

# Opinion

TUESDAY, APRIL 23, 2019

**CONCERTED GLOBAL ACTION**

M Venkaiah Naidu, vice president of India

Mere condemnation and compensation will not suffice. We have to contain and root out terror in all its forms by going to the root cause



## SELF-SUSTAINING

THE NATIONAL MINERAL POLICY OF 2019 RECOGNISES THAT MINERALS ARE ESSENTIAL FOR INDUSTRY AND EMPLOYMENT AND HAVE EXPORT POTENTIAL

# Develop mining to improve national security

**T**HE RECENTLY ANNOUNCED National Mineral Policy 2019, covering non-fuel and non-coal minerals, brings back into focus the crucial significance of vital raw materials for India's economy which is set to become the third-largest in the world over the decade ahead. India has a great historical legacy in mining and metallurgy, which enabled the development of advanced material civilisations on our soil from ancient times. Yet, mining and minerals have rarely been given an appropriate importance by policymakers or in the public imagination. If anything, mining has come to be associated with damage to the environment and tribal habitats, and unfair acquisition of natural resources. The release of the NMP 2019 is an opportunity to bring back a balance between such concerns and the undeniable need for minerals to sustain daily life in our modern economy. We have reached dangerously high levels of import dependency while less than 10% of India's potential has been explored. It is also time to understand the implications for national security of access to critical minerals.

The NMP 2019 recognises that minerals are essential for industry and employment and have export potential. Actually, the growth and diversification of our economy, combined with restrictions on domestic mining, have led to a surge in imports of minerals and metals—reaching over \$130 billion in the last year, contributing significantly to the current account deficit. A rational approach to sustainable mining at home will release resources for other essential imports.

A well-developed, sustainable mining industry has immense scope for employment generation and the NMP rightly targets human resource development for the sector, as well as

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robotics and automation to assist in deep underground mining. Given the spread and diversity of India's geological potential, mining can create new centres of economic activity in various parts of the country, including some which face internal security threats. Mining contributes just over 2% of our GDP as against 5% in China and 7-8% in Australia and South Africa, with whom we share geological characteristics.

Minerals are required not just for the traditional manufacturing industries of our present (including defence industries that require large quantities of copper, aluminium, titanium, bismuth, etc) but are inextricably linked to our future hi-tech, digital economy and renewable energy sources. Our ubiquitous mobile phones require cobalt, graphite and aluminium as well as lithium. It is estimated that 62 elements are used in making high speed, high capacity, integrated circuits. The French expert Guillaume Pitron has written that the electric transport of the future will give up oil, but will be "dependent on some 30 rare metals which have outstanding electronic, optical or magnetic properties". Vehicle batteries may require 10kg of cobalt. Permanent magnets used in electronics and "smart" missiles consume up to 3.5kg of rare earth metals like samarium, and lasers use

neodymium and other rare metals. The "green tech" demand of tomorrow will require more exploration, mining and refining of rare earths. Currently, China controls over 90% of global rare earth supplies. It can, and has used this leverage to cut off supplies to customers abroad for geopolitical reasons; and it may do so again to keep its lead in the new technologies underpinning its Made in China 2025 vision.

NMP 2019 specifies that research will be directed towards the raw materials required for production of materials of high purity for use in advanced technology applications. We have to tap our substantial potential for mineral resources which will ensure we have the wherewithal to join in advanced manufacturing for the digital age, including hi-tech defence industries.

The NMP gives long overdue recognition to mineral security as an important issue with strategic as well as economic significance, and seeks long-term mineral security for the nation through enhanced exploration and development at home and acquisition of assets abroad. China has had a strategy on critical minerals since 2003. It has very little cobalt, but has moved fast in Africa, acquiring companies in the Democratic Republic of Congo which produce about 30% of the world's cobalt

production!

After the Second World War, the US created a strategic mineral stockpile by law, and this is managed by the Defence Logistics Agency. Analysts suggest that the stockpile, which once held 3 years supply of as many as 75 minerals, began to decline after the Cold War ended, reaching just 18 minerals with a value of \$1 bn in 2016. President Trump has, however, identified the reliance on imports of minerals as a vulnerability, and enunciated a new strategy to ensure secure and reliable supplies of critical minerals. (Industry experts have identified China, Russia, South Africa and some other developing countries as being the key sources of many of the 50 minerals for which the US's import dependence exceeds 50%). The US president's executive order of December 2017 defined a "critical" mineral as one that i) is essential to the economic or national security of the US; ii) has a supply chain which is vulnerable to disruption; and iii) serves an essential function in the manufacturing of a product, the absence of which would have significant consequences for the economy or national security.

