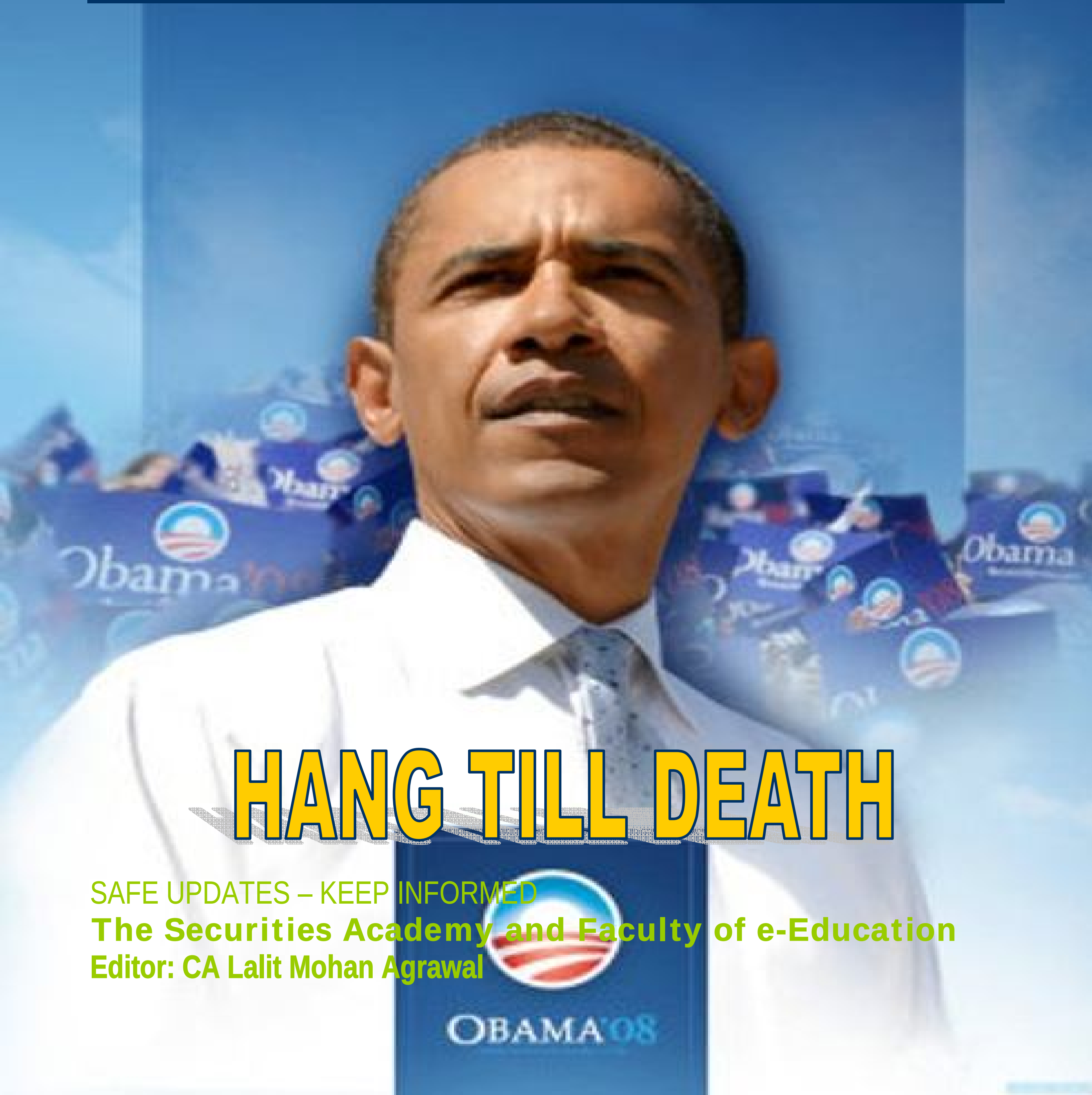
Volume 26 / February 2009

FINANCIAL ADVISOR PRACTICE JOURNAL

JOURNAL OF THE SECURITY ACEDEMY AND FACULTY OF e-EDUCATION



HANG TILL DEATH

SAFE UPDATES – KEEP INFORMED

The Securities Academy and Faculty of e-Education

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Editorial Preamble**: Hang till death**

1.1 WHAT IS IN THE YEAR 2009?

Patience is the key

As the new-year begins, investors across the world are feeling like locusts in a dessert. After getting used to picking off a feast, there are currently no asset classes that offer any obvious appeal. In many parts of the marketplace valuations and sentiment do seem quite depressed. But that largely pertains to risky assets. On the flip side, government bonds offer greater safety but valuations in this space have been stretched to the extent that there's talk of 'risk averse' assets falling victim to the next bubble.

Not surprisingly, then, markets are stuck in a tight trading range. And this tug of war, between deteriorating economic fundamentals on the one side and oversold markets with low valuations and hyperactive policy action on the other will likely to continue in 2009. A major takeaway from the 1930s' experience is that there is nothing wrong in husbanding cash in a deflationary world.

Patience is the key in such an environment as there could be many false dawns. And, even in a broadly sideways market, *it's important to have a fix on the few themes* that will prove to be enduring and serve as the fundamental backdrop for making investment decisions in the year ahead.

1. **US recovery will stimulate rally in stock market –** Policymakers in the US will probably succeed in preventing a Great Depression redux, but they cannot engineer a new growth cycle. There is certain inevitability about what follows a debt binge: total credit as a share of the US economy is at a record 350%, similar to the levels in the Japanese economy preceding the end of its boom in 1990.

After having borrowed growth from the future, the US economy will now have to sacrifice growth for a long time to come. Much the same as Japan over the past two decades; US economic growth is likely to average a meager 1% for the foreseeable future. That implies some sort of a growth recovery in the US as policy action will arrest the current sharp pace of economic contraction.

The Japanese economy has witnessed several mini-growth cycles within an era of stagnation and those recoveries have led to sharp market rallies. *At some point in 2009, the US economy too will start to turn around providing the stimulus for a rally in the stock market.* Typically, the market bottoms 3 - 6 months ahead of the low in an economic cycle. However, any rally will be capped by the weakness of the economic recovery given the underlying economic problems related to over-indebtedness.

2. **Appeal for investing will increase in emerging markets –** The acceleration in the growth of developing countries from an average 3.6% prior to 2003 to more than 7% over the following five years was an aberration largely rooted in the global credit bubble. However, emerging markets are nowhere near as leveraged as the US and most other developed countries and should, therefore, be able to expand at their 1980-2002 average economic growth rate of 3.5 - 4%. That is not too bad an outcome at a time when the US and much of the developed world face an extended period of sub-par growth.

Furthermore, emerging markets are currently trading at a 25% discount to the developed world on most valuation metrics. While it will be hard for emerging markets to completely free themselves of the US market's ball-and-chain, this asset class should over time deliver higher returns as has been the case over the past five to 10 years. *The sluggishness in the west will increase the relative appeal of investing in emerging markets.* This is in contrast to the 1980s and 90s when the US was growing at a robust 3% - nearly as fast as the developing world – and looked much less risky.

3. **Commodities prices will not be in secular uptrend –** It's amazing to see how many financial analysts are still consumed by the myth that commodity prices are in a secular uptrend due to the continued industrialisation of emerging market economies such as China and India.

They are forgetting lessons from history that commodity prices decline over the long-term as the cost of production falls with better technology, increased automation and greater economies of scale. Although they oscillate widely around their long-term trend line, the broad direction is unmistakably down.

After overshooting in the late 1970s, commodity prices steadily fell through the 1980s and '90s even though global growth remained robust through those two decades.

As the 2003-07 credit bubble artificially inflated growth across the world to well above trend levels, commodities prices surged but are now quickly reverting to their long-term mean. They have no justification for trading above their marginal cost of production and in times of distress, the prices fall well below the cash cost of production. All of this suggests that prices of commodities are going back to levels that prevailed prior to the 2003-07 boom.

4. **The dollar is most likely confined to a trading range –** It's intellectually easy to be bearish on the dollar. But as has been the case for so many years now, reports of the dollar's demise are greatly exaggerated.

With US adopting a quantitative easing approach to monetary policy, the image of too many dollars flooding the market readily springs to mind. However, there will be a limit to the dollar's decline.

The deflation of the credit bubble is a global phenomenon and almost all countries around the world are in an aggressive easing mode. It's just that the US is ahead of the curve.

But expect other central banks to soon enough engage in a similar accommodative policy framework as the US, which in turn should limit any downside for the dollar. The dollar is unlikely to make fresh record lows against major currencies in 2009.

5. **A mix of value and quality at a reasonable price should outperform –** The dispersion in valuations – defined as the gap between the highest and lowest-priced stocks – is currently at near record levels.

Ordinarily that would suggest it is time to blindly buy the lowly valued equities and sell the relatively richly priced stocks, typically in the defensive stocks.

But the problem is that the cheap stuff is mostly in troubled sectors such as financials. It's hard to see such stocks outperforming unless the bear market regime comes to an end.

The valuation gap is too extreme to ignore. It's time to overweight that part of the equity universe where valuations are cheap even after normalising earnings and stripping away the abnormal profits of the past few years. However, a premium still needs to be paid for companies with high management quality as survival of the fittest is still an issue and when corporate governance standards are on the decline.

1.2 SECURITY MARKETS

Still stuck in the Mud

As January goes, so goes the year. If that popular trading rule on Wall Street is any guide, then the fact that US equities recorded their worst January in recent history.

Following the excitement at the beginning of the year that 2009 might usher in a different trend there's a growing acceptance that a new year doesn't necessarily imply a new trend.

But it is human nature to engage in drama with many twists and turns along the way, even if there's no chance in the overall market regime.

So, while the basic premise remains that US is just at the start of a multi-year deleveraging process and the global economy will keep keying off trends in the US, it's worth exploring the various ways the market can move in 2009.

There are three possible scenarios.

Scenario 1: **A W-shaped economic recovery –**

While a sentiment on growth keeps deteriorating, there are some early signs to suggest the downward momentum is stabilising. A likely implication of these developments is that equity markets hold the lows made late 2008 and rally for a few months.

But, nobody is prepared for an imminent rally as even the few relatively bullish investors left standing are calling for a recovery in the second half of the year at the earliest.

Scenario 2: **A longer lasting cyclical bull market –**

If the Japanese experience of the 1990s is the base case for the US, then it's important to remember that there were a few rallies of up to 50% in that market. These rallies coincided with a cyclical economic recovery even though the overall growth rates and equity returns for the decade were lackluster.

And this time policymakers across the world are throwing the kitchen sink at the problem with aggressive stimulus packages worldwide. Under such scenario, the global recovery should start to recover by the second quarter of 2009.

Scenario 3: **The deleveraging process continues resulting new lows –**

There is still something incomplete about the current downturn: Overall leverage ratios are way above trend and after the overshoot on the upside valuations need to fall to bargain-basement levels to form a true bottom for equities.

The base case here still is that the US and the global economies avoid an Armageddon-type scenario in the wake of all the concerted policy action. However, in current consensus among opinion makers it is for governments to end the downturn through intervention and aggressive spending.

It's key that disturbing trends reverse quickly and the US market holds the November lows for Scenario 1 or 2 to have a chance to play in 2009.

New Year begins with 7% pullback rally

Depressed investors found relief in the opening week of the New Year 2009 as the stock markets staged a pull-back rally and the government and the financial regulator Reserve Bank announced a fresh set of fiscal and monetary measures aimed at boosting growth.

Daily review	26/12/08	29/12/08	30/12/08	31/12/08	01/01/2009	02/01/2009
Sensex	9,328.92	204.60	182.64	(68.85)	256.15	54.76
Nifty	2,857.25	64.95	57.30	(20.35)	74.30	13.30

Weekly review	26/12/08	31/12/08	Points	%	02/01/09	Points	%
Sensex	9,328.92	9,647.31	318.39	3.41%	9,958.22	629.30	6.75%
Nifty	2,857.25	2,959.15	101.90	3.57%	3,046.75	189.50	6.63%

The upbeat mood in bourses is expected to gather on Monday on the back of government's second stimulus package, announced after trading hours on Friday and the RBI slashing repo and reverse repo rates to all-time lows and also reducing the CRR by 50 basis points, the lowest since February 2006.

1st week of January '09 – Sensex back at 10K level on Monday; **tanks after Satyam scandal**

It has been a happy new year for bulls so far. Equities extended their gains to the third straight session on Monday, with the Sensex closing above the psychological 10,000-mark, boosted by policy measures announced over the weekend. Strong overseas markets added to the positive sentiment. Yet, most market players are not convinced that the rally can sustain. Analysts said the biggest concern for investors was the upcoming October-December quarter results, starting later this week.

Daily review	02/01/09	05/01/09	06/01/09	07/01/09	08/01/09	09/01/09
Sensex	9,958.22	317.38	60.33	(749.05)		(180.41)
Nifty	3,046.75	74.70	(8.65)	(192.40)	Holiday	(47.40)

Weekly review	02/01/09	09/01/09	Points	%
Sensex	9,958.22	9,406.47	(551.75)	(5.54%)
Nifty	3,046.75	2,873.00	(173.75)	(5.70)

The New Year rally failed to last long and the key indices plunged by about 6% as the disclosure of the country's biggest accounting scandal at Satyam Computer sent shivers down the spine of investors and crushed the impact of a second stimulus package. In a dramatic turn of event, the markets went into tailspin and crashed by 749 points on Wednesday after India's fourth largest software exporter admitted to its accounting manipulations, raising concerns over corporate governance issues.

