FUND MANAGEMENT DIARY
Meeting held on 1st May 2018

India's time to shine

- Household and government spending should support a pick-up in India's economic growth rate over the next eighteen months

- Some progress has been made to implement structural reforms and economic growth could average around seven per cent per annum if this continues

- Although India's importance to global growth will rise over the coming years, it won't have the same impact on global trade flows, inflation or commodity markets as China did

Near term outlook relatively upbeat

India's economic prospects over the near term are relatively upbeat. Household consumption appears to have recovered impressively since demonetisation. Meanwhile strong wage growth, particularly in rural areas, should help to boost consumption further over the coming months. Government consumption should also support growth, particularly as fiscal policy is set to be loosened at state level ahead of next year's general election.

As the economy gathers momentum, capacity utilisation will rise, and this should boost core inflation. This is likely to keep headline consumer price inflation above the Reserve Bank of India's four per cent target, which it has just officially switched to in April from a target range of two to six per cent. Markets have recently started to price in possibility of policy tightening to commence this year.

India's medium term growth prospects are dependent on structural reform progress

Beyond the next eighteen months or so, India's growth prospects over the longer term are dependent on the government, and its ability to push ahead with structural reform. To set the context, India's services sector has been the most dependable engine of growth for the past couple of decades. But growth of eight per cent or more has only been achieved when industry has been growing strongly too. In other words, the extent to which reforms can boost local industry, particularly manufacturing, will be an important determinant of long-term growth.

There are four key areas that require addressing by the government to boost local manufacturing: (i) labour market rigidities; (ii) problems with land acquisition; (iii) poor infrastructure; and (iv) a difficult business environment.

However, the government hasn't shown much willingness to push ahead with necessary measures to tackle land and labour constraints. This is unsurprising given how politically contentious it is to implement reforms like these. As such, enacting them is likely to be more difficult in a democracy like India than in countries with more autocratic forms of government. However, a lack of reform in these areas could ultimately prevent India from matching the growth rates of the very best performing emerging economies in recent decades.

But at the same time, there have been some notable successes in the reform agenda. First, the Goods and Services Tax was finally rolled out last July over a decade after its conception. This was the biggest change to India's tax system since independence and it replaced more than a dozen state taxes. The tax reform should have material longer term benefits to the economy. The tax system will become less complex and this will improve the business environment. This should help to boost intra-state trade and could lift foreign investment. In addition, the changes will help to widen the tax base and boost fiscal coffers. This won't directly impact infrastructure spending, but it should ensure that more revenues are available for the government to invest.

Second, a large-scale recapitalisation programme, which was announced in late 2017, should help India's struggling banks. Lending growth has slowed sharply in recent years as banks have become more risk averse – a response to rising non-performing loans and concerns about their ability to meet global capital requirements. This has choked off a key source of financing for local firms. Although the recapitalisation won't result in an immediate pick-up in lending growth, it should accelerate over a longer time horizon as stronger capital buffers make banks less risk averse. This bodes well for infrastructure investment, and indeed investment more generally, over the coming years.

Finally, measures to improve the business environment have been wide-ranging, and one of the major policy successes of the Modi government. For example, there have been efforts to streamline the bureaucracy, while restrictions on foreign direct investment have been lifted in numerous sectors of the economy, including aviation, defence, insurance and construction. And the improvement in India's ranking in the World Bank's Ease of Doing Business Survey suggests that things are heading in the right direction (the country's rank has improved to 100 in 2018 from 142 in 2015).

These measures should help to boost India's productive potential over the longer term.

If the government continues to take an incremental approach to reform, then India's economy could grow at around seven per cent per annum. This would place India among the top 25 per cent of performers at its stage of development, and it would also leave India on course to comfortably outperform the rest of the emerging world over the coming decade. So while those hoping India will match the former growth rates of the fastest growing emerging economies in recent decades are likely to be disappointed, the big picture is that the long-term outlook for India is bright.

Can India become the next emerging market powerhouse?

The next thing to consider is whether all of this is enough to ensure that India can become the new emerging market powerhouse as growth in China slows – an inevitable comparison given both countries' enormous populations. India is already making a fairly significant difference to overall global gross domestic product growth. Over the past five years or so, about ten per cent of global gross domestic product growth has been due directly to India.

Over the coming years, India is likely to contribute around the same as China to global growth. This is because despite being a smaller economy, it is set to grow faster. What's more, although India may not offset all of China's coming slowdown, it will take up a significant part of the slack.

But while India's contribution to global growth is set to increase, developments in India are unlikely to have the same impact as developments in China during its boom years. India's exports as a share of gross domestic product are unlikely to rise to the levels that China's did in its boom years, given that India is already integrated into the global economy, and reforms to boost manufacturing competitiveness are likely to be incremental. Meanwhile, the nature of India's growth has been more services-focused in comparison to China's. Less focus on industry and investment means that growth will be less commodity-intensive, with fewer implications for global commodity markets compared with China's development.

