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Sequential Growth

Safe Updates (Keep Informed)

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Editorial Preamble: *Sequential growth*

1.1 Global Growth Recovery

Stunning pace of comeback

Success, according to legendary US army general George Patton, is how high you bounce after hitting bottom. Judging by stunning rally in global equity markets, it seems policymakers across the world have been remarkably successful in engineering a recovery from the depths of last year's panic.

Several economic and financial market indicators have returned to pre-crises levels less than a year after the world apparently changed on 15 September 2008 – the day that Lehman Brothers went bust. The pace of the comeback has been truly stunning. Emerging market stocks have rallied by 90% off the lows and are now at exactly the same level as on 12 September 2008, which was the last trading day before Lehman's collapse. Similarly, investment grade corporate bond yields, bank credit default swaps and VIX have all returned to levels that prevailed just before the Lehman bankruptcy.

The benchmark US stock market indices are still 20% below the September 12 levels but the 50% rally from the March 2009 trough represents the fastest advance for stocks since 1933. The only other two comparable periods in terms of pace and magnitude of recovery are 1938 and 1974-75, when the US market rose by around 50% in seven and nine months time respectively.

The resurgence is not just a financial market event. Economic growth too has hooked higher, led by China where sequential growth is running at a record pace. The global economy is set to expand by over 3% in the current quarter, driven by a rebuild in stocks after producers dramatically cut backs on inventories and jobs earlier this year fearing a Great Depression redux. It is clear that such an extreme economic outlook will not materialise but the debate is now over the path forward. There are three camps of thought:

Camp 1: This is it, *nothing comes next*. While the inveterate bears are willing to concede that the worst is over, they believe that any recovery will be shallow since the still over-indebted global economy will take a long time to work off the excessive leverage in the system. The bears argue that the US consumer has just begun the process of deleveraging and will refrain from any major new spending until the personal savings rate gets back to the historical norm of 8% from 6% currently.

Under such a scenario, the economic rebound will prove to be a one or two quarter wonder, driven merely by the vicissitudes of the inventory cycle. Even China will not then be able to sustain the revival in its economic activity, as it essentially remains the world's manufacturing base and will need the export engine to start humming again soon. Chinese policymakers are attempting to reorient their economy by encouraging greater domestic consumption but such structural changes take a long time to pan out. A big chunk of the Chinese fiscal stimulus has mean-while gone towards increasing fixed asset investment although investment as a share of GDP is already at abnormally high levels of more than 40%.

During other fleeting economic rebounds within structural downtrends, market rallies too fizzled out after gains of around 50%. From a technical perspective, the S&P 500 is currently at the same level in inflation-adjusted terms as it was at the low of the previous bear market in 2002. In a secular downtrend, the low point in the previous cyclical bull market usually ends up acting as a resistance in the subsequent rebound. The fact that many financial market indicators are back at pre-Lehman levels should act as a line in the sand as it is too soon to return to the world that existed before the Lehman episode. All of this would have us believe that markets the world over are currently in the process of peaking.

Camp 2: The cyclical bull market still has some way to go. This camp is willing to acknowledge the structural problems that plague the global economy but thinks that concerted policy actions by governments across the world will lead to at least a one year-long economic upturn. The cyclical bulls say a simultaneous expansion in the global economy is well underway with the US too coming out of a recession. The momentum should be strong enough to take the S&P 500 back to the pre-Lehman level of 1,250 before both economic growth and markets run into structural headwinds again.

A further 25% rise in the S&P 500 could result in even more fireworks in the emerging market space. A global easing of monetary policy usually leads to a greater channeling of liquidity towards the least broken asset class. In late 1998, interest rates were cut in the US to deal with the deflationary shock emanating from the emerging market crisis. That led to a bubble in the tech space. This time around, emerging markets are the bubble candidate as money chases the best growth story around. The meteoric rise in emerging market indices this year is already reminiscent of the NASDAQ's performance in the immediate months following the policy actions to tackle the Asian and Russian financial crisis in the third quarter of 1998.

However, the cyclical bull camp holds that any rally will start to fade in 2010 once the effects of the stimulus begin to wear off in the US and policymakers in developing countries start to withdraw liquidity as they become wary of asset bubbles forming in the domestic markets. In short, the current economic momentum inspired by government stimulus efforts will likely keep financial markets well bid for much of 2009 but the environment will be more challenging next year.

Camp 3: A full-fledged economic recovery is underway. The outright optimists argue that the discussion on the global economy's future is much too US-centric and that in turn exaggerates the negative effects for the rest of the world arising from the relative decline of one major power. Back in the late 1980s, Japan's economy too had become the biggest contributor to global growth, and its stock market accounted for half the world's market capitalisation at its peak in 1989. Still, a sharp fall in Japanese economic growth and its stock market did not unravel the global economy.

The bears at that time warned of a full-scale capital repatriation by Japanese investors to shore up their balance sheets at home. Such fears proved to be unfounded, mainly because the US economy was in a position to assume the global growth leadership role. Emerging markets led by China seem to be taking on that status now, according to the folks in the bullish camp. The Shanghai A-share market has indeed become as much of a trend-setter for global equity markets as the S&P 500. The current rising wave of optimism in the marketplace may well then turn out to be the start of a major expansion cycle, setting off a multi-year bull market run.

All three camps share the common feature of a macroeconomic forecast lying at the heart of each thought process. Valuations and sentiment from a contrarian standpoint are not presently an issue – as those variables tend to matter only at extremes and not when they are stacked in the middle. Hopefully, we can stick with the second camp at present: a cyclical upturn and a bull market this year followed by some sort of a relapse next year as structural problems of excessive leverage come back into play. But we all need to retain the flexibility to switch camps at the slightest sign of incremental change, especially with many financial market indices back at the pre-Lehman levels. For markets to move higher hereon, economic data needs to keep surprising on the upside for as goes the global economy, so go the markets.

1.2 Stock Markets

Waiting to exhale

It's almost becoming a trend. Some investors booked profits as he expects the markets to fall. Some others also booked profit partially. The reason for selling their stake was the same. They are afraid about the fast recovery of the stock market. Also, they don't see any major trigger for the market to move up.

And they're definitely not the only ones; most industry experts with a few exceptions are expecting a fall, especially in view of the super fast recovery of the markets. And there are several reasons ranging from domestic to global, for a correction to take place, they feel.

Most blame the sharp recovery for the expected correction. The Nifty has recovered more than 90% from year lows while other Asian indices such the Hang Seng have risen more than 60% from their lows. The Dow, too, has recovered around 50% from its March lows. This rise seems to be happening too fast. Therefore, Nifty may start consolidation with a negative bias, which means probability to come down is higher. Also investors have started feeling that at current levels valuations look a bit stretched.

Analysts looking for a correction believe that historically September and October have not been the best months for the equity markets. The Lehman collapse also happened in September 2008. In the 10 years through 2008, the Dow fell during seven September. Most of times, it is seen that either the market fall more or gain less than other months.

Chinese markets have also caught the eye of investors. Analysts expect the market to fall for some time not just in India but globally. They say that China is the major concern. In the near term China is bit of a overhang for the Indian equity markets. Beijing is selectively tightening lending, with new loans falling to near Chinese Yuan 300 billion for August from levels well over yuan 1 trillion per month earlier in the year. And the Shanghai Composite Index has fallen by over 20% in the month of August. With any substantial fall in the Chinese stock market, the Sensex may touch its lower level of around 13,000.

In the last six months, the market rallied due to several triggers. First and foremost was the election. On the very first trading day after the election result, the Sensex gained as much as 17% from its previous closing price. In fact, the duration between the start of election process and formation of the new government was in itself a trigger. Everyone knew that during this period no change in economic policy was going to rake place; so many investor and fund manager encashed it. Market got the next trigger from the 100 days plan of the new government and again, markets appreciated sharply.

Now, what's there to watch out for! The whole industry is currently waiting for the next quarterly results. These results may surprise the market on the positive side like it did in the first quarter. In addition to this, in the next 6 to 12 months, the government's commitment on bringing capital flows and pursuing the reforms process will be the key drivers for the equity market. The amount of advance tax collection will show a clear picture of expectation of profit growth by companies. Apart from quarterly results investors should also look at sowing of Rabi crop and commodities price movement. Also the market may rally on the back of good global cues in the next 1-2 months.

While experts are still giving their logic for a 'V' or 'W' shape recovery for the market, according to a joint analysis, the Sensex has already made one 'W' shape with two bottoms around 8,000 in October 2008 and early March 2009 and intermediate high of 10469 in early January 2009. Also, until recently, it has been considered that the current rally is a bear rally. On the contrary a research shows that during the several bull rallies in past, mid cap stocks outperforms the large cap ones, which is the case in the current rally. Since end February large cap stocks advanced by 75% while the mid cap went up by 92.2%.

3rd week of August '09 – Sensex consolidating at 15k

DOWN 627 POINTS ON MONDAY: Global stock markets, depressed by weary figures from Japan & China India joined the worldwide slide in equities on Monday, as the latest set of numbers coming in from Japan and China left investors wondering if the global economy was indeed recovering. Stock markets globally have risen between 50-80% since March this year, and with conflicting signals about the recovery, there are concerns that shares are pricing in too much optimism too soon.

Japan *GDP growth* of 3.7% for April-June was below market expectations, and there are concerns that even this rate may not sustain once the stimulus packages of governments globally are exhausted. China was the top loser in Asia, with the Shanghai Composite Index crashing nearly 6% as *foreign direct investment* into that country declined for the 10th successive month in July. Experts believe a recovery in China holds the key to the fortunes of the global economy. But macro data from the largest economy in Asia has not been encouraging of late.

Daily review	14/08/09	17/08/09	18/08/09	19/08/09	20/08/09	21/08/09
Sensex	15,411.63	(626.71)	250.34	(225.62)	202.68	228.51
Nifty	4580.05	(192.15)	71.00	(64.80)	59.35	75.35

Weekly review	14/08/09	21/08/09	Points	%
Sensex	15,411.63	15,240.83	(170.80)	(1.11%)
Nifty	4580.05	4,528.80	(51.25)	(1.12%)

Market is in consolidation mode: The Sensex fell 171 points during the week ended August 21 and seemed to be consolidating at the psychological 15K-level with alternate weeks of gains and losses.

4th week of August '09 – Sensex up on hopes of economic recovery

Daily review	21/08/09	24/08/09	25/08/09	26/08/09	27/08/09	28/08/09
Sensex	15,240.83	387.92	59.72	81.38	11.22	141.27
Nifty	4,528.80	114.00	16.55	21.50	7.35	44.15

Weekly review	21/08/09	**28/08/09**	Points	%
Sensex	15,240.83	**15,922.34**	681.51	4.47%
Nifty	4,528.80	**4732.35**	203.55	4.49%

Increased investor optimism about a recovery in global economy and revival in monsoon drove Indian bourses to recent highs even as the bellwether Sensex neared 16k mark and Nifty hit the highest level in 15 months in the week under review. Investor confidence seems to be on the rise following a revival in monsoon and the government's expectations that GDP growth will accelerate to over 8% in 2010-11.

Finance Minister Pranab Mukherjee said the economy would expand more than 6%. He indicated reforms would continue to get the economy back to 9% growth. The government has extended various tax sops and special incentives on trade with markets in Asia and Africa, in its Foreign Trade Policy, in a bid to bolster exporters. On the global front, Fed Chairman Ben Bernanke and European Central Bank President Jean-Claude Trichet said the world economy is pulling out of its deepest recession since 1930s. Global stocks also surged too nearly 10-month high on fresh hopes of a recovery in global economy.

Last day of August – Sensex down 1.42%

Daily review	28/08/09					31/08/09
Sensex	15,922.34					(255.70)
Nifty	4732.35					(70.25)

Weekly review	28/08/09	31/08/09	Points	%
Sensex	15,922.34	15,666.64	(255.70)	(1.42%)
Nifty	4732.35	4662.10	(70.25)	(1.48%)

Monthly review

Month	June '08	June '09	**July '09**	**Aug '09**
Date	30.06.08	30/06/09	**31/07/09**	**31/08/09**
Sensex	13,461.60	14,493.84	**15,670.31**	**15,666.64**
Points			**1,176.47**	**(3.67)**
%			**8.12%**	**(0.02%)**

1st week of September – Market into consolidation mode

Daily review		31/08/09	01/09/09	02/09/09	03/09/09	04/09/09
Sensex		15,666.64	(115.45)	(83.73)	(69.13)	290.79
Nifty		4662.10	(36.75)	(17.00)	(14.80)	86.85

Weekly review	31/08/09	04/09/09	Points	%
Sensex	15,666.64	15,689.12	22.48	0.14%
Nifty	4662.10	4680.40	18.30	0.39%

Indian bourses turned into a consolidation mode after nearing the crucial 16,000 resistance after global markets turned vulnerable to the Chinese counterpart. Market is expected to consolidate at current levels in the absence of any major trigger and once breached the 16,000 strong resistance, it may get a rally.

2nd week of September – Street back at 16K, hits 15-month high

Daily review	04/09/09	07/09/09	08/09/09	09/09/09	10/09/09	11/09/09
Sensex	15,689.12	327.20	107.35	59.88	33.31	47.44
Nifty	4680.40	102.50	22.35	9.00	5.15	10.15

Weekly review	04/09/09	11/09/09	Points	%
Sensex	15,689.12	16,264.30	575.18	3.67%
Nifty	4680.40	4,829.55	149.15	3.19%

Indian bourses turned green as both the benchmark Sensex and Nifty hit a 15-month high during the week following sustained capital inflows in view of improvement in business confidence and revival of monsoon. Global markets have been on a buoyant note with US markets hitting fresh 2009 highs in intra-day trade during the week on hopes of sustainability in the recovery in global economy.

Interest rate futures

Interest rate futures have clocked trading volumes of Rs 276 crore in their first day of trade. Trade in the newly launched derivatives is expected to pick up with regulators and government officials stating that the exchange traded instruments are superior to over-the-counter overnight index swaps. Interest-rate futures are the first major product to be introduced in India after the launch of the currency futures in August '08.

Trading in interest rate futures began on the National Stock Exchange (NSE) on Monday (31/08/09). The contracts are based on 10-year government bonds bearing a notional coupon of 7% per annum, compounded every six months. Close to 15000 contracts of the two bond futures were traded on Monday – based on the 10 year notional bond maturing in Dec '09 and March '10. The contract expiring in December '09 ended at a yield of 8.20%. Dealers said that the market had priced the futures in such a way that there was very little opportunity by arbitrage. Now, a trader can either buy a 12-year bond now holding on to it till December 2009 or alternatively buy a futures contract expiring in December funding it through the money market – the gains made would be the same.

Speaking at the launch, Ms Shyamala Gopinath, DY Governor RBI said, "Unlike the OTC interest rate swap market (OIS), which is really an inter-bank market dominated by banks, this is more transparent and price discovery is there. Probably, going forward the OIS will evolve to offer customised products to the customers, may be longer term in nature." The view was supported by finance Secretary Ashok Chawla who said that internationally interest rate futures are almost 25-30% of all derivatives. "India will continue with financial sector reforms. It is a continuous process, incremental, not big bang."

Sebi chief, CB Bhave said that the advantage of a guaranteed settlement and the fact that a third party makes sure that sufficient margins are posted, is an important feature.