The gravity of the stunning development could be gauged by the fall in share price of Satyam, which hit an all-time low on the BSE as well as the NSE. This also led to Satyam's humble exit from the Sensex family as well as from the BSE IT Tech indices, BSE-100, BSE-200 and BSE-500. Satyam would be replaced by Sun Pharma in the Sensex and by Reliance Capital in Nifty from January 12.

2nd week of January '09 – Dalal Street continues downslide

Daily review	09/01/09	12/01/09	13/01/09	14/01/09	15/01/09	16/01/09
Sensex	9,406.47	(296.42)	(38.69)	299.13	(323.75)	276.85
Nifty	2,873.00	(99.90)	(28.15)	90.35	(98.60)	91.75

The Dalal Street continued it's downward for the second straight week. However the inflation numbers, which fell for the 10th successive week to 5.24% for the week ended January 3, supported the market to some extent. But market continued to move southwards, on fresh concerns over the corporate governance standards after Satyam Computer's shocking disclosures last week about its accounts manipulations.

Weekly review	09/01/09	16/01/09	Points	%
Sensex	9,406.47	9,323.59	(82.88)	(0.88%)
Nifty	2,873.00	2,828.45	(44.55)	(1.55%)

3rd week of January '09 – Sensex ends with a weak note

Daily review	16/01/09	19/01/09	20/01/09	21/01/09	22/01/09	24/01/09
Sensex	9,323.59	5.98	(229.02)	(321.38)	34.67	(139.49)
Nifty	2,828.45	17.75	(49.60)	(90.45)	7.65	(35.25)

The Indian capital market continued to remain under severe pressure throughout the week with indices falling by about 5 to 6%. Both domestic and global corporate quarterly earnings numbers impacted the market sentiments adversely. Also with the confidence in the banking systems, especially in the US and UK, having plummeted to an all-time low, due to fears of over exposure to bad loans, fresh panic has spread across the global financial markets. .

Weekly review	16/01/09	24/01/09	Points	%
Sensex	9,323.59	8,674.35	(649.24)	(6.96%)
Nifty	2,828.45	2,678.55	(149.90)	(5.30%)

On domestic front, there are strong expectations on reduction in petroleum product prices very soon which if happens could boost the market sentiments. Next week is a truncated week and also having an 'expiry' in F&O segment. Data suggests markets are in 'oversold' state now and could stage a 'come-back' with emergence of a 'value-buying' at lower levels. Any positive surprise of the RBI monetary policy scheduled on 27th January or any government measures may trigger 'short-covering' which may push indices higher. However, low 'volumes' are still the concern.

4th week of January '09 – **Sensex spurts 8.65%**

The sensex notched handsome gains on frantic short-covering ahead of expiry of derivatives contract on January 29. Large-scale buying by Domestic institutional Investors (DIIs) in the week also boosted the market sentiment. Indian capital market displayed strong buoyancy during the week. Also the sharp fuel price cut of 11% reducing petrol prices by Rs 5 per litre, Diesel prices by Rs 2 per litre and LPG prices by Rs 25 per cylinder boosted the market sentiments.

Daily review	24/01/09	26/01/09	27/01/09	28/01/09	29/01/09	30/01/09
Sensex	8,674.35	Republic	329.73	253.39	(21.19)	187.96
Nifty	2,678.55	Day	92.80	78.15	(25.55)	50.85

Weekly review	24/01/09	30/01/09	Points	%
Sensex	8,674.35	9,424.24	749.89	8.65%
Nifty	2,678.55	2,874.80	196.25	7.33%

However going ahead with the recent fuel and LPG price cuts being announced, inflationary levels are expected to cool off significantly over the next few weeks. With the earnings seasons getting over, the market have clearly discounted all the bad news factored in the stock prices and appear to be more resilient and one is likely to witness a ranged movements in the coming week with a positive bias.

Monthly Review

Month	Dec '07	March '08	June '08	Sept. '08	Dec. '08	Jan. '09
Date	28/12/07	31.03.08	30.06.08	30/09//08	31/12//08	30/01//09
Sensex	20,206.95	15,644.44	13,461.60	12,860.43	9,647.31	9,424.24
Points	Base	(4,562.51)	(2,182.84)	(701.17)	(3,213.12)	223.07
%	Base	**(22.58%)**	(**13.95**%)	**(5.21%)**	**(24.99%)**	**(2.31%)**

On Monday (27/10/2008), the sensex plunged to a 3-year low 7,697.39, intraday

Ride the Wave

Volatility is no longer being shunned by retail investors these days. In fact, a new breed of investors has emerged which likes to play with the market and ready to take risks. This is a far cry from the days when retail investors used to play safe and invest with a long-term horizon.

Analysts advise that you should strive to become an expert in at least one investing strategy. While you might miss some opportunities, you will gain confidence in your investing approach. Later, when you become an expert in this approach, you can always expand your knowledge base by adding a new approach that compliments your proven strategy.

Besides, you must at all times be willing to churn your portfolio and replace stocks that have lost flavour with stocks gaining momentum. It is again important for investors to back investment decisions with qualitative research. This will give you access to an unbiased view on companies. Also, in volatile markets, it is desirable to have a pre-defined entry and exit points, thus restricting your downside.

2.1 INDIAN ECONOMY

Are stimulus packages sufficient?

The central government has announced the second package of measures designed to revive the ailing economy. While the main component of the first package announced in early December was increased government expenditure in order to bolster aggregate demand, the second set of measures focuses on improving or facilitating the supply of credit.

These measures include liberalised overseas borrowing norms and the setting up of an alternative channel of finance for non-banking finance companies dealing exclusively with infrastructure financing. Of particular significance is the permission given to the public sector India Infrastructure Finance Company (IIFC) to borrow Rs 30,000 crore from the market by issuing tax-free bonds. Moreover, state governments whose tax collections have been adversely affected by the slowdown in the economy have also been allowed to borrow an additional 0.5% of their state gross domestic products from the market.

The government is hoping that these measures will result in additional credit supply of Rs 56,000 crore. It is not clear how the government has arrived at this figure.

Only time will tell: whether the two packages will be sufficient to reverse the slowdown in the Indian economy. Obviously, much is going to depend on what happens elsewhere in the global economy – in this era of globalisation, individual country initiatives can have only limited impact. Having said that, it is still interesting to speculate on the likely impacts of the two packages on the domestic economy.

Walking on two legs is always preferable to limping alone on one leg alone. So, it is good that the government has announced the twin packages which contain measures to increase government expenditure as well as cheap money policies designed to increase the availability of credit to domestic industry. However, there are good reasons to believe that increased government expenditure is a more powerful antidote to recession than policies designed to improve the delivery of credit. This is because increases in public expenditure are a very direct means of boosting aggregate demand.

There are two very distinct reasons why these policies may fail to be really effective in reversing the downtrend in the economy: **First,** despite reductions in the cost of borrowings, the private sector may still be reluctant to undertake new projects if it finds the overall economic environment very gloomy – any new investment may look too risky. **Second,** even if the lower cost of credit increases the demand for loans, suppliers of credit – namely the banks – may still be reluctant to provide credit. The banks are apprehensive that against the backdrop of the worsening economic outlook and falling house prices, loans to small businesses and house owners may soon turn out to be bad debts.

This seems to be an appropriate context for "thinking out of the box". That is, either the government or the Reserve Bank of India has to assure the banks that loans given to target groups and which satisfy "eligibility criteria" will be insured by the Reserve Bank i.e., the RBI will reimburse the banks in the event that the borrowers fail to pay back the loans. Of course, it is foolish to expect any such radical policy to be implemented in the near future.

One can ask instead why the government shied away from a much larger public expenditure programme – the measures announced in the first fiscal stimulus package totalled about Rs 31,000 crore, a tiny amount in comparison to the programme announced by China and several other countries. The only answer must be that the government is concerned about the size of the fiscal deficit. This must surely exceed the target set in the current budget. But, surely this is a time to forsake caution?

Growth forecasts

PM's EAC lowers 2008-09 growth forecast to 7.1%

Prime Minister Manmohan Sigh's economic advisory Council (EAC) lowered its growth forecast for the current fiscal year ending March 31, 2009 to 7.1% from its previous estimate of 7.7%. It said the fiscal deficit would balloon to 8% of gross domestic product (GDP) if subsidies are included. However the economy is likely to recover by the second half of 2009-10.

The economy is likely to remain relatively weak in the first quarter of 2009-10 and slowly pick up thereafter. It is expected to show fairly strong recovery in growth in the second half. Growth rate is projected between 7-7.5% or above in 2009-10.

The slowdown in the economy in 2008-09 has been triggered by high commodity prices in the first half of the fiscal and a deeper-than-expected recession in rich countries in the second half. While growth in the next fiscal would be fuelled by lower borrowing costs, tax cuts and higher government spending, the sharp fall in global commodity prices would help bring down fiscal deficit.

RBI cuts growth forecast to 7%

The Reserve Bank of India's economic growth forecast for 2008-09 began with an 8-8.5% projection in April 2008. But, in the third quarterly review of Monetary Policy 2008-09 it's now down to 7% as the subprime crisis worsens every quarter.

The RBI, in its quarterly review of monetary and credit policy has, however, said that even though India's financial system is sound and healthy, and exports constitute only 13.5% of GDP, it cannot escape the impact of the global crisis. RBI, however pointed out that once the global economy begins to recover India's fundamentals will ensue that it turnaround will be sharper and swifter than the rest of the world.

Economists believe that RBI has not cut rates despite lower growth and falling inflation as it awaits banks to pass on the benefits of its rate cut on January 9 2009. However, RBI has revised all its macro estimates, indicating in a way that the central bank is open to easing but is awaiting the response of the real economy to its recent measures and it is keeping some ammunition available for the next time.

2.2 INDIA INC

Merge and Emerge is the New Mantra

Year 2008 was a year that investment bankers would like to forget, but it also brought a light of hope for merger & acquisitions (M&As) in India. With corporate valuations witnessing a deep correction, the New Year could see many companies return to the negotiating table.

Dealmakers say we would see multinational firms with strong balance sheets acquiring Indian companies. The strategy would be to get a bigger presence in one of the few markets where they can hope to grow when the global economy is going through a bad patch.

At the same time, India Inc would use this market meltdown to acquire global technologies at lower cost for future expansion besides building a base in developed markets.

Further, the financially troubled firms internationally would be forced to liquidate assets and Indian business groups could figure among the buyers.

This has already started with Reliance ADA besides some other financially sound groups believed to be in the race to acquire the Asian insurance assets of AIG, the financial services major, which was bailed out by the US government last October.

However, these billion dollar deals will face the challenge of funding, but the small and mid size deals should see a lot of activity.

The trend towards more mid to high sized transactions become visible last year itself when the mega $5 billion + deals of 2007 (Tata Corus, Vodafone-Hutch and Hindalco-Novelis) were replaced by relatively smaller but equally impressive transactions.

Even as there were no $5 billion plus deals in 2008, the total number of billion dollar plus deals went up from 7 in 2007 to 9 last year.

Another area which can see a lot of merger and acquisition activity is distressed assets. With the global economic slowdown, the domestic industry would see consolidation in various sectors where the inefficiently managed players would be bought over.

Besides, the market meltdown has also created opportunities in various ‘special situation’ transactions such as promoters trying to reduce exposure in some sectors.

Given the correction in the stock market, promoters’ expectations looking to sell-out have also moderated which would allow merger and acquisition to go through.

The promoters have now come to realise the good old days of 2007 are gone. They are also looking at realistic valuations for their assets.

2.3 INDIANS

2009: The Year of India

As old merges into new, as past fuses into present raising hopes for the future, let us – collectively as Indians – strive to make this year – 2009 – the year of India. A year in which India would up and ante; a year in which India would demolish all boundaries; a year in which India would stay on the path of growth; a year in which India would be the beacon to the world. Let us all; on this new dawn of the New Year, work together to make 2009: The year of India.

A tumultuous year 2008 is finally over. The financial crisis has been contained, for the most part. But it has given way to deep concern about the global real economy, and corporate profits and bankruptcies. Despite the gloom, here is why we should look forward to 2009.

The unprecedented and unconventional measures taken by central banks together with the fiscal stimulus provided by several nations seem to have averted a catastrophe, and at some time in the second half of 2009 the global economy should begin to look up. Though, the individual incomes are unlikely to go up in the new-year for a vast majority. But then, because of declining inflation and an outright absolute drop in the prices of many goods, including consumer goods, existing incomes should count for more and that opens a host of opportunities, particularly for investments.

On nearly all valuation measures – price-earnings ratio, book value, to name a few – shares present once-in-a-lifetime buy opportunity. And for those who have been priced out of the real assets markets, housing for one, plunging prices should bring cheer. Falling interest rates should double the joy. Investments that looked unviable a few months ago suddenly look feasible.

Crisis and opportunity are actually alter egos; one is not far from other. So, don't be surprised or cynical when we say some aspects of the current economic slowdown are opportunities waiting to be utilised, not threats. Repositioning, overcoming weaknesses and prepping to resume growth are the way to go, so that when the world gets back to spinning the right way, you're ahead of the curve. So, here are nine things that you can be cheerful about in 2009.

1. **The goods come cheap**

India is likely to undergo a temporary period of deflation – a decline in general level of prices of goods and services, as opposed to a price rise. India's chief statistician Dr Pronab Sen said he anticipates inflation to slip into negative zone by March 09 due to lower commodity prices coupled with high base. This means that your grocery and fuel bills will reduce compared to last year.

2. **Blue chips at historic lows**

Then there is the Sensex that has nose-dived along with the Nifty, signalling a great opportunity to pick up frontline stocks at dirt-cheap valuations. Most stocks right now are quoting either near their 52-week lows or historic lows like heavyweight Tata Motors, ICICI Bank. In fact, analysts expect India's equity market to bottom out by March this year.

