India's economy prepares to take centre stage

Indian movie RRR with its catchy song *Naatu Naatu* created history by becoming the first Indian feature film to win an Oscar award in 2023. It's believed that India's economy is also having its RRR moment, with the major reforms of the last decade starting to bear fruit.

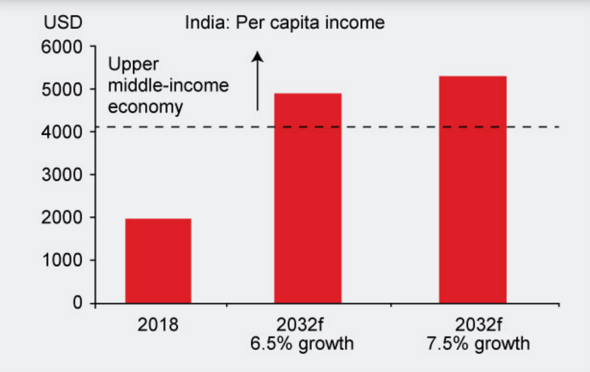
According to the latest IMF forecast released in July, India is set to be one of the fastest growing major economies in the world, with its GDP growth expected to accelerate to 6.1% in 2023[1]. In addition, India is projected to overtake Japan and Germany to become the world's third largest economy (in nominal US dollar terms) by the end of the decade, with Indian households being the biggest spenders among the G20 economies[2].

The power of 1.4 billion people

The United Nations announced earlier this year that India had overtaken China to become the most populous nation on earth. At the same time, India has a relatively young population with a median age of 28 years, 10 years younger than China (38 years) and the US (39 years). It is also projected that India's working-age population will continue growing until 2050[3]. This demographic dividend not only foretells a productivity growth, but also creates a huge consumer market.

In fact, it is estimated that India is set to cross over into upper-middle-income status within a decade, and that its middle class could potentially grow from one-third of the population at present to two-thirds by 2047[4], according to a November 2022 report by PRICE, a Mumbai-based think tank. Thanks to an expanding middle class and newly minted millionaires, the reforms and upgrades in consumption patterns are expected to dramatically increase across the income pyramid, bringing significant growth potential to the local consumer market.

Chart 1: India is set to move to upper-middle-income status by 2032



Source: HSBC Global Research, data as of May 2023. Any forecast, projection or target contained is for information purposes only and is not guaranteed in any way. HSBC Asset Management accepts no liability for any failure to meet such forecasts, projections or targets. For illustrative purpose only.

While the demographic dividend certainly helps support productivity growth, the sheer size of India's population can be a double-edged sword if not enough jobs are created for the expanding workforce. It is therefore imperative for the government to continue with its major reforms and focus on its manufacturing and infrastructure push to facilitate job creation over the next decade.

The "Make in India" initiative

Almost a decade ago Prime Minister Modi launched the "Make in India" initiative with the goal of transforming India into a global design and manufacturing hub. This initiative is made possible by reforms undertaken by the government over the last decade to improve the cost and ease of doing business in India. For example, corporate tax rates were reduced to 22% from 30% in 2019, while the Goods and Services Tax Law, the Real Estate Regulation Act, and the Bankruptcy Code had been introduced over the previous five-year period. One of the major policy actions that deserves a mention are the 13 Production-Linked Incentives that have been put in place since 2020 to create national champions and six million new jobs[5] for India's vast working-age population.

This initiative has gained momentum over the last few years as a result of the evolving global geopolitical landscape and the COVID 19 pandemic. India presents itself as an alternative location given its comparatively low production costs, huge domestic market (amid a fast-growing middle class), and the government's reform agenda improving India's ease of doing business and deepening its integration into global value chains. As a result, the country has emerged as one of the preferred locations for MNCs pursuing geographic diversification in supply chains, attracting significant investments from global companies. There is also a growing trend of outsourcing labor demand and offshoring to India, making it "the office of the world."

Foreign investments pledged to India covered the hi-tech sector, clean energy, and defense. Most noteworthy was a memorandum of understanding, identified as the Semiconductor Supply Chain and Innovation Partnership, under which two different US companies committed significant investments in setting up new assembly and innovation facilities in India. Furthermore, Google disclosed plans to invest around USD10 billion through its existing India Digitization Fund. In addition, according to a Bank of America research report released in June, India's monthly mobile phone exports reached the run rate of USD1 billion per month in February 2023[6], thanks to the government's production-linked incentives that have drawn companies such as Apple and Samsung to produce their high-end smartphones in India and export to markets in Europe and Asia.

