

India continues to power ahead

India's economy grew 7.7%, faster than any other major economy last year and it's now the fifth largest in the world. The forecast for 2024 is for another year of 7%+ growth. We agree



India's Finance Minister Nirmala Sitharaman before the country's budget speech earlier this year

What's going well for India

One of the perennial problems for most emerging economies is that fast growth often degenerates into an inflation or balance of payments crisis. India has avoided this so far. Inflation has not exceeded the Reserve Bank of India's 6% upper inflation target since August last year, when a seasonal food spike led to a temporary surge. This will probably happen again at some point, though the occasional temporary lapse does not invalidate the fact that, for the most part, inflation has been well-behaved.

At 6.5%, the RBI's policy rates are some of the highest in the region. The RBI has run a fairly conservative monetary policy regime and is reaping the rewards. GDP growth also owes far less to unproductive household spending and far more to productive capital expenditure. This conclusion is supported by the current account data, where the deficit narrowed at the end of 2023 to only a little over 1% of nominal GDP. No sign of runaway spending here.

India's external balance has been supported by a number of factors. The Indian external deficit is often a victim of energy-cost shocks, but import costs have been tempered by greater imports of cheap Russian crude oil. This has probably gone as far as it can realistically go for now, and we

don't expect any further incremental boost from this.

On the export side – increasingly – exports of transport, machinery and electronics are picking up the pace, while agriculture is flatlining as constraints on exports of staples such as rice and sugar have led to more stable domestic supply and have also helped tip the balance towards a more sustainable inflation environment. Evidence of the growing role of manufacturing is also visible in the GDP figures, where, on a gross value-added basis, industry has been contributing a greater proportion to total output than previously. All of this is evidence of travel up the value-added curve. Also by region, India now exports more to non-China and non-Japan Asia than it does to the US, reflecting in part the growing relevance in the region of SE Asia as a new engine for growth.

The exchange rate is also helping

The stable USD/INR exchange rate will also have helped encourage foreign direct investment and potential output at a time when much of the developed world is rethinking its relationship with China and looking for alternative locations within Asia to base production. Along with Vietnam, India has been one of the key beneficiaries of this re-division of the investment cake, even if flows more recently have softened everywhere.

The stability of the INR, which has been managed very tightly since October 2023, may reflect official concerns about fast money inflows following the decision to include Indian Government bonds in the JP Morgan global bond index this June. Recently, the INR has shown a little more volatility, but it remains one of the most stable currencies in the Asia-Pacific region. This stability has been achieved without burning through the RBI's FX reserves, which remain very comfortable at more than 11 months of import supply.

Some of the credit for strong and sustainable growth should go to fiscal policy too. The government has managed to reliably hit its deficit reduction targets since the pandemic, helped by more efficient tax revenue collection as payments have become increasingly digitised. Despite bringing the deficit down and stabilising the debt ratio, the government has still found room for substantial capital expenditure on productivity-enhancing infrastructure.

Areas of concern

The one area where we have some concerns is household credit growth, which is centred on housing loans, personal loans, and credit cards. This is very high and growing faster as the Unified Payments Interface (UPI) now offers credit options to customers. Although inflation and external balance data don't suggest anything to worry about, this looks to us to be an area that needs very close watching. And if anything does go wrong in the coming years, this looks like a possible source of risk.

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