Clouds on the Horizon

India's economy has accelerated over the last couple of quarters with GDP growth rising to 7.2 per cent between October and December. This is led mainly by robust consumer demand manifested most evidently in rising automobile sales, representative of buoyancy in urban and rural spending. More importantly, there are now perceptible signs of a turning investment cycle complemented by a recovery in the agricultural economy. Barring misfortunes within the banking system such as the recent one involving Punjab National Bank, the recapitalisation initiative should spur lending, especially to small and medium enterprises that rarely have access to other forms of funding, specifically the equity and bond markets. We believe that this momentum will be sustained in the coming year and expect GDP growth to rise to between 7 per cent and 7.5 per cent.

Still, external factors may create pressures specifically on capital flows thereby weakening the current account and causing inflation to rise. This is more worrying in the context of farm loan waivers that are becoming the pattern across several states of the Indian Union. Such waivers have little more than a cosmetic political impact. On the other hand, they create fiscal pressures leading to a rise in interest rates, ultimately dampening demand.

Global factors will have an impact on what is now a much more integrated economy than even before. India is greatly dependent on capital inflows which are likely to stumble as a result of policy shifts in the United States. Most important are the tax reforms announced by the Trump administration and a rise in Government spending within America. Secondly, the United States Federal Reserve recently announced its intent to unwind its bond buying programme. The European Central Bank has also begun to moderate bond purchases leading markets to believe that the era of cheap money is now coming to a close. A spike in bond yields has already happened and markets expect that the inflation cycle in America will begin to turn. This may motivate a recall of capital from emerging markets as punters scurry to the safety of the dollar together with expectations of higher returns. Consequently, we expect the Reserve Bank to harden interest rates by at least 50 basis points. Bond markets seem to agree with this view with yields rising since September 2017 from 6.43 per cent to 7.73 per cent now.

Adding to these worries are likely trade wars between America and its partners. Punitive import taxes have been imposed by the US across a few important sectors of industry with indications of more to come. India will also be impacted as duty hikes on certain Indian exports are effected. But the bigger worry is the collateral damage resulting out of trade wars should these actions continue and derail the global mercantile system. For instance, China has responded furiously to America's tariffs, imposing retaliatory measures of its own. Growing antagonism across the world can lead to more disturbing actions in the months ahead. Meanwhile, the threat of escalating conflict in regions such as the middle east and the Korean peninsula continue to weigh upon the global economic system. For instance, oil prices, which were showing signs of moderation earlier in the year, have resumed their upward trajectory with Brent crude at USD 75 a barrel against USD 50 a year ago. Given this state of affairs, markets are likely to remain impulsive, possibly for an extended period of time. Clearly, this would create operating and investment risks for businesses; however, it may also provide opportunities to innovate and profit from uncertainty. If India can keep a check on its fiscal and current account vitals it should sail through possible turbulence, unhurt. ■

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