

**India**

POLITICAL COMPETITION ADDS TO ECONOMIC RISK

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Recent opinion polls support our view that Indian politics is entering a more competitive phase. Below we examine the implications for national policymaking during the remainder of Prime Minister Narendra Modi's term in office.

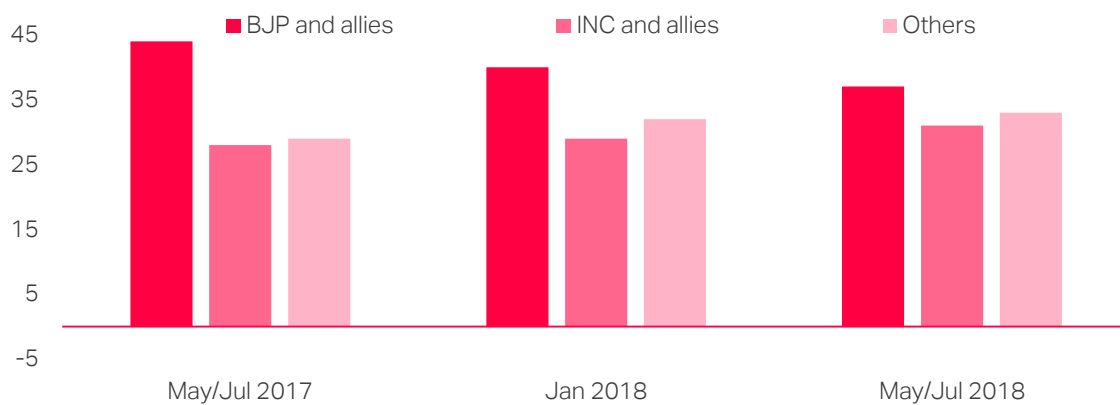
- Two national opinion polls held in May and July 2018, respectively, show a narrowing of the vote gap between the Bharatiya Janata Party (BJP)-led coalition and the Indian National Congress (INC)-led alliance; voters' economic concerns are eating into Modi's lead.
- Both surveys show that an expanded opposition alliance that includes more regional parties could produce a hung parliament, which would be negative for market sentiment because of the subsequent uncertainty.
- Political competition is contributing to increased populism in an increasingly inflationary environment, making a hard landing for the economy after the elections more likely.
- The BJP has an advantage in resources, messaging and organization, which in our central case should push it over the finish line in a close election; but economic factors are increasingly weighing against it.

Political gap narrows

Fresh opinion polls this month have reinforced our view that Indian politics is entering a more competitive phase. There is now an increased likelihood that Prime Minister Modi will have to build a broader coalition more dependent on regional parties if he is to return to office in 2019.

In our 15 June 2018 note [Weaker coalition on the horizon](#), we described how, based on the results of a May 2018 opinion poll, the vote gap between the BJP-led National Democratic Alliance (NDA) and the INC-led United Progressive Alliance (UPA) had narrowed considerably, from a projected 18pp in May 2017 to 6pp in May 2018. The gap in the 2014 general election had been 15pp. Another more recent poll, conducted last month, has found a similar narrowing of the vote gap, from 14pp in July 2017 to 5pp in July 2018 (see Chart 1 below).

