India
7 June 2024

Modi 3.0: The Going Will Be Tougher

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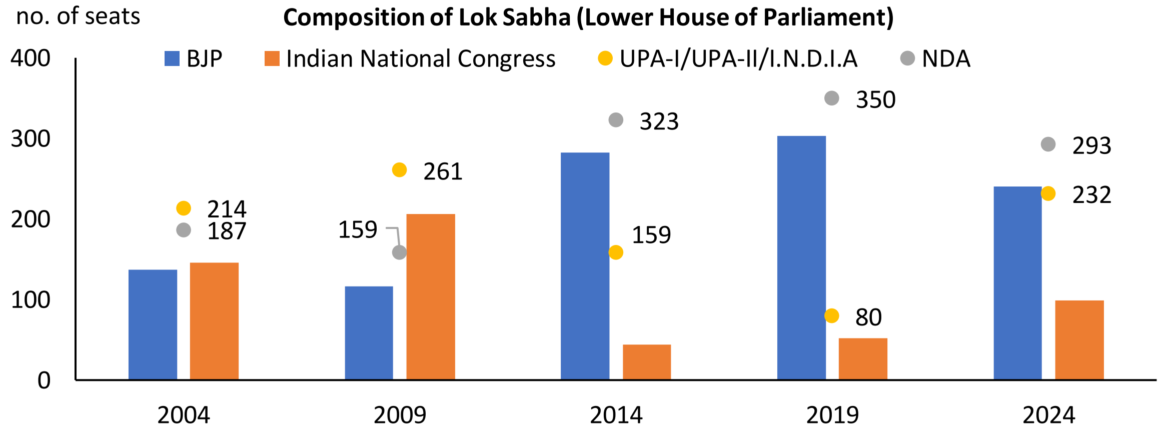
- PM Narendra Modi will get a third term in office, but not without a reality check. The return of coalition politics will rein in the BJP's economic reform agenda.
- We expect the incoming government will stick to low hanging fruit such as a focus on infrastructure spending and digitalisation. Our GDP growth forecasts for FY25, FY26 and FY27 are 7.2%, 6.2% and 6.0%, respectively versus 8.2% in FY24.
- We expect RBI to cut its policy rate by a cumulative 75bp, in gradual, calibrated cuts from CY4Q24 through to CY2Q25.

A Changed Political Landscape

It is a historic third term for Narendra Modi as the Prime Minister of India, but it is not without a political reality check. The BJP won its lowest number of seats in the Lower House at 240, falling short of the single party majority of a minimum of 272 seats, that it had claimed in the 2014 & 2019 elections. The National Democratic Alliance (NDA), of which the BJP is the biggest party, will remain in power for third term with support from its regional allies with a total of 53 seats.



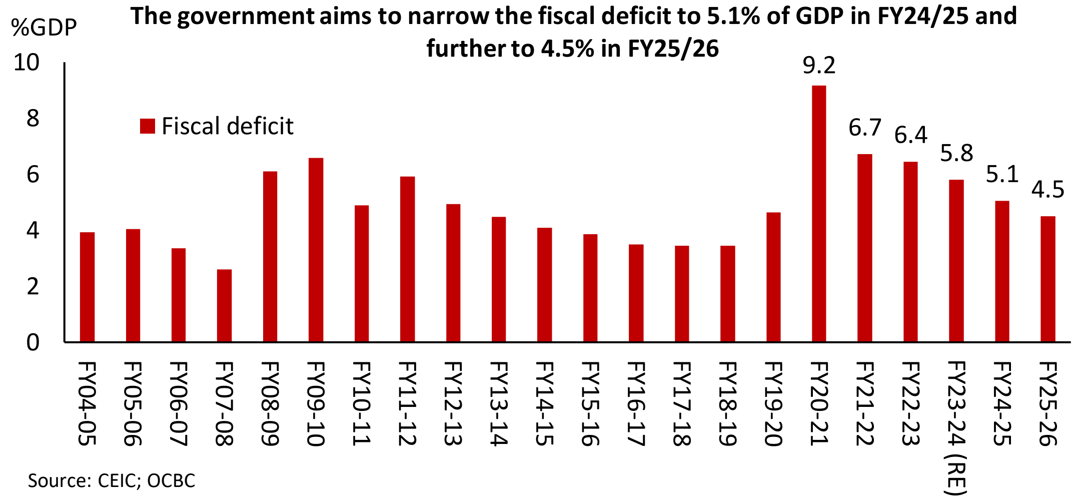
Source: Inter-Parliamentary Union; OCBC.

