

Global Financial Crisis

Is India Insulated?



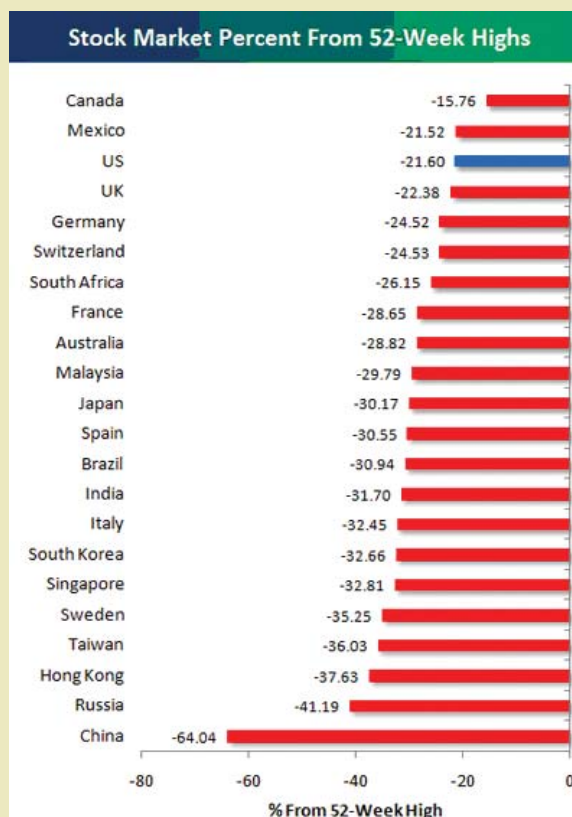
Introduction

1. The recent financial crisis impact on large investment banks in the US such as Lehman Brothers have had impact on global stock markets which came down by more than 3% in a single day.

It is not just US alone. Most prominent stock markets across the world have come off by more than 30% from their 52-week highs.

It's quite easy to write on the sub-prime mortgage issue in US which was the first to be known across wherein banks gave out funds to borrowers who do not qualify for a regular home loan. When times were good, huge growth was noticed in advances, largely coming from this bottom trench of the overall banking mortgage segment. This over lending, however, had no regulatory protection by way of adequately increased provisions. The working is clear on the fact that out of USD100 value of the property which itself was inflated to the extent anything between 5-10%, top-ups were given after some EMI's were honoured by the borrowers.

The triggering effect is that when the cost of goods rises higher than disposal income levels without



Source : World Stock Exchange

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a compromise on living standards, the cascading effect starts to build up in the event of one single stepslip. During this situation, credit cards borrowings buildup which was first seen in US. Hence, when the cost of goods rises, interest rate hike is only a matter of time. Hence, rising EMI's *diminishes* the affordability of consumers who then tend to look out for credit card borrowings to manage the same levels of living standards. However, once the threshold limits are by-passed, credit crunch starts affecting corporate world in terms of reduced demand. Once the demand for goods starts reducing, product prices come down which increases the pressure on margins and many companies file for bankruptcy. Hence, money gets sucked out of many markets to provide for the safe fall in their home countries. US investments in many countries were liquidated due to the current situation which had its impact on local stock prices.

Political situations coming up in US and India

2. US is very close to identify the right candidate as their president who would like to reduce the nervousness of investors. The existing Government had to bail out the largest insurance company AIG for US \$ 85bn by acquiring 80% of their assets. Failure of this bailout would have had political impact given that AIG insures US citizens.

So, while anticipation for stability in US is expected by next year, volatility would be witnessed in Indian stock markets next year due to upcoming Indian political elections. Majority at the Centre would bring stability to the stock markets.

Difference to exist between West - East

3. There is major gap between the West and the East in GDP growth rates. A slower growth between

2-3% in the West with lower interest rate exists while in the east, GDP growth rates are in excess of 6% with higher interest rates than the west.

The major differential factor lies in population growth which is much lower in the developed nations of the West while there are more number of mouths to be fed in the East which tilts them from negatives to positive.

No major leap is expected in the West which makes investors look out for growth stories in the East while at the same time, companies in the East look out for cheaper sourcing of funds available in the West. Many Indian companies with stronger balance sheets have been able to raise capital from the West at cheaper rates.

