# 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

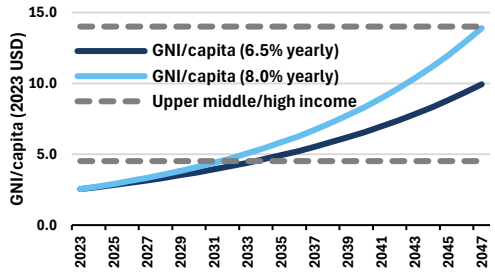
**India is in many aspects a very interesting study these years, particularly as it moves up the income ladder from a low-income country with high poverty rates. Economists and market analysts continue to produce a seemingly endless stream of research on the implications of India's economic development for stock market returns. In this note, 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

India's 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. The threshold for a high-income country is a Gross National Income (GNI) per capita of USD 14,005 in 2023, while India's was USD 2,540, placing it in the lower middle-income group. To reach its 2047 goal, India needs to raise its GNI per capita by 5.5x over the next 23 years or equivalently to grow GDP by 8% annually (applying UN forecasts for population growth).

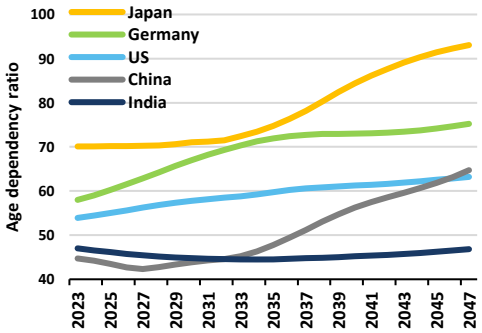
**Chart 1: GNI/capita in different scenarios**




Source: World Bank, UN & Haver Analytics

Clearly, 8% yearly growth over a 23-year period is ambitious and it might also prove to be overly ambitious. 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 below, 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 as forecasted by the UN for the next 23 years.

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



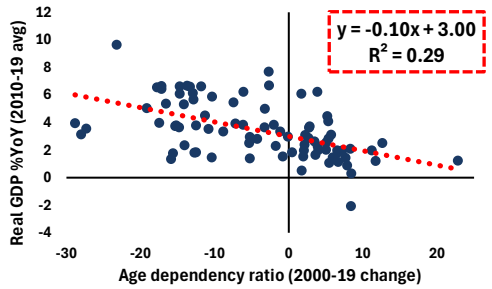

Source: UN & Haver Analytics

It is obvious from the chart that 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 23 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 below, 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). On the X-axis we show the change in age dependency between years 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)**



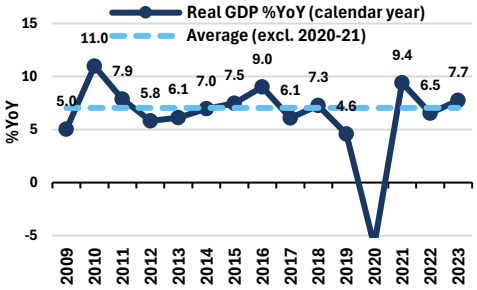

Source: IMF, UN & Haver Analytics

A higher age dependency ratio will in general mean that fewer people are available to work and generate economic output. Also, families need to allocate more resources to child-and elderly care (or pay higher taxes) rather than save and invest income 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 them reaching such a high level of growth? For one thing, they have been rather 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 that far away from 8%.

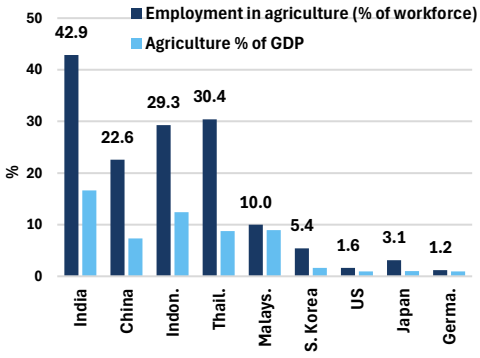
**Chart 4: India real GDP growth 2009-2023**




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 below depicts, 42.9% of the Indian workforce was employed in agriculture in 2023.

