

State Elections in India “All Systems Go”

Uttar Pradesh, India's most populist State, delivered a stunning election result over the weekend for Prime Minister Modi and the BJP, winning 312 out of 403 assembly seats in the local parliament. The party also won comfortably in Uttarakhand (57 out of 70), and despite finishing a close second in Goa and Manipur, is expected to form local governments in these States also. Punjab went the way of the Congress Party, with the only upset here coming from the failure of the AAP to advance meaningfully in the polls since their shock win in Delhi in 2015. The extent of the BJP's victory beat all expectations, defying opinion and exit polls once again, and heralding an inflection point in traditional voting patterns. As well as other major democracies, a right wing political agenda appears to be on the march in India also.

These results will **not** have any immediate fillip to investment spending or elusive corporate profitability. Nonetheless, the outcome is expected to provide fresh impetus to equities (removing some downside risk), as the market anticipates bolder reform and the increased probability of Modi's re-election in 2019 for a second five-year term. Key risks remain; in particular, rising valuations, a faster than expected upward move in US interest rates (or a stronger US Dollar), a step-up in oil prices, or any unforeseen change in the Prime Minister's personal circumstances. As always and in the shadows, lies a Hindu nationalist agenda that will also be emboldened by the strength of this result.

Grasping the significance of this outcome lies in understanding the voter's perception of Modi. Plainly voters in India's largest and poorest State do not share the media's negativity surrounding the demonetisation exercise (and broader reform agenda), rather believing that the Prime Minister is working for them directly in the battle against corruption. No party has won so convincingly here since 1980. That India's poorest chose to abandon caste based and entitlement politics to endorse a reform drive and pro-growth agenda, was a vote for Modi as leader and not for the BJP as a party, which tellingly chose not to field a Chief Ministerial candidate. As well as highlighting irreconcilable differences between supposed political allies opposing Modi, the depth of the victory also points to a party that has learnt important lessons from earlier losses in State elections in Delhi and Bihar. The political machine appears to have integrated successfully into the real grass roots in a way no other political organisation has come close, providing a coherent argument to suggest Modi's re-election chances in 2019 have been strengthened.

Our sense is that whilst the reform agenda may become bolder, the pace of reform is unlikely to pick up, as it is already straining at the seams. As has earlier been articulated, we should expect further efforts to pursue “black money”, both in property and where possible, offshore. Smooth implementation of the Goods and Services Tax remains a top priority, with the possibility of renewed focus on land acquisition and some stream lining of Labour laws. It is worth noting that Modi will have control over the election of the new President this year but, although his party's influence in the Upper House will rise, mathematically the BJP cannot gain a majority until 2020.

Source: Ocean Dial Asset Management; Credit Suisse

David Cornell
+44 20 7068 9874
davidc@oceandial.com

Tim Adams
+44 20 7068 9877
tima@oceandial.com

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