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Future of Indian Markets: POST-BREXIT

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Abstract
"When elephants fight, the grass suffers" – will be the impact of "BREXIT" on the Indian markets. BREXIT is a portmanteau of "Britain" and "exit" from the European Union (E.U.). Experts describe this event as a 'once in a lifetime' which will haunt the economies across the globe for years to come. Uncertainty and risk aversion will rise. Nobody knows how it will all pan out. Reserve Bank of India (RBI) ex-governor, Raghuram Rajan warned long ago, "We are in the midst of an age of competitive devaluation and beggar-thy-neighbour policy". In this backdrop, the present paper attempts to analyze the concept of BREXIT and the reasons which led David Cameron for the referendum of 23rd June, 2016 and throws a light on the series of political and economic changes that took place after the referendum in U.K. as well as in international markets. From the Indian perspective, an analysis is made on the positive and negative effects after 23rd of June, 2016 and the future impact on the various sectors of Indian markets post BREXIT accompanied by some secondary data. The paper concludes with the finding whether BREXIT will be a Boon or a Bane for Indian Market in the future.

Keywords: BREXIT, UK, EU, Indian Markets

1. Introduction

Britain's exit from the European Union took the world by surprise. Experts describe this event as a 'once in a lifetime' which will haunt the economies across the globe for years to come. "When elephants fight, the grass suffers" - this can be commonly said as an impact that "BREXIT" will have on the Indian markets. BREXIT is a portmanteau of "Britain" and "exit" i.e. a possible withdrawal by U.K. from the European Union (E.U.). Thus, what will the consequences of BREXIT be on the Indian market? Uncertainty and risk aversion will rise. Capital flows will be in jeopardy and competitive currency devaluations are more likely. World economic growth, which was anyway sputtering, will be further dampened. But that is a doomsday scenario. Governments and central banks won't be sitting back idly. Central banks will flood the markets with money. The Centre in Europe might rally against the threat from the far-right. It is unlikely that either the UK or the EU will retreat into protectionism. Nobody knows how it will all pan out. But some things are certain: a) The risks have increased; b) The outlook for global growth has gotten worse; c) European leaders haven't covered themselves in glory in the way they have handled the continent's problems; d) With the interest rates at rock bottom, some of them even negative, there is a limit to how much further stimulus central banks in developed markets can give their economies; and e) as Reserve Bank of India (RBI) governor Raghuram Rajan warned long ago, "We are in the midst of an age of competitive devaluation and beggar-thy-neighbour policy". In this backdrop, the present paper attempts to analyze the following objectives.

2. Objectives

1. Concept of BREXIT and the reasons which led David Cameron for the referendum of 23rd June, 2016.
2. A light on the series of political and economic changes that took place after the referendum in U.K. as well as in international markets and U.K's future after BREXIT.
3. From the Indian perspective, an analysis is made on the effect of the referendum after 23rd of June, 2016 accompanied by some secondary data.
4. The future predictions on the Indian markets post BREXIT.
5. Concluding remarks- with a finding whether BREXIT will be a Boon or a Bane for Indian Market in the future.

3. Concept of "BREXIT" and Pathway Leading To BREXIT.

BREXIT is a portmanteau of "Britain" and "exit". It was derived by analogy from Grexit, referring to a hypothetical withdrawal of Greece from the eurozone (and possibly also the EU). Thus, this term is commonly used as the intention of United Kingdom (UK) to withdraw from the European Union (EU). The possibility of withdrawal from the European Union has existed under Article 50 of the Treaty on European Union of EU member states since 2007.

In the beginning, UK was not a signatory to the Treaty of Rome which created the EEC in 1957. But in their third application for membership, they successfully became the member of EEC. As a result of the Maastricht Treaty, the EEC became the European Union (E.U.) on 1st November, 1993.

There was a thorough hue and cry from different spheres in U.K. for a referendum on U.K.'s E.U. membership for many years. Ultimately, in 2012, Prime Minister David Cameron rejected calls for a referendum on the UK's EU membership, but suggested the possibility of a future referendum to gauge public support.

In a speech to the House of Commons on 22nd February 2016, Cameron announced a referendum date of 23rd June 2016 and set out the legal framework for withdrawal from the European Union in circumstances where there was a referendum majority vote to leave, citing Article 50 of the Lisbon Treaty.

