Global Macro Research - Insight
5 June 2024

9:54 minute read | #India / #Growth / #Politics

India election results: implications of a third Modi term

India's elections delivered a surprise result, with the governing Bharatiya Janata Party (BJP) losing its majority. We expect Modi to secure a third term as prime minister, but he will be reliant on coalition partners. This should result in economic policy continuity but will curb his ability to address difficult structural challenges.

Key Takeaways

- Indian election results on 4 June delivered a shock result, with incumbent prime minister Narendra Modi's Bharatiya Janata Party (BJP) losing its lower house majority.
- The BJP won 240 seats, falling short of the 272-seat threshold needed to reach a majority. As such, Modi will now have to rely on his coalition partners to form a government, with negotiations ongoing.
- Even with a coalition, we would expect broad policy continuity; namely a continued focus on infrastructure development, expanding manufacturing, and reforms to improve India's 'ease of doing business'.
- More challenging reforms, such as agricultural or land ones, are likely to be sidelined, and fiscal consolidation may prove slower, with a greater focus on social spending.
- As such, India should continue to be a global economic bright spot, but a likely less expansive reform agenda will ultimately dampen the longer-term growth trajectory.
- In the near term, some fiscal consolidation, softer household demand and tighter financial conditions should weigh on growth, which would slow from 7.8% in 2023 to 6.3% in 2024.
- As food price pressures ease, headline inflation should converge towards the Reserve Bank of India's 4% target midpoint in the second half of 2024, allowing two 25bps cuts in late 2024. We then expect the policy rate to be lowered to 5.75% in 2025, helping to boost private sector credit and investment.

Modi-mania falters at the ballot

India's elections delivered a sobering result for incumbent prime minister Narendra Modi. Official results showed it failed to reach the 272-seat threshold needed to reach a majority, obtaining 240 of the 543 seats in the Lok Sabha, the lower house of India's parliament.

This is considerably lower than the 370 seats the campaign targeted initially and represents a 63-seat decline from the 2019 election result. The main opposition party, the Indian National Congress, increased its haul of seats by 47 to a total of 99.

The result means the BJP will have to rely on partners within its coalition, the National Democratic Alliance (NDA), to form a majority. The Congress-led Indian National Developmental Inclusive Alliance (I.N.D.I.A.) is unlikely to succeed in attempts to block the BJP from doing so. Reassuringly for Modi, other NDA parties performed well; the Telugu Desam (TDP) secured 16 seats and the Janata Dal (United), also known as JD(U), secured 12. Combined, the NDA should have around 290-293 seats.

As such, Modi finds himself in a new position, needing to rely on coalition parties and facing the prospect of having to appease them by forgoing some of his policy agenda and preferred cabinet appointments.

The government must be sworn in by 14 June.

The result came as a surprise to markets and pollsters. Opinion polls showed very high approval ratings for Modi – Morning Consult polls had his approval rating at 78% ahead of the elections – while exit polls also proved misleading.

Issues such as job creation, inflation, the post-pandemic economy and concerns over the political direction likely all contributed to a smaller share of the vote for the BJP.

The I.N.D.I.A. coalition's campaign on stronger welfare support and a better redistribution of the wealth being generated by India's booming economy may have also resonated more than expected with voters. Indeed, initial analysis of the regional shifts suggest lower income households were a key group in which the BJP saw its popularity drop.

Modi maintained his commitment to infrastructure development, manufacturing, and pro-business reforms in his post-election speech. Moves to tackle more challenging reforms, such as agriculture, land and market competition, were never particularly likely in the near-term, but they may now be sidelined in the long term too.

Longer term, the direction of the BJP is also less clear. Issues such as whether Modi will stand for a fourth term and whether the party leans further into Hindu nationalism will linger. An element of political uncertainty has returned to India after a period of relative stability.

Manifesto points to reform focus

The BJP's manifesto emphasised continuity, maintaining a pro-business and pro-investment stance, doubling down on prior commitments to manufacturing, the green transition, infrastructure spending and on improving the ease of doing business.

