FINly | Finstreet's Fortnightly Newsletter

K. J. Somaiya Institute of Management Studies and Research

05 Nov 2012

The little things

- **Forex Reserves:** $ 295.2908 billion as on 26 Oct
- **Brent Crude:** 106.33 USD / bbl as on 04 Nov
- **Sensex:** 18755.45 as on 02 Nov
- **Gold (10 gm)**: Rs.30940.0 (as on 02 Nov in Mumbai)
- **Exchange rate (Rupee)**: Rs.53.74/USD as on 02 Nov

Some terminologies -

- **Bear Trap:** A false signal that the rising trend of a stock or index has reversed when it has not.
- **Green shoe Option:** A provision contained in an underwriting agreement that gives the underwriter the right to sell investors more shares than originally planned by the issuer.

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RBI DISAPPOINTS THE NORTH BLOCK

RBI kept the Interest rates unchanged contrary to the expectations of the Finance Minister and the Investors. The Finance Ministry had taken a slew of reforms recently and anticipated some help from RBI in the form of cut in Interest rates to spur growth. However, Mr. Subbarao wants the Inflation to peak before cutting the Interest rates and anticipates the cut in interest rates to happen in the Jan-Mar Quarter. RBI has cut India's GDP growth estimate to 5.8% , closer to other estimates and has also reduced the CRR, Cash Reserve Ratio by 25 basis points to improve the liquidity in the system.

SANDY HITS US SHORES

Hurricane Sandy hit New York & New Jersey and wrecked havoc and destruction in its path. The Private Insurance Companies will take an estimated hit of $ 10 - 20 billion and the National Flood Insurance program and Uninsured losses will have an impact of another $ 10-15 Billion. The Stock Markets and most of the Companies closed for two days on account of the Super storm adding salt to the wound. However, Reconstruction activity necessitated by Sandy is expected to give a boost to the local business after an initial lull.

GREECE LOCKS HORNS WITH THE TROIKA

Greece seeks an extension of two years for meeting the Fiscal targets put forth by the Troika, the IMF, EU and the European Union Central Bank. Greece will run out of Currency reserves by Nov 16 if it fails to get the EUR 31.2 Billion as part of the rescue fund.

FINMIN TO VERIFY OMCS' LOSSES BEFORE DECIDING ON SUBSIDY

Petroleum Minister Veerappa Moily had said that his ministry will seek over Rs 1,00,000 crore from the Finance Ministry this fiscal towards fuel subsidy, after the Rs 43,580 crore already paid. The Finance Ministry will verify the claims of losses by state-owned oil companies on selling diesel, LPG and kerosene below cost price and decide the quantum of subsidy for 2012-13 based on the report.

HONG KONG AND CHINA RALLY ON A POSITIVE NOTE

In Hong Kong, shares rose to a 15 month high along with a favorable increase in China's markets. Positive Employment data from the US showing a good number of Job additions has bolstered the market sentiment. China's Economic data is indicating positive signs and Chinese equity fund inflows have increased, these have helped the markets to end the week on a positive note

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Acid Test Ratio: A stringent indicator that determines whether a firm has enough short term assets to cover its immediate liabilities without selling inventory.

India's Big Bang reforms: Will they be loud enough ?

Authored by: Saher Mukaddam, PGDM-A

On 14th September 2012, the government of India gave the Indian economy some hope, an economy that constantly lived with the fear of its credit rating status being downgraded to junk. The hope- a series of reforms aimed at liberalizing the country further, making it attractive for foreign investment and pulling itself out of the 'policy paralysis' that hovered around the Congress government for about three years now.

A series of corruption scams, alarming increase in the fiscal deficit, a worrisome growth rate of GDP, eye popping double- digit inflation, apprehensive potential investors……and many more problems forced the government to rethink its standing and call for the much needed reforms.

A quick look at the reforms that were announced by the government:

Cut back in diesel subsidy and a cap on LPG cylinders

The first step that the government took is increasing the diesel prices. This move was necessary owing to the piling fiscal deficits of the government. Also, an increase in the oil price and a depreciating rupee prompted this action. The government has put a cap on providing only six subsidized LPG cylinders to households (each provided at a rate of Rs.410.42. Thereafter, every additional cylinder will cost Rs.922.

