ANDBANK RESEARCH

Global Economics & Markets

Alex Fusté
Chief Economist

alex.fuste@andbank.com

+376 881 248

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India – To be or not to be?

I guess it's better to be (Equities, fx and bonds)

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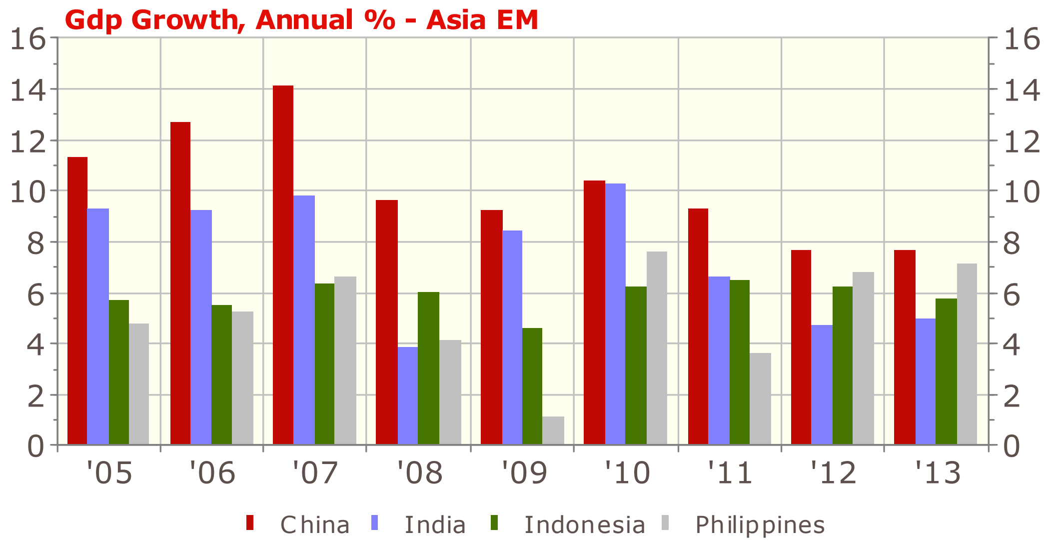
India – The new economic credo of Nerandra Modi

1. Making India a "Manufacturing Nation".
2. Adopt the tried-and-tested East-Asia development model (with national resources "retained" to ensure the development of a large and competitive manufacturing base).
3. Economic diplomacy trumping Geopolitical ambitions.

Why is it good to raise a new narrative for India?

India has gone from being one of the two engines of the region, to be a drag on the whole.



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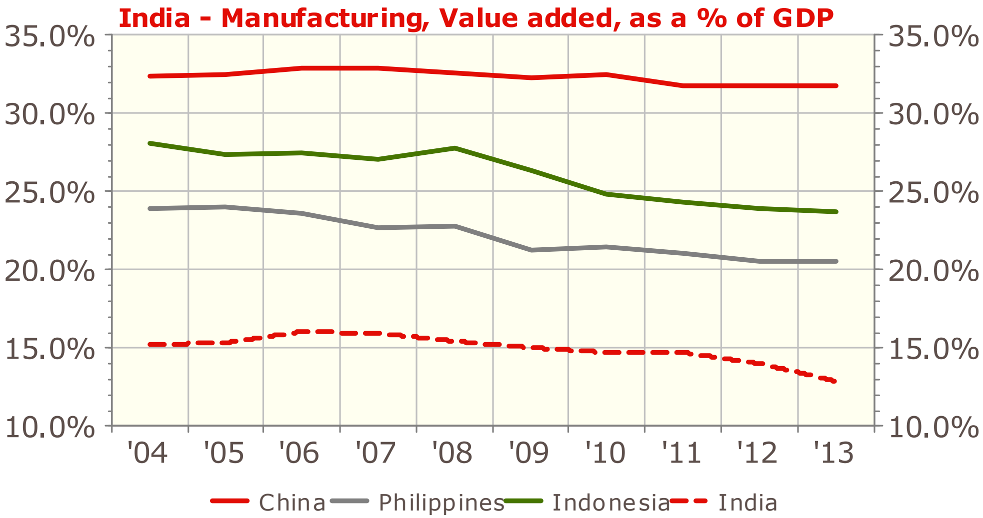
India – A preliminary opinion about this new approach

1. The new "made in India" campaign makes sense:

- ✓ India must resurrect its moribund manufacturing sector, whose share of GDP is already below 13% (certainly unsustainable) compared to 32% in China, 24% in Indonesia or 21% in Philippines (see the chart)
- ✓ India must find employ for the 10 million new entrants to the work force each year.
- ✓ If this campaign works, this should prove to be an important trigger for every aspect of this economy and its financial markets. If only for the great impact of the base effect.



