2024 Indian General Elections and its implications on the markets

10 June 2024

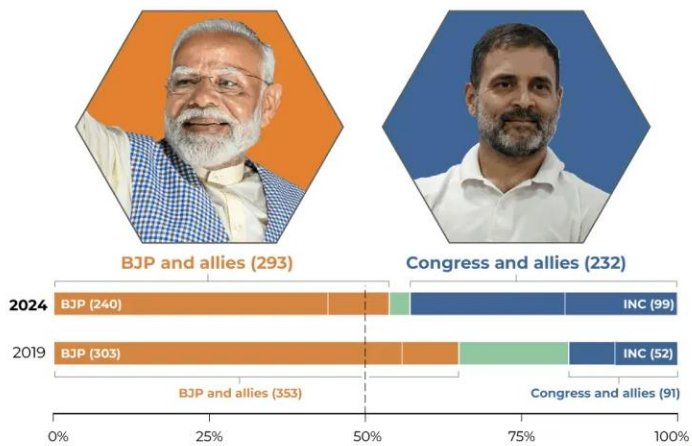
Overview

- Modi-led coalition won a majority with thin margin of victory
- Stable coalitions can still undertake important reforms
- India's economic up-cycle can persist amid policy continuity
- A pro-growth budget with public capex as a strategic focus
- Fiscal consolidation can coexist with higher social spending
- Likely lower bond yields on softening inflation & peak rates
- Market volatility post-general election should be short-lived
- Positive on India's growth story amid its rich equity valuation
- Stellar equity returns have mainly been driven by earnings
- More FX buffer and limited disorderly large Indian Rupee (INR) depreciation

What is the outcome of India's elections?

PM Modi-led Bharatiya Janata Party (BJP) lost its parliamentary majority on 5 Jun 2024. For the first time since the BJP swept to power in 2014, it did not secure a majority on its own, winning 240 seats **(Fig. 1)**. PM Modi's BJP then had to form a coalition government with the National Democratic Alliance (NDA) allies, thus winning a majority (293 seats) with a narrow victory i.e., slightly more than the 272 seats needed to secure a majority.

Figure 1: BJP wins but fails to achieve majority on its own



Source: Election Commission of India (5 Jun 2024)

The election results clearly indicated that jobs and economic aspirations matter to the voters. For a long time, the (young) Indian population has been grappling with a lack of quality jobs and productive employment. Rural wages have been stagnant. In addition, we saw a more determined and united opposition on the ground. Finally, the election outcome could reflect some fatigue around PM Modi's advocacy of Hindu nationalism.

The BJP is now heavily reliant on the goodwill of its NDA allies whom we can expect will demand their pound of flesh, both in terms of policymaking and government formation. Execution risk is worth monitoring. If anything, BJP's remarkable victory in 2014 and 2019 was extraordinary. In this regard, today's election results can be deemed simply as a reversion to the mean.

Where will India's economic policy be heading?

First, it is essential to recognise that the significant economic improvement in the future is a function of reforms that have already been undertaken and cannot be rolled back. Second, the economic goals of the major parties are aligned, reflecting those of the population. Third, it is noteworthy that political parties have delivered stable governments with an even slimmer majority and many more parties in the coalition in the past.

With these in mind, it is likely that India's economic up-cycle can persist amid policy continuity. Coordination with the two most important allies (JDU and TDP) will be key. Markets broadly expect that the new government will focus on more populist, pro-growth policies in the budget. Given lower fiscal deficit for FY24, there is additional fiscal space for the new government in FY25, assuming an interim budget target of 5.1% of GDP.

The public capex plan focusing on infrastructure, manufacturing and technology will likely continue amid higher social spending focused on the poor, women, as well as rural areas. Supply-side reforms through a renewed focus on skill development and employment creation will also feature in the economic agenda. Strong tax growth aids fiscal consolidation. The government's commitment to the fiscal glide path will be verified by the budget in July. Fiscal slippages, if any, could lead to higher interest rates. Having said that, bond yields are still biased downward given softening inflation and a peak in the rate cycle.

How might the Indian markets fare going forward?

Given some degree of political uncertainty, equity valuations could be impacted in the near term especially since the multiples are at a huge premium relative to historical averages and the broader emerging markets. Foreign investors could rethink the apt country risk premium with these political developments.

Having said that, any market volatility should be short-lived. India's structural growth story remains strong amid its relatively demanding equity valuation. We expect Indian equities to stay supported with their upward price trajectory largely intact. For the last 40 years, Indian equity returns have been exceptional under various governments and regimes. In the 3 to 6 months post general elections since 1991, a correction has tended to manifest as a buying opportunity over the long term. Importantly, Indian equities benefit from the secular trends including a young demographic, rising consumption per capita as well as robust corporate profitability. India's stellar equity returns in the past decade have mainly been driven by solid earnings growth.

Finally, India's forex reserves have risen from USD 38 bn in FY2000 to USD 650 bn as of April 2024, witnessing growth under each political regime. Higher forex buffers will likely limit any disorderly large depreciation in the Indian Rupee (INR).

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