

**FICCI**

# Banking & Finance

Issue : 3

**JOURNAL**



**INDIAN FINANCIAL  
MARKETS-2020**

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# ABOUT FICCI

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A non-government, not-for-profit organisation, FICCI is the voice of India's business and industry. FICCI has direct membership from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 83,000 companies from regional chambers of commerce.

FICCI works closely with the government on policy issues, enhancing efficiency, competitiveness and expanding business opportunities for industry through a range of specialised services and global linkages. It also provides a platform for sector specific consensus building and networking.

Partnerships with countries across the world carry forward our initiatives in inclusive development, which encompass health, education, livelihood, governance, skill development, etc. FICCI serves as the first port of call for Indian industry and the international business community.

# PREFACE

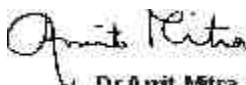


In its role as a facilitator, FICCI has always been at the helm of affairs of pertinent economic and policy issues. To carry forward our endeavour of being an integral part of policy affairs and value added resource to our stakeholders, it gives us immense pleasure to bring to you the third issue of our widely circulated and appreciated Banking and Finance Journal. Eminent people from various industries contributed towards the success of our last Issue and expressed their views on finding ways and means for meeting the funding needs of the Indian Economy.

Current issue of our journal aims to bring to the forefront perspectives of experts from India Inc. and financial sector intermediaries on 'Indian Financial Markets-2020'. The Banking and Financial Services sector over the years has seen participation from domestic and foreign fronts; this sector has played a vital role in partnering growth over the past two decades by effectively intermediating funds for the capital expenditure requirements, channelizing domestic savings and inducing capital flows from the developed markets to India. Going by the trend, financial markets will be a key pillar for growth, fuelling the Indian economy. Through the voice of some of India's leading names of financial sector, this issue reflects on the pending reforms and future road map of Indian Financial sector over the next decade.

We thank our partners MCX for extending their support to help achieve our endeavour.

We do look forward to views and suggestion from the readers to help us improvise the content of the journal and make it more relevant and informative.

  
**Dr Amit Mitra**  
Secretary-General  
FICCI



# India's financial sector in 2020

**Ms. Shikha Sharma**

*Managing Director & CEO, Axis Bank*

## The financial sector will evolve in tandem with the transformation of the real economy

It is always challenging to divine the shape of things to come: unmet needs, new technologies, consumer preferences and, most importantly, the spirit of innovation and enterprise. Fortunately, the contours of the evolution of the financial sector might be somewhat more amenable to description; In India, these are likely to be shaped by the fundamental drivers of economic and social developments.

One of India's key economic strengths is a dynamic financial sector, which has played a vital role in partnering growth, effectively intermediating funds for the capex required. This interaction will rapidly increase, with funding and credit lines being vital for initiating and sustaining economic expansion. Rather than dwelling on the financial sector, particularly the banking industry, per se, this article attempts to envision some changes in the real economy that will define the contours of the financial sector.

A brief overview of developments in the financial sector might help provide some perspective to our thoughts delineated below. India has a high savings rate, approaching or surpassing those of Asean countries, providing access to a stable source of funding. At the same time, India's financial sector remains predominantly bank centric, inter alia due to debt markets not having sufficiently matured and deepened. The banking sector, the predominant provider of debt finance, has grown commensurately, at a CAGR of 19 percent over 2004 to 2010, and is increasingly profitable and efficient. It has managed to contain a moderate deterioration in asset quality, even while passing through one of the worst downturns in recent memory.

However, given the increasingly complex financing structures for the funding profile of India's corporates capex needs, many capital markets segments have emerged or have transformed, as has access to global capital pools. Equity markets, in particular, have played an

increasingly important role in raising risk capital for India's substantial investment and acquisition needs. Continuing process reforms have created a robust and efficient infrastructure for equities trading, clearing and settlements. Amongst other financial segments, one of the most visible transformations following these reforms was the development of the life insurance industry, which responded to customer demands for highly customised products and prompt service.



## The changing profile of India's economy

The Indian growth story is largely a domestic demand, savings and investment led theme. The story actually began in the decade of the Nineties, with reforms fostering administrative, economic, market, fiscal and financial liberalisation. There was a move to markets and market-determined prices, relaxing the maze of administrative rules and controls, opening up sectors to competition, allowing foreign investment and participation in India's growth and integrating with the global economy.

These changes will result in the acceleration of certain trends, already evident, enabling sustained high growth into the next decade. These trends will, in turn, define basic financial needs, with concomitant changes in the financial sector. Five of the most distinctive of these structural trends are delineated below.

1. Inclusive growth will be fostered through technology and distribution innovations:

Maintaining a high 9 percent plus growth trajectory requires, among other things, the assimilation of lower income households into the formal financial system. This is important, both to tap into savings that have hitherto been inaccessible, as well as to enhance productive efficiency

through credit delivery. Distribution has been an impediment for increasing financial access, but this is likely to be mitigated. Technology plays a critical part in providing this "last mile connectivity" and in reducing the service delivery costs on a per-transaction basis.

2. Increasing urbanization, yet with a more efficient agricultural logistics chain, will increase rural-urban linkages:

The most significant transformation of the past decade was a shift in the fulcrum of consumption towards emerging countries. This will become more pronounced, driven largely by two features, although at different time scales. In the short term, slow growth and high leverage in developed markets will remain an endemic and structural feature of their consumption, and the gap will be filled by growth in emerging markets. Over the longer term, the significant under-penetration of all product and service segments in countries like India will be the opportunity. In particular, India's retail financial penetration remains very low, compared even to its emerging markets peers.

3. Deepening trade and financial linkages with the global economy will open new financing opportunities:



The above consumption trends will be augmented by changes in the global supply chain, increasingly driven by the people and knowledge resources of emerging markets. India's growth will open new markets, increase its interactions with existing ones, in the quest for new markets, industrial inputs, technologies, management expertise and global finance. Opportunities for trade finance, funding mergers and acquisitions and capital raising are likely to increase rapidly. In addition, the off-shoring process is likely to transform, with global multinationals focusing on a range of innovations, not just to cut costs but develop products for more price conscious emerging markets.

4. Increasing manufacturing depth, with vibrant small and medium enterprises:



Even as India's knowledge based industries continue to expand, the improvement of India's rankings in many global manufacturing competitiveness surveys are a pointer to developing potential for increased manufacturing activity. At the forefront of this will be the SME sector, from where much of the innovations and efficiencies are likely to emerge, and will be a significant financing opportunity.

A progressive improvement in infrastructure facilities has been partially responsible for the increasing competitiveness. Although much remains to be achieved, there has been a steady improvement in capacities, which are likely to continue with the progressive enabling of appropriate pricing and market structures

5. Transactions will become increasingly market oriented, changing the risk profile of economic activity, necessitating new risk management products:

The above developments will result in an increasingly market oriented economy, where the profile of risks

will change, becoming more complex, with the consequent need for more effective mitigation. This will require the introduction of a whole range of hedging tools and derivatives instruments for fixed income, currencies, equities and commodities markets.

Greater market orientation will also imply volatility in household incomes as one of the side effects, necessitating increasing use of insurance and pension products. The insurance and pension segments will be crucial not just for increasing social security, but are also likely to emerge as a catalytic factor in development of long term debt markets in India, a crucial feature for the massive financing needs for infrastructure projects.

How might the role of banks change in this context? Even as bond markets mature, and it will probably be some time before they sufficiently deepen, banks will continue to play a dominant role in financing the large capex needs of infrastructure and corporate investment. In addition, banks will be the main channel for intermediating and aggregating the

large domestic savings pool. New participants will emerge and existing ones transformed. Overall, it is likely that lines demarcating lines between the various segments of the financial sector will blur, despite the implementation of proposed global financial sector reforms.

Finally, there is the issue of regulation and oversight of this complex financial architecture. Through a combination of experience, insight and intuition, policy authorities have managed to steer India's economy through the worst financial crisis on a relatively even keel. Even more notably, despite the introduction of new financial products, the adoption of risk management practices by market participants, combined with regulations requiring stringent solvency margins and adherence to prudential norms, enabled the financial sector to withstand severe business and liquidity shocks.

To sum up, India will be one of the most significant contributors to global growth over this decade. India's financial sector will be a key pillar for this growth.



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### About the Author

Ms. Shikha Sharma is the Managing Director & CEO of Axis Bank. Previously, she was the Managing Director & founder CEO of ICICI Prudential Life Insurance Company. She has done her B.A. (Hons.) in Economics, and completed her Masters of Business Administration from the Indian Institute of Management, Ahmedabad in 1980. She has a Post Graduate Diploma in Software Technology, from the National Centre for Software Technology, Mumbai.

# Indian Financial Markets-2020

**Mr. Amit Chawcharia**

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## India: Current Scenario

India is already a trillion dollar economy ranking amongst the top Countries in purchasing power terms and growing at a very rapid pace. Financial Markets in India is probably one of the few infrastructure areas where India can feel proud of and compare itself with the best in the world. The Banking and Financial Services sector has seen a good mix of domestic and foreign participation. A lot of development in the financial markets that has facilitated this growth can be traced back to the post '91 reforms. So in a sense these developments are fairly recent and that helps us in not having to deal with too much of legacy issues that are probably plaguing some of the developed markets.

We have a fairly developed and liquid exchange traded Equity Markets that offers a world class trading and clearing platform. We also have a

fairly liquid currency market on the Over-The-Counter (OTC) platform. The existing Financial Infrastructure in the form of efficient exchanges, clearing infrastructure, stringent regulations around banking, financial disclosure norms and corporate governance stemming from a sound legal system based on common law principles, makes us as one of the attractive emerging markets that can facilitate investments from both domestic and foreign investors. We also have an economy with very robust savings rates of 35% that leads to a healthy Domestic Investor appetite for funding the capital market needs. This is also helping us as a country to mitigate some of the problems associated with the global financial crisis linked to over leverage, high dependency on foreign capital and associated vulnerability of domestic currency.

The Corporate Bond segment is still at a nascent stage and needs a lot of

development. Only a very limited set of Interest rate derivatives product are currently available and mostly on the OTC. We have a relatively nascent organized Commodities trading but growing at a rapid pace through the exchanges mechanism. This is in itself a sea change from the unorganized localized mandi trading that exists in most parts of the country today.

Some of the problems being faced by the Indian economy include high inflation, growing employable



population without adequate job opportunities, high fiscal deficit and low tax to GDP ratio.

