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Renaissance

Safe Updates (Keep Informed)

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1.1 ECONOMIC FREEDOM

...new paradigm of inclusive growth

India's Constitution gave political freedom to all Indians. All, rich and poor men and women, were given the right to vote: before the US and several European countries had given such rights to their citizens. In the 1990s, new policies brought economic freedoms to Indians that they had been denied earlier: the freedom to start and expand businesses, accumulate wealth, and even venture abroad. With these freedoms, the economy began to grow and Indian businessmen appeared on the world's stage.

In 2004, millions of Bharatis, using their freedom to vote, reminded the newly shining Indians that the masses were not included sufficiently in the benefits of the economic growth that followed economic liberalisation. Since that election, inclusion became the political mantra in India again. And with its emphasis on inclusion, the Congress won an even stronger mandate in 2009.

India sits on a demographic time bomb. Its economic growth is not providing decent jobs and incomes to everyone. Hundreds of millions of youth, who are expected to give India a demographic dividend, can be a huge liability unless the country alters its pattern of industrialisations to include more people more rapidly in the benefits of economic growth. Already youth without incomes are the terrorists' resource in the large Naxal infected areas of India. It is imperative that the country develop a new paradigm of inclusive growth: a paradigm that injects the strengths of democracy into capitalism.

India needs models of business that is not only for the people, but is business by the people and of the people. Making products and services the poor can afford, such as a shampoo sachet, is business for the people. It enables companies to make profits at the bottom of the pyramid. Whereas people at the bottom of the pyramid need income before shampoo; if they had more income, they could buy a whole bottle of shampoo! Therefore rather than only for people, business should be by the people. They must be engaged in larger numbers as workers and earners, not merely as customers.

This was Henry Ford's vision. He doubled his workers' wages over the industry norm because he wanted them to be customers for his cars. Ford later ran into problem with his employees. Unions became stronger; labour was given legal protections.

Wary of such restraints, capitalists everywhere have become hesitant to engage more labour. In India too, large industry is creating less jobs than self-employment and the unorganised sector. The problem with this pattern is that efficiencies of scale are not obtained. Scale can be obtained by the purposeful aggregation of many small and large enterprises into large networks. Within these networks of businesses of the people, ownership can be widely dispersed. In such inclusive enterprise, people at the bottom of the pyramid can make profits on their stakes. They become capitalists too.

Mahatma Gandhi gave independent India's leaders a test for their policies. Consider how they will benefit the poorest man. It was not answered. He said he understood why many looms had to be aggregated into one large factory when looms were powered by steam which could not be transported over long distances. He wondered why the looms could not be dispersed when they were powered with electricity which can be transmitted widely. Moreover, by the 21st century, advances in IT and telecommunications are enabling co-ordination of widely dispersed activities. Therefore it should be possible to break out of the concept of the large integrated factory that Henry Ford created and develop a new paradigm of an inclusive, networked enterprise. The innovations required to create such enterprises will not happen within industrial laboratories. Such inclusive enterprises will evolve from innovations in the design of supply chains, as well as innovations in models of governance and leadership. It is such innovations that India must pursue for inclusive industrialisation.

1.2 STOCK MARKETS

Too much, too soon

Despite the crash after Pranab Mukherjee's big-spending budget, India is now the best performing emerging market in the world. Clearly foreign investors aren't responding to reforms or big macro picture while pumping dollars back into Indian equities. They're probably excited by the fact that Indian companies are growing profits faster than anyone expected.

Today the sensex trades a more than 17 times the earnings of its 30 companies: That's more than double the multiple of eight that is plunged to in November last year, when the market hit bottom. Today's PE multiple is not frightening, it's still lower than the figure of 25 it hit on December 16, 2007, at the peak of the equities mania. But we are scared at the speed at which the market has run up. Too much, too fast could set us up for another bubble in stocks. And that's something we simply can't afford.

Yes, India is one of the great economic stories for the century. Most people agree that it has the potential to grow fast for a very long time, may be for the next 20 years or so. Its population is young and energetic. And there's no doubt that India's appetite for roads, bridges, ports, schools, hospitals and energy will not continue until all Indians have a chance to lead a life of dignity.

But that's the long-term story, and we know that financial investors – pressed to show returns every quarter. Ultimately financial investing is all about buying into companies that promise steady revenue and profit growth. Today, we're seeing faster than expected profit growth, but the topline moves sluggishly. Slow sales growth means only one thing: demand is growing slower than expected.

Demand is slack in India. And the demand is falling in many parts of the world. Meanwhile, there's a giant wave of cash that's building up, ready to turn into a tsunami of funds. These funds will flood into any market that looks better than the rest.

For example, China's printed 28.5% more money from June last year, to June this year. The US has forked out tens of trillions of new dollars to restart its economy. It's the same in Europe and Japan. And our government has promised to spend a whole lot more to make sure growth doesn't stop.

So, there's lot money in the system. Right now, this money is going to restore confidence, shore up banks, mend financial systems, and get people to spend. But soon, there's going to be a very large amount of money chasing too few good assets.

If you look around the world, India looks very attractive, low risk, low exposure to export markets, around 7% growth, and a regulated – but relatively safe – banking system. So, we fear, India is going to be one place where this funds tsunami will head. We're seeing the first breakers from that wave hit us. That's probably why we're seeing markets run up so much so fast. You could argue, quite reasonably, that the lower number was a product of unnatural circumstances – the fallout from the worst crash in living memory. Point taken, but the recent run up has happened at terrifying speed.

Can policy help? Unlikely – and probably undesirable – as any action by the government to stern the tide of money coming in could cause investors to turn tail. That in turn could create further problems with exchange and interest rates and foreign currency reserves. But there's hope. If the tsunami of money breaks up into smaller waves that hit different countries around the world, the impact on India will be less severe. For example, a lot of the money will flow towards China; a lot of it will lead our way. But as the US and Europe emerge from their troubles, investors will find value there as well. Everyone loves a healthy, growing market. Recent experience has taught us to be very wary of irrational run-ups.

3rd week of July '09 – Market regains 15K psychological level

Equity and bond streets flush with FII money: Irrespective of international rating agencies taking a cautious view on India as an investment destination, FIIs have been pouring money into both equities and debt over the past few weeks. In fact, the Indian bond market has been a major receiver of money from FIIs since the beginning of July. Sebi data show the domestic debt market received inflows worth Rs 4485 crore over the past 2- weeks, making it the highest point of debt investment this year. This apart, foreign investors have also net bought Rs 5637 crore of Indian equities in July so far. According to experts, a key reason for this rise in debt market inflows is the interest rate differential between US treasuries and Indian bonds. Through US treasuries have rallied over the past two weeks with the 10-year US government bond yielding a heavy 3.5%, it pales in comparison to Indian sovereign bonds (10-year g-sec), which have been trading at around 7% over the past two weeks.

Daily review	17/07/09	20/07/09	21/07/09	22/07/09	23/07/09	24/07/09
Sensex	14744.92	446.09	(128.52)	(219.37)	387.92	147.92
Nifty	4374.95	127.30	(33.15)	(70.20)	124.85	44.80

'Long only' FIIs step up their India focus: Traditional 'long only' FIIs, many of them newer markets such as *Australia* and *China*, have stepped up their equity investments in India over the past couple of months. Also incremental flow of money from regions likes *Europe and US* is on the rise. European funds like Carmignac Gestion (French management firm), Eurozone – Lombard Odier (one of the oldest Swiss private bankers, specialising in private asset and wealth management) are said to be some of the funds that have increased their exposure to Indian shares.

Among the China funds investing into India is *China International Fund Management Co* (CIFM), a joint venture between JP Morgan Asset Management and Shanghai International Trust. The other is *China Asset Management* (China AMC) – the country's largest fund house. These funds started with an exposure to index and are gradually becoming more sector/stock specific. The latest Chinese fund in the news is *China Investment Corporation* (CIC) – a $200-billion sovereign wealth fund, which is said to have pumped in around $150-200 million into Indian shares this month. Long-only funds follow the strategy of buying shares and staying invested for long term; they do not take any leveraged bets.

Weekly review	17/07/09	24/07/09	Points	%
Sensex	14744.92	15378.96	634.04	4.30%
Nifty	4374.95	4568.55	193.60	4.43%

Market regains 15K psychological level: The stock market entered the 15K psychological zone after a gap of five weeks as the benchmark Sensex extended gains and ended at the six-week high of 15,378.96, boosted by distinct signs of economic recovery and flows of good quarterly earnings. Revival of monsoon in the country and buoyant global cues also contributed to the upbeat mood.

The main trigger for weekly surge was fresh signs of economic recovery, shown by a 6.5% growth in infrastructure sector output. Inflation too remained negative at minus 1.17% for the week ended July 11. Indian bourses were well supported by global markets, which hit a multi-month high on revival in economy across the world as well as encouraging corporate earnings. At home, Realty, Auto and IT shares stole the line light as several companies of these sectors beat analyst's estimates, and came out with excellent Q1 performance. During the week, Maruti Suzuki, ITC, ACC, Ranbaxy Lab and Wipro announced better-than-expected quarterly earnings.

4th week of July '09 – Robust earnings, global mood lifts Sensex

Encouraging global picture and robust earnings outlook for the fiscal, propelled Indian bourses aiding the benchmark Sensex to hit a 13-month high of 15,670.31 amid end of quarterly earning season.

Daily review	24/07/09	27/07/09	28/07/09	29/07/09	30/07/09	31/07/09
Sensex	15378.96	(3.92)	(43.10)	(158.48)	214.50	282.35
Nifty	4568.55	3.75	(8.20)	(50.60)	57.95	65.00

Weekly review	24/07/09	31/07/09	Points	%
Sensex	15378.96	15,670.31	291.35	1.89%
Nifty	4568.55	4,636.45	67.90	1.49%

MONTHLY REVIEW

Month	June '08	June '09	**July '09**
Date	30.06.08	30/06/09	**31/07/09**
Sensex	13,461.60	14,493.84	**15,670.31**
Points			**1,176.47**
%			**8.12%**

The Bombay Stock Exchange 30-share barometer gained 1,176 points or 8.12% in July quarterly earning season. The major trigger was the better-than-expected financial results by majority of companies. Extending weekly gains bellwether concluded at levels not seen since June 17, 2008. The RBI's quarterly monetary policy review announced on July 28 also impacted the market. The RBI left the key rates unchanged and increased the inflation forecast to 5% in this fiscal. It also raised the growth projections at 6% in 2009-10. Meanwhile, Finance Minister Pranab Mukherjee on the same day announced tax breaks, mainly beneficial to infrastructure sector in a bid to stimulate the economy. FII activity during the month too was encouraging with a total capital flow of over 11,000 crore in July.

1st week of August '09 – Market retreats on monsoon worries after touching 16k

Daily review	31/07/09	03/08/09	04/08/09	05/08/09	06/08/09	07/08/09
Sensex	15,670.31	253.92	(93.25)	72.85	(389.80)	(353.79)
Nifty	4,636.45	74.95	(30.90)	13.65	(108.65)	(104.10)

Market touches 16K psychological level: The sensex crossed 16k level for the first time in 14 months to touch a trading high of 16,002.46 on August 4. Below the normal rainfall so far this year has halted a strong bull run. Analysts said monsoon rains is the main source for nearly 60% farm irrigation in India and considered crucial for India's economy. The IPO by the state-run NHPC, which got good response on the first of its opening, also raised fears that it will absorb liquidity from the secondary market.

Weekly review	31/07/09	07/08/09	Points	%
Sensex	15,670.31	15,160.24	(510.07)	(3.26%)
Nifty	4,636.45	4,481.40	(155.05)	(3.34%)

2nd week of August '09 – Market turned bullish, washed away monsoon concerns

Daily review	07/08/09	10/08/09	11/08/09	12/08/09	13/08/09	14/08/09
Sensex	15,160.24	(150.47)	64.82	(54.43)	498.33	(106.86)
Nifty	4,481.40	(43.75)	33.70	(13.85)	147.50	(24.95)

Industrial data, tax code wash away markers' monsoon concern: The government draft new direct tax code, remarkable growth in industrial output in June, and the Free-Trade Agreement with ASIAN on Thursday washed away monsoon concerns as the benchmark Sensex rose 498 points, the biggest single-day gain since May 27. Firm global cues and rating agency Standard & Poor upgrade of India's growth forecast further pepped up market sentiments. The trigger-starved market turned strongly bullish after stunning growth in India's Industrial production for June offset worries about the deficient rainfall. Analysts said: "The flow of good news pushed the market up. Yesterday it was good IIP numbers. Last night, in the US, there was an indication from the official quarters that recession is easing. Today Germany and France delivered a pleasant surprise."

Weekly review	07/08/09	14/08/09	Points	%
Sensex	15,160.24	15,411.63	251.39	1.66%
Nifty	4,481.40	4580.05	98.65	2.20%

6-MONTHLY REVIEW

Month	Dec '07	June '08	Dec '09	June '09
Date	28/12/07	30.06.08	31/12/08	30/06/09
Sensex	20,206.95	13,461.60	9,647.31	14,493.84
Points	Base	**(6,745.35)**	(3,914.29)	**4,864.53**
%	Base	(33.38%)	(28.33%)	**50.24%**

Terminal velocity

Jobbers fight losing battle against pre-written software codes

A decade ago, the demise of the open outcry system shifted action from noisy trading floors of stock exchanges to air conditioned dealing rooms of brokerage. Today stock trading is in the throes of the next big change. Professional day traders, hired by brokerage houses on a profit sharing basis, are slowly losing out to pre-written software, which does the same functions at a speed that is humanity impossible.

Instead of providing office infrastructure to a dozen 'jobbers' (day traders), a brokerage can now do with two CDs containing pre-written trading strategies, and two people to oversee the execution. Not only does it save costs for the brokerage firm, but also improves the chances of making profits, as software codes are faster and efficient than the most skilled traders. In short, software codes will battle each other for a share of rapidly thinning intra-day trading profits. This spells serious consequences for the 20-25,000 strong force of professional day traders who speculate in equities.

Even veteran traders are dismayed at this emerging trend, as it robs them the fun of matching their wits against those of rival market participants. Instead, they are now locked in an unequal battle with software programmes that can spot an arbitrage opportunity and cash in on it even before the traders can press the keys on their trading terminals.

Renaissance

1. India will get back to 9% growth next year

Union finance minister Pranab Mukherjee said India will take one-and-a-half years to come back to a 9% growth rate. We are facing many problems of recession; it will take time to get back to 9-10% of GDP. Earlier signs will be visible by September 2010.

Maintaining that India and China have managed to curtail the impact of recession to a 'great extent' Mr Mukherjee acknowledged that the economic slowdown that began in the US has taken its toll on India. For many years from 2003 to 2008, we enjoyed an average 8.6% growth rate but this has come down heavily with the meltdown. At least I feel the worst is now behind us. The first signs of revival, the finance minister hopes, to see particularly in the cement and steel segments by early next year.

We have ejected Rs 186000 crore already into the economy, even with the burden of the Sixth Pay Commission on us. This will show results. We are committed to create more spending power in the hands of people' He stressed on the growth of rural India which in turn will spurn growth. Eradication of poverty is our primary focus. This in itself will become a solution to the slowdown problem.