Indian economic situation

4. The recent growth story started only in 2003-04 with the Government's initiative to build roads and highways. The effect is rippling and seen on a compounded growth numbers over the last 4 years. It is clearly a path laid by the westerners and now followed by us. Laying of roads and highways leads to de-centralisation of population who would travel. Travel ensures growth for automobiles and all related ancillary companies. Affordable interest rates lead to growth in housing sector which in turn leads to growth in raw material supplier's sector such as steel and cement while at the same time, consumer durable sector picks up due to purchases.

One single decision in 2003 has led to approximately 25% growth on per annum basis up to 2008. This was the single largest factor in driving the Indian stock markets 2003 onwards.

Clearly, past 4 years growth of more than 25% p.a is not going to come back in the next 2 years. Indian companies cannot be singled out and feel

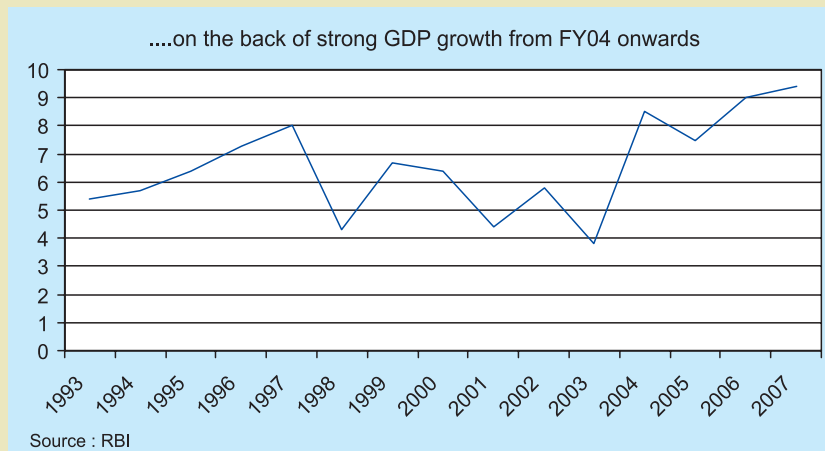
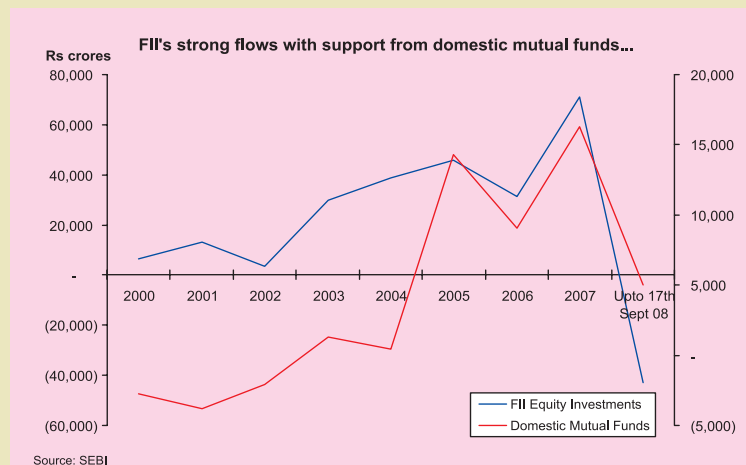


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In this article the author outlines the global impact of recent fallout of large US investment banks such as Lehman Bros, etc on Indian markets. He citing past experiences, hopes that with changing political scenario in the US, there would be a change in the investment climate. In this context, he has also explored opportunities for Indian investors in near future.

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Chart of FII/DFI - last 10 years*Chart of GDP growth - last 10 years -*

completely safe given the capital flows coming from West who are impacted now. However, given that our strengths are domestic demand which is the driving force, a moderate corporate earnings growth of 15% p.a. for the next 2 years for BSE-30 companies would stabilize the fluctuations coming from aberrated capital flows.

5. What to look out for?

- Upcoming US Presidential election. The new President would obviously want to make a difference to stabilize investors' sentiment. Consolidation would happen at big league I-Banks. Large banks with lots of cash would become even larger with lower cost.
- Upcoming Indian elections

- Interest rates cooling off in Jan 09. The emerging market interest rate direction has already been set-up by China by reducing interest rate by 25bps effective from September 17, 2008.

Expectations of a new bull market are not scary if one has to look beyond the shoulder. US economy generally starts to do well after political elections while domestically, cooling off of interest rates is going to be the single largest factor to look out for another set of good corporate earnings growth. Hence, companies with strong balance sheet and capable of raising funds would stand out in outperforming the sector and the main index.