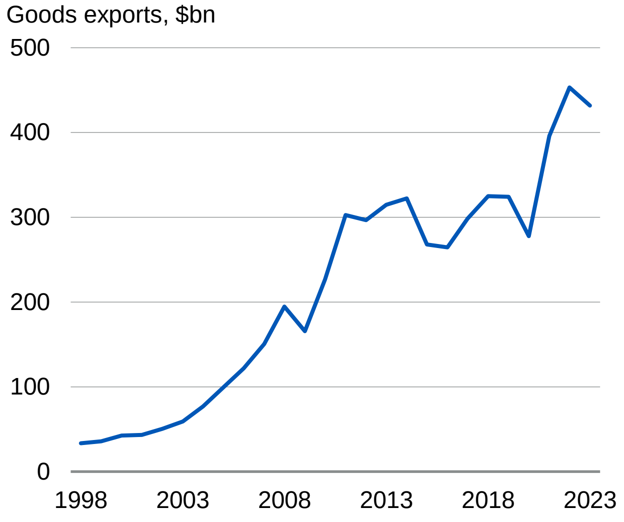
We view the likelihood of continuity on these fronts as a positive, albeit with the manifesto outlining an incremental approach rather than a step change in the pace of structural reforms. For example, the manifesto avoids revisiting agricultural or labour reforms, which the BJP has struggled to make progress on over the previous two terms.

Investors will expect the delivery of key traditional infrastructure projects, such as transport and housing, further utilisation and upgrading of India's digital infrastructure, and the continuation of economic prudence.

The election result and coalition could see the recent improvement in the fiscal mix – a greater share of spending on capex – slow, but we expect the government to avoid the imbalances that garnered India an inclusion in Morgan Stanley's 'Fragile Five' framing in 2013.

The manifesto also outlines several ambitious industrial targets, including tripling electronic goods manufacturing to $300bn by 2030, and making in-roads into industries such as biosciences, toy manufacturing, ship building and semiconductors.

Figure 1: Targeting a meteoric rise



Source: Haver, abrdn, June 2024

However, the likely success of Modi's 'Made in India' initiative and targets to develop India's manufacturing and services sectors remains unclear. Manufacturing has failed to increase as a share of the economy over Modi's leadership – at around 15% of output this remains unusual given India's stage of development – and efforts to attract foreign direct investment (FDI) have been modest, with it only running at around 1.3% of GDP.

For potential growth to rise, India will need to increase the share of its workforce entering productive areas of the economy, specifically in the industry and services sectors.

Figure 2: Infrastructure and 'ease of doing business' reforms are the Modi-operandi

Policy area	Key BJP manifesto pledges
Infrastructure	Greater focus on aviation and rail infrastructure expansion/modernisation, with road investment focused in rural areas. Digital infrastructure also a priority (6G leader), alongside the digitalisation of land records.
Housing	Slum redevelopment continued. Working with state governments to reduce red-tape and other construction costs.
Manufacturing	Targeting $300bn in electronic goods manufacturing by 2030, alongside becoming a major toy manufacturing hub. In addition, sports goods, semiconductors, shipping, rail, EVs and aircraft manufacturing capabilities are all mentioned as areas to develop.
Agriculture	Infrastructure drive to improve productivity, including storage and processing facilities. Self-reliance in pulses and edible oils. In addition, farmer support schemes and crop insurance.

Green transmission	Achieve energy independence by 2047, via a reduction in petroleum imports, expanding nuclear energy production and a target of 500GW of renewable energy. Efforts to promote greener manufacturing processes. The government will also promote EV infrastructure and manufacturing, while investing into rare earth mining.
Labour market	Social support and formalising support for gig workers. Further digitalisation support for small businesses and traders, with a greater focus on distribution opportunities. And technical education expansion, targeting 100% enrolment rates up to secondary level.
Welfare support	Free ration programme extended for five years. Alongside improved healthcare and insurance options for the poorest households, alongside free electricity.

Source: BJP manifesto, abrdn, June 2024

India is well positioned geopolitically, but can it turn this to its economic advantage?

India's foreign policy stance is unlikely to change; independence, with alignment on specific issues, and a growing assertiveness on the international stage will continue.

For example, security cooperation with the US, and other likeminded countries, will persist, providing a counterweight to China's influence across the Asia Pacific region. But trade and diplomatic ties with Russia will also continue.

Free trade agreements (FTAs) are a priority for the Modi government as part of its push to develop its export capabilities and job opportunities. Discussions with the EU will continue, albeit with slow progress. Talks with the UK look more fruitful, although with a likely change in UK government, near-term progress towards a FTA will stall.