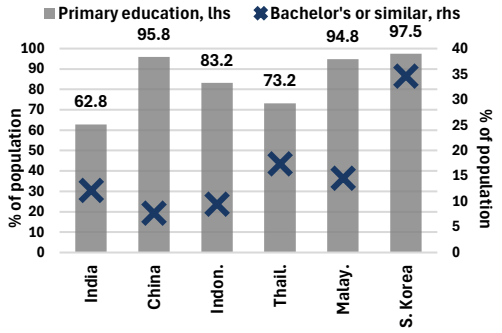
**Chart 5: Agriculture % of employment & GDP**




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 they are able to rearrange the workforce towards manufacturing and services. China has done so, and so has Indonesia, Thailand and Malaysia through the last 20-40 years, while South Korea did it even earlier. These other Asian nations have achieved upper-middle- or high-income status. Another factor that speaks in favor of India's rising income level and growth rates in the longer horizon is education levels.

### Chart 6: Primary and higher education levels




Source: World Bank & Haver Analytics

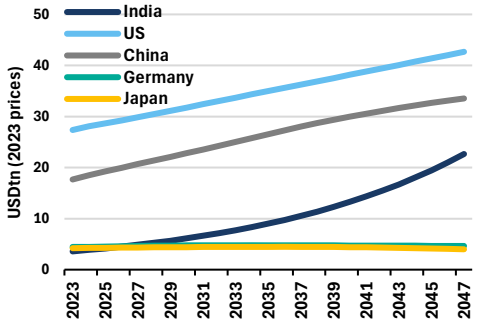
As India urbanizes and shifts from agriculture to services and manufacturing, primary and higher education rates will rise, boosting the country's long-term growth and differentiating it from other Asian nations.

However, India faces structural challenges in moving up the value chain, such as bureaucratic land acquisition and rigid labor laws. To reach the extraordinary growth rates required to achieve high-income status by 2047, meaningful reforms are needed, but Modi may lack both willingness and mandate.

### India as a global super-power

In the following charts, we provide a simplified outlook for how the World could look by 2047, if India is able to reach 8% yearly growth.

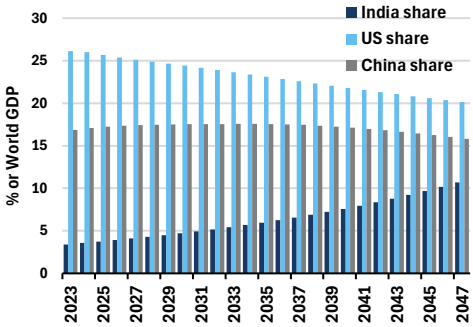
### Chart 7: GDP projections (2023 USD)




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

Until 2029, we use the IMF World Economic Outlook (WEO) forecasts for growth (except for India, where we use 8%). After that, we rely on changes in demographics, where we take the findings from Chart 2 above 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

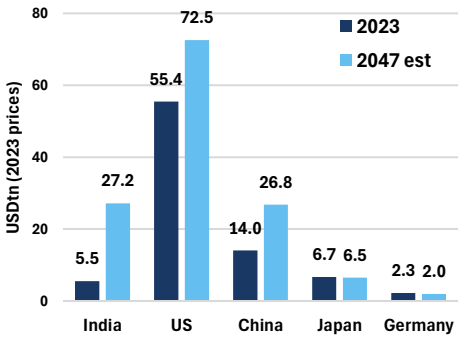



Source: IMF, UN & Haver Analytics. Estimates by Global Evolution

Charts 7 and 8 show the potential disruptions among global superpowers in the coming decades. While India will not "catch" China or the US, 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 SOEs. 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

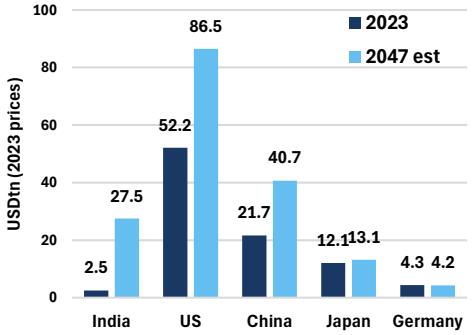



Source: Bloomberg, WFE & Haver Analytics. Estimates by Global Evolution

As it stands, the total amount of debt securities (bonds) issued by Indian entities is 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%, which is in line with China's level today.

