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SAFE UPDATES – KEEP INFORMED

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Editorial preamble:

1.1 ROLLING BACK

The Downside of Stimulus

With the market fireworks of early this year now fizzling like bottle rockets on a damp day, many investors are wondering how the environment changed so suddenly. After all, the widespread expectation at the start of the year was that rallies in most asset classes would continue for a while longer on the back of a recovering global economy. Policymakers were rushed to save the world from a Great Depression redux through their stimulus efforts. However, the realisation that all the money injected into the system has not necessarily found the right home is now spreading from Beijing to Washington.

In emerging markets such as China and India, economic growth has indeed rapidly returned to trend but inflation is resurfacing much too early in the economic cycle. Meanwhile, in developed countries such as the US, frustration is growing over the rather mediocre recovery that is only benefiting a privileged few despite the explosion in government spending.

Cracks in the Keynesian script of stimulating your way back to prosperity have been widening over the past months. An extraordinary jump in prices of commodities from oil to copper in the face of rising inventories was a major troubling sign. The sharp appreciation in commodity prices began well before the global recession ended in the second quarter of 2009 due to a surge in paper rather than physical demand.

Financial investors poured more than $50 billion into commodity funds in 2009 – more than three times the average annual pace in the 2003-07 boom years – spurred on by excess liquidity in the system and due to a loss of confidence in paper money, preferring 'hard assets' instead.

The rise in commodity prices is self-limiting beyond a point, as it damages global economic growth. Oil and food prices typically do not increase meaningfully at the early stages of an economic upturn because enough excess capacity from the previous cycle satisfies incipient changes in demand. This allows inflation to remain low and central banks to maintain an accommodative monetary policy stance.

In the current cycle, commodity price-led inflation is forcing many emerging market central banks to tighten monetary policy prematurely. It is no coincidence that the sell-off in financial markets began following China's decision to raise the reserve requirements on its banks in mid-January. Market bulls argue that it took a similar action in early 2004 and after a few months of volatility, the Chinese and the global economy were again firing on all cylinders.

They forget, however, that the global economy was on a much stronger footing then. In fact, a surge in exports boosted China's growth later in 2004 even as domestic demand took a while to recover from the monetary tightening. This time around, the world is looking for China's import demand to be the saviour.

Furthermore, inflation was not an issue in 2004 in many other emerging markets as commodity prices had not risen so violently. Oil was trading below $50 a barrel and food prices outside China were stable for much of that year. Many economic observers overlook the fact that at $75 a barrel, oil is back to where it was at the peak of global industrial activity in October 2007; the price of oil has made its way back up more due to liquidity-driven speculative fervour rather than genuine demand.

Apart from being inflationary, higher oil prices are a tax on growth. Estimates show that every $10 increase in the price of oil shaves off 0.3% from US GDP growth. As most models put the fair price of oil closer to $50 a barrel – given the prevailing trend in consumption and inventories – the current $25 'liquidity' premium is cutting a percentage point from US growth.

While higher oil prices are not on their own a burning issue in the US today, they add to the angst of the average consumer who is anyway worked up by the shallow recovery that all the stimulus has achieved, with overall unemployment still close to 10% and wages unchanged. As a result, a near-revolt is underway against the stimulus policies in the US. One of the main reasons why George W Bush lost the support of a part of his Republican base as well as some independent voters in his second term was due to his failure to rein in government spending. At 40% of GDP by 2008, total US government spending as a share of the economy was at its highest level in post-war history. The anger against the rise in government spending has spread further under the Obama administration, with his $800-billion stimulus package only adding to the mounting debt load without yielding any real widespread benefits.

One of the less-understood aspects of the fiscal and monetary stimulus is that it ends up protecting the inefficient and well-connected players instead of ushering in renewed vigour in the economy.

Some sort of a Darwinian flush is necessary after a long boom to clear the ground for a fresh crop to emerge. Capitalism draws its dynamism from a natural clearing mechanism. Allowing boom-bust cycles to play out served the US economy well during the downturns in the 19th century; it emerged stronger each time with no government intervention.

However, the faith in the purging power of the market went too far in the 1930s, when the policy mix of tight money and high taxes remained in place well after the excesses had been wrung out of the system. The result was the Great Depression. Parallels drawn to the 1930s following the 2008 meltdown brought on the impulsive reaction by policymakers to do everything possible to bail out the economy.

In doing so, they may have swung to the other extreme by not allowing a cleaning of the rot and legitimising a part of the preceding debt binge. *Research from the firm Ned Davis shows that it has taken over $5 of debt to produce one dollar of US GDP over the past decade compared with $3 in the 1980s and 1990s and an even smaller $1.50 on average in the 1950-80 period.*

Japan too tried to prop up its economy through massive fiscal spending and various bailout packages over the past two decades following the end of the 1980s debt-financed boom. That led to an increased share of the government in the economy and an associated decline in productivity. The US was headed for the same fate but the one key difference could be that the US is by nature less of a socialist society than Japan or Europe and does not like too big a role for the government.

The message the US electorate has started sending to the incumbents in Washington is that it has had enough with all the wasteful government spending and will lean toward candidates more focused on fiscal rectitude and smaller government. This was evident in last month's surprise election victory of Republican candidate Scott Brown as the senator from the traditional Democrat preserve of Massachusetts. Two-thirds of US voters think the stimulus spending is ineffective. Small businesses, which employ nearly 60% of the US workforce, say they are not hiring new workers amid concerns over a hike in taxes in the future to finance the mounting debt load. The declining popularity of the Obama administration is mainly because he is coming across as an old-fashioned, big government liberal.

When the global economy was in crisis, policymakers could easily justify all the proactive government action as necessary measures to stave off a complete collapse. Now that it has stabilised, attention has turned to the effectiveness of the stimulus. Unfortunately, the negative aspects are surfacing: ranging from commodity price inflation in emerging markets to the lack of a big bang for the enormous bucks spent in the developed world. A withdrawal of the stimulus may lead to some fresh pain in the short term, with the latest global market selloff reflecting that risk. But it could well clear the deck for a more sustainable, inclusive and organic upturn to materialise in the medium-to-long term.

1.2 STOCK MARKETS

Focus On Retail Investors

NTPC's follow-on public offer (FPO) just about frayed through, primarily because state-owned LIC and the SBI came to the rescue. Retail investors applied for only 16.5% of the shares earmarked for them. Employees, too, took away less than 50% of the shares they were offered. Four bankers – ICICI Securities and Kotak Mahindra Capital Company from India and US-based Citigroup Capital and JP Morgan – had made tall claims of selling these shares at a premium at the time of their appointment.

However, there were several things wrong with the issue. The one big proximate factor was, of course, the return of nervousness on stocks created by the sudden plunge in stock prices of late.

But that was not all. The design of the issue is open to question, the so-called French auction used to determine allocation and price among institutional buyers, for instance. In a French auction, bidders are allotted shares at the price at which they bid. But the bids must remain confidential. In the NTPC FPO, every bidder could see the price and quantity bid by others, and they were free to revise their bid upwards. This system encourages people to bid low, and keep revising the bids upwards, tracking others' bids.

How is this French auction? How does this incentivise anyone to apply their own judgment as to the worth of the company and put their money on that judgment? Next time around, let the bids remain sealed and let the French auction function the way it is supposed to. Why at all attempt to discover the price of a listed and traded share? The market already offers a price.

Conspiracy theory: The department of disinvestment is believed to have compiled a list of institutional investors and brokerages that have sold NTPC shares in the past one month. The government is also concerned that poor investor response to the NTPC issue may impact the forthcoming FPOs of Rural Electrification Corporation (Rs 4,500 crore) and NMDC (Rs 14,000 crore), which are slated to enter the market on February 19 and March 10, respectively.

Thanks to the dismal returns from investing in recent IPOs, retail investors may not be willing to touch what are received to be high-priced issues despite managements trying to convince that theirs is a “unique business model” and may not be compared with their listed peers. Fund managers who invested in many of these offers are counting losses. Retail investors seem to be getting wiser than fund managers. They are staying away from IPOs. But their wisdom may spell trouble for promoters and investment bankers.

The lukewarm response to utility NTPC’s follow-on share sale, and the IPOs of Godrej Properties, JSW Energy and MBL Infrastructure are signalling that promoters’ attempt to squeeze the last penny out of investors’ pockets may well be killing the goose that lays golden eggs.

Consider this: Of the 22 IPOs in 2009 and now, 13 returned between 4% and 27% while the rest led to losses between 3 and 20%. This is in sharp contrast to the trend in 2007 when all the listings, about 100, returned between 82% and 175% on debut, some of which subsequently declined too. While many IPOs offered smart listing gains to the investors during the stock market boom of 2007-08, there is now a reversal in the trend with the market turning extremely volatile and choppy.

But it may weaken the finances of the government, which is planning to raise funds selling record number of shares, including in miner NMDC and steelmaker SAIL. What we need is a string of successfully listed IPOs and stable secondary market conditions to revive retail sentiment towards the primary market.

1st week of February 2010 – Sensex dipped below the psychological 16,000-level

Daily review	29/01/10	01/02/10	02/02/10	03/02/10	04/02/10	05/02/10	06/02/10
Sensex	16,357.96	(1.93)	(192.59)	332.61	(271.10)	(434.02)	124.72
Nifty	4,882.05	17.65	(69.60)	101.75	(86.50)	(126.70)	38.6

We all fall down

Friday's 434-point (2.7%) fall in the BSE Sensex has put on hold to decoupled fantasies. We have always been sceptical of the decoupling thesis. In today's globalised world, the fortunes of all economies and markets are so inextricably interlinked that strong global cues will always prevail over domestic factors.

Yes, in the short term, better-performing emerging markets may be able to march to a different tune, as Brazil, Russia, India and China (the Bric countries) did for most of the latter part of 2009 and early 2010. But in the medium to long term, no economy is immune to developments elsewhere.

Large-scale anxiety over the quality of the US economic recovery, the implications of President Obama's proposals for bank reforms banning proprietary trading and fears of sovereign debt defaults in countries like Greece, Portugal and Spain have combined to take their toll on markets across the world.

Ironically, none of these (save US employment data) is a sudden development. But as is markets' wont, there is a tipping point beyond which they seem to lose their head. And so it was on Friday when Asian markets fell for the second consecutive day and the Indian market followed suit.

Rationalists would argue that, as far as the Indian market is concerned, there is no change in macroeconomic fundamentals that can justify Friday's collapse. In fact, the central bank has just raised its GDP projection for the year to 7.5 per cent (up from 6% earlier) and corporate results have also been robust. There is an element of uncertainty about government withdrawing some of the fiscal stimulus in its forthcoming Budget but that is no reason to panic.

Yet, none of this will be of any avail if the fear of double-dip recession in western economies takes root. Then we may again see the dollar become a safe haven to which funds flee from emerging markets, including ours. But as long as the India growth story remains intact - and the non-export dependent real economy is largely in our hands – there is no cause for despair.

We might all fall coupled, but will also rise again and faster than many others.

Saturday Special: Sensex rises 125 pts: Snapping a two-day slide, Indian shares rose about 1% on Saturday in a special trading session, helped by the absence of foreign investors, which have sold heavily over the last couple of weeks. A late rebound in US equities on Friday also encouraged local traders to trim their short positions on Saturday, aiding the bounce. BSE's 30-share Sensex closed at 15,915.65, up 124.72 points or 0.79%. NSE's 50-share Nifty ended at 4757.25, up 38.6 points or 0.82%. In the broader market, gainers beat losers 1931:607 on the BSE. **Both the stock exchanges were open between 11 AM and 12:30 AM as the NSE sought to upgrade its existing trading system.**

Weekly review	29/01/10	06/02/10	Points	%
Sensex	16,357.96	15,915.65	(442.31)	(2.70%)
Nifty	4,882.05	4757.25	(124.80)	(2.56%)

2nd week of February 2010 – Sensex gained 230 points, consolidating at around 16k before budget

Daily review	06/02/10	08/02/10	09/02/10	10/02/10	11/02/10	12/02/10	13/02/10
Sensex	15,915.65	19.96	106.57	(120.01)	230.42	MAHA	
Nifty	4757.25	3.15	32.25	(35.45)	69.65	Shinratri	Saturday

Weekly review	06/02/10	13/02/10	Points	%
Sensex	15,915.65	16,152.59	236.94	1.49%
Nifty	4757.25	4826.85	69.60	1.46%

3rd week of February 2010 – Sensex preparing for the budget day, gained 39 points

Daily review	13/02/10	15/02/10	16/02/10	17/02/10	18/02/10	19/02/10	20/02/10
Sensex	16,152.59	(114.24)	188.33	202.23	(101.07)	(136.21)	
Nifty	4826.85	(24.90)	53.80	58.25	(26.25)	(42.85)	Saturday

Weekly review	13/02/10	13/02/10	Points	%
Sensex	16,152.59	16,191.63	38.94	0.24%
Nifty	4826.85	4844.90	18.05	0.37%

4th week of February 2010 – Sensex during budget week, gained 1.47%

Daily review	20/02/10	22/02/10	23/02/10	24/02/10	25/02/10	**26/02/10**	27/02/10
Sensex	16,191.63	45.42	49.27	(30.35)	(1.77)	**175.35**	
Nifty	4844.90	11.50	13.65	(11.45)	1.15	**62.55**	Saturday

Weekly review	20/02/10	27/02/10	Points	%
Sensex	16,191.63	16,429.55	237.92	1.47%
Nifty	4844.90	4,922.30	77.40	1.60%

Finally, street breaks B-Day Jinx

The stock market witnessed a rare budget rally – the first time in four years – boosted by the government's pledge to cut fiscal deficit, but concerns about rising inflation, and with it interest rates, tempered the mood. Prices of government bonds also rose, before easing amid inflation worries. Rating agencies were pleased, with Moody's Investor Services saying it may "countenance" an increase in India's local currency rating if the government kept its pledge on deficit.

