Top 10 issues for 2013

Performance of Major Asset Classes in 2012

G-Sec Yield	(%)
30-Dec-2011	8.57
31-Dec-2012	8.05
Data from Bloomberg	

Commodities	2012
Silver	14.05
Gold-India	12.46
Brent Spot Price (Europe)	1.1

International Indices	2012
BSE Sensex	25.70
S&P CNX Nifty	27.70
Bovespa	7.40
CAC 40	15.23
DAX	29.06
Dow Jones	7.26
FTSE 100	5.84
Hang Seng	22.91
Jakarta Composite	12.94
KLSE Composite	10.34
Nasdaq	15.91
Nikkei 225	22.94
NYSE	12.93
RTS Index	10.50
Seoul Composite	9.38
Shanghai Composite	3.17

Indices	1 Year
BSE Sensex	25.70
S&P CNX Nifty	27.70
BSE Auto	40.31
BSE Bankex	56.72
BSE Capital Goods	34.71
BSE Consumer Durables	46.08
BSE FMCG	46.61
BSE Health Care	38.53
BSE IPO	44.44
BSE IT	-1.18
BSE Metal	19.13
BSE Midcap	38.52
BSE Oil & Gas	13.14
BSE Power	10.86
BSE PSU	15.24
BSE Realty	53.44
BSE Smallcap	32.97
BSE Teck	1.41
BSE-100	29.96
BSE-200	30.98
BSE-500	31.20
CNX Media	58.67
CNX Service Sector	26.87

Top Ten Themes

1. Interest rate cycle to start moving downward
2. India's GDP on upswing
3. Politics and its impact on economics and Bills pending in Parliament
4. Portfolio Flows
5. Global economics
6. Rupee vs dollar
7. State of infrastructure
8. Gold as an asset class.
9. Primary markets
10. Aadhaar

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1. Interest rates

Current:

- Repo rate remains at 8 per cent.
- Last cut by 50 basis points in April 2012.
- Cash reserve ratio (CRR) cut by 125 basis points to 4.25 per cent (in 2012).

Expectation

- Repo rate cut in January: 25 basis points

and/or

- Repo rate cut in March: 25 basis points

or

- 50 basis points in March -- If RBI is able to see concrete evidence of decline in inflation and Government's seriousness about fiscal consolidation in Budget.

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- **Rate-cut of at least 100 basis points expected in CY 2013.**

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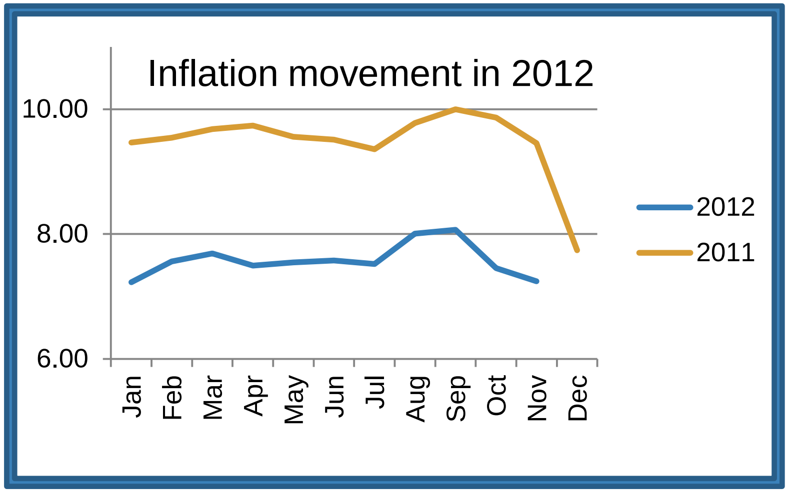
Inflation

Currently:

- WPI inflation eased to 7.24 per cent in November from 7.45 per cent in October, 2012.
  in 2011 WPI inflation was at 9.46 per cent in November and 9.87 in October.
- Core inflation declined to 4.5 per cent in November (33-month low).
- However, CPI inflation (retail) inflation remained high at 9.90 per cent for November, up from 9.75 per cent in October.
- Decline in inflation in Q12013 expected due to base effect and softening demand.



Inflation estimates (in %)	FY 13	FY 14
Citi	7.5-8	7
Goldman Sachs	7.9	6.8

Reasons for estimates

1. Food inflation to remain sticky.
2. High inflationary expectation leading to wage growth.
3. Suppressed inflation: government did not pass on full extent of price rise in fuels to public.
4. Any revision in administered prices will drive inflation up.
5. Inflation will also depend on factors like commodity prices, fiscal deficit, rupee's stability, and continuation of reforms.

