Impact of Brexit- First thoughts
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Strengthening of centrifugal forces advocating dismemberment of the EU

As I had mentioned in early morning Brexit would trigger fears of centrifugal forces getting unleashed. Other disgruntled members of the EU who are unhappy with the functioning of what they perceive to be an overbearing & opaque decision making apparatus of Brussels-based bureaucrats would demand similar referendums from their national governments. This would be vehemently opposed by the governments in Germany & France who are advocating an 'ever closer union'.

This can open fissures which would increase acrimony & social discord in the political discourse which would have a chilling effect on the economic decision making as businesses abhor uncertainty and would defer any investment decisions till a sense of clarity returns. In short, a domino effect to exit the EU would strength among other nations in the EU.

Li mi ted fir epow er i n EC B's
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It makes the task of the ECB in reviving economic growth that much harder as it has used almost all the arsenal in its armory namely it is continuing to buy bonds worth billions of Euros on a monthly basis to stimulate growth as well as has imposed negative interest rates on banks for keeping some of their reserves with the ECB. Despite this the GDP growth rate of the EU area is anemic at 0.6% in 1Q CY 2016.

Apprehensions of immediate rate increases in the US buried for now

It would also allay fears of any immediate rate increase by the US Fed which would see a rising dollar (and falling currencies of its trade partners like Euro, Pound etc) as well as falling commodity prices as strong headwinds to US economic growth.

Spike in Risk aversion and movement into safe havens. Industrial commodities (Crude & Metals) to take the brunt

A spike in overall risk aversion would lead to money gravitating towards safe havens like Dollar assets and Gold. Pound and Euro will weaken the most- being the direct sufferers of slowing economic growth and currency turmoil. Industrial commodities will like crude & metals will weaken due to fears of slow economic growth.

Export dependent economies to suffer the most

Many export-oriented economies like those from the Far East like Japan, South Korea, Taiwan etc whose GDP is primarily export dependent (roughly 60 to 70% of GDP is net exports) will be hit hard due to global trade getting impacted as a result of this uncertainty. Commodity-exporters like Brazil, South Africa, Russia, Nigeria, Gulf countries (like Saudi Arabia, UAE, Kuwait etc) etc will suffer due to fall in their major export commodity basket. Also, aggregate demand in these economies will suffer if their currencies weaken as a result of fall in prices of their major revenue contributing commodities as well as fears of flight of foreign capital into safe haven assets.

Impact on India:

Domestic-focused & domestic-demand led major economy (other than the US)

Once some semblance of sanity returns investors will realize that nearly 65-70% of Indian GDP is domestic consumption. We are primarily a domestic-focused & domestic demand-led economy.

Fall in crude to aid trade deficit & CAD

Fall in commodity prices like crude would lead to large savings in import bill (every $1 drop in crude prices leads to roughly $ 1 billion savings in India's oil import bill). This would reduce India's trade & current account deficit (CAD) and counter any negative impact due to foreign capital outflow that may happen as part of movement towards safe haven assets.

Lower commodity prices to dampen imported inflation

Lower commodity prices would dampen 'imported' inflation and help the RBI in pursuance of its stance of monetary accommodation.

Record forex reserves. Fiscally prudent g ov er nment, l arg e FDI i nfl ow s to c us hi on I ndi a's exter nal economy

With record foreign exchange reserves of $ 340 billion & expected forex outflows in September 2016 on the FCNR (B) front already covered, RBI is likely to intervene to stamp out any unusual volatility in the currency markets. India emerged as the recipient of the highest FDI inflows in 2015 surpassing China & US due to open door policy pursued by the Indian government by increasing the caps on foreign holdings in many crucial sectors & improving measures of ease of doing business. Government's adherence to fiscal discipline & narrowing CAD would allay any apprehension in the bond markets which otherwise would betray a sense of nervousness due to likely FII outflows especially on the debt side.

Overall we feel investors need to take a measured approach and not get carried away by doomsday scenario in so far impact on Indian economy & markets are concerned. Once the dust settles down, India will be seen to be a net gainer and inflows would continue to gravitate towards Indian shores.

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