3. **Its raining discounts**

Next is discount-mania. Anxious retailers are dying to clear inventories and that means cheaper cars, branded clothes, appliances and more. Most leading high street brands such as FCUK, Mango, Adidas, Puma, and Reebok are running discounts of up to 50% and even luxury carmakers like BMW are giving sweeteners.

4. **My home affordable**

The real estate sector had been artificially bloated for the last few years. With the slowdown-induced correction, property rates have dropped, rentals have eased, and home loan rates have also softened. In fact, ICICI Bank's KV Kamath expects the home loan rates to drop below 5% by July. Yes, it is now possible to dream about home-sweet-home again.

5. **Your money is safe, growing**

The Indian financial system has remained relatively insulated from the mayhem in the West. This has meant that banks are safe havens for savings and investments. In a bid to attract investors, banks and companies are offering high rates of interest of up to 10.5% on fixed deposits.

6. **Best education, jobs**

Indian higher education is held in high regard around the world. It also remains one of the cheapest. Despite reports of pink slips in sectors such as IT/ITeS and real estate, others like pharmaceuticals and FMCG are still bullish on hiring. The Indian job market is still much better than in many other countries. There are jobs galore in sectors like education, healthcare, telecom, FMCG, and financial services. These opportunities are more in the non-metro and rural India and are attracting a lot of talent.

7. **The thrills come cheap**

Airfares, hotel rates and imported liquor have also come down. While airfares have seen a cut of over 60% on some routes, luxury hotel rates have also come down by more than 25%. This means that you can holiday at the best of destinations at fares that were unbelievable until sometime back… and yes, enjoy a good bottle of wine too.

8. **The fundamentals are in place**

India has always been one of the more self-reliant economies with two-third of its produce consumed domestically. This has saved us some of the harsher repercussions of the slowdown. Even the most conservative estimates peg India's growth at 7%, a good scenario considering the situation in the West where countries such as Germany and UK have declared recession.

9. **Land of the enterprising**

India is a land of enterprise. It has shown that more than 1/2 of the country's salaried professionals and a 1/3 of the engineering/management students want to become entrepreneurs. Brand guru Jagdeep Kapoor says: "During these times, one need to build brands, start a new venture, and use the journey of adventure to grow because consumption has not come down. Pricing may change. There is a level playing field right now with everybody being brought down to the ground. The opportunity cannot get bigger than this."

So, the economic slowdown can be a pep-up. It depends on how you see it. In India, not all, but a lot of fear of slowdown is in the mind. The country's economic profile is such that the slowdown impacts a small section of the populace. We need to be positive and spread the good word around.

President Barack Obama's inaugural address

My fellow citizens: I stand here today humbled by the task before us, grateful for the trust you have bestowed, mindful of the sacrifices borne by our ancestors.... 44-Americans have now taken the presidential oath. The words have been spoken during rising tides of prosperity and the still waters of peace. Yet, every so often the oath is taken amidst gathering clouds and raging storms. At these moments, America has carried on not simply because of the skill or vision of those in high office, but because we the people have remained faithful to the ideals of our forebears, and true to our founding documents. So it has been. So it must be with this generation of Americans.

That we are in the midst of crisis is now well understood. Our nation is at war, against a far-reaching network of violence and hatred. Our economy is badly weakened, a consequence of greed and irresponsibility on the part of some, but also our collective failure to make hard choices and prepare the nation for a new age. Homes have been lost; jobs shed; businesses shuttered. Our health care is too costly; our schools fail too many; and each day brings further evidence that the ways we use energy strengthen our adversaries and threaten our planet.

These are the indicators of crisis, subject to data and statistics. Less measurable but no less profound is a sapping of confidence across our land - a nagging fear that America's decline is inevitable, and that the next generation must lower its sights.

Today I say to you that the challenges we face are real. They are serious and they are many. They will not be met easily or in a short span of time. But know this, America - they will be met.

On this day, we gather because we have chosen hope over fear, unity of purpose over conflict and discord. On this day, we come to proclaim an end to the petty grievances and false promises, the recriminations and worn out dogmas, that for far too long have strangled our politics.

We remain a young nation, but in the words of Scripture, the time has come to set aside childish things. The time has come to reaffirm our enduring spirit; to choose our better history; to carry forward that precious gift, that noble idea, passed on from generation to generation: the God-given promise that all are equal, all are free and all deserve a chance to pursue their full measure of happiness.

In reaffirming the greatness of our nation, we understand that greatness is never a given. It must be earned. Our journey has never been one of shortcuts or settling for less. It has not been the path for the faint-hearted - for those who prefer leisure over work, or seek only the pleasures of riches and fame.

Rather, it has been the risk-takers, the doers, the makers of things - some celebrated but more often men and women obscure in their labor: who have carried us up the long, rugged path towards prosperity and freedom. For us, they packed up their few worldly possessions and travelled across oceans in search of a new life. For us, they toiled in sweatshops and settled the West; endured the lash of the whip and plowed the hard earth. For us, they fought and died, in places like Concord and Gettysburg; Normandy and Khe Sanh. Time and again these men and women struggled and sacrificed and worked till their hands were raw so that we might live a better life. They saw America as bigger than the sum of our individual ambitions, greater than all the differences of birth or wealth or faction.

This is the journey we continue today. We remain the most prosperous, powerful nation on Earth. Our workers are no less productive than when this crisis began. Our minds are no less inventive, our goods and services no less needed than they were last week or last month or last year. Our capacity remains undiminished.

But our time of standing pat, of protecting narrow interests and putting off unpleasant decisions - that time has surely passed. Starting today, we must pick ourselves up, dust ourselves off, and begin again the work of remaking America.

For everywhere we look, there is work to be done. The state of the economy calls for action, bold and swift, and we will act - not only to create new jobs, but to lay a new foundation for growth. We will build the roads and bridges, the electric grids and digital lines that feed our commerce and bind us together.

We will restore science to its rightful place, and wield technology's wonders to raise health care's quality and lower its cost. We will harness the sun and the winds and the soil to fuel our cars and run our factories. And we will transform our schools and colleges and universities to meet the demands of a new age. All this we can do. All this we will do.

Now, there are some who question the scale of our ambitions - who suggest that our system cannot tolerate too many big plans. Their memories are short. For they have forgotten what this country has already done; what free men and women can achieve when imagination is joined to common purpose, and necessity to courage. What the cynics fail to understand is that the ground has shifted beneath them - that the stale political arguments that have consumed us for so long no longer apply. The question we ask today is not whether our government is too big or too small, but whether it works - whether it helps families find jobs at a decent wage, care they can afford, a retirement that is dignified. Where the answer is yes, we intend to move forward. Where the answer is no, programs will end.

“Those of us who manage the public's dollars will be held to account - to spend wisely, reform bad habits, and do our business in the light of day - because only then can we restore the vital trust between a people and their government.”

Nor is the question before us whether the market is a force for good or ill. Its power to generate wealth and expand freedom is unmatched, but this crisis has reminded us that without a watchful eye, the market can spin out of control - *and that a nation cannot prosper long when it favours only the prosperous*. The success of our economy has always depended not just on the size of our gross domestic product, but on the reach of our prosperity; on our ability to extend opportunity to every willing heart - not out of charity, but because it is the surest route to our common good.

As for our common defense, we reject as false the choice between our safety and our ideals. …

Recall that earlier generations faced down fascism and communism not just with missiles and tanks, but with sturdy alliances and enduring convictions. They understood that our power alone cannot protect us, nor does it entitle us to do as we please. Instead, they knew that our power grows through its prudent use; our security emanates from the justness of our cause, the force of our example, the tempering qualities of humility and restraint.

We are the keepers of this legacy. Guided by these principles once more, we can meet those new threats that demand even greater effort - even greater cooperation and understanding between nations. We will begin to responsibly leave Iraq to its people, and forge a hard-earned peace in Afghanistan. With old friends and former foes, we will work tirelessly to lessen the nuclear threat, and roll back the specter of a warming planet. We will not apologise for our way of life, nor will we waver in its defense, and for those who seek to advance their aims by inducing terror and slaughtering innocents, we say to you now that our spirit is stronger and cannot be broken; you cannot outlast us, and we will defeat you.

For we know that our patchwork heritage is strength, not a weakness. We are a nation of Christians and Muslims, Jews and Hindus - and non-believers….

To the Muslim world, we seek a new way forward, based on mutual interest and mutual respect. To those leaders around the globe who seek to sow conflict, or blame their society's ills on the West — know that your people will judge you on what you can build, not what you destroy. To those who cling to power through corruption and deceit and the silencing of dissent, know that you are on the wrong side of history; but that we will extend a hand if you are willing to unclench your fist.

To the people of poor nations, we pledge to work alongside you to make your farms flourish and let clean waters flow; to nourish starved bodies and feed hungry minds.

And to those nations like ours that enjoy relative plenty, we say we can no longer afford indifference to the suffering outside our borders; nor can we consume the world's resources without regard to effect. For the world has changed, and we must change with it.

As we consider the road that unfolds before us, we remember with humble gratitude those brave Americans who, at this very hour, patrol far-off deserts and distant mountains….

For as much as government can do and must do, it is ultimately the faith and determination of the American people upon which this nation relies. It is the kindness to take in a stranger when the levees break, the selflessness of workers who would rather cut their hours than see a friend lose their job which sees us through our darkest hours. It is the fire-fighter’s courage to storm a stairway filled with smoke, but also a parent's willingness to nurture a child, that finally decides our fate.

Our challenges may be new. The instruments with which we meet them may be new. But those values upon which our success depends — hard work and honesty, courage and fair play, tolerance and curiosity, loyalty and patriotism — these things are old. These things are true. They have been the quiet force of progress throughout our history….

This is the price and the promise of citizenship. This is the source of our confidence — the knowledge that God calls on us to shape an uncertain destiny….

So let us mark this day with remembrance, of who we are and how far we have travelled. In the year of America's birth, in the coldest of months, a small band of patriots huddled by dying campfires on the shores of an icy river. The capital was abandoned. The enemy was advancing. The snow was stained with blood. At a moment when the outcome of our revolution was most in doubt, the father of our nation ordered these words be read to the people:

"Let it be told to the future world ... that in the depth of winter, when nothing but hope and virtue could survive...that the city and the country, alarmed at one common danger, came forth to meet (it)."

America, in the face of our common dangers, in this winter of our hardship, let us remember these timeless words. With hope and virtue, let us brave once more the icy currents, and endure what storms may come. Let it be said by our children's children that when we were tested we refused to let this journey end, that we did not turn back nor did we falter; and with eyes fixed on the horizon and God's grace upon us, we carried forth that great gift of freedom and delivered it safely to future generations.

Thank you. God bless you. And God bless the United States of America.

2.5 WARNING SIGNALS

Wipro and the World Bank

The players in this scandal are Wipro and the World Bank. Sadly while the guilty party is World Bank, punishment has been meted out to Wipro and its shareholders.

Some eight year ago, in 2000, Wipro carried out an initial public offering (IPO), of American Depository Shares in an effort to raise capital from the US market. As a part to that effort, it offered a small number of shares to its employees and clients at the IPO price through the Directed Share Program (DSP). The programme is commonly employed by companies to promote themselves to employees and clients and is approved by the Securities and Exchange Commission (SEC), the US equivalent to the SEBI.

Among the beneficiaries of the Wipro DSP were a few World Bank employees. In dealing with them, Wipro representatives had taken extra precautions by channeling the offers of shares through the chief information officer and a senior staff member. The latter directed the offers to the bank staff, their family members and friends. The Wipro representatives made sure that as per the SEC rules all buyers of the shares signed the conflict-of-interest statement declaring that they did not violate the ethics or conflict of interest policies of their employer.

Yet seven years later, in June 2007, the bank decided that Wipro had been guilty of violating its rules and banned it from direct contracts for four years. The ban remained under the wraps until January 11, 2009 when the bank decided to go public with it. That day, it issued a press statement, now posted on its website, listing Wipro, Satyam and Megasoft Consultants Ltd as companies banned from competing for direct bank contracts.

This episode raises two sets of concerns. First, while the bank insists on holding the developing countries to the highest standards of transparency, its own actions remain shrouded in mystery. To-date, it has offered no explanations of why it took seven long years to act against Wipro. Did the World Bank rules change in the interim, which it then applied retroactively? Or, did the bank realise one fine morning that it had failed to enforce the rules that had existed all along and then proceeded to enforce them with vengeance, turning Wipro into a sacrificial lamb? When and precisely what action did the bank take against its own staff members? Why the reluctance to reveal the timing and nature of actions and cause of departure of the offending employees? (These individuals are no longer employed by the bank group.)

Also disturbing is the fact that the bank waited to make its decision public until a major corporate scandal in the country broke out. Judging by the comments on various newspaper websites, the bank's press note has left the distinct impression that the Wipro leadership is cut from the same corrupt cloth as the outgoing Satyam leadership.

The second set of concerns relates to the injustice meted out to Wipro and its shareholders. Commonsense suggests it is impractical to require a company to study the internal rules of each company whose employees receive shares under DSP. The SEC requirement that the buyer sign the conflict of interest statement, which Wipro fulfilled, is the obvious safeguard against possible corruption. As such the guilt of Wipro remains unexplained. Even if we give the bank the benefit of doubt arguing that once the violation had occurred, regardless of who was guilty, it was bound by its rules to move against Wipro, its handling of the matter was grossly insensitive and unnecessarily detrimental to Wipro interests. The bank press note should have taken extra care to emphasise that Wipro had actually complied with the stipulated rules, that the responsibility for the violation rested squarely with its staff and that it was sorry that given its internal rules it was forced to subject Wipro to the ban.

