

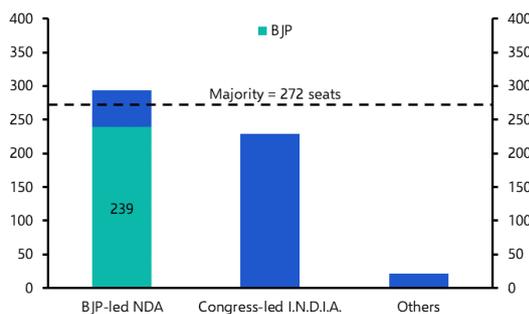


# INDIA ECONOMICS UPDATE

## What Modi 3.0 means for India's economy

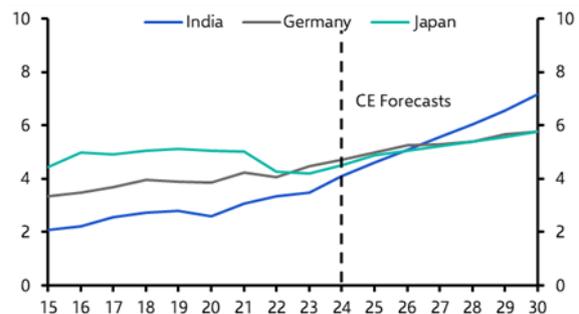
- **Narendra Modi will begin his third term as India's Prime Minister with a weakened mandate and that will make the passage of contentious economic reforms more difficult. But he will still be able to work as the head of a stable coalition, and the broader embrace across the political spectrum of the value of economic reform means the new government could still do enough to keep potential growth at 6-7%. That would leave the economy on course to more than double in size over the next decade.**
- **Prime Minister Modi's BJP appears to have failed to hold on to the single-party majority in the Lok Sabha (lower house of parliament) that it has had since 2014. At the time of writing, it is on course to win 240-245 of the 543 seats.** That is a significant setback from the 303 seats it won in 2019. However, it won't struggle to form a government as, accounting for coalition partners, the BJP-led National Democratic Alliance (NDA) is still on course to win around 290 seats. (See Chart 1.)
- **Reflecting the smaller mandate, markets have tumbled today (the Sensex is down about 5%).** But much of that move simply unwinds the big gains yesterday (when the Sensex hit a fresh record high) following the release of exit polls that pointed to a much bigger win for the BJP. Stepping back, equities are back to where they were in mid-March.
- **PM Modi will start his third term with the economy in good shape.** It is on course to grow by 6.5-7% over 2024-2026. That sets the stage for **India to overtake Japan and Germany** to become the world's third-largest economy (at market exchange rates) within the next couple of years. (See Chart 2.) And alongside that, our **proprietary risk indicators** show that financial vulnerabilities in India are at historically very low levels.
- The next government's focus should therefore be on enhancing India's longer-term prospects. The tried and tested way of doing this is to nurture the manufacturing sector, which can generate rapid productivity gains and create jobs. Weak employment growth was one factor weighing against the BJP in the campaign. **Geopolitical factors should help given the likelihood that another Modi-led government will ally India more closely with the US as the global economy continues to fracture.** That presents friendshoring opportunities in manufacturing.
- To support this shift, the government in some areas simply needs to continue with the progress it has been making over the past five years. Investment in infrastructure stands out. (See our forthcoming *Update* for more.) One piece of good news from the election campaign was that it underlined the extent to which politicians from **across the political spectrum** now broadly support many liberalising economic reforms.
- But continued progress isn't assured. **Reform needs to be stepped up a gear in other areas, particularly in the context of China's manufacturing dominance. Some of these remain more contentious, notably labour market liberalisation.** Some progress has been made but it tends to come in fits and starts and so far has been limited to a few states. The election result may make further progress harder.
- Our initial conclusion though is that the next Modi administration still has enough of a mandate to enact reforms that will keep potential growth at 6-7%. That would fall short of the double-digit growth rates that the very best performing EM economies have managed to sustain. **But growth of 6-7% would nevertheless still place India among the top third of performers at its stage of development.**

Chart 1: 2024 Lok Sabha Election Projections\* (No. of Seats Won out of 543)



Source: Election Commission. \*Final result may vary slightly

Chart 2: Nominal GDP (US\$trn, Market Exchange Rates)



Sources: CEIC, Capital Economics



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