCOME PERSPECTIVE

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GlobalEvolution

# GLOBAL EVOLUTION

## INDIA: LONG-TERM VIEWS FROM A FIXED INCOME PERSPECTIVE

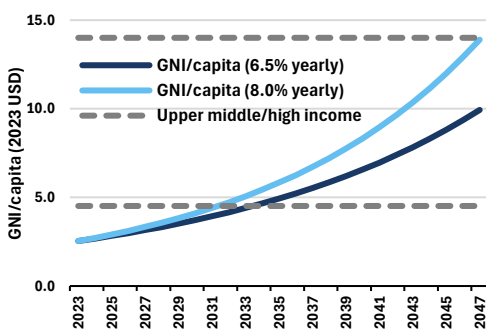
India is in many aspects a very interesting study these years, particularly as it moves up from a low-income country with high poverty rates. Economists and market analysts continue to produce a seemingly endless stream of research on the implications of India's economic development for stock market returns, while we analyze the factors supporting India's potential rise to high-income status and how such a transition could impact the global economy. We also explore potential market movements and returns from the perspective of a fixed income investor.

By Alexander Friis Illum, senior analyst

### Ambitious goals supported by demographics

Prime Minister Narendra Modi has made it a public goal that India achieves high-income status by 2047, marking the 100-year anniversary of its independence. In 2023, the threshold for a high-income country is a gross national income (GNI) per capita of USD 14,005; India's was USD 2,540, placing it in the lower middle-income group. To reach its 2047 goal, India must raise GNI per capita by 5.5x over the next 23 years, or grow GDP an average of 8% annually. While ambitious, India's young population and favorable demographics support this potential.

Chart 1: GNI/capita in different scenarios

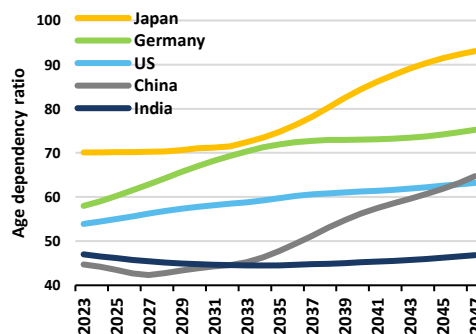


Source: World Bank, UN & Haver Analytics

Clearly, 8% annual growth over a 24-year period is ambitious and may be overly so.

However, a few factors speak in favor of India achieving extraordinary growth rates in the coming decades. Most notably, India's demographics are very supportive of continued growth, contrary to most other major economies in the world. In Chart 2 we compare age-dependency ratios (the amount of people aged 0-14 and 65+ compared to the amount of people aged 15-64) for the 5 largest economies worldwide for the next 24 years as forecast by the UN.

Chart 2: Age-dependency ratio (2023-2047)



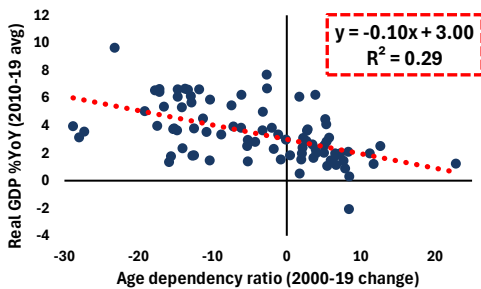
Source: UN & Haver Analytics

India stands in a unique demographic situation, where the age-dependency ratio is going to decline slightly for the next 15 years before stabilizing. There will be more than two working-age adults for every single child or elderly in India through the next 24 years.

The age-dependency ratio in China will weaken very abruptly from 2030 or so – and so will it in Germany and the US. Japan’s demographics are even more problematic.

In Chart 3, we show that over time there is a clear correlation between the age dependency ratio and GDP growth. Each dot in the chart represents a country (86 countries, representing a total of 98% of global GDP) and on the X-axis we show the change in age dependency between 2000 and 2019. On the Y-axis we show the average growth level from 2010-2019. (We intentionally leave out the covid-affected years to get a closer view of effects on potential GDP growth.)

