HSBC Asset Management

Asia Insights

Paving the way forward in India

September 2024

For professional investors only

In a nutshell:

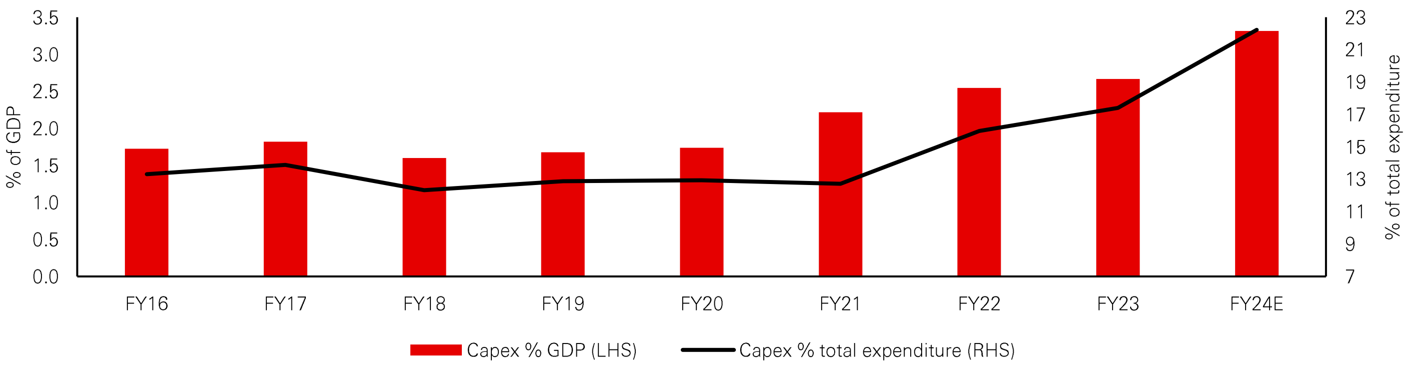
- Infrastructure development has been an important contributor to India's growth path, and continues to be a priority within government policy
- Continued modernisation is improving efficiencies across the economy and changing the business environment for incumbents and start-ups
- Listed infrastructure equities have been particular beneficiaries over recent years, significantly outperforming the broader market and highlighting the benefits of an active approach amidst an evolving economy

The role of infrastructure in India's economic transformation

In its 78th year of independence, India recently concluded general elections, re-electing the BJP-led NDA coalition for a record third term. The newly formed government presented the Union Budget 2024 which focussed on nine key priorities in pursuit of fulfilling the 'Viksit Bharat 2047' vision. This vision aims to transform India into a $30 trillion developed economy by its 100th year of Independence, prioritising economic growth, social progress, environmental sustainability, and good governance. A major milestone in this journey will be to become a $5 trillion economy by 2027, which requires India to embark on a path of rapid infrastructure development.

Over the last decade, the Indian government has kept infrastructure development at the forefront of its growth agenda, recognising the need for improved infrastructure to foster economic expansion and improve the quality of life for its citizens. Central to this was the expansion of the National Infrastructure Pipeline (NIP), a plan launched in 2019 which envisions an investment of $1.5 trillion over five years (to 2025). Currently, the NIP encompasses over 9,000 projects at different stages of implementation.

Indian government's capital expenditure (% of GDP)



Source: India Union Budget, HSBC AM, data as of June 2023

While the government is maintaining strong fiscal support for infrastructure, this year announcing a historic outlay of over $130 billion for capital expenditure – representing 3.4% of the nation's GDP – public funds alone are insufficient to meet the country's vast infrastructure development needs. To this end, new measures have been proposed to enhance the viability of public-private partnerships (PPPs), including risk-sharing mechanisms and the introduction of innovative financial instruments to facilitate private investment.

