Stock Market Boom amidst Economic Crisis

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Newspapers on Tuesday May 13 carried three reports. The first was that the Sensex had closed at an all time high of 23551 the previous day; it had also recorded a historic intra-day high of 23572.88. The other stock market indices had also shown similar remarkable buoyancy the previous day, carrying forward a rally that had begun a few days earlier. The second report was that the latest available industrial output figures showed that the Index of Industrial Production for March had contracted by 0.5 percent compared to the previous March, which was on top of a 1.7 percent contraction in February, so that for the whole of 2013-14 it had contracted by 0.1 percent as against a modest positive growth of 1.1 percent the previous year. In fact capital goods output had contracted by as much as 12.5 percent in March, signaling "dampened industrial sentiment".

As if this bizarre combination of an unprecedented stock market boom being accompanied by "dampened" inducement to invest, which incidentally undermines the very basis of neo-liberal economics that sees the stock market as reflecting the "fundamentals" of an economy, were not enough, the same day's newspapers also reported that the annual rate of retail inflation had "inched up" to 8.59 percent in April from 8.31 percent in March. This mixture, of an inflation rate which is quite severe, for a country where most of the working people do not have wages indexed to prices, and an absolute industrial stagnation (even a small contraction), certainly constitutes a first rate economic crisis. The irony is that the stock market is booming in the midst of this crisis; and what is more, this boom itself does not have any effect by way of mitigating the crisis.

In fact there are several conundrums involved here: why should there be such high inflation when the economy, far from being "overheated", is actually stagnating? Why should the stock market register such a fantastic boom in a period of inflation, while the historical experience of the Indian economy has always been that commodity price upsurges and stock price upsurges are inversely related, i.e. that the occurrence of one has usually precluded the other? Why should the stock market have a boom if "investors' sentiment" (for investment in productive activities) is weak? Why should the stock market boom itself not have pulled up the industrial sector, as this boom, though it has gathered momentum since Friday last, has been going on for some months?

Let us answer the last question first. A stock market boom stimulates aggregate demand in the economy, and hence output in a situation where resources are lying idle (as is the case in India now), in two possible ways; and these in turn react upon one another. One is by raising investment expenditure. This happens because the boom entails a cheapening of long-term funds for investment purposes, in the form both of loans and of equity. The other way is by increasing the wealth of those who hold the stocks that are experiencing a rise in prices, which in turn makes them buy more goods, e.g. yachts, villas, holiday packages and other such things. This rise in consumption expenditure increases the level of demand in the economy and hence calls forth larger output and employment.

Of these two ways, the first is less likely to initiate a turnaround, since a mere cheapening of long-term funds is unlikely to stimulate investment in a situation where demand is stagnant to start with, i.e. when the demand for the products of such investment projects is not visible on the horizon. Hence it is through the route of higher consumption expenditure, stimulated by the increase in the wealth of the stock-holders, that a stock-market boom can make its initial impact upon a stagnant economy.

Here however we immediately confront a problem. If the wealth increase is experienced by a large number of individuals then it will have a perceptible effect on demand, but if the gainers on the stock market consist of just a few large corporations, then the wealth effect on their expenditure will be small; and even such effect as there will be will largely "leak out" of the economy, creating demand for a range of foreign goods with little impact on domestic output and employment. The primary impact of a stock market boom on aggregate demand therefore depends largely on how dispersed the distribution of stock-ownership in society happens to be.

This distribution is far more dispersed in the U.S. than in any other advanced capitalist economy, which is why stock market bubbles in the U.S. have a far greater impact on aggregate demand in the U.S. itself, and on other capitalist countries, than such bubbles elsewhere. In India such ownership is hardly dispersed at all; it is concentrated in the hands of a few corporations, financial institutions, and foreign institutional investors. At the beginning of "liberalization" there was some enthusiasm among middle class "investors" for buying stocks. But over time they have dwindled into insignificance, and FIIs in particular have become dominant players on the stock market. Expecting a stock market boom to pull up domestic aggregate demand, and hence output and employment, in such circumstances therefore has become utterly unrealistic.

