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EVOLUTION

Safe Update- Keep Informed
The Securities Academy and Faculty of e-education
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1. NO LOOKING DOWN ANYMORE

Promise of improvement

There is a curious thing going on. After the cataclysm of the quarter ending December 2008 and the year 2008 in general and after no significant disaster has befallen in 2009; there is a competition on about painting the current Indian situation bleak and in hauling down expectations for 2009-10. There is also a rush to stress how these views emanate from *quantitative models* as opposed to *judgmental opinions*.

Remember if sophisticated *quantitative techniques* were all that it took to make for sound judgment, then the highly complex *mathematical* stuff that was woven into all those collateralised debt obligations, credit default swaps and other dishes of consummate delicacy served at the high table of high finance would not have left the world economy in such disarray and the US, UK and Eurozone central bankers and governments up to their necks in debt and guarantees. The events of the past years have made people realise afresh that *quantitative techniques* are a great tool when wielded by human beings with good judgment, some decency, humility and common sense – but dangerous otherwise.

Over the past 3-months things have stabilised. There is, of course, the electoral uncertainty, but in terms of economic conditions, the coming fiscal holds out the promise of improvement.

In the real world, things had got unimaginably bad in the last three months of 2008 – orders cancelled, trucks with goods sent back, big losses on stock valuation and no money to pay wages etc. From there, we have come a long way over the past three months. Things have stabilised, even if conditions are still thorny. But in terms of economic conditions, it is the promise of improvement, not deterioration that the coming fiscal year holds out. If the system is able to unfreeze the credit markets more, it will be better; if not there will be a cost in terms of lost opportunity.

The infrastructure sector is showing early signs of revival with six industries – crude oil, refinery products, coal, power, cement and finished steel – expanding by 2.2% in February from 1.4% in the previous month. Steel sector bucked the trend and recorded a higher growth rate than the last financial year. It grew by 3.6% against 2.3% in February last year.

The steel industry has bounced back to the growth path with major steel producers such as Steel Authority of India (Sail), Tata Steel, JWS and Essar operating at full capacity after a lull of almost five months. Some Steel makers had cut production by up to 40% in October '08 in the wake of a steep fall in domestic demand. They were sitting on huge inventories because of slowdown in off-take. As a result they tried to correct demand-supply mismatch by cutting production. Now steel companies have been able to do away with inventories, and steel production is back to normal.

India's largest steelmaker Sail expects January-March 2009 quarter to be better than October-December 2008 quarter. Sail Chairman S K Roongra said, "We clocked 9-10% growth in sales in February '09 and expect similar growth in March '09 as well. Demand of steel is coming mainly from rural construction, infrastructure and auto sector. The firm's annual steel capacity is close to 16 million tonne and is operating at 110% of the capacity to meet the rising demand.

India's top government officials expressed confidence that the economy is showing early signs of a revival. Cabinet secretary KM Chandrasekhar said at the annual session of CII, "We are beginning to see some signs of revival in sectors such as cement, steel, capital goods, passenger cars and trucks". Secretary (economic affairs) Ashok Chawla said, "The early signs of revival are expected to pick up from here with further stimulus measures. We will continue to ease procedural bottlenecks for exports and imports."

The world is starting to look up and ahead

Right; Please don't hang me if I'm wrong; But I sense a very, very faint green shoot under all the recessionary show. And, everyone I talk to also sense that something is happening. People seem to be emerging from their catatonic state through the winter, and beginning to go back to economic activity. Even if it isn't resulting in anything, most people report a sudden jump in being busy during March '09. It's not as dead as it was in the last quarter of 2008."

I have this theory, which is that as soon as people put their head down and start doing things, anything, even if it is running a Red Queen's Race, things are 'going to begin to start to improve'.

Half the global recession is economic – the other half is psychological. The psychological bottom of the recession, if there is such a thing, seems to be where we are floundering now. Despair has given way to resigned, but positive activity. People have just given up on being depressed with bad news, stooped waiting for happy headlines, and are slowly, painfully, shaking themselves out of shock and getting on with the grim business of making a living in the bad new world.

If the global markets' reaction to Tim Geithner's latest bank rescue plan in US is any indication, when every theoretically approved action by the government over the past 6-months has failed, markets, financial services, the real economy, investors – everyone is one clutching at straws to start the upward climb again. It doesn't matter if Geithner's hugely complex plan works or not. People want to believe it will, so it just may.

Again, indicators are beginning to fluctuate. Since October 2008 there was only one way every indicator went – straight down. Now, there's a lot more confusion – one week a confidence survey in Germany looks good, the next it looks bad. One month we see retail sales arresting the slide, the next it's down again. A purchasing manager's survey in the Eurozone looks good; an employment number in US looks bad. Foreclosures are up, but not so are mortgages. The signals are getting very mixed, but that's a positive. At least, there's something happening out there.

US President Barack Obama hopes that he would see signs of progress as he sought to reassure recession-weary Americans". We've put in place a comprehensive strategy designed to attack this crisis on all fronts. It's a strategy to create jobs, to help responsible homeowners, to restart lending, and to grow our economy over the long-term. And we are beginning to see signs of progress.

Financial chiefs from G7 powers said the global economy may be past the worst phase of recession although recovery was not yet assured. The G7 which comprises US, Britain, Canada, France, Germany, Italy and Japan, said that economic activity should begin to recover later this year.

They said in a closing communiqué, "We will continue to act as needed to restore lending, provide liquidity support, inject capital into financial institutions, protect savings and deposits and address impaired assets. We reaffirm our commitment to take all necessary actions to ensure the soundness of systemically important institutions. However, they said the outlook remained weak and there was a risk that the global economy may still worsen.

US Treasury Secretary Timothy Geithner said in a statement, "We are right to be somewhat encouraged, but we would be wrong to conclude that we are close to emerging from the darkness that descended on the global economy". However, it was a less dire assessment than the G7 finance officials delivered at their last gathering in February, when they worried that the severe downturn would persist through most of 2009 and made no mention of promising signs of stability. Recent data suggest that the pace of decline in our economies has slowed and some signs of stabilisation are emerging.

Who would have thought the local Chinese stock market will turn out to be the canary in the coal mine for the global economy? Until 2005, when a series of reforms were introduced to clean up the system, the Shanghai stock market was merely seen as a play ground for idle money – with stocks bearing little relationship to economic performance. Over past couple of years, however, the Chinese stock market has seen acting as the harbinger of global trends. After bubbling up to record high valuations in 2007, it was the first stock market to peak in early October of that year. Then even as global traders continued to frantically bid up Commodity prices till mid-2008 on the notion that Chinese demand would rise forever, the China's stock market kept heading south to correctly signal underlying demand was, in fact, slowing.

And, probably most significantly, it was ahead of other stock markets to form a bottom late last year in an almost immediate reaction to the Chinese authorities announcing massive stimulus packages. While investors across the world remained sceptical of whether the Chinese measures would work, the Shanghai stock market continued to rally sharply over the past few months.

The Chinese market is now finally getting some of its due. Emerging market investors have certainly recognised the benefits of tracking the gyrations of Chinese stocks.

After long being numbed into taking cues exclusively from the US, investors in developing countries have found their local bourses surprisingly resilient since last November. US equities made new lows in late November 2008 and then again in early March 2009, yet most emerging markets held well above the line drawn at the end of 2008. In a striking divergence, most emerging markets are in positive territory for 2009 though the benchmark US indices are down 10%. China's stock market heads the performance league tables, having risen by more than 25% year-to-date.

The Chinese stock market has been sensing a reversal in the economic downturn for a while and that's now being confirmed by the latest economic data. It seems Chinese economic activity reached a trough last November and has since been improving on a sequential basis. In March, the Purchasing Managers Index rose another 4.2% to 52.4%. A reading above 50 suggests that the manufacturing sector is expanding again, making China the first major country to record such a positive number since the global economy fell off a cliff last September. The green shoots of an economic recovery are evident in data ranging from auto production numbers to excavator sales. Latest new reports peg March 2009 sales of domestic automakers at an estimated one million units while a 50% jump in excavator sales implies infrastructure investment is increasing sharply. Fixed asset investment growth could rise by more than 15% this year if the current momentum rolls on.

State-owned Chinese banks have played a major stabilising role. Lending growth has been on a tear of growth; reports say that on the first quarter of 2009, new loans totalled more than \$600 billion or 85% of total lending in 2008. Interbank rate in China have collapsed, helping increase consumer affordability and in turn leading to a revival in the housing market, particularly in the second-tier cities.

Improving confidence in the Chinese marketplace is infecting the developed world as well with the so-called 'China-plays' – from commodity to industrial stocks – leading a rally in their equity market over the past month. The developments of the past few months indicate that the global economy is shifting to a regime where the world economy is not as unipolar. At \$3.5 trillion in size, China's economy may not be large enough to independently chart a course for the world economy but it now has the critical mass and the ability to at least save the world from falling into an abyss. So when trying to figure out which way the global economy and markets are going to zig and zag, it makes sense to follow the movements of Chinese share markets as closely as those of the S&P 500.

1st week of April '09 – Sensex up winning spree, up 300 points

Daily review	27/03/09	30/03/09	31/03/09	01/04/09	02/04/09	03/04/09
Sensex	10,048.49	(480.35)	140.36	193.49	446.84	Ram
Nifty	3,108.65	(130.50)	42.80	39.40	150.70	Navmi

Firm global mood helped the benchmark sensex to continue in winning spree for the fourth straight week, registering a gain of 300 points to close at 25-week high during this truncated week. The Market was closed on April 3 for 'Ram Navmi'. In the strongest four week of gaining streak, the sensex registered a sharp rise of total 2,023.01 points or 24.30 per cent.

Weekly review	27/03/09	02/04/09	Points	%
Sensex	10,048.89	10,348.83	299.94	2.98%
Nifty	3,108.65	3,211.05	102.40	3.29%

Optimism may extend US stock rally

US stocks should rally further next week, if investors get more signs that the economic slumps is abating and earnings season does not get off to a rocky start. In the holiday-shortened week, volume could be light, raising the specter of increased volatility as investors look to string together a fifth straight week of gains. Many market participants are likely to be out of the office next week, when Passover begins. Markets will be closed on April 10 for the observance of Good Friday.

After investors got a boost in recent weeks from economic reports suggesting that the grip of the 16-months-old recession may be easing, analysts said stocks probably would make further headway. The benchmark S&P 500 ended on Friday up 24.5% from a 12-year low hit in early March. The broad market's recovery from that significant low helped to propel the Dow to its best 4-week advance since 1933. On Friday, the Dow closed above 8000 for the first time since early February.

2nd week of April '09 – Sensex on winning steak, up 455 points

Daily review	02/04/09	06/04/09	07/04/09	08/04/09	09/04/09	10/04/09
Sensex	10,348.83	186.04	Mahavir	207.47	61.52	Good
Nifty	3,211.05	45.55	Jayanti	86.35	(0.90)	Friday

A host of positive factors helped the benchmark Sensex to complete one of the best winning rally in the five weeks since October 2007 and ended higher by another 455.03 points at a near 27-week high of 10,803.86 points during the shortened week. In the stalwart five week of advancing string, the Sensex recorded a gain of 2,478.04 points or 29.76%, the biggest gains in five week since between August 20 and October 12, 2007 when it had risen by 4,276.52 points. Frenzied buying by foreign funds on expectations of an early recovery in the US economy helped the bulls to tighten their grip.

Weekly review	02/04/09	09/04/09	Points	%
Sensex	10,348.83	10,803.86	455.03	4.40%
Nifty	3,211.05	3,342.05	131.00	4.08%

Bull or Bears: Jury is still out on that one

Bulls may be on the rampage, with more than half of companies in the BSE-500 index outperforming the benchmark 30-share Sensex since the rally began on March 9 '09, but the jury is divided if the surge is for real – and will hold. Some market watchers say the latest surge is indicative of confidence returning to the market. A number of these stocks were quoting at absurd valuations. The markets saw some kind of a stoppage of selling by FIIs at those levels, which triggered this bull-run. But not all believe this rally is for real. Some other market watches say, it's a bear market rally and urging investors to be cautious. Most of the stocks which have been given phenomenal returns are low-floating ones. It's still early days to pronounce any judgment on whether bulls are indeed back or not.

3rd week of April '09 – Bulls on the way, Sensex up by 219 points

Daily review	09/04/09	13/04/09	14/04/09	15/04/09	16/04/09	17/04/09
Sensex	10,803.86	163.36	Ambedkar	317.51	(337.33)	75.69
Nifty	3,342.05	40.55	Jayanti	101.55	(114.65)	14.90

Bulls tightened their grip as the bellwether Sensex improved further by over 219 points to close above 11,000-mark after nearly 28 weeks. The market completed six weeks of gaining string with a rise of a total 2,697.27 points or 32.40 per cent, indicating the end of bear phase. Signs of an early improvement in the Indian economy like fall in the inflation to near zero, easing credit crisis and positive global cues also helped the rally. Rally in global stock markets due to hopes of an early revival in the US economy also boosted the market sentiments.

Weekly review	09/04/09	17/04/09	Points	%
Sensex	10,803.86	11,023.09	219.23	2.03%
Nifty	3,342.05	3,384.40	42.35	1.27%

Economic hysteria

Charles Mackay's *Extraordinary Popular Delusions and the Madness of Crowds*, published in 1841, with its vivid description of celebrated financial bubbles is a very powerful book written about market psychology. The infamous Dutch tulip mania, the South Sea Company bubble and the Mississippi Company bubble mirror the economic hysteria and fluctuations in the global financial markets of today.

Crowd behaviour has not changed much over the last 300 years and Mackay's thought on the issues like, "What 'groupthink' means and how to avoid it and the importance of following your own ideas and straying from 'the pack' are very relevant even today".

Groupthink is a surprisingly common and powerful force in decision making. For instance, a family is holidaying in Texas. One afternoon the father-in-law suggests visiting the town of Abilene, fifty-three miles away, for dinner. The wife says it sounds like a great idea, her husband agrees (despite having reservations, he doesn't want to rock the boat), and his mother also agrees. They drive to Abilene, have a terrible dinner, and drive back. All four reveal that they didn't really want to go, but they all agreed because they thought the others wanted to make the trip. The paradox is that when a group reaches a decision, it can sometimes be an outcome that no single member of the group would support.

4th week of April '09 – Sensex on roll, hits six-month high

Daily review	17/04/09	20/04/09	21/04/09	22/04/09	23/04/09	24/04/09
Sensex	11,023.09	(43.59)	(81.39)	(80.57)	317.45	194.06
Nifty	3,384.40	(7.30)	(11.80)	(35.00)	93.40	57.05

The market sustained its weekly gaining streak for the seventh straight week as the benchmark Sensex settled at a six-month high. The signs in improvement in economy and a fresh rate cut by RBI on April 21 with inflation running virtually at zero level boosted the market sentiment after mid-week. Brokers said FIIs remained the net buyers in the week and are expected to step up their activity in the coming days as the April-series of derivatives expires on Thursday.

Weekly review	17/04/09	24/04/09	Points	%
Sensex	11,023.09	11,329.05	305.96	2.78%
Nifty	3,384.40	3,480.75	96.35	2.85%

Crazy valuations

Indian stock market may have corrected over 40% from its peak, and a number of stocks are deriving valuations that are either expensive or crazy in some cases. The market P/E is currently around 15, and logically a stock P/E should hover around the same levels. However, there can be some stocks which can trade a high P/E multiples based on their growth potential. But a P/E of more than 50 indicates unrealistic valuations. Capital market experts say low liquidity, punter participation, high quality of investors and management, growth-oriented business models and consistency in business earnings are some of the reasons for these scrips fetching unusually high valuations in the market.

