

## India

## India Strategy

## Money, Military &amp; Markets-VIII

- Deteriorating demographics and a disillusioned young population in China increase the likelihood of an attack on Taiwan and further arming of Pakistan.
- China will prioritize domestic needs, making it unlikely that its actions will align with cost-of-capital considerations or Western economic principles.
- Short steel and bulk chemicals; long alumina, ammonia, and fertilizer-related chemicals. Buy HAL as its order book will swell further.

**The window to attack Taiwan is becoming smaller for China**

An aging population, China's rapid technological advancement—surpassing even the US in some areas—Xi's cautious nature, disenchanted youth, rising unemployment, and Xi's self-imposed 2049 timeline to integrate Taiwan into mainland China are creating conditions ripe for political miscalculation and potential chaos in the South China Sea. While China has many of the elements needed to take Taiwan and dominate the critical new battleground of power—namely, TSMC's ultra-high-quality chip production—it still lacks the US's unparalleled ability to print money. That said, the window for taking over Taiwan is closing for China as its population ages. The number of workers supporting one retiree has dropped from 10 in 1980 to just 2 now. While drones, humanoids, and artificial intelligence (AI) are valuable, war ultimately requires human sacrifice and a motivated population. Xi's policies have created disillusioned youth practicing the *'Lying Flat', Involution, and Run Philosophy* to show disobedience, thereby exacerbating the economic malaise. China now needs a nationalist movement to inspire its youth, and what better way than to attack Taiwan—an issue most Chinese connect with deeply and one that could ignite a nationalist fervour.

**China to restrain India by arming Pakistan**

The Galwan incident and the rapid deployment of the Indian Army, coupled with India's willingness to take casualties, have made China rethink its policy towards India. There are three strategic imperatives for China vis-à-vis India: 1) Normal Indian and Chinese people do not perceive each other as enemies. While the Galwan incident changed the Indian populace's attitude, it hasn't turned into hatred. 2) The 1962 war still pinches Indians, but they blame themselves more for the debacle due to the flawed policies of the government in charge at the time, rather than blaming China directly. 3) Body bags coming from Tibet would be far more disastrous for China compared to those coming from Taiwan. At the same time, China now has Pakistan as a vassal state, whose existence is based on its hatred of India. Utilizing Pakistan and arming it with 5<sup>th</sup>- and 6<sup>th</sup>-generation technologies is much easier and more cost-effective for China. Remember, Pakistan cannot pay for this hardware, so it will borrow from China. The more they borrow, the more they become a proxy of China. India needs to match China's technology, not to fight China, but to fight Pakistan

**Tech edge to Pak results in war/proxy war - India needs to arm itself**

Pakistan is already acquiring 5th-generation aircraft, and the belief in a technological edge often leads to irrational behaviour by the Pakistani army. Facing challenges on their home turf, they may seek to assert their superiority through a border skirmish. India urgently needs to invest in 5th-generation aircraft. To Russian President Vladimir Putin's delight, India may end up purchasing the Su-57 as well as the S-500. Meanwhile, the arm-twisting by the US regarding the transfer of GE 414 jet engines is stalling India's 4.5th-generation and 5th-generation aircraft projects. Russia would likely be more than willing to transfer jet engine technology in a faster manner.

**Rationally, investors should assume irrationality by President Xi**

President Xi is a hardened communist who spent seven years (from age 15 to 22) in re-education in China's hinterlands, living among peasants after his father fell out of favour with the Chinese Communist Party (CCP). Despite being a princeling by birth, these experiences shaped his cautious nature and strong belief in Mao's philosophy, steering him away from Deng Xiaoping's principles. One should assume irrationality from Xi. While a war in the South China Sea appears inevitable within the next decade, its exact timing remains unpredictable. In this context, China will design its economic policies to align with its unique goals and ideology, making any expectation for it to act as per Chicago School of Economics unrealistic and foolhardy.

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## China's technological rise & social dilemma

An aging population, China's rapid technological advancement—surpassing even the US in some areas—Xi's cautious nature, disenchanted youth, rising unemployment, and Xi's self-imposed 2049 timeline to integrate Taiwan into mainland China are creating conditions ripe for political miscalculation and potential chaos in the South China Sea. While China has most of the elements needed to take Taiwan and dominate the critical new battleground of power—namely, TSMC's ultra-high-quality chip production—it still lacks the US's unparalleled ability to print money. This unique US capability, which could fund a war in Taiwan without triggering inflation, would likely propel US GDP upward, much like during World War II, all under the guise of maintaining world order—a strategic advantage China can never replicate.

### Demographics is destiny- President Xi will understand it best

The composition of a population—its age, race, gender, economic status, and other characteristics—has a significant impact on a society's future, shaping everything from politics and economics to culture and infrastructure needs. In the case of China: 1) It has to reinvigorate the disillusioned youth. 2) The aging population means they have the best chance to integrate Taiwan. 3) The Chinese people will have to endure a harsh economic life for the next several years, along with the real estate sector's collapse, and Xi's inward-looking policies will take a toll. A dose of nationalism is needed, and an attack on Taiwan will create a wave of nationalism, allowing people to endure all hardships. Pushed to the wall, President Xi can do it, but how soon, no one knows.

### China's one-child policy is resulting in an aging poluation ➤

The reasons for the same are as follows:

#### 1. One-Child Policy (1979-2015):

- China's strict population control measures significantly reduced birth rates for decades.
- Although the policy was relaxed to a two-child policy in 2015 and later to a three-child policy in 2021, the cultural shift towards smaller families and rising costs of raising children have kept birth rates low.

#### 2. Increased Life Expectancy:

- Improved healthcare and living standards have increased life expectancy, resulting in a growing elderly population.

