

**29 Oct 2012****The little things**

- **Forex reserves:** \$295.23 billion as on 19 Oct
- **Brent Crude:** 109.67 USD / bbl as on Oct 28
- **Sensex:** 18625.34 as on 26 Oct
- **Gold (10 gm):** Rs.31050 (as on 28 Oct in Mumbai)
- **Exchange rate (Rupee):** Rs. 53.63/USD as on 26 Oct

**Did You Know -**

- On January 1, 1791, the U.S. national debt was \$75 million. As of August 28, 2011, the official debt of the United States government was approximately \$15.9 trillion. To pay this debt would require approximately \$51,000 from every single person living in the United States.
- Legendary investor Warren Buffett bought a 40-acre farm at age 14 with \$1,200 in savings from delivering newspapers.

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**Visit Us At**<http://finstreet.weebly.com>**Like Us At**<https://www.facebook.com/TeamFinstreet>**CBDT OPPOSES SHOME COMMITTEE TO DEFER GAAR**

The country's apex tax body, the Central Board Of Direct Taxes (CBDT), has opposed Shome Panel's proposal to defer the implementation of the General Anti-Avoidance Rules (GAAR) for three years. The CBDT has submitted a report to the finance ministry on the subject. The report argues that since the Parliament had approved a one-year deferral of GAAR, a three-year deferral might invite Parliamentary conflict. The CBDT is of the opinion that if tax avoidance has to be addressed immediately, then a delayed implementation of GAAR may not help.

**SAHARA INVESTORS SEEK SEBI'S INTERVENTION ON REFUNDS**

A number of investors in Sahara have complained to stock market regulator Sebi that they have received only a part of the amount the Supreme Court had ordered the Subroto Roy-helmed company to refund. Sebi has been told by the Supreme Court to supervise repayment of Rs 17,400 crore with 15 per cent interest to investors who had subscribed to convertible bonds issued by two real estate companies of Sahara.

**OIL INDIA IN TALKS WITH MOZAMBIQUE TO PICK UP STAKE**

State-run Oil India is in talks with Mozambique to pick up a stake in giant gas field Rovuma-1 after a proposed energy policy allowed stakeholders to ship out their share of gas. Cash-rich Oil India is also considering downstream investments such as setting up fertilizer and petrochemical plants in the country through a consortium of state oil firms because of availability of abundant gas. Oil India has reserves and surplus of about Rs 12,500 crore.

**RBI SEEKS SOPS FOR REMITTING PROFITS**

RBI has asked the finance ministry to provide incentives to Indian companies that have invested abroad to repatriate a part of their profits to India, in a bid to increase the quantum of stable foreign inflows compared with borrowed funds that have become the mainstay of India's capital flows.

**GOVERNMENT MAY EXEMPT FII'S FROM FILING I-T RETURNS**

The government may exempt portfolio investors from filing income tax return as part of measures to address niggles and make the country attractive for foreign institutional investors (FIIs). Stock market regulator Sebi has also backed exemption for individual foreign investors and trust called qualified foreign investors (QFIs) from filing of income tax return.

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**Did you Know:**

Herbert Hoover the US president during whose time the great economic depression set in infamously declared in March 1930 that the U.S. had "passed the worst."

However, the worst, had just begun. From 1929 to 1932, about 100,000 businesses failed, banks collapsed at a rate of 200+ per month and GDP fell from \$81 billion to \$49 billion.

## Animal spirits in Economic Decision Making

Authored by: Pooja Gala, MMS-B

Emotions have a strong influence on economic decision making. Classical economists have failed to acknowledge the role of the irrational self in decision making. According to classical economics, wide- spread unemployment should not exist, because in the absence of availability of appropriate jobs, the workers would be prepared to accept jobs with lower pay and thus the situation would correct itself.

However, that isn't what happens. This can be explained with the term – animal spirits. Animal spirits is a phrase that was used by John Maynard Keynes in his book 'The General Theory of Employment, Interest and Money' to describe the gloom and despondence that led to the Great Depression and the changing psychology that accompanied recovery. He used this phrase to describe the psychological forces that partly explain why the economy doesn't behave in the manner predicted by classical economics.

It is evident from the current global crisis, that apart from the economic fundamentals, "animal spirits" or powerful psychological factors greatly influence the financial events around the world. The term animal spirits is related to consumer or business confidence. It includes our trust and sense of fairness of economic dealings. According to Keynes, business cycles are caused due to these animal spirits- volatile expectations about the future.

When people and businesses' have trust and faith in the economy, they tend to spend and invest spontaneously – a particular animal trait. They believe they will be successful and have few or no apprehensions. This creates an environment of optimism thereby leading to a boom condition in the business cycle. Similarly, the recessionary period in the economy can be explained by lack of confidence in the economy. The erosion of animal spirits feeds on itself. Immense market volatility serves only to reinforce people's sense that something is really wrong.

A volatility feedback loop begins: the more volatility, the more people feel they must pay attention to the market, and hence the more erratic their trades. Let us understand this in the Indian context – India grew at a growth rate of 6.5% for the year ended march, 2012, much lower than the average 9% achieved in the last three years. Most believed that the government inaction and policy paralysis was responsible for the same.

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**Terminology:**

**Blind Pool:** A limited partnership or stock offering with no stated investment goal for the funds that are raised from investors. In a blind pool, money is raised from investors, usually trading on the name of a particular individual or firm, but few restrictions or safeguards are in place for investor security.

