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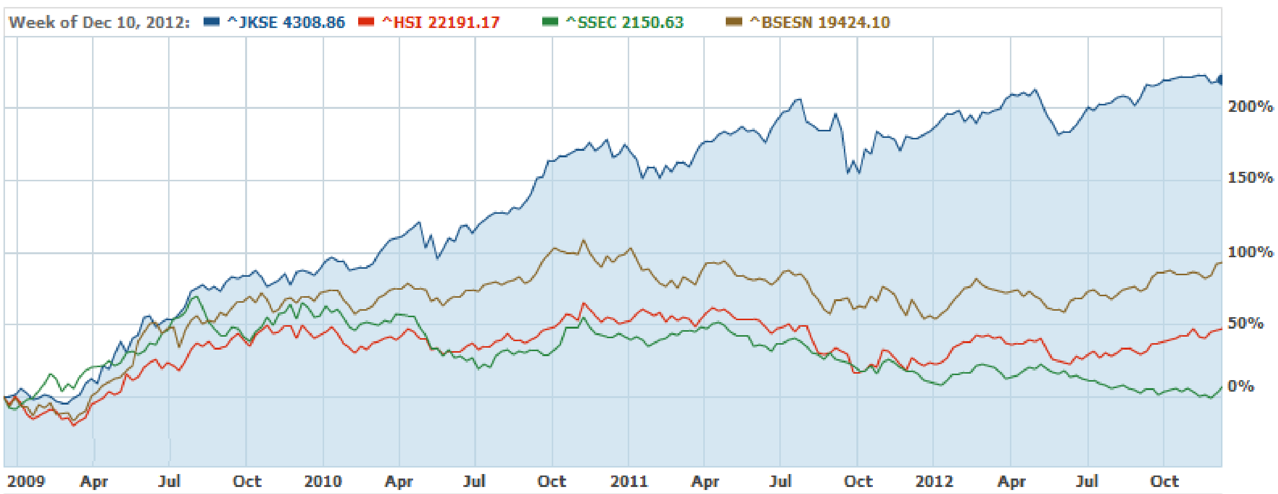
Surpassing the rhetoric of its twin deficits, slowing growth, falling exports et al, it is now apparent that India's Financial Leaders are also tending to lead its economy away from the volatility of international trade flows (as in Thailand or Taiwan) by treading onto a proven success model of its more fiscally prudent Asian cousins like Indonesia.

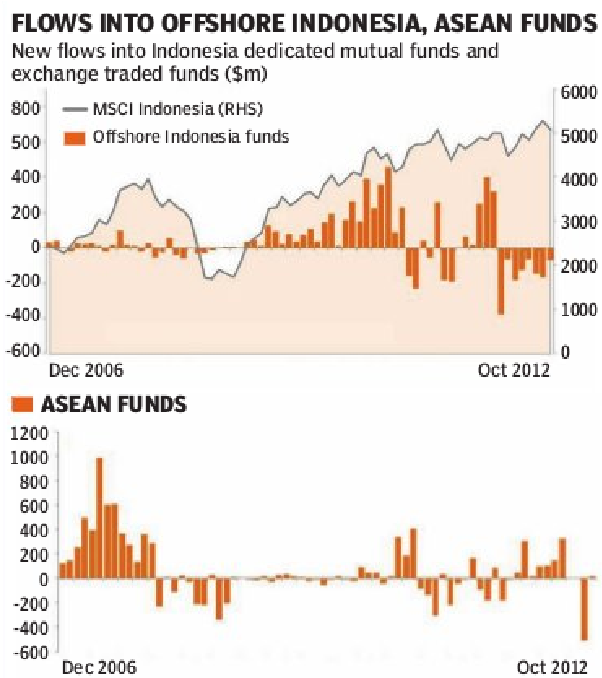
From being a nation bailed out by the IMF in the late nineties to pledging of a billion dollars to IMF's kitty recently, Indonesia has really come a long way in a very short span of time. Global Investors' interest has been continuously growing in Indonesia since 2009, while growth has moderated in its larger Asian peers – China and India, in recent years. Indonesia's strong out-performance (see figure below), as evident from its most stables growth rates over the past 20 quarters, was a result of its fiscal prudence and stable governance, complimented by a conscious drive to clean corruption and success in executing public-private partnerships.



Performance of Jakarta Composite, Hang Seng, Shanghai Composite and BSE Sensex Indices since 2009

Developing Asian economies are being driven increasingly by the domestic demands of their huge populations. The percentage of exports in their GDP has dropped significantly in the last decade. Developing Asia's combined current-account surplus, which reflects its dependence on foreign demand, more than halved from 2008 to 2011 and is only expected to fall further. Most Asian economies have allowed their currencies to ease, but not without a reason. Actually, in the aftermath of the Asian Financial Crisis, most Asian countries accumulated an impressive stock of hard-currency reserves and weaned themselves off foreign-bank loans in favour of foreign equity and local-currency bonds. Because these liabilities were denominated in their own currency, they did not rise in value when the currency fell. That freed policymakers to cut interest rates when the economy slowed. Indonesia's central bank, for example, slashed rates by three percentage points from December 2008 to August 2009. It cut rates by another point from October 2011 to February 2012. Simultaneously, Asian countries have aggressively pursued the strategy of entering into bilateral currency swap agreements, enabling them to swap their local currencies against the US dollar.

The global financial crisis also brought into question the desirability and feasibility of pegging Asian currencies to the dollar as the keystone for the regional stability and future growth. Studies post the crisis failed to establish that countries which pegged their currency to the dollar performed on an average better than those that allowed controlled flexibility (during the crisis), instead in fact suggesting otherwise (as evidenced in Indonesia). The instability of the dollar against the euro and other key currencies implied that pegging to the dollar would increase domestic currency volatility against the euro, pound, and other currencies. This effect may be sub-optimal for countries that trade heavily with the euro bloc and experience an increase in such trade over time. One way to deal with this issue was to evaluate what would have been the optimal weight of achieving real exchange stability against a basket of currencies that reflect the actual trading patterns of the region (the approach adopted by RBI in recent times). Recent analysis reflects that the emerging market countries have moved towards the middle ground, associated with greater exchange rate flexibility and limited but growing financial integration, buffered by sizable reserve holdings.



Source: Thomson Reuter

But unlike Indonesia, maintaining (or building) sound economic fundamentals is where most BRIC economies have failed thus far. Boosting consumption was the easy part, as countries like India and Brazil have realized of late. They have done (and more likely overdone) a good job of building and selling cars in recent years, but have failed to build enough roads to accommodate them. Similarly, the economy as a whole has depended too much on stoking consumer demand and not enough on increasing supply by way of investment, resulting in terrible bottlenecks that have left the economies in these nations at a standstill.

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