Leading the pack with a P/E of over 1,000 times are Sterling International a Mumbai based IT firm, Mavens Biotech, a Kolkata-based company, Hindustan Copper, India's third largest copper producer and Orissa Sponge Iron & Steel, a Bhubaneswar-based steel firm. Other stocks on the same queue include Radico Khaitan (221 times), GMR Infrastructure (173 times), RNRL (140 times), Reliance Power (100 times), and GVK Power & Infrastructure (72 times). Sunil Sinha, senior economist, at Crisil, doesn't rule out the possibility of manipulators artificially inflating the market prices of these scrips. He says, "It's true that in some cases investors perceive high earnings potential but punters also play a role in others."

5th week of April '09 – Sensex continues its forward march

Daily review	24/04/09	27/04/09	28/04/09	29/04/09	30/04/09	01/05/09
Sensex	11,329.05	42.80	(370.10)	401.50	Lok Sabha	Maharashtra
Nifty	3,480.75	(10.75)	(107.65)	111.60	Election	Day

Hectic short-covering on the last day of April series helped the benchmark Sensex to close in the positive terrain at a six-and-a-half month high of 11,403.25 during the truncated week completing its straight eight-week of winning string. Market participants said sustained buying support from the FIIs encouraged operators to cover their short positions or rollover their long positions to the next series on the last day of derivatives contract on April 29.

Weekly review	24/04/09	29/04/09	Points	%
Sensex	11,329.05	11,403.25	74.20	0.66%
Nifty	3,480.75	3,473.95	(6.80)	(0.20%)

Monthly review

Month	Dec '07	March '08	June '08	Sept. '08	Dec. '08	March'09	April '09
Date	28/12/07	31.03.08	30.06.08	30/09//08	31/12//08	31/03//09	30/04/09
Sensex	20,206.95	15,644.44	13,461.60	12,860.43	9,647.31	9,708.50	11,403.25
Points	Base	(4,562.51)	(2,182.84)	(701.17)	(3,213.12)	61.19	1,694.75
%	Base	(22.58%)	(13.95%)	(5.21%)	(24.99%)	0.64%	17.46%

Is it right time to take a plunge?

The mantra of making money on the stock markets is to buy at low valuation and sell high. Easier said than done really, since most people are not astute enough in buying stocks when prices are at the lowest and selling when they reach the pinnacle.

A peek into the past illustrates how investors often miss opportunities. Subsequent to the equity market crash last year, investors turned risk averse. Consequently they shifted majority of their investments in debt instruments. However, the current rally in the equity market has thrown up the question, is this the right time to increase the equity allocation.

Investments are made for maximisation of wealth. Preferred asset class and allocation of fund in any particular asset changes, based on the expected performance of different asset classes. Debts instruments, which were giving respite to investors through high returns last year, are not expected to continue in the same way in times to come, especially when the interest rates are expected to soften. In the last few months, the RBI has decreased most of the key rates. Repo rate came down to 4.75% from above 7% a few months ago. Cash reserve ratio came down to 5% from 6% earlier. Call rates are now hovering around 2 – 4% from double-digit numbers a few months back.

Since the interest rates have come down the return from debt-instruments are bound to come down. In fact CDs, which were trading at 8%, are now available at around 5%. All this will push the returns from the debt instruments down. The returns from short-term debt mutual funds have already started coming down.

Meanwhile, the sensex has rallied north in the last couple of months. It registered a return of more than 30% since the beginning of March. In fact, in April it appreciated by more than 15%, which is relatively higher than returns generated by debt instruments.

Also, as the revival of the economy continues equity markets are expected to perform better. Corporate earnings are expected to improve further in the next couple of quarters. Hence it would be a good option to re-look at equity as an investment. The right allocation towards equity and debt is must in highly fluctuating interest rate scenario like the current one. Since it is a difficult to time the market it is better to invest in equity periodically. And, if you have invested in the Ulip with most of the investments in debt instruments, you can switch your portfolio very conservative to a balanced one depending on your risk profile and investment horizon.

Signs of turnaround: How to read it?

The questions, though very simple, raises a naïve yet tricky subject. Here's a ready reckoner to help investors to find out where the seeds of a new bull market are getting sown.

Nature of rally: First things first; as an investor, your first priority should be to figure out the nature of the rally in process. You must assess whether the market rally is a broad-based one or sector centric.

Though there will be sectors that will outperform every other sector, this outperformance cannot be recognised as a bull run and will not continue for long. It is advisable to look at the broader pattern of the rally to identify if it is indeed a case of bulls getting back to business.

Remember that sector specific rallies cannot get converted into structural bull runs as was the case in 1992 and 2001, where the rally was concentrated towards the old economy and tech sectors, respectively.

Volatility index: VIX OR Fear Index is a measure of the market volatility. It gauges the amount by which an underlying index is expected to fluctuate over the next 30 days. For instance, if the VIX is at the low 40s on the NSE, it indicates that the equity market can witness an uptrend or downtrend to the extent of 40% over the next month. Typically, a high VIX indicate that investor fear has increased. You can keep a tab on this wonderful tool to get the first clue on revival of a bull run. Once the volatility dips below 20, you will be much safer investing.

M-cap to GDP Ratio: This estimate is a popular method of looking at whether the markets have bottomed out or not. As a rule of thumb, it is believed that when market-capitalisation to gross domestic product ratio goes above one, the equity market starts getting attractively valued. Remember, in December 2007, this ratio was 1.78 and the rest is history.

Daily moving average: To judge the first call on a bull market, another parameter you can look at is simple Daily Moving Average (SDMA). Analysts say, as long as Nifty/Sensex/stocks stay below its 50, 100, 200 SDMA, the market is said to be bearish. In bull market, the index will be above its 200 simple moving average and stock value (at least major Nifty stock) will be above its 200 DMA.

Other footprints: Apart from the above mentioned yardsticks, there are some other clues that you can look at. Analysts say a take-off in the equity markets is typically marked by – *Low inflation, Low interest rates, Earning yield to bond yield more than 1.5, Price to book value (P/BV) ratio* (look at past data as to how the multiples have expanded or contracted vis-à-vis the inherent value in the balance sheet), *Easy monetary policy, High liquidity, Buybacks, Dearth of new IPOs and Weak hands vs. strong hands* (retail investors in extremely pessimistic mood selling out to strong institutional hands).

There are, however, a few things that you need to keep in mind: One, markets would bottom out much before the economy does – typically two quarters in advance to when actual revival in economy takes place. Two, bull markets are born out of excesses of bear markets and vice versa. It is a cycle since times immemorial and nothing is perpetuity. Three, bear markets typically last between 18-24 months.

How to gain from first sign of turnaround? All in all, your ideal strategy to gain the most out of an emerging bull run should be to focus on buying fundamentally sound large-cap stocks, against mid-cap or small-cap scrips. Historical patterns show that it is large-caps which lead from the front in any bull market rally. The small-cap and the penny stocks are typically the last to move in any bull market.

We are now in the midst of the worst global recession in living memory. What started as a financial crisis has moved to the real economy - where the differences in the impact on different countries will manifest itself. The root cause of the current problems in the west is the high debt levels of the private sector and households. Therefore, these economies will go through: the de-leveraging of households and the private sector with its impact on demand; the painful rebuilding of the financial sector; and the rebalancing of country financials - the deficits of the US, etc., and surpluses in Asia.

Much alike from the west, Asia's economies have been growing on the back of an export boom fuelled by debt-laden western consumers. These economies were, therefore, bound to be hit hard by slowdown in the west. The problem was aggravated by the credit crisis which made trade finance harder to get. Trade within Asia also dropped. In the long run the Asian economies will need to boost domestic demand (consumption). The root cause for the lack of domestic demand is the composition of GDP in terms of proportion of exports and wages. They will have to shift from a capital-intensive manufacturing model to a labour-intensive services dominated one.

India was happily chugging along at an 8% plus growth rate till the world decided to ruin our party. Till recently, the surge in the prices of oil and commodities resulted in importing inflation. It forced to employ a tight money policy and a rising interest rate to curb demand. Now, the global financial crises have frozen the international liquidity. Also FIIs sold and remitted money overseas, pressurising the rupee and aggravating the local liquidity scenario. The transmission of the financial crisis to the real economy led to a major global economic slowdown, which has affected our exports as well. While it would be naïve to suggest that in a globalised world India would not be affected, it would be equally wrong to transfer the global doom and gloom in its entirety to India. Because we have a few things going for us:

One, the financial tsunami of toxic asset and crazy market regulation which flattened the financial systems of the west passed us by. Indian banks are safe, secure and profitable. The industry is crying about shortage of funds is consequent to sources of funds (other than bank finance) drying up – that is global and local equity markets, international trade finance, ECBs, etc. In order to enable banks to lend long term we have to allow them to raise long-term funds which are not subject to SLR and CRR. The RBI pays no interest on CRR and the yield of SLR is by definition lower than what banks will pay to raise money and this result in pushing up costs for the banks and corporates to unacceptable levels.

Two, about 60% of Indian GDP is domestic consumption and our percentage of exports is 23%. So, we can, through fiscal and monetary measures, coupled with government spending pump prime our economy.

Three, the fall in the prices of crude and commodities will provide the government with some fiscal spending leeway because at current prices we should not need oil or fertiliser subsidy. And, **four**, inflation is falling and will fall further as the effect of oil and commodity prices passes through the economy. Interest rates are also falling and are set to fall further.

Basically while we cannot avoid the pain, we can ensure we suffer less. Any crisis leads to anxiety and uncertainty, which affects individual and corporate behaviour. Compounding the problem is subjective uncertainty: we tend to imagine the worst. This leads to paralysis of consumers, companies and investors.

The only solution to this is to pull out all stops at one go – reduce SLR, CRR (interest rates), cut duties, oil price, spend on job creation, provide incentives for spending, etc. It will work and will get people to focus on India's structural positives – rising productivity, high savings, working financial system, low import barrier, high export potential, GDP growth, rising per capita income, and rural demand.

Indicators points to India turning the corner soon

Leading indicators – composite of a variety of indices – that track activity in vital economic sectors and encouraging data from a number of key manufacturing segments indicate that the downturn has bottomed out and that the economy will regain its vigour shortly. Nomura's Composite Leading Index, (CLI), UBS' Lead Economic Indicator (LEI) and ABN Amro's Purchasing Managers' Index (PMI) indicate a pickup in growth soon. And CMIE's capex database, which tracks investment by companies, shows no significant slowdown in investment activity.

Strong performance of sectors such as auto, cement, steel, capital goods, port traffic along with record high telecom subscriber increases corroborate the strong turnaround thesis suggested by these lead indicators. Following three successive months of climb, UBS' LEI index for India now stands at 2.1, after hitting a low of negative 2.08 last December. The LEI is a composite indicator of many variables, including government bond yields, M1 money supply, currency risk premium, foreign exchange reserves and stock market gains. UBS economist Philip Wyatt expects that recovery to sustain because of the low levels of excess capacity, private sector indebtedness and non-performing loans in India. "With this significant rebound in LEI, we are more confident of a turning point in industrial cycle by June 2009"

Nomura's composite leading index (CL) – used to identify the turning points in the growth rate cycle – rose in the first quarter of 2009 after four consecutive quarterly declines. Since the CLI indicates a turnaround in non-agricultural GDP growth rate with a two quarter lead time, the pick-up in first quarter of 2009 suggests a recovery in economic activity from June '09 onwards.

ABN Amro's PMI – an indicator of manufacturing activity in the country based on survey of 500 companies – has improved from a low of 44 in December 2008 to 49.5 for March 2009. A reading below 50 indicates contraction. That the PMI has recovered to nearly 50 suggests that the contraction bit is over and manufacturing is now about to enter an expansion phase. The suggestion is that inventories have been run down, necessitating stepped up manufacturing activity.

Car sales in India have grown from 115,334 in December '08 to 166,837 in March '09. Two-wheeler sales were 461,302 in December '08, and reached 654,017 in March '09.

CMIE's capex database of new and ongoing investments in India indicates both the rate of new investment project announcements and the pace at which projects are being commissioned remain robust. It says the downward revision of projected growth rate for the current fiscal by both the Bretton wood institutions, the World Bank and IMF is baseless. According to the database, the momentum in commissioning new projects will continue into the next fiscal as well. Over a 1,000 projects involving total investments of Rs 490,000 crore are on schedule and will be commissioned in 2009-10. Projects worth a record Rs 790,000 have been announced in the quarter ended March 2009 itself, suggesting that corporates have not pared investments to the extent expected.

Import data throw that even as overall imports have been showing down; project import growth has remained robust. While portfolio investment inflows have been fickle, direct investment inflows remain strong, prompting official expectation that FDI inflows in 2009 would best the realised inflow of \$33 billion in calendar 2008 and touch \$40 billion.

It is often said that if you can sell a product across the length and breadth of India, you can easily sell it in any part of the world. Partly due to the unimaginably diversity of the country and partly due to a great divide between its rural and urban areas, selling and marketing have been the most daunting tasks in this part of the world. The task is even more uphill, when it comes to tapping the rural customer. And, problems are plenty – lack of infrastructure, inadequate distribution network, lack of understanding of the customer's mindset. Traditionally, companies have been pegging rural markets as difficult to sell.

Like any other consumer, rural customers have desires and understand the value too. They are also ready to pay a premium for products or service providing value. But, marketers face problems in communicating value to customers in rural areas. A lack of proper communication results in lesser involvement from the buyer's side, hindering the growth of a long-term relationship between the company and the customer. It is extremely important to communicate the rural consumers how a product fits in to the requirements of the buyer and how it is different from similar products offered by competitors. Besides, reaching out is also important. The intermediary has to be very strong and trustworthy.

Simultaneously, there are certain structural changes happening in the rural landscape. The living standard has improved in the last few years. In certain cases, the rural consumer is as affluent as his urban counterpart. For instance, the per capita income of top 20-30% rural segment is not much different from the urban middle class. Moreover, the share of non-farm income in total rural income is more than 50% today, which makes the rural economy relatively less vulnerable to the vagaries of Mother Nature compared to few years ago. Today, people in rural areas don't want their children to face the hardships they faced. This means that affordability and needs are similar in these two markets and marketers can tap that affluent rural consumer with the product he is targeting the urban middle class consumer.

Certain changes are happening even in the demographic profile of the rural consumer. There is an increasing convergence between urban and rural consumers and especially the young consumer. A young consumer from a rural area has almost the same aspirations as that of a young urban consumer. And, a significant percentage of parents in rural areas want their next generation to be a part of the economic boom. This makes it easier for marketers as they can perhaps target a certain section of rural consumer much the way they are targeting the urban consumer.

There are, however, certain milestones yet to be reached by corporates in this journey towards rural markets. Companies have attitude of reaching to rural consumer only when growth from urban markets is hard to come by. Such kind of approach will be detrimental, since, like other markets, rural market requires huge amount of time, money and perseverance on the part of the marketer. This means it imperative that there has to be a strategic intent on the company's part and not an opportunistic mindset.

Companies like Hindustan Unilever, ITC, Reliance, Coke, Pepsi, LG, HDFC, and ICICI have managed to establish brand equity in the rural markets. These companies have used appropriate technology to tap rural markets efficiently. Take for instance, ITC's e-Choupal initiative, wherein the company has directly established links with rural farmers for procurement of agricultural products. This has been a win-win initiative for the company and rural farmers as company is paying a fair price for the products and farmers are making higher margins in the absence of the middlemen.

Now, the companies don't have the luxury to ignore rural markets. Industry leaders feel that strategies in the rural market place need to be redrawn. The rising effluence in rural India is a welcome sign to companies which otherwise thought that only a more affordable product could suit the requirements of rural consumers. Infrastructure is improving with government initiatives. What is required is a bit of patience as any investment needs a certain time period to pay back.