Focusing on security and prosperity, the US policy directive declares "an increase in private sector domestic exploration, production, recycling, and reprocessing of critical minerals, and support for efforts to identify more commonly available technological alternatives to these minerals will reduce our dependence on imports, preserve our leadership in technological innovation, support job creation, improve national security and the balance of trade, and enhance the technological superiority and readiness of our Armed Forces which are among the nation's most significant consumers of critical minerals". NMP 2019 should bring to bear a similar holistic vision for India's national security.

## Investigate case against CJI first, don't pre-judge it

It is possible, as the CJI and FM Jaitley have argued, that this is a hit job, but a complete investigation of the facts is essential

**G**IVEN THE HIGH-PROFILE nature of cases in the Supreme Court (SC), and not just the obvious political ones involving the BJP (Rafale) and the Congress (Rahul Gandhi's citizenship and his Rafale comments), it is obvious there would be many who would like to see the Chief Justice of India (CJI) hobbled. But that goes for most people in influential positions across the country. That is why, it is difficult to understand why, when faced with a sexual harassment charge, the CJI chose not to delegate the inquiry to a body he was not in charge of; the SC's Prevention of Sexual Harassment committee, for instance, is not empowered to examine cases relating to sitting judges including the chief justice. Instead, he said this was a larger plot to 'deactivate' him; he was quoted by one website as saying the judiciary was under "very, very serious threat" and that, if judges had to "work under these conditions, good people will never come to this office". Equally astonishing was the manner in which the Attorney General, the Solicitor General and even the finance minister chose to back the CJI. In a blog post on the matter, finance minister Arun Jaitley seemed to suggest the allegations were part of the "assault on the institution" that was on since the 1970s and, while saying it should be left to the SC to decide how to deal with the allegations, he spoke of how this was "not the first case of the 'institutional destabilisers' nor will it be the last".

There have been, as the finance minister has said, some cases of influential members of the Bar trying to browbeat the judges, and it is certainly curious that, apart from the fact that the complainant's representation was distributed to judges of the SC, only some online news portals were given the details of the complaint even though all newspapers/TV channels have legal reporters; and this case is surely of relevance to more than just legal reporters? But surely these statements of support could have followed an independent inquiry? This is, after all, not the first time that an eminent person has been accused of sexual harassment, especially after the #MeToo movement gained momentum, and in many cases, the accusations have been found to be true. Indeed, by presiding over a bench that asked the media to exercise its judgment on publishing details of the case—"leave it to the media to take off such material which is undesirable"—even though his name was not on the brief order, the chief justice did act as a judge in his own cause.

Unlike many sexual harassment charges where, very often, it boils down to one person's word against another, in this case, the allegations made are very specific and involve many actions that can be independently verified; similarly, there are fairly detailed allegations about what fate befell the victim's family after the alleged incident, and these charges involve the action of some other organisations whose conduct has been alleged to be unfair. Each one of these allegations can, and must, be probed; and the results of the probe will go a long way in helping to arrive at a conclusion. This case, as is obvious, is very important from the point of view of the reputation of the chief justice of the country; it is even more important from the point of view of millions of women who face sexual harassment at work, so classifying it as a blackmail attempt without any investigation is unfair to all of them. While the CJI was wrong to preside over the bench that made some observations on the matter, he must do the right thing now by appointing a committee, perhaps of retired chief justices of India, to examine the allegations in detail. Asking the CJI to step aside till the enquiry is over, perhaps, would be succumbing to the "institution disruptors" the finance minister warned about; but giving the committee a tight deadline to investigate the matter, while the CJI continues to preside over SC, would perhaps be the best for all involved.

## What Earth Day?

Most nations still unwilling to do what's needed to save planet

**T**HETHEME OF this year's Earth Day (April 22) was protecting the planet's species diversity. The theme is a pertinent one, considering nearly half of 177 mammal species surveyed in a study by three researchers, from the Universidad Nacional Autónoma de México and Stanford University, saw their distribution fall by more than 80% between 1900 and 2015. Scientists strongly believe that the planet may be in the midst of the sixth mass extinction, and unlike other times in the past, this could be largely anthropogenic. Indeed, as per WWF's Living Planet Index that categorises the causes of decline of wildlife population, 37% of the wildlife population lost in the last 40 years can be attributed to exploitation by humans, 31% to habitat degradation, 13% to complete habitat loss and 7% to climate change. Current extinction, a paper published in Science says, is 1,000 times higher than what would have been if there were no people—a Duke University study estimates that while nearly a 1,000 species are lost every year due to anthropogenic reasons, less than one species a year was lost annually 200,000 years ago, before modern humans evolved. At the same time, another study estimates that, at the rate of average global consumption today, we need 1.5 planet Earths to sustain human life, while at the level of consumption in the US, we would need four planets. The worst offenders in the consumption & climate change problem, meanwhile, obstinately refuse to change course.