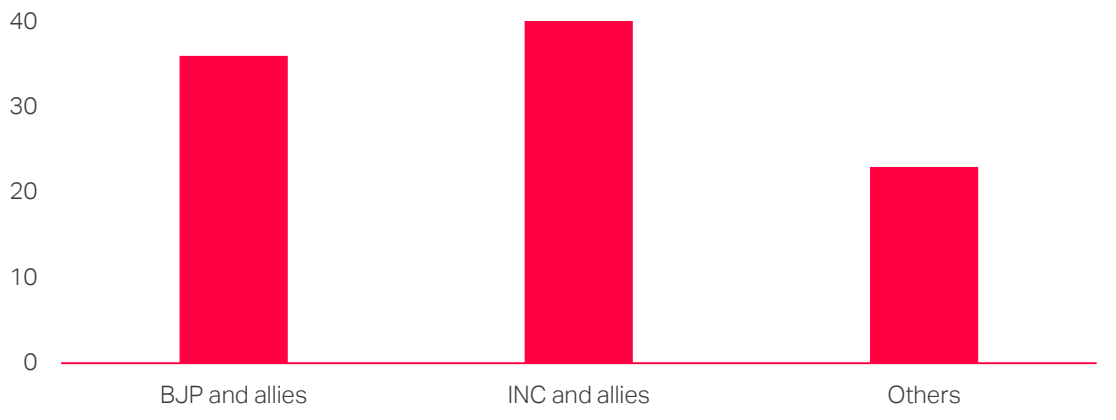
Chart 1: Voting intentions - average of two national polls (%)



Sources: India Today-Karvy Insights poll, July 2018; Lokniti-CSDS-ABP News poll, May 2018.

Seat projections this far ahead of the elections, which are scheduled to take place in April-May 2019, can, of course, be misleading. Both polls project the NDA crossing the halfway mark of 272 in the Lok Sabha (the lower house of the parliament) even as the BJP loses its majority.

The risk for the BJP is that if the INC managed to stitch together a wider UPA alliance, it would overtake the NDA in vote share. If the UPA included three large regional parties – the Samajwadi Party (SP) and the Bahujan Samaj Party (BSP) from India’s largest state Uttar Pradesh and the West Bengal-based Trinamool Congress Party – in a seat-sharing agreement, the India Today poll projects the UPA vote would rise to 41% vs 36% for the NDA (see Chart 2 below). This scenario would produce a hung parliament.

Chart 2: Voting intentions if UPA allies with more parties (%)


Source: India Today-Karvy Insights Mood of the Nation poll, August 2018.

There is more bad news for the BJP. An August 2018 ABP News-Cvoter opinion poll found that the INC is likely to defeat the BJP in the three large states of Chhattisgarh, Madhya Pradesh and Rajasthan, where state elections are to be held in November-December 2018. The BJP currently rules in all three states, which are part of the BJP’s traditional stronghold of northern India.

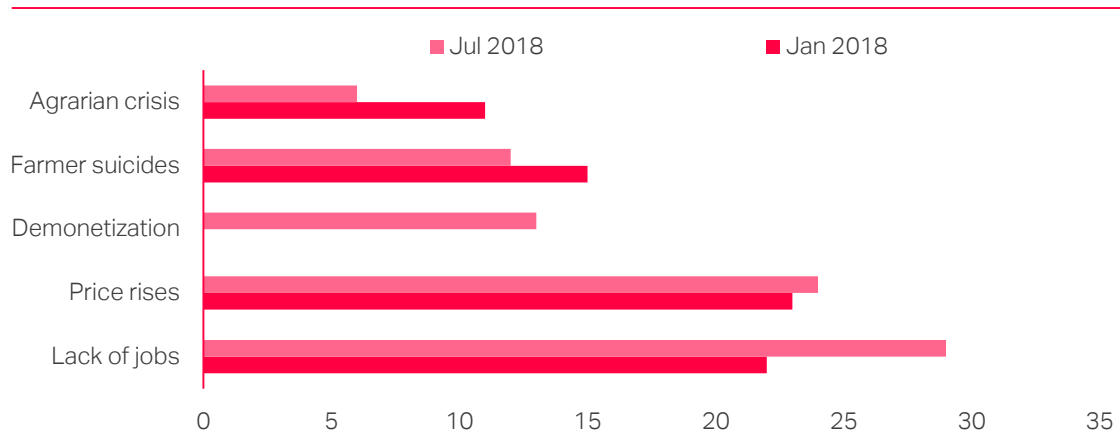
A strong INC performance in these state elections could help build momentum for the party in the run-up to the general election, which is due to take place four months later. But there is a silver lining for the ruling party: the BJP polled more than the INC in all three states when respondents were asked who they would vote for in the forthcoming general election.