## Global markets scenario

The Developed world is recovering from an unprecedented financial crisis that not just eroded financial capital but also shaken Sovereigns and investor confidence. This is leading to major Financial Reforms including some of the following:

- US Congressional negotiators have approved the most sweeping overhaul of U.S. financial regulation since the Great Depression, reshaping oversight of Wall Street. Lawmakers are working at restricting proprietary trading by banks and oversight of the derivatives market;
- The World is getting together to agree on financial hygiene reflected in the recent G20

agreement to cut down fiscal deficits by 50% by year 2013

- Move toward exchanges & central counterparty / clearing houses from OTC and thereby mitigating counter party risks and increasing standardization and transparency of financial products in world wherein the derivativization of all asset classes and even abstracts including yet-to-be-released Hollywood commercial cinema is happening.
- Basel norms (BIS) - The Basel Committee is well advanced in its preparation of regulatory reforms addressing the core elements of bank soundness - capital, liquidity and leverage.
- Compensation models of financial firms changing to encourage calculated risk taking

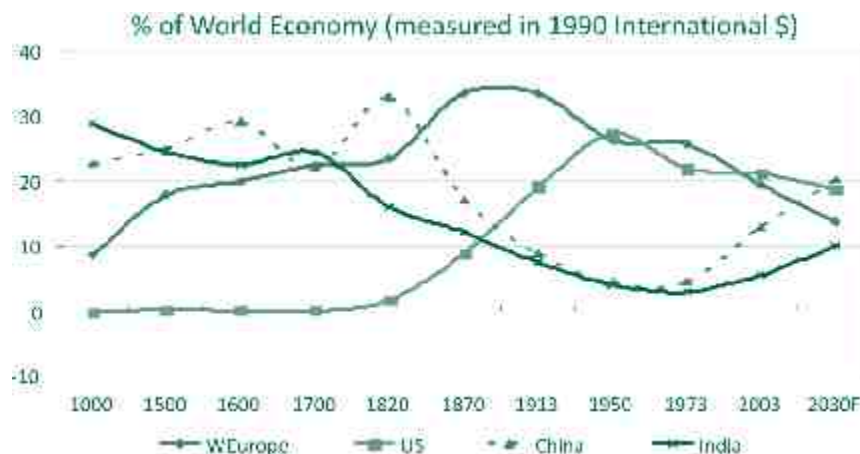
Over the past year, growth in many emerging market economies has

recovered strongly. This has helped to improve global demand conditions. But inflation and capital inflow pressures leading to sudden currency appreciation pressures and monetary shocks in many of these economies including India are now raising difficult policy dilemmas.

## India implications for the next decade:

The foresight of our Regulators and the measured policy making has helped us avoid some of the above problems that are plaguing the global financial markets. There is now a need to prepare India for the next decade. Global economic order would change towards the now so-called emerging economies - these economies will have a lion's share of growth in the next many years and probably would be amongst the top-tier economies. China and India would be amongst the forefront.

GRAPH DEPICTING % GDP SHARE OF INDIA & CHINA- PAST, PRESENT & FUTURE



Source: CIRA estimates based on data from Angus Maddison, 2001, *The World Economy: A Millennial Perspective*, and, "The west and the rest in the world economy: 1500-2030"

Some of the expected developments in the Indian markets include

- **Corporate sector becoming global** and is aspiring for much more growth in scale and complexity. That would require a much larger sized financial intermediation and accordingly the scale and risk appetite of Indian financial Institutions needs to grow as well to keep pace.
- India needs to pay attention and do a war-footing execution in the physical Infrastructure space. This is already being a bottleneck for industrial growth and causing every day issues for the residents of the country both at rural as well as urban centers. Be it transportation for people or movement of goods, power for industry and domestic consumption, housing or even providing safe drinking water for residents - a lot needs to be done and all these infrastructure creation would need lot of financing of a different nature and magnitude along with a Public Private Partnership (PPP) model. It would be pertinent in that light to have a financial market that will support the infrastructure funding requirement of this nature and size.
- Financial intermediation by **channelizing the growing savings** of the domestic population to the funds-hungry corporate sector

across various financial instruments with differing risk profiles and tenor

- **Financial inclusion** is a must to tackle growing income disparity, rising unemployment, to avoid social unrest and associate issues.

These would require changes in the regulatory framework on one hand to support such growth while on the other hand prevent the kind of excesses seen in the developed markets.

The resultant implications and shaping up of the major constituents of the Indian financial markets is attempted to be captured below:

#### Fixed Income Markets

- Expansion of Corporate Bond markets: Required changes that can lead to the expansion of the Corporate Bond market would be - means to off-load credit risk, uniform stamp duty, screen based trading, clearing house settlement; increase in secondary market activity and thereby assist in transparent price discovery and avenue for early exits for investors and consequently also lead to more Issuers of long tenor debt
- Gradual relaxation of investment restrictions and forced rule based buying on long-term investors such as insurance companies, pension funds and Banks. This will give the required flexibility in

deciding the investments based on its merit.

- Consolidation of existing series of Government bonds to improve liquidity and facilitate better price discovery
- Linking of small savings interest rates to variable market benchmarks. Even the banks would need to get the flexibility of offering more than vanilla deposits i.e., structured deposits linked to variable market benchmarks viz foreign exchange, equity indices or commodities. This will also give a wider segment of society access the capital markets indirectly;
- Need for a special hybrid debt instrument that will change the standard risk-return paradigm; For example: a long term infrastructure funding need could be funded through a hybrid debt instrument wherein the interest amount could be linked to the





performance of an existing equity / infrastructure index benchmark or linked to inflation

### Foreign Exchange /Currency markets

- Regulations need to be more relaxed - capital account convertibility to be implemented further both for inward receipt of capital as well as outward flow of capital, relaxation of FDI in insurance and other restricted sectors thereby increasing access to more intellectual capital and associated products and efficiencies
- Risk management tools in Currencies including Fx Derivatives need to be made more flexible to allow Indian companies access to same type of hedging avenues as are available to their competitors globally. Banks, as providers of these products, will have to play a very important role in this process to ensure that while the growing corporates access these instruments to better manage their risks they should not succumb to some of the mistakes committed by their global peers.
- Exchange traded currency products need to be expanded to provide ease of access, transparent pricing and alternate risk management & trading tools to retail as well as institutional clients.

- Hitherto we have largely been a net receiver of foreign capital; however there is tremendous opportunity for domestic money flowing out to chase global opportunities. Further liberalization in this space required to provide Indian investors the choice and taste of global opportunity and associated diversification benefits.
- With US \$ is losing ground as the world's reserve currency, India has been prepared to manage its Fx reserves in a more productive manner.

### Equity Markets

While we have an efficient framework for equities trading on the exchange in the form of liquid cash and Futures & Options on primary indices and large cap stocks, we still need to further the equity derivatives space in a measured manner. The general educated urban population in India is quite familiar with equities and has a long tradition of equity trading.

- Supplementing the existing standardized exchange-traded products with some more customized and innovative products; there is possibility of having more sophisticated and bespoke products including third-party warrants and hybrid capital market instruments getting listed on the exchange platform for the

advanced set of investors chasing a differential risk-return profile.

- Role of program / algorithm trading is expanding thereby making the underlying markets more liquid and to facilitate this, execution cost needs to be reduced further - both from trading platform providers as well as various state levied duties or central government levied taxes to encourage the growth and associated liquidity in the markets.
- The investor participation is fairly shallow considering the size of the economy. Both direct as well as indirect investors through Mutual Funds, Insurance and Pension Scheme needs to be further promoted. We have the advantage of high savings rates that if channelized properly can become a measured and consistent source of capital. This





will also help moderate the market dependency on foreign money.

- Professional money management - There is scope to reduce cost of entry, inculcate genuine professional fund management and making the products transparent and investor friendly in an environment that facilitates healthy competition amongst various fund managers in a level playing field.
- Financial literacy - There is no substitute to financial literacy. Hence an investor education program on a massive scale should be implemented through various medium and intermediaries associated with the financial intermediation. With the sheer number of potential investors in India the economies of scale would kick in thereby justifying the reduction in absolute amount of associated fees.
- Increasing healthy competition and having multiple exchanges with smart order routing systems to ensure best price availability to investors across exchanges and cross-margining would make us further progress in this regard.

#### Credit

- Credit trading is an essential pre-requisite for the development of the corporate debt market.

Regulatory reforms are required in this space keeping in mind the learnings from the international space.

- With the growth in size, geographical expansion and complexity of Indian Corporates, there will be significantly more credit requirement for organic growth as well as potential leveraged buy-outs. The banking sector would need to re-align themselves in terms of ability of assessing complex credit / transactions as well as ability to defuse risk in other geographies and meeting the associated risk adjusted capital requirements.
- In the retail credit space, the creation of centralized Credit Bureau (CBIL) is already a step in the right direction, with the advent of UID, this process can further strengthen to provide a very comprehensive mechanism for credit monitoring and thereby growing the financial inclusion in a constructive manner with contained credit losses

#### Commodities

- Create a regulatory framework to ensure adequate economic risk hedging mechanisms are in place as in an uncertain global climate, commodity price volatility for both producers and consumers has taken on a different meaning altogether



- With the internationalization of financial markets domestic commodity prices have largely aligned themselves to international prices - We would need to de-politicize this space and free up international trade to accommodate free import & export of commodities keeping in mind the domestic price sensitivity and genuine needs of the domestic producers and consumers.
- Policies to ensure that producers are adequately incentivized and intermediation costs are limited to the value addition rather than increase in costs to end-consumer, thereby ensuring food security for the nation with probably the maximum number of people
- Commodities are also becoming investment asset classes in themselves, people are investing in Gold, Silver and other

commodities in a big way. A lot of investors will be chasing inflation adjusted returns and commodities can provide the necessary underlying benchmark.

- Global warming will become a much more serious consideration in the next decade; Emission reduction and energy sufficiency consideration will evolve and grow multi-fold. An economic platform to monetize and support this change including carbon trading, funding of alternate fuel projects, etc would be required.

### Others

Banking - India needs another green revolution - this time of a different kind i.e. financial inclusion that includes providing access to banking & financial services to the entire population. We need to ensure that banking both in terms of channelizing of savings as well as availability of credit to the majority of our people. This is a challenge worth taking for the banking sector as the opportunity



size and associated benefits are enormous. The existing postal network should also be harnessed to give effect to this goal.

Based on a recent published statistics, there are more people on the social networking sites than on our national depositories i.e., there are 31 million social networking individual accounts Vs only 17 million demat accounts holders - there is clearly a emerging class of individuals who would be looking for financial products

Technological changes are unpredictable but one can safely say that the world will not be the same as it is today and the pace of change would be much faster than what we have experienced in the past decade. Technology can change lot of things for example, the biggest competition to camera makers today are not from any other camera maker but from mobile manufacturers like Nokia! Similarly one can expect healthy competition amongst the various money channelizing agencies including Banks, Asset management Companies / Mutual Funds and Insurance Companies. Maybe the telecom operators become the biggest distributors of financial products. There is a huge scope to use technological progress to expand the reach of financial products to the masses in a low cost scalable manner. Mobile / virtual banking if deployed by the financial sector can

change the way our rural economy functions.

Tax reforms: Currently, only a small percentage of population is paying taxes. There is a need to have a simplified, less burdensome and stable tax regime for stake holders to take a balanced decision. Multiplicity of bilateral treaties leading to preferential treatment to investors coming from certain geographies may not remain. Tax compliance should increase multifold with the simplification of rules, technological progress and implementation of UID. Government needs to show judicious use of tax money and bring in more accountability to reduce / eliminate corruption and increase tax compliance. The Direct Tax Code implementation, uniform Goods & Services Tax (GST) and rationalization of subsidy - oil price decontrol are steps in the right direction. Over the next 10 years, given the right political will, it is not difficult to envisage a scenario where subsidies are reduced to bare minimum and get replaced with direct financial assistance to the needy sections of society, tax base widens to entire earning population and fiscal deficit gets converted into a surplus

Unique Identification would be a great enabler including ensuring financial inclusion, tracking of beneficiaries of various government assisted programs / subsidy; checking corruption & misuse of resources;

containing credit losses of financial institutions, immigration control, social security and electoral reforms. With this data mining in place a lot of strategic policy level initiatives can be focused and channelized for the general good of the society and avoid pilferage and misuse.

India is already a trillion dollar economy and looking to grow multi-fold in the next decade. India is on the agenda of all meaningful financial services firm globally and its importance shall only rise in the years to come. With a strong domestic consumption story and

favorable demographic profile, India shall be the leading consumer and a large trade partner for the world. We shall have many of the home grown global corporations providing world class products and services. By creating a Rupee symbol we have already included ourselves amongst the very few global currencies to have a unique symbol. This will go a long way in building brand-India. One advantage India possesses that is probably second to none is that of having one of the most educated, english-speaking youthful demographic profiles and a good mix of entrepreneurial talent. That can

certainly lead us to become a global financial center for intellectual capital.