Driving productivity through improved transportation links

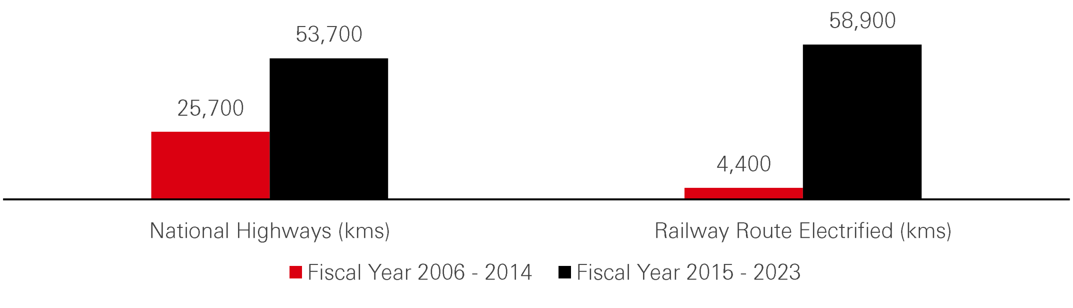
As per a 2022-23 government economic survey, India's logistics network generates costs in the range of 14-18% of GDP against a global average of around 8%.[1] Transportation inefficiencies account for almost a third of this cost ($45 billion or 4.3% of GDP) according to a McKinsey estimate.[2] The government aims to gradually eliminate these inefficiencies, halving logistics costs by 2028. Hence, several initiatives have been launched over recent years, putting the annual growth trajectory for construction of transport infrastructure at over 6% for the next decade.[3]

India aims to cut logistics costs by 50% by 2028, through major infrastructure investment supporting all modes of transport.

The road network is the second largest globally, stretching over 6 million kilometres. Today, 40% of total traffic is carried by national highways and expressways, even though they make up only 2% of the entire road network. This imbalance is being addressed through the National Highways Development Project (NHDP) and the Bharatmala Pariyojana, under which 200,000 kilometres of national highway will be developed by 2025, through investment of around $72 billion.[3]

Likewise, India's railway network is one of the largest globally, transporting more than 1500 megatons of freight annually while facing challenges related to congestion, outdated infrastructure, and safety concerns. The government has focused on alleviating congestion on the railway network and improving freight efficiency by constructing two major freight corridors, with high-speed rail projects like the Mumbai-Ahmedabad bullet train, which will cover a 508 kilometre journey in 2 hours, along with other measures such as the electrification of railway lines. As of 2023, about 85% of the railway network had already been electrified.[4]

Transport infrastructure has expanded significantly over the last two decades



Source: HSBC Global Research, data as of May 2023

Covering all bases in transport, the government also plans to operationalise 100 additional airports by 2026 under the UDAN scheme, which aims to make air travel affordable and widespread by connecting underserved and unserved airports. For ocean freight, India's coastal infrastructure is also seeing a reduction in logistics costs, through enhanced port capacity and connectivity under the Sagarmala Project that set aside over $100 billion in port investments.

[1]Government of India, *Economic Survey 2022-23*, 2023, p. 349.
[2]McKinsey&Company, Building India – Transforming the nation's logistics infrastructure.
[3]Ministry of Commerce and Industry, Government of India, India Brand Equity Foundation (IBEF) - Infrastructure Report, May 2024.
[4]Source: National High-Speed Rail Corporation Limited (NHSRCL), data as of August 2024.

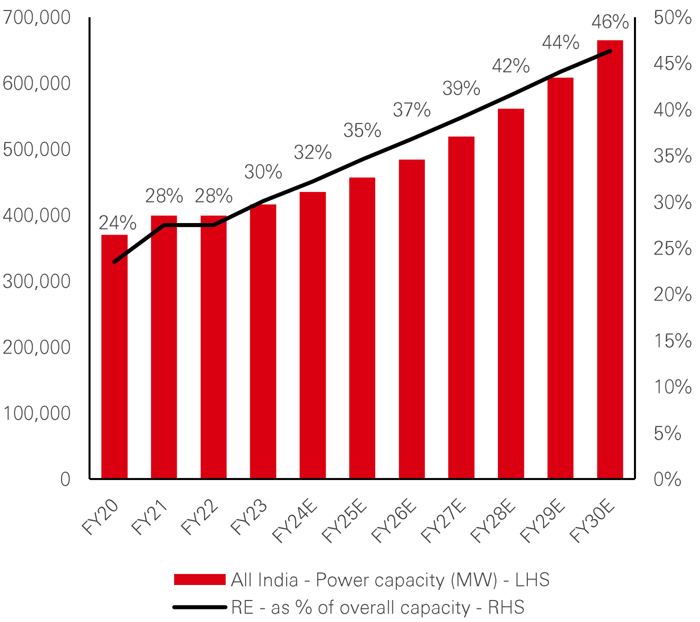
Energy infrastructure facilitating development aspirations