Again, caution is advisable in reading anything into opinion polls at this stage. However, the weight of evidence supports our call that politics in India has entered a more competitive stage, albeit one in which Modi retains a meaningful edge.

It’s the economy, stupid

The causes for the slide in support for the BJP are straightforward. In the *India Today* poll, respondents identified joblessness, “price rises” (a proxy for both inflation and low incomes) and demonetization as the main failures of the Modi government (see Chart 3 below).

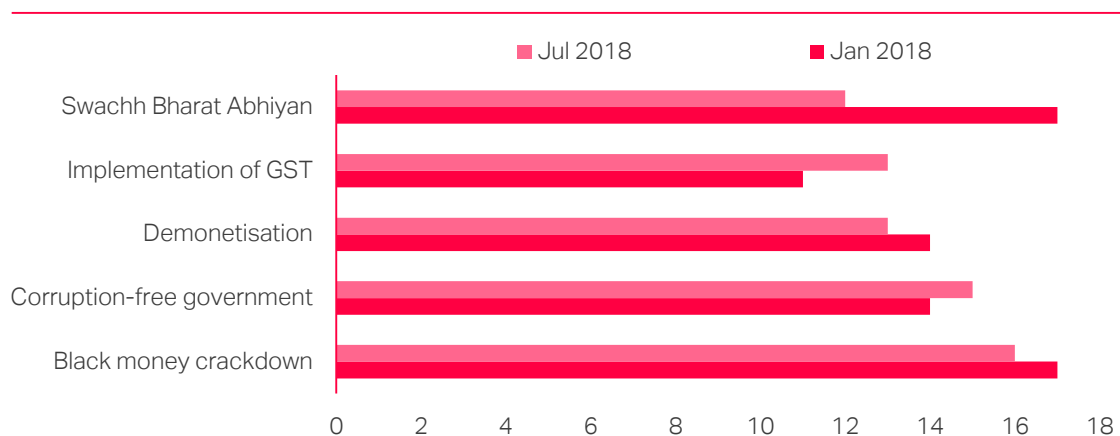
Chart 3: Voter response: Biggest failure of Modi govt. (%)



Source: India Today-Karvy Insights Mood of the Nation polls, January 2018 and July 2018.

But Modi also received support from those who believe that he has made a sincere effort to combat corruption (see Chart 4 below). To be sure, the continuing debate over the EUR7.9 billion purchase of 36 French Rafale warplanes for the Indian Air Force is pinching Modi. The INC accuses Modi of bypassing Cabinet procedures and overpaying for the jets while favouring businessman Anil Ambani by channelling associated defence offsets to him rather than to state-owned enterprises. While the government and Ambani deny these charges, the former has bungled by refusing to state the actual cost of the deal in the parliament, sparking protracted discussions in the media and giving the opposition talking points. The risk here is that government evasiveness hurts Modi, who has long projected an image of personal incorruptibility.

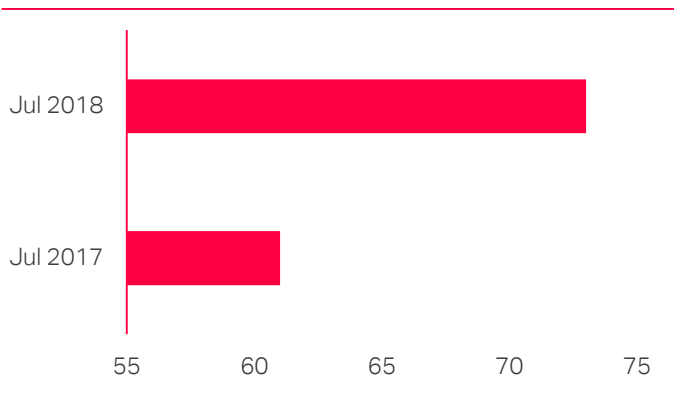
Chart 4: Voter response: Modi's biggest achievement (%)



Source: India Today-Karvy Insights Mood of the Nation polls, January 2018 and July 2018.