Lastly, am intentionally not pronouncing or making any predictions on the expected interest rates, \$-Rupee levels or the Sensex as I guess will leave that to the Octopus and the Parrots of the world! Their vision seems to be 20:20.

Look forward to India playing a more meaningful role in the Global arena supported by a comprehensive and robust financial markets platform.



**Mr. Amit Chawcharia**

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## About the Author

Mr. Amit Chhawchharia is the Director within the Global Markets unit of Citi in India. He is currently working as the Treasurer for Citi's NBFC i.e. Citicorp Finance India Limited.

He is a top ranked Cost Accountant (ICWA), qualified Chartered Account and Company Secretary. He has more than 11 years of experience in the financial services domain covering finance, transaction banking, security services and treasury functions.

# 2020 - Looking into the crystal ball

**Ms. Naina Lal Kidwai**

*Group General Manager and Country Head, HSBC, India*

**T**he world expects India to achieve double-digit growth.

The world expects India, with some other emerging markets to drive the global economy; and both India and Bharat want the growth to be sustainable and inclusive. Is it possible? Can India meet the expectations of the world and its citizens – the answer are an unequivocal Yes; provided that is, that a few issues are addressed.

As the country undertakes this journey towards growth at a faster clip, the financial sector that comprises of financial institutions, financial markets, financial instruments and services, will be both the highway and the fuel that will enable it to reach its destination, and thus will need to be on top of the list of sectors where reforms are undertaken on an urgent basis.

Admittedly, the government and all regulators are aware of this, and the process has already begun. I also understand that some reforms may take longer than others to be implemented, but it is my dream that if I were to wake up in the year 2020, I would find a strong, diverse, functional, efficient financial system that is an able partner in the growth of the economy, and supports and attracts investments.

I would wake up to find:

## **Deeper, wider, stronger Indian Debt Markets**

The infrastructure development initiatives are in full swing with multiple avenues for long-term funding, thanks mainly due to the avenues available to infrastructure issuers to issue long term debt paper. What's more, these issuances are at fixed rates to make cash flows predictable thus assisting viability

analysis of projects. This, in turn, has been made possible by the development of a swap market for long tenors, with the introduction of a term money market benchmark rate; the RBI has eliminated SLR on interbank borrowings, thus aiding the development of a term money market. This has allowed investors like banks to swap long tenor bonds





into floating rates in line with their cost of funding and thus participate in long tenor bond issuances. Banks have also been permitted to float 10 to 15-year tax-free bonds to raise long-term resources specifically for financing of infrastructure projects.

Foreign institutional investors (FIIs) too have been encouraged to enter the long term bond markets and they no longer prefer to stay in the short end of the market, as they used to in 2010. The withholding tax (WHT) framework has been changed. Also, since FIIs require to hedge their currency risk and at times their exchange rate risk, they are able to enter into currency swap and interest rate transactions, in line with global markets.

The Investment guidelines of long term investors like Insurance companies and Provident/Pension Funds have moved towards a risk-based investment norm rather than investments patterns based on issuer specifications (GoI, State Government, PSU etc). This kind of investment pattern used to stymie the development of the market and would vitiate pricing dynamics denying financing to even Public-Private partnership infrastructure projects. We would also have multiple large domestic pension funds, insurance companies, mutual funds and investors to invest in these longer term instruments.

Under the Direct Tax Code, investors continue to be offered incentives to invest through Mutual Funds for debt

investments with additional tax incentives for investors to participate in the bonds market. This has increased participation of High Net Worth Individuals and retail investors in the debt market.

Savers have been incentivized into investing in long-term debt instruments through concerted efforts to create a debt market, which has brought in much-needed liquidity into the market, and increased attraction for debt instruments of longer maturity.

Another important development that has taken place is that a corporation to guarantee debt issued by infrastructure finance agencies and municipalities has been set up, to encourage a wider issuer base.

## Insurance

The issue of under-penetration of the insurance sector has been addressed, and easy-to-understand insurance schemes are available for a much larger section of the population, especially in rural areas in line with other emerging market economies. This has happened largely due to active insurance sector reforms, including liberalization of investment norms by foreign partners, bringing in much-needed capital into the sector, and introduced best practices that have unshackled the industry.



## Banking sector

The banking system remains, as always, the most dominant segment of the financial

sector. Indian banks continue to be well-regulated, and under the regulator's watchful eye, have emerged stronger. More importantly, the government's steps to ease capital constraints faced by Indian banks have resulted in consolidation in the banking industry. In fact today, there are a number of Indian banks in the list of the world's largest banks, and they are well-capitalised and in a great position to support Indian companies as they expand into newer markets and geographies, organically and through mergers and acquisitions.

With increased competition the customer has seen higher standards of service delivery. Several foreign banks have acquired Indian banks, and Indian banks too have acquired some foreign banks, and this has resulted in the cross-pollination of



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ideas and learnings and adoption of best practices. Technology, namely, the mobile telephone has enabled banks to reach out to the remotest corner of the country, and an increasing number of people have been brought into the formal banking and financial services system.

On the lending front, better flow of information and a central database of citizens and corporates have led to better data available to financial institutions to make their lending decisions. Lenders are able to gauge the credit-worthiness of borrowers in a more informed manner when they approve or decline a loan and also in pricing the loan appropriately. The credit infrastructure that began with the Credit Information Bureau has borne fruit. The legal framework has also undergone changes, making it easier for lending institutions to recover their loans without resorting to cumbersome, expensive and time consuming litigation, and in turn, make the formal lending system accessible to the really needy members of society.



If the above scenarios were to come true, it would mean that the financial sector has taken large strides towards greater efficiencies and strength, and the reforms implemented have worked their magic. Mumbai would be emerging as a global financial centre and the rupee as a global reserve currency.

Reforms will remain, as they do now, a continuous process to enable us to adapt to the changing environment around us and ensuring we emerge stronger.

## About the Author

Naina Lal Kidwai is Group General Manager and Country Head of HSBC in India, which employs 35,000 people comprising Banking services, Insurance, Asset Management, HSBC Securities and Capital Markets, Retail broking, HSBC Software Development (India) Private Limited and the Global service centres (BPOs servicing HSBC's operations in the UK, EU and USA).

Her international engagements include being a non executive director on the board of Nestle SA, Chairman City of London's Advisory Council for India, Global Advisor Harvard Business School. She is on the Governing Board of NCAER, Audit Advisory Board of the Comptroller and Auditor General of India, and on the National Executive Committee of CII and FICCI.

Ms. Kidwai has been repeatedly ranked in the Fortune global list of Top Women in Business, in the Wall Street Journal and Financial Times Global Listing of Women to Watch and listed by Time Magazine as one of their 15 Global Influentials 2002. She received the Padma Shri from the Government of India for her contribution to Trade and Industry.

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# Mapping infrastructure investments for 9% structural growth

**Mr. Anup Bagchi**

*Executive Director, ICICI Securities Ltd*

India indeed in the last 4-5 years has grown at a robust pace and still has the potential to grow at a rapid pace atleast for the next decade. It stood 49th in the Global competitive survey for 2009-10, up by one position from the previous years standings compared to its peer countries like Brazil and China which have gained 16 ranks and 5 ranks over a span of two years. India still needs to cover a lot of ground before becoming highly competitive market even though GDP growth has been robust in the past.

There are various variables the presence of which makes a particular economy/market globally competitive. The growth in India is mainly happening from factor driven variables like evolution of financial institutions, increased priority on infrastructure and enhancing social infrastructure. We believe the most important variable is the presence of infrastructure which is a key

ingredient for robust and sustainable level of GDP growth. This also should be supplemented with a better accessibility to low cost finance from institutions coupled with a better regulatory framework. These factors would lead to creation of efficiency driven factors, such as better goods and labour market efficiency, financial market sophistication and business innovation which can shift economy's growth to a higher orbit in the long run.

Infrastructure development, promoted by both the public and private sector, will be the key for India to move on to a structural 9% GDP growth. The pace of growth in the last 4-5 years has been mainly attributed to the increase in Investment to GDP ratio from 25% to 35%-37%, helped by a rise in private sector savings (8%-9%). So to maintain a high investment to GDP ratio (say a consistent ratio of over 35%) one needs huge flow of capital

into the infrastructure and increased participation by private sector holds the key.

As per the planning commission estimates, the government needs over \$500bn of investments over the 11th five year plan for infrastructure development, 31.4% of the investment outlay will be met by budgetary resources of the government. The rest will be divided in a between debt and equity in 2.3:1 proportion respectively.



Total Outlay on Infrastructure investments in the 11th Plan (2008-2012)

(Rs crores)	Budgetary Resources	Proportion	Internal generation	Proportion	Borrowings	Proportion	Total	Proportion
Centre	200000	31%	169687	40%	395936	40%	765623	37%
States	444671	69%	67880	16%	158386	16%	670937	33%
Private Sector	-		185877		433713	44%	619590	30%
Total	644671		423444		988035		2056150	

Source: Planning Commission

#### Composition of Budget Resources, Equity and Debt in total investment plan ( Rs crore)

Budgetary Resources ( Central+ State)	644671	31.4%
Internal Generation/Equity	423444	20.6%
Borrowings	988035	48.1%
Total Requirement	2056150	

Source: Planning Commission

The equity portion i.e. is the risk capital will be mainly contributed by the government which stands at 56% and remaining 44% will be contributed by the private sector. This means that private sector going ahead will be one of the prominent sources of risk capital for incremental

capital formation which is estimated at \$147bn. So the private sectors contribution in the total infra investment is expected to reach to 30% by FY12 from the current 17%-18%. In terms of targets the private sector investments have already reached 61% of their targeted

commitments within 3 years of the eleventh plan period. However, overall infra achievement may not happen as planned as we are already seeing slippages in investments as has been the case in power which forms 1/3 of the infra spend.

Break up of Private Investment (Infrastructure)	( Rs Crore)	Proportion
Internal accruals/equity	185877	30%
Borrowings	433713	70%
Total	619590	

Source: Planning Commission

Equity Requirement	( Rs Crore)	Proportion
Government sector	237567	56%
Private sector	185877	44%
Total Equity	423444	

Source: Planning Commission

One area where government can work upon is facilitation on the regulatory aspects so that private sector is able to channelize the risk capital required for funding this requirement. An important source of risk capital is foreign flows (FDI+FII), which though a bit volatile, can help accentuate the supply of risk capital given policy reforms keep happening on the ground. For instance FDI can bring in huge amount of equity capital provided the government raises.

FDI inflow as % to GDP in FY10 stood at 3%, which is a miniscule figure, but if the policy reforms are eased then FDI inflow can increase significantly. Though the FDI inflows were to the tune of \$35bn for FY10 (FIPB route+ other capital+ internal accruals), inflow towards the infrastructure segments like construction and power just comprised 10% of the total FDI inflows. So policy and

regulatory framework should be more infrastructure inductive (More focus on PPP, promotion and encouragement to BOOT & BOT type of projects, Increase in viability gap funding (VGF) should be encouraged for sustainable private sector and foreign sector participation) so as to increase the share of infrastructure segment in total FDI flows.

On the other hand India does attract good amount of portfolio flows specifically in the stock markets. Going ahead one can expect \$20bn-\$25bn of portfolio flows p.a. for next few years, which can help Indian corporate to source risk capital for capex programmes. But FII flows being volatile, domestic savings (mainly household savings) should be encouraged in the stock markets as a cushion against the volatile portfolio flows. Though this will be a gradual process but at the same time can be a significant and a sustainable source



of risk capital for fuelling growth. This can be either achieved by attracting this money via the direct route or equity mutual funds or via the insurance companies which are fairly large source of capital, second only to FII flows.