While rich nations have been stepping up conservation efforts, this is at the expense of the developing world—the developing world now undertakes production to cater for not only domestic needs, but also for exports, with an ever-growing ecological footprint. Indeed, between 1990 and 2008, a third of all the products of indiscriminate deforestation, viz. timber, beef and soya, were exported from developing nations to the EU. While China, Japan, and the US continue to over-exploit marine resources, West Asian nations, Kuwait, Qatar and UAE have the world's worst per capita ecological footprint—seventeen of the 21 nations that beat the world average in terms of ecological damage caused, are rich nations. The problem is exacerbated by the non-action on the climate change front. The Climate Action Tracker, which analyses individual countries' (those for which data is available) likelihood of meeting a lower-than-1.5°C-warming future, says the US and Russia's efforts are 'critically insufficient'. This means that if all governments were at a level similar to that of the two countries—both of which are fossil-fuel rich nations—a 4°C-plus warming is inevitable. While Canada and China are making "highly insufficient" efforts, the EU's performance is "insufficient". Indeed, only India, Ethiopia and the Philippines are making efforts compatible with a 2°C rise, while Morocco is the only nation in the world that is on a 1.5°C compatible pathway. So, Earth Day, unfortunately, is little other than tokenism if nations switch off their destructive ways just for a day every year.

## Building Security

Kerala's housing project for the homeless is an initiative worth serious consideration

**T**HE KERALA GOVERNMENT'S Mission LIFE (livelihood inclusion and financial empowerment) that aims to provide shelter and security to the homeless has been reaping some success. Under the initiative, the state will be providing shelter to 4.3 lakh families that are without a home. The first phase of this project has been completed—as per *The Indian Express* (IE), the newly built housing complex in Adimali contains 271 units in a total of seven floors. The complex offers decent living space to the homeless and has amenities that are now common in housing complexes elsewhere in the country, including waste management facilities and power back-up. Additionally, the complex also houses a health sub-centre and *anganwadis*.

The project will be implemented in coordination between the departments of local self-government and social welfare—Adimali complex, IE reports, cost ₹26 crore. The Kerala government estimates that if each of the 4.3 lakh target families were to be provided with independent housing, the total land requirement would have been 6,000 acres, which would have made the project unsustainably expensive and impossible to follow through with because of the paucity of land; thus, the decision to opt for apartment complexes and housing clusters that reduce the land requirement. The project website also lists the provision of social security and skill development schemes, making each recipient independent and empowering them to change and work for their own future. In addition, the construction of houses for that section of society which is supposed to receive the majority of government-provided aid enables officials to track the receipt of such benefits as the beneficiaries are not constantly on the move or are scattered. The fact is that taking the homeless off the streets has many gains for healthcare, delivery of government services, law and order, etc. Other states would do well to take a leaf from Kerala's book.

## Jalan report to help lending rate cuts

Transfer of excess RBI capital to the fisc will not impact liquidity/RBI open market operations (OMO) if it is deployed to recapitalise banks

**MEDIA REPORTS SUGGEST** that the expert committee, chaired by ex-RBI governor Bimal Jalan, to examine the RBI's economic capital framework, will submit its report soon. How much will the Jalan committee identify as excess RBI capital? Contingency reserves would release ₹1,282 bn if halved to 3.25% of RBI book from 6.5% now. This is still 50+% higher than BRICs' (ex India) average. A 4.5% yield hike cover releases ₹1,160 bn. It is estimated that the reserves would also release ₹1,170 bn if restricted to cover a yield rise of, say, 4.5%, from about 9% now.

**Revaluation Reserves: ₹300-1,800 bn**

Limiting the appreciation cover in RBI's currency and gold revaluation account (CGRA) to 25% (i.e., ₹52/USD) would release ₹357 bn to the fisc. The current CGRA balance is about ₹7,300 bn and covers ₹18.2/USD to a level of ₹51.15/USD, i.e., a 26.3% appreciation. A 20% appreciation cover releases ₹1,744 bn. Limiting the appreciation cover to 20% (i.e., ₹55.5/USD) would release about ₹1,744 bn to the fisc from the CGRA.

