

# Economy

## Macro

June 10, 2024

### Coalition journey: Long travails ahead

Fears of the current coalition government being unstable are too premature. The more probable outcome would be slower decision making with slower passage of legislative agendas given a larger opposition and major executive decisions requiring a more consultative approach. All solutions to electoral losses need not be translated into populism and away from a macro framework built over the last decade. We expect the government to remain fiscally prudent and populism to be used opportunistically.

#### Compromises will increase in coalition

The weaker strength of BJP in NDA 3.0 (see Exhibits 1-2) increases the risks of compromises in the Indian government with interests of coalition partners needing relatively higher priority. We are already witnessing the cabinet size increased substantially (see Exhibit 2) although key ministries remain with the BJP. At the same time, demands from Andhra Pradesh and Bihar for higher budgetary allocation (comparable with special status) may result in at least Rs500 bn of additional allocation (see Exhibit 3). Furthermore, the executive agenda may become more consultative.

#### Not all solutions may require populism

While BJP's lower seat count will be linked to need for more populism, we believe that not all solutions need to be fiscal-led. Beyond the political tweaks, over the next two years, assembly elections in Haryana, Jharkhand, Maharashtra (all in Oct-Dec 2024) and Bihar (Nov 2025) could imply populism on the state governments' agenda rather than the center's (see Exhibit 4). The center will likely continue to focus on (1) fiscal consolidation, (2) steady infrastructure spending, (3) basic spends such as on education, health, shelter, and security, and (4) efficient delivery of rural-based programs. Loans for capex to states could be increased with a lower share being conditional.

#### Increase in opposition strength may curtail legislative agenda

The sharp increase in opposition's strength in Lok Sabha will make it hard for a quick passage for passing important bills, unlike the case in 16<sup>th</sup> and 17<sup>th</sup> Lok Sabha (see Exhibits 5-6). Nonetheless, we believe that most of the major investment-related reforms are already near completion (see Exhibit 7). The opposition may further sharpen their populist demands, risking to shift the focus away from long-term-oriented growth policies.

#### Gains in Rajya Sabha may be short-lived if electoral trends continue

The strong performance of BJP in Odisha and that of its NDA ally (TDP) in Andhra Pradesh may result in some increase in its strength in Rajya Sabha (see Exhibit 8). However, the recent weak performance in a number of states in Lok Sabha (see Exhibit 9) increases the risk of it losing a few states in the next two years—if current trends continue. As a result, we do not expect BJP to gain a significantly large majority in Rajya Sabha in the next two years. Exhibit 10 shows the upcoming assembly elections. Risks of a more populist Union Budgets would increase if the upcoming state elections' results turn adverse for the BJP.

#### Summary of key macro metrics for India

	2023	2024E	2025E	2026E
<b>Real economy</b>				
Real GDP growth (%)	7.0	8.2	6.9	6.7
Nominal GDP growth (%)	14.2	9.6	11.3	11.2
CPI Inflation (avg., %)	6.7	5.4	4.4	4.2
<b>Public finance</b>				
Center's GFD/GDP (%)	6.4	5.6	5.0	4.5
<b>Monetary policy</b>				
Repo Rate (% eop)	6.50	6.50	6.00	5.50
SDF Rate (% eop)	6.25	6.25	5.75	5.25
CRR (% eop)	4.5	4.5	4.5	4.5
<b>External sector</b>				
Current Account Balance (% of GDP)	(2.0)	(0.8)	(1.1)	(1.1)
Brent crude oil price (avg., USD/bbl)	95.4	83.0	85.0	80.0
USD/INR (avg.)	80.3	82.8	83.1	84.0

