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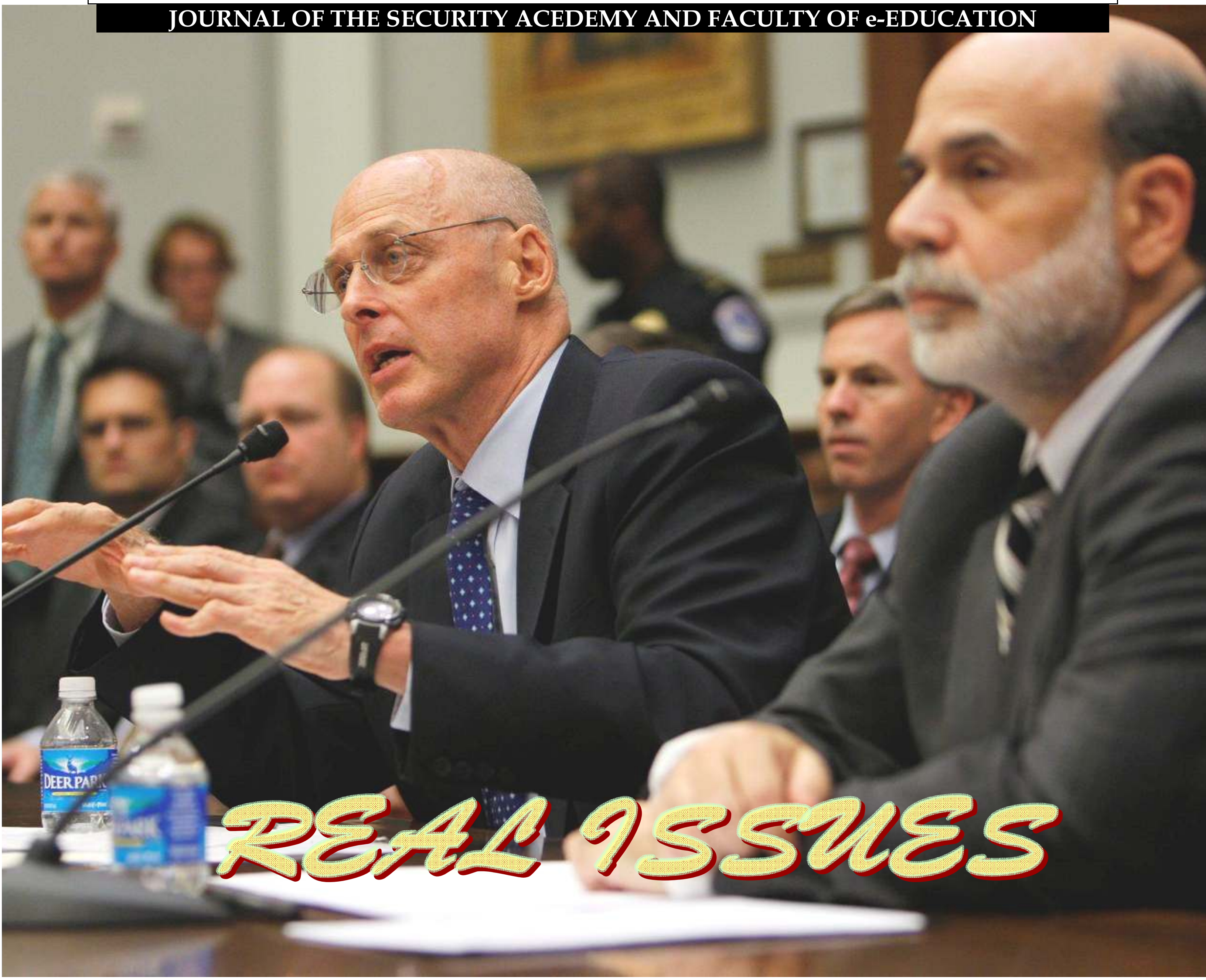

SAFE UPDATES – KEEP INFORMED

The Securities Academy and Faculty of e-Education

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Editorial preamble:

1.1 REAL ISSUES

Why are good policies bad politics?

From the day after the collapse of Lehman Brothers last year, the policies followed by the US Treasury, the US Federal Reserve and the administrations of President George W Bush and Barack Obama have been sound and helpful. Credit easing and support of the banking system helped significantly by preventing much worse.

The alternative – standing back and letting the markets handle things – would have brought the US and the world higher unemployment than now exists.

The fact that investment bankers did not go bankrupt in December 2008 and are profiteering immensely in 2009 is a side issue. Every extra percentage point of unemployment lasting for two years costs $ 400 billion; A recession twice as deep as the one we have had would have cost the US roughly $ 2 trillion – and cost the world as a whole four times as much.

In comparison, the bonuses at Goldman Sachs are a rounding error. And any attempt to make investment bankers suffer more last fall and winter wound have put the entire support operation at risk.

As Fed vice-chairman Don Kohn said, ensuring that a few thousand investment bankers receive their just financial punishment is a non-starter when attempts to do so put the jobs of millions of Americans – and tens of millions outside the US – at risk.

The Obama administration's fiscal stimulus has significantly helped the economy.

And the cost of carrying the extra debt incurred is extraordinary low: $12 billion a year of extra taxes would be enough to finance the fiscal stimulus at current interest rates. For that price, US taxpayers will get an extra $1 trillion of goods and services, and employment will be higher by 10 million job-years.

The valid complaints about fiscal policy over the past 14 months are not that it has run up the national debt and rewarded the princes of Wall Street, but rather it has been too limited.

Yet, these policies are political losers now: nobody is proposing more stimulus.

This is strange, because usually, when something works, the natural impulse is to do it again.

Good policies that are boosting production and employment without causing inflation ought to be politically popular, right?

With respect to Obama's stimulus package, it seems to us that there has been extraordinary intellectual and political dishonesty on the US Right, which the press refuses to see.

For two-and-a-half centuries, economists have believed that the flow of spending in an economy goes up whenever groups of people decide to spend more.

Sometimes, spending rises because there is more disposable cash in the economy, and sometimes because changes in opportunity costs – the cost of forgoing some other action, such as saving – make people want to spend the cash they have more rapidly.

Sometimes, and to some degree, these increases show up as increases in prices, and sometimes and to some degree as increases in production and employment.

But whatever the cause or effect, spending always goes up whenever groups decide to spend more – and government decisions to spend more are as good as anybody else's.

They are as good as the decision of mortgage firms and new home buyers to spend more on new houses during the housing bubble of the mid-2000s, or the princes of Silicon Valley to spend more building new companies during the dotcom bubble pf late 1990s.

Obama's Republican opponents, who claim that fiscal stimulus cannot work, rely on arguments that are incoherent at best, and usually simply wrong, if not mendacious.

Remember that back in 1933, when the Clinton administration's analyses led to seek to spend less and reduce the deficit, the Republicans said that that would destroy the economy too.

Such claims were as wrong then as they are now.

But how many media reports make even a cursory effort to evaluate them?

An argument, though not by much, is that the fiscal stimulus is boosting employment and production, but at too great a long-run cost because it has produced too large a boost in America's national debt.

We would agree with this argument, if interest rates on US Treasury securities were high and rising rapidly as the debt grew.

But interest rates on US Treasury securities are very low and are not rising.

Every single Treasury auction, at which the market gobbles up huge new tranches of US Treasury debt at high prices, belies the argument that the economy has too much debt.

Those who claim that the US has a debt problem and that it cannot be cured with more debt, ignore (something deliberately) that private debt and US Treasury debt have been very different animals – moving in different directions and behaving in different ways – since the start of the financial crisis.

What the market is saying is not that the economy has too much debt, but that it has too much private debt, which is why prices of corporate bonds are low and firms find financing expensive.

The market is also saying – clearly and repeatedly – that the economy has too little public US government debt, which is why everyone wants to hold it.

1.2 STOCK MARKETS

The rules of the game might have changed somewhat

There are two types of investors. There are investors, who read that markets were incredibly oversold at the end of 2008 and early 2009. Given the oversold nature of the markets, they invested in equities, commodities and went short on the dollar. These are the people who made a lot of money in 2009 and this category is concerned that the markets have overshot. So some of them have taken profits and some of them are inclined to do so. Some people, who got it right in 2009, will now reduce their positions in emerging markets and go long on the S&P because, in theory, it is possible that there is a dollar rally and an outperformance in the S&P vis-à-vis emerging markets.

The other type of investors got in totally wrong. They bought US government bonds at the end of 2008 and early 2009; they were in dollars and they could not get into equities at the right time because they thought it was a bear market rally. So, we still have a lot of cash on the sidelines. Now, I think these people will be forced to buy equities, especially that cash at zero interest rate and government bonds are not attractive investment options because if the economy recovers there could be pressure on interest rates sooner or later and inflation expectations will go up, government bonds will go down.

Marc Faber, publisher of the Gloom, Boom & Doom report, says, in the long run, the dollar has to be weakened. I started to talk about the equation of weak dollar-strong asset markets and vice-versa several years ago. The rules of the game might have changed somewhat and what you could get is six months of a strong dollar and strong US stock markets, relatively speaking. I don't think the S&P or any market will go up significantly after rising 50-100% in the past eight months. I don't see the markets rising the same way over the next eight months. The risk-reward is not as favourable as it was in March 2009.

Besides, the geopolitical situation around has deteriorated very badly. When you think of it, nobody is interested in solving the problems, but a lot of money is being channelled into these issues. These issues may not have an immediate impact on equities, but if the situation escalates, it can have a serious impact. Secondly, without the intervention of the Fed, US mortgage rates will be much higher and also the interest rates on treasury bonds. So, we will have to see how far the quantitative easing will proceed to support the market. If it stops, the bond market will seem quite vulnerable. So, if the 10-year treasury goes above 5.0-5.5% and the BBB, say 7%, then it will be quite a competition to equities.

So, in 2010, I would be just happy to preserve what I have made in 2009. You can make money here and there, but risks have increased and valuations are not as compelling as they were a year ago.

1st week of December 2009 – Sensex back to 17K on strong GDP growth

Daily review	30/11/09	01/12/09	02/12/09	03/12/09	04/12/09
Sensex	16,926.22	272.05	(28.36)	15.77	(84.14)
Nifty	5,032.70	89.30	1.25	8.45	(22.80)

Weekly review	30/11/09	04/12/09	Points	%
Sensex	16,926.22	17,101.54	175.32	1.04%
Nifty	5,032.70	5,108.90	76.10	1.51%

Indian share market closed marginally higher in the week to December 5 on the back of a strong 7.9% growth in GDP in the second quarter of this fiscal. The market has been witnessing a sea of global liquidity amid weakening dollar which resulted into a rush of capital inflows into Indian equity.

The rupee appreciated by a whopping 11% against dollar, from the record low of 51.97 in March this year. FIIs bought shares worth USD 1,183 million in November taking the total inflow this calendar year to more than USD 15 billion in Indian equity. The market, however, seem concerned about rising food price inflation which may force the central bank to initiate some monetary measures.

2nd week of December 2009 – Market set to consolidate above 17K

Daily review	04/12/09	07/12/09	08/12/09	09/12/09	10/12/09	11/12/09
Sensex	17,101.54	(118.40)	244.54	(102.46)	64.09	(70.28)
Nifty	5,108.90	(42.20)	81.25	(33.95)	22.65	(17.35)

Weekly review	04/12/09	11/12/09	Points	%
Sensex	17,101.54	17,119.03	17.49	0.10%
Nifty	5,108.90	5,117.30	8.40	0.16%

The Market is set to consolidate above the 17,000 psychological-level in stock-specific trade in the next few days as the Sensex and Nifty ended flat after hitting 8-week intra-day high in the week under review. Generally, investors were in no mood to extend their commitment at the current levels and booked profits at the intra-day higher levels despite sustained capital inflows into equity in the current calendar year.

Reserve Bank of India Governor D Subbarao reportedly clarified that the central bank has no plans to curb foreign fund inflows at the moment. However, a lower-than-expected industrial output and concerns about rising inflation made investors cautious ahead of the third instalment of advance tax paid by corporates. India's industrial production spurted by 10.3% in October, but failed to enthuse investors as the GDP numbers did a week ago. The market is likely to consolidate in the coming days as the current trend in industrial output may continue in the next few months. The government reportedly has viewed the same trend for the remaining months of this fiscal.

3rd week of December 2009 – Market corrects after two weeks of gains

Daily review	11/12/09	14/12/09	15/12/09	16/12/09	17/12/09	18/12/09
Sensex	17,119.03	(21.48)	(220.39)	35.61	(18.52)	(174.42)
Nifty	5,117.30	(11.60)	(72.65)	9.00	(0.30)	(54.05)

Weekly review	11/12/09	18/12/09	Points	%
Sensex	17,119.03	16,719.83	(399.20)	(2.33%)
Nifty	5,117.30	4,987.70	(129.60)	(2.53%)

The Market corrected after two-weeks of gains as the benchmark Sensex tumbled by nearly 400 points during the week. Marketmen said profit-booking emerged after inflation trebled to 4.78% in November. World stocks also displayed a feeble trend after US Federal Reserve at the end of two-day policy meeting on Wednesday detailed its plans to remove excess liquidity. The market was worried that the RBI might hike rates even before the January policy meet as food inflation touched 19.95% as of December 5, has become a hot political issue which even stalled Parliament proceedings earlier this week.

However, majority of Marketmen are not much worried as they attribute the fall to year-end selling by FIIs ahead of Christmas and new year season.

4th week of December 2009 – Sensex at 19-month high on short covering

Daily review	18/12/09	21/12/09	22/12/09	23/12/09	24/12/09	25/12/09
Sensex	16,719.83	(118.63)	90.80	539.11	129.50	Holiday
Nifty	4,987.70	(35.10)	33.25	158.75	33.80	

Weekly review	18/12/09	24/12/09	Points	%
Sensex	16,719.83	17,360.61	640.78	3.83%
Nifty	4,987.70	5,178.40	190.70	3.82%

The market bounced back with a vengeance, due to hectic short-covering amid positive development. The week began on a sluggish note with the Sensex logging its six-week low, but later it rebounded sharply on the news of rise in advance tax payments by India Inc and the Finance Minister's statement that the stimulus would continue till the next fiscal and the economy would grow around 8% this financial year.

The bourses were closed on December 25 for Christmas, will remain shut on December 28 for Moharram and again on January 1 for the New Year holiday. Frenzied short-covering ahead of holidays and last day of derivatives contract on December 31 mainly supported the market.

Year end calendar 2009 – Sensex

Daily review	24/12/09	28/12/09	29/12/09	30/12/09	31/12/09	01/01/10
Sensex	17,360.61	Holiday	40.95	(57.74)	120.99	Holiday
Nifty	5,178.40		9.55	(18.50)	31.60	

Weekly review	24/12/09	31/12/09	Points	%
Sensex	17,360.61	17,464.81	104.20	0.60%
Nifty	5,178.40	5,201.05	22.65	0.44%

The Bombay Stock Exchange benchmark index Sensex closed on a promising note on the last trading session of the year and closed the day with the biggest annual gains in 18 years. The sensex witnessed a historic 81% rally this year, boosting by the UPA victory in May on expectations that new government would introduce measures to boost economic growth. Another reason for the rally was the sooner-than-expected economic recovery of the country.

