

AT A GLANCE

1. **Foreign policy:** Narendra Modi is setting up a realistic foreign policy to impose India as a regional power against the China-Pakistan alliance. As a result, India's footprint in the Indian Ocean Rim is expected to expand.
2. **Home affairs:** As Modi lost the last regional elections, the majority needed at the Upper House to reform the country is hindered. Coming with new sensitive topics at the Monsoon Parliament session, he will have to sharpen his arguments in front of the Congress, which is weak but can still thwart Modi's plans.
3. **Economy:** Raghuram Rajan decided to not apply for a second tenure at the Reserve Bank of India, which has created a lot of uncertainty, both politically and economically. In a communication sleight of hand, Modi released a reform to increase and promote foreign direct investments in India.

INDO-CHINESE TENSIONS BROUGHT TO THE FORE

The last months were very eventful with several official visits, which consequently lifted the curtain on geopolitical movements and postures.

End of last May, Narendra Modi went to Iran for the first visit by an Indian Prime Minister in 15 years. The main outcome is the development of the Chabahar Port in Southern Iran, which will give India access to Afghanistan and Europe, thus avoiding going through Pakistan. They also agreed to cooperate on fighting radicalism and terrorism. Besides the bilateral pact to develop the port, for which India will invest USD 500M, a Transport and Transit Corridor trilateral agreement was also signed by India, Afghanistan and Iran. According to observers, this agreement between India and Iran is a major boost for both countries, as well as for Afghanistan, which will avoid Karachi's port. In particular, growing the cooperation between the three countries will counterbalance the China-Pakistan alliance in the geopolitics of South West Asia.

In November 2015, India hosted the biggest Indo-African summit ever organized by Delhi, with 54 African countries. Six months later and only within only one month (June 2016), the Indian executive branch conducted roadshows in Africa to improve their commercial and political relationships. Mohammed Ansari visited Tunisia and Morocco, Pranab Mukherjee went to Ivory Coast, Ghana and Namibia and Narendra Modi visited South Africa, Mozambique, Kenya and Tanzania. It is not without relevance that Modi visited only four countries in Africa, which have the following commonalities: a large diaspora originates from Modi's Gujarat; they border the ocean, which is a means to secure the maritime leadership in the Indian Ocean wished by India; they are in the top 5 of India's main commercial partners.

These diplomatic visits do not only aim at promoting Indo-African ties but also at challenging the Chinese position. Indeed, China continues to strengthen its naval footprint. The Chinese

Navy recently made a stop in Tanzania and China will soon inaugurate a deep-water port in Cameroon.

Nevertheless, a window of opportunity could appear for India. Several African countries are facing national economic tensions because of the Chinese economic slowdown and they would be keen on cooperating with a powerful partner with solid economic assets. Even though China already has significant partnerships throughout Africa, India has deep-rooted relations forged during the decolonization process. The Indian Executive branch is aware of that "competitive advantage" over China and plays on it.

For years, New Delhi has been lobbying to get a membership at the Nuclear Suppliers Group (NSG) with the support of the US, France, Russia and the UK. Pakistan and Namibia are also in process of obtaining their membership. The NSG is a group of 48 nuclear supplier countries that seeks to contribute to the non-proliferation of nuclear weapons through the implementation of two sets of guidelines for nuclear exports and nuclear-related exports. During the last months, Modi was personally involved in the negotiations and raised the NSG agreement as a flagship. Nevertheless, India was denied membership, and was left disappointed by the successful block led by China. This topic is really important for India in its confrontation with China and Pakistan and India has made it a question of legitimacy and of belonging to a respected group of "mature" countries. After this "no-go", the Chinese attitude was badly perceived in India, and every eyes turned on Modi's failure in front of their genuine enemy, Pakistan, which, in May 2016, applied to the NSG, with the support of China and Turkey.

Episodes opposing China and India begin to be more and more frequent and appear less and less indirect. Their objective is clear: implement a supremacy throughout the Indian Ocean Rim thanks to a network of ports and military presence to control commercial flows.

INDIAN POLITICS: "SAME PLAYERS, SAME BALL"

The 2016 regional elections in West Bengal (90M inhab. – 7.5% GDP), Kerala (35M inhab. – 3.6% GDP), Tamil Nadu (68M inhab. – 9.3% GDP), Assam (30M inhab.) and Puducherry to elect new chief ministers was supposed to be an important milestone for Modi's rally to gain the Upper house majority. Unfortunately, the BJP central government lost several regional elections. In West Bengal and Tamil Nadu, previous chief ministers were elected with an enhanced and comfortable majority in spite of numerous legal procedures and impactful BJP campaigns. The Kerala State was won by a regional left party; Assam is the only one won by the BJP but at the cost of an alliance. Modi's chance to win these States was very low and his capacity to carry through important reforming laws was reduced at the same time. These defeats will have an impact on the next Monsoon Parliament session in which the Congress will not hesitate to emphasize Modi's declining leadership, needed to reform the country.