Coalition politics will come with its own set of challenges and compromises, as historical precedence in the Indian context has shown. India's governments were largely coalitions through the 1990's. There will be an increased resistance to tougher, unpopular economic reforms. However, the government is likely to remain focussed on infrastructure development and enhancing the ease of doing business.

Budget FY24-25: The First Litmus Test of Policy Direction

The incoming government's first order of business, soon after cabinet formation, will be to table the FY24-25 Budget (year ending March 2025). In the interim budget, tabled in February 2024, the government aimed to narrow the fiscal deficit to 5.1% of GDP from 5.8% in the revised estimate of FY23-24. RBI's bumper dividend transfer of INR2.1trn (0.7% of GDP) versus market expectations of INR1trn (0.3% of GDP) could help further narrow the deficit further.

The government aims to narrow the fiscal deficit to 5.1% of GDP in FY24/25 and further to 4.5% in FY25/26



Source: CEIC; OCBC

Nonetheless, **the direction of the FY24-25 budget will likely set the tone of PM Modi's third term.** Steady tax revenue collection growth of 12% YoY, slightly higher than our nominal GDP growth assumption of 10% YoY, a similar pace of growth for non-tax revenue, contained operational expenditures of 6.0% YoY (versus 8.3% in FY2014-19 and 12.2% in FY2020-24) with capex rising ~13% will, by our estimates, allow the government to reach its fiscal deficit target of 4.5% of GDP by FY2025-26.

The implies that the government will have to be steadfast with its focus on fiscal consolidation with little room to manoeuvre on the fiscal side. Sustained efforts to plug tax revenue loopholes and continuous administrative improvements will likely help keep revenue collections strong. That said, additional tax reforms are still necessary underscored by the need tax revenue growth to surpass nominal GDP growth for keep fiscal consolidation to stay on track. By the same token, the government does not have a large amount of wiggle room to placate voters considering fiscal spending will likely need to be closely monitored, particularly if capex objectives are to be met.

Continue with Low Hanging Fruit…

Attendant to broader fiscal consolidation, we expect the incoming administration to remain focused on economic priorities, that will not be met by significant political opposition. These include infrastructure development and digitalisation.

Infrastructure development: The Modi administration has been instrumental in supporting the infrastructure development drive. Since 2014, the length of railway tracks has increased 10% (as of 2022) while the length of national highways has increased 60% (as of 2023). Bolstering infrastructure for roads, railways, ports and airports will be met with limited political resistance given its far reaching benefits and positive externalities. Progress on projects which are currently underway will continue. Given PM Modi's regional coalition partners are from Andhra Pradesh and Bihar, we would not be surprised if national mega projects are announced within these states in coming years.

Some key infrastructure projects currently underway
Roads & Bridges
Delhi-Vadodara Eight-Lane Expressway Project (NH-148N)
Bhiwani-Jind-Karnal Two Laning Road Project (NH-709A)
Jaisingh-Nagar-Madhya Pradesh Chhattisgarh Border Road Project
Tirunelveli-Sengottai-Kollam Four Laning Road Project (TNRSP-Phase II)
Airports
Noida (Jewar) International Greenfield Airport Project
Mopa International Airport Project
Shimoga Airport Project
Mysore Airport Runway Expansion Project
Coimbatore Airport Expansion Project
Railways
Jammu-Udhampur-Katra-Qazigund-Baramulla Railway Line
Ahmedabad-Rajkot Railway Electrification Project
Redevelopment of Mumbai Central Railway Station Project
Ports & Shipping
Vizhinjam International Container Transhipment Terminal Project
Khandaleru Creek North-South Industrial Cluster Road Project
Kochi Water Metro Project
Diamond Harbour Container Terminal Project at Kolkata Port
Sources: National Infrastructure Pipeline; India Infrastructure Monitor; OCBC.

