

India Market Strategy

Labour reforms on the horizon?

Equity Strategy

India

Labour reforms – Rajasthan government leads the way

India's labour laws have been often cited as "archaic" or regressive, and as one of the reasons for India's employment problems. According to media reports, the Rajasthan state government (BJP ruled) has proposed to bring about changes to the labour laws which apply in Rajasthan. As we have highlighted earlier (please see "What will Modi likely do? dated 19th May 2014), subjects like labour, land, etc., fall under the "Concurrent list" and according to article 254(1) of the Constitution of India, in case of inconsistency between the Central and State Legislation, the Central Legislation prevails – and hence each state has to act within the bounds of central law. Amending the Central legislation requires parliament approval which can arguably be a difficult process. However, Article 254(2) of the Constitution of India provides for state legislation to prevail with the President's assent, and hence laws can be amended such that each state can decide on specific aspects.

Major reforms possible. States' empowerment can make implementation easier

What exactly has the Rajasthan govt done? It has proposed to amend the Contract Labour Act, the Factories Act, and the Industrial Disputes Act to make them less stringent – see details in table below. These are proposed to be introduced in the state assembly (where the Govt has majority) next month and then sent for the President's assent. We believe that this will ultimately encourage other states to follow suit, to stay competitive. Fostering competition among states can make some issues politically easier to implement, arguably. Mr Modi has talked about empowering states and a more constructive engagement with states. We think that the Rajasthan government's initiative is an early sign that difficult reforms are no longer impossible. In "Reformasia - India will benefit; buy-on-dips market" dated 3rd Jun 2013, we had highlighted that tougher reforms (like land, labour) are more likely now than expected 6 months back.

Mr Modi's agenda – now and long-term. Govt has already started acting

The unprecedented mandate for Mr. Modi led NDA implies a strong and stable govt, paving the way for sensible policy making, in our view. In the near term, inflation and fiscal consolidation are likely to be focus areas – as highlighted by the govt already. Other focus areas will be general administration/governance improvement = SOE reformation, policy clarity, appointment of regulators, effective bureaucracy. Announcements on FDI liberalisation (with implications for manufacturing, CAD & potentially exports), tax reforms (important one being GST), Insurance and Pension Bills should also begin shortly. For the longer term, focus areas will be Coal/Power, Tourism, Rail/Roads, Agri, Urbanisation, and Skill Development.

Remain bullish. Buy Financials, SOEs (oil & gas, banks), power/infra/industrials

We remain bullish on Indian equities. We believe investors will be willing to give a premium for growth hope and look beyond FY15 earnings estimates. Based on our top-down expectation of 15% earnings growth in FY16 & 15x PE, our Nifty target for end-2014 is 8000. There could be upside to the target based on how policy-making evolves.

Figure 1: Labour reforms – Rajasthan government leads the way

| | Central Legislation | Proposed Amendment by Rajasthan government |
|--------------------------------|---|---|
| Contract Labour Act | Applies to companies with more than 20 workers | Applies to companies with more than 50 workers |
| Factories Act | Applies to premises with more than 10/20 workers with/without power | Applies to premises with more than 20/40 workers with/without power |
| Industrial Disputes Act | Retrenchment of up to 100 workers, without government permission | Retrenchment of up to 300 workers, without government permission |

Source: Media reports

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