Other sources of capital	Volatility of flows	Comment
FDI	Medium	Flow depends on regulations and policy framework lead to smooth and efficient functioning of the business/industry
FII	High	Require more long only funds which commit capital for long period of time
MF and Insurance	Low	High household savings can be encouraged given right products coupled with better risk return profile are offered.

On the debt side the main source of financing for 11th plan infrastructure investments will happen via bank credit (51.3%) followed by funding from specialised NBFC's (23%) and ECB's (12.4%).

Funding of debt component	(Rs crore)	Proportion
Bank Credit	423691	42.9%
NBFC	224171	22.7%
Pension	55414	5.6%
ECB	122263	12.4%
Unallocable GAP	162496	16.4%
<b>Estimated Debt Requirement</b>	<b>988035</b>	

Source: Planning Commission

The stock markets/equity funding alone cannot make the capital markets of any country globally competitive as stocks markets cannot suffice the financial needs for corporations and the economy. What Indian market is lacking is a vibrant debt market particularly in the corporate segment. Though there are intentions and signs of some activity happening in this (Corporates like

L&T, TATA's and few NBFC's have been tapping these markets with attractive rates of return) to develop this market but how soon it becomes a reality is a key question so that debt capital is available at the right time, at the right cost and without creating a demand supply mismatch.

Though India is moving in the right direction we believe the pace of reforms and infrastructure building

should intensify. Therefore the question is not the quantum but the ability to drive liquidity through proper market platform. There is definitely a need for intermediation, instruments and markets that can perform that can function according to the risk, maturity and duration to suit the needs of investors so as to optimally utilise the funds available at disposal.



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# 1 crore to 5 crore investors: Opportunities and Challenges

**Mr. Praveen D G**

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Capital markets in India are maturing, and undergoing a growth phase but the potential is much bigger almost similar to that of the telecom boom in the current decade. The rapid pace of innovation in the financial services spectrum has created immense investment avenues for the investors. The initiatives of policy makers only witnessed sustained enthusiasm displayed by investors and new exchanges in the country. Earlier investors looked to a narrow assets' band. The developments and growth of markets has brought significant changes in investors' attitude towards financial investments and services. Recent years have witnessed good retail participation in public offers from companies both domestic and abroad operating beyond conventional sectors. Yet, gaps remain and challenges abound.

The challenges in the capital markets arena have underlined the need for heralding third generation financial sector reforms. One of the daunting challenges that need to be met by the Indian capital markets is expanding the investor base and provides them access to high quality financial services. Among a population of one billion, a mere 1% of the population participates in capital markets, and of that only a fraction is active. This is dismal even when compared to conservative economies like China where it is around 7-10%.

India has a robust household savings rate of around 30% of GDP. Post 1990s, the rate has grown over years, but still almost 55 percent of savings drained into physical assets. A large number of corporates and especially SMEs are in need of risk capital but

face constraints in tapping it. Around 58% of the household financial savings (gross) in India were diverted towards the banking system in 2008-09.

While corporates see markets to raise low cost risk capital, investors see liquid secondary markets for exit options. The regulated markets have grown significantly, but the markets need greater depth and liquidity. Notwithstanding the growth in market cap, the market liquidity and depth have not improved. 90% of trading is from top 10 cities and of over 6000 listed companies, trading is largely confined to top 100 securities. The average daily turnover in cash market grew to only Rs.17,506 crores from Rs.9321 crores a decade back (2000-01) when the benchmark Sensex rose to 17,700 by end of Jun '10 from a year end

closing of 3604 in the year 2000-01. The growth in turnover is primarily contributed from cash settled derivatives.

Indian markets are more equity oriented and 70% of the total turnover is in the cash settled equity derivatives segment. Equity and equity derivatives in the US account for just 13% of the market share whereas in India these are around 86%. The capital market cannot be said to be developed without active debt market. Unfortunately, the development in Indian debt market has never been impressive. So is the growth in bond derivatives market. In the US interest rate derivatives account for 85% of the market share but they are almost absent in India. Bank borrowings of the corporate sector that stood at 11.3% in 1984 have on an average rose to 21.5% during the period 2001-02 to 2007-08.

### Penetration of Financial Services: Innovative Integration of Intermediaries

The penetration of the financial markets outside 5-10 major cities has remained very poor. Collaboration among market intermediaries like banks, exchanges, mutual funds, brokers and insurance companies would go a long way in expanding investor base.

The banking infrastructure can be used adequately to grow the financial

markets. RBI has identified the importance of the role of private sector role and private-public partnership, and has been considering more banking licenses to private sector players to achieve expansion and sophistication. Currently 40% of India's population has access to banking through 80,500 branches. The RBI aspires to achieve 100% financial inclusion. Financial inclusion speaks about the ease of access to various financial services in a cost effective manner to all sections of population. Lead banks have been guided to provide banking services to every village that has a population of 2000 by March 2011. The central bank has directed the banks to further the Business Correspondent (BC) model by using the services of local facilitators like storekeepers, retired teachers and army personnel to reach the unbanked areas.

Similar to banks and insurance companies, mutual funds and stock brokers should aim to expand their branch and agent network for furthering the cause of financial inclusion. Akin to them stock exchanges which have long been recognized as financial infrastructure companies have to definitely build a stronger member network. Introduction of more fee based services, innovative products can result into a win-win situation for the economy. Brokers of exchanges can provide the much needed low cost penetration as they are already

connected electronically, they are regulated, have data base of clients with KYC and have low operating cost which makes them highly suitable for such financial services at incremental marginal cost.

The mutual fund industry also plays a pivotal role in attracting retail investors to capital markets and has ample scope to develop in India. There are around 40 AMCs offering around 630 schemes giving large scope for investors with diversified risk appetite and there are a total number of only 44.5 million investor accounts or less than 20 percent households holding mutual funds. In contrast, in the United States, as per ICI/SIFMA survey, the overall equity and bond ownership rate is around 47 percent of US households (54.5 million), and about 43% of the US households owned mutual funds.

Banks' and stock exchanges' role in development of mutual funds market is crucial. The branch network of mutual funds is limited to



few cities and exploitation of banking network is necessary for the penetration of mutual funds in rural areas. Recognizing the stock exchanges' role, SEBI has allowed online trading of open-ended mutual funds on stock exchanges, which are connected with 200,000 broker terminals spread across 1500 towns.

It is a welcome step that SEBI has relaxed its regulatory norms and has also eased KYC norms to attract more number of retail investors towards mutual funds. Similar supportive and consistent policy environment would boost the MF industry.

Financial market integration is absolutely necessary for penetration. The services of insurance agents (~ 3 million), stock brokers and banking business correspondents may be extended and be used to cross sell products and contribute to greater financial inclusion through integration.



### Use of Technology to Multiply Financial Services

Technology has demonstrated its potential to make investing and trading activities easier, swifter, safer and cost efficient. With over 600 mobile subscribers, mobile based trading has potential to stir a new trading revolution in the country. The introduction of internet trading has brought many changes in the trading patterns of investors, and has added a large number of investors into the system. However, the penetration is yet to see the potential. India has 70-80 million internet users while internet penetration rate stands at 7% for a billion population as against 25% in China and Singapore, and 75% in United States. This is alarming but it highlights opportunities to tap the untapped potential of internet trading. The planned issuance of biometric based Unique Identification (Aadhar) cards will provide access to the hitherto underprivileged.

### Competition among Financial Service Providers

Competition has become new mantra in sectors like telecom, banking and airlines that helped customers with a wide product range and better service, all at competitive rates. Today India has one of the largest mobile user base. Airline sector is no more catering only to specific classes. Banking services

have significantly improved and widened. A similar success is necessary for the wholesome development of capital markets in India.

Need for a wider customer base prompts introduction of new products and services, technology advancements at competitive prices. These benefits can accrue only if competition is fostered. Competition is encouraged in all quarters in developed countries like United States. The service providers need to be bolstered while focusing on expanding reach. Contrasting to two national level electronic stock exchanges in India, there are 11 SEC registered national securities exchanges, 2 unregistered exchanges and more importantly around 73 active Alternative Trading systems (which act as deemed exchanges) in United States. There are around thousands of national commercial banks in United States as against hundreds in India.

The role of capital markets is vital for inclusive growth in wealth distribution and making capital available for corporate across the country. Capital markets in an emerging economy can create greater financial inclusion by introducing new products and services tailored to suit investors' preference for risk and return as well as borrowers' project needs and risks appetite. Innovation, credit

counseling, financial education and proper segment identification constitute the possible strategies to achieve this. A well developed capital market creates a sustainable national level low cost distribution mechanism for distributing multiple products and services across the country.

The growth and development of small and medium enterprises play a vital role in greater financial inclusion. SMEs contribute greatly to our foreign trade and to employment on a large scale. The much awaited SME stock exchanges should be given due consideration given the potential they have in assisting the entities in raising capital and reducing their excessive dependence on bank lending. These companies have the potential of driving investors from local area where the companies are located towards the capital market.

### Financial Services: Role of Financial Education

One of the greatest challenges in expanding India's investor base lies in fostering financial education among masses. Lack of financial education is a major reason behind people's preferences to low-earning fixed deposits.

Education institutions, financial intermediaries and local correspondents should all work together to heighten financial literacy among people. Business networks, technological aids and other

resources can be used by the intermediaries to adopt low cost business models. The institutions may include the criteria regarding financial literacy and financial inclusion in the performance evaluation of their field staff. Financial education may be made a part of curriculum for bringing awareness among young generation.

### Capital Raising - Essentiality of Developing the Corporate Bond Market

Bond market comprises of government and corporate bonds. Indian bond market is dominated by the government securities. Only 4.14% of the total bond market comprises of corporate bonds as compared to between 40 to 50% in the above markets. An active corporate bond market is essential for India Inc. The corporate bond market is still at the nascent stage. The market capitalization of outstanding corporate bonds in India as a percentage of GDP stands only at around 2.5% against 43%, 34%, 35% and 19% in Malaysia, Singapore, Hong Kong and Japan respectively. The market cap of Indian equity market is around 110% of country's GDP.

The challenges involved in developing the bond market in India include generating demand from domestic investors along with boosting market infrastructure and



rationalizing the taxation regime. A liquid secondary market is necessary for development of primary market as investors get easy exit route. However, we do not have an active secondary market too. The exchange market is not active and the market is largely OTC. The introduction of mandatory reporting of trades in corporate bonds is a welcome step as that gives direction to the market and improves market efficiency. The SEBI data for corporate bonds during March 2010 shows an average daily reported turnover of less than Rs.3,300 crore.

The rating companies and valuation entities need to be strengthened to foster confidence among retail investors. A retail investor, who is not very confident of monitoring the equity market behavior, prefers bonds which are relatively safer. Interest rates are easily understood as they are dominantly used in the



form of fixed deposit. It is felt that guarantee mechanisms including bank credit default swaps can help investors to participate in issuances by mid-tier corporate. However, credit default swaps are nearly missing from Indian market. Recent indications from the RBI suggest that introduction of CDSs is being considered seriously. Besides, it is a welcome step that repos have been introduced in the corporate bond market.

