

Short-term impact of General Elections on the markets and economic indicators

It is difficult to find a strong connection between them

The countdown begins in earnest: India prepares to hold its 18th Lok Sabha elections in Apr-May'24. General elections are assumed to have wide-ranging consequences, affecting not only the political and economic landscape but also the financial markets. In this note, we focus on the short-term impact of general elections on four broad parameters: 1) financial markets, 2) monetary variables, 3) fiscal parameters, and 4) indicators related to the rural economy. For most of our analysis, we consider data from the past five elections (i.e., 1999, 2004, 2009, 2014 and 2019) and analyze the changes in these indicators pre- and post-elections, i.e., six months before and after the election results. Overall, the benchmark large-cap equity market index (Nifty50) has increased both before and after the elections, with lower 10-year bond yield during most election periods and no uniform trends in the currency. Further, we find it difficult to establish any uniform patterns in monetary or fiscal variables vis-à-vis election years. Within the rural sector indicators, MSP hikes tend to be higher in the year before elections, but other indicators do not show any connection.

Impact on financial markets before and after elections:

- What are the typical behaviors of different financial markets before and after election results are announced? In this section, we provide answers using data on the equity market (Nifty-50 index), 10-yr bond yield, Indian Rupee vs. US Dollar (INR/USD), and foreign portfolio investment (FPI) flows. Broadly speaking, equity markets (and FPI equity flows) appear to grow in the six-month period before and after results, with lower yields in the majority of election periods and stronger/weaker INR/USD in the pre-/post-result periods during the last two elections.
- An analysis of the past five general elections suggests that the stock market (using point-to-point data) has exhibited higher returns in the run-up to elections, and while there are immediate fluctuations post-election results, the equity market totally absorbs them over time (*Exhibit 1*). Nifty-50, a benchmark index of India's large-cap listed companies, has grown between 7% and 36% in the run-up (i.e., six months prior) to general elections since 1999, with an average growth of 21% during the last five elections. In the quarter following the election results, markets fell twice (in 2004 and 2019); however, they moved into the growth territory within the subsequent quarter (i.e., six months after the election results), with an average growth of 14% during the past five elections. The trends are broadly similar for the mid-cap and small-cap indices as well.
- A similar analysis for the benchmark 10-year government bond yield reveals that the yield fell four times in the last five pre-election periods (except in 2004), with an average decline of 40bp (one bp is one-hundredth of a percentage point – pp). Unlike the Nifty-50, the movements in the post-result period gain strength over time but do not change direction. For instance, the bond yield fell in three of the past five post-result periods (except in 2004 and 2009). The fall in yields in 1999, 2014 and 2019 in the month following the results exacerbated in three and six months after the results. Similarly, the 10-year yield rose in the month immediately post-results in 2004 and 2009, which increased further in the following three-month and six-month periods (*Exhibit 2*).
- An analysis of the movements in INR/USD reveals that INR weakened in the pre-election period in 1999; it was broadly stable in 2004 and 2009; while it strengthened in 2014 and 2019 (*Exhibit 3*). Interestingly though, the INR appeared to strengthen against the USD in the month post-elections every time, except in 2014. Over the next few months (i.e., six months post-results), however, INR strengthened against the USD in 2004 and 2009, while it weakened in 2014 and 2019 (when it had strengthened in the pre-election period). The only uniformity, thus, happens to be that the pre- and post-result movements in the INR/USD are opposite to each other, as confirmed by the past four general elections.
- In line with the trends seen in equity markets, the FPI equity inflows have also been positive during the past five pre- and post-election periods (*Exhibit 4*). Notably, FPI equity inflows in the post-result six-month period were only 0.2x of the pre-results six-month period in 2019, while they were as much as 8.4x in 2009 (which suffered due to 2008 great financial crisis). Interestingly, the pre-election FPI equity inflows were ~USD10b each in 2014 and 2019, albeit they were notably lower in the post-result period in 2019 (only USD2.4b), compared to 2014 (only USD8.9b). The conclusions are not very different for total (equity + debt) FPI flows (*Exhibit 5*).

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Impact on monetary variables before and after elections:

- How do the monetary variables react during election periods? Instead of looking at the policy interest rates, we look at four other indicators to answer this question: currency with public (CwP), broad money supply (M3), bank credit growth, and the banking sector's liquidity (via liquidity adjustment facility – LAF window).
- Does the “currency with public” (CwP) witness a sudden increase in the run-up to elections? The logic behind asking this question is very straightforward. It is argued that the political parties announce freebies and may indulge in cash distribution to entice voters before the elections. If so, CwP would rise in the run-up to the general elections. However, we do not find any evidence to support this argument. Historical data suggest that the growth in CwP improved slightly in the months before elections only twice (1998-99 and 2003-04) of the last five elections. Even if we exclude 2018-19, which saw distortions due to demonetization in Nov'16, there was no pick-up in CwP a few months before the elections in either 2008-09 or 2013-14. The growth in CwP in the past few months is at the lowest in the past three decades (*Exhibits 6 and 7*).
- What if the politicians deposit money directly into the voters' bank accounts instead of distributing cash? The M3 can be measured as the sum of deposits and CwP. The trends seen in M3 growth were broadly similar to those in CwP, although the latter is only a small part of M3. In four of the last five elections, there was no sudden or material surge in M3 growth, except 2003-04. It remained broadly stable in the year before the elections. M3 growth has remained very stable between 10.5% and 11.5% in the past many months as well (*Exhibits 8 and 9*).
- Were more loans disbursed by the banking sector in the run-up to the elections? Not really. Like CwP and M3, there is no evidence to doubt that the government uses its discretion to make banks loan out more in the run-up to the elections. There was definitely some uptick in bank credit growth in a few months before 1999 and 2004 elections. However, it was totally missing in 2009, 2014 and 2019. In 9MFY24, bank credit growth has remained robust and very stable at ~15% YoY (*Exhibits 10 and 11*).
- Lastly, we analyze the banking system's liquidity using LAF balances to gauge if there is any evidence of monetary easing in the run-up to the general elections (please note that LAF data is available only from 2008/FY09). An improvement in LAF balances suggests easy liquidity in the banking sector, and vice versa. Again, our findings suggest that there is no visible pattern of improved LAF balances (i.e., monetary easing) before the last three elections (*Exhibit 12*). This is not surprising considering that we did not find any connection between various monetary variables in the run-up to general elections.
- Overall, we do not find any connections between various monetary variables and general elections. Neither has the nation seen a sudden splurge in cash distribution before the elections, nor has there been a rise in M3 (or deposits) in the run-up to the general elections and nor has there been an uptick in bank credit growth. Further, banking system liquidity also does not show any unusual trends around elections, thus entirely refuting the idea of any impact of elections on these variables.