Source: CEIC, Kotak Institutional Equities estimates

#### Quick Numbers

BJP won 240 seats in 2024 versus 303 seats in 2019

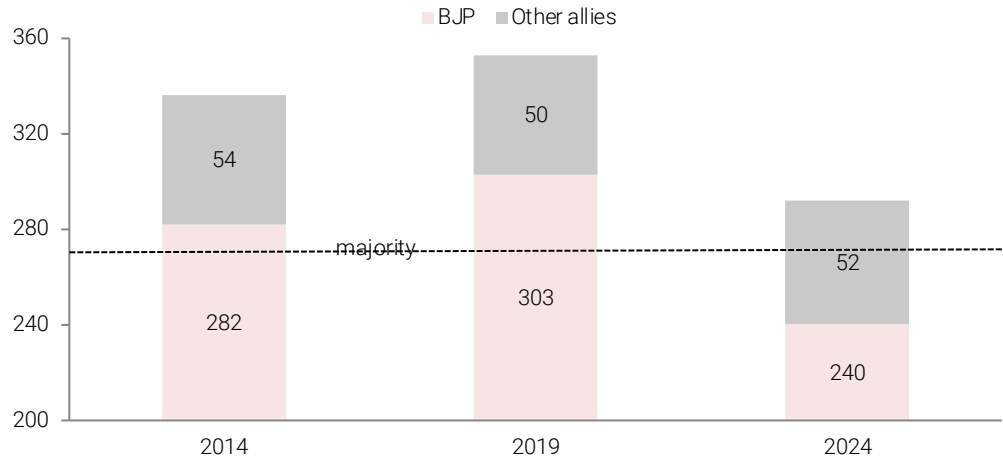
NDA may have 119 seats out of 241 (non-vacant) seats in Rajya Sabha at the end of this Rajya Sabha election cycle

Possibly around Rs500 bn of additional allocation required to put Andhra Pradesh and Bihar at par with other special status states

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**Weaker position of BJP in NDA 3.0**

**Exhibit 1: Performance of BJP and its other NDA allies in 2014, 2019 and 2024 Lok Sabha elections (#)**



Source: Election Commission, Kotak Institutional Equities

**Most governments in the past were formed with the dominant party not having a simple majority of its own**

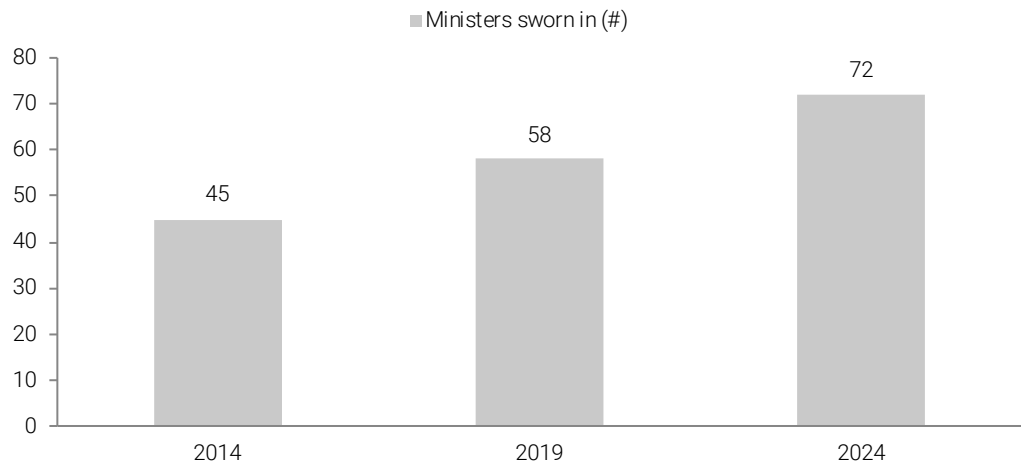
**Exhibit 2: Composition of past coalition governments in India, March fiscal year-ends, 1991-2024**

Election year	Winner	Seats	Key allies	Comments
1991	INC	232	Janata Dal (59)	
1996	United Front (Janata Dal)	46	INC (140)	INC gave outside support; BJP government failed trust vote
1998	BJP	182	AIADMK (18), Samata (12), BJD (9), Shiv Sena (6)	TDP (12) gave outside support; AIADMK withdrew support later
1999	BJP	182	TDP (29), JDU (21), Shiv Sena (15), BJD (10), DMK (12), AITC (8)	
2004	INC	145	RJD (24), NCP (9), DMK (16), TRS (5)	CPI(M) gave external support
2009	INC	206	AITC (19), DMK (18), NCP (9), RJD (4)	SP, BSP gave external support
2014	BJP	282	Shiv Sena (18), TDP (16), LJP (6), SAD (4)	
2019	BJP	303	Shiv Sena (18), LJP (6), SAD (2)	
2024	BJP	240	TDP (16), JDU (12), Shiv Sena (7), LJP (5)	

Source: Election Commission, Media articles, Kotak Institutional Equities

**Sharp increase in the size of ministry in NDA 3.0**

**Exhibit 3: Number of ministers in BJP government, during swearing in ceremony, in 2014-24 (includes Ministers of States) (#)**