## Conclusion

The robust savings figures of the country reflect the potential to expand the customer base from a crore to five crores given the savings are channelized in the right direction. Consistent efforts by the government and regulators to foster an investment climate that is conducive and by the financial intermediaries to go beyond the customary can herald a financial services revolution across

the country and drive 100% financial inclusion. Intermediaries need to attract the new customers along with retaining the existing chunk. Expansion of the customer base implies that intermediaries strictly adhere to the dictate-"Customer is the king". This demands keeping abreast of technology and consistently innovating to bring out a diverse range of products to suit the customer needs.



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Praveen DG is an Asst. Vice President in the Research & Product Development Department at the MCX Stock Exchange (MCX-SX). During his over a decade of career with financial expertise in capital, commodity and currency market products, he has extensively studied several global exchanges and global markets' practices and products, and has been involved in designing financial products. He is an active member of the core team of research and product development of the exchange and undertook various empirical studies in the areas of risk management and financial products. Prior to this he was with Multi Commodity Exchange of India (MCX) where he contributed to the product research and development.

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# Indian Financial Markets-2020

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**D**emographic dividend combined with a burgeoning middle class already bigger than the US population provides a platform for India to become one of the largest economies by 2020. One of the key segments that will drive this growth will be financial services sector that will help productively channelize domestic savings and induce capital flows from developed markets back to the increasing important Indian market.

Financial Services sector contributed ~15% to India's GDP in FY09, and is the second-largest component after trade, hotels, transport and communication all combined together. The Indian financial sector has gone through significant reforms over the past two decades post the recommendations of various Committees, which have facilitated operational flexibility and functional autonomy. Going forward this growth

trajectory will require a balanced approach between mobilizing the near dormant household savings residing as deposits towards productive investments and providing stable platforms for global capital inflows.

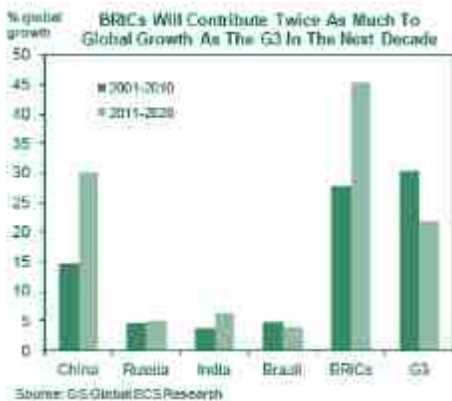
Experience across world-wide confirms that the countries with well developed and market oriented financial systems have grown faster and more steadily than those with weaker and closely regulated systems. While global linkages have in recent times stressed many financial markets, for India their impact can be limited by mobilizing domestic savings and introduction of pro stability led reforms.

Also, while Indian regulators such as RBI have played a judicious role in ensuring a well regulated financial services sector so as to minimize the aftermath of the recent global crisis, the time is opportune for some

structural changes in the industry that are likely to craft the contours of the Indian financial system.

## Changing Landscape of the Indian Financial Markets-2020

Over the last decade, growth in the emerging markets have surpassed that in the advanced economies leading to a significant increase in the global capital flows (comprising of FDI, Cross border equity & debt investments & lending). As per the McKinsey MGI study, global capital flows have grown three fold from \$3.8 trillion in 2001 to \$ 10.5 trillion in 2007 (At the onset of the economic crisis, global capital flows dropped by ~82% in 2008 at \$1.9 trillion, because of the drop in cross-border lending). However in terms of relative contribution, India captured less than 1% (\$79 billion) of the global capital flows in 2007 & ~3%



(\$51 billion) in 2008. As the crisis ebbs, capital flows into emerging market economies have resumed as a consequence of a global system awash with liquidity, the spectre of low interest rates ruling in advanced economies and the prospects of robust growth in emerging market economies. With strong underlying fundamentals & stable macro-economic outlook, India is distinctively positioned to capture more than 5% of the global capital flows by 2020.

The banking system is, by far, the most dominant segment of the Indian financial sector. Domestic Institutional Investors like Insurance, Asset Management Cos & Private Equity have grown at an average of 25-30% p.a. over the past decade due to the ongoing financial reforms and increasing participation from the retail & HNI investor. At less than 11% (AuM to GDP) in Asset Management as on March'10 and 4% (Premium collected to GDP) in Life-Insurance by end of 2008, Indian DIIs continues to be low on the global

penetration index. One of the key reasons for lower penetration is low urbanization rate in India at ~30% in 2008. As per the McKinsey MGI report on "India's Urban Awakening"- Over the next 20 years, urban India will create 70% of all new jobs in India and will create demand for financial products. We will witness an urban transformation the scale and speed of which has not happened anywhere in the world except China. In terms of both population and GDP, many Indian cities will become larger than many countries today (Mumbai Metropolitan Region's GDP is projected to reach \$265 billion by 2030, larger than the GDP of many countries today, including Portugal, Colombia and Portugal). Indian DIIs are well positioned to leverage these opportunities with time to come as they move towards the next generation of transformation through industry consolidation, innovative distribution, enhanced product offering, coupled with regulatory reforms, we are certain to see some of them featuring among the Global league tables by 2020.

Till two decades back, significant part of the household savings were invested in physical assets (gold etc) or put into bank deposits and other saving schemes of the Government. However since the late eighties, equity & debt capital markets have started gaining some importance for the retail investors as 12% of the

total household savings were invested in shares, debentures & mutual funds in FY09 (Only ~3% of the household savings were invested in shares, debentures & mutual funds in FY10 with the onset of the crisis). This is still much lower when compared with any developed or emerging market. With growing investor awareness & confidence levels, higher risk appetite to garner better returns and increasing contribution of the Tier II & III cities, retail investments are likely to see multi-fold increase over the coming decade. This will bring in the much desired stability and autonomy in the Indian capital market which is still highly vulnerable due to the changes in the FII flows.

Also, lack of a developed bond market has restricted investors to bank deposits with standard maturities and very low returns compared to any other investment asset class. India's size of the bond market as a % of GDP is close to ~40% only. The Indian bond market is



composed of government bonds & corporate bonds. However, the market is still overwhelmingly dominated by government bonds, which account for almost 92% of the market and form liquid component of the bond market. The share of corporate bonds in GDP is merely 3.3%, compared to 10.6% in China, 41.7% in Japan & 49.3% in Korea. With the expected regulatory reforms and setting up of a bond exchange in India, we are likely to see a much vibrant and developed bond market in India with strong participation from both the retail & Institutional segment.

Another important theme for 2020 will be focus towards financial inclusion. Financial inclusion has long been a challenge in India, where bank transactions are mainly urban based and people living in rural areas rarely even have a bank account. Only 5.2% of India's 650,000 villages have bank

branches even though 39.7% of the overall branch network of Indian banks (31,727 branches) is in rural India. Further nearly 80% of the Indian population is without life, health & non-life insurance coverage. While life insurance penetration is 4%, non-life cover is even lower at 0.6%. The per capita spend on life and non-life insurance is just about Rs 2,000 and Rs 300 respectively, compared with global average at least Rs 18,000 and Rs 13,000.

Financial Inclusion is going to be a necessary enabler towards equitable growth. It will allow rural & semi rural sector to build savings, make investments & provide access to credit. However addressing financial inclusion will require holistic approach on the part of banks in creating awareness about financial products, education, offering counseling on savings and credit. Brick and mortar expansion of the banking system is going to find it difficult to reach large sections of the population purely for commercial reasons. Branchless banking as a concept will emerge very strongly and will over-take conventional bank branches by either using information & communication technology services or by forging linkages with third party organizations like MFIs (Micro-Financial Institutions) & Business Correspondents. Technology will drive innovation and especially mobile-banking technology can be a very valuable

tool in providing access to banking products in remote areas at the lowest transaction cost. ATMs cash dispensing machines can be modified suitably to make them user friendly for people who are illiterate, less educated or do not know English.

In this era of globalization, Indian banks are going to serve their domestic, corporate & NRI clients in the international markets with increasing competitive pressures from their international peers. Indian public sector banks will continue to strengthen and be the dominant players with the likelihood of further consolidation. Indian banks will gain further prominence in the international arena as some of the leading public & private sector banks will, like some Chinese banks, emerge as global leaders. Foreign banks will become more niche players and will increasingly focus more on the cross border products like equity raising, debt raising, M&A, transaction banking support.

Technology will play a critical role in increasing penetration for a variety of financial services and products and will be the mainstay in facilitating the next wave of financial services growth in this country. This will largely be driven by improved accessibility and reduced costs. Considering India's mobile & internet penetration (active internet users) has grown significantly with already ~617 million & ~60 million subscribers respectively as on



June'2010, integrating mobile telephony, into customer targeting will become extremely critical over the time to come. Further, we are likely to see increasing interaction via mobile based applications, as mobile payments (e.g. e-money) will reduce check transactions. Transaction costs will see a significant drop as technology plays an important role to reach customers cost-effectively.

We have already established a fairly robust regulatory system in place through the various reforms over the past two decades. In the wake of the recent crisis, Indian financial system has shown great resilience partly due to the prudent regulatory framework and proactive response by the regulators. Prudency and customer protection will continue to be the core agenda for the regulators. However, the Indian regulators will need greater alignment with the foreign regulations, as increased globalization introduces common vulnerabilities and increasing demands from foreign nations

towards harmonization. On the domestic front, greater integration among domestic regulators will be the natural course towards improved accessibility and investor confidence.

Another important enabler that is likely to emerge will be an Indian Sovereign wealth fund. Even though this has been a subject of discussion over the last couple of years, setting up a Sovereign Wealth Fund for India could be an important channel to invest both in the local market to bring financial stability and confidence coupled with acquisition of critical global assets in sectors that are of significance for the Indian economy such as energy, communication, defense and healthcare. Most developed & emerging economies even in Asia such as China, Singapore, and Malaysia etc have established SWFs from their current account surpluses and are actively expanding their national interests via this platform.

The fundamentals of the Indian growth story remain unchanged and by 2020 as suggested by many

studies, Indian GDP is expected to grow multifold. India finds itself at the centre stage of global interest and growth. The financial sector as part of this growth story finds itself at a critical juncture in India. The various initiatives taken by the Government to meet the challenges of a complex financial architecture have ensured that a new face of the Indian financial sector is crystallizing into a strong, transparent and resilient system. And even though a sound and resilient banking system and well –functioning financial markets have helped Indian economy to rebound buoyantly and remain largely resistant from the communicable effect of the global meltdown, India cannot afford to be complacent. Over the next decade, Indian financial services sector, supported by sound regulatory decisions, promises to offer immense growth opportunities and will serve as key enabler towards reorienting both domestic and global capital flows into Indian financial markets. Financial services 2020 will see the emergence and embedding of the



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Mr. Godhwani has given strategic direction to Religare's growth since his joining in 2001. He has been instrumental in establishing Religare's vast network and shaping the Company's strategies in India and abroad. Mr. Godhwani brings to the company strong leadership skills, vigor and a passion for excellence. He believes in nurturing a culture that is entrepreneurial, result oriented, customer focused and based on teamwork. He has a diverse and wide-ranging experience of over two decades in managing large scale businesses.





# Indian Economy – an update

India's strong macroeconomic performance during the fiscal year 2009-10 is an indication of the economy's swift recovery from the global financial and economic crisis. The resilience of our economy is thoroughly reflected in the high economic growth rate of 7.4 percent registered during 2009-10, which was one of the highest in the world. The growth outlook for the year 2010-11 is also robust with the country's central bank, RBI, projecting a growth of 8.5 percent with an upward bias. Corroborating the bright economic prospects for the Indian economy, various international agencies have also consistently perked up their growth outlook. In the latest World Economic Outlook, the International Monetary Fund (IMF) forecasts India's GDP to clock a growth of 9.5 percent in 2010. Asian Development Bank (ADB) too has mentioned that they will revise India's growth forecast in their September-end review.

