

India – A profile of Narendra Modi

Following Indian Prime Minister Narendra Modi's visit to Australia, our specialist Emerging Markets investment partner, Northcape Capital, penned this outline of the popular leader's rise to India's highest office and why some of his domestic policies are likely to have a lasting impact on the country. As at 31 May 2023, India represented a geographic portfolio weight of 21% of the *Warakirri Global Emerging Markets Fund*, the Fund's largest geographic exposure.

This information has been prepared by Northcape Capital, the underlying investment manager for the Warakirri Global Emerging Markets Fund.

Narendra Modi's supporters argue that the Gujarati was always destined for greatness. Born the third of six children into a poor family of merchants – his father operated a tea stall on a local railway station platform – Modi began to attract attention from a young age.

According to legend, the shrine in Modi's village was located on an island in the middle of a crocodile-infested lake. The villagers avoided crossing the lake, except on holy days when an ancient ritual needed to be performed at the shrine. If the ritual-performer was careful this could generally be done without disturbing the crocodiles but on one occasion, following a rainstorm, the crocodiles were agitated and aggressive, making the crossing perilous. Young Narendra rounded up the villagers and told them to make noise by beating pots and pans to distract the crocodiles whilst he swam safely to the shrine and performed the rituals. Legend has it that the villagers pronounced that Modi would one day become a great leader.

Later, at the age of eighteen, Modi fled an arranged marriage without consummating it (according to him, and of relevance given the importance of lifelong celibacy within Modi's religious views), ending up in the foothills of the Himalayas – **see Exhibit 1**. Exactly what he did for two years in the mountains remains obscure, but it seems that he travelled from monastery to monastery, intending to live a spiritual life. One particularly memorable anecdote has Modi coming across a solitary hermit in a 'remote jungle' and spending a month helping the recluse tend to his vegetable plot whilst discussing the cosmos. Later in his wanderings young Narendra met a monk who revealed to him that he was not destined for a life as a spiritual mystic and Modi abruptly ended his journey, returning to his home village. "Where have you been?", asked his mother, after two years apart from her son. "The Himalayas" replied Narendra laconically. The next day he went to the local office of Rashtriya Swayamsevak Sangh (RSS) – a leading nationalist Hindu political organisation – and started a life in politics.

Exhibit 1: A young Modi in the Himalayan Mountains



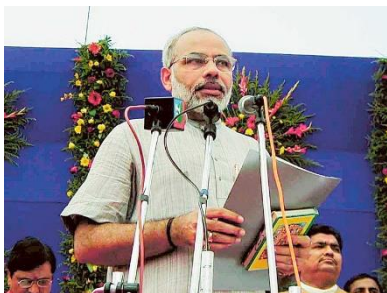
(Source: India Today)

These are just two examples of childhood and youth which remains fundamentally mysterious to Modi's biographers, where the boundaries of myth and reality blur as so often seen in the great storytelling tradition of the Indian subcontinent. Indeed, it is Modi's own, distinct story of India – with history seen through his experiences and its future as envisioned by him – that makes Modi a break from previous prime ministers and so compelling to his supporters.

On October 7th, 2001, following two decades of meteoric rise through the RSS and then the linked Bharatiya Janata Party (BJP), Narendra Modi was sworn in as Chief Minister of Gujarat, India's fifth-largest state – **see Exhibit 2**.

Modi's charisma and unique, almost ascetic, lifestyle had already made him something of a celebrity amongst the state's Hindu nationalists. In addition to celibacy, Modi was (and remains) a lifelong vegetarian and teetotaler. He is famously frugal, preferring simple food and clothes. According to biographers, he only bathes in cold water, regardless of the season.

Exhibit 2: Modi taking the oath as Chief Minister of Gujarat in 2001 (Source: PTI)



