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CHALLENGES AND IMPACT OF BREXIT

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ABSTRACT

An unexpected majority of British voters have overthrown not just Britain's relationship with its European neighbours but the established political order in the UK, and, potentially, Europe. In the UK, those who promised to the British people that leaving the EU would let them 'take back control' over their lives are now expected to deliver on that promise.

This will not be easy. Blaming the EU for all of Britain's ills has been pure displacement activity. Being a member of the EU is not the reason that Britain has failed to live up to its self-image as a 'proud trading nation'.

Brexit is unlikely to have a notable impact on India's GDP (gross domestic product) growth in fiscal 2016, ratings agency Crisil has said retaining its forecast of 7.9% growth, with agriculture as the swing factor.

However, Britain's exit from the European Union (EU) is likely to impact Indian companies in a multiple ways — demand weakness on account of potential slowdown in the EU and the UK, volatility in commodity prices, currency impact on account of the potential depreciation of the rupee, euro and the pound, and balance sheet impact on account of exposure to unhedged overseas borrowings.

KEYWORDS: *Brexit, Indian Economy, EU, Currency, IT Industry, Investment, Rupee, Pound*

SUB THEME:

Brexit – Pros and Cons for Indian Economy

INTRODUCTION –

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.

Britain's ills – and there are many, as this vote has revealed – are self-inflicted.

Nor has EU membership made Britain less secure domestically or influential internationally. Being in the EU has generally complemented the UK's military and diplomatic objectives, whether in dealing with Russia, Iran or ISIS. Britain in the EU was not in 'managed decline', as one pro-Leave politician described it again this morning – in fact, as those same politicians often pointed out, the UK is prospering as the world's fifth-largest economy and has remained one of its most powerful nations.

This means that the triumphant Brexiteers now need to fold the popular expectations they have raised within the envelope of reality.

In the near term, they may have some breathing space. Financial markets will hopefully stabilize once they have digested this shock to their expectations. And EU governments are unlikely to want to compound the risks to their own political and economic situations by pushing for a rapid Brexit. Britain's market and businesses remain fully integrated into the EU for the time being.

But fairly quickly, Britain's weaknesses outside the EU will be scrutinized more carefully than they were when it was inside, including its continuing high annual budget deficit and growing debt, as well as its persistently high current account deficit. Fixing these weaknesses will require structural reforms that will take time and may end up punishing the very voters who believed that voting for Brexit would somehow change their lot in life for the better.

Britain's decision to move out of the EU comes at a time when the global economy is not in great shape and growth forecasts for 2016 have been marked down. Indian Companies in sectors such as automobiles, auto components, information technology services, textiles, pharmaceuticals, gems and jewellery, leather, and leather products are most vulnerable to changes in demand and currency value.

Which are the Sectors which will be affected by Brexit?

• The UK alone accounts for about 17% of overall IT (information technology) exports from the country. "The economic uncertainty in the EU and the consequent impact on discretionary spends such as IT would, therefore, hurt domestic software companies.

• Garment exporters are also likely to feel the pinch, despite the tax and production incentives announced by the union government recently, it said. The EU is the largest market for garment exports. The UK is the largest market for Indian garments within EU. The weakening of the euro against the dollar would affect revenues in dollar terms.

• Within the automobile space, component suppliers will be more adversely impacted compared with original equipment manufacturers with the exception of the JLR business of Tata Motors, Crisil said. Around a quarter of India's auto component exports are to Europe.

• The UK has a share of about 5% in overall auto components exports. Any dampening of prospects due to economic uncertainty and depreciation of the pound would have a corresponding impact on the revenues of these (auto components) companies.

The decision by the UK leaving the European Union has impact on India on multiple layers. However, economists and experts are of the opinion that the country need not be overly worried about the development as the transition is going to be slow and also more details are to be expected.

Britain always provided a gateway to the European Union. Many Indian businesses have their offices in Britain so they can avail benefits and continue to remain a part of the EU. But with Brexit, this benefit will be taken away and may result in companies relocating their business set ups to other places.

Brexit might also have a positive effect, but these results may not show up immediately. The process might take time considering that the new government will take time to design and implement their policies.