1. Fed recession remedy for US

The US Fed launched a bold \$1.2-trillion effort on 18 March 2009 to revive the economy; to do so; the Fed will spend up to \$300 billion to buy long-term government bonds and an additional \$750 billion in mortgage-backed securities guaranteed by Fannie Mae and Freddie Mac.

The key short-term bank lending rates were kept unchanged at a record low of between zero and 0.25%. The decision to hold rates near zero was widely expected. But the Fed's plan to buy government bonds and the sheer amount - \$1.2 trillion – of the extra money to be pumped into the US economy was a surprise. The Fed also said it would consider expanding another \$1 trillion programme that's being rolled out very soon. That program aims to boost the availability of consumer loans for autos, education and credit cards, as well as for small businesses.

Terry Connelly, dean of Golden Gate University's Ageno School of Business in San Francisco said, "The Fed is clearly ready, willing and able to be the ATM for the credit markets.

However, the Fed said it's mindful of the risks of pumping more money into the economy and leaving a key rate near zero for too long. There's the potential to plant the seeds for higher inflation, put ever-more taxpayer money at risk encourages "moral hazard". That's when companies make high-stakes gambles knowing the government stands ready to rescue them.

There's an old saying on Wall Street: Don't fight the Fed. With its power to create money, the Federal Reserve has virtually unlimited resources to achieve its goals.

That clout was in full view on March 18, when policy makers made the surprising move to start buying \$300 billion in longer-term Treasury securities and to more than double their commitment to purchase federal agency debt and mortgage-backed securities, from \$600 billion to \$1.45 trillion. Since the Lehman Brothers' bankruptcy, assets on the Fed's balance sheet have exploded from \$900 billion to \$2 trillion, and these newest plans could push the total to more than \$4 trillion. Policy makers are clearly serious about their pledge to "employ all available tools" to promote recovery. But at what cost!

The danger is that inflation ultimately will surge before policy makers can sop up all the excess liquidity they have created. For now, though, times are hardly normal. The capital scarce banks deposit funds to the Fed instead of using them to make loans. But that could change quickly. The stock market's powerful endorsement was the first hopeful sign that the banking system can begin its healing process.

Most analysts believe the Fed will have plenty of time to take back its excess funds without fuelling inflation or disrupting markets. That's because the recession has created enormous slack in the economy in terms of unemployment and excess production capacity, which is weighing heavily on pricing power and wage growth. Even after the economy starts growing again, many economists believe it could take a couple of years to return to full employment of labour and capital, generally defined as about a 5% jobless rate and about an 80% utilisation rate of industrial capacity. Right now, unemployment, at 8.1%, is likely to rise throughout 2009, and the industrial operating rate is a record low 67%.

As banks and credit markets stabilise, Fed's aggressive funding will work into the system in a more stimulative way. At that point the Fed will have to start shrinking its balance sheet in order to drain the excess funding from the system.

2. US Treasury plan for toxic assets

The Obama administration has offered major incentives to private investors who may want to buy toxic derivative assets from big American banks. The idea probably is to create some liquidity for toxic assets worth about \$1 trillion the banks are saddled with, causing unprecedented crises of confidence in the global financial system.

What exactly is the central idea behind the treasury rescue plan which has been proposed in the public-private partnership format? The US treasury has invited private entities and individuals to buy some of the toxic assets in the bank book at rock-bottom prices. The banks have partially marked these assets to the market and booked huge losses in recent quarters. There are additional incentives for investors to buy these assets at heavily marked-down prices. The private investor is being asked to bring in less than 10% of the acquisition cost and the treasury is willing to fund the remaining 90% or more. Also, the government is ensuring private investors could walk away if the values of these assets fall further. So there is no further downside for the private investor.

There are two aspects to the present macroeconomic situation:

- *There is a financial crisis brought about by a brushing of the housing bubble in the US.*
- *There is also a global recession which is resulting in drying up of demand.*

For much of the last decade, any crisis that threatened asset prices has been solved by creating fresh bubble that is even bigger than the earlier one. To some extent the housing bubble has been supported by the easy liquidity regime created by the Federal Reserve under Alan Greenspan. But in the present situation the headroom to recreate fresh bubbles is no longer there. The immediate issue on hand, however, is getting back America's bank on the rails failing which all economic activity would come to a standstill, pushing up unemployment further and worsening the macroeconomic situation. This is where Barack Obama's \$1-trillion toxic asset purchase plan comes in. As borrowers default and banks repossess homes, house prices crash further, creating a crisis that feeds itself. Banks cannot simply write off the bad loans as they do not have enough capital to do that. One solution is to buy the loans that have gone bad and those that are likely to go bad because of the fall in asset values.

While the toxic asset buyout plan is a noble idea, there are few in the US who believes it could work. Two of the biggest criticisms against the plan are – one, Banks would be unwilling to sell loans at a discount and second, the fund size is too small to meet requirements.

However, it is better than the other alternative. One reason why banks may not want to sell is – as long as borrower is repaying his instalments, the bank need not make provisions on the loan, even if the value of the mortgage has fallen by half and increased the possibility of a default. If, however, the bank decides to sell the loan at 70 cents to the dollar, it has to write that down and take a hit on its capital. But, if you are a large bank with a huge capital base, this (writing down the value of mortgages) is the best way to clean your balance sheet. But if a bank is only marginally solvent, it is a risky strategy.

According to economists, the Obama administration has gone back to the original concept of TARP and developed this public-private partnership arrangement to get credit market functioning. While the concept is good, there are some aspects of the plan that remain problematic, particularly the scale. Most economists believe much more than \$1 trillion of assets need to be addressed. It's a noble effort, but it's not big enough. Also, it remains to be seen how the actual implementation is planned, the price points that are offered by private investors, their attractiveness to banks.

Markets always surprise people. They go up or down when no one expects. No one in the world has been able to predict markets correctly on a consistent basis. Still, most of the investors believe that either they would be able to time the market on their own or through an expert advice.

Everyone has heard about the three golden rules of financial planning – start early, invest regularly and maintain asset allocation in line with your risk profile and investment goals – but most investors never follow them. It's very easy to understand the first two principles that if you invest early, compounding works for you and if you invest regularly, volatility works for you.

The asset allocation rule is something which creates confusion. Many investors ask on the need for asset allocation. One should simply be telling them to put all the money in the best performing asset class for next year but there cannot be a bigger fallacy than this. As has been mentioned earlier, it is difficult to predict markets and even if one dares giving a view based on research or otherwise the market can always surprise. So the first myth which investors should get rid of is either they or an expert would be able to predict the market and guide them to invest in the best performing asset class. One has no choice but to bow to market unpredictability and buy the protection through diversification and asset allocation.

The second myth about the asset allocation is when to do it. Should one do it daily or half yearly? Should one do it whenever market moves or otherwise? There is no scientific answer for this. We all live a busy life. One should have the discipline of doing asset allocation when ever there is big market movement impacting heavily on an asset class like a sharp jump or a fall in equity indices or on a periodic interval at which one can do it regularly. There is no need to time it precisely. The law of average will help if you do the allocation on a regular basis.

The third myth is that asset allocation can be done independent of financial goals. Most of the times, investors invest without keeping in mind the financial goal. It is extremely critical to allocate assets based on your financial goal. If the goal is to pay for the management fee next year, than there is no point in allocating to equities even though you are very young.

The fourth myth about asset allocation is that it is similar for same-age group investors. Since the need of investors varies from person to person, asset allocation, too, varies. There is no one solution that will fit all. Each investor has to assess his/her risk profile and create an allocation which suits them the best.

Let's apply this simple principal to the equity market which zoomed in 2007 and crashed in 2008. When the equity markets rose almost seven times between 2003 and 2007 most investors became way overweight on their equity allocation in portfolio. Every one was expecting the dream run to continue. Your portfolio in a month was appreciating more than what you were earning in a year or may be five years. But still there was no profit booking. There were few disciplined investors who maintained allocation and probably paid the price of exiting bit early for a while. However, they benefited the most when the market corrected subsequently. In 2008, when the market was falling, most investors stayed out of fear of making losses. Very few people maintained their allocation and kept on investing at various levels. Today, when the market is up 40% from the bottom levels these investors are laughing their way to the bank. There's a lesson to be learnt from the investors who failed to time the market and those who benefitted from the discipline of asset allocation. Investors should follow a regular asset allocation plan focused on the risk profile and their financial goals.

After wealth management for the rich and private banking for the super rich, institutions are now targeting the ultra super rich with the latest concept in financial services to hit India – Multi Family Offices.

MFOs provide exclusive service to the families of the wealthy and their advices span a breadth of services, including investment, philanthropy, legal and taxation. They even provide concierge services for family members across generations. The concept is coming to India at a time when some of the ultra rich are setting up their own family offices.

Deutsche Bank, BNP Paribas, Merrill Lynch, Citi, HSBC, Barclays and Indian banks like HDFC Bank, Kotak Mahindra and ICICI Bank have already been providing private banking services in India. While private banking services are available for those with R 5 crore of assets under management, MFOs are only for those with at least Rs 75-100 crore of family wealth.

Private bankers say that some of India's billionaires have set up their own family offices. These include an entrepreneur who sold off his holding in a cement company to a multi-national. Others like Nadathur S Raghavan a co-founder and former MD of Infosys Technologies, has set up a family office last year. Azim Premji and Narottam Sekhsaria are said to have set their own family offices. A group of senior professionals are also said to be setting up an MFO in Dubai targeting Indian families.

BNP Paribas and couple of European foreign banks are also looking at MFOs. For BNP, the threshold level will be Rs 100 crore. Internationally, the threshold for an MFO is anywhere between \$50 million and \$ 100 million. There are around 6,000 families in the country with investible surplus of Rs 120 crore each. There are another 20,000 families with assets over Rs 40 crore each, according to Celent LLC.

Altamount Capital Management – a recent start up – manages around Rs 200 crore for three families. Altamount is targeting families with assets of around Rs 75-100 crore. The firm offers investment management, legacy planning, philanthropy and family corporate governance. Altamount, like other MFOs, work on an independent platform.

Richa Karpe, director investments, Altamount says, “We identify the best investment managers in each asset class and we do not believe in following a star manager. We help the families in investment management, trust and succession planning, educating the younger family members, identifying private investment opportunities. We also help these families in looking for funding opportunities and also evaluating buy/sell opportunities for their businesses or for diversification.”

Though, globally, the fees would be around 1% of the assets under supervision, in India it is currently at around 20-30 basis points annually.

Altamount is looking at signing up around 10-15 families with assets under supervision of around Rs 1,000 crore and over the next three years it is looking at 50-60 families with around Rs 4,000 crore.

Other banks and institutions also have similar plans. Incidentally, some of the individual family offices are said to be looking at managing the wealth of others too like in the West.

After overseas pension pools and foreign portfolio funds, it's now SWFs that find India an irresistible investment destination. Government-promoted investment funds of various countries have invested nearly Rs 14,850 crore during the eight-year period beginning 2000, according to a report released by the United States Government Accountability Office. Typically sovereign wealth funds are state-owned investment funds with a global investment horizon. Some times, they are owned by central banks.

Although SWF investments into India during the period under consideration were fractionally lower compared with peers such as Thailand and Indonesia, investment consultants in India say SWFs have begun looking at Indian assets more seriously over the past few years.

Numbers collected by the US Government Accountability Office reveal that net SWF investments into India in the 8-years through 2008 stood at \$3.3 billion. Indonesia pocketed \$4.2 billion (Rs 18,900 crore), Thailand bagged \$4.3 billion (Rs 19,350 crore) and China recorded a whopping \$12 billion (Rs 54,000 crore). Global crossborder SWF investments increased from \$429 million in 2000 to \$53 billion in 2007.

From a couple of SWF investments till 2004 to more than nine funds with direct investments in Indian asset classes by end March '09, the trend is growing. Some of the major SWF investments in Indian asset classes include Kuwait Investment Authority's investments in Chryscapital and ICICI Venture Funds. Malaysia's Khazanah national's 9.9% shareholding's in IDFC, Government of Singapore's 6.3% holding in Anant Raj Industries, the Palestinian Investment Funds' 50% stake in India-Oman Special Investment Fund and Temasek's 8.3% and 5% equity shareholding in ICICI Bank and Bharti Airtel, respectively, according to a survey by London-based research firm Preqin.

According to India-based experts, the shallow equity market – low public floats in listed companies and limited asset classes – caps on foreign institutional holdings and cautious investment approach of sovereign wealth managers have compelled SWFs to go slow on India. SWFs are large funds. They still do not find India big enough to set up a research base. They prefer to have an exposure in India through investment banks and private equity companies rather than directly.

According to a equity head of a US-based investment bank, "The Indian government, too, hasn't been keen on allowing SWFs to invest in Indian assets. Though most of them are allowed to invest as FIIs, there is an investment cap on almost all investible sectors. The government is keeping caps to ensure that SWFs pump in money to make investments and not have any other motives". Chinese SWFs have recently bought resources and underpriced assets across the world, sparking speculation that companies and some small countries were overselling their assets and may subsequently cede control.

London-based Baer Capital Partners founder President Alok Sarna said, "It's certainly not the case that something inherent in the Indian market makes it unsuitable for SWF investments. SWFs are looking for the right assets to make significant commitments to India."

Sarna added, "The recent losses suffered by SWFs in their commitments to global PE funds and hedge funds have made them more conservative. SWF investments will increase after the Indian market become mature. It would be fair to say that large global institutional investors are interested in India, but it's a fringe market yet. The value proposition for such sovereign funds is much more compelling in the Western World. So there is a natural tendency to gravitate towards what they know best."

The new pension system (NPS) first introduced for government employees in 2004 will now be available to all Indian citizens. All citizens can open an NPS account in any of the 22 points of presence (PoPs) in various parts of the country appointed by the interim pension fund regulator from May 1, 2009.

In August 2008, the government advised PFRDA to extend NPS, currently subscribed to by government employees, to all citizens on a voluntary basis. Central government employees, who joined service on or after January 1, 2004, are covered under NPS. Unlike the old pension scheme, in NPS both employees and the employer (in this case, government) contributed an equal amount to the pension fund. Twenty-one states have also joined the scheme.

Giving details of the new pension system, the Pension Fund Regulatory and Development Authority (PFRDA) said the investment guidelines for individual subscribers have been provided on its website. Apart from the 22 points of presence in various parts of the country, six pension fund managers have been appointed by PFRDA to manage the funds. The six fund managers selected by PFRDA are UTI Mutual Fund, Reliance MF, ICICI Prudential Life Insurance, IDFC MF, SBI and Kotak MF.

The NPS managers will manage three separate schemes each investing in a different class of asset – equity (E), government security (G) and credit risk bearing fixed income instruments (C). The investment will only be in Index funds that replicate either BSE sensex or NSE Nifty 50 index. The subscriber will have the option to actively declare as to how the investment will be in the three asset classes.

However, the PFRDA have capped the maximum exposure to equities at 50%. The beauty of the NPS is that it opens up an avenue for people with low incomes to acquire rights over the production capacity of the fast-growing economy, at a very low cost, probably the lowest cost in the world.

Pension schemes, it can be argued, are meant to provide adequate income to an individual upon retirement and therefore contribution must be adequately protected from risks associated with investing in the stock markets. A scheme that limits equities to 50% is a welcome as a default option, meant for those, with limited understanding of saving instruments.

In the event of the subscriber being unable to decide, his contribution will be invested according to the ‘auto choice’ option, which is based on a predefined portfolio varying with the age of the subscriber.

Taxation may be a challenge for NPS investors. Withdrawals from NPS will suffer tax, while those from employees’ or public provident fund or even mutual funds do not. This asymmetry is unfair and should be removed. All long-term saving schemes should have the same tax treatment during contribution, accumulation and withdrawal. There is no reason why NPS should be Exempt-Exempt-Taxed.