Fiscal deficit estimates

Fiscal deficit estimates	FY 13 (%)	FY14 (%)
Govt of India	5.30	--
Citi	5.90	5.50
Goldman Sachs	5.80	5.30

Reasons

- **Citi**: Rohini Malkani of Citi expects Aadhaar-based cash transfer and implementation of GST (higher revenues) to help rein in deficit in FY14.
- **Goldman Sachs**: Expects gradual fiscal consolidation in FY14 and beyond due to revenue buoyancy on account of higher growth, and lower subsidy bill (chiefly fuel subsidy due to declining price of oil). Major fiscal consolidation likely only after 2014 elections.

Expectations regarding commodity prices

Commodity prices will fall due to:

- Supply surpluses
- China likely to follow a less resource-intensive growth model in future.

Effect

- Lower commodity prices will help India reduce deficits and inflation.
- The Govt plans to allow the fuel prices to rise over the course of next year by a small margin every month will reduce the fiscal burden.

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2. GDP growth

GDP growth rate estimates	FY13 (%)	FY14 (%)
Ministry of Finance	5.7-5.9	
RBI	5.8	
Asian Development Bank	5.4	
Citi	5.4	6.2
Goldman Sachs^	5.5	6.7

^Goldman Sachs estimate of improvement in economic growth from **2HFY13** based on:

- **Declining price of oil** over the next few years (forecast by their commodities team, due to massive shale gas discoveries in US that will act as substitute and put pressure on price of crude). Will improve India's CAD, fiscal deficit and inflation.
- **Improving global climate**: reduction in risks in euro area; gradual improvement in US economy. Will lead to gradual improvement in exports.
- **Benign liquidity conditions** as Western central banks will not abandon easy monetary policies soon. Will lead to capital flows that will fund India's deficits.
- **Structural reforms** will boost confidence in Indian economy and lead to higher investments over next two-three years.
- Near-term difficulties remain: high twin deficits and high inflation.

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3.1. Politics and its impact on economics

Politics will affect policy during the year due to the following reasons.

a. State elections due in 2013

- Meghalaya, Tripura, Nagaland, Karnataka, Madhya Pradesh, Mizoram, NCT Delhi and Rajasthan
- Among them Karnataka (28 LS seats); Madhya Pradesh (29 LS seats); NCT Delhi (7 LS seats); Rajathan (25 LS seats) will be crucial.

State elections covering 80 LS seats will provide indication of public opinion prior to General Elections.

b. Anti incumbency vs Development model (UP, Guj)

- Uttar Pradesh: SP won (March 2012) highlighting problems of citizens and the development work it would undertake in the state if elected.
- Gujarat: BJP won (December 2012) by portraying the development that has taken place in the last 10 years.

c. Other issues related to politics

- Fuel pricing. Budget outlay for fuel subsidy was Rs 436 billion, of which Rs 385 billion went into paying FY12 dues. Under recovery is likely to be Rs 1,670 billion. Of this the government will have to pay Rs 1,000 billion. As in the past, is likely to defer 50% to FY14. Only way to fix this is by rationalising fuel pricing. Will government be able to raise fuel prices in a pre-election year?

Conclusion: Given above-mentioned dynamics, development of infrastructure (or even the perception of development) that can be attributed to the central government will make a lot of difference. Will have a bearing on this year's Budget.

3.2. Bills pending in Parliament

- **Insurance bill**: Though the bill was supposed to be taken up in the monsoon session (Dec 2012), it was deferred to the budget session. The bill has provision for allowing foreign investors to own up to 49% in local insurance companies, up from 26% currently.
- **Direct Tax & GST**: If implemented in 2013, will rationalise taxes on individuals and businesses. May also increase central government's tax revenues. Budget ‘13 may spell a clear time table.

Other bills

- **Land Acquisition**: Provides for fair compensation to landowners in both rural and urban areas. Has stipulation that consent of 80 per cent of people required for acquiring land for private industry. Will impact cost of setting up industry in India.
- **Lokpal Bill**: Transparency International's Corruption Perception Index (CPI) places India at rank 94 out of 176 nations in 2012. India's rank in ease of doing business stands at 132. With the passing of Lokpal Bill, there is the possibility that India's position will improve under both the categories.