The Congress has already begun to shoot at the Government and prepares Monsoon Parliament session debates. Gandhi's party will attack Modi's government on the following 3 subjects: firstly, the Government has decided to open up key sectors to foreign

investments, which Gandhi's party will criticize because it will jeopardize India's strategic independence and security environment in the defense and pharmaceutical sectors. Secondly, the Congress is not pleased with the way the Government has negotiated a membership at the **Nuclear Suppliers Group** (NSG). Indeed, the Congress asserts that the Government's faulty strategy for NSG membership allowed Pakistan to claim an equal status, while the issue of nuclear proliferation is notorious. Thirdly, the Good & Service Tax Bill (GST) will come again on board to be passed through. By submitting amendments to the Government, the Congress will also shed light on BJP's contradictions while, when it was in the opposition, it did not support the same bill. The BJP strengthened in the recent round of election at the upper chamber, but is still short to beat the opposition. The Congress will thus create a new trade-off saying this bill is constitutional and implies a two third majority and not a simple one. Not surprisingly, **Anand Sharma**, Sonia Gandhi's right-hand man, is at the forefront, leaving **Rahul Gandhi** behind.

The **Brexit** impacts on India's economy and society need to be assessed wisely after the financial turmoil: on Friday 24th June, the Mumbai stock exchange lost 400 points and the British Pound decreased from 100 INR to 90 INR. Although **Arun Jaitley** said that the referendum "will not shock India's economy", Indo-British relationships are so close that it will have consequences.

Exports and imports between the two countries have been growing, but the UK is only India's 12th largest trade partner, well behind Germany and France. Over the last decade, the EU and India have negotiated a free-trade agreement, now stalled over several topics. This vote will open a gate for a bilateral free-trade agreement which could take into account the interests of both parties in an easier way to increase their bilateral commerce. British textile companies could be targeted and Indian IT firms will find new frameworks less restrictive than the EU framework.

India is currently the 2nd biggest source of **FDI** for the UK. There are about 800 Indian-owned companies in the country, employing roughly 110 000 people. As an entry point for India into the EU, the UK is a platform to export their goods and services throughout Europe. After the Brexit, they will not have same ability to get access to the EU's free market. IT, pharma and automotive Indian companies will be negatively impacted.

The Indian business community reacted differently. **Tata Group** reacted to the referendum result by saying that each of its UK-based companies would review their strategies, and "*access to markets and to a skilled workforce will remain important considerations*". On the other hand, **Anand Mahindra** said that "*with the lower pound, if there are some hi-tech assets which can be acquired in the UK, suddenly this makes the UK a much better shopping mall for Indian companies*".

The Monsoon Parliament session promises to be hectic because of sensitive national issues which will be debated. Last sessions resulted in failure and if the next one has the same result, it will show how the India Parliament system is rusty, even breathless. The Indian perception of time is not the same as in Europe...

ECONOMIC OPPORTUNITIES AND MID-TERM FEARS

The "Brexit" vote came just after the "RajanExit". Indeed, **Raghuram Rajan**, Governor of the Reserve Bank of India (RBI), has released his decision to leave his position in September 2016, at the end of his first three-year mandate. This surprise announcement gave way to a lot of comments. His deft stewardship of monetary policy won the trust of local and foreign investors, allowing him to manage the balancing act between controlling inflation and supporting growth. Under his tenure, the RBI has taken important steps to develop the financial markets and enhance the banking system.

Several commentators made assumptions about his departure. His strained relationship with Modi and the Finance minister is also positive because their common interest is to bring India on a liberal and deregulated economic track. Both of them have defended his action at the helm of the RBI and saluted his commitment. Rajan has also set up measures which have put into trouble nationalist politicians and greedy businessmen. He has always emphasized a pragmatic and clear picture of the Indian economy, which needs to be deeply reformed. The end goal of the bank reform was to clean up the banks' balance sheets. Damaged banks balance sheets have limited their ability to lend and support the economic activity. This will require public funds to recapitalize the banks but also changes to their incentive and governance structures. This challenge is huge, and having benefited from favorable macroeconomic trends of the Indian economy, he probably prefers to leave with a laudatory track record than an upcoming struggle which could defeat him, regardless of external issues.

At the same time of his announcement, the government undertook an overhaul of the **foreign direct investment** (FDI) regime, making it easier for foreign investments. Several sectors are particularly impacted such as defense, food processing, pharma, airlines/airports. This release came at the right time to counterbalance Rajan's own release. Modi's government keeps the initiative and flaunts its willingness to continue the reform.

Beyond this political sleight of hand, Modi's intention is to attract more foreign investors in India because Indian companies and public banks are too fearful and risk-averse to invest beyond the public investments needed to accelerate India's growth. Several commentators called his release a bet because the overall economic picture is attractive, while lot of work still needs to be done relative to the mitigation of banking risks because of toxic products, a labor market considered to be less liberal, a too slow judicial system, an administrative governance reluctant to making decisions, endemic corruption, and an unhealthy State budget.

Modi continues to roll out his economic agenda. Rajan's decision has dented Modi's core ambition, the international reputation of India as an attractive manufacturing platform. Financial markets and international companies need to be convinced of Modi's determination to achieve his economic reform objectives. They will be definitively convinced if the GST Bill passes through during the Monsoon Parliament Session.