

Mapping the Potential Impact of Brexit on Indian Economy

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Abstract

Bold move of Britain to step out of the European Union came at a time when the global economy was actually in a bad shape and growth predictions for 2016 had been marked down. 'Brexit' resulted in weakness, fragility and uncertainty disturbing the markets. Even though Britain will remain a full member of EU for at least more than two years but exit negotiations with the European Commission has started soon. Question addressed in the present study is how these developments are likely to affect the Indian economy. In India, while Brexit is likely to cause slow growth, economic prospects remain relatively doubtful due to the affect of factors like strong monsoon, effect of pay hikes and higher public capex. India is strongly committed for factors like economic stability, while its basics were sound with "a very comfortable external position, a rock-solid commitment to fiscal discipline and declining inflation.

Keywords: Brexit, European Union, FDI, Indian Economy, Trade, Uncertainty

1. Introduction

Economic integration is an agreement between two or more economies for reducing or completely removing tariff or non tariff barriers for free flow of goods and services as well as for free and perfect mobility of labour, capital or other mobile factors of production. There could be five major forms of economic integration: preferential trade union, free trade area, customs union, common market and economic union. In a historic move, Britain voted to leave European Union, leaving the world's fifth-biggest economy facing deep uncertainty about the growth prospects and its attractiveness to investors, hurting other economies in Europe and beyond. Analyzing the concerns over impact of Brexit on India, the government showed confidence over the economy that it will not suffer any long-term impact of Britain's decision to leave EU and that it is prepared for all eventualities.

The new agreement with EU has paved the way for the upcoming referendum in the UK about EU membership focusing on four areas: economic governance, competitiveness, sovereignty, and social benefits and free movement of people. Since 1973, with the UK joining EU, UK GDP per capita doubled.

1.1 Objectives

- To understand the concept of Brexit and its relevance
- To study the impact of Brexit on Indian Economy.
- To offer policy recommendations and suggestions for implementation.

1.2 What is Brexit?

Brexit is a term coined for Britain's referendum to exit the European Union. Deal was announced by David Cameron on the date after he secured a deal with other European leaders at a crunch summit in February. Irish, British, and Commonwealth citizens (except citizens of Gibraltar) who have been living in the UK, along with Britons living abroad for less than 15 years, were able to vote. Government decided to hold the vote before the initiation of summer migration crisis that could stir up more Eurosceptic feeling among the British public.

Brexit is used for "British exit," that refers to the June 23, 2016, referendum whereby British citizens voted out to exit the European Union. The move moved global markets, including currencies, causing the pound to fall to its lowest level.

People who supported Brexit based their support

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on a variety of factors like global competitiveness of British Businesses, European Debt Crisis, concerns about immigration etc. Britain already opted out of the European Union's monetary union means that it used pound instead of Euro – and the Schengen Area, meaning that it does not share open borders with a number of other European nations.

This referendum on *Brexit* is also a platform of discussion on: (i) reducing the involvement and improving economic governance for non-euro zone countries; (ii) improving competitiveness (specifically reducing regulatory burden); (iii) increasing national sovereignty (instead of further European integration); and (iv) allowing more national control on the immigration policy.

2. Possible Impact

2.1 Finance: Firms Fear Loss of EU Market

London has been one of the global financial hubs, along with New York. Brexit has put position at risk, depriving almost UK-based financial firms of their passport to conduct business anywhere in the EU. In spite of developed domestic financial markets, its size is confined by UK's economic output of £1.9trn (US\$2.7trn, about 3.9% of world GDP) and a population of about 64m (around 0.9% of the global total).

2.2 Retail: Consumer Uncertainty to Depress Sales

Leaving EU can create economic shock by creating a situation of uncertainty. Consumers will retrench and consolidate income and expenditure as they continue to witness and wait for the outcome of negotiation. Falling value of sterling will increase the prices in line with the import cost. For retailers there will be more shocks. The supply chains and agreements evolved on an even playing field with partners in the EU will need to be revised as the goal posts begin to move. Regulatory requirements of safety, quality and consumer protection that are currently consistent across member states will diverge.

2.3 Automotive: Brexit is Worrying for Car Firms

The Brexit scenario is certainly worrying for many in the UK automotive industry on a business level.

Large companies, including original equipment manufacturers (OEMs), were particularly against to Brexit, with connection to EU markets, skilled labour and the influencing capability. EU regulations being the biggest reasons for staying in. Toyota was among those highlighting the risks of Brexit.

2.4 Healthcare: Domestic and Foreign Demand could Suffer

Government, Bank of England and IMF all focusing on the economic risks of Brexit, the pharma industry is increasingly worried about the after effects. On the regulation side, Brexit would bring more uncertainty rather than benefits which is applicable for research funding as well.