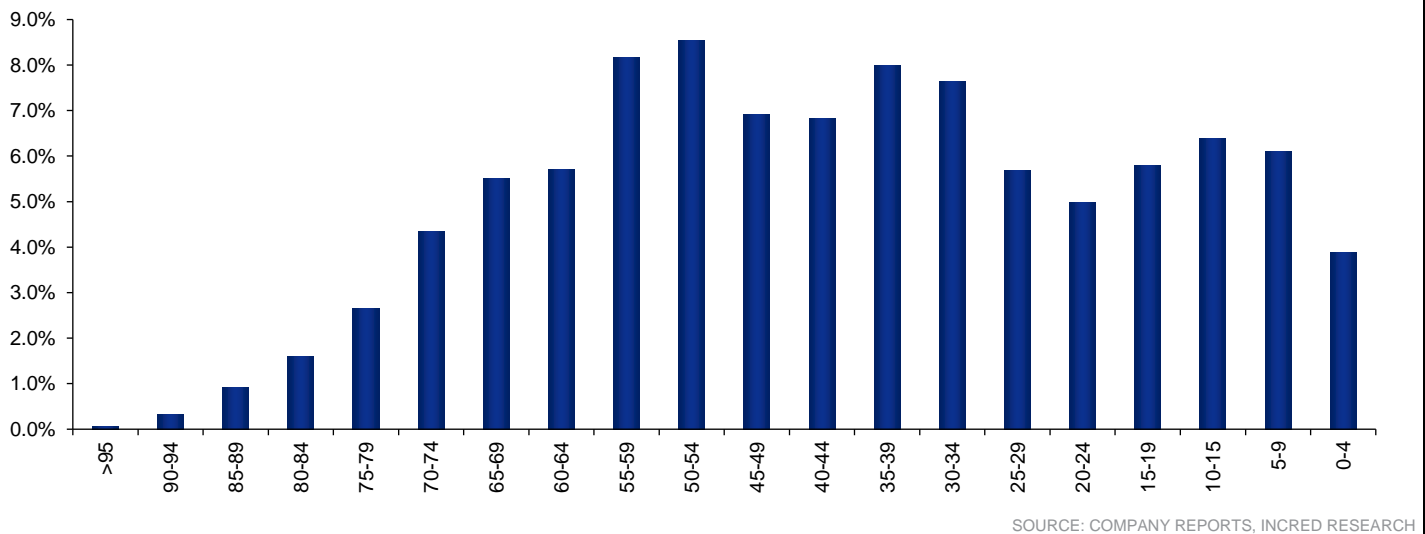
#### 3. Declining Fertility Rates:

- Fertility rates are well below the replacement level of 2.1 children per woman, with recent estimates showing rates around 1.2–1.3.

### By 2050F, almost 30% of the population will be over 65 years of age ➤

As of 2023, China's median age is around 39 years, significantly older than other developing countries. Over 14% of the population is aged 65 and older—a figure projected to double by 2050F. The working-age population (15–64 years) has been shrinking since 2014, with fewer younger workers entering the labour market.

Figure 1: The fighting-age population of China is falling rapidly



### China is taking text book rapid measures to course-correct ►

- Relaxing Birth Policies:** Moving from a one-child to a three-child policy and offering incentives for larger families, although the results have been modest.
- Promoting Automation & AI:** Investing heavily in robotics and artificial intelligence to counteract labour shortages.
- Pension & Healthcare Reforms:** Expanding and restructuring social safety nets to address the growing needs of an elderly population.
- Encouraging Immigration:** Though historically reluctant, China may need to attract foreign workers to supplement its labour force.

### Meanwhile, President Xi has come up with strict communist measures ►

Key policies contributing to youth discontent are as follows:

- 'Zero-Covid' Policy (until late 2022):**
  - Prolonged lockdowns caused frustration and economic hardship, disproportionately affecting the younger generation.
  - Youth unemployment reached record levels, exceeding 20% in 2023.
- Economic Policies:**
  - Regulatory crackdowns on sectors like tech, education, and real estate disrupted career prospects in industries that were once major employers of young professionals.
  - A slowing economy has reduced opportunities for upward mobility.
- Nationalist and Restrictive Policies:**
  - Increased censorship and surveillance stifle creative and entrepreneurial freedom.
  - Strong nationalistic narratives limit global exposure and opportunities for international education and employment.
- 'Common Prosperity' Campaign:**
  - While aimed at reducing inequality, the campaign has added pressure on private companies, reducing job security for many.

### One of the major disasters resulting from these policies is the shutdown of the home tutoring business ►

At its peak, China's tutoring market stood at US\$100bn per annum. New Oriental Education & Technology was a leading provider of private educational services in China, offering tutoring, K-12 education, test preparation, vocational training and language training.

To enforce educational reforms, President Xi did the following:

1. China banned for-profit tutoring for school curriculum subjects.
2. It banned subject-based tutoring institutions from listing on stock markets or raising funds
3. Tutoring companies can no longer teach compulsory school subjects taught during school hours nor earn a profit.

**Figure 2: New Oriental Education & Technology's stock price shed almost 85% in a few days and limped back to US\$64, which is still 65% below its peak**

**New Oriental Education&Tech 64.180 +1.210 (+1.92%)**



SOURCE: COMPANY REPORTS, INCRED RESEARCH

**Unlike Deng Xiaoping, President Xi is a hardened communist leader who was 're-educated' for seven years while living with peasants in rural China ➤**

**Deng Xiaoping: Pragmatist and Reformist**

1. Deng rose through the Communist Party ranks during the revolutionary period but was later purged multiple times, including during the Cultural Revolution.
2. Despite personal hardships, he emerged as a pragmatist, famously advocating for reforms with his maxim: *"It doesn't matter whether a cat is black or white, as long as it catches mice."*
3. Deng prioritized economic pragmatism over ideological purity, launching market-oriented reforms and opening China to the global economy.
4. His policies created unprecedented economic growth and laid the foundation for modern China's integration into the world system.
5. Deng believed in collective leadership and was cautious about concentrating power.
6. He sought stability and gradual reform, avoiding radical ideological moves.

**Xi Jinping: Hardened Ideologue**

1. Xi Jinping's formative years were shaped by hardship during the Cultural Revolution. His father, a prominent Communist leader, was purged, and Xi

- himself was sent to the countryside for ‘re-education’ in Liangjiahe, Shaanxi province.
2. During his seven years in rural China, Xi lived and worked alongside peasants, enduring severe conditions and reportedly developing resilience and loyalty to communist ideals.
  3. Unlike Deng’s pragmatism, Xi leans heavily on ideological control and the consolidation of power.
  4. His focus on Marxist-Leninist principles and his revival of Mao-era governance styles (e.g., the cult of personality, centralization) signify a departure from Deng’s reformist legacy.
  5. Xi aims for national rejuvenation, emphasizing party control over all aspects of Chinese society, including the economy, culture, and education.
  6. His policies, such as the ‘Common Prosperity’ campaign and the crackdown on private enterprises, reflect a commitment to not only reduce inequality but also tighten state control.

