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ASPECTS OF THE MACROECONOMY- POST OPERATION SINDOOR

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"*You cannot negotiate peace with someone who has come to kill you*". Late Golda Meir, Prime Minister of Israel

Pakistan crossed the red line by its calibrated provocation, by the heinous massacre of 28 individuals, in the pursuit of its avowed objective of "*sustained low-intensity conflicts and proxy warfare*". There was unequivocal condemnation across the development spectrum of the tragic loss of so many lives. It was unmistakably realized that there was no case for any strategic restraint, no longer in the context of the transformed international geopolitical architecture, against the handiwork of the Pakistani army and its proxies.

Munir badnaam hua, darling kiske liye

Retaliation and deterrence must constitute integral elements of a broad-spectrum strategy in the post-apocalyptic Kashmir world, a world in which the attackers cannot escape with impunity and there is no silent normalization of violence.

Accordingly, the message from India was loud and clear: there would be hell to pay by elements all along the line, viz., the perpetrators, handlers, and planners of this inhuman, ghastly attack. Candle march and condemnation cannot remain a eulogy to the hapless victims of this horrid terrorist attack.

People of Kashmir rose in spontaneous protests against these dastardly attacks. This manifested in surging solidarity and support from the local people against the divisive forces. Pakistan realised the hard way that India meant business after its nine air bases were destroyed, and "*sued for peace*" by seeking a cessation of hostilities. Pakistan was utterly humiliated, with most of its strategic airbases completely devastated.

In the emerging new order, a "*new normal*", India set and definitively rewrote the rules of the game and engagement. The message is loud and clear: Pakistan will face consequences for supporting terrorism. Things would have gone into a free fall for Pakistan; hence, the desperate plea for a ceasefire.

Divergence between the Pakistan and the Indian Economies

The cost of conflict between India and Pakistan transcends direct defence spending costs, impacting trade routes, export-import dynamics, regional trade, aviation, and diplomatic relations. The India-Pakistan war impacted the economies of both countries. But the impact was markedly different. At this moment of churn, it's difficult to say how this situation will pan out. India's economy took a hit, but Pakistan's economy was far worse off because of its escalating economic strains and continuous political instability. Let us identify and isolate some factors of considerable contemporary significance in these retaliatory strikes between India and Pakistan for a comprehensive assessment and perspective.

Given the massive difference between the size of the Indian and the Pakistani economies in terms of all identified parameters, the diversity between the two stock exchanges manifests their starkly different perceptions of risk and resilience. Pakistan has historically lurched from one economic crisis to another because of deeply entrenched and structural economic vulnerability. Accordingly, Pakistan was forced to seek repeated bailouts from the International Monetary Fund (IMF) for its cash-strapped and debt-ridden economy. The IMF approved the release of $1.1 billion to Pakistan, part of a broader $7 billion bailout intended to keep the country's economy from collapsing, subject to conditions: cut subsidies, tax the untaxed, stop the rupee's freefall, and most importantly, close the war.

India has emerged as a fast-growing economy, consistently growing at over 6 %, outstripping 2.5 % to 3 % global growth by a fair clip, and a global growth driver, with 17 % of the global growth coming from India, despite occasional difficulties. The Indian situation could, however, have changed if there was a protracted war, the hit to the economy was significant, investor confidence dipped steeply, and the elaborate system of institutions promoted assiduously over the years developed real and worrisome fault lines.

Resilient Indian markets in war times with Pakistan- This time was no different - A Sense of Déjà vu

The Indian market is expected to be strong and resilient, buoyed by sustained foreign institutional investment (FII) of $ 440 billion in the last fourteen sessions, decelerating growth in the USA and China, and a declining Dollar. The global growth is muted, and the Indian economy has emerged as an outperformer and a bright spot in the global economy. While the stock market oscillations are a function of multiple forces and factors, macroeconomic factors, such as, sustained economic growth, low and stable inflation, buoyant forex reserves of over $ 688 billion, manageable Current Account Deficit (CAD), glide path of the fiscal deficit, corporate earnings, valuations and continuity and stability in policymaking and the Government are important in fostering sustained growth.