3.1 CURRENCY MARKET

Euro turns 10, keeps promises

Ten years ago, Europe launched its grand experiment with a shared currency – and watched it plunge in value before recovering. But as the anniversary approaches of the January 1, 1999, arrival of the euro, economists say the new currency is finally fulfilling its promise as a way to lower borrowing costs, ease trade and tourism, boost growth and strengthen the European community.

And Euro is doing it amid a global financial crisis. After 10 years it has truly created a zone of security and stability. From all these points of view, the euro has in fact proven wrong the forecasts some made against the euro 10 years ago.

When it was launched for non-cash purposes in 1999, just 11 countries were on board – Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. Notes and coins were added on January 1, 2002, and the original 11 have been joined by Cyprus, Greece, Malta and Slovenia, with Slovakia slated to join on January1, bringing the total to 16. Now, some people in longtime holdouts such as Sweden and even strongly euro-skeptic Britain are beginning to reconsider the question.

Now, the euro is celebrating its tenth anniversary against the background of the most difficult climate since its birth. The financial storm that swept in front the United States, and the onset of a severe economic downturn, confronts Europe with unprecedented challenges. Faced with the biggest test in its history, the euro is far from steering into disaster, Milton Friedman predicted ten years ago. On the contrary, Europe's Economic and Monetary Union is proving a major asset in these tumultuous times.

Doubters should remember that the euro was itself born out of a crisis. The single currency was conceived as an answer to the upheavals of the post-war period-double-digit inflation, high unemployment, and speculative attacks on the pound, the lira and the French franc. It was the crisis of the European Monetary System that drove the euro's launch on January 1, 1999.

In ten short years, the euro revolutionised the global economic environment, rising to the status of the world's second currency and rivalling the dollar as a medium for international trade and finance. The EMU is now the world's largest market, and continue to grow. With Slovakia's entry on January 1, the euro spans 16 countries and 329 million citizens.

The benefits of a MU based on a stable macroeconomic framework and governed by an independent central bank are manifest: the euro area has enjoyed low inflation and low interest rates for much of the last decade, a boost in trade and investment, and rapid integration of financial markets. Moreover, 16 million jobs have been created over the last 10 years – a record more successful than even the US.

Today's financial turmoil and economic downturn are highlighting the EMU's advantages in several important ways. First, the euro has eliminated the possibility of exchange-rate turbulence and speculative currency attacks that more vulnerable economies could have expected in the current turmoil. As a stable and strong world currency, the euro is also limiting exchange-rate instability globally.

Second, the euro area benefits from an independent Central Bank whose swift actions to ease liquidity constraints and coordinate monetary policy have recently helped to avert a financial meltdown. Such rapid, coordinated steps by 16 national central banks would have been unthinkable.

Third, the EMU's stability-oriented macroeconomic framework has better prepared euro-area countries for economic storm. Thanks to the fiscal rules of the Stability and Growth Pact, the euro area achieved its soundest budgetary position in 2007, bringing deficits to their lowest levels in 25 years. This allowed many European Union countries to approach the crisis with room for manoeuvre.

Such are the EMU's benefits that the visible costs of remaining a non-member are beginning to recast the political debate surrounding euro adoption in several countries. Of course, the euro is no panacea, nor has it functioned perfectly over the last decade. Divergence between euro-area economies in terms of growth and inflation have been a persistent challenge. This is why it is even more important to continue to improve the EMU's functioning. In a potentially more volatile twenty-first century global economy, the euro-zone must reap the maximum benefits of economic integration in terms of growth and jobs.

The key to a better functioning EMU is closer surveillance and deeper coordination of economic policies. Leaders must start living up to the responsibilities that come with sharing a single currency. They must recognise the impact that national economic policies have on the euro area as a whole, and thus discuss and coordinate economic programmes at the euro-area level.

Here, the launch of the European Economic Recovery Plan – the initiative for an EU-wide fiscal stimulus equivalent to 1.5% of GDP, endorsed by the European heads of government in December – constitutes a major step forward. This must now be followed by closer budgetary monitoring. The Stability and Growth Pact must remain the cornerstone of the EU's budgetary framework, and effective surveillance and peer support will be vital to help member states work towards balanced budgets once the economy rebounds.

Deeper fiscal surveillance should be matched by broader economic surveillance, especially since current-account imbalances have become more acute during the crisis. The European Commission is now working on extending the focus of surveillance beyond fiscal policy so that we can identify risks stemming from macroeconomic imbalances or changes in competitiveness and address them before they become entrenched.

Finally, euro-area nations must strive harder to find common positions on international issues and to speak with a single voice in the global arena. This is the only way to promote and defend the EMU's economic interests in the world where the challenges are global and overcoming them will increasingly depend on multilateral cooperation.

Consider November's international summit on the financial crisis. Agreeing a common position ahead of the meeting gave Europe a greater role. When the euro area managers agree swiftly on a coordinated position, this can be instrumental to finding agreement in the EU as a whole and internationally. It is vital to build on this success and develop a genuine international strategy for the euro.

The European single currency has been a major success, but it remains a work in progress. A decade after the euro's introduction, all must follow the example of its founders and turn crisis into opportunity by uniting in a sprit of cooperation and ambition – and thereby reinforce the EMU's foundations.

3.2 CRUDE EFFECT

Oil slump: No room for complacency

With its predominant hold over transportation which has pervaded most economic activities in human life in one form or another, the bull run of crude oil during early 2008 affected all the importing nations. Some of the nations passed the burden of rising crude oil prices onto the stakeholders and most others passed it partially, bearing the burnt of it in their budget with the hope that the situation would reverse soon. Market analysts too were divided on their take on the direction of crude prices, and those who were of the belief that it would reverse, feared the domino effects it could create given the extensive participation of the economic stakeholders from developing nations in crude markets.

Thanks to the initial spark to the current financial crisis in the form of the subprime crisis which started earlier to the crude market reversal, the crude effect had become a subset of the whole crisis.

Interestingly, when the crude prices came down, much of the purchasing power had already been washed off due to the credit crisis and hence could not help build up demand sentiments. This resulted in building up of bearish sentiments in both the physical and derivative markets leading to the reversal of the increasing trend in crude prices with a fall that is steeper than its earlier rise.

Crude being one among the commodity asset class, its fall would have definitely provided relief to the policy makers of the largely import dependent emerging economies such as that of China and India. The moot point is that oil prices near $40 level can harm the overall oil economy more than it could benefit the importing countries. Remember, the increase in crude oil production to a large extent is dependent on increased investment incentivised by higher oil prices.

The current low prices had already taken a toll on the Federal Government of Nigeria, the world's seventh largest exporter of crude oil which had presented a deficit budget of Nigerian Niara 800 billion for its 2009 budget with a benchmark of $45 per barrel. A country that had already been riddled with high incidence of socio economic problems, lower government spending would further worsen the socio-economic situation in Nigeria. With worsening socio-economic situation it would not incentivise any interest abroad to bid for new fields that may be thrown open.

Another nation that is increasingly trying to reduce the dependence of its budget on oil revenues is Iran, with the current fall in oil prices, as part of its good governance. According to President Ahmadinejad, his government has cut dependence of the budget plan on oil revenues by 10%, i.e. from about 62% of the previous budget plan; the current budget plan has only envisaged 52% of the total revenues attributed to oil-related income. It would be interesting to watch its implications on government spending and efforts to develop other sources of revenue without pumping more oil from the existing reservoir at current prices. Obviously, for a not so open economy in terms of foreign investments such as Iran, it would only mean that there will not be supply augmentation beyond a point.

Amongst the top producers, Russia too if facing the peril of its gloomy oil and gas industry. To sustain production, Russia needs to overcome the 'Greenfield challenge', i.e. the need to develop remote and capital-intensive new oil and gas fields in an environment where newly created "national oil and gas champions" are too heavily leveraged with debts. According to estimates (2008-10), Gazprom, the Russian oil and gas major, faces a high probability of its cash flow moving in loss territory by 2009. As a result, now when many of Russia's Brownfield oil and gas potential are on the verge of expiring, the development of the Greenfield potential to compensate their losses is proving to be difficult as it requires increased capital investment.

4. FINANCIAL SECTOR: TRANSFORMING TOMORROW

Hang till death

If things start falling on you, does it mean that stuff is dropping faster than you are? Or that may be, you have hit bottom and things that have a built-in time delays are now floating down upon you.

It has become a truism to say we are now in unchartered territory. Nobody knows what to expect from a co-ordinated global slowdown because we've never seen one on this scale before.

1. FINANCIAL ADVISORS:

Weigh impact on investors

Financial crises

A recent working paper No 14656 of the US National Bureau of Economic Research "*The Aftermath of Financial Crisis"* examines the depth and duration of the slump that invariably follows severe financial crises. It looks at all the major post-war banking crises in the developed world (a total of 18) with special emphasis on the ones dubbed "the big five" (Spain 1977, Norway 1987, Finland 1991, Sweden 1991, and Japan 1992) and a number of famous emerging market episodes: the 1997-98 Asian crisis (Hong Kong, Indonesia, Korea, Malaysia, the Philippines, and Thailand); Colombia 19998; and Argentina 2001.

In a nutshell, it finds financial crises are protracted affairs. They have deep and lasting effects on asset prices, outputs and employment. But it eventually ends. More often than not, the aftermath of severe financial crises share three characteristics.

First, *asset market* collapses are **deep** and prolonged. *Real housing price* declines average 35% stretched out over **6** years, while *equity prices* collapses average 55% over a downturn of about **3½** years. Not surprisingly, equity price declines that accompany banking crises are far steeper than are housing price declines, if somewhat shorter lived. The average historic decline in equity prices is 55.9% with the downturn phase of the cycle lasting 3 - 4 years.

Second, the aftermath of banking crises is associated with profound declines in *output* and *employment*. The unemployment rate rises an average of 7% over the down phase of the cycle, which lasts on average over **4** years. Output falls (from peak to trough) an average of over 9%, although the duration of the downturn, averaging roughly **2** years, is considerably shorter than for unemployment. The good news for emerging markets, particularly those in Asia, is that when it comes to banking crisis, they seem to do better in terms of unemployment than do advanced economies.

Third, *the real value of government debt* tends to explode, rising an average of 86% in the major post-world war II episodes. Interestingly, it finds the main cause of debt explosions is not the widely cited costs of bailing out and recapitalising the banking system. Rather the big driver of debt increases are the inevitable collapse in tax revenues that government suffer in the wake of deep and prolonged output contractions, as well as often ambitious countercyclical fiscal policies aimed at mitigating the downturn.

There's bad news in store for emerging markets. For the post-world war II period, the paper finds the declines in real GDP are smaller for advanced economies than for emerging market economies. A probable explanation is the latter are more prone to abrupt reversals in the availability of foreign credit. When foreign capital comes to a 'sudden stop', economic activity heads into a tailspin, with serious consequences as the Indian experience has shown.

But, how relevant are historical benchmarks for assessing the trajectory of the current global financial crisis? It is argued the authorities today have more flexible monetary policy frameworks, thanks to a less rigid global exchange rate regime. But the authors suggest it would be wise to not think we are smarter than our predecessors. Besides, to the extent these historical comparisons were based on episodes that, with the exception of the Great Depression in the US, were individual or regional in nature, the global nature of the present crisis makes it far more difficult for many countries to grow their way out through higher exports. Or to smooth consumption effects through foreign borrowing. In such circumstances, the recent lull in sovereign defaults is likely to come to an end with defaults in emerging market economies rising sharply because many countries are simultaneously experiencing domestic banking crises.

Bailout packages

The government has prepared an unwritten rule that it won't bailout a private company in a competitive market place with the sole exception of banks. Several aviation, real estate and infrastructure companies have sought government bailout in the last few months, but it was shot down by the Prime Minister Manmohan Singh. Bailouts in the case of banks are not uncommon but the circumstances are very different. These are regulated institutions, which take deposits from the public. There is some presumption on the part of the public that the regulator has ensured the adherence of procedure. All these factors justify government interventions. History also demonstrates conclusively that a modern economy cannot grow if its financial system is not operating effectively. So it sounds obvious for three reasons –

First, banks allow people to pay each other easily – without them commerce will be severely impeded. Second, along with the wider financial system, they act as vital intermediaries following credit to flow from savers to borrowers with viable ventures. The third reason is potentially the shakiest – by their nature of lending for long periods but borrowing short, banks rely on confidence for their existence; fear or disruption in one part of the financial system can spread like a virus and bring it crashing down.

Their crucial role underpinning economies means the authorities are loath to let them fail. The big lessons of Lehman Brothers' catastrophic demise, and the huge disruption it caused to markets in the months that followed, was that no leading economy could afford to let another bank of significant size fail. No other industry has the potential to spread its woes to the rest of the economy like this. So, the crude reality is that, regardless of who was to blame for the mess, there has been no alternative but to offer the taxpayer support for the banks until the crisis is over.

But for all the importance of the financial system and banks, it is difficult to attribute the deepening recession in all leading countries to a sudden drop in credit availability after the banking crisis of September and October '2008. That happened later.

The evidence suggests that the strained economic conditions shattered confidence and caused a sudden reduction in demand worldwide. So the companies began retrenching and scaling back investment plans. Companies' sales and profitability have dropped, and the proportion of corporate defaults has risen. As the banks' fears over the weakness of their balance sheets, they have naturally become ever more conservative in their lending, with their corporate customers suffering the consequences. The authorities an all advanced economies are determined to break the downward spiral. In all countries, monetary policy has been loosened to encourage confidence and risk-taking in the real economy.