Yearly Review

Month	December 2007	December 2008	**December 2009**
Date	28/12/07	31/12/08	**31/12/2009**
Sensex	20,206.95	9,647.31	**17,464.81**
Points	Base	(10,559.64)	**7,817.50**
%	Base	(52.26%)	**81.03%**

Seeking Laggard Stocks

Signs this year's EM equity bull-run may extend into 2010 are prompting investors who missed the rally to seek out so-called laggard trades – stocks that are still relatively cheap but may outperform in future.

EM equities rebounded after hefty falls fuelled by fears a debt crisis in Dubai would paralyse the word financial system again. Many investors see the weakness as a chance to buy into the resurgent sector.

Emerging markets are up 75% in 2009, having pulled in over $50 billion this year. That makes valuations seem just earlier this year a distant memory.

But to those who want to share in the EM story but balk at current elevated valuations, central European as well as Western firms with exposure to developing nations, are recommended as laggards.

Robert Ruttman, emerging equities strategist at Credit Suisse said, "People are looking for catch-up trades. For people who missed the first entry points, the question is: where are we going to see further upside? Laggards countries like South Africa, Czech Republic and Hungary have underperformed and will probably outperform in the coming years." He says one way to play emerging markets growth story now is via firms based and listed in developed markets but with large exposure to developing nations. These firms are expected to benefit from urbanisation in the developing world. Given better earnings growth for 2010, the valuation might become even more attractive for indirect EM plays going into 2010.

The past months' rally has pushed Latin American stocks to 13.6 times one-year forward earnings versus a five-year average of 10, while non-Japan Asia trades 14.7 times 2010 earnings.

Emerging Europe, seen so far as the most vulnerable of the emerging regions, has seen stocks rise 60% in 2009 compared with 105% in Latin America. And most of these gains were in Russia which in recent months has drawn investors betting on higher oil demand. Czech and Polish stocks are up 30% in 2009 and in dollar terms they lag further. Many hope these markets will gain from recovery in Western Europe, especially Germany. Czech stocks, for instance, trade at under 11 times forward earnings compared with their five-year average over 13 and analysts expect a re-rating if there is a recovery in the euro zone, the destination of 85% of its exports.

Oliver Bell, senior investment officer at Pictet has gone overweight central Europe, including Hungary and Czech, for the first time in years, having trimmed back Asia and Latin America. Bell said, "Central Europe looked close to disaster a year ago, but now valuations have become much more interesting and there is more confidence that if the world economy recovers these countries will be okay."

Daniel Tubbs, fund manager at Blackrock agrees. "In (Poland, Hungary and Czech Republic) where we had zero exposure until recently, we now have substantial exposure. Those are few of the countries which offer considerable upside from here. They are laggards compared with others." His top pick is Russia where shares, despite a 120% rally, remain half as cheap as Asia. Other laggards may be found in the Gulf despite the debt crisis embroiling the United Arab Emirates. Tubbs highlights energy-rich Qatar, trading at 9.5 times 2010 earnings but with high oil and gas prices offering potential for gains next year.

Besides, many deny emerging stocks are overvalued, arguing better earnings prospects in the developing world make a case for even higher prices. And bargains may be found in unexpected places. Julian Mayo, fund manager at Charlemagne Capital said, "There are opportunities within EM, for instance, the biggest laggard market in the recent months was China".

2.1 INDIAN ECONOMY

GDP Cheers

The Indian economy grew at 7.9% in the July-September period, its fastest pace in the last six quarters. The growth figure surpassed individual projections of more than 25 economists surveyed by various agencies and is second only to that of China's among major economies. Chinese economy grew 8.9% in September quarter. The strong is driven largely by a pickup in manufacturing, increased government expenditure, surprising decent investments and positive growth in farm sector output despite the drought.

C Rangarajan, chairman of the PMEAC said, "This (7.9% growth) has turned to much more positive than one has expected. Overall growth of 6.5% may have to be revised upward.

The government, however, did not see any immediate need to raise interest rates. Montek Singh Ahluwalia, deputy chairman of the Planning Commission said, "I don't believe there are serious worries on inflation except food items. Food prices are a matter of concern, but I don't think conventional monetary policy will take care of that problem.

The central bank too, was guarded in its response. RBI deputy governor Subir Gokarn said that he would not be surprised if growth slowed in the December quarter. "While it is a recovery and it seems to be gaining strength, we should not ignore the fact that it is still being driven substantially by public spending." The RBI has already began its exit from its loose monetary policy by removing certain liquidity support measures like lower statutory liquidity ratio in early part of October 2009.

But Growth Still Needs Boosters: Doubting Thomases on India's growth rate are all now revising the current fiscal year's growth rate sharply upwards, with the Central Statistical Organisation estimating growth in the first half (April-September) at 7.8%, pulled up by the 7.9% growth in the second quarter (July-September). Does this mean that the slowdown is now history that the government and the central bank can now afford to take their foot off the accelerator, leaving the economy to cruise along on its own?

While we are optimistic in India's growth all through these troubled times, we would still urge caution in writing off growth hurdles. Growth could slow down substantially in the next two quarters. The effect of a poor monsoon (June-September) does not show up on the field or in GDP numbers in the first half, but will, with a vengeance, in the second. So, the marginally positive growth in farm output in Q2 will turn negative in the coming quarters. The Sixth Pay Commission largesse for civil servants kicked in from Q3 of the last fiscal year, which means that Q2 of this fiscal year is the last period for which exceptionally high growth will be recorded for community and social services, whose value is estimated as the government's salary bill. From Q3 this fiscal onwards, like government wage bill will be compared with like government wage bill, whereas for Q2, Pay Commission-boosted salary bill has been compared against unlike salary bill, to yield a high growth rate.

Another similar source of growth arising from inter-year asymmetry is mining: the Krishna-Godavari basin gas started flowing in Q4 of 2008-09, so for the first three quarters of 2009-10, the value added in mining would be high because a higher level of aggregate mining output is being compared against mining output that did not include KG basin gas. This growth booster will disappear in Q4 this fiscal. That only pre-existing redeeming feature of H2 growth this fiscal would be the stunted H2 growth of last fiscal, post-Lehman. Growth in fixed capital formation, at 7.3%, shows a pick-up. Fiscal and monetary policy should stay focused on keeping that trend going.

2.2 INDIA

INCHing ahead: India, China are emerging financial giants

India, China are emerging financial giants: IIFL published the first INCH – stands for INdia and CHina – research report in February 2009. At that time, we had observed that India and China accounted for 40% of the world's population, 9% in the world GDP, 16% of world's GDP in PPP terms and yet only 2.6% of the S&P Global Equity Index. Over the past 9-months, India and China weightage in global equity index has already moved to 3.3%, which is a significant shift over a relatively short period of time and a trend that is likely to continue for a long time.

As per the current IMF forecasts for global economic growth, INCH would account for 14.5% of the world's GDP by 2014 at market exchange rates and 21% in PPP terms. As such, it's quite rational to expect that INCH's weightage in global equity benchmarks would double from current levels over the next 3-5 years and double again over the following five years. This would induce substantial fund flows into these markets.

The INCH economies were stress-tested in 2009. Not only have the two economies been resilient, but have continued to grow at significantly higher rate. We sense a real desire among global funds for increased assets allocation towards emerging markets. While growth in emerging market economies has been far outstripping growth in developed markets for quite some time, global funds now seem acutely aware that the US and Europe will not provide the kind of returns witnessed in the years preceding the recent financial crisis. Structural concern on the US dollar further tilts the balance in favour of emerging markets like India and China.

Banking systems in India and China have emerged almost unscathed from the recent crisis, which is a reflection of their largely domestic focus as also prudent and proactive regulators in both these countries. While we believe that China will continue its strong growth before the pace moderates, the opportunity in India seems to be underexploited at this stage. Financial services' penetration remains very low in India and China, with even basic savings and loan products inaccessible to a vast section of the population, assuring several years of strong growth ahead. Proliferation of non-banking products such as insurance, mutual funds and broking provide additional growth avenues for financial services companies. For instance, credit card outstanding as percentage of GDP is 0.5% in India and 3.3% in China compared to international benchmark of 5-40%. Life and non-life insurance sectors in India and China are in early stages of growth, as reflected in the low penetration and density levels.

Indian banks have delivered consistent profit growth and RoE over the past several years, have had no asset quality issues, and have been well-capitalised all along. The Reserve Bank of India has proved to be an excellent regulator, with its proactive risk-weightage, NPL provisioning and exposure norms that have averted many a possible mishap.

Asset quality, capitalisation level, profitability and growth prospects are similar for INCH banks. However, Indian public sector banks trade at steep discounts to their Chinese counterparts. We attribute this valuation gap largely to technical factors like size of free-float, average trading volume and weightages in benchmark indices, on which parameters Chinese banks clearly have an advantage.

The combined AuM of the Chinese mutual fund industry reached $337 billion in June 2009, 2.8 times of India's $122 billion. Only 10-12% of the household financial savings in India were invested in equities and debentures in bull market year of FY07 and FY08, with much of the rest going into bank deposits and insurance products.

The strong revival in primary markets in both India and China has resumed fund flows into the corporate sector, but has caused concerns on its possible adverse impact on the secondary market. We believe that the primary markets are still a relatively low level compared with the last bull market in 2006-07, measured by funds raised as percentage of trading turnover or as percentage of market cap. This may indicate that the primary markets can go further, without seriously hurting secondary markets.

Sharp deterioration in government finances is perhaps the most potent medium-term risk for the Indian market. While we can take some solace from the fact that government finances seem to be in a mess everywhere, but inflation could become a major headache for India earlier than it becomes one for the developed markets. High inflation is politically unpalatable and may put the regulators in a tricky situation of implementing an adequate level of liquidity tightening, while weighing economic growth conditions. The resultant situation may require a strong policy response from the authorities with a view to making India an even more attractive investment destination.

India may be shining
But Bharat is definitely rising: Study

Urban consumers may be back in the market, but the real action will continue to happen in the countryside where the market grew three times faster than the urban areas last year with the likes of Maruti Suzuki, Hero Honda and Bharti Airtel having a harvest feast.

A white paper prepared by CII-Technopak says, "The rural consumer market, which grew 25% in 2008 when demand in urban areas slowed due to global recession, is expected to reach $425 billion in 2010-11 with 720-790 million customers".

That will be double the 2004-05 market size of $220 billion. The study attributed last year's performance largely to a number of government initiatives including agriculture loan waiver, the rural job guarantee scheme and higher minimum support prices for crops.

Expert say the boom in rural demand will continue as the impact of poor monsoon rains this year will be minimal. Rural incomes may be down by only about 2% this year due to the less than normal rains. Only rice-crop in parts of north and west India was affected. And any deficiency in rice production will be compensated by a comfortable rabi-harvest in wheat. Also, about 50% of rural incomes are from non-farm sources like carpet weaving, handicrafts, handloom, leathercraft, gems & jewellery and agarbattis.

According to the study, rural demand for FMCG, pharma, auto and consumer durable industries is estimated to match sales generated in urban areas soon. While durables market shrunk in urban India, rural market is seeing a 15% growth rate, FMCG sales up 23% and telecom is growing at 13%. The rural consumer is upgrading to branded products thanks to extensive media penetration in village. Tweaking the marketing mix in price conscious rural markets led to improved sales for companies like Adidas and Reebok, which saw sales go up 50% by reducing prices in rural areas. Philips launched a low-cost stove in rural markets and LG's customised TV (to pick up low density signals) sold one lakh models in the first year. Experts say the increase in mobile penetration in villages has driven up aspiration levels.

And Wipro's soap brand Santoor's success in 45 gm packs at Rs 6 also demonstrated the importance of low-priced units in breaking into villages that house 75% of the country's population. Education is another important factor as there are more graduates in rural areas than in urban centres. For marketers, a key target segment is the rural youth who has migrated to the nearest town. For him, brands are aspirational and he brings the experience back with him to his native village.

2.3 INDIA INC

Satyam No Wake-Up Call: Governance Given Go-By

It's ironic that it was only at the fag end of two days of soul-searching discussions on corporate governance that the ghost of Satyam scam came back to haunt the audience at the historic Hall of India and Pakistan at the Royal Overseas Lodge, London, on a cold rainy October afternoon.

It was during the concluding address at the 10th International Conference on Corporate Governance that Madhav Mehra, president, World Council for Corporate Governance got around to explaining how Satyam ended up winning the UK based institute's prestigious Golden Peacock Award for Excellence in Corporate Governance.

Because the 60-page Satyam document on corporate governance was simply the best. On paper the Satyam board was truly top-notch with luminaries like Harvard management maven G Krishna Palepu, Silicon Valley superstar Vinod K Dham, ISB's Dean Mendu Rammohan Rao, among others. And that eminent board coupled with creative accounting, snazzy documentation, and an elaborate cover-up strategy that included even paying taxes on non-existent revenues managed to dupe the council into believing that the charlatan was a knight in shining armour.

Bathos apart, Satyam was symptomatic of much of what is wrong with corporate governance practices amongst many Indian businesses: a tick-box approach that just about meets legal requirements, passive yes men for independent directors, eager-to-please accountants, and a cosy board culture that just failed to look beyond profits. The journey that Indian businesses started towards raising the level of corporate governance, after the Birla Committee recommendations were incorporated in Clause 49 of Listing Agreement, has actually been rather slow.

It's sorry state of affairs; India Inc's report-card on corporate governance is rather dismal. A research of major Indian companies undertaken by search firm Spencer Stuart for its first India Board Index reveals that Indian businesses are nowhere closer to global corporate governance standards.

In fiscal 2008-09, 54% of surveyed companies had a non-executive chairman while the figure was a much lower 39% in US.

The number of companies with at least one foreign non-executive director was just 29.7% while the corresponding number in the US was 74% and 47% in the UK.

Women directors represented 3.9% of total number of directors in 2008; the number is 10.7% in the UK and 29.7% in the US.

The sitting fee for non-executive directors varied widely from Rs 2,500 to Rs 20,000 per meeting, with an average fee (exclusive of commission) of Rs 13,000 while in the UK, the average fee was euro 50,500 per annum and average for non executive compensation was close to $ 218,000 in the US.

In India, 62% of audit committees comprise only of independent directors while in the US and the UK 100% of audit committees are independent members.

And these are just some metrics on which corporate governance standards can be judged. That's one part of the entire picture though; the real devil lies in board malpractices that are often shrouded in secrecy under the convenient excuse of 'board confidentiality'.

The biggest stumbling block for the adoption of the true spirit of corporate governance is the independent directors, the so called guardian angels of minority shareholders.

Besides, many Indian promoters think a controlling stake makes the public company their family estate and fill the boards with pliable independent directors; eminent people who fulfil the criteria of "independent directors" but are not directors of an independent mind.

And nothing much has changed in the last 12 months on that front; a study by Prime Database says that more than 7 of 10 independent directors sitting on the boards of listed companies to improve corporate governance are "home" members – relatives, friends, neighbours etc.

Analjit Singh, chairman, Max India, who sits on the boards of six leading companies including Hero Honda and Tata Tea says, "Some CEOs have caught on to the corporate governance bandwagon and that's all. It's not about ticking the box, that's not the spirit and advantage of corporate governance. It shouldn't be about reaction to an event. It's a much larger question of how you run your company."

N Vaghul, ex-chairman, ICICI who sits on boards of six leading companies like Wipro and M&M says, "All isn't lost, however: the Satyam episode did manage to shake things up. I think Satyam was a watermark in terms of corporate governance in India. There has been a shift in the attitude of promoters. Corporate governance is moving to meaty issue from being ritualistic. It's not a complete shift but a journey that has started. But the shift is noticeable predominantly in the leading companies."