Monthly Review

Month	December 2007	December 2008	December 2009	January 2010	February 2010
Sensex	20,206.95	9,647.31	17,464.81	16,357.96	16,429.55
Points	Base	(10,559.64)	7,817.50	(1,106.88)	71.59
%	Base	(52.26%)	81.03%	(6.34%)	0.44%

REC FPO subscribed over 3 times, retailers skip

The Rs 3,500 crore Rural Electrification Corporation (REC) follow-on-public offer is subscribed fully on the final day of the issue, with merchant bankers to the issue attributed the success to the last-minute interest from foreign institutional investors. The overall subscription picked up sharply and finally ended at 3.14 times. The strong response comes as a relief to both the government and the merchant bankers to the issue, who were criticised for their inept handling of the recent follow-on-offerings.

The qualified institutional book was subscribed 5.6 times and non-institutional investors two times. But the retail part remained undersubscribed, at just about 0.23 times (or 23 per cent).

LIC, which bid for Rs 3,200 crore worth of shares at Rs 204-205, may not get any shares as the entire issue was oversubscribed at Rs 206 per share and above, said an investment banker involved in the issue. In French auction, the shares are allotted starting from the highest bidder, downwards.

Besides LIC, even state-owned SBI may not be allotted any shares, as it is learnt to have bid for Rs 300 crore worth of shares at Rs 204 per share.

Halbis, which is part of the HSBC group is learnt to have bid for Rs 1000 crore worth of shares at Rs 206 per share. Some of the leading FIIs learnt to have put in bids at Rs 206 and above include New Vernon – Rs 460 crore, Morgan Stanley – Rs 200 crore, PPM –Rs 160 crore, GMO – Rs 154 crore, Sansar – Rs 150 crore, Jardine Fleming – Rs 100 crore and Nomura Rs 80 crore. Domestic funds that participated in the issue include Sundaram, Reliance Mutual Fund and JM Mutual Fund.

Retail investors turn Street-smart, skip IPOs

After cold shouldering some of the recent initial public offerings (IPOs), retail investors seem to have changed their minds on some of those companies post-listing. The stocks have attracted good interest from retail investors in the secondary market. According to brokers, retail participants would have adopted a wait-n-watch approach during the subscription period and subsequently entered the secondary market to take advantage of the sluggish movement in the shares, post-listing. Another possibility is that some IPOs may not have evoked good retail response due to unfavourable market conditions. But, the investors could have taken a positive view on it with the improvement in sentiment after listing.

2.1 INDIAN ECONOMY

Economic Survey 2009-10.

Finance Minister Pranab Mukherjee on 25th February 2010 tabled the Economic Survey 2009-10. Following are the highlights of Economic Survey:

* Economy posted a remarkable recovery expected to grow at 7.2 per cent in 2009-10 against 6.7 per cent in 2008-09.

* Survey hopes the Indian GDP can be expected to grow around 8.5+/- 0.25 per cent, with a full recovery, breaching the 9 per cent mark in 2011-12.

* Manufacturing growth more than doubled to 8.9 per cent in 2009-10 from 3.2 per cent in 2008-09.

* Survey recognises food inflation as major concern.

* Per capita income increased to 5.3 per cent in 2009-10 from 3.7 per cent in 2008-09.

* Gross Fiscal deficit stands at 6.5 per cent of GDP.

* Liquidity condition remained comfortable during 2009-10.

* Bank credit grows by 13.9 per cent on year-on-year basis. Non-food bank credit recorded an increase of 8.7 per cent on financial year basis till January 15, 2010 as per the latest available data.

* Agricultural credit disbursal exceeds target. At sectoral level, there has been a rebound in the growth rate of investment in the agricultural sector, which grew at 16.5 per cent and 26.0 per cent in 2007-08 and 2008-09 respectively against 1.4 per cent recorded in 2006-07.

* Investment Deposit Ratio increases to 32.52 per cent.

* Balance of Payment situation improves due to surge in capital flows and rise in foreign exchange reserves, which have been accompanied by rupee appreciation.

* Net capital flows to India at US$ 29.6 billion in April-September 2009 remained higher as compared to US$ 12.0 billion in April-September 2008.

* During fiscal 2009-10, foreign exchange reserves increased by US$ 31.5 billion from US$ 252.0 billion in end March 2009 to US$ 283.5 billion in end December 2009.

* Recommendations of the Thirteen Finance Commission need to be taken on board in shaping the fiscal policy for 2010-11 and in the medium term.

* Momentum in telecommunication sector continues with monthly additions exceeding 17.6 million connections.

* Share of central government expenditure on social services including rural development, in total expenditure, plan and non-plan gone up to 19.46 per cent in 2009-10, which was only 10.46 per cent in 2003-04.

Summary of Indian Railway Budget 2010-11

There will be no increase in the passenger fares of any class or category of trains. Freight tariffs will also remain the same for 2010-11.

Railway has proposed INR 41,426 crore, the highest ever plan investment to provide efficient, customer focused and modern railway network. Out of this allocation, INR 4,411 crore has been proposed to achieve the target of 1,000 kilometers for new lines and INR 1,302 crore for passenger amenities. The Plan would be financed through gross budgetary support of INR 15,875 crore, Diesel Cess of INR 877 crore, internal resources of INR 14,523 crore and EBR of INR 10,151 crore including market borrowing through IRFC of INR 9,120 crore.

Railway is committed to take up socially desirably projects connecting backward areas of the country. Surveys for 114 projects for such areas will be updated and surveys for 55 new lines will be taken up during the year. 800 kilometer Gauge Conversion and 700 kilometers of doubling the rail line will be achieved during the year besides a number of new projects on cost sharing with state governments or through PPP route.

Target has been set to add 25,000 kilometers of new lines in next 10 years.

In order to bring more transparency in freight business, the Railway Minister announced RFID technology will be introduced for tracking of wagons, allotment of the rakes would be accessible through the web.

In order to upgrade railway infrastructure, the Minister said that a centre for Railway Research will be set up at IIT, Kharagpur for research in key areas of railway technology and a state-of-the art advanced loco pilot training centre at Kharagpur and an advanced railway track training centre at Beleghata.

To overcome of the shortage of coaches, new coach factories are being set up at Rae Bareilly, Kancharapara and Palakkad. A wagon repair shop will be set up at Badnera and a new Rail Axle Factory will be set up at New Jalpaiguri through PPP or Joint Venture mode. Besides 5 state-of-the-art wagon factories also through joint venture and PPP mode at Sikandrabad, Barddhaman, Bhubneshwar/Kalahandi, Guwahati and Haldia.

Proposing several new initiatives for freight business, the Minister said that Railways will introduce a modified wagon investment scheme for high capacity general purpose and special purpose wagons for carrying iron ore, coal and cement. A scheme to run special freight train by private operators for commodities such as automobiles, vegetable oil, molasses, chemicals and petrochemicals will be notified.

Reiterating Railways' commitment for time bound completion of dedicated corridors; the Minister said preliminary Engineering-cum-Traffic Surveys for North-South, East-West, East-South and South-South corridors will be taken up this year. She also said that Railways is also working on high speed passenger rail corridors, a National High Speed Rail Authority will be set up for planning, standard setting and implementing these projects.

In order to promote industrial activity, Kumari Mamata Banerjee said that Railways would welcome investment through PPP mode for providing rail connectivity to important ports. Additional 2,000 kilometers routes will be electrified within two years.

2.2 INDIA

India: A Country of Paradox

India is such a land of contrasts that sometimes one wonders how the different pieces form part of the same whole. How does the 8%-plus GDP growth economy coexist with one where little, unclothed children sleep in the freezing streets of our Capital? How do we have a world-beating IT sector living side by side with huge amounts of corruption in our civil society?

How do we educate some of the brightest minds in our IITs and IIMs and yet are not able to provide basic education to a huge mass of our children? Why is it that we have some of the richest people on the planet but yet also the highest number of malnourished children in the world?

How do we aspire to be the new global superpower when we live in some of the worst cities of the world as far as infrastructure is concerned? How do we claim to be the world's biggest democracy when our politicians use every trick in the book to divide people on the basis of religion or caste or region?

This contradictory reality makes India a true paradox – a country hard to understand, where the future path is less clear than it should be. While on the one hand our middle class, nationalistic aspirations would have trumpet India's rise in the world and growing influence within it, at the same time, when we see the results of our elections – where chances of success are often directly correlated to the level of corruption. So, who are we really: are we truly world-beaters, or are we a cold-hearted people not caring much for the suffering of our fellow citizens?

Our thesis is that there really are two Indias at work here.

The first is the one that is honest, hard-working, carries the aspirations of the large mass of Indians, is proud of the nation and is looking forward to India's emergence in the world and is working towards it.

We hate to call it middle-class India but essentially that's what it is – in mindset at least it espouses middle-class values – of wanting a better lifestyle, being consumption-oriented, working hard, carrying the right set of values, perhaps secular in outlook, not wanting to get or grant any special discrimination either, still caste oriented – but rapidly losing this vestigial hang-up, and so on.

This India operates above board: it is transparent and, by and large, follows the rules of the game. It is not necessarily urban only – the same values drive many in rural India as well.

Then there is the 'other' India – the one that is driven primarily by self-interest. The motive of this lot of folks is self-enhancement at all costs.

This India believes in subjugation and exploitation by any handle: whether it be based on religion or caste or ethnicity, as long as it perpetuates financial or political interests. It thinks nothing of flouting rules, does not believe in growing the pie – and certainly not in sharing it – indulges in corruption on a vast scale, and thrives on the seamy nexus between business and politics, and politics and criminals. This India wins plenty of elections too: taking advantage of the immaturity of our voters, it gets or doles out large government contracts, mining leases, land and other public assets at lower than market prices – and benefits personally in the bargain. This is the India where public funds are diverted to line local pockets at the cost of the poorest and the most dispossessed without batting an eyelid.

This India operates alongside the aspirational India, and it does not have a soul.

There are many who operate seamlessly between the two Indias — and, in fact, there is a large grey area between the two Indias and there are those who can swing either way, and, in fact, often do.

The struggle between the two Indias is in some way a struggle for India's soul, and will determine where we end up as a nation and as a people. As the modern India grows and the middle class increases in size and middle class values become more deeply-rooted across a broader swathe of people, then the chances are that, over time, this is the India that will become more robust and stronger.

And, in fact, this is the best way out of our current paradox. More growth, even though it is highly inequitable right now, will inevitably pull more people into the 'aspirational class'. As this happens, our society will slowly become more open and more transparent.

Our democracy will become more effective and robust, and the benefits of growth will be spread more widely through more effective government programmes, NGOs that operate in the field, and a higher level of philanthropic activity on the part of more giving citizens.

However, there is equally the chance that this growth is held back by the other backward-driving elements or, more disturbingly, is held back in the hands of the few, further concentrating wealth and, along with it, power. Or that this growth is held back from the underdeveloped parts of India so much so that divisiveness in the country keeps increasing, and dark areas within the country keep becoming darker.

The statistics say that every year, 1% of India is pulled above the poverty line. But some 25% of India – a full 260 million Indians – still eke out their existence in some fashion or other. It is not only this part of India that we will let down if we lose the battle for India's soul. It is in everybody's interest to ensure that the paradox of India is not only resolved over time, but that it is the aspirational India that is able to impose itself on the 'other' India. This will only happen if we have sustained, high-quality 8% growth for many years, and the quality of our civil society develops at a rapid and corresponding pace. And this depends on all of us contributing in our own unique but important middle-class way – working hard, working honestly and contributing to society sincerely. Motherhood and apple pie perhaps, but important nevertheless to the next and very critical phase of India's future journey.

India set to benefit from global recession: Betbeze

According to French economist Jean-Paul Betbeze, India is well placed to take advantage of global economic condition as competition has weakened in the global market place. "You merely have slowing down here. As a consequence you have every possibility of benefiting from the situation because of (contraction in) US and Europe… The lesson for India is that please take advantage of the situation. You benefit the most when competition is weak. But do that without forgetting about the risks. If you advantage of this situation, you can grow more efficiently than before."

Commenting on the capital controls, He said: "It is better to have capital flows than outflows; But if inflows are too much and for speculation then it is another issue. Inflows to buy companies that are long-term in nature are good, but not good for short-term and here there could be some ceiling. But you cannot be selective between short and long-term. Be happy with 7% growth. Take advantage of this bonanza."

Explaining the genesis of the global financial crisis, Betbeze said that the crisis was largely an outcome of overconfidence among investors. Against the backdrop of this confidence, "the regulators often does not warn the investor and then one tends to overestimate the risks till the risks materialise.

2.3 INDIAN INC

The FGIE Business Example

We in India have absorbed, adopted and admired western management philosophies, operating models and specific change management interventions right through the decades of 1970s, '80s and '90s and continue to deploy them in various depths and measures. Starting from MBO, TQM, core competency models, business process reengineering, balance scorecard and so on, they all have the gravy-mix of enterprise wide ramifications, impacting the financial performance of the business group.

We also equally bought into the Japanese style of management in the '80s and '90s. The continuous improvement frameworks, Canon production system, Toyota production system, total employee involvement, TPM and so on. Somewhere down the line in '90s and this century, we were keenly studying the Korean (Chaebol success stories) and Chinese (mass manufacturing) models.

