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K. J. Somaiya Institute of Management Studies and Research

26 Nov 2012

The little things

- **Forex reserves:** $293.56 billion in the week ended Nov 9
- **Brent Crude:** 110.39 USD/bbl as on Nov 23
- **Sensex:** 18,506.57 as on Nov 23
- **Gold (10 gm):** Rs 31620 as on Nov 23 in Mumbai
- **Exchange rate (Rupee):** Rs. 55.42/USD as on Nov 23

Did you know?

A great example of Banks consolidation can be seen in America from 1990 to present.

In 1990 there were 37 major banks in America. By 1999 there were 21. Just 14 in 2003. Presently, there are just 4. The "big four" banks hold 39% of all U.S. customer deposits (as of 2009), and consist of:

- Bank of America
- Citigroup (through its Citibank subsidiary)
- JPMorgan Chase (through its Chase subsidiary)
- Wells Fargo

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THE LUXURIOUS IRANIAN BAN

Iran announced a ban on imports of 75 luxury products, part of efforts to promote domestic products and stem the outflow of dollars and other foreign currency as Western economic pressures increasingly choke off Iran's commerce and critical oil revenue. However, it allows for foreign parts to be shipped in for local assembly plants, which make cars such as Peugeots, European-brand home appliances, laptops and mobile phones, all covered by the new ban. Western sanctions have cut sharply into Iran's oil sales, which account for 80 percent of the country's foreign currency revenue.

UNSOLD SPECTRUM

45% of the spectrum remained unsold after 7 rounds of bidding due to the high reserve price set by the Government. The Telecom department said it had received bids worth a little over Rs 9,200 crore on the opening day, less than a fourth of the government's target of Rs 40,000 crore from the airwaves sale. After the refund of the licence fees paid by companies in 2008, the net gain to the exchequer might be zero or even negative.

ETF'S MADE ELIGIBLE FOR LENDING AND BORROWING

SEBI allowed "liquid" Index Exchange Traded Funds (ETFs) eligible for trading in the Securities Lending and Borrowing (SLB) segment. Earlier, SEBI had allowed only securities traded in the Futures & Options (F&O) segment for lending and borrowing of securities. ETF is a security that tracks an index, a commodity or a basket of assets like an index fund, but trades like a stock on an exchange. ETFs allow investors to invest in a wide range of asset classes that include stocks but are not limited to them.

WORLD SIZE BANKS FOR INDIA

Finance Minister, P. Chidambaram said that consolidation in banking system was inevitable and that India must have two or three world-size banks. SBI merged one of its associate, State Bank of Saurashtra, with itself in 2008 besides merging itself with State Bank of Indore in 2010.At present, there are five associate banks of SBI. Two of them are fully-owned, State Bank of Patiala and State Bank of Hyderabad, while remaining three, State Bank of Mysore, State Bank of Travancore and State Bank of Bikaner and Jaipur (SBBJ), are not 100 per cent owned and listed at the bourses.

NO EASY REJECTION OF EDUCATIONAL LOANS

Rejecting any educational loan would now require approval of controlling authority of the branch concerned and the reason for rejection should be communicated to the applicants in writing. The banks had Rs 41,340 of outstanding educational loans as of March 2011. To remove problems faced by students in obtaining education loans, the Government is working on a scheme under which it would extend guarantee for advances up to Rs 7.5 lakh.

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The five countries with the fastest GDP growth in 2011, according to CIA estimates:

- Qatar (18.8%)
- Mongolia (17.3%)
- Turkmenistan (14.7%)
- Ghana (13.6%)
- Timor-Leste (10.6%).

