FINANCIAL TIMES

September 23, 2013 2:47 pm

India suffers fresh currency concern

By James Crabtree

Tens of thousands crammed on to Mumbai's Chowpatty beach late last Wednesday night in a riotous ceremony designed to bring good fortune by immersing clay effigies of Ganesha, the portly and popular Hindu elephant god.

The more financial-minded among the revellers may have found their prayers answered surprisingly quickly. At almost exactly the same moment Ben Bernanke began to demur on US Federal Reserve plans to "taper" its ultra-easy monetary policy – bringing an end to one of the most turbulent periods of market fluctuation in recent Indian history.

Market whipsaw

Indian rupee against the dollar

The widespread relief that followed was only underlined when Raghuram Rajan, head of the Reserve Bank of India, unexpectedly raised interest rates two days later. A mark of the new governor's growing authority, the revived investor confidence was based on someone, finally, taking control of the nation's rickety finances.

Yet behind this sense that the bullet had been dodged there now lies a new anxiety: uncertainty over whether the worst of the currency crisis that has buffeted India and other emerging markets is now over – or whether the true moment of reckoning has just been delayed.

There were signs on Monday of continued jitters as investors digested the likely effect on growth of Mr Rajan's tightening moves and sent the benchmark Sensex stock market index down nearly 2 per cent. The rupee dropped too, falling to Rs62.60 against the US dollar, although it has still rallied strongly from an all-time low of nearly Rs69 in late August.

Such wobbles aside, those who believe the storm has passed take confidence from stabilising steps introduced by Mr Rajan in early September. These include a programme to attract as much as $10bn in new capital flows from Indians living abroad, in turn helping plug a sizeable current account gap.

The continued faith of global investors helps, too. Even amid the recent tumult, little foreign money flowed out of equity markets. "In India, the appeal of the 'baby' outweighs the foul stench of the 'bathwater', unlike in previous emerging market crises," says Nicholas Spiro of Spiro Sovereign Strategy in London.

Yet, while stability may have returned to Asia's third-largest economy last week, the longer-term outlook is hardly rosy.

Indian equities have held up relatively well compared with their emerging market peers since tapering fears emerged in mid-May, according to Bank of America Merrill Lynch, but the rupee's sharp fall means that returns in dollar terms are much less positive, down about 10 per cent.

Inflation is a further concern. Mr Rajan's interest rate hike signalled a newly hawkish stance, as the central bank renews its battle against stubbornly rising prices, even as it plans to unwind the emergency measures it brought in to protect the rupee since July.

That battle is now set to intensify: Goldman Sachs predicted on Monday that rates will rise by 100 basis points over the next six months. JPMorgan economist Sajjid Chinoy agrees that hopes for reductions are now off the table, as the RBI tries to counteract the effect of currency depreciations on import costs, and ultimately domestic prices.

A series of further rate hikes are now likely to hit growth, which barely exceeded 4 per cent in the last quarter, along with corporate profits. "Markets will be volatile, up and down," says Rashesh Shah, chief executive of Edelweiss, a Mumbai-based broker. "But more important is that earnings will be down, and there will be downgrades soon."

People will be quite cautious in putting new money into India, because the fear is all of this instability could return

India's government promises to respond, with finance minister Palaniappan Chidambaram telling the Financial Times last week that he would push further pro-growth measures, including a long-awaited move to allow increased foreign investment in the insurance sector.

Yet with jockeying for next year's national elections already under way, many observers doubt major reforms are possible. And if they are not, the odds of new capital inflows are slim, says Herald van der Linde, head of

- Herald van der Linde, HSBC

Asia-Pacific equity strategy for HSBC. “People will be quite cautious in putting new money into India, because the fear is all of this instability could return.”

The turbulence of recent months means these fears are now deep-seated and relate as much to India’s newly revealed economic weaknesses as to the inability of its leaders to repair them before eyes turn again to Mr Bernanke, later this year.

“There is a sense that India has some gas left in the tank,” says economist Eswar Prasad of Cornell University. “But the recent whipsawing effect in the markets is just an indicator of how vulnerable India remains on a variety of dimensions. So the sense that the worst is over is probably more than a little premature.”