The current decade which witnessed rapid boom and equally faster bust cycles has moved the Indian entrepreneur model, especially the **first generation Indian entrepreneurs** (FGIE) model to the centre-stage. It is time to look inward for the lessons and best practices followed by the first generation entrepreneurs:

Business focus, scalability & globality:

The FGIE have focused on one or more of the following areas, all having global footprint – basic commodities including metal; infrastructure development; technology services; pre-engineered products; and health care, new generation services like telecom, retail and other consumer oriented businesses. Be it Mittals, GMR, IT firms, Vedanta, Suzlon, Essar, the pharma companies, they all have one thing in common. FGIE have invested their energies, battled through the early hurdles of establishing and growing within Indian markets. And within no time moved beyond India to other developing nations and developed markets alike.

In the core areas of their business, they have either organically grown, implemented large expansion projects and/or acquired companies in their domain (more often distressed assets) on a global canvas. The FGIE companies have highly leveraged their growth funding. They have innovatively structured equity, debt, convertibles in world financial markets and deployed the funds on productive assets. They have sweated the capital to the hilt. The key strategic focus in the FGIE model has been exponential growth on a global canvas-highly leveraged yet with appropriate risk-measures in place.

Strategy is the prerogative of promoters:

With the FGIE model, the strategic decision making lies with the promoters, invariably supported by an in-house loyalist CFO. The M&A decisions, technology selection, vendor selection for capital equipment, hiring decisions, fund-raising strategies, org-structure and such core aspects of fuelling growth are decided by the FGIE.

The other functionaries including at times the CEO, COO and other executives have to be adept in implementation. Hence in FGIE model, there is a clear demarcation of roles between the promoters and professional managers. The FGIE thus prefer to appoint loyal, down-to-earth doers with a commercial and cost mindset. The model encourages managers who have to post quarter-on-quarter performance and grow from where the capital-decisions are made.

Importance of cost-optimisation and risk mitigation:

The cost strategy is played right from the inception. Nondescript offices, low-salaries and highly negotiated, often one-sided, contracts for every rental, purchasing and borrowing areas marks the early establishment phase of an FGIE company. These firms are so rigorously managed under the eyes and lens of the promoter that the risk strategies which in the western world is a separate subject-matter where external expertise is sought, is a naturally ingrained phenomenon in a FGIE firm.

Cost optimisation in operations, highly negotiated sourcing strategies especially during project management phases, innovative financing and structuring of deals and above all adrenaline pumping for growth, is the core of the FGIE model.

Government relations & dealing with regulatory affairs:

The FGIEs often directly themselves or through influential liaison managers (called lobbyists in the US) deal with the government machinery.

They strike customised agreements with the state to secure clearances, approvals and as a quid pro quo offer promoting welfare and development schemes to society.

Securing land, mines, forest clearance, environment, water on the industrial side, bidding, MoU, BOT, purchase agreements, licensing and so many regulatory areas on infra development and specific areas — such as privatisation, cross-border transactions — require interpretation of legal framework, persuasion and direct engagement of the promoters.

This is where there is an extended phase of negotiations with the government followed by the award or the approval which signals investment of risk capital. This is the virtuous cycle which actually represents the purple spot of the FGIE: the grey area management!

Transformation:

There is a threshold size of revenues unique to each chosen sector, when business operations become too big and unwieldy for the personal and direct engagement approach of FGIE. This is where the transformational process sets in. First and foremost, they hire leadership from the external environment.

They resort to committees to drive decision-making through consensus building approaches, develop foolproof assurance and risk management verticals and put in place performance measurement systems.

This transformation may set in once they cross a turnover of 1,000 crore or sometimes $1 billion or sometimes even a higher figure. If these processes gain speed, the FGIE is released from a number of day-to-day management issues and devotes all its energies to visioning, mentoring and exploring newer avenues of growth.

So, aptly, the FGIE devotes a part of his time to charity and CSR work. Each and every strand, as well as the complete FGIE model itself, is uniquely Indian, and its form and content is visible in various shades across all sectors and geographical regions.

Time for Indian model to walk the talk

Bharti Group chairman Sunil Mittal's dreams of taking the **Indian telecom business model** global has finally become a reality with the Indian operator buying out the Kuwait-based telco's African assets. "The Indian business model is crying to go out. It's a unique model-low cost, high volume and high minutes of usage," Mr Mittal had said recently when the telco had crossed the 100-million user mark.

The strategic alliance between India's largest telco Bharti Airtel and Zain's African operations will see both companies use each other's strengths and evolve what may well be the new business model for the future of communications in the developing world.

For Kuwait based Zain Group, operations in African market are significant in terms of subscriber base but not as profitable as its operations in the Middle East. The learnings therefore will have to come from Bharti's highly successful strategy of maintaining neat margins despite lower tariffs. The Indian operator has also managed to stay lean and mean and its employee headcount has remained constant despite its scorching pace of growth. This can be attributed to its industry-first **outsourcing model**.

Consider the figures: Bharti has streamlined its business in terms of employee productivity. In last two years, its revenue has almost doubled to Rs 39,383 crore (for trailing four quarters to December 2009. In contrast, its employee base has fallen by nearly 20% to 18200. As a result, employee productivity (measured in terms of revenue generated per employee) has nearly doubled.

The deal will also give Bharti an access to fast growing African markets. Bharti was long eyeing on this region and the unsuccessful attempt to merge with MTN did not change its strategy. With takeover of Zain's African operations, Bharti would be able to enjoy the pie of this market which still has a better per user revenue. Zain's average estimated ARPU was $ 8 for its 15 African countries, much higher than $ 5 for Bharti's Indian operations.

Industry executives say that Zain's business platform for offering financial services is 'very interesting'. Zain offers *mobile money transfers* across several countries and also offers '*mobile wallet'* services where customers can pay from their phones to at fuel stations & restaurants. Zain's expertise could therefore help Bharti crack what it calls '**the next frontier for mobiles'** in India *where bills payment, bulk (salary) payments, cross border & domestic transactions and bank transactions are all done on the mobiles.*

Besides, the biggest savings for the joint entity would come in the combined capex of this new company. It is no secret that Zain pays 30-40% more for its equipment when compared to Bharti. The combined entity will negotiate and push for better deals with equipment vendors. This will be the biggest positive behind this alliance. But the larger implication is that assuming Airtel succeeds in transferring its optimal cost model to Zain across several African countries, it is not hard to imagine the latter's profits show significant gains even if the topline remains at the current level.

An industry executive said that both telcos would look at integration of their undersea cable business at the earliest. A lot of global undersea majors are betting big on Africa and making huge investments in that continent and these include India's Tata Communications and Reliance Communications-owned Flag, which are executing large undersea cable projects to tap the nascent African market. Zain has been joining undersea cable consortiums to tap the African market, but an alliance with Bharti will give it a major boost as it can now boast of a global footprint. For Bharti, the partnership allows it to challenge the likes of Flag and Tata Communications even in Africa.

2.4 **INTERNATIONAL**

China Surprises with 2nd CRR Hike In Four Weeks

Reserve Ratio will rise by 50 basis points effective February 25: China ordered banks to set aside more deposits as reserves for the second time in a month to cool the fastest-growing economy after loan growth accelerated and property prices surged. People's Bank of China said, "The reserve requirement will increase 50 basis points, or 0.5 percentage point, effective February 25.

The central bank on January 12 increased banks' reserve requirements for the first time since June 2008.

Stocks pared gains in Europe after the announcement on concern that tighter lending in China will damp the global economic recovery. Policy makers aim to avert asset bubbles and restrain inflation after banks extended 19% of this year's 7.5 trillion yuan ($1.1 trillion) lending target in January and property prices climbed the most in 21 months. The central bank moved after Chinese markets closed and on the eve of a weeklong Lunar New Year holiday when the nation moves into the Year of the Tiger from the Year of the Ox. The Shanghai Composite Index rose 1.1% before the announcement.

Record lending and a 4 trillion yuan stimulus package have helped the nation to lead the recovery from the first global recession since World War II.

Avoiding 'Overheating':

With China's increasing economic significance in the world economy, major policy moves will always touch a nerve with global markets; Timely tightening in China will help sustain growth and avoid overheating, benefiting the world in the long term.

Investors' concern about investment bubbles in China, and what action the government may take to prevent or deflate them, has mounted this year. There's a monumental property bubble and fixed-asset investment bubble that China has underway right now. And deflating that gently will be difficult at best. The central bank said that it wanted to gradually normalise monetary conditions from a "crisis mode" after GDP grew 10.7% in the fourth quarter, the fastest pace in two years.

Pegged Currency:

Policy makers are yet to drop the yuan's effective peg to the US dollar, which was adopted in July 2008 to aid the nation's exporters, stoking friction with the US and Europe. Today's move will remove about 300 billion yuan from a financial system.

The central bank will keep raising the ratio frequently until the middle of the year," said Lu Zhengwei, a Shanghai- based economist at Industrial Bank Co., who predicted today's increase. "The central bank wants to stay ahead of the curve by tightening before inflation starts to gain pace."

Weaker Inflation:

This week's data showed consumer prices rose 1.5% in January from a year earlier, down from 1.9% in December, on smaller gains in food prices. Inflation will accelerate to 3.6% by the end of June, according to a Bloomberg News survey of economists. Economic data this week showed property prices across 70 cities surged 9.5% in January from a year earlier, exports climbed and producer price inflation accelerated. Bank lending of 1.39 trillion yuan topped the total for the previous three months combined.

AMERICA: Muddling out of free fall

Defeat in the Massachusetts senatorial election has deprived America's Democrats of the 60 votes needed to pass health-care reform and other legislation, and it has changed American politics – at least for the moment. But what does that vote say about American voters and the economy? The message it sends is the same as that sent by voters to President Bill Clinton 17 years ago: "It's the economy, stupid!" and "Jobs, jobs, jobs."

The US economy is in a mess – even if growth has resumed, and bankers are once again receiving huge bonuses. More than one out of six Americans who would like a full-time job cannot get one; and 40% of the unemployed have been out of a job for more than six months. Hardship increases with the length of unemployment, as job skills and prospects deteriorate and savings gets wiped out. America experiences its own version of "Japanese malaise."

President Barack Obama took a big gamble at the start of his administration. Instead of the marked change that his campaign had promised, he kept many of the same officials and maintained the same "trickle down" strategy to confront the financial crisis. Providing enough money to the banks was, his team seemed to say, the best way to help ordinary homeowners and workers. When America reformed its welfare programs for the poor under Clinton, it put conditions on recipients: they had to look for a job or enroll in training programs. But when the banks received welfare benefits, no conditions were imposed on them. Had Obama's attempt at muddling through worked, it would have avoided some big philosophical battles. But it didn't work, and it has been a long time since popular antipathy to banks has been so great.

Obama wanted to bridge the divides among Americans that George W. Bush had opened. But now those divides are wider. His attempts to please everyone, so evident in the last few weeks, are likely to mollify no one. Deficit hawks – especially among the bankers who laid low during the government bailout of their institutions, but who have now come back with a vengeance – use worries about the growing deficit to justify cutbacks in spending. But these views on how to run the economy are no better than the bankers' approach to running their own institutions. Cutting spending now will weaken the economy. Trying to "square the circle" between the need to stimulate the economy and please the deficit hawks, Obama has proposed deficit reductions that, while alienating liberal democrats, were too small to please the hawks. Other gestures to help struggling middle-class Americans may show where his heart is, but are too small to make a meaningful difference.

Three things *can* make a difference: a second stimulus, stemming the tide of housing foreclosures by addressing the roughly 25% of mortgages that are worth more than the value the house, and reshaping our financial system to rein in the banks.

There was a moment a year ago when Obama, with his enormous political capital, might have been able to achieve this ambitious agenda, and, building on these successes, go on to deal with America's other problems. But anger about the bailout, confusion between the bailout (which didn't restart lending, as it was supposed to do) and the stimulus (which did what it was supposed to do, but was too small), and disappointment about mounting job losses, has vastly circumscribed his room for maneuver.

Indeed, there is even skepticism about whether Obama will be able to push through his welcome and long overdue efforts to curtail the too-big-to-fail banks and their reckless risk-taking. And, without that, more likely than not, the economy will face another crisis in the not-too-distant future.

Most Americans, however, are focused on today's downturn, not tomorrow's. Growth over the next two years is expected to be so anemic that it will barely be able to create enough jobs for new entrants to the labor force, let alone to return unemployment to an acceptable level. Unfettered markets may have caused this calamity, and markets by themselves won't get us out, at least any time soon. Government action is needed, and that will require effective and forceful political leadership.

2.5 WARNING SIGNALS

Be Prepared For another Storm

There is a danger in taking an unqualified upbeat outlook. Emerging economies in Asia had recovered nicely, but there were several problematic elements in the global situation – continued trade contraction and missing job recovery in advanced economies and the difficult challenge of managing the massive expansionary fiscal and monetary stance that the west had used to tackle the crisis. Further, that the common currency in the Eurozone was shackling adjustments necessary for the region to recover. It looks that 2010 appears set to be a "bumpy ride" and the rest of us are advised to keep our seat belts fastened.

In other words, reduce risk in the policy sphere, especially fiscal and monetary. To put it in plainer language, for Asian economies that have seen growth revive – the prudent course is to avoid excess liquidity in money markets and strengthen public finances by starting to cut the fiscal deficit.