Source: PRSIndia, Media articles, Kotak Institutional Equities

**Additional spending of around Rs500-600 bn is possible in order to mimic special status**

**Exhibit 4: Stylized illustration of allocation to Andhra Pradesh and Bihar, March fiscal year-ends (Rs bn)**

	2018	2019	2020	2021	2022	2025E	2025E (revised)	Extra expenditure
Total tax devolution	6,730	7,615	6,507	5,950	8,829	12,198	12,488	290
- Andhra Pradesh	290	328	282	245	354	489	625	137
- Bihar	651	736	634	599	914	1,262	1,417	155
Total CSS transfers	2,698	2,774	2,942	3,514	3,464	4,795	5,019	224
- Andhra Pradesh	122	108	111	130	105	146	219	73
- Bihar	150	184	181	223	218	302	453	151
<b>Total (AP+Bihar)</b>	<b>1,212</b>	<b>1,356</b>	<b>1,208</b>	<b>1,197</b>	<b>1,591</b>	<b>2,199</b>	<b>2,714</b>	<b>515</b>

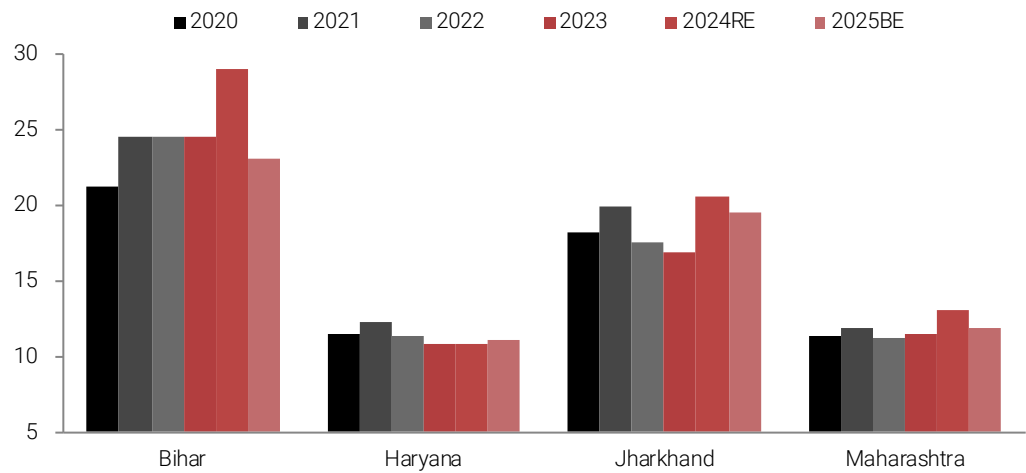
Notes:

- (a) Historical data is based on answers in Parliament. Shares for 2025 are assumed to be same as 2022.
- (b) We assume 1 ppt increase in share in devolution for AP and Bihar each in revised scenario.
- (c) Center's share in CSS is assumed to increase to 90% from 60% in revised scenario.
- (d) Revised scenario for 2025E is our assumption and not necessarily the only way to increase allocation.

Source: Parliament of India, Kotak Institutional Equities estimates

**Revenue expenditure shares have been stagnant over the years**

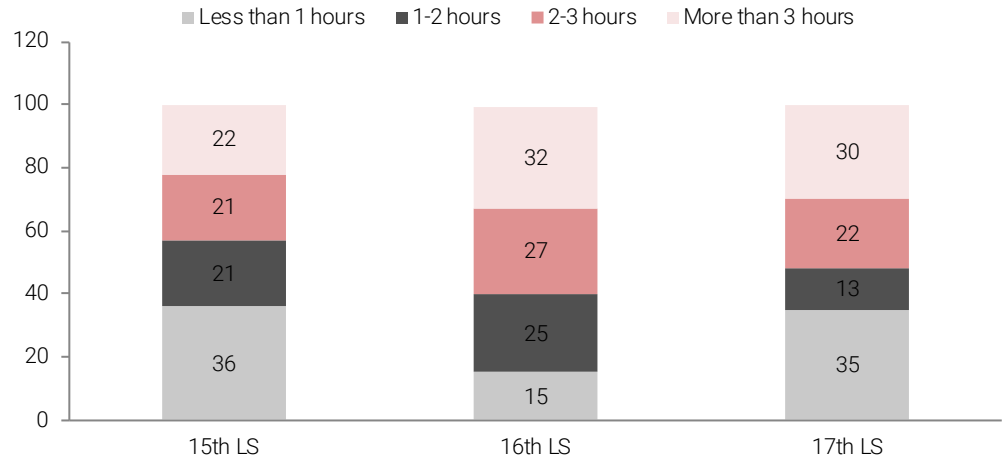
**Exhibit 5: State revenue expenditures as share of respective GSDP, March fiscal year-ends (%)**



