INDIA

MODI HEADS TOWARDS A THIRD TERM

The reform policies initiated since Narendra Modi came to power in 2014 are expected to continue with his very likely re-election next June. His economic performance has been positive overall, with robust growth, a strengthening banking sector, a surging investment rate and infrastructural deficiencies being reduced. However, the country is still facing many substantial structural challenges. GDP per capita is still much lower than in other Asian countries (China, Vietnam and Indonesia), the manufacturing sector is barely growing and the country fails to create enough jobs for young people, who are still experiencing very high unemployment rates.

GENERAL ELECTION

India's general election started on 19 April and will run until 1 June. The latest polls forecast that the Bharatiya Janata Party (BJP), led by Prime Minister Narendra Modi, and members of the National Democratic Alliance (NDA) will win the election for the Lok Sabha, the lower chamber of India's Parliament, and form a government for the third time running. This victory should help to maintain stability in the country and provide a platform for continuing to introduce reforms. Over the past five years, trust in the ruling coalition has seemingly increased. In April, the alliance was only one seat short of a majority in the Rajya Sabha, the upper house of India's Parliament, which contains 240 seats in total. By contrast, the coalition only held 34.7% of the seats five years ago. Winning a majority in the Parliament's upper house would make it easier to adopt essential reforms for boosting the country's economic growth. However, their adoption may not be enough. During Modi's last term in office, some key reforms adopted by the Parliament were abandoned (such as the agricultural reform) or have still not been fully implemented (such as the labour market reform).

On the international front, India is still not particularly integrated into global trade. Structural constraints and its limited participation in free trade agreements for protectionist reasons (such as the Regional Comprehensive Economic Partnership, which includes China, Japan, South Korea, Australia, New Zealand and the ten ASEAN countries) have limited its expansion. However, the government is gradually changing its strategy. The inclusion of Indian sovereign bonds into the JP Morgan and Bloomberg indices (which will be done gradually from June 2024 for the former and from January 2025 for the latter) should increase its financial integration. On the geopolitical front, India is expected to maintain its neutral stance towards the Ukraine-Russia conflict. Under this "non-alignment" or even "multi-alignment" strategy, it can receive oil and weapons from Russia (which has been its main oil and weapons supplier), while maintaining stable relations with Europe and the United States. Its partnership with the United States was strengthened in 2022 with the Initiative on Critical and Emerging Technology framework, which aims to enhance cooperation on advanced technologies and defence. Conversely, its relations with China are still strained.

FORECASTS

	2021	2022	2023e	2024e	2025e
Real GDP growth, % (1)	9.7	7.0	7.6	6.7	6.6
Inflation, CPI, year average, % (1)	5.5	6.7	5.4	4.7	4.3
General gov. balance / GDP, % (1)	-9.6	-9.2	-9.0	-8.1	-7.3
General gov. debt / GDP, % (1)	85.2	85.0	84.4	83.9	82.5
Current account balance / GDP, % (1)	-1.2	-2.0	-1.7	-1.9	-1.8
External debt / GDP, % (1)	19.7	18.4	18.7	19.0	18.5
Forex reserves, USD bn	618	562	618	578	620
Forex reserves, in months of imports	7.9	6.7	8.6	8.1	8.5

TABLE 1

(1) FISCAL YEAR FROM APRIL 1ST OF YEAR N TO MARCH 31ST OF YEAR N+1
e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