As pointed out by the recently released reports such as The Macroeconomic and Monetary Developments, PM'S Economic Advisory Council Report as well as the Annual report of RBI, the positive growth momentum of the economy has been mainly driven by the buoyant performance of the industrial sector and the rising investment and consumption demand. Consumer confidence is on the rise, as suggested by strong corporate sales figures, higher auto sales and augmented consumer durables production. Even the corporate sector is recording strong profitability and higher capacity utilization levels. Companies are exuding optimism and confidence about the future and are bringing out projects that were put on hold about a year ago due to difficult economic conditions. They are also looking at new proposals and diversifying into new areas. With the upcoming

festive season, the domestic demand in the economy will only be on an uptrend.

While India is returning to its pre-crisis growth trajectory, an issue of concern looming over the economy is the high and generalized inflation. We have been facing a situation of rising prices for a long period now. While initially inflation was confined only to food articles due to a deficient monsoon season in 2009-10, it has gradually manifested itself in the prices of manufactured goods and the fuel group. To contain





inflation and anchor inflationary expectations, the Reserve Bank of India (RBI) initiated the process of calibrated exit from the accommodative monetary policy stance much before other countries of the world. With a near normal monsoon this year and an upcoming good harvest it is expected that the inflationary pressures will ease off gradually. The downward trend in inflation has already begun and most estimates including those by RBI project inflation to reach the level of 6 percent by March 2011.

In response to the crisis and to support the ailing economy, the government and RBI deviated from their fiscal consolidation path and undertook huge expenditures which were not planned and which resulted in a high fiscal deficit for the economy. In view of the adverse impacts of the high fiscal deficit which were particularly emphasized through the sovereign debt crisis in

Greece, the Union Budget for 2010-11 the government announced a medium-term fiscal consolidation plan. The 3G/BWA auction proceeds leading to unexpected gains of almost Rs. 1 lakh crores for the exchequer along with the deregulation of petrol prices and upward revision in prices of other petroleum products as well as robust indirect tax collections are expected to somewhat ease off the stress on the government's fiscal situation. However because of the additional expenditure of Rs. 55,000 crore as reflected in Supplementary Demand for Grants, the above developments may not contribute much towards a faster fiscal correction.

It can be said that the global trade has contracted much sharply than global GDP during the crisis period. Even in India's case the turnaround in export and import growth came about only after a contraction for 13 and 11 months respectively. According to the latest figures, India exports grew at a moderate rate of 13.2 percent in July 2010 while the imports grew at 34.3 percent. The lower growth rate of exports in comparison to the 30-35 percent export growth experienced during the last couple of months partly reflects the base effect setting in. So far in 2010-11, import growth has largely exceeded the export growth, reflecting stronger growth performance of India and its sustained domestic demand. With



the expected global economic outlook much worse than what it was a couple of months back a durable global aggregate demand to sustain our growing exports seems uncertain. Recognizing the pressure on export's sector due to adverse global developments, the Commerce Minister Mr. Anand Sharma has once again announced additional sops worth over Rs. 1050 crore for the exporters in the recent Annual review of the Foreign Trade Policy. Despite considerable uncertainty about the pace and shape of global recovery, the government is optimistic of achieving its annual export target of USD 200 billion by March 2011.

In the beginning of fiscal year 2010-11, capital flows to India had moderated somewhat in response to the sovereign risk concerns in the Euro zone. But given the strong growth outlook of the Indian economy the capital flows have revived and are expected to ascend





from now on. In the first quarter of 2010-11, we have seen foreign direct investment inflows into India amounting to USD 5.8 billion whereas the foreign institutional investments, which have shown more volatility, have brought in funds worth USD 3.5 billion.

After witnessing considerable volatility against most of the world currencies during the year 2009-10, the Indian rupee has tended to maintain its value vis-à-vis a dollar between the range Rs. 46/USD to Rs. 47/USD during the last three months. It is very important for countries like India to contain large exchange rate volatility since it may lead to unfavorable effects on either exports or inflation.

While these have been the key macroeconomic developments, a lot has been happening in the policy/reform space. Government of India is actively engaging itself with the stakeholders in bringing about policy reforms in a various areas. The focus of the government on economic reforms is clearly reflected

through the various developments taking place such as release of discussion papers on FDI in defense and multi-brand retail, IPR issues as well as on the entry of new banks in the private sector, government's notification for all listed companies to have a public float of at least 25 percent, steps initiated to reform the PDS system, etc. Given the present state of affairs, it looks that the States and Centre would take some more time to reach a consensus on Goods & Services Tax (GST). In view of this, the deadline of April 1, 2011 for implementation of GST looks a little too ambitious. However, it is hoped that reform of the Indian taxation system shall begin on the same date atleast with the implementation of the Direct Tax Code (DTC).

## Banking sector

1. Worried about an inflationary spiral, the Reserve Bank of India hiked its key policy rates. The apex bank increased the repo rate (the rate at which it lends money to banks) and the reverse repo rate (the rate at which it withdraws funds from banks) to 5.75% and 4.5%, respectively. Additionally, moving in line with the global practices and keeping pace with the fast-changing changing monetary environment, the Reserve Bank of India has decided to undertake mid-quarter review of the monetary policy.
2. Top bankers in the country should stop expecting more than 15% hike in their fixed salaries annually since a new rule on compensation to whole time directors and chief executives of Indian non-government banks is on its way. RBI came out with draft guidelines, proposing to restrict the fixed component of the annual salary hikes of CEOs and wholetime directors of private banks to 10-15%. This is part of RBI's comprehensive guidelines based on the compensation policy formulated by the Financial Stability Board (FSB), a global body for standardisation of rules for the financial sector.
3. To bring out farmers from the clutches of money lenders, finance minister Pranab Mukherjee on Tuesday urged public sector banks (PSBs) to increase their kisan credit cards (KCC) across the country by 20% in 2010-11, both in terms of the number of accounts and the amount disbursed.
4. To address the need for better collaboration and sharing of information on fraud and high-risk activities throughout banking and financial industry, Credit Information Bureau (India) Limited and TransUnion, on Wednesday, announced the launch of Cibil Detect - a nationwide database of reported fraudulent and suspect activities.
5. The Government has set up a committee to look into deregulating interest rates on small savings instruments such as public provident fund schemes, a move aimed at linking them to market rates. The panel, to be headed by RBI deputy governor Shyamala Gopinath, will review the structure of the National Small Savings Fund (NSSF) and give recommendations on making schemes more flexible and market-linked.
6. The Department of Industrial Policy and Promotion (DIPP) said that the ICICI Bank and HDFC Bank will not suffer from any "handicap" due to their foreign ownership tag. These banks are on the same footing as other nationalised banks as they are incorporated in India.
7. Standing Conference of Public Enterprises (SCOPE) has opposed a reported proposal to separate the role of Chairman and Managing Director in listed entities. Any such decision should not be made in haste and should be arrived at only after detailed interaction with public sector enterprises (PSEs), the SCOPE Director-General, Dr U.D. Choubey, has said.
8. The Reserve Bank of India (RBI) has eased the burden of financing infrastructure projects in the country by allowing companies to replace domestic rupee loans taken from banks and financial institutions with external commercial borrowings under the approval route.
9. In a move to tame price rise, the Reserve Bank of India (RBI) on Tuesday hiked its short-term



indicative lending rate by 25 basis points from 5.5 per cent to 5.75 per cent and borrowing rate by 50 basis points from 4 per cent to 4.50 per cent with immediate effect.

10. The Union Cabinet on Friday approved release of Rs 4,868 crore as interest subvention to public sector banks (PSBs), Regional Rural Banks (RRBs) and cooperative banks. This interest subvention will enable farmers to receive short-term crop loans at interest rate of 7 per cent per annum during 2010-11.
11. After acquiring the RBI's stake in State Bank of India, the government plans to pick up the central bank's stake in apex agriculture bank Nabard and housing finance regulator National Housing Bank (NHB). There would be cash outgo of Rs 1,900 crore for the acquisition of RBI's stake in both these institutions and the government has sought Parliament's approval for the purchase.
12. The Reserve Bank shuffled the portfolios of its four deputy governors -- Usha Thorat, Shyamala Gopinath, KC Chakrabarty and Subir Gokarn. Gopinath, besides her existing departments, will look after the Department of Payments and Settlement Systems too. Subir Gokarn gets the additional responsibility of administration, personnel management and human resources development, besides the Deposit Insurance and Credit Guarantee Corporation. Usha Thorat gets the Rural Planning & Credit Department and Urban Banks Department in addition to her existing seven departments, including housekeeping.
13. In order to plug loopholes in the manner the banks are managing government securities portfolios, the Reserve Bank of India (RBI) has changed the existing norms. RBI has now said if the value of sales and transfers of securities to/from held to maturity (HTM) category exceeds 5% of the book value of investments held in HTM category at the beginning of the year, bank should disclose the market value of the investments held in the HTM category. Also, it should indicate the excess of book value over market value for which provision is not made.
14. The Reserve Bank of India (RBI) released a discussion paper on capital, ownership structure, foreign shareholding norms and the business model of new private banks, but stayed away from taking any position on the profile of the new entities that will be given licences to run such banks. The Indian banking regulator merely flagged off certain issues and said it will set policies after receiving feedback from stakeholders by 30 September. It has not given any time frame for finalizing the policy, but said all applications will be examined by an external group and "a limited number of licences" will be given, based on the group's recommendations.
15. The Rajya Sabha passed the State Bank of India (Amendment) Bill providing for reduction of government equity to 51 per cent from a minimum of 55 per cent. The Lok Sabha had already passed the Bill.





## Capital Markets sector

1. The Securities and Exchange Board of India (SEBI) has relaxed the norms for disclosure of securities lent by foreign institutional investors (FIIs) to overseas entities. According to a circular issued on Tuesday, FIIs are now required to disclose information on a weekly basis, instead of the current practice of daily disclosures
  2. The Securities and Exchange Board of India (SEBI) on Tuesday relaxed reporting norms on short sales by foreign institutional investors (FIIs), allowing them to make weekly submission on securities lent to entities abroad. The new reporting norms came into effect from July 2.
  3. The Securities and Exchange Board of India (SEBI) on Wednesday relaxed the exposure margin requirement for stock derivatives, based on the feedback received from market participants. SEBI issued a circular saying that the exposure margin would be higher of five per cent, or 1.5 times the standard deviation of the notional value of the gross open position in single stock futures and gross short open position in stock options in a particular underlying.
  4. A framework for an alternative means of settlement of derivatives will soon be out said CB Bhave, chairman of the Securities and Exchange Board of India (SEBI). Guidelines for physical settlement of derivatives are expected to be out by the end of the month, he said.
  5. The Securities and Exchange Board of India (SEBI) on Thursday allowed the two premier stock exchanges, BSE and NSE, to introduce a share-based settlement system, also called physical settlement, for futures and options trading in stocks. This has been a long-standing demand from the market participants, mainly to put the Indian F&O settlement system at par with the other developed markets like the US, Europe, Japan, Hong Kong, etc.
- The Securities and Exchange Board of India (SEBI) is reviving the practice of pre-opening session for share trades, and has asked stock exchanges to put systems in place for it. To begin with, the pre-open session will be introduced on a pilot basis, and will be applicable only for shares in the BSE Sensex and NSE Nifty indices.
6. Lok Sabha passed the Securities and Insurance Laws (Amendment) and Validation Bill 2010 to replace the Ulip



ordinance with finance minister Pranab Mukherjee working hard to allay Opposition's apprehensions of a "super-regulator" dwarfing the RBI. The joint mechanism being set up under the bill will have a limited mandate of intervening only when there is an issue of jurisdiction between two regulators. The securities bill provides for setting up a joint body under chairmanship of the finance minister with representatives from four financial sector regulators. The bill states the RBI governor will be vice-chairman of the joint committee.

