After market craziness, it's business as usual

Spectrum

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The markets surely were crazy this week. The Sensex closed on May 31, which was also the day that the GDP growth numbers were released, at 73,961. The release came out after the markets had closed. On Saturday as the fmal round of polling was completed, various agencies had their exit polls which showed a clear majority for the BJP party and even higher for the NDA. Naturally the markets were enthused that the exit polls gave very positive signs for the future of the economy and the Sensex increased to a high of 76,468 on Monday. This spooked expectations that there were even greater things in store. However, the party was spoilt on Tuesday when the election results were declared. The NDA had the majority, which the BJP didn't, and the Sensex ended lower at 72,079. The notional gains and losses in market capitalisation were calculated and the picture was nothing short of being dramatic on both the days.

Markets are driven by irrational exuberance. There was no reason for the increase of almost 4% on Monday. After all, the ruling government was expected to come back to power and the only conjecture was the number of seats. Similarly when the coalition got the majority, the fact that the leading party didn't should not have shaken the market. But both happened, and this is how the market works.

On Wednesday, June 5, which is one session after the election results were out, the Sensex recovered to end at 74,382 which is still higher than the May 31 closing. What is one to make of this madness? In short, the market still believes that the economy is on the right path with the coalition government in place and hence has reposed faith. The fall on the 4th was a knee-jerk reaction. The continuation of the era means that things will be business as usual. The policy framework will remain more or less the same and while there can be some tweaks to accommodate the coalition partners, the structure will remain unchanged.

What will be watched from here on by investors will relate more to the finances because the fiscal deficit is the most singular indicator of the health of the finances of the country. Therefore, the glide path to the short-term goal of 4.5% of GDP by FY26 is one area that will be monitored. Here there is little reason to be sceptical as the government has guided the deficit in difficult times. Now that growth is expected to be on the path of upwards of 7% in the next few years, there is unlikely to be any external pressure on the deficit. As long as growth is in the range of 7-8% this year with inflation under control at less than 5 % there is reason to believe that there will be revenue slippages. GST collections for the first two month appear to be on the right path giving confidence to this belief.

The other related area would be capex of the government. The biggest victory over the last 10 years has been the progress made in the digital space as well as capex by the government. Both have had strong backward linkages with the related sectors thus providing a fillip to the economy at a time when the private sector has been slow to invest. The budget to be presented in July will provide direction here. The amount allocated in the interim budget is fairly high at Rs 11 lakh crore which would have to be largely spent in nine months' time. Therefore, it does not appear to be a tricky situation on account of the coalition government.

The coalition partners at their respective regional level have been progressive in terms of reforms and hence there is little reason to conclude that there could be any impediment along the way. There are touchy issues like labour, land and agricultural reforms which have not been addressed even in the past, and hence would not be ones that would take the government by surprise. These are works in progress where a consultative approach is called for, especially when it comes to the farm laws. However, this is something the government should take up as the farm sector is the only one which has not witnessed any reforms in terms of improving productivity or marketing.

The economy may be expected to go along the existing path of high growth with the government providing support through enabling policies. Hence measures to up industrial and exports growth would be something that would be expected as they remain the weak links in the growth story. On social welfare there would be some bit of introspection as there may be need to address specific concerns of some of the stakeholders. But this can be subsumed in the available space provided by the fortuitous higher transfer of RBI surpluses to the government.

From the point of view of the market, it should be back to normal. There will continue to be some volatility until the new government is sworn in as markets factor in all possibilities until the final decision is taken. The content of the budget will be important here as that will be scrutinised in some detail to gauge the strength of the resolve of the coalition government. The rest will be driven by the corporate performance as it would also be the time when the first quarter results would be out and a better picture of the monsoon would emerge. Foreign investors however will continuously monitor what happens in the corridors of power while looking out for all messages that come from the government on reforms. Hence articulation will be very important on the policy front to reassure investors when a coalition government is in power.

The author is Chief Economist, Bank of Baroda and author of 'Corporate Quirks: The Darker Side of the Sun'. Views are personal