A referendum vote, in which everyone (or nearly everyone) of voting age can take part, was held on Thursday 23rd June,

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to decide whether the UK should leave or remain in the European Union. Leave won by 52% to 48%. The referendum turnout was 71.8%, with more than 30 million people voting. Thus, this decision by U.K. can be regarded as a Magna Carta in the history of world economy.

4. Aftermath of BREXIT in U.K.

The political scene in the UK went through substantial change and shock after the referendum. There were petitions for a new referendum within hours of the result's announcement. On 27th June 2016, David Cameron's spokesperson stated that holding another vote on Britain's membership to the European Union was "not remotely on the cards." Theresa May made the following comment, "The campaign was fought... and the public gave their verdict. There must be no attempts to remain inside the EU... and no second referendum.... BREXIT means BREXIT." The petition was rejected by the government on 9 July.

After the result was declared, Cameron resigned and Theresa May became the Prime Minister. George Osborne was replaced as Chancellor of the Exchequer by Philip Hammond while Boris Johnson was appointed Secretary of State for Foreign and Commonwealth Affairs and David Davis became Secretary of State for Exiting the European Union.

The UK economy appears to have weathered the initial shock of the BREXIT vote, although the value of the pound remains near a 30 year low, but opinion is sharply divided over the long-term effects of leaving the EU. Some major firms such as Easy-jet and John Lewis have pointed out that the slump in sterling has increased their costs.

Britain also lost its top AAA credit rating, meaning the cost of government borrowing will be higher. But share prices have recovered from a dramatic slump in value, with both the FTSE 100 and the broader FTSE 250 index, which includes more British-based businesses, trading higher than before the referendum.

The Bank of England is hoping its decision to cut interest rates from 0.5% to 0.25% a record low and the first cut since 2009 will stave off recession and stimulate investment, with some economic indicators pointing to a downturn.

5. Impact of BREXIT in Global Economy

Global stock markets lost about $2 trillion in value on 24th June after Britain voted to leave the European Union, while sterling suffered a record one-day plunge to a 31-year low and money poured into safe-haven gold and government bonds.

Mainland European equity markets took the brunt of selling as investors feared the vote could destabilize the 28-member bloc by prompting more referendums.

The traditional safe-harbor assets of top-rated government debt, the Japanese yen and gold all jumped. Spot gold rose nearly 4 percent and the yield on the benchmark 10-year U.S. Treasury note fell to a low of 1.406 percent, last seen in 2012, though it climbed higher in afternoon trading.

Stocks tumbled in Europe. Frankfurt. GDAXI and Paris. FCHI each fell 7 percent to 8 percent. Italian. FTMIB and Spanish. IBEX markets posted their sharpest one-day drops ever, falling more than 12 percent, led by a dive in European bank stocks.SX7P. Italy's Unicredit (CRDI.MI) fell 24 percent while Spain's Banco Santander (SAN.MC) fell 20 percent.

London's FTSE.FTSE dropped 3.2 percent, with some investors speculating that the plunge in sterling could benefit Britain's economy. The index closed up 2 percent for the week for its best weekly gain in over two months.

Stocks on Wall Street traded down more than 3 percent, with the Dow Jones industrial average dropping as much as 655 points, its worst daily drop in 10 months.

The Dow Jones industrial average. DJI fell 611.21 points, or 3.39 percent, to 17,399.86, the S&P 500.SPX lost 76.02 points, or 3.6 percent, to 2,037.3 and the Nasdaq Composite. IXIC dropped 202.06 points, or 4.12 percent, to 4,707.98.

6. Future of U.K after BREXIT

From the economic point of view a possible British exit from the EU would cause more economic damage for the UK than benefits. The rest of Europe would suffer from lower economic growth, too. However the economic losses they face would be much lower. Again, leaving the EU would increase prices for British exports and hence reduce the level of economic activities and production. Furthermore, prices for imported goods and services would rise for British consumers and companies. The extent to which a BREXIT would lower economic growth in the UK depends on the degree of trade reduction with the EU.

On the positive side, the UK would save its annual payments to the EU budget. In 2013, the net contribution to the EU was around 0.5% of the British GDP. Compared to the calculated losses in real GDP, even in the most favourable case these savings do not compensate the reduction in real GDP due to less trade activities. Hence, in economic terms the UK would not benefit from leaving the EU.

Things get even worse if we take into account the dynamic effects of a reduction in cross-border trade activities: Less trade implies less pressure from international competition. Hence, companies have less need to improve their productivity through investments and innovation. And a lower increase in productivity reduces the long-term rate of economic growth. In summary, we come to the conclusion that a BREXIT would have damaging effects on the economic development in the entire EU. Apart from these economic disadvantages, a BREXIT would also cause severe political damage and would weaken Europe geopolitically.