"There is a clear superiority here. First and foremost if the prices are transparent and known to the whole market. There are no doubts to the valuation of the assets that are on your books as well, as the books of the counter party. If you recollect one of the reasons why credit markets froze last year was, people were not sure as to the value of assets on the counter party's balance sheet. This was because these markets were opaque and no one knew what the pricing was."

NSE MD Ravi Narain said that world over, as a result of the global financial crisis, more and more countries regulators and markets are actually biasing their policies away from the OTC forward market in favour of exchange traded market. "This is because if there is one institution that has come about unscathed in this crisis, it is the fact of a centrally counter-party guaranteed exchange traded market."

1.3 Interest rate future

Take a view on the interest rates

Gazing into the future may be a rewarding proposition but only a few enjoy the skill required to master the science. On Dalal Street, investors try to predict the market movement by trading in the derivatives segment. On August 31, 2009, the National Stock Exchange (NSE) launched trading in interest rate futures (IRFs). The introduction of this trading platform is anticipated to provide an opportunity to take a view on the interest rates and trade. However, IRFs, as an instrument class, are considered more complex than other financial products such as bonds or equity shares or mutual fund units. A clear idea on interest rate movement is a must. Globally, retail investors start with commodities, equity, currency, and then when they become savvy graduate to IRFs.

To help you with all such queries, here's a layman's guide to make you familiarise with this new product.

For the uninitiated, IRF is a contract to buy or sell a debt instrument (ten-year government bond bearing a notional interest rate of 7% payable half-yearly) at a price fixed at the time of the contract for delivery at a future date. The transaction takes place via the stock exchange, which ensures delivery.

The technical nature of the contract makes the delivery complicated. So, it would be better to offset the transaction before the delivery period.

Get the basics right:

Debt expert say to gain an expertise in IRFs, you should be well versed with the fundamentals of the product. So knowledge is the key. Basics like historical range of interest rates and risks involved should be known before trading. IRF is the most actively traded asset class with over 80% of entire derivatives volume coming from this product. On the whole, it is much more efficient platform to deal with market risk – either for speculative or risk control purpose.

This is how trading in IRFs occur: if the interest rates are 8%, the IRF would be trading at 92, and if you expect the interest rates to increase to 9%, the future price would actually fall to 91 (100-9). Thus, the idea is if you are bullish on interest rates (anticipate a jump), you need to sell the IRF and vice-versa.

IRFs, like other futures contracts, have symmetric pay-offs (equal probability and extent of profit or losses) and is a leveraged instrument. So, on the one hand, if the interest rates move in favour of your anticipation, the pay-off would be positive and return on investments high, depending upon the level of leverage. Then on the other, if the interest rates move against your expectations, the market-to-market losses would be high and require you to honour margin requirements. There's a risk of extreme pay-offs. So if you have high risk appetite, then only you should trade.

To trade in IRFs, you need to have a subsidiary general ledger account with the exchange to facilitate delivery of securities at the time of settlement. However, it would be better to offset the transaction before the delivery period. As such there is no other criteria and any resident Indian can trade in IRFs in the same manner as one buys or sells equity in the futures and options market.

The contract size of the notional security is Rs 200,000 and with a margin of 2.5%, you can purchase a contract with funds of as low as Rs 4,500. National Stock Exchange has waived off transaction fee till the end of this year. So, the only cost you would incur is brokerage paid to the broker.

Deepening domestic markets

India's pragmatic middling through in financial reforms has served it well, protecting its financial sector from the extreme collapse seen in western system. That collapse does not mean we should stop deepening our markets, but it does offer some lessons for the way forward. The focus must be on financial inclusion, development of domestic markets, and their contribution to the real sector.

Our strategy of liberalising equity flows while restricting debt flows has worked well since equity shares in risk, but debt repayments are heavier in bad times. Emerging markets with a heavy dependent on foreign loans have suffered badly in this and in past financial crises. But there are pressures to further liberalise debt inflows to help develop debt markets and meet government and corporate financing requirement. So the question is, can domestic debt markets be developed without more active participation from foreign investors?

The second attempt to launch ***interest rate futures*** is a step in this direction. Reducing the risk of holding or trading debt futures deepens debt markets. A future is a contract to buy or sell an underlying interest bearing instrument at a specific future time and price. These contracts allow exposure to interest rate risk to be laid off. For example, those long in G-secs can short them in the future thus cancelling out the impact of interest rate fluctuations. But futures also allow speculative positions on the expected future interest rate movement. Derivatives have become a dirty word after the global financial crisis.

So why then are our regulators allowing a new type of derivative?

First, futures are simple standard transparent exchange traded contracts. Complex customised OTC products were at the heart of the implosion in the global financial system. Their impact and risk were poorly understood, and there was no record of aggregate amounts outstanding. But such records are there for exchange-traded products. Moreover, modern exchanges have robust risk and margining systems. During the crisis, although many banks became bankrupt not a single exchange had to close down. Therefore, regulators worldwide now want to encourage more exchange-traded derivative products.

Second, there is a myth that Indian financial institutions escaped the crisis because regulations had stifled markets. On the contrary, development of equity and forex markets was rapid in this decade, and they survived the trial by fire. But the slow liberalisation of debt markets was a deliberate strategy. Foreign debt liabilities have delivered several shocks to emerging market balance sheets; repayments often have to be made when exchange rates are also depreciating, and interest rates rising in defence. But since debt markets serve needs for long-term finance, developing the internal debt market remains a policy aim.

Third, India has moved far from the days when interest rates were administered. Repo rates have changed from a peak of 9% to a low of 4.75%. The general structure of interest rates have moved with policy rates, although less. The volatility of Indian interest rates has been increasing over the years and is higher now than in most countries of the world. Therefore, interest risk is high for many types of transactions.

Fourth, interest rate futures are part of the market deepening that will improve the transmission of monetary policy. If the impact of a change in their interest rates on bank balance sheets is lower, they will be willing to change lending rates faster, following a policy rate change. They will not wait, as now, for the bulk of deposits to be given at lower interest rates.

Given these advantages, why did interest rate futures fail to take off earlier?

First, the two-way movement of policy rates was not so well established.

Second, there were design issues. The theoretical zero coupon yield curve used as the underlying, created too much basis risk. This time liquid ten-year G-secs are to be used.

Third, only hedging transactions were allowed. This time pure trade is also allowed. Banks are naturally long in government securities, so they are largely sellers of future contracts. Speculator and arbitrageurs create opposite position, making trade possible.

These design problems are being sorted out through interactions with market participants. **An unresolved issue is the insistence on physical delivery,** which may be problematic as G-secs are not widely held. For example, households are exposed to interest rate risk through floating rate loans, but do not hold G-sacs. Banks could offer them hedging services in a package with housing loans. Or, the contract can be offset before the delivery month.

Interest rates are volatile and the impact of a change is widespread. High volatility makes interest futures attractive; **but ironically they will help reduce the volatility**. As banks transmit a policy rate change faster, a few basis points' change can have a larger impact on fresh investment, reducing the need for a large change. The shock delivered by policy is reduced. Deeper markets have lower price volatility. Bid-ask spreads and transaction costs fall. Spreads between deposit and loan rates can also fall as earnings come through volumes, although structural reasons for large spreads also have to be addressed.

By anticipating policy and acting on it markets help policymakers achieve the required change. For example, if markets expect policy rates to rise, bonds are sold reducing their price and raising yields through the term structure. Future prices are used to estimate market expectations. Even so, since markets are subject to bubbles, and when speculative build-ups dominate, policymakers need to deliver an occasional surprise.

The new experiment with interest rate futures will be closely watched. If it works, it implies Indian markets have grown up. They can walk without the foreign crutch that has a tendency to disappear when it is most needed. Foreign participation maybe a useful but not an essential ingredient for markets.

2.1 Indian Economy

Economy spurts back to life @ 6.1%

India's economic growth accelerated for the first time in **six quarters** and clocked 6.1% for the Q1 of 2009-10. Policymakers and economists said the GDP numbers suggest that worst is over for the Asia's third-largest economy as a strong showing by the services and manufacturing sectors suggests that the economy, beating all pessimistic estimates triggered by truant monsoon, will grow robustly this fiscal. A growth rate of 6.1% pales in comparison with the 9% that India had got used to prior to the global financial crisis. But in the current global context, this is a growth rate that most countries would die for.

In the aftermath of the global financial crisis, India's economic growth had dropped to 5.8% in the last two quarters of 2008-09, pushing the overall growth rate for the last fiscal to 6.7%. Growth in the first two quarters of the last fiscal had been relatively robust, at 7.8% and 7.7%. The growth rate of 6.1% for the first quarter of 2009-10 has, in other words, been achieved on top of a high base for Q1 of the last fiscal making the 6.1% figure all the most respectable.

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Finance minister Pranab Mukherjee said the process of economic reforms will continue "in right earnest" to get the economy back to 9% growth. The economy had "weathered the storm" created by the global downturn. We grew by 6.7% last year. This year, we are getting mixed signals. The finance minister however noted that the government was not in a position to lower its guard, given the uncertainties over revival of the global economy. Asserting that **the intent of reforms** was not in doubt, he said it had now been accepted that a calibrated approach to reforms worked better. Economic reform is a continuous process and not a flurry of an-announcements, he said.

- The government was moving ahead with the proposal to set up *an autonomous debt management office*, which will handle the government's debt and fresh borrowings. It would remove the conflict of interest inherent in the RBI's role as investment banker to the government, monetary policy manager and the banking regulator.

- Continuing with its efforts to deepen the corporate bond market in the country, the government would soon introduce *repos – repurchase agreements* – in the corporate debt market. Repos allow a holder to sell a bond for a short period to another investor with an agreement to buy it back at a higher price, the difference between sale and purchase prices constituting the interest for the intervening period.

- All efforts were being made to implement the goods & service tax (GST) from April 1, 2010. The tax is meant to replace all indirect taxes at state and central level such as excise duty, service tax and value-added tax, and create a unified internal market for India.

- The new direct tax code would be presented to Parliament after public debate. The thrust of the code is to simplify and improve the tax regime and the rates presented in the draft code are only illustrative, not final. The government had unveiled a draft tax code on August 12 to replace the four-decade-old income tax law.

On disinvestment, Mr Mukherjee said the government's intention was not just to raise money by offloading shares of state-owned enterprises, but also to make them more productive and efficient.

Emphasising that fiscal consolidation was high on his agenda; he sought to assure Indian industry that the Centre's large borrowing would neither crowd out private investment nor nudge interest rates up. The government's total borrowing for the current financial year is pegged at over Rs 4 lakh crore. The 13th Finance Commission, which is expected to submit its report soon, is drawing out a new road map for fiscal consolidation for both the Centre and states.

FDI inflows cross $3-b mark in July

The Indian economy could well be on its way out of the woods if the money pumped into the country by foreigners is anything to go by. For the first time in more than one year, 'foreign direct investment (FDI) crossed the $3-billion mark on a monthly basis. Total FDI inflows amounted to $3476 million in July, up 55% from $2,247 million a year ago.

More heartening though is the fact that cumulative inflows from April-July, despite being lower at $10.5 billion compared with $12.3 billion in the year-ago period, are marginally higher than inflows through the portfolio route, which amounted to $10.35 billion over the same period. This, according to experts, points to the foreign investors' faith in the resilience of the Indian economy which has weathered the recessionary headwinds better than most countries and is set once again to move to a high growth trajectory. FDI inflows are inherently more stable than the portfolio money that is invested into shares and considered more volatile.

Yes Bank chief economist Shubhada Rao said, "Inflows overall are looking up since sentiments in the India story is bullish considering the new government's stress on infrastructure, an improvement in industrial production and the growth in exports in absolute terms since April. We believe going ahead inflows will continue to remain buoyant." Sidharth Sanyal, economist at Edelweiss Securities said, "We are bullish on capital inflows through all routes such as FDI as well as the portfolio route including QIPs. As far as FDI is concerned, it is less volatile than foreign portfolio flows. So we might see it pick up steadily over a period of time as investors here are betting on the country's long-term growth story.

Centre, states to float co to draw foreign funds

The government decided to set up a not-for-profit company with state government and the private sector to entice more foreigners to invest in the country. The country needs foreign capital to boost economic activity that has sharply slowed down during the economic downturn. Official data showed that investments (gross fixed capital formation) grew at a shade over 4% in the April-June period this year as against over 9% in the same time last year.

The department of industrial policy promotion (DIPP) the government wing that makes foreign investment policy, said in a statement, "The proposed company, **Invest India**, will promote foreign investments into the country in a more focused, comprehensive and structured manner". The company will act as the first point for FDI inflow into the country. It will facilitate investors meeting with officials, hold sector specific consultants and coordinate with state governments. The company would facilitate foreigners in identifying and realising investment opportunities in India.

Commerce and industry minister Anand Sharma said, it will have six government directors and an equal number of directors from industry chamber Federation of Indian Chamber of Commerce and Industry (Ficci), which would own 51% in the entity. Although it is authorised to have a capital of Rs 10 crore, the initial paid capital would be Rs 1 crore. The union government's 49% stake will eventually come down to 35% as state governments bring in equity into the company. The minister also said that FDI into the country in April-July 2009 period stood at $ 10.53 billion, 14.5% less than the inflow reported in the same period a year ago. Services, housing and real estate, construction, automobile and telecommunication were the areas that received FDI in a big way.

India, Asean free trade deal

India and the 10-member South East Asian country group **Asean** on 13/08/2009 signed a landmark free trade agreement (FTA) which could make imports of electronics, consumer goods, pharmaceuticals, machinery, metals and even ready –made garments cheaper in the country, as duties on 4,000 goods imported from the region get eliminated over the next three-sex years.

The pact is a strategic victory for India which has been trying to intensify its relationship with the region as an answer to the regional blocs forged by Western powers. Formal negotiations on liberalising services and investment, however, are yet to begin and the challenge before India is to expedite the process as it stands to gain a lot in these areas.

Commerce and industry minister Anand Sharma said after signing ceremony in Bangkok, "The agreement with **Asean** is well-balanced and is in harmony with India's "Look East Policy." The two sides expect trade to increase from the current $40 billion to $50 billion in 2010. The agreement, which will be implemented from January 1, 2010, will result in elimination of duties on about 3,200 products by December 2013, while duties on the remaining 800 products will be brought down to zero or near zero levels by December 2016. The agreement keeps 489 items out of the scope of tariff cuts. These include 300 farm products, automobiles and certain categories of auto parts, machinery, chemicals and textile products. Duties on the "sensitive" farm products – palm oil, tea, coffee and pepper – will be brought down to levels between 45% and 50% over a 10-year period.

Asean goods in bag, India targets services: After successfully concluding a free-trade agreement on goods with Asean, India is now learning on the 10-member South-East Asian bloc for an early conclusion of the negotiations on liberalising services and investments, which would allow smoother movement of professionals and enhance flow of investments. India is mostly interested in liberalising cross-boarder movement of services, which includes BPO services and freer movement of professionals through easing of visa restrictions and mutual recognition of qualifications. While Malaysia and Singapore have a large English speaking population and would immediately provide job opportunities for Indian professionals, in other countries the language barrier can be crossed gradually.

Under the ATG, New Delhi will eliminate the tariffs on 4,185 items (80% of the total tariff line) in four to seven years, from Jan 1, 2010. Most of these items currently attract the peak customs duty of 10%. India maintains a simple average tariff of 15% on goods while the same is about 5% for most Asean countries. So, it is easier for Asean to comply than India.

