Matthews Asia Perspective

Asia's Election Results May Boost Investor Confidence

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The 2019 election season across Southeast and South Asia wrapped up recently, with a parliamentary election in India, presidential and parliamentary elections in Indonesia, midterm elections in the Philippines and a general election in Thailand. Here's a look at the outcome in each country along with the post-election implications for investors.

India

The incumbent Bharatiya Janata Party (BJP)-led National Democratic Alliance (NDA) coalition won a landslide victory, overcoming India's traditional anti-incumbency bias to be re-elected with a stronger mandate. The strong showing by the BJP, which garnered a larger single party majority than it did in 2014 when it won 282 seats, was better than the outcome projected in pre-election opinion polls. This was not expected by the market; BJP/NDA's victory was expected but by a narrower margin, which would have left BJP in need of support from its allies. The equity market is likely to take this positively, though a surge on the order of 2014 is unlikely as a BJP win had been discounted by prices even if the results were expected to be slightly softer. We also note that forward multiples are demanding and limit the market's upside when viewed against the backdrop of a slowing economy and earnings undershoot.

What could we expect following this significant BJP/NDA victory? Capital markets prefer predictability, and a ruling alliance led by a BJP with a sole majority and a strong five-year mandate answers that prescription. A single-party BJP majority will allow BJP to exercise greater leverage in the ruling coalition, and should ensure policy continuity and consolidation of the past five years of reforms along with more rapid implementation of policies commensurate with the new mandate. Existing policy stances such as infrastructure spending, fiscal consolidation, low inflation framework of positive real interest rates and rate differential along with low food prices, and boosting foreign investment in manufacturing (Make in India) will likely continue. Despite the populist policies bandied about during the election campaign, a strong mandate should allow the BJP/NDA to continue to target fiscal consolidation, with priorities balanced between rural subsidies and infrastructure spending. This could open up policy space for further interest rate cuts, a boon for the business sector. Flagging economic momentum and the strong mandate from the rural sector, however, are likely to lead BJP/NDA to deliver on promises of fiscal income transfers, which may lead to increased tolerance for wider fiscal deficits.

Other areas of focus could include policies to simplify the goods and services tax (GST), ease conditions for small and medium-sized enterprises, accelerate banking sector reform, boost middle class purchasing power, and prioritize job creation, the Holy Grail in the Indian political economy. The increase in the disposable income of lower income segments (with high marginal propensity to spend) should drive consumption spending, particularly in consumer staples and fast-moving consumer goods, as well as in select low-ticket consumer durables, while lower rates should drive demand for loans and housing. Interest rate-sensitive stocks are thus likely to perform well.

We continue to believe India's long-term growth potential may come closer to realization now that India has a government with a strong second-term mandate and the ability to push forward economic reforms. This does not change the existing narrative, but will hopefully allow the government to build on its achievements and to make adjustments where policies have failed or floundered (Make in India, for instance, if refocused appropriately, could position India to capture foreign direct investment (FDI) relocation flows partly resulting from the U.S.—China trade conflict). Importantly, a strong government might be good for the markets in the short run, but we hope that it will also build transparency and accountability—typically better-nurtured in a coalition environment—which would better equip India to avoid drastic missteps that could send the economy backward.

Indonesia

Indonesia's presidential election was won by incumbent President Joko Widodo, also known as Jokowi. With the election outcome now clear, flows into equities should pick up as the political uncertainty is dispelled. Hesitancy over the election outcome was evidenced by foreign buying stalling from the end of January 2019. In recent weeks, local investors also pulled back slightly as the spread between the Jokowi and Prabowo tickets narrowed; this, too, should reverse going forward.

A shift in focus to the policy agenda and potential interest rate cuts in the second half of 2019 (given low inflation and stabilization in both the current account deficit and in Indonesia's rupiah) should provide positive reinforcement, while a return of private sector confidence and capital expenditures after several quiet years should help to accelerate earnings growth through 2020. That said, the risk is that the escalation of the U.S.–China trade war and a deterioration of Indonesia's current account balance in the interim may once more ratchet up external volatility, limiting Indonesia's room to maneuver on interest rates. Rate-sensitive sectors such as banks and real estate are likely to be in focus.

Indications are positive for economic reforms after the elections, but labor reforms may come only next year. Indonesia's rigid labor laws that dictate high severance pay have long been an impediment to hiring and new investment, so revisions that could address the issues and also introduce a new productivity-based mechanism for setting minimum wages could help increase Indonesia's competitiveness in attracting foreign direct investment (FDI) into labor-intensive export-oriented industries.

The Philippines

The results of the midterm elections signify a still very strong mandate for President Rodrigo Duterte, with an overwhelming win for all pro-administration/Duterte candidates in the Senate. A strong showing by pro-Duterte senatorial and lower house candidates left the Duterte Administration in control of Congress, making a more coordinated push on its current legislative agenda likely completion of tax reform, infrastructure, and a switch to a federal system. While the former two would be seen as positive, response to the latter is likely to be guarded. Federalism could arguably advance income redistribution, but it would also add bureaucracy in an already decentralized system of government. With the economy growing at a solid pace and inflation under control, markets may focus more on the near-term opportunities (corporate tax cuts, infrastructure funding) than the threats.

Generally, we expect the status quo on economic policy direction after the election, with rapid adoption of pending infrastructure projects. As such, we expect a stronger fiscal impulse and continued pressure on imports and the current account. Increased government spending and borrowing could crowd out private investment, given a tighter liquidity environment. The recent deceleration in inflation following 175 basis points (1.75%) of policy rate hikes, however, is likely to allow the central bank to resume required reserve reductions, helping to inject additional liquidity following recent cuts of 200 basis points (2.0%).

Overall, a stronger and renewed mandate for the Duterte Administration in its final three years should boost investor confidence amid a more supportive domestic policy environment—facts which were presaged in Standard & Poor's unexpected recent upgrade of the Philippines' sovereign rating.

Thailand

The election was endorsed by the Election Commission recently, leaving the two main parties—Pheu Thai (PT) and Phalang Pracharath (PPRP)—to attempt to form a majority coalition in the 500-member lower house. The pro-military party PPRP is likely to form a government. This is because it alone has the ability to appoint a prime minister. A majority of lower house and Senate is required to appoint a PM. This suggests that current PM and military junta chief Prayut Chan-ocha will be re-elected PM by the new Parliament.

If it doesn't achieve a solid majority, the new government is likely to be short-lived with a new election likely within a year. The new coalition government is thus likely to maintain the status quo and come up with minor economic stimulus packages to prop up the economy until the next election. That said, any scenario is likely to yield an unwieldy, possibly unstable multiparty coalition that would find it hard to legislate or implement infrastructure plans, in our view.

Fiscal stimulus is likely to happen soon after new government takes office. The latest Bank of Thailand (BOT)'s monetary policy committee meeting noted the weakening condition of the Thai economy. The comments highlight downside risks and with the BOT lacking monetary policy space seen in other Association of Southeast Asian Nations (ASEAN) economies, the clear message is that fiscal policy has to do the heavy lifting. With the trade dispute having escalated once more, additional stimulus is likely to be deployed soon after the new government takes office with up to 1.1% of GDP in cash transfers, plus income tax cuts of up to 10 percentage points and a minimum wage hike on the agenda (based on the PPRP's campaign promises). This could provide a lift to consumer stocks, consumer lenders and property developers. In the event that an alternative (non-military backed) coalition were to take over, we would expect similar fiscal policies as for a new Prayut government, with the possible exception of tax cuts.

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