4. Portfolio Flows

FII and DII Net Investment in 2012 (Rs Crore)

Month	Equity	Debt	Total	DII (BSE + NSE)*
Jan	10,358	15,971	26,329	-6736
Feb	25,212	10,016	35,228	-11855
Mar	8,381	-6,589	1,793	-3496
Apr	-1,109	-3,788	-4,897	772
May	-347	3,569	3,222	707
Jun	-501	1,682	1,181	1171
Jul	10,273	3,392	13,664	-5271
Aug	10,804	265	11,069	-4333
Sep	19,262	623	19,884	-9160
Oct	11,364	7,852	19,216	-4583
Nov	9,577	292	9,869	-5238
Dec**	25,088	1,704	26,792	-8903
Total	128,361	34,989	163,350	-56925

SEBI website; *bseindia.com ; **Provisional data subject to change

FII Investment Activity Equity (Rs Crore)

	Equity	Debt	Total
2012*	1,28,361	34,989	1,63,350
2011	-2,714	42,067	39,353
2010	1,33,266	46,408	1,79,675
2009	83,424	4,563	87,988
2008	-52,987	11,772	-41,216
2007	71,486	9,429	80,915
2006	36,540	4,049	40,589
2005	47,182	-5,518	41,664
2004	38,966	3,083	42,04
2003	30,459	4,694	35,154
2002	3,630	48	3,678
2001	11,970	524	12,495

SEBI Website; *provisional data for 2012

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Amount of FDI inflows 2012

	(In Rs Crore)	(In US$ mn)
January	10,288	2,004
February	10,874	2,211
March	40,766	8,101
April	9,620	1,857
May	7,229	1,327
June	6,971	1,244
July	8,182	1,474
August	12,578	2,264
September	25,552	4,679
October	10,295	1,942
Ministry of Industrial Policy and Promotion		

FII investment by market cap in BSE companies

Date	Rs crore	No of Cos
Jan 01, 2012	849462.57	1342
Dec 31, 2012	1119381.21	1353
There were 1302 companies that were common in both the list		

Citrus Advisors Views:

US fiscal cliff has been averted and FII flows are expected to be strong
Easy monetary policy through most of the developed world
The new Japanese govt is also likely to follow an easy money policy giving rise to Yen carry trade
Risky asset may chase growth pockets
Possibility of Rupee appreciation will be an added incentive to FIIs

Therefore it is quite likely that 2013 may again see record portfolio flows

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5. Global politics and economics

- Weak global growth in first one or two quarters of 2013. If that period is navigated, sustained recovery expected into 2014 and beyond, according to Goldman Sachs.
- Impact of fiscal tightening will be felt most in early 2013. After that Its effect will moderate in 2H2013 in developed world. *(Source Goldman Sachs)*
- Below trend global growth of 3.3% expected in 2013. May reach trend levels in 2014.

United States of America

- Likely to grow at around 2%. *(Source Goldman Sachs)*
- Recovery in housing and labour markets.
- Household debt levels declining.
- US housing sector delivered positive surprise in 2012. This will continue in 2013: housing starts and housing prices both expected to rise.

Europe

- Most likely scenario: weak economic growth.
- In 2012, perception about European situation led to risk-on/off environment. In 2013, Europe won't be key driver of global risk appetite.
- Policy measures and institutional changes have reduced systemic risk arising from Europe.
- Euro area policy makers should be able to deal with periodic flaring up of risk in one area or another.
- Risk in Spanish economy expected in early 2013. May require ECB intervention.
- March general election will create political uncertainty about pace of reforms in Italy.
- Greece economy had a short term boost when the EU decided to bailout in Dec 2012. This will keep the country going till German elections are held between Sep 1 and Oct 27, 2013.

Global politics and economics (Contd.)

China

- Chinese growth to be lower than average of last decade:
    - Goldman Sachs expects it to be slightly above 8 per cent in 2013
    - Citi expects growth to be at 7.8 per cent
- Moderate slowing in Q1 2013 followed by moderate rise in pace of growth in 2013 and beyond.

Oil

- US shale gas production will ease tightness in global energy supplies.
- Prices likely to be in the range of
    - US Energy Information Administration – average of $90 per barrel
    - Goldman Sachs - $80-$90 per barrel.
- This will aid revival of global economy.

6.1. Rupee VS Dollar

- Rupee among worst-performing currencies this year.
  - By end of the year it stood at 54.87 against dollar.
  - Depreciated 3.1 per cent in 2012.
  - Reached low of 57.12 on 23rd June.
- Between 5th September and 4th October appreciated from 55.91 to 51.74, driven by government reforms and QE3.
- Reserve cover for imports has declined to 7 months.

