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India – Agenda for the new government

- **Providing final clearances for stalled projects to top NDA's growth agenda**
- **Measures to support infrastructure, urbanisation and manufacturing to help revive the investment cycle**
- **Controls on food hoarding, distribution reforms are expected to contain inflationary pressure**
- **Government to pursue fiscal consolidation; may announce GST implementation by FY16**
- **PM and his office are likely to play a more active role in decision-making**
- **State-driven national development model could redefine India's federal structure**

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Summary

The decisive election mandate of the National Democratic Alliance (NDA), along with a new prime minister with a reputation for quick decision-making, has raised expectations that India will unlock its growth potential in the coming years. Markets will watch closely for policies that can improve the macroeconomic environment. Meanwhile, likely changes in the government's decision-making process could have a long-lasting impact on the economy. In this report, we outline likely policy changes.

We believe that improving the state of the economy will be high on the government's agenda, in line with its election promises. We look at probable government announcements and actions in the next 6-12 months aimed at (1) reviving growth, (2) containing inflation, and (3) achieving further fiscal consolidation. These are based on election promises made in the manifesto of the Bharatiya Janata Party (BJP), which leads the NDA; speeches and interviews of leaders including incoming Prime Minister Narendra Modi; and media reports.

Providing final clearances for stalled projects on the verge of completion is likely to top the NDA's immediate growth agenda. This can be achieved through executive decisions, without the need for parliamentary approval. Removing more fundamental headwinds to new investment – including high leverage, high interest rates, low capacity utilisation, and banks' stressed asset books – will be a gradual process. Realising the NDA's vision of increasing the share of manufacturing in GDP and promoting infrastructure development and urbanisation will be key to improving the medium-term growth outlook.

To tackle inflation, immediate measures are likely to be two-pronged: (1) releasing food stock in the open market while improving distribution to increase food supply; and (2) cracking down on collusive and speculative behaviour to curb food-price manipulation. The NDA government is likely to be fiscally conservative, as reflected in its promise of "minimum government and maximum governance". Immediate subsidy cuts would likely be politically challenging. The government may opt for large-scale divestments to keep the deficit in check, as increasing tax revenue is likely to be difficult in a slow-growth environment.

The government's approach to decision-making is likely to change in two ways. First, the Prime Minister and the his Office are likely to play a bigger role in government decision-making, similar to Modi's style of governance in the state of Gujarat, where he has been chief minister since 2001. The emphasis is likely to be on a leaner but more efficient group of ministers, and an empowered but more accountable bureaucracy. Given the NDA's vision of a state-driven national development model, the new government is likely to encourage increased consultation between the central and state governments, probably via a new committee consisting of the prime minister and state chief ministers, and to give more fiscal autonomy to the states.

Measures to revive growth

Slow growth and persistent inflationary pressures have long weighed on investor sentiment towards India. While recent improvements in the twin deficits are positive, concrete efforts are needed to sustainably improve the macroeconomic enviroment.

The slowdown in India's GDP growth since mid-2010 has been driven by a slower pace of investment. Kick-starting the investment cycle is therefore likely to be the government's central growth strategy. The BJP manifesto and interviews of leading party members indicate that focus will be on actions to correct what has gone wrong in recent years, before new plans are pursued.

Focus on stalled projects

The fast-tracking of c.INR 7tn of stalled projects in the next few quarters is likely, with a focus on projects facing final approval delays

Increasing India's investment rate is likely to be a slow process, as it will require addressing high corporate leverage and non-performing assets in the banking system. On the other hand, increasing the productivity of existing investments can unlock quicker gains. We expect the government to fast-track c.INR 7tn worth of stalled projects over the next few quarters, focusing on those facing final clearance delays. Turning around such projects would boost investment sentiment and eventually attract more investment. Given that energy security is high on Modi's agenda, more reforms in this sector are likely.

Coal-sector reforms and the continuation of diesel price reforms initiated by the previous government are likely

Coal sector: An improvement in domestic coal supply is likely, but we expect this to take three to five years. In the interim, coal imports are likely to continue. The expected modernisation of the biggest state-owned coal producer in the next few months, the allocation of coal blocks, improved connectivity for faster transport of coal from mines, and assured availability of coal to the power sector are among the most widely anticipated reforms.