It can have the impact of drawing in more foreign currency resources, which in turn can further strengthen the boom, and thus create a bubble; but all this does not add an iota to the aggregate demand for real goods and services. A booming stock market therefore can coexist with an industrial recession.

It can also coexist with severe commodity price inflation. The historical experience, referred to earlier, of an inverse relationship between commodity price upsurges and stock price upsurges in the Indian economy, referred largely to the dirigiste period. The explanation for it was that speculators moved away from the stock market to the commodity market in some seasons when the latter promised greener pastures to them and in the opposite direction in other seasons. This presupposed some constraints upon speculative activity as a whole arising inter alia from the availability of finance for such activity. But in the era of globalization when foreign institutional investors are involved and funds for speculation are not limited to the domestically available financial resources alone, there are no such constraints; price increases fed by speculation can occur simultaneously in every conceivable sphere.

One can introduce another argument here. One can say that when inflation is taking place, there would be an expectation that the exchange rate would depreciate; this is because domestic goods at any given exchange rate become uncompetitive on the international market creating balance of payments difficulties. And such an expectation should ceteris paribus keep foreign funds away from the economy and

hence curb stock market exuberance. But even though speculators are concerned with the expected nominal exchange rate, they also know that in an economy prone to speculation the latter too would depend on speculative activity rather than actual developments on the balance of payments front. The nominal exchange rate in other words can remain where it is, and even appreciate, in a situation where domestic inflation is worsening the current deficit on the balance of payments. We are in short in a world where, as Keynes had put it, "enterprise (which is concerned with "fundamentals"-P.P.) becomes a mere bubble on the torrent of speculation", which means that a speculative boom on the stock market can coexist with severe commodity price inflation.

Not only thus can a stock market boom coexist with a crisis in the real economy, but, what is more, any effort on the part of the government to overcome the crisis is likely to lead to a collapse of the stock market boom. Take for instance the industrial stagnation. Measures to overcome it can take several forms: a lowering of the interest rate, an increase in government expenditure, a redistribution of income towards the working people whose "propensity to consume", especially domestically produced goods, is higher than that of the well-to-do. Each one of these measures however will act in the direction of deflating the stock market boom.

A lower interest rate will put off foreign institutional investors, and hence choke off financial inflows that feed the stock market boom. Larger government expenditure, if it is not accompanied by higher taxation of the rich, will enlarge the fiscal deficit to the annoyance of finance capital, which in turn will choke off the stock market boom. Larger government expenditure financed by taxes on the rich, while it will keep the fiscal deficit under control, will have the same effect of annoying finance capital and hence choking off the stock market boom. Larger government expenditure financed by taxes not on the rich but on the working people, while it would not choke off the stock-market boom, will not lead to any stimulation of demand in the economy, since the addition of demand by the government will be counterbalanced by the reduction of demand by the working people. And redistribution of income in favour of the working people will again, by going against the wishes of finance capital, choke off the stock-market boom.

Likewise, since the current inflation is not caused by an excess demand relative to potential supplies, an increase in interest rate, which is the typical monetary policy instrument for combating excess demand inflation, is not going to reduce it. What is required instead is a set of direct measures for insulating the people from its ravages, through an extension for instance of the scope and coverage of the public distribution system. But in India, while food prices have been rising, the government has held on to excessive foodgrain stocks and even exported vast quantities of foodgrains, instead of distributing them through the PDS, because such distribution would raise the fiscal deficit as currently defined. And this again will annoy finance capital, even though there is not iota of truth in the claim that such an increase in the fiscal deficit has adverse consequences for the economy, leading to a possible collapse of the stock market boom. Thus the primary instrument that the government can use in the current inflationary context is likely to come in the way of sustaining the stock-market boom.

Not only does the stock market boom coexist with a real economic crisis, but obsession with sustaining the former comes in the way of overcoming the latter. This however is only a manifestation, in a concentrated form, of the fact that the interest of

finance capital is directly opposed to that of the working people. It is not surprising that finance capital loves fascism which curbs the people’s rights and whose appearance on the horizon underlies the current excitement on the stock market.