**Overall cap: ₹2,000 bn**

Capping reserves at 20% of RBI book (25.5% now) above the 2004 Thorat group's 18% and Economic Survey's 16%, releases ₹1,959 bn. Can RBI really transfer reserves to the fisc beyond its annual surplus? The 1934 RBI Act places no bar as long as the ministry of finance maintains ₹5 crore/\$0.7 mn of reserve funds under Section 46. While Section 47 enjoins RBI to credit its annual surplus to the fisc, after provisions, it does not place any restriction on further transfers.

**Excess RBI capital OMO neutral if it recaps banks**

**INDRANIL SEN GUPTA**  
India economist, DSP Merrill Lynch (India)



RBI's surplus capital held in, say, contingency reserves in net non-monetary liabilities (NNML) (net worth) is transferred to government deposits with it. The government draws this down to inject capital into PSU banks. PSU banks invest the monies received from recapitalisation in a government account that is parked with RBI. The entire transaction set is liquidity neutral. In the government balance sheet, the ministry of finance draws down its balances with RBI to

infuse capital into banks. Banks, in turn, put these monies back in a government scheme that is held at RBI. The entire transaction set is fiscal deficit neutral. Finally, in the bank balance sheet, the bank invests the capital infused in a government scheme. This still relaxes its credit constraint by 10x at 9% CR. This should help to ease lending rates.

Edited excerpts from BofAML's *India Economic Watch* (April 22)

RBI's contingency reserves are highest amongst BRICs		200 bps jump in 10yr needs only 15% of CR today	
Central Bank	Ratio of contingency reserves to assets (%)	10 yr yield on Jun 30 2018	7.9
Brazil	3.7	10 yr yield today	7.26
Russia	1.1	Purchase price (at par)	100
India*	6.5	Coupon	7
China*	1.9	Yield today	9
S Africa	1.5	Price today	88.8
		Capital loss	-11.2
		Coupon accrued	7
		Total return due	-4.2
		RBI's G-sec holding (₹ bn)	7,119
		RBI's likely loss (₹ bn)	-299
		CR (₹ bn)	2,321
Govt uses surplus deposit with RBI to recapitalise PSU banks			
Inflow		Outflow	
Step 1			
RBI's excess capital	10	Infusion of capital into PSU banks	10
Total	10	Total	10
		Fiscal deficit	0
Step 2			
Banks invest capital in govt scheme	10	Gol holds these monies with RBI	10
Total	10	Total	10
		Fiscal deficit	0
Source: BofA Merrill Lynch Global Research estimates			

## LETTERS TO THE EDITOR

### Sri Lanka attacks

Man's inhumanity to man could not have been demonstrated more vividly and dreadfully than in the blast sites—churches and hotels—in Sri Lanka. Of particular poignancy were the photographs of a blood-smeared Christ and the inconsolably wailing kin of the victims taken moments after the Easter Day tragedy. In the attacks on the luxury hotels was a dire warning to those who plan a sight-seeing tour of the island of indescribable scenic beauty. The perpetrators of the crime are said to be Sri Lankan nationals. The sophistication, coordination and meticulousness with which the attacks were carried out could possibly mean the involvement of those with expertise and resources beyond the shores of Sri Lanka. These appalling attacks underscore the destructive power of religious intolerance and hatred and the need to repudiate violence and replace it with non-violence tempered with love

— G David Milton, Maruthancode

### Case against CJI

The sexual harassment complaint against Chief Justice of India (CJI) Ranjan Gogoi cannot simply be brushed as one aimed at maligning the reputation of CJI and the institution he heads. While the CJI had every reason to be aggrieved over the sexual complaint raised against him, he could have exercised restraint and refrained himself from publicly attributing motives to the sexual complaint. CJI's apprehensions about the need to protect and preserve the judicial independence are genuine and cannot be faulted, but the question now is whether the higher judiciary has the institutional resolve to look into the same (sexual complaint) with the fairness and objectivity it truly deserves