India's energy infrastructure has already experienced significant transformation, with the government achieving near-universal electricity access since 2021, electrifying over 26 million households under the Saubhagya scheme, launched in 2017. This was a significant milestone given the country's vast and diverse geography. With roughly 3-4% new capacity being added annually, total installed power generation capacity for India has reached 448 GW as of July 2024, enough to power 336 million households.

Reflecting the need for sustainable growth, over a third of this installed capacity is in the form of renewable energy. The exponential growth in solar power, driven by favourable policies and declining costs, has taken its installed capacity to almost a fifth of overall capacity. This has resulted in India surpassing Japan last year as the world's third-largest producer of solar power.

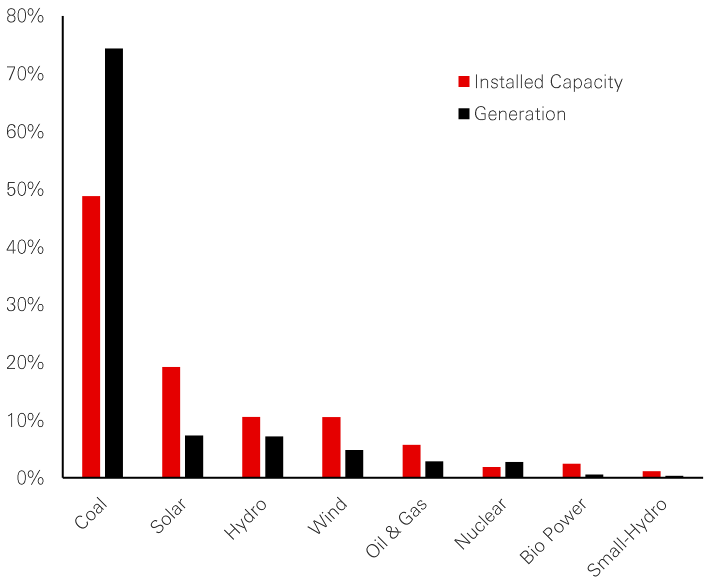
Grid modernisation will be necessary to increase the share of renewables and support growing urban populations.

Renewables as a % of the overall installed capacity



Source: Jefferies, HSBC AM, data as of September 2023

Power source mix – installed capacity v/s actual generation



Source: HSBC AM, NITI Aayog – Government of India, data as of June 2024

Despite big strides in expanding renewable energy capacity, India is still heavily reliant on coal as the dominant energy source. To address this, the government is investing in grid modernisation, including smart grids and energy storage systems, to better accommodate a growing share of renewables and integrate them into the national grid while maintaining reliability. Additionally, through its National Hydrogen Energy Mission, India aims to produce 5 million tons of green hydrogen annually by 2030, with hydrogen allowing for efficient energy storage and conversion to electricity as needed.

Building the cities of tomorrow

According to World Bank estimates, India's urban areas are expected to accommodate 600 million people by 2036 (40% of the population) and contribute almost 70% of GDP. This is a rise of almost 100 million people in urban areas from today. The surge in urban population already underway has exacerbated issues like housing shortages, traffic congestion, pollution, and inadequate public services. Accordingly, the government launched its Pradhan Mantri Awas Yojana (PMAY) initiative which targets the construction of 20 million affordable homes. Concurrently, the Smart Cities Mission, launched in 2015, aims to modernise 100 cities with advanced infrastructure prioritising sustainability. These cities are envisioned as models of urban development, leveraging technology to improve public services and enhance residents' quality of life.

Improvement in urban transport infrastructure clearly goes hand in hand. The government plans to invest over $136 billion by 2030 in expanding metro rail networks, promoting electric vehicles, and developing bus rapid transit systems to mitigate traffic congestion and reduce air pollution. The push in metro rail network expansion is expected to soon take India ahead of Japan and South Korea to become the third-largest metro rail network. Today, over 945 kms are already operational in 21 cities with another 919 kms under construction in 26 different cities.[5]

Lastly to address critical gaps in urban development to date, initiatives like the Swachh Bharat Mission and the Atal Mission for Rejuvenation and Urban Transformation (AMRUT) 2.0 have been launched to ensure universal access to clean water and improve waste management systems across cities.