7. Effects of BREXIT upon Indian market along with Indian Companies

India is one of the most lucrative markets for foreign investors and, hence, we attract attention globally. So, any major change across the globe, be it political or economic, is bound to have an impact on India too. After the referendum on 23rd of June, 2016, there has been a change in the Indian market. The Reserve Bank of India (RBI) ex-governor, Raghuram Rajan warned long ago, “We are in the midst of an age of competitive devaluation and beggar-thy-neighbour policy. When elephants fight, the grass suffers.” So, listed below are the effects of BREXIT upon the Indian market:-

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Sl No.	Markets	Effect In India After 24th June, 2016
1.	**Currency**	• Rupee depreciated by a lower extent of 89 paisa against the US dollar after 24th June, 2016.
2.	**Equities**	• Foreign institutional investors (FII) have already retreated a bit. • FII net long positions in the index futures market amounted to Rs.13,600 crore on 10th June, 2016, but these had been trimmed to 7,000 crore within one week after 24th June 2016. • MSCI UK and MSCI Europe indices stood at 6.6% and 6.7% after BREXIT while MSCI India index lately has done well—boasting a 15% return and Indian stocks did relatively well to retreat by only around 2%.
3.	**Commodities**	• Hit a bump. • On 24th June, 2016, crude oil suffered a 5.2% decline. • Bloomberg Commodity Index was down by 1.4% • As US dollar appreciate, it saw commodities with strong links to financial markets to weaken.
4.	**Bonds**	• The bond market reaction is the clearest signal of how investors are now interpreting the economic hit from BREXIT. • 10-year government security yields have gone down by half a basis point
5.	**Gold**	• Gold prices in India shot up as much as 6% and 4.2% versus the US dollar after 23rd June, 2016.

8. Impact of BREXIT on Indian companies

Currency volatility have straightaway hurt revenue and profits for some of those doing business with the UK and Europe. Here are some of the Indian sectors that have been affected after the Referendum of 23rd June, 2016.

SL. No.	Sectors	Negative Effect
1.	Auto and auto components	• BSE auto index was badly affected. • Tata Motors Ltd fell the most, losing 8%. • Maruti Suzuki India Ltd’s shares fell by 2.25%. • Shares of MothersonSumi Systems Ltd fell the most (8.48%) among component firms.
2.	IT companies	• IT companies with the largest exposure to the UK and Europe fell the most on Friday. • Tech Mahindra Ltd and HCL Technologies Ltd, which get about 30% of revenue from Europe, fell sharply. • Shares of TCS, Tata Motors, Tata Steel and Motherson fell on the BSE along with Sensex, which ended the volatile 24th June, 2016, with 2.24 per cent fall.
3.	Metals	• Tata Steel Ltd’s stock plummeted by 6.37%, the biggest loser among metals that will face the direct wrath of BREXIT. • Hindalco Industries Ltd’s shares were down by 5.17%. • Some firms may also suffer an indirect impact, such as Vedanta Ltd, Steel Authority of India Ltd, JSW Steel Ltd and Hindustan Zinc Ltd.
4.	Oil	• Brent crude oil has fallen sharply • Lower crude oil price is negative for oil producers such as Oil and Natural Gas Corp. Ltd (ONGC), Oil India Ltd and Cairn India Ltd.
5.	Aviation	• Jet Airways (India) Ltd stock plummeted. • 60% of its capacity (Q4FY16) deployed on international routes, the concern is about BREXIT denting travel demand, due to weaker currencies and economic slowdown in the UK or Europe.
6.	Pharmaceutical	• Aurobindo Pharma Ltd gets 28% of its sales from Europe.
7.	Infrastructure	• Drop in Larsen and Toubro Ltd’s stock. • Multinational corporations, Cummins India Ltd exports to Europe through the UK, has been affected.
8.	Garments Exports	• Garment exports accounted for a fifth of India's exports to the UK. • Indian garment exporters have already witnessed a 5% drop in demand last year, and could see lower sales due to a slowdown in growth for BREXIT.

9. Future predictions of Indian market after BREXIT.

BREXIT will hurt growth the UK, as well as in the European Union. The UK is a big market for goods and services from the EU area. But it is too soon to assess the impact of BREXIT on the global economy and India. There will be more clarity once the actual policy response from United Kingdom and the European Union is spelled out. Things can be positive if the situation is managed well by both the European Union and the United Kingdom. Nonetheless, some frictional issues that would come with the transition cannot be ruled out.