— M Jeyaram, Madurai

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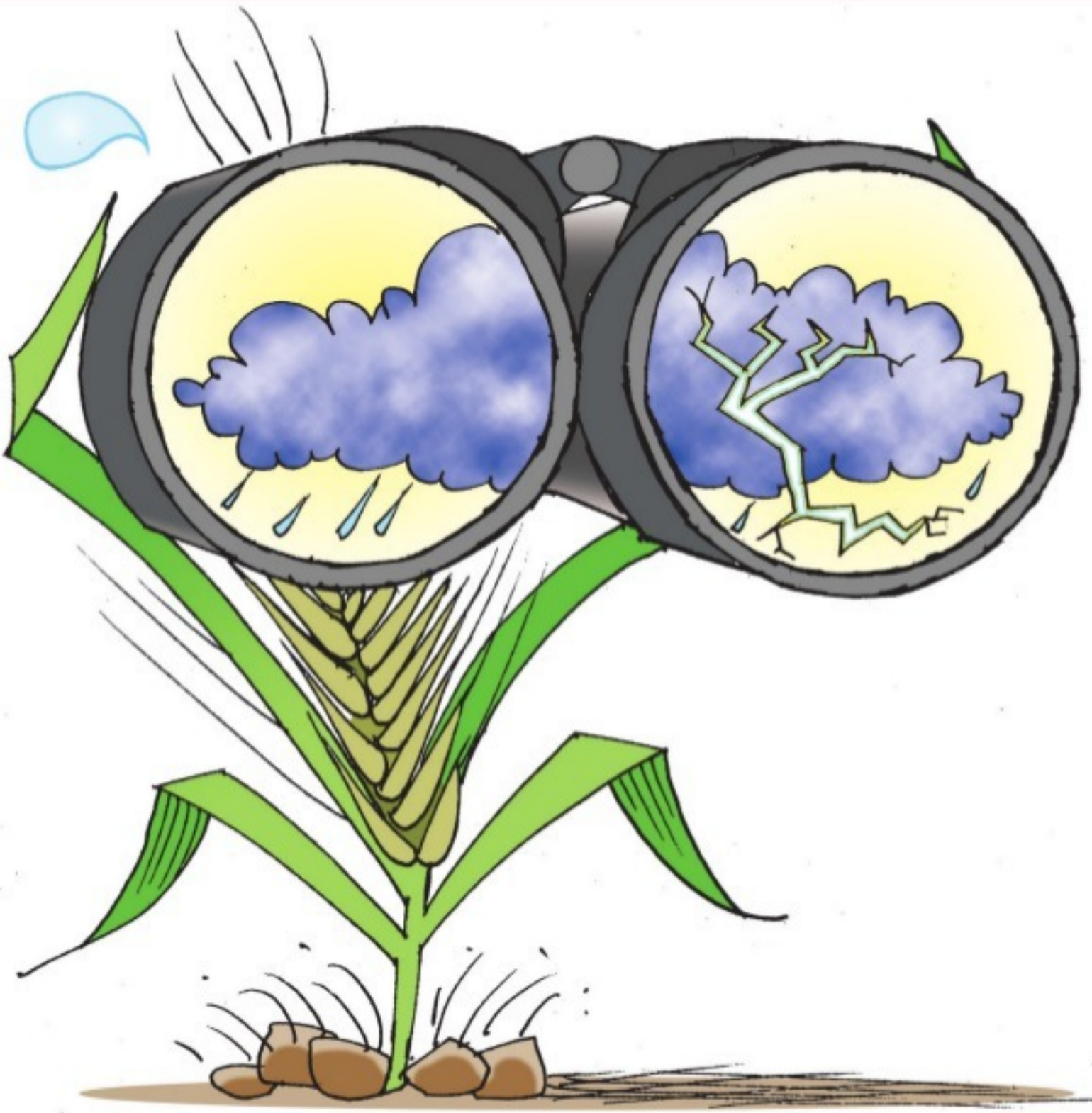


ILLUSTRATION: ROHINIT PHORE

**ANUJ AGARWAL**

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# Reading the clouds

A silver lining is the recent forecast for 2019 south-west monsoon. The MET has forecast a near-normal monsoon, and the Skymet has forecast south-west monsoon for 2019 at 93% of LPA. In case these forecasts fail to hold and the monsoon is deficient, certain states and regions can be in a difficult situation, coupled with adverse consequences for the rural economy

