# Macro outlook

## Winner's curse?

**"The term stagflation was coined in 1970 by Alistair McLeod, then UK's Chancellor of the Exchequer, to describe the economic environment at the time. Inflation was accompanied by stagnant economic growth and hence resulted in a debilitating erosion in spending power and thus wealth. We are doubtful that Rishi Sunak, the current Indian-origin Chancellor, would aspire to preside over only the second recurrence in half a century. However, if global economic growth does not sustain through 2021, the risk of stagflation is perceptible."**

*- our shareholder letter dated May 2021*

Human aspirations are a funny thing. Based on recent events, it appears that Rishi Sunak desperately aspired to preside over the current stagflationary environment as Prime Minister, even though he clearly saw it coming and warned so with fervor. Ambition, one of the most basic human instincts, routinely trumps practical considerations of one's ability to turn a difficult situation into a success.

Having risen to the top job, what does the man in power do next? As a student of history and clearly a rapid learner given his meteoric rise, he needs to focus on self-interest (i.e., stay in power) and national interest (i.e., fix the mess).

## Politically acceptable *quick* wins

**"Right now our country is facing a profound economic crisis…I will place economic stability and confidence at the heart of this government's agenda. This will mean difficult decisions to come…"**

*- Rishi Sunak, October 25th 2022, in his first speech as Prime Minister*

Sunak has undoubtedly taken the helm at one of the worst times in recent memory. He will need to take tough decisions and show politically acceptable quick wins while (hopefully) achieving longer-term fundamental fixes.

The challenge involves striking a balance between improving the UK's fiscal position by enhancing revenues (tax increases being the obvious but painful option) and reducing costs (privatization and outsourcing come to mind). One can aspire for both goals by arguing for access to new markets for the UK to sell products (i.e., economic growth) while also procuring cheaper goods and services without impacting lifestyles (i.e., curbing inflation).

*Cheaper procurement to curb inflation*

Import bans and import duties create a scarcity of goods and fuel inflation. It stands to reason that when the procurement of Chinese goods or Russian energy is banned, prices go up due to supply constraints. Even though China has been the factory for the world (producing everything from chemicals to iPhones), world leaders are politically challenged to continue Chinese procurement even though inflation is a logical consequence.

India has emerged as one of the strongest, most reliable, and politically acceptable procurement alternatives to China. In one particularly ironic example, most European countries have imposed anti-dumping duties on Chinese solar panels whereas Trump had banned their purchase outright. Hence, US producers, desperate for Indian panels, are paying huge premiums and funding billion-dollar advances to Indian companies that haven't built factories yet! In the meantime, Apple has been steadily shifting iPhone production to India and nurturing a domestic supplier base which didn't previously exist. Outside technology products, even items as mundane as towels for Wimbledon, the most British sporting event, are manufactured solely by an Indian company within our portfolio.

*Reducing costs by outsourcing and offshoring*

Serco, the UK's largest outsourcing business, was formed in 1929 during the era of the Great Depression. Today, the business employs over 50,000 people and operates critical activities for the government such as border security, train services, prison management, and waste management services. One wonders how Serco can accomplish so much with a limited headcount until one realizes that this does not include offshored staff of service providers in India – perhaps monitoring the UK's borders from their seats in Gurgaon, among other things.

Mr. Sunak knows all too well about the success of India's IT services and business process outsourcing industries, given that his father-in-law founded Infosys, one of India's largest IT companies. It stands to reason that the UK and indeed other western governments will accelerate initiatives to outsource various government functions using "technology" such as cameras, sensors, and workflow software, enabling the majority of the manual efforts to be conducted offshore.

Is cost efficiency the only reason why companies in western countries are moving services to India? The answer is no. The psychographic profiles of workforces across nations also play a major role.

Much has been written about the “Great Resignation” where less ambitious (or frustrated) Americans and Europeans have preferred to sit at home rather than accept jobs that are out of sync with their qualifications or self-esteem. They have had the luxury of doing so, in droves, thanks to covid-induced government handouts, generous pensions and savings programs, and a culture of comfort and entitlement. In the UK today, ~22% of the working age population is neither employed nor looking for a job.

The psychographic profile of India’s workforce is very different from those of the West. Till the ‘90s, there was a strong focus on austerity resulting in a feeling of deprivation. With newfound economic freedom, the common man is ambitious to travel (and settle) the world, and rise up the ladders of business, science, and politics. Setting egos aside, Indians typically view any kind of employment as a sure shot path towards a more glamorous life.

Russell Peters, a comedian and the son of Indian immigrants into Canada, illustrates the point by quipping about his father’s exhortation for him to become a baggage handler at Toronto Pearson airport. Which American or European aspires to be a baggage handler nowadays? Or a security camera monitor or janitor? Or work in a factory? With ~20% of the world’s population and a larger share of the willing and able labor pool, examples of success such as Rishi Sunak inspire a billion countrymen to study and work hard, generating meaningful economic impacts across continents. In that context, it comes as no surprise that Indians comprise 2.5% of the population but generate 6% of UK’s GDP, while repatriating $4 billion annually back to family members in India.

Sir Winston Churchill was famously dismissive of Indian leaders as being “low caliber and men of straw…”. His grandson, Rupert Soames, the current CEO of Serco, will presumably have a more calibrated view given the compositions of his workforce as well as his government!

## Free Trade Agreements – a *quick win* solution?

**“Financial services is an area where there's enormous opportunity for both of our countries. India's goal is to spread insurance across the entire economy because insurance is a great tool for enabling protection for individuals and growth. We can help with that in the U.K., because we have a fantastic insurance industry.”**

*- Rishi Sunak, July 2022*

It is indeed true that ICICI Bank set up their life insurance business as a joint venture with Prudential UK back in 2003. Right from day one, ICICI Bank contributed 74% of the capital and virtually 100% of the management talent and operating expertise. Notwithstanding, it is certainly aspirational for the English voter to hear about how their fantastic insurance industry will expand into India and generate income and highly paid jobs in the UK.

It is our view that the UK-India Free Trade Agreement (FTA), which has languished for the past few years across successive UK governments, will now be signed swiftly, and to India’s advantage. We believe that Mr. Sunak’s motivations will mostly arise from lowering the costs of procurement of goods and services (i.e., stemming inflation). Any incremental economic growth arising from the UK offering insurance (or other products) is far-fetched at best.

In 2021, total trade between India and the UK stood at $17.5 billion, a rather modest sum when compared with India’s trade with the US of $119 billion. Goods form ~60% of India’s exports globally; hence, an FTA with the UK gives India tremendous upside to export products including textiles, engineered goods, auto components, chemicals, and pharmaceuticals. With lower duties, Indian exports will surge and help stem the inflationary impact of Chinese goods being taxed or supplanted.

India already conducts annual trade with the UAE of $73 billion which will increase by $100 billion due to the FTA signed in February 2022 (discussed in our May 2022 letter). Other geopolitically aligned western countries (e.g., Australia, the EU, the US, and Canada), may well flock to sign similar deals with India in the years to come.