Market Response to Operation Sindoor

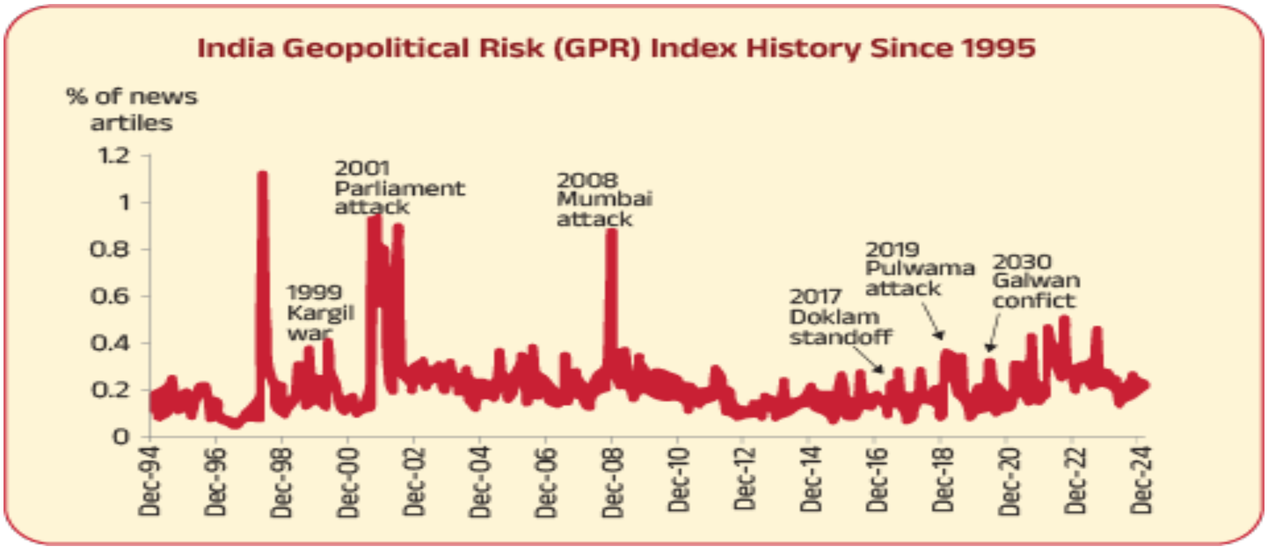
Despite greater volatility because of the high-octane tensions and military escalations, the Sensex remained steady till May 9, 2025, when the Sensex fell upto 950 points. Indian markets were not disrupted severely because of strong forex reserves, stable economic parameters, and the precedence of resilience during conflicts. Important factors underpinning this resilience were strong economic fundamentals, investor maturity, government stability, macroeconomic reforms, and India's global perception. At the global level, there are, however, persisting issues of rising trade tensions, the US Fed's policy, and rising inflation and unemployment risks in the US, reflecting the stagflationary impact of the tariff levels.

Watershed Moment - Advice to Investors

According to April data from the Association of Mutual Funds in India (AMFI), traded funds (ETFs), investors are shifting away from actively managed equity schemes towards exchange traded funds (ETFs) because of volatile markets triggered by geopolitical events, e.g., the Trump Tariffs, the Pahalgam attack, and India's precision strikes in Pakistan. However, during sharp market moves, investors in index funds faced challenges in securing same-day NAVs, despite placing orders within the deadline.

In this overarching environment, the investors did well not to panic but remained invested. India has weathered many crises, and this time was no different. This thesis can be substantiated by the fact that most incidents (except the Parliament attack in 2001) led to positive market returns over the medium to long term, e.g., the Nifty 50 rose nearly 30 % after 12 months post-Kargil War in 1999, the market rose 15.6 % after

12 months post-the Uri attack and surgical strikes in 2016, and the Nifty 50 rose 12.7 % post the Pulwama attack. Similarly, India's market sensitivity to rising cross-border tensions can be quantified based on the India Geopolitical Risk (GPR) Index, which historically rose during the periods of conflict. India's GPR rose by 0.2% on average during the previous periods of India-Pak conflict. Based on observations since 1995, if the India GPR index rose more than 0.2%, Indian equities could see a modest 3% correction in a base-case scenario.



Source: GPR data downloaded from https://www.matteoiacoviello.com/gpr.htm, Goldman Sachs Global Investment Research. As of March 2025

NIFTY Drawdown and Recovery after prior Indo/Pak conflict episodes since 2000

Key India-Pakistan confict events since 2000			Drawdown		Recovery	
Year	Event	Date	# Days of drawdown	Maimum drawdown (%)	# Days from event date	Recovery post drawdown (%)
2001	Terrorist attact on Indian Parliament	13-Dec-01	10	-5%	18	+7%
2008	Mumbai attacks	25-Nov-08	20	-5%	28	+9%
2015	Uri attacks	18-Sep-15	9	-3%	25	+3%
2019	Pulwama attack	14-Feb-19	3	-1%	30	+7%
Average			11	-4%	25	+7%
Median			10	-4%	27	+7%

While there may have been a reason for concern, there was no reason for any alarm or a sense of trepidation because of the observed process of historical development. This is why it is necessary to distinguish between a tactical disruption and a structural shift in the process and pattern of the economy and the growth prospects over the long haul.