Source: State budgets, RBI, Kotak Institutional Equities

**Almost 70% of the bills used to be passed within the same day in 17th Lok Sabha**

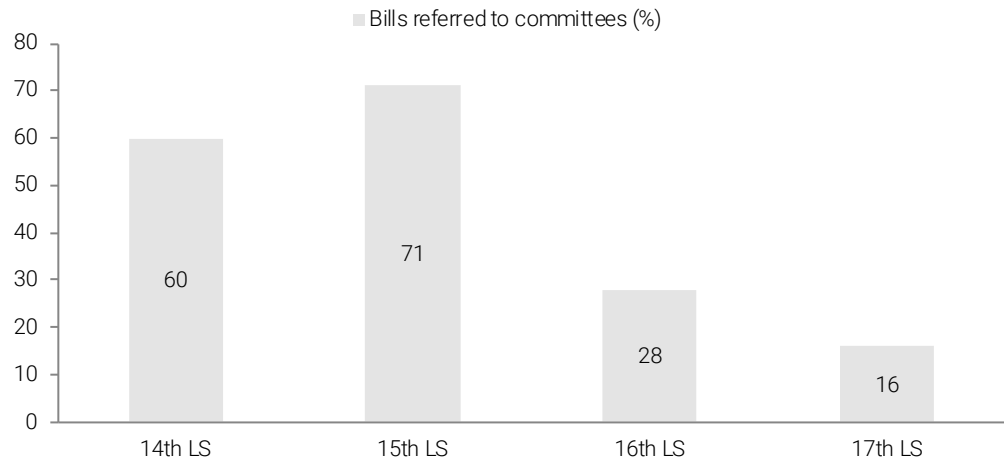
**Exhibit 6: Time taken to pass bills in 15th-17th Lok Sabha (%)**