Automobile, Pharma and IT might be the most affected. NASSCOM has predicted that the effect of Brexit will be felt on the $108 Billion Indian IT sector in the short term. Leading Indian IT firms have not commented on it as since there is a possibility of renegotiations for all the ongoing projects because of the devaluation in the value of pound. These things can be covered up in the next few years wherein alternate arrangements can be placed between the countries.

In the automobile industry, Brexit may lead to reduction in sales and companies that derive good revenues of profits from Britain could get hurt majorly.

Effect on Education Sector/ Students and Travel

• Britain is one of the most sought after education destination for Indians. Before Brexit, British universities were forced to offer scholarships and subsidies to the citizens of the UK and EU. Brexit frees up funds for the other students and more Indian students might be able to get scholarships.

• Reduction in pound value will reduce travelling cost to the UK and will make it a good travel destination.

Effect on Investment:

India is presently the second biggest source of FDI (Foreign Direct Investment) for Great Britain. One of

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the main reasons for this is the historic and cultural ties with the UK that India shares along with the fact that the UK proved to be a gateway into the rest of Europe. 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.

However, after Britain exit the EU, it is not as attractive a destination for Indian FDI as before. 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.

Britain's decision to leave the EU has forced many to sell their risky assets and rush towards safe haven investment option like Gold. Gold prices in India had breached Rs 32,000 per 10-gram level.

In the long run, Brexit will help strengthen our 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 current turmoil as an opportunity. For the common man, with every uncertainty there is a bigger opportunity to pick great stocks. It pays to focus on companies in the consumer driven sector. Financial sector companies too can surely generate great returns.

Impact on GDP

Brexit will have an impact on India's GDP growth. "We have lowered our aggregate 2016 GDP growth forecast for Asia excluding Japan from 5.9% to 5.6% and India's 2016 GDP growth forecast to 7.3% from 7.6%," said the Nomura Report. However, there is no need for Indian investors to worry about this small fall in the growth rate, because we will still be the fastest growing major economy of the world. The government is also taking steps to boost the GDP growth and steps such as the recent FDI liberalisation will help in achieving it.

When we look at the whole picture, it emerges that long-term investors need not worry about Brexit. "Investors should not change their asset allocation based on events like this. Since India's economy is doing well from a longterm view, there is nothing to worry," says Sachdeva. A. Balasubrahmanian, CEO, Birla Sunlife MF concurs with this view: "Investors should not bother too much about such events. The country is on the right direction and the long-term direction of the market is driven by fundamentals and not just by such events," he says.

Impact on 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. There have already been many proponents of the Leave Campaign that suggest that the UK should look towards the Commonwealth to forge new alliances.

Britain will still 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.

EU partnership

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.

Brexit could force India to build trading partnership with other EU nations in order to access the large EU market.

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.

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.

CONCLUSION:

What does Brexit mean for India? As a former British colony, the country enjoys particularly close economic, trade, political and cultural ties to the United Kingdom.

Although significant coverage has predictably focused on the fallout from the referendum, the UK's decision to leave the European Union presents a potential upside for India in numerous ways.

Positives:

1.UK loses a huge preferential market in the EU and would seek to build new alliances and trade pacts. India being one of the the fastest growing economies is rightly poised to gain from this development. The migration of EU skilled labour would decrease and English speaking Indian talent pool is definitely going to benefit out of it.

2.Indian students should be able to secure more financing for their college degree, as preferential scholarships to EU countries will reduce. This would mean India could be seen exporting more talent than present levels.

3.Also, let us not forget than India is a former colony of Britain and a member of Commonwealth of Nations. With UK separated from EU, it would want to create new economic alliances and may tilt towards its former colonies. Having said that, we should not forget that one of the reasons for Brexit is the large number of European migrants coming into Britain, so this might eventually be a perception.

4.With substantial Indian population in the UK (highest minority group in the UK with 2.5% of the population), which we have witnessed are treated differently during elections, and most recent instance being UK supporting India NSG bid, we could expect a stronger ally in the UK than EU. However, India may have to rework it's strategy in aligning with some other key EU nations.

Negatives:

1.Indian IT companies with European headquarters in the UK would need to spend on infrastructure and staff for setting up a new office in the EU. (There are approximately 800 Indian companies in Britain)

2.India has been negotiating a free-trade agreement with the EU for almost 10 years and now will need to rework its strategy. A separate pact might need to be negotiated with the UK.

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