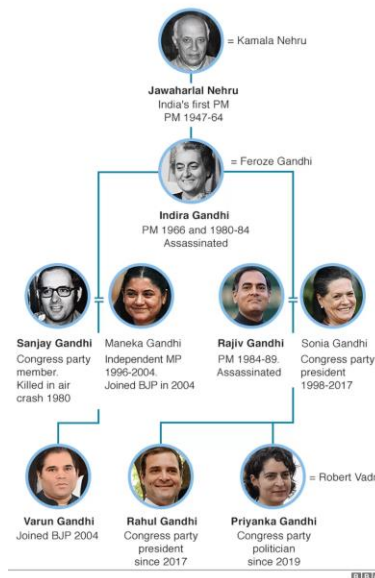
At that time, India had effectively been ruled by the Congress Party as a socialist one-party state, with only brief interruptions since the country’s independence in 1947. The Congress Party is a family dynasty: from independence until 1962, it was led by Jawaharlal Nehru. From then until 1984 it was led by his daughter, Indira Gandhi. It was then run by her son, Rajiv Gandhi until 1989 followed by his (ethnically Italian) wife Sonia from 1999 to 2014. Finally, from 2014 to present the party has been run by Rajiv and Sonia’s son, Rahul Gandhi – See Exhibit 3.

According to Modi and the BJP, the elitist Congress Party has consistently been out of touch with India’s vast working class, with misguided socialist policies which restricted economic growth. Despite a low base and colossal potential, under fifty years of Congress Party rule India’s GDP growth averaged a mediocre 3% annual rate (the consistent weak performance attracted the contemptuous label of “the Hindu rate of growth”).

Modi and his supporters argue that affirmative action and identity politics were the primary reason for the Congress Party’s poor performance. Although the mainstream Western press has focused on Modi’s relations with the Muslim community, his track record suggests that he opposes special rights for any minority group, for example pushing back against Congress’ plan to give extra seats to Adivasis (the “forest dweller” tribe) and Kshatriya (“a warrior caste which felt its historical glories were insufficiently supported by its status in modern society”). Outsiders often underestimate the complexity and diversity of Indian society; a single Congress Party commission, for example, identified sixty-three unique minorities which – the commission stated – each required slightly different treatment.

Exhibit 3: The Congress Party: A Family Affair

Nehru Gandhi dynasty family tree



Modi’s BJP argues that special treatment is a recipe for chaos and perverse incentives that severely constrain economic growth. He has consistently argued that contrary to his portrayal in many Western media outlets, he is not anti-Muslim or anti-minority but simply a defender of secularism. However, what this means for appropriate policy in India is not trivial. In the words of Scott Alexander, in his profile of the politician, “Modi describes spending his years of campaign consultancy trying to figure out a way around this dynamic. You could support more and more affirmative action, stoke more and more community tensions, and get...minority votes while making the majority hate you – or you could roll back affirmative action, doom backward castes and Muslims to irrelevancy, get tarred as a racist, and ruin your electoral chances”.

Modi’s solution, as he tells it, was free market capitalism. If he could get the economy really growing, a broad and inclusive growth, then all groups would benefit as a rising tide lifts all boats, and focus would shift away from identity politics and intergroup conflict.

During Modi’s tenure as chief minister of Gujarat, the state averaged 10% p.a. GDP growth – well above that of the whole country – and topped the World Bank’s *Ease of Doing Business* rankings among Indian states for two consecutive years, also leading Indian states in terms of economic freedom according to the Fraser Institute’s Index.

Exhibit 4: As Chief Minister, Modi successfully convinced Tata to build the famous Nano in Gujarat in 2008, paving the way for other companies to set up in the state (Source: Getty Images)



In the words of Ratan Tata, who selected Modi's Gujarat out of seven states that pitched for the Nano factory (see Exhibit 4), "the speed and the fact that Gujarat could transfer possession of the land without any hassles to Tata Motors was perhaps the singular reason that made us decide on Gujarat...Narendra Modi is an extremely easy person to deal with – very informal, compatible and pleasant, and capable as well. It is very difficult not to feel comfortable with him. The fact remains that he has taken a personal interest in the project to ensure that everything moves smoothly."

The most controversial feature of Modi's time as Gujarat's chief was the 2002 anti-Muslim riots, over which much ink has already been spilled. The central allegation is that the leader did not do enough to stop the riots, which followed an act of Muslim terrorist activity which killed Hindu pilgrims, leading to the preventable deaths of 790 Muslims (and 254 Hindus). Modi completely denies responsibility and the Indian Supreme Court found him innocent of the charges that were brought before the court, but detractors think the event highlights an underlying weakness in Modi's philosophy: that a nationwide approach in India, without special consideration for minority groups, will naturally favour Hindus, who comprise some 80% of the country's population.

