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Investment Matters

March 2012

BESPOKE
FINANCIAL EXPERTISE
TO MAKE THE RIGHT
MOVES, MORE OFTEN.

EQUITY OUTLOOK FROM CIO'S DESK

The Indian markets continue to be driven by FII flows as shown in the chart below. Slowing FII buying has seen markets trend down since middle of February.

FII's have pumped in $5.5bn in the Indian markets (adjusted for the $1.9bn stake in HDFC by Citibank which was considered as FDI, represented by the big white bar above).

Local institutional investors remained net sellers led by Life Insurance Corporation of India (LIC) which has been selling in the market to fund equity infusion in state run banks and support state disinvestment programs.

Meanwhile, Indian government managed to kick start its disinvestment program by selling its 5% stake in Oil and Natural Gas Corporation (ONGC). Call it lack of market understanding or arrogance, government priced the issue at a premium to the existing market price. The issue almost devolved but eventually LIC bailed it out by subscribing nearly 90% of the issue that too at a 5% premium to the floor price. Earlier even Citibank sold its stake in HDFC at a 5% discount to the prevailing market price but someone in the Finance Ministry thought they could get away by asking for a premium.

While equity markets have continued to rally, liquidity in the system continues to be tight driven by slower deposit mobilisation by banks and high credit-deposit ratio which resulted in 3 months Certificate of Deposits of Banks spiking to 10.90% from 9.30% levels at end of December 2011. This will only get exacerbated in March due to advance tax outflows and hoarding of cash by banks. The RBI has been conducting Open Market Operations (Bond Purchases) of $2bn+ every week to pump liquidity and at the time of writing, RBI just cut Cash Reserve Ratio (CRR) for banks by a further 75bps to ease the liquidity tightness.

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EQUITY OUTLOOK FROM CIO'S DESK

The bigger macro event for India is the forthcoming budget session on 16th March. Expectations from finance minister (FM) are to present a roadmap for fiscal consolidation, given India's fiscal deficit for 2012 is going to spike to nearly 6% with the subsidy bill coming nearly twice at 3.3% of GDP from the previously forecasted number at 1.6% of GDP and a kick start to the investment cycle given India's GDP in 3QFY12 has slowed down to 6.1%.

With the recent poll debacle of the Congress in India's most populous state, Uttar Pradesh, the fear on the street is that the government will announce further populous measures with growth/reforms taking a backseat.

However, the current budget provides a good opportunity to take some tough decisions with the state elections behind us and general elections far away in 2014. Will this government bite or as usual do nothing?

The only certainty is that taxes will increase …

Hiren Ved

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DEBT OUTLOOK

Last month of fiscal year 2012 quite dynamic in its own way owing to couple of key events which are expected to ascertain the political and economic fate for this country going ahead and eventually for the investors.

- Election results of the states (UP/Punjab/Uttarakhand/Goa/Manipur) on March 6, 2012 will eventually determine the political equations at the Centre going forward thus setting the tone for the next year's budget.

- RBI policy on March 15, 2012 widely anticipated for easing the stressed liquidity in the banking system and starting the rate reversal cycle.

- FY13 Union budget on March 16, 2012 which the market expects would address the deteriorating growth condition and provide for some fiscal consolidation.

February month had its mixed bag of events with key economic indicators listed below:

- GDP growth for the Sep-Dec quarter stood at 6.1% YoY. April –December 2011 FY12 growth stands at 6.9% as against 8.1% of previous year.

- Inflation for the month of January eased below 7% at 6.55% compared to previous month's 7.47% for the first time in last two years primarily because of favourable base effect and sharp fall in core inflation in January to 6.67% from 7.69% in December.

- IIP for December slipped to 1.8% as compared to 5.9% in the previous month and 8.1% in the same month last year, much below the consensus of 3.0%

- The rupee remained stable after a sharp rally in January. Foreign inflows helped in negating the impact of rising crude prices which was up 10% in month of February.

- Liquidity in banking system remained extremely tight despite the 50bps cut in CRR. Banks have borrowed Rs1.8 trillion or 3% of their net demand and time liabilities from the RBI, much higher than the RBI's target of +/-1% and higher than last year's 1.5%.

Clearly high interest rates and poor business sentiments are hurting both investment and consumption demands. Credit growth is getting slowed and deposit growth having picked up YoY in FY12, the liquidity deficit has widened as the RBI intervened in the forex market to halt INR depreciation in CY11. There is a shortage of liquidity, and with year end, and advance tax payments, we expect the liquidity to remain extremely tight in March. A much anticipated 50bps CRR cut will infuse another Rs320bn into the system thus covering for 18% of the current shortfall. RBI has until now performed bond buybacks up to the tune of Rs1.2 trillion through OMOs to infuse liquidity in the system. OMOs have certainly helped to keep the yields on long term bonds low. We expect the benchmark GSec to trade in the range of 8.15-8.30%. The longer end of the yield curve is expected to remain volatile given high fiscal deficit and government borrowing this fiscal.

DEBT OUTLOOK

Short term rates would remain elevated given the stressed liquidity and year end scenarios. Going forward we expect the yield curve to steepen bullishly (short end rates falling faster than long rates) over the next 2 – 3 months. The short end rates currently are at their historical highs and peaking out hence we suggest short term funds with low average maturity and high carry in the portfolio as a superior investment option. Longer end of the curve would react once there is clear sign of RBI indicating policy rate cuts. Investors with higher risk appetite can invest a part of their portfolio in dynamic bond funds to play safe duration calls to generate better risk adjusted returns.

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