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investime

Happy New Year

Stock of the Month

Paper and Exide ... read on Page 38 and 39

SPECIAL FEATURE

Looking forward to year 2012

India's growth story remains intact because the fundamentals are strong and robust.

Global Economy may Emerge STRONGER AND HEALTHIER

With domestic economic growth and other related variables shrinking faster than expected, do you expect things to improve for the economy and the markets very soon?

We agree our economy's growth prospects have been hit by both the recent global slowdown and practically no policy decisions to implement necessary reforms in the last 12 months. Nevertheless, if inflationary pressure moderates from December onwards, we expect better investment opportunities in India that will attract investors globally.

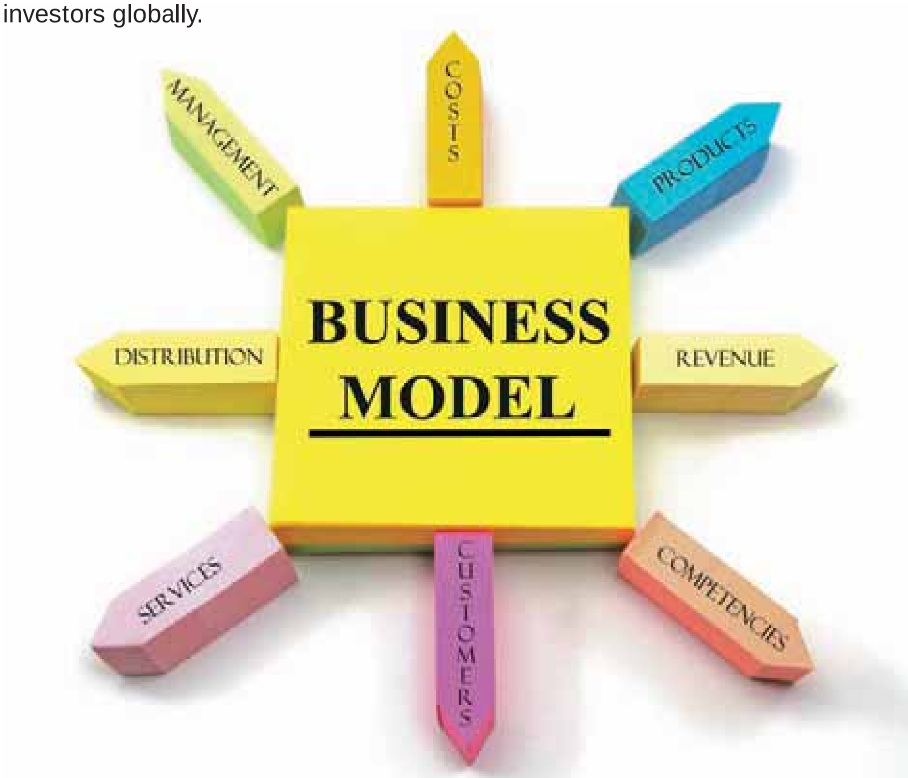
Taking a long-term perspective, India's economy still has scope for high growth, despite the disappointing numbers in the past quarter. As long as companies have a good business model, sound management practices and corporate governance, and a strong balance sheet, they can ride cyclical upturns and downturns. India's growth story remains intact because the fundamentals are strong and robust.

Mr. Vikaas Sachdeva

What is your prognosis on the European crisis? Will it have a lasting impact on our trade and economy or is it only a passing phase?

The Eurozone is facing long-term solvency and stability problems that will definitely diminish its growth for a long time, as some member countries will have to meet their debt obligations. The current structure of a common currency, common monetary policy and varied fiscal policies may make it difficult for countries such as Greece to reduce their fiscal deficit. This may also force some of these countries to exit the Eurozone, which will strengthen the Euro against the Dollar. However, for export-oriented economies such as Germany, it would be beneficial to keep the Eurozone intact and united.

In the short term, markets will continue to pose a worry. Indeed, recent developments in the Eurozone have reduced foreign institutional investor (FII) inflows into India and affected our short-term growth prospects. The uncertainty in the financial markets will also fuel protectionist sentiment



in the developed countries, hampering the recovery of the world economy as a whole. This, in turn, may put the brakes on our extremely good export performance this year.

While all this is worrisome for India, we believe that in the long term, such course corrections will help the global economy emerge stronger and healthier.

We see more consistency in the US data. Can we go by the numbers we are getting today? Will Europe's problems undermine the positive effects of an American revival?

There is a glimmer of hope for an American economic revival. However, the European crisis is posing a big threat. According to a recent analysis, the European Union's (EU) share of US exports has dropped from more than a quarter in 1999 to less than 18 per cent today. However, it is still worth $400bn and, in our ever more connected world, a downturn in Europe would hit the rest of the world too, rebounding on the US, many of whose firms also have large sums of money invested in Europe. The US needs to be careful here. I think the Americans have identified their financial woes and started taking measures, while Europe is still moving towards a consensus to agree on a way forward.

"THE CRISIS IN EUROPE MAY ALSO HURT THE REST OF THE WORLD, REBOUNDING ON THE US, MANY OF WHOSE FIRMS ALSO HAVE LARGE SUMS OF MONEY INVESTED IN EUROPE"

Considering domestic and global developments, do you think there is need to shift from a tight monetary policy to a soft interest rate regime?