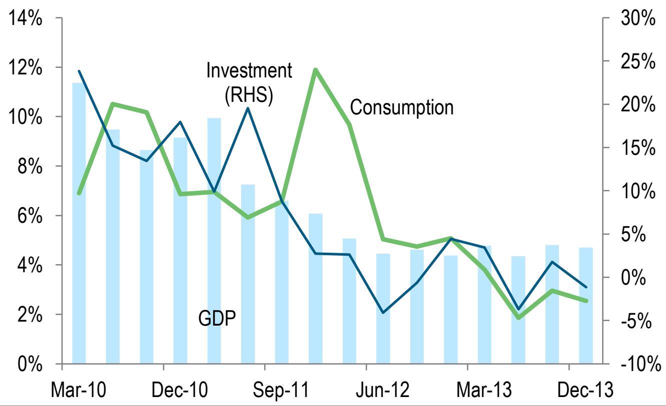
Oil and gas: We expect the new government to continue with the diesel price reforms initiated by its predecessor. At the same time, the government may implement measures to better target subsidies to their intended recipients. Other possible measures include a policy announcement to encourage more oil and gas exploration and approval of a new gas pricing formula.

Power reforms are one of Modi's key achievements; Gujarat turned to a power surplus from a deficit under his leadership

Power: The new government has indicated that it will provide a push to already-initiated power-sector reforms by (1) resolving regulatory issues (such as tariff renegotiation) and promoting competition; (2) improving domestic coal availability for

Figure 1: Growth recovery to start with investment

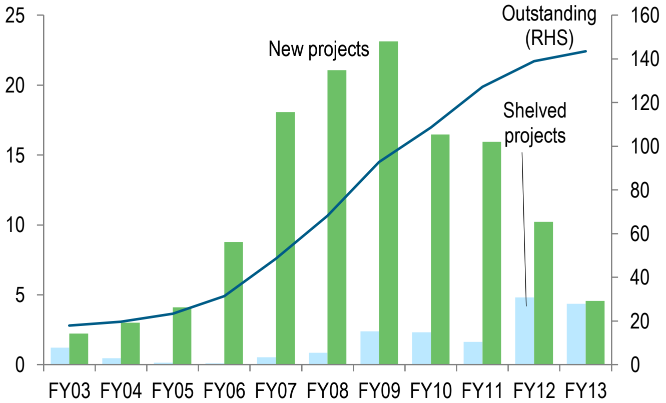
% y/y



Source: CEIC, Standard Chartered Research

Figure 2: Stalled projects to be kick-started

INR bn



Source: CMIE, Standard Chartered Research projects; and (3) fast-tracking distribution reforms. Power reforms are a key strength for Modi, as Gujarat turned to a power surplus from a deficit state under his leadership.

Roads: With a stable central government in place, the National Highway Authority of India (NHAI) is likely to award 2.5 times more road projects in FY15 than in FY13 and FY14 combined, according to our Equity Research team. Progress on these projects is likely to be quick, as the NHAI has already acquired the land. Premium rescheduling – re-bidding for unviable road bids made in FY11 and FY12 – is also likely. Progress on these unviable projects would ease stress on the banking sector.

Sectors to be targeted for new investment

Under a stable government, INR 5tn of investment in railways is expected in the next five years, in addition to maintenance capex

Railways: The BJP manifesto puts a strong emphasis on railway development, including the launch of the Diamond Quadrilateral Project, a network of bullet trains. Our Equity Research team foresees INR 5tn of investment in railways, in addition to maintenance capex, in the next five years. Indian Railways' large land bank is likely to reduce delays resulting from land acquisition hurdles.

