



MARKET INSIGHTS

## FOCUS ON INDIA: MODI'S HISTORIC WIN BODES WELL FOR INDIA

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### A STRONG, CLEAR MANDATE THAT ALLOWS THE NEW GOVERNMENT TO FOCUS ON GROWTH, REFORMS AND JOBS

In the 2014 general elections<sup>1</sup>, India delivered one of the most decisive electoral verdicts since 1984. The Bharatiya Janata Party (BJP) alone won a parliamentary majority of 282 out of 543 seats, surpassing even the most optimistic forecasts. When tallied together with its allied parties under the National Democratic Alliance (NDA), the number rises to a resounding win of 337 seats. In contrast, the ruling party, Congress, only secured 44 seats, less than a quarter of what it won in 2009. Its image has been hit by its failure to tackle rising prices and falling economic growth.

After a decade of fragmented coalitions that led to deep policy paralysis, the political platform now delivered to the BJP led National Democratic Alliance is historic and should result in a simultaneous revival of investor, consumer and corporate confidence.

A strong, fresh and stable central government will not only improve the investment climate but also accelerate the much needed infrastructure projects that have stalled or slowed due to the regulatory issues. BJP's much talked about concept of "Team India" - essentially improved central and state government relations - is expected to aid this process. Ultimately a revival of investments will boost growth.

<sup>1</sup>Source: Election Commission of India as at 17 May 2014.



Fig.1. Some of the major reforms that the new government can undertake

No.	Reform	Criticality?	Next steps
1	GST	New tax structure to integrate all state economies, improve compliance and boost growth	Reconstituting the GST Council
2	Rail reforms	Critical for new order inflow	Improve railway finances; allow private sector involvement
3	Defence	With a US\$15-30 bn size, it could be meaningful for local industry/ jobs	Opening sector to private sector involvement
4	DMIC	Project ordering can start earlier than expected	Clear pending project plans/ approvals
5	PSU Bank recapitalisation	PSU banks are capital starved, have stretched LDRs	Decide between penalising banks with poor asset quality and recapitalising purely based on need
6	Coal mining	Lack of coal is one of the primary drivers of investment slowdown	Reform Coal India, make state governments stakeholders in the process
7	Power distribution	Systemic inefficiency: High AT&C losses, no open access	Initiate dialogue with the state governments
8	Agriculture	Curb inflation, create jobs	Expand cold-storage and warehousing capacity, incentivise agri-processing

Source: Govt. of India, Credit Suisse research

It is also worth noting that India has the largest pool of young population in the world. In 2014, almost 100 million new young voters were added to the list of registered voters since the 2009 elections. For these young aspiring Indians in the age group of 18 to 22, finding jobs will be a key consideration. With the youth vote already decisive, job creation is a political imperative and will be the new government's top priority. India needs 10 million jobs every year for the next 10 years to absorb this youth entering the job market.

### WHY WE THINK MODI COULD BE A WINNER FOR INDIA?

Modi has a 14-year track record of economic progress in the Indian state of Gujarat that hosts 5% of India's population of 1.2 billion. Modi has been re-elected twice in Gujarat and is now completing 13 years in

power with the bulk of the period reporting more than 10% GDP growth<sup>2</sup>. Modi is known for running governments with bureaucrats and administrative officers. Politicians have been relegated to figurative heads, taking on roles of enablers rather than doers. Modi has institutionalised the functioning of the government, which has paid rich dividends.

Skeptics argue that the progress in Gujarat has been possible because of its small size and homogenous society. India's heterogeneous population is likely to pose different challenges. Modi and team may also face challenges in the upper house of the parliament. Bruised opposition parties will likely stand in the way of reforms. But these are definitely not insurmountable, in our view, given Modi's institutionalised, process-driven problem solving approach.

<sup>2</sup>Source: Central Statistical Organisation, CLSA India as at January 2014.



## INDIA'S ECONOMIC RECOVERY APPEARS SET TO GAIN TRACTION

Late 2013, India put together all its efforts to ensure it is dropped from the list of the fragile five. India's current account deficit has improved sharply to the lowest reading in eight years, helped by government-imposed curbs on gold imports, and rising exports as a weak currency made exports competitive. The reduction in current account deficit in India is most dramatic amongst emerging markets (EM). Consequently, the currency has recovered more than 16%<sup>3</sup> from its all time low on 28th August 2013. Further, at a time when investors are worried about the effect of tapering on EM currencies, the Indian rupee has been remarkably stable and range-bound.

GDP growth has also shown signs of improvement. The World Bank has estimated India's GDP growth to rise to 6.2% and 6.6% in FY2015 and FY2016 respectively. Inflation, which has been a persistent problem, is no longer in double digits and has moderated notably over the last few months.

Much of this macro improvement stems from the economic reforms administered over the last 18-20 months, highlighting the importance of on-going proactive policy reforms in the country with immense potential. An economic recovery has begun almost simultaneously as the political guard changes. With a landslide victory and a historic mandate for the NDA coalition, India stands on the cusp of entering its next wave of economic recovery activity.

## OUR INDIAN STRATEGIES ARE POISED TO BENEFIT

Market valuations are undemanding (refer to Fig.2.) and look attractive in the light of possible reforms and expected economic recovery. Our Indian strategies are poised to benefit from the focus on reforms and a pick-up of domestic economic activity. We have increased exposure to companies with strong cash flows, which are levered to perform better during a phase of growth recovery.

Fig.2. MSCI India Forward Price-to-Book (x)



Source: MSCI, Bloomberg as at 16 May 2014.  
The horizontal lines represent the average (the middle line) and one standard deviation (sd) on either side of this average for the period shown.

Fig.3. India Equity Cyclical vs Defensive Price-to-Earnings (x)



Source: MSCI, UBS estimates as at 19 May 2014.

<sup>3</sup>Source: Bloomberg as at 19 May 2014.



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