Top Ten issues for the year 2011

L&T Investment Management Ltd.

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A recap of 2010

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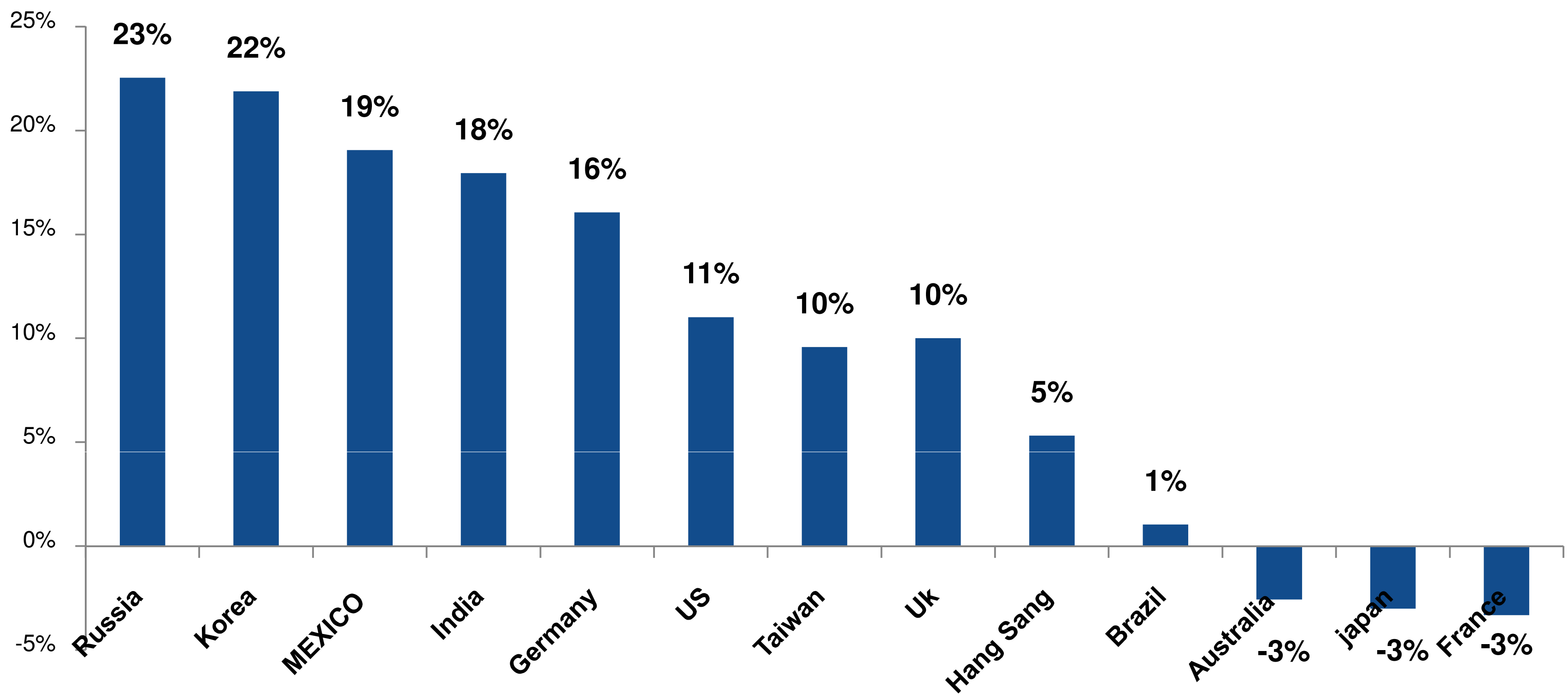
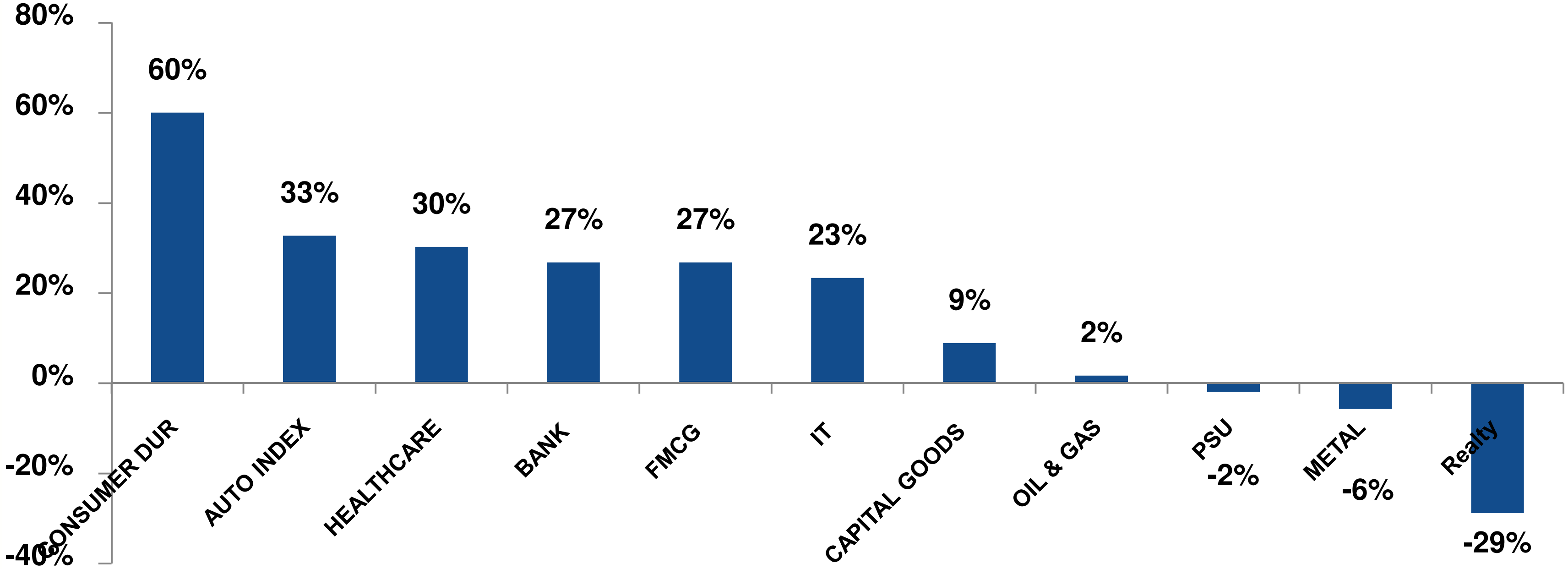
Global Equity Markets in 2010



Indian Markets touched an all time closing high during the year and consolidated its gain of CY2009

2010 – A year of Domestic Consumption



Companies with good corporate governance and high cash flows have been rewarded

Source : Bloomberg

Nifty – Who has contributed how much to the rise/fall?

