# The US Downgrade may cause ripples in the world economy

**— Lalit Dangi**

The loss of top category AAA rating of the US by the Standard & Poor's at a time when Euro Zone is grappling with severe debt crisis has hurt investing sentiments all over the World. Though India's exposure in the mounting US debt of Rs. $ 14.3 trillion is only $ 41 billion, yet it not a small amount for a developing country which itself is faced with its own set of problems back home and in a much more profound way. India's exposure to US debt is smaller compared to China to whom US owes $ 1.10 trillion, but looking to the size of its share market, yet the Indian Economy will be affected in more than one ways due to this downgrade.

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Firstly, the FDI flow to India is likely to be affected adversely as the US companies may prefer to invest money in the home country due to higher yield. Secondly, the companies in India which are doing business with the USA Government owned companies will be clobbered due to less appending / reduced budgets by the US Government. Thirdly, India's foreign trade will be also affected due to severe volatility of dollar since India's 95 % trade is done in the currencies of dollar, Euro & Pound sterling. Fourthly, the earnings of top companies in the US will go down which will increase unemployment figure in the US which will put pressure on expatriate countries.

It cannot be ruled out that a cut in spending may lead to the Greece like situation in USA. It is also possible that the concept of Global Reserve Currency may find support from large number of countries which will have direct impact on dollars. Almost all the countries of the World have kept dollar as part of foreign currency reserve due to its convertibility feature. In times to come, the control of America over the International Financial Institutions like the World Bank and IMF may diminish due to dollar losing shine in the currency market.

The Indian economy will be affected terribly as most of its international trade is done in dollars. Also, investment by the US companies in India will go down due to high yield in the US. Even, the foreign Debt Fund may not buy Indian Papers. India has got only $ 300 billion as reserves and if it depletes due to outflow then India's Sovereign Rating may also get downgraded and this may put India as a high risk investment economy. However, it is also true that amongst the developing countries, as of now, the fundamentals and growth prospects of the Indian economy are considered as strong and therefore it is known as one of the best destinations for making investment. Hence, the other countries who intend to invest anywhere but USA in the post downgrade scenario may find a good investment opportunity in India compared to the US.

Coming to the share market, well, it has become extremely volatile. Therefore it is highly recommended that the investors should now take a long term view ranging from 2-3 years. They should invest in infrastructure, pharma companies where demand will continue. The most affected companies during the recession where the demand will go down and result into decline in the profitability will be banks, IT, consumer products and real estate. Investors may stay away from those companies, in particular, which have got higher exposure to FCCBs since these companies may find it difficult to convert foreign currency loans in equity shares and will have to redeem them with a higher premium thereby affecting the liquidity and profitability of the company in an adverse way.

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credit. Serious concerns about domestic inflation within China have caused its central bank to raise the banks' reserve requirement for the ninth time since October 2010 to 21.5 per cent in June 2011. Lending in China declined to the slowest pace since 2008 and the country reported its first quarterly trade deficit of $1.2 billion since 2004 in the first quarter of 2011. Again, the sputtering of the growth engine in one of the fastest growing economies of the world is hard to ignore.

## Impact on India

Experts believe the markets may witness volatility in the short term, as investors turn risk-averse and money gets pulled out from emerging market equities. However, although Indian markets have plunged along with their global counterparts, they are more likely to bounce back faster than others. This is because once the whirl of profit-taking by FIIs ends, investors may find that slower global growth is not