Table below presents the options available for UK after Brexit.

3. Impact on Indian Economy

Brexit was one of the biggest global macroeconomic events in June 2016. The decision of Britain exiting the European Union (EU) took the world by surprise and shook markets worldwide. This is clearly reflected in rebound the Indian stock markets showed post referendum results. There has been a shift to safe options like gold, yen and US treasury for the investors. According to the market analyst Indian economy can suffer significant impact in the short term. In India, as Brexit is expected to cause a slow growth, economic prospects remain relatively sanguine due to local factors like a strong monsoon, pay hikes and higher public capex. In order to study the impact, it's important to highlight the India –UK connection.

3.1 The Good Impact

Traveling to UK to get cheaper: One thing that has Indians are happy about is the fact that their travel plans to the UK can get comparatively cheaper. On the other side, as the pound loses value, Britain may reinstate in their travel plans until there is clarity and stability in the currency. Britain is also expected to promote the tourism sector as Tourist visas may get cheaper and tour operators and hotels may announce attractive packages.

Cheaper study in UK: Brexit may made life easier for students willing to go to UK for studies. The pound is at 31-year low against the dollar and slumped 8% to

Table 1. Options for the UK outside the EU

Model	Pros	Cons
EEA – the Norway model	Belong to Single Market. Able to negotiate trade deals independently of EU.	Required to implement Single Market policies, but have no saying in setting the rules of the Single Market. Must follow rules of origin for exports to the EU and subject to EU anti-dumping measures. Must contribute to the EU budget.
Bilateral agreements – the Swiss model	Free trade of goods along with free movement of people with EU. Ability to negotiate trade deals independently. A la carte approach permits opting out of EU	Bilateral agreements require Switzerland to adopt rules of EU, but no representation in EU Decision making. No agreement with EU on trade in services. Pay fee to participate in EU programmes, but contribution likely to be lower than if in EEA.
EFTA	Free trade in goods with the EU. Able to negotiate trade deals independently of the EU. Not required to consider EU economic policies and regulations. Also there is no obligation to contribute to the EU budget.	No freedom of movement of people with the EU. No access to EU markets for service providers. Goods exported to the EU must meet EU product standards.
WTO	Able to negotiate trade deals independently of the EU. Not required to adopt economic policies and regulations of EU. No obligation to contribute to the EU budget.	Trade with EU subject to clause of MFN tariffs and any nontariff barriers complying with WTO agreements. No freedom of movement of people with the EU. No right of access to EU markets for service providers. Goods exported to the EU must meet EU product Standards.

rupee helping the students to save on school and tuition fees, living expenses, and more. Overseas education consultants are expected to cash in the opportunity.

Jobs: It is expected that Indian immigrants will be better position to get jobs in UK. It is said that Brexit can be a plus point for India as labour comes at a lower cost unlike from the EU. Businesses in UK preferred locals first and then Europeans. However, now, Indian workers, along with other Commonwealth countries like Pakistan, Bangladesh, are in line to get preference.

Positive impact could be summarized as:

- India being more of an importing country than an exporting nation, the overall effect may turn out positive if dollar doesn't rise up much against rupee.
- Because of lower pound value, Indian companies may be able to acquire many high value assets.
- As investors look around the world for safe options in these turbulent times, India stands out both in terms of stability and of growth.
- Brexit might give boost to trade arrangements between India and the UK.
- Britain will now be free for a bilateral trade pact with India.

- Because of fall in value of Pound sterling, those importing from UK will gain. Indian export houses operating in UK may also gain.
- Brexit would weaken global growth leading to decline in commodity prices. This can enhance both the relative and absolute appeal of India.
- Lower commodity prices will help the macro fundamentals: fiscal deficit, current account deficit or inflation giving government more power to pump up the investment cycle.

3.2 The Negative Impact

Markets: Uncertainty in the short- and medium- term markets is likely to continue as Britain works out how the Brexit decision will pan out. Global equity markets are expected to remain volatile, the effect of which, will be seen in India. Assocham has predicted that Brexit will result in strong ripples in the Indian markets calling for a contingency plan by the government and Reserve Bank of India.

Indian companies: Indian companies based in the UK are preparing for reevaluation of their businesses in the country as Britain decides to break away from the

EU including companies like Tata Sons, Bharti Airtel, Motherson Tech Mahindra, pharmaceutical companies, and several others.

Trade: The India-UK bilateral trade is of about \$14 billion. Because of Brexit, new trade policies from the UK and its negotiation for new trade relations with the EU will affect the trade it does with India and the rest of the world. A slowdown in the British economy as a result of Brexit will also hit India-UK trade.