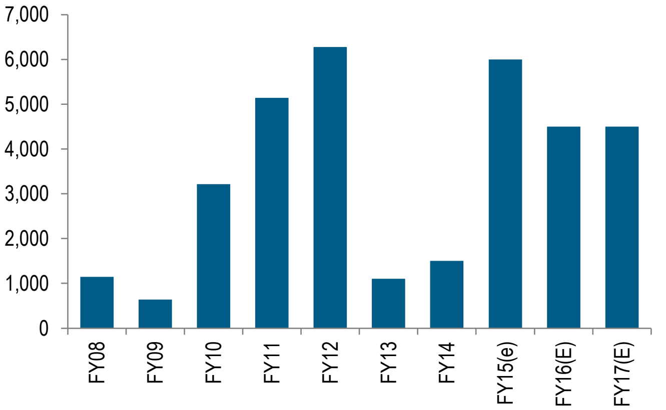
We expect several announcements on railway development in the next few months. The immediate focus is likely to be on building stretches of pending railway lines that have been delayed due to a lack of approvals or signalling system upgrades. Such projects are likely to receive increased attention, particularly if they can ease the transport of resources such as coal.

The government is likely to allow foreign direct investment (FDI) in railways in order to ease funding constraints and improve technology. FDI is currently allowed only in India's mass rapid transport systems. The outgoing United Progressive Alliance (UPA) government had prepared a cabinet note for such an announcement in early 2014, but it was not announced before the elections.

Renewable energy: Although India has 300 sunny days a year, solar power remains untapped as a way to meet increasing energy demand. Solar power meets less than 1% of India's energy demand, and the capacity is concentrated in the states of Gujarat (c.50%) and Rajasthan (40%). Given Modi's experience in implementing solar energy policy in Gujarat, he is likely to replicate it at the national level in the next five years. Gujarat has had a comprehensive solar energy policy since 2009, and the construction of Asia's biggest solar park was commissioned in the state in 2012.

Figure 3: National highway awards and targets

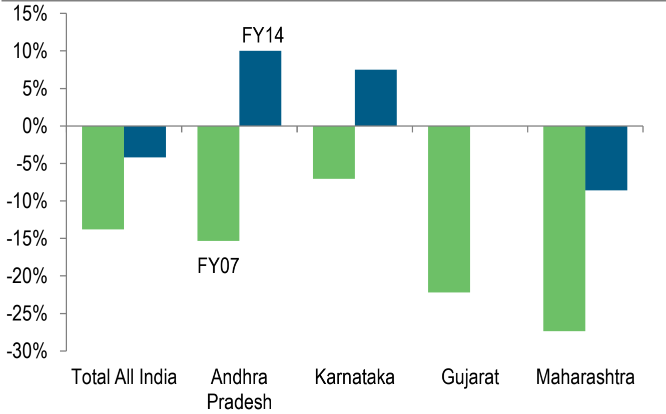
km



Source: NHAI, Standard Chartered Research

Figure 4: Gujarat's power deficit has been eliminated

% of peak power demand



Source: CEA Infrastructure Report 2013, Standard Chartered Research

Push for the manufacturing sector

Modi's experience in implementing solar energy policy in Gujarat should enable him to replicate it at the national level

The BJP has stressed the need to expand the role of the manufacturing sector in the economy, with an emphasis on SMEs. While this will require long-term policy changes, the government could start by providing tax incentives to selected sectors. We expect the creation of National Manufacturing and Investment Zones (NMIZs), or global manufacturing hubs, to be announced or implemented under the new government's National Manufacturing Policy.

Inflation and interest rate reduction

The government is likely to tackle supply-side bottlenecks to lower inflationary pressures

The government is likely to tackle supply-side bottlenecks in order to reduce inflationary pressures and create the appropriate macroeconomic environment to reduce interest rates. Accelerating investment in coal, power and roads would significantly reduce banks' stressed loans, as most of their non-performing assets are related to exposure to these projects. Such investment would boost credit growth to industry, albeit at a slow pace.

Measures to encourage FDI

Media reports suggest that the government might allow FDI in sectors like railways and e-commerce to emphasise its openness to foreign investment, particularly given uncertainty surrounding FDI in multi-brand retail. We expect announcements or a fine-tuning of current proposals on this market opening.