According to Sandeep Parekh, a former executive director of Sebi, the entire episode highlights the role of independent directors. To me it is clear that they shut their eyes and got away.

To be fair to independent directors there is no provision in the law which makes it mandatory for managements to ensure that full facts are placed before them. Decisions are based often on the information provided by the management.

Union corporate affairs Salman Khurshid said that Systemic changes and reforms in the regulatory arena here have often been carried out after scams. Sebi itself was formed after 1991-92 securities scam, perpetrated by the Big Bull Harshad Mehta. This time around the regulators never got around to making any sweeping changes except for ordering a peer review of the accounting statements of all Nifty and Sensex companies besides imposing rules for periodic and event-based disclosures on shares.

The ministry of corporate affairs, which functions like a quasi regulator despite being an arm of the government, will seek to address some of the issues which arose after Satyam through some of the provisions being built into the Companies Bill.

The lessons for the government are to make the managements as well as the board of directors of firms more accountable and empowering shareholders. However, legislative action will to an extent plug some of the shortcomings. But that cannot in any way ensure integrity and character.

C Achutan – who presided over the Securities Appellate Tribunal or SAT says that there is no prescription for the disease citing how even after the Sarbanes Oxley Act was formulated in the US, corporate crimes have not been eliminated to a large extent.

2.4 INTERNATIONAL

After Economic Storm, Asia Faces Political Risks In 2010

Investors who kept faith in Asia as the world teetered on the brink of financial meltdown a year ago have been richly rewarded – the region's markets rode out the storm in speculative style and posted stunning gains. But, the economic outlook for 2010 appears far sunnier. With frothy markets betting on a smooth return to business as usual, the danger of a sudden correction hangs over Asia, unless the region can steel its way past some treacherous political risks.

The two most important issues for the world economy in the coming year are political – the pivotal relationship between the United States and China and the timing and co-ordination of exit strategies from the stimulus measures that kept disaster at bay. Investors in Asia also need to be wary of political shocks that could suddenly overturn the region's risk profile.

Upheaval in North Korea, where there are persistent doubts about the health of leader Kim Jong-il and where the economy is going from bad to worse, could cause profound regional instability. And the risk of a confrontation between nuclear-armed India and Pakistan, perhaps sparked by another militant atrocity in India, is ticking upwards again.

Michael Denison, research director at London-based Control Risks consultancy said, "A multitude of political, security and operational risks converge in Asia. The causes of the global recession are now well understood. The contours of the recovery, by contrast, are far from clear."

Relationship Problems: The United States and China are already by far the two most important countries in terms of political clout. And in 2010 China is set to overtake Japan as the second-largest economy.

The "G2" relationship is key to shaping our destiny not just in the coming year or coming decade, but through the 21st century.

Like most relationship, it is not easy. Pressure on China to allow the yuan to appreciate will become ever intense in 2010 as economic storm clouds evaporate, and one-year non-deliverable forwards suggest modest gains by the currency by the end of 2010.

But Beijing will not want to jeopardise economic growth by letting the currency rise too quickly, and does not appreciate being told what to do by Washington or anyone else. In the United States, meanwhile, yuan weakness is regarded as a protectionist policy that threatens the US recovery.

Into this volatile mix add the ever-present threat of import restrictions, like the US imposition of tariffs on Chinese tyres in September, sparking a lit-for-tat trade war. Plus the danger that Beijing's backing of regimes that Washington finds unpalatable, from Pyongyang to Yangon to Tehran and Khartoum, explodes into a political confrontation.

Most analysts say Washington and Beijing are painfully aware of the risks and would step back from the brink before any dispute threatened the global economy. But the two countries have yet to find a way to communicate comfortably as partners. The risk of a misunderstanding or sudden chill in relations is real.

The second key political risk for Asia – and indeed the world – is dealing with the hangover from the stimulus measures that helped keep the global economy afloat over the past two years.

If governments withdraw the stimulus too soon, they jeopardise growth. But keep policy too loose for too long and they risk not just inflation but also catastrophic asset price bubbles. Given China's importance to the global recovery, signs of property and equity bubbles there are a particular concern.

Another risk for investors is if countries trying to prevent bubbles and curb inflows of "hot money" tighten capital controls. Analysts say this could be a key issue for India and Indonesia in 2010. Disagreements could also erupt within countries, between governments focused on safeguarding growth and central banks fearful of inflation and bubbles. That could lead to bad decisions, and make policy hard to forecast. Policy friction is already an issue in Japan. India and South Korea could be next.

Known Unknown: As in any year, the best-laid plans in 2010 could be derailed by unexpected shocks. We have no idea about some of the lightning bolts that will hit Asia in 2010 – the surprises that author and fund manager Nassim Nicholas Taleb calls "black swans" and former US defence secretary Donald Rumsfeld called "unknown unknowns".

But there are plenty of known unknowns to worry about. Mass social unrest due to economic hardship was the dog that failed to bark in 2009. That could change in 2010.

"A structural rise in unemployment will represent a key macro, political and security risk in 2010, even in states like China where growth has remained relatively solid," said Michael Denison research director at London-based Control Risks consultancy.

The decisive victory of the Congress party in India's 2009 elections was another good-news for markets that could be threatened if militants based in Pakistan provoke a confrontation again. Investors are already rattled that reforms in India are going slower than expected. The last thing they want is war risk.

Ian Bremmer, president of the US-based Eurasia Group political risk consultancy said, "Another major attack would all but force India's government to take a much more hostile approach to Pakistan…allowing Pakistan's military leadership to set aside attacks on local militants and turn their attention to an enemy they feel less reluctant to antagonise."

And finally, two key Asian heads of state are ailing, with the question of who and what will come after them far from settled. Thailand's 82-year-old King Bhumibol Adulyadej has been in hospital since September, another complication in the long-running political crisis that has riven the country.

Many analysts expect instability to get even worse after his reign ends – giving Thai markets another rough ride. But most say there is little risk of contagion in another markets. By contrast, when North Korean leader Kim Jong-il dies, the tremors will be felt in South Korea, Japan and beyond.

Many analysts say Kim's death would herald the collapse of the regime in Pyongyang, leading possibly to prolonged civil war in North Korea, aggressive moves against the South, or the sudden reunification of the Korean peninsula. In all of these cases, the likely market reaction would be the same – panic.

2.5 WARNING SIGNALS

Sun sets on Dubai World

Dubai World's mission statement says: True to our claim, the sun never sets on Dubai World. Our investment portfolio extends across 100 different cities in the World. We have spread across a wide spectrum of strategic industries and sectors ranging from ports management, property development, hospitality and tourism, free zone operations, private equity investment, retail to sectors as diverse as aviation, commodities exchange and financial services.

Dubai had borrowed heavily to build up a non-oil economy based on property, trade and tourism, building up a stock of debt estimated at $80 billion, comfortably in excess of national income. Experts say that the sheer size and exuberance of its property boom was always unsustainable. Dubai doubled in size and its house prices almost quadrupled during 2002-07. Property prices have halved since then.

Investors fear that a debt standstill by Dubai World, the city kingdom's largest state-owned conglomerate, is a prelude to a forced restructuring of its estimated $80 billion liabilities. The Dubai five-year credit default swap is being quoted as high as 500-550 basis points, higher than even Iceland where the possibility of a sovereign default has been high for quite some time. It costs about $500,000 a year to insure $10 million of Dubai's debt against $360,000 on November 24.

Dubai's huge infrastructure projects and palm-shaped tourist resorts were long ago revealed to have been a boom-time rush built, literally, on foundations of sand. Like Florida, Dubai became a resort centre to which people from Europe and Asia began to go for holiday, and to buy beachside apartments. Florida, however, has one advantage over Dubai. The financial support of the US government is not in question.

Dubai World's debt not guaranteed by government

Dubai's government said it hasn't guaranteed the debt of Dubai World and that creditors must help it restructure. The Company received financing based on its project schedule, not a government guarantee. Lenders should bear part of responsibility. Philipp Lotter, vice-president of Moody's Investor Service in Dubai said, "The times of implicit support are clearly over. In the past entities such as Dubai World certainly represented themselves as quasi-government entities, whereas there was no legal obligation on behalf of the government to support.

In the prospectus for its first Islamic bond sale in October, the government said, "Certain strategic government-related entities of the emirate have significant borrowings which are not direct obligations of the government of Dubai. If any of these entities are unable to fulfil their debt obligations, the Dubai government, although not legally obliged to do so and without any obligation whatsoever, may at its sole discretion decide to extend such support as it may deem suitable. The government raised $1.93 billion from local and international investors in the sale.

Desert Storm

If you ignore the dramatic timing, Dubai is just another downturn story. A bloated, debt-ridden government arm fuels a mindless construction boom only to discover that the buyers have vanished. It's a familiar plot – countless companies in a dozen markets were sitting on mountains of inventory, waiting for customers. Very soon creditors banged on their doors. How's Dubai different? It's the way they chose to handle the mess. Something that has an element of Byzantine intrigue: something that has baffled bankers in Europe and US.

On 25th November 2009 (Wednesday) a press release issued by the government of Dubai and the Dubai Financial Support Fund stunned markets after it announcement that “Dubai World intends to ask all providers of financing to Dubai World and Nakheel to ‘standstill’ and extend maturities until at least May 30, 2010. It also said that restructuring of Dubai World will be “designed to address financial obligations and improve business efficiency for the future.”

Two things surprised the markets: The announcement preceded a long weekend; second, on the same day it announced a ‘standstill’ the state had borrowed $5 billion from two state-owned banks. This money may be used to keep alive troubled firms like Nakheel rather than pay off creditors. Bankers got the message: prepare for a haircut, as we scale down project sizes and think of ways to chip in more cash as equity support. The abrupt communiqué served a singular purpose: it spooked financial markets and hammered Nakheel bonds to a level that could make negotiations easier for UAE. What’s worse is that investors are clueless on whether this is the beginning of a tortuous road.

Peer Emirate help Dubai

Peer emirate on 14th December 2009 (Monday) had a pleasant surprise for the financial world stepping in with a $10-billion bailout offer for Dubai World that is caught in a multi-billion debt crisis. Specifically, the government of Abu Dhabi has agreed to fund $10 billion to the Dubai Financial Support Fund that will be used to satisfy a series of upcoming obligations on Dubai World.

As part of the $10-billion package, $4.1 billion will be allocated to Dubai World to take care of its immediate debt obligations. In his statement, the supreme fiscal committee chairman said the remainder of the funds provided will be used to meet the obligations to existing trade creditors and contractors. “We are here today to reassure investors, financial and trade creditors, employees, and our citizens that our government will act at all times in accordance with market principles and internationally accepted business practices”.

Dubai pledge is a giant step

Mark Mobius who oversees more than $30 billion as chairman of Templeton Asset Management said, “Dubai pledge to adopt global standards on transparency and credit protection is a ‘giant step in the right direction’ and the worst of the emirate’s debt crisis is over. They said that going forward they wanted to become more transparent and keep people fully informed. That is a very giant step in the right direction. By making that statement, Dubai will be able to have a foremost position here in the Middle East”.

Some of the debts still have to be restructured. But the worst is over. To the degree that Dubai really emphasises transparency and good corporate governance, they can really become a big leader, not only in the Middle East but globally. Mobius said that there are ‘very good opportunities’ in the emirate’s stock market for long-term investors. Templeton owns shares of Emaar Properties, the developer of the world’s tallest tower in Dubai, and DP World.

3.1 MUTUAL FUND

Making mutual funds affordable

How things change! A little over a decade-and-a-half ago, if you wanted to buy or sell equities in India, you had to be prepared to shell out 2-3% as brokerage fees. What was worse, because the trading was done by calling out the trades, there was little transparency and invariably there was an element of ghala. This was the unofficial premium the investor was paying to the stock broker because the actual price at which the stock was bought or sold was never really known to the investor.

Then, the total daily volumes of stocks traded were around Rs 100 crore and the annual profitability of the stock broking industry was about Rs 400 crore.

Today, look at the difference electronic stock trading has brought to the industry. The average brokerage commission has dropped to a hundredth: down from 2-3% to 2-3 basis points (0.02-03%). There is obviously no room for ghala. Despite this, because the volumes have gone up by 1,000%, profits of brokerage houses have gone up 30 times. So, the investors have benefited by lower transaction costs. The economy has benefited with higher volumes and the brokerage houses have been making far more money.

The reason to recount all this is to put the recent modification by Sebi to the rules governing buying and selling of mutual fund units into perspective. Sebi recently mandated that mutual fund units now need to be bought electronically through the secondary market.

Compared to buying and selling of stocks, where the average transaction cost is about 0.02%, as mentioned earlier, the buying or selling of mutual fund units involved, till recently, a transaction cost, in terms of a load of 2-3%. And strangely, this was only for open-ended mutual funds. For exchange-traded funds, the transaction cost was same as equities. This was a huge anomaly.

Strictly speaking, buying or selling of stocks cannot be compared to buying or redemption of mutual fund units. This is for two reasons.

Firstly, a company issues equity once or, at the most, a few times over several years. Beyond this issuance through public offers, its relationship with its shareholders is, largely speaking, that of good record-keeping. Open-ended mutual funds are, on the other hand, issuing new units practically everyday.

Secondly, investors tend to buy equities mostly for the short term while one invests in mutual funds for the long term. Yet, these differences put together still did not justify a transaction cost that is 100 times higher. The real reason for the higher transaction costs was an inefficient mode of distribution.

Despite the fact that about $10 billion annually comes into the mutual fund space to be invested in the capital markets, most of this money is from 25-30 cities and towns. No mutual fund house or its distributor has been able to make a breakthrough and broad base the investor pool.

Since the same investors are being lured by multiple fund houses with varied schemes, the decision to invest in one fund versus the other is often governed by the amount of payback the distributor would offer. This can hardly be the kind of informed decision making Sebi desires from investors. Electronic trading and investing in mutual fund units is expected to broadbase the mutual fund investor pool by an order of magnitude. From 25-30 cities, it is expected that the investor base would be expanded to about 1,000 cities if current stock-trading patterns are an indication.

Exactly how much of impact this 30-40 times expansion of investor base will have on the mutual fund industry and the capital markets beg imagination.

But what one can reasonably calculate is how much the existing investors will benefit, if buying and selling of mutual fund units moves to an electronic platform on the stock exchanges. As mentioned, $10 billion, or about Rs 40,000 crore, comes into the stock markets through the mutual fund route. Another Rs 20,000 crore moves from one fund house to another or from one scheme to another. At a current load factor of 2-3%, the transaction costs come to Rs 1,200-1,800 crore. Even a conservative saving of 75% — though electronic trading of stocks suggests the savings will be much more — would mean a benefit of Rs 900-1,350 crore — a substantial amount by any calculations.

Now, if you consider the projections for the next decade, where Indian household savings coming into the capital markets are expected to go up from the present level of $20-25 billion to $70-90 billion, the long-term benefits to the investors are astronomical.

These are of course early days and many of the nitty-gritty issues need to be sorted out. But that is only a matter of time. We am confident that just as moving to electronic trading of stocks benefited all the stakeholders, electronic investment and trading of mutual fund units will do the same.

In the final analysis, it would lead to a broader investor base, greater investments done at lower transaction costs and a better informed investing community. As history has proved, this benefits all stakeholders.

Sebi Seeks Active Role of MFs in Governance

Domestic mutual funds may soon find themselves playing a bigger role in public shareholder activism. In its attempts to get this dominant shareholder group to question actions of companies that are against non-promoter stakeholder interests, the capital market regulator, the Securities and Exchange Board of India (Sebi), has asked mutual funds to come together to question errant companies in such instances.