Modi chose to dissolve the state government following the riots, holding new elections to "let voters decide my future". Modi won the ensuing election in the biggest landslide in Gujarati history, getting 126 seats to Congress's 51. With parallels to the current situation, where Modi's immense domestic popularity often clashes with the negative portrayals he has received in Western media, in the 2002 state election "the more he became a hate figure in cosmopolitan circles, the more his popularity soared in Gujarat" according to Swapan Dasgupta, an Indian journalist and politician. Whilst Modi's critics pointed to the very limited Muslim votes he received in 2002, as tensions

dissipated this dynamic improved – by the December 2012 election, he won 31% of the Muslim vote.

Following his success in Gujarat, in 2013 Modi was selected as the BJP's candidate for prime minister in the 2014 national election, ultimately winning in a landslide. He made much of the fact that he was the first prime minister to be born after India's independence, signalling that his election to top office represented a new era for the country - see Exhibit 5.

Exhibit 5: Prime Minister Modi at a temple in Uttarakhand (Source: The Pioneer)



Soon after the election, Modi launched the Make in India initiative (see Exhibit 6) with the goal of turning the country into a global manufacturing hub. In doing so he recognised that an increase in foreign direct investment (FDI) was necessary to underpin structurally higher economic growth in India, and that the timing was ripe given the emerging decline in relations between China and the West. The following year (2015) India led the world in FDI, ahead of both China and the US, with \$60 billion committed – a remarkable achievement for a country that had developed a reputation as xenophobic when it came to foreign capital. The early success of the initiative was further recognised by the World Bank, which upgraded India from 130th in the world to 63rd in its *Ease of Doing Business* ranking. It is still too early to determine if the initiative will be a long-term success; critics note that after an initial bump to 16.3% of GDP, manufacturing's share has dropped back to around 14%. A bottleneck to further investment has been land acquisition, which will likely be a continued focus for the Modi government going forward.

Exhibit 6: Modi Launching the Make in India Initiative (Source: Prime Minister's Office)

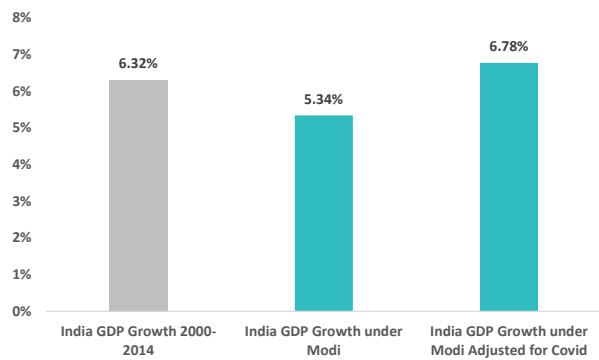


A more controversial policy was the decision on the 9th of November 2016 to no longer accept ₹500 and ₹1000 banknotes as legal tender, with the stated intention of curbing corruption and counterfeiting. The ensuing chaos resulted in significant declines for Indian stocks, mass panic and even some deaths as Indians rushed to exchange banknotes which were soon to become redundant. Modi’s supporters however point to the fact that the number of individual income tax forms submitted rose by 25% the following year; also, the policy seems to have accelerated the country’s use of digital payments, underpinning further development of the financial system.

In general Modi’s economic policy to date has focused on the liberalisation of the economy, cutting “red tape” to make it easier for businesses, both domestic and foreign, to invest and permitting greater flexibility with respect to workforces. On a recent Northcape research trip to Taiwan, we noted the significant number of companies “rebalancing” production away from China to India (and others, including Mexico). To give just one example, Hon Hai (Foxconn) is already assembling iPhones in India, leading Apple’s CEO Tim Cook to mention India some twenty times on the company’s 4th May 2023 investor conference call. The ultimate test of Modi’s philosophy and policies, however, is the impact they have had on India’s economic growth.

On first glimpse, Modi’s economic impact has been mediocre - see Exhibit 7. Even adjusting for the negative shock of Covid, GDP growth under the current PM has been an underwhelming 46 basis points higher on average per year than in the 14 years prior, hardly the “supercharged” performance the leader promised.