Each subscriber is also required to pay an annual record keeping charge of Rs 350. In addition, each subsequent transaction would invite a Rs 30 levy. Since there will have to be at least four transactions every year, the minimum annual cost comes to Rs 470.

Citing unaudited results, PFRDA said, “The NPS architecture has been operational for central government employees for over a year now – since April 1, 2008 – and the NPS corpus amounting to over Rs 2,100 crore stands invested in it. The three pension funds have generated returns varying from 12 per cent to 16 per cent on the NPS corpus during the year 2008-09, weighted average return being over 14.5 per cent”.

Evolution

Governments in both UK and US – the two major western countries whose economies have been particularly hard-hit by the global economic slowdown – have announced huge stimulus packages. Unfortunately, this does not seem to have made much difference on the ground. Both economies continue to limp along, with mounting unemployment and falling public confidence. While no one knows when the worst will be behind us, the consensus seems to be that it is not going to be any time soon. There is also some agreement that economic recovery cannot take place unless order is resorted to the financial sectors.

1. FINANCIAL ADVISORS:

Weigh impact on investors

Financial sector reforms

Everyone now hates innovative financial products. And even though financial sector reforms are a dirty word, almost for many at present, nevertheless, we make a case in defence of innovative financial products. This is precisely the time when the Indian market desperately needs some.

In simplest words, financial sector reforms aren't about G-Secs, foreign bank branches, and macro esoteric stuff, but actually about ensuring that you, as a middle class Indian, can actually use your home loan and home to generate income instead of it being burden? Without having to move out of it! If you could sell the eggs from your nest eggs, without killing the golden goose!

Despite the fact that Indian banks aren't broke, we're stuck for spending money. What's the point of gloating about India's great saving rate, if we can't tap into it to get things moving? Most of middle class India's savings is locked into property, pension schemes, and the stock market. Since nobody can unlock any of that now, it might as well be cash buried in the garden for all it is worth,

So here's just a glimpse of what you'd gain from financial sector reforms. First, the range and variety of home loans you can get, et al gives you enormous flexibility, choice and options – both at the start and through the lifetime of the mortgages. Next, most mortgages are renegotiated every five or so years, so you can re-examine the terms, spread it between various lenders, make the best pick. And more, EMIs change real time according to interest rate changes.

In contrast, the home loan market in India is still like the Ambassador Car days. Clunky and plain vanilla, take it or leave it. Frankly, given how illiquid property is in India, we've never understood why anyone would want to buy. Take for example, a second mortgage. Assume you have a home worth Rs 1 crore today, you still have, say, Rs 40 lakh left to pay on your home loan, you can't get a second mortgage for the remaining amount of Rs 60 lakh, at home loan rates. Even if you know you can pay back.

We know hundreds of Indian homeowners, pensioners, young adults, all sitting on hugely valued property assets and scrounging for pennies here or a few lakhs there. Introduce just one very minor reform, only for domestic banks, and a huge chunk of middle class savings can be dug out of the garden and put back into the real economy, releasing both demand and liquidity in the market.

Naturally, banks need to be able to buy and sell these IOUs in their markets, like your mutual fund manager can do with shares. The crisis in the west happened when bankers got lazy and passed your prized home portfolio on to others, who mixed your blue chips with their own junk stocks, and eroded the entire value of the portfolio. That, in crudely simplistic terms, is the subprime crisis. It should be easy enough not to make the same mistakes. So this is the time to act on financial services reforms or innovation. Otherwise it is a real danger for the India growth story.

2. RISK MANAGEMENT CONSULTANTS

Educate – Engineer and Enforce

Credit rating agencies

What is the future for credit rating agencies and how should they be treated under the new system of financial market regulation evolving internationally? These questions have been hotly debated in recent months and a consensus is now emerging.

The European Union is close to finalising a legislation to register and regulate rating firms for the first time in the region, and April G-20 meeting in London has affirmed the need for a globally coordinated approach to oversee these agencies.

The starting point for these reviews is the recognition that credit ratings of certain recently structured securities have not been done too accurate.

At the same time, investors and policymakers appreciate that ratings – a common and transparent language for evaluating and comparing creditworthiness – remain important to the efficient functioning of capital markets. They provide useful information to investors about credit risk and help companies and governments access capital. To achieve the aim of resorting confidence in ratings, regulation needs to be globally consistent, based on broadly accepted standards.

- First, regulators should focus on overseeing rating firms' policies and standards for managing potential conflicts of interest. Rating opinions and methodologies, however should be free from regulatory interference.
- Second, rating firms should be subject to robust, periodic inspections by regulators to check that they are complying with their processes and policies. If they are found not to be, they should be subject to regulatory sanction.
- Regulation should require high levels of transparency about rating methodologies, models and performance, to help investors compare ratings and form their own view of the soundness of the rating analysis. The meaning and use of ratings should also be clear, including their limitations and the level of risk inherent in the rating.
- Ratings on new, complex securities should be differentiated and consideration should be given to requiring issuers of these securities to disclose publicly information about these transactions that are currently provided to rating firms confidentially.
- Rating agencies must be accountable to regulators, which would provide the market with assurance that the ratings process has integrity. That should be the case whatever their business model, as all models – whether investor-pays, issuer-pays or government-pays – carry potential conflicts of interest and different levels of transparency.
- Finally, governments must look at how ratings are used by regulators and investors. If ratings are used as benchmarks of creditworthiness in regulations such as Basel II, other benchmarks should be considered as well. That would help avoid inadvertently encouraging investors to depend excessively on ratings, rather than treating them – as they should – as one of many inputs in decision making.

3. INCLUSIVE CEOs

Innovative responses to problems

Business teachings

When the international advisory board of a well known European business school met to review the school's vision and strategic plan, a member of the board read out an email he had received from a student of an American business school. The student asked whether business schools had caused the economic mess that America and the world was in.

The student's question forced the board to introspect on *the fundamental ideas* that business schools teach, and also on what they do not teach but should. They agreed that the *concept of 'responsibility'* underlying business management techniques taught in business schools is too self-centred. Also that business schools do very little, if anything to help managers build their internal moral compasses.

American business schools dominate the world of business teaching. Commenting on the malfeasance within the US business corporations, Jack Welch, the greatly admired former CEO of GE, write that it is not the job of company boards to prevent fraud. That, he says, is the job of regulators. He says the responsibility of the boards is to assist the company's managers to create more value for shareholders. In this, he is reiterating the philosophy that rules the American business world and business schools, and began to pervade the rest of the world also.

A fundamental flaw in this philosophy is the ideologically-rooted limitation on the responsibility of the boards and business leaders who are expected to focus relentlessly on the growth and profits of their business. The business of business is only business, said Milton Friedman the Nobel Laureate in economics from Chicago, with the corollary that government has no business to be in business. Friedman inspired Margaret Thatcher and Roland Reagan who promoted an 'Anglo-Saxon' model of capitalism.

With the advance of Anglo-Saxon capitalism and retreat of socialism, the world got carried away too far towards valuing money and wealth as the measures of worth of individuals and human activity. The pecking order – whether in business, sports, arts, or education – is dominated by those who make more money. The media gushes about their wealth, homes, yachts, planes and trophy wives. Business chiefs are ranked by their personal wealth, companies by their shareholder value, countries by their GDP, and business schools by the salaries their graduates obtain. Measures of goodness seem to pale in comparison.

If making more money is the goal, it becomes smart to make even more money using other people's money. Thus the financial services industry began to balloon into a world of exotic derivatives. The masters of this virtual world offered the highest salaries to the business school graduates. And the schools, to improve their ratings, ran after these recruiters. Like Icarus on wings of wax, the wizards of this financial world flew further and further away from earth until their wings began to melt and they came crashing down, unfortunately bringing the global economy down with themselves.

Institutions that claim to produce leaders for the world must take responsibility for the values they teach their graduates. In their advertisements, every business school claims it produce 'global leaders'. In reality these schools are vocational institutions providing their students with tools and skills to create efficiency and produce financial returns – and a passport to personal wealth. Business schools should examine their curriculum. Real leaders need a moral compass that points true north: to the path that improves the world for everyone. They cannot be pointed towards narrow self-serving goals of more wealth for their corporations and themselves.

The means they use to create their wealth are more important than the ends they seek. Do these 'leaders' strengthen the institutions of governance in society, or weaken and corrupt them for their own gain?

Those who espouse more freedom for business and ask for less regulation must accept that it is up to business to regulate itself more thoroughly and therefore for its leaders to have functioning moral compasses. Otherwise more regulations will have to be imposed to prevent business managers from unwittingly – or deliberately – causing harm to the environment and society.

The crumbling of economies and breakdown of trust in business leaders' demand changes in many institutions. Boards must orient themselves towards good governance, not merely production of profits and shareholder value. Business schools must reorient what they teach, and also the way they teach, to develop moral compasses within their graduates. And the media must honour business leaders and corporations who are role models of good values – as well as any business schools whose graduates, while not earning the most, help to improve the world for everyone.

4. FINANCIAL PLANNERS

Value unlocking for all stakeholders

Shareholder value

As some of the biggest corporations of the world flounder and top managers' dive for cover, the quest is on for explanations as to why the mighty have fallen. Some people think they have found the root cause: a blind focus on shareholder value.

This is not by any means a novel criticism of the way corporations function. But, in today's troubled conditions, support for the contention comes from some unlikely sources.

Jack Welch, ex-CEO of GE, recently lashed out at managers' obsession with shareholder value. He said: "On the face of it, shareholder value is the dumbest idea in the world. Shareholder value is a result, not a strategy... Your main constituencies are your employees, your customers and your products." This is the same Welch who is best known as the founder of the shareholder value movement, a man who ruthlessly downsized and restructured in pursuit of shareholder value.

The *Financial Times* has joined the chorus of criticism. A recent editorial in the paper says: "But there are reasons to think that shareholder value, like happiness and many of life's other good things, is best achieved by not aiming at it too directly." The *Financial Times* might like to explain what it means by saying managers should not be aiming "too directly" at shareholder value.

Managers do a number of things that they think will help maximise shareholder value – creating new and better products, venturing into new markets, cutting costs, investing in people, etc. Shareholder value flows from getting these things right. Welch is spot on: shareholder value is a result, not a strategy. It is a measure of performance. And that is exactly how manager view it.

Using shareholder value as a measure of performance undoubtedly has its flaws. One, it rests on the premise that markets are efficient and that the share price accurately captures the long-run performance of a firm. The fact that there are booms and busts in the stock market shows that markets are not all that efficient. Secondly, managers are substantially rewarded by being paid bonuses in the form of stocks of companies they run. Where markets are not efficient, managers have every incentive to do things that push up stock prices in the short-run and cash out their holdings of their companies' stocks. In other words, managers can take advantage of inefficiencies in the market at the expense of other stakeholders.

5. WEALTH MANAGERS

Map out the details to translate into benefits

Free trade

Self-interest had been the driving force behind the opening up of trade between and among nations – not altruism to do well to others. It was pure and simple, perceived and revealed, self-interest. The English classical economists put it in a philosophical manner called utilitarianism, which attached significance to something that reduced pain and increased pleasure. Nations did trade and still do it because it increases the mass of commodities and the sum of enjoyment.

However, instances surfaced when some nations deviated from free trade and did something opposite of it, despite their vigorous advocacy of the merits of free trade. The first opposition was voiced by the German economist Friedrich List in his celebrated work *The Nation System*. In this he argued **that trade should be between and among equals**. A nation not matching another should not take to free trade because it might lose. Accordingly, the former should strive to develop its productive potential under tariff protection, match the level of the other nation, and engage in trade. This stipulation has some grain of truth in that it speaks of an unequal situation and seeks to rectify it in a time-bound manner.

In the '50s of the last century, the world economy confronted the issue of the long run dollar problem. The problem was, every country needed dollar and ran a surplus trade with the US so that it could get it. This was because dollar provided infinite possibilities to its owner in terms of material benefits. The more overpowering reason was the high productivity level of the US economy. It is the high productivity of the US that made dollar so strong and also coveted. Riding on the waves of this high productivity, the US reigned supreme in a most positive manner for two decades since the end of the Second World War.

Now US has promulgated the American Recovery and Reinvestment Act withdrawing some one-lakh H-1B visas. Obama has even suggested that any firm practising outsourcing will be treated with harsher measures of taxation. The US policy response – including that of protectionism – arises from short- to medium-term concerns such as protecting employment; but, what about a rational long-term response? America must re-orient its thinking from short-run exigencies to long-term development imperatives. In that lies the key to the resolution of its present predicament and future prosperity.

We quote Jagdish Bhagwati to bring home this point: “Free trade comes naturally to countries that possess actual or perceived competitiveness”. This competitiveness seems from productivity growth within countries and also from productivity growth differences in comparables products between and among countries who wish to do trade relatively free from restrictions. And it is this productivity growth difference that explained the relative superiority enjoyed by the US in production and trade after World War II and also the long run dollar shortage.

Similarly, it is this productivity growth difference that has swung back with venom to hit the US economy in a different situation that witnesses both the decline of US productivity and the rise of the same in other countries. This productivity slide coupled with visible inability of policymaker to arrest wage rise has adversely affected the US and rendered it into a diminished giant and afflicted it with what Bhagwati calls the ‘diminished giant syndrome’. It is this that bursts into restrictions on trade of all forms and magnitudes. If the US is capable of overcoming this smallness in productivity growth someday it will not only be able to roll back its protectionist policies but also be able to create a Brave New World based on free society and free markets. How that conjuncture can be created will measure up the potential of the US and its ability and genius to translate it into a possibility.

6. CREDIT COUNSELORS

Resolve convertibility and recompensation issue

Asset Protection Schemes

Apart from stimulus packages, the UK and US governments have been trying to bail out financial institutions through a variety of means. However, most economists have been very critical of the specific measures adopted by the governments, but most agree that banks do need to be propped up. One of the main steps taken by the Labour government in the UK – the Asset Protection Scheme (APS) – designed to play a principal role in restoring confidence in the UK's banking sector by providing some kind of insurance to banks against future losses on their riskiest assets.

The scheme was meant to work according to the given guidelines that participating banks pay a small fee to the government, which in return provides protection for a proportion of their balance sheets. Banks are also required to enter legally binding agreements to increase the amount of lending they provide to homeowners and businesses. In theory, this seems to be a sensible scheme. As, there is overwhelming evidence that credit availability, in particular to small businesses, has turned out to be an important constraint preventing economic revival in Britain.

In fact, even banks with sufficient loanable funds are scared to extend credit to small businesses because of apprehensions that in the current economic environment, these businesses may not be able to generate returns which are sufficient to service their debts. Of course, these apprehensions will tend to disappear if the government provides insurance against bad debts. So, by applying *the Asset Protection Scheme*, the UK treasury insured euro 325 billion worth of the Royal Bank of Scotland (RBS)'s current toxic assets.

This is clearly a great deal for existing shareholders of the banks. But much criticism has been levied against the scheme because the British taxpayers seem to have got a very raw deal. Why they should bear the cost of insurance while RBS's shareholders escape virtually scot-free? Existing shareholders as "owner" of the bank should be responsible for all the decisions taken by the bank. In the very recent past, the bank expanded very rapidly, accounting for almost half the increase in aggregate assets of all British banks between 2001 and 2007. It decided to take risks along the way, and a large number of these decisions have turned sour. If the risks had paid off, then the owners would have reaped all the benefits. So, why should they not bear the costs now that things have gone wrong?

