SENSEX : BUSINESS AS USUAL

Bharat Jhunjhunwala

Which way Serisex? Is the question uppermost in the minds of investors today. Some analysts anticipate a fall to 12,500 levels. Two factors that augur in favour of decline are problems of exporters and outflow of portfolio investments. Indeed, sectors like IT and Basmati Rice will face pressure due to decline in the US economy. But this may be only temporary.

The central question is whether the lack of demand from the US is part of a larger global phenomenon; or it is a stand-alone event that may actually lead to an increase in demand from other countries. Weak demand from the US that Indian exporters see today is the result of lower wages and lesser purchasing power in the hands of its consumers. This is because wages of workers across the globe are moving towards a uniform lower level. Textile factories in the US have almost wholly closed down because they are unable to compete with low cost production from developing countries like China and India. The wages of an unskilled worker in the US are about Rs 4,000 per day at present. The corresponding wage in India is just Rs 150 per day. Both are moving towards a common middle level of, say, Rs 250. This is leading to a sharp decline in purchasing power of the US workers which is reflected in less demand for Indian exports and is creating problems for exporters. But another factor is at work simultaneously. Wages in developing countries are moving upward. The upward movement is small but the numbers involved is large, hence the total impact may be somewhat similar. Workers in developing countries are demanding more goods. The sharp increase in trade between developing countries and growth of the mall culture are indications that new demand is being generated.

Pessimists argue that Indian economy may get locked into stagnation as has happened to Japan. That country has been in a near-recession since 1988. Reduction in Japan's exports to the US has not been compensated by generation of new demand elsewhere. The argument is that if this did not happen to Japan, it may not happen to India. This may not be is the case. There is a fundamental difference between Japanese and Indian economies. Wages in Japan are closer to the global maximum while they are closer to global minimum in India. Japan is unable to penetrate new markets such as of Brazil and South Africa because its cost of production is high. Wages in India are less, hence Indian producers do not face this problem. Rather, Japan is in trouble because wages are low in India and the newly emerging markets are being captured by India.

Another argument in favour of decline in sensex is that the share of developed countries in the world income is about 80 percent. Recession in this huge area will impact the developing countries just like a flood uproots the small plants in the garden. Some adverse impact on India cannot be denied. However, the depth of this impact will depend upon the rate of growth of new markets. The share of the developed countries will speedily contract while that of the developing countries will rise. India and China accounted for nearly one-half of the world income in the seventeenth century. This declined to about five percent at the end of Second World War. Now the reverse is happening. According to the World Development Indicators published by the World Bank, the share of'High Income' countries in global GDP was 82.3 percent in 1990. It has declined to 77.7 percent in 2005. The present crisis in America may see speeding of this trend. The development of new markets may compensate for the losses in US markets.

Indications of opposite effects of the slowdown on US and India are available. The rate of interest is being reduced in US and UK. They want to make credit cheap so that businesses can borrow easily and invest. The opposite is happening in India. The Reserve Bank of India has recently increased Cash Reserve Ratio which is another way of raising interest rates. This gives an indication that America's loss is India's gain. Businesses are moving from America to developing countries. Manufacture of cars has largely shifted and that of textiles, shoes and toys almost wholly so. Banking and finance is also moving. Jobs are being cut in the developed countries while new appointments are being made in India. The developed countries are reducing interest rates to keep their businesses from moving; while India is raising interest rates to slow down more businesses from opening. This is sufficient indication that the decline of the US is more in the nature of readjustment of the global economy and is not an indicator of an all-pervasive decline.

The recent decline in the Sensex from 21,000 to 15-17,000 was precipitated by foreign investors becoming sellers to the extent of Rs 700 crore in the first half of April. But this will be short lived. Indian share markets are impacted in two contrary ways by the decline of United States. The immediate impact is negative. American banks need monies to make do their losses in the US. They are liquidating their holdings in India to remit money back home. This is the immediate impact. But another tendency is at work simultaneously. The decline in the US dollar has made that currency untouchable for the global investors. The world banking system is flush with funds. Interest rates are near zero in Japan. Oil exporting countries are earning huge amounts from oil. They need to invest this income. They are looking for safe havens. India may emerge as a desired destination. The rupee is rising vis-a-vis the dollar. This means that global investors would be well advised to sell dollar-denominated stocks and buy rupee-denominated stocks. The remittance by American banks should be assessed in this backdrop. An example will explain. If there is an epidemic in a city, some persons move towards the affected city to take care of their elderly. But most flee away. The remittance being made by US banks is like the family members moving into troubled areas to take care of the elderly. This is not the main tendency. It may take some time for the new inflows into the Indian economy to establish but it is likely to happen. The exit by American banks does not signal a wider phenomenon. The decline in Sensex will be temporary. It will rebound slowly but surely as the word capital changes its direction towards India.□