Beacon of hope

India's strong growth seen to counter slowing elsewhere

By Praveen Jagwani*

Indian politics has never been short of drama and has now even replicated the formulaic happy endings of Bollywood movies where good guys finish first. The emphatic verdict of Indian voters in returning Prime Minister Narendra Modi for another five years at the recent general election is a thumping endorsement of his performance in the first term. It bears testimony to not just the grassroot level reforms he introduced during his first term, but also his courage in tackling varied vested interests.

Billed as the largest electoral process on the planet, the election was marked by a sharp divide between the urban and rural narrative. It's fashionable among the urban elite to denigrate Mr. Modi because they were not the prime beneficiaries of his regime. In fact, most foreign visitors to the big Indian cities can be forgiven for thinking there has been no discernible progress over the past decade.

The primary reason is that Mr. Modi directed disproportionately large resources for the upliftment of the rural poor. City dwellers failed to witness the remarkable changes he engineered in the most remote corners of the country. The true impact of building toilets, providing electricity, encouraging female education, and financial inclusion will continue to be felt in the decades to come. Simply stated, his success at the election can be attributed to two main factors: delivering tangible reforms to rural India, and inspiring the youth who were hungry for a charismatic role model.

Job creation is key

In his previous term, Mr. Modi inherited a sinking ship that he managed to stabilise, and undertook critical repairs through reforms, most notably the implementation of the goods and service tax and the introduction of the Insolvency and Bankruptcy Code. But not everything he did was a success. Demonetisation was a colossal fiasco – except that it spawned about ten million fresh individual tax payers and ignited an unprecendented explosion in digital payments.

The inability of his government to effectively curtail the Hindu right-wing rhetoric could potentially deepen the historic societal faultlines. However, now that the ship is somewhat seaworthy, his team needs to create a unifying narrative, strong institutions and a governance framework to unleash the animal spirits of growth.

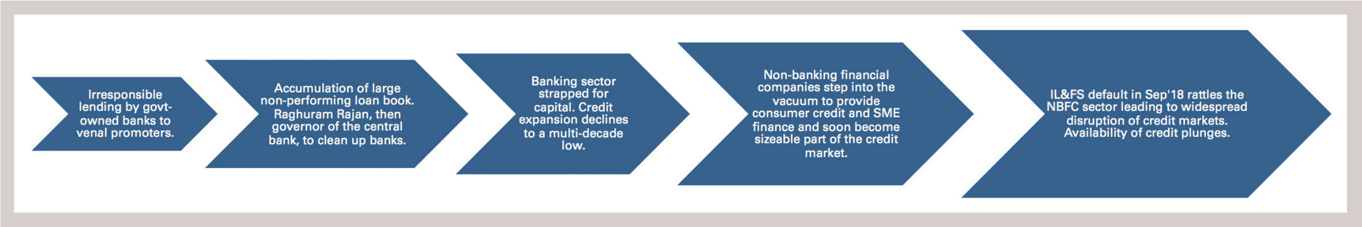
Primarily, he needs to create more jobs, particularly for the millions of first-time young voters who have gifted him an exceptional majority in Parliament. Job creation is easily the most effective mechanism for wealth creation and distribution.

There is much to be accomplished across all major sectors – banking, power, infrastructure, education, defence and agriculture. We are past the stage for grand strategy and debate. Now is the time for efficient and speedy execution. The cabinet selected by Mr. Modi inspires confidence in this promise. In what's a historic first, more than 90% of government ministers have a college degree and many are also post graduates. Mr. Modi has given strong preference to merit and track record in these appointments instead of just rewarding loyalty.

With Subrahmanyam Jaishankar as the foreign minister, he has signalled India's emergence as a voice on the global stage with a precisely crafted foreign policy. Similarly, Piyush Goyal for railways and commerce, Nitin Gadkari for surface transport, and Nirmala Sitharaman for finance are very credible choices. Mr. Modi has truly assembled a dream team.

Financial sector crisis

While many complain, perhaps correctly, about the outsized influence of the financial sector in the global economy, it remains at the core of sustainable and inclusive growth in India. Penetration rates of banking and household credit remain significantly below even other



emerging markets such as Brazil and China.