2. Core industries grow 6.5% in June

The six core infrastructure industries grew 6.5% in June on the back of robust performance by cement and steel. The infrastructure basket comprising coal, crude oil, refining, power, cement and finished steel has a 27% weightage in the index of industrial production (IIP), and the June surge hints at overall industrial growth picking up, according to economists.

A year ago, the infra sector had grown by 5.1% while the figure for May 2009 stood at 2.8%. Cement topped the chart with a growth of 12.8%, while steel went up 5.3%, both crucial inputs for construction activity. The sharp uptick in the production of coal and electricity generation is also in keeping with the increased energy consumption expected as economic growth accelerates. Commerce and industry minister Anand Sharma said, "In the last three months, it (industrial growth) is improving, but we want to ensure that this recovery continues and India returns firmly on the high growth trajectory. In fact, sectors like coal and cement have registered a double digit growth which is a very encouraging sign."

3. Industrial output stuns with 7.8% jump in June

India's industrial output increased 7.8% in June, the fastest pace since February 2009, adding to signs that the economy has been spared from the worst of the global recession and is well on its way to a turnaround. Economists say the robust manufacturing growth could offset the impact of weak monsoon on the overall economic growth. Data released by ministry of commerce and industry showed that high growth in India's capital goods sector is a sign of turnaround in the economy.

Economists pointed out that the growth in industrial output for the three straight months suggests that recovery in the economy is well underway. Industrial production has benefited from record low interest rates and availability of funds, which has increased investment demand and boosted consumption of consumer durables. Tax cuts and increased government spending to boost the domestic economy has also helped. The production of capital goods was up by 11.8% in June 2009 while that the consumer durables went up 15.5%. Robust performance by mining and electricity generation added the cheer.

Harsh Patil Singhania, President, FICCI said, “The IIP figure does no longer look like a flesh in the pan. It appears to be an indication of a turnaround in the industrial economy. I believe this is a turnaround because this growth has been registered at a time when our exports have been shrinking.”

Analysts pointed out that the IIP numbers far surpassed the market consensus. But economists were divided on the impact of the low monsoon rain – the weakest in 5 years – on industrial growth in coming months. Monsoon rains are considered as life line of Indian economy as it provides livelihood to 24 crore people and serve as crucial bulwark of demand in the economy. It is particularly relevant in the context of already poor performance of consumer goods. The production of these goods has been stagnating for a while and was up only 0.3% in June 2009 and negative 4.6 for April –June 2009.

However, given the low 17.1% weight of agriculture in GDP, despite the monsoon rains being 25% below normal so far, Morgan Stanley has recently revised India’s growth target upwards to 6.4% from the earlier projection of 6.2%. Chetan Ahya, managing director Morgan Stanley Reassert pointed out in a research note that higher than expected industrial production and services sector growth will more than offset the down side from agriculture.

Principal Economist at credit rating agency CRISIL, D K Joshi also believes that improving external environment and recovery in industrial activity will help in offsetting impact of fall in agricultural production. The Markit purchasing manager’s index, which measures the manufacturing activity in the country stood at 55.3 in month of July unchanged from June. A reading above 50 shows an expansion in industrial output.

4. India Inc back with a bang in Q1, 82% notch profits

India Inc has begun the new fiscal on a profitable note with four out of every five companies making net profits for the quarter ended June 30, 2009, helped by lower raw material costs and modest growth in wage bill and cost of borrowing. Overall 82% of companies in a study reported net profits compared with 70-72% over the previous three quarters. Net profit of 850 public listed companies covered in the study, rose 13% over the year-ago period after shrinking for three straight quarters.

The study did not include two sectors – banks, as their income is depended on the interest rate regime, and public sector oil and gas companies, since they witness abnormal gains or losses based on government policies.

Among the 22 Nifty companies that have declared quarterly results (Nifty is the benchmark stock market index that comprises 50 firms) the profit growth story appears even gripping. These firms together reported a 25% increase in standalone net profit for the quarter over the corresponding period last year, after witnessing modest earnings growth ranging between 3-8% over the previous four quarters.

This could set the tone for better earnings for the rest of the year as companies and analysts foresee lower cost of operations going forward.

5. Green shoots of economic recovery

The government is likely to take a relook at its strategy to continuing economic stimulus measures when the green shoots of economic recovery become **real.** The government, which said in the 2009-10 budget that it will continue to provide further stimulus to the economy as there are still uncertainties on the revival of the global economy. We will have a clear picture when world leaders assess the situation at the Pittsburgh summit in September 2009.

Rolling back of stimulus measures and cutting fiscal deficit are essential as many economists have pointed out that systemic risk now migrated from the private sector to national governments due to historic gaps in receipts and spending.

The group of 20 nations (G20) will access whether the green shoots of recovery are real, whether it is time to exit from the economic stimulus measures and whether there would be inflationary pressure if growth starts picking up. Ben Bernanke, chairman of the US Fed said that there are signs that the world's largest economy is starting to stabilise. The world over, governments are now contemplating how to exit from the stimulus measures – tax cuts and lower interest rates – without disrupting economic revival.

At home, the government will also take **a call on regulating certain financial sector entities** such as credit rating agencies and merchant banks taking inputs from a G20 task force comprising global association of accounting and securities market regulators. The International Accounting Standards Board and the International Organisation of Securities Commissions are working out the details now.

The stock markets have rallied impressively as more global liquidity is getting diverted to growth havens like China and India. China is getting so much foreign portfolio money that it has even started sterilising some dollar inflows. India too could be in a similar situation if even a tiny portion of the trillions of dollars with financial institutions in the US and Europe starts finding their way to India. The Indian stock market rally is largely liquidity-driven and it could become a serious cause for worry if the markets raise another 20-30% in the coming months based purely on more foreign money hitting Indian shores.

This possibility cannot be ruled out because most analysts are now clearly pronouncing that emerging economies like India and China will register a much faster economic recovery than their western counterparts. Some even speculate China and India will see a V-shaped recovery and the OECD economies could get caught in a painful W-shaped pattern.

This is bound to cause a serious asymmetry in the monetary policies of the developing and developed world. Indeed if this were to happen, the central banks in the US and Europe will continue to maintain a loose monetary policy and those in the fast-growing developing economies may be prompted to eschew easy money at some stage when growth rates return to normal. This asymmetry could then pose problems. Cheaper money sloshing about in the west try to find limited asset classes in the developing world and this will become a recipe for another asset bubble.

The G20 finance ministers also have serious doubts whether coordinated fiscal and monetary policy approach would last. It works as long as the world economy is in a secular recession. This was the assumption when all the economies were falling off a cliff late last year. But it is now becoming evident that some economies are recovering much faster than the others. So a coordinated fiscal/monetary policy is bound to break down sooner than later.

Renaissance

1. Capital inflows begin

Many Indian companies that had made outsized debt-financed acquisition at the height of the liquidity-driven M&A boom found themselves burdened with short-term debt that they could not replace with long-term funds since any form of capital became scarce as the financial crisis unfolded.

That Indian companies have managed to raise nearly $3 billion from the global markets through depository receipts is as much an indication of the increase in risk appetite of foreign investors.

The improvement in risk appetite is enabling the debt-laden companies to obtain a more viable capital structure – repay debt from equity raised. Other emerging economies have also seen a rush of capital, though India is expected to get a more than fair share given the better growth prospects. Nearly $2 trillion of liquidity is believed to be sitting on the sidelines. While the excess liquidity could create bubbles in existing assets and the repeat of 2007, this can usefully be absorbed by the economy if efforts to improve the economy's absorptive capacity accompany nimble policy on capital inflows.

2. Right issue market gets back its rhythm

Many companies had deferred their fund raising plans, following the failure of some major right issues, amid last year's stock market turmoil. Nearly two dozen companies raised Rs 12,622 crore in 2008-09 compared with Rs 32,518 crore mobilised by 30 companies in 2007-08. The fall in rights mobilisation was mainly because of the devolvement of the two biggest issues – Hindalco and Tata Motors.

The rights issue market is showing early signs of revival with a few recent offers getting fully subscribed. Merchant bankers say this response may encourage companies to raise funds through this route.

However, fate of the forthcoming offers would depend on factors such as pricing of the issues and fundamentals of the companies. Shareholders would definitely subscribe to an offer if it's pricing is good and the company's track record has been decent.

3. Securities tax kitty breaks 9-month fall

Reflecting the buoyancy in stock markets and increased investor interest in shares, the government's securities transaction tax (STT) collections returned to positive territory in July after nine months. Tax analysts expect collections to improve further in the second half of the current fiscal. The bounceback in STT collections is a clear indication that the stock market rally from the post-financial crisis March 2009 lows has been fairly broad based with large volumes.

4. Tata Motors net up 57% despite sales dip

Tata Motors pinned hopes on new product launches and decline in raw material costs to stage a better show in the coming quarters, although sales in the first quarter dipped and exports nearly halved. The auto major recorded a 57.54% jump in net profit at Rs 513.76 crore for the quarter ended June 30, despite sales declined by 7.6% year-on-year. Mainly decline in raw material costs and measures taken to increase cost efficiency improved the net profit over Rs 326.11 crore in the same quarter previous fiscal. **Tata Motor plans to spend about Rs 8000 crore** in the next 3 to 4 years on product development and capital expenditure as it looks to replace ageing models with next-generation vehicles.

5. M&M net vrooms 152%, sales up 29%

Mahindra & Mahindra (M&M), the country largest utility vehicles and tractor maker announced a better-than-expected 152% growth in net profit for the June quarter, boosted by lower raw material costs, higher sales and the merger of Punjab Tractors with itself. The company's net profit rose to Rs 401 crore in the period under review from Rs 159 crore in a year-ago period while net sales rose by 29% to Rs 4,229 crore. Operating margin grew to 14.35% from 7.75% in the previous quarter.

6. IOC net jumps eightfold to Rs 3,683 crore

Government-owned Indian Oil Corporation (IOC), country's largest oil refining and marketing firm, has recorded an eightfold jump in its net profit for the first quarter of 2009-10. The company's net profit jumped to Rs 3,683 crore compared to Rs 415 crore in the same period previous year.

Despite the sharp drop in the gross refinery margin for the quarter June 30 from $16.81 a barrel in Q1 (2008-09) to $7.36 a barrel in Q1 (2009-10) IOC managed a robust financial performance due to inventory and foreign exchange gains. Its bottom line also strengthened by Rs 448 crore due to the falling interest rates. The robust financial performance of the company in the first quarter of the current fiscal year is also due to the merger of Bongaigaon Refinery & Petrochemicals Ltd (BRPL) on May 5 this year.

7. Promoter's encash market rally

The stock market rally triggered by the result of General Election 2009 saw a slew of promoters across industry segments offload their stake and raise money, mostly, to pay off debts or address immediate liquidity concerns. According to an analysis, promoters of 214 companies including DLF, Suzlon Energy, Kotak Mahindra Bank, Dish TV India, Yes Bank, Mahindra & Mahindra, Reliance Communications and Wipro sold shares worth Rs 11,924 crore between April-June 2009.

India's biggest real estate firm DLF sold more than 16 crore shares during the last quarter, which is estimated at current value at Rs 6,755 crore. As a result, promoter holding in the company came down from 88.55% to 78.65% as on June 30, 2009. DLF raised the fund to pay off its debts, as the global financial slowdown dried up demand for its apartments while a credit squeeze raised the cost of funds.

Suzlon Energy, one of the world's biggest makers of wind energy equipment, was the second largest seller of shares in terms of value. They sold shares worth of Rs 893 crore, bringing down promoter holding by around 6% to 59.82%.

Among others Kotak Mahindra Bank sold shares worth around Rs 833 crore in the last quarter. This brought the promoters' holding down marginally by 3.92% to 48.47% as on June 30.

DR Dogra, deputy MD at CARE Rating, said selling of stakes by promoters is a serious matter though the effect of this on the ratings would depend on the quantum of stake that promoters have. If the promoter has large holdings and they sell a smaller fraction of their holding it may not be a major issue. But if the promoter holding is low and they are still selling stake then it's a serious matter and it may impact the rating of the company adversely.

Analysts feel investors should not worry too much if the stakes offloaded are low. Most of these went towards servicing personal debts or raising cash for daily operations.

8. Tata Steel to invest Rs 40,000 crore in 5 years

Tata Steel plans to invest Rs 40,000 crore over the next five years to ramp up its production capacity to 16 million tonnes. The company has decided to complete the expansion of its Jamshedpur facility from present 6.8 million tonnes to 10 million tonnes ahead of of the schedule. It has also put its two Greenfield projects in Chhattisgarh and Orissa on the fast track to reach 16 million tonnes capacity by 2014, even as many global players have put their investment plans on hold.

Tata Steel vice-president corporate services Partha Sengupta said, “Downturn is best time to expand. So our Greenfield projects would now be taken up on a priority basis. We have decided to invest close to Rs 40,000 crore for enhancing our capacity, of which 3 million tonne Greenfield capacities each would come up in Chhattisgarh and Orissa besides 3.2 million tonnes brownfield expansion at Jamshedpur.”

The first phase project of Chhattisgarh and Orissa envisages an investment of close to Rs 15,000 crore each, while brownfield capacity at Jamshedpur would come up at investment of Rs 10,000 crore. The Jamshedpur facility will reach its intended capacity of 10 million tonnes by the end of fiscal 2010-11.

Emphasising on expediting the pace of Greenfield projects, which have been stuck for the past two years, Mr Sengupta said that the land acquisition process in Chhattisgarh was at an advanced stage and could be completed by June next year.

The state government has already acquired about 70% of the project land in Jagdalpur and would soon start handing it over to the company.

The company has already been assured of iron ore captive linkage for the project from the Bailadila mining range in the state. Elaborating further, vice-president long products Hridayeshwar Jha said only long products (construction grade steel) would roll out from the plant for which the first phase of 3 million tonnes is likely to be commissioned by 2013-14.

For its Orissa plant, Tata Steel has acquired about 4000 acres and is hopeful of beginning some ground work on the ambitious project by the year-end. The company has already ordered equipment worth Rs 6,000 crore for the plant. The world’s fifth-largest steel maker is confident of igniting the blast furnace for the first phase of the project by 2013-14.

Asserting that money would not be a problem, Mr Sengupta said, “The Company had sufficient resources to manage proposed expansion plans.” A decision on raising funds from outside could, however, be looked at a later stage, he said. Tata Steel has a cash reserve of close to $ 2 billion.

The fastracking of projects by Tata Steel comes at a time when the company has persistently underperformed in the last three quarters. Company’s officials, however, said that steel demand was picking up and this was good sign for the company to expand. The flat steel prices have also started moving up for last three months.

The company has seen a jump in demand from infrastructure sectors like power, road and airports. The revenue from this sector alone stood at over Rs 4,000 crore in 2008-09 and is expected to cross Rs 5,000-crore mark this year. Tata Steel has also joined hands with its Corus operations to provide customised solutions for airport modernisation works. It is already doing it for Chennai and Kolkata airports and has also provided solutions for Delhi and Mumbai airport’s modernisation programme.

2.3 INTERNATIONAL

The end of the recession

It appears the US economy is not shrinking any more. Pundits are predicting a 2-3% growth in the Gross Domestic Product in the third quarter of the current year (2009). If their predictions turn out to be correct, the length of the current recession would be about 19 months – the longest since the Great Depression, but just two or three months longer than the general recessions since the beginning of the 20th Century.