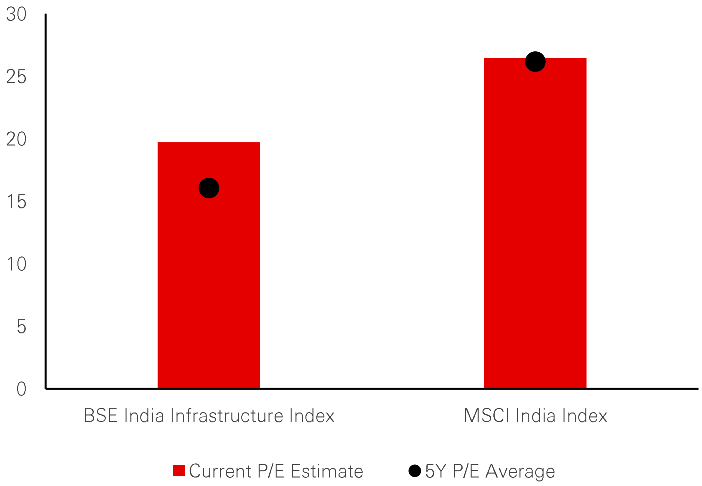
Infrastructure sector a particular beneficiary from growth and policy

The infrastructure sector in India, encompassing transportation, utilities, and energy, among others, has seen a positive influence from the significant government initiatives facilitating infrastructure development. Increased public spending has been successful in encouraging private sector participation and creating growth opportunities, driving valuation expansion in the sector, per the chart below.

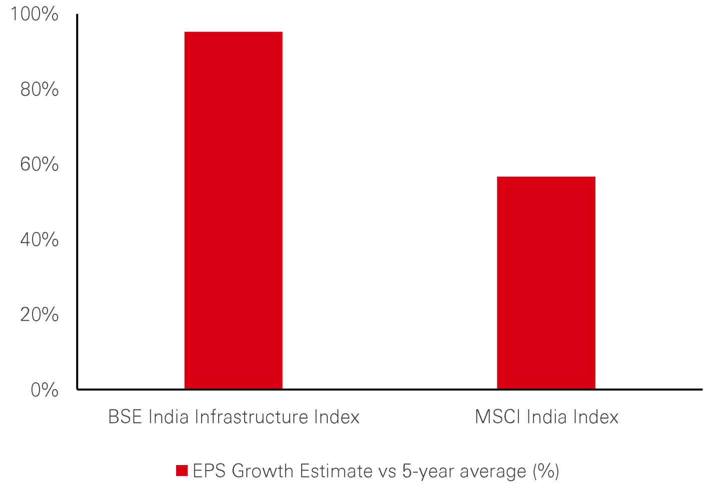
While the current 12-month forward P/E estimate of 19.7x looks expensive compared to the 5-year average of 16x, higher valuations could be supported by the long-term growth prospects associated with rapid urbanisation and industrialisation. This is also reflected in EPS growth estimates.

Listed infrastructure equities in India have outperformed amidst the boom in development.

Price-to-earnings for infrastructure sector are expensive compared to history…



…however, 1-year forward earnings growth estimates are nearly double their 5-year average



Source: HSBC Asset Management, Bloomberg, data as of August 2024

Caveating the growth potential, there are several risk factors that could lower the profitability of companies in the sector and make them look less attractive in future. These include the capital-intensive nature of the sector, with higher debt levels and interest expenses, longer gestation periods before generating revenue, and risks related to regulatory and policy uncertainties – as was demonstrated by the volatility experienced after the recent election when the governing BNP did not perform as strongly as expected, sparking worries around policy continuity.

Furthermore, a major challenge remains the scale of investment still required, from both the public and private sectors. To meet the projected infrastructure demand by 2036, India needs to invest an average of $55 billion or 1.2% of GDP per annum.[6] This will be a big leap in comparison to the estimated 0.6% of GDP which capital expenditure on urban infrastructure accounted for across most of the prior decade.

