

A hung parliament poses little challenge to India.

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Executive Summary

The general election is almost upon us. Could the BJP-led National Democratic Alliance (NDA) pull together the 272 seats it needs to win a second term? If NDA falls short of a majority, can the opposition manage to get a workable majority? Opinion polls and surveys such as India-Today's Mood of the Nation survey (Jan'19) indicate a hung parliament, with neither NDA nor United Progressive Alliance (UPA) gaining a majority.

The possibility of a hung parliament seem to terrify the stock market, and the general opinions tend to favour a majority government as against coalitions. However, a coalition government or even a minority-led one is not necessarily a doomed scenario for India. For example, India witnessed the biggest economic reforms from 1991 when a minority government was in power. We take a closer look into a few different scenarios that could emerge as an outcome of the elections.

BJP no longer looks unbeatable in the 2019 elections

The BJP no longer seems unbeatable as we head for the national elections to be held by May 2019. The BJP gained all the political momentum in 2014 where they won the first single-party majority in over 30 years. Soon after, the party focused on an ambitious agenda with the aims to raise the growth rate, lower inflation level and attract foreign investors. By gaining power in various states, at one point the BJP controlled governments in 21 of India's 29 states.

However, the euphoric mood for Mr Modi's government started to change when his government suddenly withdrew most bank notes in circulation in late 2016 and then implemented the GST in 2017. More recently, the defeat in five state assembly elections in December 2018 dealt significant blow to Mr Modi's credibility as a "winner". The alliance between the regional parties (Samajwadi Party (SP) and Bahujan Samajwadi Party (BSP)) in Uttar Pradesh announced in January 2019 further raises the sense of vulnerability for Mr Modi's government.

Policy impact from alternative election results

	Scenario 1 (Hung house)	Scenario 2 (UPA wins)	Scenario 3 (NDA wins)
INR	Negative	Negative	Positive
Growth rate	Neutral	Neutral	Positive
Fiscal policy	Profligate	Profligate	Prudent
Inflation	Inflationary	Inflationary	Neutral
Economic reforms	Populistic	Pro-rural	Pro-growth
Bond market	Negative	Negative	Positive

Note: Above table has been further explained in the report below.

Opinion polls and surveys as pointed out in the table below show that National Democratic Alliance (NDA) led by Mr Modi can fall short of 272 seats required to maintain a majority in the parliament. The most likely outcome after election seems to be a hung house that could, in turn, create a weak coalition government. Depending on the outcome of the elections in 2019, we see several different political scenarios.

Recent opinion polls depict a hung house is the most likely outcome

Date of publication	Opinion poll agencies	Projected Seat share			Outcome
		NDA	UPA	Others	
31st Jan, 2019	Times Now-VMR	252	147	144	NDA coalition without majority
20th Jan, 2019	Deccan Herald	160-175	180-200	160-180	Third front coalition with outside support
24th Jan, 2019	India-Today-Karvy	237	166	140	UPA coalition with others support
24th Dec,2018	ABP News-Cvoter	233	167	143	Weak NDA coalition
9th Dec, 2018	India TV CNX	281	124	138	NDA coalition with a majority

Scenario 1: BJP secures less than 200 and Congress supports the United Front from Outside.

In the first scenario, the BJP may shrink by losing over 100-120 seats from its current tally (268 seats) and Congress may improve to over 140-150 seats, but may not gain enough to claim leadership. The other regional parties from Uttar Pradesh (SP, BSP, RLD and others), West Bengal (All India Trinamool Congress (TMC)) and Andhra Pradesh (Telegu Desam Party (TDP)) together secure 100-140 seats. Thus, no party emerges with a clear majority. The regional parties could lead a coalition with the outside support from Congress, for which at least 15 to 20 parties will need to come together. A scenario of this kind will be a replay of the United Front coalition years between 1996-1998. The alliance between SP-BSP parties (with a strong vote share for Ms Mayawati) could give them 50-55 seats from the state of Uttar Pradesh. The party from West Bengal (TMC) can also join hands with the SP-BSP together increasing the number of seats to 80-100 seats. The united opposition or the third front will have to set aside their differences to challenge the political might of the BJP. They have gained momentum over the last five years and can set the opposition agenda.