Just the other day, remember, pundits were predicting that the current recession in America may be similar to the Japanese recession that started in the early 1990s and lasted more than a decade. There were fears that the bursting of the real estate bubble in the US that had triggered a financial meltdown across the globe would cause a global economic depression similar to the Great Depression that lasted almost four years and wiped out a quarter of the US GDP.

Short, it may be, but the so-called likely end of the recession does not look sweet. The US economy remains fragile and job market conditions are terrible. The economy has lost close to 7-million jobs in less than 2-years. The job loss continues although at a much lower pace than it did at the peak of the recession.

True, there is some good news driving the positive forecasts. In the second quarter of this year, the GDP fell by just 1% after shrinking by 6.5% in the first quarter. The manufacturing index is up and inventories are down. The housing market is looking much rosier. After falling for three consecutive years, the index of housing prices in top 20 cities has become flat and housing prices in eight of them have begun to increase. In June, sales of existing houses rose for the third consecutive month.

What has spurred such quick recovery from what seemed like a global depression just a few months ago? In two words: government intervention.

According to Christina Romer, chief of the President's Economic Advisory Council, the government's stimulus package raised GDP growth in the second quarter by at least two percentage points.

Non-government experts give somewhat less credit to the stimulus package per se, but there appears to be a consensus that government intervention has rescued the economy from recession.

Note that most of the $ 787 billion has not yet been spent. White House officials say that only $100 billion of the stimulus money had been spent through June 2009. Hopefully, the remaining hundreds of billions would create green or non-green jobs for those millions who have lost employment since the beginning of the recession.

Stimulus spending has been just one of the several ways in which the US government has tried to rescue the economy, and so far, not the most significant one. Perhaps that most important government intervention was the bailout of banks that restored confidence in the ability of the banking system to cater to corporate credit needs.

Next to that was the role that the Federal Reserve played by creating a number of borrowings programs for financial institutions and businesses through which it channeled vast sums of money to thaw the credit freeze confronting corporate America. The Federal Reserve is also buying trillions of dollars worth of mortgage-backed securities which has lowered mortgage costs for homeowners and new buyers. These decisions have been heavily criticised by the media and US Congress, but they have helped rescue the economy from what could have become a second Great Depression.

The good news is that the signs of economic recovery appear to be global. A recent OECD report states that there are strong signs of economic recovery in Italy and France and clear signs of troughs in Canada, Germany, the United Kingdom and the US. Asian economies are also emerging from economic slowdowns. Such recovery, if it materialises, will strengthen global economic growth.

Pessimists, however, think that the ensuing recovery will be short-lived. There is also some mention that the current recession will not be V-shaped but W-shaped, meaning that the current expected recovery will be followed by another recession very soon. However, there is something to be said about the immense ability of the US economy to adjust to the economic environment by allowing outdated industries to die or restructure, and it is one of the factors behind the early signs of recovery.

The worst may be over and the economy situation may be better than what everyone predicted three months ago. But, the long-term job market situation, however, appears to be very bad. According to July employment report, a third of the unemployed have been out of work for more than six months, the highest since the government started collecting this data in 1948. The number of persons who have been unemployed for at least 15 months has increased by 74% since last December.

Indeed, if recessions were measured by the state of the job market, pundits would be cautious in pronouncing the end of the recession in the US.

Will unemployment fall as quickly it has risen in the past one year? Will GDP growth translate into more jobs quickly? If the past is any guide, the answer to these questions is negative. The unemployment rate has often remained high and rising for months after the US economy has emerged from a recession. For instance, the unemployment rate kept rising for a year and a half after the 2001 recession was over, and for a year and three months after the end of the 1991 recession. The unemployment situation is much worse in this recession than it was in the previous two recessions.

In the last two recessions, however, the government did not announce any stimulus package, and was nowhere as closely involved in the rescue effort as the current administration. President Obama's approval ratings will not remain insulated from the state of the job market for long, and therefore, his government is expected to use stimulus funds to create jobs.

Worst over for US but recovery to be slow

The sharp contraction in the US economy "seems to be ending" but recovery will be slow with risks still looming from the weak labour and housing markets. The IMF, in its annual report on the US economy, said, "As a result of their increasingly strong and comprehensive policy measures, the sharp fall in economic output seems to be ending and confidence in financial stability has strengthened". Nevertheless, with financial strains still elevated, the recovery is likely to be gradual, and risks are tilted to the downside. The unwinding of fiscal and monetary stimulus measures would have to wait, until a sustainable recovery is underway. But they need to develop exit strategies from stimulus programs, strengthen financial regulation and in the medium term cut budget deficits.

2.4 WARNING SIGNALS

The time bomb in corporate debt

No surprise in the US: As the recession grinds on, more companies are falling behind on their debt payments. The defaults rate tops 11% up from 2.4% last year – and could peak at 12.8% by the end of the year 2009, the highest ever, according to credit rating agency Moody's Investors Service. But what's worrying economists more is that the rate could remain stubbornly high for quite a while.

Analysts say, "Be prepared for a multi-year period of high defaults, we're going to see peaks like a mountain range." Companies aren't cleaning up their balance sheets that much, and current debt levels are unsustainable. The debt overhanging could hamper the economy for years to come.

The problem, of course, is that corporate borrowers binged on credit during the boom years. Now US companies carry some $1.4 trillion in high-yield bonds and loans, a burden that's nearly triples the amount in 2001. And more than half of the debt comes due in the next five years. Already the pile of debt is forcing companies to make painful choices that will reverberate through the economy.

In fact, it's proving more difficult to unwind debt today than in previous downturns. Distressed companies can't easily sell assets to pay off debt amid the harsh dealmaking environment. And many owe more than their undertaking assets are worth. Meanwhile, big banks and other financial firms, still battered and bruised from the financial crisis, don't have the strength or, the will to refinance all the debt. Without many options, more borrowers will find it tough to meet their financial obligations. So far this year, 128 companies have defaulted, including *General Motors*, clothier *Eddie Bauer*, aerospace company *Fairchild*, and paper maker *Bowater.* Besides, S&P figures an additional 207 are "vulnerable" to default.

Companies are doing everything they can to avoid default.

Amend and extend: Some have worked out "amend and extend" deals, which postpone the due dates on their loans. For example, video rental chain *Blockbuster* was able get an extra 13 months to pay off a bank loan. In exchange, the company agreed to pay an additional 8% in interest. Lenders are being cautious. *Accuride*, which makes chassis for trucks, got a mere 45 days to meet financial tests that are a requirement of its loans.

Put off interest on bonds: During the boom years, more than 60 companies issued bonds that allowed them to put off interest payments for the life of the bond. In a sign of distress, at least 23 companies are using that option today. But such moves provide only temporary relief. The arrangements "are like *Band-Aids*". They "don't solve the basic problem" of too much debt. Instead, companies are postponing the inevitable, which weighs down their balance sheets and drags the broader economy.

Debt modification: In the first six months of 2009, nearly 40 companies made special deals with creditors to trim their debt. Generally, only a handful of companies make such arrangements each year. And they're often unsuccessful. About half the companies that got these sorts of concessions end up filing for Chapter 11 anyway. The economy may be better off if companies filed for bankruptcy at the outset.

Sure, Chapter 11 isn't a cure-all. But the proceedings do a better job of cleaning up the books and reducing debt loans. *Spectrum Brands*, the maker of Rayovac Batteries, *Terra fish food*, and other consumer products, are all set to emerge from bankruptcy in August with one-third less debt than when it filed in February. That's twice the relief that companies typically get from creditors out of court. Bankruptcy often yields better results. The only way to really repair a balance sheet thoroughly is Chapter 11; and the more debt that's wrung out of the system, the stronger the overall recovery.

3.1 MUTUAL FUNDS

Renaissance

1. MF trading, distribution platform

Action is building up in the mutual fund distribution arena, with four large institutions submitting their bids for setting up the Sebi-proposed trading and distribution platform. Such a facility will enable investors to transact mutual fund units like the way they transact shares.

The NSE, NSDL, CDSL and the CAMS-Karvy consortium (registrar and transfer agents) have submitted their proposals to build the Amfi platform. Amfi will select the best bidder and forward the proposal to Sebi for final clearance. While it is quite natural for CAMS-Karvy to jointly bid for the platform because of their status as top registrars for Indian MFs, the decision of others to enter the fray is surprising.

The platform is being set up after Sebi directed Amfi to develop 'free and impartial' trading and distribution alternatives. The idea is to empanel all the 38 fund houses under one roof. The platform will allow investors to buy/redeem schemes, compare fund performance and receive portfolio statements through a single online window.

The need for an online platform has grown after Sebi scrapped the entry-load system and imposed restrictions on mutual fund houses reimbursing distributors through the funds collected from investors. These steps are expected to affect the finances of MFs, as they will have to reimburse distributors from their own pockets. Against this backdrop, the industry been forced to take up initiatives to cut costs that are deemed high. A shift to online platform, which will be similar to that of stock trading account, will reduce overheads incurred on printing applications, performance statements and postage.

2. Exit load – a new source of revenue

For every regulation there is a loophole and a backdoor. Sebi may have abolished entry load to make mutual funds cheaper for investors, but fund houses have now found a new way to keep their revenues intact. AMCs such as ICICI Prudential, IDFC Mutual Fund and HDFC Mutual Fund have all started charging exit load on switching money when a trigger is activated in funds providing trigger facility. Fund managers, on their part, are justifying these charges saying this facility demands huge amount of churning of the portfolio resulting into high operational cost.

Here how the trigger facility works: an investor' money is switched from one fund to other when the trigger is activated. The existing fund in which investor has invested money is called a 'source fund', whereas, the fund where money gets transferred after the activation of trigger, is called a 'target fund'. For instance, if an investor fixes a target return of say 10% and asks for shifting the gain to other fund, the AMC will shift the gain from the source fund to target fund once the set target is touched.

3. MF can't charge varying exit loads from investors

The Sebi has restrained fund houses from charging unitholders different exit loads based on the value of their investments. The market regulator has told AMCs that they can charge exit load within the existing limit of 7%, but without discriminating against any category of investors.

Mutual funds are making distinction between unit holders by charging different exit loads based on the amount of subscription. In order to have parity among all classes of unit holders, it has now been decided that no discrimination among unit holders should be made, based on the amount of subscription.

3.2 COMMODITIES

Several driving force at work

While the 1980s and the 1990s witnessed above-average returns on the equity and bond markets, the 2000s (until 2008) were clearly the decade of the forgotten asset class. Commodities have experienced a renaissance, with several driving force at work. The strong demand for commodities from the developing countries, as well as from emerging countries (especially from China), has pulled prices significantly higher. At the same time, supply was limited by nature and bottlenecks in the production appeared due to negligence in investments. Additionally, investors also rediscovered the forgotten asset class.

Investments in commodities not only offer the possibility of expected price increases but also reduce the risk in a portfolio since commodity returns have historically shown a very low or negative correlation with the traditional asset classes of equities and bonds, although the correlation between asset classes increased in 2008. This diversification effect can be amplified by investments in different commodities since the price of each commodity reacts differently to economic forces and commodity returns appear to display a low correlation to each other.

Against the background of financial turmoil in 2008, commodity prices have corrected sharply. One of the biggest corrections has been observed in the oil price. After reaching a record high in July 2008 at \$147, the price of the "black gold" dropped to \$32, a fall of almost 80% within just five months.

On a broader basis, the CRB Commodity Index, one of the most recognised indices to track commodities prices, has also shown a significant loss of 58% after reaching a record high in July 2008 as well.

The main reasons for the sharp correction were global recession, a stronger dollar and rising risk aversion among financial investors. As everyone was discussing the sharp fall in equities, commodities slumped even more. Considering the recent strong equity rally, it make sense to rethink commodities, as after reaching the bottom late in 2008 most of them could recover from their multi-year lows.

Given the base forecast that the global recession will likely extend through 2009, a broad-based sustainable rally in economically sensitive commodities (i.e., energy and industrial metals) is unlikely. In addition, deflation and demand destruction will continue to put downward pressure on prices in the near term. However, traditional indicators (i.e., Baltic Freight Index, leading indicators and Chinese demand) have declined significantly from their peaks, showing much of the economic slowdown has likely been priced in. Supply reductions (i.e. Opec cuts) and the expectation of a weaker dollar are supportive.

Currently, we prefer less cyclical commodities such as gold and agricultural commodities.

Gold:

- **In the short term,** *negative real interest rates, investment demand for ETFs, the potential for geopolitical conflicts* and *financial turmoil* are supportive of higher precious metals prices.

- **In the long term,** *expected dollar weakness*, *increased commercial demand*, and *rising inflation from aggressive monetary and fiscal policy* should support higher gold prices.

Investment demand for gold ETFs, gold coins and bars outpaced jewellery demand for the first time on record in 1Q09 as global demand rose 38% (YOY). We expect investment demand is likely to continue to rise as investors seek protection in an environment of dollar weakness and global economic uncertainty.

Gold also acts as effective hedge against **deflation**, which it is believed to be a most likely scenario during 2009, and usually outperform other asset classes in this type of environment.

Gold can also act as a hedge against **inflation** especially if the source of that inflation is loose monetary policy as many governments spend vast quantities of money, and potentially start the printing presses to produce more currency to fight deflation.

Agricultural commodity:

Agricultural commodity prices came under pressure in June as planting progressed and crop conditions improved. However, any weakness should be viewed as a buying opportunity given the expectation that low inventory levels, growing demand and higher input costs will support higher prices.

Crude oil:

Oil markets in June were driven by upward demand revision from the major oil information agencies and supply disruptions in Nigeria. Slack fundamentals should lead to lower prices in the near-term (3-month target: $70/barrel). Geo-political tension in the Middle East, production shut-ins due to hurricanes, and a recovery in global economic activity in 2010, driven by the energy intensive emerging markets will support higher oil prices in the long-term (12-month target: $85/barrel).

Metal:

The narrowing of arbitrage opportunities between London and Shanghai metal prices and concerns over the sustainability of the frontloaded policy stimulus in China could weigh on industrial **metal prices**. The pace of increase in China leading indicators has not matched the record rate of industrial metal imports, suggesting stockpiling has been behind the recent rise in prices, rather than real demand. So presently investors are taking defensive stance versus industrial metal.

Commodity returns

As distinct from returns generated by equity and bond ownership that come in the form of dividends and coupons, commodity returns come from three main sources:

Total Returns = Spot Return + Roll Yield + Collateral Yield

The spot return is simply a result of commodities becoming more or less expensive over time.

In terms of **the roll yield**, where the price of a commodity is higher for shorter delivery dates; an investor earns a positive roll yield by buying the future (Backwardation), waiting for the price to appreciate as the delivery date approaches, then selling and using the proceeds to reinvest at a cheaper price at a future date. A negative roll yield indicates that the spot price is lower than the future price (contango) and is a typical feature of the precious and industrial metals market.

The final source of return is the **collateral yield** which is the return accruing to any margin held against a future position and which we proxy with the US T-bill rate.

Renaissance

The Congress party has come to occupy the leading position within the UPA coalition at the Centre. Unlike the 14th Lok Sabha where the Congress had only 156 seats of its own, it has emerged as the centre of power in the 15th Lok Sabha with 206 seats of its own in the House of 543. It deserves to be underlined that the pro-*aam-aadmi* agenda of the Congress is not based on any rhetoric. As Sonia Gandhi stated at the meeting of the Congress Parliamentary Party, the voters of India have renewed their confidence in the party because of its socially inclusive and pro-poor developmental philosophy of governance.