Of course, with income levels rising and the investment rate being high, India is becoming an import-intensive economy and this would be so for the next few years at least. Almost all major Asian countries, including China, Indonesia, Malaysia, Singapore and Thailand export more value to India than they import. Rising consumption is making tariff walls redundant and there is increasingly clear evidence against the policy of keeping 'bound tariffs' at very high rates. Even as we take a tough stand at the WTO, the tariffs on most goods are, in any case, being cut progressively to cater to the rising needs of the industry and consuming public. Therefore, there is hardly a case for scare-mongering if the tariff are cut a little faster and steeper for some 10 countries that together account for 10% of India's global trade.

2.2 India

The 100-day Agenda

It was a novelty for India when the newly elected government announced a work programme for its first 100 days, through the President's inaugural address to the 15th Lok Sabha.

The UPA government had in the Presidential address to Parliament on June 4 laid out a 25-point action plan for the first hundreds days. Faced with impediments such as global recession, swine flu and drought the government did skid on many fronts. It, however, also made some progress in a few decisive sectors. If the government had not set a 100 days' agenda for itself, its performance over this period would have looked more impressive than it does when checked off against a list of promises. Quite a bit has been achieved already in the ministries of finance, education and home.

The direct tax code, which seeks to modernise and rationalise direct taxes, has been put up for debate. Disinvestment has been kicked off, in a non-confrontationist fashion. The government continues to sustain the fiscal stimulus the economy needs right now. The Centre is trying to switch over GST.

Internal security has been strengthened on an institutional basis, with better equipment and more personnel being given to the police forces. Coordination among intelligence agencies, computerisation of border check posts, regional hubs for the National Security Guards have been created.

Education has been the sector where action has been most prominent, and received public accolades. But there has been progress on other fronts too. The Free Trade Agreement with Asean has finally been signed. India is playing an active role in mobilising opinion to conclude the protracted Doha round of World Trade talks. The government has also kicked off its plan to ramp up highways construction in the country. The road transport and highways minister Kamal Nath has taken a slew of measures including relaxation in bidding norms to attract private investment in the sector. On the health front, the emergency posed by the swine flu menace has consumed the government's attention, to the exclusion of much else. The move to create unique identification numbers for all citizens, roping in the services of a top-notch professional from the private sector, is a wholly welcome move. This has the potential to transform the way government subsidies are distributed, apart from improving national security.

Inclusive growth remains the goal being pursued by the government. While three months and ten days is too short a period for assessing the performance of the government, it looks that 100 days is a long time in politics for the Manmohan Singh government.

Left & Right talk of part of India

Reaffirming Congress' centrist 'ideology' Congress general secretary Rahul Gandhi said his party would bridge the gap between extreme position of Right and Left to build a prosperous India. Taking a dig at the Opposition BJP and Left parties, for their outlook on the country's development, he said it was the Congress which can ensure all-round development. "India is now a country of opportunities on one side and the lack of it on the other. While BJP's view (on development) was that of 'India Shining', with all focus on opportunities, Left parties say 'ignore the India with opportunities and focus on that without it'. But, we will bridge these two Indias and create opportunities for all. In order to realise this, flagship programmes such as NREGA and massive expansion of the education and health sectors were being done, he said and termed them as 'weapons of national development'.

Global leadership

The key to becoming global is to create leaders who can manage global businesses. I mean leaders who have the ability to be effective across geographies, nationalities and cultures – leaders who excel at collaboration, innovation and managing change. Global leadership is all about developing mindset that wants to leverage resources seamlessly, across geographic boundaries. A mindset that is eager to build unique capabilities, to transcend the barriers of cultures in order to create value. It's about being global in attitudes – but without letting go of your roots.

Cosmopolitan forever

Mahindra & Mohammed of pre-Independence days may have changed to Mahindra & Mahindra but the group has managed to hold on its basic ethos – to remain as secular and as cosmopolitan a company as ever, be it work culture or business. From being an automobile-focused group with a few other businesses, M&M is now an auto-cum-IT major.

Anand Mahindra, the vice-chairman and managing director of the eponymous tractors-to-software group said, "The architecture for a kind of multi-business federation was laid back in 1994. That was the time when we began trimming some businesses which we felt didn't live up to the philosophy or the objectives we had. The challenge was – can you create a federation of businesses which will grow with India?

Be part of the India story; leverage every opportunity in every sector that India will have to offer, including the service sector! And yet do it without falling into the trap of unrelated diversification within the conglomerate, which clearly the analysts and investors frowned on.

And that's when, in 1994, we created the sector structure with focused presidents. And then we made a promise that in each sector we would create a flagship that would be listed. Hence we would have both financial as well as managerial focus that would allow us to become a multi-business federation. The promise, that every one of our sectors would have a flagship listed, took a long time to fulfill for a variety of reasons – scaling up (took time), markets were sometimes fickle. That's why when we recently had the Club Mahindra IPO it was an emotional moment. Because it was the final promise that had to be fulfilled. That was the one sector where we didn't have a listed flagship yet. And once that was done, the promise of '94 was fulfilled. So in a sense the architecture of a multi-business group was laid way back in 1994.

Similarly, we have to hive off certain businesses that didn't conform to what we now call the 'Blue Chip Mantra'. If there is anything close to portfolio logic within the group it is these 'Blue Chip Mantras'. There are four mantras. Essentially they have to do with businesses that are global or have global potential; businesses that have innovation as a measurable plank; certainly we also want to be leaders, preferably one or two in all the businesses in which we compete. Finally the fourth mantra is financial – they have to do with free cash flow and return on capital employed. So any business we go into must conform to these mantras. What we were hiving off businesses that perhaps did not fit those mantras or where we could not guide their destiny. Or where there were partners who would have wanted a say in it.

Game changer

According to Anand Mahindra of M&M group, every deal you do adds to competency and experience. The components to a deal have to do with both the right brain and the left brain. There are Excel spreadsheets, there are IRRs, and we look at projections. As to whether we do them differently, no, not really. But, we really look very hard and say what if sales go down by 5%? What if the costs go up by 5%? What implication would it have on this business and on the rest of the group?

That's a very hard-nosed analysis. There has to be a right brain side as well when you analyse these factors. There has to be somebody at the top leadership looking at the bigger picture, bringing some passion in, some conviction, and some commitment. The balance between these two is critical.

Recently, in Satyam acquisition, we got a very-very clear walk away price negotiation with all the boards that were involved. We knew exactly what we were going up to and you would have seen, in classic Mahindra fashion, that if that price had been breached we would have happily walked away from the deal.

We had reached a strategic point in Tech Mahindra where the board had determined that it was time now to look beyond the telecom focus. And the question was when you are close to a billion dollars in turnover how you making a meaningful entry into other verticals do? For us it was very, very important that if we are going to go beyond the telecom-focused domain, we do it in a meaningful and significant manner. Clearly, you do it organically but it is going to take an awful long time and the industry was already maturing. Not a great time to grow organically. So the inorganic option was the one we had looked at. And there were a number of companies we had looked at. I had actually approached Mr Raju a year before this has happened proposing some kind of alliance between the companies. I was puzzled by his lack of response. Subsequent events, of course, explained to me why he hadn't responded.

But, I didn't realise the impact this would have on the public arena. I really hadn't understood the extent to which people in the public domain had gotten their emotions involved in this. The IT industry had clearly been a champion and a symbol of India's new self-esteem. And the unfortunate vicissitudes of Satyam had begun to erode that. The kind of feedback we have gotten since then – a lot of it exaggerated sometimes including reactions about our being white knights and saving the situation – are surprising to me. They also bring a huge burden and responsibility to us. So in that sense I think if we succeed in turning around Satyam, clearly it will have added dramatically to the reputation of our group. In that sense, it could be game changer. I think it is still early days. We have to move humility and acknowledge that we have to lot to do there. But, if we are successful, it will add a great deal to our group.

And when the envelope was opened and Tech Mahindra's name was announced as the winner bidder, I was pleasantly surprised because we were up against some serious competition; competition that was committed and had shown its commitment in a number of ways. I was surprised, and at the same time what always goes through your mind when you make a bid is, "Oh my God. Now the real work starts. The real work involves turning around Satyam. I wish it to do tomorrow. Anyone who makes time frames beyond tomorrow probably isn't pushing himself hard enough. So I'd like to turn it around tomorrow.

Anand Mahindra is biz leader of the year

It is a vote for strong performance in the face of overwhelming odds. It is a reward for unflinching determination and a relentless desire to succeed. A tumultuous year, which saw the collapse of western economies and businesses due to dodgy and reckless market investments, also saw the emergence of a breed of companies and individuals who braved all odds to emerge victorious. They put their faith in the time-tested methods of leadership and gritty hard work and were rewarded with a sterling performance. The jury of the Economic Times Awards for Corporate Excellence attacked the job with gusto and rigour. Offie-Pekka Kallasvuo, the CEO of Nokia Corporation was the first foreign-born chairman of India's best business awards. Mr Kallasvuo guided and steered the process with ease and dexterity. At the end the hours of deliberation, the jury members were enormously satisfied with a job well done.

2.4 International

FED, ECB eye recovery; too soon to hit breaks

US Fed chairman and other central bankers on 21st August 2009 (Friday) said the worst global recession in 70 years was nearing a close but, warned it would be a long, slow climb to normal growth. At an annual Fed retreat set against the backdrop of the Grand Teton Mountains, the officials said the coming recovery would have its ups and downs, and it was too soon to withdraw trillions of dollars in government and central bank support.

US Federal Reserve Chairman Ben Bernanke said, “After contracting sharply over the past years, economic activity appears to be levelling out, both in the United States and abroad, and the prospects for a return to growth in the near term appear good”. But both Bernanke and European Central Bank President Jean-Claude Trichet said there was still much work to be done to restore the global economy to self-sustaining growth. Trichet said he was “a bit uneasy” about talk of a return to normal and that policy-makers should be as active as possible.

Surprisingly strong US home sales figures, released just as Bernanke was beginning his speech, added to investors optimism that recovery was in sight, sending stock markets higher while US government debt prices fell. The conference, held at a no-frill rustic lodge in a national park in the western state of Wyoming, is a big draw for the world’s leading monetary policy-makers and economists. The event includes a mix of speeches and academic papers.

A large part of Bernanke’s speech was devoted to reliving those months, looking at how officials around the world responded and what lessons they had earned about how to regulate and monitor financial markets. This year’s event sounded more upbeat than a year ago. Weeks after the 2008 gathering, Lehman Brothers bank collapsed and the United States rescued American International Group Inc, touching off a tumultuous period of slumping economic growth in both rich and developing countries.

Bernanke said, “We must urgently address structural weaknesses in the financial system, in particular in the regulatory framework, to ensure that the enormous costs of the past two years will not be borne again”. Stephen Cecchetti, a senior official at the Bank for International Settlements, said strong, sustained growth would not be achieved unless the global financial systems were fixed. You don’t want to become complacent … just because things are starting to look better. We’ve got to keep on the job.

Bernanke, whose term as Fed chairman expires in January unless President Barack Obama renominates him and he wins Senate backing, defended the US central bank’s controversial emergency rescue efforts and tried to explain why the Fed helped AIG but not Lehman. The bailouts have landed the Fed – and Bernanke – in the middle of a sometimes heated political debate over whether it had overstepped its authority and ought to be reined in. Bernanke credited an aggressive co-ordinated policy response for averting “the imminent collapse of the global financial system, an outcome that seemed all too possible.”

Michael Feroli, an economist with JP Morgan in New York said Bernanke’s words did not change his view about the Fed’s next policy steps. “The Fed is firmly on hold and isn’t prepared to break out the confetti at the first signs of growth.” In fact, given the issues he focused on, Bernanke’s talk seemed more directed toward the political establishment than toward nudging views of financial market participants.”

In the past couple of weeks, reports have shown that some major economies, including Germany, France and Japan, generated positive growth in the second quarter, and polls showed that most economists think the current quarter will mark the end of the US recession, which started in December 2007.

Stimulus needed for some more time: G20

G20 finance leaders insisted that trillions of dollars of emergency economic supports would be needed for some time. Although the global economy looks brighter than when Group of 20 finance ministers and central bankers met in April, they would not remove economic stimulus until the recovery was well entrenched. While the timing of these eventual policy reversals may very, the G20 said for the first time there should be some coordination to avoid adverse international fallout.

But as the focus shifted from crisis-fighting to establishing a safer financial system for the future, ministers searched for consensus on precise plans to rein in banker' huge bonuses and use more of their profits to build buffers against any future crisis.

On the public stage, the message was one of solidarity as policymakers agreed they must keep spending the $5 trillion already earmarked as economic stimulus and delay any unwinding of emergency fiscal and monetary measures until economies are sturdy enough to stand of their own. The G20 officials from rich and developing countries also said they would work with the International Monetary Fund and Financial Stability Board to develop cooperative and coordinated exit strategies.

US Treasury Secretary Timothy Geithner said, "We cannot put the world in a position where things go back to where they were at the peak of the boom. It cannot happen, will not happen and you can't expect the markets to solve that problem on their own because it's a huge collective action problem, so it has to come through things that countries legislate." Geithner said, "The classic errors of economic policy during crises are that government tend to act too late with insufficient force and then put the breaks on too early. We are not going to repeat those mistakes."

International Monetary Fund chief Dominique Strauss Kahn said, "There is broad agreement on what to do. The problem is we need to go beyond agreement. We need to have concrete measures. I'm impressed by the level of consensus but I'm still waiting for strong measures to be decided and also to be implemented at the national level."

Bernanke gets second term

US President Barack Obama nominated Ben Bernanke to a second term as Federal Reserve chairman on Tuesday, (25/08/2009) aiming for continuity at a time when the US economy is breaking free from a deep recession. Obama said, "Ben approached a financial system on the verge of collapse with calm and wisdom; with bold action and outside-the-box thinking that has helped put the breaks on our economic freefall." Now, the US auto industry was showing signs of life and business investment was stabilising after the deep recession. The housing and credit markets had also been saved from collapse. A White House Official said that the Obama had wanted to 'put to rest' speculation about the future of the US Federal Reserve chairman. Obama is counting on Bernanke, a soft-spoken former Princeton University professor, to nurse the economy back to health at a time when unemployment, home foreclosure and bank failures are still mounting. Bernanke, whose appointment must be confirmed by the Senate, has pushed US interest rates to near zero and flooded financial markets with hundreds of billions of dollars to stem a credit crisis and turn back recession.

2.5 Warning Signals

The man who saved the world

It would have been insane (not to be too subtle) for President Obama not to nominate Ben Bernanke to a second term as chairman of the Federal Reserve Board. The economics dictated it; the politics dictated it. Imagine the fallout if Obama had instead selected White House economic counsellor Lawrence Summers. The next-day stories would have been predictably critical. Was Obama trying to compromise the Fed's 'independence'? Even naming someone less controversial than Summers might "have rattled markets and unsettled the foreign investors". Looking ahead, Obama surely anticipated what might happen if the economy unexpectedly worsened. The shift from Bernanke might be blamed. Considering the strong support for Bernanke among economists, business executives and bankers, frankly, only a moron wouldn't have reappointed Bernanke.

Of course, Bernanke has critics in Congress; but that is the fate of any Fed chairman during the hard economic times. Beyond these political calculations, however, there was a larger reason to rename Bernanke: He deserved it. We will never know whether the world might have suffered a depression if Bernanke's Fed had not responded so aggressively. The fact that the global economy is no longer uncontrollably spiralling downward was not a foregone conclusion. Nor was it ordained that the panic gripping financial markets just six months ago would subside. From recent lows in March, the US stock market is now up roughly 50 percent.