Scenario 2: BJP secures less than 200 and Congress supports the United Front from Outside.

Here, NDA will again secure less than 200 seats which will mean UPA getting close to 230-240 seats. The Congress with a multitude of smaller parties forms the coalition government. This will be similar to the 2004 elections, where Congress had secured 145 seats and formed the UPA coalition government with the support of other parties such as Janta Dal (S), Nationalist Congress Party (NCP) and others. More importantly, the post-election alliances that Congress party can pull together with DMK from Tamil Nadu or with TMC from West

Bengal will play a huge role for Congress to improve its performance. Dravida Munnetra Kazhagam (DMK) and All India Trinamool Congress (TMC) which will each have about 30-35 seats will thus form an aggregate of 60-70 seats.

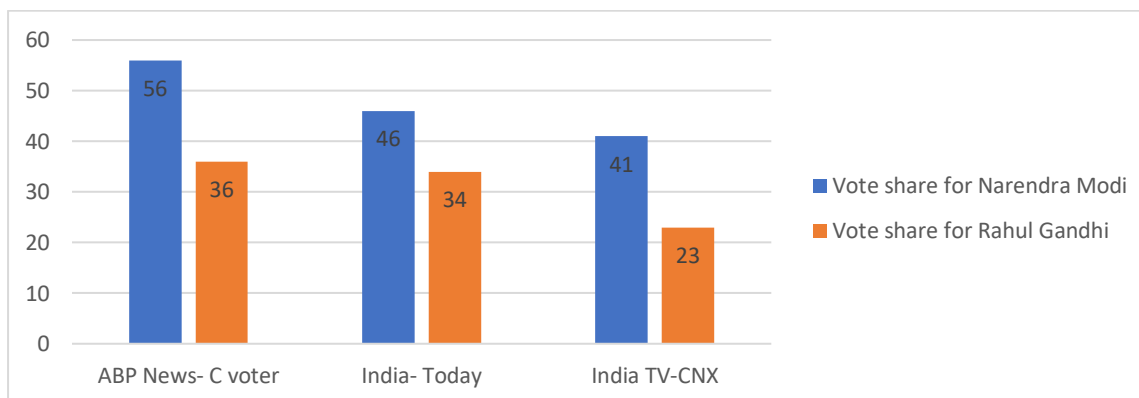
The SP-BSP alliance which could take away 50-55 seats from the state of Uttar Pradesh, if Congress forms an alliance with them, UPA coalition government can be created. BJP will then find it very difficult to get the necessary numbers.

The number of votes can improve for the Congress mainly because of the rise in rural distress among farmers and rising debt levels. These factors could alter the vote share by 3-4% in favour to leaders from Congress. The Indian National Congress (INC) party’s promise to implement the minimum basic income guarantee to the poor along with adding Ms Priyanka Gandhi as General Secretary in charge of Uttar Pradesh, will certainly provide an effective counter.

Scenario 3: BJP emerges as the majority party and leads the NDA majority government for the second term.

A scenario where the BJP led NDA government comes back to power for the second term was certain until late 2017 when BJP outperformed in the state assembly elections. The BJP can emerge as the largest party (250-260 seats) and will reach out to their existing NDA allies form a broader coalition. This would mean certain compromises on its ideological agenda and power distribution. If this scenario prevails, it could lead to a replay of the 1998 or 1999-2004 Vajpayee led BJP government depending on the numbers BJP acquires. Given the fact that the present government has given out an interim budget that has emerged as pro-rural, housing and middle class-centric one (Rs. 6000 per annum for small farmers and a tax rebate for middle-income earners), voters could re-elect the party. Assuming that more than half of India’s voters are satisfied with the overall performance of BJP-led NDA government, a chance for serving for a second term is likely.

