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Look beyond India's autumn of discontent

14 October 2024, 07:24 am MYT, written by UBS Editorial Team

Despite having ceded the Asian investment limelight to China over the past three weeks, investors would do well not to forget India's equities and bonds. India's positive structural story remains intact, while its markets are likely to be generally less vulnerable to the potential disruption to global trade from more tariffs. Investors would do well to buy the current dip in India equities; IGBs are a good way to diversify global fixed income exposure; and the INR remains an attractive yield carry play in Asia.

After being the Asian darling amongst equity investors over the last three years, India in mid-September ceded the limelight to China. The MSCI China (MXCN) has since 23 September risen as much as 32%, while the MSCI India (MXIN) has fallen over 5%. This is after the MXIN had risen 228% since the end of 1Q2020, compared to the MXCN's 25% fall over the same period. Within Asia, market talk has even contemplated a rotation back to China.

All this comes against the macroeconomic backdrop of slowing growth in India as domestic demand eased in previous months, and looks set to continue doing so. Recent consumption and investment data argue for a continuation at around the current pace. In fact, we have lowered our economic growth forecast for India to 6.8% (from 7.0%) for both 2025 and 2026, and we expect the policy easing in India to be shallower than in other economies—we see just 50bps of cuts for this cycle.

But investors should remember that India's structural story remains intact and likely to persist as a key driver for the medium term. Despite the growth forecast downgrade, India is still growing at a brisk pace, compared with the broader region. Also, the shallower RBI easing cycle is due to the robustness of the expansion; this organic economic resilience is actually better than having to rely on stimulus measures. Additionally, Indian financial assets are still useful as diversifiers and hedges against geopolitical risks.

Diving into the equity dip. We remain Neutral on India equities and recommend that investors make use of this dip to replenish or build up allocations to the appropriate size. Thanks to the dip, we believe return prospects for the next 12 months have improved. This is especially given that state governments recently announced several populist measures that led to a rebound in rural spending, which should help boost corporate revenues.

Although there are near-term risks from a continuation in the rotation out of India equities, and a potential rise in oil prices, these might turn out to be somewhat fortuitous. These immediate negatives might end up helping to lower multiples and provide more attractive entry levels to investors who had missed the boat the first time round. Although we expect price-earnings multiples to narrow, the better earnings growth should still allow for upside in stock prices. Investors would thus do well to capitalize on the current dip and buy into future ones in this structurally appealing market.

Indian government bonds (IGBs) remain a good diversifier. Indian local government bonds continue to be an attractive way to diversify global fixed income exposure. We expect the benchmark 10-year IGB yield to trend lower as the erstwhile drivers— Federal Reserve rate cuts, foreign inflows to the debt market, and a better growth-inflation balance— remain in place. Our target of 6.25% by September 2025 —compared to the 6.75-7.00% range that's been seen over the past 3-4 months—leaves scope for sizable upside from current levels, offering attractive returns to investors. Also, data pointing to both inflation and economic growth moderating suggest the RBI may turn more dovish, potentially producing a rate cut by end- 2024.

Additionally, both the demand and supply dynamics of the IGB market should help keep yields biased lower. On the demand side, the ongoing inclusion of India in JPMorgan's emerging market bond index should see sizable inflows into the domestic market continue for the next six months. Meanwhile, continuing post-general election fiscal consolidation should leave supply in the coming year somewhat constrained.

INR stability likely to continue amid stronger external balances. Year-to-date, the USDINR has been largely kept in a relatively tight 82.6-84.0 range, as a function of both India's broadly healthy external balances, and RBI policy. Fundamentally, the INR's stability is supported by India's low single-digit current account deficit (-1.1% of GDP), and well-contained inflation in the 3-4% range. Meanwhile, the large FX reserves (close to USD 700bn) attest to capital inflows and the RBI's disciplined inflation management to limit imported inflation.

We expect the USDINR to remain in the 82-84 range over the coming 12 months. This USDINR stability could prove useful as we approach the US election. A Trump win could see the INR outperform other cyclical Asian currencies that are more sensitive to global trade tariffs; a Harris win could see the opposite outcome. Aside from this partial hedge against tariffs later in the year, we still think the INR is an attractive yield carry play in Asia.

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