But, it is not that Bernanke's performance was flawless. *Far from it; He made two blunders*. *First, he didn't see the crisis coming.* Even after the collapse of the investment bank Bear Sterns in March 2008, he didn't foresee a widespread financial panic or a savage recession. In the summer of 2008, the economy was weakening but looked as suffering from inflationary "overheating." Consumer prices were increasing at a 5% annual rate; oil was peaking at $ 147 a barrel.

Second, along with then-Treasury Secretary Hank Paulson, Bernanke allowed Lehman Brothers to go bankrupt in September. Both have said they lacked the legal power to rescue Lehman and that no one wanted to buy it. Many observers find this defence to be self-serving. If Bernanke and Paulson had fully anticipated the consequences of Lehman's failure, they almost certainly would have found a way to save it. Once, Lehman collapsed, the crisis got much worse. Banks retreated from lending to each other; investors stopped buying new bonds; banks, consumers and businesses hoarded cash. The economy contracted at a 5 percent to 6 percent annual rate.

Here is where Bernanke distinguished himself. A student of the Great Depression, and especially of the disastrous effects of bank failures, he went well beyond the standard response of lowering interest rate. The Fed created a dizzying array of "liquidity facilities" that substituted more than $1 trillion of Fed credit for retreating private credit. The Fed supported markets for mortgages, money market funds, commercial papers, auto loans and student loans. The strategy was to do 'whatever it takes' to avoid complete loss of credit and confidence and culminating in depression. Although there were other actors, the Fed' interventions were decisive in lifting the panic. It is an open question whether any other Fed chairman would have been so bold in supporting credit markets.

Moreover, Bernanke's approach inspired similar moves abroad. After the 1997-98 Asian financial crisis, Time magazine ran a cover story called "The Committee to Save the World" featuring Summers, then-Fed Chairman Alan Greenspan and then-Treasury Secretary Robert Rubin. An updated version might have Bernanke on the cover under the headline "The Man Who Saved the World." *But this is also Bernanke's burden.* If the Fed doesn't withdraw all that all that extra credit quickly enough, it may spawn inflation. If it withdraws it too quickly, it may subvert recovery. Further, either way, could mean that reappointment marks the zenith of Bernanke's prestige.

3.1 Mutual fund scheme

Take a close look at pre-defined objective

The mutual fund industry thrives on transparency and disclosures. Most fund houses come out with a fund fact sheet for each scheme every month. They provide information about the investment particulars of the corpus (company and sector wise), credit ratings, market value of investments, NAVs, returns, repurchase and sale price of the schemes. The fact sheet also contains the scheme's objectives, fund manager's commentary on the portfolio and market outlook.

The effort is to help an existing and potential investor take an informed decision to invest, stay invested or redeem out of the fund. It is an important piece of document as it communicates the fund house's philosophy and past performance. It is also used by distributors as a marketing tool. Here are some important points that an investor should look at in a fund's fact sheet.

Investment objective

It explains what the fund intends to do. Each category of funds is backed by an investment philosophy, which is pre-defined in the objectives of the fund. An investor can align his/her investment needs with the funds objective and invest accordingly. Based on the investment objectives, various schemes can be broadly classified as follows:

Equity/growth schemes:

These aim to provide capital appreciation over a medium to long term. In these schemes a majority of the portfolio is invested into equities.

Income/debt schemes:

These aim to provide regular and steady income by investing into fixed-income instruments such as corporate and government bonds, debentures and other debt securities.

Balanced schemes:

These aim to provide both growth and income. They invest in equities and fixed income securities, in a proportion which is pre-defined in the investment objective of the scheme.

Liquid funds/scheme:

These aim to provide capital preservation and easy liquidity. They invest in relatively safer instruments such as inter-bank call money, T-bills, certificate of deposits and commercial papers.

Portfolio & performance

The equity/balanced fund's portfolio diversification can be explained under two parts:

Top 10 stocks:

The percentage of the top 10 holdings accounts for of the net assets of a fund can reveal whether the fund is well-diversified or is a concentrated one.

A concentrated portfolio has the potential to generate higher returns but at the same time is more volatile as compared to others. The consistency in the top stock holdings can also reveal a lot about the fund's management style.

Sector allocation:

A diversified equity fund is expected to invest across various sectors. A concentrated portfolio across a few sectors enhances the fund's risk profile and makes it prone to volatility. Funds at times tend to have higher allocations towards a single sector. While the same could be indicative of the fund manager's confidence in stocks from a given sector, it also makes the fund an over-leveraged one. Income/debt schemes and liquid schemes normally invest in debt instruments of government, banks, financial institutions and corporates carrying different ratings and maturity profiles. The portfolio is constructed depending on the risk return profile as well as the liquidity needs of the portfolio in compliance with the scheme objective.

The fact sheet contains returns of funds vis-à-vis the respective benchmark across various time frames. The hallmark of a good fund is in its ability to deliver superior performance year after year. The objective of any active investment strategy is to outperform the benchmark, and this extra return is what is called as the fund manager's alpha.

It is therefore important to identify funds with a track record of beating the benchmark. Thus, an investor should ensure consistency in returns over different periods of time before investing.

Expense ratio

AMCs usually disclose the expense ratios and load structure in the fact sheets. The load and expense ratio affect the fund's performance. Higher expenses charged to a scheme can alter the scheme's performance. The impact is more in case of debt funds as here the payback is less than for equity funds.

However, investors should understand that although loads and expense ratios have a different impact on the returns, they cannot be used as the sole criterion for evaluating a fund. The fund's investment style and performance are far key parameters than load and expenses while evaluating a fund.

Performance evaluation period

This is one of the key aspects of a fund's performance evaluation. Each type of a scheme has different investment objective and time horizon of investment for risk-adjusted return expectation. A liquid fund's performance should be evaluated over a short period (say for 3-6 months) and an income fund's performance should be evaluated over 6-18 months whereas an equity/balanced fund should be evaluated over medium to long term (2-5 years). Such an evaluation is necessary to get an appropriate perspective of the fund's performance profile and help investor to take right decision.

3.2 Non-convertible Debenture

Companies woo HNIs with high returns

Loop Mobile of the Ruias of Essar Group, Jaiprakash Associates and Reliance Capital are leading the way to sell NCDs for funds as banks slam the door on them and overseas borrowings become difficult.

Companies succeed in raising funds as they offer as high as 14% return on a two-year debenture in these privately-sold issues to high net worth individuals compared with 8-11% for retail investors.

There is a fairly high appetite from the wealthy for this product. Companies have realised this in the last leg of low interest rates. So (they feel) why not try and raise money.

Banks wary of bad loans, are investing record amounts with mutual funds instead of lending to companies and individuals. So, companies in need of funds raise resources through sale of debentures in private placements. RBI data shows banks' investment in MFs rose 102,838 crore between April to July this year.

The non-convertible bonds are beneficial to both the seller and the buyers. While the costs of funds are lower than bank rates for companies, for investors they yield higher returns than bank deposits, or other fixed income yielding instruments.

The success of retail sale of debentures by Tata Capital and Shriram Transport Finance indicates that investors will lap the instruments up with high interest rates. Both of them together raised Rs 2,500 crore from the primary market.

Wealth managers say, "Indian companies may raise 20,000 crore for the rest of the year". They have raised almost Rs 30,000 crore through NCDs this year, according to Thomson Reuters.

The quantum of funds raised has shown a positive aspect of the economy. Companies are raising some serious money for a worth-while cause. Experts say that they have not seen such a fund raising activity in this product at a single point in time

Apart from high yields, the collateral offered by companies in the form of receivables and their promoter' offer of shares in another draw.

A typical issue of such debenture has a debenture trustee to whom the shares are pledged. The value of the shares usually is a multiple of the amount raised.

Companies which raised funds through NCDs

Axis Bank – Rs 1,500 crore	Reliance Capital – Rs 862 crore
Reliance Utilities & Power – Rs 500 crore	Bank of Baroda – Rs 500 crore
Gitanjali Gems – Rs 150 crore	United Phosphorus – Rs 100 crore
ICICI Securities Primary Dealership – Rs 60 crore	Era Infra Engineering – Rs 40 crore
Mahindra & Mahindra Financial Services – Rs 10 crore	

Sequential growth

The latest economic data released by several countries indicate that the green shoots of recovery seem to be sprouting in these countries. Much of the surprise of most economists, the German and French economies both recorded a modest growth of 0.3% in the second quarter of the current year. This seems a paltry rate of growth. But, it assumes significance when viewed against the perspective of the previous four quarters, during which both countries had actually experienced negative growth rates.

4.1 FINANCIAL ADVISORS:

Weigh impact on investors

Signal of exiting recession

The global recession is coming to an end faster than thought just a few months ago and may already be over, according to forecasts published by the Organisation for Economic Co-operation and Development.

The recovery may even prove a little stronger than previously predicted, OECD chief economist Jorgen Elmeskov said in an interview where he elaborated on the forecasts for several key economies.

The OECD forecasts show a third-quarter return to expansion of economic output, as measured by gross domestic product, in the United States and the 16-country euro zone, led by two largest economies, Germany and France. The forecasts showed an annualised expansion of 1.6% in the United States in the third quarter, 0.3% in the euro zone and 1.1% in Japan.

The OECD is generally more optimistic than the last update in June. In June, OECD predicted quarter-on-quarter shrinkage of 1.1 and 0.5% respectively in the third and fourth quarters on an annualised basis.

It now expects 2% growth in the fourth quarter. The previous forecasts for the United States had been zero and 0.5% - now upped to 1.6% and 2.4% respectively.

The OECD’s 30-member countries do not include rising powers such as China but do include the long-industrialised ones where the trouble began in 2007.

While it predicted continued 3Q contraction in Britain and Italy, and a rise followed by a fourth-quarter dip for Japan, the broad picture for the G7 group of industrialised powers was better.

The forecasts, including information up to September 2 show the euro area turning positive in both of the last two quarters of 2009 after five straight quarters of contraction.

The OECD is still predicting GDP contractions for 2009 as a whole across the G7 group primarily because of a particularly bad first half, despite the improvement now in the pipeline. But it sees annualised GDP rises of 1.2 and 1.4% in the third and fourth quarter for the G7 as a whole, also signalling an exit from recession at that level.

In some countries including the United States it also looks as if the bottom of the housing market might have been hit a little earlier than assumed.

4.2 WEALTH MANAGERS

Map out the details to translate into benefits

Appraisal of future prospect

On the other side of the Atlantic, the Federal Reserve Board has issued an optimistic appraisal of future prospects. The latest output and unemployment figures in America suggest that the recession in the country is very probably finally over. Although aggregate output fell for the fourth quarter in a row during the second quarter of 2009, the latest fall was small – only 0.8%. Most analysts feel that the American GDP will increase during the current quarter, although not sharply. Another hopeful sign was that unemployment rate actually fell slightly in July.

Even Nouriel Roubini, who earned a little of *Dr Doom* for his bleak predictions of the global recession, now sees light at the end of the tunnel. He claims that both advanced and emerging economies are showing signs of bottoming out of the recession. Of course, Dr Roubini and many others warn that the global recovery will be slow and uneven, with many countries perhaps continuing to experience a contraction in their economies well into the next year. For instance, Spain, whose booming economy was once the envy of its neighbours, continues to exhibit signs of deep recession. In the UK, the governor of the Bank of England warned that the recovery will be "slow and protracted."

Only the foolhardy will attempt precise predictions about turning points and how fast economies come out of recession. Certainly, the historical experience is not of much help because there are few discernible patterns. For instance, the US economy seemed to recover very fast from the Great Depression of the 1930s for a couple of years during 1934-36. Unfortunately, that recovery was short-lived because the economy fell back into another severe depression. On the other hand, Japan did not experience any spell of even a short recovery after the depression of the 1990s.

The current situation is further complicated by the fact that in this globalised world, individual countries have only a limited influence on their own economies. What will determine the speed with which we bid goodbye to the global slowdown is the rate of the change of world aggregate demand!

Fortunately, it is the large economies which look likely to come out of the recession faster than others.

Chinese seem determined to restore their economy to the incredibly high growth rates which they experienced prior to the slowdown. Although exports constitute a large share of their total basket of goods – and Chinese exports obviously do not directly help boost demand in other countries – they also demand a wide range of intermediate goods. Any increase in the Chinese demand for intermediate goods does help several countries.

The German and Americans economies are also very large, and any increase in their growth rates will help to boost world aggregate demand directly. Their determined government action persuading the companies that residual risk is small enough for them to start production that they would normally have undertaken in happier times. There is some preliminary evidence that the massive infusion of public funds have borne fruit. Of course, there are lessons to be learnt.

However the rate of the change of world aggregate demand would determine the pace of revival.

4.3 RISK MANAGEMENT CONSULTANTS

Educate – Engineer and Enforce

Balance aggregate demand

The collapse in US consumption has questioned the sustainability of Asia Ex-Japan's (AXJ) export-dependent model. In 2004-07, above-trend global growth was premised on the unbalanced formula of a *debt supercycle* and *consumer leveraging* in the developed world and *a giant export machine in current-account-surplus Asia.* This need to rebalance is high for China and Asean. As US households now rediscover the need to save and are unlikely to take on leverage with the same vigour, Asian exporters will find it harder to extract growth beta in the tepid global growth environment.

Moreover, in AXJ, a large part of fixed investment is made with an eye to boost exports. Indeed, the decline in exports in current cycle has been much steeper than in the previous two cycles. Exports have declined 31% from the peak to bottom on a seasonally adjusted basis in the current cycle versus 14% in the 2001 cycle. It's time to reshape the export-driven growth model. Since the Asian financial crisis, the region's dependence on exports has been steadily rising; simultaneously private consumption to GDP is decreasing. This continuous rise in exports to GDP has created imbalances. Boosting domestic demand by increasing private consumption is gaining maximum importance now. We feel the key structural challenges to increasing domestic demand in AXJ are as follows.

Rise in saving since 2000s has been largely in corporate balance sheets, not households: Since the Asian financial crisis, and the bursting of the tech bubble, the corporate sector has been risk averse and has preferred to increase savings for reinvestment. Surplus labour, as reflected in low wage growth, has meant a high incremental share of income to corporate rather than households. This shows the complexity in boosting private consumption as a part of the excess saving lie with corporates.

Social security/ infrastructure support still lacking: The coming 'silver tsunami' means Asia needs to prioritise efforts to strengthen social security programs. Given the low levels of social security support, more people save to provide for consumption during old age. Also, most countries are plagued with poor education and healthcare infrastructure due to low spending on social infrastructure.

Structural reforms to boost domestic demand on a sustainable basis is less easy: While we can argue that AXJ region's policy makers should respond to the challenge of rebalancing and initiate structural reforms to boost domestic demand on a sustainable basis, doing the right thing is less easy.

As the external demand shock crushes growth, policy makers are undoubtedly taking small/piece meal steps in the right direction, consisting of short-term stop-gap measures to fill the vacuum created by the collapse in exports rather than being structural. Moreover, macro rebalancing and domestic demand reflation is a delicate process and not one without adverse policy side-effect. In a bid to jump-start domestic demand, government expenditure growth has accelerated, and aggressive policy rate cuts have created an extremely loose monetary policy. Unless external demand revives quickly, policy makers are likely to err on the side of maintaining accommodative policy measures, thereby increasing the risk of asset price bubbles made in Asia. As we have learnt from the Japanese experience, unintentional side-effects of loose policy measures are the fuelling and bursting of asset bubbles, which could pose a setback to the longer-term blueprint of domestic-demand reflation. Indeed, in the case of Japan, the economy never rebalanced amid the bursting of asset market bubbles, and a lost decade ensued. We believe Asian policy makers face a long and bumpy path on the road to macro rebalancing.

