One local and two global risks facing India

The beginning of a new year usually sees think tanks and insurance companies list their version of perceived global risks over the next 12 months. As India lurches towards the 2019 general elections, it might be appropriate to list some of the risks that confront the country.

India’s numerous direct and indirect geopolitical challenges are well known. Some of these are: problems with a mendacious neighbour on the western border; China’s aggressive expansionism and its belligerent posturing in the South China Sea; smouldering conflicts between Saudi Arabia and Iran and Qatar aggravating; the proxy war in Syria coming to a boil; and tensions further escalating in the Korean peninsula.

War and geopolitical conflicts have persisted throughout modern history and 2018 is unlikely to be an exception. But, India’s primary concerns spring from geo-economics, traditionally neglected in future risk scenarios and risk mitigation frameworks.

Three large risks dominate the landscape and they all impinge on both the fiscal and current account deficits.

The first one is uncertainty over oil prices and India, a large net importer, is directly exposed to this volatility. Slow but certain recovery in the global economy has pushed oil prices from the 2015 lows of $30 per barrel to over $60 now. The future direction of oil prices will be decided in a power play between USA-based shale producers and the informal alliance between the Organization of Petroleum Exporting Countries (Opec) and Russia.

The unofficial Opec-plus arrangement has been successful in cutting oil production and slashing overstocked inventories. As oil prices have risen, record volumes have gushed from the US, threatening to eclipse production from the world’s two largest producers—Russia and Saudi Arabia. There are apprehensions that as prices further appreciate, some other South American oil producers might add to the US flood. This might force the Opec-plus grouping to push for further production cuts which could eventually threaten the agreement. Added to the mix is the risk that energy prices and flows might become the next weapon in the renewed US-Russia conflict.

As things stand, the Opec-plus agreement is scheduled to be reviewed soon and is likely to be extended. Even if they agree to wind down the arrangement, it has to be done in an orderly fashion, without disrupting markets. India is exposed to these volatilities through its reliance on oil imports, and its recent agreement with the United Arab Emirates to construct strategic oil reserves might be a bit too late.

India’s second geo-economic risk emanates from the wave of protectionism that threatens the global economy, particularly the ongoing trade war between the US and China. Apart from real and threatened tariff measures affecting India’s exports to the US, there are indirect consequences also.

The Economist Intelligence Unit notes in a recent publication, *Cause for Concern*: “Any ramp-up in protectionism would certainly have repercussions beyond North America and China. Prices and availability for US and Chinese products in the supply chains of companies from other nations would be badly affected. Consequently, global growth would be notably curtailed as investment and consumer spending fall back.”

India’s third geo-economic risk originates from a person: Jerome H. Powell, the Federal Reserve chairman. Based on his recent testimony to Congress, markets are sensing greater aggression compared with his immediate predecessor (Janet Yellen) and, consequently, expecting three to four interest rate increases during 2018. This could inject a new degree of turmoil in the markets, especially in the face of what many find unsustainable asset markets. The Reserve Bank of India's sixth bi-monthly monetary policy statement noted: "Financial markets have become volatile in recent days due to uncertainty over the pace of normalisation of the US Fed monetary policy…The volatility index (VIX) has climbed to its highest level since Brexit."

India, like many other emerging markets, is particularly vulnerable, given that recent asset market developments are predicated on global capital flows. Any reversal of these flows could spell trouble for not only asset valuations but also future capital raising. The World Economic Forum's The Global Risks Report 2018 states: "…economic and financial risks are becoming a blind spot: business leaders and policy-makers are less prepared than they might be for serious economic or financial turmoil."

It would be negligent not to account for risks on home terrain: various state assembly elections in 2018 and general elections in 2019. Governments, on the eve of elections, are tempted to loosen policy restraints, succumb to populist forces and spend more. Another election-related threat looms. Risk Map 2018 from specialist risk consultancy Control Risk states: "A political environment in which parties leverage emotive and controversial social issues for electoral support could foster the spread of adverse nationalist rhetoric, potentially posing risks for foreign businesses in 2018."

That said, with 16 general elections already under India's belt, the next one also falls in the business-as-usual category. Therefore, in the balance of risks confronting India, the beyond-border challenges remain trickiest as they run the risk of derailing India's twin deficits and, as a consequence, critical macro variables like inflation and growth.

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