**Figure 3: Key differences between Deng Xiaoping and Xi Jinping policies**

Aspect	Deng Xiaoping	Xi Jinping
Economic Philosophy	Market-oriented reforms	State-led control and regulation
Leadership Style	Collective leadership	Centralized, authoritarian
View on Ideology	Pragmatic, results-driven	Ideologically driven
Global Approach	Opening up to the world, avoiding confrontation	Assertive global stance, focusing on Chinese dominance
Personal Hardships	Purged and sidelined but remained pragmatic	‘Re-educated’ in rural China, reinforcing loyalty to the party

SOURCES: INCRED RESEARCH, COMPANY REPORTS

**Re-education and its impact on Xi**

Xi’s re-education experience was intended to instill party loyalty and ideological conformity, which seems to have deeply influenced his world view. His time in the countryside gave him insights into rural life and the struggles of ordinary people, shaping his emphasis on reducing poverty and addressing inequalities. However, it also solidified a deep distrust of Western liberalism and a belief in the superiority of CCP rule.

**While serving as the governor of Fujian, Xi remained cautious, and his stance—always 100% aligned with the CCP central leadership—earned him a major promotion to the Shanghai Party secretary and later to general secretary ➤**

This highlights Xi Jinping’s strategic rise through the ranks of the Communist Party of China (CPC), underscored by his unwavering loyalty to the central leadership. Let’s break down the key points about this phase of his political career:

**Tenure in Fujian (1985–2002):**

Xi Jinping served in various roles in Fujian, including vice governor and later governor, during a critical period of reform and opening up. Fujian, being a coastal province, was a key region for economic reforms, foreign investment, and trade, especially with its proximity to Taiwan.

Xi was known for being **cautious and measured**, avoiding controversy and ensuring his policies aligned with the central government’s directives. He emphasized **economic development**, anti-corruption, and environmental protection, all of which resonated with the party’s priorities.

**Alignment with the CCP central leadership:** Xi maintained a reputation for being **politically orthodox** and **loyal to the party’s core leadership**, avoiding any appearance of dissent or ambition that could be perceived as a threat.

**Promotion to Shanghai Party secretary:** In Mar 2007, Xi was appointed party secretary of Shanghai, China’s financial hub, following a corruption scandal that had tainted his predecessor, Chen Liangyu. Despite his brief time in Shanghai, Xi maintained a low profile and focused on **stabilizing the party’s image** in the region. Shanghai is a high-profile political position, often seen as a stepping stone to national leadership. Xi’s ability to **restore stability and toe the party line** further solidified his reputation as a reliable and capable leader.

**Ascension to general secretary in 2012:** Xi's consistent loyalty and ability to navigate complex political environments without controversy made him a **consensus candidate** for general secretary post of the CPC in 2012. His promotion was partly due to his perceived lack of factional bias, making him acceptable to various party factions.

**Contrasting Approach:**

While Xi initially appeared as a cautious and collective leader, his tenure as general secretary quickly revealed a more **assertive and centralized approach**, with significant consolidation of power under his leadership.

**Xi's policies are leading to unemployment and radical measures are leading to stagnation of the country's economy >**

Take one simple example - The implementation of China's 'Double Reduction' policy in 2021, aimed at reducing the academic burden on students, led to significant disruptions in the private tutoring industry, resulting in substantial job losses.

**Total Employment Impact:** Prior to the policy, approximately 15m people were employed in off-campus education and training. Following the policy's implementation, an estimated 10m individuals experienced unemployment.

**Company-Specific Reductions:** For instance, New Oriental Education & Technology Group, a major player in the sector, reported cutting 60,000 jobs and an 80% decline in operating income after the crackdown.

**Industry Contraction:** The policy led to a significant reduction in the number of tutoring institutions: Offline Institutions: Decreased by 83.8%. Online Institutions: Decreased by 84.1%.

**Recent Developments:** As of late 2024, there are indications that China is easing restrictions on private tutoring companies to support economic growth. This shift has led to a revival in the industry, with companies resuming operations and increasing hiring, potentially mitigating some of the earlier job losses.

**Xi's economic policies are even more stringent >**

Xi Jinping's government has implemented a range of capital control measures to manage China's financial stability, ensure control over foreign exchange, and prevent capital outflows. Here are key aspects of Xi Jinping's capital control measures:

**Stricter Foreign Exchange Controls**

- **Limit on Currency Outflow:** China has imposed tighter restrictions on the outflow of capital, including limits on the amount of yuan that individuals and companies can convert into foreign currencies (such as US dollars). For instance, individuals can only convert up to US\$50,000 per year.
- **State Approval for Large Transactions:** Chinese authorities have been increasingly scrutinizing large foreign currency transactions, requiring approval for significant outflow of capital.
- **Monitoring Cross-Border Capital Flows:** The People's Bank of China (PBoC) and other regulatory bodies closely monitor financial transactions crossing China's borders to prevent large-scale capital flight.

**Clampdown on Unregulated Overseas Investments**

- **Restrictions on Outbound Investments:** Xi's government has targeted 'irrational' outbound investments by Chinese companies, particularly in sectors like real estate, sports, and entertainment. High-profile investments, like the overseas acquisitions by Chinese conglomerates (e.g., Anbang Insurance's purchase of Waldorf Astoria), were curtailed to prevent massive capital outflows.
- **Overseas Asset Purchases:** Companies and individuals face restrictions on purchasing assets abroad, such as real estate or foreign stocks, unless deemed strategic or essential by the Chinese government.

**Increased Regulation of Overseas Listings**

- **Delisting of Chinese Companies from US Stock Exchanges:** Under Xi's leadership, there has been a rising scrutiny of Chinese companies listed abroad, particularly in the US. China has sought to tighten regulations on companies wishing to list overseas, requiring them to comply with Chinese data protection laws and financial regulations.
- **Pressure on Companies Going Public:** The Chinese government has also clamped down on companies planning to list in foreign markets, particularly in sectors like technology and education. For example, China's Anti-Monopoly Law has been applied to stop or curtail certain mergers and acquisitions.

**Increased Surveillance and Reporting**

- **Heightened Monitoring of Overseas Transfers:** Chinese banks are required to report cross-border transactions, and large sums transferred abroad are subject to scrutiny. There is a system in place to flag unusual or suspicious transactions that could indicate attempts to bypass capital controls.
- **Strengthened Anti-Money Laundering (AML) Regulations:** China has enhanced its AML regulations to prevent money laundering and capital flight, ensuring that large, unreported capital movements are curbed.

**Mitigate Risk of Financial Instability**

- **Tightening of Property Market Controls:** The Chinese government has implemented policies to curb speculative property investments, which could lead to excessive borrowing and capital outflows. The 'three red lines' policy, aimed at limiting the amount of debt property developers can take on, is one example of this measure.
- **Control of Shadow Banking:** Xi's administration has taken steps to regulate the shadow banking system, which involves unofficial financial services, often used to bypass formal capital controls. Stricter regulations have aimed at minimizing systemic financial risks.