**Chart 3: Change in age-dependency ratio (X) vs. GDP growth (Y)**



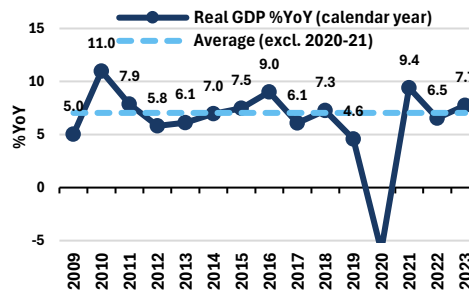
Source: IMF, UN & Haver Analytics

A higher age-dependency ratio in general means that fewer people are available to work and generate economic output. Also, families need to allocate more resources to child- and elder care (or pay higher taxes) rather than save and invest for future productive capacity. If fiscal deficits rise to counter the rising age-dependency ratios, it will generate higher debt burdens that can constrain GDP growth over time. These factors, we believe, are the main explanation for the correlation shown in Chart 3, which are supportive of growth in India.

**8% annual growth: Challenging but possible**

So, what speaks in favor of India reaching such a high level of growth? For one thing, the country has been close in recent years. From 2010-2023 (excluding covid-affected 2020 and 2021), the average yearly growth rate was 7.2% (see Chart 4), not far from 8%.

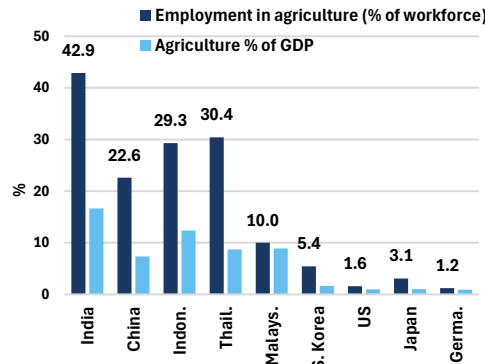
**Chart 4: India real GDP growth 2009-2023**



Source: India Statistical Organization & Haver Analytics

A factor with potential to bridge the gap to 8% is the high share of employment in agriculture. As Chart 5 depicts, 42.9% of the Indian workforce was employed in agriculture in 2023.

**Chart 5: Agriculture % of employment & GDP**

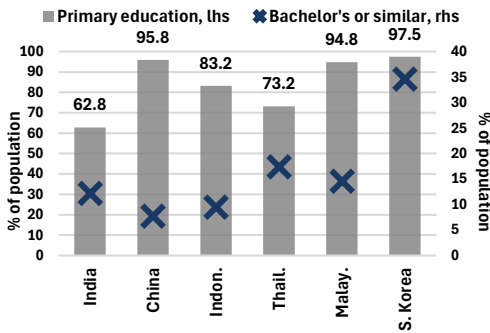


Source: India Statistical Organization & Haver Analytics

Furthermore, the 42.9% working in agriculture generated a meagre 16.6% of economic output, meaning that the remaining 57.1% of the workforce generated 83.4% of output. India’s growth potential could be highly improved if it can rearrange the workforce toward manufacturing and services. China has done so, as has Indonesia, Thailand and Malaysia during the last 20-40 years, while South Korea did it even earlier. These Asian nations have all achieved upper-middle- or high-income status.

Another factor that speaks in favor of India’s rising income level and growth rates in the future is education levels.

Chart 6: Primary and higher education levels



Source: World Bank & Haver Analytics

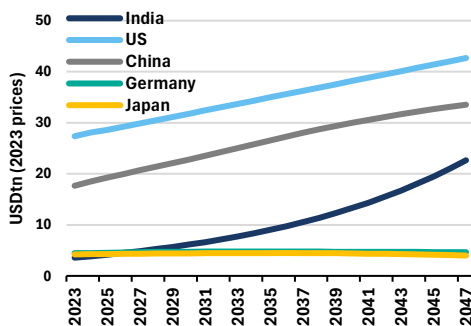
As India urbanizes and shifts from agriculture to services and manufacturing, primary and higher education rates will rise, boosting the country's long-term growth and differentiating it from other Asian nations.