GDP PER CAPITA AT CONSTANT PRICES IN PPP

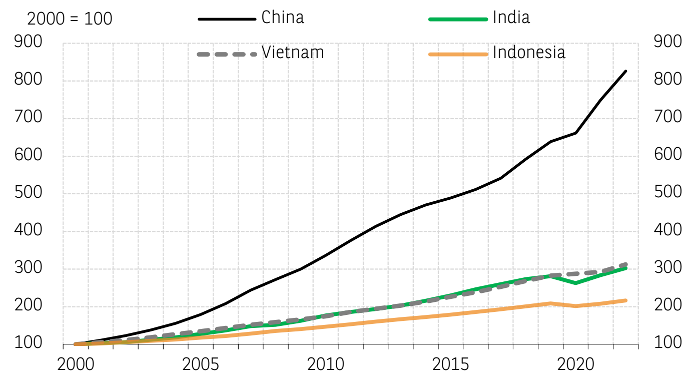

CHART 1

SOURCE: IMF-WEO, BNP PARIBAS

THE ECONOMIC PERFORMANCE FOR MODI'S LAST TERM OF OFFICE

Overall, Modi can boast a positive economic performance: i) the economy has held up well against successive external shocks (the pandemic, rising raw material prices and monetary tightening in advanced economies); ii) the banking sector has strengthened significantly and has helped to boost investment demand; iii) infrastructural deficiencies have been reduced but are still significant: the country rose nine positions on the World Bank's Logistics Performance Index between 2014 and 2023, and now ranks 47th out of 139 countries, ahead of Vietnam and Indonesia.

Over the last five years, average economic growth has been more dynamic than in other Asian countries. It averaged 4.3% per year including the two pandemic years, but stood at 7.2% per year on average if these two years are excluded (over the 2017-19 and 2023-24 periods). At the same time, GDP per capita has risen by 6.1% per year on average (excluding the pandemic) and the poverty rate has fallen by ten percentage points (pp) to 12.9% over the past ten years. However, GDP per capita (in volume and in purchasing power parity terms) is still 2.5 times lower than in China and 1.7 times lower than in Indonesia and Vietnam.

The domestic economic environment is generally favourable for the Prime Minister. Economic growth is expected to exceed 7.6% for the fiscal year ending at the end of March and, although a slowdown is expected for 2024-2025, it is expected to remain robust, buoyed by investments remaining dynamic thanks to rising production capacity utilisation rates and the financial consolidation of companies and banks. In addition, inflationary pressures have eased over the last twelve months (+5.1% y/y in February), even though risks are on the rise (due to climate events and geopolitical pressures).

A MORE ROBUST BANKING SECTOR THAN TEN YEARS AGO

Over the past decade, the government has adopted two measures that have helped the banking sector to recover: implementing the Insolvency and Bankruptcy Code in 2016 and creating a bad bank (which came into operation in 2023). In September 2023, the non-performing loan (NPL) ratio stood at 3.2% of total loans, compared to 10.8% five years earlier. Although public banks are still fragile (the NPL ratio stood at 4.4% in September 2023), their solvency ratios are satisfactory (the Capital Adequacy Ratio stood at 15.2% in September 2023) and publc banks are not expected to need a capital injection to cope with a domestic or external shock, according to the most recent stress tests by the Reserve Bank of India (RBI). Along with the consolidation of banks, growth in credit supply has accelerated significantly (+20.5% y/y in February 2024). Although outstanding credit has remained modest, it has risen by five percentage points over the past five years to 56.7% of GDP in February 2024. According to the Bank for International Settlements, private sector debt remains contained (household debt and corporate debt amounted to 37.2% and 54.7% of GDP, respectively, in Q3 2023). Companies' financial situations are much more robust than ten years ago (their debt remained contained at 72.1% of GDP and their pre-tax profits were enough to cover their debt servicing costs 5.3 times, compared to three times a decade ago). However, the rising household debt levels should be monitored, as households have variable-rate debt. Nevertheless, their overall financial position is still generally good. Their financial assets were enough to cover the value of their liabilities 2.7 times in March 2023.

MAJOR STRUCTURAL CHALLENGES REMAIN

Despite real improvements over the last five years, the country is still facing many structural challenges: i) public finances are still notable for their high level of debt (83% of GDP), some of the lowest budgetary revenues in Asia, which barely exceed 9% of GDP (despite VAT being adopted in 2017), and an interest burden on debt that consumes more than 39.2% of revenues and reduces the budgetary leeway for spending on research and development, infrastructure, education and healthcare; ii) the structurally low level of FDIs (0.8% of GDP in 2023, compared to 1.6% in Indonesia and 2.1% in Malaysia); iii) weak governance; iv) a high exposure to climate risk and v) low employment levels.