Company Name	%Change	Index Pts
Infosys Technologies Ltd	33%	137.66
ICICI Bank Ltd	30%	101.16
ITC Ltd	39%	89.14
Housing Development Finance Corp	36%	85.02
HDFC Bank Ltd	39%	77.95
Tata Consultancy Services Ltd	57%	71.91
Tata Motors Ltd	66%	56.22
Larsen & Toubro Ltd	19%	54.10
State Bank of India	26%	51.98
Hindalco Industries Ltd	54%	37.70
Mahindra & Mahindra Ltd	46%	35.48
Axis Bank Ltd	38%	31.32
Sun Pharmaceutical Industries Ltd	60%	23.08
Hindustan Unilever Ltd	18%	16.24
GAIL India Ltd	25%	14.98
Punjab National Bank Ltd	33%	14.08
Bharti Airtel Ltd	10%	13.77
Wipro Ltd	20%	13.68
Oil & Natural Gas Corp Ltd	10%	13.10
Siemens India Ltd	42%	12.15
Tata Steel Ltd	11%	11.73
Ambuja Cements Ltd	41%	11.46
Infrastructure DevFinance Co Ltd	18%	9.20
Hero Honda Motors Ltd	17%	8.91
Cairn India Ltd	20%	7.98

Company Name	%Change	Index Pts
ACC Ltd	23%	6.86
HCL Technologies Ltd	23%	6.35
Kotak Mahindra Bank Ltd	15%	5.15
Cipla Ltd/India	9%	5.07
Idea Cellular Ltd	25%	4.61
Ranbaxy Laboratories Ltd	15%	3.95
ABB Ltd/India	22%	3.55
Unitech Ltd	7%	1.88
Bharat Petroleum Corp Ltd	6%	1.39
Tata Power Co Ltd	0%	-0.62
Jindal Steel & Power Ltd	0%	-0.81
Reliance Power Ltd	2%	-0.89
Power Grid Corp of India Ltd	-10%	-1.72
Bharat Heavy Electricals Ltd	-2%	-2.88
Reliance Communications Ltd	-17%	-6.91
Maruti Suzuki India Ltd	-9%	-7.39
Reliance Capital Ltd	-22%	-7.58
Suzlon Energy Ltd	-39%	-9.44
DLF Ltd	-20%	-9.71
NTPC Ltd	-14%	-10.41
Steel Authority of India Ltd	-23%	-11.71
Reliance Infrastructure Ltd	-27%	-14.81
Jaiprakash Associates Ltd	-26%	-15.49
Sterlite Industries India Ltd	-13%	-18.02
Reliance Industries Ltd	-2%	-20.41

Nifty has gained 965 points in 2010. Given above is the security-wise contribution to rise/fall.

Source: Bloomberg. Any reference to scrip/sector is only for illustration purpose and should not be considered as a recommendation from the author or the AMC or its associates

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Sensex – Who has contributed how much to the rise/fall?

Company Name	Change (Rs/share)	Index Pts
Infosys Technologies Ltd	865.7	519.47
ICICI Bank Ltd	264.7	376.35
ITC Ltd	49.1	336.33
Housing Development Finance Corp	192.9	320.43
Tata Consultancy Services Ltd	422.1	313.03
HDFC Bank Ltd	655.4	306.91
Tata Motors Ltd	518.5	215.10
Larsen & Toubro Ltd	314.1	211.13
State Bank of India	585.8	209.19
Hindalco Industries Ltd	85.95	140.87
Mahindra & Mahindra Ltd	246.3	133.95
Hindustan Unilever Ltd	46.85	61.45
Oil & Natural Gas Corp Ltd	118.6	59.51
Wipro Ltd	81.56	57.45
Bharti Airtel Ltd	32.9	52.99

Company Name	Change (Rs/share)	Index Pts
Jindal Steel & Power Ltd	96.4	51.66
Tata Steel Ltd	64.15	42.85
Hero Honda Motors Ltd	278.8	36.60
Cipla Ltd/India	27.35	17.79
ACC Ltd	109.1	13.76
Tata Power Co Ltd	10.1	-1.98
Bharat Heavy Electricals Ltd	-36.95	-11.98
Reliance Communications Ltd	-28.7	-28.36
Maruti Suzuki India Ltd	-149.2	-31.46
DLF Ltd	-73.85	-44.12
NTPC Ltd	-32.3	-57.43
Jaiprakash Associates Ltd	-36.45	-59.32
Sterlite Industries India Ltd	-27.82	-59.91
Reliance Infrastructure Ltd	-307.4	-60.49
Reliance Industries Ltd	-16.7	-61.93

Sensex has gained 3165 points in 2010. Given above is the security-wise contribution to rise/fall.

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Top 10 Issues for the year 2011

Issues which may be prominent themes for the capital markets during CY2011

1. Rise in commodity prices

- CY2011 is expected to witness increased demand for commodities (precious metals, industrials, basic minerals and agri commodities). Also commodities as an asset class has gained prominence in the last decade

- Per capita consumption of commodities in emerging economies is a fraction of developed economies. With India and China, the two most populous countries all set to become new growth engines for global economy, world might see considerable growth in demand for commodities.