4.4 INCLUSIVE CEOs
Innovative responses to problems

Create employment cheaply

Our biggest development challenge is abolishing poverty. The UPA-I government broadly followed the following model to achieve that end: attain high levels of investment which leads to high growth of GDP, which, in turn, leads to greater tax revenues, which are then employed in the social sector and in programmes that serve to directly attack poverty.

An alternative approach is to use the engines of economic growth and entrepreneurship to create jobs- the millions of jobs we need – outside agriculture. Picture countryside dotted with millions of small firms manufacturing products and providing services, employing many millions of semi-skilled and skilled workers, adding value to the economy and cutting away at the roots of poverty.

But, has there been a mushrooming growth of small firms? Unfortunately: No. So, why don't small firms mushroom and sprout as we would wish them to?

The World Bank has just released its sub-national *Doing Business (DB) in India 2009 Report* in which regulations have been compared across 17 cities on seven indicators. The indicators cover the key regulations that impact a business: starting and closing a business, dealing with construction permits, registering property, enforcing contracts, paying taxes and trading across borders. The study is an extremely useful guide to the burden of regulation businesses bear in India, and a possible (long) answer to the question: why aren't the millions of micro and small firms we need being set up?

The short answer is, it's too much of a hassle. Compliance burdens are high for all other regulations: Starting a business, enforcement of contracts, obtaining a construction permit, exporting and importing goods, closing a business, and most of all, paying taxes. Uniformly, across India, all businesses complain of the excessive compliance burden imposed by the tax system. Firms cite high tax rates and inefficient tax administration as a key obstacle to growth. Complying with the tax administration is particularly burdensome: a business in India needs to make 60 payments a year and will spend 271 hours doing so.

Red tape and corruption affect businesses. The World Bank's *Investment Climate in India: Voices of Indian Business (2009)* reports that gift or informal payments were requested or expected during inspections by 54% of tax inspectors, 56% of labour officials, 48% of fire and building safety officials, 54% of sanitation and epidemiology officials, and 59% of police officials. Overall manufacturing firms paid on average 4.9% of total sales in bribes. Moreover, corruption hit smaller firms harder, large firms reported paying about 2% of their annual sales as bribes; smaller firms paid more than 6% of annual sales.

Clearly, we need to simplify our business regulations and bring down barriers to business entry. We need to create a business environment that will let the millions of budding entrepreneurs turn their dreams into reality. Some states and cities have already begun innovating in key areas – Hyderabad in construction permits, Jaipur in property registration, Noida in starting a business. An easy way to improve the business climate is to learn from the good practices of other states. But a lot more reform is needed in the areas of trade, contract enforcement, and taxes – reform that is focused on reducing compliance costs and, hence, barriers to entry for small business. Such reforms are easy to do. It's nice and easy way of getting more and more small businesses to start, and to create those millions of jobs we so need, cheaply.

4.5 FINANCIAL PLANNERS
Value unlocking for all stakeholders

Gear up solar mission

Over the past decade, the solar energy industry has been revolutionised. Unprecedented technological innovation, investment, and development catapulted solar energy to a fast-growing, increasingly affordable energy source. The nations and businesses leading this revolution have recognised solar energy as a critical asset to energy portfolios. After all, solar is the most abundant source of energy; reduces a nation's dangerous reliance on energy imports; crests thousands of quality jobs in manufacturing, sales and installation; reduces harmful air pollution; and delivers energy that reduces electricity prices over its 50+ year life, protecting against volatile – and ever rising – fossil fuel prices.

Like China, South Africa, Turkey, and other nations pursuing solar energy, India struggling to deliver adequate energy to its people, and deals with the perils of over-reliance on fossil fuel energy. For India, "business as usual" is unsustainable. The country faces a growing shortage of fossil fuels and water. In addition, air pollution clogs the shies of Indian cities (and the lungs of its residents). Already, India is a net importer of coal and natural gas – two key fuel sources for energy generation – and its reliance on imports is expected to go up through its continued economic expansion. In Addition, India is plagued by daily blackouts that occur despite efforts to build more old-fashioned coal-fired power plants. New coal plants are not an immediate solution as most of the coal plants take 5 year to complete.

India has taken its first step with its National Solar Mission – a clear signal to the marketplace that it is serious about ramping solar energy. The Mission would provide 20,000 MW of solar power by 2020. Over 1,000,000 jobs-years of work will be necessary to sell, engineer, design, manufacture, and install the solar power across India. Solar is a perfect technology to stop these power interruptions. India has abundant sunshine. Solar is always "shovel ready" meaning India can approve new projects and immediately put the technology and employees to work. New solar construction can start a few weeks after contracts are signed, and large system can be operational in 90 to 180 days.

India's current energy politics provide billions of dollars in subsidies and incentives to the coal, natural gas and oil industries. These subsidies hinder GDP growth, plus make fossil fuels seem cheaper than they really are, resulting in greater consumption. Solar power critics who claim that solar energy is too expensive conveniently omit fossil fuel subsidies in their arguments.

As an example, for the new Tata Mundra project, coal is imported from Indonesia, financing is imported from the World Bank, and technology is imported from China. The power plant benches hundreds of thousands of tonnes of pollutants into air and water each year. This is on top of the 10-year tax holidays on electricity sales, custom duty and sales tax allowances, accelerated depreciation benefits, performance subsidies, cheap land, and assist in the development of physical structure.

Meanwhile, solar photovoltaic panel's prices are in a free fall, dropping by 45% over the past eight months thus far. Ultimately, Indian entrepreneurs can make solar happen. They did it before when they seized the moment and ushered in India's global leadership in the hi-tech sector. Now they must seize its abundant sunshine. The result will be improving the lives of its people by expanding access to energy and spurring economic development. It's up to India's government leaders to push the legislation to jump-start its own solar technology revolution.

4.6 CREDIT COUNSELORS

Resolve convertibility and recompensation issue

Revamp old, legacy systems

India's department of post (DoP) is set to spend up to $ 1 billion on its IT-led businesses revamp over the next 3-5 years with top tech firms pursuing several outsourcing contracts for helping the postal department automate and integrate its business processes with a standard software solution.

DoP's IT revamp is a classic example of old, legacy systems and software applications being unable to cope with rising operational pressures and newer business models. Apart from several outsourcing, system integration projects, DoP will also need to invest in procuring computer hardware systems for modernisation of around 1.55 lakh post offices across the country. With the government seeking to evolve DoP as a well diversified services provider offering postal, insurance and financial solutions across remote parts of the country, there is a need to upgrade the systems. The DoP has been using software applications such as Meghdoot developed in-house for over a decade. Meghdoot software is not yet upgraded to work in a wide area network environment. The DoP will also need a new corebanking software solution. The DoP currently use Sanchay Post developed internally, but it has lived its life.

India's government departments and state-owned enterprises such as BSNL, ONGC and other ministries are also seeking to become more efficient with the help of technology. The government has made change in its buying strategy – now the tenders are talking about revenue-driven models. Venders are also approaching these opportunities with a business solution and not merely a technical solution.

4.7 TECH SAVVY PROFESSIONALS

Take first step to ensure efficient and reliable system

Trap big fishes

Prime Minister Manmohan Singh said the perception that "big fish" escape punishment must change and that CBI and other agencies should act swiftly and without fear.

Opening the conference of CBI and state anti-corruption bureaux, he said there was no single remedy for fighting corruption which has to be combated at many levels, one of which was making existing systems less discretionary. High-level corruption should be pursued aggressively. There is a pervasive feeling that while petty cases get tackled quickly, the big fish escape punishment. This has to change.

While quick investigation was important and necessary, it was not sufficient to bring the guilty to book. Trials should be conducted expeditiously and judgments delivered quickly. To begin with the aim should be to conclude the trial in two years so that punishment could be given to the offenders within a period of three years or so. The government therefore recently decided to set up 71 new CBI courts and expected them to function as model courts, hold day-to-day proceedings and avoid unnecessary adjournments.

The prime minister said the world respects Indian democracy, its plural and secular values, independent judiciary, free press, its commitment to freedom and peace and its pursuit of equitable and inclusive growth. But pervasive corruption in our country tarnishes our image. It also discourages investors, who expect fair treatment and transparent dealings. As the country grows and integrates with the world economy, corruption continues to be an impediment to harnessing the best technology and resources.

4.8 MICRO-FINANCE PROFESSIONALS
Developing alternative credit delivery models

Monitor social sector schemes

With UPA's flagship National Rural Employment Guarantee Act (NREGA) being projected as the nodal social sector scheme to reach out the poor. The government is working to improve the delivery of the NREGA, and to address the loopholes in the implementation process which deprives real beneficiaries of its benefits. The government is planning an "independent" survey mechanism which will source information about its implementation in the states and also release it to public.

The rural development ministry discussed twelve such "follow up" measures. One of the most interesting of these proposals is a plan involve citizens in monitoring the scheme by getting 100 eminent persons drawn from "judiciary academics, civil services and society". The group will not be encumbered by official goodies and perks and hence can be expected to present an "unbiased" view of the situation on ground. The move is aimed at addressing the many lacunae in the effective implementation of the NREGA, which has become a key instrument to address unemployment as well as other crises, such as the drought, and to ensure a modicum of food security.

The ministry has held a series of meetings to address shortcomings in the NREGA. It had set up four working groups on decentralisation, sustainable development, the role of technology and public accountability to suggest measures to improve the efficacy of the scheme. The ministry's note on these follow-up measures also included action such as getting enough "technical hands" for the scheme's implementation; setting up a 'Rajeev Gandhi Seva Kendra' in each of the country's 2.52 lakh panchayats and appointment of 'Lok Sewaks'; according priority to water harvesting on a large scale and construction of water bodies under NREGS in rainfall deficient areas.

Miles to go on NREGA: PM

With the much-hyped NREGA, the government's showpiece social development programme, showing an "uneven" performance across the country. Prime Minister Manmohan Singh asked states lagging behind in implementation of his government's flagship programme "not to fail the poor".

Addressing a conference of state ministers of rural development and panchayati raj, he asked states to learn from the "success stories and indifferent performances" in implementation of the jog guarantee scheme to improve its performance. "We still have miles to go before we achieve the full potential of this unique legislation. The performance of the programme has been uneven across states. Some states have shown good results, some are lagging behind. I urge them to catch up."

The prime minister's remarks come close on the heels of party president Sonia Gandhi admitting there have been complaints about NREGA's implementation and asking party workers to be vigilant so that the scheme "does not fall victim to corrupt and inflexible bureaucratic practices".

The prime minister said the time had come to draw correct lessons from the experience of the past five years, when the NREGA has been in place, and put in place a reform programme which meets the legitimate aspirations of the rural people. "We cannot fail the poor of our country particularly at the time when resources are available to provide gainful livelihood security for at least 100 days to the rural poor.

Recalling the words of Nobel Laureate Amartya Sen, he said, "We have today the means to put purchasing power in the hands of the rural population.

Sequential growth

I think Dr Amartya Sen has repeatedly emphasised that famines are not necessarily famines of deficient production but of deficient purchasing power and for the first time in our history we have an opportunity to put purchasing power in the hands of most needy parts of our population through the mechanism of the National Rural Employment Guarantee Programme.

With the allocation to NREGA increased to Rs 390 billion this year, the prime minister said, "we have now to ensure that our people get the best value for every rupee spent on their behalf. Effective oversight of these programmes is therefore, extremely important." In terms of outlays, the ministry of rural development has the highest priority in our schemes of things and that is a measure of our commitment to do all that we can to get rid of chronic poverty, ignorance and disease which still afflict millions and millions of people of our country. Mr Singh said the programme was also making a contribution to financial inclusion. "State governments are being encouraged to make wage payments under the programme through banks and post office accounts. Nearly 7.8 crore of such accounts have been opened. The growing practice of making use of the financial institutions for disbursement of wages is one means of reducing leakages and in often ensuring that wages are paid in accordance with prescribed schedule."

4.9 ONE-STOP-SHOPS

Dedicated to offer related services under a roof

The Financial crisis: one year later

It is now almost a year the world economy teetered on the edge of calamity. In the span of three days, September 15-17, 2008, Lehman Brothers filed for bankruptcy, the mega-insurance company AIG was taken over by the United States government, and the failing Wall Street icon Merrill Lynch was absorbed by Bank of America in a deal brokered and financed by the US government. Panic ensued and credit stopped circulating. Non-financial companies could not get working capital, much less funding for long-term investments. A depression seemed possible.

Today, the storm has broken. Months of emergency action by the world's leading central banks prevented financial markets from crashing. When banks stopped providing short-term liquidity to other banks and industrial companies, central banks filled the gap. As a result, the major economies avoided a collapse of credit and production. The sense of panic has subsided. Banks are once again lending to each other.

Although the worst was avoided, much pain remains. The crisis culminated in a collapse of asset prices at the end of 2008. Middle-class and wealthy households around the world felt poorer and therefore cut their spending sharply. Enterprises could not sell their output, leading to product cuts and layoffs. Rising unemployment compounded the loss of household wealth, throwing families into deep economic peril and leading to further cutbacks in consumer spending.

The big problem now is that unemployment continues to rise in the US and Europe, because growth is too slow to create enough new jobs. Dislocations are still being felt around the world. A huge debate has ensued around the so-called "stimulus spending" in the US, Europe, and China. Stimulus spending aims to use higher government outlays or tax incentives to offset the decline in household consumption and business investment. In the US, for example, roughly one-third of the $800-billion two-year stimulus package comprises tax cuts (to stimulate the consumer spending); one third is public outlays on roads, schools, power, and other infrastructure; and one-third takes the forms of federal transfers to state and local governments for health care, unemployment insurance, school salaries, and the like.

Stimulus packages are controversial, because they increase budget deficit, and thus imply the need to cut spending or raise taxes sometime in the near future. The question is whether they successfully boost output and jobs in the short-term, and, if so, whether they do enough to compensate for the inevitable budget problems down the road. The true effectiveness of these packages is not clear. Suppose that the government gives a tax cut in order to increase consumer' take-home pay. If consumers expect that their taxes will rise in the future, they may decide to save the tax cut rather than boost consumption. In that case, the stimulus will have little positive effect on household spending, but will worsen budget deficit.

An early assessment of the stimulus package suggests that China's programme has worked well. The sharp fall in China's exports to the US has been compensated by a sharp rise in the Chinese government's spending on infrastructure – say, on subway construction in China's biggest cities. In the US, the verdict is less clear. The tax cut has probably been saved rather then spent. The infrastructure component has not yet been spent because of long lags in turning the US stimulus package into real construction projects. The third part – the transfer to state and local governments – almost surely has been successful in maintaining spending on school, health, and the unemployed.

In short, the US stimulus effects on spending have probably been positive but small, and without a decisive effect on the economy. Moreover, concerns about the enormous US budget deficit, now running at $ 1.8 trillion (12% of GNP) per year, are bound to increase, not only creating enormous uncertainties in politics and financial markets, but also dimming consumer confidence as households focus their attention on potential future budget cuts and tax increases.