Impact on fiscal indicators before and after elections:

- There is a general belief that the incumbent government tends to use populist measures before elections to counter anti-incumbency and lift economic sentiments. To validate this hypothesis, we look at the deviation of the actual fiscal deficit vis-à-vis budget estimates (BEs) for the year before and after elections (i.e. FY19 and FY20, for 2019 elections). Further, we also look for any exceptional surge in the growth in revenue spending, or subsidies or reduction in capital spending, to gauge if the fiscal expansions during elections is a usual occurrence. Our conclusion is very simple and in contrast to the general belief. We do not find any uniform patterns in the fiscal indicators before or after the general elections (including Interim Budgets).
- During the past five elections, the actual fiscal deficit was lower than BEs in two years (FY04 and FY14), higher than BEs twice (FY99 and FY09) and broadly in line with BEs once in FY19. In fact, between FY13 and FY23, barring the pandemic years (i.e., FY20 and FY21), the actual fiscal deficit of the Union Government has been broadly in line with the BEs (*Exhibits 13 and 14*). As a % of GDP, the Government of India (GoI) has missed its deficit targets only four times in the past two decades – FY09, FY12, FY20 and FY21. The GoI missed its targets in all the years prior to FY04 (*Exhibit 15*).
- Further, it is equally difficult to connect election years with higher revenue spending and/or subsidies. In three of the last five election years, including the recent two, the average growth in revenue spending was 8%, with an exceptional growth of 20%/33.5% in FY99/FY09 (*Exhibit 16*). Similarly, barring FY99 and FY09, there was no growth in subsidies in the remaining three election years (*Exhibit 17*). Moreover, revenue spending in three of the last four elections was actually lower than BEs (*Exhibit 18*), with subsidies being lower than budgeted in the last two election years, i.e., FY14 and FY19.

- One may argue that the Government of India (GoI) may announce some new populist measures during the interim budgets before the elections, which would reflect in the following years (i.e., FY00, FY05, FY10, FY15, and FY20), rather than the election years (*please see Exhibit 16 again*). Well, the average growth in revenue spending and subsidies during these five years was 12% and 7%, respectively, which does not qualify as exceptionally high, especially considering the fact that FY20 was hit by the pandemic (with 17-18% growth each in revenue spending and subsidies).
- Does the government cut capex during election periods? It is more sensible to look at the pre-election years to answer this question. The average growth in GoI's total capital spending (including loans & advances) in the last five pre-election years (i.e., FY99, FY04, FY09, FY14 and FY19) was 15% (and 13% excluding FY99), and it was substantially higher/lower than BEs only in FY04/FY14, as well as broadly in line with BEs in FY09 and FY19 (*Exhibits 19 and 20*). During the last four election years (i.e., FY05, FY10, FY15 and FY20), the average growth in GoI's capital spending was 11%, not much different from what it was in the pre-election years.
- Lastly, is there a sudden rise in rural spending by the GoI during election periods? Similar to what we discussed above, barring FY99 and FY09, the average growth in rural spending (including the Ministry of Agriculture and Farmers' Welfare, Department of Fertilizers, Department of Drinking Water and Sanitation, Ministry of Panchayati Raj, and Ministry of Rural Development) was 4.4% in the pre-election years (i.e., FY04, FY14, and FY19). The growth was less than 10% each in FY00, FY05, and FY15 in the post-election year; declined in FY10 (due to base effect in FY09) but jumped to 26.6% (partly due to the announcement of PM-KISAN scheme) in FY20 (*Exhibit 21*).
- Overall, there is no sudden surge in any of the fiscal parameters, which suggests that the GoI does not give in to the temptation of populist measures around general elections. FY09 was certainly an exceptional year, which included various schemes (such as the implementation of the 6th Pay Commission, and expansion of MGNREGA to the entire rural India); however, it was also the GFC period. Similarly, we know that new populist schemes were announced during the last interim Budget in 2019, just before the elections. However, neither FY04 nor FY14 saw any major policies. There were no such populist schemes in 2023-24 Budget as well; however, the possibility of some announcements during the interim budget in Feb'24 cannot be ruled out.