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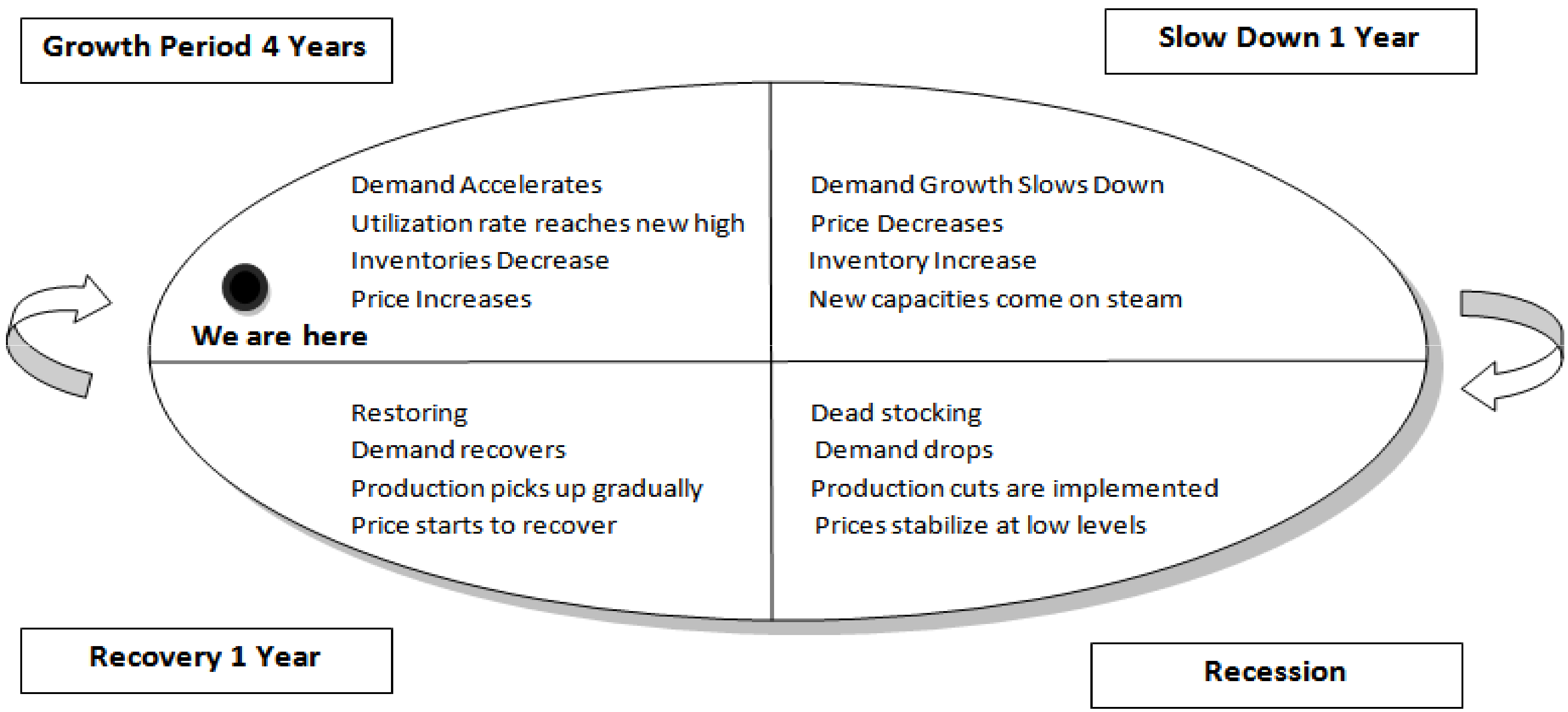
➢ Impact on corporate margins is likely to be limited as demand is strong enough to absorb the hike in commodity prices.



Source: Societe Generale

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Commodity Snap shot

Commodity	View	Rationale
Crude Oil	Bullish	• Global Inventories contracting alongwith demand reaching an all time in • 3Q 2010.
		• Spare capacity to decline, falling to 2007-08 levels by 2012. • Creation of strategic reserves to fuel demand.
Gold	Bullish	• Fears of Currency debasement fuelling demand.
		• EU Sovereign debt issues driving safe-haven demand.
		• Declining official sector sales tightening market. • Central banks increasing exposures in gold.
Copper	Bullish	• Strong OECD Consumption growth and resilient demand in China driving tightness in physical market.
		• Downgrades of mine production by major producers.
Nickel	Bullish	• Demand recovery has returned the market to balance.
Sugar	Neutral	• Early end to Brazilian crush leaves inter-harvest balances tight.
		• Good Indian production but export outlook unclear.
Aluminum	Neutral	• Market likely to be in surplus until 2012, with strong demand not eliminating effects of excess capacity.
		• Physically backed ETFs likely in 2011.
Zinc	Neutral	• Chinese mine and smelter capacity has responded quickly to improved demand from galvanized steel.
		• Stock-to-consumption ratio has risen in 2010.

Views/ statements made herein regarding future prospects may not be realized and author or AMC or its associates are not liable to indemnify in any case.

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2. Interest rates to remain benign

- **US**
  - Fed expected to maintain status quo on key rates
  - Execution of quantitative easing measures announced will support treasury yields
  - On the other hand expectations of higher spending to boost the economy, leading to higher fiscal deficit and higher inflationary expectations has led to rise in yields
  - April 2010 saw 10 yr US treasury note touch a high of 3.99% and Oct 2010 saw a low of 2.39%. Currently at 3.35%
  - So far FED has bought about US$ 140 bn of medium and long term treasuries out of the US$ 600 bn it has announced
  - Expect 10 yr US treasury to trade in a band of 2.50 to 4.25% in 2011

- **EUROPE**
  - Expect no major changes in key rates by ECB and UK
  - Expect further credit rating downgrades of weak EU members in 2011
  - Bond yields of strong EU member countries like Germany is expected to remain stable

Overall while inflation could become a concern for global bond yields in 2011, actions of central banks would also play a key role in deciding the direction.

3. Earnings performance

- Revenues (for Sensex ex-oil) grew by 32% yoy and PAT (for Sensex ex-oil) grew at 28% yoy during H1 FY2011
- Prominent themes which resulted in earnings revisions are mentioned below:
  - **Sectors which contributed to strong earnings upgrades**
    - **Banking and Finance sector** – on account of strong loan growth and margin performance
    - **Auto** – on account of volume surprise and margin performance
    - **Metals** – on account of recovery in metal prices globally
    - **Consumer Non Durables** – on account of strong volumes and margins
    - **Pharmaceuticals** –Approvals received from regulatory authorities for key drugs resulting in earnings upgrades, lawsuits won by few companies with respect to drugs and M&A also resulted in earnings upgrades
  - **Sectors which have seen earnings downgrades include**
    - **Telecom** – on account of increased competitive intensity resulting in lower tariffs and lower realisation and margins,
    - **Cement** - volumes declined sharply on account of heavy monsoons. Lower utilization and higher supply especially in the Southern markets impacted pricing
    - **Power** – Players focused on merchant sales of power saw decline in profitability due to fall in merchant tariffs

Any reference to scrip/sector is only for illustration purpose and should not be considered as a recommendation from the author or the AMC or its associates

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- **Strong earnings growth / turnaround in operations of overseas subsidiaries for Index heavyweights such as Tata Motors, Hindalco and Tata Steel**

- **Sectors which are expected to exhibit strong earnings momentum for CY11:**
  - **IT-** Strong growth in outsourcing volumes on the back of improvement in global economic conditions, good margin performance
  - **Auto –** Volume momentum to continue on the back of rising income levels for the middle class, pricing power to remain with auto manufacturing companies
  - **Consumer Non durables –** Increasing disposable incomes, Uptrading will keep the demand growth intact. Pricing power visible if commodity prices strengthen.
  - **Consumer Durables –** Rising income and aspirational levels and urbanization to result in strong volume growth for the consumer durables sector
  - **Natural Gas –** Cost effectiveness viz other liquid fuels, and ramp up in supply from RIL KG basin and increase in LNG capacity will help drive earnings growth.