Source: PRSIndia, Kotak Institutional Equities

**17th Lok Sabha had seen sharp decline in bills referred to committees**

**Exhibit 7: Percentage of bills, referred to committees, in 14th-17th Lok Sabha (%)**



Source: PRSIndia, Kotak Institutional Equities

## Several reforms have achieved critical mass but others are still work-in-progress

### Exhibit 8: Potential reforms and schedule

	Action	Schedule	Remarks
<b>(A) Fiscal</b>			
1	Auto fuel subsidies; LPG subsidy curtailment; kerosene and LPG monthly price increases	Work-in-progress	Government has reinstated price controls on retail prices of diesel and gasoline. Subsidies on LPG and kerosene have continued
2	Direct benefit transfer (DBT) schemes	Meaningful progress	The government implemented direct cash transfer subsidy for LPG from January 1, 2015 and for kerosene from April 1, 2016. Food and fertilizer subsidies go directly to FCI and companies
3	Divestment program, privatization and improved management of PSUs	Work-in-progress	The government consolidated 27 PSU banks into 12 PSU banks over FY2017-19 to improve their market position. It also reduced its stake in several CPSEs by selling to ETFs as well as through mergers (such as HPCL being acquired by ONGC). It has announced privatization of BPCL, Concor and SCI but not privatized any government company as yet. The New Public Sector Enterprise Policy of February 2021 has categorized several sectors as strategic with the intent to retain one or more PSUs in strategic sectors
4	Electricity subsidies, tariff increases	Work-in-progress	This is outside the central government's domain as power distribution is a state subject. However, several states have increased power tariffs over the past 3-4 years. Further power tariff increases will reduce the subsidies of states' and India's consolidated fiscal deficit. This will also address potential increase in NPLs in the Indian banking system
	GST implementation	Complete	GST implemented on July 1, 2017. GST will likely result in higher tax-to-GDP ratio in the long term and reduce India's consolidated fiscal deficit
<b>(B) Investment</b>			
1	Approvals	Work-in-progress	Online application for forest and environment approvals started by the central government in July 2014; several other state governments have implemented similar systems. This is an executive area and thus, implementation is more important; center and states working on single window clearing mechanism (most states on-board)
2	Auction of coal and other mineral ore blocks; private sector commercial mining allowed in the case of coal	Largely complete	The amendment to Coal Mines Act and Mines and Minerals (Development and Regulation) Act have enabled the central and state governments to allocate coal and other mineral ore blocks through transparent auctions
3	Electricity distribution	Work-in-progress	State-owned power distribution companies have started offering letter of credit to generation companies for power purchases from August 2019. Government has introduced the Electricity (Amendment) Bill, 2020 to (1) ensure better enforceability of PPAs, (2) implement DBT of subsidies, (3) have a renewable energy policy, (4) faster adoption of changes in tariffs, etc.
4	Incentives for manufacturing	Meaningful progress	The government has announced Rs2.6 tn worth of incentives over five years to promote domestic manufacturing under Production Linked Incentive scheme (PLI)
5	Labor reforms	Largely complete	Central government has passed four labor codes to simplify earlier labor laws, easing compliance burden on firms and allow them flexibility on hiring and retrenchment of workers. Some states have suspended certain provisions till FY2023 to encourage setting up of new firms
6	Land reforms	Work-in-progress	Government let the Land Acquisition Ordinance lapse in August 2015 due to political opposition to its proposed amendments to the LARR Act, 2013.
7	Market pricing of energy (oil & gas)	Work-in-progress	The government has (1) withdrawn pricing freedom on automobile fuels (retail diesel and gasoline) for the oil marketing companies, (2) imposed additional tax on crude oil, which limits pricing freedom for upstream oil & gas companies and (3) linked natural prices to crude oil prices with ceiling and floor, which limits pricing freedom for upstream oil & gas companies
8	Taxation	Meaningful progress	The government has implemented simpler taxation systems for both direct and indirect taxes. In the case of direct taxes, it reduced the corporate tax rate to 22% (effective from FY2020) from 30% subject to companies not availing any exemptions. In the case of indirect taxes, GST will result in a simpler and transparent system
<b>(C) Banking sector</b>			
1	Financial inclusion	Largely complete	The government's 'Jan Dhan Yojna' was started in August 2014 with a target of financial inclusion for all. Over 400 mn new bank accounts have been opened under this scheme. The new accounts are already being used for saving and payments. The accounts can be used for DBT-related cash transfers
2	Restructuring of PSU banks	Largely complete	The government has completed the merger of (1) BOB, DBNK and VJKB, (2) CBK and SNDB, (3) PNB, OBC and UNTDB, (4) UNBK, ANDB and CRPDK and (5) INBK and ALBK. It has infused significant capital in the PSU banks, resulting in five PSU banks exiting the PCA framework of the RBI
3	NPL situation	Largely complete	The parliament passed the insolvency and bankruptcy code (IBC) bill on May 11, 2016. Most large cases admitted to National Company Law Tribunal (NCLT) courts under IBC have seen satisfactory outcomes within reasonable time limits
4	Reduction in SLR over a period of time	Largely complete	SLR has been reduced and maintained at 18% from 25% in late-2000s; SLR used as part of LCR per Basel III guidelines
<b>(D) Governance</b>			
1	Reducing bureaucracy	Work-in-progress	The government has focused on empowering bureaucracy and streamlining decision-making
2	Corruption/black money	Meaningful progress	The Undisclosed Foreign Income and Asset (Imposition of Tax) Act, 2015 implemented from September 2015. Government progressively reducing disclosure limit on high-value transactions. Indian government cancelled high-denomination notes from circulation from November 9, 2016 and replaced them with new ones
3	Judiciary reforms	No progress	New system for appointment of judges to the Supreme Court and High Courts; bill passed in the parliament but the new system has been rejected by the Supreme Court
4	Creation of new regulators, sector super-regulators	No progress	All regulators related to communication, energy and finance should come under a sector super-regulator

Source: Kotak Institutional Equities estimates

## NDA is close to gaining a majority in Rajya Sabha

Exhibit 9: Rajya Sabha composition, June 2024 (sorted on 2024 seats)

Party	2024
BJP	98
INC	28
AITC	13
AAP	10
DMK	10
BJD	9
YSRCP	11
BRS	5
Nominated	7
RJD	6
CPI (M)	5
JD (U)	4
AIADMK	4
SP	4
NCP	1
NCP (SP)	2
SS	1
SS (UBT)	2
Independent	3
JMM	3
CPI	2
AGP	1
BSP	1
IUML	1
JD (S)	1
KC (M)	1
MDMK	1
MNF	1
NPP	1
PMK	1
RLD	1
RPI (ATWL)	1
TMC (M)	1
UPP (L)	1
Vacancies	4
<b>Total</b>	<b>245</b>
<b>NDA (total)</b>	<b>119</b>