Sebi wants fund houses to play an active role in ensuring superior corporate governance of public listed companies in order to restore faith and protect the interest of investors. The regulator wants fund houses to cooperate and share information among them for enhancing transparency. The market regulator may also ask fund houses to disclose about their participation and voting to the public. This is similar to the rule by the US Securities and Exchange Commission (SEC), which mandates mutual funds there to disclose their proxy voting record.

These proposals come against the backdrop of a handful of instances where it was felt that the influential public shareholders were not questioning the actions of company managements. Sebi, at the meeting, expressed its concerns over fund houses not actively, exercising their voting rights at shareholders meetings. Mostly, fund houses instruct their custodians (they provide proxy voting services) to go and execute their decision on a particular issue.

The role of institutions in shareholder activism is minuscule compared to the developed nations, where these stakeholders have been blocked mega merger on grounds that the proposed move was not in their best interests. In India, the impact of shareholder activism was seen at its best in a recent case, where investors scuttled an attempt by the Satyam to acquire promoter-controlled Maytas Infrastructure.

Mutual fund officials, however, claim a handful of them are prompt in questioning controversial move, but fewer instances are publicly discussed. However, many of them don't raise a hue and cry because of the 'live and let live' attitude. In select cases, where the mutual funds are owned by banks, they are forced to maintain silence on insistence of the parent, as the erring company could be a client.

MFs may soon have to disclose break-up of AUM

Domestic mutual funds may soon have to change the way they report their assets under management (AUMs) every month-end. India's capital market regulator Sebi plans to ask mutual funds to disclose the composition of their AUM — equities and debt, and the pattern of client holdings — institutional and retail — in their schemes and investments of group companies.

As of now, mutual funds are required to disclose total AUMs, but don't need to specify how much of their total money is in debt and equity schemes, separately. Also, they don't have to specify whether clients in a scheme are institutional or retail. The move is in line with regulator's plan to arm retail investors with more knowledge about the schemes in which they invest.

Investors carry an impression that if a fund company has large AUM, then it must be good. However, there is no connection between the two. Industry officials said the move is to prevent fund houses from flouting the '20-25 rule', which requires a scheme to have a minimum of 20 investors, with a single investor not owning more than 25% of assets.

MF assets jump 64% to Rs 800,000 crore

Indian banks preferred to park their funds in the debt schemes of mutual funds, as they waited for lending opportunities to emerge. Average assets under management (AAUM) by Indian mutual funds crossed the Rs 8 lakh-crore mark for the first time and are almost 64% higher than the Rs 5 lakh crore that the industry was managing in March this year, because institutional investors, banks and companies, preferred the safety of MFs to the risks of lending and investing in a volatile economic environment. Banks' outstanding investments with MFs have grown from about Rs 45,000 crore at the end of March 2009 to over Rs 1.6 lakh crore as on the first week of November 2009. Their corresponding investments last year were Rs 18,692 crore in March 2008 and Rs 18,722 crore as on first week of November 2008.

In contrast, retail as well as corporate money seems to have had a laid back approach as far as investments in mutual funds are concerned. Corporates currently don't appear in a mood to raise debt and are simply ploughing back their surpluses into the business instead of parking them with MF. And, retail investors are awaiting a correction to invest at reasonable valuations. The lack of distributor interest in selling equity MFs has also stunted the growth of the equity segment. These trends may lead to future trouble as institutional money may flow out rapidly if the policy environment changes.

Among the big guns of the MF industry, Reliance Asset Management, part of the Anil Dhirubhai Ambani Group (ADAG) continues to dominate with AAUM of over Rs 1.22 lakh crore, while HDFC Asset Management has become the second fund house to cross the Rs 1-crore mark. Its AAUM was Rs 1 lakh crore for November 2009, a growth of nearly 10% since the previous month.

3.2 DOMINO EFFECT ON COMMODITY TRADE

Dubai's Debt Crisis

Real estate may be the epicenter of Dubai's Debt crisis, but it is the Indian commodity trade that will feel its aftershocks for months to come. Two reasons make Dubai important to Indian companies:

One, Dubai is the hub of most-traded commodities, from pearls, gold and diamonds to tea, cotton, basmati and sugar. Crucially, it is gateway to west Asia. All the top players in the region, especially Gulf Cooperation Countries (GCC), have a presence there and use Dubai as a convenient and glitzy business centre to meet each other and the outside world. So, to Indian companies, Dubai epitomises their entire west Asian business, whether it is Saudi companies or Iranian traders. Two, Dubai is attractive because of light-touch regulation and easy finance. Most use the City of Gold as a trans-shipment point and its local banks as moneybags for short-term trade, usually six months.

West Asian companies have never been too sold on the idea of getting their books audited or sharing them with perfect strangers. But this was never a major hurdle till now because the region was all about traditional values like trust, relationships and family name. Not any more. Since balance sheets are not available, there is no way for an Indian bank or company to figure what is the actual exposure of its potential partner to Dubai's debt crisis. So, everyone will be presumed guilty unless proved innocent. In other words, trust will be replaced with deep suspicion.

The cost of this shift to Indian business will be huge. Dubai-based importers would reduce buyer's credit because they will themselves be feeling the squeeze as local banks hunker down. Trade finance will start drying up, because the liquidity crisis and higher risk will drive up interest rates on loans and advances. Indian exporters will reduce open account sales where the goods are delivered before payment is due because they are so risky. Intense competition may have forced Indian exporters to make such sales in the past. Not any more. Right now, their focus will be on getting back the money they are owed.

Nervous Indian banks will start demanding more documents and letters of credit because this substantially reduces risks for both exporters and importers. You can bet on documents meant for Dubai being scrutinised more carefully and a higher rate of rejection. Banks will also charge more for the same trade finance instruments because of exploding counterparty risk.

The volume and value of trade itself may be affected for a while because channels will be clogged with traders trying to exit a crumbling credit market. Stock and sale, the favourite formula for trading means continued exposure to risk. It will be replaced with just-in-time mentality.

In case the UAE choose the last resort of printing more notes and devaluating its currencies, Indian exporters would lose further. Today, at a reported debt of $120 billion and population of 250,000, every man, woman and child of Dubai owes the world half-a-million dollars. A decline in purchasing power would mean that many high-value Indian products would become unaffordable.

Luckily, Saudi Arabia, Qatar and Abu Dhabi may coordinate to rescue Dubai, in a similar position. Iceland was bailed out by the European Union. What may seem like a doomsday scenario is hardly far-fetched. Last year's global debt and banking crisis had the same effect on trade across the world. The upside – and don't they say life is about silver linings – is that it might lead to a deeper scrutiny of crony capitalism that has been the leitmotif of west Asia business. Balance sheets and risky investments will be put under the lens and the market will favour the prudent and the secure. More importantly, Indian companies will quickly discover who are the really trustworthy.

3.3 GOLD AT $ 1200

Gold Isn't Best Hedge against Inflation

Economic chaos? The dollar crumbling? Central banks printing money like crazy? Probably the only real surprise about the surge in gold prices over the past few months is that it took so long to arrive. Recently, gold touched an all-time high of $1,227.50. Back in September, it was still less than $1,000.

Chalk that up as a victory for the gold bugs.

Now the price is heading down, dropping below $1,200.

Chalk that up as a victory for the gold sceptics, who regularly point out that the metal's value, is just a sentimental memory from a long-buried era.

In reality, while investors are right to be nervous about inflation, maybe they are catching on that it's wrong to see gold as the best hedge against a general rise in prices. There are plenty of alternatives: Equities, Property, Oil, Luxuries or PE funds should prove just as effective a way of shielding yourself.

It isn't hard to figure out why investors had been getting interested in gold again. Central banks are pumping freshly minted money into the system. A few hundred years of economic history says that eventually this will lead to inflation. It might be next year, or the year after.

Alloyed Record

But gold? Whether it's a hedge against inflation depends on where you want to start drawing the graph.

- Back in 2002, gold was less than $300. If you bought it then, you'd certainly have protected yourself against rising prices.

- The 1990s were a different story. Gold started that decade at around $400, and ended it below $300. Not so great. As for the 1980s, forget it: gold lost almost half its value during that decade.

There isn't much chance, either, of the world's central banks making their currencies convertible into gold once again. They would bankrupt their governments in the process.

In truth, while gold may have a role in protecting against inflation, there are plenty of alternatives.

Rate Squeeze

The only real way to control inflation once it gets started is to raise interest rates high enough to create a deep recession, and so choke off rising prices. That's what central bankers did in the late 1970s and early 1980s, and may do again sometime around 2015 or 2020.

Once that happens, you'll need to think again – you might not want to be in property or equities. That, however, is some way off. As we move into the early stages of an inflationary era, those five assets should do at least as well as gold, if not better.

4.0 FINANCIAL SECTOR: TRANSFORMING TOMORROW

Real Issues

The new architecture for governance of finance will have to strike the right balance between the state and the marker, and between national priorities and global coordination, says Y V Reddy

4.1 FINANCIAL ADVISORS:

Weigh impact on investors:

Global financial crisis: The way ahead

The financial markets and large institutions are functioning without disruption today. In fact, there are some signs of euphoria in financial markets despite the fact that huge public funding of financial sector in the western world with bloated balance sheets of central banks persist. Further, the declining trends in output and employment have been arrested, and growth resorted in some countries, but the adverse impact on economic activity and employment is still evident in many countries. The recent developments in Dubai are a reminder of the possibility of unexpected dangers.

Huge uncertainties remain in regard to the journey towards normalcy and the exit from the unconventional measures and stimulus. Managing the crisis has been critical and largely successful, thus front-loading the benefits, but the costs are back-loaded and the distribution of burden among the different sections of people in future contentious. Unless rigorous growth is resorted in ample measure, the burden on the taxpayer or the stress on public services and the pressure on prices may be noteworthy.

The crisis is global; actions are national; benefits could be universal; but burdens in future on their account have to be incurred at national level. Exit is essential as the risks to growth abate and inflation risks emerge and intensify. The timing of exit is critical since premature exit may derail recovery and growth while a delayed exit may feed inflation and threaten growth over the medium term. Each country will have to consider the tools for to exit. More important, communication of policies and intent becomes challenging if the interests of financial market participants and the intent of policy diverge.

There are, broadly speaking, two approaches to new normalcy.

One advocate rethink: rethink of the fundamental, ideological and theoretical foundations of a market economy.

In practical terms, this is reflected in an informal chat with a Chinese official, who said that they used to see the US as their teacher but now they realise that the teacher keeps making mistakes and, hence, they have decided to quit the class.

(*China has shown that high growth in real sector for a prolonged period was possible consistent with stability without any significant development of a modern free market-based financial sector.) Initiatives have started to develop a new economic thinking (INET), which has an advisory board that includes two winners of Nobel Prize in economics. It is therefore, argued that the current Great Recession, comparable to Great Depression, may result in such fundamental rethink of theory, practice and institutions.*

The alternative view is that the markets do benefit the society and economy significantly, but some of the excesses or aberrations that took place leading to the crisis need to be rebalanced, within the broader but existing framework.

At this stage, it is reasonable to assume that the destination of exit strategies currently under consideration would be towards a new normalcy based on yet-ill-defined rebalancing.

However, the rebalancing will be in favour of state; the presumption will continue to be in favour of relative efficiency of markets; but with a clear understanding that it is a presumption that could be rebutted when appropriate, with state acquiring the policy space to intervene at its discretion.

There is recognition that there has been excessive financialisation of the economy with a cognisable disconnect between development in real sector – i.e., goods and services finally consumed – and that in financial sector. At the same time, finance plays a critical role in mobilising resources and allocating them efficiently. Finance contributes to the well being of people through a variety of ways.

The real issue is determining the appropriate level of financial sector development as well as sophistication and regulation that promotes genuine innovation and curbs excess speculation.

In any case, there is a consensus on the excessive leverage in the financial sector, warranting corrections. Some curbs on the growth of financial sector relative to real sector thus seem to be part of rebalancing that are already under consideration, viz. higher capital cushions; curbs on managerial remuneration; changes in incentive framework; taxes on financial transactions; measures for investor and consumer protection including for certification of safety of financial products; restrictions on over-the-counter trade; expanding the scope and intensity of regulation etc.

There is a virtual consensus that the regime of regulation of financial sector in major developed countries needs a thorough overhaul. The crisis has strengthened the view that globalisation of finance has significant risks unlike globalisation of trade. The rebalancing could happen by globalising regulation or recalibrating globalisation of financial sector or a combination of both.

There are efforts to develop globally-acceptable standards of regulation, at a technical level in Board for Financial Stability. The renewed interest in capital controls, Tobin Tax and strengthening of regulation by host countries may be indicative of the reality of recalibrating globalisation of finance.

The focus on tax havens is a recognition of the fact that harmonisation of financial regulation at a global level may not address the issues of tax arbitrage.

More generally, the advocacy of counter-cyclical regulation also affects the balance between policy-space available at national level and compulsions of global finance.

The national authorities have to decide on the weight to be given to national level economic cycles and global cycles; unless it is assumed that they will always converge.

Further, counter-cyclical policies, to be effective, require harmonisation of policies of financial regulation, monetary and fiscal authorities.

The rebalancing exercise in regulation of financial sector may have to address the broader issues of policy-space for national authorities and governance of arrangements that oversee globalisation of finance.

4.2 FINANCIAL PLANNERS

Value unlocking for all stakeholders: I

Polarisation and paralysis of American politics

Political paralysis: It is hard for international observers of the United States to grasp the political paralysis that grips the country, and that seriously threaten America's ability to solve its domestic problems and contribute to international problem solving. America's governance crisis is the worst in modern history. Moreover, it is likely to worsen in the years ahead.

The difficulties that US President Barak Obama is having in passing his basic programme, whether in health care, climate change or financial reform, are hard to understand at first glance. After all, he is personally popular, and his Democratic Party holds commanding majority in both the Houses of Congress. Yet, his agenda is stalled and the country's ideological divisions grow deeper.

Deep ideological divisions: Among Democrats, Obama's approval rating in early November was 84%, compared with just 18% among Republicans. Among Democrats, 58% thought the country was headed in the right direction, compared with 9% of Republicans. Only 18% of Democrats supported sending 40,000 more troops to Afghanistan, while 57% of Republicans supported a troop build-up. In fact, significant majority of Democrats, 60%, favoured a reduction of troops in Afghanistan, compared with just 26% of Republicans. On all of these questions, a middle ground of independents – neither Democrats nor Republicans – was more evenly divided.

Divergences in views: Part of the cause for these huge divergences in views is that America is an increasingly polarised society: Political divisions have widened between the rich and poor, among ethnic groups (non-Hispanic whites versus African Americans and Hispanics), across religious affiliations, between native-born and immigrants and along other social fault lines. American politics has become venomous as the belief has grown, especially on the vocal far right, that government policy is a 'zero-sum' struggle between different social groups and politics.

Broken political process: Moreover, the political process itself is broken. The Senate now operates on an informal rule that opponents will try to kill a legislative proposal. The proposal's supporters must muster 60 of 100 votes, rather than a simple majority. This has proven impossible on controversial policies – such as binding reductions on carbon emissions – even when a simple majority supports the legislation.