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In the near term, globally linked sectors and domestic cyclicals, such as BFSI and Consumer Discretionary, specifically, sectors related to tourism and travel, could have taken a hit, whereas defensive sectors, such as utilities, telecom, and staples, may have bucked the trend. A granular examination of the market structure during conflicts revealed that in the four India-Pakistan conflicts since 2000, NIFTY saw a median drawdown of 4% within the first ~10 trading days. But the market usually recovered within a month of the day of the event. India VIX, which is a volatility index based on the NIFTY Index Option prices, rose by a median of 17% in the initial days.

The Indian investors realised the quintessential truth of the Biblical saying, "*This too shall pass*"; it would not have lasted forever since the Indian growth saga remained intact, "*digitalization-induced productivity gains*" are here to stay and grow, and robust economic growth is on. There is, therefore, a case for systematic investing through SIP and STP in asset allocation, hybrid funds, and large-cap-oriented funds.

Free Trade Agreement (FTA) between India and the UK- Contextually Significant

With almost 30 % of total global spending and about $ 5 trillion stock of foreign direct investment (FDI) (the largest globally), the USA remains the pivot of the global economy. The US is India's largest trading partner and the largest export destination. Such FTAs will not, therefore, completely offset the impact of stiffer tariffs by the USA, though the UK is India's 16th largest trading partner, and India is the UK's 11th largest trading partner. India-UK trade balance is about $ 60 billion (India's trade surplus is $13 billion). This deal will enhance bilateral trade by $ 34 billion. The UK expects to save $ 534 million worth of tariffs with India agreeing to slash tariffs on 90 % of the product categories, with 85 % of them becoming "*tariff-free*" within a decade. India will benefit from the tariff elimination on 99 % of its export product categories. While textiles and automobiles are set to grow, there are some concerns in agriculture and MSMEs. Such FTAs will, therefore, cushion the impact of higher tariffs by the US to a limited extent and, therefore, are welcome both politically and economically.

India's response to the evolving tariff issue must not be guided by unrealistic notions of "*realpolitik*" but must be gradual, measured, and calibrated to overcome the travails of transition. Historic bilateral pacts between India and the UK/ EU with lower tariffs and higher bilateral trade, and securing trade agreements with ASEAN and Gulf countries, will help to diversify and expand India's export markets and provide a level playing field for competitors, who may have already entered FTAs with partner countries. Such pacts enhance trade and investment by reducing tariffs and non-tariff barriers, improving market access, and expanding technology, healthcare, and education opportunities. In a welcome development, US tariffs are also likely to be resolved.

Shifting Sands - Pakistan's Stock Exchange

Pakistan's economy is already fragile, an economy in the ICU if not on the ventilator, irrespective of the criteria adopted. In 2025, Pakistan's $348.72 billion GDP is projected to be less than one-tenth of India's $ 4.2 trillion economy. Pakistan's per capita income of $1,300 is not even half of India's per capita income of $3,000. Fiscal deficit is at 7.4% of GDP (India's fiscal deficit is likely to be 4.4% of GDP in FY 26), nearly twice the regional average. 1 $ = 280.95 PKR on April 28, 2025 (in India, 1 $ =85.66 ₹). Pakistan's total foreign exchange reserves were precariously placed at $16.04 billion (no way comparable to India's forex reserves of $686.2 billion). Projected revenues are not collected, and expenditure on listed items does not occur because there is no money.

This makes it necessary to take fresh loans to repay past loans in a vicious, self-perpetuating cycle. The banking sector is 80 % foreign-owned, and the telecom sector is 100 % foreign-owned. The controlling stake of three major airports will shortly be handed over to foreign powers. Repayment dues exceed $22 billion in external debt in the financial year 2025, including nearly $13 billion in bilateral deposits. Stark inequalities in the distribution of income and wealth are accentuating. The data and evidence reveal a contrasting saga of strength and resilience versus jitters and weakness, and the asymmetry with the Indian economy could not possibly have been more pronounced.

The stock market is largely considered to be a microcosm, a miniature model of the macroeconomy. With rising investor panic in Pakistan's markets because of India's deterrent measures, on top of chronic socio-economic and political instability and intense geopolitical tensions, Pakistan's key stock market index, Karachi-100, tanked 9 % in two days. Subsequently, the Karachi Stock Exchange halted trading for 60 minutes after gaining 9% on May 12 because of the ceasefire and the IMF's bailout package.

The Indian stock market is symptomatic of enduring investor confidence in domestic fundamentals. Should the war have proceeded for some more time, Pakistani investors would have been in for greater pain and a rude shock.

Note: This is a slightly revised and expanded version of the analysis published in *CS Conversations* on May 13, 2025.