Source: Rajya Sabha, Kotak Institutional Equities estimates

## BJP lost 63 seats, due to large loss in vote-share in key states

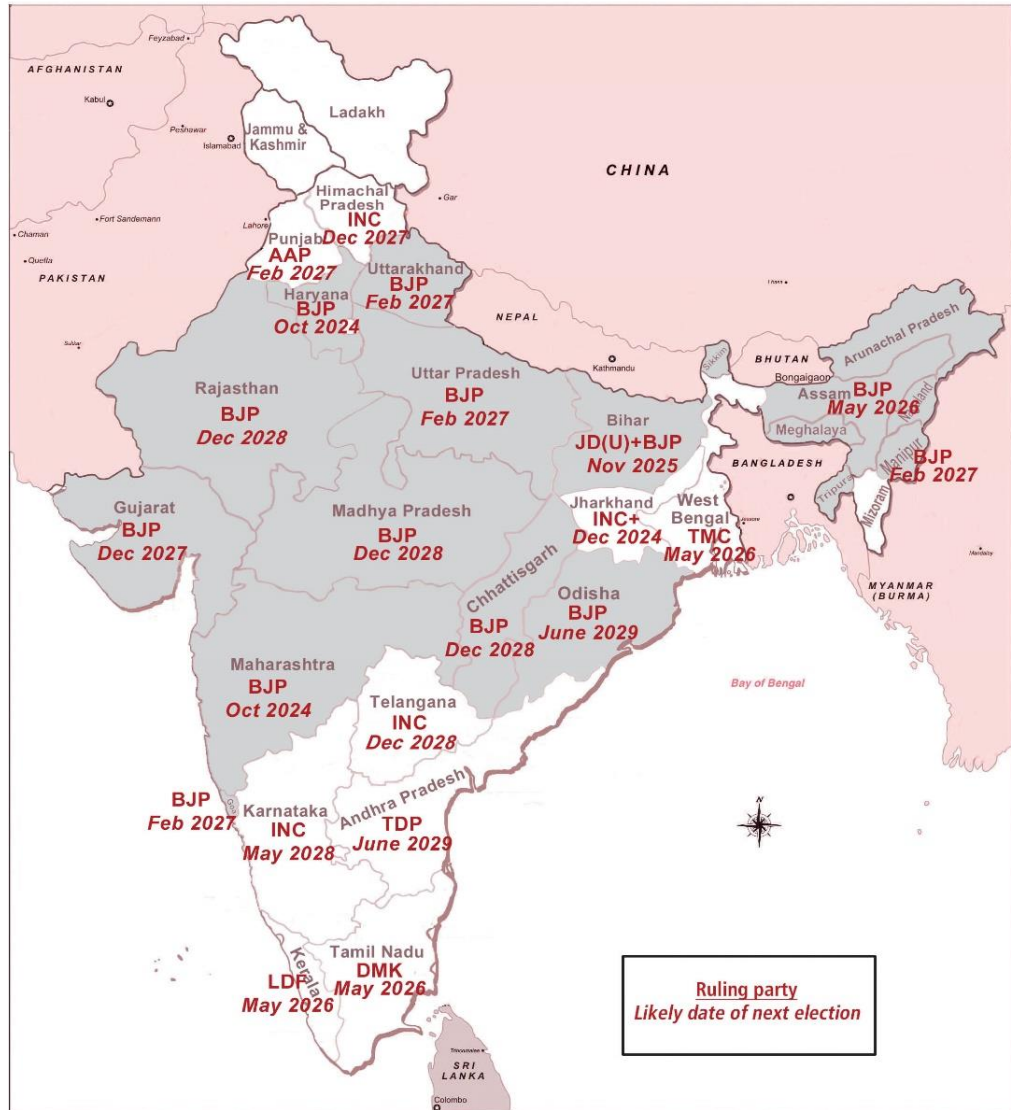
Exhibit 10: Performance of BJP in various states in 2019 and 2024 Lok Sabha elections