Outsourcing

President Barack Obama's views on 'outsourcing', articulated in the run up to the US presidential elections, is a real cause of concern for the $60-billion Indian IT and ITES industry, which has grown rapidly on US orders, in the last over a decade. Obama had spelt out his views against outsourcing and is opposed to companies shipping jobs overseas.

However, one hopes pragmatism will replace the rhetoric, now that he is the US President and that he will see the mutually beneficial, 'win-win' strategic advantages of outsourcing.

A closer look at outsourcing will, in fact, reveal that the game now is not just irreversible, but any adverse action against it will be mutually harmful.

First of all, outsourcing in IT and ITES industries is no different from the larger trend of outsourced 'contract manufacturing' in the manufacturing sector and hence it should not be looked with disdain. In the past, US lost jobs in textiles and garments, shoe and toy making, and in other low-stuff industries, first to Japan, then to South Korea and later to China and other low-cost countries.

Even in computer hardware, Intel ceded the low-cost advantage in chip making to companies in South Korea and Taiwan. Dell and IBM did the same in desktop computers and laptops.

Today, the ground reality is that US no longer has the capability and infrastructure to manufacture such low-cost products. The trend is the same in the IT and ITES sector and it is not an exaggeration to say that US has no (ready built) infrastructure left to enter and compete in low-end IT products and services.

Indian IT industry may have grown exponentially, but mostly the work 'outsourced' is what some people calls as 'coolies' jobs. It is only recently that Indian giants, such as TCS, Infosys and Wipro are offering some competition to US biggies IBM and HP in the services contracts. But, volumes and values fetched so far are negligible.

Secondly, US companies have hugely benefited by outsourcing in general and in R&D activities in particular. Some higher-end jobs outsourced to India have created high value products at low costs and the US companies have been able to sell those products globally, and obtain higher returns. In fact, money spent in India in such activities may ultimately be recovered from sale of such products here.

Thirdly, Indian IT companies have themselves been huge consumers of hardware products from the US companies. Generally, US-based IBM, HP and Sun Microsystems have been in the race to sell hardware in India. Networking companies like Cisco have also been selling hardware for the fixed phones, the wireless and for the internet. Thus while Indian software coders write codes for US companies, US companies find readymade market for 'Made in US' hardware stuff.

Fourthly, Indian IT and ITES companies are also huge consumers of 'Made in US' software. Not only the hardware giants, such as IBM, HP, Sun and Cisco sell their software services, others like Microsoft now have a huge market share in all types of industrial and consumer software.

Fifthly, the outsourcing has created indirect markets for US companies, as the overall computer literacy has risen by larger penetration of computers and computer softwares.

For example, by adopting-governance, the government sector has created a huge market for hardware and software. Markets have expended for products related to security, data-warehousing, etc. Thus benefits to the US companies by way of demand for computer in India may far exceed the presumed loss of a few thousand jobs in US.

Sixthly, it should not be presumed that if the US companies were forced to do their work locally under some legal or other compulsion, the software coders' jobs would go to US citizens only. Sooner or later, companies will find a way out to work circumvent those compulsions. It is also likely that those jobs may go to the immigrants – Indians, Chinese or others. Benefits to US citizens may thus be only marginal.

Taken as a whole, outsourcing has also created indirect benefits to the non-IT US companies. For example, prosperity of those working in the IT sector has created a non-rich 'Yankee' class among the Indian youth, who have fast adopted to the American way of life and culture and created a demand for 'Made in US' branded goods, such as cars, shoes, clothes, drinks etc. Since Asian brands are few only, imports of branded consumer goods mostly from the US or EU has been rising.

Outsourcing, therefore, does not seem to have hurt the real or perceived interests of the US citizens and so there is no cause for special protection for jobs in the IT industry within the US. It is only hoped that US policy makers will not turn the clock backward and rather promote the globally networked world.

That being so, however, Indian IT industry cannot sit back and relax. Hence, the industry must evolve a Plan B, to deal with future uncertainties. Indian IT industry had in the past successfully weathered the slowdown in 2000-01, when the internet-led world came crashing down. This time, it will be the second major challenge for the Indian IT industry to evolve suitable strategies not only to deal with the slowdown but also to come out on top when the markets recover later.

Here are some suggestions:

Since pundits expect the recessionary trend to last at least a year or two, orders for the Indian IT companies are bound to dry up. Hence, it will be a strategic advantage, if Indian companies use their cash pile for investing in major R&D work and retain their best talents for inventing new products that may rule the markets when the recession is over.

Secondly, IT industry, which has so far remained focused on exports, must now diversify to cater to the domestic market by inventing products and services at a low cost. Industry may have to compromise on the bottom line, but they must not bother about their share prices which may go down, in the short run, if profits plummet.

The third major strategic step would be to enter markets of other third world countries with low-cost products and services developed at home to cater to the local demand in those countries.

In nutshell, bad times call for adopting flexible and innovative strategies and saving the customers in a better manner, so that when the markets recover, Indian IT companies develop better competencies, products, services and the skill-sets necessary to service the future markets.

FIIs Exposure

The bull-run in Indian bourses in the past was driven by foreign institutional investors (FIIs), the fall in stock prices now likewise has largely been because of them too. As the sensex tumbled from one low to another in 2008, the FIIs slowly reduced their exposure in Indian stocks.

For instance -

- The share of FIIs holding in the total equity of Reliance Industries has gone down by 3.2 percentage points from 18.72% at the end of 2007 to 15.52% at the end of 2008.
- The FIIs holding in Tata Motors and Tata Steel have declined from 17.48% and 20.55% as on December 31, 2007 to 9.18% and 12.98% as on December 31, 2008, respectively.
- The FIIs holding in Bharti Airtel has gone down by 3.27 percentage points and
- The FII holding in Hindalco Industries has declined by 3.48 percentage points during the period.

Maybe the continuous fall in stock prices since the middle of 2008 had unnerved the FIIs and they chose to reduce their exposure to avoid bigger loss at a later period. Indeed, as things have turned out, they probably were right as the deceleration in stock prices has continued through the beginning of 2009 also.

What is interesting, however, is that while FIIs have reduced their stake, Indian promoters have increased their holdings. The fear of takeover apart, the fall in scrip prices must have given them a chance to increase their holdings in their own companies at a lower cost.

For instance -

- Tata have raised their holdings in Tata Motors by a huge 8.36 percentage points from 33.42% at the end of 2007 to 41.78% at the end of 2008. Much of this in the promoter's holding has come at the expense of FIIs and the mutual funds. The share of FIIs in the total equity of Tata Motors has gone down sharply in 2008. and
- Aditya Birla Group has increased its stake in Hindalco Industries from 31.42% to 36.06% in 2008; while holdings of FIIs have declined from 13.84% at the end of 2007 to 10.36% at the end of 2008.

Like FIIs, the mutual funds too had reduced their exposure following unchecked slide in stock prices. Mutual funds' holdings in Reliance Industries, Tata Motors, Hindalco Industries and Reliance Communications have gone down sharply during the period.

But what must be surprising is that while the FIIs, mutual funds, banks and domestic financial institutions have reduced their holding, individual investors have increased their stake. This may be due to sharp fall in prices of blue chip scrips. Individual investors took the chance to buy shares of these companies at prices which even six months ago did not look possible.

Whether their move were right, however only time would tell.

Failed bank's executives

They've have been bailed out, but not kicked out. The same people at the top are still there, the same people who made the decisions causing a lot of our financial crisis. Less fortunate are more than 100,000 bank employees laid off during a two year stretch when industry unemployment nearly tripled, bank stocks plummeted and credit dried up.

The trouble with the bailout is that nobody in government ever stopped to figure out who caused the avalanche and who simply got buried. Under the government's no-string-attached bailout plan, taxpayers must take it on faith that bank executives will make better decisions this time around. But when you deal with the same dogs, you're going to end up with the same fleas.

Now, a new administration is taking shape in the US. One of its first tasks will be to find ways of tackling the economic slowdown and ensuring the long-term survival of its financial system. Some of the steps taken so far by the current administration, represented by treasury secretary Henry Paulson, have come in for criticism for providing a lifeline to unrepentant and spendthrift financial institutions. So, what will the new administration do that's going to be drastically different?

For one, do not expect anything radical too soon. The US systems works in curious ways, but cuts across party lines when it comes to confronting national crisis. Therefore, the Obama government is sure to continue with the work of implementing and monitoring Paulson's rescue multi-billion package.

But do not for a moment think that the Wall Street villains of this world have been forgotten. Once the new administration feels the time for crisis management is over, it will go after the people it thinks are responsible for the current meltdown – the guys who sold the mortgages to families that clearly did not have the capacity to repay, banks which then created virtual pyramids out of these simple loans, rating agencies that put their seal of approval on these instruments, and CEOs who lulled shareholders into a false sense of comfort by repeatedly lying to them about their banks' falling health & impending demise.

There will be tremendous political pressure to go after the Wall Street villains because of two over-riding reasons. One, the popular vote seems to have communicated that it does not view the Republican Party's close links with the financial buccaneers too kindly. And, two, it does not like being weighed down by the uncomfortable burden of having to bail out their derring-do. Plus, there is an uncomfortable vision of many CEOs drawing safely with multi-million-dollar bonuses while Middle America hunkers down for an extended period of unemployment and lost wages.

The compelling imagery of once-powerful CEOs in handcuffs (a la Enron, Boesky, et al) is all too potent and depicts in a single, two-dimensional frame of the robustness of the American judicial system. This kind of action will not only be expected but demanded from the Obama administration.

Here is the most unsettling image: Lehman CEO Richard Fuld picked up a $22-million bonus in March 2008 even as the firm was struggling to stay afloat and would eventually go bankrupt six months later. There are some other CEOs who could be in the firing line too. Merrill Lynch CEO John Thain, who merged his bank with Bank of America, received a $15-million cash bonus on joining the bank in November 2007. Goldman Sachs showed $20.2 billion as payroll costs in 2007! Some CEOs read the writing early enough to forsake their bonus – Bear Stearns CEO James Cayne gave up his months before the firm was absorbed by JP Morgan Chase.

6. WEALTH MANAGERS
Map out the details to translate into benefits

Momentum drive approach of investment

The real dilemma today is how to protect wealth from erosion and make it grow at least to beat inflation. The volatility has been unnerving and is not restricted to equities; even bonds have seen swings never experienced before. Real estate which witnessed a price spiral in the last 3-years is also a major victim of the market slump. Also, compression of time for market moves means shorter window of opportunities to react. Risk aversion & risk premium is at its peak and investments flows have evaporated.

So does the turmoil in the markets mean that investors remain passive and wait for the troubled times to pass? Inaction may not be best solution for one's portfolio. As adages go, "Invest when there is blood on the street, sell when there is greed, buy when there is panic." These words of wisdom which have stood the test of time suggest well through-out action even in chaotic times.

Investors would do well to adopt a portfolio approach where asset allocation is balanced to provide the right measure of safety, liquidity and return. It is also important that the portfolio mix suits the temperament of the investors so that long term investment strategies remain fairly undisturbed and unaffected by likely emotional and impulsive investor action in trying times.

Leading global economies are rather stagnating or have slumped into an excruciating recession. In the scenario of global bloom, India and China stand out as oases in a desert. These two large economies are expected to continue to register healthy growth. The Chinese economy will get relief from the large government spending (pump priming) which will help sustain the economic activity levels. China boasts of a massive fiscal surplus which it can spend on keeping the growth engine running.

India, on the other hand, does not have the luxury of either a fiscal or a trade surplus. It, however, has the advantage of large domestic demand driving its GDP. It has the advantage of a young population, abundance of skilled human resource and excellent entrepreneurship, advantages well documented and recognised by global investment gurus. It is less leveraged to global economy compared to any other economy in the peer group of emerging markets. This will help to underpin economic growth at 6-7% levels in the current slowdown and propel to double digit growth when order is resorted. The substantial easing of liquidity and cut in interest rates are efforts by the government to restore business confidence and spur growth. Given that India will be among the first to bounce back, global capital flows are also expected to come back to India once stability returns to the battered world economy.

In a scenario of excessive risk aversion, there seem to be no buyer despite valuations of even good quality Indian stocks having crashed to unrealistic levels. This is a rare opportunity to build a high quality portfolio. The key is to take measured, calculated risk backed by incisive research.

In the current junction, high quality bonds are also a good investment option in India. There has been a rush to invest in government securities, driven by the extreme risk aversion of investors. This has resulted in a sharp decline in the yields of these instruments. On the other hand, bonds of some of the blue chip corporations – many of them owned by the government – continue to rule at high yields. This is a pocket of opportunity to make superior returns by taking measured risk. So what is the way to leverage this opportunity? First and foremost, we need to protect wealth from erosion so that we live to fight another day. This means a strict no-no to momentum driven approach and get back to basics,

Pledged shares

For long, promoters had managed to get away by not making disclosures about the shares had pledged with lenders. The recent Sebi ruling that promoters will have to make public the details of their shares pledged with lenders. These disclosure requirements are as per the primary market advisory committee's recommendations. The disclosures will have to be made in two ways. One is event-based – as and when the shares are pledged by the promoters, and the other one is periodic, i.e., at the time of quarterly results. For the event-based disclosure of pledged shares there will be certain limit, and those will be notified when changes are made in regulations. As far as periodic disclosure is concerned, there will be no limit.

Sebi has shown alacrity in plugging the many regulatory loopholes that have been exposed following the financial turmoil and Satyam episode. However, capital raising procedures need to be improved upon and their implementation speeded up. The regulator has moved quickly to impose disclosures on shares pledged by promoters to raise funds, but it should have gone a step ahead and also brought key company management executives under the rule.

