Only 18 months ago we wrote about the impact of the US Federal Reserve's (FED) surprise announcement to begin "tapering" its quantitative easing (QE) programme and what the consequences were for heavily indebted emerging market economies. We cited India as an example, with its currency plummeting nearly 20% against the dollar and its then Prime Minister Manmohan Singh openly declaring that India faced "very difficult circumstances".

Fast forward to today and much has changed. In May last year the Indian general election became the largest democratic event in world history. Approximately 814,500,000 Indians were eligible to vote and the average voter turnout across India was over 66% (the highest ever in the history of Indian general elections). To put this in context, only 61% of the electorate voted in the 2008 United States presidential election. Narendra Modi, leader of the Bharatiya Janata Party (BJP), won 31% of the vote, subjecting the Congress party to their worst defeat in any general election and enabling Modi to establish the largest majority government since 1984.

So, who is Modi and why is this result good for India? After all, India is still an emerging market economy competing in a world without the support of FED QE and many of its large peers such as Brazil and Russia are in the midst of deep recessions. Investing in emerging markets poses major risks. One way to assess these risks is to follow a strict checklist procedure aimed at highlighting pitfalls and assessing both growth prospects and vulnerabilities. We believe that India now represents an exciting investment opportunity and this month we explore this opportunity by answering six important questions that we believe should be considered when investing in emerging markets.

Is the political situation supportive of the required policies?

Narendra Modi, India's newly elected Prime Minister, has no shortage of previous political achievements. As Chief Minister of the state of Gujarat (population c60 million) from 2001-2014, Modi's business focused policies helped the state to achieve annual GDP growth of almost 10%, far in excess of the rate achieved by the wider country. Modi's focus was on infrastructure and the ease of doing business. Those living in and around Gujarat's largest cities have become accustomed to modern roads and electricity supply as well as clean water, a privilege afforded by few of India's 1.252 billion people. Business in Gujarat thrives. Much of the red tape surrounding permits, licences and environmental clearances were removed by Modi and as such, many larger Indian corporations are setting up shop in the state. Investors are also buoyed by the application of IT to the provision of government services. This is a system that helps clamp down on corruption and hold those dealing with state financing and tax payments more accountable.

The stage is of course much bigger now but Modi has already made an impact. One of Modi's visions is to turn India into a manufacturing hub. His "Made in India" campaign sparks visions of China's move to manufacturing that saw it grow its average annual GDP per head from around $300 to $6,750 over 30 years. Such a transformation has the potential to bring prosperity to hundreds of millions of Indians, a quarter of who currently live on less than $1.25 a day.

Early signs of progress were evident in the government's amendment to the land acquisition act which now no longer requires that some 80% of affected landholders consent to a land purchase when a large industrial project is proposed. Although potentially disruptive in the short term, such projects would likely unlock job potential for millions.

Modi masks held high in support of the newly elected BJP.

The government is also making greater steps to encourage foreign direct investment (FDI), with proposals to increase the foreign investment threshold allowed in the insurance industry from 26% to 49%.

Ranked number 142 in the world for ease of doing business, India has much to improve upon, but under Modi, it has made a good start. Many of the country's stalled projects and the backlog of applications for business licences are now being worked through. India's restrictive tax system is being reformed, helping to pave the way for Modi and his highly experienced team to elevate the country to a new level.

How sound is fiscal and monetary policy?

The Reserve Bank of India (RBI), the institution responsible for setting interest rates and inflation targets, is run by Raghuram Rajan who previously served as the Chief Economist for the International Monetary Fund (IMF) and before that received a PhD from MIT in the United States. His impromptu decision in January to cut interest rates by 0.25% to 7.75% is a sign that inflation is coming under control in India. The Indian CPI index registered 5% in December, well within the RBI target level which aims to have inflation below 6% by January 2016. The falling price of oil has obviously been a large contributor to this decrease in inflation and for India, a country that imports c80% of its oil, there are opportunities to take advantage of these lower energy costs as we will highlight later.

Arun Jaitley, India's finance minister is another key figure in India's political system. Jaitley has worked with Modi before, orchestrating a well organised campaign to return Modi to power in Gujarat in 2007. Unveiling India's first full budget under the Narendra Modi government on 28th February, Jaitley promised billions of dollars of investment in infrastructure as well as a wave of economic and tax reforms. India plans to replace its assortment of local fees and taxes that have hitherto stymied a single market with a nationwide Goods and Services Tax (GST). This will reduce incentives for companies to evade taxes (as taxes will only be paid on the value added portion of products, this will likely lower their tax bill). The GST will widen the tax base and also help to facilitate free moment of goods across states, thus greatly boosting India's productivity.

Jaitley also announced a business friendly reduction to the corporate tax rate from 30% to 25% over a 4 year horizon.

