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India rules out further capital controls

By James Crabtree in Mumbai

India has rejected suggestions that its faltering economy faces a balance of payments crisis and has ruled out new capital restrictions on foreign investors, despite rising concerns about rapid rupee depreciation, capital outflows and a falling stock market.

Prime Minister Manmohan Singh at the weekend reassured investors that India’s $279bn of reserves would be sufficient to let the country ride out what is arguably its most pressing economic crisis in two decades.

“There is no question of going back to [the balance of payments crisis of] 1991,” Mr Singh told Press Trust of India, referring to a period of financial emergency that ultimately prompted the nation to introduce reforms opening up its economy.

India’s large current account deficit and inability to introduce substantial economic reforms have made it especially vulnerable to capital outflows from emerging markets in recent months, and it now needs to find new sources of foreign capital to protect against further currency falls.

The introduction of limited controls on domestic capital spooked investors last Friday, driving the rupee to record lows against the dollar and sending equity markets down sharply. That sharp reaction raised worries of a possible rundown of the country’s foreign currency reserves.

Policy makers have ruled out the possibility of new controls on foreign investment flows, following concerns that last week’s limited measures on domestic capital could be broadened.

“It is absolutely not on the table to put any limits on the ability of FIIs [foreign institutional investors] who have put money into India to take it out whenever they want. In fact we are taking measures to make it more attractive for them to invest more,” one senior official told the Financial Times.

The government is considering new steps to close the current account deficit by lowering gold and coal imports, restarting stalled iron ore exports and pushing large Indian state-backed companies to raise new dollar debt abroad.

However, many analysts believe the country is likely to face further downward pressure on its currency and markets in the absence of more comprehensive measures to restore investor confidence and tackle faltering growth.

“The degree of vulnerability of the Indian economy to global shifts has increased, so we are now at a knife edge, where foreign investors are concerned about pulling their money out,” says Eswar Prasad, an economist at Cornell University.

“It will be very difficult to stem the rot with short-term measures, because the market thinks these are reactive, so if we don’t see a significant reform package in the next few weeks it will be time to be really worried,” he added.

Even were the government able to force such reforms through India’s divided and fractious political system, it also must now ensure that any announcements do not inadvertently dent investor confidence, especially in the aftermath of last week’s partly self-inflicted market turbulence.

“I think the best course now is probably not to do anything drastic and to wait for the market to settle down on its own,” says Chetan Ahya, chief economist for Morgan Stanley in Asia.

“They are trying to walk a tough path, and it looks as if their game plan for now is to do some small things to discourage outflows and to bring in inflows, which is sensible.”

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