In the US, after much debate, the SEC had imposed disclosure of shares pledged as collaterals by executive officers, directors and director nominees and also on those shareholders whose pledges could result in a change in control. The argument against company executive/directors disclosing such collateralised borrowing was that it was a personal issue that had no bearing on the company. Besides, this was a good way of meeting short-term cash needs, as many executives are generally reluctant to sell shares in their own companies for fear it may be read as a bearish sign by the market. But the SEC imposed the disclosure on executives and directors as it felt that pledged shares may be subject to 'material risks or contingencies', which could influence management's performance and decisions.

Vijay Mallya's shares used as collateral: Over 44% stake in the world' third-largest liquor marketer United Spirits Ltd, including most of the UB Group chairman Vijay Mallya's stake in the company, has been pledged to lenders for raising a Rs 6,900-crore loan for past acquisitions as well as corporate guarantees for funding Kingfisher Airlines. The lenders include IDFC, IL&FS, Citigroup, IFCI and ICICI Bank. All these institutions have decades-long association with various UB Group companies, which have used share pledging extensively to grow their businesses over the years.

Mr Mallya's said: "My shares in the company are provided as collaterals or top-up securities and the lenders will look at it only if the company and Mr Mallya are unable to meet obligations. Even speculation must have some logic. I have not raised a single rupee in cash by pledging the shares. The loans are all backed by robust assets. Further. 17.2% USL shares are the primary security creation for the company's acquisition of Shaw Wallace & co and Whyte & Mackay. These shares are not pledged at any specific stock value but on certain financial covenants – meaning USL's performance guarantees – with the lenders. Hence, it will not trigger margin call pressure in a falling market.

Sebi unveils norms for pledging of shares: In a circular dated January 28, Sebi said the promoters, who have pledged shares, have to disclose the details to the company within seven days of such transaction. Further, the market regulator said that companies should disclose all the details pertaining to the promoters' share pledge, if at the end of any quarter, the total number of such pledged shares exceeds 25,000 or one percentage of the total shareholding, whichever is lower.

8. TECH SAVVY PROFESSIONALS

Take first step to ensure efficient and reliable system

Accounting frauds

Almost seven years ago, when the Enron scandal unfolded, Vinod Dhall, who was the secretary of the department of company affairs – as it was known then – was quoted as saying that several Enrons were waiting to explode in India. You could well say that Mr Dhall was being upfront about the common belief that the accounts were being manipulated by many local firms. In February 2002, when some of the big accounting firms were shamed in the US, a section of the government did move a proposal to possibly prevent accounting frauds of the sort that rocked the US.

That was the time when the ministry of finance passed on a note to the department of company affairs – now christened the ministry of corporate affairs – suggesting the creation of an independent regulator to exercise oversight over auditors. Perhaps, the move might have been inspired then by the developments in the US, where after the Sarbanes –Oxley Act, the Public Company Oversight Board came into existence. The rationale offered then for an independent body to oversee audits of public firms was to ensure that audit statements were not opaque.

That holds good even now. And the case for such a regulator is far stronger now, considering that unlike last time – when the trigger for the proposed change was an accounting scandal overseas – it is events at home this time around.

The Public Company Oversight Board by its structure is a private sector non-profit organisation, which oversees audits of public firms. It aims to protect the interests of investors and to promote public interest in the preparation of informative, fair and independent audit reports. Five members on the board are appointed by the US securities regulator – the SEC.

The Board has outlined its strategic plan for five years, starting from 2008 to 2013 and listed out its goals – strengthening effectiveness and coordination of audit oversight efforts not just in the home country but also abroad and promoting investor confidence in audited financial statements of public firms through an effective use of a supervisory model. The Board says it wants to strive to reduce the risk of auditing failures in the US and promote public interest. There are far more ambitious things that the oversight body hopes to do such as anticipating risks and responding swiftly to emerging issues.

All this is to not overstate the case for a regulatory model designed in a country where several flaws have emerged. Rather, use this opportunity to clean up the system and a problem, which is publicly acknowledged only when an accounting scandal of this magnitude is unveiled.

It is not just the old proposal from the finance ministry that the government needs to dip into if it is keen on systemic changes. The Raghuram Rajan committee was also sensitive to this. Its report did talk of the absence of any mechanism for regulatory review of corporate accounting statements for compliance with disclosure norms. It did strike the committee that there was no system of reviewing accounting reports even on a selective basis when the SEC has a division devoted to it. The Public Company Oversight Board also reviews portions of audit using its own staffers who are experienced professionals.

The Rajan committee recommended that the process of review was absolutely essential making a case for a selective review and for penal action against offenders in case of financial frauds. So it is clear that there is no mechanism to review audit in India. Government needs to show firm resolve to correct the systemic flaws that lie beneath accounting frauds that are now being unfolded.

Threats to bloc's unity

Despite promises to tackle recession together, EU governments are scrambling each in their own corner to come up with new measures to revive their economies, threatening the bloc's unity. Since the start of the year 2009, Germany has launched a new economic recovery plan, Britain unveiled a fresh rescue package for its banking sector and a number of countries are putting together plans to help their carmakers.

The hodge-podge of various measures contrasts with the spirit of unity that led EU leaders as recently as December 2008 to agree on a euro 200 billion stimulus plan to snap the European economy out recession.

Although most of the package is made up of national measures, leaders made much of the fact that Europe's efforts to beat recession would be closely coordinated in order to reduce waste and avoid distortions to markets. However, the new wave of government actions since then has left some worried that EU states risk causing more harm than good by failing to coordinate.

EU Economic and Monetary Affairs Commissioner Joaquin Almunia said: "I think we should improve the way we monitor the implementation of the recovery plan and the financial packages for the support of the financial sector. Based on this monitoring, it will be useful to increase the coordination, because all these kinds of programmes and schemes can create distortions in the level playing field.

For instance, Britain announced earlier in January 2009 an insurance scheme to relieve banks of the impact from the toxic assets ravaging their balance sheets. Belgium meanwhile is considering a so-called good-bank bad-bank scenario where lenders' toxic assets would be hived off and put into separate state-owned institutions, relieving banks' balance sheets. Germany too is considering a range of measures for its banks, but has so far ruled out creating a bad bank. Almunia warned that before rushing to set up bad banks, European governments must first agree on what assets would qualify for such schemes and what prices should be paid for them. We need to have this discussion before going into the discussion about the possibility of these institutions. But while some governments are moving fast to prop up their banks, some people consider a second wave of rescue to be unnecessary, adding to the cacophony. Meanwhile, Luxembourg's Premier and finance minister Jean-Claude Juncker, who heads the group of eurozone finance ministers said: "I don't see the need for a second set of big, huge massive bank plans. It goes without saying that any new initiative will be examined in detail in the Eurogroup."

Another instance is that after Europe saw the weakest new car sales in 15 years in 2008, governments including France, Germany, Portugal, Spain and Sweden are mulling measures for the auto industry, one of the biggest employers on the continent. Measures under consideration range from incentives for scrapping old cars to encourage purchase of new vehicles through tax breaks and public procurement initiatives and outright state investments in carmaking. Amid the smorgasbord of ideas, EU Industry Commissioner Guenter Verheugen has ruled out a further relaxation in state aid rules to allow governments to prop up their struggling car industries, warning against a "race of subsidies."

On the economic front, government also taking up different approaches with London cutting value added tax to boost consumption, Berlin mulling big infrastructure investment and Paris looking into aiding companies. Each country is tempted to act according to its national specificity. So there is an urgent need for more coordination on economic stimulus plans.

Compartmentalised economics

How did something that looks increasingly like the precursor of a slowdown or slump creped up on almost all of us last year? It is a good question. But it is an embarrassing one, too. Perhaps this was more than could reasonably be expected. But we need to ask ourselves whether we could have done a better job of understanding the processes at work. The difficulty was that we all tend to look at just one bit of the clichéd elephant in the room. Look at it -

- Monetary economists looked at monetary policy;
- Financial economists looked at risk management;
- International macro-economists looked at global imbalances;
- Central bankers focused on inflation;
- Regulators looked at Basel capital ratios and then only inside the banking system;
- Politicians enjoyed the good times and did not ask too many questions;
- Commentators tended to indulge in the fantasy that they never knew what they were talking about.

One big lesson is that economics is too Compartmentalised and so, too, are official institutions.

To get a full sense of the risks, we needed to combine the worst scenarios of each set of expects. Only then would we have had some sense of how the global imbalances, inflation targeting, the impact of asset price bubbles, financial innovation deregulation and risk management systems might interact.

At the root of the crisis is the huge increase in leverage in recent years – at the level of banks, asset managers and consumers, embedded within products.

We have long known that once leverage reaches certain levels, the system can be vulnerable to shocks that cause a catastrophic loss of confidence. Once this point is reached, the result is panic and a dash for cash, creating the self-feeding vortex of reduced asset prices.

Historically most financial crises have during their course destroyed 15-25% of a year's national income of the affected states. We risk this happening today on a global level, given the joined-up nature of the financial system in the liberalised and informational technology enabled world.

So, what should individual states do to prevent a recurrence? First, they should ensure the architecture exists both to help limit the build-up of leverage and to minimise the damage if instability ensues; and Second, create an effective range of policy tools to mitigate the build-up and its impact.

Global crisis

We all want President Obama to succeed in reviving the economy, but that shouldn't obscure his long odds. We need to recognise that we're grappling with three separate crises that, though interwoven, are also quite distinct. The solution to any one of them won't automatically resuscitate the larger economy if the others remain untreated and unchanged. Here are the three.

First crisis: the collapse of consumer spending. American consumers represent 70% of the economy. Traumatised by plunging home values and stock prices – which have shaved at least $7 trillion from personal wealth – they've curved spending and increased savings. That's led directly to layoffs. In December 2008, vehicle sales were down 36% from year-earlier levels.

Second: the financial crisis. Lower lending deprives the economy of the credit to finance businesses, homes and costly consumer purchases (cars, appliances). The deepest cuts involve 'securitisation' – the sale of bonds. Investors have gone on strike. In 2008, the issuance of bonds backing credit card loans fell 41% and those backing car loans 51%.

Third: a trade crisis. Global spending and saving patterns are badly askew. High-saving Asian countries have relied on export-led growth that, in turn, has required American consumers to spend ever-larger shares of their income. Huge trade imbalances have resulted: US deficit, Asian surpluses. As Americans cut spending, this pattern is no longer sustainable. Asia is tumbling into recession.

Overcoming any of these crises alone would be daunting. Together, they're the economic equivalent of a combined Ironman triathlon and Tour de France.

A temporary stimulus can't fuel a permanent recovery. That requires a strong financial system to supply an expanding economy's credit needs. How we get that isn't clear. The pillars of a successful financial system have crumbed: the ability to assess risk; adequate capital to absorb losses; and trust among banks, investors and traders. Underlying these ills has been the consistent underestimation of losses. Economists at Goldman Sachs now believe that worldwide losses on mortgages, bonds, loans to consumers and businesses total $2.1 trillion. In March 2008, the Goldman estimate was about half that.

All the new credit programme – The Treasury's Troubled Asset Relief Program (TARP) and various Federal Reserve lending facilities together with new House $825 billion package – aim to counteract problems by providing government money and government guarantees. Probably Obama will expand these efforts, despite some obvious problems. Let's assume Obama's policies succeed. Credit flows rise. Even then, we have no assurance of a vigorous recovery, because the economic crisis is ultimately global in scope. The old trading patterns simply won't work anymore. If China and other Asian nations try to export their way out of trouble, they're likely to be disappointed. Any import surge into the US would weaken an incipient American recovery and probably trigger a protectionist reaction.

Down that path lies tit-for-tat economic nationalism that might harm everyone. Indeed, if the rest of the world doesn't buy more from America, any US recovery may be feeble. What's needed are policies that correct the imbalances in spending and saving. As Americans save more of their incomes, Asians should save less and spend more, so that they rely more on producing for themselves rather than exporting to US. But this sort of transformation requires basic political changes in Asia. The success of Obama's policies lies, to a large extent, outside his hands.

Recession

Governments across the globe are using Keynesian stimuli to revive dropping economies. Even George Bush has presided over the greatest stimuli in US history, with a projected fiscal deficit of $1.2 trillion and monetary injection of almost $2 trillion by the Fed.

But is the recession Keynesian? Trillion of dollars of stimuli have failed to end the downswing. Keynesians argue that even trillions are not enough. Really?

The current recession looks more Hayekian than Keynesian. A Keynesian recession represents a sudden fall in demand and can be remedied within six months by pumping enough purchasing power into the economy. A Hayekian recession, however, is caused by misallocation of resources over a long period, driven by unrealistic interest rates, ending in a bust that requires years of structural adjustment. Such a recession can last a decade (as in Japan in the 1990s)

The many recession between World War II and oil shock of 1973 proved amenable to Keynesian remedies. But 1973-80 witnessed a Hayekian recession, caused by excess pumping of money into economies in an attempt to stimulate them. Rising trade union demands meant that the stimuli translated into higher wages and inflation, not higher production. After this era of stagflation economists could hardly utterly the word Keynesian' without a snigger – it had become a joke.

However, the recession of 1991 and 2001 were mild affairs remediable by Keynesian stimuli. Keynes was back in fashion. So, when the subprime mortgage crisis hit the US in 2007, it responded with Keynesian nostrums. But to no avail. Politicians want to be seen as quick and effective. They love Keynesianism, which puts them in the driver's seat, allowing them to portray recession as caused by greedy business villains, and paint themselves as rescuers.

But Hayekian recessions occur when politicians themselves distort the economy for years creating misallocations of resources that ultimately prove unsustainable. The consequent bust cannot be ended by pumping in more money. Rather, the entire economic structure must change to correct the historical misallocations, and make future growth sustainable. This involves wrenching changes in individual, corporate and political behaviour. Neither the public nor politicians are quick to acknowledge a Hayekian recession. They would rather hope it is Keynesian, remediable by pumping in more money. Yet at some point somebody will surely declare that Emperor Keynes has no clothes.

