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STATES OF MATTER

The curious case of the bullish stock markets in the pandemic

Sukumar Muralidharan | Updated on July 15, 2021

The relationship between growing inequality and booming asset markets has never been this stark

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After a harsh lockdown in the first quarter, the next three quarters of growth during the last financial year were celebrated in the official Economic Survey as early intimation of a V-shaped recovery. India's gross domestic product (GDP) fell over 7 per cent through the year. And just as the economy seemed primed to rebound, a far more lethal second wave of the coronavirus struck, forcing panicky and disorderly shutdowns across the country.

The economic stocktaking will turn up its measure of losses at some point. But while the human costs remain to be tallied, there is one sphere untouched by the gloom. As incomes plunged and livelihoods came under unprecedented stress, the stock markets rose dizzily after some initial hesitancy. Between February and March last year, the index of prices on the BSE (formerly the Bombay Stock Exchange) fell by about 30 per cent. Those were the first sustained setbacks after years of virtually unbroken rise. But with all the sentiment built up through preceding years, market capitalisation of all companies listed on the exchange stood at over 51 per cent of GDP as financial year 2019-20 drew to a close.

Though steeped in gloom, the following year brought a strange exuberance to the stock markets. Beginning with a 14 per cent gain in prices in April 2020, the BSE partook of a global rally that persists to this day. At the end of 2020-21, market capitalisation on the exchange stood at almost 100 per cent of the GDP for the year.

By way of anecdote, BSE market cap last touched this level in 2007-08, in the glory days of India's growth story. Driven by strong inflows of overseas funds and a boom in credit, BSE market cap went up in leaps and bounds from just over 23 per cent of GDP in 2002-03 to over 100 per cent in 2007-08. The following year, the illusion crumbled. Recovery was slow, but accelerated with the current regime taking office in 2014, before the setback of February 2020.

Since then, the much anticipated V-shaped recovery in official circles has been an isolated feature of the stock markets. In May last year, ***The Economist*** commented with uncharacteristic sombreness, that "the market's recent V is not for victory". Editorially, The London Weekly **warned** that the markets had got "out of whack" with the real economy and something "had to give".

The "delirious rally" of stock markets, a feature mostly of the US, but also more remote parts of the globe, was underwritten by a massive purchase of assets by the US Federal Reserve (Fed), the bank of last resort and seigneur of the global currency. This included the unprecedented purchase of corporate bonds, enabling big firms to finance their debts and investors to shift from "panic to optimism without missing a beat". And all this time — unemployment, growth and other indicators of underlying economic health were telling a different story — of gloom unprecedented since records began.

India was conservative in building up the central bank's balance sheet. The Reserve Bank of India (RBI), as the banker of last resort, only purchased sovereign government bonds to infuse liquidity into an economy that threatened to shudder to a halt. As the RBI's recent annual **report** puts it, emerging market economies — India counts itself as one — "deployed almost all tools... that the advanced economies' central banks employed". However, the advanced economies were "more prolific in the use of asset purchases/sales and forex swaps".

For all the RBI's prudence, India's markets are powerfully influenced by global practice, particularly as evidenced in the US. With its relatively open rules of entry and exit, India's markets — among emerging economies' deepest and widest — have been a welcoming ambience for global capital seeking quick returns. As the RBI has observed, foreign portfolio investment (FPI) flows surged through the year, as "risk appetite returned, with ultra-accommodative monetary policy stances of advanced economies' central banks acting as the main push factor".

Aside from China, India was the only emerging market economy that received FPI inflows during calendar year 2020. As the RBI again notes, foreign investors "remained net buyers in the Indian equity market, with November (2020) witnessing record inflows". During a financial year abbreviated to nine months because of a change in accounting formats, India received a net FPI (foreign portfolio investment) inflow of ₹2.8 trillion ($37 billion), against an outflow of ₹62 billion ($830 million) the previous year.

These figures rendered into equivalents in terms of the mighty US dollar, would seem a mere trifle, for a time when the US Fed doubled its balance sheet size. Between the time that the coronavirus pandemic was officially declared and now, the US Fed boosted its assets from $4.2 trillion to $8.1 trillion. India's economy today is estimated to be about $3 trillion. So the US Fed has added one India and then some more in terms of loose cash in the US. And what is most remarkable about this situation, in the context of prevailing monetary dogmas, is that the global economy has not yet caved in under the weight of this profligacy.

Every principle of conventional economics has been stood on its head by the new orthodoxy. "Quantitative easing" or QE, was first devised to combat the 2008 financial meltdown and has now been extended beyond imaginable bounds to deal with the pandemic-induced crisis. Ben Bernanke, chairman of the US Fed through the years of the meltdown, had this bit of pithy wisdom to offer on the eve of his retirement: "The problem with QE is that it works in practice, but doesn't in theory".

This astonishing admission of ineptitude by an economist who has occupied prestigious university chairs has deep roots in how the discipline of economics has evolved, particularly in terms of its relationship with the sources of power. Robert Skidelsky has pointed **out** that "the main homage which mainstream economics pays to power is to render it invisible". Irrespective of what the theory says, policy regimes that preserve the rich and powerful in times of great dislocation are assured of success. By design then, the burden has to be placed elsewhere.

Where could that be? Theory and practice differ widely, especially when governments chose ignorance rather than reckon with the consequences of their policy choices. Theory had no place for QE and it was only with great reluctance that it sought an accommodation with the curiosities of the policy turn since 2008. As a face-saver, theory posited that QE would be neutral in its distributional effects. Between rich and poor, neither would be disadvantaged by an overall expansion of money supply.

Yet if central banks use assets purchase as the foundation for monetary expansion, it is obvious that asset owners should benefit. In advanced economies, all who earn an assured wage and invest in a pension fund, would be counted among asset owners. In emerging market economies, the numbers of assured wage earners are minuscule, and those dependent on fickle and precarious work, numerous. Even if those of precarious cash flow have some asset ownership, they tend to get **pledged** and even lost in times of hardship.

Since free market economics established its dominance in the 1980s, inequality has been a topic passed over in silence. The harsh realities of a polarised world has forced a hesitant emergence of the theme in recent debates.

An aspect where general agreement exists, is that inequality tends to be more acute in asset ownership than income flows. Since the 2008 meltdown, income flows have themselves been tied, like never before, to asset ownership. That has fuelled varieties of dysfunction in liberal democracies across the world, prompting a headlong flight towards authoritarianism. And for all the hand-wringing in elite circles, that democratic dysfunction is only deepening.

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