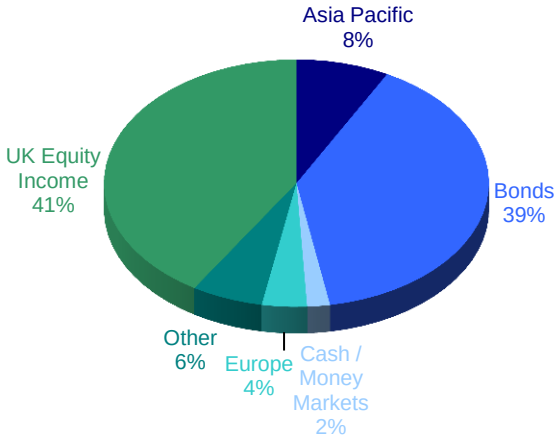
Overall, India is unlikely to grow as fast as China did in its boom years, and it won't have the same profound impact on global trade flows, inflation or commodity markets as China. But growth in India is still likely to accelerate over the longer term, which will solidify its position as a key contributor to the global economy.

Strategy

Future Money do not invest in specialist India funds, our fund range has exposure to India through some of our Asia Pacific and Emerging Markets funds. A positive environment for Indian business is encouraging, yet it is not the only reason to be optimistic on Asian markets. Higher growth rates than in the developed world and increasing affluence across large parts of the region makes exposure to developing markets across the world attractive with a long term perspective.

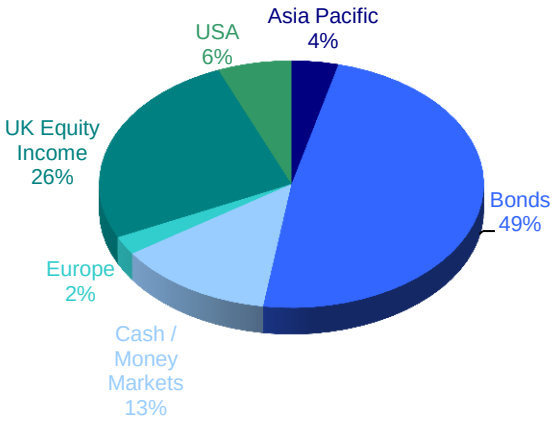
Income

The Rathbone Income fund is currently under review. The recent performance profile has been different from our expectations and the reasons for this will be investigated. No changes are currently being considered.



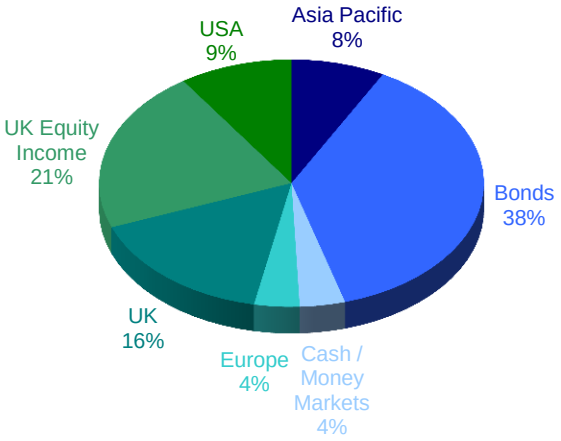
Real Value

Fund selection is performing well in the current environment with both the bias towards UK equities and short duration bonds adding to relative returns. Our focus on defensively exposed Asian and European equity funds has also performed well as these markets have experienced challenging conditions in recent months.



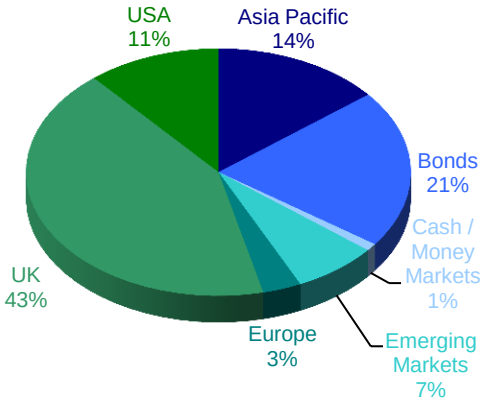
Real Growth

The Schroder European Alpha Plus fund was added to the portfolio in February, and while only the short term so far, the fund has produced a significant outperformance of its peers over this time.



Dynamic Growth

No changes will be made this week for Future Money Dynamic Growth, however the total equity exposure is being closely monitored given recent rises in stock markets. The fund selection is performing in line with expectations and currently there are no areas of concern.



Important Information

Please note that the contents are based on the author's opinion and are not intended as investment advice. This information is aimed at professional advisers and should not be relied upon by any other persons.

Any research is for information only, does not constitute financial advice or necessarily reflect the views of the author and is subject to change.

It remains the responsibility of the financial adviser to verify the accuracy of the information and assess whether the fund is suitable and appropriate for their customer.

Past performance is not a reliable indicator of future performance. The value of investments and the income derived from them can fall as well as rise and investors may get back less than they invested.

Important information about the funds can be found in the Supplementary Information Document and NURS-KII Document which are available on our website or on request.

For any information about the Future Money funds please contact the authorised corporate director, Margetts Fund Management Ltd, on 0121 236 2380, admin@margetts.com or at 1 Sovereign Court, Graham Street, Birmingham B1 3JR. A copy of their Terms of Business which relates to investments into the funds can also be obtained using these contact details.

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