**Attempting to go back to basic communism and a banking crackdown has led to unemployment and a massive erosion of wealth ➤**

Every year China is producing 11.2m graduates but employment opportunities are scarce. The flight of capital is only exacerbating the overall problem. While estimates widely vary, anywhere between 50-80m apartments are vacant and the bankruptcy of Ever Grande put a hole of US\$1tr in Chinese consumer pocket.

**Xi's strange policies are leading to a unique form of rebellion among the youth ➤**

China's youth, traditionally seen as conformist, are expressing their discontent in unique and often passive ways:

1. **'Lying Flat' Movement (躺平, Tǎngpíng):**
  - A trend where young people reject the rat race and adopt minimalistic lifestyles, refusing to overwork or chase societal expectations.
  - It reflects a growing disillusionment with the pursuit of material success in an increasingly competitive and unequal society.
2. **'Involution' (内卷, Nèijuǎn):**
  - The feeling of being trapped in endless competition without meaningful rewards, especially in education and jobs.
  - Many youth feel overworked but see little progress in their quality of life.
3. **'Run Philosophy' (润学, Rùn Xué):**
  - A slang term referring to the desire to 'run away' or emigrate to other countries to escape the pressures of life in China.
  - This trend reflects dissatisfaction with China's current trajectory and the desire for more personal freedom.

**4. Social Media Satire:**

- Despite strict censorship, young people use memes, coded language, and humour to criticize government policies and express frustration.

**5. Declining Marriage and Birth Rates:**

- Many young people are delaying or forgoing marriage and children, partly as a rejection of state pressure and economic insecurity

**The Communist Party's indirect message to the Chinese — 'We will make you rich, just keep your mouth shut' — is failing ▶**

The implicit message that the Communist Party will ensure economic prosperity if people remain silent on political matters is starting to unravel. Economic challenges, job losses, and the suppression of personal freedom are beginning to push more Chinese citizens to question whether the benefits of staying silent and loyal to the CCP are worth the costs. With growing discontent and the failure of the system to deliver on promises of prosperity, the CCP's strategy of political repression in exchange for wealth is becoming increasingly difficult to maintain.

**However, Taiwan's reunification with the mainland could be the ultimate unifying factor for Chinese youth ▶**

Like Kashmir is for the average Indian and Pakistani citizen, Taiwan appears to have the same emotional significance for the Chinese population. Reunification is the ultimate agenda for Xi, and it's a great point to invoke nationalism, propel the war industry, and allow him to impose harsher measures to bring the economy back on track.

**At the same time, Xi needs to act fast as the demographic trends do not favour him, next 10 years is his best chance ▶**

The peaceful integration of Taiwan is an unlikely event, and even the CCP will understand this well. At the same time, the Chinese population has peaked, and the combat-age population is only about one-eighth of the current Chinese population. The best chance for China to have enough combat reserves will be in the next decade. Remember, Xi also wants to gift the Chinese people with an integrated Taiwan at the centenary celebrations of the Communist Revolution, i.e., in 2049.



## For Xi's China, India will be best handled by Pakistan and internal strife

The Galwan incident and the rapid deployment of the Indian army, coupled with India's willingness to take casualties, have made China rethink its policy towards India. There are three strategic imperatives for China vis-à-vis India: 1) Normal Indian and Chinese people do not perceive each other as enemies. While the Galwan incident changed the Indian populace's attitude, it hasn't turned into hatred. 2) The 1962 war still pinches Indians, but they blame themselves more for the debacle due to the flawed policies of the government in charge at the time, rather than blaming China directly. 3) Body bags coming from Tibet would be far more disastrous for China compared to those coming from Taiwan. At the same time, China now has Pakistan as a vassal state, whose existence is based on its hatred of India. Utilizing Pakistan and arming it with 5th- and 6th-generation technologies is much easier and more cost-effective for China. Remember, Pakistan cannot pay for this hardware, so it will borrow from China. The more they borrow, the more they become a proxy of China. India needs to match China's technology, not to fight China, but to fight Pakistan.

### Pakistan military is a state within a state ►

Pakistan's military as a 'state within a state' underscores the centrality of the military in shaping the country's political, economic, and strategic environment. While Pakistan officially functions as a democratic republic, the military's pervasive influence often leads to civil-military tensions and affects the governance of the nation, creating a disjointed political reality where the civilian government's control is often circumscribed by the military's power and influence.

The military in Pakistan has historically played a dominant role in shaping the country's political landscape. While Pakistan is formally a democratic republic with a civilian government, the military has held significant influence over key state matters, including foreign policy, defence, and national security.

The military has directly ruled Pakistan for a significant portion of its history, with military dictatorships established through coups in 1958, 1977, and 1999. Even during periods of civilian rule, the military has often been a powerful political actor, influencing or undermining democratic processes.

The military in Pakistan also has considerable economic power, controlling a large number of businesses, industries, and land. Some estimates suggest that military-run businesses make up a significant portion of the country's economy.

The military's influence extends beyond the defence sector, as it has its own set of institutions and a vast network of organizations, such as the Inter-Services Intelligence (ISI), that operate almost independently of civilian oversight.

The military often has its own foreign policy agenda, particularly regarding India and Afghanistan, which can sometimes be at odds with civilian leaders. The military's strategic priorities are also evident in Pakistan's relationship with China, the US, and other global powers.

The military establishment also plays a central role in defining Pakistan's stance on terrorism, nuclear policy, and border disputes with neighbouring countries, sometimes even overriding civilian government decisions.

This situation leads to a civil-military imbalance, where the civilian government is often seen as weaker, lacking full control over national decisions. This has led to periods of political instability, where civilian leaders have been forced to work under the shadow of military influence, or in some cases, been removed from office by military intervention.

The civilian leaders sometimes lack the autonomy or decision-making power needed to implement policies fully, particularly in areas related to defence and security, where the military has significant authority.

## To keep themselves relevant they indulged in radicalization of Pakistan and created a bogey of Indian aggression ►

The military's strategy of creating a bogey of Indian aggression has played a crucial role in maintaining its domestic power and regional influence. By portraying India as an existential threat, the military has justified its substantial spending on defence, its nuclear arsenal, and its central role in Pakistani politics. However, this narrative has contributed to radicalization within Pakistan, as militant groups have been nurtured for geopolitical purposes, and Pakistan's internal challenges have been overshadowed by external fears. While it has helped the military stay relevant, this approach has also hindered Pakistan's ability to develop a sustainable democratic and economic future.

