

India elections: Policy over politics

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Cricket fever has noticeably receded in India, a nation of 1.4b fans, following the recent World Cup, only to be replaced by the early stages of another fever - elections.

Politics is one of the evergreen interests for Indians, in addition to cricket and movies. Just like the players in blue and the Bollywood dance numbers, politics also inflames passions and creates divisions, as political parties head for the polls with the promise of improving the lives of common Indians.

The country, the world's largest democracy with 28 states and 8 Union territories, sees several elections each year. But the most intensely fought and closely watched ones are the national elections to form the central government in New Delhi, which will be held sometime in the first half of 2024. When the ruling Bharatiya Janata Party (BJP) led its National Democratic Alliance (NDA) alliance to ride to power with a landslide victory in 2014, it was for the first time in 20 years that a single political party (BJP) got a majority in the Lok Sabha, the Parliament's lower house that is directly elected by the people, by winning over 272 seats. The following years have brought not just political stability, but also policy stability and the ability to implement some long-awaited structural reforms. The upcoming national elections will be keenly watched for signs the political stability will continue. There are some early headwinds facing the BJP, as 28 opposition parties (national and regional) are attempting to form a national political alliance, called "I.N.D.I.A". While this alliance looks formidable on paper, it has left some crucial questions unanswered, the most important one being who its Prime Ministerial candidate will be. Another challenge for the alliance to overcome will be its seat-sharing formula, based on which party will field candidates in different constituencies.

A temperature check was provided in the state elections in five elections that started in November. These states are home to 17% of the country's population, and together account for about 15% of the seats in the Lok Sabha that will be contested next year. BJP delivered a landslide victory in three of the four large states beating the pre-election opinion polls and post election exit polls. We believe BJP's win cements Prime Minister Modi's appeal even further ahead of the national polls.

Source: HSBC Asset Management November 2023.

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The outcomes of these elections have greatly mitigated the risk of populist rhetoric from the ruling party ahead of the national elections and they continue to focus on measured and efficient welfare programmes in keeping with their fiscal goals.

While it may seem counter intuitive, state elections held just before the national elections have often not been an accurate indicator of how the electorate will vote in the national elections. One key reason for this is that the voters seem to be discerning local vs national issues and voting accordingly and differently in the two elections.

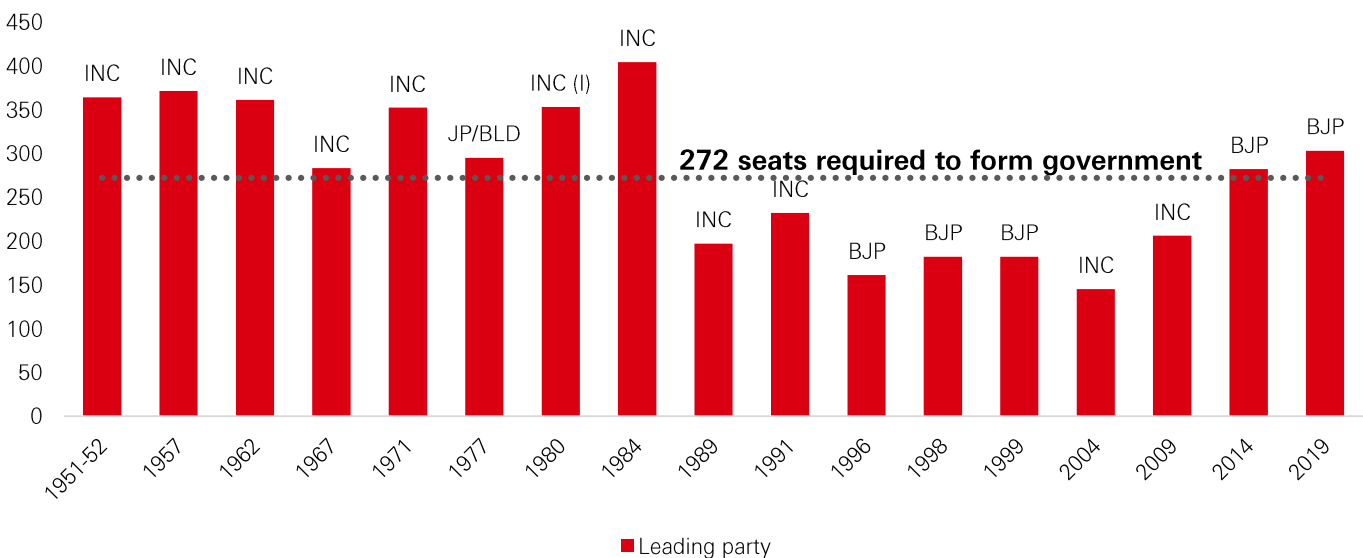
Exhibit 1 below shows the BJP’s **vote share increased** in the national elections in 2019, relative to the state elections held in 2018.

Name of the State	State Election – 2018	National Election - 2019	State Election – 2023
Rajasthan	39%	59%	42%
Chhattisgarh	34%	51%	46%
Madhya Pradesh	42%	59%	49%

Source: Election Commission of India

Exhibit 2

No of seats won by single largest party in in the Lok Sabha



Source: Election Commission of India

At the national level, opinion polls conducted by local media, including India Today, India TV and NDTV, recently indicate a clear win for the BJP and its NDA alliance. It is worth bearing in mind that a sharp increase in short-term volatility had been observed in the market in the past, when actual outcomes differed from opinion polls.

