The Telegraph

India is on course to complete a remarkable turnaround

India could achieve growth of up to 8pc a year for the next decade, amazing for an economy which already accounts for 3pc of global GDP

Narenda Modi was elected last year Photo: RAJESH KUMAR SINGH/AP

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4:00PM GMT 07 Mar 2015

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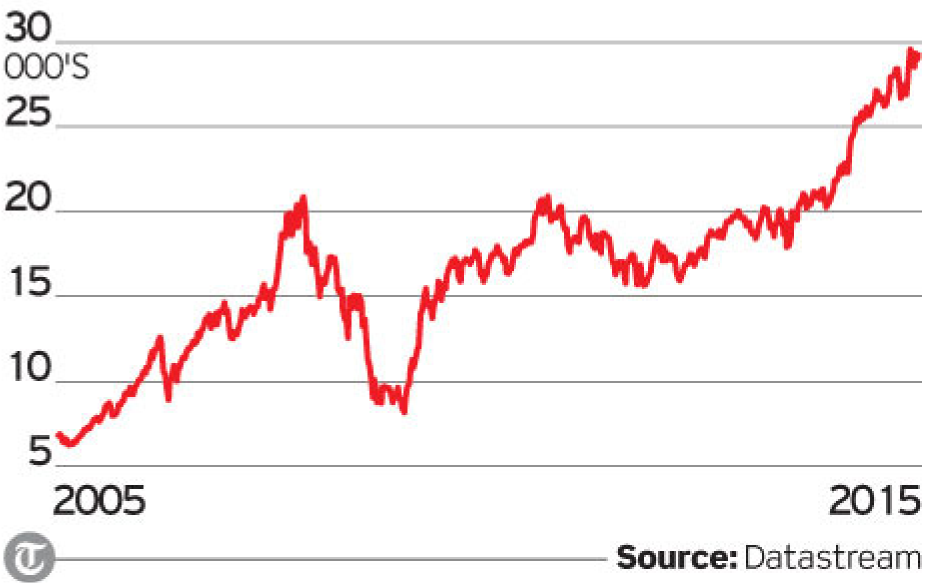
Whatever you think about India – and it's been in the news for good and bad this week – you can't ignore it. Years of playing bridesmaid to China look like they are coming to an end. On current trends, the South Asian giant will soon be the world's fastest-growing major economy and its most populous country.

It has certainly been the stand-out stock market in the past year, with Bombay's Sensex index up more than 35pc, outpacing even the red-hot markets in the rest of Asia such as Shanghai's A-shares (up 19pc), Indonesia (26pc) and the Philippines (21pc).

It has been a remarkable turnaround story when you consider that two years ago everyone was agonising about years of sub-par growth and a potential balance of payments crisis.

The rise and rise of India's Sensex



India's stars are better aligned than they have been for many years, with a reformist government, positive demographics, a newly credible central bank and a large dollop of luck in the form of a plunging oil price – India is one of the world's biggest beneficiaries of cheaper commodities. The recent highlight has been the announcement of the newish BJP government's first budget, much anticipated and largely delivering what investors hoped for.

Often it is better to travel than to arrive in investment, but this time the market held on to its gains, just as it did after the election of Narendra Modi as prime minister last May. Then, too, the pre-election bull market carried on regardless.

If India is to match its potential, it needs to make progress in four areas. First, like China, it must find work for its urbanising, better-educated millions.

They can't all work for Infosys, so the country must build on its success in IT services and take on China as a global manufacturing hub. "Made in India" must be more than a slogan, so it was encouraging that the budget took a number of steps to improve the business environment, cutting red tape and encouraging the development of skills.

Second, it needs to reform a Byzantine and ineffective tax system. The introduction of a national goods and services tax will make it easier to do business across states, expand the tax base and reduce the deadening cascade of multiple layers of taxation. The clarification of anti-avoidance rules will mean multi-nationals no longer view India as a no-go zone.

Third, India needs to get to grips with its dreadful infrastructure. A 33pc increase in spending on rail, road and power generation is key to catching up with China. Beijing's oppressive centralised system may be less appealing to Western eyes than India's chaotic and colourful democracy, but for 30 years it has made the trains run on time.

Fourth, it must balance the books which have been in deficit for many years. The tax reforms will help, as will a scaling back of various welfare schemes and subsidies that the previous Congress government implemented between 2008 and 2012.

This is where the dollop of luck comes in. The unexpected plunge in the oil price in the second half of last year has taken the pressure off on two fronts. First, it has allowed the government to cut back on fuel subsidies. Second, it has helped inflation ease back, which in turn has allowed the Bank of India, under highly regarded Governor Rajan, to cut interest rates twice this year.

Raghuram Rajan has steadied the country's central bank

So India has plenty of helpful tailwinds today but, in terms of its long-term growth potential, none is as important as its demographic dividend. Nearly two thirds of India's 1.25bn population is under the age of 35, according to Barclays.

Over the next 25 years its population is expected to rise by 350m people, about three quarters of which will be of working age. Because of that, in tandem with all the other reforms and structural changes in India, the country could be on the brink of an explosion in consumption and growth. China, by contrast, thanks to its one child policy, faces a rapid ageing and then shrinking of its population.

So, looking forward, India could achieve growth of up to 8pc a year for the next decade, amazing for an economy which already accounts for 3pc of global GDP. Better still for investors, the country is full of high-quality, well-managed companies well-placed to take advantage of its economic potential. It's not the cheapest emerging market, but there's a good reason for that.