While several factors could help India reach high-income status by 2047, India faces structural challenges in moving up the value chain such as bureaucratic land acquisition and rigid labor laws. Meaningful reforms are needed, but Modi may lack both willingness and mandate.

**India as a global superpower**

But how would the world look in 24 years if India achieves its ambition of gaining high-income status with 8% yearly growth? Chart 7 provides an estimate.

Chart 7: GDP projections (2023 USD)

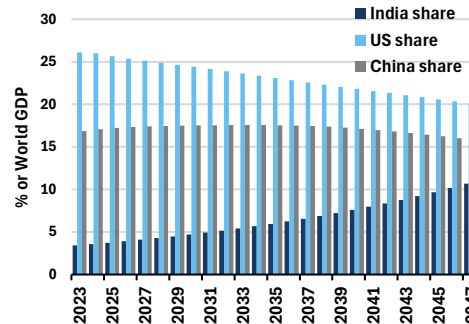


Source: World Bank & Haver Analytics. Estimates by Global Evolution

We use the IMF World Economic Outlook (WEO) forecasts for growth through 2028 (except for India, where we use 8%), and then rely on changes in demographics, where we take the findings from Chart 2 at face value. Hence, any 1-point rise in the age-dependency

ratio shaves 0.1%-pts off GDP growth. This is of course highly simplified, but the country-by-country differences of technology adoption and any associated productivity gains are difficult to forecast.

Chart 8: India, US, China share of world GDP

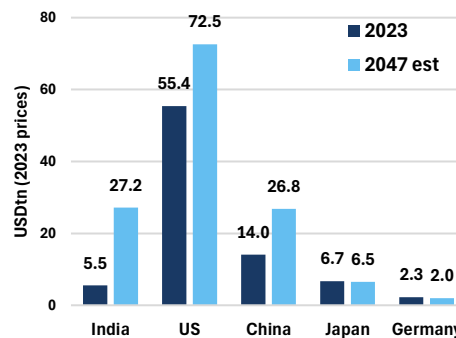


Source: IMF, UN & Haver Analytics. Estimates by Global Evolution

Charts 7 and 8 show the potential disruptions among global superpowers in the coming decades. While India will not "catch" China or the US GDP, the gap will narrow. The Indian economy could grow 6x, with its share of global GDP rising from 3.4% today to 11%.

As India's economic importance grows, so will its role in financial markets. Unlike China, India's equity markets are more open to foreign investors and less dominated by state-owned enterprises. The market capitalization of Indian equities relative to GDP has increased from 75% in 2015-19 to 120% in 2022-24, while Chinese equities have declined. If this trend continues, India could have the second-largest equity market by 2047.

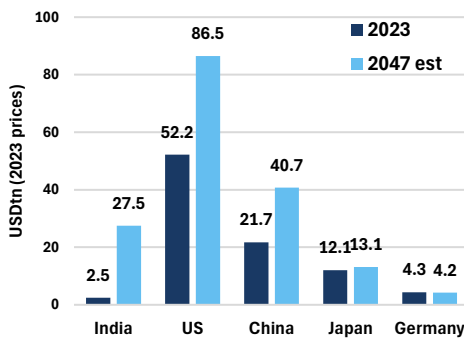
Chart 9: Equity market capitalization 2023-47



Source: Bloomberg, WFE & Haver Analytics. Estimates by Global Evolution

As it stands, the total amount of debt securities (bonds) issued by Indian entities stands at 75% of GDP. This is lower than the 100% of GDP in Germany, 120% in China, 200% in the US and 285% in Japan. As the Indian economy grows, market access for the private sector becomes easier and we would expect the total debt in the economy to grow relative to GDP. In Chart 10, we assume that India's total debt-to-GDP rises to 120%.