The current recession is deeply structural. For a decade, the US has run the biggest trade deficit in history, matched by corresponding trade surpluses of China, Opec, and other Asian countries. After the financial crisis of 1997-99, many Asian countries swore to build large forex reserves to avoid another decade. So they deliberately undervalued their exchange rates, ran large current account surpluses, and so generated large forex reserves. This had to be mirrored in corresponding large current account deficits in some other countries. The biggest turned out to be the US.

This defined conventional economic logic. Normally, rich countries run trade surpluses, and send their excess savings to poor countries with scarce capital that are running trade deficits. This normality was turned on its head by Asian countries determined to build large forex reserves after the trauma of 1997-99. These forex reserves went mainly into US gilt.

Suddenly the world was flooded with money. The US trade deficit sent a flood of dollars into Asia and Opec, which then flooded back into US financial markets, mainly through forex reserves. Bernanke called this the Asian savings glut. The flood of dollars drove down long-term interest rates, especially in the US, and drove up asset prices. It became highly profitable for Americans to borrow cheaply to invest in houses, stocks and commodities. Even when the Fed raised short-term interest rates in 2006, long-term rates remained low because of the flood of money from Asia. Innovations in the US financial system, some productive and some mere con-games, encouraged leverage by everybody – individuals, corporations, banks, speculators. This was classical Hayekian misallocation.

This misallocation yielded mouth-watering short-term gains. It provided a huge stimulus for the global economy, which grew at its fastest rate in history in 2003-08. Record US trade deficits sucked in record imports of manufacturers from Asia and oil from Opec. Asia in turn bought record quantities of commodities from Africa and Latin America to be converted into manufacturers for export. Thus the whole world economy boomed as never before, and so did asset prices.

Yet the boom was patently unsustainable. American households, who historically saved 6% of disposable income, started saving nothing at all, and dipped into their wealth to spend as never before. Today, this seems terribly irresponsible. Yet the boom had hugely increased the wealth of Americans, and it was logical for them to spend part of this wealth. The spending spree was subsidised by artificially low interest rates, which also generated bubbles in the markets for houses, stocks and commodities.

These bubbles have now burst. A Keynesian stimulus amounts to an attempt to re-inflate those bubbles. That is neither practical nor wise. The US government in 2008 mailed $80 billion to households to stimulate spending, but households spent only $12 billion of that and saved the rest – they knew, even if politicians did not, that the old spending spree had to stop.

The world – and India – must accept that the global boom of 2003-08 was based on an ‘unsustainable economic structure. In future Americans will have to save much more (and export more), and Asians will have to consume much more (and export much less) to end existing global imbalances. This Hayekian adjustment, which started in 2007, may take years to complete.

So, the global – and Indian – economy may not revive in mid-2009. Even if it does, the recovery may be so weak as to count for little. Hayekian theory suggests that we may have to wait till 2010 or 2011 for a sustained economic bounce. One ray of hope: the current recession may be partly Keynesian even if mainly Hayekian. That may diminish its travails.

5. BANKING SECTOR

It's time to set up a good bank

The global banking system is not working. We still aren't getting any credit for our daily business needs. Frankly, nobody seems to have, as yet, the foggiest idea how to solve this recession. Each global leader is blaming each other. The latest round of 'revival' tactics and debates at the highest levels in Washington, London or Davos, is still circling around the same roadblock. The original problem hasn't been solved, before everyone moves on to fixing the damage it did.

The discussion, in Washington, London or Davos, has veered around to setting up a 'bad' bank. That is, the governments will take all the rubbish off bank balance sheets and dump it into some kind of financial nuclear waste disposal facility, scarily similar to Mr Paulson's original intent.

- *Post-Lehman, the US treasury wanted taxpayer's money to buy up all the toxic junk derivatives that were bringing banks down.*

- *Mr Brown, in the UK, with help from some senior City bankers, decided to hit the nationalisation route, and recapitalised banks, and gave guarantees to lending. The Americans switched to the same route. The Europeans followed suit. Okay, that didn't work. Banks still refused to lend, not before repairing their fractured balance sheets.*

- *Central bankers crashed interest rates, controlled inflation. In India they eased capital adequacy norms. In Japan, in China, they tried every trick in their book. It still didn't work.*

- *So US (and everyone else) announced economic stimulus packages directly injecting money into the economy. It is not known whether Mr Obama would swing it, but the ones every other government threw out didn't work.*

- *Thereafter, UK came up with yet another bank bailout, this time a much more complex one, almost rivalling a CDO in its complexity. It's eerily similar to the original US proposal – the government takes on the responsibility of large parts of bank's toxic assets, but that's not working either.*

Right now, the hopes of the world are pinned on, well, almost a prayer. One, China will turn around and buy up half the world debt, with all that excess money they used to have. Next, Mr Obama's economic stimulation package will deliver, because everyone has now agreed that if the US economy recovers, all will be sunny again. But we wouldn't bet on these odds. Not yet anyway.

But there's just one glimmer of an idea from Davos, from the great George Soros himself. That instead of a 'bad' bank, governments should set up a 'good' bank. Use all the capital we're doling out to existing banks to set up a clean, non-toxic fresh entity, which can be owned by the government and lend to industry and individuals. The current crop of infected banks can then take their own sweet time to recover or not, without dragging the rest of the world into the ICU.

Now that is the first sensible thing, we've heard in a while. In some remote past, before ICICI turned into this shoot from the hip rodeo banker, it used to be something called the Industrial Credit and Investment Corporation of India. Those of us with long-enough enough memories remember the concept of the development financial institutions in the bad old days of a closed economy and astronomical interest rates. They were set up to stimulate and provide credit to industry. Maybe the west has completely forgotten, or never needed these kinds of institutions before. May be it's time to bring them back.

A good bank might ease the nightmare scenario that most countries in the west now face. In some ways, it's pretty much the argument that's increasingly coming from the real economy.

6.1 TAX UPDATES

Tax sword on cross-border M&A

SC turns down Vodafone plea against I-T notice: The Supreme Court on 23rd January 2009 (Friday) refused to entertain a special leave petition of Vodafone International BV challenging the show cause notice of the income tax department demanding tax on its $11-billion acquisition of Hutchison Essar. The apex court also asked the assessing authority of the I-T department to decide if they had jurisdiction to tax the transaction carried outside the country. The ball is now in the court of income-tax authority. It will look into all the relevant material to arrive at the conclusion.

The I-T department had issued a show cause notice to Vodafone International Holdings BV under section 201(1) of the Income-Tax Act, 1961, asking it to show cause as to why it should not be treated as an assessee in default for failure to deduct tax on payment made in respect of transfer of securities relating to Vodafone Essar. Vodafone filed a writ petition in the Bombay High court on January 28, 2008, challenging the show cause notice. Vodafone moved the Supreme Court after the Bombay High Court dismissed its petition challenging the I-T notice on its takeover of Hutch Essar.

I-T officials said jurisdiction was the key to taxability in any transaction. The department's special counsel and former director general (international taxation) GC Srivastava said: "Issue of jurisdiction relates to chargeability of income to tax." Vodafone will now have to convince the assessing officer that Indian tax authorities did not have jurisdiction to tax its $11.2-billion purchase of 67% stake in Hutchison Essar in February 2007. The assessing officer, in his order, can now ask the company to pay $1.7 billion as tax besides penalty (of equal amount) and interest, which could take the total tax outgo to over $4 billion.

"It's only a show cause notice," said a Bench comprising Justice SB Sinha and MK Sharma when Vodafone's counsel and noted senior advocate Fali S Nariman stood up to argue the case. The Bench, headed by Justice SB Sinha, declined to hear the Vodafone plea that had challenged the Bombay High Court judgement. The high court had on December 3, 2008, dismissed a petition by Vodafone International Holding BV, contesting a show cause notice by the income-tax department.

Commenting on the SC's decision, a press statement issued by Vodafone said: "Given that petition filed by Vodafone involves important question of jurisdiction, the Supreme Court has asked the tax authorities to decide, as a preliminary issue only, whether it has jurisdiction to proceed against Vodafone (and no other issue). Should Vodafone be aggrieved by the order of the tax authorities' preliminary adjudication on jurisdiction, Vodafone has been permitted to again directly approach the high court."

Although the SC ruling has given I-T department a right to send notices demanding tax on such deals, the court did not decide on the taxability of acquisition of India's telecom major Hutch Essar by Vodafone. It merely asked Vodafone to go back to the I-T department to settle the question at the administration level before taking legal recourse. Taxation on such deals is at various stages of litigation across different parts of the country. In the light of the latest SC ruling, these companies cannot challenge the right of Indian tax authorities to investigate their transactions.

The clear message of the apex court's verdict is that tax authorities of a country have the right to claim tax on the profit made in that country irrespective of whether parties involved in the transaction are resident or non-resident. The SC decision read with the amendment of Section 201 of the I-T Act which has been incorporated in the budget '08 clearly tilts the balance in favour of the I-T department. The amendment made effective retrospectively, from 2002, empowers the department to claim tax from the buyer of the shares if the seller has not paid the tax. Most of the major cross-border deals were concluded during this period. The SC decision makes it incumbent on non-resident companies to deal with the Indian I-T department on the merits of their case, like other resident companies in India.

Conflict of Interest

As the skeletons of financial statements come tumbling out of Satyam's cupboard and the list of the discredited grows, three, in particular, stand out: **auditors** and, to a lesser extent (since they depend on auditors for a veracity of financial statements), **independent directors** and **rating agencies**.

On the face of it, they have nothing in common other than the fact that all three are expected to protect the interests of investors. But look a little closer and there is something else they share in common i.e., conflict of interest in the discharge of their duties.

Under Company Law, shareholders have the right to appoint auditors. In practice, their appointment and remuneration is decided by the company management, more specifically the finance director and audit committee. Similarly, in theory, independent directors are appointed by shareholders. In practice, appointments are done by the management and are then rubber-stamped by shareholders. It's no different when it comes to rating agencies. They are also appointed by the management.

All the three entities are, therefore, beholden to the management. The problem is auditors are expected to point out inconsistencies, inaccuracies in the books of account, independent directors are expected to pose uncomfortable questions at board meets and rating agencies are expected to give an honest and professional opinion on the credit worthiness of the company. This results in a conflict of interest.

An auditor who refuses to fall in line and insists on seeing documentary proof – as in the case of Satyam's non-existent bank balance where simply calling for the bank statement would have given lie to the management's claim – risks not being re-appointed. A pesky independent director who shows his independence by questioning board decisions runs the same risk as does a rating agency that refuses to give a rosy rating.

Over the years as accounting scandals laid bare and shaky foundations on which much of the modern finance rested, numerous efforts have been made to tackle this problem. But, all these measures went some way to address the problem of perverse incentives. But none of them address the fundamental conflict of interest. As Omkar Goswami, an independent director on the board of Infosys, points out, "Non-executive directors are usually invited to join the board by the promoters or management, often due to prior friendships. Thus, many of them feel they are de facto appointed by the management – and need to be more agreeable to management proposals than to be trustees of the shareholders."

Besides, there is also the question of remuneration. While companies cannot get high caliber directors unless they pay commensurately, too high a remuneration package risks compromising the independence of independent directors. Especially if, as is often the case, a part of the remuneration is linked to the company's profits in which case the interests of independent directors is aligned with that of the company management rather than of shareholders whose interests they are supposed to present.

This is not to say all audit reports or independent directors or rating agencies are compromised as a result of this conflict of interest. But it is one thing to depend on the 'goodness' of individual players. However, we need to find a systemic solution to the problem rather than depend on the integrity of individual audit companies/independent directors and rating agencies. Clearly much more thought needs to be given to finding a solution. Ideally, the appointment of investor watchdogs should not be entrusted to company managements but left to an independent agency whose interests are aligned to shareholder interests. Else it is only a matter of time before the next Enron, WorldCom, Parmalat or Satyam bursts on the scene.

7. IS INFLATION THE RIGHT BATTLE

Inflation Retreats; Now address Growth

Over the last five months inflation has fallen from a near 13% level to less than half the level and economists of all hues have a rare consensus view that it moderate further to near 2% levels over the next few months. In tandem with this, market interest rates have also collapsed with the 10-year gilt quoting at a yield of under 6%, a steep fall from the 9.5% level obtaining five months ago. The Reserve Bank of India has pumped in liquidity in excess of Rs 200,000 crore into the system during this period and signaled a soft interest rate regime leading to banks beginning to trim interest rates. The economic stimulus initiatives announced by the government covering indirect tax cuts, increased social sector spending and making credit available to infrastructure creation, commercial vehicles, housing and exports are expected to soften the impact of the economic slowdown.

It is useful to analyse the potential impact of the recent monetary and fiscal measures. Soft interest rates and increased liquidity need to be seen as only two of the several factors that can influence investment or the willingness to borrow. For a potential house buyer, in addition to the confidence that he will continue to be gainfully employed over the next couple of decades or more, the price-rent-EMI (equated monthly instalments) equation needs to be in his favour to enable him to decide on the purchase.

A commercial vehicle operator would look to expand his business based on an assessment of the interplay between factors like freight rates, maintenance costs, traffic potential and vehicle acquisition costs in addition to financing costs and the level of depreciation allowance for tax purposes.

Similarly, for a corporate contemplating new capacity creation, in addition to low enough interest rates, what is critical is the confidence on optimum capacity utilisation once the capacity is in place.

And, for a commercial bank, in addition to lower deposit costs, what is critical is the ability to lend at rates that adequately price the risks relating to the economic environment and the capacity of the borrower to service the loan.

