INDIA

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Indian economic growth reached 8.2% for the fiscal year 2023/2024. However, this performance did not enable Narendra Modi's ruling Bharatiya Janata Party (BJP) to retain a majority in parliament. Over the next five years, the BJP will have to deal with the smaller parties that are partners in the coalition it leads to run the country. Adopting new reforms to further liberalise the economy could prove difficult. In addition, the Prime Minister may have to change the structure of budget spending in order to increase once again the share of subsidies and other social transfers, which have been falling for the past five years. Such a change in strategy could slow the ongoing fiscal consolidation and/or put the brakes on infrastructure development, which is essential to attract foreign direct investment and adapt to climate change. This would, in turn, have a negative impact on medium- and long-term economic growth.

GROWTH FORECAST FOR 2024/2025 REVISED UPWARDS

In the fiscal year (FY) 2023/2024 (ended in March 2024), India's economic growth exceeded the government's forecasts. It accelerated to 8.2% (the highest level among Asian countries) after reaching 7% in FY2022/2023. However, the rate of growth in value added, which better reflects the development of economic activity than GDP (because GDP includes the impact of indirect taxes), was lower (+7.2% compared with +6.7% the previous year).

Unlike in the last ten years, the main growth driver was not household consumption, which slowed significantly, but investment. The investment rate reached 33.5% of GDP (compared with 32.4% five years ago). Net exports, on the other hand, made a negative contribution to growth.

The growth outlook for FY2024/2025 has been revised upwards, due in particular to a favourable base effect in the fourth quarter of the FY2023/2024 (growth having reached +7.8% year-on-year). Economic activity is expected to reach 7.2% according to the latest forecasts from the Reserve Bank of India (RBI).

April's activity indicators show that industrial production remained strong (+5% y/y after growing by 5.1% in Q1 2024). Urban and rural household demand accelerated. Investment remained dynamic, albeit at a slower pace if the trend in bank credit is anything to go by (+7.4% y/y in April for the industrial sector compared with +8.8% in Q1 2024). Production capacity utilisation rates remained high and corporate balance sheets continued to improve. Business confidence strengthened and household confidence returned to pre-pandemic levels.

Inflationary pressures continued to ease, albeit at a slow pace (+4.7% y/y in May compared with +5% in Q1 2024). While the rise in energy prices eased, the rise in food prices remained high (+8.7% y/y in May). What's more, extreme heat in June and below-normal water reserves (-8% nationwide) are putting summer harvests and fruit and vegetable prices at risk. Fortunately, these inflationary factors could be offset by a fall in cereal prices compared with last year. According to forecasts made by the India Meteorological Department (IMD) at the end of May, the monsoon (which began at the start of June and will finish at the end of September, and which is decisive for the winter harvest) should be slightly more intense than normal this year. If these forecasts are confirmed, pressure on food prices could ease, allowing the RBI to ease monetary policy in the fourth quarter of 2024. Nevertheless, the RBI remains cautious about its inflation forecasts (+4.5% over the current 2024/2025 financial year as a whole).

FORECASTS

	2021	2022	2023e	2024e	2025e
Real GDP growth, % (1)	9.7	7.0	8.2	6.9	6.7
Inflation, CPI, year average, % (1)	5.5	6.7	5.4	4.7	4.3
General gov. balance / GDP, % (1)	-9.5	-9.6	-8.8	-8.3	-7.7
General gov. debt / GDP, % (1)	85.2	85.0	83.3	82.7	82.0
Current account balance / GDP, % (1)	-1.2	-2.0	-0.7	-1.5	-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

(1) Fiscal year from April 1st of year N to March 31st of year N+1

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

INDIA: STRONG REAL GDP GROWTH

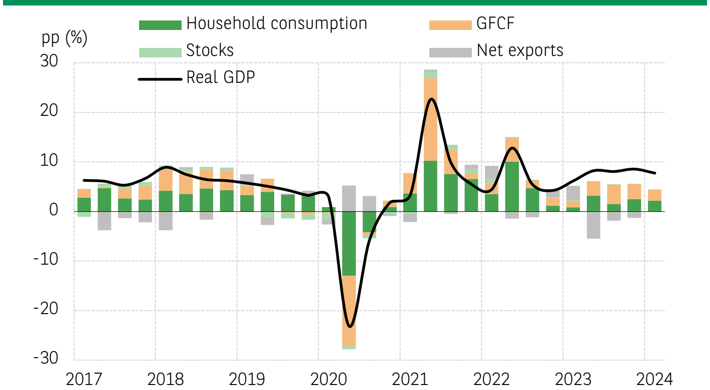

CHART 1 SOURCE: CEIC, BI, BNP PARIBAS

MODI'S PARTY HAS LOST ITS MAJORITY IN PARLIAMENT

Narendra Modi's party, the Bharatiya Janata Party (BJP), lost 63 seats in the Lower House of Parliament (*Lok Sabha*) in the June 2024 general elections. Its losses are concentrated in three states: Uttar Pradesh (-29 seats), Maharashtra (-13 seats) and Rajahsthan (-10 seats). With 240 out of 543 seats, it no longer has an absolute majority (272 seats).

However, its coalition party, National Democratic Alliance (NDA) has 293 seats, 59 more than the opposition alliance (I.N.D.I.A) led by the Indian National Congress. The latter won 47 more seats than in the last elections in 2019.

