COMMENT

Indian Exports and US Economy

THE INTERNATIONAL MONETARY Fund has expressed satisfaction that the world economy is likely to grow at a record rate of 5.1% in the current year. At the same time it has warned that the risks of a global slowdown in 2007 are much greater. The immediate cause of concern is the fall in the US property market. This sector has a decisive contribution in the present growth of the world economy. Americans are investing heavily in the construction of new homes. This has led to an increase in property prices and given them a sense of financial security. They are mortgaging their homes, taking loans and purchasing goods such as 51" Flat Screen TVs and Basmati rice in large quantities. This is leading to a huge demand for imported goods in the US. This demand is being met in substantial measure by exporters from the developing countries including India. The fate of India exporters is, therefore, linked to that of the US properties.

Another factor critical to the present buoyancy of the global economy is the role of the developing countries in providing money to the US consumer to be able to purchase goods. The US banks are giving loans to the US consumers at easy terms because India, China and Japan are making the money available to the US Federal Reserve. The Reserve Bank of India is buying Treasury Bills issued by the US Government in a big way. India's forex reserves have swelled from a meagre $20 billion about 8 years ago to about $165 billion today. The RBI has purchased US Treasury Bills with this money. India's wealth was being transferred to Washington, New York through such purchases. The US Federal Reserve was making this money available to the domestic banks who, in turn, were giving out the money to the US consumers as loans. The purchasing power of the US consumer, therefore, rested on capital inflows from the developing countries like India and China.

The collapse of US property prices means that US consumers do not have the money to buy goods from India.

Many commentators in the pink newspapers in India are alarmed at this development. They suspect exports from India will take a beating. The less demand from the US economy may affect Indian economy adversely. Unquestionably Indian exports will be affected. But that is not the full story. The Reserve Bank too will not have the necessity to buy US Treasury Bills because the US consumer will no longer buy goods from India. The position of the US economy vis-a-vis India is like that of a customer vis-a-vis the automobile company. The company gives a loan to the customer to buy its car. Similarly the Reserve Bank is giving loan to the US consumer to buy Indian goods. If the US consumer is not in a position to buy Basmati rice, then there is no occasion for the RBI to buy US Treasury Bills either. The money previously deployed in the purchase of US Treasury Bills can now be used elsewhere. Alternatively the government can reduce the level of taxes in the domestic economy and place more purchasing power in the hands of Indian consumers. The point at issue is whether India is really interested in getting rid of US-dependent export strategy.

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(*Contributed*)