Beginning January 21, 2010, financial markets began showing signs of unease that has blown into a storm in the first week of February. The story starts with the previous government of **Greece** that had cooked its books wholesale. On October 4, 2009 elections put a new government headed by Georgios Papandreou in office. Two weeks later his government restated the deficits for 2008 and 2009. The former was raised from 5 to 7.7 % and the latter from 3.7 to 12.5 % of GDP, which was upped to 12.7 % next month. The CDs (credit default swap or insurance) for Greek bonds soared.

Burned by Greece, investors began to eye other potential sleepers. They identified three more – **Portugal, Ireland and Spain**. The CDs for Greece, Portugal and Ireland went up sharply through November and December 2009. Spain followed. European banks have large exposures to these economies, so they are in the firing line. But as you may recollect there was no panic. Most probably you never heard of it. Things were going well and so it did till January 20, 2010.

It is perhaps unwise to call the sudden loss of confidence in financial markets. But jitters it certainly is. Most important perhaps is that it yet remains unsettled how Greece will realistically get back on track. The CDs for Greece is at 415 basis points (bps), Portugal 226 bps, Spain 164 bps and Ireland 150 bps. Italy has joined the crowd with its CDs rising to 152 bps. To put things in perspective, the CDs on German government bonds is 47 bps. The cost of protection of all sovereigns, even those far removed from the mess, has gone up 20 to 40 bps over the past month.

When the cost of protection on bonds rise, it becomes harder for governments to raise money. And for the most part, they need lots of it – there still is that very large deficit to feed. Well, you can raise the money, but there will be a price to pay – after all the CDs are used to price the bond. To add insult to its injury, Greece apparently harboured the fantastic notion that they could raise an e25 billion loan from America's favourite banker, i.e., China. It cast fresh doubt on whether the EU as a body was serious about resolving the problem. If one were to draw that inference, then Portugal and the rest start looking seriously bad.

Still, there is some crying "fire", which includes the now well-known personage, sometimes uncharitably dubbed Dr Doom, Nouriel Roubini. He has declared Greece "bankrupt" and predicted the "break-up" of the Eurozone. Then there is Simon Johnson, previously chief economist of the IMF who writes that "another Lehman /AIG-type situation lurks somewhere on the European continent".

It is more likely than not, that 2010 will be year when many questions will pop up all over the place, as governments scramble to manage their finances. It augurs a bumpy ride. India, like many other Asian economies, has her fundamentals right, no major imbalances. So we should set our course to 9 % growth, alive to the rough seas, but not intimidated by it. And yes, be prepared for a storm.

3.1 MUTUAL FUNDS

Sectoral MFs Make a Comeback through ULIPs

Sectoral and thematic funds, which were a rave hit among mutual fund investors during the bull run, are making a comeback through unit-linked insurance plans (ULIPs) this year. Private insurers have introduced sectoral or thematic flavours like power, infrastructure, PSU companies, blue-chip stocks and price-to-earnings multiples in about 30 ULIP schemes since the beginning of this year.

According to wealth managers, sectoral and thematic funds will make ULIPs more attractive to retail investors. Till recently, the ULIP segment only had products that acted like diversified equity funds or mid-, and small-cap funds. In their bid to attract more investments this tax season, private insurers like Bharti Axa, Aviva, ICICI Life and Tata AIG have launched schemes that invest in sectors like infrastructure and PSU sectors. Themes such as ‘bluechip portfolio’ and ‘dynamic PE funds’ have also been introduced to ULIP investors by private insurance companies.

Sectoral funds are becoming popular among ULIP investors. In fact, even in these markets, there is value in pockets like auto, infrastructure and sectors that are linked to global cycles (like oil & gas and metals). Investing in growth sectors can yield decent returns on investor portfolios, said Sandeep Nanda, chief investment officer, Bharti Axa Life Insurance, which has recently launched ‘Build India Fund’, a sector fund investing in infrastructure companies.

Aviva Life has launched two funds with exclusive investment mandates in infrastructure and PSU companies. According to Aviva officials, both the funds aim at providing focused exposure to large-cap and mid-cap companies engaged directly or indirectly with these two sectors. Tata AIG has also launched an infrastructure sector plan for its ULIP investors.

The infrastructure portfolio of Bharti Axa, Tata AIG and Aviva Life will include construction, metals, building materials, energy, power, chemicals and engineering companies. The PSU portfolio of insurers will typically invest in companies where the central and state governments have a majority shareholding of more than 50% or the management control is vested with the central or state governments.

Themes such as ‘bluechip portfolio’ and ‘frontline portfolio’ only invest in large-cap stocks or sector frontliners. ICICI Prudential Life’s Dynamic PE Fund has asset allocation strategies pegged on to the price-to-earnings multiples of Nifty-50 index. In other words, investment in a Dynamic PE Fund is managed between debt and equity on the basis of the valuation of Nifty companies.

Sector funds in ULIP category are relatively a new trend in the Indian market. With ULIPs becoming a mainstream investment product, there is pressure on insurers to launch newer products that are more focused and different in investment approach,” said Sanjiv Bajaj, joint MD, Bajaj Capital.

Retail investors are showing renewed interest in sectoral and thematic ULIP funds. Sectors like PSU and infrastructure will attract retail investments,” Mr Bajaj added.

Ironically, at a time when insurers are promoting sectoral funds in a big way, sectoral mutual fund schemes are finding it difficult to keep their returns profile in green. In line with the downtrend in the stock market, all sector funds listed saw negative performance in January. Funds investing in sectors like IT, banking, infrastructure and pharma have all logged negative returns between 3-4%.

3.2 COMMODITY FUTURES

Trade with Care

The process of initiating a trade in any commodity futures product is similar to that of trading in equity F&O, save for one difference – in commodity futures trading, you have a choice of opening a trading account with your broker if you're not interested in taking delivery or open a demat account if you want to take/give delivery as most commodities that are traded on commodity bourses, such as gold, are compulsory delivery contracts. In equity F&O, you can trade with just a trading account since there is no delivery involved. Brokers say since most retail clients are only interested in trading and not in taking delivery, they opt for a trading account.

An investor should always remember that futures are high-risk instruments as they can subject one to huge losses while yielding high gains. There are a few key points worth taking note of.

Getting Started: First, for a lay investor who has never bet on a commodity, national-level commodity bourses such as MCX, NCDEX, NMCE and, of late, ICEX, offer platforms for such trades. As in equities, you've got to go to a broker who's a member on one or more of these exchanges. Names that come to mind are not very different from those active in the equities space, who offer trading through commodity broking arms. Brokerage can vary between 0.02% and 0.05% of the contract value for a single transaction. This excludes service tax and turnover tax.

Choosing A Commodity: Once you've chosen the platform, you're ready for a tryst with commodities. Gold is generally the preferred product for a retail investor and one that one probably understands better than any other non-agri commodity. For gold, which is the most popular product among retail investors, MCX, as any broker would tell you, is your best bet as the commodity along with other metals and energy products is the most liquid on that bourse. Apart from kilo gold, which is costly for ordinary investors, there's a mini contract and a gold guinea contract. A gold mini contract has a lot size of 100 grams that's cheaper while the gold guinea is the cheapest at 8 grams. Kilo gold is a bi-monthly contract while mini gold and gold guineas are monthly contracts.

High-Risk High-Reward Game: A futures contract is one that facilitates buying or selling of an asset at a pre-determined price for delivery at a future date. A futures contract allows an investor to take a large position in any asset by paying just a fraction of the contract value known as the initial margin. This means if a kilo gold contract is priced at, say, Rs 16,750 per 10 gram, one lot will translate into Rs 16.75 lakh. The margin required to be put up with the broker to trade one lot works out to Rs 67,000. A huge sum for one with not so deep pockets! So the best bet would be to go for the mini or gold guinea contract, where the margin for trading at 4% would work out to Rs 6,700 and Rs 530, or so. Here, it must be borne in mind that brokers usually ask their clients to put up a buffer amount in addition to the margin that's put up to trade to protect against price volatility.

The tick size, or the minimum amount by which the price can rise or fall, in all the three contracts is Re 1. A Re 1 change in price either way translates into a gain or loss of Rs 10,000 for a kilo contract and Rs 1,000 for a 'cadbury' or 100-gram contract. In the case of an 8-gram guinea, one tick movement will result in a price change of Re 1 for 8 grams.

If the market moves by an excessive amount, say by Rs 1,000 upwards or down, it can lead to a client's margin being wiped out. That is what makes futures such a risky proposition and necessitates that client's trade with strict stop losses in place. Where there's high reward, there's high risk and a first-time investor in the commodities futures market should pay heed to this fact since her positions are marked-to-market daily, meaning that losses or gains are settled on a daily basis.

3.3 COMPANY FIXED DEPOSITS

Do The Due before investing in Company FDs

As much as 55% of Indian savings find their way to bank fixed deposits. Over the past one year, fixed deposit interest rates from nationalised banks have gone down from 8-9 % to around 6-6 .5% now for a period of 1-3 years. With fixed deposit rates from banks coming down, investors seeking higher returns from fixed income products are investing in company fixed deposits. Here are some key points you need to keep in mind while investing in company fixed deposits.

Security: Company fixed deposits are unsecured. In case of bank fixed deposits, the Deposit Insurance and Credit Guarantee Corporation of India guarantees repayment of Rs 1 lakh in case of default. There is no such guarantee offered in company deposits and the safety of your deposit depends on the financial position of the company. This means, as a depositor, you have no lien on any asset of the company, in case it goes into financial difficulties and is wound up. Your turn to get your money back would come only when secured lenders have been paid. So do not invest in unknown companies.

Risk v/s Return: Schemes like the post office NSC and PPF give you a 8% return, but are locked in for six years and 15 years, respectively. A corporate like Tata Motors or Mahindra & Mahindra would offer you an interest rate of 8-8 .5% while smaller companies like Avon Corporation or Ind Swift offer you an interest of 11-12 % for a year. It’s a simple investment philosophy. “You trade return for risk”. Definitely, the risk involved while investing in smaller companies is higher. Unless you need income regularly, you should prefer cumulative schemes to regular income options since the interest earned automatically gets reinvested at the same coupon rate, resulting in better yields.

Check Parentage & Financials: Opt for companies that pay dividends and are profit making. Avoid loss-making companies or those who do not pay dividends. If a company has made a one-off exceptional loss in a particular year, but has a good parentage and past track record, you could consider it. Also, it is important to check the servicing standards of the company. How quick are they are in dispatching interest warrants and principal amount is something you should know.

Ratings Are Important: For NBFCs, RBI has made it mandatory to have an ‘A’ rating to be eligible to accept public deposits. Investors should go only for AAA or AA-rated schemes. Go for shorter tenures such as 1-3 years. This way, you can keep a watch on the company’s rating and servicing, and also have your money back in case of an emergency. Watch out for any adverse news on the company you have invested in and take necessary action if need be.

Liquidity: Most companies accept fixed deposits for a period ranging from 1-5 years. Compared to mutual funds or bank fixed deposits, company fixed deposits are rather illiquid. In most cases, premature withdrawal is not allowed before completion of three months. If you wish to withdraw between the third and the sixth month, you get zero interest income. If you wish to withdraw between the sixth and the 12th month, you get 3% less than the guaranteed return. And when the company pays back, the cheque may take time to clear. FDs are not listed and non-transferable. Interest income from fixed deposits is taxable. So if you are in the highest tax bracket, weigh your options accordingly. If there is a probability, you may need the money before a year, it is beset not to park it in company fixed deposits.

Do Not Put All Eggs In One Basket: Depending on risk profile, consider putting 5-15 % of investments in company fixed deposits. So if you have Rs 10 lakh to invest, it would then be worthwhile putting around Rs 1 lakh in company deposits for the extra Rs 3,000 per annum. However, if you have a mere Rs 10,000 to invest, it may not make sense to invest it in company fixed deposits for the extra Rs 300, especially when your next door bank offers you more convenience and flexibility of investments.

3.4 EURO

The Final Countdown

The introduction of the euro in 1999, it was claimed, would narrow the economic differences between the member countries of the monetary union. Unemployment rates would converge, as would other macroeconomic variables, such as unit labour costs, productivity, fiscal deficits and government debt. Ultimately, the differences in wealth, measured in terms of income per capita, would diminish as well.

After the common currency's first decade, however, increased divergence, rather than rapid convergence, has become the norm within the euro area, and tensions can be expected to increase further. The differences between member states were already large a decade ago. The euro became the common currency of very wealthy countries, such as Germany and the Netherlands, and much poorer countries, such as Greece and Portugal. It also became the currency of the Finns, runners-up in innovation and market flexibility, and of Italy, which lacked both, earning the apt moniker, 'the sick man of Europe'.

Such differences were a highly complicating factor for the newly-established European Central Bank (ECB), which had to determine the appropriate interest rate for all members, the so-called one-size-fits-all policy. The larger the differences have become during the euro's first decade, the more the ECB's policy could be described as 'one size fits none'. We have compared the performance of the best-performing and worst-performing euro-zone countries between 1999 and 2009. To avoid comparing apples and oranges, we have compared the data for the 11 countries that were included in the first wave in 1999, supplemented by Greece, which joined shortly thereafter.

Because the ECB was given the sole task of achieving and maintaining price stability in the euro area, **inflation rates** seem the most logical starting point for comparison. In 1999, the difference between the eurozone countries with the lowest and highest inflation rate was two percentage points. By the end of 2009, the difference had almost tripled, to 5.9 percentage points.

As for economic growth, we have made an exception. For that variable, we looked at the **average yearly GDP growth in the first five years after the introduction of euro banknotes and coins in 2002.** The difference between Ireland and Portugal in the first half of the decade was 4.8 percentage points. By 2009, it had increased to six percentage points. Moreover, the productivity difference increased from 25 index points in 1999 to 66.2 in 2008; the difference in unit labour costs went from 5.4 percentage points to 31.8; and the difference in the unemployment rate rose from 10.1 percentage points to 15.4.

