

South Asia

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India squanders education potential

By Kunal Kumar Kundu

India can weather Fed's taper, but then...

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With Federal Reserve chairman Ben Bernanke announcing (in his very last press conference) a gradual closing of the quantitative easing tap from which has spewed dollops of liquidity in response to the global financial crisis, India and emerging market economies appear more confident than previously of weathering a crisis that was perceived could be severe on the back of potential en-masse withdrawal of hot money once tapering materializes.

In a sign of this growing confidence, stemming from the relative recent stability of India's currency, Reserve Bank of India governor Raghuram Rajan on December 18 announced an unchanged policy rate, a few hours before in the United States the rate-setting Federal Open Market Committee meeting was to take place, despite being aware that there was a possibility of the Fed announcing the dreaded "tapering" word.

The Fed did eventually announce the taper, albeit at the margin, with a reduction of monthly bill purchases of US\$10 billion, from \$85 billion to \$75 billion. The market remained relatively calm and there was no major sell-off.

While India's central bank should get credit for ensuring stability of the rupee (as much as for the decision to tighten import control of gold), the economy is far from being robust, and the government needs to take most of the blame for that.

The economy may well have bottomed out, but faster recovery is not in sight. For the current financial year, which ends next March, the economy may barely grow at 4.6%. For the next year, India will be lucky to grow at 5.5% - that also contingent on how general election due early next year pans out.

It is important that India gets a stable coalition government at the helm, with either of the central coalition party BJP (of National Democratic Alliance or NDA coalition) or the Congress (of the United Progressive Alliance) getting at least 170 to 180 out of a total of 543 seats. While the market is pinning hopes on the NDA coming to power, recent state election results do not help us arrive at a conclusion either way.

In what is widely considered as a semi-final for India's national elections in spring 2014, the result of results at four important states in India - Delhi, Madhya Pradesh (MP), Rajasthan and Chhattisgarh - were announced on December 8. Of the four, two (Delhi and Rajasthan) were ruled before the elections by the Congress and the remaining two states (MP and Chhattisgarh) were ruled by the BJP.

In the event, the BJP achieved a widespread victory, emerging the majority party in three states and number one in Delhi, though with less than an absolute majority, while the Congress was virtually decimated. Although the overall final result was not unanticipated, Delhi surprised analysts by given the astounding success of the newly formed Aam Aadmi Party (AAP, or "the party of the common people").

The Congress party, after ruling Delhi for three continuous terms, was relegated to third position. The AAP, which made corruption and inflation its main election platform along with populist schemes of drastically reducing household electricity and water charges, came a close second.

While the Congress is steadily losing its political clout, and is mired in numerous cases of corruption, guilty of economic mismanagement, policy flip flops and so forth), the BJP may not have made much headway.

Given the general prevalence of anti-Congress sentiment, the BJP has been able to win elections in those states where they have been directly pitted against the Congress. However, in states, where there are strong regional parties, they are yet to make much headway. Hence, it may not be easy for BJP to be closer to the desired number to secure national power after next year's general election. As things stand, the NDA still seems to be in a better position.

What is, however undesirable from India's point of view is the possible emergence of a much more fractured mandate that leads to the formation of a third alliance. If some parties do finally stitch together such an alliance, it will remain an opportunistic alliance of ideologically diverse parties.

As a result, it will not remain stable and will collapse due to its inherent contradictions. In such an eventuality, the economy will suffer, and one cannot rule out another year of sub-5% growth, if not worse.

The baseline scenario for now remains the formation of a stable government. We expect this to lead to more-meaningful policy actions going forward. Usually, the first two to three years (out of a maximum total tenure of five years) of a new government are punctuated by sensible policy making before political reality triumphs over economic necessity. Our expectations on policy making also stem from our experience of witnessing the tendency of Indian policy makers to act when there's a crisis but not before.

This will likely improve business sentiment and there will probably be a meaningful improvement in investment in the country, especially during the second half of the next financial year. Essentially, we would likely see an investment driven growth going forward. Thereafter growth could exceed 6%.

Having said that, an 8% plus growth rate is as good as ruled out, unless the policy makers get serious about structural reforms. We do not have as much confidence on that happening in the short to medium term.

As for inflation, while the current phase of high inflation will pass and we expect it to ease going forward - though mostly because of a high base effect - we expect it to hover between 5% to 5.5% given the structural impediments, especially in light of a potential pick-up in domestic demand (which has been badly bruised by high inflation and high interest rates) as the economy gains some momentum.

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