India Chart Book

Modi on the cusp of victory

- Exit polls signal that Prime Minister Modi’s BJP and its coalition partners in the National Democratic Alliance have won India’s election. (See Chart.) Admittedly, exit polls have been wrong in the past, not least in underestimating the strength of the BJP’s victory in 2014. We won’t know the official result until late on Thursday. But taken at face value, the polls indicate that the next government will be a stable coalition. This would set the stage for continued gradual reforms that would sustain rapid economic growth over the next few years. Markets have rallied on the polls: Indian equities surged by 4% to an all-time high yesterday. Further strong gains may now only come if the BJP is able to secure an outright majority.

- **Activity indicators** suggest that government spending helped to boost growth in Q1, offsetting the weakness in household consumption. (Page 2.)

- **Business indicators** have remained reasonably upbeat over the past few months. (Page 3.)

- **Consumer indicators** suggest that household spending growth has weakened in the early stages of 2019, but we think it is likely to stabilise soon. (Page 4.)

- **External indicators** show that the monthly goods trade deficit widened a touch in April, but we think it will retreat over the coming months as oil prices begin to fall. (Page 5.)

- **Inflation indicators** show that both headline CPI inflation accelerated last month, and that underlying price pressures remain elevated. (Page 6.)

- **Fiscal & Monetary indicators** show that after 11 months of FY18/19, the cumulative fiscal deficit stood at over 130% of the total that had been budgeted for the entire year. But the finance ministry should still have hit its revised target following a surge in asset sales. (Page 7.)

- **Financial market indicators** show that the Sensex hit a fresh record high yesterday after exit polls pointed to a BJP victory in the general election. (Page 8.)

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**Chart: Lok Sabha Election Exit Polls (21st May, No. of Seats out of 543)**

- **BJP-led NDA**
- **Congress-led UPA**
- **Other**

Source: Times Now/VMR, ABP-Neilsen

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Activity Indicators

• GDP data for Q1 are due at the end of May. The latest available numbers for Q4 2018 show that growth slowed to 6.6% y/y, from 7.0% y/y in Q3 (1). This was due in large part to a sharp drop in government consumption growth, while private consumption also eased a touch (2). The drag from net exports eased, but continued to make a negative contribution to overall GDP growth last quarter.

• More recently, the latest data are showing that the weakness of industrial production at the end of last year extended into Q1 2019 (3). This appears to have been driven primarily by a sharp fall in vehicle production growth (4).

• However, other indicators suggest that activity remains solid. For example, rail freight volumes continue to grow by double-digit rates (5). Expenditure by the central government has also rebounded in the early stages of 2019 (6), and we expect spending at both the central and state level to have risen further prior to the general election.
Business Indicators

- The latest business indicators remain reasonably upbeat. Although the manufacturing PMI dropped in April, it continues to point to decent manufacturing output. The reading has stayed above the 50 mark, which in theory separates contraction from expansion, for 21 consecutive months (7). The services PMI has also remained above 50 for a prolonged period (8).

- Sales growth for corporates has picked up in recent quarters (9). The OECD’s leading indicator for India, which aims to capture swings in the business cycle, remained at a seven-year high in March (10). Meanwhile, surveys from the RBI show that businesses remain fairly optimistic (11). Business prospects should remain healthy in the near term as local SMEs have been the key beneficiary of recent policy moves ahead of the election, including tax exemptions and an easing on lending restrictions.

- Structural improvements also appear to be boosting India’s business environment over the longer term, and further reforms are likely if PM Modi’s BJP secures another election victory. The World Bank’s Doing Business Survey for 2019 showed that India jumped 23 places to rank 77th out of 190 countries (12).

Sources: HSBC/Markit, CEIC, OECD, RBI, World Bank
Consumer Indicators

- The breakdown of the GDP data for Q4 2018 shows that private consumption growth slowed to 8.4% y/y, from 9.8% y/y in Q3 (13). Other indicators suggest that consumption growth has slowed further in Q1.

- Production of consumer durable goods and point of sales card transactions have dropped over recent months (14 & 15), while mobile transactions have also weakened (16). However, we expect private consumption growth to stabilise in the near term. The government has unveiled several measures aimed at boosting wage growth in rural regions in time for the election and has also released the first tranche of payments from its guaranteed income scheme announced in the interim budget.