Exactly the same kind of criticism has been levied on the other side of the Atlantic against the US government's Troubled Asset Relief Plan (TARP), whose purpose was to purchase "troubled" or "toxic" assets from financial institutions so as to enable them to improve their balance sheets and resume normal operations. But, taxpayers bought a worthless asset. So, when will they get any reasonable returns on their investment? Also, these government actions open up the possibility of what economist call "moral hazard". If institutions know that they can gain from risky ventures if these come good, but do not have to bear any downside risk, then this will induce them to undertake riskier ventures.

On the other hand, governments cannot afford to sit on the sidelines either. The collapse of a financial behemoth such as AIG or RBS creates very large ripple effects which obviously affects the entire economy. Since significant economic slowdowns also have their deleterious effects on taxpayers, the latter do have an interest in restoring financial stability – even if this involves using some of their own money. Indeed, this was precisely the justification for the AIG bailout used by Fed Chairman Ben Bernanke. But, then how can governments tackle the problem of moral hazard? The answer must lie in greater regulation. Rules and regulations must prevent financial institutions from adopting undue risk.

7. TECH SAVVY PROFESSIONALS

Take first step to ensure efficient and reliable system

A new International reserve currency

A proposal at the G-20 summit at London by Zhou Xiaochun, governor of the People's Bank of China, to establish a new international reserve currency, what he called a 'super-sovereign reserve currency', has caused quite a stir. Zhou wants the end of the dominance of the dollar as the international currency of reserve and replaces it with the Special Drawing Rights (SDR) of the IMF.

He suggested the creation of an open-ended SDR- denominated fund at the IMF which could be used by countries to convert their reserves into the SDR. Zhou argues that any national currency is not suitable as a global reserve currency because it imposes the twin challenges on the currency issuing authority to achieve the domestic monetary policy goals and meet international demand for the reserve currency.

Zhou's proposal for the new international currency is based on British economist Keynes' suggestion at Bretton Woods in 1944. As the world economy was emerging from the World War II, Keynes suggested the creation of a global reserve currency that he named bancor – whose value was to be determined by a basket of about 30 commodities, including gold. His aim was to create a currency that would not be vulnerable to the vicissitudes of any single economy.

But the G-20 would not resolve any of the major, or even minor, problems facing the world economy today. Simply, the goal of the G-20 summit was not to establish a new financial order or to resolve any major disagreements between nations. They had a rather modest objective. They only wanted to give the impression that their summit achieved tangible results. So they assigned their deputies to fabricate a few fictitious numbers. These must be the worst of times!

Then the US was not ready for another currency to supersede the dollar. In the post World War II period, the dollar emerged as the primary global currency of reserve and exchange. Several countries pegged their currencies to the dollar, which in turn was pegged to gold. However, pegging the dollar to the gold meant that the US could not print an unlimited amount of dollars.

The system came under tremendous pressure during Vietnam War that imposed a massive strain on the US treasury and ultimately led to the withdrawal of the US dollar from the gold standard in 1971. The US dollar has, however, continued to be the primary currency of international reserves. Currently, two-thirds of the official foreign exchange reserves of national governments are in dollars, followed by the euro that holds about a quarter, the pound sterling and the Japanese yen that holds between 3-4% of the international reserves.

The US economy enjoys certain privileges by keeping its currency as the primary international currency of exchange and reserve. It can run huge trade deficits and pay them off by simply printing more greenbacks. In addition, having reigned over the world economy for almost three quarters of century, policymakers in the US are not ready to accept or even discuss the possible demise of the dollar as the currency of international reserve. At a recent press conference, President Obama rejected the idea that the world economy needs a global currency and both treasury secretary Geithner and Fed chairman Bernanke responded in a similar fashion at a congressional hearing.

Mr Zhou is right that the international financial system is defective. But this still raises the question whether SDR can replace the dollar as the main currency of international reserves.

8. MICRO-FINANCE PROFESSIONALS

Developing alternative credit delivery models

Jump start securitisation

If there is a supreme irony in this financial crisis, it may be this: The complex money games that helped sink the US economy are actually crucial to any sustainable recovery.

In March'09 the Fed kicked off a \$1 trillion campaign to breathe new life into the securitisation. This is where Wall Street firms pool and repackage all manner of cash-flow-producing financial assets – *from mortgages to credit cards* – into securities, which are then sold to investors. During the boom, Wall Street stretched to dangerous extremes the system of bundling mortgages and other loans into bonds for investors. The securities are still blowing up and damaging the economy.

While a lot of attention has rightly focused on the health of the US banking system and its ability to lend, reviving the securitisation market is probably even more important at this stage of the game.

The securitisation market, which once accounted for a third of lending in the US, is all but dead. According to trade publication Asset-Backed Alert, banks and other financial firms sold \$152 billion in asset-backed securities last year, down from a high of \$906 billion in 2006.

So far this year, only \$16 billion of deals have been done. Also, at present, there aren't that many loans to securitise. Cars aren't selling, and consumers are cutting back on their credit cards.

The closing of securitisation markets has added considerably to the stress in credit markets and financial institutions generally. Ben Bernanke said that the new plan "is aimed at resorting securitisation."

Success is far from assured. But if the Fed can fine-tune the details of its current program, the plan might just help thaw the credit markets, the lifeblood of the economy. The federal efforts to revive this critical market center on the inelegantly named 'Term Asset-Backed Securities Loan Facility', or TALF. Fed has promised to lend up to \$1 trillion to private investors to buy *newly issued securities*. The Fed also intends to let investors purchase *existing securities* to help create a market for these moribund bonds.

The tepid reaction of investors to TALF Funds is understandable. Many worry that asset prices will continue to tumble. Others fear the government will interfere in their operations. But TALF is also a work in progress, and the program may ultimately entice investors and jump-start securitisation.

Among the kinks: the list of eligible assets that investors can purchase. Under the current TALF rules, **new** securities backed by auto loans, credit-card debt, student loans, small-business loans, and other marginal loan categories qualify for government aid. But such asset classes have historically made up a small piece of the overall securitisation market, so hedge funds and the like traditionally don't find those sorts of securities all that appealing.

But, things take time to work out. With one big deal, the market could ramp up quickly. The government is also crafting TALF 2.0 for commercial and residential real estate debt. Over time, TALF will have a far greater impact. Money managers are gearing up for the TALF funds for big investors. Clients haven't signed on yet, but money managers are confident there will be interest once the government tweaks the program. They are ready to provide this for prospective investors.

9. ONE-STOP-SHOPS

Dedicated to offer related services under a roof

American capitalism

Can capitalism survive? No. I do not think it can, said Joseph Schumpeter in 1942. The story of American capitalism is, among other things, a love-hate relationship. We go through cycles of self-congratulation, revulsion and revision. Just when the latest onset of revulsion and revision began is unclear. Was it when Lehman Brothers collapsed? Or when General Motors pleaded for federal subsidies? Or now, when AIG's bonuses stir outrage? No matter. Capitalism is under siege, its future unclear.

Joseph Schumpeter, one of the 20th century's eminent economists, believed that capitalism sowed the seeds of its own destruction. Its chief virtue was long-term – the capacity to increase wealth and living standards. But short-term politics would fixate on its flaws – instability, unemployment, inequality.

Capitalist prosperity also created an oppositional class of “intellectuals” who would nurture popular discontents and disparage values (self-enrichment, risk-taking) necessary for economic success.

Almost everything about Schumpeter's diagnosis rings true with the glaring exception of conclusion. But Schumpeter's question remains. Will capitalism lose its vitality?

Successful capitalism presupposes three conditions:

- First, the legitimacy of the profit motive – the ability to do well, even fabulously;
- Second, widespread markets that mediate success and failure; and
- Finally, a legal and political system that, aside establishing property and contractual rights, also creates public acceptance. Note that the last condition modifies the first two, because government can, through taxes, laws and regulations – weakens the profit motive and interfere with markets.

The central reason why Schumpeter's prophecy unfulfilled is that US capitalism – not just companies, but a broader political process – is enormously adaptable.

It's also wrong to pit government as always oppressing business. Just the opposite often holds. Government boosts business. It adjusts to evolving public values while maintaining adequate private incentives. Meanwhile, the ambitious, striving character of American society supports an entrepreneurial culture and work ethic – capitalism's building blocks. As for new regulations, many don't depress profitability because costs are passed along to consumers in higher prices. Some New Deal Reforms helped by making risk more manageable such as - deposit insurance ended old-fashioned bank panics. Mortgage guarantee aided a post-World War II housing boom. Homeowners skyrocketed from 44% in 1940 to 62% in 1960. Earlier, the federal government distributed 131 million acres of land grants from 1850 to 1872 to encourage railroads.

Still, the present populist backlash may not end well. The parade of big companies to Washington for rescue has spawned understandable anger that could veer into destructive retribution. If companies need to be rescued from the government, then why shouldn't Washington permanently run the market? That's a dangerous mindset. It justifies punitive taxes, widespread corporate mandates; selective subsidies and meddling in companies' everyday operations (think the present anti-bonus tax bill). Greater government is an inevitable reaction to today's economic breakdown. But there is a thin line between “saving capitalism” from itself and vindicating Schumpeter's long-ago prediction.

10. CONTINUING LEARNING CENTRES

Take informed decisions

Humbling of financial capitalism

With men bearing the burnt of the economic contraction, “the US recession has opened up the biggest gap between male and female unemployment rates since records began in 1948.” A report in London Financial Times says, “Men have lost almost 80% of the 5.1 million jobs lost in the US since the onset of the recession pushing male unemployment to 8.8% as against the female jobless rate of 7%.

This is a dramatic reversal of the past when rates for male and female unemployment were more or less the same. More importantly, if this trend continues, which is not unlikely, women could soon overtake men to become the majority in the US labour force.

This development, dramatic as it is, is not entirely surprising. Men have been hurt more than women because they dominate those industries that have been particularly hard by the recession: nine in every 10 construction workers are male, as are seven in every 10 manufacturing workers. These two sectors alone account for 2.5 millions jobs lost in the US.

In contrast, women tend to hold more cyclically stable jobs and make up 75% of the most insulated sectors of all: education and healthcare. Regardless of how bad the slowdown is, people still want their children educated and sickness has scant regard for the state of the economy. In fact a prolonged and deep recession is likely to increase health woes as people fall prey to stress-related diseases.

In India the situation is quite different; partly because female participation in the (paid) work force is much less to begin with. Also because many of the industries affected by the slowdown are export related and these tend to employ a large number of women. Even construction, which is another sector impacted by the slowdown, employs a large number of women.

Nonetheless, to the extent the developed world usually sets the trend and the developing world catches up, albeit with a lag, these two developments – equal, if not higher participation by women in the work force and greater prominence for a new set of sectors – could well result in two very welcome outcomes: **One**, greater gender equality as far as salaries are concerned. **Two**, a reordering of societal priorities, and hence of salaries, in favour of sectors that genuinely contribute to human wellbeing – education, healthcare, policing, administration and so on – rather than ephemeral sectors like finance.

In other words, a shift to a new world order where people are judged (and paid) by how much they contribute to society rather than by how much they earn. Hopefully, that will change. As subsequent events have shown, the anger of taxpayers on bailout institutions led astray by rocket scientists who strayed into finance without understanding the human dynamics that underlie financial decisions at the micro level or political economy dynamics at the macro level.

Unfortunately over the past few years we allowed ourselves to be carried away by the ‘miracles’ of financial capitalism. So we had a situation where financial engineers, conjuring value out of thin air, came to be seen as somehow more deserving than civil engineers who built dams bringing water and power to millions or doctors healing the sick. This completely skewed ordering of priorities. Average pay in the financial sector rose from close to the average for all industries between 1948 and 1982 to 181% of the average in 2007. Add-ons like bonuses and severance benefits widened the gap further with the result that the best and the brightest in business schools and engineering institutes headed for financial sector.

11. GLOBAL OUTLOOK

Global pathways

Global macroeconomic cooperation

The world has yet to achieve the macro-economic policy cooperation that will be needed to restore economic growth following the Great Crash of 2008.

In much of the world, consumers are now cutting their spending in response to a fall in their wealth and a fear of unemployment. The over-whelming force behind the current collapse of jobs, output, and trade flows is even more important than the financial panic that followed Lehman Brothers' default in September 2008. There is, of course, no return of situation that preceded the Great Crash. The worldwide financial bubble cannot and should not be recreated.

But if the world cooperates effectively, the decline in consumer demand can be offset by a valuable increase in investment spending to address the most critical needs on the planet: sustainable energy, safe water and sanitation, a reduction of pollution, improved public health, and increased food production.

Households will gradually save enough to restore their wealth, and household consumption will gradually recover as well. Yet this will occur too slowly to prevent a rapid rise in unemployment and a massive shortfall of production relative to potential output. The world, therefore, needs to stimulate other kinds of spending. One powerful way to boost the world economy and to help meet future needs is to increase spending on key infrastructure projects, mainly directed at transportation (roads, ports, rail and mass transit), sustainable energy, pollution control, and water and sanitation.

There is a strong case for global cooperation to increase these public investments in the developing countries, and especially in the world's poorest regions.

These regions, including Sub-Saharan Africa and Central Asia, are suffering harshly from the global crisis, owing to falling export earnings, remittances, and capital inflows. Poor regions are also suffering from climate changes such as more frequent droughts, caused by rich countries' greenhouse gas emissions. At the same time, impoverished countries have huge needs for infrastructure, especially road, rail, renewable energy, water and sanitation, and for improved delivery of vital life-saving services, including health care and support for food production.

The G-20, which comprises the world's largest economies, offers the natural setting for global policy coordination. The leading economies – especially the US, European Union, and Japan – should establish new programmes to finance infrastructure investments in low-income countries.

Japan, with a surplus of savings, a strong currency, massive forex reserves, and factories without domestic orders, should take the lead in providing this funding for infrastructure. Moreover, Japan can boost its own economy and those of the poorest countries by directing its own industrial production to the infrastructure needs of the developing world.

Cooperation can turn the sharp and frightening decline in worldwide consumption spending into a global opportunity to invest more in the world's future wellbeing. By directing resources away from rich countries' consumption to developing countries' investment needs, the world can achieve a 'triple' victory. Higher investment and social spending in poor countries will stimulate the entire world economy, spur economic development. And promote environmental sustainability through investment in renewable energy, efficient water use, and sustainable agriculture.

12. ISSUES OF THE PRESENT

Freedom to get & fail in the system of free enterprise:

New rules for finance at last

The World Monetary and Economic Conference took place in London 76 years ago, in June 1933, with 66 countries meeting to put an end to the unfolding monetary disorder and trade wars while trying to draw the lessons of the Great Depression. When it was over, the negotiators admitted failure. On April 2, 2009, world leaders headed to London again to find a solution to a financial and economic crisis as dire as that of 1929. We cannot let history repeat itself if collective inaction prevails, we risk a return to the political and economic woes of the 1930s.

Financial rescue plans: Of course, we must respond to both the weakening economy and financial instability in a virtual state of emergency. This is why stimulus packages and financial rescue plans were for the first time adopted concomitantly in Europe, the US, and some large Asian countries. All the countries did their best and made massive efforts to repair their economic machinery as fast as possible. But, the policies chosen are different and all states favour solutions that seem most appropriate to them.

Redefine the basic principles: Economic stimulus work efficiently only if confidence is restored. And confidence can be restored only if the financial system is fully overhauled. We obviously need to strike at the root of the problem, which requires us to redefine the basic principles of the system. At the Washington Summit in November 2008, the EU suggested a basic principle: all markets, territories, and actors putting the global financial system at risk should be monitored. This principle, to which all agreed, must be enforced even if it upsets old habits and comfortable incomes.

Combat money laundering: We cannot build a safer system if we do not raise global requirements and if we tolerate non-compliance with the rules. It implies confronting to states that refuse to collaborate on financial issues at a global level or to combat money laundering or prevent financial risks. It requires to draw up a list of uncooperative countries and to design a tool kit of appropriate sanctions.