Impact on rural sector indicators before and after elections:

- There is another belief that the GoI tends to do something special for the rural sector to entice them during the voting season. Although we did not find any uniform pattern in rural spending, there are other measures that can be taken to support the rural sector. We look at the trends in three such indicators – minimum support prices (MSPs), MGNREGA spending, and food inflation – to gauge if GoI provides an extra support to the rural sector during election periods.
- There are two agricultural seasons in India – kharif (summer) and rabi (winter). Both seasons account for roughly half of total food grain production in the country, with the kharif season being dedicated to rice and coarse cereals, while wheat and pulses production dominates the rabi season. However, as far as MSP-crops are concerned, the kharif season accounts for ~60% of the total production. Minimum support prices (MSPs) is one indicator, which shows higher growth in the pre-election years (*Exhibits 22 and 23*). This is true for FY24 as well, when the production-weighted MSP hike was 7.7% (including kharif and rabi crops), the highest in five years.
- Despite the fact that the National Rural Employment Guarantee Act (NREGA), 2005 is a demand-driven program, it is widely believed that the government tends to increase expenditure under this program during election years. NREGA was implemented on the national level (for rural areas) only in 2009, before it was operational in only selected areas. It is no surprise then that NREGA spending was revised to INR300b in FY09 from INR144b. However, in FY14 and FY19, there were no such substantial differences between the actual spending and BEs (*Exhibit 24*). Notably, though the actual NREGA expenditure has been higher than BEs each year since FY16 (including FY24), it reflects the inability of the GoI to forecast its demand accurately.
- Food items account for ~40% of India's CPI (consumer price index) basket. Higher food inflation is definitely not good for consumers and thus, the economy. However, food prices are the realization for its producers, namely the farmers. It is then possible to boost the farm sector by pushing up food prices or inflation. During the past five elections, food inflation (from CPI for rural laborers) was in double-digits in FY99, FY09, and FY14, but only 2-4% in FY04 and FY19. Thus, there is no uniform trend (*Exhibit 25*). In fact, higher inflation is seen as one of the factors that led to the fall of the government in 2014. So, it would be surprising if higher food inflation were used as a strategy to support the rural economy.
- Overall, except in MSPs, there is no uniformity in NREGA spending or food inflation during election years. Since NREGA is a demand-driven program, the GoI has little control over it, and higher food inflation may do more harm for the incumbent government. The MSP hike in FY24 was the highest in five years; NREGA expenditure will also be much higher

than the BEs this year and food inflation will also remain high (6.5-7.0%). However, it would be unfair to conclude that the GoI has helped to achieve them in order to entice the voters, especially when the rural spending of the GoI declined 3% YoY in Apr-Nov'23.

In sum, it is challenging to establish a strong connection between general elections and economic indicators. Despite our beliefs, we failed to find any uniformity in currency with public (or M3), fiscal indicators, and GoI's rural spending (including NREGA expenditure) leading up to the general elections. However, this does not rule out the announcement of populist measures in the Interim Budget 2024-25, which is set to be presented on 1st Feb '24.

Exhibit 1: Benchmark large-cap equity market index tends to rise before and after election results

Election result dates	Nifty-50 performance (%)					
	Pre-election			Post-election		
	6-month	3-month	1-month	1-month	3-month	6-month
06-Oct-99	36.3	11.0	-0.9	-1.0	15.8	5.4
13-May-04	6.7	-9.2	-6.9	-11.8	-6.1	9.3
16-May-09	30.6	28.9	5.4	22.1	24.7	37.8
16-May-14	17.6	17.8	5.8	5.8	9.4	17.8
23-May-19	11.5	8.8	1.2	-0.1	-8.5	1.5
Simple average	20.5	11.4	0.9	3.0	7.1	14.4

Pre-election Nifty-50 performance is calculated using the point-to-point index until the end of day before result date; Election result end-day index is the starting point for calculating post-election Nifty-50 performance Source: India Stock exchanges (BSE/NSE), CEIC, MOFSL

Exhibit 2: The 10-year bond yield has mostly fallen during election periods

Election result dates	Change in 10-year bond yield (bp)					
	Pre-election			Post-election		
	6-month	3-month	1-month	1-month	3-month	6-month
06-Oct-99	-0.42	-0.26	-0.05	-0.09	-0.35	-1.19
13-May-04	0.12	-0.09	0.11	0.14	1.45	2.05
16-May-09	-1.05	0.38	-0.24	0.47	0.69	0.90
16-May-14	-0.23	-0.02	-0.17	-0.14	-0.27	-0.57
23-May-19	-0.45	-0.16	-0.22	-0.40	-0.70	-0.76
Simple average	-0.41	-0.03	-0.11	0.00	0.17	0.09

Pre-election Nifty50 performance is calculated using the point-to-point index until the end of day before result date; Election result end-day index is the starting point for calculating post-election Nifty50 performance Source: RBI, CEIC, MOFSL

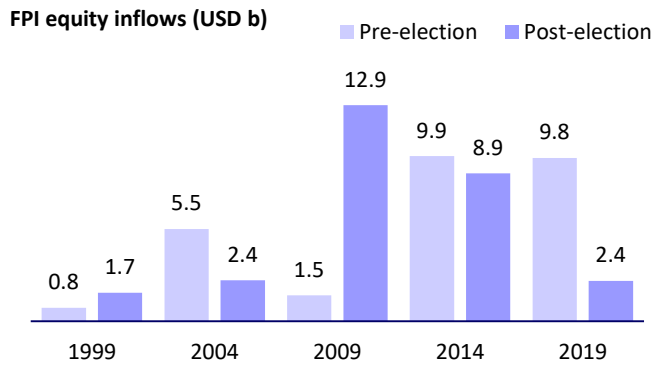
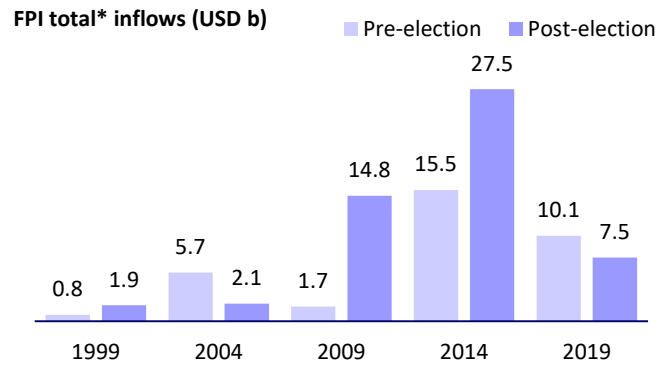
Exhibit 3: INR has strengthened/weakened in the pre-election period with opposite reaction post-results