- **Reasons for weakening rupee:**
  - Low GDP growth for last three quarters,
  - Slowing industrial output,
  - Weak capital inflows,
  - High inflation,
  - High twin deficits
  - Lack of reforms in the first half of calendar year.

Steps taken. RBI and Finance Ministry have taken several measures to encourage inflows: deregulated interest rates on NRI deposits; relaxed external commercial borrowing (ECB) norms; allowed wider participation by FIIs in debt markets by raising investment limits (to $ 20 billion in government bonds and another $ 20 billion in corporate bonds).

Future. Strength of the rupee in 2013 will depend on implementation of crucial reforms, twin deficits, inflation, forex cover and growth rate. Government and RBI may undertake more measures to attract capital flows.

6.2. Current Account Deficit

Facts

- According to RBI's Financial Stability Report, **gold imports** responsible for **2/3rd of CAD** in **last three years**.
- India accounts for one-fourth of world gold demand.
- In January 2012, 2% import duty imposed. Levy doubled to 4% in Budget 2012-13. Excise duty on branded and non-branded jewellery also introduced in Budget but rolled back amid protests by jewellers.
- CAD reached all-time high of **5.4 per cent of GDP** by **September-end**. Expected to remain high (above 5 per cent) in December quarter as well.

Quarter ending	CAD ($ Billions)
March 2012	-21.7
June 2012	-16.4
September 2012	-22.3

Reasons

- **India's imports continue to remain inelastic**. Widening CAD can be largely attributed to steep rise in gold imports, oil imports and Indian exports taking a beating due to global slowdown.
- **Slow export growth**: Despite depreciating rupee, exports didn't rise due to global slowdown.
- **Gold imports**: More household savings channeled into physical assets like gold than into financial assets.

Expectation

- In 2013, more steps likely to curb demand for gold and curb CAD.

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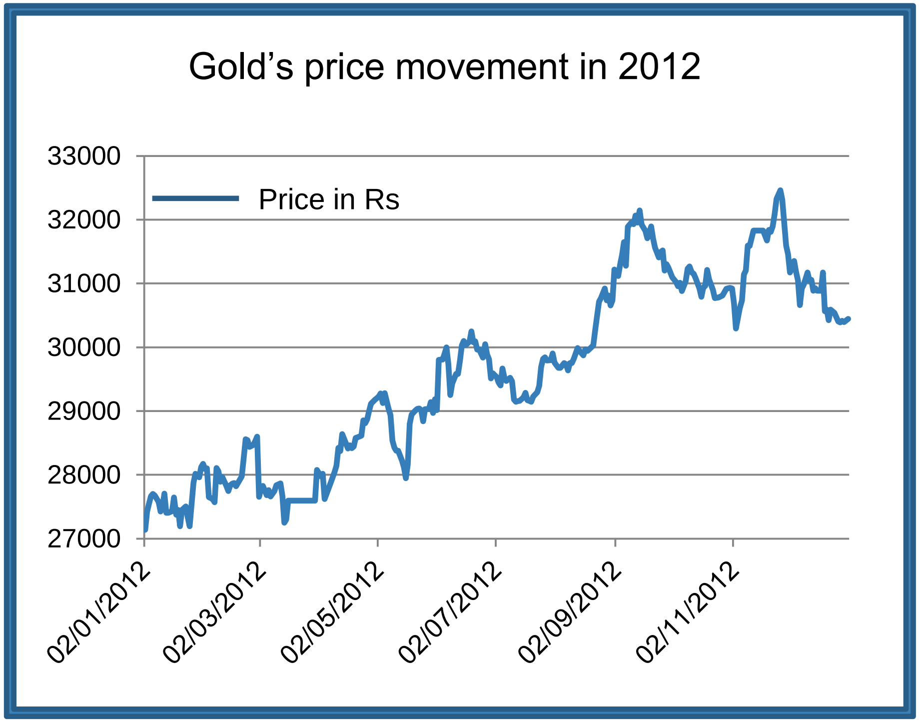
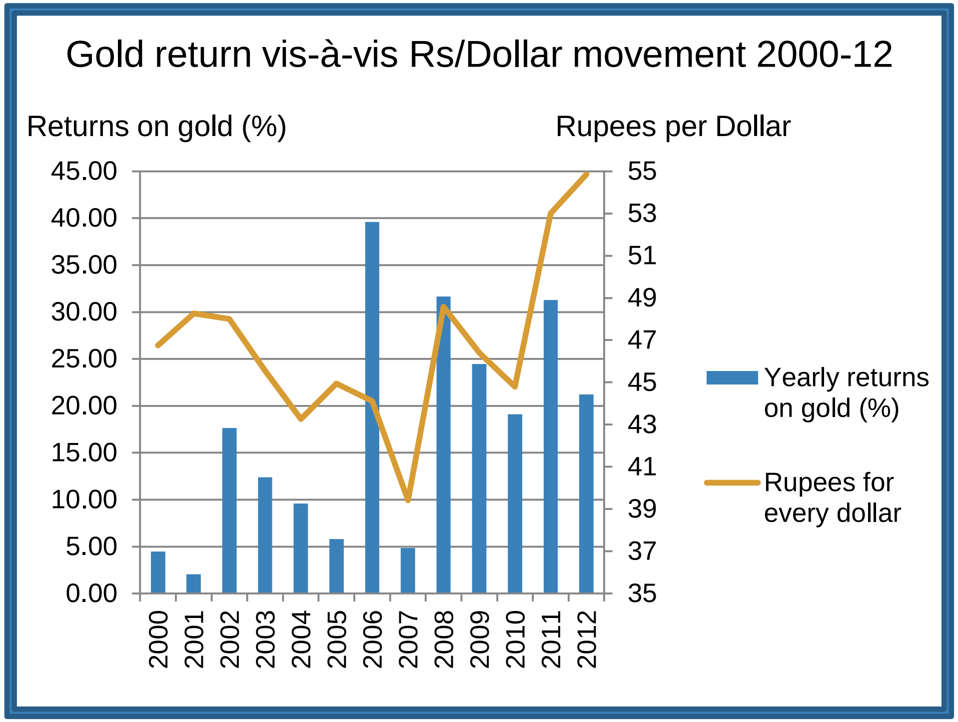
7. Gold as an asset class

