

## Tales From the Emerging World

# Emerging India in a Multipolar World



MACRO INSIGHT | EMERGING MARKETS EQUITY TEAM | 2022

When the 15-nation UN security council hastily called for a vote in February to condemn Vladimir Putin's invasion of Ukraine, India joined China and Qatar to abstain. It was a difficult balancing act. Delhi didn't want to alienate Russia, an important historical friend, which supplies 46% of its military equipment,<sup>1</sup> without also antagonizing the U.S., its largest trading partner.<sup>2</sup> India also depends on Russia's diplomatic support at the UN for its claims over Kashmir. After all, the Soviet Union has used its veto six times at the Security Council on India's behalf.

For Delhi, though the abstention vote was an embarrassment, the clear and present dangers come from a prickly Pakistan and a muscular China. India is forging its own geopolitical path in this multipolar world and focusing on its strategic interests. That means siding both with Russia and joining Western alliances, such as the Quadrilateral Security Dialogue, alongside the United States, Australia, and Japan. From Brussels to Tokyo to Washington, governments are determined to lower their dependence on Beijing. At a time of when investability in China is being questioned, shifting geopolitical realities offer India an opportunity to shine.

Coupled with its geopolitical stance, India's economic condition is looking favorable for the rest of this decade. India has not been able to realize the kind of industrial transformation that turned countries like China and South Korea into miracle economies by building their manufacturing capabilities. Instead, India's economic growth was led by services unlike the Asian tigers. Recently there has been a change in the mindset from the Gandhian principles of small is beautiful, to actively incentivizing large scale manufacturing capacities through production linked incentive (PLI) schemes.

These schemes have attracted interest across 14 sectors including automobiles, solar panels, and advanced batteries. Buoyed by the government's PLI scheme, India now is an exporter of mobile phones. Delhi is also focusing on

### AUTHORS



**JITANIA KANDHARI**  
*Head of Macro and Thematic Research, Emerging Markets Equity Team*



**AMAY HATTANGADI**  
*Co-Lead Portfolio Manager Emerging Markets Core Strategies*

<sup>1</sup> Bloomberg, Haver, SIPRI.

<sup>2</sup> World Trade Organization, COMTRADE, Haver.

import substitution in manufacturing to enhance domestic capacity and reduce external dependence. As firms everywhere reconfigure supply chains to lessen their reliance on China, India has an opportunity to increase its manufacturing, helped by a \$26 billion subsidy scheme.<sup>3</sup>

Emerging sectors such as aerospace, semiconductors, and renewables should help increase youth employment. The

reform measures are starting to pay off. The “Make in India” initiative encourages both foreign and domestic investment in the manufacturing sector; “Smart Cities” aims to eradicate urban squalor and “Digital India” targets an overhaul of government services with electronic identity, digital payments, and bank accounts. Additionally, the government has launched its Open Network for Digital Commerce (ONDC) in an attempt

to deepen e-commerce penetration and foster innovation by start-ups with a special focus on small merchants and rural consumers. Each of these are enhancements in efforts to improve the country’s infrastructure. India has backed the “tech stack” and direct welfare and persevered with the painful task of shrinking the informal economy. Financial reforms have made it easier to float young firms and bankrupt bad ones.