4.1 FINANCIAL ADVISORS:
Weigh impact on investors

Bottom-up approach

A political party in a democracy does not survive on the basis of its old achievements or moments of electoral glory. It has to perform for its survival and future electoral victories and the Congress party is not an exception to this general rule.

The commitment of the Congress party led by Sonia Gandhi to India's future was clearly and unambiguously reflected in the annual budget of 2009-10 presented by finance minister Pranab Mukherjee. A few salient features of the annual budget indicate the direction towards which the country may be moving under the new UPA-II government.

It is for the first time in the history of post-independence India that an annual expenditure of more than Rs 10 trillion has been proposed in the budget.

Second rural India, i.e. Bharat, is the focus of investments and the special focus is on the farmers and the poor. While farmers have been given an 'interest subsidy', the NREGS - the flagship programme - has received an amount of Rs 39,000 crore, an increase of 144% from the Rs 16,000 crore of 2008-09.

Third, the focus is on Bharat Nirman, the rural housing fund, road connectivity, et al. The budget which is a political policy statement of the government is clearly focused on expanding the rural domestic market by creating purchasing power among the rural people.

India had begun its journey of planned economic development on the basis of an assumption that the benefits of economic growth will have a '*trickle-down-effect'* and pull the people out of poverty. The new vision of the Congress party seems to be that it is only the *'bottom-up,* socially inclusive approach' which will bring the 300 million or so people out of their existence below the poverty line.

The UPA government in its first term had launched the bold programme of NREGS. In its second avatar, the UPA government is taking the next step in the direction of welfare of the real poor in the form of the National Food Security Act. While the right to employment to the rural poor is a prerequisite to create a sense of 'self-esteem and feeling of dignity' the right to food is a must for survival.

Strong voices have been raised against the rural poor-oriented policies and budgetary allocations. Such pressure groups exist within and outside the Congress. No doubt, Sonia Gandhi has to manage contradictory pressures or lobbies which are operating against its socially inclusive growth policy.

Inclusive employment

Few employment generation programmes have created as much buzz as the National Rural Employment Guarantee Scheme. The scheme is aimed at benefiting BPL households in rural India by enabling at least one member of such households to find guaranteed employment as unskilled labour for at least 100 days in a year. What is special about this scheme is that it has built in some measure of transparency and accountability into its functioning.

The NREGA makes it mandatory for job-seekers to have a job card, for which they have to apply to the panchayat. The panchayats in their turn are required to provide applicants with job cards within 15 days. The application for work and dated receipt act as *job trigger mechanisms*.

The system is still rough around the edges with many of the states unable to keep pace with the demand for job cards and dated receipts. According to NREGA web site, as of March 31, 2009, out of a total 99 million households that demanded employment, the number of households working under NREGA is only 14 million and the cumulative number of households that have completed 100 days of employment is about 4 million. Although there is considerable lag in meeting the set targets, the fact that the NREGA has been able to provide jobs and employment to millions of rural households in some of the poorest states in the country is a major achievement.

More significantly, it promises to serve millions of households, especially those who are poor. The programme has even won the admiration of sceptics like economist Jean Dreze who now feels that the NREGA is a powerful tool of economic redistribution and social equity.

The most eligible rural families that the NREGA hopes to benefit are those of the landless-labourers as well as small and marginal farmers. According to the NCAER's National Survey of Household Income and Expenditure, there were 88.5 million such households in rural India, comprising a population of 432 million. These are actually the poorest and most disempowered people in the country.

The NREGA, as it currently exists, suffer from a couple of major drawbacks. First, there is no focus on guaranteeing a minimum quality of assets that are sought to be created through the programme. Labour intensive employment programmes are notorious for creating low-quality output. It is not surprising that village roads that are built by unskilled workers under such schemes are often washed away during heavy downpour. Thus, the entire programme has no lasting value other than providing employment for a specified number of man-days. Second, the emphasis seems to be on providing work opportunities to unskilled labour and no attempt is being made to upgrade the skills of rural youth and enable them to earn more. The NREGA needs to be a support system for the desperately poor and should enable, encourage and empower them to stand on their own feet. In its present format, the NREGA could become yet another subsidy programme that runs the risk of becoming a burden on the national exchequer.

The NREGA would do well to encourage saving and investing among the households and tie it up with education related and healthcare benefits. In the final analysis, the challenge for NREGA would be to transform itself into a self-sustainable programme that benefits the poorest of the poor without becoming yet another subsidy-driven programme that is a drain on taxpayers.

Economic legislation

If all goes according to government plans, 2010 may prove to be a watershed year for economic legislation. There will be a new Companies Act, a new Direct Tax Code, and some indirect taxes would be replaced with a comprehensive Goods and Service Tax (GST) at the Centre as well as the states. The Companies Bill 2009 is already in Parliament, the draft of new Direct Tax Code has already been put in public domain and the empowered committee of state finance ministers in consultation with the Centre may publish a white paper on GST implementation in the next few months.

Each of these legislative changes will have a significant bearing on how Corporate India conducts its business and keeps its books. The Companies Bill and the new Direct Tax Code present a complete overhaul of existing laws, with rewriting and reorganisation of clauses in an easy-to-use format. Several provisions are being modified, and that would have far reaching consequences. The underlying objective is to create an environment where doing business will be less cumbersome, and to ensure the law is easier to interpret, thereby bringing down compliance costs.

The overhaul of Companies Act, 1956 and I-T Act, 1961 was long overdue – the large number of amendments over the years and existence of obsolete clauses have made both laws unwieldy.

New Companies Bill: On 3rd of August 09 the government re-introduced the new Companies Bill in the Lok Sabha, which will eventually replace a five-decade old corporate law with a sophisticated one that reflects the current economic realities. The bill was introduced in the lower house by minister for corporate affairs Salman Khurshid. The proposed new law promises simplified regulations relating to formation, mergers and winding-up of companies.

The Bill is similar in content to the one that was introduced in October 2008, which got lapsed early this year with the change in government. The Bill has now been re-christened as Companies Bill 2009, and forwarded to a Parliamentary Standing Committee. The new legislation will try to promote shareholder democracy with protection of rights of minority shareholders, responsible self-regulation with adequate disclosure and accountability and lesser government control over internal corporate process.

New Direct Tax Code Bill: The present income tax law was enacted in 1961 by replacing the earlier Act of 1922. The Act of 1961, which was more comprehensive in comparison to the 1922 Act has undergone major changes since then to keep pace with the economic and business trends and to foster the use of technology in tax administration. As a result, the Act has totally lost its original shape and for this reason, there is clearly as strong case to rewrite the I-T Act on a new slate with farsightedness, so that the provisions do not need frequent amendments for a reasonable time.

Removal of ambiguity, less usage of legal jargon or mathematical formula/expressions, removal of redundant provisions, grouping of similar provisions, avoidance of frequent cross references and well-thought-out procedural law may add significant brand value to the new law. The whole exercise is being carried out by the officials within the government keeping the contents close to their chest. The new code would reflect the vision of the tax administrators and would also set the expectations for the future. The new tax regime will encourage voluntary compliance. Faster dispute resolution is an arena, which almost all stakeholders expect to be dealt with utmost priority in the new code.

Education to children

The passage of the Right of Children to Free and Compulsory Education Bill is, indeed, a historic moment and it shows the commitment towards transforming the education system. Parliament passed the Bill on August 4, 09. Once the President gives assent to the Bill, every child in India between 6-14 years will be entitled to free and compulsory elementary education.

Minister for human resource development Kapil Sibal said "The (abysmal) standards of elementary education in the country have been a national concern. Now, sixty-two years after independence, we clearly can't wait any longer to take measures to create the critical mass of people at class 12 level, that is, people who are in a position to participate in the civil society in a meaningful way and hence contribute to nation-building. This is all the more relevant in a world where knowledge is reckoned increasingly to be the real asset rather than physical properties or resources.

The Bill passed by Parliament would in no way interfere with the state government's role in providing elementary education. The Bill provides for giving priority to mother tongue as the medium of providing elementary education. Also, it envisages the setting up of state-level recognition authorities, which are required to ensure that all schools comply with the specified infrastructure standards within three years.

The state level authorities would de-recognise the schools failing in compliance. It will also be incumbent on these state-level authorities to ensure that the teachers are of required quality, that all teachers acquire the necessary knowledge level within five years. The Bill envisages a situation where the local communities can demand a new school as a right on the basis of demographics and other criteria and involve themselves in the management of the school.

Mr Sibal said: We are very clear that without paying heed to 'inclusion,' the nation cannot prosper. The government would not in any circumstances give up on the principal of inclusion. The Bill stipulates the principal of inclusion that even private schools should reserve a quarter of the seats to the underprivileged children. We not only have to reinforce the public schooling system but also have to create the conditions in which the private sector can supplement the efforts to deliver quality education, even to the underprivileged. What the Bill would set in place is a broad-gauge; the fuelling of the engine will have to be done by sundry agencies including private players, NGOs and civil society groups.

But where do the resources come from? Sibal said that two thirds of the government investment in education is by states and it is important they continue to (increasingly) invest in this sector. If things go well, by the end of the current five-year Plan, investment in education would be about 5.8% of the GDP.

In contrast, many developed countries invest around 10% in education.

This is despite the fact that they have already got the infrastructure in place, whereas we are still grappling with that issue… True, said the minister adding that the gap is really huge. That is why we need the private sector and the tool of public private partnership. The Bill envisages a situation where the public funds would come in droves to the education sector, of course, with government intervention to ensure that the underprivileged groups too get the benefit thereof.

4.5 WEALTH MANAGERS

Map out the details to translate into benefits

Promoters' stake

The finance minister Pranab Mukherjee's Budget proposal to deepen markets by bringing promoters' stake in listed companies below 75% may leave markets dealing with a flood of equity issuance.

If the proposal comes through, listed companies could be expected to raise as much as Rs 152,519 crore from the capital market, with public sector stalwarts such as bullion trader MMTC, power generation NTPC, and the country's largest iron and steel producer SAIL expected to lead the fray.

An analysis of BSE 500 companies shows that as many as 57 companies have promoter shareholding above 75% and would be required to offer shares in to the market to comply with the new norms. Of these, 18 are public sector undertakings (PSUs) and 39 firms are in private sector.

While the numbers of public sector companies may appear to be less than half of the private companies, these companies will nevertheless account for the bulk of the money to be raised. Of the Rs 152,519 crore that may be raised, about Rs 130,961 crore will be accounted for by PSUs.

Among PSUs, MMTC will be required to sell shares worth Rs 36,703 crore (at current prices), while NMDC needs to offload stake worth Rs 34,042 crore.

NTPC is 89.5% government-owned and to bring down its promoters holding to below 75%, it will have to sell shares worth Rs 25,562 crore.

A large proportion of this disinvestment will be via the follow-on public offer (FPO) route as most of these companies are already listed. With PSUs largely funded by the taxpayer, the process will have to be democratic and done in such a way as to give good value to shareholders. The issues are likely to priced reasonably and attractively in order to drive maximum retail participation.

Meanwhile, the effort to comply with the new norms will mean private firms will need to sell shares worth Rs 21,558 crore based on their current market prices. Reliance Power is likely to be the largest fundraiser among private players with a total promoter holding of 84.78%. The 9.78% promoter holding that it will be required to offload is worth around Rs 3,982 crore at current prices.

Wipro and DLF will be required to dilute stakes worth Rs 2,886 crore and Rs 2,466 crore respectively.

Other prominent private sector companies expected to raise large sums include Mundra Port and SEZ, Mangalore Refinery and Petrochemicals and Spice Communications.

Experts say the market will be able to absorb heavy equity issuances as sentiment has picked up and there is liquidity on the sidelines.

Motilal Oswal, chairman & MD of Motilal Oswal Financial Services, agrees that the budget proposal could help increase the depth and liquidity of the market. It will not cause any crisis because it is going to take place in a phased manner. However, given the current market condition, I think promoters will choose the QIP route for offloading their stakes.

4.6 MICRO-FINANCE PROFESSIONALS

Developing alternative credit delivery models

Basic financial services

The recent media coverage and debate about the credit meltdown has focused largely on big lenders in the developed world. But attention must also be paid to the developing world to prevent parallel crisis in the microfinance sector. This vital industry, with 150 million clients worldwide and a global loan portfolio of $40 billion, provides access to basic financial services for millions of people in emerging countries including Brazil, Kenya, Bangladesh and India.

If microfinance institutions suffer losses akin to big banks in the developed world, their clients could lose a vital lifeline: access to affordable credit.

Today, the microfinance sector appears solid, with repayment rates as high as 98%. But this doesn't mean that all is smooth sailing. The subprime market collapse has made many microfinance institutions nervous. And rightly so: like banks in developed nations, microfinance organisations were incentivised to expand rapidly in recent years, transforming the sector from an industry dominated by **NGOs**, like Grameen Bank in Bangladesh, to one **led by for-profit companies** including Compartamos in Mexico and SKS Microfinance in India.

This for-profit shift has boosted microfinance institutions' capital, enabling them to serve more of the poor, but it also put pressure on Microfinancers to provide competitive rates of return for their investors.

Ultimately, increased competition is good for the industry, although, as we have learned from the subprime crisis, it is imperative that best lending practices aren't compromised as a result.

The good news is that evidence suggests the microfinance model has allowed many borrowers to start small enterprises that generate income.

This provides the poor with a productive 'hand up' rather than a short-term 'hand out'.

Yet this progress does not come without risk, for microfinance CEOs know little about their loan recipient. There is a dearth of research and empirical evidence about the borrowing habits of the world's poor. In the absence of any formal credit bureau or co-operation between organisations to promote best lending practices, anecdotal evidence suggests that borrowers are taking loans from multiple microfinance institutions and other sources, such as loan sharks. This could destabilise the sector as a whole.

To strengthen and safeguard the microfinance sector, first, microfinance organisations should support both research and technology initiatives that will help them better understand the creditworthiness and spending patterns of their clients. Second, regulators should create an environment that encourages prudent growth, with the guidance of specialist teams that focus on microfinance as an independent sub-sector of the financial services industry.

Finally, investors should heed the lessons from the credit crisis and encourage microfinance organisations to better understand the true risks in their loan portfolios and continue to apply and develop best practices in lending to the world's poor.

Equal Opportunity Commission

The government is considering the possibility of **arming** the Equal Opportunity Commission (EOC) with powers to enforce its orders. Minister of state for ministry affairs Salman Khurshid will be meeting professor N Madhava Menon, who headed the expert group, to discuss the issue. The ambit of the Commission will also be discussed at the meeting. Once the issues of sectoral ambit and enforceability are resolved, the proposal will be taken up for approval by the Cabinet.

In its current form, the proposed Commission has been given the powers of civil court trying a suit under the Code of Civil Procedure 1908, for inquiries and investigations. It does not have penal powers. Mr Khurshid would like to explore the possibility of providing the Commission with the powers to enforce its orders. Mr Khurshid said, "The expert group was not clear on this issue. We will look into the practices of the countries that have functioning Equal Opportunity Commission."

In its report, the expert committee had suggested that the Commission needs the powers of a civil court, but not penal powers, for its inquiries and investigations.

The report states that the impact and the efficacy of EOC would depend mainly on its ability to influence public opinion and provide credible evidence.