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



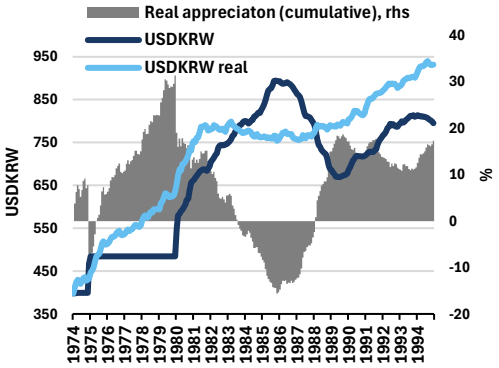

Source: Bloomberg, BIS & Haver Analytics. Estimates by Global Evolution

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 more than the case is 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

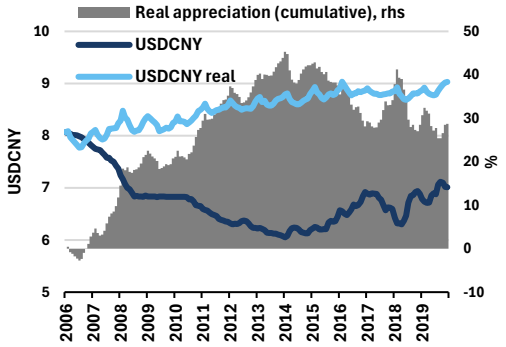



Source: Bloomberg & Haver Analytics

Back in 1974, South Korea had a GNI per capita of USD 550, which in 2023 prices translates to USD 2,600 or roughly where India is today. A little more than 20 years later, they became a high-income country with a GNI per capita above USD 18,000.

The dark blue line in Chart 11 above 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 70s and weakened materially once made free-floating in 1980. But from that point onwards, KRW 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



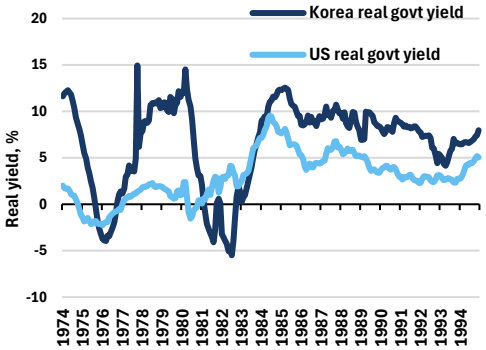

Source: Bloomberg & Haver Analytics

A similar – if even more straightforward – picture holds for the Chinese Yuan in the period where they moved from lower middle-income (like India today) to almost reaching high-income, as Chart 12 above 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 impact 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 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 (see e.g. Chart 13 below).

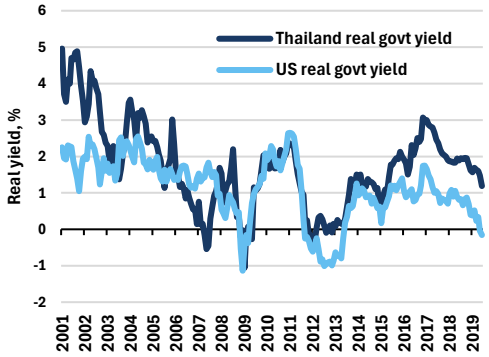
**Chart 13: Korea vs. US real yields, 1974-94**




Source: IMF, Bloomberg & Haver Analytics

Data availability of bond yields is somewhat problematic back in time, but the IMF collects a weighted-average series. Once again using the example from Korea in 70s-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 the door to high-income, but their 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 (though in some cases we do), 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- |
| Δ notches | +2-3 | +2-3 | +5-6 | - |

Source: World Bank, Bloomberg & Haver Analytics. *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 Korea, ratings are not available as far back as the 1970s, but it is reasonable to assume that they 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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