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Kunal Kumar Kundu: Back to future shocks

Indian politicians can rejoice. Their US counterparts seem to have well and truly upstaged them and pushed the [US economy](#) to the brink. Given the immediate and potentially disastrous consequence of not resolving the stalemate, most market watchers did call their bluff, though a negligible probability was assigned to the unthinkable.

Having said that, it is important to remember the reason the crisis was averted (albeit for a short period) was the immediacy of the potentially debilitating impact. The problem is, when the impact is relatively long term in nature, kicking the can down the road tends to be the preferred option, especially when the immediate aim is to solve the eternal puzzle facing any politician - how to get re-elected. In the case of India, with the general [elections](#) around the corner, the focus is clearly on salvaging electoral prestige even as the economy awaits redemption.

Given this, little can be expected from the government till the elections. In fact, during the current regime, there's hardly been any meaningful (read economy-positive) policy actions that have been taken, save possibly for the decision to gradually raise prices of diesel and kerosene although a one-time major hike did not materialise, despite all the assurances given in various fora. Multiple projects have been cleared by the government but there are other hurdles on the way that still need to be tackled. The Goods and Services Tax and Direct Taxes Code remain unimplemented despite multiple rounds of discussions. The impact of the pension Bill will be more at the margin at this point in time while the much desired land acquisition Bill suddenly took a turn towards populism - no prizes for guessing why.

The current account deficit is seemingly on the mend. However, apart from the decision to curb gold imports, the reasons are extraneous. Exports have shown signs of picking up because of a generally stable global growth environment as also the weakening rupee. On the other hand, the slowing economy has resulted in falling non-oil imports. What also came to India's rescue was a flood of remittances from non-residents taking advantage of the weak currency. However, the twin deficit problem persists - though it is getting more skewed towards the fiscal deficit since the government's finances are getting pummelled out of shape

by falling revenue while expenses remain on track with no perceptible effort to rein in the undesired ones.

The recent Fed call on [tapering](#) and the impact of shutdown on the US economy means that actual tapering is likely off the table for the remainder of the year - resulting in the resumption of a risk-on rally. With the foreign institutional investors back in play with gusto and the [rupee](#) showing signs of slow appreciation, there is every likelihood of the policymakers being lulled into a sense of complacency. In a way, the apparent good news is not good news for India since postponing the crisis can mean postponing the desire to do the obvious.

Not that we are expecting the current government to take any meaningful measures till the forthcoming elections. Rather, we are likely to see a muddle-through approach and shifting of burden. We, for example, are likely to witness the continuation of financial repression as a recent announcement makes it clear - a hallmark of a financially-challenged government. Government-owned enterprises are now expected to either give substantial dividend to fill the coffers of the government or ensure capital investment (irrespective of its relevance to their core business) and hence, fill the vacuum created by the government's inability to squeeze out resources.

We, at Societe Generale, have identified seven bars (though likely interconnected) that are keeping the Indian tiger caged. These are:

- Boosting power supply and rationalising power tariffs
- Optimising the use of natural resources (which includes a desire for a more pragmatic land acquisition Bill as well as environmental regulations)
- Streamlining administrative procedures (including bureaucratic and judicial reforms)
- The ability to leverage favourable demographics (focussing on outcome-based expenditure on health and education)
- Ensuring steady fiscal consolidation (also includes taxation of agricultural income to plug rampant corruption and under-reporting)

- Building a single flexible domestic market and,
- Reduction of policy uncertainties to boost investment

We understand that all of these bars cannot be removed in one go and that the elimination of some of these constraints would take a longer time than others. But for the tiger to be well and truly uncaged, serious effort needs to be made in working toward those. We see relevant actions only after the new government takes charge next year.

Till that time, a muddle-through scenario is our baseline expectation. Given this, a sub-5 per cent gross domestic product growth is par for the course.

As for the rupee, the appreciating trend is nearing its end, given that all the positive external news have virtually been priced in. The focus will now shift to economic fundamentals and, going forward, we expect the rupee to react negatively to the expected weak economic data flow. Add to that, the announcement of a potential tapering early next year and one can see the rupee bears clawing back in.

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Views are those of the author*