Voters still prefer Mr Modi to Mr Rahul Gandhi



Source: Taken from the respective news reports of each polling agency. The values are in percentage.

The vote share of Mr. Narendra Modi compared to Mr. Rahul Gandhi, two of important contenders for the post of Prime Minister of India still seem to favour Mr. Modi. However, the past policy mistakes and a lackluster job market could hurt Mr Modi in retaining power.

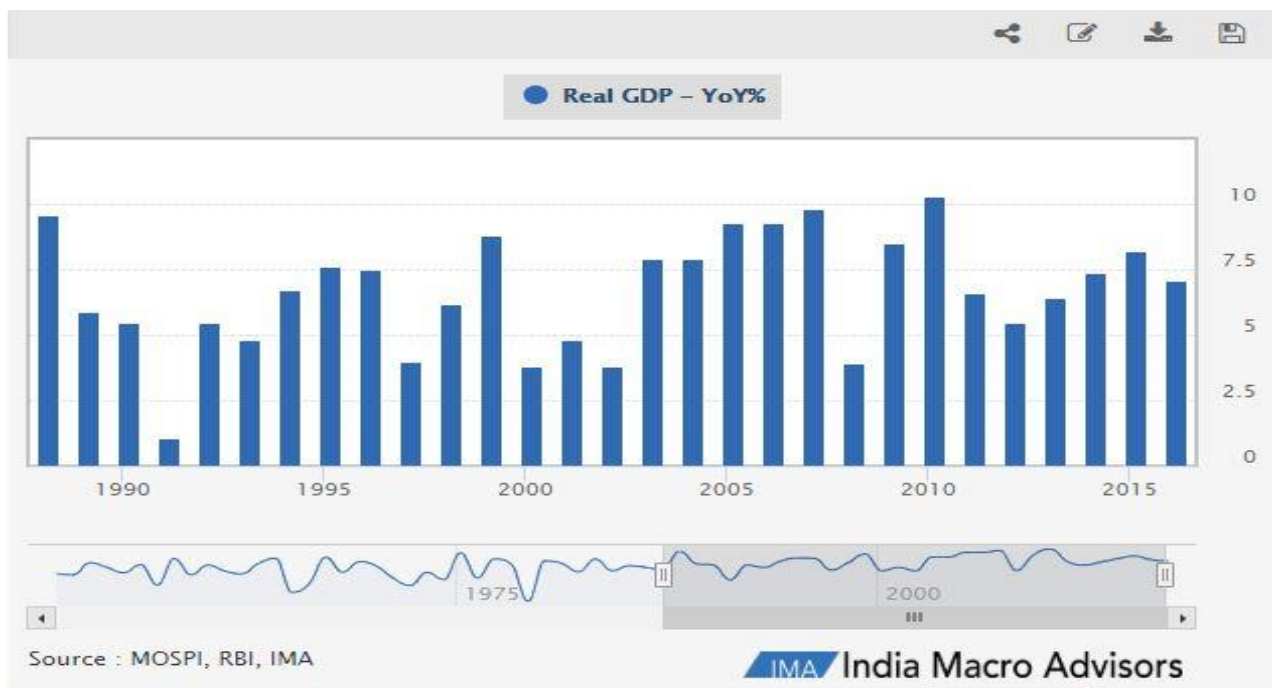
The benefit of a majority government is over-rated.

The sense of the desirability of a majority-led government was formed in the run-up to the 2014 election. By the end of the ten-year UPA rule between 2004 and 2014, people came to long for a strong and decisive leadership, with the perception that too many vested interests inside the Cabinet was leading to political and economic uncertainty. As elections in 2014 grew nearer, a majority government was favored as better policies for the economy would emerge.