Exhibit 7: India’s Economic Growth Under Modi



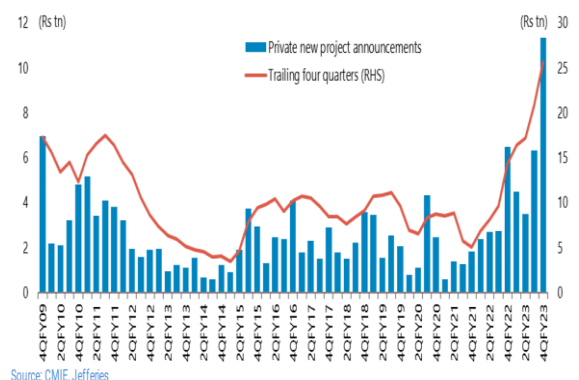
(Source: Bloomberg data, Northcape analysis)

The government argues, with some merit in our opinion, that many of the reforms Modi has pushed through are long-term, and hence we should not expect an immediate impact. There are finally signs, however, that the “Modi effect” is starting to show in the data. India is one of a handful of countries where economists have been upgrading GDP forecasts for this year and next (Mexico is another). Jefferies Research now expects the Indian economy to grow 6.5% in the year to March 2024 (real GDP) and 7% the year after – very impressive given forecasts of a significant global slowdown and potential US recession.

Headline and core CPI inflation have declined from 6.5% YoY and 6.1% YoY in January to 4.7% YoY and 5.2% YoY in April, both now below the upper band of the RBI’s target (6%), in part due to continued improvement in supply bottlenecks. The next major upgrade will come from two dedicated freight rail corridors which are nearing completion and will reduce the time needed to move goods from Delhi to Mumbai, for example, from at least 24 hours to 12-15 hours. This is part of the government’s plan to reduce the cost of logistics from the current 14-16% of GDP to 9% in the coming three years. Consequently, inflation is likely to continue to moderate and the central bank’s likely next move will be to cut rates.

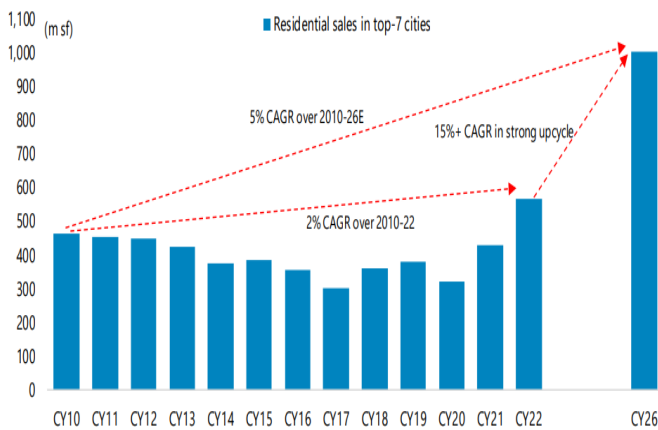
Strategist and Asia expert Christopher Wood believes that India “could be on the brink of a major capex cycle”. India’s gross fixed capital formation as a share of GDP has jumped from 27.3% in FY21 (March year-end) to 29.2% in FY23, and private sector new projects are surging as shown in Exhibit 8.

Exhibit 8: India Private Sector New Project Announcements



The final piece of the near-term economic puzzle for India is the residential property market. After more than a decade of stagnation in residential sales there are multiple signs that the market is finally turning a corner, leading Jefferies to forecast 15% p.a. growth over the next three years - see **Exhibit 9**. Analysts believe that a newfound confidence in India's future inspired by the charismatic prime minister is in part responsible for this turnaround.

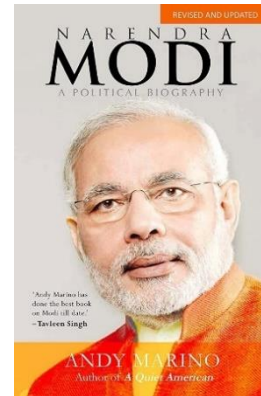
Exhibit 9: India's Residential Property Market Entering High Growth Period Following a 'Lost' Decade



Source: Propequity, Jefferies

These various signs of an uplift in economic growth should underpin another victory for Modi in the 2024 general election (expected to be held in April or May), which will allow him to continue to push forward with his unique vision for India, as described in his biography (see **Exhibit 10**), with broad, inclusive economic growth and unconstrained by the shackles of the past.

Exhibit 10: Narendra Modi's Biography – Vision for India



Note: In addition to Northcape research and recent trips to India, this piece was inspired and informed by both Andy Marino's "Modi: A Political Biography" and Scott Alexander's excellent review of the book and profile of the Gujarati.

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