The US has reached the practical limits of reliance on short-term stimulus spending, and will need to foster alternative pathways to growth. When the crisis deepened a year ago, Barack Obama introduced into the presidential campaign the theme of a "green recovery," based on a surge of investment in renewable energies, new electric vehicles, environmentally efficient "green" buildings and ecologically sound agriculture.

But, in the heat of the battle against financial panic, policy attention turned away from that green recovery. Now the US needs to return to this important idea. Debt-burdened consumers in the US and Europe will limit their spending for years to come as they rebuild their wealth and pension assets. But the resulting economic slack gives us the historic opportunity – and need – to compensate for low consumer spending with increased investment spending on sustainable technologies.

Policies in the US and other rich countries should stimulate those investments through special incentives. These include a cap-and-trade system for green-house gas emissions, subsidies for research and development on sustainable technologies, feed-in tariffs and regulatory incentives for renewable energy, consumer subsidies and other inducements for the uptake of new "green" technologies, and implementation of "green" infrastructure programmes, such as mass transit.

The rich world should also provide the poorest countries with grants and low-interest loans to buy sustainable energy technologies, such as solar and geothermal power. Doing so would add to the global recovery, improve long-term environmental sustainability, and accelerate economic development.

The crisis can yet be an opportunity to turn from a path of financial bubbles and excessive consumption to a path of sustainable development. In fact, seizing this opportunity is the only recipe for genuine growth that we have left.

4.10 CONTINUING LEARNING CENTRES

Take informed decisions

Will the recession really go away?

Most analysts have attributed the current recession in the developed countries to the greed and impropriety of leading financial institutions. However, a broader review of international economic trends during the last three decades would reveal that the recession was inevitably and the subprime mortgage crisis only hastened its arrival.

The recession stems from two basic trends in the developed economies. The first is a near saturation of demand for new manufactured goods because most households have the basic appliances, automobiles, apparel, etc., that they need. This has been a consequence of the steadily growing consumer affluence over the post-War decades with increasing wage levels. This deceleration of demand growth has brought in its wake a stagnation of industrial growth. This is best illustrated by the trends in steel consumption, since steel is a constituent of a host of modern manufactured products. Steel consumption in the US rose in the post-War boom years from 50 million tonnes in 1946 to peak 110 million tonnes in 1975 and then started declining to reach around 90 million tonnes last year. More significantly, employment in the US steel industry has gone down from over 500,000 in 1974 to less than 150,000 now.

The second fundamental structural change has to do with a decline in the cost competitiveness of western goods arising from a steady increase in the wage costs. This has caused a shift to low wage countries in the east, first to manufacturing and later on, even of services. Ironically, the unionised labour in the west – responsible for the high wage spiral – has been the worst hit by job losses, in the current slowdown.

For a while, the increase in wage costs was compensated in the developed countries by improved productivity through the deployment of superior technologies and more efficient systems. However, as the east caught up with these tactics the west lost the productivity advantage. There was a time when microprocessor fabrication, a highly complex process, was wholly centred in the west. But countries like South Korea and Taiwan soon picked up the threads and now account for a majority of the devices made.

To some extent, the advanced countries have countered the flight of manufacture of conventional products to the east by leveraging their strength in cutting-edge research and innovating new products based on the spin-off technologies such as nanotechnology, biopharma, robotics, micro-motor systems and the like. But these are few and far between and the turnover from their sales is a fraction of what has been lost in the conventional product market. The employment-potential of these new industries is far lower than the declining conventional ones. Moreover, with their now enhanced capabilities in engineering and manufacturing, it does not take the developing countries long to invade the new product space.

There are some products, like commercial jet liners, in which the developed countries maintain their stranglehold. But even these once impregnable niche areas are being successfully invaded by the developing world, as the success of Brazil's Embraer has proved.

Perhaps the one sector where the advanced countries still maintain their edge is the defence equipment. This is because security concerns have forced them to pour in government funds in maintaining a lead in this area and keeping the technologies close to the chest. Thanks to the unrelenting spread of strife in the world, the global arms bazaar remains a good outlet for western industry. But it cannot make up for the loss of the civilian market.

The high incidence of unemployment in the G8 countries during the current recession can be attributed more to the circumstances detailed above than to the failure of banks. There is a vicious cycle operating here, with loss of market causing more unemployment which in turn further reduces demand. Since there is a fundamental structural shift here, the mere appearance of green shoots in the banking system will not lead to a major revival of the job market. We are afraid we may never see employment figures in the US or Western Europe going back to the pre-recession levels.

This discomfiture of the west can offer no comfort to us, even though we have gained from the shift of manufacturing and services to the east. This is because the developed countries were the major customers for our exports. With those economies in decline, our exports have been badly hit.

And, if the unemployment rate there continues to remain high, as seems likely, our export sector, which churns out mainly consumer goods like apparel and jewellery, will remain in the doldrums for a long time to come. This is bad news for us, not just on the foreign exchange front but also the employment front, since many of our export industries are manpower-intensive. Perhaps, the strategy now adopted by the Indian jewellery industry to open manufacturing outlets in China, which looks likely to become the new consumer hub of the world, shows a way out.

4.11 GLOBAL OUTLOOK

Global pathways

Will recovery go global?

Before we get too giddy about any US economic "recovery," we should remember that the preceding economic collapse was global. No recovery can succeed unless it, too, is global.

Will that happen? The world can no longer rely for growth on free-spending Americans, who are overburdened by debt and sobered by trillions of dollars of losses on homes and stocks.

Without a substitute for American buying, any global revival will be feeble**,** because **the United States** needs **exported growth** and **other countries must somehow offset their lost sales**.

Developing countries would seem to be the obvious replacement for American spending. These countries already account for nearly half of global economic output, estimates the International Monetary Fund. **China** (11.4 percent), **India** (4.8 percent) and **Brazil** (2.9 percent) alone represent nearly a fifth. By comparison, the United States is also a fifth. All these societies have huge needs for housing, consumer goods, health care and more. Except as a job creator, export-led growth doesn't make much sense. Logically, these countries should produce more for themselves and less for export.

What economists call "global imbalance" – big US trade deficits matched by big surpluses in China and elsewhere – would shrink. World economic growth would revive, Problem solved.

Just possibly, this transformation is starting. Other countries have stimulated their economies, most conspicuously China. Government spending increased; credit eased. China expanded at an impressive 7.9% rate in the second quarter. "Asia's Astonishing Rebound," headlines the *Economist*, which also notes fast growth in Indonesia and South Korea.

Sequential growth

As for India, the IMF reckons it will grow 5.4% this year and 6.5 percent next. Brazil's long-term prospects are good, judges Norman Gall, an American who heads the Fernand Braudel Institute in Sap Paulo. The country has a "strong industrial base and energetic and creative entrepreneurs"; government debt has dropped from 85% of GDP in 2002 to 65% now.

Sounds reassuring; Still there's room for skepticism. If Americans are spending less and saving more, then a balanced global economy requires people elsewhere to spend more and save less. The large trade imbalances fundamentally stemmed from high saving rates, especially in Asia. The surplus savings were invested abroad. China is the key country in any transition.

But, despite China's rapid economic growth, overall employment increases have been sluggish, about 1 % annually since 2000. The export sector is what created jobs. So, it's going to be difficult to get away from export-led growth. This suggests China may resort to aggressive export promotion, at other countries' expense. Its currency, the renminbi, remains undervalued and export rebates on its value added tax recently increased. As US and European markets have weakened; Chinese exporters have shifted to "emerging market" countries, such as Brazil and Egypt. China's exports could hurt other developing countries. What counts is the political and cultural capacity of countries – especially China – to graduate from export-led growth. The global economy is at a fateful junction. Without the prop of American spending, the world needs a new basis for mutually beneficial growth. Without it, we may face protectionism, nationalism and economic strife.

4.12 ISSUES OF THE PRESENT

Freedom to get & fail in the system of free enterprise

Remembering Lehman's collapse

It is a year since Lehman Brothers did task as the financial equivalent of the 50 megaton Tsar Bomba – the Soviet plane that dropped the bomb in 1961 barely escaped the fireball. The seismic shock went thrice around the earth; nobody lived on Novaya Zemlya in the Arctic Circle and Soviet engineers had tamped the Tsar Bomba down from its 100 megaton yield to reduce the fallout. Forty seven years later, the crew who dropped the Lehman Bomba certainly got away alive. Nut unlike the Soviets, leave alone tamping it down, they were clueless about its explosive yield. And of course, it was not barren, remote Novaya Zemlya that was the target, but New York City – the very heart of global finance. The fireball scorched the citizens of the world, governments and taxpayers, and will continue to do so for years, as bills for bailouts and stimulus programmes come due for payment.

Letting Lehman go was presented as an act of virtue and worse still, of prudent regulation. In the hothouse of impending elections, the take was that the US government was not going to bail out Wall Street fat cats. Likely that counted for Treasury Secretary Hank Paulson who took the decision to let Lehman go – as a prelude to his 859-word Draft Proposal for Bailout Plan requesting Congress to authorise the Treasury to buy $700 billion of mortgage-related assets. Maybe it was a variant of the "Shock and Awe" theme: Shock them with the failure of Lehman, awe them with the fear of another Great Depression and zap them into authorising $700 billion with limitless freedom.

It was a draft idea, a terrible one. These were grown, sharp and very successful men. The head honcho had made $500 million, if proof be needed for just how smart he was. One cannot but help wonder what on earth were they thinking.

Two separate threads ran through this global crisis. *One is the cyclical downturn due in the advanced economies and, to an extent, in a world over-heated by five years of very strong growth. Central bankers since mid-2004 were tightening monetary policy in response. The world has seen several recessions in the developed world and while the bite may well have been deeper and more prolonged this time round, this was not what caused the train wreck.*

It was the second thread – the one that lived and breathed in the world of finance; that was the train wreck. Subprime mortgages were transferred into securities that were regarded as being as good as treasuries. And this alchemy of turning lead into gold was mediated through the sordid magic of diluted standards, abandonment of previous good practices and prudence; and fuelled by huge deal flow and fees in an environment of dysfunctional regulation.

For three decades the idea had been diligently championed that markets were self-regulatory, since self-denial was implicit in rational behaviour. This bastion of rational self-denying behaviour has the world's largest prison population, including one Bernard Madoff. The illusion, like many others, lasted a while and all those who made hundreds of millions must surely have thanked the architects of such a fruitful theory that provided endless gain to the well-placed.

But illusions come to a rude end and this one did too. The complex securities were revealed to be crafted not from gold – but an alloy of base metal and gold, with a tag that read '24 carat gold'. That was the summer of 2007. Even then the world of finance did not come to its knees. It rallied and tried to deal with all the fool's gold that it held, paid for by short-term loans taken from the capital market.

The US administration launched a scheme to refinance sub-prime mortgages on the last day of August 2007. It bombed: so they launched another in December 2007 which too did not go far. There was time and opportunity to prevent a meltdown and contain the damage – but it was wasted.

Banks went on a capitalisation drive. Sovereign wealth funds in Asia bought shares of US banks at what they must have re-acknowledged bargain prices. They are wiser and poorer today.

The US Fed slashed interest rates. Never mind high inflation, they seemed to say, we will save the banks by recapitalising them through higher bond prices. Inflation lent both ears, but the sprits that sustain bank solvency paid no heed. And then in March 2008, Bear Sterns, on the point of bankruptcy, was sold to J P Morgan Chase at the intervention of officialdom.

The US Fed had begun to finance the illiquid assets after a haircut, but this repo window was accessible only to commercial banks, not investment banks. Richard Fuld, former Lehman boss, says that he tried to convince Treasury to permit access to the repo window and was repeatedly refused. By early September the last strength of investment banks – certainly Lehman and Merrill – was sapped. At the behest of Treasury, US and British commercial banks looked the two over for acquisition. After a hectic and yet unclear sequence of negotiations, Merrill went to Bank of America and Lehman was let go. Within days, investment banks (and several others) were allowed to convert to bank holding companies and access the repo window. Some say that there was personal ire involved that led to Lehman failure. If true, then not only was the failure of Lehman a global disaster, it was a tragedy in the classic sense of owing to flaws and frailties of character in leading members of the cast.

The rest of the world has learnt much from the financial crisis. Among them (hopefully) is to trust their own judgment first and last, and entertain healthy doubt regarding fanciful ideas that, apparently by sheer coincidence enrich its advocates.

5. Banking Sector

Catch the next big wave

CIRCA 2006: ICICI Bank is the market leader in retail lending, be it housing, auto or credit cards. At its peak, the bank disbursed over Rs 1200 crore of car loans each month, more than twice the Rs 500 crore lent by its nearest rival. Nearly 2.5-3 lakh credit cards were issued by the bank every month.

Cut to 2009: Car loans are less than Rs 100 crore a month. Credit card issuances are down to 1,000 a month. Is the bank, which drove multinationals out of business, developing cold feet in extending retail loans? According to Chanda Kochhar, bank's new MD&CEO, it is more of a tactical retreat to consolidate and catch the next big wave.

The banking sector will go through one more phase of growth, which will come sooner than what all of us are expecting when all the projects and the activity in the housing sector comes back. I want to use the current year to position our balance sheet to take advantage of the next phase. Although it has been just two months since Ms Kochhar took charge, a major behind-the-scenes upheaval that's demolishing old structures within the bank is under way.

The focus has shifted from pure, unadulterated growth to the four Cs – capital conservation, credit quality, CASA (current and savings accounts) and cost optimization.

Although money markets are awash with funds, Ms Kochhar has decided to focus on retail rather than wholesale deposits, given the volatility in the aftermath of the credit crisis.

Her attempt is to achieve this without higher operating expenses (rentals and ATM costs). The bank aims at adding 580 new branches without spending more money or recruiting more people. Rentals are being renegotiated while employees are being shifted from the retail lending business to the branches.

In a bid to improve credit quality in retail, the bank has become extremely choosy. The lender is getting out of selling personal loans, credit cards and two-wheelers through DSAs, and will hereafter sell only to its own customers. Another focus area is net interest margin (NIM) – difference between interest earned and paid by a bank. ICICI Bank's NIM stood at 2.4% as at June..

At the same time, the bank is looking at transactional business to increase fee income. Till recently, ICICI focused on this business only in the SME segment, while on the corporate side it concentrated only on project finance and M&A deals. Ms Kochhar said, "In this business, you get more fees for issuing LCs, BGs, remittance of money, forex payment overseas, inward remittances."

She is also slowly bringing about operational changes by moving from a centralised operational structure to a regional one in order to help the bank become more responsive to customers. Branch staffs are also being empowered. Internally, a whole lot of organisational changes have happened. Senior people are being identified as branch managers. The focus will be now on empowering the branches."

The branches would now be a hub-sourcing model which will do both business acquisition and servicing against only servicing earlier. The aim is to have two managers manning the branches – branch manager and branch sales manager – with the branch sales team reporting to the latter. As the bank starts using its own sales force, the DSA expenses would fall more. In addition, the bank will have a new set of mega branches. Today there are 20 of these branches. The aim is to have 100 mega-branches in two years' time.

The other shift is to use of its own employees for loan marketing and recovering delinquent loans. We are in-housing a lot of collection efforts. This is to prevent overdues from taking place rather than collecting the overdues. Collections are now part of customer service. They (the staff) will be like relationship managers who solve the problems of customers through financial planning in early days. In other cases, such as willful default, the bank now plans to use legal and social deterrents such as informing the employers of employees who default on repayments.