Nor could we find any **convergence regarding government deficits and debt**. In 1999, Finland boasted the smallest government debt, equal to 45.5% of GDP. The difference with the largest debtor in the euro area, Italy, was 68.2% points. Despite the most severe economic crisis in almost a century, the Finnish national debt actually decreased by 2009, to 39.7%. Italy, meanwhile, failed to use the significant windfall from the steep decline in long-term interest rates to repair its debt position. Italy's debt barely budged and stayed well above 100% of GDP. As a result, the difference between the debt positions of Finland and Italy, the most prudent and most profligate eurozone members, shot up to 73.3 percentage points in 2009.

The implications of these increasing differences could be severe. Increasing tensions between the euro countries on economic policy are likely. Tensions at the ECB and between the euro-zone countries do not bode well for the stability of the common currency. The ECB will be scapegoated for that. If it keeps its interest rate too low for too long, countries like Germany and the Netherlands will protest. If it hikes the interest rate, the southern eurozone countries will complain. In any case, support for the euro, already fragile, will erode further, weakening the common currency. The Final Countdown seems more appropriate for the euro area with every passing day.

4.0 FINANCIAL SECTOR: TRANSFORMING TOMORROW

Rolling Back

President Obama has recently proposed some fundamental changes in the way the Wall Street banks will henceforth be able to conduct their business. The first such measure is a levy of 0.15% for 10 years on the non-retail liabilities of banks with balance sheets over $50 billion in the US. This measure is estimated to raise $90 billion over 10 years and is intended to part-cover the cost of bailing out the banking system in the US over the last two years. The other more radical proposal is to ban proprietary trading by banks and disallow investments in hedge funds and private equity funds, thus ostensibly reducing the chances of requiring a future government bailout.

It's not, as everyone is realising, going to be easy, or fast. It's going to be extremely tricky to change the habits of an entire generation, private sector, public sector, and top managements. Think, for an instance, what it would do if suddenly we had to totally reinvent the way we work, live, spend, save and do business, and even think.

4.1 FINANCIAL ADVISORS:

Weigh impact on investors:

New rules for global financial markets:

New norms must ensure that another intervention would never need to bail out failing financial institutions.

The US is not alone in wanting to ensure that a global financial meltdown like the one we experienced over the last couple of years is never allowed to recur. This was the subject that was hotly debated at the recent Davos meet of the World Economic Forum.

However, in the anxiety to get even with the perceived villains of the financial meltdown, it appears the attention has shifted away from the urgent need to reduce systemic risks and maintain the integrity of and confidence in the international financial system.

The large international banks have been, of late, the object of much political and public anger across both sides of the Atlantic. This is because of their perceived insensitivity to society at large who bailed them out at the taxpayers' expense just a few months ago to save the global financial system from a near certain collapse. The surging profits of some of these banks are directly attributable to the massive capital infusion by governments and hence the news of bankers paying themselves huge bonuses on the back of such profits has been frowned upon almost universally. Clearly, the public is right in expecting banks to deploy the profits generated through bailout funds to be largely used to shore up the capital funds of these banks to ensure that a bailout like situation never recurs.

While these are steps in the right direction, the larger issue is about strengthening the foundations of the global financial system.

New proposals on minimum level of capital for banks

Several ideas in this regard have been forthcoming over the last few months. Given that one of the fundamental causes of the meltdown was the excessive leverage of the large banks, the Basel Committee on Banking Supervision has come out with new proposals on the minimum level of capital to be held by banks. The effort is to ensure that banks are able to conduct business as a going concern even in abnormal conditions by imposing minimum short-term liquidity requirements, while capping overall leverage with increased levels of common equity to absorb potential losses.

Treat over-the-counter derivatives more like bonds

Again based on recent experience, it has been proposed to treat over-the-counter derivatives more like bonds and allocate additional capital to address counterparty risks.

Build bigger capital cushions during good times

Countercyclical capital rules have also been proposed requiring banks to build bigger capital cushions during good times. When capital comes close to the minimum prescribed levels it has been proposed to limit bonus and dividend payouts.

Issue long-term bonds convertible into equity at times of stress

There have been several other suggestions including banks being required to issue long-term bonds that automatically get converted to equity at times of stress, thus providing a capital cushion when most needed and is difficult to come by. Though such bonds would be somewhat expensive for banks, it may be worth the increased cost in the interests of the stability of the financial system.

Adopt 'living wills' plans to wind up in case of bankruptcy

In order to ensure an orderly way to let financial institutions fail, there have been suggestions to have these institutions adopt 'living wills' wherein detailed plans to wind up the institution in case of bankruptcy are clearly laid out without assuming any financial support from the government.

Need to crack down on carry trade

Foreign exchange carry trades – where speculators borrow in a low interest rate currency and then lend or invest in another currency for profit – are increasingly being seen to pose a major risk to international financial stability. UK Financial Services Authority chairman Lord Turner has, of late, articulated the need to crack down on this activity since he feels it hardly serves any useful social or economic purpose. It is common knowledge that the Yen carry trade and more recently, the dollar carry trade have helped speculators create asset bubbles, especially in the developing world.

Coordinated global action is taken instead of unilateral action

As long as the expected public response to a global financial crisis is a massive taxpayer-backed intervention, a new crisis may not be far in coming. The new rules have therefore got to ensure, as far as possible, that another such intervention would never again be required to bail out failing financial institutions. To prevent regulatory arbitrage, it is essential that coordinated global action is taken instead of unilateral action like the one President Obama has recently announced. For example, the plan to force banks to quit proprietary trading could marginally reduce the risks carried by US banks.

While all these suggestions are indeed worthy of support, regulators and governments have a responsibility to balance tougher capital adequacy standards with the force of good that higher levels of leverage can contribute to accelerated economic growth. This in turn depends on the continuous expansion of markets led by a growing labour force, lower barriers to trade and capital movements, as also the virtuous interaction between capital investment and technological change that needs to be recognised while adopting any new rules for global financial markets.

4.2 WEALTH MANAGERS

Map out the details to translate into benefits:

Fed begins its long march to roll back

An announcement of a 25-basis-point hike in the discount rate by the US Federal Reserve, along with some modifications to the terms of its discount window under which it lends to banks, is a small first move towards a tighter monetary stance. It is of a piece with the closure of a number of extraordinary credit programmes earlier this month, signalling further normalisation of lending facilities.

However, it does not spell either an immediate end to easy money or a material difference to the credit climate in the US. Predictably, global markets reacted, with Tokyo's Nikkei dropping over 2% in early trade along with the Kospi and the Hang Seng, while the Sensex ended the day 0.8% down. Equally predictably, the dollar strengthened. But the response was probably a reaction more to the suddenness of the Fed's announcement. Indeed, given the ambiguous signals emanating from the US economy – surprisingly high annualised growth of 5.7%, combined with an unemployment rate of close to 10% - it is unlikely the policy-making FOMC will hike the Fed funds rate in the near future.

But, it is a signal that the Fed is seized of the need to pull back the rush of liquidity it had unleashed on to the market in a desperate attempt to keep the economy afloat. And, to that extent, we can take solace that we are near approaching 'normalcy'. It will be a long while before the world economy gets back to the heydays of early 2007 (if it ever will!).

4.3 INCLUSIVE CEOs

Innovative responses to problems:

US sanctions for Iran energy sector

Indian companies engaged in Iran's energy sector could be in for some turbulence as legislation seeking to curb foreign participation in Iran's fuel sector reaches the final stage in the US Congress. The US Senate approved a legislation that will let US president Barack Obama impose sanctions on non-Iranian companies that are involved in Iran's energy sector. The legislation seeks to sanction companies that help expand Iran's oil refining capacity or help Tehran produce or import products like gasoline.

Only recently ONGC along with Hinduja Group and Petronet entered into an agreement with Iranian authorities for participation in the development of gas fields and liquification facilities in Iran. ONGC/OVL is looking at picking up 20% or more stake in the South Pars-12 field development project.

Indian companies have already been affected by earlier US efforts in this direction. In 2008, US legislators had urged the US Export-Import Bank to suspend financial aid to Reliance unless it agreed to stop the sale of gasoline to Iran. The US has sought to use different pressure points to push Iran on its nuclear programme. US President Barack Obama in his State of the Union address had warned Tehran about ``growing consequences'' for its nuclear programme.

The Senate version, according to reports in the US media, would stop US government from buying goods from companies that do business in Iran's energy sector and make it easier for state and local governments and private asset fund managers to divest from energy firms doing business with Iran.

4.4 CREDIT COUNSELORS

Resolve convertibility and recompensation issue:

UK suspends accepting student visa application

Hundreds of students from this part of the country are facing the heat of an unanticipated decision of the UK Border Agency to temporarily stop accepting student visa applications at its three centres in North India. As there is no guarantee of getting their tuition fees back, which students have already paid in some cases, the fear of losing lakhs of rupees is looming over their head.

Besides this, the British high commission also failed to save the future of many gullible students who learned about the blacklisting of their college (in the UK) after paying the fees or after reaching there. There are many cases where students had to return to India as the college where they got admission lost affiliation in-between. There is no provision of transfer to some other college in the same field.

This indefinite suspension, put in force, was the direct result of a 10-time increase in student visa applications during the period October to December 2009, at three visa application centres of Chandigarh, Jalandhar and New Delhi. Last year, 13,500 applications were received during this period whereas only 1,800 and 1,200 were received in 2008 and 2007, respectively.

Nigel Casey, British deputy high commissioner said that this suspension was necessary to scrutinize the situation and to save genuine applicants as there were some cases where people were abusing the student visa norms. "Some unscrupulous agents mislead youth by telling them that they can easily attain PR (permanent residency) through student visas, which is totally wrong," he pointed out.

Indian students should remain doubly cautious from corrupt education consultants and from applying to blacklisted colleges. They should approach only professional people. Moreover, everything is available online and they can easily check the credentials of a college to avoid further problems, stated Casey. "Presently there are nearly 2,000 licensed institutions in the UK and we have a very tight system of evaluation. The UK Border Agency continuously monitors the performance of colleges. In the last few months we had cancelled the affiliations of 100 colleges, whose work was not found up to the mark."

4.5 TECH SAVVY PROFESSIONALS

Take first step to ensure efficient and reliable system:

EU increases VAT on offshoring

The new value-added tax (VAT) rule introduced by the European Union from January this year, will make offshoring costlier for banking and healthcare customers in the region by up to 15%, and squeeze margins of India’s top tech firms including Tata Consultancy Services (TCS), Infosys and Wipro. Starting January 1, 2010, the 27-nation bloc has imposed VAT on services delivered from non-EU nations such as India, a move which will put a renewed squeeze on the profit margins of these tech firms.

The new VAT regime define the place of supply as the buyer’s location hence making offshore service VAT liable on verticals such as banking and financial services, healthcare and education. As per the latest study by Everest group on the performance of global outsourcing business in the fourth quarter of 2009, while prior to imposition of VAT a buyer could save 30% on the costs, its savings may take a hit of 10-15% assuming that the seller pass on the entire cost burden arising from tax liability.

Nasscom president Som Mittal said, "VAT ruling which came into effect in January was to harmonise tax regime across EU as every country including Germany, Belgium and France had their own VAT structure. Since an Indian outsourcing services provider does not cater to the end user, an EU customer may offset VAT being paid to the former against VAT charged to the end users. So there's no question of pressure building up on billing rates."

Europe accounts for over a quarter of the $60-billion revenues of the Indian outsourcing industry currently. The fourth quarter of 2009 reported signs of improvement in business sentiment and revival in the outsourcing market as the number of outsourcing deals increased 21% in ITO and 25% in BPO sector, led by US and Europe, according to the Market Vista report from Everest.

4.6 FINANCIAL PLANNERS

Value unlocking for all stakeholders:

Australia tightens immigration rules

In a move that could have a big impact on skilled Indians planning to immigrate, the Australian government is changing its permanent skilled migration programme to ensure that it is more responsive to the needs of Australian industry and employers and better addresses the nation's future skill needs.

The new reforms, which are being seen as an overhaul of the existing system, will be more demand rather than supply-driven skilled migration programme that meets the needs of the economy in sectors and regions where there are shortages of highly skilled workers, such as healthcare, engineering and mining.

Australian minister for immigration and citizenship Chris Evans said the new arrangements will give first priority to skilled migrants who have a job with an Australian employer.

Mr Evans said, "There are some occupations where there will be high demand for skills. Hospitals can't go without nurses, country towns can't do without a local GP and the resources sector increasingly needs skills. These latest changes will continue reforms already implemented by the government and result in a more demand-driven skilled migration programme that attracts highly skilled migrants to Australia to work in areas of critical needs."

Australia continues to want skilled migrants be they from India, the UK or China – our three largest source countries – or elsewhere. Six of the top ten countries which make up our skilled migration intake are also among out top ten trading partners, including the UK, India, China and South Korea. Migrants bring with them their networks, new ideas and an entrepreneurial sprit.

The changes will however, in no way impact international students going to Australia to gain a legitimate qualification and then return home.

Mr Evans said, "Some unscrupulous migration agents have been misleading international students into believing that completion of a course in Australia gave them an automatic entitlement to permanent residence. It does not and it will not. A student visa is just that: a visa to study."

4.7 RISK MANAGEMENT CONSULTANTS
Educate – Engineer and Enforce:

RBI refusal for relief to realty sector

RBI has ruled out any further relief to developers who are finding it difficult to repay their loans. This was made clear to banks that had made a representation that they be allowed to restructure real estate loans in a repeat of the one-time dispensation extended to them a year ago.