Election result dates	INR/USD performance (%)					
	Pre-election			Post-election		
	6-month	3-month	1-month	1-month	3-month	6-month
06-Oct-99	2.7	0.7	0.3	-0.4	-0.2	0.1
13-May-04	0.2	0.4	4.1	-0.7	1.8	-0.5
16-May-09	0.2	1.7	-0.7	-3.2	-2.6	-7.0
16-May-14	-5.7	-4.5	-1.3	0.9	2.7	3.7
23-May-19	-2.0	-2.0	0.0	-0.2	2.8	3.0
Simple average	-0.9	-0.7	0.5	-0.7	0.9	-0.1

Pre-election Nifty50 performance is calculated using the point-to-point index until the end of day before result date; Election result end-day index is the starting point for calculating post-election Nifty50 performance

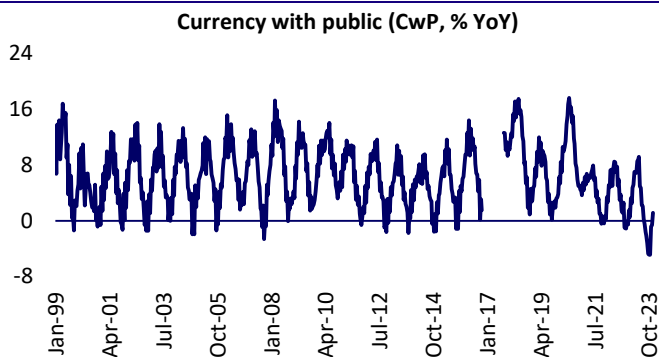
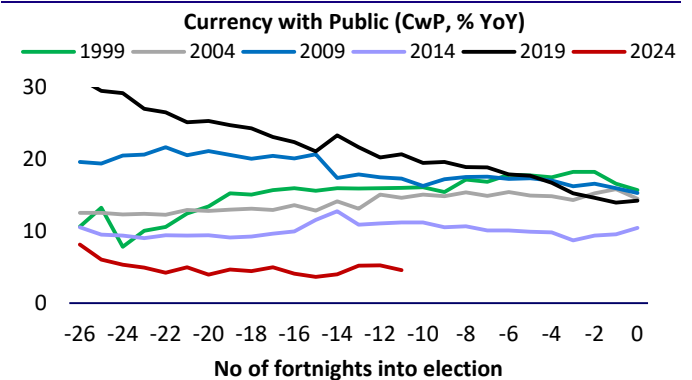
A rise (fall) represents INR depreciation (appreciation) vis-à-vis USD

Source: RBI, CEIC, MOFSL

Exhibit 4: FPI equity flows have been positive before and after elections...**Exhibit 5: ...and the same was the case with total FPI flows (including debt)**

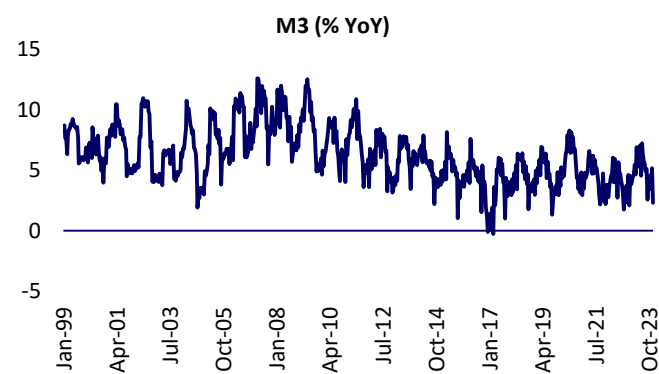
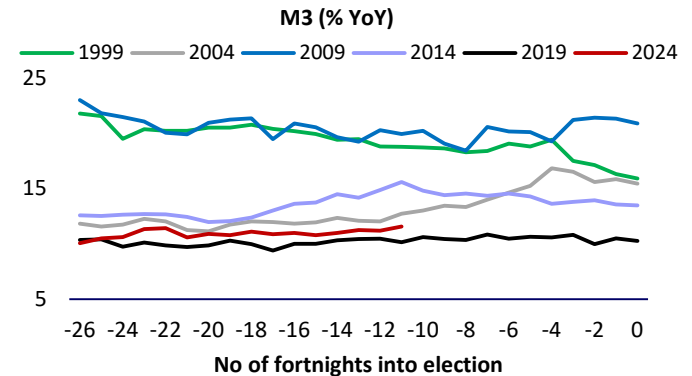
* Debt + equity flows

Source: Various national sources, RBI, CSO, CEIC, MOFSL

Exhibit 6: Long-term trends in CwP**Exhibit 7: Changes in CwP in the run-up to the elections**