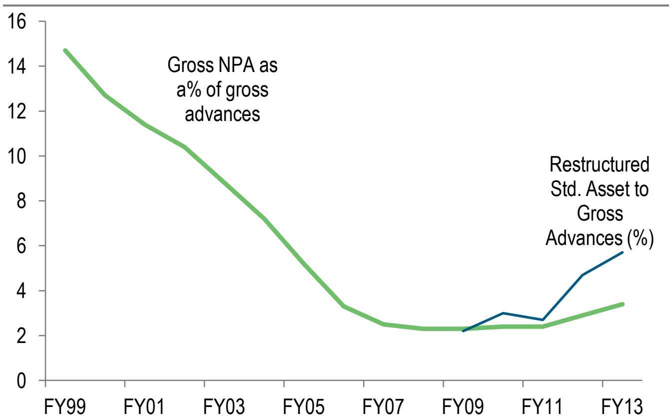
Job creation

Creating employment by focusing on labour-intensive sectors like manufacturing, tourism, retail, infrastructure/housing, and agriculture is a focal point of the BJP manifesto. When it was previously in power (1999-2004), the NDA created 61mn jobs, primarily in the construction sector; this compared with just 2.7mn jobs created from 2005-09. The BJP has opposed FDI in multi-brand retail partly on the grounds that it would reduce self-employment opportunities for retail traders.

A broader revival in economic activity would reduce job insecurity and ultimately create more jobs

If the government can boost economic sentiment, this will reduce job insecurity. Kick-starting stalled infrastructure projects is also likely to create more jobs. The government might also redefine the scope of its employment guarantee scheme in order to increase the productivity of workers employed under the scheme. A policy announcement on skill development is likely, though the impact is likely be felt only in the medium to long term.

Figure 5: Improving banks' asset quality depends on growth



Source: RBI, Standard Chartered Research

Figure 6: Job creation has been slow

Number of jobs created

	FY00-FY05	FY05-FY10
Agriculture	21.25	-15.71
Manufacturing	11.72	-7.23
Mining & electricity	0.64	0
Construction	8.48	26.14
Trade	6.74	-1.29
Hotels & restaurants	1.48	-0.19
Transport, storage, communication	3.86	0.89
Banking insurance, real estate	2.82	1.75
Public administration & others	3.71	-1.64
Total	**60.7**	**2.72**

Source: Planning commission, Standard Chartered Research

Containing inflation

India has faced persistent inflation in recent years. The BJP manifesto identifies controlling inflation as an urgent priority, and Modi has reiterated this view in various speeches.

While structural reforms – such as boosting agricultural production by improving yields, expanding irrigation facilities, and making other input improvements – will take time, the government can address price pressures in the shorter term by improving the distribution of agricultural products.

Price monitoring and anti-hoarding measures

In 2011, the PM's Working Group on Consumer Affairs, headed by Modi, recommended setting up Special Courts under the Essential Commodities Act (ECA) to ensure speedy trials of food hoarders. It recommended that such offences be made non-bailable and carry strict penalties. Various studies have shown that hoarding contributes to price spikes. However, strong action to prevent such activities has been lacking.

Better co-ordination and stricter measures against hoarding and food-price speculation are likely

According to a parliamentary standing committee report in mid-2012, less than 4% of those prosecuted for black marketing in essential commodities from 2009-12 were convicted. In 2011, for example, only 30 of 4,486 cases were convicted. Inadequate responses from state governments and the failure of the central government to take action against states that do not meet requirements drew heavy criticism from the committee.

Better centre-state co-ordination and stricter measures against food hoarding and speculative activities are likely under the new government for both essential commodities and perishables.

Price stabilisation fund

The BJP manifesto promises a price stabilisation fund to contain food-price volatility. States are expected to use the fund to intervene in food markets when prices become unreasonably high. Such a scheme already exists, but only for four plantation crops: tea, coffee, rubber and tobacco. We expect the scope of the fund to be expanded, probably in the FY15 budget, with states playing a greater role.