For its third term in office, the new Modi government's room for manoeuvre will therefore be less comfortable than when it took power in 2014 and 2019, when the BJP had an absolute majority. However, it is common practice in India for a prime minister to govern without their party having a majority. Remember that in 2014, it was the first time that a party had had a majority in the Lower House of Parliament since the victory of the Congress in 1984.

The composition of the new government, led for a third term by the outgoing Prime Minister, Narendra Modi, suggests that the policies pursued will be in line with those of previous governments. Of the 71 members of this new government, only 11 are from outside the BJP. Some key ministers, such as the finance minister, have been reappointed for a second term. But even if the political environment is expected to remain stable, the Modi government will find it more difficult to adopt new structural reforms to liberalise the country. In particular, it seems unlikely that it will succeed in convincing the parties in its coalition to vote in favour of the amendment on land acquisition that it had hoped to resubmit to Parliament, even though it would have encouraged the development of the industrial sector.

To date, apart from a freeze on reforms, the main risk posed by this coalition government is a slippage in public finances and/or a review of the budget structure.

PUBLIC FINANCES: BUDGETARY MARGINS ARE STILL TIGHT

Public finances are one of the biggest constraints for the new government. Even though the elections revealed the dissatisfaction of part of the population (due to high unemployment, particularly among young people, and a sharp rise in inequality), the government's fiscal room for manoeuvre to increase social spending is limited because fiscal revenues remain low and debt interest payment are high. Furthermore, an increase in social spending would run counter to the fiscal strategy pursued by the Modi government over the past two years, which has placed infrastructure spending at the heart of its development strategy, at the expense of social spending. Although on a favorable trend, the inadequacy and sometimes mediocre quality of infrastructure is stifling economic growth.

In FY2023/2024, the government deficit declined by 0.8pp to 5.6% of GDP, but it was still higher than the pre-pandemic level (3.8% of GDP over the 2016-2020 period). Similarly, the general government deficit remained high at 8.8% of GDP, according to initial estimates.

Government revenues, although still very low, rose slightly over the past year (+0.3pp) to 9.4% of GDP. They are at the same level as ten years ago. However, the increase in gross tax revenues over the last decade (+1.6pp) is to be welcomed, reaching 11.7% of GDP, a low but unprecedented level. This rise is mainly the result of an increase in the income tax base. In fact, corporation tax revenues fell as a result of the reduction in corporate taxation in 2019 to boost competitiveness. Customs revenues also fell.

Fiscal expenditures, which fell by 0.6pp over the past year to 15% of GDP, remained above the pre-pandemic level and the level that prevailed ten years ago. However, their structure has changed.

INDIA: PUBLIC EXPENDITURES

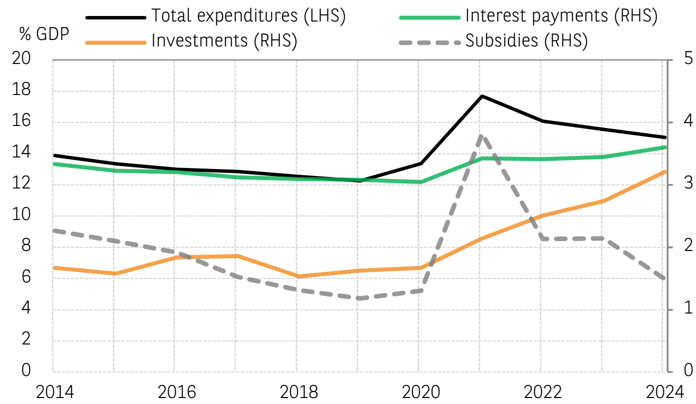

CHART 2 SOURCE: CEIC, MOF, BNP PARIBAS

Indeed, although debt interest payments still remain the largest item of budget spending (23.9% of total spending in 2023/2024, the same level as ten years ago), the weight of certain other spending considered to be "incompressible" has decreased. Subsidies, which had risen sharply at the time of the Covid-19 pandemic, fell to 1.5% of GDP in FY2023/2024; they accounted for 9.9% of total expenditures, a level below the average recorded over the five pre-pandemic years (11.3% of total expenditures). Similarly, spending on education, pensions and healthcare fell very slightly to 1.4% of GDP, and accounted for just 9.5% of total spending last year, compared with 12.7% five years ago.

On the other hand, investment has increased significantly since FY2020/2021. The Modi government reallocated part of its social spending to infrastructure, which reached 3.2% of GDP last year (compared with 1.6% of GDP five years ago). In FY2023/2024, 21.4% of total expenditure was given over to investment, 9.4pp more than ten years ago.

For the FY2024/2025 budget presented in February, the government aimed to reduce its deficit to 5.1% of GDP. This slight consolidation was based on a further reduction in spending, particularly subsidies. The aim was once again to reallocate the "saved" funds to infrastructure spending. However, given the low level of revenues (expected to fall by 0.1pp for the current fiscal year), the new government is now faced with a choice: increase social spending while keeping its investment targets unchanged, at the risk of widening the fiscal deficit, or reduce public investment at the risk of seeing foreign direct investment flows slow further, which would then weigh on medium-term economic growth and could weaken external accounts. The new government is due to announce a review of its budget in mid-July, which will give an initial idea of its new priorities.

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