

"For Indian Stocks, the Answer Is Blowing in the Political Wind"

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After a year of economic jolts, investors in India's stock market looking forward to 2014 have politics in mind, and one politician in particular: opposition candidate Narendra Modi. They shouldn't get too excited.

National elections are slated to be held by May, and India's right-wing Bharatiya Janata Party is fielding Mr. Modi, who brings with him a pro-business track record as chief of the western Gujarat state, as its prime ministerial candidate. Brokerage firm CLSA calls Mr. Modi "the Indian stock market's greatest hope."

The election comes as India's economy has gone out with the tide under the ruling Congress Party. Growth has halved to below 5% from last decade, largely because of poor investment in roads, power plants and factories.

But Mr. Modi's Gujarat has done better. He has built infrastructure, approved big investment projects and enabled the state to grow 1.5 percentage points faster than the country as a whole every year on average between April 2007 and March 2012.

Extrapolating these policies nationally could mean a building boom. Infrastructure sectors like roads or ports should benefit, which would buoy sales at engineering and construction companies such as Larsen & Toubro.

The power sector could get a boost, too. One of Mr. Modi's biggest achievements is creating a parallel electricity system in Gujarat that provides power at market prices—a coup in a country that otherwise subsidizes the retail price of electricity.

If Mr. Modi can promote overhauls across the country, it will improve earnings at power-generating firms such as Tata Power and Adani Power that can sell electricity to distributors at higher prices.

Getting rid of sector-specific bottlenecks could bring India's broader growth up a notch. However, what is really needed to shift the economy onto a permanently higher plane are deep reforms related to land, labor, taxation and education.

These areas are controversial and Mr. Modi has been coy in terms of endorsing reform proposals. Worryingly, Mr. Modi is a controversial Hindu nationalist, which could affect how his national government, likely a coalition, builds consensus.

What is more, India's constitution gives the states some power over areas like land and education. It won't be easy for a divisive figure like Mr. Modi to coax the states to support his ideas.

The Bombay Stock Exchange's benchmark Sensex stock index already hit a record high after Mr. Modi's BJP won four state elections this month, because investors saw the result as a precursor for next year's poll. Some of the Modi premium seems baked in, though if investors see a win at the national scale, they will likely become even more optimistic.

And even if Mr. Modi doesn't win, there is a chance investors will still like the election. On average since 1989, the Sensex index has risen 38% in the 12 months after a general election, as investors get some resolution of uncertainty about the outlook, notes Jon Thorn at fund manager India Capital Management.

Long bull runs, though, like the kind between 2004 and 2007 when Indian stocks tripled in value, tend to need sustainably high economic growth. For Mr. Modi to succeed there, it will take more than just one electoral victory.

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