Focus on improving the efficiency of the Public Distribution Scheme

We expect the new government to accelerate the computerisation of the Public Distribution Scheme (PDS) for food, as Modi has stressed the need to leverage technology to improve efficiency. The outgoing UPA government launched a push for end-to-end digitisation of the PDS scheme in 2012. As of March 2014, 22% of the INR 8.84bn set aside for this purpose for 2012-17 had been released to 20 of 28 states/union territories.

Progess on digitisation has been uneven. More than 80% of states and union territories have completed digitisation of PDS operations for ration cards/godowns, while fewer than 10% have completed the computerisation of their supply chains. Only a handful of states have taken steps to issue smart cards to consumers.

Reforms to the Public Distribution Scheme for food are likely

Given funding availability, an increased emphasis on faster PDG digitisation is likely, as it can help to curb food grain leakages during distribution. A study by PRS Legislative Research estimates that c.40% of food grains under the PDS are leaked into the open market while being moved from central storage facilities to the shops where they are distributed to consumers.

Unbundling of Food Corporation of India (FCI)

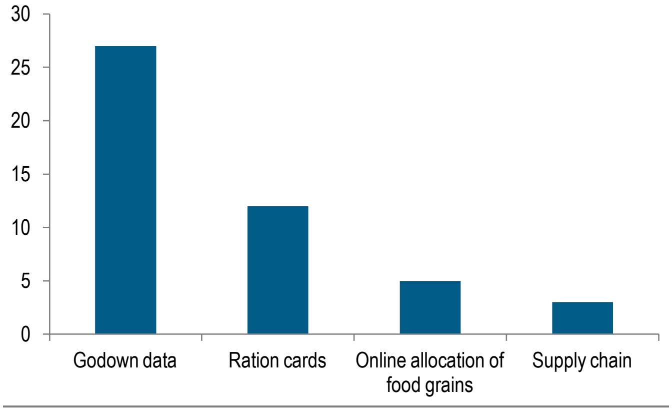
The FCI is currently responsible for (1) procuring and storing food grains, (2) maintaining a buffer stock, and (3) allocating and distributing food grains to states for the PDS. The government is likely to unbundle these three activities to improve transparency and efficiency. We expect it to emphasise the creation of more storage capacity, evenly distributed across the country. The Comptroller Auditor General report of 2013 found that the FCI's storage capacity had stagnated at 15.1-15.6 million tonnes (mt) from 2006-11, falling short of accommodating the minimum buffer stock of 21.2-31.9mt for various food grains. The government may also introduce regulations to ensure that the FCI offloads excess stock in the open market, according to media reports.

Improvements in agricultural marketing

We expect increased efforts to improve agricultural marketing under the new government. The BJP manifesto identifies agri marketing as a priority sector for lending. Implementing this would require coordination between the government and the Reserve Bank of India (RBI).

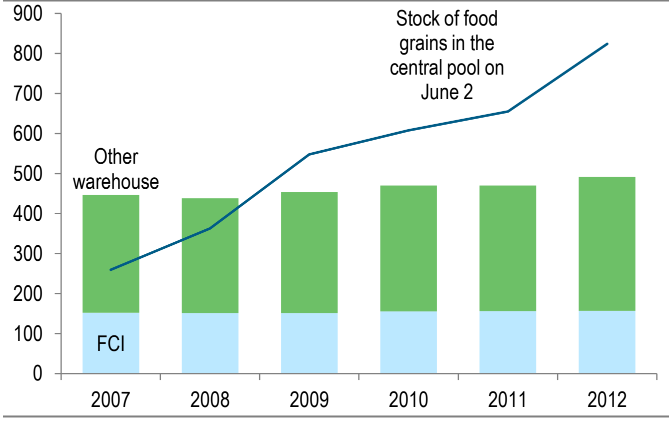
Figure 7: Status of digitisation of PDS

Number of states that have computerised selected PDS operations



Source: Department of Food & Public Distribution, Standard Chartered Research

Figure 8: Urgent attention is required to boost food storage capacity *(lakh mt)*



Source: CAG report 2013 'Storage management and movement of food grain in FCI', Standard Chartered Research

