INDIA'S ELECTIONS: WHAT SHOULD INVESTORS EXPECT FROM MODI 2.0?

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Democracies are like a 60/40 portfolio. Gradual growth and modest volatility, just like a 60/40 portfolio, have also been hallmarks of India's economic reforms, which started in 1991. In 2014, when in an interesting turn of events Prime Minister Narendra Modi was elected with a thumping majority, many hoped he would fast-track implementation of reforms.

Five years later, after completing a mammoth democratic exercise, the world's largest democracy finally gave its verdict on May 23 when it selected Modi again as its leader.

Here is my analysis of what investors can expect from India's newly elected government—that is, Modi 2.0.

- **Political Stability:** For decades, India's political system has been dominated by a coalition government. While this may not necessarily be bad, it certainly reduces the pace of reforms. The majority result for Modi ensures a clear leadership and policy direction—something that investors surely prefer over a chaotic and uncertain leadership.
- **Acceleration in Reforms & Growth:** A big part of Modi's last five years was directed toward the implementation of guardrails for India's economic engine. A few critical steps implemented by the Modi government from 2014 to 2019 include the following:

    1. **Financial Inclusivity:** A Guinness world record in opening bank accounts by giving incentives to banks as well as to its citizens to open savings accounts.

    2. **Digitization:** A biometric database for 1.2 billion people, which was then linked to their bank accounts, cellphones and all economic connections, making India's economy a data gold mine in the making and a supercomputer for economic connectivity.

    3. **Opening of the Economy:** Liberalizing all economic sectors, ranging from consumers to defense. This makes it easier for foreign investors to access the world's fastest-growing large economy. Under Modi's watch, India's foreign direct investment increased from $25 billion in 2014 to $45 billion today.

    4. **Simplifying Taxes:** Subsuming India's complicated and multitude of state and federal taxes with just two-line items under its Goods and Services Tax (GST) bill.

5. **Bankruptcy Code Implementation:** Setting up a legal infrastructure for debt liquidation, providing a quicker exit mechanism for loan recovery. This stimulates credit growth and fuels private loans.

Moving ahead, I expect Modi 2.0 to fuel India's growth engine on the economic guardrails that were put in by Modi 1.0.

- **Newer, Bolder Reforms:** While Modi 1.0 was limited in its ability because it didn't have a majority in India's upper house (comparable to the U.S. Senate), Modi 2.0 will not be. Two consecutive victories and changes in the configuration of the upper house mean that Modi 2.0 can be much bolder and swifter in implementing newer reforms. Some areas that could see big changes, in my opinion, include:

1. **Land Reforms:** Acquiring land for industries in India is a huge challenge. Modi 1.0 did try to simplify land acquisition for industries but quickly ran into political roadblocks because it didn't have a majority in the upper house. With that situation changed, I expect this to be a welcome revisit by Modi 2.0.

2. **Privatization and Monetization of Loss-Making Assets:** One of the popular slogans of Modi government has been "Minimum Government, Maximum Governance." I expect Modi 2.0 with its better majority to stick to this narrative and sell its loss-making enterprises.

3. **Labor Reforms:** A new political mandate gives confidence to the Modi government to change labor laws to encourage private sector growth while managing social security and welfare aspects, which affect the economy in terms of retail spending.

4. **Ease of Doing Business:** This was already a big focus of the Modi government in 2014, and India's ease-of-doing-business ranking in the World Bank Index increased from 142 in 2014 to 77 in 2019. I expect this focus to continue at the heart of Modi 2.0's policy making.

5. **Stimulating Credit Growth:** As Modi works closely with the Reserve Bank of India, we expect it to stimulate credit conditions by working with regulators to provide mechanism to boost banks' liquidity.

6. **Infrastructural Boost:** As a two-time prime minister, Modi 2.0 can focus on a fiscal boost to infrastructure, which in turn would stimulate manufacturing in India, Modi's long-held dream.

Conclusion

If Modi 2.0 can implement even 50% of these newer reforms, per our estimates it could boost India's GDP of 7.5% by 1% to 2.5%, thereby providing a tremendous boost to earnings and a stock market expansion.

India's economic reform journey started in the 1990s, when it gradually started to open its economy. Since then, just like a 60/40 portfolio, it's seen a slow and steady growth. While this may be slower compared with the pace of reforms in single-party-ruled economies, it’s often the case in investing that 60/40 portfolios tend to do better than pure risky bets on a risk-adjusted and long-term basis.

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60/40 Portfolio : A portfolio of 60% equities and 40% fixed income.

Volatility : A measure of the dispersion of actual returns around a particular average level. .