7. The market watchdog SEBI came out with a consultative paper on portfolio management services (PMS), suggesting that the portfolio managers be paid the performance-based fee, only if the client gains from the capital markets. The proposal will help



large investors from limiting their losses by way of paying a fixed fee to their portfolio managers.

8. To bring greater transparency in the fee structure and improve turn-around time for customer service processes, market regulator SEBI has amended four mutual fund regulations and omitted one schedule. These regulations pertain to offer period, allotment of units, refund of excess subscription, account statements and management fees chargeable by the asset management companies. The offer period for ELSS (earnings linked savings scheme) have been brought down by 30 days. These will now be open for more than 15 days instead of 45. Fund houses are now expected to refund excess subscription money within five working days instead six weeks. A failure to do so would start attracting penal interest at 15 per cent per annum on the expiry of five working days.
9. SEBI extended the deadline for mutual funds to implement the ASBA facility for new fund offers (NFO) to October 1. Earlier in March, SEBI had kept the deadline of July 1. ASBA is currently in place for IPO subscribers in the equity market. ASBA facility is an investor

friendly measure as it would allow investors earn interest on NFO investments till its deployed by its fund managers.

10. The Securities and Exchanges Board of India (SEBI) has allowed exchanges to introduce currency options on US dollar pairing with rupee, providing another alternative to corporates for hedging against currency fluctuations. In another move, it also asked stock brokers, FIIs, asset management companies to report all over-the-counter transactions made by them in commercial papers (CP) and deposit certificates (CD) from August 16 to make these transactions more transparent.
11. The market watchdog SEBI shortened the period within which mutual fund schemes can be subscribed and refunds can be claimed, a move that will safeguard investors from market volatility. The Securities and Exchanges Board has slashed the calendar for availing of mutual fund schemes and seeking refunds, from 87 days to just 20 days now.
12. Market regulator the Securities and Exchanges Board of India (SEBI) today asked stock brokers, FIIs, asset management companies to report all over-the-

counter transactions made by them in commercial papers (CP) and deposit certificates (CD) from August 16 to make these transactions more transparent.

13. In a move to usher in more transparency in disclosure of shareholding pattern by companies, the Securities and Exchange Board of India (SEBI) has asked companies that have issued depository receipts to classify them as either promoter/promoter group and non-promoter in their quarterly disclosures to stock exchanges. The SEBI board has also decided





to make it mandatory for companies to disclose within 10 days a change exceeding 2 per cent of the paid-up share capital of the company, after a corporate event.

14. The Securities and Exchange Board of India (SEBI) has directed mutual (MF) fund houses to provide investors an exit option before increasing the administrative fees in a fund-of-fund (FoF) scheme. FoF schemes are those where a mutual fund invests in a scheme of another MF.
15. Public Sector Undertakings (PSUs), heaved a sigh of relief as the government exempted the listed state-run firms from the mandatory condition of 25 per cent public holding. Now the PSUs would have to reach a level of 10 per cent public holding in three years for remaining listed in stock exchanges, a notification issued by the Finance Ministry said here.

## Insurance sector

1. The government has increased the existing limit of the Employees Deposit Linked Insurance (EDLI) amount from Rs 60,000 to Rs 1 lakh. The amount will be paid to the next of kin of an employee in case of his death. In a notification issued on June 18, the government in the newly modified Employees' Deposit Linked Insurance (Amendment) Scheme, 2010, said the benefits will be for employees of both the public and private sector.
2. The government notified one more avenue for saving tax - investment in infrastructure bonds. The exemption in these long-term infrastructure bonds, under a new Section 80CCF of the Income Tax Act, 1961, would be in addition to the deduction of Rs 1 lakh allowed under Sections 80C, 80CCC and 80CCD of the Act.
3. The Insurance Regulatory and Development Authority (IRDA) has issued a diktat barring lenders from distributing policies under referral arrangements.
4. IRDA has directed insurers to constantly inform the policy holders at all times, the nearest possible alternative hospitals, where the cashless facility is available and the conditions thereof. The regulator has also directed insurers not to discontinue cashless facilities even if certain hospitals are removed from the PPN list in case policy holders have pre-authorisation to get treatment from these medical centres. This is the first direction from IRDA to insurers after four PSU general insurance companies with effect from July 1 suspended cashless medical facilities at certain super specialty medical centres on grounds of overbilling.



# FICCI Economic Outlook Survey July 2010

**F**ICCI's Economic Outlook Survey is a quarterly survey conducted amongst leading economists of the country with a view to gauge their perception and views on topical economic issues as well as seeks their outlook for key macro-economic variables. The economists who take part in this survey largely come from the banking and financial sector. The sample however also includes economists from industry and research institutions.

The first survey report was released in January 2010 and the second report was released in April 2010. This is the third report of the Economic Outlook Survey. The survey was conducted during the period June 24, 2010 and July 15, 2010. As part of the survey, a structured questionnaire was drawn up and sent to key economists for their inputs and views. This time 14 economists of repute participated in the survey.

The economists were asked to provide their forecast for key macro economic variables for the year 2010-

11 as well as for Quarter 1 (Apr-June) and Quarter 2 (July- Sep) of 2010-11.

In addition to these, FICCI sought the views of economists on some topical issues like expected monetary policy action by RBI in the forthcoming monetary policy review; downside risks to growth during fiscal 2010-11; outlook for inflation of primary articles and manufactured products.

The feedback received from the participating economists was aggregated and analyzed. The results obtained are presented in the following pages.

The findings of the survey represents the views of the leading economists and do not reflect the views of FICCI.?

## Annual Forecasts for 2010-11

- GDP growth - 8.5 percent
- Agriculture and allied activities growth - 3.5 percent
- Industry growth - 10.0 percent
- Services growth - 9.0 percent

- Fiscal Deficit - 5.1 percent of GDP
- IIP - 10.6 percent
- WPI inflation rate (End March 2011) - 6.5 percent
- Money Supply (M3) growth - 17.0 percent
- Trade Balance - (-) 8.2 percent
- USD / INR exchange rate (End March 2011) - Rs. 44.5/USD
- Bank credit growth - 20.0 percent

## Quarterly Forecasts for Q1 (Apr- June) and Q2 (July- Sep) of 2010-11

- GDP growth - 8.7 percent (Q1, 2010-11) and 8.5 percent (Q2, 2010-11)
- Agriculture and allied activities growth - 2.6 percent (Q1, 2010-11) and 4.0 percent (Q2, 2010-11)
- Industry growth - 11.0 percent (Q1, 2010-11) and 10.0 percent (Q2, 2010-11)
- Services growth - 9.2 percent (Q1,

2010-11) and 9.1 percent (Q2, 2010-11)

- IIP - 13.1 percent (Q1, 2010-11) and 11.0 percent (Q2, 2010-11)
- WPI inflation rate - 10.0 percent (Q2, 2010-11)
- Money Supply (M3) growth - 15.8 percent (Q2, 2010-11)
- Trade Balance - (-) 8.0 percent (Q2, 2010-11)
- USD / INR exchange rate - Rs. 46.0/USD (Q2, 2010-11)
- Bank credit growth - 19.5 percent (Q2, 2010-11)

## Economists' views on

- **Expected monetary policy action by the RBI.** Majority of economists feel RBI would continue to move ahead on the path of monetary tightening and **anticipate a hike of 25 basis points each in the repo rate and reverse repo rate in July 27, 2010.** Given the present liquidity situation, a hike in CRR on July 27, 2010 was however ruled out by the participating economists.

Surveyed economists feel non-food manufacturing inflation is now rising at a fast pace and this could be a source of worry for the RBI. Further, the full impact of the fuel price revision on inflation numbers is yet to be seen according to the economists. On the growth front, surveyed

economists believe that while the recent IIP numbers may have shown a decline from 16.5 percent in April 2010 to 11.5 percent in May 2010, such a growth is still reasonable and may not dissuade RBI from restricting monetary policy action.

Though the above is the majority view, a few respondents opined that given the moderation in IIP growth and the expected slowdown of inflation in the coming months, a further rate hike by RBI during the policy review appears unlikely at this juncture. They also feel that such frequent rate hikes could derail the growth momentum the economy is witnessing presently.

- **Potential downside risks to growth in 2010-11.** Downside risks to growth emanate from both domestic and global developments.

### ❖ Domestic factors that could pull down growth include

- **One, progress and spatial distribution of the monsoon.** Data shows that cumulative rainfall in the country between June 1 and July 14 was below normal by 13 percent. A less than optimum monsoon would adversely impact agricultural growth. Even if the rains were normal this year,

overall agricultural performance may not be 'too strong' as overall soil productivity is now on the lower side. Further, if less rainfall can impact agricultural output, excessive rains and subsequent floods too will be a negative development. Some of the northern states are already seeing floods and this will have a bearing on agri output.

- **Two, inflationary situation.** **The headline inflation continues to remain stubbornly high.** The recent fuel price revision will have an inflationary impact in the months ahead. Economists have pointed out that high prices are eating into the budget of the middle class population as far as their outlay for industrial produce is concerned. Thus if inflation persists at the current levels for a long time or if there is a sharper than anticipated pick-up in inflation then consumption demand could get dampened.
- **Three, premature and aggressive monetary policy action.** While normalization of the monetary policy is expected and RBI would continue to tighten rates in the months ahead,



premature and aggressive rollback of easy money policy can jeopardize growth. Rapid tightening of monetary policy will affect both consumption and investment demand and this could ease the growth impulses.

- **Four, social unrest leading to output losses.** Given the recent pick up in naxal activities there is a fear that greater social unrest in times ahead may also lead to output losses and thus impact the growth trajectory.
- **External factors that could pull down growth include**
  - **One, uncertainty regarding global recovery.** There are evident concerns with regard to developments taking place in the Euro Zone. Many believe that the next shock to the capital markets could come from evolving situation in the Euro area. This could increase volatility in capital flows and restrict availability of funds for supporting growth. Besides Euro area, economists are also skeptical about the direction of the US economy. There is a slight chance, some believe, of US economy getting into another recession. This, if it happens, will put a cap on our export growth (services sector like IT

will get hit) and in turn affect GDP performance.

- **Two, high commodity prices.** High commodity prices including crude prices is also being seen a risk to India's growth in 2010-11 by a small set of economists.
- **Inflation situation. Majority of the economists do not expect inflation rate to fall to the 5 percent mark by end December 2010 as estimated by the government.** The general view is that headline inflation would continue to remain around the present levels for the next few months and then gradually trend downwards. There are three broad reasons which economists feel would prevent headline inflation from coming down at least in the next one or two months -
  - ❖ **Impact of recent hike in the fuel prices** - Fuel price hike will add to the transportation cost for primary articles as well as increase the input costs for manufactured goods.
  - ❖ **Sticky food inflation** - Spatial distribution of monsoon will be a key factor under watch here
  - ❖ **Depreciation of INR** which is preventing any meaningful reflection of lower global prices in metals on inflation rate in India

Although inflation would after some time trend downwards, but **a good number of economists expect that by December 2010, headline inflation rate would continue to be in the range of 6 percent to 8 percent.**

Looking at the prognosis for the two key components - primary articles and manufactured articles - the trend is expected to be the same as for overall inflation. The only difference being that primary inflation will start to cool down from July / August 2010 onwards as the 'negative base effect' will come into play then and manufactured articles inflation would trend down from November 2010 onwards as it was in November 2009 when manufactured goods price index had shown a spike. Besides this base effect, some of the other factors that should help ease inflation later this year include -

- ❖ **Low probability of further high MSP hikes** (Primary articles inflation)
- ❖ **Slowdown in global growth which would keep a lid on commodity prices particularly those of industrial metals** (Manufactured articles inflation)



# FICCI Quick Survey on Yuan Exchange Rate Flexibility – July 2010

## Executive Summary

Just before the meeting of the heads of state of the G20 countries in Toronto, authorities in China announced that they would impart greater flexibility to their exchange rate management. This announcement caught the attention of policy makers worldwide.