So, it is currently predicted that BREXIT will likely change the course of Indian businesses with other nations along with U.K. and strengthen India’s foreign ties in future. The key findings are:

9.1 The uncertainty following BREXIT: The biggest drawback of the Leave Campaign is that they have not mapped out the future course of action if BREXIT indeed happens. There is no sound plan regarding Britain's future relationship with the EU or any other specific country within the EU. If BREXIT does happen, global financial market volatility can be readily expected. The pound will depreciate against most major economies. India cannot remain immune to this. The GBP-INR exchange rate before 23rd of June, 2016 was approx 96.54 but in the last month of 2016, it has been recorded as 85.74 INR and it is expected to depreciate more in the future. Prolonged period of risk aversion in equity market could spark foreign portfolio investor outflows and add to the rupee's weakness. This would open more room for RBI to cut rates, which won't be a positive for the rupee. Moreover, if pressure on prices persists, then marketing companies such as Bharat Petroleum Corp. Ltd, Hindustan Petroleum Corp. Ltd and Indian Oil Corp. Ltd will be lower than expected.

9.2 Investment: India is presently the second biggest source of FDI (Foreign Direct Investment) for Great Britain. Indian companies that would set up their factories in the UK could sell their products to the rest of Europe under the European free market system But having said that, Britain would not want to lose out on capital coming in from India. Thus, one can expect Britain to try extra hard to woo Indian companies to invest there by providing much bigger incentives in terms of tax breaks, lesser regulation and other financial incentives. Further, if Britain is leaving the EU due to the latter's complex bureaucratic regulatory structure, Indian companies can expect a deregulated and freer market in Britain.

9.3 Another EU partner: As aforementioned, if Britain exits the EU, India will lose its gateway to Europe. This might force India to forge ties with another country within the EU, which would be a good result in the long run. India is already trying to build trade negotiations with Netherlands, France, Germany, and others, albeit in a small way. Netherlands is India's top FDI destination as of now.

9.4 The Commonwealth: With Britain cutting off ties with the EU, it will be desperate to find new trading partners and a source of capital and labour. Britain will need a steady inflow of talented labour, and India fits the bill perfectly due to its English speaking population. With migration from mainland Europe drying up, Britain would be able to accommodate migration from other countries, which will suit India's interests. Further, Britain is one of the most important destinations for Indians who want to study abroad. Presently, British universities are forced to offer subsidized rates for citizens of the UK and EU. With BREXIT, however, the universities will no longer be obliged to provide scholarships to EU citizens, which will free up funds for students from other countries. Many Indian students may be able to get scholarships for studying in the UK. BREXIT will free up funds and more Indian students will be able to get scholarships.

9.5 Ties with European Union: With or without a BREXIT, it would be in Europe's interest to develop India as a strong trade and strategic partner. BREXIT would surely accelerate this process. Europe needs to counterbalance United States and China geopolitically and would also need to hedge against a slowing China for its economic interests. For this, Europe would be looking at the fastest growing major economy in the world and would need to quickly resolve the pending trade issues with India in order to develop a lasting relationship.

9.6 Indian economy to change: On a positive side, it is predicted that India would benefit as the bond market remained resistant after 23rd of June, 2016 and it might open up the prospects of more monetary accommodation in India. With slower global growth, it will help lower commodity prices and help keep inflation down in India. Lower crude oil prices are positive for Indian economy considering its huge import requirements. Further, BREXIT will likely compel London to seek a more robust trade relationship with New Delhi.

On a negative side, BREXIT may lead to reduction in sales and companies that derive good revenues of profits from Britain could get hurt majorly, in the future. For companies manufacturing in the UK, access to the single market is important, products will get uncompetitive if they have to pay duties. In the near term, products become cheaper but profits will fetch lower amounts and it might create a situation where too many investors will exit from U.K. Stocks could recover as risks are minimal unless trade agreements between nations affect the price competitiveness of its products.