Backroom lobbying: An equally-deep crisis stems from the role of big money in politics. Backroom lobbying by powerful corporations now dominates policymaking negotiations, from which the public is excluded. The biggest players, including Wall Street, the automobile companies, the healthcare industry, the armaments industry and the real estate sector have done great damage to the US and world economy over the past decade. Many observes regard the lobbying process as a kind of legalised corruption in which huge amounts of money change hands, often in the form of campaign financing in return for specific policies and votes.

US federal budget: Finally, policy paralysis around the US federal budget may be playing the biggest role of all in America's incipient governance crisis. The US public is rabidly opposed to paying higher taxes, yet the trend level of taxation, at around 18% of national income, is not sufficient to pay for the core functions of the government. As a result, the US government now fails to provide adequately for basic public services as modern infrastructure (fast rail, improved waste treatment, broadband), renewable energy to fight climate change, decent schools and healthcare financing for those who cannot afford it.

Powerful resistance to higher taxes, coupled with a growing list of urgent unmet needs, has led to chronic under-performance by the US government and an increasingly dangerous level of budget deficits and government debt. This year, the budget deficit stands at a peace-time record of around 10% of GNP, much higher than in other high-income countries.

So far, Obama seems unable to break this fiscal logjam. To win the 2008 election, he promised that he would not raise taxes on any household with income of less than $250,000 per year. That no-tax pledge, and the public attitudes that led Obama to make it, block reasonable policies.

There is little 'waste' to cut from domestic spending, and many areas where increases in public spending are needed. Higher taxes on the rich, while justified, don't come close to solving the deficit crisis. America, in fact, needs a value-added tax, which is widely used in Europe, but Obama himself staunchly ruled out that kind of tax increase during his election campaign.

These paralysing factors could intensify in the years ahead. The budget deficits could continue to prevent any meaningful action in areas of critical need. The divisions over the wars in Iraq and Afghanistan could continue to block a decisive change in policy, such as a withdrawal of forces.

The desire of Republicans to defeat the Democrats could lead them to use every manoeuvre to block votes and slow legislative reforms.

A breakthrough will require a major change in direction. The US must leave Iraq and Afghanistan, thereby saving $150 billion per year for other purposes and reducing the tensions caused by military occupation. The US will have to raise taxes in order to pay for new spending initiatives, especially in the areas of sustainable energy, climate change, education, and relief for the poor.

To avoid further polarisation and paralysis of American politics, Obama must do more to ensure that Americans understand better the urgency of the changes that he promised. Only such changes – including lobbying reforms – can restore effective governance.

4.3 WEALTH MANAGERS

Map out the details to translate into benefits: The $ reserve currency conundrum…

US House gives nod to financial reform agenda

The US House of Representatives approved the biggest changes in financial regulations since the Great Depression, making a win for the Obama administration and Congress Democrats.

Faced with a recession and multi-billion-dollar taxpayer bailouts of the firms such as AIG and Citigroup Inc, started by the Bush administration, Obama and fellow Democrats have vigorously pushed for change.

The sweeping bill, which may have to be reconciled with any measure the slower-moving Senate eventually approve, aims to safeguard financial system and ward off future crises of the type that punished the nation in the past year with its deepest recession since the 1930s. Republicans and an army of lobbyists for banks and Wall Street firms, whose profits would be threatened, have fought for months to weaken and delay reforms, criticising what they call an unneeded and costly intrusion on business. The battle will continue for months in the Senate, which is expected to push for more modest legislation.

The House bill faced a flood of amendments during floor debate, with mixed results for both sides. In a win for the banking industry, the House voted to reject a measure that would have allowed bankruptcy judges to change the terms of mortgages for distressed homeowners. President Obama sharply criticised Wall Street bankers and said, banks do not understand how angry people are with them. I did not run for office to be helping out a bunch of fat cat bankers on Wall Street.

Once a bill clears the Senate, the two chambers will have to agree on the compromise that could be passed into law. President Barack Obama said, “This legislation brings us another important step closer to necessary, comprehensive financial reform that will create rules of the road, consistent and systematic enforcement of those rules, and a stronger more stable financial system.”

The bill would create an inter-agency council to police systemic-risk in the economy, crack down on hedge funds and credit rating agencies, set up a financial consumer watchdog agency, and expose Federal Reserve monetary policy to unprecedented congressional scrutiny, among other reforms.

4.4 CREDIT COUNSELORS

Resolve convertibility and recompensation issue: Death by renminbi…

Mega banks: Too big to live

A global controversy is raging: what new regulations are required to restore confidence in the financial system and ensure that a new crisis does not erupt a few years down the line. Mervyn King, the governor of the Bank of England, has called for restrictions on the kinds of activities in which mega-banks can engage. British PM Gordon Brown begs to differ: after all, the first British bank to fall – at a cost of some $50 billion – was Northern Rock, which was engaged in the ‘plain vanilla’ business of mortgage lending.

The implication of Brown’s observation is that such restrictions will not ensure that there is not another crisis; but king is right to demand that banks that are too big to fail be rained in. In the US, the UK and elsewhere, large banks have been responsible for the bulk of the cost to taxpayers. America has let 106 smaller banks go bankrupt this year alone. It’s the mega-banks that present the mega-costs.

The crisis is a result of at least eight distinct but related failures:

1. Too-big-to-fail banks have perverse incentives; if they gamble and win, they walk off with the proceeds; if they fail, taxpayers pick up the tab.

2. Financial institutions are too intertwined to fail; the part of AIG that cost American taxpayers $180 billion was relatively small.

3. Even if individual banks are small, if they engage in correlated behaviour –using the same models – their behaviour can fuel systemic risk.

4. Incentive structures within banks are designed to encourage short-sighted behaviour and excessive risk-taking.

5. In assessing their own risk, banks do not look at the externalities that they – or their failure – would impose on others, which is one reason why we need regulation in the first place.

6. Banks have done a bad job in risk assessment – the models they were using were deeply flawed.

7. Investors, seemingly even less informed about the risk of excessive leverage than banks, put enormous pressure on banks to undertake excessive risk.

8. Regulators, who are supposed to understand all of this and prevent actions that spur systemic risk, failed. They, too, used flawed models and had flawed incentives; too many didn't understand the role of regulation; and too many became 'captured' by those they were supposed to be regulating.

If we could have more confidence in our regulators and supervisors, we might be more relaxed about all the other problems. But regulators and supervisors are fallible, which is why we need to attack the problems from all sides.

There are, of course, costs to regulations, but the costs of having an inadequate regulatory structure are enormous. We have not done nearly enough to prevent another crisis, and the benefits of strengthened regulation far outweigh any increased costs.

King is right: Banks that are too big to fail are too big to exist. If they continue to exist, they must exist in what is sometimes called a 'utility' model, meaning that they are heavily regulated.

In particular, allowing such banks to continue engaging in proprietary trading distorts financial markets.

Why should they be allowed to gamble, with taxpayers underwriting their losses? What are the 'synergies'? Can they possibly outweigh the costs?

Some large banks are now involved in a sufficiently large share of trading – either on their own account or on behalf of their customers - that they have, in effect, gained the same unfair advantage that any inside trader has. This may generate higher profits for them, but at the expense of others. It is a skewed playing field – and one increasingly skewed against smaller players.

The one thing nowadays that economists agree upon is that incentives matter. Bank officers got rewarded for higher returns – whether they were a result of improved performance (doing better than the market) or just more risk-taking (higher leverage). Either they were swindling shareholders and investors, or they didn't understand the nature of risk and reward. Possibly both are true. Either way, it's discouraging.

Given the lack of understanding of risk by investors, and deficiencies in corporate governance, bankers had an incentive not to design good incentive structures. It is vital to correct such flaws – at the level of the organisation and of the individual manager.

That means breaking up too-important-to-fail – or too-complex-to-fix – institutions. Where this is not possible, it means stringently restricting what they can do and imposing higher taxes and capital adequacy requirements, thereby helping level the playing field.

The devil, of course, is in the details – and big banks will do what they can to ensure that whatever charges are imposed are sufficiently small that they do not outweigh the advantages gained from being underwritten by taxpayers. Even if we fix bank incentive structures perfectly – which is not in the cards – the banks will still represent a big risk. The bigger the bank, and the more risk-taking in which big banks are allowed to engage, the greater the threat to our economies and our societies.

These are not matters of black and white: the more we limit the size, the more relaxed we can be about these and other details of regulation. That is why King, Paul Volcker, the UN Commission of Experts on Reforms of the International Monetary and Financial System, and a host of others are right about the need to curb the big banks. What is required is a multiprong approach, including special taxes, increased capital requirements, tighter supervision and limits on size and risk-taking activities. Such an approach won't prevent another crisis, but it would make one less likely – and less costly if it did occur.

4.5 RISK MANAGEMENT CONSULTANTS

Educate – Engineer and Enforce: Will L-U-V stand test of time?

Global recovery is likely to slow down

It's the silly season again, with much of the financial commentariat spewing out predictions for the New Year. Based at least on the impressive price action of the stock markets of late, research analysts are calling for the good times to roll in the New Year. Well, we are all indeed entitled to our opinions, but not to our own facts. So, before succumbing to the folly of forecasting, it would be worthwhile to get the facts right on the key issue of global growth as that is the most important factor in making projections.

There is no consensus on the shape of the global economic recovery so far. Most of us are still lost in the alphabet soup of whether it is an L-, U- or V- shaped recovery. Despite the return of growth in almost every country, the pattern of the global rebound is very uneven.

For the US, a U-shaped recovery is a charitable description. The economy grew at an annualised pace of 2.8% in the third quarter of 2009 and is on track to expand at roughly the same pace in the fourth quarter. This is the weakest rebound on record; in the first year of a recovery, the economy's growth rate has typically been twice the size of the decline in the downturn. The US economy contracted by 3.8% on a peak-to-trough basis during the recession that began in late 2007. By historical standards, the US economy should now be printing GDP growth numbers of more than 7% to recoup lost output.

A recovery-to-loss ratio of barely one is a disappointing outcome and explains why large unemployment, huge excess capacity and terrible government finance still plague the country. After a sharp downturn, a growth rate of 3% is just not enough to lift the employment rate and businesses are still shedding their workforce. Instead, 5-months after the end of a recession, US should be generating 2 lacs jobs a month.

The story is grimmer in other parts of the developed world. The recovery in countries such as Japan and the UK is more L- shaped with a gentle upward slope. Although both those economies are on course to register growth rate of 2% on an annualised basis in the Q4, the recovery-to-loss ratio is still well below one. The Japanese economy shrank by a staggering 7.7% during the recession while the UK contracted 5.6%. A run rate of 2% growth implies that even two years from now, these economies will be operating at a lower level of output than at the peak in early 2008.

The picture for much of continental Europe is only slightly better. While countries from Germany to Sweden are on track to grow at a some what faster pace of 3%, it would still leave them with a recovery-to-loss ratio of less than one as the Euro-area contracted by 4.7% on a peak-to-trough basis through the downturn. The tepid recovery in the developed world – ranging between U- and L-shaped – explains why economic sentiment remains moribund in many parts of the world even in the face of all the headline about the end of the Great Recession and monster stock market rallies.

The handful of countries in the V-shaped camp is all from the developing world. China leads the pack: the economy experienced just a single quarter of negative growth at the end of 2008 and is on course to expand this year by 9% - in line its trend growth rate. India and Indonesia have followed a similar path though the rebound is far less spectacular than that of China.

Brazil and South Korea too are witnessing a V-shaped comeback; with a recovery-to-loss ratio of greater than one, their economies will have regained the near-5% loss in output by the middle of 2010. Poland and the Philippines have impressed more with their resilience through the downturn than by the ensuing rebound. Both economies held up well despite the expected negative repercussions from falling remittances and trade exposure to their respective regions.

But in many other emerging markets, the recovery is rather U-shaped. It could take at least two more years before real GDP returns to pre-crisis levels in Russia, Mexico, Turkey and Taiwan. These economies contracted by anywhere between 9% and 13% during the downturn and they are presently not even growing at half that rate.

In a few developing countries where domestic finances are in a complete mess and dependence on external financing is high, the recovery is turning out to be merely L-shaped. Ukraine, Hungry, Bulgaria and Romania are still struggling to return to positive growth territory while the three Baltic states of Estonia, Latvia and Lithuania will likely register another decline in GDP growth in 2010, albeit a much smaller shrinkage of 2-3% following an incredible 15-20% drop in 2009. Meanwhile, growth in the United Arab Emirates could be close to zero next year following the ongoing debt crisis.

In sum, it appears that after the deepest and longest economic downturn the global economy has faced in its post-World War II history, the recovery is turning out to be sub-par. Conventional wisdom that the further the economy dips under water the stronger it will pop back up is not playing out. This is because lot of the excesses in the system, from the high leverage on the US consumer’s balance-sheet to overcapacity in global manufacturing, has not been washed out. Consumers and businesses across the globe including in many emerging markets are also still in a state of shock after the near-miss from last year’s financial cataclysm.

Of course, the fact that there is any revival underway, regardless of shape and size, is a mini-miracle, especially when contrasted with the dire outlook a year ago. The enormous policy support, in the form of fiscal and monetary stimuli, has ensured the Great Recession did not morph into Great Depression 2.0.

The question now is whether the current pace of expansion will sustain through the course of next year. The effects of massive government spending will begin to fade and the private sector will have to pick up the slack. While the impact of government spending in reviving growth in the US is well-documented, its significance in boosting emerging market growth this year is probably underestimated.

The consumer in places such as China, India and Brazil has undoubtedly been relatively resilient but an increase in both government consumption and investment here also played a major role in shoring up growth in these countries. According to JP Morgan Research, stimulus spending added 2.8% to emerging market growth this year. Such a powerful impulse will be missing in 2010 as some of the spending is non-recurring and policymakers have little scope for offering a fresh stimulus given their high debt burden.

Policymakers will also be under pressure to focus more on initiatives that foster greater stability in the financial system rather than promote unhindered credit growth seen in the years preceding the crisis.

Their problems will be further complicated if surplus liquidity due to the highly accommodative monetary policies drive commodity prices even higher, leading to an inflation problem. These factors combined with some continued caution from consumers and businesses after the hellish experience of last year imply that it will be challenge to sustain the current growth momentum, which is sub-par to begin with in most parts of the world.

The risk for 2010 is that as government support begins to fade, the global recovery that is currently U-shaped in many parts of the developed world and V-shaped in several emerging markets begins to look more like an L and a U in those regions. It is important to have a proper perspective of the current growth profile before indulging in the annual ritual of navel-gazing. Otherwise, the widespread ebullience in the financial marketplace can get us all a bit too excited about nature of the economic revival.

4.6 TECH SAVVY PROFESSIONALS

Take first step to ensure efficient and reliable system: Labour pains in Obama land

Labour Pains in Obama Land

Double digits or double dips are bad news, in economics as well as in politics. In October 2009, the unemployment rate in the US soared to 10.2%. Going by a broader measure, one in every six workers is unemployed or underemployed. The US economy, it appears, returned to growth in the third quarter, after the longest period of contraction since the Great Depression, but fears of a second dip in recession continue to linger. For most families, the statistics of economic recovery are just statistics since most employers are cutting wages, jobs and hours or work.

This does not bode well for the Barack Obama presidency.

Obama is neither responsible of what is now commonly referred to as the great recession in the US nor for the double-digit unemployment rate. Both were triggered by the meltdown in the financial sector that began before Obama's arrival in the White House. But these are his problems now. Since the beginning of the recession, the US economy has lost over several million jobs. Over five million were lost in the first year of the Obama presidency. A third of the unemployed have been out of work for at least six months.