Accordingly, the proposed EOC would have the power to announce codes of good practice, standard powers of a civil court relating to inquiries, power to provide legal assistance to complainants and engage legal counsel, power to demand information and to inspect records and power to require compliance of equal opportunity practice codes.

The other issue that will be up for discussion is the sectoral ambit of the Commission. "There is a view that we should restrict it to few sectors in the beginning before expanding the scope while some others feel that we should broad base the scope of the Commission," the minister said. For now, Mr Khurshid says he is keeping an open mind.

However, there appears to be a preference for restricting the Commission's ambit to employment, education and housing. Sources argued given that there is no scientific data available in the country, broadbasing the Commission's ambit may not be a good idea. It might be better to restrict it to key areas and build the requisite expertise, research and data base, before increasing its ambit.

The Equal Opportunity Commission had run into rough weather with objections being raised by key ministries on the viability of the Commission, especially on its power to monitor the private sector and possible duplication.

Mr Khurshid has argued that since the Commission is about setting standards in public realm, it would be meaningless to leave the private sector out. On the issue of possible duplication, the minister has indicated willingness to work out some mechanism to delineate spheres of influence. Mr Khurshid said: "We have put our view forward and now the matter can be discussed in the Cabinet."

Free trade pact

India and South Korea signed a comprehensive economic partnership agreement which will make Korean consumer products and auto-parts cheaper in India. The idea excludes fully built-up vehicles, and provides for easier movement of contractual service providers and professionals between the two countries and treatment of investments from the one another's country at par with domestic investment.

This is the second CEPA signed by India, the other being with Singapore. This is also India's first bilateral trade agreement with an OECD country.

As per the agreement, South Korea will eliminate duties on 93% of its industrial and agricultural products and India will do the same on 85% of its goods. India has excluded sensitive items farm products, textile items and built up automobiles from tariff elimination commitments. Duties will be phased out on most of these products in the next eight years.

The Indian subsidiary of Korean electronic goods manufacturer, Samsung India, pointed out that the pact will further strengthen business relationship between the two countries. "It will become easier to get new technology and innovative products into the country. Besides, the move will attract more Korean investments into India and vice-versa."

South Korean auto manufacturers with operations in India, too, are celebrating the pact as gradual elimination of the 12% duty on auto components would considerably bring down their input costs. Hyundai Motor India said, "It will make us more price-competitive. Though the actual benefits of the FTA will result in a few years, but the reduction in duties on components and other automotive parts will bring down their effective prices and help create price advantage from our Indian operations."

The Indian industry is looking at the pact as an opportunity to bridge the bilateral trade deficit in favour of South Korea and improve export of services. Ficci secretary general Amit Mitra said, "We have projected a doubling of trade between India and South Korea within the next 5 years. Of the $10.2 billion bilateral trade for the period April 2008-February 2009, India had a deficit of $4.6 billion with Korea and this imbalance has to be corrected through greater market access for exports from India."

CII Director General Chandrajit Banarjee pointed out, "Liberalisation in movement of service professionals is among the major gains expected for Indian industry out of the India-Korea CEPA. India has a competitive advantage in services, such as IT/ITeS, Educational Services etc. We welcome the market access provided by Korea for Indian service providers."

CII expects Korean investments to flow into sector like chemicals, food processing and metals. Both countries have committed to provide national treatment and protect each other's investments to give a boost to bilateral investments in all sectors except those specifically exempted from it.

The CEPA will come into force after it is ratified by the Korean National Assembly and the notifications to bring it into effect are made by the two countries.

4.9 ONE-STOP-SHOPS

Dedicated to offer related services under a roof

Unique identification

The metaphysical, existential question, "Why am I?" (The purpose of life) has intrigued humans only marginally more than the psycho-social query "Who am I?"

Now the government of India will help you answer the question of identity. The government is going ahead with the project of providing a single, unique identification for all adult residents of India. While many parameters are yet been defined, few projects anywhere match the scale and complexity of this effort. What is known is that the Unique Identification Authority (UIDA) will itself not – as was commonly presumed – issue any kind of ID card; it will confine its role to providing a number, as a unique identification, to each individual.

An ID from birth to death will facilitate a whole host of applications. It will make possible the tracking of vaccinations, school entry, health and nutrition status, age at marriage and a range of other parameters. While aggregated data would provide valuable inputs for monitoring specific projects, individual data can be used to ensure appropriate attention to each person. In all this, UIDA's role will be crucial, but limited to providing the universal, unique ID for residents of India.

It will be for others to evolve and implement various applications.

Thus, while creating an ID database is absolutely necessary, true value will emerge only if others use it to do things better and – more interestingly – do new things. More often than not, high value added applications will require the working together of different organisations.

For example, the simple process of crediting wages into the bank account of a NREGA beneficiary will require that the bank, local administration and the NREGA authorities work together, with the UID serving as the base for authentication, payment and opening of bank-account.

More complex applications, correlating transactions with an individual, will require greater coordination, access to each other's databases, and information-flows across organisational or ministerial divides.

Such applications will necessitate sharing – and occasional ceding – of turf and free flows of information. It will require re-engineering of processes and of organisations; gate-keepers will lose power and many hierarchies will be demolished. Training and change-management will be essential, as will a major shift in mind-set. If this can be handled well, the pay-off can be huge.

Transparency, efficiency and accountability will be spinoffs; better delivery will change the life of the disadvantaged; migrants will get an identity; financial "inclusion" will move from concept to reality. Doubtless, this will have a positive impact on GDP. More importantly, it will be a big step towards greater social and economic equity.

These are exciting prospects. What provides hope that they are not mere dreams in one name: Nandan Nilekani; with an outstanding record of entrepreneurship and management, and a clear and optimistic vision, there could be no better choice for this onerous task. Navigating the shoals of bureaucracy and channelising the divergent forces of politics will, of course, pose major challenges.

4.10 CONTINUING LEARNING CENTRES

Take informed decisions

Financial freedom

The best thing about freedom, they say, is that you have the freedom to interpret it differently, depending on your location in time and space. For the small-time investor in rural India, looking for an alternative to leaving his small savings in the bank, freedom possibly came to his doorstep in the form of a micro SIP that he could put his money into or the option of purchasing an insurance policy for Rs 1,000 and being allowed to pay premiums of as little as Rs 10.

But while freedom is equated with access for the investor in the Indian hinterland, the urban investor's version is one of choice. Be it mutual funds or insurance, the Indian investor has the privilege of choosing between a wide range of products and simultaneously lowering the cost of his investment.

Experts say that the history of the modern mutual fund industry in India is only a little older than the Sebi (Mutual Fund) 1996 regulation, which literally set the basis for the industry structure. This has been regularly followed up changes that brought greater benefit to the investors. And the efforts still continue. Topping it all is Sebi's latest initiative to bring down the cost-related entry barriers for the investor by removing entry load in mutual funds.

Meanwhile, the insurance industry too has seen a great deal of evolution in the 9 years since the private sector players were allowed to enter this space; and, then emerged the Ulip that gave investors access to the market as well as the benefits of life insurance at a single go. The penetration into the rural areas has been ensured by the compliance norms that the regulator has set down regarding the percentage of policies that need to be sold in rural areas. The latest move of the Irda regarding capping of charges on the Ulip will bring down the cost of investment and insurance effectively.

Moving to the stock market – there's been a sea change there in the last few decades, which is all about more power to the investors. Now there's freedom from floor trading and physical share certificates. In fact, the very hallmark of Dalal Street – where brokers bought and sold shares by out crying – is, as we all know, a thing of the past. Of course all that is history, today its electronic trading. Investors have the freedom to buy or sell from anywhere with the help of the Internet. The impact cost has also come down substantially. Investors no longer need to struggle with share certificates as all the shares are in electronic form. And best of all, overall cost of transaction in India is probably the lowest in the world.

Why is it then that every small investor is not jumping into the equity bandwagon? Much of the trading is done by corporates and high net worth individuals and there is little participation from retail investors. There is a need for more depth and more participation from retail investors. The latest move to bring down promoters' holding to at least 75% will increase the float. But it is not yet clear when that will actually happen.

Nevertheless, members of financial service sector agree that financial illiteracy and lethargy are two greatest challenges in India. Investing time and resources to educate current and potential investors will be the key to financial freedom or inclusion. Despite the government drive, the country continues to have very low level of financial literacy. Financial freedom is not to play poker in the financial markets. It is imperative that citizens also realise the time value of money and use this freedom to patiently build a nest egg for a rainy day.

4.11 GLOBAL OUTLOOK
Global pathways

Crisis won't upset **US dominance**

The American economy has been battered by the present financial crisis. It could take several years for it to get back to normal. Some commentators and political leaders have suggested this could be the beginning of the end of America's dominance of the global economy. Those who contend that the present crisis will be a huge setback for the US put forward several reasons:

- The US economy could take several years to come back to normal. Meanwhile, rivals like China will power ahead.
- America's national debt is set to explode and this will limit its future growth.
- The US dollar will lose its status as the reserve currency in the near future.
- The American financial system will soon be a pale shadow of what it has been.
- The IMF expects the US economy to shrink by 2.6% in 2009. Recovery will be slow in coming years – in 2010 the US economy is projected to grow by just 0.8%. Many think this could alter the race between the US and its principal economic rival, China, to China's advantage.
- In 2007, Goldman Sachs had forecast that China's GDP would equal that of the US in normal terms by 2027. If the US economy suffers low to zero growth over the next four years while China grows by 6%, one would think that China could catch up with the US even earlier.

Wrong, says historian Niall Ferguson. In an article in the *Harvard Business Review* (july-August 2009), Ferguson argues that, while America's financial sector may be end up weaker, American dominance of the global economy is likely to continue.

Ferguson points out that, going by IMF's forecast (of April 2009), US growth rate will be lower than the growth rate of 2007 by 4.6 percentage points. But that of China would be lower by 6.3 percentage points. So, the present crisis could mean that China won't catch up with the US until much later than forecast earlier, say, 2040. **The crisis will have stretched out America's dominance instead of abbreviating it.** (The IMF's July forecast raised the growth forecast for China in 2009 but growth will still be 5.5 percentage points lower than in 2007).

This applies with greater force to America's other rivals. Growth in the European Union is expected to shrink this year by 3.2%, in Japan by 5.8% and in Russia by 6.5%. **The present crisis has highlighted how central the US is to the world economy.**

A serious recession in the US and one arising from problems in its financial sector impacts on other economies in two ways. It lowers exports to US and it reduces capital flows from the US and other advanced countries. That is why the present US crisis has translated into a global crisis. **Even more perversely, many economies are hurting more badly than the US, which is the source of the crisis.**

Indeed, there is no dearth of conspiracy theorists who believe the US is interested in prolonging the crisis – and may have even engineered it – knowing that its principal rivals, especially China, would be severely impacted. China has used its double-digit economic growth rate to contain discontent. A decline of 5% or so in its growth rate risks fuelling serious disaffection within the country.

America's public debt is set to rise sharply following the resort to a fiscal stimulus as a means of reviving the economy. The federal deficit is expected to exceed 12% of GDP in 2009. And Federal debt is expected to rise from 89% of GDP in 2009 to 101% of GDP in 2019, even on the optimistic assumption that the US economic growth rises to over 4% by 2011.

In India the consolidated fiscal deficit is expected to be around 12% of GDP in 2009-10. Our combined debt to GDP ratio of the Centre and the states was 73% last March. We worry, despite the fact that we can count on a long –term growth rate of 8% and we know that a growth rate of this order renders the fiscal problem self-correcting. Surely, the US should have a problem given its lower growth potential?

But, there are differences in the two situations. The US is still regarded as a safe haven by investors whereas confidence about the Indian economy is nowhere as strong.

More importantly, the dollar is the reserve currency and even America's rivals prefer to invest overwhelmingly in dollars. This gives the US enormous borrowing potential.

It can simply print dollars which others will gladly pick up.

For all the talk of the dollar losing its primacy, no alternative is in sight. **Indeed, the present crisis has underscored the inherent attractiveness of the dollar.** The dollar rallied in the face of bad news about the US economy and has defied predictions of a steep decline since.

As Ferguson notes, there are practical obstacles to switching to the Special Drawing Rights issued by the IMF. A senior Chinese mandarin summed up the situation very well earlier this year: "Except for US Treasuries, what can you hold? Gold? You don't hold Japanese government bonds or UK bonds… there is nothing much we can do."

Because the problems of the US economy hurt the rest of the world, the US appears set to retain its primacy in the world economy. The dollar will remain the dominant currency and the world resigned to financing America's deficits.

If there is a question mark, it is over the future of the American banking system. For the US banking system to regain its vitality, the US government will have to assume control of the top banks at least for some time, organise the disposal of banks' toxic assets, put in place rules that rein in high leverage in the banking system and get a lot tougher with executive pay in banking. But the Obama administration has so far lacked the will take such decisive steps.

This undermines the chances of an early recovery in the US economy and hence the world economy. But for the reasons mentioned above, it does not pose a threat to America's dominance of the world economy.

When the US catches flu, the rest of the world goes down with pneumonia and the US ends up looking stronger.

4.12 ISSUES OF THE PRESENT

Freedom to get & fail in the system of free enterprise

Financial crisis? No,
Capitalism as usual

Just five months ago, when stock and commodity markets hit rock bottom, capitalism was viewed as seriously if not terminally sick. The *Financial Times* ran a series of articles titled "The Future of Capitalism." Economists, politicians, and philosophers saw the Great Recession of 2007-09 as a historic watershed, and produced new visions of a changed capitalism.

Today, that looks like much ado about nothing. Stocks markets are booming, commodity prices are rising and shipping rates have tripled.

Pessimists warn of rising defaults in credit cards, commercial realty and corporate debt, so we could have a double-dip recession.

But markets believe the worst is over.

Despite political and public courage over 'casino capitalism' the financial reforms being contemplated across the world are not fundamental.

Four month ago, pundits waxed eloquent about learning lessons for reform from the financial crisis. Today the greatest lesson of all seems to be that capitalism, with all its flaws, can cope with Great Recession. We have always had financial crisis and always will: that's the nature of capitalism.

The system will always need reforms to keep pace with changing technologies and innovations. Yet it has proved its resilience.

In the years ahead, financial regulation will definitely increase.
But this will change capitalism's profile only slightly.

Hedge funds, the least regulated financial entities of all, survived the crisis without bailout. While banks, the most regulated entities, suffered badly; so regulations does not prevent all crisis: Japan had the most regulated financial sector among developed countries but suffered a lost decade in the 1990s.

Lesson: while the future will see more regulation, financial crisis will still happen.

Stiffer capital adequacy norms look certain, to check the excessive leverage of the last decade.
Yet history suggests that financial innovation will ultimately find ways round regulations. *Bank regulation was ultimately circumvented by a shadow banking system and off-balance sheet vehicles.*

In future, most derivatives will have to be traded through a clearing house, ending the counterparty risk that sank the asset-backed securities market. Despite criticism, securitisation will continue with modifications. Banks will be able to securitise mortgages subject to retaining a certain portion of mortgages they originate, a safeguard against excessive risk-taking in mortgage origination.

Some flaws will not be removed at all.

- A special US problem is that its mortgages are non-recourse loans: the lender can get back the house after a default, but cannot go after the other assets of the borrower. This encourages massive willful default. This carries the seeds of a future bust.