Name of state	Members	Seats (#)			Vote-share (%)		
		2019	2024	Change	2019	2024	Change
Andhra Pradesh	25	0	3	3	1	11	10
Arunachal Pradesh	2	2	2	—	59	49	(10)
Assam	14	9	9	—	36	37	1
Bihar	40	17	12	(5)	24	21	(4)
Chhattisgarh	11	9	10	1	51	53	1
Goa	2	1	1	—	52	51	(1)
Gujarat	26	26	25	(1)	63	62	(1)
Haryana	10	10	5	(5)	58	46	(12)
Himachal Pradesh	4	4	4	—	70	56	(13)
Jammu and Kashmir	6	3	2	(1)	47	24	(22)
Jharkhand	14	11	8	(3)	52	45	(7)
Karnataka	28	25	17	(8)	52	46	(6)
Kerala	20	0	1	1	13	17	4
Madhya Pradesh	29	28	29	1	59	59	1
Maharashtra	48	23	9	(14)	28	26	(2)
Manipur	2	1	0	(1)	34	17	(18)
Meghalaya	2	0	0	—	8	NA	NA
Mizoram	1	0	0	—	NA	7	NA
Nagaland	1	0	0	—	NA	NA	NA
Odisha	21	8	20	12	39	45	6
Punjab	13	2	0	(2)	10	19	9
Rajasthan	25	24	14	(10)	59	49	(10)
Sikkim	1	0	0	—	5	5	0
Tamil Nadu	39	0	0	—	4	11	8
Telangana	17	4	8	4	19	35	16
Tripura	2	2	2	—	50	71	21
Uttar Pradesh	80	62	33	(29)	50	41	(9)
Uttarakhand	5	5	5	—	62	57	(5)
West Bengal	42	18	12	(6)	41	39	(2)
<b>Name of UT</b>							
Andaman and Nicobar Islands	1	0	1	1	46	51	5
Chandigarh	1	1	0	(1)	51	48	(3)
Dadra and Nagar Haveli	1	0	1	1	42	59	17
Daman and Diu	1	1	0	(1)	44	39	(4)
Lakshadweep	1	0	0	0	0	NA	NA
NCT of Delhi	7	7	7	0	57	54	(3)
Puducherry	1	0	0	0	NA	36	NA
<b>Total</b>	<b>543</b>	<b>303</b>	<b>240</b>	<b>(63)</b>	<b>38</b>	<b>37</b>	<b>(1)</b>

Source: Election Commission, Kotak Institutional Equities

**BJP controls state assemblies in North and Central India, where their performance have been poor in 2024 Lok Sabha elections**

Exhibit 11: Map of India with likely date of the next assembly elections



Source: Election Commission, Kotak Institutional Equities



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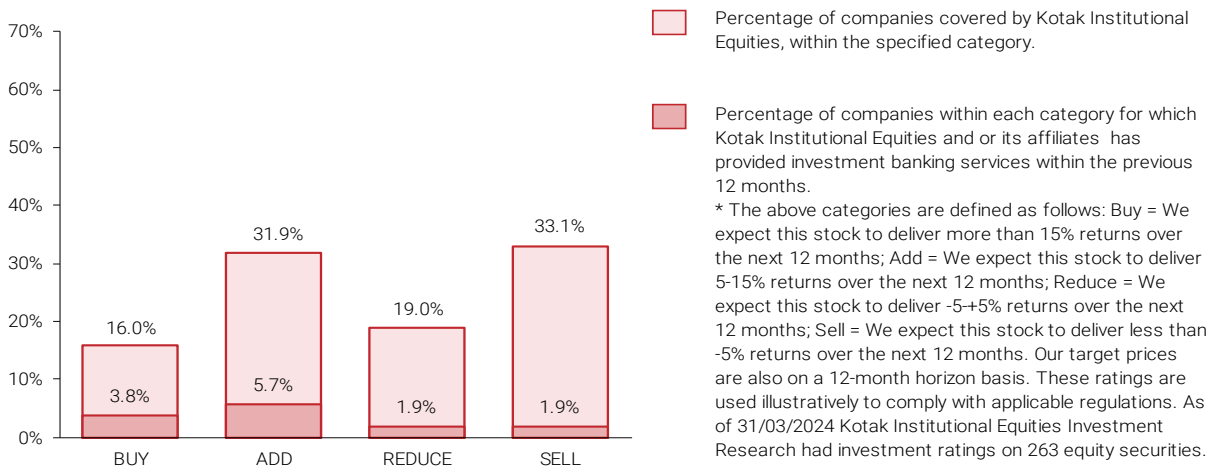
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