The almost $ 800-billion stimulus package helped the economy emerge from recession, but it has not brought any solace to the millions who have lost jobs or have been forced to cut hours or accept a lower wage. According to the Obama administration, the stimulus plan helped generate over one million jobs. But this claim has not brought any comfort to Obama's fans or critics who believe that the stimulus money has helped Wall Street more than the real economy.

Optimists believe that the US economy will start generating new jobs by this time next year. Pessimists, you guessed it, are less hopeful. Job creation generally comes with a lag after recovery begins. After the 2001 recession, the lag between the end of the recession and job growth was of more than two years. By most forecasts, unemployment will not be down to the pre-recession level of 5% before 2014.

This is a bad news for the democrats and Obama. Unless the unemployment rate starts to decline, whether as a result of government policy or increased private investment, Obama's political base will most likely shrink. The recent gubernatorial elections in New Jersey, and Virginia showed how lackadaisical the electoral base of the Democratic Party has become in just a year after Obama's landslide victory.

What caused the liberals to become disenchanted with democrats? A combination of factors, including the great recession, the jobless recovery, the outrage that the stimulus money has helped Wall Street and the financial sector but not general public, frustration among liberals with America's unending involvements in Iraq and Afghanistan or the wishy-washy statements made by Obama and key members of the Democratic Party about healthcare reform.

The young and new voters who turned out in massive numbers to support Obama a year ago did not bother to show up in recent elections. While this gubernatorial election was not a referendum on Obama, it did show that liberals, in particulars, young voters were upset with the Democratic Party and they took their anger out by not voting. Last year, 47% of the electorate in New Jersey and 51% of the electorate in Virginia were under 45. In recent elections, their number dropped to 34% in both states. More than any other factor, it is the change in the age composition in the electorate that cost the Democrats' the 2009 governors' election in the two states. The young people, who overwhelmingly supported Obama in 2008, are the hardest hit by the recession. The unemployment rate among teenagers is 27%!

It is not clear how long it may take for the economy to start generating jobs in a sustained manner.

Some economists argue that the longer the boom that preceded the recession, the longer it would take for the private sector to generate jobs.

Reason: during the boom, companies postpone reorganising their workforce and some of the laying off during the recession and in the recovery period is a spillover of the restructuring that should have been implemented during the boom time.

Take a case of a 2001 recession that followed the glorious 1990s during which the US economy generated 22 million jobs. The employment boom of the 1990s was followed by a recession and years of jobless recovery. For over two years after the official end of the 2001 recession, there was no job growth in the US economy.

Jobless recoveries, however, have been a recent phenomenon.

Most economic recoveries led to quick returns to employment growth in the second half of the 20 century.

But, the current recession has been different from the previous ones in many ways.

According to Alan Krueger, assistant treasury secretary for economic policy, more jobs have been lost in the current recession in proportion to the decline in gross domestic product than the historical association between GDP declines and unemployment rate predict.

In addition, the number of workers in forced part-time jobs is 50% more now than before the start of the recession. In all, 6% of the labour force is employed part-time. Thus, some of the recovery in the job market will result in part-time workers becoming fulltime.

At the same time, unlike the previous recessions, the government has been using both the fiscal and monetary policies to jump start the economy. Krueger thinks that only 10% of the effect of the economic stimulus plan on employment generation would occur in 2009, and the peak of the impact on job growth would be in 2010. The political success of the stimulus plan would, however, depend on whether it will bring the unemployment rate down to single digit.

4.7 INCLUSIVE CEOs

Innovative responses to problems:

Recession ‘over’

Emergency jobs programme needed, Paul Krugman

If you’re looking for a job right now, your prospects are terrible. There are six times as many Americans seeking work as there are job openings, and the average duration of unemployment – the time the average job-seeker has spent looking for work – is more than six months, the highest level since the 1930s.

You might think, then, that doing something about the employment situation would be a top policy priority. But now that total financial collapse has been averted, all the urgency seems to have vanished from policy discussion, replaced by a strange passivity. There’s a pervasive sense in Washington that nothing more can or should be done, that we should just wait for the economic recovery to trickle down to workers. This is wrong and unacceptable.

Yes, the recession is probably over in a technical sense, but that doesn’t mean that full employment is just around the corner. Historically, financial crises have typically been followed not just by severe recession but by anaemic recoveries; it’s usually years before unemployment declines to anything like normal levels. And all indications are that the aftermath of the latest financial crisis is following the usual script. Federal Reserve, for example, expects unemployment, currently 10.2%, to stay above 8% - a number that would have been considered disastrous not long ago – until sometime in 2012.

And the damage from sustained high unemployment will last much longer. The long-term unemployed can lose their skills, and even when the economy recovers they tend to have difficulty finding a job, because they’re regarded as poor risks by potential employers. Meanwhile, students who graduate into a poor labour market pay a price in lower earnings for their whole working lives. Failure to act pn unemployment isn’t just cruel, it’s short-sighted. So it’s time for an emergency jobs programme.

How is a jobs programme different from a second stimulus? It’s a matter of priorities. The 2009 Obama stimulus bill was focused on restoring economic growth. It was, in effect, based on the belief that if you build GDP, the jobs will come. That strategy might have worked if the stimulus had been big enough – but it wasn’t. And a big enough second stimulus seems politically unrealistic.

So our best hope now is for a somewhat cheaper programme that generates more jobs for the buck. Such a programme should avoid measures, like general tax cuts that at best lead only indirectly to job creation, with many possible disconnects. Instead, it should have steps that more or less directly save or add jobs.

One such measure would be another round of aid to beleaguered state and local governments, which have seen tax receipts plunge and which’ unlike the federal government, can’t borrow to cover a temporary shortfall. More aid would help avoid both a drastic worsening of public services (especially education) and the elimination of thousands of jobs.

Meanwhile, the federal government could provide jobs by … providing jobs. It’s time for at least a small-scale version of the New Deal’s Works Progress Administration, one that would offer relatively low-paying (but much better than nothing) public-service employment. There would be accusations that the government was creating make-work jobs, but the WPA had many solid achievements. And the point is that direct public employment can create a lot of jobs at relatively low cost.

Finally, we can offer businesses direct incentives for employment. It's probably too late for job-conserving programme, like the highly successful subsidy Germany offered to employers who maintained their work force. But employer could be encouraged to add workers as the economy expands.

Later this week, President Barack Obama will hold a "jobs summit". Most of the people expect the administration to offer no more than symbolic gesture. But it doesn't have to be that way. Yes, we can create more jobs – and yeas, we should.

4.8 CONTINUING LEARNING CENTRES

Take informed decisions: Wall Street: Living in denial, despite the disaster

Living in denial: Paul Krugman

When I first began writing for The Times, I was naïve about many things. But my biggest misconception was this: I actually believed that influential people could be moving by evidence, that they would change their views if events completely refuted their beliefs.

And to be fair, it does happen now and then. I've been highly critical of Alan Greenspan over the years (since long before it was fashionable), but give the former Fed chairman credit: He has admitted that he was wrong about the ability of financial markets to police themselves.

But he's a rare case. Just how rare was demonstrated what happened recently in the House of Representatives, when – with the meltdown caused by a runaway financial system still fresh in our minds, and the mass unemployment that meltdown caused still very much in evidence – every single Republicans and 27 Democrats voted against a quite modest effort to rein in Wall Street excesses.

Let's recall how we got into our current mess. America emerged from the Great Depression with a tightly regulated banking system. The regulations worked: the nation was spared major financial crises for almost four decades after World War II. But as the memory of the Depression faded, bankers began to chafe at the restrictions they faced. And politicians, increasingly under the influence of free-market ideology, showed a growing willingness to give bankers what they wanted.

The first big wave of deregulation took place under Ronald Reagan – and quickly led to disaster, in the form of the saving-and-loan crisis of the 1980s. Taxpayers ended up paying more than 2% of GDP, the equivalent of around $300 billion today, to clean up the mess.

But the proponents of deregulation were undaunted, and in the decade leading up to the current crisis politicians in both parties bought into the notion that New Deal-era restrictions on bankers were nothing but pointless red tape. In a memorable 2003 incident, top bank regulators staged a photo-op in which they used garden shears and a chainsaw to cut up stacks of paper representing regulations.

And the bankers – liberated both by legislation that removed traditional restrictions and by the hand-off attitude of regulators who didn't believe in regulation – responded by dramatically loosening landing standards. The result was a credit boom and a monstrous real estate bubble, followed by the worst slump since the Great Depression. Ironically, the effort to contain the crisis required government intervention on a much larger scale than would have been needed to prevent the crisis in the first place: government rescues of troubled institutions, large-scale lending by the Fed to the private sector, and so on.

Given this history, you might have expected the emergence of a national consensus in favour of restoring more-effective financial regulation, so as to avoid a repeat performance. But you would have been wrong. Talk to conservatives about the financial crisis and you enter an alternative, bizarre universe in which government bureaucrats, not greedy bankers, caused the meltdown. It is the universe in which government-sponsored lending agencies triggered the crisis, even though private lenders actually made the vast majority of subprime loans. It's a universe in which regulators coerced bankers into making loans to unqualified borrowers, even though only one of the top 25 subprime lenders was subject to the regulations in question.

Oh, and conservatives simply ignore the catastrophe in commercial real estate: in their universe the only bad loans were those made to poor people and members of minority groups, because bad loans to developers of shopping malls and office towers don't fit the narrative. In part, the prevalence of this narrative reflects the principle enunciated by Upton Sinclair: "It is difficult to get a man to understand something when his salary depends on his not understanding it." As Democrats have pointed out, three days before the House vote on banking reform Republican leaders met with more than 100 financial-industry lobbyists to co-ordinate strategies. But it also reflects the extent to which the modern Republican Party is committed to a bankrupt ideology, one that won't let it face up to the reality of what happened to the US economy.

So it's up to the Democrats – and more specifically, since the House has passed its bill, it's up to 'centrist' Democrats in the Senate. Are they willing to learn something from the disaster that has overtaken the US economy, and get behind financial reform?

Let's hope so. For one thing is clear: if politicians refuse to learn from the history of the recent financial crisis, they will condemn all of us to repeat it.

4.9 ONE-STOP-SHOPS

Dedicated to offer related services under a roof:

India, China should team up for 21st century

India and China are ancient civilisations, neighbours, the two most populous countries of the world, its two fastest-growing economies, friends in global power talks such as over climate change or world trade, rivals when it comes to winning friends and influencing people around the world, conquering export markets and cornering mineral resources. They tried to be *bhai-bhai* for some time, and then fought a war. There is no burning desire in either capital today for a mutual relationship as between blood brothers, nor is there any hunger to run a blood feud. The sensible course for both countries is to rid their rivalry to overt friction, extend the many areas of cooperation and share the special place in the sun reserved in the 21st century for those who work economic miracles.

The biggest irritant in India- China relations is a border dispute. The dispute is a colonial legacy. The British negotiated an agreement with Tibet in 1914 in an accord at Simla on the border with India and that border, named after the then British foreign secretary McMahon, is what the government of Independent India chose to uphold. The Chinese never accepted this boundary, saying that Tibet never had the sovereign authority to negotiate a boarder. The Chinese claim some 150,000 sq km south of the McMahan line as theirs, while India deems this territory as its own.

The Chinese are not prone to respecting other civilisations. For centuries, they considered their Middle Kingdom as the centre of the universe, as the epitome of human achievement. However, the Chinese had respect for India, as the land of the Buddha and as the land from which they procured valuable knowledge. But, emancipation from colonial hangover took time.

The Chinese went through their wrenching experience of the Cultural Revolution followed by the restoration of order and a new game of cat and mouse in which the colour of the cat did not matter so long as it caught billions of mice. China with India, in the mean time has quarantined their border dispute to a committee of babus from both sides and proceeded to interact like two normal nations in other matters overtly. Covertly, the Chinese tried best to keep India tied down in a perpetual deadlock with Pakistan, proliferating nuclear technology and missiles to that country.

But India has outgrown that hyphenated relationship, and after the Bush administration went out of its way to get India quasi-membership of the nuclear club and, with it, release from the high-technology denial regime that had crimped the growth of its strategic capacity, which is slated to fulfil the aspiration of all countries in south-east Asia and much of the world, and in emerging as a strategic balancer of emerging Chinese power.

The world increasingly recognizes China as the number two power in the world, after the US. The world, in the process, underestimates Europe, whose woolly incoherence prevents its economic might from translating into proportionate political clout. The world also underestimates Russia and India.

Indians mostly underestimate India vis-a-vis China. India is actually a more efficient economy than China, contrary to all impressions. Indians invest around 36% of their output and generate close to 9% growth (let’s set aside the post-Lehman phase of global crisis). The Chinese cannot invest all of the 55% of their output they save, and get about 10% growth from the 48% they invest. Per unit of capital, India squeezes out more growth than the Chinese do.

4.10 MICRO-FINANCE PROFESSIONALS

Developing alternative credit delivery models:

A Billion Heroes For 2010

When the Berlin Wall was hammered down in 1989, it was, along with the smaller, potent and possessed freedom movements in eastern and central Europe, plainly labeled as The Revolution of ’89. All the people, all their strivings, all their passions, all their fight for their freedoms, all the sweat and all the toil just vanished, collapsed like the Wall, into that genus: The Revolution of ’89.

Twenty years on, what we and the world see are grainy TV images of milling multitudes, vast throngs of people emitting vapours, hooded and jacketed, their personal stories along with their individuality making up that collegial yet charged crowd.

These were the people who ended the Cold War; their battles for their own freedoms becoming politicians’ battle cry: a collective drumbeat for change.

Everyone remembers a Havel, a Walesa but no one, even if he dives deep into the well of memory, has an inking of those people. Like the vapours they breathe, they are nothing but mere phantasms, their irrefutable reality becoming an irredeemable TV image.

Gone they are into TV, their fervent and vigorous efforts disappearing into fuzzy TV images of vast, expectant and ecstatic crowds. Collectively, as a crowd, they display their power; as individuals they just vanish into the magnificent mass: their personal brilliance battened down for the crowd's collective splendour.

We remember Solidarity; we clearly remember its pugnacious leaders Lech Walesa. The historically minded may even remember Lenin Shipyard in Gdansk, Solidarity's birthplace, but does anyone remember the strikers, the students, the priests who were the unknown faces of the revolution. Whose untold stories together made the story of the revolution?

The unknown faces and their untold stories: behind every revolution are these solid and determined people with their remarkable stories of courage, tenacity, perseverance, pluck, grit, fortitude. People who make the movement, people who form the revolution, people who drive their own crowds to achieve the unachieved, people who push their leaders into uncharted territories: where freedom, liberty – and prosperity – exist. Their existence a given, not grabbed.

For almost two decades, India and Indians have been making their own revolution. The Revolution of '89 started with a war cry in Gdansk and ended with the smashing of the wall separating two similar peoples. Prosperity on one side and poverty on the other: liberty on the one side and lament on the other. And in between a wall, erected by man and, finally, razed by man to make freedom intermingle with fraught circumstances.

In India, we too have been pulling down many walls. Ours is an ongoing revolution, a valiant one. Intead of velvet marked by strong feats, marked by preternatural show of fearlessness, marked by invincible determination, marked by boldness, marked by untold yet incredible stories.

The purposeful and heroic stories that unite to form the intrepid image of India that travels around the world; the unknown faces who together – as a crowd, as a throbbing throng of people – form the iconic face of changing India. The change that gains traction from the many unknown facts and untold stories: the drivers, the pushers, the engines of growth, of whatever a revolution brings.