**Animal spirits in Economic Decision Making***Authored by: Pooja Gala, MMS*

In such a scenario, the concept of animal spirits argues for the necessity of an active government intervention in economic policymaking to prevent a further deterioration in consumer and business sentiment leading to the risk of a deflationary depression. Here, attempts by politicians and others to talk up confidence by making optimistic statements about economic prospects can rarely help.

The decision makers need to provide for confidence measures strong enough to stall the downward spiral of animal spirits. The various measures taken by the UPA since then - allowing FDI in various sectors - has already helped in improving the public sentiment or 'confidence'. So, for reviving our animal spirits, and thus economic growth rate, we should have massive and targeted programs that are strong enough to impact public confidence.

Even in the case of the euro-crisis, the question to be asked is- are the stimulus packages big enough to restore confidence back into business activities and markets given the pessimism surrounding euro zone crisis?

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**Terminology:**

**One-cancels-the-other order:** A pair of orders stipulating that if one order is executed, then the other order is automatically canceled.

## Priority Sector Lending

*Authored by: Mayank Arora, PGDM-B*

The RBI under directives from the government instructs Indian banks to lend at a cheaper rate to certain sectors such as agriculture and SME industry and for the purpose of education loans, housing loans, in an effort to keep the markets competitive and ensure that credit from banks is within easy reach of the weaker rugs of society.

The description of the priority sectors was formalized in 1972 and although initially there was no specific target fixed in respect of priority sector lending, in November 1974 the banks were advised to raise the share of these sectors in their aggregate advances to the level of 40 per cent by 1985.

As per a directive issued on July 20, 2012 foreign banks that have a large presence in India – Standard Chartered and Citi bank – shall come under the purview of the Priority Sector Lending (PSL) policy from April 1, 2013.

There are two types of PSL, Direct and Indirect. In the Agricultural sector Direct PSL is intended towards farmers to procure land and other allied services related to farming and to repay debts to non-institutional lenders. In-direct lending is meant for NBFC's and other non-rural institutions such as co-operative societies that have made investment in the agricultural sector.

Banks are also directed to provide loans for the purpose of education - ₹ 10 lakh for studies in India and ₹ 20 lakh for studies abroad – and housing to individuals. The intentions with which directed lending was implemented were laudable, as it helped in meeting the financial needs of the agriculturists and the village artisans to a considerable extent, and paved the way for transformation of the village economy substantially during the past (over) four decades. While in the initial years, mandatory lending to priority sectors served the purpose for which it was intended, subsequently, the entire philosophy was driven by the political class and became an instrument of exploitation of the rural population for political gains, at the cost of the lending banks.

The Reserve Bank of India (RBI) had recently constituted a committee under the chairmanship of MV Nair, Chairman & Managing Director of Union Bank of India, to re-examine the existing guidelines and suggest revised norms with regard to priority-sector lending and related issues. The report was tabled on 21st February, 2012 and suggested few structural changes keeping in mind the cautious nature of the government and the regulator in these difficult times.

The overall target of 40% of adjusted net bank credit (ANBC) for priority sector and 18% ANBC sub-target allocated to agriculture continues. But, there are other changes.

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**Terminology:****Corner A Market:**

To acquire enough shares of a particular security type, such as those of a firm in a niche industry, or to hold a significant commodity position to be able to manipulate its price. An investor needs deep pockets to be able to corner a market.

## Priority Sector Lending

As per the existing guidelines, 13.5% of ANBC was to be given as direct loans to agriculture. While the report claims that it has removed the distinction between direct and indirect lending by placing agriculture as a chain from the farm gate to food plate, it has actually reduced the direct lending target to 9%, but has carved out the target to small and marginal farmers (SFMF).

While this is good news from an equity perspective, this would be a killer clause from the banks' perspective. To sweeten the bitter pill, the committee has given a time frame for achieving this by providing incremental targets for each year before they are penalized. It has also recommended that banks increase the number of SFFM accounts by 15% every year. The implications of the change in farm credit targets are significant.

The committee's entire approach is to provide access to finance to those who are now excluded. The aim is to make available universal financial access through inclusive finance extending schemes. However it discounts the fact that, to achieve the 9% of the target to agriculture, banks will move towards the organized segment. This squeezes out direct finance to medium and large farmers. Thus equity loans that were being extended to SFFM will reduce drastically and this segment will disappear.

Also, the report does not specify an upper limit for production loans to SFFM, while for allied activities a ceiling of ₹ 3 lakh has been prescribed. As a result there might be larger misclassifications into this category, particularly as the banks have the freedom to tweak the scale of finance to suit specific geographical and crop-specific peculiarities. The advisory to increase the number of accounts to SFFM may negate this concern to an extent.

In a recent statement RBI Governor D Subbarao has accepted cognizance of the concern's raised by bank's over the fact that they see little opportunity of meeting the direct lending target of 13.5 per cent to agriculture, and added that the bankers expressed addition concern whether the agricultural sector has the ability to absorb so much credit.

If this report is converted into a notification, it intends to create a credit guarantee fund for agriculture and give farmers maneuverable space in a country where monsoon makes or breaks livelihoods. Although pressing issues need to be resolved and RBI must ensure that there is a regulatory structure in place to ensure that the targeted recipients of the PSL are benefited and there is no diversion of funds now that distinct sub-classifications have been done away with.

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