[EXCLUSIVE TO fe] AMITENDU PALIT

# Foreign investor: look long, not short

GIVEN the backdrop of global downturn and domestic elections, the room for innovative policies in the Budget was cramped. The Budget moved on expected lines by focusing on social sector, agriculture and infrastructure. But does it have anything that will either encourage or depress foreign investors?

The Indian economy's links with the world is more than what many normally assume. Merchandise trade is 35.5% of India's GDP. Combining trade and invisibles, current account transactions are more than half of India's GDP. There will be some impact of the global crisis on this segment. Apart from merchandise exports, revenues from software and business and transport services will go down. Remittances are also likely to decline given the setbacks in mature economies.

The capital account presents a different scenario. A robust and healthy capital account is the key to BoP stability and reserve growth. There are two contrasting trends visible in the capital account. Short-term portfolio investments are withdrawing. During April-January 2008-09, FII outflows were almost $12 billion. But longer-term FDI flows have been surprisingly robust. During April-November 2008-09, FDI inflows touched a record high of $23.2 billion. This was a 45% increase over the corresponding period of 2007-08. The surge in FDI is consistent with UNCTAD's rating of India as one of the most attractive emerging markets for long-term investors. The surge also explains why capital inflows are almost 9% of the GDP despite difficult times.

Budgets play around with fiscal tools, not monetary instruments. The latter, through their impact on money and capital markets, are more likely to influence FII sentiments. RBI has already announced several measures for improving liquidity. However, long-term FDI investors are unlikely to be influenced by short-term counter-cyclical measures. They would be happy to note that at a GDP growth of 7.1%, India remains the second fastest-growing economy. They will also be happy at the 7.4% growth of per capita income of Indian consumers. FDI investors have always perceived India as a land of strong skills. They would be encouraged by the decision to start more IIMs and IITs. The enhanced outlay on higher education will also be considered a step in the right direction. Furthermore, the thrust on building new infrastructure capacities through Bharat Nirman and a host of private-public-partnership (PPP) projects will also encourage investors.

There are two factors, however, which might not amuse investors much. First, lack of action in cutting subsidies. The increases in fertiliser, food and oil subsidies show that expenditure management is facing problems. These might send out wrong signals regarding future moves towards market prices. Second, fiscal and revenue deficits are much higher than expected. Though circumstances demand greater fiscal headroom, such room may create uncertainties for short term yields. However, they are unlikely to affect outlooks for long term returns.

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