In India, the reach of the revolutionary change is not total. Walls exist between the rich and the poor. Prosperity, growth, development means different things for different people. Your riches can be their refuse. Their wastelands can be your wealth. Walls exist and they need to be broken, with a pickaxe or with peace or with prosperity.

So, we, at the culmination of almost two delightfully delirious decades of change should take note from the stories of people, who, despite their personal dejections, persisted to change themselves – to change the country they lived in – and still live in. Faced with despotic denials and destitution, they decided decisively for change. By dint of their hard work, they withstood the dips in the economy. Their pluck is changing India's luck. The revolution they set in motion raising, every moment, still sleepy Indians from their slumber. They are the faceless people whose unsung enterprise drives India; there are the untold stories which together make the India Story.

This is the crystal cup overflowing with an uninterrupted blue and gold light. Ladies and gentleman partake of the overflowing cup: India Incredible: The Untold Story – Ordinary Lives, Extraordinary Tales.

4.11 ISSUES OF THE PRESENT

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

Chasing Green Dreams

The recently-concluded UN conference on climate change at Copenhagen may not have succeeded in reaching the deal that was being worked towards. However, it’s not exactly the end of the road for the global green dream just as yet. The high-level talks at Copenhagen have set out the ground rules for next year’s climate change talks in Mexico. The top brass US participation at the summit, and the presence of other global leaders was an indication that the world today is serious about the environment. Copenhagen also drew attention of the entire world and made the man on the street, the mother at home and the kids in school realize the importance of climate change and what each one of us can do to save the world.

As for India, we continue to oppose any legally binding green emission norms – plastic bags are still in vogue and millions of outdated cars and trucks still run on smoky diesel and petrol. But there is realisation among businesses across sectors today that adhering to green solutions is the way forward. An example is the infrastructure sector, where both we are moving towards a green strategy before it becomes too late. As the push for the country’s large core sector projects is set to intensify in the coming years to bridge the infrastructure gap of $ 500 billion, there is a strong case for taking the green strategy on board.

We are also learning to build green homes. The housing sector is looking at a turnaround in 2010. But several builders are pitching the new growth on environment-friendly buildings bringing a number of benefits for residents such as better lifestyle, more ventilation and an opportunity to conserve resources. Analysts also say that green buildings may be a wiser investment for the future. With this change in mindset, more developers will eventually need to address the growing demand in green segment.

Come 2010, green is expected to set fashion trends as well. The luxury and fashion industry is moving towards adopting a sustainable model. Indian fashion is getting a global footprint and desi designers can set the ramp on fire with dresses designed using environmental-friendly fabrics. And, we are not just talking about the environment here. It’s also time to leave the slowdown behind and welcome the Green Shoots that are sprouting globally, ushering in hope that all will be line soon. Even Manhattan, which was battered by the economic slowdown last year, is now wearing the festive colours. The snowstorms that brought America to a standstill before festival did not deter shoppers from making their Christmas purchases. Santa couldn’t have brought us a better gift.

In India, 2009 did turn out to be much better than we anticipated. The capital markets have recovered from their lows, the job losses have been minimal and in most cases pay cuts have been resorted. Further, as a barometer of things to come, most engineering and management campuses are reporting better off-take, thereby indicating a positive economic outlook. The Indian stock market has rebound sharply this year to go up 65% and more after touching lows of 8,000 in March. Stock market analysts now say that rather than losing sleep over lost opportunities, an Indian investor’s priority should be to get the portfolio right for the coming year. As for the office-goers, this is the time to get one’s act together. The employers are going to be watching over what you do, more carefully this year – not just to assess how employees are performing but also to ascertain whether they have what it takes to be leaders. Coming after a year, when companies recognised the value of having good talent on board, stringency in performance management is, one lesson that India Inc is not likely to forget immediately. Be it compensation policy, leadership training or incentives for attraction and retention, the outcome is going to be linked to performance and productivity. So as 2009 and with it an eventful decade – the first of the millennium – nears an end, we try to wrap it up for you. Here, in this year-end edition, is a about real issues, which tries to help you look ahead at a brighter future. If anything be warm, let it be the wishes.

5.0 BANKING SECTOR

PSUs Disinvestment for Better Governance

The government is set to give a fresh boost to disinvestment. It plans to sell 10% equity in unlisted, profit-making PSUs. It will also sell equity in listed PSUs where the public holding today is less than 10%. These are welcome moves and should have happened much earlier. Of the 242 PSUs, only 46 are listed at the moment. The proposed move will add another 42 to the list. Selling additional equity in listed PSUs where the public holding is less than 10% is estimated to fetch the government Rs 28,000 crore. Listing another 42 PSUs will fetch the government Rs 32,000 crore. The proceeds from the disinvestment will be used for capital expenditure in social sector programmes. To that extent, budgetary allocations for the social sector can be reduced. This will naturally help rein in the fiscal deficit.

But too much should not be made of the fiscal benefits of disinvestment. First, the planned disinvestment won't happen overnight. Secondly, the fiscal benefits of disinvestment are somewhat illusory. When the government sells its equity in a PSU, it is only realising upfront the value of dividends it would realise over the life of the PSU. Any gain to the fisc in the short-term is offset by a loss of the stream of dividends over a longer period.

So, disinvestment must be seen primarily as an instrument for improving performance of PSUs. Many believe this can never happen because politicians and bureaucrats will keep interfering with commercial objectives. They think the only way to get lasting performance improvement is to privatise, that is, for government to give up control over PSUs. This is a serious misconception and it has caused much harm. When the NDA was in power, Arun Shourie went all out to privatise some PSUs through strategic sales. His attempts got mired in scandal and there was a severe political backlash. As a result, the first UPA could not proceed with disinvestment. The Left and the unions began to oppose disinvestment because they saw it as a prelude to privatisation.

How can disinvestment and listing on stock exchanges make a difference when the government continues to call the shots? Well, it helps in several ways. Government firms become subject to greater market discipline as the stock price is watched daily. The existence of retail and institutional shareholders acts as a check on political interference that would adversely impact the stock price. Management becomes more focused on commercial performance when subject to continuous monitoring by analysts and comparison with peers. This explains the trend towards convergence in performance between PSUs and private firms in the post-reform period, as several studies have shown.

Government ownership is widely seen as an obstacle to good governance. Managers lack incentives, decision-making is slow. But in at least two respects, PSUs have advantages over private firms. One, given the elaborate checks and balances in the public sector, there is less scope for manipulation of accounts. The Satyam type of disasters is less in PSUs. Secondly, the mechanism of independent director can be more effective in PSUs. In the private sector, 'independent' directors owe their jobs to the management and often collect fat fees. As a result, they rarely live up to the expectations. In PSUs, independent directors are appointed by the ministries and do not owe their positions to the management. The PSUs have a chance to build on these advantages and set the standard when it comes to governance.

Thanks to the financial crisis, there is grudging appreciation of the merits of government ownership in the banking sector. The UPA government is committed to retaining control in industrial PSUs as well. By raising the standard of governance in PSUs, the UPA government has a great opportunity to prove to the world that the **Nehruvian vision of a mixed economy** is still relevant in conditions such as ours.

6.1 TAX UPDATES

Advance tax data offers peek into India Inc health

Manufacturing and pharmaceutical companies, along with some of the local financial institutions, seem to have emerged stronger from the downturn than foreign banks, if advance tax numbers for the quarter-ended December that have trickled in so far are any indication.

An uptick in tax numbers during the third-quarter of a fiscal year (Apr-Mar) improves business sentiment as almost three-quarters of a company's annual tax liability are usually paid by December.

Companies such as Reliance, HUL, L&T, Hindalco, Grasim, Century Textiles and GSK Pharma Glaxo Smithkline have paid higher tax in Q3 this year than in the corresponding period of the previous fiscal.

Even, the numbers for the mortgage giant HDFC and the biggest local investor LIC have gone up.

The increase in tax payout by manufacturing firms may be attributed to the fiscal stimuli in the form of lower excise duty and reduction in interest rates put in place in the months following the breakout of the global recession in September last year.

The country's largest private sector company Reliance Industries Ltd paid Rs 850 crore, over 5 % increase over the year-ago period while HUL showed a 29% rise to Rs 200 crore.

For LIC the outgo is Rs 980 crore (against Rs 870 crore in the year-ago period) while for HDFC Rs 320 crore (Rs 280crore).

Engineering major Larsen & Toubro recorded a robust 29% increase to Rs 270 crore.

Hindalco showed a YoY increase of 150 % to Rs 100 crore while manufacturing major Grasim Industries showed a 33% rise in its tax outgo to Rs 285 crore.

Glaxo Smithkline, pharma major, showed a 26.87 % to Rs 85 crore. G S A Pharma too have made a YOY increase of about 30 % to Rs 85 crore.

Textile major Century Textiles made a remarkable upswing to Rs 49 crore from Rs 3 crore it paid during the corresponding period last fiscal.

Against a sharp decline in collection during October-December 2008, income-tax authorities have been expecting higher revenue for the third quarter ending December 2009.

There were signs of improvement since September 2009, following higher collections from tax deducted at source (TDS) and securities transactions tax (STT).

With these advance tax numbers, the revenue department hopes to meet its target of Rs 400,000 crore this fiscal, against a shortfall of Rs 60,000 crore last year.

6.2 SECURITY LAWS UPDATES

Credit Rating Agencies

The expert group, set up by the High Level Coordination Committee on Financial Markets (HLCCFM), has made specific recommendations on improving and disclosing the way credit rating agencies rate financial instruments, and has sought debate on the very need to have mandatory rating of financial instruments. HLCCFM is a forum to deal with inter-regulatory issues arising in the financial and capital markets and functions under the chairmanship of RBI governor, with SEBI chief, finance secretary, Irda chief and PFRDA chief, as members. Rating of debt instruments except private placement is mandatory while grading of IPOs became mandatory in May, 2007.

Credit ratings agencies have come under fire for their failure in the global financial crisis. They have been blamed for assigning high ratings to toxic instruments, such as subprime mortgages and regulators in many countries, are now adopting rules to make ratings more transparent.

There are strong views against mandatory rating, which have been reinforced by what some critics consider as the dubious role of ratings agencies in the crisis. The conflict of interest inherent in the ratings business – rating is sought by and paid for by the company floating the financial instrument, which compromises the third party, independent nature of ratings.

Agencies do not take up the responsibility for their ratings. While large investors have institutional strength to assess financial instruments, small investors tend to look at ratings and believe in them strongly. Making ratings purely voluntary would help bring out the conflict of interest more clearly, as investors would know that rating was obtained by and paid for by the issuer. The US Securities and Exchange Commission has even decided to drop reference to ratings in some of its rules and forms to reduce reliance on ratings. It is also debating if credit rating agencies should be considered as 'experts' under the law, making them more responsible for their ratings.

RBI governor Duvvuri Subbarao had said in a speech recently, "The crisis has questioned the integrity, conduct and business model of credit rating agencies. Corrective initiatives under way include stronger regulation of credit rating agencies, measures to address conflicts of interest, differentiation between ratings of structured and other products, and strengthening the integrity of the rating process". Regulators are exploring ways to deal with the issue.

However, the structure of rating agencies in India is quite robust and very much in line with the principles laid down by the IOSCO (International Organisation of Security Commissions). This is, however, unlikely to affect the ratings business as market pressure would force issuers to seek a rating.

Raman Uberoi, senior director-Ratings, Crisil said. "CRISIL has always maintained that the healthiest way for a market to develop is for investors to demand for ratings. If you go back to when Sebi made ratings mandatory for public or rights issue of debt but not private placements, we still saw over 90% of private placements were rated". He said investors seek a rating and in an evolved market requirement of rating will always be there. Rating agencies have already responded positively in the changed environment. We as an agency have already enhanced disclosures levels in our structured finance rating rationales. We have introduced complexity levels for financial instruments, a global first and begun issuing credit alerts whenever we see significant changes in any sector which could impact credit profiles.

7.0 INFLATION

India's high growth offset by rising food Inflation

The Indian economy's 7.9% growth in the second quarter of this fiscal has seen the daily grocery bill shoot up sharply, has dampened some of the euphoria. Food inflation has reached an alarming level of **17.47% for the week ended November 21, 2009**. In the same period last year inflation in food articles was at 10.75%. Chairman of the Prime Minister's economic advisory council C Rangarajan has underlined the need to control food inflation.

There are fears that the impact of agriculture could affect other sectors. The latest data shows that the stimulus measures put into place in several phases since September 2008 have definitely played a role in reviving the economy. Barring inflation, it is clear that the government has been able to weather the crisis as it seems that there is now truly a durable turnaround.

The next step for policy makers is to rein in food inflation. But it has been an extremely difficult balancing act to ensure that economic growth is not affected while keeping prices under control.

The situation was compounded by the failure of the monsoon during the vital kharif sowing season. This underlines once again the country's vulnerability and complete dependence on monsoon.

One can only hope that the rabi (winter crop) season provides a bountiful wheat harvest. Usually the rabi crops remain relatively less affected by the fluctuation of rainfall as most of the country's surplus stocks come from the irrigated areas of Punjab, Haryana and western Uttar Pradesh.

In any case, it is clear the authorities cannot wait till the fresh harvest comes to the market. Urgent action is needed on the price front. Any delay will ultimately hinder the economic revival in the current fiscal.

Food prices hurting, at 10-year high

Inflation in food articles touched **19.05% for the week ended November 26** against 10.48% a year ago. Inflation in food articles had last crossed the 20% mark in 1998.

Food inflation touched its highest in over a decade as the relentless rise in prices of key food articles, including vegetables and pulses, continued, belying expectation that arrival of kharif crop will help moderate price. Though high inflation is still being seen primarily as a supply-side issue, experts have raised concerns that it could become a far more serious issue if high inflation expectations take root.

FM promises action as food inflation hits 19.95%

A key Parliamentary committee on finance has came down heavily on the government for its management of the food situation in the country, as the annual inflation in food articles rose to **19.95% for the week ended December 5,** the highest in a decade. The committee would strongly recommend that a comprehensive food pricing and management policy be formulated not only to provide much needed relief to the common man but also as an antidote for the growing imbalance in the country.

It has suggested a host of steps, including strict enforcement of measures to curb speculation and hoarding and an immediate end to diversion of agriculture land for industrial purpose to address the issue of price rise. The committee has asked the government to submit a report within a month about the state-wise action-taken and cases booked under the Essential commodities Act.

The current high annual inflation comes on a high double-digit inflation of 10.28% in the corresponding week last year. The near 1% increase in inflation in food articles over the week is driven by further spike in vegetables prices and a sharp increase in prices of milk.

Inflation hits 11-year high, veggies cool

The annual food inflation rose to a near 11-year high, but policymakers took heart from cheaper perishable food items for the second straight week after an influx of vegetables and fruit into markets. The food inflations climb to 19.83% in the third week to December from 18.65% the week before. The index had soared to 19.95% in the week to December 5, the highest since December 1998.

Though food prices of vegetables and fruit in the last two weeks have broken a three-month rising streak, the surge in global commodity prices is likely to accelerate inflation. A resurgent global economy, which is healing faster than expected, is bumping up the prices of commodities through increased demand. Crude oil prices alone have doubled over a year and are hovering at $80 per barrel.

Rate hike fears loom large as annual inflation hits 4.78%

The annual rate of inflation shot up a 10-month high of 4.78% for November from 1.34% a month ago, prompting fears that high food prices could fuel inflation elsewhere soon, imparting urgency to the need to check price rise. India is the only emerging economy where inflationary expectation is high and central bank will be compelled to tighten the liquidity scenario from January 2010 onwards.