- In 2012 gold appreciated by 12.19%. Gold ETFs gave returns of nearly 11%. The bull run in gold has lasted a decade now.
- Indian culture promotes purchase of gold since it is considered auspicious. Equities' poor run and low real returns from fixed-income instruments also fuelled the demand for gold.
- So long as Western central banks continue with their loose monetary policy stance, gold is likely to keep appreciating. Beware of the time when these economies mend and rates are normalised there.
- Stick to an 8-10 per cent allocation to gold. Sell when its value rises beyond that level in your portfolio and buy when it falls.

Citrus Advisors View : Expect gold rally to take a breather in 2013



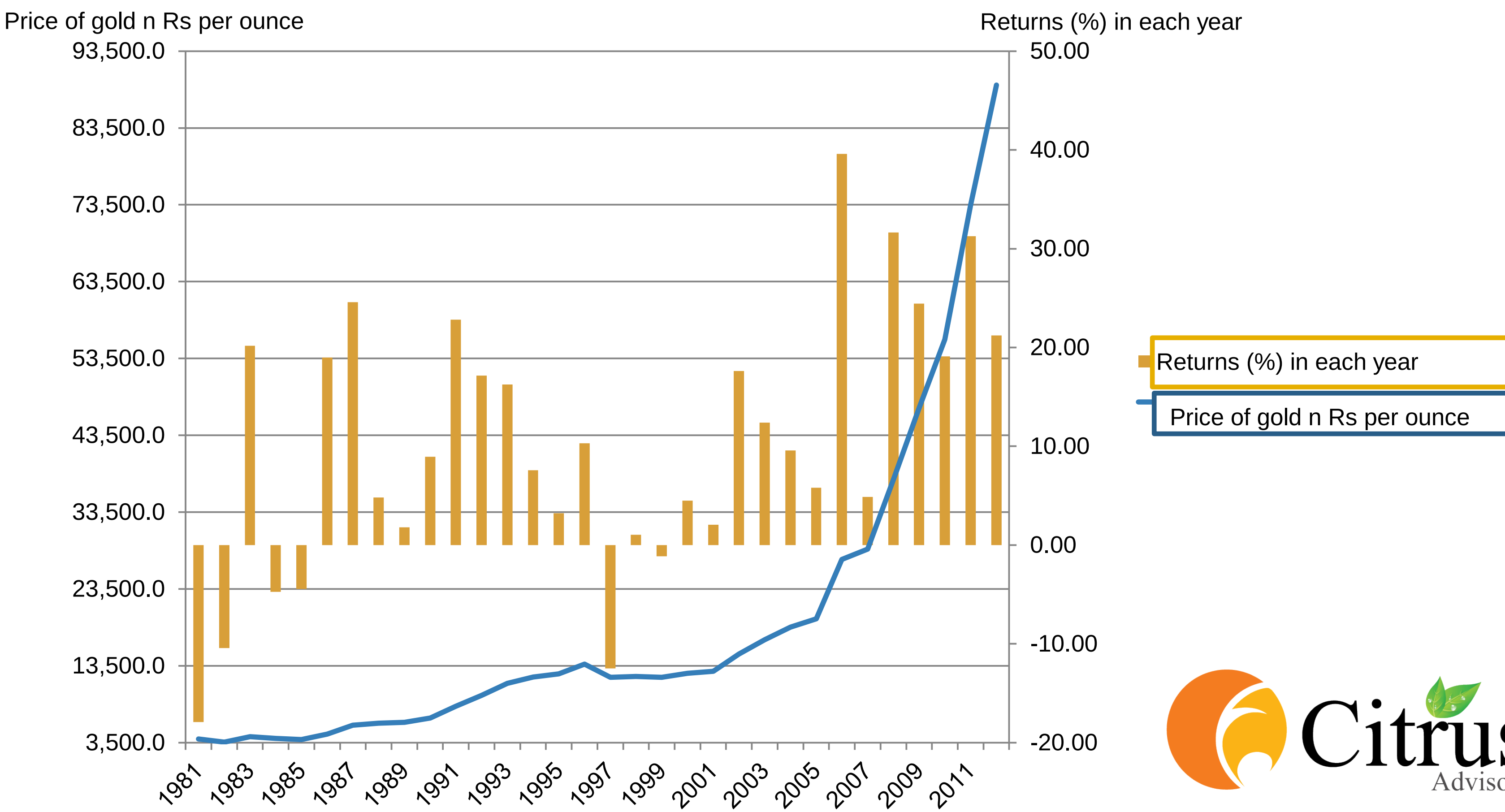
Source: MCX



Source: World Gold Council

Gold as an asset class (Cont.)

- Between 1981 to 1985, gold as a investment gave positive returns only in 1983.
- Then there was a bull run and it gave decent positive returns from 1986 to 1996.
  During this period the precious metal gave less than 5 per cent in 3 years and between 5-10 percent in two years.
- From 1996 to 2002, the performance of gold was dismal at best.
- Only since 2008 there has been a strong up movement.



8. Infrastructure

Project announced vs executed:

- Infrastructure sector facing serious issues due to slow clearance to projects and policy paralysis. No fixed time limit for granting clearances.
- In light of this problem and the CAG report on allocation of coal blocks, Union Cabinet cleared the proposal to set up a National Investment Board, later renamed Cabinet Committee on Investment.
- Will be chaired by Prime Minister and will comprise members from various ministries.
- Will fast-track approvals such as mining leases, mining plan, forest clearance, environmental management plan and land acquisition for accelerating commencement of mining. Projects of Rs. 1,000 crore and above will be taken up by this committee.

11th Plan – Target vs execution

	Original	Actual	Under- /Over-achievement (%age of target)
Telecommunications	258,439	345,134	34%
Roads and bridges	314,152	278,658	-11%
Irrigation (including watershed)	253,301	246,234	-3%
Railways (including Mass Rapid Transit System)	261,808	200,802	-23%
Water supply and sanitation	143,730	111,689	-22%
Ports (including inland)	87,995	40,647	-54%
Airports	30,968	36,138	17%
Storage	22,378	8,966	-60%
Oil & Gas	16,855	127,306	655%

