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ECONOMY AND FINANCE

DIFFICULT TIMES

The month of August brought substantial anxiety to the Indian Economy. After a bad July, August brought further concerns, uncertainties and anxieties to the Government as well as the people of India. The economic climate continued to deteriorate, especially on the back of sustained fall of the Rupee against the US Dollar and many other major currencies of the world. The fall was very quick and sharp and on a number of days the Rupee lost more than one per cent of its value. The overall depreciation for the month was about 10%. The Reserve Bank of India (RBI) tried to control the fall of the currency by intervention in the foreign exchange market. The Government tried to pacify the market by making positive announcements and giving assurances about the stability of the economy and foreign exchange policies. However, the exodus of foreign currency continued due to unwinding of positions in debt and equity markets by foreign investors. The demand of foreign exchange from the Indian importers remained strong and the supply could not match with the demand, thereby depressing the Indian Rupee. It touched its all time low of ₹ 69.18/- per US Dollar towards the end of the month, before bouncing back a bit in the last couple of days of the month. Though the Government is trying to portray that the worst is over, many economists and foreign exchange experts are not sure and many of them believe that the weakness of the Indian currency will persist for at least some more time and the worst may yet come.

The weakness of the Indian currency, which has emerged in the recent months, has suddenly taken the centre stage of the Indian economy. Though the last straw on the camel's back for the emergence of the problem was the fear of the end of quantitative easing by the US FED, the primary reason of the persistent fall was the structural imbalance in the Indian economy. Over the last few years, money from foreign investors kept on pouring into India as foreign direct investment or portfolio investment and that gave a comfort to the Indian Government to liberalise the foreign exchange user as well as imports, which were expected to give impetus to the economic growth in the country. It opened the Indian economy to foreign suppliers and the Indian consumption story became bigger and louder. India, like many other developing countries, welcomes the foreign funds not only in the equity markets but also in the debt markets. Due to the continuing inflow of the foreign exchange, the Rupee remained reasonably strong though India was continuously clocking inflation at an average of about 10%, against the US inflation rate of about 2%. To give a boost to the sagging US economy, the US FED devised Quantitative Easing programme in late 2008, whereby it kept on buying billions of dollars worth US treasury from the market, month after month, thereby pumping in Dollar supply in that economy. As at that time the economic prospects of the US were not looking great, the investors invested a part of this liquidity in the developing economies, including India, which were clocking better growth rate then and wherein greater opportunities to grow wealth were visible. Over the last few months, the US economy has started performing better and its short term prospects are perceived to be even better. The yield of the US treasury has increased and its returns have once again become attractive for the risk averse investors. The recent talk of the ending of quantitative easing has created a vacuum of liquidity; and so better opportunity for funds in the US economy. Therefore the fund flow, which was hitherto diverted to developing economies, has started to turn back to the US. This reversal is creating drain of foreign exchange resources to many developing countries. Many countries in Asia, South America and Africa have faced sudden outflows of foreign exchange, thereby causing pressure on their domestic currencies and many of them have depreciated between 5% to 20%, over the last six months.

Unfortunately, the Indian Rupee has been one of the worst hit currencies due to the current global phenomenon in the developing economies and the RBI is not able to control the outflow of foreign exchange. This situation has glaringly brought to surface the continued imbalance in Indian foreign trade. The trade deficit of India has been growing for various reasons over the last few years. The pressure on the precious foreign exchange reserves has increased due to hike in the international prices of petroleum products, which is the single most nonflexible import which India needs to sustain its economic activity. Increase in non essential consumption based imports was aided by the availability of foreign exchange to the country due to foreign investment. The capital inflow was used more for consumption than for investment. The opening up of the economy for the foreign investment and consumption of foreign goods can support the economic growth to a certain extent; but in crucial times it can make an economy critical.