## Pakistan is heavily indebted to China due to the much-vaunted CPEC project ►

Pakistan's debt dependency on China, exacerbated by CPEC projects, is a double-edged sword. While CPEC has the potential to improve infrastructure and boost trade, the rising debt burden could jeopardize Pakistan's economic sovereignty and long-term financial stability. The country faces a difficult challenge in managing its economic relations with China while ensuring that its domestic priorities and geopolitical interests are not compromised. As Pakistan continues to grapple with its economic crisis, the CPEC debt will remain a critical issue.

1. **CPEC Loans:** Pakistan has borrowed substantial sums from China to fund CPEC-related infrastructure projects. As per latest estimates, Pakistan owes China around US\$30bn in loans. The CPEC initiative is financed largely through loans provided by China's state-owned banks, such as the China Export-Import Bank (EXIM Bank).
2. **Debt Projections:** Over the coming decades, Pakistan's overall debt to China is expected to rise due to ongoing and future CPEC projects, with some reports suggesting that China's total lending could surpass US\$50bn by 2030F.
3. **High-Interest Rates:** While CPEC loans from China have been structured with relatively long repayment periods, the interest rates are often higher compared to loans from international financial institutions like the World Bank or the International Monetary Fund (IMF). Pakistan faces challenges in meeting its debt obligations, especially with high interest rates and the large volume of loans.
4. **Repayment Concerns:** Pakistan's financial resources are stretched thin due to the need to service both domestic and external debt, with a large portion allocated for repayment of loans related to CPEC projects. The repayment schedule of these loans places a heavy strain on Pakistan's foreign reserves and fiscal stability.
5. **Debt-to-GDP Ratio:** Pakistan's overall debt-to-GDP ratio has risen significantly in recent years, driven in large part by borrowing to finance CPEC projects. As of recent estimates, Pakistan's external debt stands at over 40% of GDP, and the debt servicing burden has escalated, crowding out funds for critical social and economic programs.
6. **Structural Reforms:** To manage this rising debt, Pakistan has turned to the International Monetary Fund or IMF for financial support, which has often demanded austerity measures and structural reforms in exchange for loans. This has led to economic hardship for ordinary Pakistanis, further fuelling domestic discontent.

## At the same time, Pakistan's military is buying more military hardware from China which suits China's interests ►

Even President Xi will understand that annexing Indian territory in Ladakh and the northeastern part of India is simply not possible. So, while Xi places himself next to Mao, Mao's plans and the 'Five Fingers' strategy are not possible to fulfil, especially when the Indian military is strong enough for defensive capabilities.

However, what President Xi wants to avoid is pressure on China’s western border while it is focused on invading Taiwan and battling the US Armada in the South China Sea. This can be achieved by forcing Pakistan to launch an attack on India’s western borders. China will arm Pakistan to the extent that it can hold India off for enough time, allowing China to complete its Taiwan operation. Currently, India could achieve complete air superiority over Pakistan in a matter of days, and the war would likely be over in a few weeks. This scenario would not be in China’s interest, so it will need to arm Pakistan with advanced technologies, such as fifth-generation aircraft, missiles, and other deterrent arsenal. Also, the more airplanes and arms Pakistan acquires, the greater its debt will become, leading to a rising dependence on China for its daily sustenance

**Hence, paradoxically, India needs to match China's strength to fend off Pakistan ➤**

**Figure 4: China already has multiple 5<sup>th</sup>-generation and 4.5<sup>th</sup>-generation aircraft which they can provide to Pakistan at short notice; please note that already Pakistani pilots are training on these aircraft**

Feature	5 <sup>th</sup> -Generation Fighters (J-20, J-31)	4.5 <sup>th</sup> -Generation Fighters (J-16, J-10C)
Stealth	Full stealth capabilities (reduced radar cross-section)	Partial stealth (reduced radar signature)
Avionics	Advanced radar, sensors, and data fusion	Modern radar (likely AESA), enhanced EW capabilities
Engines	Advanced Chinese or Russian engines, super cruise capability	Older Russian engines or Chinese WS-10/WS-13
Combat Role	Primarily air superiority and strike missions	Multirole, air superiority, ground attack, and strike
Weapon Carrying Capability	Internal weapons bays for stealth, external pylons possible	External pylons for larger payloads
Introduction	Mid-late 2010s and ongoing development	Early 2010s, in active service

SOURCE: INCRED RESEARCH, COMPANY REPORTS

However India’s 5<sup>th</sup>-generation capacity is non-existent. AMCA is at least a decade away. Remember, China has, at the most, next 10 years within which it will have to merge Taiwan with itself if it intends to use force on them. The demographics will deteriorate so much beyond that It will not be possible for China to fight a war unless they raise a big humanoid force. During this time it cannot have enough power to keep India under pressure on its western front so that India cannot even think of intervening with its operation in the Indo Pacific.

**India needs 5<sup>th</sup>-generation or at least 4.5<sup>th</sup>-generation aircraft immediately ➤**

India urgently needs 5<sup>th</sup>-generation or 4.5<sup>th</sup>-generation aircraft to match its western neighbour, which has a habit of creating border havoc and escalating militancy whenever it acquires new arsenal. While India’s ill-fated MMRCA and now MRFA competition continue, there seems to be no light at the end of the tunnel. Most likely, India will resort to what it has done for decades — a panic purchase to match Pakistan’s Chinese-supplied J-10/J-31 capabilities.