9.7 Effect on different Indian Sectors: Indian businesses have presence in a wide array of sectors in the UK which include automobiles, auto components, pharmaceuticals, gems and jewellery, education and IT enabled services. Most of these sectors will be vulnerable to changes in demand and currency values.

a) Auto components: India is a major supplier of auto components to the EU region. The region accounts for about 36% of India's total auto component exports, while the share of UK is about 5%. The anticipated slowdown in the UK and the EU region will have a dampening effect on the sector. Also, the depreciating Pound will impact the revenue stream companies of over the near term. The real impact will also depend on imposition of any trade restrictions between the EU and UK, which will become clearer over the medium term.

b) Information Technology: India is one of the largest exporters of IT-enabled services and the sector has significant exposure to the European market especially the UK. UK accounts for about 17% of India's total IT exports. India's IT exports to other European countries is at about 11%. The IT companies thus 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 an increased probability that the companies lower their IT budgets (a discretionary spend). This would have an impact on the domestic software companies. Majority of the costs by the IT companies are incurred in INR owing to the off-shoring model deployed by the Indian IT services player. So a sustained depreciation of Pound might call for a renegotiation of the contract, as the profitability of these contracts might fall below the expected levels.

c) Metals: With the global recovery remaining frail and an evident moderation in China, the steel and aluminium sectors are already facing the issue of overcapacity. Demand in the EU has been subdued and this latest development is expected to further dampen demand. This might lead to a greater weakening of metal prices giving rise to earning pressures for companies.

d) Pharmaceutical: United States is India’s biggest market for Pharmaceutical exports, while EU accounts for 10-13% of India’s total pharma exports. The 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 already different for UK and EU and hence any adverse impact on the sector can be ruled out.

e) Garment: Readymade garment is one of the key export items to the UK from India. Readymade garments account for about 20.0% of the India’s total exports to the UK. The sector is expected to feel the pinch on account of moderation in demand; the spend on readymade garments is primarily discretionary. Also, the drop in the Pound is expected to impact the un-hedged export contracts with British counterparts. Nonetheless, some of the garment exporters have also opined that they .

f) Financial Services: There are currently bond issuances planned of range USD100-150m in USD and INR. UK’s credit rating has been cut, and given most buyers of the bonds are from the EU there is nervousness around these bond issuances. This is important for India as it would be difficult to imagine financing India’s huge infrastructure appetite through debt finance in London as aggressively as currently planned. Again, this would depend on what BREXIT scenario plays out. But in the meantime, greater uncertainty will impact the bond pricing.

g) Predictions by analysts: NASSCOM has predicted that the effect of BREXIT will be felt on the $108 Billion Indian IT sector in the short term.

An analyst of a multinational brokerage said that BREXIT could lead to increased outsourcing work.

Analysts expect a strong dollar versus the Indian rupee to be positive for Reliance Industries Ltd (RIL) earnings.

Analysts fear that cost of borrowing for companies may increase due to volatile currency movements in the near to medium term.

Deutsche Bank AG wrote, “A heightened level of financial market volatility and uncertainty over the outlook for currencies and global macro will undermine equity markets—including India.”

Thus, even though Britain stands to suffer from leaving the European Union in terms of reduced trade and a sustained drop in its GDP, the net effect can turn out to be positive for India. The actual impact depends on what kind of a trade agreement is drawn up to replace the existing free market access. Reports say that EU trade agreements with other nations will cease to apply to Britain, which will have to renegotiate with each country in its own capacity.

10. Concluding Remarks

A question that is still hankering in our mind whether we are in an advantageous or in a disadvantageous position regarding BREXIT. The scenario of Indian economy is a bit different as in the long run after BREXIT takes it full effect and U.K. leaves E.U., it will help India strengthen the ties with Britain because India's focus on innovation and entrepreneurship still makes it an attractive destination for outsourcing and investment. India's economy is doing well and should use the turmoil as an opportunity. For the common man, with every uncertainty there is a bigger opportunity to pick great stocks. For now, investors seem to be betting that Indian companies won’t be affected much.

As of now, for the UK to leave the EU, it has to invoke an agreement called Article 50 of the Lisbon Treaty which gives the two sides two years to agree the terms of the split. But there is a twist in the tale as U.K. High Court, recently in its landmark decision stated that the British Govt. does not have the power to implement Art. 50 to leave EU without Parliamentary vote. This means that Parliamentary approval is needed for BREXIT. On the other hand, BREXIT Secretary David Davis has suggested the country could formally sever its relationship with the EU by December 2018. But no one really knows how the BREXIT process will work as Article 50 was only created in late 2009 and it has never been used. Moreover, the landmark decision of U.K. High Court means the Parliamentary approval is needed for BREXIT. So, till then EU law will stand in the UK until it ceases being a member and UK will continue to abide by EU treaties and laws, but not take part in any decision-making.

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