portfolio construction CONFERENCE

PRESENTATION BY THE DEPUTY HIGH COMMISSIONER OF INDIA – MR. V.K.SHARMA

INDIA - COMING THRU’ THE GLOBAL FINANCIAL CRISIS AND LOOKING AT THE OPPORTUNITIES AHEAD

Impact on India: WHY?

- There have been two arguments as to WHY India has had to face an impact because of the G.F.C.

- Indian banking system has had no direct exposure to the sub-prime mortgage assets or to the failed institutions. It has very limited off-balance sheet activities or securitized assets. So how can India be caught up in a crisis when it has nothing much to do with any of the maladies that are the core of the crisis.

- India's recent growth has been driven predominantly by domestic consumption and investment. External demand, as measured by merchandise exports, accounts for less than 15% of our GDP.

ANSWER:

- The answer to both the questions lies in globalization.

- First India's integration into the world economy over the last decade has been remarkably rapid. Integration into the world implies more than just exports. Going by the common measure of globalization, India's two-way trade as a proportion of GDP, grew from 21.2% in 1997-98 to 40.6% in 2008 – 09.

- Second India's financial integration with the world has been deep. If we take an expanded measure of globalization, that is the ratio of total external transactions (gross current account flows plus gross capital flows) to GDP, this ratio has more than doubled from 46.8% in 1997 – to more than 98% in 2008 – 09.

Impact on India: HOW?

- India's financial markets – equity markets, money markets, forex markets and credit markets – had all come under pressure from a number of directions. First, as a consequence of the global liquidity squeeze, Indian banks and corporates found their overseas financing drying up, forcing corporates to shift their credit demand to the domestic banking sector.
- Second the forex market came under pressure because of reversal of capital flows as part of the global deleveraging process. Corporates were converting the funds raised locally into foreign currency to meet their external obligations.
- Third, RBI's intervention in the forex market to manage the volatility in the rupee further added to liquidity tightening. Rupee-US$ rate moved up from 40.25 during 2007 – 08 to 45.92 during 2008-09 and 48.65 during April -1 – July 21, 2009.
- There was a slump in demand for exports. The United States, European Union and the Middle East which account for three quarters of India's goods and services trade are in a synchronized down turn.
- Net capital inflows, which increased sharply to 9.2% of GDP (US$108 bn.) in 2007 -08 from 1.9% of GDP in 2000-01, witnessed a sharp decline to 0.8% of GDP (US$9.2 bn.) during 2008-09.
- FDI and NRI deposits witnessed a surge over their previous year's level. Portfolio investment declined to outflow of US$15.0 bn. in 2008 – 09 from net inflow of US$29.6 bn. inflow during 2007-08.
- The current account deficit stood at US$29.8 bn. (2.6% of GDP) in 2008-09 as against US$17.0 bn. (1.5% of GDP) during 2007-08.
- Beyond the financial and real channels of transmission as above, the crisis also spread through the confidence channel. In sharp contrast to global financial markets, Indian financial markets continued to function in an orderly manner.

Indian Response – Monetary Policy

- The policy responses in India since September 2008 have been designed largely to mitigate the adverse impact of the global financial crisis on the Indian economy.

- The RBI has multiple instruments at its command such as repo and reverse repo rates; cash reserve ratio (CRR), statutory liquidity ratio (SLR), open market operations, including the market stabilisation scheme (MSS) and the Liquid Adjustment Facility (LAF), special market operations, and sector specific liquidity facilities.

Indian Response – Monetary Policy

- The key policy initiatives taken by the RBI since September 2008:

- **Policy Rates** – The policy repo rate under the liquidity adjustment facility (LAF) was reduced by 400 basis points from 9.0% to 4.75%.
- The policy reverse repo rate under the LAF was reduced by 250 basis points from 6% to 3.25%.

- **Rupee Liquidity** – The Cash Reserve Ratio (CRR) was reduced by 400 basis points from 9% of net demand and time liabilities (NDTL) of banks to 5%.
- The Statutory Liquidity Ratio (SLR) was reduced from 25% of NDTL to 24%.
- The export credit refinance limit for commercial banks was enhanced to 50% from 15% of outstanding export credit.
- A special 14 day term repo facility instituted for commercial banks was enhanced to 50% from 15% of outstanding export credit.