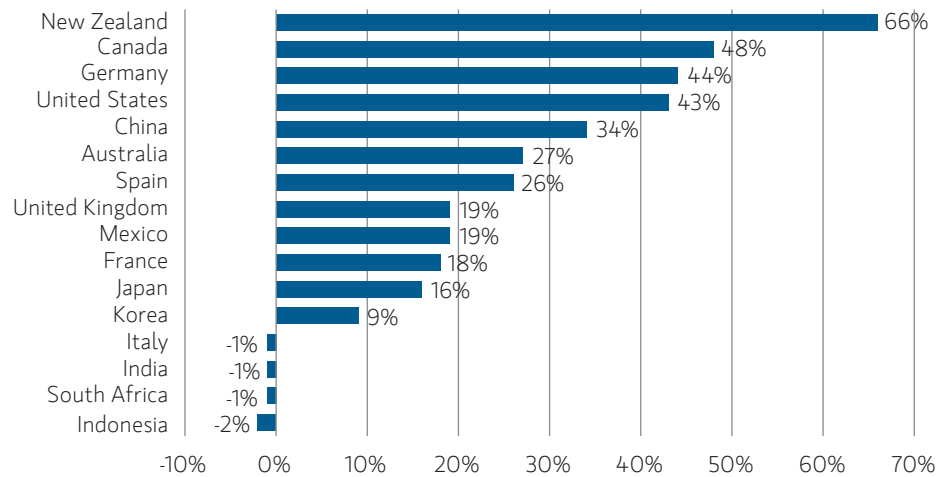
In contrast, China continues to focus on transitioning its economy away from investment to consumption. China’s economy is slowing down, faced with a shrinking workforce, industrial overcapacity, a floundering property market, a mountain of debt and renewed COVID lockdowns. A serious downturn in the property market, a key engine of GDP growth, has eroded confidence in the economy. Real estate lies at the heart of an investment cycle. While investment to GDP ratio in India hovers at 30%, China’s has peaked at 45% and a big share of that is real estate investment. The real estate sector accounts for around 29% of GDP in China, more than double the ratio in India, according to IMF economist Yuanchen Yang.<sup>5</sup> Excessive supply is dragging down China’s heavily indebted property sector. The working-age population in China is now shrinking,<sup>6</sup> which will further erode the demand for housing over the coming years hurting future growth.

The reverse holds in India. After being in doldrums for the past 3 years, India’s real estate sector is set to recover. As more of India’s population heads to the cities, demand for housing increases. India’s young work force stands to benefit from affordability at almost unprecedented levels in terms of mortgage payments relative to income growth, that has declined to 28% in Q1 2022 from 53% in 2012.<sup>7</sup> House prices

**DISPLAY 1**

**India Missed the Global Real Estate Party**

*Real House Price Appreciation: 2015 – 3Q21*

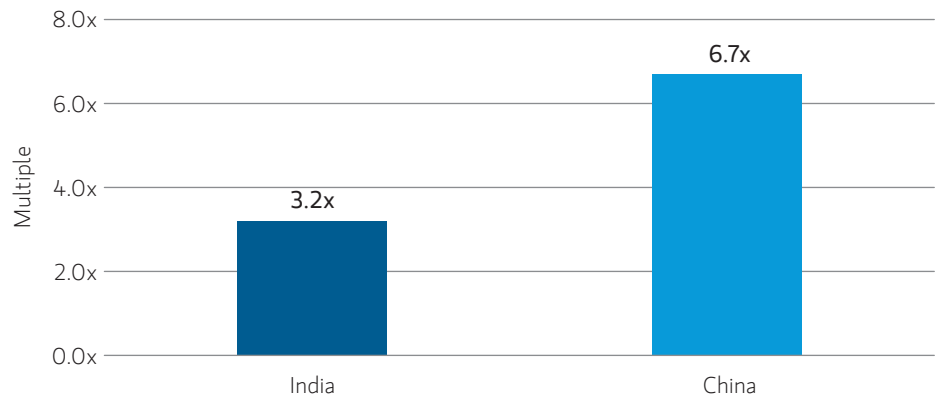


Source: OECD as of 3Q21.

**DISPLAY 2**

**India Beats China on Housing Affordability**

*Home Price to Income Multiple*



Source: MSIM, JPM, NBS, HDFC.

<sup>3</sup> Reuters, Bloomberg.

<sup>4</sup> MSIM, Bloomberg, FactSet, Haver.

<sup>5</sup> VoxChina, Haver.

<sup>6</sup> BCA Research, Rhodium Group.

<sup>7</sup> HDFC, SBI, Jefferies. Note, data for Q1 2022 represented by fiscal year ended March 31, 2022.

are 3.2 times average income in India compared to 6.7 times in China.<sup>8</sup> In fact, the five biggest cities in the world, with the lowest rental yields, are all in China, making it one of the most expensive countries in the world.