**Chart 10: Bond market size 2023-47**



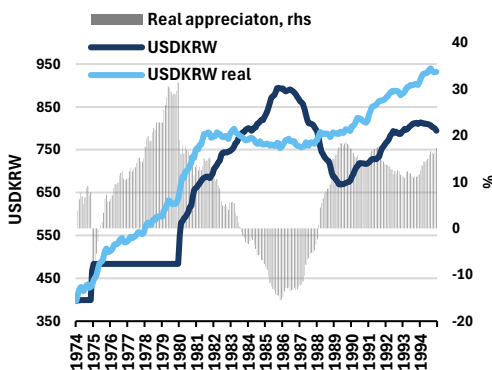
Source: Bloomberg, BIS & Haver Analytics. Estimates by Global Evolution

While India will still “only” be the third-largest bond market, it will be 10x bigger than today. Capital movements into and out of India will have market-moving implications much greater than is the case today.

**Market returns on the road to high income**

We naturally care what happens to our returns in the time between now and 2047. Within fixed income (and FX), the case for high returns in the coming years and decades is less clear than for equities, as there is no direct connection to growth.

**Chart 11: USDKRW (nominal & real), 1974-94**

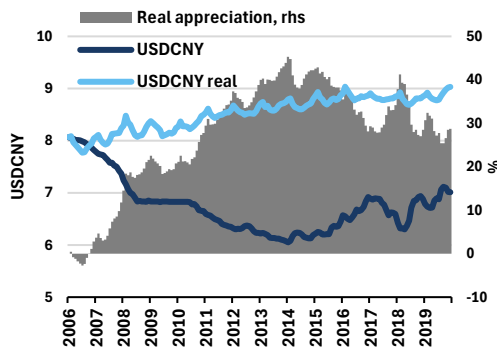


Source: Bloomberg & Haver Analytics

Back in 1974, South Korea had a GNI per capita of USD550, which in 2023 prices translates to USD2,600 or roughly where India is today. A little more than 20 years later, it became a high-income country with a GNI per capita above USD18,000.

The dark blue line in Chart 11 shows the development of the Korean won (KRW) versus the US dollar in nominal terms between 1974 and 1994. The light blue line shows how the development would have been if the FX pair only moved according to inflation differentials (“law of one price”). As we see, the KRW was pegged in the 1970s and weakened materially once made free-floating in 1980. But from that point onward, the KRW actually strengthened despite South Korea having higher inflation than the US, and the real appreciation of the period ended just shy of 20%.

**Chart 12: USDCNY (nominal & real), 2006-19**



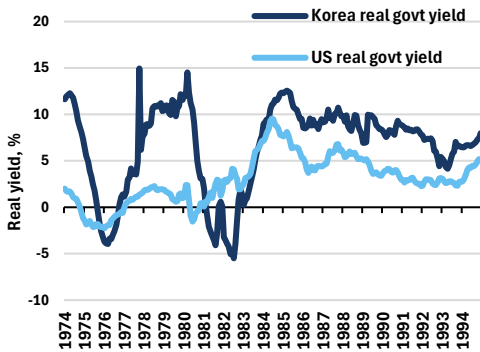
Source: Bloomberg & Haver Analytics

A similar – if even more straightforward – picture holds for the Chinese yuan in the period where the nation moved from lower middle-income (like India today) to almost high-income, as Chart 12 shows. We could show similar charts for most other Asian countries that have made the journey from low- to high-income, but the trend is clear.

In the short term many things affect FX movements and in the case of FX pairs, as we show here, fluctuations are inevitable. However, in the long term as countries develop and move up the value chain, they attract investments, and their currencies strengthen more than is warranted by the inflation differentials.

Despite government bond yields being highly impacted by the inflation environment and outlook, it seems that countries moving up the income ladder in general experience falling real yields (e.g., see Chart 13).