Bank's off-balance sheet items

Reserve Bank of India has expressed concern over the high growth of off balance sheet items at banks. According to RBI, derivatives account for close to 80% the off balance sheet exposure of banks.

Speaking at the 62nd International Banking Summer School in New Delhi, RBI deputy governor KC Chakrabarty said "One area that needs to be watched continuously due to recent crisis is the off-balance sheet (OBS) exposure of the banks. The spurt in OBS exposure is mainly on account of derivatives whose share averaged around 80 per cent". The deputy governor pointed out that the derivatives portfolio has also undergone change with single currency Interest Rate Swaps (IRS) comprising 57 per cent of total portfolio at end March 2008 from less than 15 per cent at end March 2007.

According to Mr Chakrabarty, India has remained insulated from the global financial crisis because of the nascent stage of development of the credit derivatives market, regulatory guidelines on securitisation, which do not permit immediate profit recognition and perseverance of prudential policies.

Fair treatment to customers

Mr Chakrabarty also said that banks need to adopt the concept of fair treatment to customers (FTC) in all their products and services. "This requirement is key to the operation of the efficient retail market for financial services. FTC is also central to consumers having confidence in the financial services industry. This principle must be adopted and supported by the leadership of financial firms, and embedded throughout a firm's operations and within its culture". He added that banks have a special responsibility to customers for providing fair treatment. Banks need to respond to the challenge of restoring consumer confidence in the financial services industry and ensuring that they treat their customers fairly.

According to Mr Chakrabarty, in a competitive marketplace, FTC should be an important element (alongside service levels, pricing and customer satisfaction) in determining the success of a bank in acquiring and maintaining market share. However, in many markets for retail financial products and services the incentive structure for firms to treat their customers fairly has not always been robust enough to deter all firms from inadvertently or deliberately taking advantage of the relative weakness of the financial services consumer.

6.1 Tax Updates

1. I-T lens on buyouts of unlisted foreign firms

Acquisition of unlisted foreign companies by Indian corporates has come under the scanner of income-tax authorities who plan to scrutinise the deals to ensure they are not being structured to evade tax. Valuation of unlisted entities in many countries is an unregulated area as no public interest in involved. This allows acquisition of unlisted foreign companies at inflated valuations. As a result, a large amount of cash or ownership of Indian company moves to a foreign entity and essentially amounts to **asset-stripping** of the domestic firm, which could have tax implications.

The Indian company surrenders cash or equity and receives shares in a foreign company the real value of which may be a lot less, which is effective a net asset loss for the Indian firm. The I-T department wants its officials to closely examine such deals to ensure the tax due to the domestic authorities is not avoided. The fundamental objective behind the department's proposal is to prevent tax evasion by domestic entities, as they may not declare actual profit or gain through these transactions.

Deals involving equity swaps are particularly in focus, as these could be used to transfer part-ownership of Indian companies to overseas jurisdiction. The department is particularly training its guns on acquisitions carried out through equity swaps instead of cash. Manipulated swap ratios can be used to transfer ownership and thereby profits to foreign companies and avoid tax.

The need for a closer look at cross-border transactions has been increasingly felt with India becoming a hotbed of such deals in the past few years. According to Grant Thornton deal tracker, the total number of mergers and acquisitions in calendar year 2008 stood at 458 involving a total announced value of $30.95 billion.

A proposal to set up a specialised investigation unit to investigate cross-border transactions is being examined by the apex direct tax body, the CBDT. Taxation issues thrown up by big cross-border transactions figured at a recent tax conference of income-tax commissioners and directors general. Field formations have been asked to remain vigilant to such transactions and take action in suspect cases.

2. I-T officials to get info on tax evaders' assets

The government will arm income-tax officials with details about assets of individuals whose tax payments are pending, a move aimed at meeting the Rs 13,153 crore for arrears collection this fiscal. With tax arrears of Rs 2,13,646 crore due as on April 1 this year, the CBDT is following an action plan that includes swift action by tax officials and confiscating assets of defaulters, among others. The Rs 2,13,646 crore tax arrears pending as on April 1, 2009, include Rs 82,913 crore tax demand raised by the department during 2008-09.

Demand arrears are the ones that have been raised by the department but not received from the taxpayer. Much of this demand, Rs 71,874 crore, is attributable to one group – The Hssan Ali Group. The action plan for collection of tax arrears includes quick action by tax officials, ascertaining tax liability for attachment and recovery of assets of individuals whose tax arrear is pending.

The modes used by the assessing officer are to identify the current assets and take necessary action for attachment and recovery for the same.

Takeover code set for complete makeover

India's takeover code, which was responsible for a big wave of M&A activity and corporate consolidation after its introduction in 1997, is set for a big change. The Securities and Exchange Board of India (Sebi) has set up a special committee to review its key provisions after realising the need to make it relevant to current needs of investors and companies.

C Achutan, who has handed out many a ruling on mergers and acquisitions as former presiding officer in the Securities Appellate Tribunal, will head the panel as the regulator examines the possibility of making changes to some of its provisions such as the trigger limit for open offers. It will also look at doing away with the provision of non-compete fee and reviewing norms relating to indirect acquisition.

India introduced a formal takeover code in 1997, which helped set basic rules for mergers and acquisitions in the then nascent market for such transactions. However, the rules left scope for interpretation leading to many disputes. Sebi last did a review of the code in 2002 when it made greater disclosures at every level of holding mandatory and exempted preferential issues from the purview of the code. At that time, Sebi wanted to introduce greater transparency to help investors.

The purpose this time is similar. Bur there are other consideration too. For instance, both industry and financial institutions such as private equity funds have been clamouring for greater leeway when it comes to making small but significant purchases into companies. Current provisions with a trigger limit of 15% don't give them enough room. They also don't want to make an open offer as they don't actually try and control the company though they are given veto rights.

Cyrill Shroff, managing partner, Amarchand Mangaldas, a leading law firm specialising in M&A-related transactions says, "The time is ripe for another relook at the number of issues." An open offer after acquiring 25% makes more sense than the current system. Also the offer should be for the entire balance 100%. Besides, indirect acquisition also faces a lot of practical problems and needs a relook.

Sebi's decision to review the takeover code is timely, as there is a need to encourage mergers and acquisitions to free up locked assets in under-performing companies and attract more foreign investments. Takeovers improve utilisation of the economy's productive assets, even if they are bad news for incumbent management. The takeover code must be seen to be fair to promoters, investors and those interested in acquiring a substantial stake in the company.

The provisions that seek to ensure this are the 15% acquisition limit after which an open offer becomes mandatory and disclosure at particular thresholds. The open offer allows non-promoter stakeholders to exit at a fair price, if they have issues with the acquirer. Promoters were, on the other hand, allowed in October last year to increase the stake in their companies through creeping acquisition to 75% from 55% earlier. This allowed them to consolidate their position in the company and almost make it takeover-proof. That leaves the acquirer, who is required to make a disclosure when his holding crosses 5%, 10% and 14%, in a weaker position. Besides disclosing his intent, the acquirer also has to make an open offer for another 20% stake when his holding crosses the 15% mark. The mandatory open offer imposes an immediate obligation on the acquirer and, therefore, the low limit at which it kicks in discourages both private equity and hostile takeover attempts.

A large chunk of foreign investment moves through M&A, as investment in established businesses is usually less risky. So, if India is to attract more FDI from direct investors or private equity funds, then M&A rules have to be more accommodating. Besides, the pressure of hostile bids would tend to ensure better management as a poorly managed company would be seen as a good acquisition target.

1. Checking of IPOs

The government will soon set up an expert body that will collate and analyse business data of companies raising capital through initial public offerings (IPOs) in an attempt to detect early the possibility of fund-raising with fraudulent intent. The intent behind the new agency, which will be a part of ministry of corporate affairs, is to make investment in IPOs a safer option for retail investors.

The specialised body, to be called Market Research and Analysis Unit (MRAU), and will function under the commands of the ministry's Serious Fraud Investigation Office (SFIO), will help in early detection of frauds by scrutinising offer documents of companies planning to raise funds. The new agency will primarily get its inputs from all parties such as banks, deposit holders, investigation agencies that are related to the company raising capital. The agency will, apart from scrutinising data made available in the offer document, also look at details available with the ministry's computerised data repository. As per the ministry's e-governance programme MCA-21, details of financial data of companies are maintained in a prescribed format and can be accessed at the click of a button. Apart from analysing companies' credentials prior to their IPO issue, the unit will also monitor end-use of funds raised by companies.

According to the data provided by the ministry of corporate affairs, there is no trace of 238 companies which raised capital through IPO during year 1992-2005. However, the ministry has managed to track down 117 out of these 238 companies. MRAU will also look into this issue of vanishing companies and suggest steps to check the spread of the malaise.

2. Grading of listed stocks

The country's biggest rating agency and Standard & Poor's Indian arm, Crisil is stepping into uncharted territory to grade listed stocks – an experiment that will be the first of its kind in the world and is sure to have its own share of controversies.

Retail investors, many of whom are returning to the market after last year's turmoil, can use the grading of a stock to find out how fundamentally sound the company is. But such equity gradings, which may find many takers, are not meant to be stock recommendations similar to reports generated by brokerages. Traditional equity research capture some of the basic questions before an investor – like 'how good is the company; 'is it the right price' and 'is it right investment for me' – to arrive at the customary 'buy', 'hold' or 'sell' recommendation. While Crisil will refrain from the price part of the question, it will address some of the other issues like 'is the business good', 'are the financials robust', 'is the governance strong' and most importantly, 'is the company poised for healthy earnings growth'.

At present, local rating agencies like Crisil and Icra confine themselves to grading initial public offerings (IPOs), a factor many investors make a mental note of before investing in an issue. But unlike IPO grading, which is mandatory under Sebi regulations, the proposed grading of listed stocks would be optional for a company. A company keen to grade its stock will have to hire the services of a rating agency, a process similar to obtaining a rating for a bond or debenture. The methodology that will be used to grade listed stocks would be in many ways similar to IPO grading rather than the rating of debt.

Roopa Kudva, MD & CEO OF Crisil said, "the job of a debt analyst is to find out what could go wrong in a company while in equity grading the job is to find what could go right… it will be our effort to spot the winners." The Crisil would launch the service later this year.

Set up new exchanges

Bad times can sometimes bring out the best of business acumen. And if it's a question of survival – fortune often favours the brave. Even as a slew of new financial products make their presence felt thus hotting up the scene for Indian investors, a bunch of brave promoters are looking closely at the business of setting up new exchanges. For them it could be an annuity plan – just sow the seed for once and reap the harvest forever. In the business of exchanges, one continues to reap benefits after an initial outlay – no wonder then it looks like the proverbial goose that could lay golden eggs.

The operating expenses are few. In fact, the global exchange industry has witnessed a growth of over 20% in a last couple of decades. Likewise, the $ 4 trillion domestic exchange industry by turnover is expected to grow with a compounded annual growth rate (CAGR) of 19% to $ 10 trillion in the next five years. In India, the equity market is most vibrant, and next is the commodity and then Currency.

The opportunities are huge. Globally, the trading volume in commodity market is around 30 to 40 times of underlying commodity. However, in India currently the trading volume is around 3 to 4 times the underlying asset, which will provide huge opportunity for commodity exchanges going forward.

In the last few years, the industry has witnessed proliferation of stock exchanges and financial products for trading. As far as the stock exchanges are concerned, *United Stock Exchange* is the latest to make an entry. It is going to focus on trading of financial derivative contracts.

Also Multi Commodity Exchange (MCX) launched *MCX Stock Exchange (MCX-SX)* on October last year. MCX-SX, although, started its shop with currency trading but it is expected to launch stock trading platform also for investors. Currently it offers currency trading in the rupee-dollar contract, however, it is expected to launch rupee-euro contract soon. Meanwhile, *Power Exchange India* has got approval in September last year and started its operations last October. The promoters of Power Exchange India are NSE and NCEDX. Around three months ago, *Indian Energy Exchange (IEX)* started operations too. IEX is promoted by Financial Technology India and PTC India.

It is not just about proliferation of exchanges but in the last couple of years several financial products have been launched by existing exchanges. The major source of revenue to exchange is the transaction fee. Higher the transaction and volume of trading, higher is the income. In India, exchanges charges fees based on the turnover of the product, however, globally it is dependent on the number of contracts. Membership fee and annual charges are other sources of revenue for exchanges. In addition, equity stock exchanges earn listing fees. Initial listing fee in the NSE is Rs 25,000. In fact, during 2008-09, NSE earned as much as Rs 76,286 crore from IPO, right issues, QIP and preferential allotment.

Liquidity is a major factor for success of an exchange. Higher participation increases the volume of trade, which in turn, helps in lowering the impact cost. Impact cost is the cost involved in carrying out a transaction. Trading volumes of several commodity exchanges have declined substantially. Besides, over a period of time competition amongst exchanges will force them to develop specialisation and discover their own niche. Internationally, Different commodity exchanges specialise in different contracts and commodities. So it could be a win-win situation for investors and promoters of exchanges.

7. Issue of Inflationary Pressure

Don't fear the inflation, yet

There is a growing fear that the world economy is heading into a long period of hyper inflation. The gigantic stimulus programmes governments across the world executed using fiscal and monetary policies to pull their economies out of recession are the cause of these fears. Politicians and policy analysts are predictably reacting to the inflation paranoia by proposing that central bankers would hit the breaks on their expansionary monetary policies at appropriate times. For the most part, we think, these fears are overstated – especially in the United States and Europe.

True, worries about high food prices in India are warranted. But the monetary policy has nothing to do with the price of sugar and food grains. If the Reserve Bank of India, in response, executes a contractionary monetary policy, it will stifle growth without bringing down the prices of food grains. Food prices can be lowered only with a more efficient management of the food reserves. Concerns about rising asset prices in China are also valid. But despite the sharp rise in GDP growth in the second quarter, consumer prices in China fell by 1.8% in the year ending in July.

For most of Europe and the United States, the fear that these economies are at the brink of a long period of high inflation is truly exaggerated. And the belief that no matter what actions governments take, the world economy will move from the current recession to high inflation is misguided. Large and growing fiscal deficits and national debts in Europe, the United States and several Asian economies form the basis of this belief. The US government has a fiscal deficit close to 13% of its GDP – or $ 1.8 trillion. It will end the current fiscal year with a net federal debt of 56% of the US GDP. These are indeed scary numbers. But note that part of the debt was incurred to bring back the economy from what could have been a prolonged and deep recession.

The US federal debt is projected to grow further in the next decade. The Obama administration has projected the net federal debt would be 70% of the GDP by 2019. High debt is not good, but if the economy continues to grow, it can service and manage this debt. In the 1990s, Italy, Japan and Belgium had net fiscal debts over 110% of their GDPs, and these did not lead to financial crises or hyper inflation.

If the world economy is able to emerge from the current recession in a sustained manner, it is possible that inflation world-wide may rise somewhat – by three to four percentage points. But the belief that it would suddenly jump to 50% or even 30% is baseless. More certainly, the stimulus packages implemented in the last one year would not be the cause of any such inflation. It is most likely that as China regains its pre-recession growth of 10-12% and India grows at 9% for two to three years, the oil price will rise to its 2007 peak, and commodity price will rise too in turn of spiralling inflation.

There are two reasons why we think the stimulus programmes will not cause hyper inflation.