Digitalisation: A feather in PM Modi's cap has been creating a conducive environment for rapid digitalisation and adoption of new technologies. While these plans were in place prior to PM Modi's taking office, his government has maintained a steadfastness in implementation and adoption which we expect will continue into his third term.

The introduction of Aadhar cards, provided by the Unique Identification Authority of India (UIDAI), has helped target subsidy rationalisation and cash payments reducing the scope of leakages. The rapid adoption of Unified Payments Interface (UPI) has been a game changer for India's digital payment platforms paving the way for a cashless payment across all economic strata. The ubiquitous presence of mobile users in India has catalysed UPI.

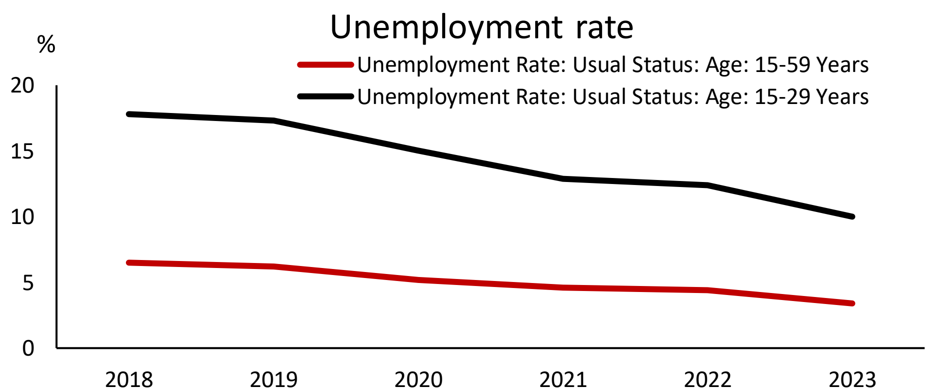
The next steps will be in terms of honing digital capabilities in the fields of education, gen-AI adoption, innovative cloud technology. These will be more challenging but again the political capital will likely sustain given the positive impact of past reforms in these efforts.

…But Could Be a Realignment of Priorities

The election outcome clearly showed that on-the-ground concerns need to be actively addressed. **The first one of which is unemployment.** More public sector schemes to promote employment and alleviate cost of living burdens through more targeted cash handouts cannot be ruled out given the upcoming state elections of Haryana and Maharashtra; BJP fared poorly in both these states during the general elections.

Tougher National Reforms Will Be Less Forthcoming

While the unemployment rate has been declining, anecdotal evidence shows that unemployment among the youth is elevated. Resolving this issue will not be a straightforward process and maybe complicated by the penchant of coalition governments to dole out cyclical solutions rather than addressing structural constraints. Few such measures include a stricter implementation of the 2020 National Education Policy to ensure better learning outcomes and processes/programs to establish stronger linkages between education outcomes and job market requirements.



Source: CEIC; OCBC.

Economic Reforms that require more political capital such **as fine-tuning Goods & Service Tax exemptions** (including petroleum, alcohol, real estate) and **further rationalising subsidies** may, however, be put on the back burner. Similarly, the ability of the incoming government to press ahead with **agriculture reforms** (after the 2020 agriculture reforms were withdrawn) will be difficult.

PM Modi's focus on bolstering manufacturing sector has become sharper in recent years. These include measures such as the government production-linked incentives scheme[1] and large subsidies to foreign investors to set up shop in India. While these programs have helped bolster the manufacturing sector, we see some risks that these could be de-prioritised. Nonetheless, the risks for schemes such as PLI will mainly come ahead of its expiration dates.

An Eye of State Dynamics

While the purview of the state is clearly demarcated by the Constitution of India, centre-state collaboration could become more tenuous. There are now numerous states for which the ruling state party differs from the party of representation at the centre. Importantly, Maharashtra and Haryana go to the polls later this year, further testing the BJP-led coalition.