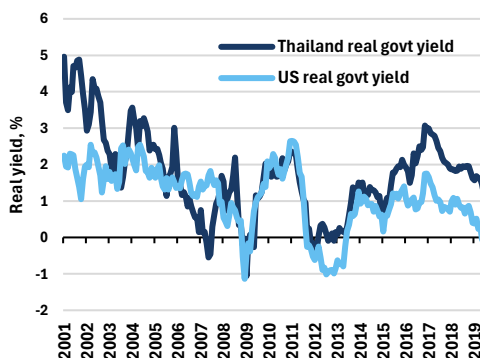
**Chart 13: S. Korea vs. US real yields, 1974-94**



Source: IMF, Bloomberg & Haver Analytics

Historical data availability of bond yields is somewhat limited, but the IMF collects a weighted-average series. Once again using the example from South Korea circa 1970s-90s, where we deduct the 2-year rolling average CPI inflation from the nominal yield (same method for the US), we see clear evidence of real yields dropping. The first 10 years were marked by high and volatile inflation, but from 1985 we see the real yield gradually falling and the spread to the US compressing.

**Chart 14: Thailand vs. US real yields, 2001-19**



Source: IMF, Bloomberg & Haver Analytics

Thailand is not yet knocking on the door to high-income status, but its GNI per capita rose 2.5x between 2001 and 2019 and is currently 3x the size of India's. In this period, we saw a drop in real yields and stabilization versus the US.

We are acutely aware that short-term market movements are influenced by a range of factors beyond improvements in per capita income. Still, other Asian countries that have undergone this journey in the past 50 years have experienced the positive developments we are seeking. While we don't typically invest in inflation-adjusted FX or real rates, countries with strong potential in real FX or real rates often show similar potential in nominal terms.

**Table 1: Credit rating overview**

	CNY*	THB	IDR	KRW
Period start	2003	2001	2006	1974
Period end	2019	2019	2024	1994
GNI/cap. end	12,000	8,300	5,000	18,000
Mdy** start	A3	Ba1	B2	-
Mdy end	A1	Baa1	Baa2	A1
S&P*** start	BBB+	BBB-	B+	-
S&P end	A+	BBB+	BBB	AA-
#nothes	+2-3	+2-3	+5-6	-

Source: Bloomberg. \*Currency codes as abbreviations for countries. \*\*Mdy = Moody's. Ratings for long-term foreign-currency debt are shown.

The Indian government has so far refrained from issuing a sovereign Eurobond yet holds a Baa3 rating from Moody's and a BBB- rating from S&P. Table 1 shows rating developments from when countries had a GNI per capita similar to India's today. While the end levels vary, all of them are at least twice as high as India's current level. During this period, these countries clearly experienced numerous rating upgrades. For South Korea, ratings are not available as far back as the 1970s but it is reasonable to assume that it would not have had an A1 or AA- rating at that time. Other factors besides growth are at play, but the trend is clear.

If India were upgraded by three notches in the coming years, spreads could compress by around 50 basis points, based on current JP Morgan EMBI prices—an attractive opportunity for investors.

**Conclusion**

Prime Minister Modi's goal for India to attain high-income status by 2047 is undeniably ambitious. However, several factors suggest that India could achieve remarkable growth

and substantial increases in per capita income in the coming decades. The most obvious factor is India's favorable demographics, which stand in stark contrast to its global peers. Additionally, a relatively low share of the population has basic education, and a high proportion is employed in agriculture. As the country develops, more people will gain access to better education and higher-paying jobs.

If this outlook materializes, India could emerge as an economic superpower. Its share of global GDP could approach China's, while its financial markets would become a focal point for global investors. A study of other Asian countries that

transitioned to high-income status over the past 50 years provides clear evidence that this journey has offered investors attractive returns in fixed income and FX markets. In our view, India may very well follow a similar path.



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