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THE CHINA PRICE

Authored by: Riddhi Doshi, MMS-A

The 19th century belonged to British Because of their ability to exploit their colonies throughout the world. The 20th century belonged to the Americans because of their ability to innovate and produce things the world had never seen. The 21st century, it is said, it will belong to China with its ability to produce things at a price, which no one around the world can seem to match- **Alexandra Harney, the author of** *The China Price: The True Cost of Chinese Competitive Advantage.*

"The China price" They are the 3 scariest words in U.S. industry. It is a term that the business-people in the US began using around 2003 to describe ultra-low prices of goods made in china. In general, it means 30% to 50% less than what you can possibly make something for in the U.S. It is one great force of our time, throwing millions of people out of work around world, helping millions of families in rural china out of poverty, and encouraging Americans and Europeans to buy lot of stuffs they probably didn't need. It has been a big factor in the loss of 2.7 million manufacturing jobs since 2000. Meanwhile, America's deficit with China keeps soaring to new records. It is likely to pass $150 billion this year. How has China been able to emerge as the world's "factory floor"? The answer lies in the eight major "economic drivers" of the China price:

1) Low Wages

In China, goods are manufactured by a highly disciplined, educated, and non-union work force and at very low wages. Due to Non-Union Labor, workers are forced to work for 12-18 hours a day. The average hourly earnings are well below a dollar.

2) Piracy and Counterfeiting

Despite tough rhetoric from the Chinese government, many critics have argued that much of the country's counterfeiting and piracy is state-sanctioned. This is mainly because counterfeit and pirated goods sold domestically help keep inflation low, and selling these goods internationally creates jobs and export revenues. Counterfeit or pirated factors of production are able to cut significantly their costs relative to countries where intellectual property rights are respected.

3) Minimal Worker Health and Safety related Regulations

China is one of the most dangerous places to work in the world. The highest risk industries include building materials, chemicals, coal production, machinery manufacture, metallurgy, plastics and textiles. As for the cost advantages to Chinese manufacturers inherent in a lax health and safety regulatory regime, these range from the use of cheaper equipment for workers and fewer safety-related expenses to savings on training.

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Did you Know?

Only six U.S. corporations have reached a $500 billion market cap, according to multiple reports. Apple is the most recent. Exxon, Microsoft, Cisco, Intel and GE are the other five, though none of them currently have market caps that are that high.

THE CHINA PRICE

4) Lax environment regulations and enforcement

China is rapidly becoming one of the most polluted countries in the world. It is home to 16 of the 20 the world's most polluted cities. While China has some strict environmental laws on the books, the fines that may be levied to enforce the regulations are so insignificant that they are seen merely as a cost of doing business rather than a true deterrent.

5) Export Subsidies

China has constructed a "Great Wall of Protectionism" around both its agricultural and industrial sectors. Energy and water are heavily subsidized. state-owned enterprises, which still control key sectors of the economy such as oil and steel, benefit from free land. China's state-run banks provide heavily subsidized capital and credit to Chinese enterprises without any expectation of repayment.

6) Industrial Network Clustering

Industrial network clustering refers to the practice of locating all or most of the key enterprises in an industry's supply chain in close physical proximity to one another. This type of localization of industrial focus generates significant production and distribution benefits as it speeds both physical and information flows and extends "just in time" principles to the entire supply chain.

7) The Catalytic Role of FDI

Among developing nations, China has become the leading destination of FDI. It finances the transfer of the most technologically advanced production and process technologies. FDI is also often tied to the improvement of both marketing and distribution skills. When all of these attributes are tied to one of the least expensive labor forces in the world, FDI becomes a powerful competitive driver.

8) A Chronically Undervalued Currency

Since 1994, China has pegged its currency, the Yuan, to the US dollar at roughly an 8-to-1 ratio. China's "beggar thy neighbor" currency policy is an important engine of its export-driven growth. China has adopted a "fixed exchange rate system" in which it pegs the value of its currency to the value of the U.S. dollar. It means that no matter how big a trade deficit the United States runs with China, the dollar cannot fall relative to the Yuan.

The ability of Chinese entrepreneurs to offer the China Price across an incredibly diverse array of industries is China's premier weapon of mass production—one that is at the root of China's conquest of one export market after another.

