FINly | Finstreet's Weekly Newsletter

K. J. Somaiya Institute of Management Studies and Research

10 Dec 2012

The little things

- **Forex reserves:** $294.98 billion in the week ended Nov 23
- **Brent Crude:** 109.99 USD / bbl as on 23rd Nov
- **Sensex:** 19424.10 as on Dec 7
- **Gold (10 gm)**: Rs.30700 (as on 7 Dec in Mumbai)
- **Exchange rate (Rupee)**: Rs.54.20/USD as on 7 Dec

Some terminologies -

- **Book Building:** It refers to the process of generating, capturing, and recording investor demand for shares during an IPO (Initial public offering) in order to support efficient price discovery.
- **Bootstrapping:** It is a method for constructing a (zero-coupon) fixed-income yield curve from the prices of a set of coupon-bearing products, e.g. bonds and swaps.

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MALDIVES AIRPORT OUT OF GMR'S HAND

Singapore court ruled in Maldives' favor in the South Asian island nation's move to cancel a $511 million airport development contract with India's GMR Infrastructure, clearing the way for it to take over the airport. The ruling comes after an order won by GMR that had suspended the government's decision to cancel the contract, although the Maldives had still been pressing ahead with plans to take over the airport. On Friday, Maldives Government repossessed the country's main airport from GMR.

FDI CLEARS LOK SABHA TEST, RETAIL SHARES CELEBRATE

Investors rushed to buy retail stocks on Thursday after the government won a vote in the Lok Sabha to allow foreign direct investment in multi-brand retail sending companies like Pantaloon Retail , Shoppers Stop and Trent to a 52-week high on opening.

100 percent FDI in single brand retail is allowed in India. Pavers England and Ikea recently got permission to open stores in India. Others like Marks & Spencer and Zara are already present here through tie-ups with local firms.

CSC'S TO HELP IMPLEMENT CASH TRANSFER SCHEME FOR RURAL INDIA

Indian banks signed an agreement with the information technology department's common service centre (CSC), a chain of Internet-enabled kiosks that provide online services to villagers. As part of the accord, 95,000 rural CSCs will act as business correspondents and help implement the government's electronic cash transfer programme. The agreement was signed between CSC's special purpose vehicle and 12 public sector banks. The government plans to roll out direct cash transfers to beneficiaries of welfare schemes, including pension and scholarships in 43 districts starting 1 January.

POLICY MAKERS FACE A WALL ON CURBING GOLD DEMAND

The unbridled import of gold that accounts for more than two thirds of the current account deficit, according to some policy makers, is causing macro economic imbalances. Some believe that deficit could be addressed by somehow curbing demand for physical gold. While those who think it is harming economic activity are a minority, but that is the group that wields power. The majority believes in accumulating it - both as an object of desire, and also as a protection against economic mismanagement by government inflation. The government doubled import duty after high imports in the past few years. The current account deficit is forecast to touch a record 4.9% in the September quarter after gold imports surged to 223 tonnes, up 9% from a year earlier, and almost a fifth of the global demand.

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On the run: In finance, an on the run security or contract is the most recently issued, and hence most liquid, of a periodically issued security. On the run securities are generally more liquid and trade at a premium to other securities.

Will the BRICS be engulfed in MIST ?

Authored by: Harish Mohan, PGDM-A

BRICS was a new and relatively lesser known acronym in 2001, when it was created by the Goldman Sachs Asset Management Chairman, Jim O Neil. Since then, BRICS has come a long way and occupied the minds of all the investors especially after the 2008 crisis. Now the BRICS Inventor, Jim O Neil is trying to create a new Storm in the markets with his new Acronym MIST. For the uninitiated, MIST stands for Mexico, Indonesia, South Korea and Turkey and was created by Goldman Sachs with the purpose of focusing their N-11 Fund Investments in these countries. The Goldman Sachs N-11 Equity Fund (GSYAX) has grown by 12 % this year compared with a mere 1.5% gain in Goldman Sachs' fund for BRICS. This shows the huge underlying economic growth potential in MIST and the diminishing investor confidence in BRICS. The MIST Economies have nearly doubled in this decade coming out of deep slumber with an impressive growth rate in GDP undeterred by the recent turmoil in Euro Zone and US Markets. Let's have a look at the strengths of the individual countries in the MIST:

Mexico has developed its Manufacturing Industry by leaps and bounds focusing on lower costs and is posing a serious threat to China, famed for its China Price. Mexico is able to lower costs by taking advantage of the cheap labour force available abundantly whereas China has had to contend with rising costs on account of increasing wages, land prices, Environmental and safety taxes. China's wages have recently been hiked by 22%. Mexico's cheap labour is owing to the growing young population with 65% of its population falling in the 15-65 years bracket. These demographic trends can be better understood in this ratio: 9 children for every elderly person in Mexico. Mexico also benefitted from reduced shipping costs to the US and lesser transaction costs as it is a NATO member. Mexico has grown by 4.6% in the first 3 months of 2012, with strong growth prospects in the future.