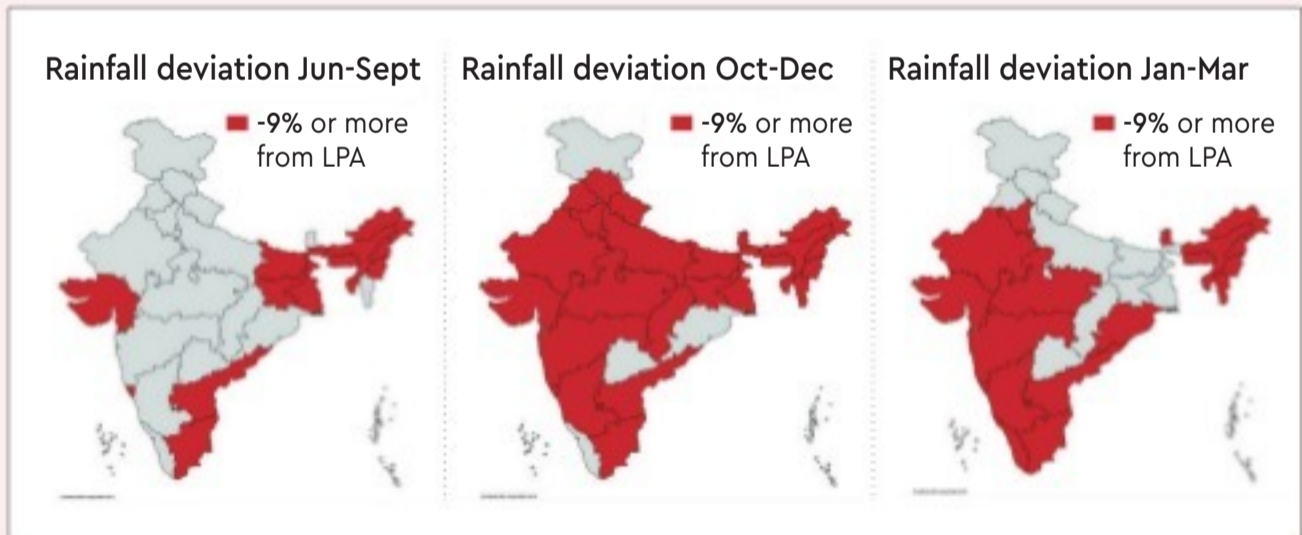
receives. Another 13% is accounted for by post-monsoon rains during October to December. These two spells of rain are very critical for the major cropping seasons in India—kharif and rabi. While the south-west monsoon is deficient, the crop growth during kharif season, it is also critical for soil moisture content and water in the reservoirs that irrigates and supports the rabi crop. While the south-west monsoon in 2018 was 9.9% below LPA (long period average), the October to December rains were deficient by almost 44%. At a regional level, the north-eastern states, Gujarat, Andhra Pradesh, and parts of Telangana and Karnataka have had deficient rainfall throughout June 2018-March 2019. This has resulted in low reservoir levels, low ground water levels and low soil moisture content. A combination of all these factors has led to a drought-like situation in certain parts of these states.

Around 68% of India's cropped area is prone to drought. The impact of these weather conditions is exacerbated by the state of the rural economy. A major chunk of rural households are agricultural households, for whom agriculture is the primary economic activity. According to the NABARD All India Rural Financial Inclusion Survey, the average agricultural household income was Rs 8,931 per month. A major share of this income is attributable to cultivation and wage labour. Both of these sources of income get adversely impacted by a poor monsoon. In fact, 52.5% of the agricultural households in the country are indebted and have an average debt of Rs 1,04,602. Andhra Pradesh, Gujarat, Karnataka,

**While the south-west monsoon in 2018 was 9.9% below LPA, the October to December rains were deficient by almost 44%**

50% of the cultivated land is covered by irrigation. That leaves much of Indian agriculture and agricultural households at the mercy of monsoons.

Let's look at what 2018 has been like. The south-west monsoon season, which lasts from June to September, accounts for almost 73% of the rainfall India



Maharashtra, Odisha and Rajasthan have declared droughts in many of their districts. All the above mentioned states have less than 60% of the cultivated area under irrigation. These states also have a significant share in India's foodgrain production. Barring Andhra Pradesh, more than 50% of the rural households in these states are agricultural households. Moreover, a significant share of agricultural households in these states is indebted. Amidst all this, a drought-like situation and an extension of the same can have a severe adverse impact on the rural economy. The demand from these rural households can take a hit, and there could be a sharp demand of farm loan waivers—adding to state's fiscal stress.

At a macro level, a poor monsoon seems to impact agricultural output. Years following a poor monsoon have generally seen a contraction in foodgrain output. By broad logic, a poor south-west monsoon will adversely impact kharif crop, which is dependent on rains. Subsequently, soil moisture level as well as reservoir levels will be low for the subsequent rabi crop, which depends on winter rains and irrigation, thereby impacting rabi output adversely. A poor winter rain will further add to the woes of rabi crop. With poor realisations in successive kharif and rabi seasons, the farmer is off to a start in the next kharif season in a poor financial health, thereby reducing his investment in quality inputs for the next crop. Unless there is a good monsoon, this vicious cycle will continue.