Infrastructure build-up

Infrastructure development is key to improving India's manufacturing competitiveness and an important enabler of higher future growth. Capital investment outlay for infrastructure accounts for 3.3% of India's GDP in the FY23-24 budget, and India estimates that it requires USD1.5 trillion in infrastructure investments over the next decade[7], according to a forecast by CMIE, a data and information provider.

Chart 2: Potential public and private sector infrastructure spend over the next 10 years

Infrastructure Opportunity	USD bn
Irrigation and waterways	458
Power	353
Railways	252
Roads	401
Urban infrastructure	79
Total	**1,542**

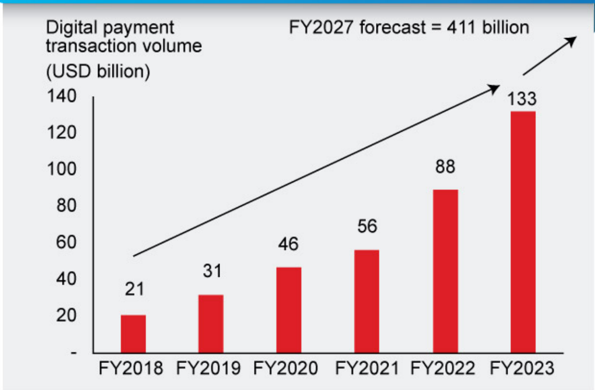
Source: Centre for Monitoring Indian Economy (CMIE); Ministry of Statistics and Programme Implementation (MoSPI), data as of May 2023

Investors believe this focus on infrastructure will lead to an improvement in capex to GDP, which would see India witness higher productivity-led growth in the coming years. Sectors such as capital goods, engineering and construction companies, and power utilities are likely to be major beneficiaries.

Digitization and the "New India"

In addition to manufacturing and infrastructure, digitalization serves as another important growth driver for "New India". India's digitalization has come a long way in a short amount of time, thanks largely to the country's deep engineering talent pool and increased entrepreneurial spirit among young Indians. Another catalyst here is the massive boost to the tech ecosystem from various government-backed initiatives such as India Stack and Startup India. Investors can see how this is playing out by taking digital payments as an example.

Chart 3: Digital payments revolution



Source: Ministry of Electronics & Information Technology, Government of India, PwC forecasts, May 2023. Investment involves risks. Past performance is not indicative of future performance. Any forecast, projection or target where provided is indicative only and is not guaranteed in any way. HSBC Asset Management accepts no liability for any failure to meet such forecasts, projections or targets. For illustrative purposes only.

The current run rate of retail digital transactions has exceeded 100 billion in terms of volume and scaled USD2 trillion in value per year. And the ride isn't over. It's estimated that annual digital payment transaction volume in India will more than triple by 2027 from today's levels[8]. Rising digitalization is great for innovation and productivity. It is democratizing access to credit for small businesses and the unorganized labor force, while creating new job opportunities for young Indians entering the workforce. India's focus on building Digital Public Infrastructure alongside physical infrastructure is not only boosting economic growth but also balancing the social need for sustainable long-term growth. Benefiting from this is the Indian economy as a whole and its equity market in particular.

This "New" India is also being defined by the country's growing startup and unicorn landscape. Unicorns are spread across sectors, though fintech, SAAS (software-as-a-service), and e-commerce top the ecosystem. Despite last year's slowdown in the emergence of new unicorns – a trend that was also seen globally amid rising interest rates – India's unicorns are now valued at around USD350 billion, or 11% of its stock market capitalization, a higher share than in the US and China[9]. These unicorns transform the markets and increase investment opportunities.

Another important theme is energy transition, which is estimated to be an investment opportunity worth more than USD720 billion in 10 years[10]. This is strongly backed by the government's commitment to lowering carbon emissions, and the supportive regulatory environment. Investors also see the technology sector as key to this New India – this includes IT services, pharma, electronics, and high-tech manufacturing. Together, these areas form the new growth engines—engines that should help India become the world's third largest economy in just four years' time[11].

Conclusion

India's economy is making a mark on the world stage in exciting and energizing ways, carving a path for a "New India" that is enabled by digitalization, technology and energy transition, and offering appealing investment opportunities. As India continues its transformation on various fronts, investors believe that its capital markets would likely expand alongside strong economic growth in the medium to long term. It will be increasingly relevant for international investors allocating to a country that offers alpha generation opportunities, as well as exposure to secular and sustainable growth amidst seismic shifts in the global landscape. This is also a major trend that Hong Kong investors cannot neglect.