The current problem of sudden heavy depreciation of the Indian currency has not developed abruptly but it has partially resulted from the complacency of the Government towards the trade deficit and as well as budgetary deficit. It is a financial crisis resulting from long term use of short term funds. Over the last few years, in spite of great promises in the budget, the Government is not able to sustain its promise to control the budgetary deficit due to inadequate control on developmental as well as non developmental expenses. Though there has been a huge cry resulting in promises for a reduction in the subsidies, they have been reintroduced through new avatars and for new causes. NREGA was introduced a few years back to give employment to the unemployed in the country and it has caused pressure on the budgetary deficit. Added to it are subsidies for people below the poverty line, which though may be desirable, have caused a drain on the national resources beyond the planned numbers. The Government is not able to reduce the subsidies on fertilisers and farm inputs due to political pressure. The subsidies on petroleum products are bruising the nationalised petroleum product distribution companies as well as on the resources of the Government. Added to that is the impact of the recently passed Food Security Bill, which will assure food at a very subsidized rate for poor people in the country. It will cause a further burden of about one lakh crores on the Government spending and will create difficulty in controlling the budgetary deficit. Though the Finance Ministry is optimistic about keeping the deficit within the budgeted limit; the businesses, industry and specially the foreign investors do not seem convinced about the same. There is a danger of downgrading, which can be a serious threat for the economy of India.

The present political scenario is not very conducive for bold economic steps which are required for the revival of the economy. The coalition Government at the centre is standing up with the support of a number of parties, which have different ideologies and political objectives to achieve. The country has to face Parliamentary elections in the next 12 months. The ruling coalition as well the opposition are all focused on pleasing the voters than to be concerned about the economic state of affairs and prospects of the country for the time being. This lack of focus and political will does not auger well for the progress of Indian economy. In the current scenario, reforms may not take speed and they will probably have to wait till the new Government comes into power after about 9 months. Till such time, the policies of the past may continue, which will keep the economy moving at a slow pace. Over the last several quarters, the growth rate of the Indian economy has been moving downwards and its quarter on quarter growth has been reduced to 4.4% for the quarter ended 31st June, 2013, which is the lowest in the last four years. The growth rate is likely to worsen in the quarter ending September 2013 and things may not be better immediately thereafter. Though there are various opinions and estimates of growth rate for the fiscal year 2013-14, starting from 5.5% to 4%, it will not be surprising if the growth rate turns out to be just at 4% for the current fiscal year. Though this may sound pessimistic, the negative momentum faced in the country is not easy to arrest and the economy may take some more time for recovery. The silver lining is the possible increase of export realisation due to the free fall of the Rupee against the US dollar. It has made the Indian Rupee cheap, which can give advantage to exports. A number of Indian manufactured goods, the export of which was hitherto not competitive in international market, have suddenly becoming competitive and that can help Indian exports to perk up.

The Indian economic scene remains uncertain and therefore the investment climate remains hesitant. Though the valuations of many stocks are looking cheap, it is believed that the markets can go down by 10-15%. Therefore, there is no urgency of buying stocks. Gold has appreciated substantially purely on the back of the falling Indian Rupee and if the Rupee depreciates further, it can get more expensive. Gold is not a preferred investment avenue as of now but it can simply operate as an hedge against the falling Indian currency. The rates of the immovable properties across the country seem to be blinking now. They have started coming down due to the slowdown in the economy, unemployment and high interest rates. It is likely that the property market will lose further steam as there may be a supply pressure without a corresponding demand. High interest rates are likely to make holding the stock by the developers, uneconomical. It is likely that the property prices may come down in near future and they may remain flat for a few more years to come. Property investment is no more as lucrative as it was and investors should stay away from this sector as of now.

The only reasonable opportunity for the investor as of today lies in investing in fixed deposits and debentures. The short term interest rates have hardened and they may remain so for some more time, probably even till the end of the current fiscal year. The debenture yields are volatile but that will not affect the medium to long-term investors, as the volatility will get adjusted over a period. Liquid schemes of mutual funds offer good opportunities to investors for deploying their short-term liquidity as they are currently giving a yield of about 10%, which is very attractive. Fixed maturity plans of mutual fund schemes for a horizon of one to three years give good opportunity to investors to lock their funds for long-term at a good rate of return with a tax benefit. Investors may take advantage of such schemes based on their liquidity position. Times are uncertain and safety is valuable. Investors are advised to remain cautious and not to get carried away with eye catching advertisements and promotions. It is time to remain steady on one's investment plan and not to get carried away by a mirage.