- Politicians rail against excessive executive pay, and pay curbs have been instituted in companies being bailed out. Yet there is no move to fundamentally change payment structures in solvent companies.

- There is vague talk of reducing the global imbalances that exacerbated the crisis, but no sign of a credible remedy. Neither the IMF nor Financial Stability Forum has the requisite powers to check future imbalances. Asian countries still want to build high reserves as insurance, perpetuating global imbalances.

- Politicians want to check future bubbles, but are unclear how to do so. There will always be differing opinions on when exactly a boom become a bubble. Besides, bursting an asset bubble without damaging the overall economy is problematic.

  - High interest rates will check a housing bubble, but will also hit corporate and consumers, and may cause a recession.

  - Imposing stiff margin requirements to check a stock market bubble might drive money into other assets and cause bubbles there.

In sum, no major overhaul of capitalism seems on the cards.

- The rapid transition from despair in March to the stock market boom today suggests that the markets don't really see the need for great change.

- The existing system has survived the Great Recession, and that is seen as Great News.

Is this because humans are utterly myopic?

- Recessions are viewed by the public as outcomes of policy blunders, as tragedies that cost jobs and production. But the recessions are not necessarily the correctives to a capitalist system, innovations, and the search for higher returns.

- The system works through creative destruction. This entails boom and bust, fast growth and recession. Recessions and financial crises are actually integral part of capitalism. So, even after reforms expects more financial crisis and recessions in the future.

We would be wise to institute reforms that reduce the risks, but even wiser to understand that the risks cannot be ended in the system of free enterprise.

5. BANKING SECTOR

RBI quarterly monetary policy statement

Over the past few years the RBI had acquired a reputation for taking markets by surprise. Things were no different on Tuesday (28/07/09); except this time around the surprise really lay in the bank playing copy-book style and doing exactly what the market expected. All policy instruments – repo rate, reverse repo rate, CRR – have been kept unchanged. Rightly so, there is no case whatsoever to loosed policy further.

India Inc should take the hint that interest rates will not remain low forever. As inflation rises, interest rates will harden and the surplus money sloshing around the system will be mopped up by RBI. But till there are no 'robust signs of recovery', the central bank has promised liquidity to help a decent GDP growth, which it has pegged at 6% with an upward bias.

In the quarterly monetary policy statement, RBI governor Duvvuri Subbarao said, "The accommodative monetary stance is not the steady state stance. On the way forward, RBI will have to reverse the expansionary measures… The exit strategy will be modulated in accordance with the evolving macro-economic developments."

Unlike his predecessors, RBI governor is quite direct on what action banks should take on the interest rate front. The governor has repeatedly stressed on the central bank's efforts to work in a transparent manner. Mr Subbarao addressed the media on the central bank's take on the economy.

Scope for bank lending rates to come down

Subbarao said: There is scope for a reduction in lending rates within the policy rate adjustment already done by RBI. Even if we take into account the inflation rate and returns to depositors, the lending rate should be around 9.5%, but they are 10.5% and above… so there is scope for banks to reduce lending rates. We have also said in the policy statement that as deposits mature and get re-priced, the cost of funds will go down for banks and they will have room for reduction of lending rates.

Expectation for a reversal of the expansionary policy

The governor clarified: We will look at non-oil imports, we will look at credit growth, we will look at inflation and we will look at manufacturing. However, it will be inappropriate and improper to speculate on the future. We have been debating to exit strategies in our internal meetings, but are not in a position to give any more details. In fact, central banks around the world have been talking of exit strategies.

Maths behind RBI 6% growth rate estimate

RBI governor Duvvuri Subbarao told to reporters that we debated a lot internally on the growth rate for the economy. Besides numbers, we also looked at when the forecasts were made. Several of the forecasts were made before the monsoon situation became clear. But let us first consider the risk factors for the economy. A lot would depend on agriculture. We all know the rainfall situation at present is 19% below normal. The agriculture performance could spill into industry and services, with a lag effect.

Exports have been negative for the past eight months. Although exports only account for 15% of the economy, they are significant, but they would depend on the state of the global economy.

Lastly, investments (in the economy) also have to pick up, although some bankers said credit from the housing and retail side have picked up.

6.1 TAX UPDATES

More goodies flow from finance minister's bag

Emphasising on sustained economic stimulus, in his reply to a debate on Finance Bill 2009-10 in Lok Sabha late evening, FM Pranab Mukherjee on 27/07/2009 proposed incentives and extended tax breaks so as to step up economic growth to 8% by the end of the next fiscal.

Interest subsidy of 1% for home loans up to Rs 10 lakh for houses worth up to Rs 20 lakh:

Mr Mukherjee proposed an interest subsidy of 1% for home loans of up to Rs 10 lakh availed for houses worth up to Rs 20 lakh. The interest subsidy will be routed through scheduled commercial banks and housing finance companies registered with the National Housing Bank.

Deduction of interest paid on education loans availed for those under their legal guardianship:

While calculating applicable income tax, tax payers can now deduct the interest paid on education loans availed for those under their legal guardianship. Earlier, the benefit was available only on loans taken for the benefit of the taxpayer, spouse and children.

Giving yet another sop, the minister said the eligible deductions for assessee with severe disability will be raised from Rs 75,000 to Rs 1 lakh for purpose of income tax.

Tax-free profits from housing projects approved by a local authority

The minister also proposed an amendment to the Income-Tax Act so that profits from housing projects approved by a local authority between April 1, 2007, and March 31, 2008, will be tax-free if they are completed before March 31, 2012. The minister urged builders to pass the benefit to consumer.

Firms engaged in processing, preservation and packaging of meat, poultry, marine and dairy products are also now given exemption from tax on their profits.

Tax holiday for industrial park for two more years

With a view to providing stimulus to the infrastructure sector, Mr Mukherjee extended the tax holiday for industrial park for two more years to March 31, 2011. Accordingly, profits from development, operation and maintenance of industrial parks will continue to be tax-free.

The government also extended the tax holiday earlier proposed for natural gas production from blocks licensed under the eight round of the national exploration licensing policy to natural gas production from blocks licensed under the fourth round of bidding for exploration of coal bed methane as well.

Service tax exemption on repair and maintenance of roads

The government also tried to infuse more activity in the road sector by exempting repair and maintenance of roads from service tax the same way as construction of new roads is kept out of the tax. The tax break is available immediately.

The new services brought under service tax in the finance bill 2009 – those in relation to transport of goods by rail and inland water, coastal goods, legal consultancy, cosmetic and plastic surgery – will come into force only from September 1, 2009.

Clearly, the government's focus is to stimulate the economy for a faster recovery. The finance minister told lawmakers, "I intend to remain focused on our immediate priority of providing stimulus to generate economic activity in the present environment of economic slowdown.

The lower house of Parliament passed the finance bill with the proposed modifications.

A model tax code for you

The Government on 12/08/09 unveiled the draft of a brand new direct tax law, which will replace the four-decade Income Tax. Realising the draft direct taxes code, Finance Minister Pranab Mukherjee said: The thrust of the code is to improve the efficiency and equity of our tax system by eliminating distortions in the tax structure, introducing moderate levels of taxation and expanding the tax base.

The tax code makes radical changes in all areas of taxation: It lowers the incidence of tax on corporate and individual incomes but reintroduce wealth tax and capital gains tax, albeit at lower levels. It also proposes to bring a uniform pattern of taxation on all long-term savings in the form of EET – exempt at the stage of contribution, exempt during accumulation and taxed during withdrawal. If a reasonable level of discussion happens on the code, a bill could be placed in the winter session of Parliament. The government is hoping to implement the new code from 2011.

The code proposes to exempt income up to Rs 160,000 a year from tax. Income up to 10 lakh will be taxed at 10%, 10-25 lakh at 20% and beyond Rs 25 lakh at 30%. But under the new tax law, an individual's gross salary would also include perquisites such as value of rent-free accommodations, medical reimbursements and leave travel encashment. Tax payers will also not be able to claim tax benefits on interest repayment on housing loans. However the benefit would be available if the house is rented. All savings scheme would also come under EET, implying that they would face tax at the time of withdrawal. However, tax exemption would be available to the Public Provident Fund and other pension fund schemes on withdrawals of amounts accumulated upto March 31, 2011.

The Code further proposes abolition of STT.

Capital gains on shares and securities have been proposed to be taxed as income, added to other income after indexation with base year 2000. The capital gains regime is proposed to be simplified by eliminating the distinction between long and short-term capital assets.

Wealth tax provisions are proposed to be overhauled. Net wealth, which would include all wealth of an individual in excess of Rs 50 crore, will be chargeable to wealth tax at the rate of 0.25%.

One of the key changes suggested by the Code includes giving supremacy to the Indian tax law in case of a dispute between provisions of a tax treaty and the Code, and introduction of a general anti-avoidance rule to combat tax avoidance. This would help the tax authorities' deal with cases such as Hutch-Vodafone, where if they infer that a tax treaty was being abused for tax benefits.

Besides, a massive overhaul is suggested for corporate taxation besides slashing the corporate tax rate to 25%. The new rate would not have any surcharge or cess. Moreover, the current profit-linked tax incentives for businesses will be replaced with investment-linked incentives. To put it simply, a company would be able to enjoy tax benefit only to the extent it invests. But, all the tax exemptions such as those available to SEZ would be given time to adjust to new regime.

A minimum alternate tax on assets of companies is being proposed as it provides incentive for efficiency at the rate of 2%.

It also proposes rationalisation of tax provisions for amalgamation and demerger so that tax remains neutral when businesses reorganize.

Dividend distribution by companies would be taxed @ 15%.

In move that would have major impact on foreign companies or companies that have made investments in foreign countries, the code is proposing to treat a company as an Indian resident even if it partly controlled in India. Presently, a company is treated an as Indian resident and taxed only if full control of that company lies here. The measure is primarily aimed at preventing escape of any income from taxation.

The draft direct code is a brave attempt by the income tax department to clean up the maze India's income tax laws had become with innumerable – over 3,300 – amendments carried out in the past three decades. There is no better way to usher in a new direct taxes code than rewrite the whole thing from scratch, and that is precisely what the department has successfully done in a little more than three years.

The proposed code appears easy to interpret and hopefully will lead to fewer litigation. We welcome the basic principle to do away with exemptions and move to moderate tax rates, both for corporates and individuals. We have always argued tax rates should be low to moderate and exemptions withdrawn; exemptions are distortionary in nature.

And surely, no one will dispute that the proposed tax slabs for individuals – with incomes up to Rs 10 lakh paying only 10% tax – will provide a big relief to the salaried class. The tax for corporates proposed at 25%, after scrapping all exemptions, is in line with the effective tax rate for majority of companies. The proposal to replace minimum alternate tax with a 2% levy on gross assets on balance sheets is welcome, and it will bring all companies enjoying various tax holidays, including those in SEZ, into tax net.

Putting out the draft direct tax code for discussion before the Bill is moved in Parliament is a commendable move, but there is a danger that several interest groups will lobby for changes in the draft code to retain sectoral benefits. Only meritorious suggestions must be accepted.

The government must not compromise on the basic philosophy of simplicity and transparency underlying the new tax code. There will be gainers and losers as exemptions are phased out. Some losers will protest. The finance ministry must not pay heed.

Lower direct tax coupled with removal of distortionary exemptions will neatly complement the other equally critical project of implementing GST after April 2010. The two are clearly linked. Together, they will usher in an era of optimal equity in India's tax policy.

6.2 SECURITY LAWS UPDATES

Sebi say no to differential voating rights

The Securities Exchange Board of India (Sebi)'s decision to bar listed companies from issuing shares with differential rights to control and dividend should be welcome; as such instruments only distort the market for corporate control.

Society gains by the economy's productive assets being managed in the most optimal fashion. Managements that have demonstrably failed to put the assets under their control to optimal use should lose that control to others who can. Potential takeover threats serve to raise the economy's productivity levels. It is important that regulators create conditions where small shareholders have the option of selling out to effect management change in companies that belied their trust.

1. Sebi scraps no-delivery period

Pursuant to the recommendations made by the Secondary Market Advisory Committee of Sebi at its meeting held on June 30, 2009, it is decided to do away with 'no-delivery period' for all types of corporate actions in respect of the scrips which are traded in the compulsory dematerialised mode and accordingly, short deliveries, if any, of the shares traded on cum-basis may be directly closed out.

Sebi said in a circular that this will come into effect from August 1, and accordingly will apply to all corporate actions for which the record date or book closure falls on or after August 10.

In the no-delivery period, shares can be traded, but are not transferred from one holder to another. The first day of the no-delivery period is the ex-date and the buyer of the shares on or after the ex-date will not be eligible for benefits of the corporate action such as bonus, rights shares and dividend. The trades are settled only after this period. This system was relevant when delivery of shares was done in a physical format, through certificates. The share certificates had to be delivered to the registrar of companies before the book closure so that investors get the bonus, right shares or dividend. Now, with shares being held in the demat format, the concept of no-delivery period has lost significance.

2. Sebi plans to reduce right issue timeline

Sebi is considering a further reduction in the right issue timeline to 30 days or less from the existing 43 days. The move is in line with the regulator's ongoing efforts to streamline primary market procedure.

As part of this process, an offer document may no longer be required for the right issue. In effect, what it means is that post-board resolution; a company can make an announcement directly to stock exchange, akin to a qualified institutional placement (QIP). The perception is that an existing investor in the company is aware about the background of the company and also other developments. All he needs to know is how much money the company plans to raise and why?

Over the past couple of years, the regulator has been steadily reducing the quantum of disclosures for rights issues. Last year in August, Sebi chairman CB Bhave had indicated that the board would review the timeline further, since 43 days is also not seen as an ideal time for completing an issue. The reduction in timeline approved for rights issues by Sebi in 2008, included bringing down the number of days for the notice period for a board meeting from seven days to two working days; the notice period for the record date reduced from 15/21/30 days to seven working days for all scrips; issue period reduced from minimum 30 days to a minimum of 15 days with a maximum of 30 days and the time for completion of post-issue activity reduced from 42 days to 15 days.

3. Brokers may've to return idle cash every month-end

In a bid to prevent stock brokers from misusing funds and securities lying in their clients' trading accounts, the Sebi has proposed that brokers settle the balance funds/securities lying in the accounts on the last day of every calendar month.

Under a practice called 'running account authorisation', clients give the brokers the right to retain their (clients) funds and securities on an ongoing basis. These funds/securities are to be used to meet settlement/margin obligations for later trades. However, Sebi received many complaints that many brokers were misusing the residual funds and securities in their clients' accounts.

The regulator said in the discussion paper: The funds and securities of the clients lying with the brokers are prone to several risks. To prevent such occurrences, the regulator has proposed that 'running account authorisation' should be dated and also contain a clause that the client can revoke the authorisation at any time. There should also be a clause in the authorisation mentioning that actual settlement of funds and securities should be done by both the parties on the last day of every calendar month.

If the client requests for return of the securities/funds lying in the account at any time during the interim period, the broker will have to transfer it within one working day from the date of receiving the request.

Some clients may be having outstanding transactions/positions in cash/derivative segment on the running account settlement date. In such cases, the broker may make due adjustment by retaining the requisite securities/funds from the running account towards such obligations of clients and may also retain the funds expected to be required to meet margin obligations for next 5 working days.

The broker will also have to send a monthly statement to the client, and in case of a dispute, the client will have to bring it to the notice of the broker within seven working days.