- **Sectors which are expected to exhibit deceleration in earnings momentum during CY11:**

  - **Banking –** Current estimates of earnings could be impacted on account of rising cost of funds and negative surprises on asset quality

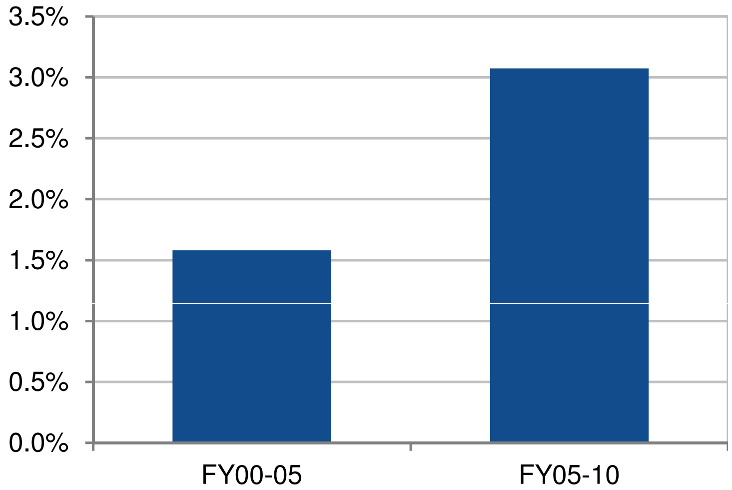
For illustration purpose and should not be considered as a sector recommendation from the author or the AMC or its associates.

4. Rural India - Emergence of new consumption engine

Aggregate rural consumption expenditure is 30% more than aggregate urban consumption expenditure

Agricultural growth and increased government spend driving rural India

Agri GDP Growth



Source: CSO,IIFL

High Minimum Support Prices Support Rural Incomes

	Rs/Quintal						
	Paddy Common	Coarse Cereals	Wheat	Gram	Arhar	Moong	Urad
F2007	580	540	750	1,445	1,410	1,520	1,520
F2008	645	600	1,000	1,600	1,550	1,700	1,700
F2009	850	840	1,080	1,730	2,000	2,520	2,520
F2010	950	840	1,100	1,760	2,300	2,760	2,520
F2011	1,000	880	1,120	2,100	3,000	3,170	2,900
Cumulative Increase in F2011 over F2007	**72%**	**63%**	**49%**	**45%**	**113%**	**109%**	**91%**

Source: CSO, IMF, PPAC, NREGA, SAIM, Company data, Morgan Stanley Research

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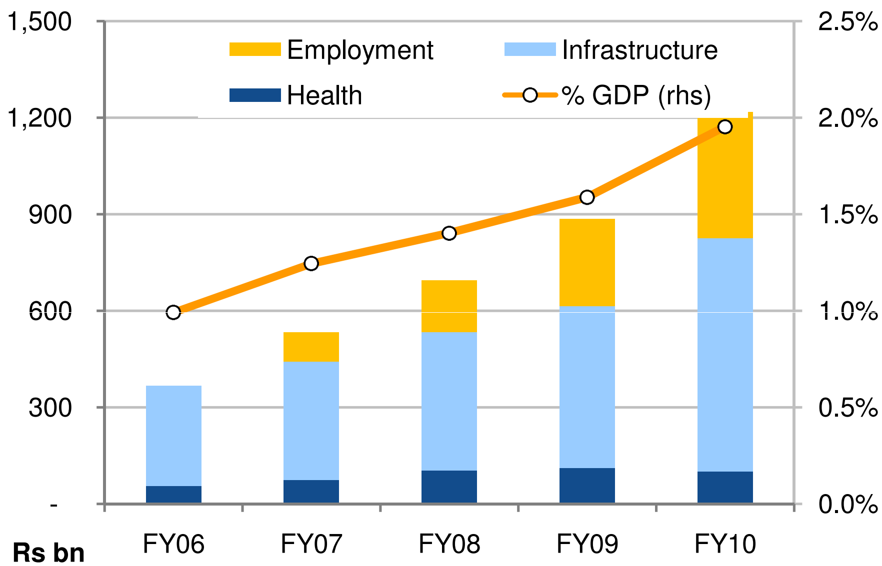
Government expenditure on Key rural schemes



Source: CSO,IIFL

Expenditure on NREGA

NREGA*	FY07	FY08	FY09	FY10	FY11(Till 30 Nov'10)
Total Expenditure (Bn)	88	159	273	379	190
Household Employed (Mns)	21	34	45	53	39
Person days crated (Bn)	0.9	1.4	2.2	2.8	1.4
Scheduled castes/ Tribes (%)		57	55	51	40
Participation of women (%)		43	48	48	51

* Source: nrega.nic.in

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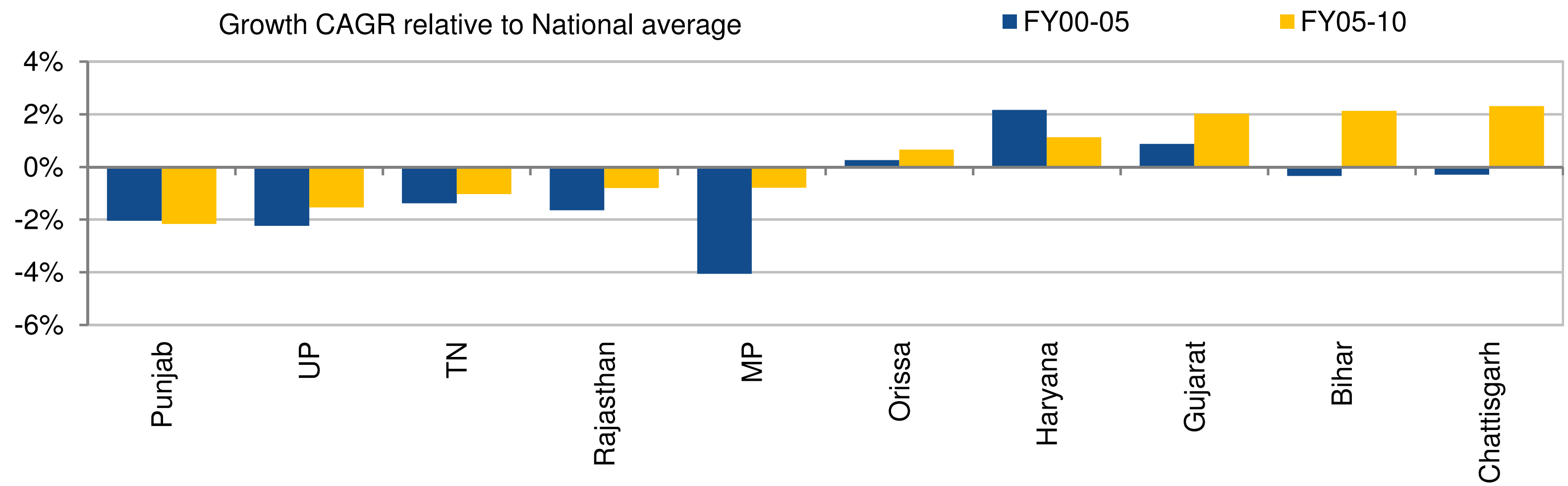
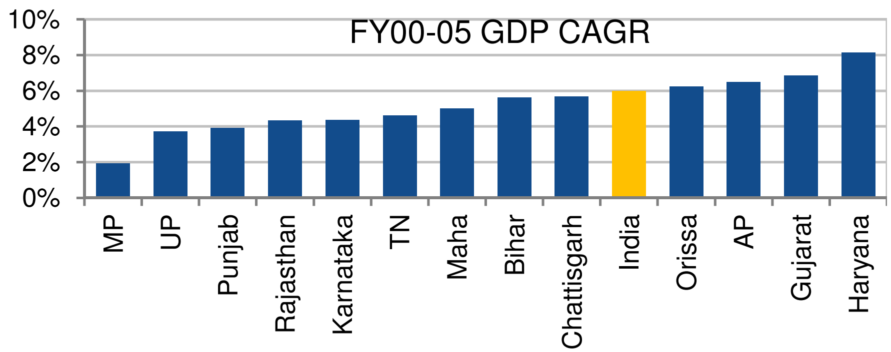
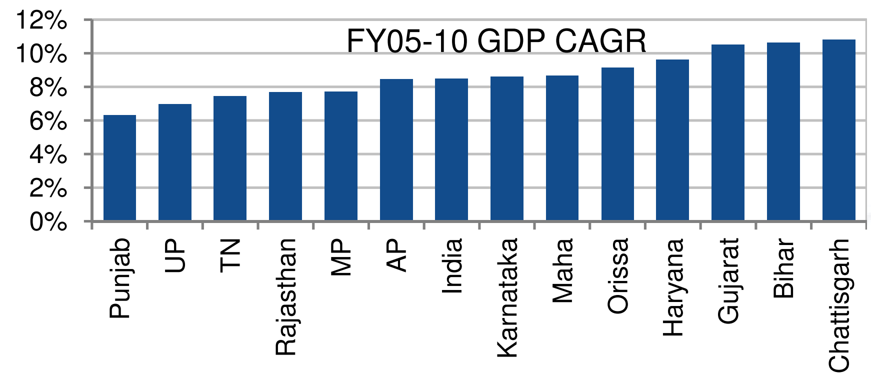
Laggard states catching up fast