[5]Ministry of Commerce and Industry, Government of India, India Brand Equity Foundation (IBEF) - Infrastructure Report, May 2024.
[6]World Bank Group, Gearing up for India's Rapid Urban Transformation, 30 January 2024.

Infrastructure and Real Estate sector performance over 5 years versus broader Indian equity market (Indexed to 100 on 31 August 2019)

Past performance does not predict future returns.
Source: HSBC Asset Management, Bloomberg, data as of August 2024

Per the multiple expansion highlighted, over the last 5 years Indian real estate and infrastructure equities have returned roughly 33% per annum compared to the still impressive 19% annualised return of the broader MSCI India index. This performance reflects the ongoing structural reforms and direct growth in infrastructure development, with corresponding positives for real estate values across the country.

Improved transport infrastructure is opening access to consumers, creating new business opportunities while reducing market power for established industry leaders.

Beyond boosting economic activity through new jobs and stimulating demand in related sectors, infrastructure development is also removing barriers to entry across the economy by improving the ease of doing business.

With a significant portion of the population still living in rural areas, companies that had previously established robust distribution networks to reach these consumers have enjoyed high profit margins and competitive advantages up to now, due to difficulty of market entry. This is especially true for large consumer goods companies selling everyday products. However, with improved infrastructure, more companies are expanding their distribution networks effectively to reach the vast rural population, creating more choices for consumers.

Infrastructure improvements have also facilitated the growth of tech-driven logistics startups, by providing a more reliable and predictable environment for deploying innovative solutions like real-time tracking, route optimisation, and last-mile delivery services. While poor infrastructure and logistical issues had previously restricted companies from scaling, improvements have now increased competition, pressuring the profitability of incumbents.

This scenario is similar to the one observed in the cement sector in neighbouring Indonesia, which used to be a highly profitable oligopoly. As infrastructure investments picked up, foreign cement producers started entering the market, increasing competition and reducing profit margins for the existing players.

Likewise, infrastructure development in India should continue to drive economic expansion but may not translate into higher profits for all companies. Although a significant growth runway is anticipated ahead, a rising tide won't necessarily lift all. Dispersion in sector and company performance will certainly continue, supporting opportunities for an active approach in the world's fastest growing major economy.

Regional dynamics driving divergence in Asian equities

The outlook for Asian equities turned into that of cautious optimism as investors moved away from South Korean and Taiwanese large-cap and AI-related technology stocks amid concerns about their high valuations. Despite the entailing volatility, the long-term growth potential remains strong, driven by increasing investments in AI and related advancements. Companies in these regions are well-positioned to benefit from the demand for advanced computing capabilities, suggesting that market corrections could present attractive entry points for investors.

Japanese equities, too, experienced historic one-day losses following record highs in July. This decline was primarily driven by concerns about potential recession risks in the United States, unexpected hawkish signals from the Bank of Japan (BoJ), and continued yen strength, which led to an unwinding of the carry trade. In the near term, market volatility is expected to persist; however, Japan's positive long-term fundamentals and attractive valuations remain intact. Structural factors such as a reflationary tide, governance reforms, corporate investment, and underweight global portfolios continue to support Japanese equities.