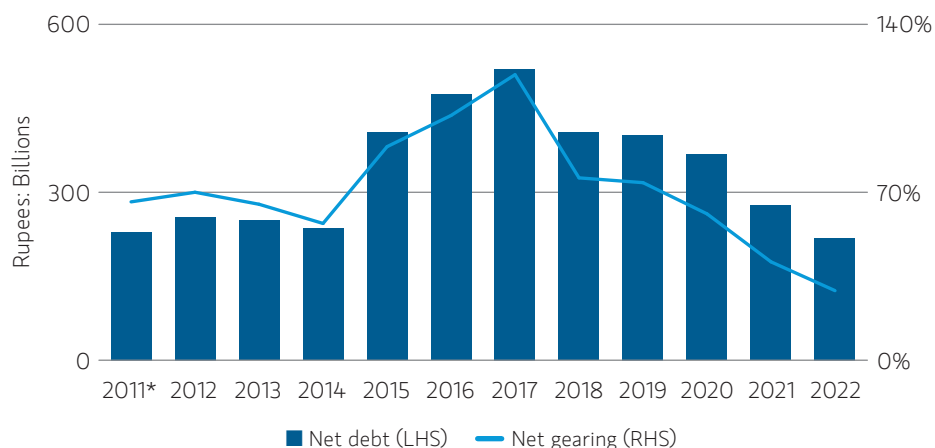
Residential inventory levels have declined to a nine-year low of 24 months of sales for the top seven cities in India.<sup>9</sup> Nominal wage growth of around 8% should fuel demand just at a time when supply has declined.<sup>10</sup>

China's economy is also more levered, with total debt to GDP at 300%.<sup>11</sup> Chinese property developers have excessively high debt levels. Goldman Sachs expects a third of China's property firms to default this year and a massive chunk of onshore and offshore bonds are maturing by the end of 2022.<sup>12</sup> Two of the largest have already defaulted on their offshore bond repayments. Corporate bonds of property developers are trading at less than 50 cents to the dollar.<sup>13</sup> Household debt has risen from almost nothing in 2007 to 62% of GDP today, mainly on account of rising mortgage debt.<sup>14</sup> China's households are refusing to pay mortgages in 50 cities.<sup>15</sup>

Chinese property firms are facing debt deflation, falling asset prices with high debt burden, whereas property markets in India have healthy debt ratios and in our view, a high

### DISPLAY 3 Declining Developer Debt: A Sign of Improving Property Markets

India Property Developer Borrowing



Source: MS Research. \*All years reflect the fiscal year ending March 31 of that year.

probability of increasing asset prices. India's real estate sector has been cleansed of weak players. Developers have been prudent with their finances and have cut their balance sheet debt by half over the last 3 years.<sup>16</sup> As Indian developers are not allowed by the Reserve Bank of India (RBI) to take loans from abroad, there are no dollar-denominated borrowings in the sector. The banking sector today stands much healthier with steadily improving nonperforming loan (NPL) ratios and no asset quality concerns as such.<sup>17</sup> According to the RBI, businesses have seen a steady net profit-to-sales growth over the past year and are sitting on piles of cash.

It is true that India will face headwinds from geopolitical uncertainties. Inflation and global supply chain disruptions will challenge the government's ability to smoothly manage the economy, however macro fundamentals today are stronger than that seen during the 2013-14 period. But unlike China today, Indians benefit from a healthy real estate market and global businesses seeking more resilient and cost-effective alternatives to China. The stage is set for Delhi to move forward with an investment cycle to create a path for growth. That way, India truly emerges from under the shadow of China.

<sup>8</sup> MSIM, J.P. Morgan, NBS, HDFC.

<sup>9</sup> Reserve Bank of India, Bloomberg.

<sup>10</sup> World Bank Data, Reserve Bank of India.

<sup>11</sup> Bank of International Settlements, Haver.

<sup>12</sup> Bloomberg.

<sup>13</sup> Bloomberg.

<sup>14</sup> Reuters.

<sup>15</sup> Bloomberg.

<sup>16</sup> Morgan Stanley Research.

<sup>17</sup> Reserve Bank of India Financial Stability Report.

## Risk Considerations

There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by a portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (natural disasters, health crises, terrorism, conflicts, social unrest, etc.) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration and potential adverse effects (portfolio liquidity, etc.) of events. In general, equities securities' values also fluctuate in response to activities specific to a company. Investments in foreign markets entail special risks such as currency, political, economic, market and liquidity risks. The risks of investing in emerging market countries are greater than the risks generally associated with investments in foreign developed countries. Real estate investments are subject to risks similar to those associated with the direct ownership of real estate and they are sensitive to such factors as management skills and changes in tax laws.