51% FDI in Multi- Brand Retail

The government cleared 51% FDI in Multi- Brand Retail opening its doors for foreign retail giants. However, the central government is leaving it to respective states to decide whether to allow the likes of Wal-mart or stick to the status-quo.

49% FDI in Indian Aviation

Foreign carriers can now own 49% of Indian carriers, subject to certain conditions. These include the carrier to be registered in India, its principal place of business to be within the country, and its chairman and two-thirds of directors to be Indians. Besides this, substantial ownership and effective control has to remain in Indian hands.

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Leveraged Buyout: Usually used in M&A is an acquisition where the purchase price is financed through a combination of equity and debt and in which the cash flows or assets of the target are used to secure or repay debt.

India's Big Bang reforms: Will they be loud enough ?

Sale of equity in PSU's

The government has also cleared stake sale in four PSU's - Oil India Ltd, Hindustan Copper, National Aluminium Company (Nalco) and MMTC. Raising adequate funds from disinvestment was necessary to keep in check the fiscal deficit which is facing pressure due to rising food, fuel and fertilizer subsidy bills.

Other reforms include FDI in broadcasting services, increase in FDI cap in insurance from 26% to 49% and FDI in pension now stands at 26%

These 'big bang reforms' as one may decide to call them, are slammed by the Opposition and other parties, but welcomed by the industry.

The hike in diesel prices has generated much expected controversy. Increasing diesel prices was inevitable. For the reasons mentioned earlier, and the disaster of a nearly 6% fiscal deficit looming large on the Indian economy, called for such a step. Finding it hard to balance piling deficits on one hand and to keep in control the prices of a fuel which is the backbone of the transportation of various essential goods and service in the country, the government chose to incline towards minimizing the fiscal deficits. The inevitable consequence- increase in the price of goods and services. However, this move cannot be criticized as inflation is only a short term effect. Over the long run, prices tend to stabilize and India can reap the benefits of fiscal consolidation as India's current revenues are far below its expenditures, forcing the government to borrow. Statistics reveal that year after year, the fiscal deficits are climbing, necessitating the borrowings from abroad at high costs. Thus, in the long run, cutting back on subsidies is the best option.

As India urbanizes, develops and liberalizes it would be a little backward to say that FDI should be limited in retail and other sectors. Opening up the Multi-Brand retail sector will not only bring smiles on the ever growing middle class population (by providing employment) but also be a boon for the farmers. Benefits will come in the form of elimination of unnecessary middlemen, excellent logistical network, lower prices and better quality for consumers and lastly, a good bargain for the farmers on their produce. On the flip side, entry of retail giants in the Indian scenario could dominate India's highly inefficient and relatively new retail sector. Possibility exists of farmers being exploited too in the hands of these giants.

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Open interest: Also known as open contracts or open commitments refers to the total number of derivative contracts, like futures and options, that have not been settled in the immediate previous time period for a specific underlying security. A large open interest indicates more activity and liquidity for the contract.

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India's Big Bang reforms: Will they be loud enough ?

FDI in aviation has been given the nod which will give the much needed impetus to the otherwise loss making Indian aviation industry. Worries are here too. With carriers like Lufthansa and British Airways still apprehensive about investing in India, will the Aviation Industry ever break even?

But will these reforms be loud enough?

With the FDI in retail Bill being successfully passed by the Parliament, Indian consumers eagerly await the arrival of foreign retail giants. However, various states like Uttar Pradesh, Tamil Nadu, West Bengal, etc have decided not to allow FDI. This may do more harm than good as foreign retailers may not be able to source the produce from the farmers of these agriculturally rich states.

Further, with the TMC (Trinamool Congress) already deserting the UPA, the Congress led government has a daunting task of convincing its allies that these measures are indispensible.

Though the party in opposition, the BJP, has always supported a market oriented approach for the economy, it may take an about turn in this matter for the sake of pushing the idea of 'policy paralysis' of the government.

Now, the hope is that the reforms see the light of the day soon, before the condition of the Indian economy worsens. But for that, support from leading politicians, a stop button on the scams that plagued the Indian scene, faster and quicker decision making is required. Too much to ask for? Will all these be actually implemented? Only time will tell.