New Auditing standards: New Auditing standards must reflect an overhauled financial architecture that focuses on transparency. The aim of such standards must be to attenuate the impact of financial failure, not amplify it, as has occurred in the crisis.

A specific rating scale: Indeed, the rating agencies, whose malfunctions contributed to the crisis, must be regulated. It demands stricter rules (especially when fighting conflicts of interest), a specific rating scale for complex products, and regular publication of their returns.

Revise compensation schemes: Responsibility must be put back at the heart of the system that has sunk into excess. The methods used to pay market operators reflected our collective mistakes. Everything seemed to conspire to push to accepting excessive risks. We must revise compensation schemes and delay bonus payments until the long-term profitability of a firm's investments is known.

Solidarity with poor countries: Finally, we must express our solidarity with emerging and poor countries. Weakened by this crisis, they are first to suffer from the cuts in financial flows. The international financial institutions must support them massively, and also have the resources needed to foresee global unbalances and prevent crises, rather than respond only when events become urgent.

Strengthening financial regulations without combating the laxity that prevails elsewhere makes no sense in a globalised world. We should not delude ourselves; we cannot solve all the problems of the crisis in the coming days. We must, however, give clear signs of a true collective ambition.

With election announcements freezing government policy initiatives, it is up to the RBI to deal with the economic crisis. In the months following Lehman Brothers' collapse in November '08, RBI and the government have worked in tandem, with the central bank's financial package going together with government policy measures aimed at an economic stimulus. However, after polls are announced by the election commission, no new initiatives can be undertaken either by the government and its arms. RBI is an exception to this rule. Its status as an independent entity gives the central bank the freedom to announce measures even during polling.

RBI tries to lift economy with another cut in rates

Amid mounting fears that the economic slowdown may linger, RBI governor Duvvuri Subbarao is not holding back the ammunition. After nudging banks to cut rates, Mr Subbarao on Wednesday (4/03/09) brought down the two key benchmark rates by 50 basis points each. The monetary authority has cut the reverse repo – the rate at which it borrow from banks as well as the repo rate – the rate at which RBI lends – to 3.5% and 5%, respectively.

Managing sticky loans get easier

Corporates will find it easier to manage sticky debts while banks can show a higher profit with the RBI tweaking the accounting rules for lenders. The central bank relaxed provisioning norms for restructured loans on Thursday (09/04/09). This will not only improve bank bottom lines but also help several corporates which have been hit by the downturn. In difficult times a more realistic provisioning norm will help banks protect their bottom lines.

Annual review of RBI monetary policy:

On Tuesday (21/04/09), in a policy statement devoid of histrionics, the RBI effected a nominal 25 basis points reduction in both repo and reverse repo rates to 4.75% and 3.25% respectively, the rates at which the central bank infuses and absorbs liquidity from the system. All other rates have been kept unchanged.

For the policy meeting with bankers RBI governor D Subbarao changed the format slightly. After hearing out banks on their constraints, the governor demolished all their arguments against easing lending rates. He made it clear banks needed to lend to ensure economic activity continues unhindered. Under the current environment their challenge was to keep credit flowing, and reschedule loans of those in difficulty without evergreening unviable businesses.

Duvvuri Subbarao's patience is running out. For months, the RBI governor tried to make his point through policy hints, using an understand languages that only central bankers speak. It didn't work. Indian banks were slow to cut interest rates even as Mr Subbarao and his team aggressively lowered key policy rates and pruned reserve requirements to flood banks with funds. RBI on its part, has categorically said in its credit policy report, "While the response to policy changes has been faster in the money and government securities markets, there has been concern that the large and quick changes effected in the policy rates by the RBI have not fully transmitted to bank lending rates.

Justifying its stance of weak-pass-through of policy transmission, RBI said that while it has cut the repo rate – rate at which it lends to banks against securities – by 425 basis points and cash reserve ratio (CRR) – non-interest bearing deposits banks have to park with RBI – BY 400 basis points over the past six months, banks have reduced lending rates only by 50-150 bps over the same period.

Central bank communication

The RBI has been enjoying a rare moment in the sun. It has performed commendably compared with many of its more ‘able’ peers. Where it has fallen short is in its communication, especially with the public. As Alan Blinder of Princeton University put in a paper “*Talking about monetary policy: the virtues (and vices?) of central bank communication*” presented at the annual conference of the Bank for International Settlements last year, central bank communications are rarely known for their sparkling prose – or even for their clarity.

In fact, there is a school of thought that believes a transparent central bank cannot move real activity because it cannot create surprises. And hence some degree of opacity is essential. In times of great uncertainty, it is also tempting to take refuge in Alan Greenspan’s pet philosophy of ‘mumbling with great incoherence’. But this is an increasingly outdated view.

In the real world there is now a clear trend towards more frequent and more open communication, suggesting most central banks have decided more communication is beneficial. Despite this the jury is still out on whether clearer communication is necessarily a good thing. And the reality is that no central bank currently communicates too much information and many, in fact, communicate too little. Blinder argues that part of the reason is because many central bankers and economists confuse communication with commitment – and are worried that the public too might do so. They fear that words uttered today might reduce the effectiveness of monetary policy by restricting the freedom to manoeuvre tomorrow. But this is not necessarily true.

Communication is an important and powerful part of the central bank’s toolkit. It contributes to the effectiveness of monetary policy by creating news (for instance, by moving short-term interest rates) and/or by reducing noise (e.g. by lowering market uncertainty). Central bank talk moves financial markets and improves the predictability of monetary policy. There is no doubt that central bank communications usually affect financial markets very quickly. But interest rates and asset prices affect the rest of the economy only gradually – which make monetary policy much less comprehensible to the public.

The problem is compounded by the fact that the same message is often interpreted very differently by listeners, who may have different expectations or believe in different models.

Unfortunately, here there is very little to guide the RBI. Most research to date focuses on central bank communication with the financial markets where the RBI does reasonable well. Increasingly, however, it has become necessary for central banks to pay attention to its communication with the general public as well. (Remember communication with the general public has to be very different, in both content and style from communication with the financial markets if it is to be effective.) And here the RBI falls short.

True, communication with the public is not easy. Two reasons: One, because the public does not pay as close attention to the central bank’s policies or pronouncements as market participants do; Two, because central banks almost invariably eschew populism in favour of long-term prudence. This often makes their decisions unpopular with the public.

But to the extent that central banks derive their democratic legitimacy, and hence their cherished independence, from the consent of the general public, they need to make the effort. Especially if, as former RBI governor Reddy conceded, communication has enhanced the RBI’s *de facto* independence while *de jure* there has been no noticeable movement towards greater independence. In the country where the political class is notoriously self-serving and short-sighted that is a goal worth fighting now.

No Service tax on commercial renting

The Centre had brought “service provided in relation to renting of immovable property other than residential properties and vacant land for use in the course or furtherance of business or commerce” under the tax net through the Finance Act, 2007. Subsequently, a detailed notification and a circular were issued on May 22, 2007, and January 4, 2008, referring to ‘renting as a taxable service’.

The Delhi High Court has said commercial renting of premises will not attract service tax. The court held that renting of immovable property for use in the course or furtherance of business could not be regarded as a service, and, therefore, can’t be taxed. It gave this ruling while disposing of petitions by retailers such as Lifestyle, Shopper’s Stop Home Solution and Barista Coffee.

They had taken the plea that since the Act provided for levy of service tax on service provided in relation to renting of immovable property but it could not be construed as levy of tax on renting.

The court upheld the view and ruled that the interpretation taken in the notification and the circular on the provision was not correct and *ultra vires* to the Act and set aside both of them.

The court observed that service tax is a tax on value addition provided by some service providers and renting of immovable property for use in the course or furtherance of business did not involve any value addition and could not be regarded as a service.

The decision comes as a major relief to retailers, realtors and companies operating their businesses from rented space. The high court order is a welcome one for the business and shall reduce the input costs in these tough times. However Centre will appeal against the ruling in the Supreme Court as the decision could have serious ramifications for service tax collections. And if the government appeals to the Supreme Court, there may be some time before the issue is resolved fully.

No Service tax on sale of lottery tickets

The Supreme Court ruled that no service tax can be levied on the sale, promotion, and marketing of lottery tickets. A bench comprising Justice SB Sinha and Justice Cyriac Joseph dismissed an appeal by the Centre challenging a Sikkim high court order.

Martin Lottery Agencies and others were the agents of the state of Sikkim. The state government had floated “schemes” which had prescribed the total number of tickets. In terms of the scheme, the agent purchases all lottery tickets in bulk form on “all sold basis”. It pays Rs 70 per ticket for the face value of Rs 100. In turn, it sells the ticket to his principal stockists on ‘outright’ and ‘all sold basis’. The agent makes a profit out of the difference between the amounts received from the principal stockists and the amounts paid to the state government. The principal stockists in turn sell the tickets to the sub-stockists and who in turn sell to the agents. The retailers purchase tickets from the agents and in turn sell the same to the ultimate participants of the draw.

The entire transaction was governed by the Lottery (Regulation) Act, 1998. In accordance with the circular letter issued by Commissioner (Service Tax), Ministry of Finance, CBEC on Jan 14, 2007, the nature of transactions between the distributor and the state government do not constitute a sale. However, the government said that the activities of the distributor were that of promotion or marketing of lottery tickets for their client i.e. the state government and, thus, would be exigible to service tax.

Pursuant to the opinion of the Board, the Superintendent of the Central Excise, Gangtok had directed the agents to obtain registration and pay service tax under the heading ‘business auxiliary service’. It was challenged by the agents in the high court. The high court, had allowed the plea. Against it, the Centre had come to the apex court.

Supporting evidence

Recently, the Supreme Court had to determine whether a company is under a statutory obligation to collect evidence that its employees have actually utilised their LTA claims. In a brief order, the apex court held that there is no CBDT circular requiring the employer under section 192 to collect and “examine” the supporting evidence to the LTA declarations made by the employees.

In respect of each financial year, the CBDT issues a circular relating to income-tax deduction from salaries under section 192 of the I-T Act. The circular pertaining to the recently concluded financial year 2008-09, requires an employer to collect and examine the supporting evidence to the declarations submitted by the employees only in case of HRA claims, made under section 10(13A) and rent claims made under section 80GG.

Experts say: “The employer is required to withhold tax from the estimated salary of its employees. It has to be *bona-fide* estimation made without intent to avoid withholding of tax. All that Supreme Court decision does is to state that as long as the *bona-fides* of the employer is established, the tax authorities cannot charge the employer for short withholding of tax merely because the requisite supporting documents to prove the incurrence of actual LTA expenses were not collected or examined, as actual examination in case of LTA is not obliged by law.”

However, employers need to continue to ensure in case of all tax exemption/deduction claims of employees that they have the requisite material to convince the tax authorities that the estimation of salary income of the employee on the basis of which tax was withheld was honest and fair.

The employer cannot turn a blind eye to wrong-doings of employees. For instance, some employers may just pay lip service to their obligation of fairly estimating and deducting tax. They may resort to convenient means of overlooking some dodgy claims – thereby keeping their administrative costs low and being perceived as an employee-friendly organisation. But, think, India needs its slice of the tax pie. Withholding tax at source is the best mechanism for mitigating tax avoidance. Ushering in practical tax laws will make life easier for the diligent, dutiful Indian companies.

Relaxation of AS 11

Thanks to the global crisis, fair value accounting, mtm rules and many more have become part of our everyday lexicon. Accounting professionals might have wondered why the apex professional body (ICAI), was going into such hoops over something that went by the beguiling phrase, 'relaxation of AS11'.

AS 11 sets out the manner in which losses or gains arising out of forex transactions need to be accounted. During the boom period when the rupee was strengthening against the dollar, there was no problem. Many businesses took huge dollar loans, confident that when it was to repay, the rupee, equivalent would be less. Many others who did not take on dollar debts got carried away by the temptation to make quick money and entered into forward contracts bearing on the rupee continuing to strengthen.

But, now the tables have turned. Instead of strengthening, the rupee has been weakening against the dollar. The same repayment obligation costs more in rupee terms, not less. What looked like a surefire bet is now a losing proposition. Adherence to AS 11 means companies that over-extended themselves in dollars have to book substantial losses, given the recent sharp depreciation in the rupee against the dollar.

Not surprisingly, corporates are unhappy, to put it mildly, since this would show them in much worse light than if they were allowed to ignore the losses. Hence the clamour from industry to relax the standard; hence also the stand-off with ICAI that, rightly, see this as nothing but a fudge but has been over-ruled by government.

Under the new dispensation, companies can create a special reserve to park exchange differences and write it off it over a period of time. This is a bit like a fat man trashing the weighing scales instead of heeding its message and altering his lifestyle. Altering the manner of accounting does not alter the reality of companies sitting on potential losses. Agreed these are only potential losses, not realised ones. But mark-to-market accounting is one of the basic tenets of accounting. Companies had no complaint when the rupee was appreciating; but faced with the possibility of having to show losses are now chaffing against the very same rule.

Unfortunately the government has chosen to play along. The rationale, presumably, is that the time is not opportune to find out who's been 'swimming naked'. But this 'heads-I-win-tails-you-lose' philosophy that allows corporates to benefit from the upswings while protecting them from the downswings will do neither corporates nor the economy any good. Allowing corporates to fudge their accounts will destroy what little faith the public has in their accounts. This is not very different from the fraud at Satyam Computers except that it is driven by political expediency and has official sanction.

Of course, the Indian government is not the only one to succumb to corporate lobbying. Early this month under pressure from the US Congress, the US Financial Accounting Standards Board voted to modify the 'mark-to-market' accounting standard to allow banks to hold toxic assets on their books without marking them down to currently depressed market prices.

The hope in both cases is that investors will not be able to see through the smoke and mirrors. In effect it makes a mockery of all talk of corporate governance and transparency. A far more ethical solution would be to tell corporates to publish two sets of accounts, one adhering to AS 11 and other taking advantage of the relaxation. In a market economy *caveat emptor* (buyer beware) is par for the course; the same cannot be said about activity conniving with corporates to pull the wool over the public's eye!

Relaxation of US accounting rules

A revamping of US accounting rules is likely to ease the strains on the banking system, and the impact could be felt almost immediately. Analysts say that the change voted on Thursday (02/04/09) by the US accounting industry's standard-setting body overhauls the so-called "mark-to-market" rules that had required losses to be quickly booked – and which had been blamed by many for worsening the financial crisis. The rules were tightened after a series of corporate scandals including at energy firm Enron, which used unrealistic figures to inflate its wealth.

Under pressure from lawmakers and others, the Financial Accounting Standard Board (FASB) revised its 'fair value' standards, which requires a quarterly markdown of assets that have fallen in value. Jocelynn Drake at Schaeffer's Investment Research says, "The step could enable greater lending activity to spur the broader economy. Banks may also not be as likely to take big write-downs, she said, while adding that critics say that altering the rules could make banks' financial health less transparent to investors."

Nathan Topper at Moody's Economy.com said the FASB move to revise the rules for securities for which fair value cannot be reasonably determined "is likely to improve banks' bottom lines". In case of mortgage securities where markets are frozen, banks will no longer be required to take a hefty write-down, which would turn a paper loss into a real loss that would force banks to boost capital reserves. Topper added, "The new rules will allow firms to value those troubled assets such as residential and commercial mortgage-backed securities at higher prices produced by (computer) models."

US banks had been forced to write off over \$800 billion worth of losses linked to the real estate meltdown in the past two years. The new rules are to take effect in the 2nd quarter but may be applied retroactively to first-quarter results to be released in the coming weeks. Ed Yardeni at Yardeni Research said, "The latest change should give a boost to profits of financial companies. More importantly, it should take the pressure off of them to raise funds to fill up black holes in their capital created by the original rule."