The government relaxed its time horizon for meeting its fiscal (tax) deficit target of 3% from two years to three in order to stimulate growth with enhanced spending. Any additional fiscal leeway is to be spent on infrastructure. The government plans to establish a National Investment and Infrastructure Fund (NIIF) that will be financed initially with an annual payment of 200bn rupees from the government. A further boost to infrastructure will come from tax-free infrastructure bonds for roads, rail and irrigation projects. With energy prices falling, the government have also taken small steps to reign in its subsidy bill from 2.1% of GDP in 2015 to 1.7% in 2016.

With such a positive focus on infrastructure and business investment it is evident to us that Modi is committed to implementing his Gujarat model on the broader Indian market.

What are the economic growth prospects for the economy?

India's GDP grew by 5.8% in 2014 and the IMF forecasts growth of 6.3% in 2015. The boost brought on by lower oil prices is likely to offset weaker global export demand. The large scale infrastructure spending and productivity improvements associated with a more efficient tax system will also contribute to higher growth prospects. By 2016, the Indian economy is forecast to outpace China, whose economy has slowed considerably as it moves from manufacturing to a more consumption driven economy. A further boost to Indian growth could come from the recapitalisation of its state banks. Banks are currently weighed down by dud loans and could need up to $85bn in fresh capital, a figure which is likely to be too high for the government alone to fund. The decision to allow private investors to hold up to 48% of state bank's shares will likely force a greater degree of transparency and reporting in order to encourage investors to pay higher prices for their shares. Modi's goal of drawing all citizens into the formal financial system through bank accounts is also likely to increase long term growth prospects through the facilitation of efficient transactions and access to credit facilities.

Is the currency competitive and are the external accounts under control?

The rupee was one of the hardest hit currencies after FED chairman Bernanke made his "taper" speech in May of 2013. Officials went to extreme measures in August of that year to try to control the flow of rupees out of India by tightening capital controls. With foreign investors spooked by the prospect of their funds being locked up, many raced for the exit and the result was a bloodbath for the rupee.

India's current account deficit swelled to 4.8% of GDP in 2013, a level far in excess of what many believe to be sustainable. In an effort to close the funding gap the government imposed strict rules on the imports of precious metals, particularly gold, which had been in high demand after its price fell 28% in 2013.

These import restrictions (although since lifted) coupled with lower energy prices have helped to reduce the current account deficit to a far more sustainable 1.7% of GDP today and the currency has stabilised.

India received over $40bn dollars from international institutional investors in both debt and equity in 2014 and this flow, based on optimism about the prospects for India has helped to support the rupee against the US dollar.

Is Liquidity plentiful?

Foreign currency reserves have been replenished to c$330bn having dropped below $280bn in September of 2013 and this provides confidence to investors that India has enough resource to defend against reversal of QE. As a rough guide, traditionally reserves have been judged adequate when they are equal in value to three months' worth of imports. India currently has reserves to cover seven months' worth of imports.

Is external debt under control?

In a bid to deepen the country's bond market and bring India's external borrowing and domestic debt under one roof the government has voiced its intention to set up a Public Debt Management Agency (PDMA). This central agency will help to streamline the entire government debt structure, enabling better oversight of risks, costs, uses and repayments of debt. A deeper bond market is also fundamental to the success of the governments push for infrastructure investment. At present, India's foreign debt to GDP remains in manageable territory (<25%) at 23.3%. Although the dollar has rallied hard against many emerging market economies including Brazil and Russia in the last 12 months, the rupee has remained stable. This gives us confidence that India's ability to service debt repayments are less likely to be jeopardized by a falling currency.

Final words

With such a large and diverse population, there is a huge amount of potential in the Indian economy and the task of unlocking this has fallen on the shoulders of Narendra Modi. His early steps are very encouraging and not just on the domestic front. Modi's first official day as leader was spent meeting Pakistani Prime Minister Nawaz Sharif in a bid to strengthen ties between the neighbours that have been strained for decades. Relations with neighbouring Sri Lanka are also likely to flourish after voters there replaced the previous authoritarian government. India is Sri Lanka's largest trade partner globally and Sri Lankan tourists are one of the top ten sources for the Indian tourism market. Cordial ties between the two countries post the election are likely to boost tourism in the coming years.

Further afield, Modi is strengthening relations with the US. Delivering a speech in the packed out Madison Square Garden arena, Modi emphasised India's bright economic prospects in front of thousands of Indian Americans. His meetings with President Obama to discuss trade and security have bolstered the already positive investor sentiment. The fact that Obama becomes the first sitting American President to visit India twice emphasises to us India's arrival on the global investment stage.

Despite being the third best performing stock market last year, the range and depth of reforms are so great that we feel very positive about further growth in the Indian economy and indeed further stock market growth over the coming years. As a result, having held very low exposure to emerging markets over the last 18 months we are now starting to invest into Indian equities across all client portfolios.