Indonesia also has the advantage of young demographics that is helpful in growth of economy. It also has the advantage of being in the ASEAN-China Free Trade area and has translated all these advantages effectively to put up impressive growth rates of 6% in GDP in the last 3 years. Indonesia's growth rate has surpassed that of India's GDP growth recently with a smaller population and fewer resources. Indonesia grew strongly during the 2008 crisis mainly with the help of robust Consumption driven growth with 60% of GDP being contributed by Indonesian consumers. Indonesia's exports were negligible during the years of crisis and that helped in limiting the negative effects. Of late,

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Did You Know:

1. The word millionaire was first used by Benjamin Disraeli in his 1826 novel Vivian Grey and if you stack one million US$1 bills, it would be 110m (361 ft) high and weight exactly 1 ton.

2. The term "Blue Chip" as used in Blue Chip Companies comes from the colour of the poker chip with the highest value, blue.

Will the BRICS be engulfed in MIST ?

Indonesia has raised its exports to China significantly with the main export items being Commodities and natural resources.

Turkey has a relatively small Debt to GDP ratio of 40%, along has managed to attract significantly high amounts of FDI. This has helped in improving the Investor's confidence in Turkey and attracted investments from foreign countries and local markets. South Korea can be considered more of a developed country, with many internationally acclaimed Brands such as Samsung, Hyundai, LG, etc. These Companies have managed to bring in Investor flows into the country and rise South Korea into the Spotlight.

Finally, it's time to look at the other side of the coin as well. Though MIST has overtaken BRICS in terms of Growth rate, MIST has a very small GDP of $3.9 trillion (Each of the MIST countries represent only 1% of the world's GDP) last year compared to $13.5 trillion of BRICS. In Population parameters, MIST nations have fewer than 500 million people in contrast with the 2.9 Billion people in BRICS countries. Although we have considered the MIST countries in unison as good performing economies, we should also consider the Macro-factors affecting them. The consequences of fiscal cliff of US has a direct implication on Mexico's exports; a hard landing in China can deter Indonesia from continuing its growth spiral, growing inequities in South Korea can pull down the prospects of MIST significantly. Moreover, the sputtering engines of growth in India, China and Brazil can revive in the next 2 years and come back strongly. MIST's prospects are good in the short term, but how they will pan out in the long term; we have to wait and watch.

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3. The world's largest coins, in size and standard value, were copper plates used in Alaska around 1850. They were about a metre (3 ft) long, half-a-metre (about 2 ft) wide, weighed 40 kg (90 lb), and were worth $2,500.

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Taylor Rule

Authored by: Shivani Ghildiyal. PGDM-B

We know that its the Central bank which decides the interest rate to be followed in a nation. How, it decides the interest rates are given by Taylor's rule, given by John Brian Taylor in 1993.

Taylor rule is a monetary-policy rule that stipulates how much the central bank should change the nominal interest rate in response to changes in inflation, output, or other economic conditions.

This rule is based on 3 factors:

1) Actual versus targeted inflation levels

2) Actual employment versus full employment levels

3) The appropriate short-term interest rate consistent with full employment.

It says that for each 1-percent increase in inflation, the central bank should raise the nominal interest rate by more than 1 percentage point. The monetary policy should become tighter when inflation (and/ or growth) is higher than "targeted", and looser when inflation (and/ or growth) is less than targeted.

This aspect of the rule is often called the Taylor principle. It prevents the ill-effects that may arise from time inconsistency and discretionary policy.

Time inconsistency- For a decision, Policymaker's preferences change over time, in such a way that a preference, at one point in time, is inconsistent with a preference at another point in time.

Discretionary policy is a macroeconomic policy based on the ad hoc judgment of policymakers as opposed to policy set by predetermined rules.

Before Taylor Rule was introduced, the Federal Reserve stipulated the future interest rates based on the rational expectations theory of macroeconomics.

Rational expectation theory is the idea that people in the economy make choices based on their rational outlook, available information, past experiences and expectations. This method had several critics. One was that assumptions about individual behaviour do not carry over to aggregate behaviour. Secondly, even if all individuals have rational expectations, the representative household describing these behaviours may exhibit behaviour that does not satisfy rationality assumptions.

This was a backward-looking model that assumes that if workers, consumers and firms have positive expectations for the future of the economy, interest

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4. The first credit card was issued by American Express in 1951.

Taylor Rule

rates don't need an adjustment. It doesn't take into account long-term economic prospects.

The Phillips curve was the last of discredited rational expectations theory models that attempted to forecast the trade-off between inflation and employment. While short-term expectation may have been correct, long-term assumptions based on these models are difficult.

The Taylor Rule has been applied to 26 countries, 17 developing and 9 developed economies, on the basis of quarterly data since 2002. Although the Federal Reserve does not explicitly follow the Taylor rule, many analysts have argued that the rule provides a fairly accurate summary of US monetary policy. Similar observations have been made about central banks in other developed economies, both in countries like Canada and New Zealand that have officially adopted inflation targeting rules, and in others like Germany where the Bundesbank's policy did not officially target the inflation rates.

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