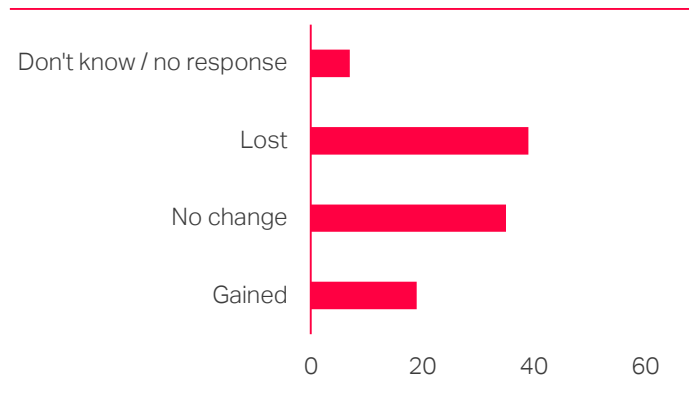
Modi is also given credit for GST and demonetization, but the government cannot be complacent about the political consequences of those two moves (see Charts 5-6 below).

Chart 5: Demonetization was "more pain than gain" (%)



Source: India Today-Karvy Insights poll, August 2018

Chart 6: Gained or lost from GST? (%)



Source: India Today-Karvy Insights poll, August 2018

Indeed, Modi failed to mention demonetization at all in his 15 August 2018 Independence Day speech. Rather, he focused on his ambitious health insurance scheme ("Modicare"), toilets built under the Swachh Bharat Abhiyan (sanitation programme), the GST, rural electrification and the Mudra small loans scheme for entrepreneurs, among other policies.

Modi also talked about how he had restored the country's global prestige compared with the time when India was considered part of the "Fragile Five". The last claim was poorly timed – at least in political terms – as the rupee had slid past the psychologically key mark of 70 to the dollar just two days earlier. In 2013, Modi had criticised the UPA for letting the rupee fall to 68 and the BJP has long had a vocal strong rupee bias. For its part, the opposition is paying Modi back in the same coin, replaying clips of his speeches from that time on social media.

However, the fall in the rupee has political consequences beyond social media battles – namely, in the form of higher inflation. Consumers are already sensitive to high (and climbing) fuel prices at the pump, and imported consumer goods will likely become costlier as the Diwali festive season approaches. Unfortunately for the government, voters are unlikely to observe the benefits of improved export competitiveness in the short term. The weak rupee adds incrementally to negative political sentiment.

Conclusion: Political battles intensify

Growing voter dissatisfaction is shaping the final eight months of the Modi government. It is giving government policy a further nudge in the direction of populism in what is an increasingly inflationary environment. Our view is that this spending splurge will inevitably end in a hard landing following the April-May 2019 general election (see our 16 August 2018 note [Return to inflationary normal](#) and our 21 June 2018 note [Welfare tilt hits fiscal credibility](#)).

Modi's calculation is that voters will remain impressed by his policy initiatives and will be wary enough of a fractious opposition to reward him with a second term. The BJP's advantage in resources, messaging and organization could tilt things in its favour in a close election. Furthermore, Hindu nationalist sentiment could be stirred up in the run-up to the election by issues including identification and disenfranchisement of (mostly Muslim) illegal immigrants in the northeastern state of Assam and the possibility of a court ruling – whether positive or negative – in the Ayodhya case (related to the 1992 demolition of the Babri mosque, which many believe stood on the spot on which the Hindu deity Lord Ram was born).

As was the case in the December 2017 Gujarat election, economic stress is vying with identity factors (see our 20 December 2017 note [Close shave in Gujarat puts spotlight on 2018 elections](#)). The problem for Modi is that economic disenchantment appears to be overwhelming those identity factors, at least judging from the opinion polls. Our base case is still that Modi returns to power with a diminished majority. However, the risk of a hung parliament is growing, and this would be a negative outcome for markets.

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