The regulator has also barred broking firm from creating mail ids for clients, on which electronic contract notes (ECNs) are sent. Often brokers create these ids without informing their clients, and do not send the ECNs on the e-mail ids that the clients had provided them.

4. Sebi to fund class action suit against Satyam

Market regulator Sebi will fund a domestic investors' association that has filed a class action suit against Satyam Computers, its former promoters, auditors and directors.

The lawsuit is seeking compensation from Satyam and the parties involved for the losses these investors incurred in its stock price crash, after an accounting fraud came into light in January 2009.

In class action, which is a collective lawsuit presented by the representative-member before a court on behalf of a large number of investors, has been filed by New Delhi-based Midas Touch Investor Association in the Supreme Court. This is among the many several class action suits that the company is facing, mostly in the US. Midas, which represents three lakh investors, collectively holds nine crore shares of Satyam, now renamed Mahindra Satyam. Virendra Jain of Midas Touch Investor Association said, "We have sought compensation on behalf of retail investors who were defrauded due to fudged accounts, which helped the ex-promoters manipulate prices. The former auditor, Price Waterhouse and the company's directors have been blamed for being party to this fraud."

This is the first instance in the country where Sebi is financially assisting investors to legally challenge wrong-doing by companies or promoters. The market regulator will use the investor protection and education fund to fund Midas. The association will be reimbursed 75% of the total expenditure on legal proceedings that it will incur.

Lawsuits here are handled differently from countries like the US, where the lawyer gets his fee only if the verdict is in the clients' favour. They also get a share of the compensation amount. Meanwhile, in India, irrespective of the outcome of the case, lawyers charge a flat fee.

5. FII cap in g-sec

The finance ministry is reportedly toying with the idea of raising the cap for foreign institutional investors (FIIs) in government securities.

This may seem a simple solution to the problem posed by government pre-empting the bulk of domestic savings. FIIs are more than eager to invest in what is virtually risk-free investment (unlike Latin America, we have never defaulted on our sovereign borrowing) at an attractive rate of interest.

So why not allow them to buy more and ensure both government and the private sector's need are met?

Given that foreign institutional investors hold less than 1% of the outstanding government debt, a case can possibly be made out for more foreign subscription of government securities.

There is, however, a flip side of this policy. Any increase in FII holding of government securities creates a dollar liability. Though the debt is dominated in rupees, as and when FIIs sell their holdings they will convert the rupee proceeds into dollars.

A sudden outflow of dollars could have implications not only for the exchange rate but also for the real economy. Given the large number of people living below poverty line in India with no cushion to fall back on in bad times, any shock to the real economy must be viewed far more seriously than in say, the US where currency can be printed to repay debt.

One of the most important lessons of the ongoing financial crisis is the danger posed by dollar liabilities.

Hence increasing the cap on FII holdings in government securities may not be the panacea that the finance ministry seems to think it is.

To be sure no policy, whether regarding the cap on FII investment in debt or FDI in various sectors, must be seen as cast in stone.

It must be constantly reviewed depending on the country's macro-economic fundamentals and the evolving global scenario. Ideally, government should curb its draft on domestic savings so there is no untoward pressure on interest rates. But if that is not possible in the short run, it must tread very, very carefully in increasing our overseas liabilities.

7. ISSUES OF INFLATIONARY PRESSURE

Inflation may play spoilsport

The Reserve Bank of India (RBI) may be faced with a daunting task of fighting inflation, as supply-side constraints are expected to add to the inflationary pressures in the economy.

Even as the current phase of negative inflation, generated by a high base effect in the corresponding period of the previous year, is expected to wear off by October 2009, RBI has revised its inflation projection upwards to 5% from 4% for FY10 (April to March).

However experts from brokerages and research houses term the forecast "conservative", and estimate that the rate of inflation will rise to around 6%. This is because food prices, which have a weight of about 23% in the WIP, are expected to remain high. Moreover they warn that the number could be higher in the light of deficient rainfall. Recent figures related to food inflation have already indicated that.

Goldman Sachs' calculation suggests that a 1% increase in crop prices adds 30 basis points (bps) – a basis point is .01% - to headline WPI inflation. Its estimation for WPI-inflation is 6.5% by March 2010.

Similarly, Edelweiss Securities sees a possibility of inflation reaching 6-7%. These brokers have attributed a possible escalation in inflation to rising food prices.

The emerging inflation is on account of supply-side factors.

Put simply, experts envisage a situation of too much money (arising out of an easy monetary policy) chasing a few goods, as foodgrains supply will be constrained. Conventional theory suggests that it is easier for the central bank to manage demand-side inflation rather than supply-induced inflation.

- In the case of demand-pull inflation (higher purchasing power), the bank can influence the supply of money and, hence, reduce purchasing power.

- In general, traditional monetary policy has very little impact to contain inflation when it is from supply shocks. But, still it will play an important role in containing inflationary expectations.

- According to analysts, it remains to be seen when policy rates harden, as premature monetary tightening could increase the risk of a prolonged slowdown, while delayed tightening could increase future inflationary pressure.

- However, DK Joshi, principal economist of Crisil, feels irrespective of the origin of inflation in the short-term, the central bank has to be proactive in managing the phenomenon.

- RBI has echoed similar views in its policy statement, "October onwards, once the high base effects wears off, the year-on-year WPI inflation will creep up even without any major supply shock, largely on account of the global trend in commodity prices, which has been an upsurge ahead of the economic recovery, and the domestic demand-supply balance."

This means inflation will result from both, a rise in prices of industrial goods as well as food articles. As a result, any move at tightening monetary policy may, to an extent, help anchor inflation. Yet, overall inflation is likely to be higher than RBI's targeted rate. RBI may face an uphill task in fighting inflation.

Week ended July 11: Costlier food pushes up inflation to -1.17%

The annual rate of inflation based on the wholesale price index (WPI) stood at -1.17% in the **week ended July 11.** The inflation for June 11 week was marginally above 1.21% fall in the previous week, although it was sharply lower than the 12.13% rise recorded in the corresponding week a year ago.

Wholesale price fell year-on-year for the 6th consecutive week, even as a week-on-week increase in prices of mass-consumption food items such as pulses, fruit, potatoes and rice pushed up household grocery bills. In fact, calculations show that grocery bills have increased by almost 9% since January, prompting some experts to warn that it will soon impact consumer spending on less essential goods. As groceries are essential items, one cannot cut expenditure on the same though the prices are rising. Expenditure on consumer durables, entertainment and travelling, which are discretionary in nature, could ne reduced.

Economists agreed on that increasing grocery bill effect middle and lower income strata of the society in terms of reduction in purchasing power, but said there won't be a significant shift in consumption pattern. The stimulus in the form of arrears payment and salary increase due to implementation of the Sixth Pay Commission, increase in minimum support prices and loan waiver for farmers and reduction in surcharge on income tax will increase the disposable income in the hands of lower and middle income groups.

Week ended July 18: Wholesale price index remains below zero

India's annual rate of inflation fell marginally to -1.54% for the **week ended July 18** from minus 1.17% in the previous week. Higher vegetables and pulses prices pushed up the country's food inflation by 1.2% during the week giving no relief to consumers, even as the overall price level for the seventh week in a row remained below zero. Wholesale prices of vegetables rose by 4.2%. Prices of meat, egg and fish rose by 3.5%. Prices of most pulses are ruling high owing to supply-demand mismatch. As far as pulses are concerned, arhar has breached a psychological mark of Rs 100 a kg in most retail counters in the country. The wholesale price of mutton has also shown a sharp rise of about 14%.

Week ended July 25: Inflation still in negative zone, but food stays on hot plate

Government data showed that the annual rate of inflation for all commodities stayed negative for the eighth straight week, but prices of food items continued to surge. As per latest official data, annual inflation based on the wholesale price index (WPI) stood at – 1.58% for the **week ended July 25**, against 12.53% a year ago. The negative inflation is, however, no consolation for consumers as inflation in food articles is almost in double digits 9.7% for the week ended July 25.

A negative rate of annual inflation offers the government little comfort when prices, particularly of food, go up week after week, as was evident from finance minister Pranab Mukherjee's statement in Parliament: "The government is responsive. We are sensitive to it (price rise) …as and when appropriate policy measures are needed, they will be taken."

The minister said vegetable and milk prices have increased due to erratic monsoon. He said when inflation had reached a very high level last year; the government took a number of steps to insulate the common man. While the overall inflation has come down and the tight monetary policy of last year has been reversed, there are signs of global pressures building up on commodity prices. Mr Mukherjee said this was related to appreciation and demand for dollars and it would be difficult to predict the global behaviour of prices of commodities, including fuel.

India's chief statisticians and the top bureaucrat in the ministry of statistics, Pronab Sen said the rising food prices have more to do with speculation at this stage than a crop failure. "Before the harvest, a lot of speculation activity takes place, driving up prices. We cannot say as yet that crops are failing… There is no real threat to economic growth this fiscal (on account of any disappointing harvest)'.

Week ended August 1: Inflation still negative; touches 33-year low

The annual rate of inflation touched a 33-year low of -1.74% for the week ended August 1, but there was no respite for consumers as poor rains continued to cause prices of food articles to harden week after week. The wholesale price index (WPI) based annual rate of inflation remained in the negative for the ninth straight week on account of high base effect – higher inflation numbers in corresponding week last year. As the base effect starts to wane, the annual inflation is expected to harden from here on account of revival in industrial output and week monsoon.

Prime Minister Manmohan Singh has already pointed out that below-average monsoon rains may adversely affect crop output and fuel inflation in coming months. Weather office warned that India may get only 75% of the average southwest monsoon rains this year. Economists are in consensus that inflation will move up from here on.

A lift-off in factory output due to broader recovery in capital goods and consumer durables despite shrinking exports is expected to lead to higher demand for raw materials, there by stocking inflation. A strong showing by the intermediate goods segment and an expansion in 12 out of 17 manufacturing sub-sectors shows that recovery is broad-based and sustainable. Inflation had peaked at 12.91% in the corresponding week last year on account of soaring commodity prices and is expected to move into positive territory in coming months.

Drought Might Dry up Green Shoots

The 7.8% increase in industrial growth in June should help shed remaining doubts about the economic recovery underway. However, poor monsoon could somewhat upset the gathering industrial momentum if farm incomes drop drastically and high food price inflation forces adjustments in consumption.

The manufacturing sentiments could sour quickly if farm production is hit severely due to poor monsoons, though it has been amply demonstrated in recent years that overall growth has partially got delinked from agriculture. A poor monsoon could not only affect rural incomes but cause discretionary consumption to shrink due to food inflation.

The government would do well to use its food stocks to shore up rural purchasing power as far as possible. This may help in maintaining the industrial growth momentum.

Lastly, there is no sign of pick up in exports though the global economy appears to have bottomed out. And this is something the government will have to live with as no amount of incentives can increase exports if there is no improvement in overseas demand. Therefore, the government would do well to keep greater focus on domestic demand. The government must continue to use all policy instruments to maintain a positive investment climate and a healthy growth momentum.

8.1 MISCELLANEOUS UPDATES

1. Government employees

All eyes are now on the government sector. Don't be surprised. It is seen that across major categories – real estate, consumer durables and auto – government employees are being wooed like never before. In fact, banks are also introducing special schemes to woo the sarkari brigade. Maruti Suzuki India, for example, claims that 11% of their sales contribution came from government sector employees this financial year as compared to negligible contribution a year back. In fact, government employees have contributed to the turnaround of the auto industry. Auto majors have a view that the industry managed to grow by a single digit growth in 2008 after witnessing a decline in the previous year only due to increasing demand from this segment.

Similarly, housing finance company, Dewan Housing Finance, saw a sizable rise in loan offtake from this sector. According to them, almost 40% of their total book size came from this category. And mid-scale developers such as Delhi-based Piyush Group will be coming up with some special schemes in the affordable segment for government sector employees. Real estate biggies also confirm the activity from this sector that they are seeing more people from the government sector buying as compared to earlier.

Banks are not legging behind in these initiatives as well. UCO Bank launched a special scheme for government employees to provide housing and auto loans to civil servants. And since the launch, these schemes have been received quite well. For other banks it is also a case of relatively lesser risk in lending.

You can call this ironic for private sector employees or plain good luck for the public ones, but the fact remains that government employees have been the least impacted by the slowdown blues. They even got a huge jump in salaries after the implementation of the Sixth Pay Commission last year, and a part of their arrears are due this year. Leading consumer durable companies such as LG also contend to the fact that a significant part of the business has come from first time buyers which include rural sector and government sector employees. The large part of the demand in the current calendar year has come from first time buyers and upgradation to LCD categories. They are holding the growth rate of the consumer durable industry, which may not have been the case otherwise.

2. Withdraw money from stores

A new avenue for withdrawing money will soon present itself to 14.3 crore debit cardholders. Apart from accessing an automated teller machine (ATM) for pulling out cash, a debit cardholder will soon be able to do just the same at a retail store through a **point of sales** (PoS) terminal, which lets a customer pay for purchases made by either credit or debit card. The Reserve Bank of India (RBI) allowed cash withdrawals at PoS terminals. The facility will initially be made available to persons holding debit cards that have been issued in India. The amount which can be withdrawn through the new facility will be restricted to Rs 1,000 a day. RBI also said the facility would be made available irrespective of whether the cardholder makes a purchase or not at the store. However, in the case of purchase by the cardholder, the receipt will have to separately indicate the cash withdrawn. For this, PoS terminals will have to upgraded.

The new service will bring huge benefits to the customer, the retailer and the banking industry. The customer will no longer have to search for an ATM, which will be a big plus especially in smaller towns and rural areas which have fewer machines. For the retailer, the move will bring down the amount of money it needs to deposit in a bank every day as it can disburse the same. The move could also increase the debit card usage in the country. Currently, Customers can withdraw cash only from ATMs. However, the number of ATMs in the country stands at just 10% of PoS terminals. As on May 31, 2009, the number of ATMs was 44,857, while that of PoS terminals stood at 470,237.

8.2 INSURANCE SECTOR

Ulips get better

Retail investors in unit-linked insurance plans (Ulips), arguably one of the hottest investment products, could see a rise in returns. Insurance regulator Irda has put a cap on charges that insurance companies, which sell Ulips, collect from investors. A slice of the charge is the commission to agents, which is set to drop. Irda's decision is fallout of a vehement attack on Ulips by mutual funds, which compete with insurers. Since mutual funds have to stick to ceiling on charges laid down by Sebi, fund houses felt they were at a serious disadvantage compared to insurance companies. In fact, MF industry has alleged that these high levies and commissions allowed insurance companies to hard sell these products. Sebi has been driving down the cost structure of mutual funds, widely seen as competing product by all stakeholders – investors, fund managers and insurance companies.

Unit linked insurance products (Ulips) and mutual funds (MFs) have always been compared. While some experts think insurance and investment objectives are two different things and rather than buying Ulips they recommended MFs for investment and term plans for insurance, other prefers Ulips. Regulators of both industries – insurance and mutual funds – have issued new guidelines related to cost structure. While in MFs, there is no entry load, in the insurance sector, the Irda has capped the maximum cost of Ulips.