**A separately managed account may not be appropriate for all investors. Separate accounts managed according to the Strategy include a number of securities and will not necessarily track the performance of any index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing. A minimum asset level is required.**

**For important information about the investment managers, please refer to Form ADV Part 2.**

The views and opinions and/or analysis expressed are those of the author or the investment team as of the date of preparation of this material and are subject to change at any time without notice due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all investment personnel at Morgan Stanley Investment Management (MSIM) and its subsidiaries and affiliates (collectively "the Firm"), and may not be reflected in all the strategies and products that the Firm offers.

Forecasts and/or estimates provided herein are subject to change and may not actually come to pass. Information regarding expected market returns and market outlooks is based on the research, analysis and opinions of the authors or the investment team. These conclusions are speculative in nature, may not come to pass and are not intended to predict the future performance of any specific strategy or product the Firm offers. Future results may differ significantly depending on factors such as changes in securities or financial markets or general economic conditions.

This material has been prepared on the basis of publicly available information, internally developed data and other third-party sources believed to be reliable. However, no assurances are provided regarding the reliability of such information and the Firm has not sought to independently verify information taken from public and third-party sources.

This material is a general communication, which is not impartial and all information provided has been prepared solely for informational and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The information herein has not been based on a consideration of any individual investor circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

Charts and graphs provided herein are for illustrative purposes only. **Past performance is no guarantee of future results.**

This material is not a product of Morgan Stanley's Research Department and should not be regarded as a research material or a recommendation.

The Firm has not authorised financial intermediaries to use and to distribute this material, unless such use and distribution is made in accordance with applicable law and regulation. Additionally, financial intermediaries are required to satisfy themselves that the information in this material is appropriate for any person to whom they provide this material in view of that person's circumstances and purpose. The Firm shall not be liable for, and accepts no liability for, the use or misuse of this material by any such financial intermediary.

This material may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this material in another language, the English version shall prevail.

The whole or any part of this material may not be directly or indirectly reproduced, copied, modified, used to create a derivative work, performed, displayed, published, posted, licensed, framed, distributed or transmitted or any of its contents disclosed to third parties without the Firm's express written consent. This material may not be linked to unless such hyperlink is for personal and non-commercial use. All information contained herein is proprietary and is protected under copyright and other applicable law.

## DISTRIBUTION

This material is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.

**MSIM, the asset management division of Morgan Stanley (NYSE: MS), and its affiliates have arrangements in place to market each other's products and services. Each MSIM affiliate is regulated as appropriate in the jurisdiction it operates. MSIM's affiliates are: Eaton Vance Management (International) Limited, Eaton Vance Advisers International Ltd, Calvert Research and Management, Eaton Vance Management, Parametric Portfolio Associates LLC, and Atlanta Capital Management LLC.**

This material has been issued by any one or more of the following entities:

### EMEA

This material is for Professional Clients/Accredited Investors only.

In the EU, MSIM and Eaton Vance materials are issued by MSIM Fund Management (Ireland) Limited ("FMIL"). FMIL is regulated by the Central Bank of Ireland and is incorporated in Ireland as a private company limited by shares with company registration number 616661 and has its registered address at 24-26 City Quay, Dublin 2, DO2 NY19, Ireland.

Outside the EU, MSIM materials are issued by Morgan Stanley Investment Management Limited (MSIM Ltd) is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

In Switzerland, MSIM materials are issued by Morgan Stanley & Co. International plc, London (Zurich Branch) Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland.

Outside the US and EU, Eaton Vance materials are issued by Eaton Vance Management (International) Limited ("EVMIL") 125 Old Broad Street, London, EC2N 1AR, UK, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority.

**Italy:** MSIM FMIL (Milan Branch), (Sede Secondaria di Milano) Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy. The **Netherlands:** MSIM FMIL (Amsterdam Branch), Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. **France:** MSIM FMIL (Paris Branch), 61 rue de Monceau 75008 Paris, France. **Spain:** MSIM FMIL (Madrid Branch), Calle Serrano 55, 28006, Madrid, Spain. **Germany:** MSIM FMIL Frankfurt Branch, Große Gallusstraße 18, 60312 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Denmark:** MSIM FMIL (Copenhagen Branch), Gorrissen Federspiel, Axel Towers, Axeltorv2, 1609 Copenhagen V, Denmark.