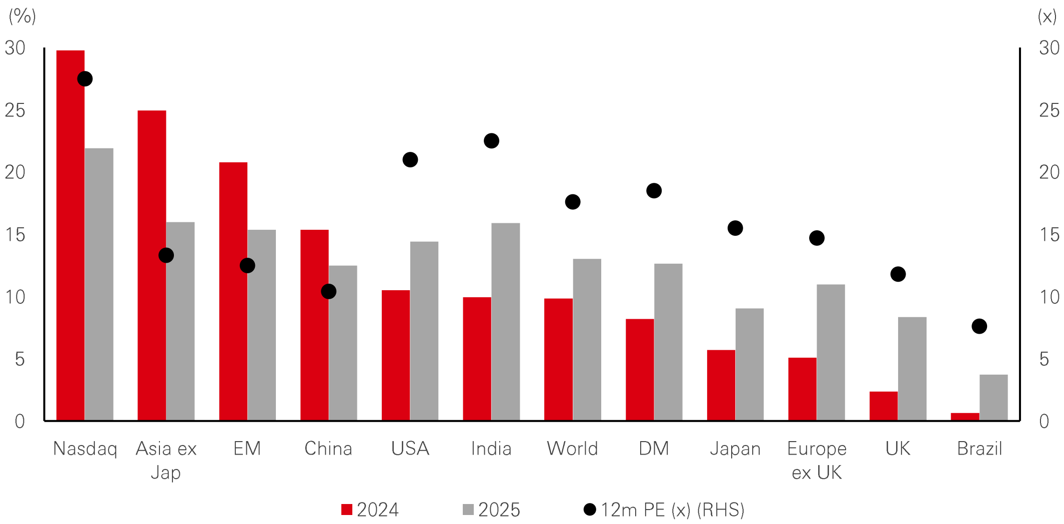
Nevertheless, strong performance by Indian equities and a rebound in ASEAN markets helped offset some of these losses at the regional level. Indian equities demonstrated resilience amid global market volatility, buoyed by strong domestic fundamentals and supportive government policies. The recent Union budget reinforced the government's commitment to sustained economic growth and fiscal discipline, fostering a positive outlook for Indian equities. The ASEAN markets, particularly Malaysia, also benefitted from increased attention as companies seek alternatives to traditional supply chains under the 'China+1' strategy.

In contrast, Chinese equities continued their decline, erasing the gains it had over the second quarter to return to levels seen at the beginning of the year. One of the factors was a weakening confidence in China's economic recovery after the recent Q2 GDP growth figure fell below market expectations. Another concern has been a potential US recession posing risks to China's export-driven growth. Despite this, potential rate cuts by the Federal Reserve could benefit Chinese equities by creating more room for the People's Bank of China (PBoC) to implement monetary easing, which is crucial for supporting the nascent recovery in the property market and easing currency pressures.

Overall, the region continues to trade at a discount relative to most of its peers. Favourable valuations are complimented by better earnings growth for both this year and the next. With differing economic dynamics, government policies, and sector-specific opportunities leading to varied performance within the region, we feel it reinforces the benefits of a balanced approach across countries.

A story of divergence has continued in Asian equities, benefiting those with a balanced approach across the region.

EPS growth (%) estimates versus 12-month forward P/E (x)



Past performance does not predict future returns.
Source: MSCI, Goldman Sachs Research, HSBC Asset Management, data as of June 2024.

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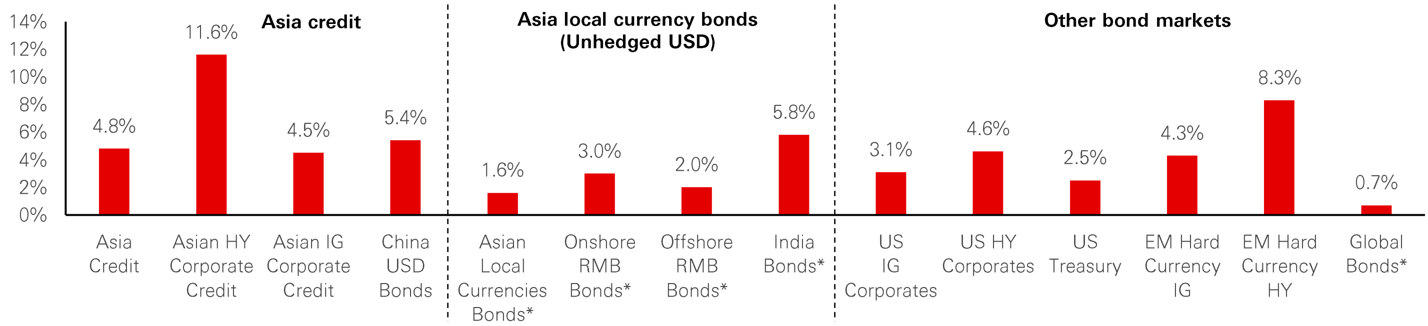
The resilience of Asia bonds

Asia's fixed income market has demonstrated remarkable resilience this year, with the high-yield segment outpacing nearly all global bond markets in 2024. The high-yield market has undergone a transformation over the past few years, resulting in increased diversification. This includes reduced exposure to mainland China's property sector and increased focus on high-growth companies and high growth economies such as India and Indonesia.