3.3 Indian IT – Boon or Bane?

The affect on IT sector doesn't appear to move other way decisively. On one side, short-term volatility and currency fluctuations are expected to have an impact on IT companies. The shares of Infosys, TCS and Tech Mahindra are all little bit down (~3-5%), mostly caused by the fluctuating pound.

Negative impact could be summarized as below:

- India will have to adjust to a changing world order.
- Sensex and Nifty to tumble in the short-run.
- Foreign funds are likely to move out as the world outside thinks that investment in India is risky.
- Due to reduction in the value of Pound sterling, Indian exports towards UK will suffer. Cheaper rupee will make Indian exports, including IT and ITeS, competitive. Indian import companies operating in UK may also suffer loss. Also note that, India is exporting more than what it is importing from Britain.

Sectors having the chance to face the heat are:

Auto components: India is one of the major suppliers of auto parts to the EU region. The region accounts for around 36% of India's total auto component exports, while the share of UK is about 5%. The UK Passenger Vehicle market is mostly export oriented and segment has close connections with EU automotive market. The anticipated slowdown in UK and the EU region will have a dampening effect on the sector.

Information Technology: India is one of the largest exporters of IT-enabled services. This sector has significant exposure to the European market especially UK. UK accounts for about 17% of India's total IT exports. India's IT exports contribution to other European countries is at about 11%. The IT companies are expected to face the heat in light of the Brexit. Given the risk of further moderation in growth

in the UK and EU, there is a chance that the companies lower their IT budgets (a discretionary spend). This would have affected on the domestic software companies. *Pharmaceutical:* United States is India's biggest market for Pharmaceutical exports, while EU accounts for 10-13% of India's total pharma exports. Share of UK in India's pharma exports is about 3-4%. The pharma companies do not really expect a big hit following the Brexit and have indicated a limited impact of Pound depreciation. Further, the companies pointed out that the rules, regulations and product registrations are different for UK and EU and hence any adverse impact on the sector can be ruled out.

4. Findings and Conclusion

While uncertainty depends largely on the future of Brexit, it is important to see that if a 'Brexit light' option is negotiated, it would necessarily entail accepting free labour movement from the EU. In such a situation, it remains to be seen whether there will be a significant difference in immigration from what is now considered 'business as usual'.

The main question is: What will be the consequences of Brexit for India? The Brexit referendums are considered as the biggest geopolitical event of the year and have ramifications way beyond just UK leaving EU. Brexit can guarantee lower commodity and crude prices for a longer duration. After the 2015 crash, commodities have already entered the bull market on the back, stabilizing Chinese Economy and demand revival. CPI inflation has been showing spike since many months curtailing RBI's ability to continue with the downward spiral in policy rates to spur investment and growth.

Looking at Brexit from India's point of view, Brexit can weaken global growth and lead to a substantial decline in commodity prices that can enhance the absolute and relative appeal of India. India can suffer in terms of:

Currency: Brexit can increase pressures on the rupee. While rupee has depreciated by a lower extent against the US dollar compared to other emerging market currencies that could well be because of RBI's intervention to stem volatility. While on the positive side, Brexit has driven away fears of US Fed rate hike and could lead to lower commodity prices.

Equities: It is obvious that the vote to leave EU came as a surprise, which explains this sharp drop in risk assets. It is speculated that Indian companies won't be affected

much. In fact, some market experts point towards the sharp drop in oil and other commodity prices and a number of companies will benefit as a result. Be that as it may, whenever investors get into a risk-off mode, Indian equities likely to suffer.

Commodities: Recovery in prices of commodity has hit a bump with Brexit. The immediate after effect of Brexit has been reflected as the US dollar appreciating and this usually witness commodities with strong links to financial markets to weaken. Since money gravitates towards the appreciating dollar, commodities take a back seat. Government and central bankers in the EU may counter with measures to prevent the adverse effects of Brexit. The US Federal Reserve may do its role by postponing further rate hikes.

Bonds: Bonds have remained resistant to the carnage created by Brexit on equity and currency markets. Infact, 10-year government security yields have gone down by half a basis point. The market is likely to take a more sanguine view of Brexit because of various reasons. One, it has opened up the prospects of more monetary accommodation in India and the rest of the world. Two, slower global growth will result into lower commodity prices and help keep inflation at a lower rate in India, another factor helping RBI cut rates.

Companies: Currency volatility will affect revenue and profits for some who are doing business with the UK and Europe. But then the big picture that is more material in the longer run is that Britain's exit may affect easy access and movement of goods across unified Europe. The actual impact depends on what kind of a trade agreement is drawn up for replacing the existing free market access. Reports say that EU trade agreements with other nations will cease to apply to Britain, which will have to be renegotiated with each country in its own capacity.

Nevertheless each successive act of globalization has left the world economy and system much more integrated. As such while the liberal trading order will be under introspection in the coming years particularly the hyper globalization that has welded financial markets.

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