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Terminologies:

Triple Witching: An event that occurs when the contracts for stock index futures, stock index options and stock options all expire on the same day. Triple witching days happen four times a year on the third Friday of March, June, September and December.

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Quantitative Easing: A boon or a bane

Authored by: Erica Fernandes, PGDM-IB

The term Quantitative Easing (QE) is a form of monetary policy that central banks use so as to increase the supply of money in an economy. It is done when the bank interest rate, discount rate and/or interbank interest rate are at near zero level. The Central bank first credits its own account with money it has created ex nihilo ("out of nothing") followed by purchases of financial assets, including government bonds, corporate bonds, from banks and other financial institutions in via open market operations. The process in turn gives banks excess reserves by way of deposit multiplication and leads to increase in money supply thus stimulating the economy.

Central banks Reason for undertaking Quantitative Easing

- Keeping interest rate low is not enough to maintain an adequate money supply in certain situations so quantitative easing is employed to increase the money supply in the financial system.
- The increase in reserves of banks which allows them to lend more and even buy bank bonds from the central bank itself. This has the effect of lowering government bonds yields and similar investments, making it cheaper for business to raise capital.
- A third reason is the investors will be able to swap investments in financial assets like shares and bonds and thus enable them to increase their portfolio wealth and reduce risk. Quantitative Easing can also help in reducing interbank overnight interest rates.

We try to understand whether Quantitative easing is a boon or a bane by looking at QE done by the Federal Reserve and its impact. We use Fed QE1 as it was the most significant of all the major central bank's QE in terms of the magnitude of bond purchases throughout the entire period except late 2011.

Boon:

Liquidity and interest rates:

Prior to Fed QE1 Banks with excess liquidity were not willing to lend to those requiring the same even at premiums leading to a credit crunch. However after Fed QE1 the signaling of lower interest rates for the future and increasing reserve balances of banks created liquidity in the market.

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Terminologies:

One-Touch Option- A type of exotic option that gives an investor a pay-out once the price of the underlying asset reaches or surpasses a predetermined barrier. This type of option allows the investor to set the position of the barrier, the time to expiration and the pay-out to be received once the barrier is broken.

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Quantitative Easing: A boon or a bane

Flows into Emerging markets

Fed QE1 not only impacted the U.S economy but also led to flows outside US, into emerging markets. Using data from EPRF we found that the sentiment in emerging markets picked up. EPFR Global which tracks aggregate flows into all mutual funds that invest in local currency debt and equities of Ems showed that a 1% increase in Fed's assets led to a 0.92% increase in EM equity funds assets during QE1.

Employment:

Fed QE and Monthly U.S. Unemployment

Source: Source: Fed Reserve, Bureau of Labor Statistics Data Releases

The unemployment rate in the U.S was climbing prior to Fed QE1. When QE1 started in Dec 2008, the unemployment rate remained sticky between 8.3 to 9.5 levels. Thereafter, unemployment began to gradually decline, coinciding with the time period when Fed QE2 took place between Nov 2010 and June 2011. It is possible that the drop in the unemployment rates to lower levels can be attributed to QE as well as other fiscal measures taken by the U.S Government.

Bane:

Inflationary Expectation:

QE has blamed to have set off rising inflationary expectations. This is because QE increases money supply leading to increased ability of individuals and firms to spend, which in turn leads to demand-driven inflation.

Rise in asset prices:

Another negative seen which is in a way related to inflation is the prices of global commodities. Both gold and crude oil have been rising. A study done by me indicated that Gold prices start to price in QE even before the actual announcement Crude Oil (Brent) pricing lags by three months .Finally, QE can neither be characterized as a blessing or a curse. During the crisis of 2008, Fed QE, i.e. QE1 was used as a tool to combat deflation, deceleration in growth rate, tight credits markets and rising interest rates and bring about stability. However not every solution can be a perfect one especially in such an uncertain landscape. Thus the benefits of QE come at the cost of inflation and rising global asset prices.