

India Elections: Diminished Sway & Dulled Bulls

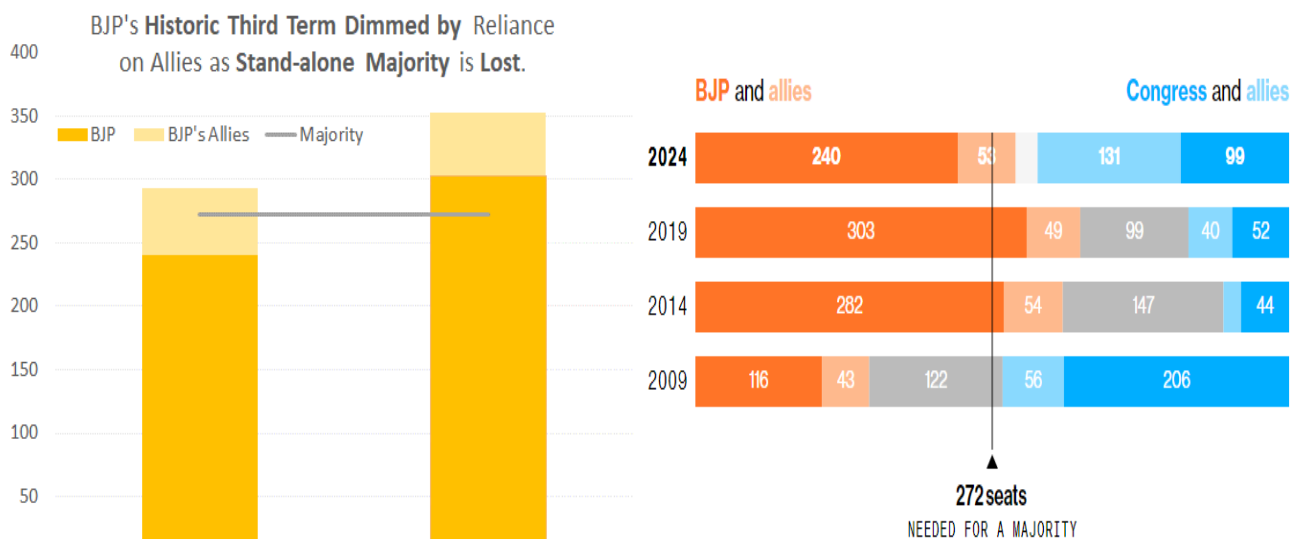
The main take-away from India's 2024 elections is that *despite the accolade of a historic third term mandate for PM Modi, diminished political sway blunt the economic reform momentum.* In turn, *near-term growth prospects* may be dimmed (fractionally) *at the margin.*

Consequently, **India bulls** are **set to be dulled** by *diminished growth-investment optimism.* **Especially given that pre-elections markets were priced-to-exuberance,** which was betting on very (overly) optimistic iterations of accelerated reforms, the attendant economic momentum pick-up and inspired deluge of investments.

PM Modi's **political setback,** insofar it is linked to economic reforms, **has proximate asset market ramifications;** *dampening equity valuations, denting bullish rates alpha* and *accentuating downside rupee sensitivity.*

Election Results - Historic, Not Hegemonic

- A **much closer race that has stunningly denied the BJP standalone majority,** in contrast to the landslide victory for PM Modi predicted by exit polls, triggered a **sharp sell-off in Indian equities (near-6% drop), bonds and the rupee.**
- For the record;
 - **BJP has clinched 240 seats,** well short of the 272 Majority
 - **BJP's allies have 53 seats,** pushing **BJP alliance (NDA) to 293 seats**
- For perspective, a **third term is still a historic feat for PM Modi and the BJP+ alliance.**
- **But hegemonic it is not.** Not only does the BJP not have an unshakeable majority (much less a super-majority), but it is **forced to rely on enduring alliances for undisputed ruling Majority.**



Note: Data as of Wednesday, June 5, 8:20 AM India Time (over 2 hours ago)

Source: Bloomberg

BJP Influence: Compromised, Not Conceded

- This translates into the risk of **compromised policy-making** and reforms as “*King-makers*” may be *tempted to opportunistically impose disproportionate influence*.
- **That said**, this is a **blemish, not a debilitating blow for the BJP**.
- Point being, whilst *forced to compromise*, the BJP will *not* be *relegated to concede the final say despite diminished sway*.
- Fact is, any other viable Alliance to constitute a Majority will be far more fraught.