- What’s more, employment prospects remain relatively good. The employment component of the PMI surveys have been considerably stronger over the past 12 months compared to the previous four years (17). Meanwhile, Dun & Bradstreet’s business expectations survey points to a pick-up in hiring intentions since the start of last year, and the measure is only just short of its long-run average (18).

Sources: CEIC, Refinitiv, Dun & Bradstreet
External Indicators

- India’s monthly goods trade deficit widened to $15.3bn in April from $10.9bn in March (19). Although the trade deficit is now at a five-month high, we think that it will stay in check over the coming months. Admittedly, April’s slowdown in exports (20) probably has further to run, given the softness in global demand. But we think that imports will soon fall. Although global oil prices have risen lately, we are expecting renewed downward pressures on prices as global demand slows this year. That should weigh on oil shipments (21), which account for a large share of India’s total import bill.

- The recent escalation in trade tensions, although a concern for most of Asia, should matter little for India. After all, it has very small supply-chain exposure to China, an inadvertent positive stemming from its failure to develop a world-class manufacturing sector (22).

- In all, we think that the current account deficit is unlikely to balloon beyond 2.0-2.5% of GDP over the coming quarters (23). It is also a source of comfort that the current account deficit is largely financed by FDI inflows (24), a relatively stable form of funding.
Inflation Indicators

- Wholesale price inflation edged down to 3.1% y/y in April from 3.2% y/y in March (25). This was due to a fall in fuel inflation and non-food manufactured products inflation (our proxy for core WPI inflation).

- Meanwhile, consumer price inflation remained unchanged at 2.9% (26). The increase in food and fuel inflation was offset by a fall in core inflation (27). Looking ahead, the continued rise in vegetable prices so far in May suggests that the recent pick-up in food inflation has further to run (28). And with capacity utilisation rates still high (29), we think that underlying inflation will soon rise again.

- However, given that CPI inflation remains below the RBI’s target of 4%, we think that another rate cut at the next meeting in June is likely. But as spare capacity remains tight, looser monetary policy is only likely to fuel inflation. The longer term concern is that the inflation-fighting credibility acquired by the RBI over the past few years is being eroded, which could undo some of its success in anchoring inflation expectations since 2013 (30).

Sources: Refinitiv, CEIC
Fiscal & Monetary Indicators

- The latest available data show that, after 11 months, the central government’s cumulative fiscal deficit stood at over 130% of the fiscal budget for the entirety of FY18/19 (31). The finance ministry is nevertheless likely to have met its revised deficit target of 3.4% of GDP. After all, a late surge in asset sales revenues has helped to boost the coffers in March (32).

- Meeting the FY19/20 target will, however, be more challenging. For a start, government spending has been ramped up in time for the general election. Meanwhile, the finance ministry’s track record in hitting its revenue targets are far from perfect (33). As such, the finance ministry will need to either relax its deficit targets again, or cut spending later in the year. We think that it will opt for the latter, especially given that debt levels are still elevated (34).

- The RBI has cut rates by a cumulative 50bp throughout the year so far. Given that inflation remains below the central bank’s target, we think that another rate cut at the next meeting in June is still on the cards (35). This should provide a further boost to bank lending over the coming months (36). Against the backdrop of limited economic slack however, monetary loosening is only likely to fuel inflation. That will eventually require interest rates to be raised.

Sources: CEIC, Bloomberg, Capital Economics
Financial Market Indicators

- The Sensex rallied by 4% to an all-time high yesterday after exit polls signalled victory for Prime Minister Modi’s BJP in the general election (37). Still, we think that the Sensex will soon fall as we expect a slowdown in the US to trigger a slump in the S&P 500 and investors to retreat from risky assets generally. What’s more, from a valuations perspective, Indian equities look extremely stretched compared to all other major EM equities (38).

- The rupee also rallied on the back of the exit polls, rising by 1% against the US dollar on Monday (39) even as other EM currencies weakened. And India’s limited exposure to a ramping up of trade tensions between China and the US means the rupee has outperformed other Asian currencies this month (40).

- Short-dated government bond yields have dropped over recent weeks as expectations of another rate cut in June have risen (41). But the 10-year yield has barely moved, perhaps reflecting concerns that looser policy now will fuel higher inflation and higher interest rates over the longer term. Net foreign purchases of Indian debt remain positive, albeit at a low level (42).

Sources: Bloomberg, Refinitiv, Capital Economics
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