Indian Response – Monetary Policy

- **Forex liquidity:** The Reserve Bank sold foreign exchange (US dollars) and made available a forex swap facility to banks.
- The interest rate ceilings on nonresident Indian (NRI) deposits were raised.
- The all-in cost ceiling for the external commercial borrowings (ECBs) was raised. The all-in-cost ceiling for ECBs through the approval route has been dispensed with up to June 30, 2009.
- The systemically important non-deposit taking non banking financial companies (NBFCs –ND- SI) were permitted to raise short term foreign currency borrowings.
- **Regulatory Forbearance:** The risk-weights and provisioning requirements were relaxed and restructuring of stressed assets were facilitated.

Impact of the Indian Response

Actual / Potential Release of Primary Liquidity since Mid-Sep. 2008		
	Measure / Facility	**Amount (US$)**
1	CRR Reduction	35.5 bn.
2	Unwinding / Buyback / De-sequestering of MSS Securities	21.7 bn.
3	Term Repo Facility	13.3 bn.
4	Increase in Export Credit Refinance	5.6 bn.
5	Special Refinance Facility for SCBs (Non-RRBs)	8.5 bn.
6	Refinance facility for SIDBI/ NHB/ Exim Bank	3.5 bn.
7	Liquidity Facility for NBFCs through SPV	5.6 bn.*
	Total	**93.7 bn.**
	Memo: Statutory Liquidity Ratio (SLR) Reduction	8.8 bn.
	Includes an option of USD 1.1 bn.	

Impact of the Indian Response

Interest Rates – Monthly Average					
Segment / Instrument	March 2008	October 2008	January 2009	March 2009	June 2009
Call Money	7.37	9.9	4.18	4.17	3.25
Commercial Paper	10.38	14.17	9.48	9.79	6.06*
Certificates of Deposit	10	10	7.33	8.61	3.7
91-day Treasury bills	7.33	7.44	4.69	4.77	3.22
10-year Government Security	7.69	7.8	5.82	6.57	6.83