Source: Mid-Term appraisal of Eleventh Five Year Plan

Infrastructure Spending

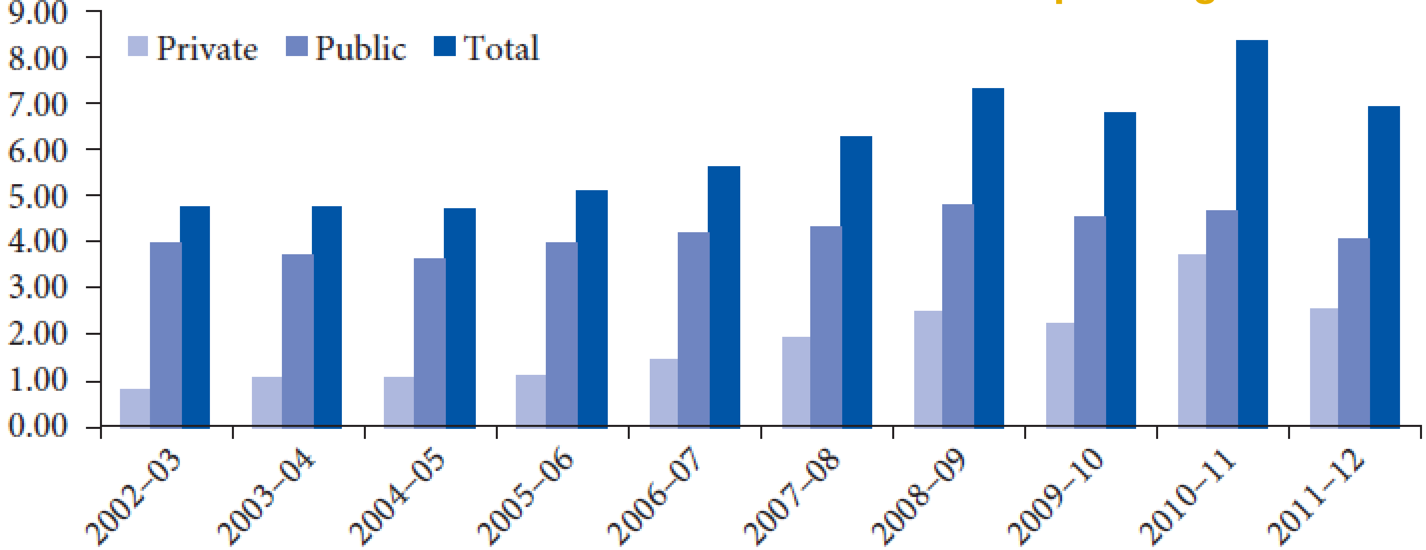


FIGURE 3.3: Investment in Infrastructure as a Per Cent of GDP

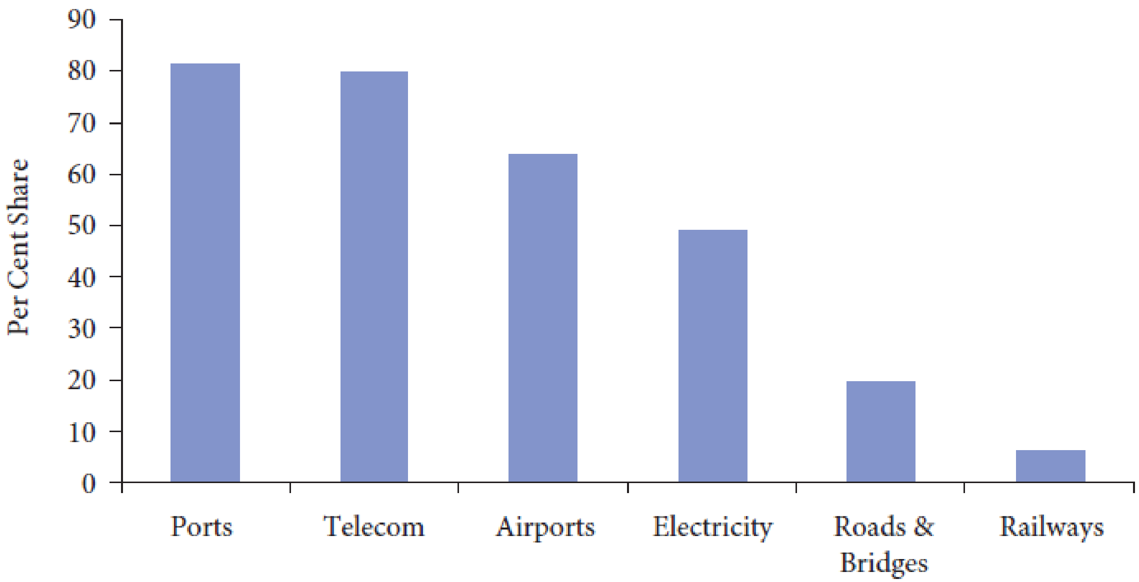
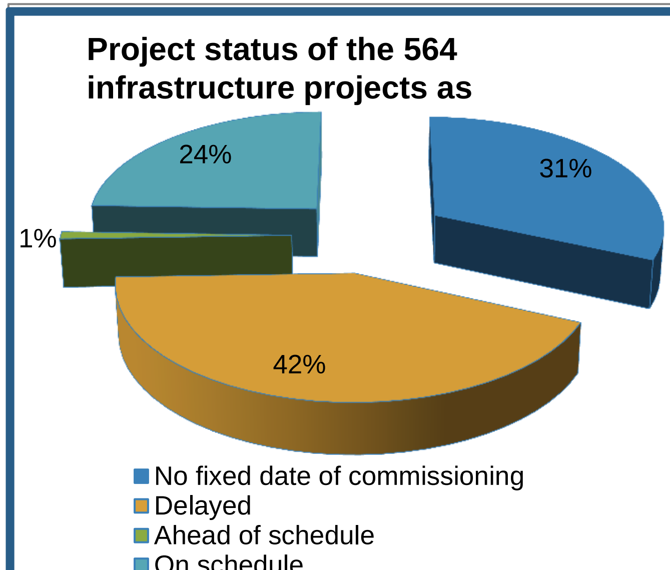