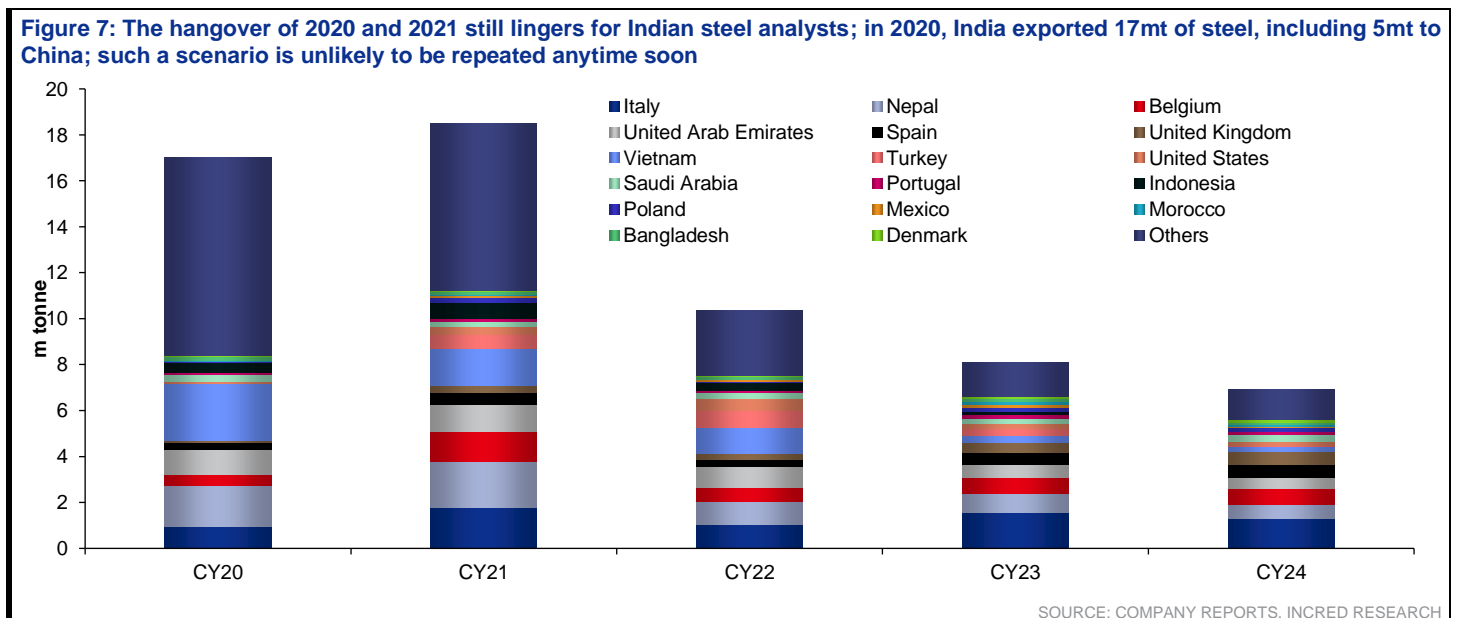
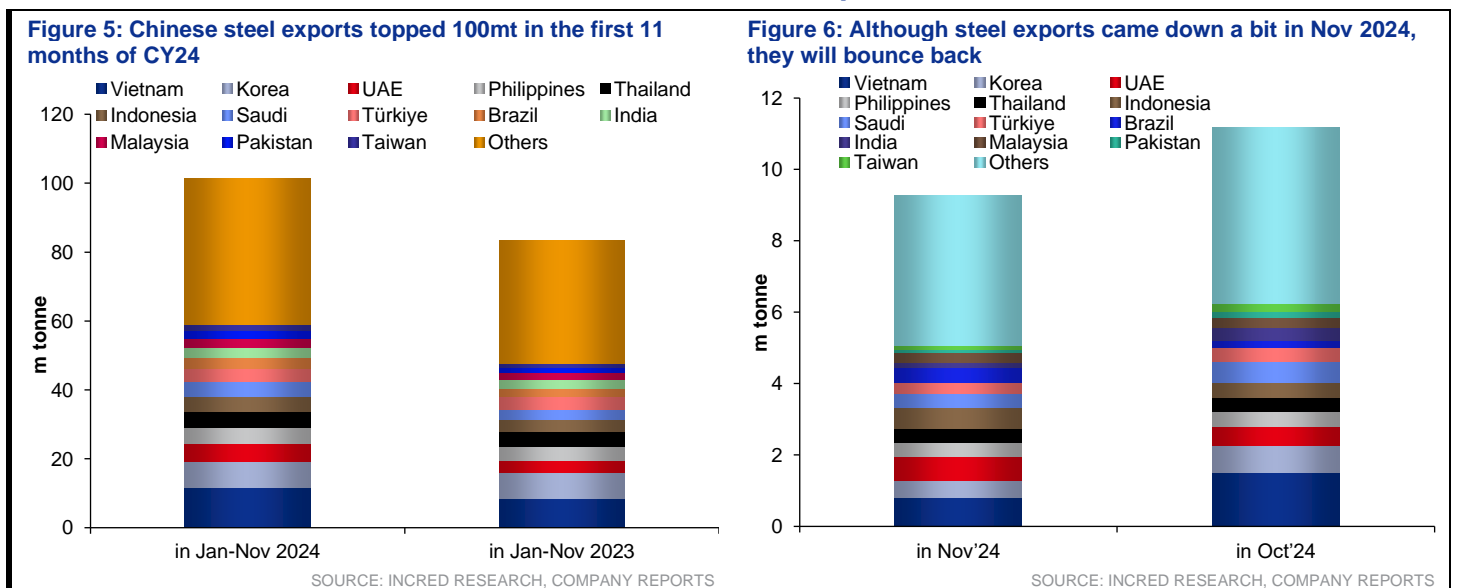
**It appears inevitable that India will purchase Su-57 aircraft and will likely opt for the S-500 as well ➤**

The Su-57 is a refined version of the PAK-FA. India had partnered with Russia to develop this aircraft; however, due to delays and cost overruns, India parted ways with Russia in 2018. With President Putin slated to visit India in 2025, the high chorus of Russian bots promoting the Su-57 on Indian social media is apparent. At the same time, India has been trying to buy 114 4.5<sup>th</sup> generation aircraft for decades now, but the deal remains elusive. Time is running out, and India will ultimately do what it normally does — resort to panic purchases of the Su-57, which will likely be assembled at Hindustan Aeronautics or HAL with full technology transfer. Fifth-generation fighter jets are all about stealth and superior engine technology. While the Su-57 doesn’t stand a chance against the F-22 or even the F-35, it is more than sufficient to match the J-10 and J-31. However, availability of Russian aircraft has always been a challenge. India has improved the Su-30MKI availability to around 60%, but current open-source reports indicate that the Su-57’s availability is only around 40%. To maintain at least three combat-ready squadrons, India would need to purchase at least 110 Su-57s.