Analysts are of opinion that rising global commodity prices are also creating input cost pressures, beyond just food prices. Expectation of higher inflation can cause employees to demand higher wages, which can in turn force manufacturers to hike product prices to cover the rising costs. This will in turn raise demand for more salary hikes, setting in motion a vicious inflation cycle.

Higher-than-expected inflation numbers have renewed concerns that Reserve Bank of India may soon initiate measures to mop up surplus liquidity. Bankers feel that the cushion or surplus cash with banks may prompt the central bank to prioritise liquidity management over rate hikes.

According to Jahangir Aziz, chief economist, JP Morgan India, ‘I think tightening will be first focused on sucking out excess liquidity through CRR hike and later through rate hikes. Much of it will be driven by the central bank’s concern on the possibility of asset price inflation.’

Conventionally, a situation of high growth and inflation is a trigger for the central bank to signal tight money conditions and hike policy rates. However, in the current circumstances with ample liquidity in the system and low credit offtake, the rate hike may be ineffective. Moreover, the current inflation is reckoned to be more due to supply-side factors. In such a situation, monetary measures may not be helpful. Everybody, including policy advisers at the Reserve Bank of India and the government would wait and see how inflation pans out by early January.

The initial signal is expected to be through liquidity sucking measures like a hike in cash reserves requirement (CRR) a portion of deposits that banks raise that needs to be mandatorily parked as cash with the central bank. Currently the commercial banks have to park 5% of the deposits they raise every fortnight as CRR with Reserve Bank of India.

High food prices: but no incentive to grow more

For months we have grimly paid hundred bucks a kilo for everything from dal to dhania patta. But surely this can't go on for ever. After receiving this bonanza from us, simple greed should make farmers grow tonnes more green vegetables, pulses, rice and sugarcane; unfortunately, not so fast. When consumers pay record prices for something scarce, producers figure they can maximise profits by increasing supply. But in food, high prices are not the cure. There are two reasons.

One, farmers are simply not receiving bullish price signals. It is retailers who are making hay. Farmers are still getting only a fraction of the over-the-top prices we are paying.

So they see no incentive to grow more. Government data shows, a farmer selling highest quality tomato got only Rs 12/kg in Delhi mandi. Retailers sold it for upwards of Rs 24/kg. The best quality potato was sold in the mandi for Rs 7.50/kg. Consumers paid double. This wide gulf between mandi/factory gate prices and retail MRP can be seen in most food items, especially sugar, pulses, fruits and vegetables.

The dispute between UP's sugar factories and farmers over cane prices, that spilled on to Delhi streets, merely dramatised how growers feel short-changed. But there is nothing to stop retailers from profiteering. As the government told Parliament in September, "There are no guidelines issued in relation to the maximum permissible difference between wholesale and retail prices of essential commodities. The wholesale/retail prices are largely determined by the market forces."

Actually most vegetable farmers are receiving little more than last year. Last December farmers sold onions in Delhi for Rs 11.40/kg. This year they got 20% more. For tomatoes, they got 8% more. Factor in higher cost of trucks, credit, general inflation and you know why they see no urgent need to clear their fields for onions and tomatoes. What's in it for them?

Two, even where farmers can see correct price signals, either through the market or government's minimum support price, there is not much they can do.

Eight out of 10 farms in India are owned by small and marginal growers. To increase supply, they need good seeds, water and timely inputs. Getting most of these factors right is expensive. And after the summer drought, cash too has dried up.

A one-hectare farmer got only Rs 2000 as government compensation when his crop was wiped out. The National Rural Employment Guarantee Scheme promises him income for barely three months. Cash was scarce even before the drought. In the capital-intensive kharif sowing season between April and July, banks met 28% of their farm loan target. Last year, they loaned less than 20% of the target in those months. With no other sources of income, farmers remain in the clutches of middlemen that lend them money. Majority farmers don't even need a market. Their harvest prices are fixed by the arhtiya.

Bigger farmers discover that conveniently reaching a large enough mandi is tiresome and expensive. They can check prices on mobile phones. But poor roads and transport services, along with high-cost labour, eat into margins. So the price signal remains fuzzy. Ironically, farmers suffer most when price signals get transmitted perfectly because we have no way to handle excess production. When everyone grows the same crop, supply pressure kills profit on the spot. Then the scarcity cycle begins again.
Is there a solution? Sure. More competition and cash; Increasing competition will force food retailers to share a bigger share of their bounty with producers and invest in storage. Better credit will allow farmers to invest in their fields and maximise gains. Today's prices are telling consumers to eat less and but not farmers to grow more. Food needs its own communication revolution.

8.1 MISCELLANEOUS UPDATES

Companies turn to MFs for raising cheap funds

India Inc has found a new, cheaper way of meeting its funding requirements — borrowing from mutual funds (MFs) through short-term commercial paper (CP) at rates lower than what any bank can offer.

Flush with cash, MFs have been deploying their surplus funds in CP issued by top-rated corporates, at rates ranging from 3-5.5%. As a result, top corporates like IOC, HPCL, Tata Motors and L&T Finance have become very active in the CP market. In fact, CP issuances have risen to an all-time high this year.

According to the latest data released by the Reserve Bank of India, outstanding CP issuances by corporates zoomed to a high of Rs 88,161 crore as on September 15, 2009, as compared to Rs 54,181 crore in September last year.

This phenomenon has clearly elbowed out banks in terms of their corporate lending. Most banks confirm that their corporate lending portfolios are yet to see a pick-up. According to MD Mallya, CMD, BOB, "Corporate lending is still yet to pick up." Bank credit growth has slumped to 9.7%, according to the latest figures released by the RBI – almost half of their year-end estimate of 18%.

For corporates, it's a win-win situation. Not only are they getting short-term cash at rates much lower than what banks can offer them, they also have the option of rolling over these CPs. Corporate paper is usually issued with a tenure of three months. MFs usually have an appetite of less than 90 days for deploying funds, so a three-month paper suits them fine. In fact, AMFI data shows that liquid and money market mutual funds saw inflows of Rs 101,441 crore in October.

ADRs, GDRs are back in demand

The depository receipt (DR) market which had lost its sheen in 2008 appears to be back in favour with Indian companies having raised a record $3.15 billion through 11 issues via this route, year to date.

Total funds raised by Indian firms through American depository receipts (ADRs) and global depository receipt (GDRs) issuances had fallen to $0.10 billion in 2008 from $2.64 billion in 2007. The number of ADRs and GDRs had also dropped to 4 in 2008 from 15 in 2007.

However, merchant bankers say, "Following the credit crisis in 2008, Indian companies were forced to look for equity capital as banks were wary about lending. This is the right time for investors and companies to raise money and realign the debt-equity ratios in their balance sheets."

ADRs and GDRs are fund-raising instruments with Indian shares as the underlying.

ADRs are listed on the New York Stock Exchange (NYSE) or the technology-focused Nasdaq, the two main US exchanges. An ADR follows the norms laid down by the Securities Exchange Commission of America (SEC) and generally accepted accounting practices (GAAP).

GDRs are traded on the London Stock Exchange and Luxembourg Stock Exchange.

8.2 INSURANCE SECTOR

The Road Less Taken In Life Insurance

The life insurance industry was liberalised in 1999 and the first set of new companies was granted licences in the third quarter of 2000. The potential of life insurance in the country attracted global giants that are among the Top 30 in the world. These new players have joined the fray not to merely hoist a flag but to capture a sizeable part of the Indian market. It would be worthwhile to note that, as a nation, India is young, populous and a rapidly-ascending economy, albeit with negligible social security.

After almost a decade of its journey in the new format, where both the private and public sector companies have been operating in complete freedom, the sector has been a story of growth and success. Till the last financial year, life insurance companies have had a dream run with high growth of over 30% compounded annual growth rate (CAGR) since liberalisation. The broad view of the life insurance industry unfolds the two major factors that moulded its high growth: A secular bull run in the capital market for five years at a stretch, and a robust distribution channels.

Incidentally, when the global majors joined the market with an Indian partner, initially they attempted to replicate the distribution model being used in their respective home markets. They wanted to rely, in particular, on bancassurance. The slow takeoff made managers realise that life insurance in India continues to be a business of hard-selling and, therefore, building and sustaining success at higher rate can be ensured only by creating a large army of feet-on-street (FoS). In fact, they were compelled to copy the Life Insurance Corp’s model of large and geographically well-spread-out tied distribution network.

Till the private sector companies were able to make significant strides in creating such a tied agency network, LIC did not lose even 5% market share. Since LIC did not focus on other channels of distribution, even though the private sector industry had since replicated former’s model, it started losing market share sharply thereafter. In the space of the past four years, LIC’s market share went down below 60%. The sudden and sustained decline in the capital market shocked the life insurance companies, particularly in the private sector space, primarily due to the overload of marketing emphasis on the sale of unit-linked policies. We feel every life insurance company must have a significant portion of its total business from the conventional life insurance products. History is witness to the fact that the mainstay and sustenance of business stems from conventional products.

Unfortunately, life insurance company managers might have been deterred from reaching for the fruits of labour on the high branches when the low-hanging fruits of unit-link products were within the plucking distance. A fallout of the approach has been the mushrooming of private distribution networks. Yet, another fallout has been huge mis-selling and customer deception. The net result has been contraction of the infrastructure: closure of branches, a short-sighted strategic approach in a hugely-untapped potential market; redundancies in both administration and marketing alike; accumulation of huge losses arising out of expense over-run; and, eventually, negative growth of the industry.

The outcome of the current situation has made industry managers sit up. Incidentally, it may be noted that the pain of decline in the growth of the industry has been felt equally by the independent distribution networks. The forward-looking stance is to visualise new strategic approaches, which will put the companies on firmer-footing of sustained growth and profitability.

The industry managers, while willingly approving the expense over-run, were reassuring themselves of benefiting from eventual emergence of the embedded value (EV) and appraisal value (AV).

However, the factor of EV and AV depends on sweating out of the resources-inputs optimally, which did not happen while industry was relaxing on the beach of high growth propelled by a booming capital market. The new trend is to slice and dice every bit of strategic approach to help resources deliver the optimal output. Such an approach has put significant stress on human resources on the marketing side that had so far enjoyed the fruits of quick and easy conversion of prospects into customers.

The new approach, though not easy to crack in implementation, can enable life insurance companies to achieve break-even faster. However, this calls for cultural overhaul and a rethink of values. First, managers at the senior, middle and even the lower middle levels have to be convinced that life insurance business is a marathon race. It is not a relay race where the outgoing CEO hands over the baton to a new incumbent with ease.

In fact, the entrepreneur shareholders will have to keep a sharp lookout for what is being accumulated in the backyard of the company: actually EV and AV or garbage. A few strategic mistakes in the case of life insurance business can blow up the company, but the explosion takes place several years later. The case of Equitable Life Insurance Co of the UK – inventor of level premia – is a singular case where corporate governance failed and the company eventually went under due to its inability to decipher irrational assumptions in the pricing of product and valuation of business.

Apparently, some sanity has dawned in the Indian life insurance industry, which will hopefully lead to better and orderly growth. The focus should shift to building the basics of the business, managing the distribution network efficiently, containing the expense over-run and building on the trust and confidence among the customers that LIC has painfully nurtured in its life's journey of nearly 60 years.

Big Daddy LIC Falls For Blue Chip Companies

FIIs may have been the driving force behind the stock market rally since March this year, but some credit should also go to the big daddy of local institutions – the Life Insurance Corporation (LIC). The insurance behemoth has raised its stake in many bluechip companies across sectors, including a few state-owned companies and banks, by picking up shares through open market purchases.

According to brokers, insurers like LIC and other public and private sector players keep investing when opportunities arise, irrespective of market trends. Anup Bagchi, ED, ICICI Securities said, "Insurers have continuously been lending support to the market whereas mutual funds have been facing some redemption pressure for the past few months. Insurers are in a better position to invest on a sustainable basis, because of the constant flow of renewal premium."

According to data on open market purchases available with stock exchanges, LIC has bought 2-3 % each in companies like Indian Overseas Bank, Bharati Shipyard, Cummins India, Bharat Electronics, Tata Tea, Andhra Bank, PTC India, Chennai Petroleum Corporation and Ultra Tech Cement, among others. LIC bought 2.1% in Tata Tea, raising its stake to as high as 16%, according to disclosures filed with BSE. PTC India is another company where LIC bought 2.1% to increase its holding to 14.6%. Andhra Bank saw LIC hiking the stake by 2.1% to 11.2% through open market purchases.

Flush with cash, LIC has been on a buying-spree in the past three quarters, which, according to brokers, reflects its confidence in India's growth story.
Latest GDP figures could only have reaffirmed LIC's faith in long-term prospects of the economy, which grew at better-than expected rate of 7.9% in the July-September quarter.

9.0 KNOWLEDGE RESOURCE

Green PIECE

Does fashion follow climate and economic changes? The obvious answer would be in the positive – but how and in which way does this cookie crumble is in the realm of fiction. The UN climate change conference in Copenhagen kick-started with a sustainable fashion show that was all about going green.

How has this been accepted? The trends in the industry, which has in the last year seen a recession reality, are equally hard to predict. So, in the realm of fiction one would first presume that the word fashion, as it applies to the rest of the world in general and to India in particular, needs redefining in the foreseeable future – moving into 2010.

Fashion like all other highly visible areas of consumption tends to be an 'over the top' business, both in its marketing and usage of resources. Other than the large output of fashion clothes which end up at discounts at the end of the season, stuffing consumer wardrobes.

The world has in the last six decades seen a fashion boom especially in the luxury markets internationally, where the aspirational value of the by-products of fashion, viz perfumes, bags, scarves and shoes etc net more than the garments designed or sold by the dozen or so, of designer fashion houses.

These, at the turn of the last century, were created by individually talented designers and run on the lines of a mom and pop shop. These smaller ateliers have today been bought out by the multi national conglomerates, who can afford expensive retailing and manufacturing, due largely to the profitability of selling the luxury image. A walk in Selfridges, London, Gallery Lafayette, Paris or Neiman Marcus, New York will expose you to the same merchandise, and throw up the same designer names regardless of the country you are in. Added to this uniformity, one is really struck by the inordinately large inventory of any type of fashion merchandise, clothes, bags, sunglasses, hair accessories.

In the last year or so the stores lack traffic, and one wonders where the mountains of goods are going to be dumped when fresh merchandise hits the stores for the next season. The cycle cannot be stopped and with every churning there is going to be a fall out of design houses and throw away goods.

It is hard to believe that the affluent world is going to give up this honeymoon with quickly obsolete fashions and embrace the green movement and buy natural and eco-friendly products only. It is, and perhaps will remain a niche market, for people who are more conscious of their environment than others. Unfortunately, sustainable fashion shows both in India and abroad, pays only lip service to the cause, and is in no way effective in their attempt to conquer consumption trends.

India, perhaps, is one of the few countries where fashion does not turn red, when like the rest of the world; it is announced as the colour of the season in Paris. We still have an indigenous and traditional understanding of nature and wear more society, regional and climatic specific fashions.

Perhaps the ever resilient factor of never throwing anything away, and buying value for money in the psyche of the Indian woman may yet be our west bet to declare that in India we, other than most of the world, think about consumption patterns – more in thrift than in sympathy with ecology, and may yet be the first country to declare 'green' as fashionable.

Green Is the New Black

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