Brexit, and the Impact on India

UK today became the first company to exit European Union. Currencies everywhere are in jitters on back of the likely impact this exit will have.

It will take the UK two-to-three years to complete the whole process and hence the impact in near-term for India will be minimal.

Selling-off which is expected now will impact markets. However, the panic will pass in a couple of days. This is an opportunity for buy on dips for Indian stocks. India is bound to recover with expectations of good monsoon and recovery in demand.

The EU is an economic-political union which was created in 1957—with just six nations—as an answer to the nationalism that had permeated Europe after World War II. The idea underlying the EU was to ensure peace by promoting economic cooperation in a single market of the member states. The EU currently has 28 members with more—such as Turkey—waiting in the wings to join in. With its headquarters in Brussels, EU has its own currency, the euro, which has been adopted by 19 member countries. It also has its own parliament that now sets rules in a wide range of areas, including on environment, transport, consumer rights and even mobile phone charges. Citizens of member states have the right to "freedom of movement", which means the citizens can move, live and work in any of the member states.

As reported by livemint-

Global consequences of Brexit:

1. Brexit would be the strongest repudiation of the post World War II consensus favouring global integration. The consensus is already fraying against the backdrop of increasing protectionism and anti-immigrant sentiment worldwide. Brexit will only add to this sentiment.

2. It could undermine global growth prospects. The EU is the largest trading partner for many countries such as India and China. Any unravelling of the EU market means uncertainty as it is an export destination and this is likely to have an impact on exports from all major parts of the world. For example, at present exports to the UK account for 0.7 % of Asian countries' GDP. Some studies estimated that a Brexit would reduce British imports by 25% worldwide within two years.

3. As Britain votes to leave, investors will rush to safety and precipitate unpredictable moves in global markets as capital moves from risky assets (possibly emerging markets) to safer havens.

4. Much of the EU's money comes from its member states. And the UK is one of the larger contributors. A British exit from the EU would rock the Union by ripping away its second-largest economy with one of its top two military powers and by far its richest financial centre. This could also give rise to more nations contemplating exit from the EU. Greece, for example, held a referendum last year when its citizens overwhelmingly rejected EU's bailout norms. Many Britons working within the vast EU bureaucracy would have to look for alternate employment.

Morgan Stanley says it sees protracted political and economic uncertainty as a key consequence. "For the US, the impacts grow over time with the economy falling to around stall speed even in the best outcome. Rate hikes comes off the table, the Fed provides liquidity," says the Morgan Stanley note.

Consequences for India:

1. India sees the UK as a “springboard” or “gateway” into Europe. Many Indian companies are listed on the London Stock Exchange and many have European headquarters in London. (According to Indian government numbers, there are 800 Indian companies in Britain). Brexit will take away this advantage.

2. India has been negotiating a free-trade agreement with the EU since 2007 and a “yes” vote for Brexit will have a direct bearing on this. As Britain leaves, then this will mean that India will need to negotiate a separate pact with the UK.

3. Brexit can affect India’s flagship IT sector given that the UK accounts for 17% or one-sixth of the sector’s global exports that topped $100 billion (approximately Rs.6.70 lakh crore). For one, Brexit will increase overhead costs, setting up new headquarters, perhaps in both Europe and Britain.

4. There are some who see an advantage for skilled migration from India to Britain, thanks to Brexit. But given that one of the arguments in favour of Brexit is the large numbers of European migrants coming into Britain, this perception of advantage could be somewhat misplaced.

Forex outflow: One of the major impact is going to be the outflow of dollars. As the UK decides to exit, foreign funds are likely to move out of the riskier markets like India. What is required in such a scenario is forex reserves. India's foreign exchange reserves hit a record high at $363.46 billion for the week ended 3 June.

The finance ministry said on Wednesday the country has sufficient foreign exchange reserves to handle any impact. RBI Governor Raghuram Rajan said the central bank will infuse whatever liquidity is needed into the Indian market to keep it "well behaved".

A note by Deloitte in May said India is the third largest source of FDI to the UK in terms of numbers of projects, with 122 projects encompassing inward investment in the last financial year, an increase of 65 percent from the previous year, which lead to the creation of 7,730 jobs and protection of 1,620 jobs. According to the consultancy firm, key sectors attracting Indian investment include healthcare, agritech, food, and drink. "There are an estimated 800 Indian owned businesses in the UK, including companies like Tata Motors, with more than 110,000 employees. Further, the UK is also India’s largest G20 investor," it said.

IANS, meanwhile, says that Britain ranks 12th in terms of India's bilateral trade with individual countries. It is also among just seven in 25 top countries with which India enjoys a trade surplus.

"India invests more in the UK than in the rest of Europe combined, emerging as the UK's third largest FDI investor. Access to European markets is therefore a key driver for Indian companies coming to the UK. Anything that lessens this attractiveness may have a bearing on future investment decisions. It is important also to ensure continued border-free access to the rest of Europe for the many hundreds of existing Indian firms that have base in the UK," Chandrajit Banerjee, director general of Confederation of Indian Industry (CII) has been quoted as saying in the IANS report.

So clearly, India will see a major impact, as UK decides to leave the EU. But India is better placed than other countries to handle the crisis.