Regional bond year-to-date returns (%)



Past performance does not predict future returns.
Source: Bloomberg, JPMorgan, BofA, HSBC Asset Management, as of 12 August 2024. *USD unhedged indexes.

The investment grade segment also continues to remain relatively stable on the back of a solid structural composition. This was evident through Asian credit's performance during the market turbulence that swept global markets in July and August. During this period, Asia credit spreads only widened slightly and have since recovered. This relative stability highlights the potential diversification benefits that Asian fixed income provides, particularly as developed economies like the US shows signs of slowing growth momentum. In contrast, Asia is at a different point in the economic cycle, with a positive outlook supported by supply chain diversification, pro-reform governments, and relatively stable political environments.

A combination of modest supply and strong local demand, particularly from Chinese investors, is supporting the Asia USD denominated credit market. Asian issuers are also benefitting from access to onshore local currency funding, particularly in China and India, providing them with multiple sources of liquidity. Looking forward, easy access to funding, strong balance sheets, and a resilient economic backdrop should enable Asian companies to meet their debt obligations in the coming years.

Meanwhile, renewed investor interest in Emerging Asia local currency markets has bolstered Asian currencies and improved the repayment capabilities of Asian dollar issuers, potentially enhancing credit quality. Asia's US dollar bonds also have a lower duration compared to other markets, reducing sensitivity to spread movements and adding to their relative stability. Overall, this should also support a continuation of the low correlation levels between Asia bonds and their peers in both developed and emerging markets.

Asian bonds have continued to show resilience, with low correlations to both developed and broader emerging markets highlighting their diversification benefits.

Asia credit spreads correlation with other regions

	Asia IG	Asia HY	Asian Composite	EM IG Corp	EM HY Corp	US IG Corp	US HY Corp	Euro IG Corp	Euro HY Corp
Asia IG	1.00								
Asia HY	0.42	1.00							
Asian Composite	0.88	0.74	1.00						
EM IG Corp	0.37	0.30	0.44	1.00					
EM HY Corp	0.37	0.51	0.56	0.87	1.00				
US IG Corp	0.23	0.34	0.40	0.52	0.72	1.00			
US HY Corp	0.14	0.22	0.28	0.51	0.65	0.76	1.00		
Euro IG Corp	0.22	0.29	0.37	0.42	0.62	0.74	0.66	1.00	
Euro HY Corp	0.26	0.32	0.42	0.47	0.67	0.74	0.72	0.87	1.00

Source: Bloomberg, JP Morgan, BAML, HSBC Asset Management; Correlation calculated from spreads, for the 5-year period as of 9 August 2024

Data watch (as of August 2024)