Ulip charges have been capped at 300 basis points for insurance contracts up to 10 years and 225 basis points for contracts over 10 years. If a fund earns a yearly return of 15%, a policyholder has to get a minimum return of 12%. The ceiling will come into force from October this year. For insurance contracts up to 10 years, the difference between gross and net yields (after netting out all charges) to the customer should not exceed 300 basis points. Of this, the fund management charges should not exceed 150 basis points. For insurance contracts of over 10 years, the difference between gross and net yields should not exceed 225 basis points. Of this, fund management charges will not exceed 125 basis points.

Let's take a look at the new guidelines issued by Irda in simple terms: Come October and the new guidelines of the Irda on the cap on charges on Ulips would be implemented. According to the new guidelines, insurance companies are required to put a charge in a way that the difference between the gross yield and the net yield should not be more than 3% in case the tenure is equal or less than 10 years. Also, out of this, the fund management charges should not be more than 1.5%. Gross yield means the overall return and the difference between the money that an investor invests and that generated by the fund manager. Net yield is return that an investor gets in his hand after deducting charges.

According to the Irda guidelines, however, if the policy tenure is more than 10 years, the difference between gross yield and the net yield should not be more than 2.25%. Also, out of this, the fund management charges should not be more than 1.25%. Any new product that gets launched from October will have to follow these rules. Also, insurance companies will have to implement these measures for their existing policies. However, they need to do it by year end.

The Irda has done well to cap the charges levied by insurance companies selling Ulips. Additionally, it has demanded more transparency in the way Ulips are sold. The limit on charges will enhance investor returns while the mandated disclosures will enable investors to make an informed decision.

The way Ulip investment works is that after deducting all costs and mortality charges (cost of insurance coverage), the balance is invested in a fund chosen by the policyholders. A fund management fee is also levied separately. Not only were these costs perceived to be very high, most investors had no clue about the extent of their contribution going towards meeting various charges including agent commission. In some products over 8% of the money invested upfront would have deducted as a commission.

The cap prescribed by the Irda and the disclosures mandated goes some distance in addressing these issues. The prescribed 225-300 basis point difference between gross and net yield, depending on the tenure of the policy, sets a ceiling on costs. Besides, the 'benefit illustration' is required to clearly mention the gross and net yields at the point of sale, ensuring that the customer is aware of the extent of appropriation of the premium paid towards costs and insurance. The proposed changes would at least ensure investors get a higher return due to the cap on the charges.

IRDA to restructure half of Ulips: The insurance regulator will have a special arrangement to clear within three days Ulips which have to be reworked because of new norms. The Irda has estimated that over half of the existing Ulip schemes will have to be restructured.

Ulips' fee cap may limit valuation of insurance arms: The potency of insurance arms to boost valuation of parent banks or companies, as seen in the last bull-run, may be restricted, following the move by the regulator to cap fees on the popular unit linked plans (Ulips). This is because the step is broadly expected to weigh down the margins of insurance companies, an event that will limit the space for analysis to assign them with higher value. Although a large part of this hit in pricing may be passed onto the distributors channel in the form of lower commission rates, it is also expected that the insurance companies to take a hit that would impact margins.

The Life Insurance Corporation (Amendment) Bill, 2009: The government on 31/07/09 (Friday) moved a Bill seeking to amend the over 50-year-old Life Insurance Corporation Act in the Lok Sabha.

1. The Bill seeks to raise the capital base of the state owned insurer to Rs 100 crore from Rs 5 crore; and

2. The Bill also seeks to empower the government to limit the extent of sovereign guarantee on the insurer's liabilities if it so desire. It may be noted that government extends guarantee to policies issued by state-owned insurer. The Bill after its passage would bring country's largest insurer on par with private insurers both in life and non-life segments that are required to have a minimum capital base of Rs 100 crore as per Insurance Regulatory and Development Authority norms.

3. The Bill reintroduced by finance minister Pranab Mukherjee also empowers the government to further raise the capital of LIC. The Bill was first introduced in the Lok Sabha in December 2008, but had lapsed as it could not be put to vote before its dissolution.

4. The new Bill proposes to allow LIC to allocate 90% or more such surplus – excess of assets over liabilities, for life insurance policy-holders and credit remaining to a separate account maintained by LIC. The account would be utilised for such purposes as the Central government may determine while the remainder would be paid as dividend. At present, the state-owned insurer is required to keep aside at least 95% of the surplus while rest goes to the government.

5. The Bill also seeks to empower LIC to make regulations in respect of terms and conditions of the agents, including method of recruitment of employees and agents.

9.1 KNOWLEDGE RESOURCE

Gas disputes in Ambani brothers

The Centre escalated its involvement in the gas dispute between the Ambani brothers by filing a special leave petition (SLP) in the Supreme Court seeking quashing of the MoU signed between the estranged brothers in 2005. The sovereign right of the government over gas and the production sharing contract between the Union of India and RIL, the contractor, will gain precedence over the private MoU in larger public interest, the government said.

The MoU, as in now wee known, requires the Mukesh Ambani led Reliance Industries Ltd (RIL) to supply gas to Anil Ambani's firm Reliance Natural Resources (RNRL) at $2.34 per million British thermal unit (mmBtu). The special leave petition (SPL) will enable the government to challenge argument put forward by both RIL and RNRL and seek direction of the court.

In its SLP, the government has named both RIL and RNRL as respondents. If the Supreme Court allows the government to become a respondent it will have wider implications as compared to it being simply an intervenor in the case. As an intervenor, the court merely seeks the government's assistance in reaching a verdict. The practical consequence of the government's SLP is that it moves it closer to the RIL position. RIL also says that the part of the MoU relating to the gas supply cannot be implemented.

The government in its SLP said, "Anything contained in the MoU between private individuals that interferes or impinges on Union of India ownership or sovereign rights to regulate the development of the country's natural resources should be set aside."

On Saturday (18/7/9), RNRL filed an affidavit in the apex court opposing the government affidavit which was filed on Friday. Anil Ambani's RNRL seeking striking of the Centre's affidavit from record of the court said that it was filed in "blatant support" of RIL. Further the government has no right to file an affidavit in the apex court as it had withdrawn its affidavit from the Bombay High Court on the issue. Again the government has filed its affidavit without examining the concerned parties in the case.

The SLP is not listed for hearing along with the petitions of RIL and RNRL on Monday. The govt's counsel TS Doabia who moved the SLP said, "We will mention the SLP on July 20 when the court will take up the case and request for its hearing.

Letter to PM

In a move that will open up yet another front to the ongoing epic battle between the Ambani Brothers, the younger sibling, Anil Ambani, has written to Prime Minister Manmohan Singh that his company does not claim any ownership of the KG D6 gas fields and has no intention of disrupting gas to the existing customers despite the ongoing litigation with RIL.

The letter dated July 15 comes even as the first hearing of the epic battle between RIL and RNRL is set to open in the Supreme Court on Monday.

The gas saga between the two estranged Ambani brothers has been on for three years and is now moving to the climax in a tri-partite court room drama between RIL (the gas producer from KG basin), RNRL (the consumer) and the government, which is both a stakeholder (by virtue of earning a revenue share from gas sales proceeds) and a regulator.

In what should come as a big assurance to all existing power and fertiliser customers who have been expressing apprehension about the impact of this case on the gas supplies to their projects, Mr Anil Ambani says the Reliance Anil Dhirubai Ambani (ADA) group will fully protect the national and economic interest and will ensure "there is no disruption of gas supply from KG D6 to existing customers, notwithstanding ongoing gas litigation.

In a direct reference to the role played by the parent petroleum ministry Mr Ambani has requested the PM to direct the ministry and Directorate General Hydrocarbons to cease "overtly and covertly from attempting to intervene in the commercial dispute with RIL except…assisting in the interpretation of the Production Sharing Contract."

He goes on to say the claims being made by RNRL, will not in any way impact the government's rights and entitlements under the PSC and has stated how the three judgments by the Bombay High Court has upheld the rights and entitlements of the government. The government's share of profit petroleum is determined as per the PSC and is not even a point of issue in the commercial dispute.

Citing the ongoing gas dispute as a purely commercial matter between the two which does not concern the government, Mr Ambani states his case does not intend to deny the government of his share of gas or ownership of the assets in any way. This comes even as the government has asked the court to declare the memorandum of understanding between the Ambani brothers null and void as it impinges upon the sovereign rights of the government. Refuting the government allegation that the claim on RIL was "based on some family conversation" Mr Ambani says it is based on a document that was signed by RIL's CMD who was authorised by the board and has been in the public domain for two years. This was subsequently made a part of a scheme, which was approved by the RIL board, its 2 million shareholders, sanctioned by the Bombay High Court with the approval of the government.

Referring to how there was always a provision for the pending cases in all government decisions, the letter says, that all three EGoM decisions (September 2007, October 2008 and April 2009) had stated that its decisions were without prejudice to the ongoing cases with NTPC and RNRL. Also, citing the January EGoM meeting Mr Ambani reiterated that "that subject of availability gas would be made available to projects in the pipeline including Dadri power project when it's ready to commence production.

All three stakeholders have made their petitions and counter petitions in the supreme court following the Bombay High Court Order which directed RIL to provide a part (28 million metric standard cubic metre per day) of its share of gas to RNRL for 17 years at the rate of $2.34 a unit (million metric British thermal unit).

Anil lets off stream at oilmin

The dispute between the Ambani brothers took an extraordinary and unexpected turn on Tuesday (28/07/09) with Anil Ambani, launching a bare-knuckled verbal assault targeting Murli Deora, India's petroleum minister and an old family friend, and the Reliance Industries, run by elder brother Mukesh. Mr Ambani did this in the course of what has got to be one of the most unusual speeches ever delivered at a company's annual general meeting. It is very unusual for Indian industrialists to openly criticise a senior government functionary or even a corporate rival let alone with the ferocity displayed by Mr Ambani. In the course of a riveting one-and-a-half hours, Mr Ambani, who was speaking at the AGM of RNRL, castigated what he described as RIL's "dishonourable conduct in … refusing to honour the gas supply contract" and the "exorbitant profits RIL is seeking to make at the cost of the power and fertiliser sectors". But more than the centerpiece of his speech was devoted to what he claimed was the "apparently biased and partisan role of the petroleum ministry".

The RNRL chairman said the petroleum ministry's stand was aimed at helping RIL, to renege on its contractual commitments with RNRL, as well as state-owned NTPC. The facts are deliberately being twisted by the oil ministry to say the corporate agreement between RIL and RNRL is a private division of sovereign assets. He also criticised the petroleum ministry's stand that RIL had violated the product sharing contract (PSC) with the government by promising gas to RNRL without informing the government. "Frankly, if the petroleum ministry is genuinely aggrieved… why don't they exercise their powers and terminate the PSC and take back the ownership of the gas fields from RIL when the provisions exist for them to do so?"

He said the ministry's claim that it was not aware of the agreement between the Ambani brothers was untrue. He said the ministry had been in possession of all relevant details of the gas deal since April 2006 when RIL provided details of the gas pact to the ministry. He also attacked the petroleum ministry for its claims that the sale price of the KG basin gas was fixed at $4.20 per mBtu. Drawing a parallel stamp duty on property, which acts as a reference rate and has no bearing on the actual transaction price, he said $ 4.20 per mBtu was fixed for cancellation of the government's share of profit from the gas sale.

Also, he emphasised the government would not lose if RIL sells gas at a lower price of $2.34 per mBtu, as directed by the Bombay High Court in June. Under the PSC, 99% of all revenues and profits would go RIL and the remaining 1% to the government. Of the initial revenue of Rs 50,000 crore from the gas sale, RIL WILL GET Rs 49,500 crore, he said. "Makes you wonder why the petroleum ministry is pushing so hard for higher gas prices, when 99% gains will go to RIL! He said sarcastically.

Cabinet must set at rest all doubts

The chairman of RNRL has accused the petroleum ministry of playing a partisan role in the ongoing gas dispute between RIL and RNRL. Without openly naming Mr Murli Deora, Ambani has virtually implied that the oil minister had been biased towards RIL, ever since he took charge of the ministry in 2006.

It was claimed that the Deora's entry into the ministry was the beginning of all kind of controversies, which eventually resulted in the RIL reneging on its contractual obligation to supply gas from the KG basin to RNRL at an agreed price. This is, indeed, a serious charge that the petroleum ministry must respond to without demur. The ministry must clarify issues raised by Anil Ambani, which have a direct bearing on the credibility of the Congress-led government.

The ministry has said that it will make its position clear in the Supreme Court where all the parties connected with the gas dispute are locked in a battle over various questions of law. The government feels there is no need to say anything at this stage in response to the accusations. But silence may not help because the entire episode has become deeply politicised. It has now to do with bigger questions relating to how sovereign ownership of natural resources such as gas can be reconciled with legitimate private contracts for exploration, marketing and distribution of gas.

What is particularly worrying is Anil Ambani's assertion that the petition filed by the petroleum ministry in the Supreme Court does not have the endorsement of the other senior Cabinet ministers, particularly the law minister. It is being implied that the petroleum ministry has acted unilaterally. Since this aspect of the controversy is not sub-judice, the government may do well to clarify that the petition has the Cabinet's backing. Indeed, if the government's interests were getting compromised following the Bombay High Court order directing RIL to meet the gas supply obligation to RNRL, the matter should have been brought to the Cabinet before taking it to the apex court. It may still not be late to set the record straight.

9.2 HIGHER EDUCATION

University Grants Commission (UGC)

In a bid to improve the transparency of higher education institutions in order to allow students to make an informed choice, the ministry for HRD issued a directive to UGC asking it to undertake a series of measures, such as setting up a website, introducing a faculty appraisal system and bringing the deemed universities under the purview of the state committees for regulation. The UGC has been asked to ensure immediate compliance. The directive issued by the HRD comes on the heels of increasing concern over the private higher education providers and the corruption racket unearthed by the CBI.

These measures are crucial as the government is planning to bring in a law that would prohibit and punish unfair practices like capitation fee, over-pricing of prospectus, false claims in advertisements and brochures. The Prevention and Prohibition of Unfair Practices in Technical and Medical Education Institutions and Universities Bill, 2009, is currently being vetted by the law ministry.

All institutes of higher education – universities set up central and state governments and deemed to be universities – will now be required to have **a website**, which will provide full and complete disclosure.

This would include information about availability of **infrastructure** and physical assets, **grants** from the government or any government-assisted agency and its utilisation. The website will be required to put information on the **admission criteria** and the process of admission for all courses of study, irrespective of whether it is a diploma or degree course or delivered through the regular mode or distance mode.

Academic curricula of course provided should also be made public on the website. For distance education, details of study courses, and its locations should be available on the website. As regards informations on the **fee structure**, the website should give exact information on all components of the fee should be given. The institutes will be required to provide details of **faculty** positions in each department or school of the institute along with their photographs. The nature of their employment – regular, temporary, visiting, guest – must also be provided.

The UGC has been asked to provide a **link** to every university and institution on its website, to ensure facility of use and access. The commission will be required to insist on compulsory **accreditation** of institutions in order to receive UGC grants. The ministry has also asked that a committee be constituted to formulate methodology and standards for benchmarking appraisal of faculty performance through out the country. The yet to be constituted committee will be required to submit its report in three months.

In its order, the ministry stated that these measures are the outcome of concern over "certain practices being adopted that could damage the creditability of the entire university system". In order to avoid being caught in the autonomy bogey, the order makes it clear that the centre government understands the need to balance the "need to harmonise the interests of stakeholders to promote accountability of higher education institutions" and "respect the autonomy" of institutions.

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