Fiscal measures

The government is likely to continue with fiscal consolidation, though a marginal upward revision of the FY15 fiscal deficit target cannot be ruled out

We expect the new government to remain on the fiscal consolidation path, though a marginal upward revision of the FY15 fiscal deficit target cannot be ruled out. The outgoing government targeted a FY15 deficit of 4.1% of GDP. We do not expect a significant upward revision given the strong fiscal discipline seen under previous NDA government and in Gujarat under Modi's leadership. Gujarat reduced its fiscal deficit to 2.6% of gross state domestic product (GSDP) in FY12 from 5.2% in FY02. The government has almost eliminated its revenue deficit in the past 10 years, reducing it from a high of 5.4% of GSDP in FY02.

Revenue generation

Buoyant equity market has improved prospects for disinvestment proceeds

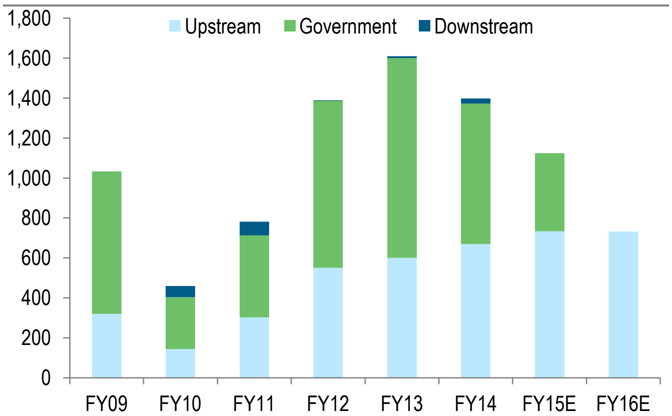
The government is likely to emphasise better tax administration as a way to improve revenue collection. We expect the government to remain highly dependent on disinvestment proceeds (especially in FY15) to contain the fiscal deficit. A buoyant equity market increases the chances of higher disinvestment proceeds in FY15 – the BSE PSU index has increased by 56% since the end of February 2014.

GST introduction would be a major supply-side reform

The introduction of a uniform goods and service tax (GST), which the new government has said is a priority, would be an important supply-side reform. The GST can come into effect in FY16; while it has been under discussion for eight years, the NDA government is likely to need more time to pass legislation enabling its implementation. The GST requires a constitutional amendment passed by both houses of parliament with a two-thirds majority. The majority of state legislative assemblies would then need to adopt it.

Further consensus needs to be built among states on contentious issues that have delayed GST implementation. These include allowing states to set the tax rate within a narrow band rather than at a single level, deciding which goods will be exempt, compensating states for revenue lost due to the GST, releasing payments due to states from the reduction in the Central Sales Tax (CST), rolling the entry tax (currently levied by some states when goods produced in other states cross their borders) into the GST, and setting up a dispute resolution authority. The parliamentary standing committee on finance has given its opinion on most of these issues, and the NDA government will have to make the required changes in the constitutional amendment bill. The government will need to strike a balance between addressing states' concerns about losing their fiscal autonomy and ensuring that the GST is not diluted by too many exemptions and concessions to states.

Figure 9: Fuel subsidies may be reduced by FY16
INR bn



Source: Standard Chartered Research

Figure 10: Buoyant equity market boosts prospects for disinvestment proceeds *(BSE PSU index value)*

Source: Bloomberg, Standard Chartered Research

Based on the BJP manifesto and public comments, the government may also announce relief from retrospective taxation. The BJP government has emphasised the need for a stable tax regime, and it may roll back some retrospective decisions requiring corporates to pay additional taxes. Marginal tax relief for the middle class and tax holidays to incentivise investment in selected sectors are also likely.