The room for growth is massive. The financial sector represents a comprehensive call-option on the rising standard of living of India's burgeoning middle class. Even the ambitious infrastructure growth envisioned by Mr. Modi needs to be financed in large measure through debt.

Private equity typically contributes 30% of funding requirements for capital expenditure, and the banking system and debt markets have to come up with the balance 70%. Thus, sustainable credit expansion is the not-so-secret sauce that India must cook.

The situation in financial markets has worsened since the default of Infrastructure Leasing & Financial Services Ltd in September 2018. This default by the country's leading infrastructure player sent shockwaves through the system, causing lenders to freeze credit lines to the entire non-banking financial companies (NBFC) sector.

Never before had a company with a triple-A domestic credit rating defaulted on its obligations. It has caused serious damage to fledgling debt markets and drawn strong criticism of the role of credit rating agencies.

The NBFCs stepped in a few years ago to fill the vacuum left by the public banks in providing credit to small and medium enterprises and the retail segments. But they grew by borrowing short-term money which they deployed into long-term loans. This asset-liability mismatch evidently had to have its day of reckoning.

Most of the main NBFCs are facing an illiquidity crisis today even though their operating businesses remain healthy. They are having to resort to a fire-sale of performing assets to remain solvent. But it does appear that we are past the worst stage of this crisis.

The appointment of Ms. Sitharaman as finance minister is an astute move by Mr. Modi. Her measured manner and objectivity will go a long way in restoring confidence in the beleaguered sector. Her main priorities should be to unlock the credit markets, capitalise the banking system, create the environment for increasing private investment, and alleviate stress in the rural sector.

Leading on growth

The global economy is experiencing a synchronised slowdown but major central banks unfortunately have fewer options than they did in 2008 to stimulate growth. Rock bottom lending rates mean that, except for the US Federal Reserve, the central banks don't have room for more rate cuts. Even China's ability to step into the saviour role has been curtailed by the disruption caused by the trade war with the US, as well as its own massive debt bubble.

So the world is looking to the rest of the emerging markets for deliverance and the shining beacon in that pack is India. At its current gross domestic product growth rate of 7%, India will be a bigger economy than both the UK and France this year, and is expected to eclipse Germany to become the fourth largest global economy in the next three years.

According to forecasts by Standard Chartered, by 2030, India is likely to become the world's second largest economy on a purchasing power parity basis, behind China and outpacing the US.

A large consuming middle class is a powerful weapon against recessionary conditions. At some stage in the next five years, global indices will re-balance to give India a rightfully enhanced allocation and share of global investable assets. With Mr. Modi at the helm, India's investment case has become even more compelling.

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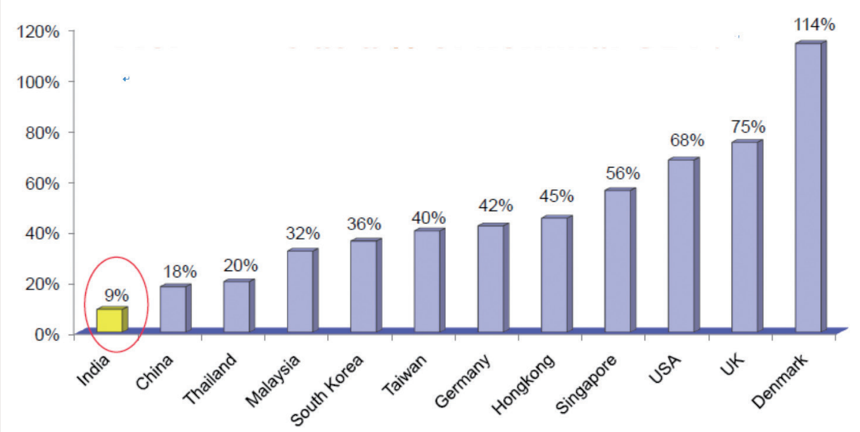
Mortgages as a % of nominal GDP



Sources: Bank for International Settlements and HDFC