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India – A preliminary opinion about this new approach

2. Economic diplomacy trumping Geopolitical ambitions. This strategy promises to be very fruitful.

- ✓ This new narrative seeks to change focus from geopolitical ambitions to securing alliances and partnerships
- ✓ This makes more sense given India's overture towards Japan, China or the US.
- ✓ The Indian diplomatic efforts have already yielded important gains:
  1. In his first official visit to Japan (September) Modi returned with $35bn in Japanese investment commitments.
  2. In his visit to the US, Modi was greeted with an unusual interest, sharing exclusive and private dinners with Obama , Biden, Bill Clinton and Hillary Clinton. Additionally, the executives of major firms, including Boeing, General Electric or Google, wanted to meet him. Certainly an agenda available to very few leaders. Why?
     - i. America is eager to find a strong ally to offset the dominance of China in the region. That strong ally may be India. Maybe not today. But with the appropriate steps (and influence) India may be so in the near future.
     - ii. Pending deals include the bilateral investment treaty, the Commercial Space Launch Agreement (CSLA), and renewal of the Defense Framework Agreement. There were expectations that every bilateral summit could have a nuclear deal.

India –About the hypothetical problems that India will face

1. According to some analysts familiar with this issue, in order to implement this "made in India" campaign, Modi must seek to imitate the model used in Taiwan, South Korea or China (mercantilist approach), by channeling resources into an export oriented "manufacturing champions". Countries adopting such approach must have certain degree of authoritarian governments:

   - ✓ Imposing policies favoring producers vs consumers…
   - ✓ … throughout financial repression to compress consumer spending and channel captive funds towards manufacture.

2. The strategy of forging economic alliances with the different powers may result in conflicts with some of these powers.

   - ✓ Probably, Modi's hug with the Japanese prime minister did not like much to Xi Jinping (much less the economic agreement they reached).

3. Other analyst argue that in an era of increased automation, it is unclear that a singular focus on low end manufacturing will be enough to realize Modi's manufacturing dream.

4. Other critics refers to the fact that China had a more rational disbursement of production since it had an army of entrepreneurs ethnically Chinese (in Taiwan and Hong Kong) which built manufacturing operations across east Asia in the 60's. They say that it is not clear that manufacturers will rush into India.

India –Most of these "risks" are more myths than anything else

1. The threat of authoritarianism, resulting from such a mercantilist approach, is not realistic.

   - ✓ Channeling resources from consumption into manufacturers, does not have to be materialized using authoritarianism. You just need a concrete system of incentives for savings, taxes and investments. This is commonly known as a "pro-business industrial Policy". Suffice to make clear to consumers and renters that they have a better choice than just to consume or to invest.

   - ✓ This channeling of resources (capital) can also be materialized (at least initially) via State-backed development banks.

   - ✓ It is not true that the only model available would be the one in South Korea, Taiwan, Japan,… focused in offering advantages to their "Export Champions". India could follow a different approach, focusing on setting manufacturing facilities and involving the use of special economic zones in order to attract foreign firms (overseas manufacturers) instead of perpetually protect their "national champions", (a model of questionable effectiveness).

2. The threat of generating conflicts as a result of forging strategic alliances, is not reasonable.

   - ✓ Indeed, some experts have noted that Xi Jinping did not probably liked Modi's fruitful visit to Japan. In view of some other experts, this need not to be a serious problem, as long as the Chinese authorities only have to share an even bigger bear hug. At the end of the day, if Japan was first in reaching alliances it was probably because China did not previously. Knowing this, it has little sense to continue not doing it.

India –Most of these “risks” are more myths than anything else

3. The threat of failure in the industrialization process, given the high degree of automation, need not to discourage the development of a broad manufacturing industry.

   - ✓ Proponents of this threat argue that the country could fail in delivering a certain level of industrialization since automation and robotics will easily penetrate in the low end manufacturing.
   - ✓ However, it is a mistake top assume that India can only develop a low value added industry. Thanks to the rapid and effective flow of capital (monetary, technological and human), the industrialization process can refer to both low value-added manufacturing and high added value.
   - ✓ Robotic penetrates throughout the industry, and by no means the manufacturing sector will cease to exist.

4. Regarding the critics who say that India can not be repeat of China, since the latest started with the advantage of having an army of entrepreneurs ethnically Chinese. An advantage that India does not have.

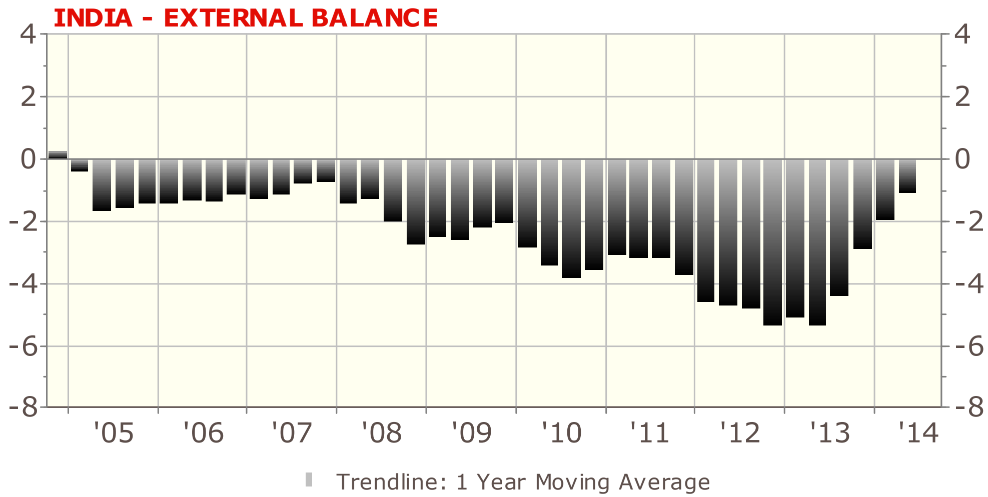
   - ✓ Not having an army of entrepreneurs does not prevent other investors coming to the country.
   - ✓ These entrepreneurs just need enjoy aspects like visibility, stability, guarantees, returns, etc…
   - ✓ If not, you only have to look at Vietnam, Bangladesh or Cambodia.