## What does it mean for stock prices? HAL to be back in the reckoning, commodities to be under stress

In a bull market, significant underperformance over a prolonged period can sometimes trigger a rally in stocks. While it makes sense to trade this rally and profit from it, expecting China to make decisions based on economic principles rooted in Western philosophies or capitalist ideals is naive. Currently, China's primary goal, under President Xi, is to keep its youth employed by returning to age-old communist principles. Maintaining high production levels to sustain employment has become a top priority. It's worth noting that the Chinese population has likely lost at least US\$1.5-2tr in the housing bust and Evergrande bankruptcy. Disillusioned youth, grappling with a declining population, are engaging in innovative protest techniques like the **Lying Flat Movement** (躺平, Tǎngpíng), **Involution** (内卷, Nèijuǎn), and **Run Philosophy** (润学, Rùn Xué). To prevent unrest, this disillusionment must be countered with the 'opium' of nationalism. President Xi has directed the People's Liberation Army or PLA to be combat-ready for a potential forceful occupation of Taiwan by 2027F. Until then, China's industrial policies are unlikely to ease. Expect continued high exports of steel and significant imports of alumina to combat groundwater pollution. Conversely, the bulk chemicals sector is unlikely to see any price recovery.

### Steel: Chinese steel exports won't decline ➤



## Alumina will remain strong - NALCO is the biggest beneficiary ➤

China is facing multiple challenges regarding primary aluminum raw materials: 1) Slowdown in domestic bauxite production, and 2) high groundwater pollution, which could worsen if alumina is produced on the mainland. Additionally, it's important to note that China's aluminum production revolution is relatively recent, and so it doesn't generate enough scrap aluminium to significantly replace primary metal production.

Given these challenges, China has two options: 1) Increase bauxite imports from other regions, which is economically inefficient since it involves paying for the freight of the waste material contained in bauxite along with the  $Al_2O_3$ ; or 2) it is more cost-effective to buy alumina rather than importing high-priced bauxite and bearing the significant environmental costs associated with the generation of highly toxic red mud. It appears that China is opting for the second option, which is driving up alumina prices. Recent tenders from NALCO have attracted bids as high as 25% of aluminium.

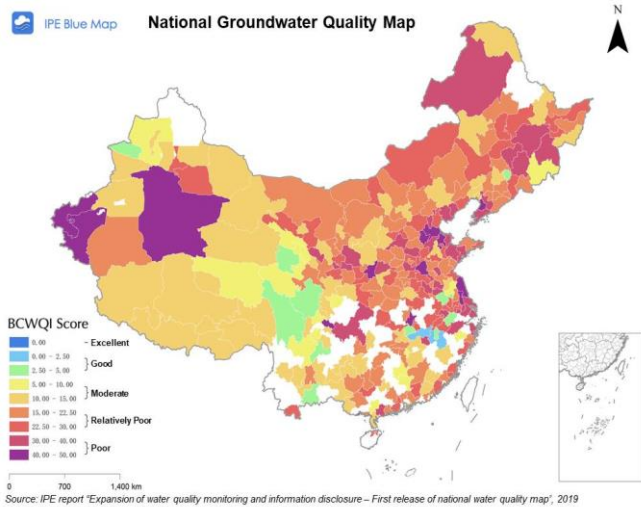
We expect alumina prices to remain strong due to continued Chinese buying, which is positive news for Indian producers like NALCO and Hindalco. We have an ADD rating on Hindalco and a HOLD rating on NALCO. Our previous estimates assumed alumina at 17% of aluminum prices. However, given the current trend, if alumina stays at 22-23% of aluminum, NALCO could generate an EBITDA of Rs60bn (based on an average yearly aluminium price of US\$2,350/t).

## China's alumina refineries are concentrated mainly in five regions ➤

In China, alumina refineries are primarily concentrated in areas that are rich in bauxite or close to industrial zones. The major regions for alumina production include:

1. **Shandong Province:** This region is a major hub for alumina refining, with several large plants operated by companies like China Hongqiao Group. Shandong benefits from both proximity to bauxite imports and a strong industrial base, making it a key region for refining activities.
2. **Henan Province:** Henan is another significant area for alumina refining. The province has substantial bauxite reserves, which support local refining industries. Chalco (Aluminum Corporation of China) operates several refineries in this area.
3. **Guangxi Province:** Located in southern China, Guangxi is an important region for both bauxite mining and alumina refining. It is home to several refineries due to its natural resources and access to transportation networks.
4. **Guizhou Province:** Known for its bauxite resources, Guizhou also hosts alumina refineries that serve both local and national aluminum production.
5. **Inner Mongolia:** Although known more for its energy production, Inner Mongolia also has significant alumina refining capacity, with companies like East Hope Group operating there.

Figure 8: The ground quality survey of 2019 is shown in the picture below



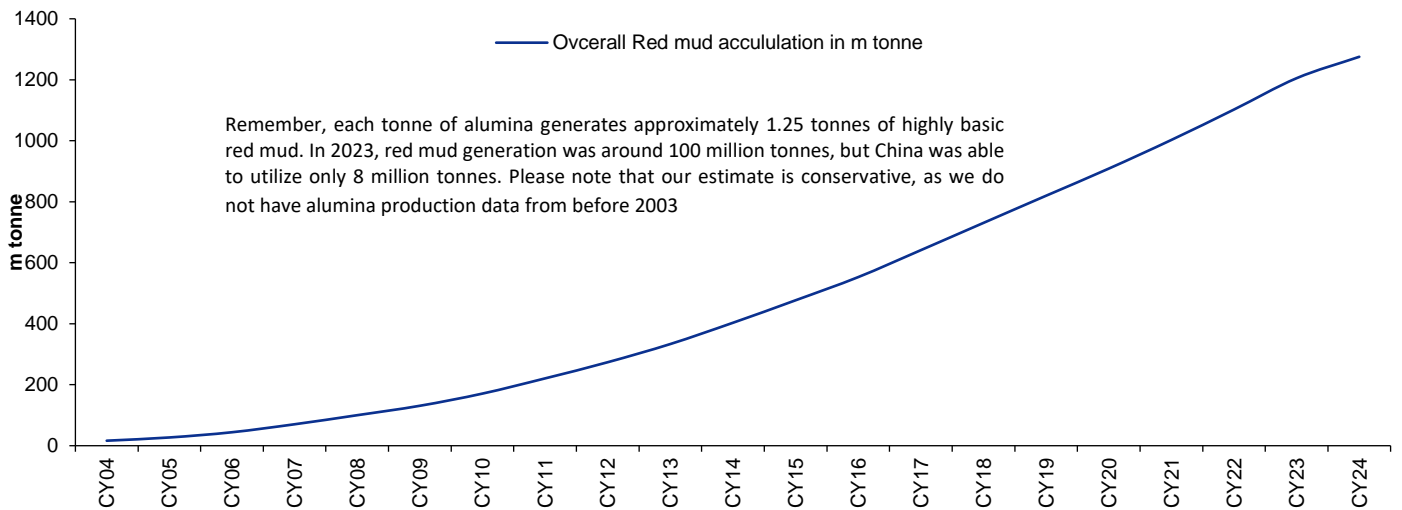
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 9: For regional identification, we have provided the names of the regions in the picture below