- First, there continues to be excess capacity in Europe and the United States. The OECD Economic Outlook for 2009 estimated an excess capacity of 4.9% of potential gross domestic product in the United States, 5.4% in the United Kingdom, 5.5% in the Eurozone and 6.1% in Japan. GDP growth in the US, the UK, the eurozone and Japan this year is expected to be much less than the estimated excess capacity that exits in these economies. Thus, if these estimates are an indication, risks of deflation are greater than those of inflation.

- Second, most governments are paranoid about being caught in hyper-inflation. Hyper inflation can be politically damaging, and politicians do not like to be blamed for it. Consider, for instance, government response to the growing inflationary fears.

Recently, at the G20 finance ministers meeting, it was agreed that government should develop transparent and credible processes for withdrawing the "extraordinary fiscal, monetary and financial sector support as recovery become firmly grounded."

The US treasury secretary, Mr Tim Geithner, announced the government will be "winding down" some of the steps it took to support the financial system. In addition, funding guarantees for banks are being ended or restricted to emergency cases. In the words of an unnamed treasury officer quoted in the *Financial Times*, the government wants to 'reduce our footprint in various areas of the markets' but does not intend to end support overnight.

Similar signals have been conveyed from Europe as well. In an article in the *Financial Times*, Jean-Claude Trichet, president of European Central Bank wrote: "We at the ECB designed the non-standard measures with our exit strategy in mind, and we are ready to implement this strategy when the appropriate time comes." Such plans are reassuring, and should help contain the paranoia about inflation. But as Mr Trichet wrote, "stressing the importance of the exit strategy should not be confused with the activation: it is premature to declare the financial crisis over. Today is not the time to exit." So governments should not be in a hurry about ending their stimulus programmes – not yet.

What will happen, if despite the knowledge that the world economy is not completely out of the recession, governments decide to rollback their liberal monetary and fiscal policies?

The chances are that what has so far looked like a **V**-shaped **recovery** may become a **W**-shaped **recession**. It would be a repeat of what happened when the world economy was emerging from the Great Depression. In the late 1930s, governments, including the government of the United States poorly managed its monetary and fiscal policies by executing contractionary policies too soon, leading to **double dip recession** in many countries. History, remember, has a bad habit of repeating itself.

Inflation at -1.53%, food remains hot

The annual rate of inflation for the **week ended August 8** came in at -1.53%. This measure had been -1.74% the week before, indicating that the pace of decline of wholesale prices has come down. The food prices continued to rise, because of the deficient monsoon, prompting economists to say that inflation is likely to move only up from now on. Fall in inflation has bottomed out and the upward spike in food prices and the base effect, which is beginning to wear off, will trigger an upward movement in inflation from here on. Annual inflation for food items is already into double digits at 10.52% for the week ended August 8, and is expected to move up further though Planning Commission deputy chairman Montek Singh Ahluwalia said the country had enough food stocks to counter inflationary pressures.

Inflation still in negative at -0.95%

The annual rate of inflation based on the wholesale price index remained below zero for the 11^{th} straight week but the prices of food articles continued to rise in the face of a severe drought in many parts of the country. Inflation stood at -0.95 for the **week ended August 15**, but this negative figure could end up closer to zero once the final numbers are announced. For instance, for the week ended June 20, inflation has been revised to -0.80% from -1.30%.

Inflation moves up to -0.21%

Annual inflation measured by wholesale price index (WPI), registered its lowest fall in the last three months, with inflationary pressures starting to build up in the economy. Inflation for the **week ended August 22** moved up to -0.21% from -0.95% recorded in the week before, data released by the commerce ministry. The Planning Commission had warned that the wholesale price inflation could overshoot the central bank's forecast of 5% by the end of the current fiscal year. The commission, however, said prices will remain in control as the country has adequate food stocks to tide over a drought situation. Inflation in food prices stood at a multi-year high of 15% for the week.

Inflation inches up to -0.12%

The wholesale price index (WPI) fell for the 13th successive weak through the drop was lower at 0.12% for the **week ended August 29**. However, going by the 0.46% point upward revision in the index for the week ended July 4, the annual rate of inflation is likely to already be moved into the positive zone. Driven by the higher food prices, the index for which is up over 12% in the current financial year, the inflation build up in the fiscal so far is already at 5.47%. Analysts believe rising inflationary pressure in Asia's third largest economy could force Reserve Bank of India raise interest rates.

Stability at risk

Cautioning the government that growing tension between fiscal and monetary policies can hit financial stability, the RBI said it cannot maintain price stability if the Centre continues to borrow large amounts from the market to fund its expenditure. Making a case for early return to the path of fiscal consolidation, RBI governor D Subbarao said, in India too we are confronting the dilemma of managing the tension between fiscal and monetary policies. Nothing that preserving and strengthening financial stability is a complex challenge, he said, we need to be vigilant about protecting our financial stability as developments anywhere in the world can affect us.

8.1 Miscellaneous Updates

Broker-builder nexus at work again

The broker-builder nexus that propelled property prices to unreasonable levels to beguile home buyers in the National Capital Region (NCR) during the realty boom of 2006 and 2007 seems to be back in action to stave off a fall in prices after a slew of launches.

Brokers are increasingly underwriting properties in new projects being launched by developers – blocking a large number of apartments during the so-called soft-launches, hoping to offload them at a premium to end-buyers after the formal launch.

This will help builders claim huge sales immediately and create an artificial scarcity in the market. But if brokers fail to offload the stock to end-users or long-term investors, property prices may take a beating and the nascent recovery in the residential market may be hit.

Indian economy, which expanded by a creditable 6.7% in the financial year ended March 2009 despite a global economic downturn, seems to be encouraging speculators in the property market. Asia's third largest economy is expected to grow at 6% despite deficient monsoon rains.

Property prices had fallen by around 25% in the last one year in Gurgaon, Noida and Faridabad. Some analysts had anticipated a further correction in prices this year with a large number of property firms announcing launches after a gap of almost two years. The combinations of builders and brokers have now managed to keep prices steady despite a huge increase in supply.

New properties in Gurgaon are offered at around Rs 3,600 per sq ft while in Noida and Faridabad; prices are hovering around Rs 2,923 and Rs 2,250 respectively. Brokers usually charge a commission from developers, generally 3-4% of the value of the property. But during the boom year, several brokers started underwriting properties slated for launch with the backing of a bunch of investors.

The problem started arising when the property market went into a deep downturn and these broker-underwriters were left with huge unsold stock. In most cases, brokers managed to dump the unsold stock back to developers, as they had paid hardly 5-10% of the total property value.

With property slump seemingly close to it end now, brokers have again become active and started underwriting projects. Several developers, including Unitech, Jaiprakash Associates, BPTP, Emaar-MGF AND The 3C Company claim that they have been able to sell thousands of apartments since April. It's impossible to verify these claims because these companies are either privately-held or don't give out quarterly balance-sheets. Also, since realty companies follow percentage of completion method (POCM) for accounting, the revenue from sale of new launches starts getting recognised only after a quarter or two. Under POCM, sales are recognised as per the pace of execution and are first shown in books only after 30% of the project is complete.

A combination of end-users, investors as well as broker-underwriters is driving the market at present. When market anticipate prices to go up, more investors and underwriters enter, which is what is happening now. That is also the reason why underwriting at present is limited to low-priced projects. Brokers are part of all property markets, but developers' dependence on brokers in the NCR seems to be much higher. Traditionally, brokers have played a very strong role in the NCR. Developers have been forced to deal with brokers in the NCR, as they would 'bad-mouth' the project, hampering the sales.

Rebuilding the city of dreams

Historically, Indian cities have had random, haphazard and incremental growth process rather than a deliberately planned one. Take for instance, the financial capital of the country, Mumbai with population of around 20 million and growing daily, infrastructure has always been a constraint. Lack of new land for development has led to a very dense and congested development.

Mr Mayank Gandhi, secretary, Remaking of Mumbai Federation (RoMF) said, that federation is working very closely with the Council of Tall Buildings and Urban Habitat (CTBUH), Chicago to revamp the inner city of Mumbai to save lives and make Mumbai a world-class city. We could take cue from globally successful models like that of Shanghai, Hong Kong and Singapore. He explained that the model on which this entire project would work would be to create a "City Planning and Management Company (CMPC)" in every major city. This company would have a corporate structure with equal representation from the government undertakings and stakeholder associations.

In order to instill confidence to the financer, the intention was to create an equity platform of millions of citizen stakeholders. The CPMC will enter into strategic alliance with leading corporates to take up various projects of urban renewal in inner city areas across the nation. It can have participation from financial institutions, fund managers and individual investors among others. To conclude, it's time to establish a sustainable development processes using green building, eco-friendly fuel, waste treatment, recycling materials and renewable energy with inclusive, win-win and self-financing solutions.

New gold trade centres

A tectonic shift in global gold market looks imminent, with the world's top two traditional centres of gold – Switzerland and Dubai – set to make way for the South East Asian hubs of Singapore and Bangkok.

The reason: the recent India Asean free trade agreement, which could make it cheaper for India to source gold from these two countries. India being the world's biggest gold consuming country in the world, any change in its sourcing pattern will easily change the market dynamics.

The pact signed by India with the 10-nation Asean trade bloc entails zero duty on most gold products to be imported from Asean nations from 2013 onwards. It's a concession India has not given to any other gold producing country as yet. According to data available from April 2008 to February 2009, India imported gold worth \$9.1 bn from Switzerland and \$2.9 bn from Dubai against a meagre \$30 mn from Singapore and Thailand combined. Indian imported \$ 2.1 bn worth of gold from South Africa during the period, making it the only other country which exports a sizeable amount of gold to India.

A commerce ministry official said it was logical that Singapore would emerge as a major gold market catering to the Indian market as it would enjoy zero duty on most gold, diamond and pearl items that it exports to India once the India-Asean pact is implemented. Among the Asean country, Singapore and Thailand, which already have an export base catering to Indian consumers, will benefit the most. According to India-Asean FTA, various forms of gold, including monetary gold, non-monetary powder of gold and non-monetary unwrought gold, all of which currently attract 10% duty, will have zero duty from 2013. World Gold Council's Indian subcontinent MD Ajay Mitra said that the withdrawal of 10% duty as a result of the India-Asean FTA would benefit consumers. After all, the variety on offer will widen and the retail trade margins will improve as the pricing mechanism is on MRP basis.

8.2 Insurance Sector

1. Financial disclosure by insurers

Insurance regulator IRDA will make it mandatory for all insurers to disclose their financial statements to the public even if they are not planning to get listed on stock exchanges.

J Hari Narayan, IRDA Chairman said, "We have sent a proposal to the government as we reckon that insurers should make public disclosures irrespective of whether or not they plan to launch initial public offerings. Disclosures will apply to both public and private insurers." The proposed move will bring in transparency and enable policy-holders gauge the financial strength of insurance firms. It will also help potential investors assess the strength of a company that plans to launch an initial public offering (IPO).

Currently, insurers furnish quarterly statements to IRDA, but this is not in public domain. Most life insurance companies are yet to start making profits – a fact that many policy holders may not be aware of in the absence of financial statements. Holding companies of insurance firms that are listed on the stock exchange, however, make certain disclosures on their subsidiaries based on the norms stipulated by the market regulator SEBI. If the government accepts the insurance regulator's proposal, the country's largest state-owned insurer Life Insurance Corporation and other private insurers will have to make public disclosures of their quarterly statements, among other things.

2. Commission disclosures

Insurance agents will have to disclose the commission they get from insurance companies for selling various policies. The move is expected to prevent broker from wooing clients away from customer-friendly products to those yielding higher commission. A panel is expected to analyse the insurance, retirement benefit and mutual funds sectors and suggest steps to bring transparency and reduce mis-selling in all sectors. The penal of financial regulators is chaired by PFDA chief D Swarup and comprises officials from RBI, Irda, Sebi, and finance ministry. It will submit its recommendations.

Officials of the penal said that mutual funds and the New Pension System suffer because distributors push insurance products some of which offer nearly 40% of the first year's premium as commission. The recent efforts of the government and the regulators to bring discipline to some segments of the financial markets have benefitted other segments having products with hefty commissions such as insurance products. Recently capital market regulator, Sebi replaced the commission that mutual fund brokers take from their client's investment with a fee to be collected from the customer. This investor friendly decision is feared to encourage intermediaries to push insurance products to customers approaching them. The ministry, however, believe that the merits of the mutual funds will attract customers. If mutual funds do well, there will be pressure on other segments of the market to reduce commission. A ministry official said, "It is difficult to remove commission on insurance product as it is provided in the insurance law itself".

3. Five year lock-in for Ulips

Insurance regulator set to raise the lock-in period of investments in Ulips to five years from the three years to promote long-term investment.

The regulator had proposed a cap on all charges last month to ensure higher returns for investors. But it has now accepted the insurance industry's demand to exclude mortality and morbidity charges from the overall ceiling. The change allows insurance companies to continue providing adequate protection to policy holders, which is the core objective of a life insurance policy.

Fight against hunger and extreme poverty

The G-8's $20-billion initiative on smallholder agriculture, launched at the group's recent summit in L'Aquila, Italy, is a potentially historic breakthrough in the fight against hunger and extreme poverty.

With serious management of the new funds, food production in Africa will soar. Indeed, the new initiative, combined with others in health, education and infrastructure, could be the greatest step so far towards achieving the Millennium Development Goals, the internationally agreed effort to reduce extreme poverty, disease and hunger by half by 2015.

The United Nations Millennium Project aimed to achieve the Millennium Development Goals. One cornerstone of the project was 'smallholder farmers,' meaning peasant farm families in Africa, Latin America, and Asia working farms of around one hectare (2.5 acre) or less.

These are some of the poorest households in the world, and, ironically, some of the hungriest as well, despite being food producers. They are hungry because they lack the ability to buy high-yield seeds, fertiliser, irrigation equipment and other tools needed to increase productivity. As a result, their output is meager and insufficient for their subsistence. Their poverty causes low farm productivity, and low farm productivity reinforces their poverty. It's a vicious circle, technically known as a poverty trap.

The UN Millennium Project's Hunger Task Force examined how to break this vicious circle. The Hunger Task Force determined that Africa could substantially increase its food production if help was given to smallholder farmers, in the form of agriculture inputs. The Millennium Project recommended a big increase in global funding for this purpose.

Drawing on that work and related scientific findings, the then UN Secretary General Koffi Annan launched a call in 2004 for an African Green Revolution, based on the expanded partnership between Africa and donor countries. The current UN Secretary General Ban Ki-moon has worked hard to make this possible, with Ban repeatedly emphasising the special emergency arising from the global food, financial and energy crisis of the past two years.

The G-8 announcement reflects these years of effort, and of course the boost from the leadership of US President Barack Obama, Spanish Prime Minister Jose Luis Zapatero, Australian Prime Minister Kevin Rudd, World Bank President Robert Zoellick, European Commissioner Louis Michel, European Parliamentarian Thijs Berman, and others.

Now the key is to make this effort work. The lessons of history are clear. Getting seed and fertiliser to smallholder farmers at highly subsidised prices (or even free in some cases) will make a lasting difference. Not only will food yields rise in the short term, but farm households will use their higher incomes and better health to accumulate all sorts of assets: cash balances, soil nutrients, farm animals, and their children's health and education. The boost in assets will, in turn, enable local credit markets, such as micro-finance, to begin operating. Farmers will be able to buy inputs, either out of their own cash, ort by borrowing against their improved creditworthiness.

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