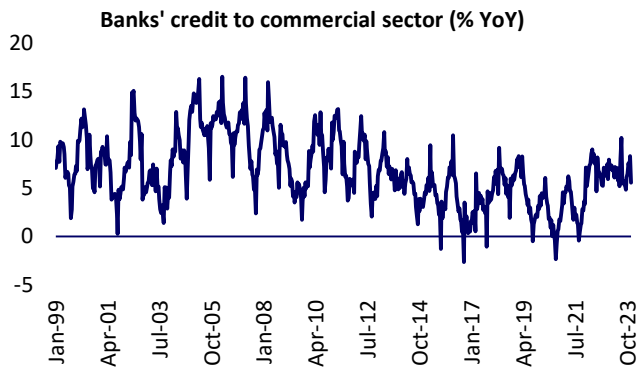
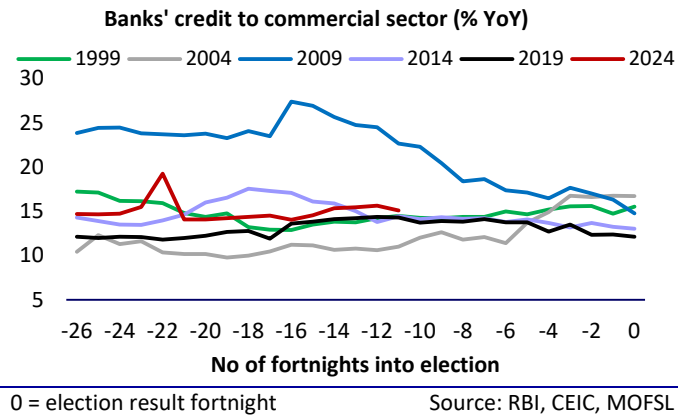
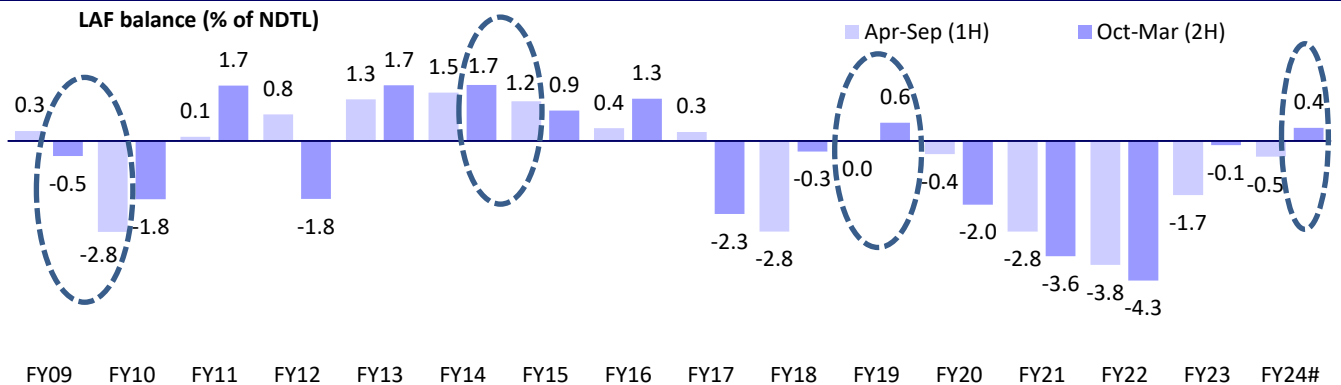
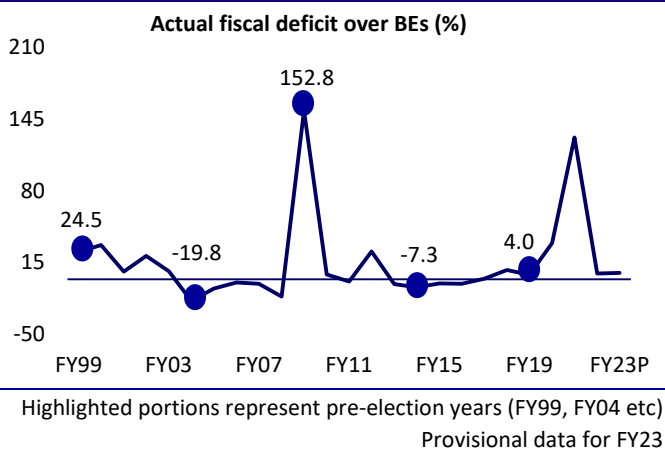
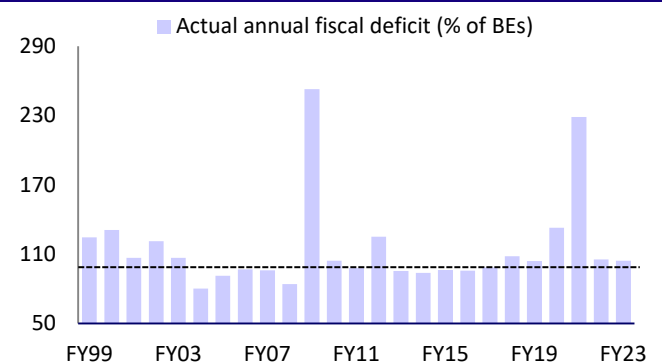
0 = election result fortnight

