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Global Disquiet, Local Discipline: What Europe's Summer Revealed

It was hot in the last week of June: 32°C in Zurich, 35°C in Milan and a scorching 40°C in Athens. I was in the thick of it, travelling across Europe for a sales roadshow. Ironically, Mumbai's Monsoon offered far more pleasant weather. The European summer heat mirrored the heat in global conversations around policies, investments and uncertainties.

During a similar investment meet late last year, the conversations had centred around China and the post-election environment in India. This time, the discussions about China were limited. What was at the top of investors' minds and what did they want to talk about? Conversations were dominated by every possible facet of US policies, including tariffs, capital flows, foreign and military policy. Investors everywhere are trying to come to terms with the disruption caused by the Trump administration. Nobody is quite sure if this is a short-term blip or a rupture in the template that investors have become used to over the past few decades.

I landed in Switzerland to the news that the Swiss National Bank (SNB) had cut its key rate by 25 bps to zero. The Swiss CPI fell 0.1% yoy vs their stated target of between 0% and 2% so they had sufficient headroom to cut rates to zero. Theoretically, they could go even lower!

We all remember how SNB was one of the banks that held the policy rate at negative for many years and reversed it only after the pandemic. Note that their currency is not falling in response to this race to zero; the Swiss Franc has rallied over 14% ytd vs the USD.

During my conversations with investors, many expressed fears about the US approach to the dollar and concerns about potential taxation on investments in the US. Nobody suggested that clients were pulling back money in any material way. However, markets often move and reprice before the actual flows.

If you only watch the gyrations of the rupee versus the dollar, you may have missed the effective weakness of the rupee against other currencies such as the Euro, Swiss Franc and the British Pound. In the first half of CY25, the Euro has gained just under 14% vs the US Dollar, while the British Pound has gained just under 10% vs the US Dollar. For the Indian holiday maker, a holiday in Europe or the UK is costlier by 12-14% due to the strength of those currencies. What is clear, however, is where tourists are staying away from: inbound tourism into the US has dropped sharply this summer.

There were many questions about the recent military conflict between India and Pakistan. I reminded them that conflict with Pakistan was not that unusual an event in the context of our history. Many older investors would remember that in the year 2000, the then US President Bill Clinton had described South Asia, and more precisely the ceasefire line in Kashmir, as the most dangerous place in the world. This was just two years after both countries had carried out nuclear tests and announced their nuclear capability to a stunned world.

Looking back, I think investors were far more nervous back then. I pointed out what has changed now: 'India's willingness to pursue military strategies to address cross-border terrorism'. In this new paradigm, India will go up the escalation ladder as it deems fit in response to terrorist attacks.

With the curtains swiftly drawn on this most recent conflict, I assume investors are much more at ease on this issue. In my opinion, the longer-term strategic rivalry that India will have to worry about is China, not Pakistan. There is a distinct possibility, based on our recent experience, that there is heightened coordination between these two neighbors of India. In military parlance, that is what policy makers and generals call India's challenge of a two-front conflict. As India's late prime minister, Atal Bihari Vajpayee, once said on the issue of Pakistan: 'You can change friends but not your neighbours'. Investors in India will have to live with this risk.

China is dominant in global supply chains, which poses an economic risk for India. In recent weeks, there have been reports about Indian companies being unable to buy rare earth magnets and certain fertilisers from China. In the first week of this month, there was also news that Foxconn was pulling back all its Chinese staff from Indian facilities. These employees were arguably helping Indian manufacturing units (that are now part of the Apple supply chain in India) to upskill. In the medium term, these developments can be considered as friction rather than roadblocks. Although these can create delays, they can't prevent our growth due to the fragmentation, distribution of the supply chain and rerouting of products. India's strategy would be to continue with its rapid and steady capability building and growth. Our economic size, prosperity and military strength create the best possible defence against all such forms of risks.

What about valuations in India, which remains the largest challenge confronting allocators? According to an investor I spoke to, in the MSCI All Country World Index, two countries are significantly more expensive than all others. One is India and the other is the US. The weight of the US in the benchmark index is nearly 65% and the weight of India is under 2%. The risk of being underweight India is much lower than the risk of being underweight the US due to their relative sizes. Maybe that finds reflection in the middling flows into India from FPIs.

India's biggest relative advantage today is the prudence with which we have conducted our macro-economic policy across the fiscal and monetary domains in recent years. This has created a headroom for policymakers to provide support when needed. They have the flexibility to respond to economic and geopolitical shocks as the old order is disrupted.

Good health is a blessing, and at this juncture, India's macroeconomic parameters are in robust shape, well-equipped to navigate the headwinds and crosscurrents of the global landscape.

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Author's profile



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