The asset classification norms, which decide when a loan is to be treated as a non-performing asset, are much stricter for non-manufacturing companies, including developers.

For a manufacturing company, it is only after a loan is restructured for the second time that lenders are required to classify it as an NPA.

But if it for non-manufacturing purposes, which includes real estate, personal loans or loans to brokers, the loan has to be classified as NPA the moment it is restructured. Typically, restructuring of a loan involves reducing the rate of interest and giving the borrower more time to repay.

Following the collapse pf Lehman Brothers, a part of the relief package extended by RBI included a dispensation that allowed banks to restructure loans to both manufacturers and developers and continue showing the loan as a standard asset. This dispensation was available for only those loans where the borrower was regular in repaying dues until September 1, 2008, and where the bank would be able to restructure the account by March 31, 2009. The total outstanding loan to banks to the real estate sector stood at Rs 88,581 crore by November 2009, according to data given by RBI.

In a meeting with RBI governor, when some bank CEOs pitched for one more dispensation for restructuring real estate loans, it was indicated to them that builders are hoarding property – ‘Let them lower the price and clear their inventory’. The second dispensation to developers would only encourage them to hold on to pricing. Incidentally, in its monetary policy, RBI governor, Mr Subbarao had made his concerns about rising asset prices very clear.

Banks are wary of the risk associated with commercial real estate because demand for commercial space such as malls has come down and there is a decline in pickup in the residential sector across all income groups. So, the problem cannot be solved by repeated restructuring of loans, but by reviving the market by lowering prices, making property more affordable and showing the customer some economic value in their purchases.

Banks had restructured loans of several real estate companies under a one-time dispensation that was allowed in the beginning of calendar year 2009. Further, many real estate companies sold their land banks and raised money from the capital market through the qualified institutional placement (QIP) of shares. The money raised by them was mainly used to repay loan, but at the same time, they refrained from lower their product (property) price.

Bankers pointed out that there are some sector still under pressure like gem & jewellery and handicraft and are more deserving of a second-time dispensation on restructuring if at all it is being considered.

4.8 MICRO-FINANCE PROFESSIONALS

Developing alternative credit delivery models:

Reserve Bank warns MFIs to shape up fast

India's booming microfinance segment is under the scanner, with the RBI issuing a veiled warning that it could be taken off the priority sector lending list of banks if the industry fails to improve its governance standards. Currently, all loans to MFIs are categorised as priority sector lending that banks have to fulfil as part of their social obligation and regulatory requirement. Losing priority sector status could snap credit lines that MFIs have with banks.

The RBI officials reportedly told MFI executives that the central bank was aware of the extent of benami loans being given by MFIs, the practice of writing off bad loans and sloppy corporate governance in some of the entities, all of which could have their impact years down the line.

Many MFIs have generated big returns, often as much as 20-30%, to the promoters and private equity players, who have stepped in as financial investors, looking for an exit in about four years. Nonetheless, there is growing acceptance that private equity has to come in to shore up capital that's necessary for growth. And these investors will not come in unless growth and returns are delivered.

But, what's perhaps worrying the regulator and some of the stakeholders is that MFIs are still being run like small, family-owned firms. Insider said about dubious practices like board minutes being fudged, senior management tries to enrich themselves, local level staff advancing fresh loans to hide bad debt and staffers running small rackets on the side. Under the circumstances, RBI's warning is a powerful one.

4.9 CONTINUING LEARNING CENTRES

Take informed decisions:

Committee to review bourses structure

The market regulator Sebi has constituted a committee headed by former RBI governor Bimal Jalan to review the structure of the stock exchanges as their role as self-regulatory bodies and functions as profit entities are sometimes conflicting in nature. The Sebi board in its meeting held on December 22, 2009 had approved the proposal to constitute a committee.

Sebi said these institutions are increasingly called upon to undertake regulatory functions, including supervision of the markets, while simultaneously pursuing commercial objectives. The role of market infrastructure institutions has been continuously evolving to meet the challenges of the emerging securities market. Accordingly, a committee has now been constituted under the chairmanship of Bimal Jalan. The committee may also look into the listing-related matters of the stock exchanges.

Sebi board had considered the issues with regard to the emerging market microstructure and the evolving role of market infrastructure institutions, which call for a review of their ownership and governance structures to ensure that they remain relevant and effective. CNI Research chairman and managing director Kishore Oswal said the committee has been set up to look into the problems of the existing stock exchanges and new bourses that may come in future. Currently, the Bombay Stock Exchange and National Stock Exchange are two premier stock exchanges, but other players like Financial Technologies are interested to come with stock exchange. Earlier, the government had made all stock exchanges to shed members' stake in them to aggregate below 51 per cent.

4.10 ONE-STOP-SHOPS

Dedicated to offer related services under a roof;

Sebi's whip on delisted companies

Sebi told stock exchanges to seek financial details of companies suspended for non-compliance with the listing agreement from the Registrar of Companies (RoC). The regulator had formed a committee comprising senior officials from Sebi, investor associations, BSE and NSE to resolve complaints pending against companies suspended by the exchanges.

Non-payment of listing fees is the most common reason for suspension of companies from the bourses. The committee debated on the need for a different method for charging listing fees, so that its non-payment does not become an easy route for companies looking to delist without having to compensate their shareholders. Further, several measures, including prosecution, are being considered to punish errant directors and companies resorting to such tactics.

Some companies that have been suspended for non-payment of listing fees were doing well financially. This gives an impression that the companies deliberated defaulted on the listing fees to dupe retail shareholders by not providing a fair exit.

The committee is considering several measures like debarring the directors of the suspended company from holding a similar post in any other company, launching prosecution proceedings against the suspended companies and compulsory delisting after a certain time.

Around 1,700 companies have been suspended by the BSE and NSE as on December 2009, blocking over Rs 60,000 crore of individual investors' money. Around 30 lakh investors are unable to sell their holdings due to suspension of trading in those shares. The committee will also try to ascertain the losses incurred by genuine investors and find out ways to compensate them.

The Securities Contract Regulation Act has been amended by including provisions whereby errant companies and their managements can be penalised up to Rs 25 crore or jailed for up to 10 years.

However, legal experts say that in these kinds of cases, regulators have to go after the individuals and hold them responsible rather than the company. It is important to identify promoters and penalise them so that they do not defraud investors again.

It is proposed that stock exchanges may either take a one-time listing fees or in a block of five years. Currently, exchanges charge listing fees from the companies on the basis of their share capital. For instance, BSE charges an initial listing fee of Rs 20,000 and after that company with a capital of up to Rs 5 crore pay an annual fee of Rs 10,000. Similarly, those with a capital between Rs 5 crore and Rs 10 crore pay Rs 15,000, while those having capital ranging from Rs 10-20 crore pay Rs 30,000. Companies which have an issued capital of more than Rs 20 crore are required to pay an additional fee of Rs 750 for every extra Rs 1 crore. Capital includes equity shares, preference shares, fully convertible debentures, partly convertible debentures and any other security convertible into equity shares.

4.11 Global OUTLOOK

Take notice from global events:

IMF recants on Capital Controls

Sure, they have hummed, added riders and conditions, but IMF economists have finally come out with a recantation: developing countries could, in some conditions, be better off deploying capital controls.

This is welcome crumbling of an orthodoxy that had made the IMF, the world's lender of last resort; prescribe policy that made a crisis-stricken economy's problems actually worse. Michel Camdessus, former managing director of the IMF, pushed to amend the Articles of Agreement to give the fund the mandate to promote capital account liberalisation. But the Asian financial crisis in 1997 and the global financial crisis questioned the validity of the thesis that capital flows are always a good thing.

Emerging economies, including India, have pushed further capital account liberalisation to the backburner. And rightly so. Capital inflows in excess of an economy's ability to absorb them run the risk of creating asset price bubbles and can potentially impair financial stability.

There is also a fiscal cost to absorbing such inflows and problems of managing liquidity.

Curbs, may, thus, have to be in place if capital inflows into emerging markets go beyond what they can productively absorb. Or the world economy could slump back into recession.

The IMF is bang on target when it says there is no one size fits all solution to developing country problems. Every country must devise a policy tool that is best suited for it. Brazil taxed capital inflows while reviewing its macroeconomic policy in the aftermath of the global crisis. But that does not mean all economies should follow suit.

The suggestion on the conditions that would warrant imposition of curbs on capital inflows also merits consideration:

- If the economy is operating near potential;
- If the level of reserves is adequate;
- If the exchange rate is not undervalued and
- If the inflows are likely to be transitory,

Then use of capital controls, in addition to both prudential and macroeconomic policy, is justified as part of the policy-tool kit to manage inflows," says the IMF staff paper.

Curbs on capital should be a part of the policy mix and not the only instrument to prevent excessive risks in the financial system.

4.12 ISSUES OF THE PRESENT

Freedom to get & fail in the system of free enterprise: Investors' assumptions are already wrong

Investors' assumptions

After last year's stunning rally in global stock markets, many investors thought they knew what to expect in 2010. Among their bets were –

- That the worst of the credit crisis was over, that the global economy would continue to expand;
- That the $ would remain weak as economies abroad were expected to grow faster than that of US; and
- What's more, if anything was to derail the new bull market, it was the likelihood that government efforts to jump-start the global economy would fan the flames of inflation.

Now move to the present. Less than two months into the New Year, many of these assumptions are already under fire. For starters, economic turmoil overseas, spearheaded by a crippling debt crisis in Greece, is leading to new doubts about the global recovery. Even if Europe doesn't fall into a double-dip recession, some economists fear that the region won't fully recover until 2012.

As a result, investors have been selling euro-denominated investments and buying the dollar. The surprising events prove a couple of important points. First, they highlight the risks investors face whenever a strong consensus forms around any market call. There's an old saying that goes, 'if everyone is forecasting something, then you know it won't come true. More often than not, it's the thing that investors don't see coming that ends up unsettling their portfolios. After all, at the end of 2009, how many people were concerned that the Greek debt crisis would stall the new bull?

At the core of the recent global credit crisis, de Vaulx noted, was the dangerous amount of risk that individuals and corporations assumed by borrowing to spend and invest. And, he said, "The way this crisis has been addressed around the world has been through a huge amount of fiscal stimulus." In other words, to keep the economy afloat while the private sector has been repairing its balance sheet, governments worldwide picked up the spending slack. "But the result of all those actions is that now, suddenly, the focus is on the creditworthiness of governments themselves," he added.

That means the fiscal actions around the globe didn't end the credit crisis. They merely shifted the focus to another segment of the economy: the public sector. Does this mean that the rally – and the recovery – are over? Not necessarily, market watchers say. But at the very least, it's a sign that the market may have gotten ahead of the underlying economy.

Ernest M Ankrim, senior markets advisor at Russell Investments, said that after stocks soared nearly 70% between March 9 and December 31, as measured by the total return of the S&P 500, investors were probably betting on an economic rebound that would be as good as the downturn was bad. But Ankrim noted that the markets might have miscalculated in one crucial area. After suffering through recent troubles in the housing, equity and job markets, consumers aren't likely to go back immediately to their free-spending ways. That, in turn, is likely to slow the economic recovery both at home and abroad.

This would seem a strong argument to bet against the economies of the United States and Europe and to bet on the much more rapid growth of emerging markets. Just as the world's developed economies surprised investors negatively early this year, they could just as easily surprise on the upside later in 2010. But that's what often happens in markets where investors are prepared for one scenario, but where another one unfolds. "If you don't expect something to happen and you haven't prepared for it," says Stovall, "that's when panic often sets in."

5.0 BANKING SECTOR

1. Number of frauds swelling by year

If you are one of those who like playing it safe with hard-earned money and would rather stick to bank deposits, watch out. No lesser authority than the RBI says that bank frauds are on the rise. What's more, public sector banks, perceived to be safer bets than private banks, beat the latter in the swindling game. Crores of rupees are disappearing from bank accounts or are being used deceitfully everyday.

Recently, a bank branch manager recklessly sanctioned housing loans for the purpose of flats. On spot verification by the Central Bureau of Investigation (CBI), at the behest of the bank's chief vigilance officer, it transpired that the three-storey building was constructed as a hotel. Further investigation revealed that the branch manager had sanctioned many other housing loans against fabricated agreements of sale in fictitious names. By the time the investigation was completed, the bank had been duped of Rs 25 crore. This is an alarming scenario. After all, it is people's hard-earned money. Banks the world over keep a tight vigil as any slip will bring them down and even impact the economy.

Information collated by the CBI shows that bank frauds - the central investigation body tracks frauds valuing only a crore or above - amount doubled in 2008-09 from Rs 659 crore in 2007-08 to Rs 1,404 cr. The number of such frauds also rose from 177 to 212.

Not that the RBI isn't aware of the rising trend. In September last year, it had blamed senior management at banks for their failure to have proper risk management mechanism. It had then advised the banks to form a special committee chaired by their CEOs, who could oversee fraud investigation and make monitoring centralised rather than leaving it to the regional centres.

Bankers add a note of caution. According to him, bank frauds can only be minimised in the banking sector, they cannot be completely done away with. "If somebody is bent on deceiving, whatever mechanism you have in place, one will cheat. After all, you have to trust people to run an organisation.

Meanwhile, the CBI is meeting chief vigilance officers of public sector banks and sharing information relating to frauds taking place across the banking sector.

2. Banks offer credit card defaulters easy loan to settle dues

If you have a large outstanding on your credit cards and are paying the usual high interest on the same, here is an opportunity to convert it from credit card loan to a lower interest bank loan on a long tenure.

