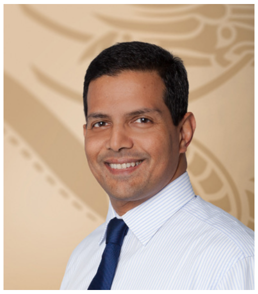
Matthews Asia

Matthews Asia Perspective

What's at Stake for India's Market Ahead of Election?



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Key Points

- India's 2019 general election presents investors with a more challenging outlook, but prospects have brightened recently.
- The risk is that elevated market multiples could fall in the event of a hung election or the prospects of policy stasis under an extended and brittle coalition.
- From a policy perspective, the election is being fought on fiscal largesse.

India's 2019 national elections began in mid-April and will run into the latter half of May 2019, with exit polls to be published May 19 and formal results on May 23.

India's 2019 general election presents investors with a more challenging outlook, in contrast to the 2014 election that the ruling Bharatiya Janata Party (BJP) took by storm along with its National Democratic Alliance (NDA) coalition partners, cementing a majority that allowed Prime Minister Narendra Modi to undertake an aggressive and mostly market-friendly reform agenda.

Since the middle of 2018, the BJP/NDA coalition has suffered setbacks in by-elections and state elections, and has witnessed the growing reversal of political party fragmentation that allowed it to dominate in the 2014 election. As such, early polls indicated that the BJP/NDA alliance, while remaining the front runner, had lost momentum and was likely to garner significantly less than a simple majority.

Recent polls have inflected positively in favor of Modi's BJP, however, following the Indian government's muscular response in a brief border standoff with neighbor and rival Pakistan. With polling for over two-thirds of the seats now completed, polls suggest that the NDA led by the BJP will approach or exceed a majority in the lower house of parliament. While there is still scope for surprise outcomes, evidence of higher voter turnouts so far may favor the BJP, which is believed to hold an edge with young voters.

The primary drivers of the BJP/NDA's early loss of momentum appeared to be low job creation and rural distress, which allowed its main rival, the Indian National Congress (INC) and its United Progressive Alliance (UPA) partners to gain ground. Besides this, state-centric political parties have regained relevance with voters and in recent state elections have shown a propensity for forming alliances against the BJP. These seat-sharing alliances could reverse the fragmentation that allowed the BJP to secure a commanding majority in India's electoral system in 2014.

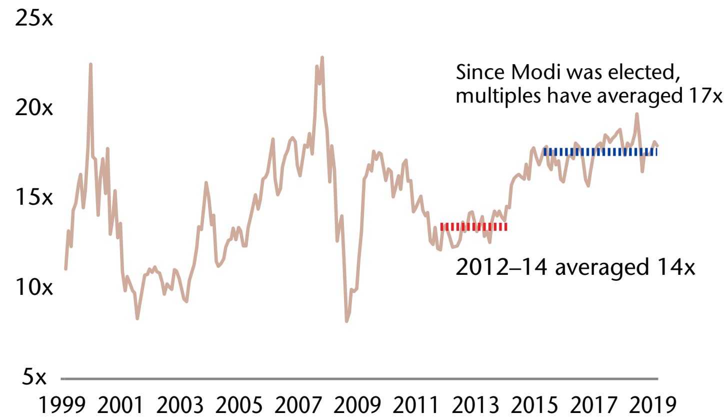
Why is this important to investors? National elections have historically generated volatility in equity markets, but a shift in popular perceptions to reflect the BJP/NDA coalition's improved positioning drove a strong catch-up equity rally in March 2019, before underperforming the MSCI Emerging Markets Index in April 2019 on jitters over rising oil prices. The risk is that renewed high expectations and elevated market multiples have added to the market premium that set in after the 2014 election. A surprise outcome, such as a hung election or the prospects of policy stasis under an extended and brittle coalition headed by either BJP/NDA or INC/UPA, could erode the stock market's rating.

What should we expect on the economic front? From a policy perspective, the election is being fought on fiscal largesse. The BJP's weak performance in last year's state elections was partly attributable to agriculture sector distress stemming from low crop prices. With that in mind, the interim fiscal year 2020 budget that was rolled out Feb. 1, 2019, incorporated significant transfers to the rural sector in the form of cash payments worth around 0.1% of GDP for the remainder of fiscal year 2019 and around 0.36% for fiscal year 2020.

The INC response was to offer even more significant fiscal incentives, notably a 72,000 Indian rupee (US$1,041) per annum cash subsidy for lower income households. That said, an outcome of a stable government that needs to make few compromises to coalition partners would be more likely to result in less fiscal slippage where rural subsidies would be offset by adjustments elsewhere. This could open up policy space for further interest rate cuts, a boon for the business sector.

Other areas of focus in such a scenario could include policies to foster rural development, small and medium-sized enterprises, accelerate banking sector reform, boost middle class purchasing power, and prioritize job creation, the Holy Grail in the Indian political economy. The increase in the disposable income of lower income segments (with high marginal propensity to consume) should drive consumption spending, particularly in consumer staples and fast-moving consumer goods, as well as in select low-ticket consumer durables, while lower rates should drive demand for loans and housing.

Figure 1. Indian Valuation: NTM P/E



Source: Datastream

Index definitions

The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (EM) countries. With 1,138 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. EM countries include: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates.

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