Expenditure management

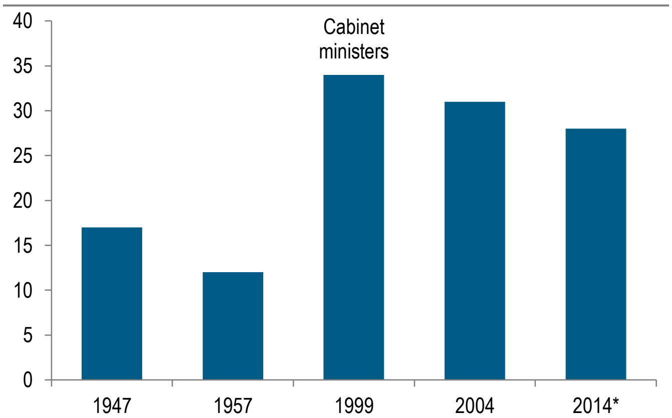
The allocation for capital expenditure is likely to be increased to 2% of GDP from 1.8% currently.

The gradual reduction of fuel subsidies is likely to continue, but they are likely to stay close to the target set by the outgoing government in the interim budget. The cap on the number of cooking gas cylinders allocated to each household per year may also be reduced to nine from 12 currently, according to media reports. Our Equity Research team forecasts a minimal fuel subsidy requirement in FY16, assuming a stable currency and crude oil price. A reduced fuel subsidy burden would give the government more flexibility in allocating capital expenditure.

Better targeting of subsidies and the continued reduction in the number of Centrally Sponsored Schemes (CSS) are likely. These schemes are funded by the central government and implemented by states. The UPA government announced that the number of CSS would be consolidated to 66 in FY15 from 142 in FY14 to improve monitoring and efficiency; the FY15 interim budget includes allocations for 66 CSS programmes. We broadly expect this policy to continue. The policy of giving states more flexibility to implement CSS, and to use a proportion of CSS funds for other expenditures more relevant to each state, is likely to be strengthened.

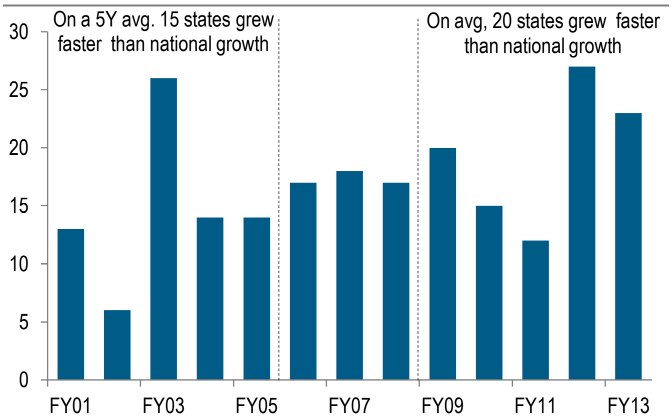
The BJP manifesto promises to bring black money back into government coffers, prompting expectations of a tax amnesty scheme like the one announced in 1997. While such an announcement cannot be ruled out, we highlight three arguments : (1) such schemes are usually considered unfair to honest taxpayers and may therefore draw criticism; (2) the implementation of an amnesty scheme could prompt the Supreme Court to seek explanations from the government, under an assurance provided by the government to the court in 1997; and (3) the government might not have enough time to put the mechanism in place to implement the scheme in the FY15 budget.

Figure 11: Size of cabinet has grown over the years
Number of ministers



* UPA government; Source: Cabinet ministers, media reports, Standard Chartered Research

Figure 12: An evolving partnership with states is important as they grow stronger *(number of states)*



Source: Planning Commission, Standard Chartered Research

Minimum government, maximum governance

Fewer ministers, more technocrats

The Council of Ministers is smaller

The new government has reduced the number of cabinet ministers to 23 from 28 to improve policy making. The Council of Ministers includes cabinet ministers (most senior ministers), Ministers of State (junior ministers reporting to cabinet ministers) and Ministers of State with independent charge (those that do not report to cabinet ministers). The size of the Council of Ministers including the prime minister is now 45, from 72 under the UPA.

Ministries can be consolidated and better coordinated

A single energy ministry may set policy for oil and gas, coal, power, renewable energy and nuclear energy, according to media reports; currently, different ministries handle each of these areas. Similarly, 18 ministries related to infrastructure are likely to be consolidated into one or two. More technocrats are also likely to be included in the Council of Ministers.