### MIDDLE EAST

**Dubai:** MSIM Ltd (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158).

This document is distributed in the Dubai International Financial Centre by Morgan Stanley Investment Management Limited (Representative Office), an entity regulated by the Dubai Financial Services Authority ("DFSA"). It is intended for use by professional clients and market counterparties only. This document is not intended for distribution to retail clients, and retail clients should not act upon the information contained in this document.

This document relates to a financial product which is not subject to any form of regulation or approval by the DFSA. The DFSA has no responsibility for reviewing or verifying any documents in connection with this financial product. Accordingly, the DFSA has not approved this document or any other associated documents nor taken any steps to verify the information set out in this document, and has no responsibility for it. The financial product to which this document relates may be illiquid and/or subject to restrictions on its resale or transfer. Prospective purchasers should conduct their own due diligence on the financial product. If you do not understand the contents of this document, you should consult an authorised financial adviser.

### US

**NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT**

## LATIN AMERICA (Brazil, Chile, Colombia, Mexico, Peru, and Uruguay)

This material is for use with an institutional investor or a qualified investor only. All information contained herein is confidential and is for the exclusive use and review of the intended addressee, and may not be passed on to any third party. This material is provided for informational purposes only and does not constitute a public offering, solicitation or recommendation to buy or sell for any product, service, security and/or strategy. A decision to invest should only be made after reading the strategy documentation and conducting in-depth and independent due diligence.

### ASIA PACIFIC

**Hong Kong:** This material is disseminated by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this material have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this material shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore:** This material is disseminated by Morgan Stanley Investment Management Company and should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"); (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This publication has not been reviewed by the Monetary Authority of Singapore. **Australia:** This material is provided by Morgan Stanley Investment Management (Australia) Pty Ltd ABN 22122040037, AFSL No. 314182 and its affiliates and does not constitute an offer of interests. Morgan Stanley Investment Management (Australia) Pty Limited arranges for MSIM affiliates to provide financial services to Australian wholesale clients. Interests will only be offered in circumstances under which no disclosure is required under the Corporations Act 2001 (Cth) (the "Corporations Act"). Any offer of interests will not purport to be an offer of interests in circumstances under which disclosure is required under the Corporations Act and will only be made to persons who qualify as a "wholesale client" (as defined in the Corporations Act). This material will not be lodged with the Australian Securities and Investments Commission.

### Japan

For professional investors, this material is circulated or distributed for informational purposes only. For those who are not professional investors, this material is provided in relation to Morgan Stanley Investment Management (Japan) Co., Ltd. ("MSIMJ")'s business with respect to discretionary investment management agreements ("IMA") and investment advisory agreements ("IAA"). This is not for the purpose of a recommendation or solicitation of transactions or offers any particular financial instruments. Under an IMA, with respect to management of assets of a client, the client prescribes basic management policies in advance and commissions MSIMJ to make all investment decisions based on an analysis of the value, etc. of the securities, and MSIMJ accepts such commission. The client shall delegate to MSIMJ the authorities necessary for making investment. MSIMJ exercises the delegated authorities based on investment decisions of MSIMJ, and the client shall not make individual instructions. All investment profits and losses belong to the clients; principal is not guaranteed. Please consider the investment objectives and nature of risks before investing. As an investment advisory fee for an IAA or an IMA, the amount of assets subject to the contract multiplied by a certain rate (the upper limit is 2.20% per annum (including tax)) shall be incurred in proportion to the contract period. For some strategies, a contingency fee may be incurred in addition to the fee mentioned above. Indirect charges also may be incurred, such as brokerage commissions for incorporated securities. Since these charges and expenses are different depending on a contract and other factors, MSIMJ cannot present the rates, upper limits, etc. in advance. All clients should read the Documents Provided Prior to the Conclusion of a Contract carefully before executing an agreement. This material is disseminated in Japan by MSIMJ, Registered No. 410 (Director of Kanto Local Finance Bureau (Financial Instruments Firms)), Membership: the Japan Securities Dealers Association, The Investment Trusts Association, Japan, the Japan Investment Advisers Association and the Type II Financial Instruments Firms Association.