India stands to benefit from outright reshoring or a China+1 trend given its growing domestic market and the policy steps towards improving the manufacturing environment. However, having opted out of the Regional Comprehensive Economic Partnership and enacted barriers to Chinese investment, India's diplomatic efforts will also need to be ramped up to ensure it is not left out of the key supply chains shifts in the Asia Pacific region.

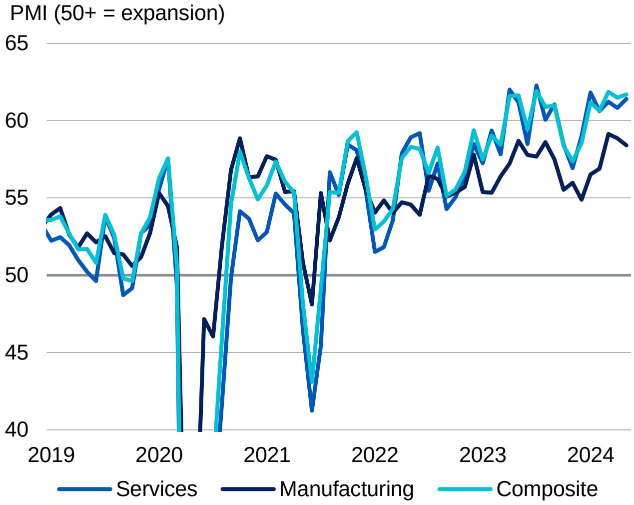
India is still an economic bright spot

Near-term growth at least remains robust. In Q1 2024, real GDP grew 7.8% year over year, far exceeding consensus expectations of 6.7%. We were more optimistic than consensus, but 1.3% quarter-over-quarter growth was still slightly below our expectations of 1.5%. Strong exports growth and a rebound in government consumption were partly offset by a sharp drop in fixed investment.

The latest set of national accounts prints incorporated back data revisions that partly explain the consensus miss. GDP data now show a slightly worse path for the economy during the pandemic, but a better recovery in 2022 and 2023.

Looking ahead, survey data still point to strong momentum. April Flash PMIs continued to signal elevated activity; the services PMI ticked 0.6 points higher, reflecting the steepest expansion in business activity in four months. Consumer confidence indices have also improved, with current and future expectations at their highest levels since mid-2019.

Figure 3: PMIs point to renewed service sector strength



Source: Haver, abrdn, June 2024

Hard data support the pick-up in service sector sentiment. Imports of office equipment (on a 12-month rolling average) have risen to their highest point since mid-2020. Credit growth to services increased 20% in the year to April. Given services account for around 55% of GVA, investment in this sector bodes well for growth.

However, there are signs that the pace of external demand growth will slow. Industry expectations have also eased off their highs, suggesting some near-term challenges to India's manufacturing push.

We expect a mix of slower export growth, a tightening of credit conditions and some fiscal consolidation to weigh on economic activity over the coming quarters. Overall, we anticipate growth will slow from 7.8% in 2023 to 6.3% in 2024 and 6.0% in 2025.

Inflation provides 'food for thought'

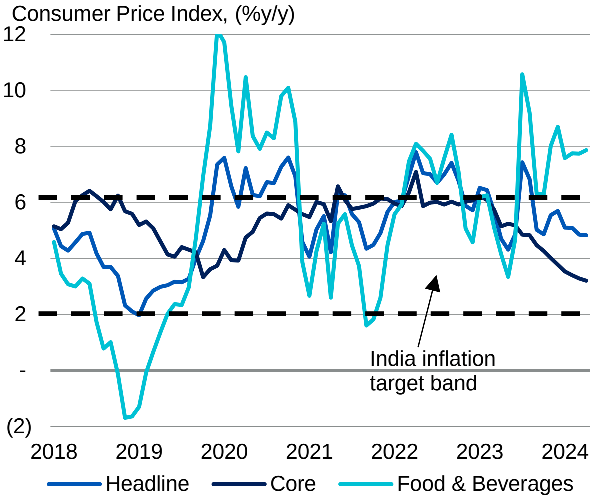
One of the key issues for lower income voters has been the rise in food prices. Modi's government introduced export bans and pledged to extend the free ration programme for a further five years in an effort to address the impact on low-income households.