**relates to May 2009*

RBI Policy Stance

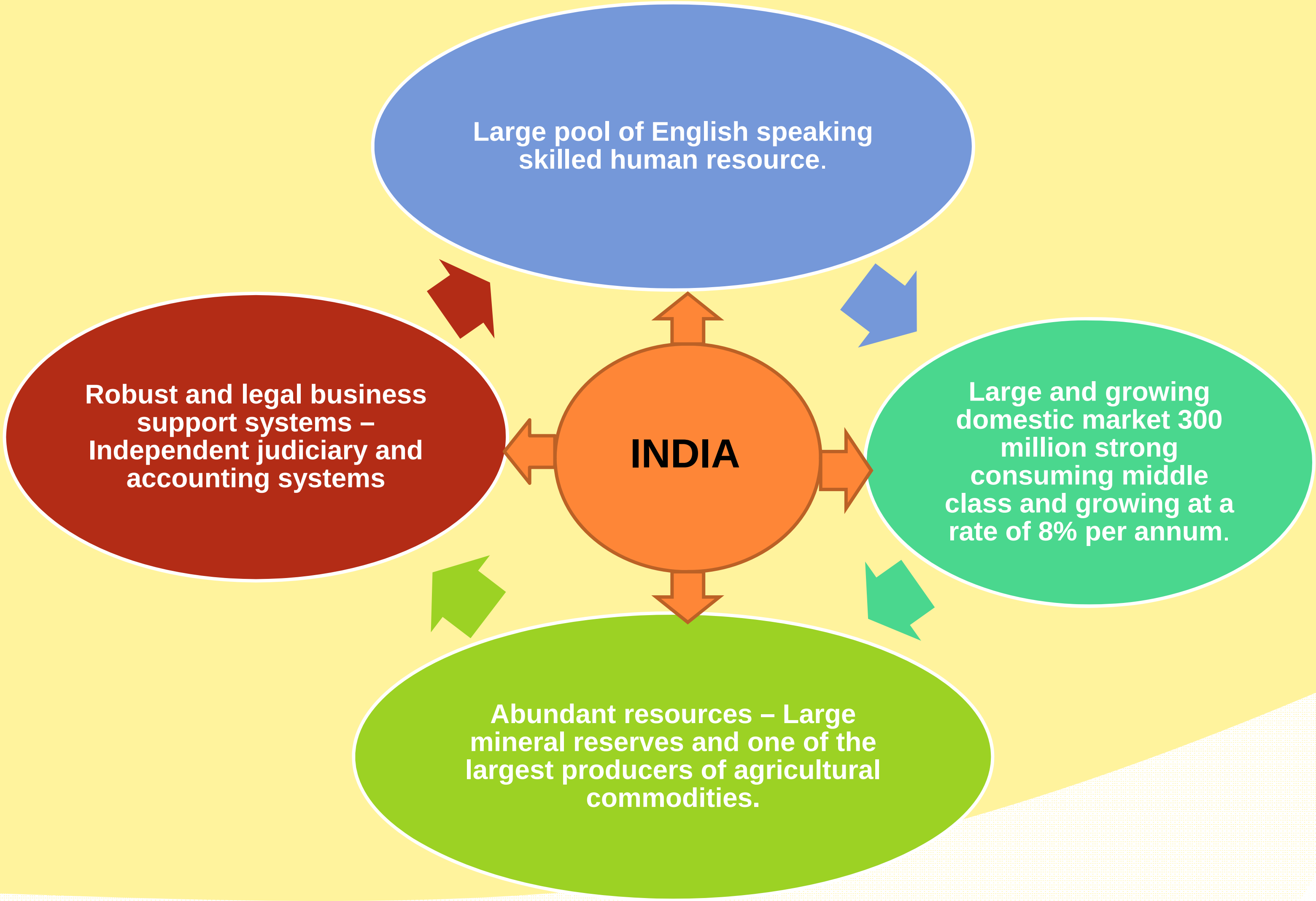
- The Reserve Bank of India's Annual Policy Statement, 2009-10 announced on April 21, 2009 stated the following policy stance:
- Ensure a policy regime that will enable credit expansion at viable rates while preserving credit quality so as to support the return of the economy to a high growth path.
- Continuously monitor the global and domestic conditions and respond swiftly and effectively through policy adjustments as warranted so as to minimise the impact of adverse developments and reinforce the impact of positive developments.
- Maintain a monetary and interest rate regime supportive of price stability and financial stability taking into account the emerging lessons of the global financial crisis.

WAY FORWARD…

- Investors need to base their decision on investing in emerging and developing markets which are the engines of growth and are responsible for the containing the effect of the G.F.C.

- The Indian market has the capability to absorb investments and provide for a good return on the investments.

WHY INVEST IN INDIA



MACRO ECONOMIC INDICATORS

- **GDP (current prices)** :**US$1.18 trillion** (*IMF forecast)(2009)*
- **GDP Growth** : **6.7%** (*2009 Union Budget*)
- **Foreign Exchange Reserves** : **US$ 254 bn.** (*June 2009*)
- **Main natural resources** :Coal, Iron Ore, Bauxite, Manganese and Chromium.
- **Currency**: A$ 1= Rs. 40.00 / US$ 1 = Rs.47.74 (*Aug. 2009*)
- **Inflation**: **6.26%** (*2009 Estimate*)
- **FDI Investments** : **US$27.3 bn.** (*April 2008 – March 2009*)
- **FII Investments** : **U$5,562 mn.** (*Jan. 1 2009- 2 Jun 2009*)
- **Leading Investing Countries** : Singapore, USA, U.K., Netherlands

FDI POLICY OVERVIEW

- India has one of the most transparent and liberal Foreign Direct Investment (FDI) regimes among emerging and developing economies.
- Differential treatment is limited to a few entry rules, predominantly in some Services sectors, spelling out the proportion of equity that the foreign investor can hold in an India-registered company or business – termed “sector caps”.
- Foreign corporate and individual investment in India, termed collectively as Foreign Direct Investment (FDI) when it relates to control or ownership of a company in India, takes one of two routes:
- Automatic Route or Automatic Approval:
- FIPB Approval – the Foreign Investment Promotion Board (FIPB) approves investment proposals:

FDI POLICY OVERVIEW

- Automatic Route or Automatic Approval:

  This requires no prior approval for FDI. Post-facto filing of data relating to the investment made with the Reserve Bank of India (RBI) are for record and data purposes. This route is available to all sectors or activities that do not have a "sector cap" i.e. where 100% foreign ownership is permitted, or for investments that are within a sector cap (e.g. less than or equal to 26% share of an Insurance company).