REWRITING BOOKS

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Sebi: New rules of the game

Declare dividend on a per share basis

In order to bring about uniformity in the manner of declaring dividend among listed companies, Sebi has made it mandatory for companies to declare their dividend on a per share basis only. This means that irrespective of the face value of the share, the company will have to mention on an absolute basis. For instance, a company having shares of face value Rs 2, and declaring a dividend of Rs 2 will have to say that it has declared a dividend of Rs 2 per share and not a dividend of 100%.

The percentage change in aggregate prices as measured by the Wholesale Price Index is close to 0. Now there is a new debate on how deflation is going to hit India.

Simply put, deflation is a condition when prices fall for a long enough period of time. Economic theory does not define the period for which prices have to fall for it to be ‘officially’ declared as deflation. The problem with sustained price falls (or deflation) is that it encourages people to delay consumption and also delay saving in financial assets. This can lead to a downward spiral in investment and consumption, and overall economic activity. Deflation typically occurs when there is deep general sense of pessimism and typically is associated with helplessness. There are no such conditions in India. For one we have a range of products within the WPI that have had price increase – for instance, inflation as measured by the Consumer Price Index is still in double digits.

But by far the most important point is that for many quarters we have had very large price increases across almost all major commodities and assets. These needed to correct, and that is precisely what we are seeing. Almost everyone now has classified the conditions of the past as a bubble. At that time a strange mania had grabbed households and businesses alike, and demand it seemed was totally unresponsive to prices. But thankfully the bubble stopped expanding and now it is correcting. The India growth story will continue, though in a weakened state. But India will be among the rapidly growing world economies this year and next. During this period, the global economy will not be doing very well, demand will fall further in many developed countries, and many other negative economic shocks will be felt and transferred to India. But even that will be a part of the correction process.

There is a very important and needed restructuring that is going in the Indian economy. This is a part and parcel of free markets and critical to sustain high long-term growth. During this process of creative destruction, many sectors will not grow in the same manner as they were in the past. Falling prices are an important signal of where additional investment should not go.

So why this price falls is not deflation?

First, India invests a very large part of what it produces. We may not invest as much this year or next as we did in the past, but it will still be about a third of what we produce. This is not pessimism.

Second, there is significant domestic demand that is growing. For the next couple of years the growth may not be as much in southern or western parts of India (since they are more integrated with the world) as it will be in the east and the north. Or demand for premium goods and services may not grow as much as that of essentials and basics. The structure would be different, but the aggregate growth will be there.

Third, there is general agreement that we have a very stable set of institutions that performed much better than those in other countries when the bubble was created and went burst.

Fourth, the current price fall in a few commodities at the wholesale level is the result of events that occurred many months back. As negative shocks take a while before they spread through the economy, so do positive interventions by the governments.

Fifth, significant expenditure allocations by the government have been made; these will create new demand. The structure of this demand will be very different from that in the last few years and not everyone will benefit from the opportunities it will throw up; but in the aggregate it will have an impact. Though many have criticised the form that government action has taken. But that does not take away from the fact that eventually this action will have some impact.

Sixth, the RBI has been easing the monetary conditions in many different ways. But there again, none can deny that it takes months before their impact fully plays out. The actions taken in October, November and December '08 will impact in May, June, and July '09 and thereafter. The point is, the bubble has burst and the economy is going through a restructuring process. There will some losers and many prices will go down; this is all a part and parcel of well functioning markets.

Deflation is a result of overall pessimism in long-term potential of the economy. Some bad news in a few industries and commodities is not deflation. In fact, some price fall may be good thing for a restructuring and correcting economy.

That is, of course, not to say that all is well. Let us recognise that the ensuing months will see some more bad news. But let us also keep in mind that we have a good thing going; there is no overarching pessimism; we are investing more and consuming more than we ever did. Most importantly, the Indian economy has the ability to take much worse than circumstances are currently throwing at us.

March 28 '09: Inflation cooled to 33-year low of 0.26%

Annual inflation, as measured by changes in the WPI, cooled to a 33-year low of a 0.26% for the week ended 28 March. Economic affairs secretary Ashok Chawla said the contraction has been on expected lines and has been triggered by a fall in demand from overseas. "If you see look at the numbers, the impact continues to be on sectors where there is a very heavy export linkage. The internal demand continues to be robust particularly in the rural sectors."

April 4 '09: Annual inflation dropped to 0.18%

A sharp increase in prices of food items during the week ended April 4, kept inflation from falling to sub-zero level. However, despite the 0.4% week-on-week increase in the wholesale price index, annual inflation dropped to 0.18% - the lowest since annual records for inflation started in 1977-78 – on account of high base effect, or high index number in the corresponding week last year. Annual inflation was at 7.7% in the corresponding week last year.

April 11 '09: Inflation stays in positive zone, rises slightly to 0.26%

Higher prices of food items and textile products during the week ended April 11 '09 pushed inflation further away from its widely anticipated fall into negative territory. Annual inflation measured in terms of wholesale price index inched up to 0.26% from 0.18% in the week before. Even though inflation no longer remains a concern, increase in prices of vegetables (2.6%), fruits (0.8%) and cereals (0.3%) continues to be a major worry. Prices of manufactured items have also been moving up for the last one-and-a-half months. Textile products, chemicals and basic metals also became costlier over the week.

April 18 '09: Inflation climbs to 0.56% as food prices refuse to cool

Inflation edged up to a seven week high of 0.56% for the week to April 18, defying expectations of a drop towards zero, with data once again highlighting the persistent problem of stubbornly high food prices amid rigidities in the farm sector. The rising food index reflects a deeper and longer-term problem in the agriculture sector. Analysts expect food prices to rise further in the short-to-medium term, lifted by the increase in rates at which government agencies buy food grains, a projected decline in global cereal production, and low credit availability for the farm sector.

Food price rise

Food prices are rising; this time for real; Last year consumers got trampled by speculators and punters who came big game hunting in our neck of the woods; now those guys are not there to take the blame. It's just you, me and bare-boned fundamentals.

Prices rise when too many people chase too few goods. Food is something that every one chases. Rather desperately, in the case of most Indians. Despite the slowdown in manufacturing and services industries, people are still eating, albeit the cheapest option they can find. Demand for cereals, pulses, fruits and vegetables, cooking oil, salt, sugar, milk and eggs remain buoyant as ever.

Sure, purchasing power is a hitch. That is why even the slightest drop in the price of any food item sees a sudden spurt in demand. A good example is cooking oil, where imports jumped 30%, once prices cooled. Yet people are learning to cope. When families are buying sugar at Rs 30/kg, and watermelons at Rs 7/kg, you know Indian consumers have crossed a certain psychological threshold.

While demand is healthy, supply is in distress. A lethal cocktail of higher input costs, falling yields, and rising costs of living is choking off local food supply, making what's available even more expensive. One reason for expensive fruits and vegetables is the rising cost of village labour. It's fashionable to blame the serial rise in minimum support prices for higher food prices. Yet, has anyone spotted a farmer fattening on just the MSP, without additional advantages of soil, technology, credit and market access. A high MSP is no guarantee of farm profits. It's an incentive, like the variable part of salary.

The coming kharif may be even tougher. State governments are seriously worried there may not be enough fertilisers and certified seeds to meet crop targets. Water is another concern. The monsoon department has officially declared the rabi season rain-deficit. This year's monsoon will be critical because water stocks in India's 81 major reservoirs are decreasing rapidly with each passing week. The IMD predicts that in the coming kharif, North-West and North-East India are likely to receive less rainfall than last year, whereas central India may get more, and South India nearly same as last year. Not a very reassuring forecast, you'd agree.

The food processing and distribution channels are equally distressed. Companies are grappling with the higher cost of borrowing money, apart from higher bills for power, labour, freight and raw materials. Last year, most processors/traders were caught in the classic pincer. First commodity prices zoomed, ruining all long-term supplier contracts. People caught their breath and re-negotiated them for the next six months at a new higher level. They thought they had done the smart thing. Then prices crashed.

It was still too early to gauge the entire impact of destruction. Manufacturers are passing on some of these costs to consumers without worrying about losing them. That is not all; loss-making retailers can no longer continue deep-discounting groceries and food items. Those days of fighting for every consumer's last buck are over as mass closer of retail outlets clearly indicate.

The government, meanwhile, has been suffering from an attention-to-deficits disorder. It can easily keep rice prices low by offloading the record quantity lying in the godowns. But it won't. It has bluffed with sugar market, promising duty-free imports months before actually doing so. In fact, the government has done nothing to reduce the impact of supply swings on hapless consumers. Unfortunately, the current rise in food prices is more about supply distress rather than demand energy. That's what makes it so tragic.

An Asian Development Bank-sponsored study highlighted the need to close monitoring of family-run businesses in India. ADB report said, “The Satyam scandal in India highlights the need for sound enforcement of more rigorous accounting standards. A particular area for close study is monitoring of family-run businesses.” The suggestion by ADB report came as Satyam fell into a rough weather after its founder chairman B Ramalinga Raju confessed to fudging of accounts.

To revive the company, the Government dismissed its board and replaced it with the new one. The government appointed board is in the process of finding a strategic investor, and has paved the way on 21/02/09 for allowing a strategic investor to have management control by opening up the option of the investor acquiring a 51% stake in the software firm.

The board decided to allow the strategic investor to buy up to 31% equity through a preferential allotment and an additional 20% through a mandatory open offer. The net-worth of the bidder will be a qualifying criterion to be a strategic investor. The Board will prescribe a floor and firms with net-worth below this will be disqualified. The Board's equity comes two days after the Company Law Board authorised the Satyam board to make a minimum 26% preferential allotment of equity shares to a strategic investor and raising the company's capital base to Rs 280 crore from Rs 160 crore, or to 140 crore shares from 80 crore. Currently, the authorised capital of the company is 80 crore shares of Rs 2 each. Of this 67.3 crore shares have already been issued. The company will have to make a preferential allotment of 30.23 crore shares if the strategic investor chooses to buy a 31% stake. The investor will buy an additional 20% equity through an open offer as this is a mandatory requirement imposed by the capital market regulator.

The battle for Satyam is expected to heat up with Sebi announcing special norms for takeover of distressed companies whose boards have been reconstituted with government nominees.

The market regulator has put the onus on the newly-appointed board of a troubled target company to find the right suitor. If the regulator approves the investor, certain norms of takeover regulations may be relaxed. More importantly, under such circumstances no rival bidder can make an open offer once the acquirer, which has been approved by the board and Sebi, makes an open offer. According to the Sebi order, competition in the takeover process can happen only till the board finalises the acquirer.

Acting fast after getting the Sebi go-ahead, Satyam on 09/03/09 kicked off the bidding process to sell a 51% stake in the company and found a positive response from two key suitors – L&T and Spice Corp.

Goldman Sachs and Indian investment bank Avendus Advisors are advising Satyam's board on the sale process. Engineering and construction firm Larson & Toubro Ltd, which is a 12% shareholder in the company, said it hopes to bid. Besides, Spice Group Chairman BK Modi said his company would bid for Satyam. Mr Modi said it is good thing that the bidding is taking place online and there is no floor price, which should encourage many players to participate in the process.

The salient features of the bidding process are –

- The bidders will have to register with Satyam by March 12.
- The bidders then are asked to submit a detailed expression of interest by March 20.
- Qualified bidders will be shortlisted and given access to certain business, financial and legal materials, and after completing the due diligence process, they would need to submit their financial bids.
- Based on the evaluation of the bids, the company will select the successful bidder.
- The two-phase exercise to induct a strategic partner involves a 31 percent stake sale by issuing fresh equity and then a 20 percent open offer by the successful bidder.

IBM Global Services, one of the world's largest IT services firms, is in the race for Satyam Computer Services, albeit through a law firm representing it. The entry of IBM could give serious competition to L&T, so far perceived among the strongest and most serious contenders. Nearly 130 firms, including a clutch of law firms, have expressed their interest in the beleaguered IT major.

Rules of the game: Dos & Don'ts for Satyam's Bidders

- Cannot sell Satyam's assets for 2 years, and has to retain 100 key employees for a year
- Convince board of managerial ability to run Satyam
- Cannot pledge Satyam's assets to buy the firm
- Have to deposit total acquisition funds before preferential allotment
- To disclose direct & indirect shareholding in Satyam
- Cannot be a resident of the United States
- Can be a qualified investor

The government-appointed board of Satyam has attached several preconditions to qualify for the second stage of bidding, the first being registering a formal expression of interest. The board has also made it mandatory for qualified bidders to put up Rs 100-crore bank guarantee while putting in their final financial bids and suitors will not be allowed to change the bid price once the bids are submitted.

Non-disclosure pacts: A pre-requisite to do due diligence

Six suitors including billionaire investor **Wilbur Ross** have inked non-disclosure pacts with Satyam, a pre-requisite to do due diligence on the assets and liabilities of the beleaguered IT firm. Wilbur Ross, founder of the private equity firm W L Ross. Of these, 4-bidders have already done the due diligence and 2-more are expected to follow suit. This will enable them put a price tag on Satyam.

The acquisition will help a company like **L&T Infotech** expand its business globally. The spin off for **Tech Mahindra**, which is right now focused on the telecom vertical, would be diversification into other lucrative business segments of retail, manufacturing, pharma and health care. For a multinational like **IBM**, the Satyam acquisition will come in handy to compete more effectively with its rival HD-EDS and consolidate its leadership in the global outsourcing market.

US headquartered **Cognizant Technology Solutions** is the fourth largest India-based IT services exporters. After TCS, Infosys Technologies and Wipro, it ranks as the next highest exporter, but unlike them is domiciled out of the US. While Cognizant has been conservative in its acquisition strategy, what may have prompted it to bid for Satyam is the advantage of the scale that the acquisition will bring it, propelling it into the same league as TCS and Infosys. Another factor working in Cognizant's favour is that among the top four IT firm it has the least overlap of clients with Satyam.

The government appointed Satyam board had short-listed around eight bidders who had expressed interest in Satyam. The short-list included the **B K Modi's promoted Spice Group**. But the Spice Group did not sign a non-disclosure agreement as it reckoned the bidding process was not transparent.

Minister of corporate affairs Prem Chand Gupta took a dig at B K Modi, "What do we say... the whole thing is being supervised by a retired Chief Justice of India... I don't know we have to get a person from space to satisfy people like him." The bidding, which is being conducted as per the guidelines prescribed by the Company Law Board and Sebi, is being overseen by retired chief justice S P Bharucha.

Satyam made minor changes in the bidding rules to select a new owner. In a move aimed at ensuring greater transparency, the government-appointed Satyam board has decided an open auction if there is a 10% difference between the price quoted by the highest bidder and that by others. The highest bid, however, would become the floor price for the open auction.

The Satyam board had also extended the deadline for submitting bids from April 9 to April 13. The extension of the deadline will enable the bidders to complete due diligence. The information pack to bidders runs into 700 pages, with data on the firm's revenue streams, order-book position, current and fixed assets, and current liabilities. It will also help them put a price tag on the firm.

The sale process for the scam-tainted software service company is heading for a dramatic end with the Satyam board meeting on Monday (13/04/09) to examine the technical and financial bids of the interested parties. The board may have an informal floor price in mind and may not accept bids if they are very low.

According to the schedule drawn up by the Satyam board, the technical and financial bids will be submitted simultaneously by the bidders on Monday morning in the presence of ex-Supreme Court Justice S P Bharucha. It is expected that all the bidders will clear the technical criteria and their financial bids will be subsequently opened. If the financial bids are more than the board's informal floor price, the highest bidder will be declared the winner. However, if the difference between the price quoted by the highest bidder and the others is ten per cent or less, the other bidders have the option to take the bidding process to the next round. This will be done through an open auction with the highest price in the earlier round become the floor price for the next.