Food inflation is also a concern for the Reserve Bank of India (RBI) and was a reason why the monetary policy committee showed no signs of a dovish pivot at its meeting in April.

Food and beverages have contributed around 3.5ppts to headline inflation over the past four months, as poor weather conditions have continued to hamper production.

Headline inflation came in at 4.8% year over year in April, still above the 4.0% target midpoint but within the +/- 2ppt target range.

Figure 4: Underlying inflation receding



Source: Haver, abrdn, June 2024

However, the earlier-than-expected start to the monsoon season in India's south raises the prospect of a better harvest, which should give the RBI some comfort over the path for food prices in the coming quarters.

Importantly, underlying inflation has been moderating and our preferred sequential measure (a three-month average of month-over-month core prices, annualised) has fallen to 2.9% in April. This shows the outlook for inflation is improving.

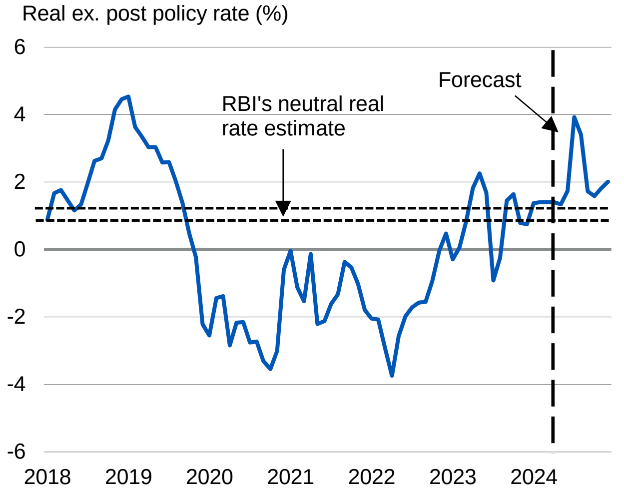
We expect the RBI's focus to turn more to whether the economy needs its support. As it stands, the expansion in credit growth has been aggressive (16.3% year over year), with the RBI tightening lending standards to limit the build-up of systemic risks in unsecured consumer lending. Indeed, bank lending standards have only modestly tightened in the past quarter, which risks keeping the RBI on the sidelines despite the better inflation backdrop.

One factor that could sway the RBI is the performance of private investment. The Modi government is keen to get more private sector buy-in into India's capital investment drive, but there has been hesitancy. Credit growth to the service sector (19% year over year) is far outpacing that of industry and infrastructure (7% and 5% respectively).

While the minutes of the April policy meeting noted "signs of upturn in the private capex cycle", we think the RBI will cut to ensure financial conditions do not stifle the improvement.

Financial conditions are also set to tighten over the coming months. We forecast the real ex. post policy rate to spike higher over the coming months, becoming more restrictive compared to the RBI's judgement of neutral.

Figure 5: RBI to cut as financial conditions tighten



Source: Haver, abrdn, June 2024

As such, we maintain our call for two rate cuts before year-end, taking the policy rate to 6.00%. We expect the first one to come in October, and the RBI to move cautiously. However, a 'higher for longer' path is possible, symptomatic of an Indian economy surpassing market expectations.

Author

Michael Langham

Important Information

For professional and Institutional Investors only – not to be further circulated. In Switzerland for qualified investors only.

Any data contained herein which is attributed to a third party ("Third Party Data") is the property of (a) third party supplier(s) (the "Owner") and is licensed for use by abrdn**. Third Party Data may not be copied or distributed. Third Party Data is provided "as is" and is not warranted to be accurate, complete or timely. To the extent permitted by applicable law, none of the Owner, abrdn** or any other third party (including any third party involved in providing and/or compiling Third Party Data) shall have any liability for Third Party Data or for any use made of Third Party Data. Neither the Owner nor any other third party sponsors, endorses or promotes any fund or product to which Third Party Data relates. **abrdn means the relevant member of abrdn group, being abrdn plc together with its subsidiaries, subsidiary undertakings and associated companies (whether direct or indirect) from time to time.

The information contained herein is intended to be of general interest only and does not constitute legal or tax advice. abrdn does not warrant the accuracy, adequacy or completeness of the information and materials contained in this document and expressly disclaims liability for errors or omissions in such information and materials. abrdn reserves the right to make changes and corrections to its opinions expressed in this document at any time, without notice.