In short, a low enough interest rate environment can hardly force entrepreneurs or house buyer to borrow or for banks to lend unless there is enough confidence in favourable economic outcomes in the future.

The inability of the system to quickly translate abundant liquidity to increase bank lending at money market related interest rates to all sectors of the economy can therefore be seen to be caused by a rational assessment of the bleak prospects of most businesses in a slowing economy. In addition, a network effect is at play wherein the working capital cycle is influenced by the flow of credit to all the parties involved, whether the vendor, the manufacturer, the service provider or the customer. If the financing needs of one or more in this chain are unmet owing to credit or solvency-related concerns, the working capital cycle comes to a grinding halt resulting in potential losses to other credit providers.

Monetary policy measures typically work in long cycles subject to the financial transmission remaining efficient. As long as banks remain fundamentally sound, lower funding costs would eventually lead to credit creation and rise in investment that should ultimately result in accelerated economic growth. The return of business confidence can facilitate this transmission mechanism but pending this, given the seriousness of the current impasse, it may be necessary for the authorities to go beyond providing liquidity by way of refinance and even interest subventions and consider some form of credit enhancement or risk sharing. Otherwise, it is fair to expect that the magnitude of the global meltdown in 2008 and its transmission into India through the channels of trade and investment would leave behind a longer trail of corporate defaults than we have witnessed thus far.

Inflation dips to 5.24% on cheaper food items

A sharp drop in prices of primary articles including food items caused inflation to drop at a faster rate to 5.24% for the week ended January 3 from 5.9% in the week before that. The sharpest decline in the last couple of months has taken the wholesale price index (WPI)-based inflation to a near 12-month low. There has been a fall of 767 basis points in inflation in a span of 5 months from peak 12.9% in the week ended August 2, 2008 to the current rate.

If the government cuts the retail prices of petrol and diesel, the annual rate of inflation could drop at even faster rate. The price index for fuel products is already below the level last year, implying that there was a deflation in this product category. Some even expect deflation to set in for a while. D K Joshi, Principal Economist at CRISIL says, “If inflation keeps on falling at the current pace, I am expecting a deflation for a brief period in July and August due to the high base effect”.

Food prices harden inflation to 5.6%

The hardening of food prices on back of the recent truckers’ strike brought a halt to the 10-week downward trend in inflation. Wholesale prices for the week ended January 10 inflated by 5.6%. In the corresponding week last year prices inflated by 4.36%.

Economists say this is a temporary blip and expect the rate of inflation to fall to near-zero in a couple of months. Dismissing the spike as expected, rating agency Crisil principal economist DK Joshi said, “We were expecting a spike in WPI by up to 50 basis points in the week as the truckers’ strike made food items costlier. This is a blip, and in the medium term, I am expecting the fall in inflation to gather momentum with the promised fuel prices cuts taking place”.

Inflation up at 5.64% on costlier food items

Government data showed inflation for the week ended January 17 at 5.64% against 5.6% in the week before that. The annual rate of year-on-year inflation was 4.45% in the corresponding week last year. Economists expect inflation to resume its declining trend from the next week with the upward spikes in prices of food articles triggered by truckers’ strike easing off.

The cut in the retail prices of petrol, diesel and LPG would cause a further sharp drop in wholesale price index-based inflation in subsequent weeks. The central government has cut the price of petrol by Rs 5, diesel by Rs 2 and LPG by Rs 25 per 14.2 kg cylinders with effect from Wednesday (28/01/09) night.

Pronab Sen, country’s chief statistician has pointed out that India will witness deflation for a short period beginning with March due to slowing economy and higher base effect. But, the RBI in its latest monetary policy has pointed out the fall in inflation will not lead to a recessionary scenario.

8. MISCELLANEOUS UPDATES

Profits in 2009

We made money. We lost money. Are we likely to make money again? That's the question 2009 needs to answer. But remember that life is about more than finance. We still need to feed, clothe and house ourselves, keep the kids entertained, and go to work. So demand for the basic necessities of modern life will increase steadily: Ditto for commodities that go into them. Current low prices are scaring off vital investment in new capacities. That means supply will start feeling the squeeze fairly soon.

Gold will be more precious. Demand for jewellery may drop. But gold will again be everyone's favourite shelter. Central banks planning to sell off their gold last year are changing their minds. Coupled with delays in new supply from mines, gold will zoom. But don't bet on platinum just yet though it is now cheaper than gold. European diesel cars (with platinum catalysts) use up a third of global production. Unless the European rev up car purchases, or mines cut output, demand for platinum will be subdued.

M&A will be frequent and fruitful. Those days of overvalued assets and capricious promoters are over. The value of every asset – from land to physical stocks – has corrected sharply. Companies are also under pressure to sell assets for paying dues. The presence of so many sellers will change the mood. Multinationals, with deeper pockets, will pick up assets in Indian grains, edible oils, sugar, coffee and freight. Consolidation is like weeding. 2009 will have great deals on offer.

Imports will be more profitable than exports. I say this for three reasons. One, Indian demand is still buoyant. So the opportunities remain. Two, governments overseas are tightening trade rules to give local industry a chance. That makes it more difficult for Indian exporters to get a fair chance. Three with drop in domestic demand, developed nations are keen to subsidise exports.

Money will return to physical stocks. After 18 months of chasing paper, we will see more fundamentals-driven momentum in 2009. That's great because it means giving the nut and bolts of demand-supply the centerstage they deserve. But don't expect hedge funds to vanish completely. They may be chastened, with fewer and wiser customers, and face more red tape. But they will still be around, waiting for a good chance to invest in commodities.

Ships are currently standing empty at ports. But they won't spend entire 2009 like that. Once exporters in USA and Latin America start getting credit and contracts; trade will resume. Grains, ores, fuel and vegetable oil will continue to move across the globe. That will pull back freight and fuel rates.

Our biggest trump card is that India is young. And the young are naturally resilient and optimistic. They can go to hell in a bucket and still believe they are princes of the universe. Today, one out of every two Indians is below 25 years, making us the world's youngest population. That means we are just starting out in life, with energy, courage and ability to take a few hard knocks. The average young Indian is not burdened with a lifetime of debts, imminent old age and misplaced expectations. He tends to take the economy as he finds it. This attitude is a marvelous gloom-buster.

In 2009, profits will still be abundant. They will just need more careful sifting. Gold, agriculture and food will make money. Companies that don't lose their heads or their nerve, and communicate effectively will stay ahead in the game.

Ultimately, 2009 will be about delivering genuine value. My parents' generation always wanted to be able to "taste the difference" before paying a premium. Multiply that kind of sceptical, cost-conscious attitude to shopping into millions and you have the new 2009 consumer. Have a great year!

9.1 LIFE INSURANCE

Jeevan Aastha

Amidst the turmoil in the financial markets, Life Insurance Corporation's policy Jeevan Aastha is breaking all records in premium collections. During the one-month window when it was open for sale, the policy has been lapped up by celebrities and middle-class investors alike. Sources said that the applicants to the policy reads like a celebrity list. A sportsperson is understood to have put in Rs 35 crore, a leading film actor has invested Rs 8 crore, and a little known business family has invested Rs 50 crore. Insiders say that there Rs 1-crore plus policies have come in the thousands. For high net worth individuals the tax free earnings were a major attraction while for the middle class there was the additional benefit of tax saving under section 80CCC.

Is the phenomenal response to the Life Insurance Corporation's Jeevan Aastha scheme (that closed on 21st January 2009, Wednesday) a tribute to the life insurance behemoth's cleverness in structuring a winning product? Or else – collections are estimated to cross Rs 9,000 crore – more a reflection of some smart, and not-so-transparent, selling by LIC? The answer is a bit of both. But much of the success of the scheme is because LIC was less-than-fully transparent about the benefits.

We always argue the need for greater financial literacy on the part of investors (and greater transparency on the part of players). *Prima facie*, Jeevan Aastha is a single premium assurance plan with guaranteed benefits on death or maturity. In an environment where banks have reduced interest rates on fixed deposits, it seemed to offer the best of both worlds – a higher (tax free) return than FDs and insurance cover as well. Not surprisingly, it met with a huge response, though a careful calculation shows returns are likely to be much less – in the range of 6.75% to 7.25% per annum in most cases! Smaller investors who were not all that savvy in reading the fine print were missold the policy promising returns of 10%.

Jeevan Aastha is more of a bond and less of an insurance policy. Although the sum insured is five times the premium in the first year, the cover amount declines to two times in the second year. Even so it is doubtful many investors, even those who are fairly clued-in, would have been able to pierce the veil behind LIC's complicated 'benefit illustration'. For instance, insurance proceeds are normally tax-free. But if the premium payable on any insurance plan exceeds 20% of the sum assured, the proceeds become fully taxable. In the case of Jeevan Aastha, the single premium is often likely to be more than 20% of the maturity proceeds rendering the maturity amount taxable. However, LIC chose not to disclose this.

Jeevan Aastha was a combination of clever structuring, planning and timing. Understanding the preference for guaranteed returns, LIC structured a product by first buying huge quantities of bonds when AAA companies were borrowing at 11 – 12%. The Corporation then obtained permission from the IRDA for a guaranteed return product where subscriptions would be open for only one month. Although permission was received earlier the scheme launch was delayed to time it closer to the third quarter and see rates come down, ultimately it was the sheer distribution strength. The policy has helped to bring LIC's flagging marketshare back on track and has enabled offices in metro achieve their premium targets.

For lakhs of investors who poured over Rs 9000 crore into Jeevan Aastha, the decision was driven by guaranteed returns and tax breaks. But, it is a little known fact that wherever LIC guarantees returns it also generates higher returns because of tax breaks on assured return policies. The tax structure applicable to LIC ensures that for a policy with non-guaranteed returns, the sum assured is a liability and any earning from the premium in excess of the sum assured is a surplus and taxed accordingly. In the guaranteed return policy, the guaranteed returns are a part of the sum assured and therefore a liability. Unless the earnings are in excess of the guaranteed return there is no tax liability. For LIC guaranteed return policies are more tax efficient than traditional policies.

9.2 KNOWLEDGE RESOURCE

Gujarati's passion for access, business & success

When Vasco Da Gama started from Kenya; a sailor come onboard his vessel. The navigator guided him to a distant land, rich in spices and herbs. The land was India and the sailor Kano Malan, a Gujarati. It was thus in 1498, that a Guajarati brought a foreigner to Indian shores for business.

After exploring business potential of ancient human colonies in Sumer, Babylon, Assyria and Egypt for centuries through its 84 ports, Gujarat has now thrown its gates wide open for investors. Although, the number of ports is now 42, Gujarat has persisted with port-led development, which has now become its growth driver. The state has also banked on its well developed infrastructure, untapped human resources to become India's premiere industrial state.

A Reserve Bank of India's report, 'Corporate Investment: Growth in 2006-07 and prospects for 2007-08', ranked Gujarat first with the proposed investment of Rs 73,200 crore in 86 projects accounting for 25.8% of total investments in India. Gujarat was followed by Andhra, Maharashtra and Tamil Nadu. At present Gujarat contributes approximately 16% of the national industrial output. Industries such as gems and jewellery, textiles, chemicals and petrochemicals, oil and gas, minerals and mining, biotechnology and Pharmaceuticals have been flourishing in this region.

A recent KPMG-TiE survey lists Gujarat as a state where Indian entrepreneurs, would prefer to launch their entrepreneurial ventures. Many appreciated Gujarat practice of cluster land development, where targeted clusters of land were developed and equipped with dedicated infrastructure such as all-weather access roads, dedicated power and water supply (prior to land allocation). With a per capita income higher than the national average and the highest growth target of 11.2% for the 11^{th} Five Year Plan, the state of Gujarat is aiming high. Perhaps, it is only a state in the country where entrepreneurship and risk-taking ability are respected more than a high-paying job, Gujarat certainly has the right mindset and social conditioning required to nurture entrepreneurship.

Chief Minister: From being vilified as the most-hated politician post-Godhra, to being eulogized as a PM-in-the-making, Gujarat CM Narendra Modi has indeed come a long way. At the fourth edition of the Vibrant Gujarat Global Investors' Summit (VGGIS) 2009 near Ahmadabad's Science City on January 12, 2009, corporate India, shedding its usual silence, went to the extent of putting the 'prime ministerial class' stamp on him. India Inc, keeping aside all recession worries, committed Rs 7.48 lakh crore investments in Gujarat by its own admission, on the first day of the biennial VGGIS.

India Inc heavyweights, Tata Group chairman Ratan Tata, RIL chairman Mukesh Ambani, CII president KV Kamath, Aditya Birla group chairman Kumarmangalam Birla, L&T chairman and MD AM Naik, Essar Group chairman Shashi Ruia, Adani Group chairman Gautam Adani, Videocon Industries MD RN Dhoot, ONGC director A K Balyan, SBI chairman O P Bhatt, HCC chairman and MD Ajit Gulabchand, IL&FS chairman Ravi Parthasarthy, Deccan Airways chairman Capt Gopinath, Welspun group MD BK Goenka, BN Kalyani, CMD of Bharat Forge, all together representing 91 listed companies and more than 25% of the total market cap of Indian stock markets were present on the dais.

ADAG chairman Anil Ambani, while addressing the valedictory session of the meet on Tuesday, was effusive in his praise of Mr Modi's leadership. "Narendrabhai has done well for Gujarat and what will happen if he leads the nation." Person like him should be the next leader of the country. He asserted that Mr Modi's achievements in leading Gujarat to an industrial state had made him "a proud Indian and a proud Gujarati." He added that the way Mr Modi had transformed Gujarat, he could change the complexion of the country as and when he takes over its reins.

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