Source:
1. IMF World Economic Outlook, July 2023.
2. S&P Global, November 2022.
3. United Nations, HSBC Global Research, data as of May 2023.
4. People Research on India's Consumer Economy (PRICE), November 2022.
5. Invest India, December 2022.
6. Bank of America, June 2023.
7. Centre for Monitoring Indian Economy (CMIE), data as of May 2023.
8. Ministry of Electronics & Information Technology, Government of India, PwC forecasts, May 2023.
9. Credit Suisse, CB Insights, March 2023.
10. Morgan Stanley Research, October 2022.
11. HSBC Global Research, May 2023.

Unlocking the disruptive power of generative AI

The AI evolution has brought significant advancements, reshaping industries and human interactions. ChatGPT and cloud computing are pivotal in this transformation. The human-like text abilities of ChatGPT clearly demonstrate AI potential, while cloud computing has provided the computational power necessary for AI's rapid growth. These improvements underscore the role of generative AI, aform of deep learning, shifting AI from concept to real-world use. This marks a period where AI's capabilities are being applied across diverse fields.

ChatGPT: a Disruptive Force

The release of the AI chatbot ChatGPT has generated significant coverage, extending beyond the specialist media and entered the public consciousness. The impact of this technology will likely be broad, reaching into diverse areas of human activity and business. It is important to analyze which industries could be disrupted by this technology, as it affects investors' potential outcomes.

Reshaping Industries: ChatGPT Impact on Various Sectors

Specifically, ChatGPT's transformative potential can be observed in a number of sectors:

- Customer Service: ChatGPT can automate and streamline customer service operations by providing instant and accurate responses to inquiries, reducing wait times, and improving customer satisfaction.
- Healthcare: ChatGPT can assist medical professionals in diagnosing and treating patients, providing access to vast amounts of medical information and helping to improve patient outcomes.
- Education: ChatGPT can revolutionize the way students learn by providing personalized and interactive educational experiences, allowing for more efficient and effective learning.
- Finance: ChatGPT can enhance financial decision making by providing real-time market analysis and investment recommendations, helping to improve investment outcomes.
- Retail: ChatGPT can transform the retail industry by providing customers with personalized shopping experiences, allowing for more efficient product recommendations, and increasing customer satisfaction.

These five industries reflect areas where generative AI is already making an impression, or at least where there is a strong promise of the technology's future disruptive impact.

Moreover, the impressive progress in AI relies heavily on advancements in semiconductors and other hardware, particularly specialized semiconductors and computer chip systems. These chips, originally developed for the specific demands of graphics processing, have been essential in powering the processing of the vast amount of data necessary to train AIs such as ChatGPT. It is no wonder that semiconductors are at the forefront of the trade tensions that have emerged between the US and China. A further dimension to this competition has been added by the recent announcement from a large Chinese corporate regarding the release of its own generative AI chatbot. It's believed the geopolitical implication of competing systems originating from different countries will be keenly observed as it plays out over the coming years.

Companies that adapt quickly and leverage the current tipping point in terms of the accessibility of disruptive new technologies stand to be big winners, while others may be left behind. For investors, what this means is an approach to stock picking that recognizes the nuances both between and within sectors, and the uneven impact that the rapid development and deployment of generative AI will have.

Cloud Computing Fuels Generative AI

Generative AI is a game-changing technology having an "iPhone moment," thanks to its potential to disrupt and transform entire industries. But generative AI needs the kind of data and processing power that only cloud computing can provide, which can create attractive investment opportunities.

The transformative power of AI and the profound developments and changes it is presently triggering in various areas of life and work will require significant computational power and infrastructure, not only to train AI models but also to help companies make use of them.

AI is an umbrella term that covers a variety of technologies and training techniques (natural language processing (NLP), virtual agents, robotic process automation, deep learning, machine learning, etc.). And they all need immense amounts of data and significant computational power to train and run their models. Only cloud hyperscalers — large-scale cloud service providers — can handle the enormous data workloads. But even these massive firms will need to expand as data volume and complexity continue to grow.

Anticipated Surge in AI-Related Cloud Spending

Although public cloud spending has recently slowed due to macro-economic pressures, the industry's mid-cycle growth rates and a rising rates environment, the portion of this spending focused on AI is forecast to rise.

- The total volume of cloud spending related to AI is expected to grow substantially over the medium term to over USD 300 billion by 2026.
- Of the total addressable market of AI-related spending, the portion dedicated to cloud infrastructure and services is expected to grow from 50% today to almost 60%, reflecting the data intensive nature of future models and inference uses.
- RBC Capital Markets projects an increase of 26% in the overall cloud providers total addressable market due to generative AI.[1]

Chart 1: Overall public cloud spending is projected to rise steadily...