While the impact on agricultural output is negative, the same is not really true for food inflation. There have been years when despite a good monsoon food inflation has remained high and vice-versa. Food inflation has behaved differently on account of different factors over the years. In the last few years, food inflation has remained low. Reports suggest various actions by the government (such as limited increases in MSP, anti-hoarding initiatives, management of food stocks, stabilising the markets via exports and imports) have really been instrumental in taming food inflation, apart from the strong seasonal swings in certain food categories. A poor monsoon can also adversely impact water-intensive manufacturing industries and hydro-power generation.

According to DEWS, last year too, almost 41% of the country was under drought-like conditions. Reservoir levels historically around this time of the year have been low. While there is no denying the fact that situation in certain parts of the country is grim, publicising this situation in the current election season could also be in the interest of some political parties. Declaration of drought enables the affected districts to seek assistance from the state disaster response fund and the national disaster response fund. While the DEWS takes into account a lot of objective data, a subjective assessment of many socio-economic aspects at the ground level has a significant weightage in declaring a particular district as drought hit. And there are significant variations in the quality and approach of assessment across states.

A silver lining is the recent forecast for the 2019 south-west monsoon. The MET has forecast a near-normal monsoon, and the Skymet has forecast south-west monsoon for 2019 at 93% of LPA. While the Australian Bureau of Meteorology has retained its outlook on El Nino as 'alert', there is no conclusive evidence of the impact of El Nino on rains and drought in India. In case these forecasts fail to hold and the monsoon is deficient, certain states and regions can be in a difficult situation, coupled with adverse consequences for the rural economy. An evenly distributed normal monsoon is what the country could really use right now.

# The benefits of interoperability

**KUSHANKUR DEY**

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Can interoperability strengthen regulatory supervision for the market?

**I**NTEROPERABILITY IN CLEARING and settlement services rendered by clearing corporations, which are subsidiaries of national-level stock exchanges, is likely to be in effect from June 1. This is a welcome move by the capital markets regulator. Interoperability can improve functioning of equity/commodity market and their derivative counterpart. The unification in clearing and settlement services can reduce chances of systematic default or trade disruption. Interoperability can bolster regulatory supervision.

SEBI has emerged as regulator of both stocks and commodities post the 2015 SEBI-FMC merger; it directed issuing of unified licences to brokers/members for trading on stocks and commodities simultaneously. The idea of interoperability dates to 2013, when a committee headed by KV Kamath was constituted, but its recommendation on effectuation of interoperability was conservative.

In 2014-15, with improvisation in trading architecture (high-frequency trading/algo trading and trading colocation), SEBI explored the feasibility of interoperability and invited proposals from clearing corporations, which were then placed before the 2017 Market Advisory Committee (SMAC) in December 2017. The reports of working sub-groups (on risk management, technology, and finance and taxation) were reviewed by SMAC in 2018. In agreement with the working group suggestions, SMAC gave the ascent for a phase-wise implementation, with interoperability of clearing corporations clearing securities in the first phase and corporations clearing commodity derivatives and long-dated options in the second.

So, what are the benefits of interoperability? First, interoperability of clearing corporations can reduce trading or impact costs, improve trade execution, and maintain optimal utilisation of margin and capital resources in securities market. It gives choices to trading member/market participants to consolidate and clear their trade through a clearing corporation of their choice instead of going through the concerned exchange where the trade is held.

Second, it may curb potential chances of trade disruption due to any systematic risk occurring on one exchange and the member would be able to trade on other exchanges without paying additional margin that can foster efficiency in the capital market and enable members participate in broad-based and product-driven trading platforms.

Third, it can catalyse competition among existing clearing houses in terms of prices and services they offer, and can affect their margin requirement from the members and commission they charge on clearing.

Fourth, execution risk can be decoupled from settlement risk as there can be an 'arm's length' relationship between the exchange and adjunct clearing corporation.

Fifth, it can potentially discourage the possibilities of inter-exchange arbitrage and agency risk since the working of clearing corporations together may bring down the inefficiency issue and improve market microstructure.

Sixth, exchanges and clearing corporations may not be required to maintain the settlement guarantee fund since the collateral margin deposited by members will be maintained by a unified account through an interoperable link among clearing corporations.

What framework of interoperability has SMAC suggested? As per the working sub-group proposal, peer-to-peer link is suggested. However, merits/demerits of the framework need to be understood. A peer-to-peer interoperable framework can potentially mitigate inter-clearing corporation default risk through existing margining system and deployment of additional financial resources. Additional capital may be required to maintain as a buffer and aid in the absorption of losses due to default by an inter-affiliated clearing corporation that is not linked to core settlement guarantee fund. Under interoperability arrangement, two clearing corporations are likely to interpose between the two counterparties that can potentially mitigate chance of credit default and improve the novation and risk management.

