

**Multi-asset class**  
**India**

# India election

## The last mile

- ▶ **Election results better than expectations**
- ▶ **Improved prospects of stable coalition and revival of economic reforms**
- ▶ **Will significantly boost sentiment for Indian asset markets: capital goods, banks and state owned companies likely to benefit most**

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## Celebrations — for now

Since 1Q09, we have held a non-consensus overweight call on the Indian equity market, and one of the two main objections investors have had is the general election. We viewed the probability of a coalition not centred on either the Congress or BJP as low.

The results announced over the weekend were better than expected. A Congress-led coalition government (it needs support of 12 more MPs), that does not contain the communist parties, is about the best election result for the equity markets and currency that could reasonably have been considered.

Indian equities have marginally outperformed emerging markets in 2009, up 1.4% in US dollar terms. Over the next week, the Indian equity market may rally on the back of these better than expected results, as this increases prospects of a stable government at the centre and expectations that economic reforms will revive.

Expectations of a revival suggest that certain sectors would benefit from a rally more than others; we believe engineering and construction, infrastructure developers, banks and state owned companies would benefit most from improvement in sentiment. There is a risk that the rally may overshoot. Our index target for the year-end is 11,000. At closing prices on Friday, the Sensex was at 14.4x 12-month forward PE and 2.25x 12-month forward PB.

The rupee is likely to appreciate sharply in the near term as it plays catch-up with the rally in the Asian forex space over the past month or two. We believe both local and foreign market participants have been under-positioned on account of election uncertainty.

### Election results

Alliance	UPA	NDA	Third Front	Fourth Front	Others & independents
Seats	262	160	79	28	14
Key party in alliance	Congress	BJP	Left parties	Samajwadi Party (SP)	
Seats	206	116	24	23	
Other major winner in alliance	TMC	Janata Dal (U)	BSP		
Seats	19	20	20		

Source: HSBC, NDTV  
 Results include four undeclared results, with Congress leading in one, BJP leading in one and Third Front leading in two

## Reform push and challenges

The Congress led alliance is expected to give reforms a major push, especially with Dr. Manmohan Singh, the architect of the first wave of reforms, at the helm. In addition, there are major challenges for the government with the economic slowdown.

The new government's first big economic test will come with the June budget. This will inevitably represent a very difficult balancing act between starting to deliver on potentially expensive election promises and keeping the budget deficit under control. The combined Central and State government deficit could hit 11% of GDP in 2009-10, given the lagged effects of the slowdown and the cost of the previous stimulus plans, even if the budget is a neutral one. Progress on this is critical as there is a risk of downgrade of India's sovereign credit rating and higher long-term interest rates. While a ratings shift would certainly not be a disaster for a currency with little external debt or foreign bond investment, it would still be damaging to India's overall investability.

Reforms that have been on the back burner could be revived such as 1) parliamentary approval of the regulator of the new pension scheme, 2) increase in FDI limit in insurance and retail sectors, and 3) banking reforms. Disinvestment of government stakes in state owned enterprises could be back on the agenda.

Other critical reforms that could get a push could be related to labour. More critical would be to step up investment in infrastructure, a challenge given fiscal constraints.

We expect economic reforms to be gradual and the slow pace could be frustrating for some, but progress would be welcome.

In addition, the global environment will continue to exert a powerful influence on the currency, in our view. For equity flows, while this election improves India's position relative to its peers, the absolute direction of flows is more likely to reflect global conditions than local ones. Further, FDI inflows are likely to continue to decelerate, not because India's growth potential is particularly poor, but because there is simply a paucity of financing and investment demand globally. And remittance flows, which accelerated exponentially through 2007-08, are likely to continue to decline as labour markets weaken through this year.

We continue to believe that for USD-Asia to uniformly weaken we need a sustained global recovery. That still seems a tough ask, and will see currencies like the rupee needing extremely significant domestic improvements to sustain appreciation.

# Disclosure appendix

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