India –The starting point is good!

- ✓ Interest rates have been largely liberalized and the Central Bank is pushing for the Financial Reform.
- ✓ The rupee is largely convertible, with its value mostly determined by market forces.
- ✓ The state in democratic India can only play a facilitator role. As such, development will depend on global demand and supply factors rather than administrative fiat
- ✓ World's largest democracy with 1.2 billion people.
- ✓ Stable political environment and responsive administrative set up. Well established judiciary.
- ✓ Investor friendly policies and incentive based schemes.
- ✓ India's growth will start to outpace China's within three to five years and hence will become the fastest large economy with 9-10 per cent growth over the next 20-25 years (Morgan Stanley).
- ✓ India's economy will grow fivefold in the next 20 years (McKinsey).
- ✓ Total labor force of nearly 530 million. This will ensure cost competitiveness.
- ✓ The proportion of population in the working age group (15-59 years) is likely to increase from approximately 58 per cent in 2001 to more than 64 per cent by 2021.
- ✓ Young country with a median age of 30 years by 2025: India's economy will benefit from this "demographic dividend".

India –The starting point is good!

- ✓ The urban population of India will double from the 2001 census figure of 290 m to approximately 590 m by 2030 (McKinsey).
- ✓ Large pool of skilled manpower; strong knowledge base with significant English speaking population.
- ✓ Robust banking and financial institutions.
- ✓ The "2012 A.T. Kearney Foreign Direct Investment Confidence Index" has ranked India second most attractive destination for FDI , an improvement from its third rank in the year 2010.
- ✓ India is solving with determination its Balance of Payment problem. The lower the external imbalance, the lower the need to attract foreign capital.



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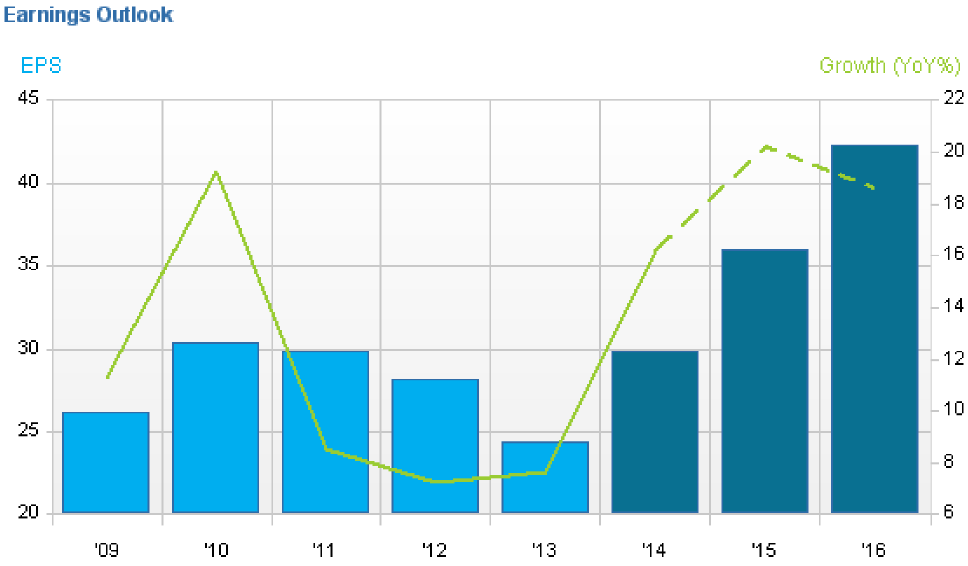
India –The starting point is good!

Fairly valued metrics
(India – Factset Market Indices)

Characteristics - LTM

	Current	World
P/E	16.9	15.4
P/E (NTM)	15.2	13.7
PEG (NTM)	0.8	1.2
P/Book	2.4	1.8
P/Tang Book	2.8	-
P/Sales	1.4	1.2
P/CF	11.5	9.6
EV/Sales	2.2	2.0
EV/EBITDA	11.0	9.1
ROE	14.2	12.0
Div Yld	1.7	2.6
Net Debt/EBITDA	1.7	1.5
Capex Growth	-10.8	2.9

Certainly, good prospects!
(India – Factset Market Indices)



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