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 10: Overall, red mud, with high alkalinity (PH 13), is seeping into the groundwater in these regions, contributing to groundwater pollution



SOURCE: INCRED RESEARCH, COMPANY REPORTS

**The decline in domestic bauxite production is also contributing to the slow growth of alumina production ➤**

China's bauxite availability has undergone significant changes due to domestic resource constraints and growing reliance on imports. Here are key points regarding the current state of bauxite availability in China:

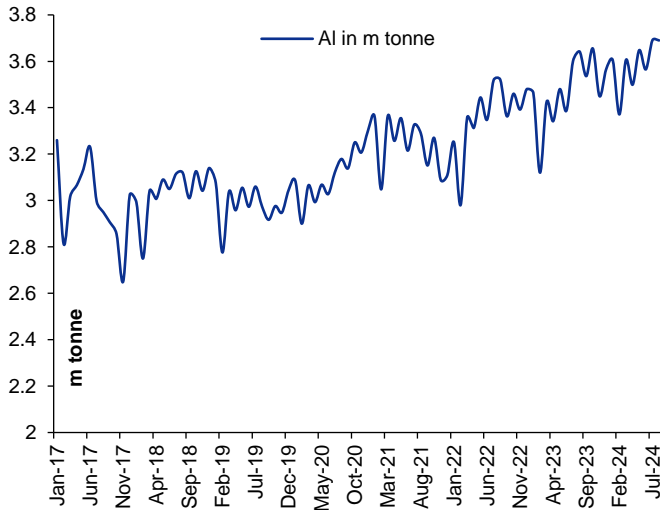
1. **Decline in Domestic Reserves:** China's domestic bauxite reserves, concentrated mainly in Shanxi, Henan, and Guangxi provinces, are depleting. The quality of domestic bauxite is generally lower, with higher reactive silica content, making it less suitable for alumina refining without costly processing.
2. **Increased Reliance on Imports:** To meet its alumina production demands, China has significantly increased its bauxite imports. Key import sources include:
  - **Guinea:** This West African nation has become China's largest supplier, providing high-quality bauxite at competitive prices.
  - **Australia:** Historically a major supplier, although its share has been impacted by geopolitical tensions.

- Indonesia:** After lifting its ban on bauxite exports in 2017, Indonesia has resumed shipments to China, although it plans to reintroduce export restrictions to promote domestic alumina refining.

In 2023, China imported over 110mt of bauxite, a sharp increase over the past decade.

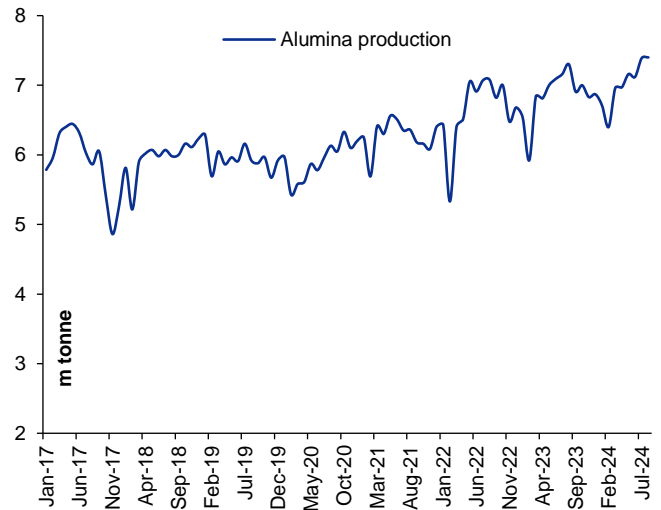
**As a result, China's alumina production is not increasing like that of aluminium and, therefore, alumina is in deficit** ➤

**Figure 11: China's primary aluminium production is increasing steadily...**



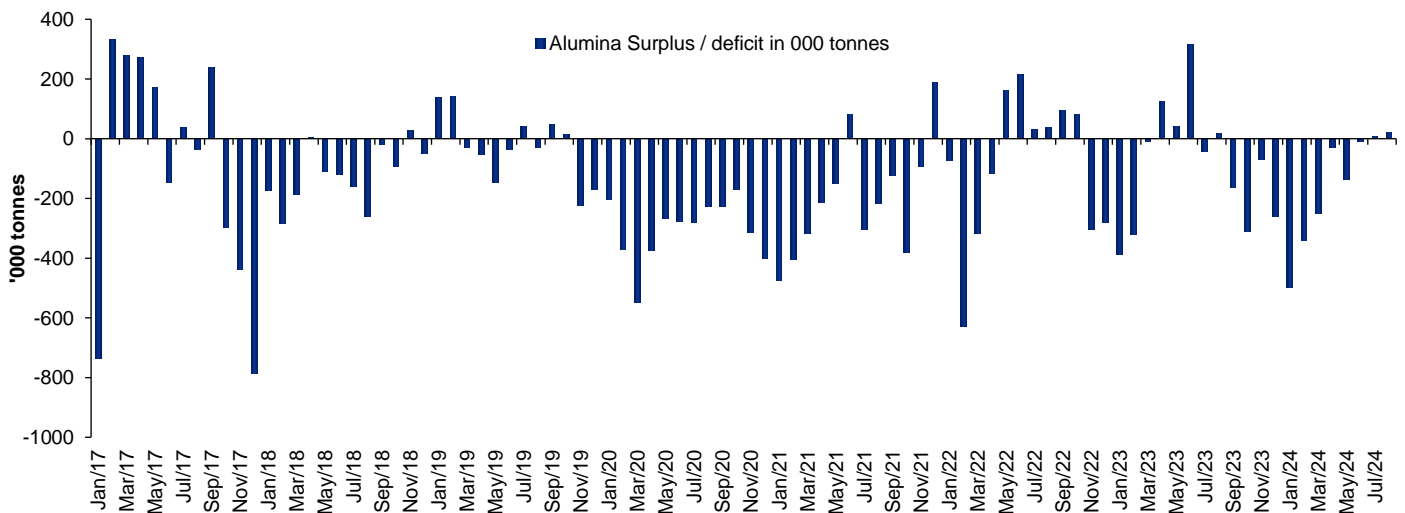
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 12: ...but alumina production is not keeping pace**



SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 13: As a result, alumina is in deficit in China which is resulting in alumina imports by China**



SOURCE: INCRED RESEARCH, COMPANY REPORTS

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Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.
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