Regarding this last point, the strong growth in the youth population is often viewed as one of the key drivers of the growth in India's economy. According to UN forecasts, the proportion of the working age population (15-64 years old) is expected to continue rising until the middle of the century (compared to China, where it has been decreasing since the beginning of the 2010s). In 2023, the median age in India was estimated to be just over 28 years old, according to the UN, while it stood at 31 years old in Malaysia, 33 years old in Vietnam, 39 years old in China and 40 years old in Thailand. However, India is currently not managing to exploit its demographic advantage. Although the employment rate has been rising over the past two years, it only stood at 37.9% in March 2024, which is still below its pre-pandemic level (39.8% in March 2020), according to the Centre for Monitoring Indian Economy (CMIE). This low employment level is due to a particularly low levels of activity among women and young people. According to the most recent public survey, the female participation rate stood at just 35.1%, while it was 76.4% for men. The share of young people who are not in a job, looking for work or in training is particularly high. According to the International Labor Organization (ILO), it hit 23.5% in India in 2023, which is similar to the rate in Indonesia (22.3%), but well above the prevailing level in other Asian countries (10.2% in Malaysia, 11.3% in Vietnam and 13.3% in Thailand). The unemployment rate among India's young people is particularly worrying. In December 2023, it likely hit (according to the CMIE) 45.4% for 20-24-year-olds and 15.5% for 25-29-year-olds, while the national average was 7.6% in March 2024.

INDIA: SIGNIFICANT IMPROVEMENT IN THE QUALITY OF BANK ASSETS

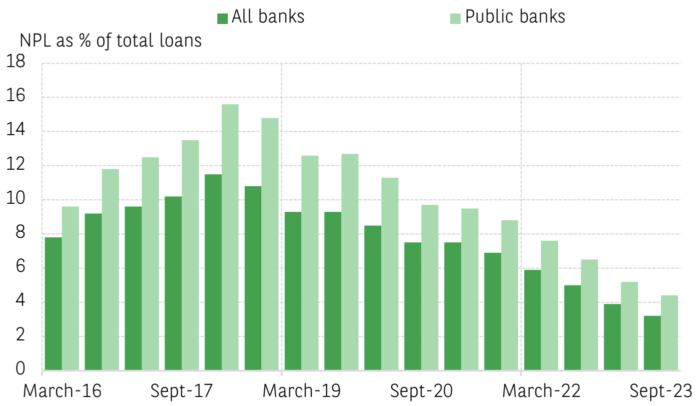

CHART 2 SOURCE: RESERVE BANK OF INDIA, BNP PARIBAS

THE MANUFACTURING SECTOR IS STILL HARDLY GROWING

One of Narendra Modi's stated goals was to make India the new factory in the world, by developing its manufacturing sector. Despite the measures taken to attract foreign direct investment (opening up many sectors to foreign companies and slashing corporate tax rates in 2019) and to boost highly labour-intensive sectors through Production Linked Incentive Schemes that have been in place since 2020, the manufacturing industry's share in the country's value-added has not increased. In fact, it has actually decreased slightly. It stood at just 16.9% during 2022-2023, compared to 17.2% in 2013-2014. In addition, apart from specific business segments, such as cars, pharmaceuticals and textiles, activity is barely growing in other sectors. However, industrial development is seemingly essential in order to meet the huge job creation needs. The share of employment in the manufacturing sector is still low (12% of total employment in 2023, according to the most recent survey) and has fallen by 0.5 percentage points over the last five years. By contrast, manufacturing employment stood at 28.7% in China (in 2020) and 21.4% in Vietnam, according to the ILO.

Whoever is elected to form a government on 4 June 2024 will not only have to continue the reforms undertaken, but also get them implemented more quickly.

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