# India's election and implications for equities

## Modi-led alliance clinches third term following a surprise election

By Anuja Munde, Asian Equity Senior Portfolio Manager
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Despite the predictions of exit polls and contrary to market expectations, the 2024 Indian parliamentary elections saw Prime Minister Narendra Modi's Bhartiya Janta Party (BJP) secure only 239 seats, falling short of the 272 needed for a majority. This was a significant decline from the 303 seats the BJP won in the previous 2019 elections. The National Democratic Alliance (NDA), the political coalition led by Prime Minister Modi's BJP, still managed to secure 291 seats.

With crucial support from pre-alliance partners in the states of Andhra Pradesh and Bihar, the NDA is set to lead the government. However, it will be a coalition government with a smaller margin. On the other hand, the opposition Indian National Developmental Inclusive Alliance (INDIA) has made unexpected gains, securing 234 seats, while the Indian National Congress (INC) nearly doubled its seat count to 100.

The BJP's allies will now have greater bargaining power, which could extend to cabinet decisions and crucial reforms. This means the BJP will need to include its allies in important decision-making processes. Prime Minister Modi's government may now have a reduced majority but Indians have voted for his government for a third term, signalling a desire for policy continuity and continued reform momentum.

## Election outcome indicates rural distress, need for large-scale job creation

The post-result analysis suggests that voters are discontent with issues like unemployment and inflation, and a more populist manifesto may have carried greater appeal. India's growth story remains resilient, but there seems to be a disparity between household consumption growth and real GDP growth. In the post-pandemic period, India has been witnessing a K-shaped consumption recovery, with demand from the affluent or premium segment doing well and with demand for entry-level and mass-market goods remaining subdued.

The lower end of the income pyramid has struggled following the pandemic and limited fiscal support has amplified the situation. To widen benefits from economic growth and reduce income disparities, India, in our view, will need a broad-based recovery in the capex cycle as construction is the largest generator of jobs outside of agriculture. We believe that the government will have to focus more on job creation and expanding the manufacturing sector while maintaining its focus on infrastructure development and digitalisation.

## Government spending may change, but fiscal situation unlikely to deteriorate

The Indian economy has seen growth led by investments, partially encouraged by government initiatives, while consumption has lagged. The election outcome could result in a partial reorientation of government spending. However, we still believe that the government will maintain its focus on macroeconomic prudence.

There could be a shift towards subsidies at the expense of some capex, but we do not see a significant impact in the near term nor any deviation from the interim fiscal deficit target of 5.1% of GDP. If government reflationary policies are enacted as a result of political necessity, this could result in slower fiscal consolidation. Supply-side reforms are likely to continue, while factor market reforms may prove difficult to implement.

## India's fundamentals remain strong

India's economic fundamentals remain robust. Reforms in India have generally survived political challenges, and we expect the government to maintain the pace of governance and administrative reforms. However, the more complex reforms involving land and labour need greater consensus building.

Therefore, while near-term uncertainty is high and the political backdrop is slightly different, the broad direction of reforms and macroeconomic factors remains unchanged. We continue to remain very positive on the longer-term potential of the India equity markets.

With Prime Minister Modi sworn in on 9 June, the immediate focus is on government formation and the political jostling between and among parties. The cabinet now has some new members from coalition partners. We will focus on the final budget, which is most likely to be put together early in July, to assess the policy direction.

The first 125-day agenda of the new government will be a key event that will set the direction of economic reforms. We believe that the agenda will focus on digitalisation, infrastructure, industrialisation and governance-related reforms.

## Focus on companies with sustainable returns undergoing positive fundamental change

In the short term, the Indian equity markets are likely to be volatile. However, now that the election uncertainty has been resolved, we believe that over the medium term, there will be a strong corporate capex and credit cycle. In addition, a multi-year buildup in domestic savings is expected to funnel into equities and potentially provide a further boost for consumption.

From a longer-term perspective, this could be an opportune time to assess quality business franchises in India. We continue to focus on companies with high free cash flows, low balance sheet leverage and high return on capital. Currently, we have a favourable view on sectors such as financials via large private sector banks, consumer discretionary via the automobile sector and communication services.

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**Nikko AM team in Europe**
Email: EMEAenquiries@nikkoam.com

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