Source: RBI, CEIC, MOFSL

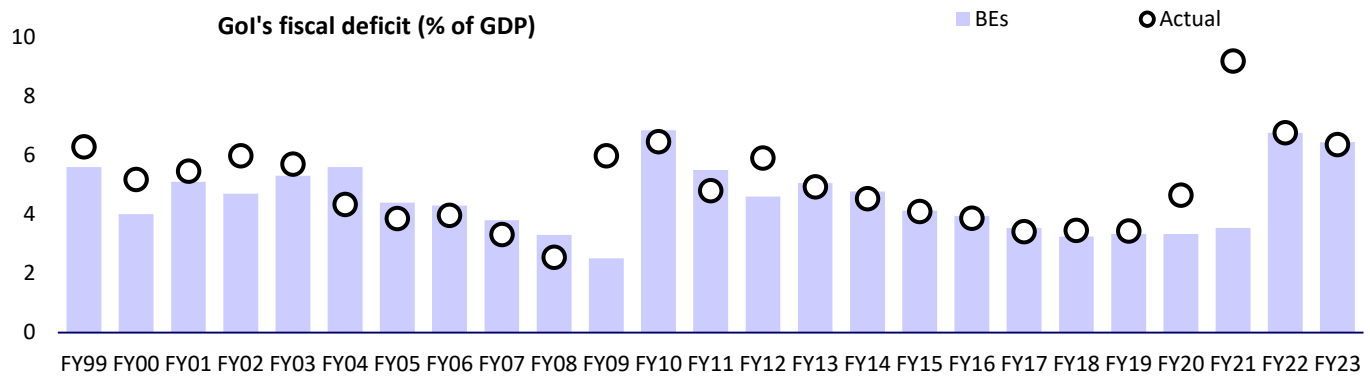
Exhibit 8: Long-term trends in M3**Exhibit 9: Changes in M3 in the run-up to the elections**

0 = election result fortnight

Source: RBI, CEIC, MOFSL

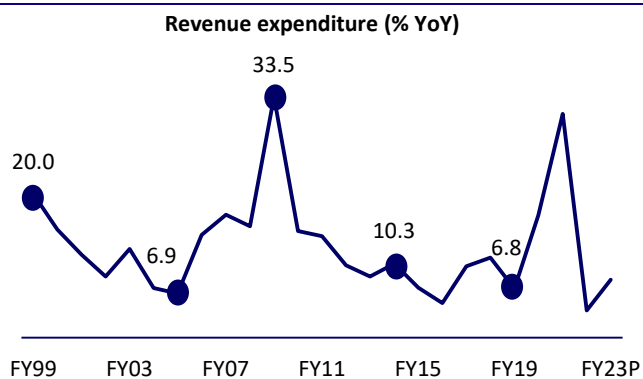
Exhibit 10: Long-term trends in banks' credit to the commercial sector**Exhibit 11: Changes in banks' credit in the run-up to the elections****Exhibit 12: No evidence of monetary easing during elections using LAF balances****Exhibit 13: Actual GoI's fiscal deficit has been higher only twice in the last five elections****Exhibit 14: Actual fiscal deficit was 104% of BEs in FY19, and <100% in FY04 and FY14**

Source: Union Budget documents, Controller General of accounts (CGA), CEIC, MOFSL

Exhibit 15: Fiscal deficit has missed BEs/targets as a % of GDP only four times in the past two decades

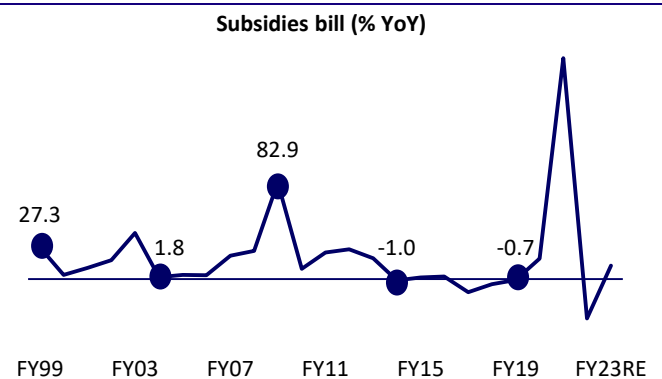
Data for FY23 is provisional

Source: Union Budget documents, CGA, CEIC, MOFSL

Exhibit 16: Revenue spending growth in FY04, FY14, and FY19 averaged only 8%...

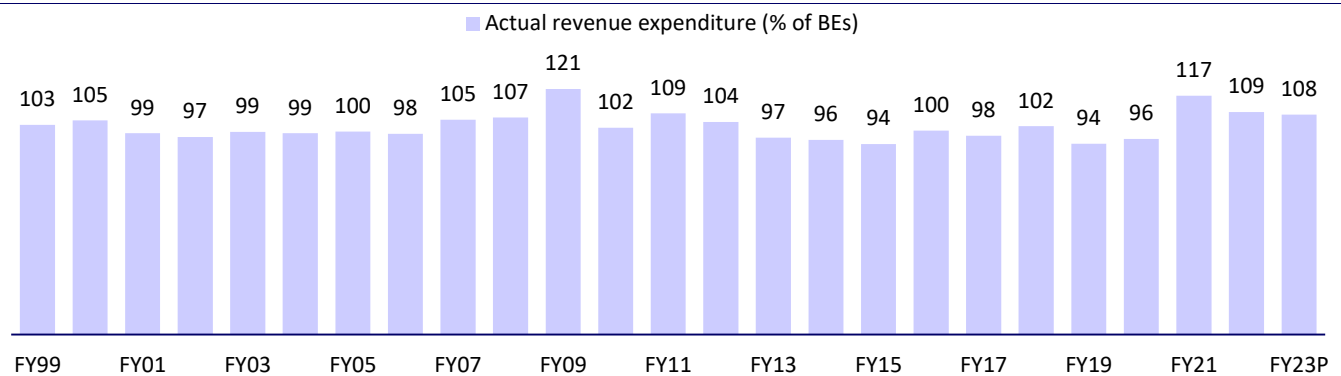
Highlighted portions represent pre-election years (FY99, FY04 etc)