Country	Economic Indicator	Data as of	Last Data	Consensus	Previous Data	Analysis
Japan	**GDP growth** % yoy	Q2 2024	-0.78	-	-0.90	Q2 GDP data was better than consensus, which expanded by 0.8% (seasonally adjusted) qoq following a 0.6% contraction in Q1. Private consumption increased by 1% sa qoq after shrinking in the previous four quarters.
	% qoq		0.77	0.60	-0.59	
	CPI Inflation Headline, % yoy	Jul	2.80	2.70	2.80	Nationwide CPI excluding fresh food and energy dropped to 1.9% yoy in July from 2.2% yoy in June, in line with market consensus. The drop was possibly due to a base effect from last year's rollback of travel subsidies.
	Core*, % yoy		1.91	1.90	2.20	
	Policy rate	Jul	0.25	0.10	0.10	The Bank of Japan raised interest rates by 15bps to 0.25% in mostly an unexpected move and revealed a detailed strategy to halve the pace of its bond purchases by Q1 2026, signalling a push to end the past 10 years of monetary stimulus.
China	**GDP growth** % yoy	Q2 2024	4.70	5.10	5.30	Real GDP growth slowed to 4.7% yoy (+2.8% qoq saar) in Q2 from 5.3% yoy (+6.1% qoq saar) in Q1, below market expectations. Weaker consumption and further weakness in property sector activities offset a positive contribution from exports.
	% qoq		0.70	0.90	1.60	
	CPI Inflation Headline, % yoy	Jul	0.50	0.30	0.20	CPI inflation rose in July partly due to higher food prices following weather disruptions. A further disinflation in core items may suggest a softening domestic demand
	Core*, % yoy		0.40	-	0.60	
	Policy rate**	Aug	3.35	3.35	3.35	The PBoC held 1-year and 5-year LPR unchanged in August, after lowering both by 10bp in July. It likely maintains its piecemeal and cautious approach on interest rates given concerns over banks' shrinking NIM and FX volatility, even as Fed rate cuts may lower the hurdle for PBoC easing
India	**GDP growth,** - % yoy	Q2 2024	6.70	6.80	7.80	India's Q2 GDP growth slowed to 6.7% yoy from 7.8% yoy in Q1 2024, below the RBI's projection and market consensus, following a slight contraction in government expenditure. However, growth in both private consumption and investment picked up in the quarter.
	CPI Inflation Headline, - % yoy	Jul	3.54	3.60	5.08	CPI inflation eased from 5.1% yoy in June to 3.5% yoy in July, driven by a decline in food price inflation due to a high base effect.
	Policy rate	Aug	6.50	6.50	6.50	The Reserve Bank of India (RBI) kept policy rates on hold, and reiterated its commitment to aligning inflation to the 4% target on a durable basis. Resilient economic growth enables the RBI policy to focus on price stability.

Improved or better-than-expected
Worsened or below-expectations
Unchanged or in line with expectations

F: Final A: Advanced P: Preliminary estimate

* Japan Core CPI is CPI excluding fresh food and energy. China core CPI is CPI excluding food and energy.
** China policy rate is the one-year loan prime rate.
sa: seasonally adjusted; saar: seasonally adjusted annual rate
Sources: Bloomberg, Refinitiv, HSBC Asset Management. Data as of 30 August 2024.

Asset class positioning

Asset class	House view	Comments
Asia local government bonds	▲	Asian central banks may soon begin policy easing in anticipation of a Fed rate cut in September. Inflationary pressures have been broadly manageable across the region, and the macro backdrop is supportive. India, Indonesia and Thailand have a more favourable rates outlook.
RMB bonds	↔	China is expected to maintain an accommodative monetary policy stance, but with a focus on structural support. A planned pick-up in government bond supply could limit the upside in the medium term, but liquidity support measures should help mitigate the impact.
Asia ex-Japan equities	▲	Earnings growth is being driven by strong demand for chips/tech-related products, Chinese policy support and other regional cyclical and structural stories. Valuations remain undemanding but there are lingering risks from global growth uncertainty and geopolitical developments.
China equities	▲	While deflationary pressures, property market weakness and low consumer sentiment are risks, valuation discounts already reflect some of the negatives. There were further earnings estimate upgrades after recent earnings releases, and effective policy support may fuel more re-ratings.
India equities	▲	Rich valuations remain a concern (particularly in small and mid-cap stocks), but a solid macro backdrop, earnings growth potential, broad policy continuity, and a strong structural story are supportive. A marked drop in inflation may open door for a shallow rate cut from the RBI in late 2024.
ASEAN equities	↔	The earnings growth outlook in ASEAN has improved, but there is wide dispersion across regional markets. A weaker dollar should support sentiment, as well as reasonable stock valuations and the benefits of supply-chain relocation. Policy easing by ASEAN central banks may also help.
Hong Kong equities	▲	Faltering domestic economic momentum and a slow recovery in the local property market are concerns. However, solid regional trade flows, signs of China's cyclical stabilisation, policy support to reinforce Hong Kong's financial hub status, and well-below-average valuations are positive.
Japan Equities	▲	Upside potential for the yen following BoJ policy normalisation may weigh on the earnings outlook for exporters but is likely to ease import costs for domestic firms. Risks of slowing global growth are a challenge, but corporate governance reforms should improve corporate profitability.
Asia FX	▲	Asia's relatively resilient FX is backed by broadly healthy fundamentals, with some regional divergence. A weaker US dollar and potential Fed pivot in September could be a near-term tailwind, with growing foreign demand for Asian assets being a medium-term benefit.

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