Many banks are offering lucrative schemes to card holders in order to pare down their credit card exposure following a sharp increase in bad assets linked to them. Almost all major banks, including ICICI Bank and Citibank, are offering similar schemes but don’t want to publicise them, which could increase the risk of more card users defaulting on regular obligations and opting for these easier settlement options.

There are various structured payment plans. These schemes are worked out in consultation with the customer as an alternative repayment plan. So, if you have an outstanding loan of around Rs 2 lakh and are paying an interest as high as 18%, you can convert this into a regular loan, spread over a period of three years, where your interest rate may be as low as 12%. Banks have a retention-oriented, assistance-based collections process, and if there is a genuine inability to pay, banks work closely with customers to offer repayment solutions based on his or her cash-flows.

6.1 TAX UPDATES

Budget 2010, stimulus & Keynes

Under normal circumstances, Budget 2010 would be as humdrum as those in the past few years. The political economy of Budget-making would have already been completed in the form of a few excise cuts here and there. The issue of protectionism can also be addressed by reducing import duties on some inputs. Finally, the finance ministry's own agenda of raising additional funds can be addressed by expanding the list of services brought under the tax net.

But, this is not a normal Budget for a number of reasons. For one, Budget 2009 continued with the largesse of the Sixth Pay Commission already committed in Budget 2008. Second, the impact of the worldwide recession of 2007-09 has been felt in the decline in tax revenues in the previous financial year. Third, the 'stimuli' given in the previous Budget needed to be addressed amid fears of rising Budget deficits. Fourth, the finance minister will have to return to the path necessary to implement the direct taxes code from 2011-12.

While the first two issues are no longer relevant, the other two issues need to be addressed. Consider the direct taxes code. Its basic principle is a reduction in the average and marginal income-tax rates while removing exemptions to keep the system revenue neutral. This actually helps in that the administrative cost of monitoring exemptions is reduced. It is likely that the finance minister will address this issue by removing some more items from the exemptions list. While exemptions on personal income tax have been removed or limited, it is likely that exemptions on business income are likely to be targeted.

However, the main issue for the finance minister remains: Budget deficit. The recession-induced stimulus last year took the form of cuts in excise duties (6%) and service tax (2%) apart from higher government expenditure on the Sixth Pay Commission account, the NREGA and other subsidies. Should this stimulus be removed? To answer this, one must take recourse to economic theory.

Barring the die-hard monetarists, almost everyone agrees that the recent recession was Keynesian in nature. In the Keynesian scenario, there is a mismatch between demand and supply not explained by price rigidities. Expectations play a crucial role for both industry and consumers in that both are pessimistic about the future and cut expenditure. As expenditure cuts are affected, industry finds sales declining and consumers find jobs' disappearing that reinforces their pessimism, and the process continues. The most important manifestation of this is a decline in both prices and output, which is normally counter-intuitive. Here, it acts to reinforce pessimistic expectations on the part of producers and consumers. Hence, the government steps in to bridge this 'expectations gap' by bridging the demand gap. Unfortunately, while Keynes was clear on this, he did not address the issue of when the government must get out of the picture.

This, then, is the finance minister's dilemma. Are expectations back on track? Has optimism returned to the economy? It is impossible to give a scientific answer at this juncture as this would require a proper survey of 'moods' in the economy. There seems to be a possibility that the worst is over with the economy returning to the normal growth path. However, it is not clear that expectations are back on track.

So how should the finance minister respond? For, if expectations are the key, then indirect or direct tax cuts are not the answer as they do not influence expectations. In other words – and this actually happened in the US with Bush tax giveaways in 2007 – tax cuts in 'Keynesian times' only increase savings and do not stimulate the economy. What about Budget deficits? It would seem that the return to normal tax revenues and no new subsidy or Pay Commission outgo should keep the deficit well below the 8% level it probably reached last year. What about government stimulus? Give it one more year?

Union Budget 2010-2011:
Crisis over, Pranab goes for growth

Fiscal consolidation back on track: Exit from stimulus begins; lower net government borrowings to ease pressure on interest rates.

Road map to goods and service tax: Cenvat rate hiked to 10% & aligned with service tax rates, more services under tax net.

More tax for less, less for more: Corporate surcharge cut to 7.5% from 10%, but MAT rate rises to 18% from 15%.

Disinvestment gets bigger: Government eyes Rs 40,000 crore from disinvestment, another Rs 35,000 crore from spectrum sales.

Taxpayer: Personal tax liability goes down across the board. Those with annual taxable income of Rs 5 lakh will save Rs 20,000 a year.

- ❖ Tax-exempt saving limit goes up to Rs 1.2 lakh from Ts 1 lakh through additional Rs 20,000 for infrastructure bonds
- ❖ Professional earning up to Rs 15 lakh won’t need to have their accounts audited.

Consumer: Chip, fridge, cars…all to become dearer if producers pass on the 2% Cenvat hike.

- ❖ Petrol and diesel prices rise; petrol up Rs 2.67 a litre, diesel up by Rs 2.58
- ❖ Carmakers up prices. Buyers need to stump up Rs 3,000 – Rs 1 lakh more
- ❖ Disposable income set to rise as tweaks to personal income-tax slabs reduce tax liability
- ❖ Gold prices to go up by Rs 100 for every 10 gram.

Investors: Stepped-up disinvestment drive will mean more listings of state-owned firms, widening choice for investors keen on buying into these firms at attractive prices

- ❖ IPOs & FPOs by state-run firms will improve market breadth and depth
- ❖ New Investment Avenue in the form of tax-free infrastructure bonds.

Business: Lower government borrowings will ensure private sector in not crowded out

- ❖ Excise duty hike unlikely to hit demand as disposable incomes to rise following the recast of tax slabs
- ❖ Compliance for small businesses with turnover under Rs 60 lakh to be easier

Economy: More money in taxpayer’s hands and higher allocation for government programmes to boost consumption and growth

- ❖ More private funds for infrastructure through bonds eligible for tax deductions
- ❖ New banking licences to encourage competition and help financial inclusion
- ❖ Fiscal prudence road map to boost investor confidence in economy and help investment flows

6.2 SECURITY LAWS

SEBI asks investors to keep away from astrology tips

Investing in stocks is often described as a game of luck and stars, but market regulator SEBI does not seem to agree and has cautioned investors against falling prey to astrological predictions.

"Do not be guided by astrological predictions on share prices and market movements," SEBI has said in its latest caution message to investors. Those engaged in the business of stock market astrology, however, do not buy and it would be business as usual for them. There are hundreds of astrologists advising investors with their stock market predictions in India for a fee and about a dozen of them also have full-fledged websites, detailing their past record and future predictions. Many of these astrologers and the websites charge an average of about Rs one lakh a year for their generalised predictions, but even the monthly fees run into such levels in case of customised predictions and for high-networth clients.

When contacted, famous stock market astrologist Satish Gupta, who also runs a website AstroStockTips.in, told that he was not aware of SEBI circular, but asserted that the people invest their money in the stock market for future returns and "only astrology can tell about the future." It’s a science. It’s a better technical analysis than many of the so-called technical analysts do.

Most of the fundamental and technical analysts fell flat with their predictions in the recent meltdown, but many of the astrological predictions were proven true. If your luck and stars are not on your side, you cannot get success and stock market is no exception. Many hedge funds and FIIs are our clients and invest on the basis of astrology. There are some designed astro funds across the world.

“There are many website in the US too. In fact, there are more books and websites on the stock market astrology in the US as compared to India” Gupta says, while debunking the myth that only Indians consult the astrology for market tips.

Eminent astrologer Bejan Daruwalla is also quite active in the stock market-related astrological predictions and a blog on this subject is updated on a daily basis on his website GaneshaSpeaks.

Another famous astrologer Jyotish Acharaya Shailendra Sharma said on his website, Astro Today, that his predictions on stock market were to guide people/investors “so that they can have better fiscal management and can be saves from financial disasters”. It is worthwhile to mention here that the stock markets are the gift of Kaliyuga to mankind as they have evolved only in last one century around the globe and several people have suffered huge losses which have seriously affected their lives.

Sharma further advises the people “not to invest their money in stock markets until unless they combinations to gain through stocks in their own horoscopes. He says, “It is strongly recommended that one must get the birth chart (horoscope) analysed for gain from stock markets before making investments. It has been observed that people not having combinations of gains through stocks in their horoscopes suffer losses even if accurate predictions are given to them as they happens to pick up wrong stocks.

Most of these websites provide real-time advice to the investors through means such as emails, SMSs and online forums. Besides specific tips, many of these websites also offer general advices. One such website Share Astrology advises those seeking profit from stock market not to “keep leather purse in pocket”, not to drink milk in night and “feed cow with green fodder every Wednesday.”

Liquid plus schemes set to lose sheen

For years, companies and banks have been parking their idle money in a particular mutual fund category, thanks to its superior returns and tax benefits. Come July 1, this ultra short-term product – better known as liquid plus scheme – will no longer enjoy this status among investors.

In one stroke, a Sebi circular has taken the wind out of liquid plus schemes.

The capital market regulator has directed mutual funds to value money market and debt securities with maturity over 91 days – the instruments that constitute this scheme – on mark-to-market basis.

In other words, fund houses will have to factor in any drop in securities' prices on a daily basis to calculate a scheme's NAV or net asset value (which reflects the price of a mutual fund unit).

The step would result in higher volatility in returns from such schemes and could dramatically reduce its attraction among bank treasurers and CFOs who are always fishing for higher returns.

Ultra short-term schemes, which comprise almost 40% of the mutual fund industry's assets under management of Rs 7.59 lakh crore, have managed to fetch 5% to 5.5% annually, while liquid schemes and banks' short-term fixed deposits have fetched 4% to 4.25%.

Returns from liquid schemes, which invest in money market instruments of less than three months maturity, have shrunk over the past year or so, after Sebi directed mutual funds to align the tenure of debt securities in the portfolio of liquid schemes with the maturity of these schemes.

The advantage of ultra short-term schemes over bank FDs is the tax aspect. Interest income on fixed deposits is taxed at 33%, but the dividend distribution tax, which funds deduct before handing over dividend to investors, is at 22% for corporates and 14% for individuals on liquid plus schemes.

Interestingly, 'liquid plus' as a product was designed by the mutual fund industry to overcome the disadvantage in liquid schemes where the dividend distribution tax was hiked to 28%.

The industry has been worried that the government would take away the tax benefit that mutual fund investors enjoyed over fixed-deposit holders, thereby reducing the attractiveness of this product.

Sebi's move is expected to deal a similar blow to the industry that has used ultra short-term funds to turbo-charge their assets in recent years. Significantly, it comes at a time when MFs have suffered an outflow in their equity schemes after Sebi clamped down on the fee paid by MFs to distributors.

The difference between liquid and ultra short-term schemes have been levelled now the preference for ultra short-term schemes will cease now and some money will move to liquid schemes

Nandkumar Surti, CIO, JP Morgan Asset Management said. "Industry officials said fund managers would need to be more careful while choosing their portfolio of securities, hereon. There are occasional periods when volatility is very high...the challenge for fund managers will be to identify pockets that are less volatile and bring them into the portfolio."

7.0 INFLATION

Increasing inflation risks in Asia

Asia Ex-Japan (AxJ) has seen a very sharp recovery in domestic demand over the last 6-7 months. Indeed, in the last three months, external demand has also started recovering at a very healthy pace. However, both the fiscal and monetary policy measures in the region are still geared for economies in crisis. Unless the recent sovereign risks in southern Europe cause a major risk aversion in the global financial markets, the recovery in the region is likely to maintain pace. Capacity utilisation is rising fast, implying that policymakers need to start reversing the current extremely accommodative monetary policy and expansionary fiscal policy to contain inflation risks. To be sure, headline CPI inflation in AxJ has already moved up to 4.7% yoy as of December 2009, as compared to 1.2% yoy in June-09.

While higher food and energy prices explain a large part of the rise, core inflation, that has greater bearing on monetary policy decisions, has also started rising. The core inflation rate has jumped closer to peak rates seen in the first half of 2008. On a year-on-year basis, core inflation in the region has accelerated to 3.2% in Dec-09 compared to 0.9% in Jun-09. The rise in core inflation has been primarily driven by India and China. The region ex-India and China are still lagging in recovery and therefore have not seen much rise in core inflation so far. Assuming that the region's policymakers will start lifting policy rates and begin rollback of the fiscal stimulus soon, we expect inflation to be contained at current levels in 2010. However, risk to our base-case inflation outlook is skewed to the upside.

We believe there are five factors, which increase the upside risk to inflation in Asia.

First, there is a risk of potential upside in domestic demand.

Strong fiscal and monetary measures have already boosted the region's domestic demand. AxJ industrial production growth has been strong at 10.9% yoy and 15.3% yoy in Oct-09 and Nov-09 respectively, above the trend line growth of 9%. The region's policymakers are hesitant about reversing monetary and fiscal policy as they see a large part of the rebound in domestic demand being policy-driven. However, the recent trend in discretionary spending indicates that growth has been far stronger than what policymakers would have aimed for. Any major surprise in autonomous domestic demand will increase the risk of inflation being higher than our base case.

Second, recent exports data have been much better than expected.

Exports growth in AxJ has accelerated to 4.7% (month-on-month, seasonally adjusted) during three months ending Dec-09 compared with a growth of 1.6% (mom, sa) seen during March-Sept 09. If the recovery during the quarter ending December exports is not one-off, but sustained in the coming months, we believe capacity utilisation could improve much faster than our base case estimates. Leading indicators such the US Purchasing Managers Index suggest that exports recovery would be sustained.