FIGURE 3.2: Private Sector Investment in Infrastructure (Per Cent Share)

Infrastructure data from draft document for 12th Plan



Ministry of Statistics and Programme Implementation

Telecom --

2012:

- In 2012 the Government of India conducted an auction between November 12 and 14 and consisted of 14 rounds. The government received bids worth Rs 9,407 crore, far lower than its target of Rs 28,000 crore from the sale of 2G spectrum in the GSM band.
- None of the bidders bid for a pan-India spectrum for which the reserve price was set at Rs 14,000 crore for 5 Mhz of airwaves.

2013:

- Government plans to conduct another sale of airwaves before March 2013 to find bidders for unsold spectrum. Media reports state that the government expects to raise approximately Rs 17,000 crore from this auction.

Conclusion

- 2013 will be an acid test if setting up of CCI actually expedites approvals and encourage investments.
- Given the shortfall of execution in key areas such as Roads, Railways, Ports etc, progress on implementation will be keenly watched.
- Only 1/3rd of projects are on schedule. Faster pace of execution will trigger optimism.

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9. Disinvestments / Primary markets

Disinvestment in companies:

- So far the government has gathered about Rs 6,900 crore.
- Government's disinvestment target for FY13 is Rs 30,000 crore.
- Issues lined up: Oil India (Jan), NTPC (Feb). Also plans to sell stakes in Rashtriya Ispat Nigam Ltd, Hindustan Aeronautics Ltd, Nalco, SAIL, MMTC, BHEL, Hindustan Copper, and Oil India.
- Plans to launch an exchange traded fund comprising PSU shares.

Primary Market

Primary markets to be vibrant:

- In 2012 nine IPOs came via NSE and 26 via BSE.
- The most awaited IPOs for 2012 were of MCX, Specialty Restaurants, CARE and Bharti Infratel.
- Two of these issues were the first from their respective industries: Bharti Infratel from telecom infrastructure and MCX from stock exchange.
- Much awaited IPOs in 2013: BSE. The oldest bourse in the country plans to list itself.
- Rally in the latter part of 2012 will make the primary market more vibrant in the coming year.
- Given the compulsions of bridging the fiscal gap, the Government may plan to list Indian Railways and LIC though partial disinvestment.

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10. Aadhaar

- Aadhaar is a 10-digit unique number which the Unique Identification Authority of India (UIDAI) will issue for all residents in India (on a voluntary basis).
- The number will be stored in a centralized database and linked to the basic demographics and biometric information – photograph, ten fingerprints and iris – of each individual.
- The objective of the UID is to enable the government to 'improver the delivery of services and effective governance to the population of the country'.

2013

- Aadhaar-based direct benefit transfer (DBT) scheme to deliver seven scholarships to 2 lakh beneficiaries across 20 districts in 16 states from January 1.
- DBT for 26 schemes to be launched in 11 districts from February 1, and in 12 more from March 1.
- Aadhaar-based DBT should be used for distributing food, fertiliser and kerosene subsidy. If this is not done, it will be a wasted opportunity.
- UPA II should try to achieve reduction in subsidy spending, and hence in fiscal deficit via Aadhaar-based DBT, instead of passing the onus on to the next government.

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Outlook for 2013

- 2013 will see local issues to create more optimism unlike 2012 where they compounded the complications linked to global issues
- The 1st quarter of CY13 may see absence of major negatives (US fiscal cliff, Euro crisis etc) and create the ground for global equity rally.
- Portfolio flows should be strong for most parts of the year – though there may be intermittent bouts of profit taking or ebb in flows
- Budget expectations will build up and if met will see a more enduring rally in India
- Progress on containing fiscal and current account deficits will decide the macro trend
- Pace of project award and implementation is expected to pick up and create a conducive environment for private sector investment to kick start
- Risk on environment is expected to resume in the latter half of 2013 with global growth coming back on track. This may provide the tail wind to Indian markets
- 2013 may see the equity markets reach a new high and the start of the next bull run.

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