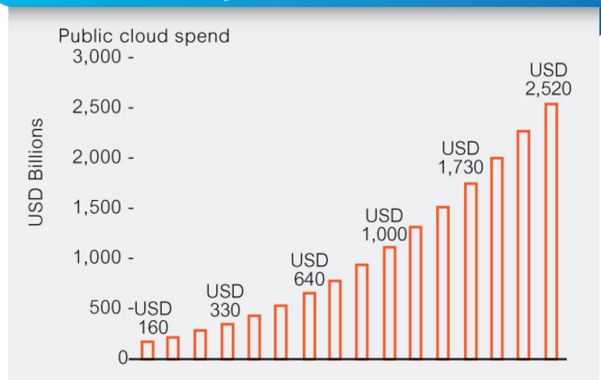
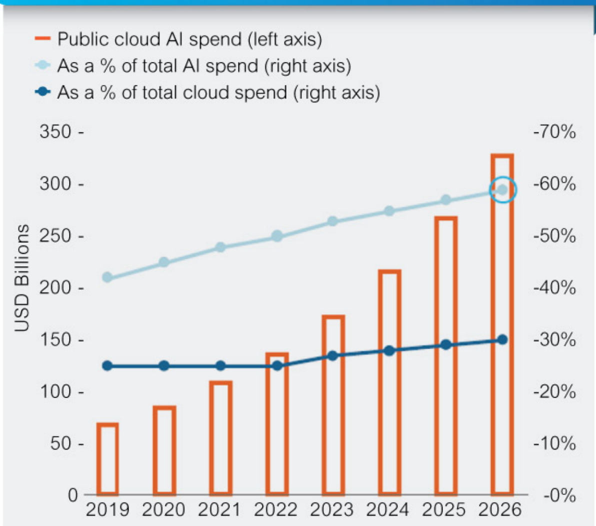


Chart 2: ... and by 2026, 60% of all AI spending will be on cloud infrastructure & services



Source: Morgan Stanley Research, IDC, as of March 2023.

Although cloud spending was forecast to continue with double-digit growth for the foreseeable future, investors saw the industry entering its mid-lifecycle. The transformative power of generative AI became evident through releases like ChatGPT, DALL-E, and Midjourney, surprising both consumers and companies. A rapid assessment is now taking place: some companies have been preparing for these moments, others new but adaptable, and some lagging or unaware. These developments are compared to an "iPhone moment" by industry observers due to their game-changing impact.

As AI experiences its “iPhone moment”, it’s believed generative AI will not only positively impact technology hardware (advanced GPUs, data centers, Edge Computing), software (cloud service providers, SaaS, customization), and security (data protection, data audits, regulatory compliance), but also alter how consumers create and absorb audio, visual, and textual information.

For businesses, generative AI should have a unique impact on how businesses utilize the technology to increase productivity and streamline workflows. After cloud services became mainstream in 2006, it’s believed generative AI could be the next major catalyst for growth in cloud computing.

Strategically Positioning Global AI Investment Opportunities

Based on a recent survey of 300 IT decision makers[2], AI was voted as the technology that will have the greatest impact on their business over the next five years. In addition, 49% said their company uses generative AI for work purposes and 29% are looking for ways to do so. Among respondents who have used it, 56% use it for analyzing data and information, 52% for customer support, and 48% for brainstorming and developing new ideas. In terms of near-term spending priorities, cloud computing was the second highest. The findings support the idea that generative AI is at an inflection point, with greatest near-term investment opportunities in AI infrastructure and AI applications.

As generative AI fundamentally transforms the technology landscape at an unprecedented pace, semiconductors and component makers should benefit. The computational demands of the large language models underlying generative AI systems are significantly greater than what the existing infrastructure can support. Meanwhile, many software companies have released generative AI modules helping customers to automate previously rote tasks and to generate valuable new insights from their data.

Over the longer term, it’s believed AI-enabled industries will be key beneficiaries as they leverage large language models to gain operational efficiencies and focus their revenue-generation efforts on the most productive areas. Given the expansive and transformative power of generative AI, especially in the near and medium term, utilizing multiple categories should provide investors with a more diversified and comprehensive approach to the opportunity set.

Source:

1. Software and Internet Applications of Generative AI and Chat GPT, RBC Capital Markets, March 16, 2023.
2. Grassroots Research® "Global IT Spending Survey," May 2023. Based on a survey of 300 IT professionals at companies with 100 or more employees. The GRASSROOTS RESEARCH® division of Allianz Global Investors commissions investigative market research for asset management professionals. Research data used to generate GRASSROOTS RESEARCH® reports are received from independent, third-party contractors who supply research that, as far as permissible by applicable laws and regulations, may be paid for by commissions generated by trades executed on behalf of clients.