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Exhibit 3

Year	Opinion polls			Exit polls			Actual results			Comments
	Leading	Incumbent/ Opponent	Count	Leading	Incumbent/ Opponent	Count	Leading	Incumbent/ Opponent	Count	
2004	NDA (BJP)	Incumbent	247-335	NDA (BJP)	Incumbent	230-278	UPA (Congress)	Opposition	218	Opinion polls were highly overestimated and actual results were completely different.
2009	UPA (Congress)	Incumbent	201-257	UPA (Congress)	Incumbent	185-205	UPA (Congress)	Incumbent	262	Actual results beat the exit polls by huge margin, but they were more in line with higher end of opinion poll range.
2014	NDA (BJP)	Opposition	211-275	NDA (BJP)	Opposition	249-340	NDA (BJP)	Opposition	336	Exit polls estimates were higher than opinion polls, Actual results beat the exit polls by huge margin.
2019	NDA (BJP)	Incumbent	225-335	NDA (BJP)	Incumbent	242-365	NDA (BJP)	Incumbent	353	Actual results were on the higher end of the exit polls range.
2024	NDA (BJP)	Incumbent	260-330							

Source: Election Commission of India, local media, UBS, HSBC Asset Management, November 2023.

Not a perfect correlation

Next year's national elections will be keenly watched across equity and bond markets, as well as the corporate world, as they try to gauge whether policy stability, a critical input in any investment decision, will continue. Equity investors, in particular, will continue to look for policies that support investments in manufacturing, and stability in the tax regime. Bond investors would like to see a continuation of fiscal discipline, and policies that support stable inflation. Corporations, both domestic and global, would like to see continued improvement in infrastructure (power, logistics) creation, along with a stable tax regime.

The recent state election outcomes and what they portend for the national polls in terms of continuity in the government serves as a shot in the arm for both equity and bond investors. We also expect inflows from Foreign Institutional Investors (FIIs) to accelerate following the state elections. FII flows turned the corner in November with over USD1 billion in inflows during the month as global risk appetite returned on expectations of peaking rates and picked up pace since the election results with around USD2 billion in inflows so far in December

By the same token any disappointment from the national elections could result in a knee-jerk negative reaction, and increase market volatility in the medium term. However, past experiences have also shown that the broader economic policy direction of various governments, since the economic liberalization started in the early 1990s, has been unidirectional and there has never been a material reversal, although delays and halts have been common.

An analysis of the five national elections over the last two decades shows that the short-term market reaction to the results is mainly a function of the expectations going into the elections, but are invariably determined more by fundamentals following the elections. For instance, opinion polls in 2004 had predicted a win for the BJP and those expectations were further cemented by strong results for the BJP in state elections. But this was the only time when opinion polls proved to be wrong, and the BJP lost the national elections. Despite the shocking result, markets delivered strong positive returns after the first six months from election results. In 2009, when the ruling party returned to power with higher seats, market reacted to the results extremely positively, though after the initial euphoria market returns were stagnant for couple of years. By contrast, in 2014 and 2019 when the election results were better than market expectations for the ruling party, markets returns were very moderate in short term.

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Exhibit 4

Period	Oct-99	May-04	May-09	May-14	May-19
-6M	36.8%	9.1%	31.0%	17.2%	11.8%
-1M	-2.6%	-9.3%	11.2%	7.3%	1.4%
Election Result day = Day 0					
+3D	5.8%	-5.4%	17.5%	1.9%	0.8%
+5D	6.9%	-9.0%	12.8%	1.6%	1.6%
+6M	7.3%	10.7%	37.2%	17.2%	3.5%
+12M	-13.1%	19.2%	40.8%	15.1%	-20.5%
+18M	-15.6%	50.7%	72.5%	9.9%	11.1%

Ruling govt before election	NDA (BJP)	NDA (BJP)	UPA (Congress)	UPA (Congress)	NDA (BJP)
Opinion poll prediction		NDA (BJP)	UPA (Congress)	NDA (BJP)	NDA (BJP)
Nature of govt	Strong Coalition	Strong Coalition	Weak Majority	Majority	Strong Majority
Winner	Ruling Party	Opposition	Ruling Party	Opposition	Ruling Party

Source: Bloomberg, HSBC Asset Management November 2023.

While a stable political set up and stable policy making is essential for an economy to deliver on its potential growth trajectory, this plays out over medium to long term. On the other hand, market returns in the short- to medium-term are a result of the interplay between multiple factors, and policy stability and favorable economic policies are only some of them. Market valuations at the point of investment, and subsequent earnings growth vs expectations, are other factors that play a large role in future returns. **Exhibit 5** below shows strong returns post-elections. This was influenced more by prevailing valuations at the time of election than the election results in themselves.

While investors usually approach crucial elections with a sense of trepidation, we believe that BJP's decisive victory in the state elections and the favourable opinion polls leading up to the national polls should mitigate concerns over political stability and policy stability. It is also worth noting that, history shows that any temporary post-election pullbacks have always been good opportunities for investors to get on India bandwagon.

Exhibit 5

NIFTY 1-yr forward PE					
Period	May-04	May-09	May-14	May-19	
-6M	6.06	8.03	13.08	16.74	
-1M	7.06	11.84	14.03	18.31	
Result day	6.53	10.69	14.90	18.29	
+3D	6.02	12.50	14.95	18.52	
+5D	5.72	12.24	14.93	18.66	
+6M	6.88	15.89	15.84	18.62	
+12M	6.35	15.66	15.67	15.56	
+18M	7.54	16.75	11.53	21.39	

Source: Bloomberg, HSBC Asset Management November 2023.

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