Data for FY23 is provisional

Exhibit 17: ...and there was no growth in subsidy bills during those three election years

FY23 data is revised estimates (REs)

Source: CGA, Union Budget documents, CEIC, MOFSL

Exhibit 18: Actual revenue spending was lower than BEs in FY04, FY14, and FY19

Data for FY23 is provisional

Source: Union Budget documents, CGA, CEIC, MOFSL

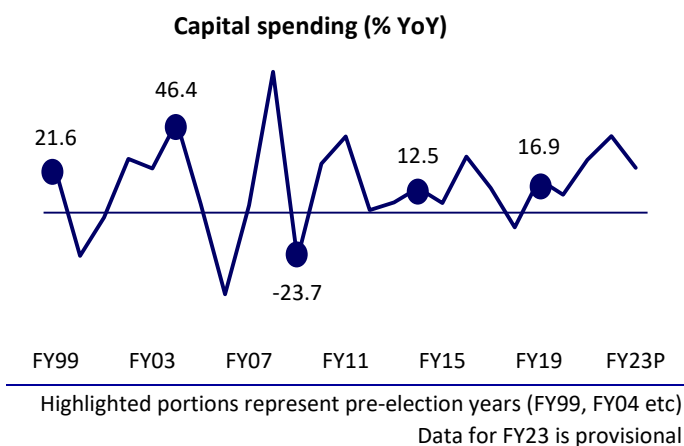
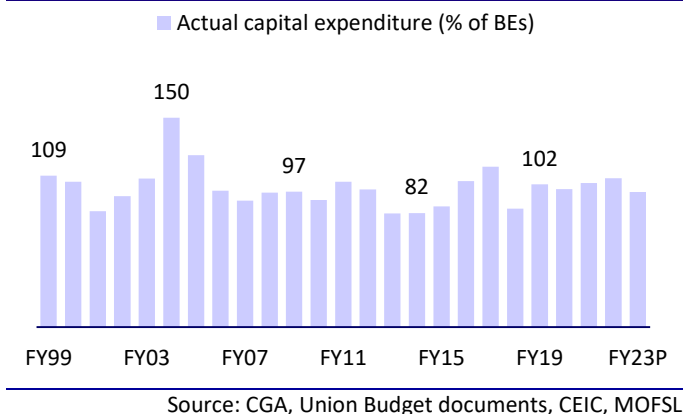
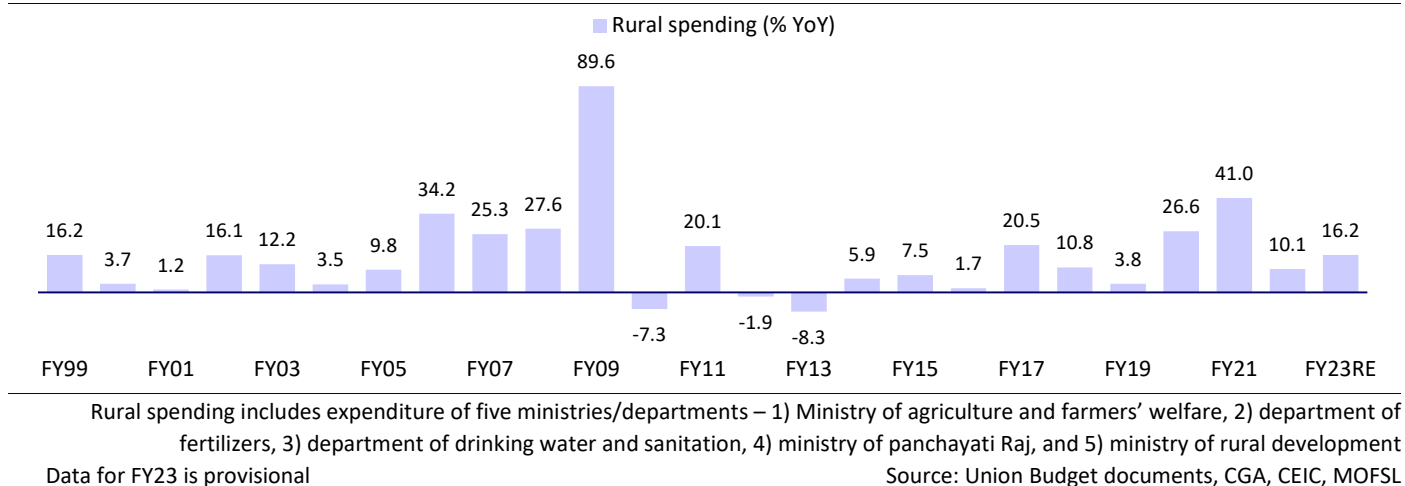
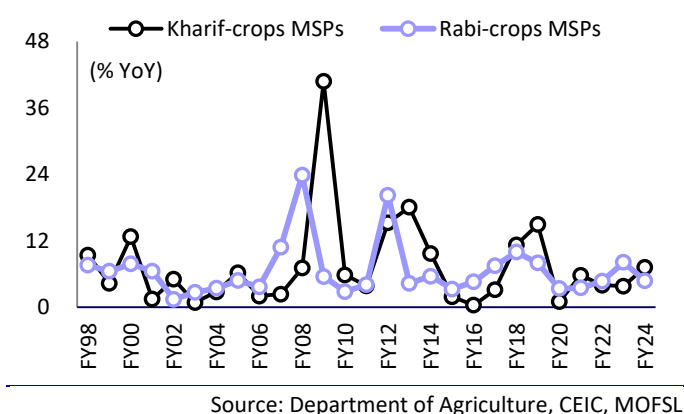
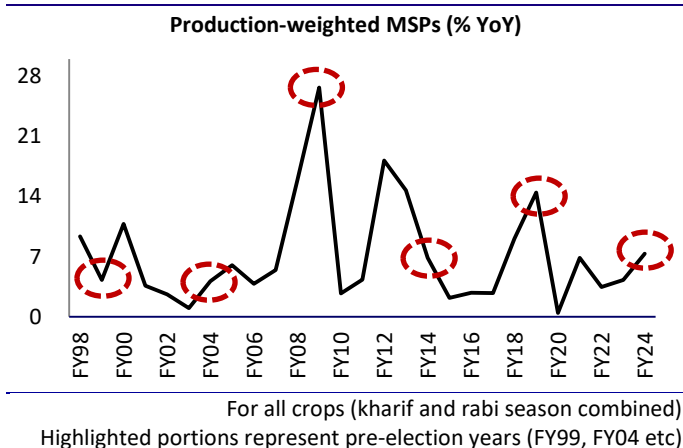
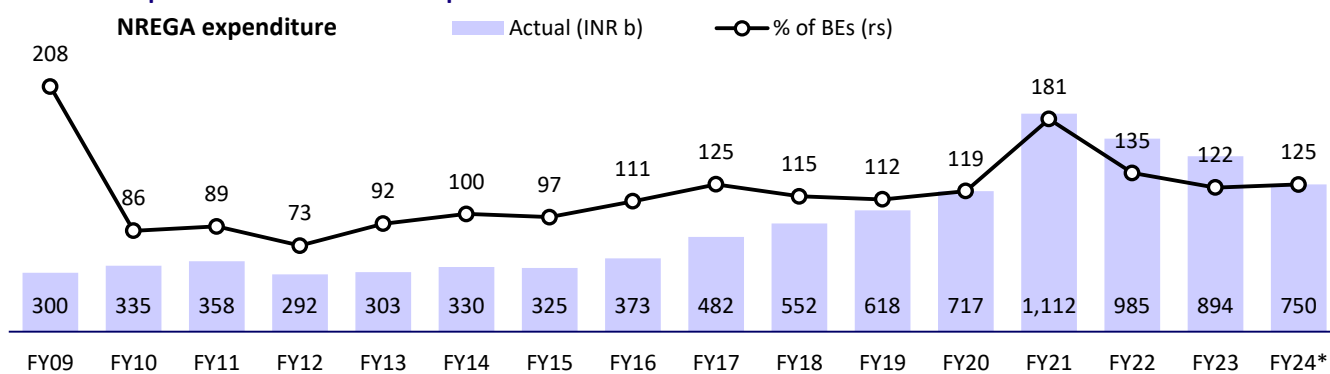
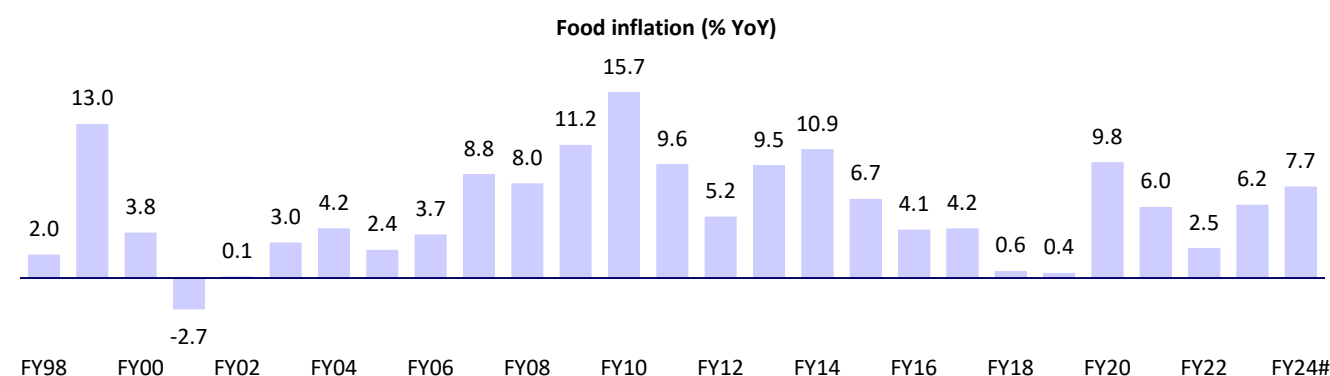
Exhibit 19: Govt's capital spending average growth was 15% before election years (13% excluding FY99)...**Exhibit 20: ...and it was substantially higher/lower than BEs only in FY04/FY14****Exhibit 21: Rural spending growth was muted in the pre- and post-election periods in FY04, FY14, and FY19****Exhibit 22: MSP hikes, especially for kharif crops, tend to be higher in the year before general elections...****Exhibit 23: ...which appears to have continued in FY24 as well**

Exhibit 24: Comparison of BEs vs. actual expenditure on NREGA

* Data for FY24 includes INR150b demanded under the first supplementary Budget presented in Dec'23, over BEs of INR600b

Source: Union Budget documents, CGA, CEIC, MOFSL

Exhibit 25: Long-term trends in CPI-food inflation

Based on CPI for rural laborers

Source: RBI, Labour Bureau, Ministry of Labour, GoI, MOFSL

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NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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