State/Union territory	Ruling State Party	Seats at Centre
Andhra Pradesh	Telegu Desam Party	Telegu Desam Party
Arunachal Pradesh	Bharatiya Janata Party	Bharatiya Janata Party
Assam	Bharatiya Janata Party	Bharatiya Janata Party
Bihar	Janata Dal (United)	BJP/JDU
Chhattisgarh	Bharatiya Janata Party	Bharatiya Janata Party
Delhi	**Aam Aadmi Party**	**Bharatiya Janata Party**
Goa	**Bharatiya Janata Party**	**Bharatiya Janata Party/Congress (INDIA alliance)**
Gujarat	Bharatiya Janata Party	Bharatiya Janata Party
Haryana	**Bharatiya Janata Party**	**Bharatiya Janata Party/Congress (INDIA alliance)**
Himachal Pradesh	**Indian National Congress**	**Bharatiya Janata Party**
Jharkhand	**Jharkhand Mukti Morcha**	**Bharatiya Janata Party**
Karnataka	**Indian National Congress**	**Bharatiya Janata Party**
Kerala	**Communist Party of India (Marxist)**	**Indian National Congress (INDIA alliance)**
Madhya Pradesh	Bharatiya Janata Party	Bharatiya Janata Party
Maharashtra	**Shiv Sena**	**Indian National Congress (INDIA alliance)**
Manipur	**Bharatiya Janata Party**	**Indian National Congress (INDIA alliance)**
Meghalaya	**National People's Party**	**Indian National Congress (INDIA alliance)**
Mizoram	Zoram People's Movement	Zoram People's Movement
Nagaland	**Nationalist Democratic Progressive Party**	**Indian National Congress (INDIA alliance)**
Odisha	Bharatiya Janata Party	Bharatiya Janata Party
Punjab	**Aam Aadmi Party**	**Indian National Congress (INDIA alliance)**
Rajasthan	Bharatiya Janata Party	Bharatiya Janata Party
Sikkim	Sikkim Krantikari Morcha	Sikkim Krantikari Morcha
Tamil Nadu	Dravida Munnetra Kazhagam	Dravida Munnetra Kazhagam
Telangana	**Indian National Congress**	**Bharatiya Janata Party/Congress (INDIA alliance)**
Tripura	Bharatiya Janata Party	Bharatiya Janata Party
Uttar Pradesh	**Bharatiya Janata Party**	**Samajwadi Party (INDIA Alliance)**
Uttarakhand	Bharatiya Janata Party	Bharatiya Janata Party
West Bengal	All India Trinamool Congress	All India Trinamool Congress

Source: OneIndia; OCBC.

[1] Production Linked Incentive (PLI) Schemes for 14 key sectors have been announced in with an outlay of INR1.97 lakh crore (over US$26 billion) to enhance India's manufacturing capabilities and exports. The scheme was first introduced in 2020 and expanded in subsequent years.

GDP Growth to Be Sustained

Taken together, we expect GDP to remain solid in the coming years, albeit moderating from 8.2% YoY in FY24. Our GDP growth forecasts for FY25, FY26 and FY27 are 7.2%, 6.2% and 6.0%, respectively. This assumes that there will be continued fiscal consolidation; this will be more passive assuming continued benefits from past reforms such as GST and a contained operating expenditure profile. We expect infrastructure spending will continue, supported by private sector investments, as political stability ensues, and policy priorities are clarified. Meanwhile, export improvements will likely remain modest over the medium-term.

RBI To Remain Steadfast

This will keep the current balance in a deficit while inflationary pressures remain volatile. Admittedly, headline inflation has been easing back to within RBI's 2-6% inflation target range over a sustained period, but the disinflation trajectory has been bumpy.

RBI will look for an opportunity to start easing its policy rate in the October-December 2024 quarter, in our view. By this time, we expect inflationary pressures would have eased further and the US Federal Reserve embarked on its easing cycle. We expect RBI to cut its policy rate by a cumulative 75bp, in gradual, calibrated cuts from CY4Q24 through to CY2Q25.

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