Policy Reforms Slowed (albeit Not Stalled)

- The upshot is that PM Modi’s broader **economic reform agenda is likely to remain intact**. And so, **fears of India’s key economic reforms** (such as *infrastructure boost, digitalization momentum* and “*Make in India*”) **unravelling are overdone**.
- **Nonetheless**, it is highly likely that **progress may be slowed** along the way.
- Especially **with regards** to; i) *seamless implementation of reforms across states*, and ii) *contentious* issues such as thornier *land and labour reform laws*.

Fiscal Consolidation Tempered by Anti-Incumbency & Inclusivity

- What’s more, **anti-incumbency votes**, ostensibly fuelled by widening inequality and cost of living issues, **may also necessitate a gentler glide path for fiscal consolidation**, than is currently pencilled in.
- Especially **given enhanced fiscal consolidation**, so desired by the regime, investors and ratings agencies, has come **at the expense of lower income groups** feeling the effects of **subsidy reductions** and revenue expenditure cut backs most acutely.
- Simply put, **inclusivity** will need to **feature more prominently, requiring** some **trade-offs** on economic reforms. Especially **on fiscal allocation and ambitions**.

Infrastructure Trade-Off?

- And to be sure, this will not be just limited to slower pace of fiscal consolidation.
- Instead, it may **involve some degree of rationalization in the pace of infrastructure spending** as social outlays compete for (relatively scant) tax dollars in the near-term.

Ratings Tailwinds Fade?

- In turn, the **tailwinds for a ratings upgrade** for India **fade**, on account of
- Granted that **S&P’s upgrade of India’s ratings outlook** to ‘Positive’ from ‘Stable’, which flags scope for an upgrade in 6-24 months, was **expressly independent of elections outcome**. So, a *rollback by S&P is neither imminent nor unavoidable*.
- Nonetheless, the **impetus for other ratings agencies to jump on the outlook upgrade bandwagon** enroute to ratings upgrade is at least **deferred**.

Economic Prospects Dimmed

- This **inevitably dampens the speed and scale of economic lift**; both from the pullback in inorganic, first-pass, FDI as well as organic growth potential unleashed.
- **But the positive direction of travel for economic prospects is not upended**.
- In concert, given monetary-fiscal policy constraints/compromises, rupee risks and diminished investment multipliers, it’s **not inconceivable that underlying growth potential is dampened by 0.3-0.5%-pts**.

RBI's Dilemma Dialled Up

- **Inadvertently, the RBI's policy dilemma is dialled up;** both *in intensity and complexity*.
- Reason being, the confluence of factors will increase policy tensions both ways.
- On the one hand, risks of *fiscal slippage* alongside *accentuated downside risks to the rupee* will on one hand **require more restraint than otherwise**.
- Yet, *softer growth* and *higher yields* (related to fiscal slippage and ratings premium) in the context of *strained consumption* and *lagging private sector capex* means that the RBI will have to be more cautious of overly tight monetary conditions.

FX: Rupee's Downside Sensitivity Accentuated

- All else equal, **rupee sensitivity to downside risks are accentuated**.
- For one, from *the negative "flows" impact* if the *dip in* investor sentiments transmits to inflows from *foreign investments* (at the margin).
- What's more, *relative* (to planned consolidation) *fiscal slippage* will also blunt rupee.
- Moreover, *potential for "windfall" financial gains from ratings upgrade* prospects now *setback, if not denied*, also take some shine off the rupee.
- All of which are over and above a *greater degree of risk premium from political certainty compromised*.

Rates: Bullish Alpha Bets Reversed

- **Scope for bullish rates alpha** (*a decline in rates due to relative advantages*), which was earlier (pre-elections) **drummed up on macro, policy, political and credit positives, are now dented**.
- Apart from RBI cuts compromised, **fiscal consolidation trade-offs** conspire with **diminished ratings upgrade prospects** to *accentuate risk and term premia*.
- To be sure, Fed rate cuts further out will more likely than not help soften IGB yields.
- But the *case to front-run the Fed* is somewhat more *impeded* near-term.
- Crucially, the *ability to leverage on, and amplify, downside in rates* will inevitably be *more challenged* at the margin, absent fresh macro, policy and credit allure.

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