We expect and recommend a change in monetary policy by the Reserve Bank of India (RBI) to ease liquidity in the markets. The RBI must hit the pause button on frequent rate hikes, as this will moderate inflation in few months. Such measures will help increase consumption and spending in the short and long term. It will have a positive impact on India's macroeconomic data and boost the index of industrial production and growth of various manufacturing and services sectors. It will also help us in our global exposure and would make us more competitive in exports, in terms of cost and pricing.

Government finances are not in good shape and the fiscal deficit is widening. It is unlikely that they will change for the better even if the government puts in a conscious effort to set its house in order. What does this mean in terms of its impact on the economy, sovereign rating and so on?

In India, the fiscal deficit is financed by obtaining funds from the RBI or from the money market. In the past 12-18 months, our Government has been slow to implement many major reforms in various sectors due to political compulsions. This has led to an increase in the year's fiscal deficit manifold. The recent event was the rollback to allow FDI in retail. This very clearly shows how difficult it is to push reforms in India, but I think politicians and businesses are getting together to find a way out.

The slowdown in growth and rising subsidies due to the high crude oil prices are affecting the country's fiscal deficit. The Government had earlier estimated fiscal deficit to be 4.6 per cent of the GDP, but slow growth in tax receipts and failure to raise funds through sale of stake in state-run firms have beaten its fiscal estimates *(Source: Businessworld)*. That loss is estimated at `1.32 trillion this fiscal, as the price of India's oil import basket has remained at around USD110 a barrel against the budget estimate of around USD90 a barrel *(Source: The Economic Times)*. We cannot afford to have such high inflation when we expect to grow not more than 6-7 per cent.

We fear reforms will be pushed back until the next elections, resulting in slowdown in growth. This will restrict foreign investment for infrastructural and resource development. The possibility of a sovereign rating downgrade by leading rating agencies due to its widening deficit may be mere speculation at the moment, but there are few strong indications to speculate about it. There is a need for a strong economic policy and reforms by the Government and a soft monetary policy by the RBI to stabilize the situation.

What are your expectations on monetary policy? Is a CRR cut (being forecast by many analysts) going to affect yields across the board?

There is pressure on the RBI for a CRR cut by at least 0.25 per cent in the next policy review. We expect this move to inject liquidity in the system. The RBI's intervention is expected this week since payment of advance tax by companies is due on December 15. This will lead to a significant amount of money being sucked out of the market.

The RBI may move to lower the CRR, which is the portion of the deposit that banks are needed to keep with the central bank. The policy rates (repo/reverse rates) have been increased 11 times since May 2010. We also expect OMO (open market operations) purchase in the bond market and USD purchase in FX market. The RBI is expected to use all three options to bring basic yield on bonds under control.

Price pressures and inflation are likely to moderate in the coming two or three months. Do you think a weak Rupee may damage the price situation?

Yes, we expect inflation and price pressures to moderate in a few months with the help of the recent trend of the RBI interest rate hikes. We also expect the RBI to now change monetary policy and ease liquidity in the market. We are positive that this will improve our export revenue further and diminish trade deficit.

What will be the triggers that would most likely aid a turnaround in the markets?

We broadly divide the Indian economy in three sections—domestic consumption, infrastructure growth and outsourcing services. We strongly believe and expect great prospects of growth in each of these sectors. However, we also do not deny the role that the government and political environment will have to play in this. The RBI's review of monetary policy would also be a good indicator of our future.

What are the three things that you would ask investors to keep in mind at this point of time while planning investments?

We understand the sentiments of investors and their reluctance to enter the market. We ask investors to follow a few guidelines while investing in this volatile market. Some of them are:

1. Long-term objective and long-term planning;
2. Investing in companies with strong fundamental valuations;
3. Investing money at regular intervals to get good returns.

Do you agree with duration enhancement to fixed-income investors?

We recommend duration enhancement to fixed-income investors in the short run seeking protection against short-term interest rate risk. They should invest in fixed-income plans, whose objective is to invest in domestic and investment-grade fixed-income securities.

At this juncture, equity investors are reluctant to commit money. What do you suggest in view of the uncertainties plaguing the markets?

Equity investors are indeed more cautious in a volatile and uncertain market. FII outflows have been the main reason for the market underperforming in the recent times. Besides, one can expect corporate earnings to shrink in the near future. Currently, there is a lack of investor confidence in the Indian markets, but the sentiment will turn positive once the investment climate in the country improves. We suggest investors look at the fundamental aspects of the corporates and their long-term valuation, rather than going by mere sentiment or sectoral preferences. The Indian economy is still going strong with an expected GDP growth rate of 6.5 per cent. We expect the current market valuation to be very attractive once the global environment stabilizes.

> **"CURRENTLY, THERE IS LACK OF INVESTOR CONFIDENCE IN THE INDIAN MARKETS, BUT SENTIMENT WILL TURN POSITIVE ONCE THE INVESTMENT CLIMATE IN THE COUNTRY IMPROVES"**

Mr. Vikaas M. Sachdeva is the Chief Executive Officer of Edelweiss Asset Management Limited.