Chattisgarh, Bihar and Gujarat were the fastest growing states over the last 5 years





Source: CSO,IIFL

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Building blocks for Inclusive Growth

- **Aadhar (Unique Identification) – Big game changer for financial inclusion**
  - Unique Identification Authority of India (UIDAI) plans to issue Aadhar numbers to 600 million Indians over next 4 years. PM has launched Aadhar in Sept 10 in Maharashtra
  - Aadhar notified as officially valid document for KYC norms for opening bank accounts
  - UID expected to reduce inefficiencies, inequities & corruption and improve financial inclusion, service delivery, compliance & tracking
- **Right to Education Act 2009**
  - Education a Fundamental Right - Every child of age group 6-14 years shall have the right to free and compulsory education. No direct (school fees) or indirect cost (uniforms, textbooks, mid-day meals, transportation) to be borne by the child or the parents to obtain elementary education
  - The government schools shall provide free education to all the children and the schools will be managed by school management committees (SMC). Private schools shall admit at least 25% of the children in their schools without any fee.
  - Central and state governments have the concurrent responsibility for providing funds

5. Fiscal Health- 2010

- **Positives**
  - 3G and BWA spectrum auction provide almost Rs 712bn incremental revenues to Govt as compared to the budgeted estimates
  - Buoyant tax collections, up 25% yoy for April-Sept vs budgeted growth rate of 18%
  - Divestment proceeds will likely meet budget estimates of Rs 400bn.
  - Food and fertilizer subsidies under control
- **Negatives**
  - Two supplementary grants from the parliament pegged additional expenditure of more than Rs750bn, consequently the Rs712bn surplus generated from 3G and Wimax spectrum auction revenues have been eroded.
  - Higher oil prices which can lead to oil under-recoveries rising to Rs600-650bn. Interestingly, govt compensation for oil under-recoveries, estimated to amount to approximately Rs280-330bn for FY10; has not been accounted for in either of the Supplementary Grants.
  - During Apr-Sept FY10, the fiscal deficit stood at Rs1.3trillion down 33%YoY and 35% of the budgeted amount of Rs3.8trillion for FY11. So FY11 deficit is expected to meet the budgeted target.

April 2010 - Oct 2010 Fiscal snapshot (Rs Bn)

		Apr-Oct FY11	Apr-Oct FY10	% yoy	% of total budget
A	Revenue Receipts	4,476	2,845	57.3	65.6
	Net Tax revenues	2,717	2,139	27.0	50.9
	Non Tax	1,759	706	149.3	118.8
B	Non-Debt cap receipts	75	73	2.3	16.6
C	Total receipts	4,551	2,918	56.0	62.6
D	Revenue expenditure	5,425	4,913	10.4	56.6
E	of which interest	1,154	1,011	14.1	46.4
F	Capital expenditure	750	456	64.5	50.0
G	Total Expenditure	6,174	5,369	15.0	55.7
H	Plan expenditure	1,925	1,480	30.1	51.6
I	Non plan expenditure	4,249	3,888	9.3	57.8
J	Fiscal deficit	1,624	2,451	-33.8	42.6
K	Revenue deficit	949	2,068	-54.1	34.3
L	Primary deficit	470	1,440	-67.4	35.4

Source : RBI

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Fiscal Outlook - 2011

Positives

- Economic activity expected to remain strong will ensure strong tax buoyancy. Moreover given the strong uptick in consumption demand, Govt will have some headroom for increasing taxes, additional cesses etc on some sectors such as cigarette, high end personal vehicles etc to generate revenues for schemes such as NREGA, right to education and other rural development schemes etc
- Success of various primary issues including Coal India will likely keep up the appetite for Govt. divestment programme

Concerns

- High crude Oil prices is likely to inflate oil subsidy burden as LPG, diesel regulation may suffer because of fear of fueling inflation.
- De-regulation of complex fertilizer prices with a move towards nutrient based pricing regime was a welcome step, but Urea remains the major contributor to subsidy provision and Govt has not shown a firm move on de-regulating prices
- Increasing populism in the form of Food security act entailing increase in food subsidy bill .
- No comfort from any big inflows (non tax) foreseen such as 3G spectrum auction which may result in Govt cutting on spending to rein in deficit.

6. Current Account Deficit

- **2010**
  - Current account balance continued to worsen from FY10 levels for the sixth quarter in a row, reaching USD 41 bn in 9MCY10, which is on the higher side.
  - The higher current account deficit was more than compensated by USD 50 bn of net inflows into the capital account. Within the capital account, the portfolio inflows remained robust . Trade credit remained strong because of improvement in international financing conditions and healthy recovery in Indian economic activity.
  - The monthly trade data suggests that trade deficit continues to widen in Q4CY10 and, therefore, until invisibles improve markedly, current account deficit will remain on higher side.