Third, slowdown in investments over the last 18 months at the time when domestic demand has recovered sharply will imply quick rise in capacity utilization.

AxJ ex-China saw a sharp decline in gross fixed capital formation by 1.5% during the 12-months ending Sept-09. While we do expect a recovery in capex in AxJ Ex-China in 2010, it will still take some time before production capacity comes on stream. China, however, should face less risk of inflation pressure in manufactured goods, as capacity utilisation remains at low to moderate levels.

Fourth, crude oil and other commodities related inflation pressures (direct and indirect impact) could be much higher during the current cycle.

Oil prices are at much higher levels during the start of the cycle as compared to the previous two cycles. Oil prices have already breached US$ 75/barrel within two quarters of growth acceleration , much earlier than in the last cycle. Moreover, given that the current global recovery has been led by emerging markets, oil demand would potentially be higher even at same level of overall global growth. The AxJ region has much higher oil intensity at 1.6 times compared to the world. All countries in the region excluding Malaysia and Indonesia are net importers of oil and oil-related products. The high share of food and energy prices in the CPI index in emerging Asia results in direct/ indirect inflationary pressures.

Lastly, surplus liquidity in the region remains high.

M1 to GDP in the region has rebounded sharply from the trough in December 2008, increasing the risk of asset price inflation in AxJ. Property prices have shown a sharp rebound in the region, driven by strong fiscal and monetary policy stimulus in the region. Indeed, low interest rates and excess liquidity have fuelled property prices, close to the peak levels seen during the previous cycle in a rather short span of time in many of the top cities. In China, a 36-cities property price Index is up 25% yoy. This, in turn, has begun to reflect in non-tradable items (including housing cost) inflation in some countries.

Policy makers are already becoming conscious of this and have initiated some non-monetary policy measures to slow property transactions. However, the high level of excess liquidity in the region means that risk still remains.

Bottom Line: Asia has seen a very sharp and swift recovery in growth over the last three quarters. Unless policymakers in the region start reversing the monetary and fiscal policy stimulus soon, the upside risk to inflation will keep rising.

January 2010:
Inflation spreads to core, at 15-month high of 8.56%

Wholesale price index based inflation soared to a 15-month high of 8.56% for the month of January. A month ago in December, WPI inflation was at 7.31% while in January 2009, it was as at 4.95%.

Inflation in manufactured products, as measured by the WPI, went up to a 13-month high of 6.55% for January 2010 from a year ago against 5.17% in December 2009. As long as inflation was largely limited to food and driven by a supply side, tightening rates would not have helped. But with inflation spreading elsewhere, rate increase has become almost a certainty. The big question remains the timing of the rate hike. RBI deputy governor Subir Gokarn ruled out any further monetary action until the policy in April unless there was any exceptional, unanticipated event.

Sonal Verma, economist at Nomura Financial Advisory and Securities (India) believes RBI may have to act earlier. We expect inflation to rise to double-digits by March. The increase in inflation in January, 2010 was led by an across-the-board surge in prices. Fuel inflation rose 1.8% month-on-month to 6.9% year on year, led by increased prices of naphtha, furnace oil, bitumen and coal. The spurt in inflation in manufactured commodities was led by higher prices of food products, textiles, chemical products, paper, rubber products, iron & steel and machinery tools. The Centre deferred the proposed fuel price hike, partly because of the soaring inflation. Finance minister Pranab Mukherjee is expected to start withdrawing the duty cuts in the Union Budget in order to tame prices.

8.1 MISCELLANEOUS UPDATES

1. Embedded valuation back in vogue

A popular valuation measure that was widely used by analysts at broking firms to justify high stock valuations in the previous bull-run is back in vogue in the wake of a sharp appreciation in stocks in the recent months. The method, known as sum-of-the-parts (SOTP) or embedded valuation, is used to value non-core businesses or assets of companies by determining what will be their worth once it's sold off or listed. Analysts add the financial prospects of these arms to a company's core business to estimate its stock's valuation. With existing stock valuations exceeding the actual value of many companies' main businesses, analysts are increasingly using the SOTP method to defend them.

Though nowhere close to the extent to which this measure was used before December 2007, the peak of the bull-run, there has been a rise in analysts applying it in the recent months compared with the start of the rally. Market participants said the rush of liquidity into Indian equities and an active primary market have encouraged analysts to use the SOTP method more extensively, with valuations of most stocks are near their peaks in 2007. Prior to December 2007, analysts were accused of stretching target prices of stocks to unreasonable levels using the SOTP method, as they were under pressure from companies and peers against assigning a 'sell' recommendation. Companies, especially mid and small-caps, marketed their growth stories to analysts and investors, with real estate holdings as the topping on the cake, though most of such assets did not contribute to earnings, but only valuations.

Some analysts said the repercussions of 'exaggerated' use of the SOTP method was felt during the sell-off starting January 2008. Kotak Securities has said in his reports that the contraction in valuation of embedded assets contributed meaningfully to the market meltdown. It is difficult to establish a fair valuation of embedded assets. The category of embedded assets stretches from a project announcement to a project due for completion and everything in between. This flexibility has helped enhance the fair valuation of stocks with embedded assets since it is difficult to stretch fair valuation based on earnings and cash flow or to stretch target multiples beyond a point.

2. Bunch of sovereign defaults ahead

Ballooning public debt is likely to face several countries to default and the US to slash spending, according to Harvard University professor Kenneth Rogoff who in 2008 predicted the failure of big US banks. He said, "Following banking crises, we usually see a bunch of sovereign defaults, say in a few years; I predict we will again." Financial markets will eventually drive bond yields higher, and European countries such as Greece and Portugal will have a lot of trouble. Global scrutiny of sovereign debt risen as nations including Greece reveal fiscal deficits that have swollen in the wake of the worst global financial crisis since the Great Depression.

Rogoff, co-author of a history on financial calamities said, "It's very, very hard to call the timing, but it will happen". In rich countries – Germany, the United States and may be Japan – we are going to see slow growth. They will tighten their belts when the problem hits with interest rates. They will deal with it.

Concern about Greece's ability to fund its debt have roiled financial markets since the government said it had a budget shortfall of 12.7% last year, the highest ratio in the 27-member European Union. Greece's debt totalled 298.5 billion euros ($407 billion) at the end of 2009. That's more than five times more than Russia owed when it defaulted in 1998 and Argentina when it missed payments in 2001.

8.2 INSURANCE SECTOR

LIC sees falling stocks as big buying opportunity

Life Insurance Corporation of India, which profited from purchasing corporate debt when Lehman Brothers Holdings Inc. collapsed in 2008, is favouring Indian equities even as the market slumps. N Mohan Raj, executive director of investments at India's largest fund manager, said, "We see the dip as an opportunity even if it is unsettling for others."

Life Insurance increased holdings of stocks by about 25 percent so far in the year that ends in March from a year earlier, when it bought more corporate bonds than shares. It has invested more than Rs 50,000 crore ($10.8 billion) in shares this fiscal year compared with Rs 40,300 crore the previous year, as it cut corporate debt investments to Rs 35,000 crore from Rs 48,000 crore. The insurer, fully-owned by the government, has $215 billion of assets, more than double the money managed by all Indian mutual funds combined. It has been buying the nation's equities as investors shun emerging-market assets on concern that borrowers in Europe and the Middle East will default on their debt.

Corporate Bonds

Life Insurance was also seeking bargains when Lehman's bankruptcy prompted banks to curb lending worldwide because of concern about getting their money back, leading to a credit crunch and the biggest financial crisis since the 1930s. India's overnight call money rate, or the rate at which banks lend to each other for a short term, rose to as high as 19.5 percent in October 2008 compared with an average 7.75 percent for that year. "It is unfair to say it was a bumper year when there was a lot of misery around," Mohan Raj said, referring to returns from corporate debt investments in the previous fiscal year.

Company bond yields are not as appealing as they were then, he said. The average yield of its corporate debt investments has dropped to about 9 percent this year after ranging between 11.5 percent and 14.5 percent last year. The Sensex gained 67 percent in the past 12 months.

Growing Economy

Asia's third-largest economy may grow 8 percent in the year starting April 1, said Chakravarthy Rangarajan, chairman of the Prime Minister's Economic Advisory Council said on Feb. 9. Gross domestic product will probably expand 7.2 percent in the year ending March 31 from a year earlier, the Central Statistical Organisation said on February 8.

In the coming fiscal year, Mohan Raj said bond yields may again rise to attractive levels. The benchmark 10-year bond yield may rise as high as 8.40 percent, the most since October 2008, from 7.86 percent now, due to concern over debt sales and inflation, he said.

Wholesale prices increased 8.3 percent in January from the previous year, according to the median estimate of economists surveyed by Bloomberg News. The data will be published on February 15. The index rose 7.3 percent in December. Reserve Bank of India Governor Duvvuri Subbarao said on Feb. 1 the government's borrowing may rise in the next fiscal year from last year's record Rs 4.51 lakh crore ($97 billion).

"We feel the rate of interest will rise in the next three to six months and that will be good for us to invest in government bonds next year," Mohan Raj said.

9.1 KNOWLEDGE RESOURCE

Dubai Crisis Puts Pressure on Islamic Finance to Reform

The global financial crisis has intensified a push for Islamic finance to "return to its roots" and move further away from conventional banking. The push to reform Islamic finance gained pace even before Dubai crisis erupted last November, and intensified because of worries that Nakheel, issuer of the world's largest Islamic bond, would default during debt restructuring at some Dubai state-owned companies. A $4.1 billion sukuk issued by Nakheel was ultimately repaid last December after Abu Dhabi provided aid to Dubai shortly before the deadline.

In 2008, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) ruled that borrowers in sukuk mudaraba and musharaka should not promise upfront to pay back their face value at maturity. Under mudaraba, a bank provides capital for a project whiles the entrepreneur manages the deal; profits are split according to a pre-determined ratio and the bank bears any monetary losses that arise. In musharaka, parties contribute capital to a venture with profits to be shared in an agreed ratio, while losses are generally divided in line with capital contributions.

Bankers say that along with the economic slowdown and the general turmoil in global financial markets, the AAOIFI's ruling contributed to a more than 50% drop in sukuk sales in 2008.

And in April 2009, the Saudi-based Fiqh Academy's decree outlawing tawarruq munazzam as a "deception" cast a shadow over the $100 billion commodity murabaha market.

Some experts have described tawarruq munazzam, as often practiced, as a paper shuffle devoid of real economic benefits despite giving a semblance of a chain of asset sales.

Critics argue such practices, as well as cost-plus sales, where they say profit is a substitute for interest in name only, are earning Islamic finance a "copycat" tag and hindering its expansion beyond markets in the Middle East and Malaysia. What has happened according to some scholars is that movement has moved too far in the direction of conventional debt and that equity-based financing has been left behind - It is like a pendulum they want to swing back.

Difficult Rode To Reform

Some bankers say the Fiqh Academy's ruling is prompting the industry to seek alternatives such as the mudaraba structure. Banks are moving away from tawarruq munazzam following the ruling.

Some experts also predict a shift towards more ijara or rental-based sukuk. Ijara is a structure in which an Islamic bank buys an asset and leases it to the customer for an agreed rental fee. The widespread introduction of such alternatives faces major obstacles, however. Throughout the history of Islamic finance, development of products has been hindered by a lack of sharia scholars and specialist bankers.

Even more crucially, investors may not want to grapple with radically new products while they are still smarting from losses during the global crisis, and while the global financial environment remains so uncertain. But as long as Islamic finance still struggles with the legacy of distrust left by the Dubai crisis, critics are likely to continue to use this issue to press for reform. The industries are in danger of dying in the cradle because it has taken poison in its food from conventional capital markets.

9.1 RESEARCH PAPER

Credit Rating Agencies in India: An overview and An Analysis in the Light of Various Acts and Guidelines

Research Paper Submitted To the Journal of Finance By
Dr. Kalpana Chandraprakash Satija

Credit Rating Agencies in India: An overview and an Analysis in the Light of Various Acts and Guidelines

Abstract

The banking sector in India underwent an unprecedented transformation in the 1990s with the emergence of a large number of private as well as foreign multinational banks entering the country increasing rapidly the number of banks in India due to the economic reforms. So the banking activities increased manifold and affected a large number of areas of operation of banks, particularly in the field of bank lending. Banks operate on the pattern of extending credit against security given by its customers associated with the bank. The facility of extending credit agencies are recognition of the changing times in which banks have to operate in a changing and ever evolving economic scenario. Growing needs and realisation of higher rate of investments is giving birth to bank credit in India.

Keywords

Research Papers in Economics, Working papers, Open Library, Articles, Open Archives Initiative, and Referred various Act and Reports.

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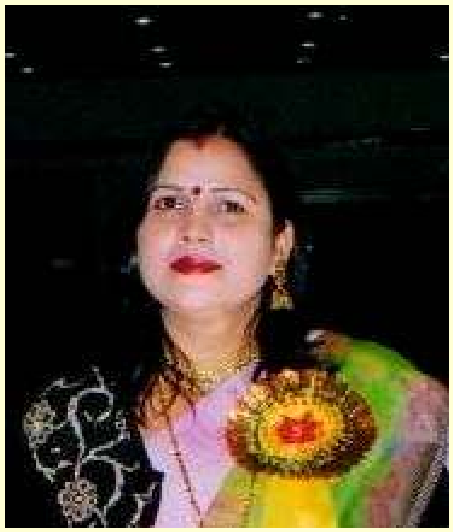

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