Satyam all set for a new owner

Satyam computer services is all set to get new owner, as the board gets ready to open the final bids on Monday (13/04/09). This will help put the company back on track after the admission of the Rs 7000 crore fraud by its own founder and chairman Ramalinga Raju. The new buyer is likely to phase out the brand Satyam to help rebuild the company. Whosoever the new owner may be, it will certainly be a good buy considering the marquee client list, and the depth of experience with the Satyam staff. The board has invoked some clauses like the winner cannot leverage Satyam's assets and cannot sell them for a required period of time. But despite the over \$100 mn in liabilities and a loss of about 40 clients in three months like Coca-Cola, it continues to draw interest from global players like IBM, Cognizant Technologies, British Telecom, and Wilbur Ross and local players like L&T, Tech Mahindra and so on.

Board midwives bid process successfully

The six wise men gathered at Hotel President around nine in the morning. They expected the Satyam finale to finish during the day but were prepared for a long meeting. It was a morning of conflicting emotions for Kiran Karnik, Tarun Das, Deepak Parekh, TN Manoharan, S Mainak and C Achuthan, who constitute the Satyam Board. The morning began with on a somber note, with the board receiving a letter from Cognizant Technologies informing it that it was withdrawing from the race.

For the last few days, board members had exuded optimism but instead they were jittery about the outcome. They were unsure about whether they would receive three or four bids. But worse, they didn't know for sure what the suitors would eventually bid. They were hoping that the highest bid would be in the Rs 40 to 50 ranges but were aware they would have a problem on their hands if the highest bid turned out to be less than Rs 40, given that the Satyam shares had closed on the last trading day, at Rs 47.

The board had, after all, been appointed by the government and was aware that it would be panned severely by stakeholders and bidders such as BK Modi, who withdrew at an early stage, if the company was sold cheaply. But board members also knew that it would receive flak for mishandling the process if it did not go ahead with the sale. The board's main aim was to get a good deal for Satyam. But all the six eminent men knew that by taking up the responsibility, they had put their own reputations on the line. A successful outcome would be a crowning achievement. Failure, conversely, could sully their reputation.

After the three final bidders – L&T, WL Ross, and Tech Mahindra – submitted the technical and financial bids, the board opened the technical bids. The directors divided themselves into groups with each team examining one bid followed by all of them together discussing a bid. The board had listed about 20-25 points in the technical criteria and the bidders had responded to each one. Assisting the board were its management advisors, Homi Khusrokhhan and Partho Dutta, representatives from investment banks Goldman Sachs and Avendus, and lawyers from Amarchand Mangaldas.

At 11am, all the technical bids had passed muster. All the bidders were called in and the financial bids were now opened alphabetically with L&T being the first. Some board members were expecting Wilbur Ross to bid aggressively as they believed that was his style. Instead, his bid came in at only Rs 20 per share. But any disappointment was drowned in the knowledge that Tech Mahindra had bid at Rs 58 per share. Satyam had a new owner. The reputations of the board members stood enhanced.

Tech Mahindra wins Satyam

For Anand Mahindra chairman, Tech Mahindra and VC and MD, Mahindra & Mahindra the work has just begun on Monday (13/04/09). He said, "There is a sense of euphoria and joy right now but it will be different when we wake up the next morning... It will not be easy. It is a challenge but we will make it work." The two entities combined, will be within striking distance of Wipro, the third largest software exporter. The Tech Mahindra stock shot up 12% to close at Rs 359.45 on BSE on Monday in a validation of its strategy to acquire Satyam despite its bids of Rs 58 a share being significantly higher than the second highest bid put in by L&T. Shares of Satyam closed 3.6% higher at Rs 48.85.

Anand Mahindra said when asked whether he was overpaying, "You don't look behind yourself in a deal. You need to look at the deal strategically. This was reasonable bid and accretive for our shareholders." Tech Mahindra will have fork out Rs 1756 crore for subscription to preferential issue of 31% fresh shares in Satyam and 20% mandatory open offer priced at Rs 58 a share, the two transactions will cost Tech Mahindra Rs 2,889 crore. The bid values Satyam, once ranked as the country's fourth largest IT exporter, at a little over \$1 billion. From being primarily a single-client company, Tech Mahindra-Satyam will now compete for projects with the top three of Indian IT – Tata Consultancy, Infosys Technologies and Wipro, and multinationals such as IBM and Accenture.

The suitable boy

The swiftness with which the process to find a new promoter was completed should go a long way to restore investor confidence in the Indian corporate sector as well as the government and regulators. It will also create confidence among foreign investors about India's ability to deal with such situations. Also an early closure of the transaction and completion of the management transition should put to end the uncertainty Satyam's employees, clients and investors have lived with over the past three months.

Much of the credit should go to the government-appointed board, which managed to complete the process in less than three months since its appointment and without much controversy.

The government, Sebi and the Company Law Board too deserve praise for moving quickly, removing roadblocks to a swift management change. Although we do not yet know what form Satyam will take in the hands of the new management, the acquisition would be enormously beneficial for Tech Mahindra, a relatively small player in the software sector with a telecom sector focus. The deal should catapult Tech Mahindra into the big league alongside Infosys, TCS and Wipro, and also expand its presence in the US.

The 85-year-old M&M group chairman Keshub Mahindra said, it all began in 1986 with a not-so-princely sum of Rs 1 crore when he set up Tech Mahindra jointly with British Telecom to get into telephony business in Maharashtra. But the government turned down his plan as it did not want private sector presence in telecom space. So, he got into IT outsourcing, more by accident than choice. And 23 years down the line, Tech Mahindra has become the country's fourth largest IT company after acquiring the Satyam Computer Services. Satyam is a beautiful fit in our scheme of things. He thought he begged Satyam with a walk-away price. He is fully aware of the challenge facing Satyam, which he thinks is a great company, and is quite confident of steering it out of the woods.

Mandatory Open offer for 20% stake in Satyam

Anand Mahindra said on Monday (20/04/09) that all the financial resources required for the acquisition were raised through the local markets and non-banking financial companies, apart from internal resources and issue of non-convertible bond, commercial papers and receivables. And the IT arm of Mahindra and Mahindra today deposited the initial subscription amount of Rs 1,756 crore and an additional Rs 1,154 crore necessary to consummate the mandatory public offer in separate escrow accounts. All this was done in a record 72 hours, which shows the world that the Indian financial market has huge depth.

Anand Mahindra, accompanied by senior executives of the Mahindra Group and Tech Mahindra, met the government-appointed members of the Satyam board and the company's key executives of Satyam to finalise plans for Tech Mahindra's acquisition and discuss important transition issues.

It is told to reporters that the Hyderabad-based IT firm will continue as an independent entity for the foreseeable future and its leadership will also continue to drive operations – Satyam CEO A S Murty and president Ram Mynampati agreed to continue in the company. The Tech Mahindra nominees will be appointed to the Satyam board after the initial allotment of shares is complete. An integration team is already in place and the company will have a new CFO in the next few weeks. The management's first priority will be to bring Satyam back to financial health; retaining current customers and winning back business lost as a result of the crisis; retaining key associates; winning new businesses and exploring the best way to realise operational and structural synergies between the two companies.

On Wednesday (22/04/09) Tech Mahindra announced an open offer to acquire an additional 20% equity in the Satyam Computer Services. The open offer if completed successfully will raise Tech Mahindra's stake in Satyam to 51%. The offer will be made by Venturbay Consultants, an arm of Tech Mahindra, which is on course to become the new owner of the firm. Kotak Mahindra Capital Co is the lead manager to the offer which will be open for subscription between June 12 and July 1 '09.

Tech Mahindra have an option to raise the open offer price, seven days before it closes, under Sebi guidelines. If the offer is not fully subscribed, the company will be allowed to acquire additional shares through a second preferential allotment. The shares acquired through preferential allotment and open offer will be subject lock-in-period of three years.

Capital markets regulator Sebi could make it mandatory for all listed companies to buy directors' & officers (D&O) liability insurance to shield them from the risk of huge liabilities in the event of frauds stemming from poor corporate governance practices. For the general insurance industry, it could mean additional business of at least Rs 125 crore, based on an average insurance cover of Rs 5 crore taken out by every listed company. In India, while it's compulsory for the mutual funds and insurance brokers to take liability covers, there is no such restriction on listed companies. At present, the premium for the D&O policy is as low as 0.5% of the total cover.

Less than 10% of companies listed on the BSE now have any kind of D&O policies, which typically cover top executives from being held personally liable in the event of misleading financial statements and mismanagement of funds. It also guards companies in case of litigation payments made on behalf of its directors or officers. Such policies could help corporate governance in firms, since risk management is part of corporate governance. Also it provides companies with a hedge against uncertain situations.

E&Y's Nitin Bhatt, partner – advisory services, said D&O policies were very popular in the west, with virtually all listed entities in the United States (US) covered by such policies. But until now, D&O liability insurance has remained low in India, largely because there have been very few claims filed against directors and officers. But ever since the Satyam scandal, the demand for D&O policies has risen as eminent people have refused to join the board of companies which have no or inadequate D&O cover. It (D&O policies) would give comfort to competent individuals who are otherwise hesitant to serve on boards. Given current corporate environment, independent directors would be extremely wary of serving on the boards of companies that do not protect them.

Insurance renewals go up as surrenders dip

The current financial slowdown has not had any impact on insurance renewals. Figures being thrown up by most insurance companies have shown that the renewal premium went up significantly during the 2008-09, and the number of those surrenders dipped.

That indicates that even in the current situation of slowdown, policy holders have taken a long-term view and made it a point to continue paying their premiums and keeping their policies alive. This is a sharp contrast to other market-linked financial instruments where investors have stopped paying their installments. Industry figures have shown that the total renewal premium went up by 16% to Rs 131,392 crore for the nine month period ending December '2008 against the same period last year.

Insurance companies are also claiming an increase in their conversion ratios. Conversion ratio measures the commitment of the consumer to pay the premium regularly over a long period of time. While LIC recorded a conversion ratio of 90.5%, Max New York Life had a conversion ratio of more than 85% the previous year. According to Sunil Kakar, CFO, Max New York Life Insurance, it is extremely important to maintain a healthy conversion ratio as it demonstrates that the product is sold to the right person. In most cases, the policyholder decides to stop paying renewal premium if he feels that the life insurance policy will not help her achieve the objectives for which he bought the policy in the first place.

Meanwhile, the life insurance industry, registered a negative growth of 8% based on first year premiums in the period between April 2008 and January 2009. This has mainly been attributed to increased economic uncertainties. Insurance companies feel that this could cause a significant impact on their renewal business next year.

How much worse can it get is the question uppermost on most minds? Well, if signal from multilateral like the IMF is any guide; there is no immediate solace at hand. After holding out the prospect of the global economy at 0.5% growth in 2009, the IMF now expects growth to dip below zero - an absolute decline in global GDP for the first time since World War II. It is a bad news for emerging markets like India, whose fortunes are inextricably linked to global growth, except to the extent the IMF MD Dominique Strauss-Kahn terms the present slowdown a 'Great Recession' not a Great Depression. So there is reason to hope that we might still escape a repeat of the 1930s experience.

There are a number of reasons for this. One, world leaders and central banks have been far more proactive than during the Great Depression. Two, there is growing realisation that co-ordinated policy action can alone save the day. Three, the Fund itself is likely to see a sharp increase in its resources. The US administration has called for a tripling of 'IMF fire-power'.

So, with the little luck, the immediate global resource crunch might be resolved. True, we might not see the root-and-branch reform of the global financial architecture we'd hoped for. But US treasury secretary Tim Geithner already admitted, "Lots of things that did not seem realistic in the past are not just realistic but compelling," so hopefully we will see a less imbalanced global economic order in the not-too-distant future. For now, given how protracted serious reform of the international financial architecture will be, the G-20 should use the opportunity of its forthcoming April 2 meeting, to get the world economy out of its present comatose state, and then address long-term imbalances.

G20 summit: **Brown's moment of glory?**

What we're all really waiting to see is if this April's party will actually lead to some coordinated action that will help. To be fair, global governments have pretty much been coordinated in their response so far: Cut interest rates, increased government spending and thrown money to prop up failing banks. But, none of which has stemmed the constant flow of bad news that's flowing through the economic system across the globe. So, what really can global leaders do that they're not already doing individually?

Well, that's the one generating all the noise and heat. Britain, which is hosting the summit, is very, very keen that this doesn't end up being a damp squib like the Washington round. Gordon Brown went off to Washington to make double sure that Mr Obama would actually show up, and get involved in the discussion. As US is still pretty much the biggest elephant in the room.

Before Mr Obama and his team could put their mind to the job, the Europeans had agreed to work on a global financial regulator, crack down on tax havens like Switzerland and also tighten the screw on banks.

Mr Obama blew the tough cop act out of the water, as soon as he entered the fray with plans as grand as his deficit. He wants the IMF to be given a lot more money, and he also wants governments to throw a lot more money at the problem – and get the rich countries to spend at least 2% of their GDP on stimulus packages.

However, the emerging countries bloc, including India, is clearly going to make anti-protectionism the cornerstone of their argument. Instead of just rhetoric, they're likely to demand clear signals that rich nations aren't bunkering down in nationalistic cubbyholes, while at the same time talking global coordination. For Mr Brown, this is a huge bet, both for his personal credibility and the UK's position in the world. As host, he desperately wants the Summit to be important, and has done his best to hype it up. If things go wrong, there will be huge negative political and economic fallout.

G20 pledges sustained action on financial crisis

Financial officials from rich and developing countries pledged on Saturday (14/03/09) to do “whatever is necessary” to fix the global economy, including supervision of free-wheeling hedge funds and restoring bank lending by dealing with the shaky securities burdening their finances. But officials remained cool to a US push for more coordinated government spending to stimulate economies. They called instead on the IMF to assess the individual government actions already taken and what more might be required, rather than laying out definite plans to ramp up spending.

Finance Ministers and central bankers from the Group of 20, which accounts for more than 80% of the world economy, agreed there was an ‘urgent need’ for a big boost to the lending resources of the IMF to help struggling governments in the developing world. They left the specific amount and who would contribute open, to be taken up at the much-anticipated summit of the group’s national leaders in London.

British treasury chief Alistair Darling said, “We’re prepared to take whatever action is necessary to ensure growth is resorted and we’re committed to do that for however long it takes to do that.”

Obama calls for global action to end downturn

President Barack Obama called for “bold comprehensive and coordinated action” to end a global economic downturn. Obama urged leaders of the G20 major economies to follow the US lead by taking action to stimulate their economies until global demand is resorted. “We are living through a time of global economic challenges that cannot be met by half measures or the isolated efforts of any nation. The leaders of the Group of 20 have a responsibility to take bold, comprehensive and coordinated action that not only jump-starts recovery, but also launches a new era of economic engagement to prevent a crisis like this from ever happening again.”

Glimmer of hope

The G20 Summit in London, billed by some as the new Bretton Woods, is nowhere near as epoch-making as the 1944 conference that gave the world its present financial architecture. But given the odds, the much greater complexity of the global economy, the extent of the global meltdown and the short lead time available, the Summit could not well bid to be a worthy successor.

The biggest achievement is, no doubt, the increase in resources available to the International Monetary Fund for on-lending to countries facing a liquidity crunch. The immediate increase is only \$250 billion, far less than the headline grabbing \$1.1 trillion mentioned in most reports, though the Summit communiqué mentions the Fund’s resources could be increased by up to \$500 billion.

The other achievements are the agreement on broad principles to strengthen financial supervision and regulation, reform multilateral institutions, resist protectionism, crack down on tax havens, and so on. The decision to establish a new Financial Stability Board with representatives from all G20 countries, as successor to the Financial Stability Forum, to oversee the health of the global financial system and establish an early warning system is another positive.



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