- **2011**
  - Current account deficit may remain high in the near term. While the widening current account deficit is more than compensated by higher capital account inflows, concerns remain, especially because large part of it is funded by FII and ECB inflows, which are heavily influenced by the global risk appetite.
  - Any rise in global risk aversion (possibly due to building up currency tensions or renewed concerns about European debt problems) could trigger high volatility in capital flows to EMs including India. However, the damage would be contained given large forex reserves of India (more than USD 280 bn) that could provide sufficient cushion.

Current A/c Deficit Widening

USD Billion		2009			2010		
	Jan-Mar	Apr-June	July-Sept	Oct-Dec	Jan-Mar	Apr-June	July-Sept
Exports	38.5	39.2	43.5	47.1	52.4	56	54
Imports	58.7	64.8	72.6	78.1	83.9	87.9	90
Trade Balance	-20.2	-25.6	-29.1	-31	-31.5	-31.9	-36
Invisibles, net	19	21.2	20.4	18.9	18.5	20.5	20
of which:							
Software service earnings	10.3	10.6	10.8	12.9	14	12.1	12
Private transfers	9.5	12.9	13.8	12.8	12.6	13.1	13
Current Account balance (deficit)	-1.2	-4.4	-8.7	-12.1	-13	-12.2	-15.8
Capital Account	1.9	15.3	19.7	15.8	15.1	15.9	19
FDI	3.2	6.1	6.5	3.9	3.2	3.2	3
Portfolio investments	-2.7	8.3	9.7	5.7	8.8	4.6	19
ECB	1.0	0.5	1.2	1.7	0.1	2.7	3.7
Short-Term trade credit	-2.6	-1.5	0.8	3.3	5.0	5.6	2.6
External assistance	0.8	0.1	0.5	0.6	0.8	2.3	0.6
NRI deposits	2.2	1.8	1.0	0.6	-0.6	1.1	1

Source : Controller General of Accounts , GOI

Populism, a drag on Fiscal

Food Subsidy

- The government of India pursues a policy of subsidizing food staples for the poor. In recent years food subsidies have averaged ¾ percent of GDP, making up about 5% of total government spending.
- Food Security Act: The government has planned to provide 35kg of rice and wheat per month to each Below the Poverty Line (BPL) family at a rate of INR3/kg versus the present issue price of INR5.65/kg for rice and INR4.15/kg for wheat. The 24.3 million extremely poor families within the BPL set (covered under the Antyodaya Anna Yojna scheme) are however likely to continue receiving food grains at an even cheaper rate (35kg of wheat/month at INR2/kg), this will add Rs 60bn to subsidy.

Oil Subsidy

- After successful de-regulation of Petrol prices, Govt seems to be faltering on LPG and diesel price de-regulation as crude prices surge above $90/bbl on economic recovery in US. Every US$1/bbl increase in oil prices increases under-recoveries by Rs30bn ~US$750mn). Based on this if crude prices remain at these levels, the subsidy bill can touch Rs 660bn.

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Fertilizer subsidy

- Urea price de-regulation (forming almost 75% of subsidy bill) seems a difficult proposition with no consensus arising for last 4 months on this issue. Although Govt has announced lower subsidy provision for FY12 for complex (nutrient based) fertilisers, any sharp hike in international prices may warrant Govt's support to private companies in the form of higher subsidy.

Rs bn	FY10	FY11E	FY12E
Fertilizer Subsidy bill	640	520	520
Oil Subsidy*	260	300	360
Food Subsidy	560	556	616

* Not provided in budget estimates but based on historical % share of Govt. of total under recovered

7. Global Events

- **USA**
  - Economy still not showing signs of self sustaining growth on the back of poor employment scenario. Moreover, Republicans have captured control of the House of Representatives and have expanded their voice in the Senate in the mid term election of 2010 giving some setback to Obama.
  - US government sells stake in bailed entities Citigroup (Full exit) and General Motors (partial exit). It plans to offer AIG during the coming year.
  - US federal reserves maintains low rates - resorts to second round of Quantitative Easing (QE2) to pump up additional $600 bn over next 8 months.

- **Euro Zone**
  - Euro-zone has been in the news throughout the year for sovereign downgrades PIGS (Portugal, Ireland, Greece and Spain) and bailouts (differences over modalities of same) to prevent the situation getting into contagion.
  - UK election resulted in hung parliament (2nd election after WW II with hung parliament). However, Conservatives and Liberals came together to form government. UK government was ruled by Labour party for 13 years.
  - ECB has also kept the rates lower and has been resorting to bond buying programs to revive the confidence in the economy.

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Asia

- China's economy is expected to grow by 10% surpassing expectation. However, China's economy appears to be overheating on account of huge fund flows chasing real estate markets. Moreover, inflation concerns have emerged with CPI touching 5% mark. Central bankers have initiated measures both monetary and prudential to curb inflationary pressure but same appear to be ineffective.
- Korean Peninsula got heated towards the fag end of 2010 with North Korea resorting to provocative steps (artillery firing) against South Korea. While no major aggression has taken place, the area continues to be under stress.

US China Standoff

- US – Chinese conflicts on economic front have emerged during the year, with diplomats and Heads of Governments involved in verbal tiff at regular intervals.
- US has been focusing on external trade to boost up its economy . However, Chinese currency policy is being blamed for creation of trade imbalances impacting US interest. China in turn (rather succumbing to pressure) has raised concerns on its dollar investments (its hard earned wealth over period) in US.
- China is inflexible in terms of currency reforms as major appreciation of its currency can lead to sharp decline in external trade causing pain in terms of employment and socio economic issues. It has expressed in the past that reforms would be gradual and over a period.
- In short, both US and China currently have conflicting interest but both cannot afford to shake their long standing trade partnership.

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Developed v/s. Developing economies debate?

- While US pursuant to its economic problems has become more inward looking, Europe owing to multi-nation framework has been grappling on sovereign downgrades and bailouts. Hence, Emerging or developing nations role, who are responsible for bulk of increment growth in global economy, have come into prominence.
- G-20 Ministers in Oct 2010 agreed on ‘Historic’ Reforms in IMF Governance that will shift country representation at the IMF toward large, dynamic emerging market and developing countries.
- Even in US President Mr. Barack Obama on his India visit has remarked that "India is not simply emerging: India has already emerged.”
- Current economic crisis has brought to fore the importance of domestic economy of the Emerging/Developing economies, that have withstood the external shocks and emerged strong with the stability in the world economy. This would continue to be the centre stage during the year 2011.

