Their View

Why 2018 is not like 2013 for India

We need to assess the macroeconomic fundamentals before arriving at a conclusion

PANKAJ MURARKA

The recent macroeconomic volatility, including rising oil prices, falling currencies and stock market sell-offs across emerging markets (EMs), has led to re-echoing of sentiments and parallels being drawn to 2013.

EMs do experience external shocks every few years. How well an economy will be able to deal with an external shock depends on the monetary and fiscal policy discipline practised by the central bank and the government of the country in the ensuing years prior to the external shocks.

Due to the integration of markets, transmission of external shocks through financial markets happens in a matter of days. And that's why it is of utmost importance for policy makers to be proactive rather than reactive; else, by the time they react, damage would already have been done.

Take, for example, the collapse in oil prices in 2014. Oil prices collapsed 50 per cent in a matter of six months—from $112 (June 2014) to $52 (January 2015). This had a significant impact on the macroeconomic fundamentals of the major oil-producing countries. But since the oil prices collapsed at such a quick pace, they couldn't do much in the short term.

In the case of Russia, the largest oil producer in the world, the ruble depreciated 93 per cent—from 34.32/$ to 66.35/$ during the same six-month period; inflation shot from 6 per cent to 16 per cent, and the economy experienced recession in the ensuing year.

In 2013, the rupee depreciated 30 per

in the 'Fragile Five' club. But this time around, we need to assess India's macroeconomic fundamentals before arriving at a conclusion.

In 2013, when the taper tantrum rattled the EMs, India was vulnerable because its macroeconomic fundamentals were in a precarious state. In the aftermath of the global financial crisi, India had embarked on a path of fiscal expansion, and the country's fiscal deficit increased from 2.5 per cent in 2007 to 5.5 per cent during 2009-2013. Inflation was in double digits—10 per cent average during 2009-2014 — due to fiscal expansion and rising commodity prices. Due to rising oil prices, India's CAD (current account deficit) expanded from 2.3 per cent in 2008 to 4.8 per cent in 2012. All this, coupled with negative real rates, led to a sharp depreciation in the rupee.

While there are some similarities today — with rising oil prices, risk-offs in EMs and a falling currency — the India of 2018 is very different from that of 2013, and is relatively on a sound footing. The country is far better placed today than it was in 2013, and our macroeconomic fundamentals are much stronger.

It's different now

The country has been on a path of fiscal consolidation over the past four years, and India's fiscal deficit has been relatively contained at 3.5 per cent, limiting the risk of a spill-over. India has formally adopted the inflation-targeting regime with a legislative framework and an inflation target of 4%+/-2%.

Thus, the country has transitioned from a high-inflation economy to a moderate-inflation one. Despite rising oil prices and a weakening currency, India's CPI (consumer price index) inflation is well-contained at 4 per cent, and the real interest rates are positive. The first principles of economics tell us that an economy with moderate to low inflation with positive real interest rates experiences less macroeconomic volatility during times of external shocks. While, India's CAD has expanded due to spiking oil prices, it should be manageable at around 3.2 per cent in FY19. The countrys forex reserves at $400 billion provide cover for a 10-month import bill, which is pretty healthy; the short-term debt is only 24 per cent of reserves.

In addition to this, over the past two years, India has executed significant structural reforms such as GST, RERA and Insolvency Code. The benefit of these structural reforms is yet to accrue, and will be significant in the years to come.

We are at the peak of the banking NPA cycle and have seen significant deleveraging from corporates, which should create capacity for new investments for both the corporate and the banking sector. We are already seeing initial signs of recovery in the investment cycle with a healthy uptick in industrial capex and green shoots in brownfield investments in core sectors such as hydrocarbons, metals, cement and infrastructure.

Thus, compared with the situation in 2013, India's growth is superior, twin deficits are much lower, inflation is benign and real interest rates are positive. The depreciation of the rupee against the dollar at 14 per cent, though steep, is a cyclical adjustment for the inflation differential between the two economies, and is not as steep as India's trade weighted index. From an equity investor's perspective, stable macroeconomic fundamentals provide the base framework for bottoms-up stock-picking and inspire confidence in the long-term durability of the economy.