Evidently, in the run up to the G20 meeting in Toronto, Canada, there was significant international pressure building on China to review its exchange rate stance as many believed that China's exchange rate policy was one of the factors that were holding back global growth from gaining momentum. Voices of dissent were particularly sharp in US and EU, both of which were finding it difficult to manage their large trade deficit with China. Leaders from US and EU had indicated that discussion on exchange rate management and attended global imbalances would be

one of their priorities at the G20 summit. By announcing its decision to make Yuan exchange rate more flexible just days before the G20 summit, China was able to deflect some of the criticism it was facing.

This signaling on part of China to end the dollar peg and its willingness to let the Yuan appreciate has evoked a mixed response from leaders worldwide. In its initial reaction the international community welcomed this move. However, soon there were apprehensions expressed on whether this move was an indication of China's intent to meaningfully contribute to the global rebalancing effort or was it only to steer attention away from this issue ahead of the crucial meet at Toronto. This skepticism arose because China did not promise a one off revaluation against the US\$ or a free floating currency. Details that followed subsequently showed that China would continue to manage its

currency through heavy intervention by its central bank.

Nevertheless, this development merits attention and calls for an evaluation of what implications would a more flexible yuan entail. It is also important to recall that in the past China has expressed a desire to broaden the global reserve / vehicle currency pool. And in the process it proposed the use of Renminbi alongside other reserve currencies like the US\$ and the Euro. To get the



process kick-started, China introduced cross-border transactions using Yuan in Shanghai and Guangdong in July last year, to reduce reliance on the US dollar. Now China has decided to expand settlements of international trade using yuan to other provinces and cities, which is a testimony to China's ambition of taking Yuan to a more globalized platform, one day. Hence the decision to have greater flexibility in exchange rate management could have a bearing on this as well. Additionally, any sideways movement in Yuan's value will also affect the competitiveness of exporters from other countries.

To gauge how leading economists from India are viewing China's announcement of having a more flexible exchange rate and what they think could be the ramifications of such a move, FICCI conducted a quick survey amongst and had detailed discussions with a group of economists. The feedback gathered from and views expressed by economists are presented in the following pages.

The findings of the survey represents the views of the leading economists and do not reflect the views of FICCI.

## Survey Highlights

- **Economists' views on significance of China's announcement of having a more flexible currency**

- Majority view is that China's announcement to return to the pre-crisis arrangement of managing its currency is merely a token of 'intent' rather than a firm commitment to strong action on the exchange rate front.
- While a more flexible Yuan would help in correcting global imbalances and safeguard fragile global recovery, this latest announcement by People's Bank of China (PBoC) would do little to address the issues at hand, as PBoC will continue to 'manage' the currency.
- To have a more meaningful rebalancing of the global economy, China should first allow a one off appreciation of at least 8 to 10 percent and then follow it up with a floating currency regime.
- **Economists' views on the intent behind China's decision on Yuan flexibility - A conscious effort to invigorate domestic demand or a move to douse trade tensions**
- Both domestic compulsions and external pressure were responsible for China to allow its currency to float within the intra-day trading band of +/- 0.5 percent. It is an occasion when global objectives coincided with Chinese objectives and this was the trigger for the announcement.
- Domestically, a stronger exchange rate would
  - ❖ Help in transforming the growth structure from being export led to domestic consumption driven as imports would become cheaper
  - ❖ Help tackle the inflation situation, which is increasingly becoming a cause for concern
- Externally, by allowing its currency to be a little flexible, China has managed, albeit temporarily, to douse trade tensions with the US and EU as well.



- **Economists' views on whether Yuan could actually depreciate instead of appreciating as widely felt**

- Unanimous view amongst economists is that the general trend for Yuan's value has to be one of appreciation. Economists have ruled out the possibility of the Yuan depreciating at least in the next couple of years. Possibly over a longer time horizon, chances of Yuan depreciating exist and this would happen only if China's growth were to witness a setback.

- **Economists' views on Yuan / Renminbi as an additional global reserve currency**

- The process for making Renminbi a global reserve currency cannot be immediate and will need a lot of effort and time. We may have to wait for at least a decade before Renminbi becomes a global reserve currency.

- Chinese government will have to make a number of structural changes before Renminbi can be considered for entry into the elite league of global reserve currencies. Steps China needs to take for making Renminbi eligible for global reserve currency status include -

- ❖ Pursue inclusion of Yuan in the SDR basket

- ❖ Establish direct currency exchange mechanism and settle trade in Yuan with different countries, especially its close trade allies

- ❖ Improve the depth of its bond markets

- ❖ Make Yuan a convertible currency on the capital account

- ❖ Ensure domestic trade and investment practices are at par with those of the advanced economies of the world

- ❖ Strengthen the financial sector

- **Economists' views on macroeconomic impact on India of ongoing currency readjustment by China**

- Going by past experience, when China allowed the Yuan to appreciate by almost 21 percent between 2005 and 2008, most of the economists FICCI spoke too said that even this time the pace of appreciation is not going to be very different. In fact there is a consensus that over the next twelve months the Yuan might move up (appreciate) by about 5 percent. There is feeling among economists, that benefits will accrue over a longer period of time to developing economies,

including India, as they will be able to garner a proportionately higher share of the gains resulting from global recovery in trade.

- In case of India, the Renminbi appreciation will be of particular significance as it could help correct, at least partially, the growing trade deficit with China.

- Indian manufacturing units in the heavy engineering and power segments will also become more competitive vis-à-vis imports from China if Renminbi were to appreciate as expected.

- Finally, an appreciating Chinese currency will also give a boost to Indian investments in China and possibly open up new markets for service sector exports.





## FICCI's Health Insurance Conference: 30th July 2010, New Delhi

FICCI organized its second edition conference on "Health Insurance" on 30th July, 2010, at FICCI Federation House, New Delhi. Mr J. Harinarayan, Chairman, IRDA delivered the Inaugural Address at the conference.

FICCI has been deeply engaged in the Health Insurance space through its Advisory board on Health Insurance supported by senior representatives from IRDA, QCI, Healthcare Providers, the Health Insurance companies, World Bank and other key stakeholders. The focus of this year's conference was to disseminate the work that FICCI's Advisory Board on health insurance has accomplished. This includes:

- o "Promoting Quality Healthcare through Health Insurance"
- o " Standardisation of Billing Procedures in Hospitals"
- o " Standardisation of TPA/Insurer and TPA/Hospital Contracts"



## Seminar on Disaster Management: August 11, 2010

A one day program was held on 'Role of insurers and reinsurers in achieving the objectives of National policy on Disaster management' on August 11, 2010 at FICCI, New Delhi. Mr. J. Harinarayan, Chairman, IRDA has agreed to deliver the keynote address.

The overarching goal of the conference was to determine the collective role of the government, NDMA and IRDA in disaster management. By aggregating views on past experiences, the conference strived to lay out a plan to devise insurance products so as to enable participation of affected persons.

The conference participants included eminent representatives from both, Life and Non-Life insurance, Insurance brokers, Re-insurers, Surveyors, Actuaries, Corporate sector, Academia, Media and other stakeholders related to the area of disaster management





## 9th Edition of FICCI-IBA Global Banking Conference:

Date: 7-9th September 2010  
Venue: Hotel Trident, Mumbai

**F**ICCI and IBA are pleased to announce the 9th edition of FICCI – IBA Conference on “Global Banking: Paradigm Shift”.

The conference will play an important role in defining the shape of the economy in the next decade. This requires SWOT analysis of the banking system vis-a-vis its global counterparts, identifying the road blocks and defining the road map ahead.

Globally, the financial sector regulations are undergoing a shift and are surely going to have an impact on the banking sector across the globe. This forum will therefore look at the evolving framework & its possible impact and also provide necessary inputs in defining the financial regulatory architecture.

Acclaimed by past attendees as an industry-relevant world class event

with outstanding content, speakers and organisation, the forum would once again provide a key platform for the financial services industry experts not only to gain insights about changing consumers behaviour, regulatory developments and forecasts of the future economic landscape but also to interact with the movers and shakers of financial services industry.

**Key Stakeholders** – The conference will aim to bring together the following at this platform.

- ❖ Executives of the Banking and Financial Services sector
- ❖ International Banking and Financial Services Companies foraying into India
- ❖ Policy makers and regulators
- ❖ Financial and Commodity Exchange Operators
- ❖ IT vendors and technology providers
- ❖ Private Equities and Venture Capitalists
- ❖ Fund Managers and Institutional Investors
- ❖ Consultants and Analysts
- ❖ Corporations
- ❖ Educational Institutes

**The theme of this years' conference is: “Banking 2020: Making Decade's Promise Come True.”**

### Day 1

1. Inauguration
2. Setting expectations: Promise of the decade and role of banks
3. Giving wings to corporate aspirations
4. Special Session with Lord James Sasoon
5. Infrastructure finance: Breaking the deadlock

### Day 2

1. Setting new paradigm in regulation
2. Transactions in the next decade: Faster, cheaper, easier
3. Supporting the inclusion aspirations: Rural and agriculture banking
4. SME finance: Broad basing the growth pattern

### Day 3

1. Preparing Indian banks for global competitiveness - consolidate or not
2. Retail Finance Act II :Funding the dreams of Indian households
3. Mumbai as finance hub in the new world reality
4. Valedictory



## Seminar on IFRS: September 2010, New Delhi

Indian Accounting Standards are to converge with IFRS in phases beginning with the financial year commencing 1st April 2011. While there are significant benefits to be gained from the process of convergence including greater

reporting transparency, better comparability of performance and reduced reporting requirements among others, the process also raises a few challenges in terms of the 'carve outs' that need to be created, as well as practical difficulties in the implementation process.

It is with this in mind that FICCI proposes to organize a conference on the subject matter with a view to highlight and better understand the various issues of concern that could possibly arise as a part of this transitional process in the coming months.

## 'Empowering India's MSME Sector': 18th September 2010, Ahmedabad

The role of micro, small and medium enterprises (MSMEs) in the economic and social development of the country is well established. However, finance is one of the key issues hampering the growth of MSME sector. MSMEs primarily rely on bank finance for a variety of purposes including purchase of land, building,

plant and machinery as also for working capital, etc. Availability of timely credit at reasonable rates is the need of the sector.

With this seminar, FICCI aims to facilitate dialogue between Bankers and Lenders to create awareness and analyze practical problems of MSME

units and to analyze the credit needs of Indian SME's and possible solutions. This seminar would also throw light on concerns pertaining to marketing issues, availability of labour as well as infrastructure, technology, skill development and Taxation issues

## FICCI's Conference on Pension: October 2010, Mumbai

FICCI is planning to organize a one-day conference on "Pensions" during **October 2010** at **Mumbai**. FICCI has been keenly involved in the development of this sector in India and has made several

representations on behalf of industry to encourage proper pension reforms in the country. The purpose of this conference is to facilitate dialogue among stakeholders on key policy

issues and challenges facing the sector, and lay down a strong foundation for the future direction of the industry.



Federation of Indian Chambers  
of Commerce and Industry

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