- FIPB Approval – the Foreign Investment Promotion Board (FIPB) approves investment proposals:
  - where the proposed shareholding is above the prescribed sector caps, or
  - where the activity belongs to that small list of sectors where FDI is either not allowed or where it is mandatory that proposals be routed through the FIPB (e.g. sectors that require industrial licensing)

FDI POLICY OVERVIEW

- The FIPB ensures a single-window approval for the investment and acts as a screening agency (for sensitive/negative list sectors).

- FIPB approvals (or rejections) are normally received in 30 days.

FDI CAPS FOR VARIOUS SECTORS

SECTOR	OWNERSHIP LIMIT	ENTRY ROUTE	REMARKS
POWER	100%	AUTOMATIC	Includes generation, transmission and distribution of power
ROADS	100%	AUTOMATIC	Includes construction and maintenance of roads, highways, bridges and tunnels
PETROLEUM & NATURAL GAS	100%	AUTOMATIC	Petroleum refining, product pipelines & marketing. 49% for Petroleum refining PSUs

FDI CAPS FOR VARIOUS SECTORS

SECTOR	OWNERSHIP LIMIT	ENTRY ROUTE	REMARKS
BANKING	74%	AUTOMATIC	Private banks.
REAL ESTATE	100%	AUTOMATIC	Sub. To minimum land area of 10 hectare for serviced housing plot and built up area of 50,000 sq. m for construction development projects.
RETAIL – SINGLE BRAND	51%	FIPB	
MINING	100%	AUTOMATIC	Mineral Ores including gold, silver and other mineral ores

FDI CAPS FOR VARIOUS SECTORS

SECTOR	OWNERSHIP LIMIT	ENTRY ROUTE	REMARKS
COAL PROCESSING	100%	AUTOMATIC	
CAPTIVE COAL MINING FOR POWER	100%	AUTOMATIC	
CAPTIVE COAL MINING FOR NON POWER	74%	AUTOMATIC	
AUTOMOBILES	100%	AUTOMATIC	Includes two-wheelers, cars and commercial vehicles

SOME RECENT INVESTMENTS & DEVELOPMENTS

- Walmart has entered the country for wholesale trading known as 'Cash and Carry' Bharti-Walmart joint venture has opened its cash-and –carry store and intends to open 15 such stores in the next three years.
- Tesco and Carrefour, have announced similar plans while the German group Metro has already established an Indian presence.
- Dow Jones & Co. is setting up a wholly owned subsidiary in India.
- Pepsi Co. is doubling its investment in its Indian beverage business for calendar year 2009 to over US$220 mn.
- Bosch will maintain its India focus and the company has recently made a commitment of US$27.1 mn.
- Damas LLC and Gitanjali Lifestyle Ltd. have formed a joint venture for retail trading of jewellery and related accessories.
- Hyatt Group Company plans to establish hotels in association with Emaar MGF for US$26.5 mn.

ESTABLISHING BUSINESS IN INDIA

- A foreign company planning to set up business operations in India has the following options:
  - Incorporate a company under the Companies Act, 1956 through
  - Joint Venture or
  - Wholly owned Subsidiary

- Foreign equity in such Indian companies can be up to 100% depending on the requirements of the investor, subject to equity caps in respect of the sector/area of activities under the FDI policy.

- Enter as a Foreign Company through:
  - Liaison Office/Representative Office
  - Project Office
  - Branch Office

- Such offices can undertake activities permitted under the Foreign Exchange Management Regulations 2000

SUMMARY

- The Global Financial Crisis has highlighted the necessity for the economies of the world to work together for framing a common regulatory frame work.
- India has been able to steer its economy well during the crisis.
- Economists believe the crisis is more or less coming to an end, thanks to the resilience of the Chinese, Indian and other developing economies.
- India provides for the astute investor safe and secure investment options.
- The investment procedures are streamlined and opportunities exist in essential sectors of the economy.
- "We came to India for the costs, stayed for the quality and are now investing for innovation." - *Dan Scheinman CISCO System Inc.*

FOR MORE DETAILS CONTACT

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