Global currency war and Trade imbalances

- Competitive devaluations has been resorted to by countries (specifically China and Japan) to shore up the trade after the end of financial crisis. This has led to retaliation by US, which passed Reform for Fair Trade Act 2010 to put safeguards against countries involved in currency manipulations. UK and US have not directly intervened to devalue their currencies but their QE programs are step in that direction.
- Trade imbalances and excessive “Financial Innovation in West” have been blamed for Financial Crisis of 2007, (Inspite of the fact that they have existed for more than a decade). Trade imbalances built up over decades cannot be reversed in months. In G-20 Summit of November 2010 Agreement had been reached to work on indicative guidelines which will set suggested maximum limits for current account surpluses and deficits, though these are not due to be fleshed out until 2011.

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- **Decoupling**

  - Decoupling (of equity markets) has been the jargon that has been tossing around since 2007 in emerging markets. But in a globalised world where capital flows freely, decoupling as far as capital markets is concerned is unlikely in the short term.

  - Economies may remain decoupled from each other over a period of time due to their inherent strengths but that may not necessarily result in capital markets being decoupled over short to medium term. (Though they may perform better over a longer time horizon.)

What to Expect in 2011?

- **Economic Growth**
  - US growth could be moderate as we expect weak consumption growth and no visible signs of meaningful improvement in employment scenario.
  - Eurozone GDP growth could be impacted as governments resorting to austerity measures could impact consumption and government expenditures. Moreover, we expect sovereign issues to continue to hog the area.
  - Asia's growth would continue to remain strong driven by China and India.

- **Inflation**
  - Expect Inflation to be key issue during CY 2011 in large developing economies like China and India, which needs to be tackled appropriately or else it may eat into the growth expectations.
  - Inflation in US and Eurozone has been low and would likely pickup as impact of huge liquidity pumped into the system would be visible in CY2011.

% GDP Growth Forecast

	2010		2011
	Dec 2009 Estimates	Dec 2010 Estimates	Estimates
US	2.7	2.8	2.6
Eurozone	1.2	1.7	1.4
Japan	1.5	3.2	1.4
China	8.6	10.2	8.9
India	6.3	8.8	8.6
Brazil	3.8	5.5	5.1
Russia	2.5	3.5	4.3
South Korea	2.8	6.1	3.9

Growth during the CY2010 for emerging and developing nations has been much higher than anticipated at the beginning of the year.

Source: Economist magazine

8. Domestic political situation

- **Aftermath of scams**
  - Bunching of various scams/irregularities/ investigations including CWG, 2G spectrum, housing loan related bank bribery has shaken the investors confidence.
- **Cleansing of system**
  - This has raised doubts in the minds of large community of India investors about India's track record on governance. However, a timely and effective action on this will restore confidence.
- **State Elections**
  - Loss of Congress in the state of Bihar is likely to restrict its ability to take bold steps. Further 4 states (Assam, Kerala, Tamil Nadu and West Bengal) will go for poll during CY11.

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Reconfiguration of UPA

- Outcome of West Bengal and Tamil Nadu may have an impact on the current composition of UPA Coalition partners as TMC and DMK are 2nd and 3rd largest parties in UPA with 19 and 18 seats respectively.

Festering Issues

- Telengana and Naxal related issues continue to remain unresolved and this overhang is likely to have negative impact on business climate and investor's confidence.

Centre – State Standoff on large projects

- The ongoing projects of Vendanta in Orissa and Lavasa in Maharashtra are facing a lot of regulatory issues including environmental clearances. Speedy resolution of the same and clear-cut spelt policies going forward could be a way to attract much needed foreign capital for large projects.

9. Infrastructure Development

- **What happened in 2010?**

  2010 witnessed a slowdown in execution of infrastructure projects on account of :

  - Stalemate with respect to the bifurcation of AP continued resulting in near complete halt to the infrastructure projects in the state especially related to irrigation and power
  - Activism demonstrated by the Ministry of Environment and Forests with respect to the necessary clearances required for the construction of several infrastructure projects resulted in a substantial slowdown in the execution of power projects
  - Particularly with respect to the NHAI, for the year FY11, out of 2500 km targeted for completion, 988 km has been completed in the first 8 months of FY11 and out of 9000 km targeted for award only 3671 km was awarded.

Contd..

What is the expectation for 2011?

- Srikrishna committee report on the demand for / against the bifurcation of Andhra Pradesh is expected in the last week of December 2010. This will pave the way forward for the resolution of the ongoing political turmoil and hence clear impediments with respect to the revival of infrastructure spending in the Southern state for 2011

- Clearances to the several projects stuck at the Ministry of Environment and Forests especially with respect to power and metal sector will provide a trigger to the spending in the sector. This we believe is a function of political disconnect at the center and timely resolution will help drive infrastructure spend during 2011.

- We expect the stalemate with respect to the above issues to continue at least till the

- First half of CY11 and hence a substantial move forward will happen only in the second half of 2011

- Announcement of cut in the toll rates for 3-axle vehicles is expected to reduce the NHAI toll collections by about 10% -15%. This may affect viability of future projects leading to higher proportion of annuity/cash based projects. Ministry of Finance has suggested a limit on the annuity spends of NHAI which may further delay the road development program.

- The overall targeted spend on infrastructure stands at Rs.5.28 trillion for FY12 as against Rs.4.6 trillion for FY11

Source: Midterm appraisal report of Planning Commission

Contd..

- **Mid term appraisal report of the 11th 5 year plan was released in July 2010. Key highlights of the report are mentioned below:**

  Revised spending for the 11th plan remains approximately at the same level as that planned originally at Rs.20.5 trillion

- **The segments within the infrastructure sector which have seen positive revisions in targeted spend include**
  - **Telecom (34%) –** Robust growth in subscriber base led to better than expected spending by the private sector
  - **Airports (17%) –** Both public and private investments in airports are likely to increase compared to the investment projected at the beginning of the Eleventh Plan

- **The segments within the infrastructure sector which have seen negative revisions in targeted spends include**
  - **Roads and bridges (-11%) -** The decline in investment is due to a shortfall in the award of road projects by NHAI during the first three years of the Plan
  - **Railways (-23%) -** both Central sector and private investments are below the original projections on account of slow progress in awarding PPP projects
  - **Water supply and sanitation (-22%) –** private sector investment in water supply and sanitation is likely to be comparatively smaller than that planned earlier
  - **Ports (-54%) -** The Ministry of Shipping has revised the original target of 545 MMT of additional capacity for the major ports downwards and now proposes to develop 48 projects with a capacity of 393 MMT

Source: Midterm appraisal report of Planning Commission

Contd..