Empowering the bureaucracy

Difficulties in obtaining bureaucratic approvals for major investment decisions have been cited as an important reason for the slowdown in India's investment cycle in recent years. We expect the government to incentivise and empower the bureaucracy. Greater empowerment of the bureaucracy has been a unique characteristic of the Gujarat administration in the past decade, and we expect this to be replicated at the central government level.

The proposed amendment aims to protect bureaucrats who make bona fide decisions; this might quicken approval processes

The passage of the Prevention of Corruption (Amendment) Bill 2008 is seen as an important step towards empowering the bureaucracy. The bill is currently pending in the upper house of parliament; the amendment aims to protect bureaucrats who take *bona fide* decisions, even if they lead to losses for the exchequer. Without this amendment, the bill does not clearly distinguish between *bona fide* and *mala fide* decisions; As a result, bureaucrats are cautious in taking decisions.

E- governance and streamlining of administrative process

Reducing the need for manual intervention by computerising administrative processes is likely to be an emphasis of the new government. To make it easier to do business in India, the government is likely to announce a roadmap for a single-window investment approval system, a 'one-stop shop' for all required approvals.

Developing the partnership between centre and states

The BJP and its leaders have emphasised a model of "national development driven by the states". In his speeches, Modi has flagged the importance of redefining the relationship between the central and state governments in order to push through reforms like the GST, which have been held back by a lack of consensus. India has a federal structure with 28 states (29 from 2 June), and policy is generally driven by the central government.

Devolving more power to the states would be a ground-breaking change. Such cooperation might take time to materialise, however, as the BJP and its allies are in power in only eight of India's 29 states. This means intensive consensus-building will be needed on these issues in non-NDA-ruled states.

Given his three terms as Gujarat's chief minister, Modi has a good understanding of issues at the state level. He will be India's first chief minister to serve as prime minister of a majority government. (Two chief ministers have become prime minister in the past, but both belonged to short-lived minority governments.) We expect increased consultation between the central and state governments, probably via a new committee consisting of the prime minister and chief ministers. We also expect changes such as increasing state governments' fiscal autonomy and flexibility to implement reforms in their own states. While quick results are unlikely, we will monitor the areas outlined below to gauge progress on government efforts to redefine India's federal system.

Land acquisition act

An overhaul of the APMC act is required to encourage more competition, improve agri-marketing infrastructure, and offer better returns to farmers

The amended land acquisition act is viewed as a key hurdle to rapid industrialisation, progress on infrastructure projects, and urban development. The central government might try to overcome this challenge, at least in states where the BJP and its allies are in power, by allowing state land legislation to prevail over the national legislation. BJP members have pointed out that under article 254 (2) of the constitution, state legislation can prevail over existing national legislation if President Mukherjee assents to the state legislation.

APMC reforms

Agricultural Produce Market Committees (APMCs) are formed by each state government to regulate agricultural produce markets, with a view to protecting farmers' interests. Farmers sell their products to licensed traders in these regulated markets at remunerative prices. Over time, however, the market and the traders have become increasingly monopolistic, reducing returns for famers. Speculative activity by traders has also pushed up retail prices. While the previous NDA government introduced a revised APMC Act in 2003 introducing modern concepts like direct marketing, contract farming, and exempting perishables from being sold through regulated markets, only a handful of states have implemented it. An overhaul of the APMC Act is needed to encourage more competition, improve agri-marketing infrastructure, and offer better returns to farmers. The central government will need to motivate more states to reform and implement this act.

Best practices at the state level to improve business environment

States have an active role to play in improving the business environment

India's business environment ranks poorly in the World Economic Forum's Doing Business survey. While the central government can take measures to address this, states also have an active role to play. The Department of Industrial Policy and Promotion (DIPP) recently identified six best practices after conducting a study all India's states. The adoption of these practices in more states would improve the business environment for the country as a whole. For instance, Karnataka's system for managing indirect taxes, Maharashtra's single-window approvals for the setting-up of industry, and Gujarat's land-related interventions have been identified as policies to enhance the efficiency of industry. The government is likely to encourage more states to adopt these practices.

Disclosures Appendix

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