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Modi 3.0: India's surprise election result

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The gruelling six-week process to elect the 543 members of India's lower house (Lok Sabha) finally came to its conclusion on 1 June, with 642 million voters (nearly 10% of the global population, and half of them women) having voted in the largest election in history, at times braving searing temperatures of over 50 degrees centigrade to cast their ballots. The end result will see incumbent prime minister Narendra Modi take his oath of office this weekend, returning for an historic third consecutive term, equalling the three-term record of Jawaharlal Nehru, India's first prime minister. This much was largely expected, with pre-election opinion polls suggesting Modi's BJP party was on course for a simple majority of seats, even increasing its count from the 2019 election.

However, the margin of victory for the BJP's electoral alliance (the NDA, or National Democratic Alliance) was significantly lower than had been expected, with hopes of up to 300 seats for the BJP alone and 400 for the NDA proving over ambitious – the BJP missed out on a simple majority, securing 240 seats, with allied parties taking a further 53 seats to form an NDA coalition total of 293 (comfortably above the 272 required to form a majority). An added element of drama involved exit polls over the weekend indicating a high probability of a 'Modi Landslide' with the NDA securing up to and beyond 400 seats, only to be proved significantly overstated when official results came out just days later. Consequently, a significant market rally following the exit polls gave way to a sharp sell-off after the full results were released, before rallying again to above of pre-election levels. Given that the final outcome was some distance from what had been expected by markets, there are number of issues the market is now digesting (hence the significant volatility seen in the last few trading days).

The pathway to electoral success in India inevitably runs through Uttar Pradesh (UP), India's most populous state (accounting for 3% of global population by itself), which carries the greatest number of seats for the Lok Sabha. In UP, the BJP's 62 seats in 2019 turned into 30 in 2024, making it the single most important reason the BJP lost their majority. Indeed, the BJP's national vote share was largely unchanged compared with the previous election, revealing the importance of losing key states such as UP. Areas where the BJP fared less well this time around are united by being more rural, less-affluent areas, which have not participated in the economic boom of recent years. In the post-Covid era, India is a clear outlier in having pursued aggressive supply-side policies as opposed to stimulating demand. This laser focus on physical and digital investment has driven strong economic growth and been critical in building solid foundations for future growth. However, the missing link of this economy has been a stagnation in lower and middle-incomes, with few sops for rural India, leading to a so-called 'K-shaped recovery', with the higher end of consumers prospering while lower-end consumers haven't enjoyed a significant uplift in incomes.

With Modi and the BJP retaining power – albeit through an alliance – we expect to see the core investment-led policies of the past five years continue, with a focus on roads, railways and power infrastructure. However, this may well now be softened to a degree in order to also respond to the rural constituency in order to win back support from the rural heartlands. Possible rural-focused policies would include strengthening the rural employment guarantee scheme (MGNREGA) and minimum support prices (MSP) for farmers.

Thanks to the tight focus on fiscal prudence in the past decade, and systematic strengthening of India's macroeconomic profile, finding the extra funds for these policies should not be overly challenging. Indeed, the Reserve Bank of India recently announced its annual dividend to the government would be $25 billion, more than double last year's payment, at a time when some developed market central banks have reported losses and negative equity. This fiscal bonus has given the government room to manoeuvre. Moreover, S&P raised the outlook on India's sovereign debt rating to 'positive' from 'stable' just before the elections in recognition of robust economic expansion and its positive impact on credit metrics, expecting broad continuity in economic reform and policies regardless of the election outcome.

Concerning the stock market – the heavy investment-focus of policy in recent years has driven relatively narrow market leadership, driven by industrial companies linked to the capital-investment cycle, while rural consumption themes have notably underperformed. A rebalancing of growth priorities as a result of coalition politics and more inclusive of rural India offers an opportunity for the stock market rally to broaden out, making it more sustainable in the medium-to-long term. Therefore, we can expect an improvement in sectors of the market such as consumer staples, that have significantly underperformed in recent years and may now see an improvement in earnings outlook.

An important question for India watchers is how the country will fare under coalition politics after a rare decade of single-party government. Modi – whether as chief minister of Gujarat, or prime minister – has always been in sole charge, and now will need to adapt to the compromise required as part of a coalition. However, when looking historically, India's economic growth rate has been remarkably consistent across single-party governments (of either side) and coalitions, showing the degree to which the structural growth expected of India's economy – due to become the world's third largest by 2027 – is unlikely to be impacted by the election result per se. In addition, the significant reforms put in place during the previous decade have already provided the key foundations for the next leg of growth. The BJP remains by far the largest party within the Lok Sabha and, while short of an absolute majority, remains strong enough that outright populism is unlikely. Indeed, the compromises required by coalition government could well broaden both the economic recovery and stock market leadership in positive ways.

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https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms

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