- **Contribution of the private sector in the total infrastructure spend is expected to increase from 30% to 36%**

- **Electricity -** Capacity addition of 62 GW is likely to be achieved during the 11th Plan as compared to a target of 79 GW

- **Railways -** Railways have opened up container movement to competition and 16 entities have been granted concessions for operating container trains

- **Roads and Bridges –** Spending on this sector has been revised downwards to Rs.2.78 trillion against Rs.3.14 trillion planned originally

Source: Midterm appraisal report of Planning Commission

10. Economic Reforms

Goods & Services Tax (GST) – Long way to go still

- In implementation of GST, though, the deferral has been disappointing, the question that continues to haunt tax payers is - when will it happen and do we have a definitive date?
- Some states are demanding unreasonable concessions - including on rate structure, central sales tax's continuance and exemption for many items from under GST's ambit - that threaten to distort the purpose of indirect tax rationalisation.
- To make the implementation into reality, it is critical that the Centre and the States need to reach a consensus by resolving differences. Once the consensus has been reached at, necessary amendments would be needed in constitution for GST regime to commence.

Direct Tax Code (DTC) – Lot of ground covered

- Probability of DTC being implemented is relatively higher. Revised draft of DTC has addressed issues relating the Minimum Alternate Tax (MAT), taxation of long-term savings, capital gains and housing loans. Minimum Alternate Tax paid by eligible companies to be computed based on profits and not on assets and retirement funds to continue to be exempt from tax on withdrawal.
- The Bill is presently with the Standing Committee. Though, there are limited insights into the deliberations of the standing committee, it is anticipated to be passed smoothly.

Financial Sector Reforms

- **Banking**
  - Pursuant to announcement made by Finance Minister regarding RBI considering issuing additional bank licenses to private sector, RBI has come out with discussion paper seeking views/comments from various stakeholders. The guidelines have covered points relating to capital requirements, ownership profile and business model.
  - Recently RBI has the released gist of comments on the discussion papers, which highlights comments, deliberations and issues raised by various stakeholders. We expect final guidelines to be released by early part of 2011 and new licenses would be issued in residual period of 2011.
- **Insurance**
  - Insurance bill that proposes to increase the FDI from current 26% to 49% has still not been introduced in the parliament. We expect some steps to be taken in the direction to hike the FDI during the coming year.
  - Private sector entry in the industry would be completing a decade of its presence. Going forward (once the norms for IPO are set out) private sector would tap the capital markets to unlock value for the Indian promoters and meet the capital requirements.
- **Microfinance**
  - Micro-finance sector has been facing some heat after the Andhra pradesh government has taken steps against the industry. MFI ordinance passed in Oct 2010, prohibits MFIs from extending and recovering loans to the rural poor without registration with the district administration. Later on it has passed the bill that seeks to regulate the industry. This has created collection problems for MFI sector, which has ~30% exposure to Andhra Pradesh.
  - RBI has setup Malegam committee to go into modalities for regulation of Microfinance Institutions. Meanwhile, RBI has had deliberations with bankers and MFI industry to look into issues of funding and has advised banks not to choke the funds as it may create further issues.
  - We can expect some concrete and better regulatory framework and business model to emerge for MFIs in 2011

Major Regulatory Changes - SEBI

- Implementation of mandatory Know Your Customer (KYC) irrespective of subscription amount for certain category of Investors w.e.f Oct 1, 2010 and for individual investor w.e.f. Jan 1, 2011
- Restriction on accepting Third Party Instruments in Mutual fund subscriptions
- SEBI allowed ASBA facility as additional mode of payment for MF subscription during NFO
- NFO period has been reduced to 15 days from the earlier 30 days in case of an open ended schemes and 45 days in case of close ended schemes. Mutual funds to allot units/refund application money and dispatch statements of accounts within 5 business days from the closure of the NFO
- With a view to ensure that the value of money market and debt securities in the portfolio of mutual fund schemes reflect the current market scenario, SEBI modified the valuation methodology of these instruments.
- W.e.f. June 01, 2010, distributors, agents or any persons employed or engaged in the sale/ distribution of mutual fund products are required to have a valid certification from the National Institute of Securities Markets (NISM) instead of AMFI certification as required before.

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- In order to provide more avenues for purchasing and redeeming Mutual Fund units, in addition to the existing facilities of purchasing and redeeming directly with the Mutual Funds and Stock Brokers, SEBI permitted transaction in Mutual fund units through clearing members of the registered Stock Exchanges and Depository participants of registered Depositories (to process only redemption request of units held in demat form)

- In order to facilitate merger/ consolidation of Schemes, SEBI decided that merger or consolidation shall not be seen as change in fundamental attributes of the surviving scheme if (i) Fundamental attributes of the surviving scheme do not change (ii) Mutual Funds are able to demonstrate that the circumstances merit merger or consolidation of schemes and the interest of the unitholders of surviving scheme is not adversely affected.

- SEBI wrt Interval Funds, decided that (i) The units shall be mandatorily listed and no redemption/repurchase of units shall be allowed except during the specified transaction period. Most importantly, SEBI advised AMCs that investments in Interval Funds shall be permitted only in such securities which mature on or before the opening of the immediately following specified transaction period.

India at a Glance

	CY06	CY07	CY08	CY09	CY10 (Approx)
Sensex (Index)	13,787	20,287	9,647	17,465	20,509
PE Ratio (1yr fwd)	17.8	25.0	11.7	18.0	17.2
Indian Market Cap (USDbn)	816	1,815	637	1,301	1,630
FII Flow (USDm)	8,038	17,810	(12,173)	17,639	29,000
MF Flow (USDm)	3,402	1,625	3,325	(1,169)	(6000)
DII Flow (USDm)	0	6,039	16,940	5,334	(4,600)
Primary Issuance#	14,612	35,600	13,580	18,428	25,169
IPOs (USDm)	4,416	8,285	4,251	4,103	8,004
FPOs (USDm)	1,085	2,693	6	5	6,938
Rights (USDm)	786	3,550	7,398	781	2,005
QIPs (USDm)	870	5,834	904	7,270	5,754
FCCB/GDR/ADR (USDm)	7,456	15,238	1,022	6,269	2,468
FDI Flow (USDm)	14,212	15,829	31,665	26,818	15,973

	FY06	FY07	FY08	FY09	FY10
Real GDP (Rs bn)	32,491	35,646	38,935	41,550	44,641
Real GDP (%)	9.5	9.7	9.2	6.7	7.4
Nominal GDP (Rs bn)	37,065	42,840	49,479	55,744	62,312
Nominal GDP (%)	14.7	15.9	15.2	15.1	12.2
Current Account Deficit (% of GDP)	(1.3)	(1.0)	(1.4)	(2.3)	(2.2)
Fiscal Deficit (% of GDP)	(4.1)	(3.5)	(2.7)	(6.0)	(6.7)
Savings (% of GDP)	34.3	34.8	37.7	32.5	33.6
Investment (% of GDP)	32.5	33.9	38.0	38.0	32.5
MF Folios (Lacs)	218	304	438	480	482
Equity AUM (Rs Crores)	99,456	122,379	177,684	101,031	197,625
Total Assets under Management Rs Crores	231,862	359,001	538,508	493,285	747,525
US$/INR - Annual avg	45	40	46	47	46

Latest Data available as on date

Source : Bloomberg, SEBI, AMFI

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