Some of the information in this document may contain projections or other forward-looking statements regarding future events or future financial performance of countries, markets or companies. These statements are only predictions and actual events or results may differ materially. The reader must make his/her own assessment of the relevance, accuracy and adequacy of the information contained in this document, and make such independent investigations as he/she may consider necessary or appropriate for the purpose of such assessment.

Any opinion or estimate contained in this document is made on a general basis and is not to be relied on by the reader as advice. Neither abrdn nor any of its agents have given any consideration to nor have they made any investigation of the investment objectives, financial situation or particular need of the reader, any specific person or group of persons. Accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the reader, any person or group of persons acting on any information, opinion or estimate contained in this document.

This communication constitutes marketing, and is available in the following countries/regions and issued by the respective abrdn group members detailed below. abrdn group comprises abrdn plc and its subsidiaries:

(entities as at 15 April 2024)

United Kingdom (UK)
abrdn Investment Management Limited registered in Scotland (SC123321) at 1 George Street, Edinburgh EH2 2LL. Authorised and regulated in the UK by the Financial Conduct Authority.

Europe[1], Middle East and Africa
[1]In EU/EEA for Professional Investors, in Switzerland for Qualified Investors - not authorised for distribution to retail investors in these regions

Belgium, Cyprus, Denmark, Finland, France, Greece, Iceland, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, and Sweden: Produced by abrdn Investment Management Limited which is registered in Scotland (SC123321) at 1 George Street, Edinburgh EH2 2LL and authorised and regulated by the Financial Conduct Authority in the UK. Unless otherwise indicated, this content refers only to the market views, analysis and investment capabilities of the foregoing entity as at the date of publication. Issued by abrdn Investments Ireland Limited. Registered in Republic of Ireland (Company No.621721) at 2-4 Merrion Row, Dublin D02 WP23. Regulated by the Central Bank of Ireland. **Austria, Germany**: abrdn Investment Management Limited registered in Scotland (SC123321) at 1 George Street, Edinburgh EH2 2LL. Authorised and regulated by the Financial Conduct Authority in the UK. **Switzerland**: abrdn Investments Switzerland AG. Registered in Switzerland (CHE-114.943.983) at Schweizergasse 14, 8001 Zürich. **Abu Dhabi Global Market ("ADGM")**: abrdn Investments Middle East Limited, 6th floor, Al Khatem Tower, Abu Dhabi Global Market Square, Al Maryah Island, P.O. Box 764605, Abu Dhabi, United Arab Emirates. Regulated by the ADGM Financial Services Regulatory Authority. For Professional Clients and Market Counterparties only. **South Africa**: abrdn Investments Limited ("abrdnIL"). Registered in Scotland (SC108419) at 1 George Street, Edinburgh EH2 2LL. abrdnIL is not a registered Financial Service Provider and is exempt from the Financial Advisory And Intermediary Services Act, 2002. abrdnIL operates in South Africa under an exemption granted by the Financial Sector Conduct Authority (FSCA FAIS Notice 3 of 2022) and can render financial services to the classes of clients specified therein.

Asia-Pacific

Australia and New Zealand: abrdn Oceania Pty Ltd (ABN 35 666 571 268) is a Corporate Authorised Representative (CAR No. 001304153) of AFSL Holders MSC Advisory Pty Ltd, ACN 607 459 441, AFSL No. 480649 and Melbourne Securities Corporation Limited, ACN 160 326 545, AFSL No. 428289. In New Zealand, this material is provided for information purposes only. It is intended only for wholesale investors as defined in the Financial Markets Conduct Act (New Zealand). **Hong Kong**: abrdn Hong Kong Limited. This material has not been reviewed by the Securities and Futures Commission. **Japan**: abrdn Japan Limited Financial Instruments Firm: Kanto Local Finance Bureau (Kinsho) No.320 Membership: Japan Investment Advisers Association, The Investment Trusts Association, Type II Financial Instruments Firms Association. **Malaysia**: abrdn Malaysia Sdn Bhd, Company Number: 200501013266 (690313-D). This material has not been reviewed by the Securities Commission of Malaysia. **Thailand**: Aberdeen Asset Management (Thailand) Limited. **Singapore**: abrdn Asia Limited, Registration Number 199105448E.

AA-140624-179494-2