Going forward, are stock exchanges ready to implement a robust interoperable link among their clearing houses? Have they adequate bandwidth to implement it? Can commodity exchanges replicate interoperability for their clearing subsidiaries? We need to wait to review the development.

# Are stock markets poised for a meltdown?

Investors should make their choices judiciously at this stage

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the Indian market. When the Indian equity market was opened to the foreign portfolio investors (FPIs), it led to a sharp rise in P/E, followed by equally sharp correction. It took a few years for the FPI regime to settle. My analysis is focused on the period after 1995. It may be noted that P/E of the Sensex (RHS of chart) has exceeded 26x just three times in the last 24 years.

**April 2000:** This was followed by the dot-com burst and the Sensex fell by 40% after that date.

**December 2007:** This was followed by the global financial crisis (GFC) and the Sensex fell by 56% after that date.

**March 2019:** Will history repeat itself?

The fact that P/Es here are based on historical earnings, and not forward earnings, should not affect our conclusions. P/Es have been computed consistently on the same

basis for the entire period. Also, forward P/E is merely a derivation of historical P/E, and any conclusion can be suitably adjusted based on expectations of forward earnings. The dividend yield (not plotted in chart) had dropped to under 1% in April 2000 and December 2007. It is currently at 1.15%.

**The economy and earnings:** The forecast for the global economy is not positive, to put it mildly. The IMF has, twice within the last few months, cut its forecast of global annual GDP growth rate for 2019 and 2020 to 3.3% and 3.6%, respectively. They may not yet be done with the cuts. All major central banks have signalled an accommodative stance for 2019, at the least.

Indian GDP growth rate has slowed down in the last two quarters, and the government has revised its estimated figure for FY19 to 7%. The fiscal deficit, adjusted for the government's obligations pushed



to FY20, should be close to 3.8%. Private investment is not showing any signs of picking up. While exports have picked up, it will be tested against the slowing global economic growth. Oil prices are again moving upward. Food inflation has been kept under control, primarily by keeping agriculture output prices low, but this may not be sustainable in the light of the unrest amongst farmers. On the whole, the economic picture looks hardly enthusing.

Corporate profitability has been subdued for several years. Market analysts are, once again, hoping profit will grow in high teens in FY20. But it is doubtful. The firms lack the pricing power in view of lacklustre growth in jobs and wages. Discretionary consumption expenditure in cars and motorcycles is sluggish. Industrial capacity utilisation has shown a marginal upward trend, but not enough to make a

positive impact on private investments in capacity expansion.

The IBC was, and still is, a singular glimmer of hope in unlocking the capital of banks. But the delay in the process of resolution of several large cases has been a disappointment. Banks are reluctant to fully adopt the IBC process and prefer bilateral negotiations with many large defaulting borrowers. Also, the losses of the power sector are building up, threatening to build up NPAs of banks.

So, why is the valuation high? One reason is central banks globally are back to creating more liquidity, which is flowing into financial assets rather than real assets. This has led to a sharp rise in FPI investments in emerging markets, including India, and helped sustain the dizzy valuation.

We also come up with appealing justifications for high valuations. We hope for a

sharp growth in corporate earnings and focus on a few statistics on the economic landscape, reflecting the brighter side of the same. We all suffer from a 'confirmation bias' and tend to selectively see the picture and justify our beliefs. The hope for a resurgence in the economy and politics, led by a second term by Modi, is also a self-fulfilling factor in keeping the valuation high.

So, what to expect? In the stock market parlance, a clichéd and often abused phrase is, "This time, it's different!" However, we need to look at the real picture. It is almost impossible to predict the time of burst of a market bubble (extreme over-valuation). But history has shown that a bubble does eventually burst, in spite of several voices justifying high valuations. A large section of institutional investors had continued to maintain a bullish view in 2000 and 2008, till the bubble burst in those years.

The risk of being wrong is doubly high this time. Even as high valuation indicates high risk of a meltdown, the correction is likely to be tougher this time around. Consider this: The real interest rates, in the past, sharply cut by central banks, after the meltdown in equity markets. This time, central banks in Europe, Japan and the US do not enjoy any significant bandwidth to reduce their nominal, or real, rates.

The high valuations of the Sensex and Nifty are not unsustainable, unless backed by a sharp rise in corporate earnings. That's a hope, balanced against an array of risks. A sharp correction is more likely than any significant rise from here. As Benjamin Graham would say, a market is a voting machine in the short term, but a weighing machine in the long term. Investors should make their choices judiciously at this stage.