In our view though, coalition governments-led by national parties, in fact, has hardly hindered India’s high-

growth trajectory since the 1980s. The Congress and BJP led coalitions ever since 1991 have been stable and have lasted their full terms. Except for the years from 1996 until 1998, where though the GDP was consistently above 5%, it paled in comparison to the economic buoyancy of other countries. However, with the presentation of the ‘Dream Budget’ in 1997, and a slew of economic reforms including cut in corporate taxes, increasing the limit of Foreign institutional investments, the decline in import duties brought back the confidence that reforms are continuous and irrevocable.

Growth rate does not hold a close association with a majority government.



Moreover, the five years of the UPA I coalition (2004-2009) produced an average GDP growth of 8.5% YoY, the highest in any five full term of an Indian government. In this period, the Congress (145 seats in the lower house) managed to introduce some of the best legislation including the National Rural Employment Guarantee Act in 2005.

Looking at the present majority BJP led-NDA government, compared to the last 15 years, we see that it has been growing at a moderate pace of average growth at 7.3% YoY till FY17. In terms of stability-oriented macroeconomic and structural reforms such as the inflation-targeting monetary framework, Insolvency and bankruptcy code, the rollout of GST and steps to liberalize FDI inflows have been initiated. Thus, given this history, it is hard to say why markets think coalitions led by national parties are not good for the economy. Of course, factors such as preconceived notions also play a huge role in leading to this way of thinking.

Going forward what’s in place for the economy

If the BJP does not get the majority in the 2019 elections as implied by the latest polls, we can expect a heavy volatility on financial markets. The expected market turmoil can also have a negative repercussion for the rupee until things settle down in the parliament. Fiscal profligacy of the government expenses is bound to occur if Third Front (coalition of regional parties) forms the government. In the initial years, there may not be path-breaking reforms that may take on as the aspirations (of each regional party) could be given higher priorities leading to inefficient fiscal spending. Revenue demands between states and the Centre may shift. There is likely to be attempts to prop up growth through fiscal stimulus. They have already announced a direct cash transfer to farmers and a tax cut for the middle-class.

If there is a return of the BJP-led NDA government, India's corporate bond market should perform better and current account deficit can remain under control with a better pace of inflow of foreign portfolio investments to India. In terms of GDP growth, moderate growth in second half of FY19 can be expected.

In either of the scenarios, there are risks to growth. The trade war between China and US, though both countries have started negotiations on the right footing, going forward in 2019 there may not be a structural deal in the making.

Probable impact on the economy for three election outcome scenarios

	Scenario 1 (Hung house)	Scenario 2 (Congress-led UPA)	Scenario 3 (BJP-NDA)
Impact on the rupee	Rupee likely to depreciate	Rupee likely to depreciate	Rupee likely to appreciate
Impact on growth rate	Neutral growth	Neutral growth	Moderate growth
Impact on fiscal deficit	Fiscal Profligacy	Fiscal Profligacy	Fiscal Prudence
Impact on inflation	Inflation likely to rise	Inflation likely to rise	Inflation
Impact on economic reforms	Focus on populist reforms	Focus on pro-rural reforms	Focus on pro-growth reforms
Impact on bond market	10-yr govt security yields will fall with increase in bond prices	10-yr govt security yields may fall with increase in bond prices	10 yr govt security yields may rise with decline in bond prices

Conclusion

What is clear is that in 2019 we may be heading for a hung parliament or one in which the ruling party doesn't get the majority. Based on the opinion polls, market analysts may start to take it badly for the economy and for political stability. However, our history tells us that it isn't a problem, we have seen consistent growth and a slew of measures initiated under coalitions led by national parties and regional party alliances. We believe, some parts of the thinking in favour of a majority government is also based on preconceived notions. There is no doubt that replicating the BJP's single-party majority in the lower house will be tough. Whichever scenario takes over at the Centre, markets should understand that the challenges the new government may face such as financial volatility and uncertainties on the global front will only be temporary.