

From New Delhi by Ramtanu Maitra and Susan Maitra

Indian market responds to Asian crash

Burdened by an industrial slowdown and a large trade deficit, the Indian market cannot insulate itself from the crisis.

On Jan. 12, the Bombay Stock Exchange 30-scrip indicator buckled under pressure of selling by foreign institutional investors. The Indian rupee, which has been losing ground steadily over the last two months, lost marginally. The collapse of the Peregrine parent company in Hong Kong also helped to make investors jittery. It is abundantly clear that the firestorm which has turned the debt-ridden Southeast Asian markets to ashes will continue to threaten the Indian market as well.

At the same time, the health of the Indian economy cannot be judged fully by the scrip prices posted at the Bombay stock exchange. The size of India's capital market is extremely small, compared to the overall size of the economy. Most of the blue chip companies are part of large industrial houses and all these companies have been affected by the industrial recession.

Nonetheless, India has now become more vulnerable to global financial events than ever before. There are two primary reasons for this: India has a large foreign debt, and a perpetual trade imbalance, caused by its weak export capabilities.

Since 1991, when the country began to reform its financial sector, India has received about \$10 billion in foreign direct investment. But most of the foreign exchange that the country posts as its reserves is in the market and is invested by foreign institutional investors. At present, forex reserves amount to about \$27.4 billion. That is sufficient to meet six months' import requirements, but most of those re-

serves can vanish in no time. Now, with the financial meltdown occurring in Southeast Asia, this capital may leave India's shore very quickly. Indian investors, worried as well about India's political uncertainties, have begun to respond to this new reality.

India's central bank and Finance Ministry, aware of the danger of dollar flight, had been steadily eroding the value of the Indian currency. Citing the rock-bottom price of Southeast Asian currencies, following their collapse, India's Finance Ministry is insisting that the rupee is overvalued, and hence it is under pressure to lose some of its value. The authorities claim that the only way India can keep up exports, in light of fresh competition from Southeast Asian nations, is by lowering its currency and making the cost of its exports more attractive to foreign buyers.

A recent report by the Ministry of Commerce, however, gives a different picture, and a truer one. The report said that India's export growth fell by 0.95% in November, largely due to rupee depreciation. The export inelasticity of some of the Indian goods caused the slowdown, it pointed out. Bringing down the value of the rupee did not help, and, in fact, did harm. Subsequently, Finance Minister P. Chidambaram announced that the rupee will not be devalued, because a cheaper rupee is no solution.

It is difficult to imagine that India's Harvard-trained Finance Minister was not aware of happenings on the ground, and needed the Commerce Ministry report to change his mind. The fact is that New Delhi is

less than honest in stating why it has tacitly approved the steady devaluation of the currency.

One does not have look far to see what New Delhi is trying to hide. India's infrastructure is in shambles, the physical economy has become less productive, and the world is in recession. There is no way India can enhance its export capability in the short term. What the authorities do not say, is that foreign investors are eyeing the cheaper Southeast Asian assets greedily, and may take their money away from the Indian market to invest in the Indonesian or Thai market, however temporarily. In order to keep the funds parked in India, New Delhi is cooperating in bringing down the rupee, in an attempt to make Indian assets equally attractive to foreign institutional investors.

The only solace at this dangerous hour is that India has not made its currency convertible on capital account and more than 95% of India's foreign debt lies with the government. A large amount of that is non-institutional, long-term, bilateral debt. In fact, unlike in South Korea or Indonesia, India's foreign debt has almost no private component. By keeping the rupee non-convertible on capital account, the government has ensured that large-scale capital flight or dollarization of the economy, are not immediate threats.

On the other hand, it is not difficult to see through the brave front put up by authorities at the Finance Ministry and the central bank, who are harping on the theme that the Southeast Asian financial disaster will not further affect India. These statements are issued primarily to "assure" the Indian voters, who will be choosing a new government in another six weeks, that New Delhi has kept the Indian economy insulated from outside disasters.