

# India Flash

## India Elections 2014 : A welcome and robust change of guard at the top

Surpassing upbeat investor expectations, the BJP led alliance – the National Democratic Alliance (NDA), led by Mr. Narendra Modi, today scored a landslide victory in India's much awaited national elections. Of the 543 seats in contest, the NDA won 328, with the BJP individually winning 281. In a major setback, the ruling Congress party won just 51 seats, reflective of voter frustration over high inflation, governance issues and policy inaction over the past five years. BJP's emergence as the single largest party with an absolute majority in parliament is historic and seminal for the Indian economy given that the nation has been led by coalition governments since 1989 where regional parties with conflicting political agendas have often undermined the efficacy of nationwide policymaking. The news of Mr. Modi as India's next prime minister and a clear mandate for the BJP proved to be a shot in the arm for India's financial markets today with the Sensex breaking fresh record highs with a 6% intraday jump while the rupee hit 10 month highs of 58.7 against the US dollar.

**We believe that BJP's stronghold within the NDA combined with the pro-reform legacy of its protagonist, Mr. Modi, should be a good fit for India.** At a time when the economy faces significant domestic macro challenges – decadal low GDP growth at sub 5% y/y, elevated inflation, high fiscal deficit, weakening private investments and leveraged corporate and bank balance sheets – a strong and stable pro-reform government is a big positive. The new government is better placed to expedite the revival of stalled infrastructure projects, implement taxation reforms such as the goods and services tax and the direct tax code and keep fiscal consolidation on track without political baggage. BJP's dominance provides Mr. Modi the much needed room to replicate his impressive performance as the chief minister of Gujarat state, which has seen consistent double digit GDP growth over the past decade. Led by policy clarity, speedy decision making, a robust infrastructure support, and an uninterrupted power supply Gujarat has been the manufacturing base for several foreign and domestic multinational companies.

**We expect BJP's economic agenda, based on its election manifesto, to focus on reviving India's sluggish investment activity.** Sector specific reform initiatives would potentially include :

- **Industrial Policy:** Speedy single window clearances, boosting labor intensive manufacturing activity, reviewing labor laws and simplifying land acquisition process.
- **Infrastructure:** Focus on urbanization, heavy public investments in infrastructure, launch high speed railway projects, accelerate work on industrial corridors, allow private participation in coal exploration.
- **Fiscal:** Achieve fiscal discipline, cutback subsidies, focus on capital spending, and expedite implementation of good and services tax and direct tax code.
- **Governance:** Focus on e-governance and use of IT to minimize discretion in decision making, digitalization of records, administrative and judicial reforms, system based policy driven governance.
- **Foreign Direct Investments:** Opposed to foreign investments in multi-brand retail but encourage foreign investments in infrastructure and defense industry. Focus on economic diplomacy for friendly trade policies.

**Focus shifts to Budget day in July:** The regular Union Budget in July, which would be NDA's first in this 5 year term, would be keenly watched for the party's roadmap towards rekindling India's growth story. Given India's already high central fiscal deficit at a tad below 5.0% of GDP, the new government's capital expenditure plans would be constrained by the need for medium term fiscal consolidation. A cutback in revenue expenses and non-merit subsidies is thus warranted alongside speedy implementation of taxation reforms.

**We believe that today's election outcome has the potential to be a game-changer for the world's largest democracy.** If Mr. Modi sticks to his promise of good governance that will be transparent, effective and include administrative reforms, we expect a significant pickup in foreign direct investments into India over the next five years, particularly across the infrastructure space. While a strong mandate bodes well for currency and rate stability the government needs to work closely with the Reserve Bank of India in stemming inflation pressures by executing supply side reforms.

With project implementation is still very weak, we foresee limited upside to India's near term growth outlook and maintain our 2014 growth forecast at 5.2% y/y. That said, effective resolution of India's deep-rooted structural issues over time would provide upside potential for our existing medium to long term growth estimates for India (Est. at 5.7% y/y, 6.4% y/y and 6.8% y/y in 2015, '16 and '17 respectively). There exists a number of impediments at the state level, such as legal hurdles, power shortages, over capacity in cement and steel sectors, etc which, to be resolved, warrant effective centre-state coordination. Over to you Mr. Modi!

Chart-1

**A turn of tables - A strong new government has the potential to be a game changer for Indian economy**

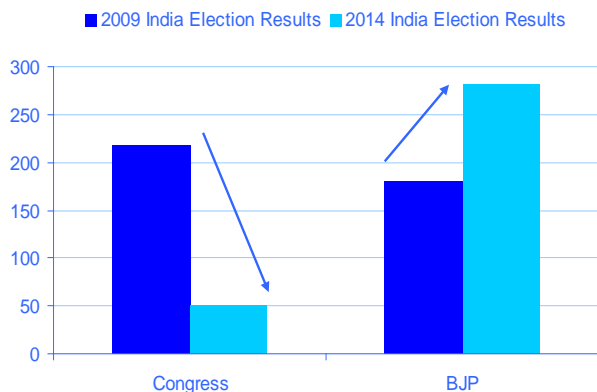
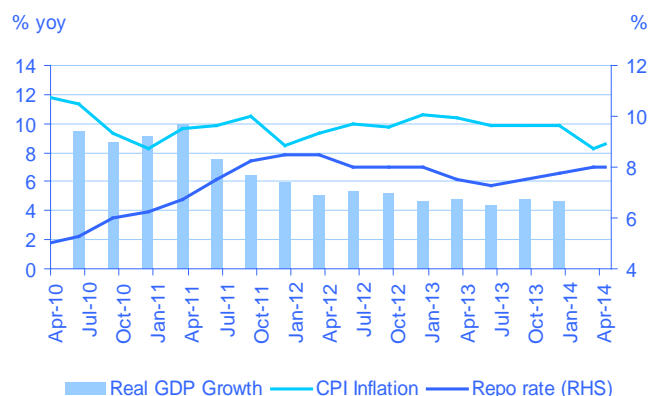


Chart-2

**New government faces significant macro challenges - weak growth, elevated inflation and high fiscal deficit**



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