India Markets Conference 2009

Be bullish!

Krish Shanbhag
+91 22 4031 3440
krish@antiquelimited.com

September 7, 2009 Strictly confidential

"ANTIQUE INDIA MARKETS CONFERENCE 2009"

Inaugural Session

Dr. K.C. Chakrabarty – Deputy Governor, RBI
Mr. K.V. Kamath – Chairman, ICICI Bank

Panel Discussion on: 'The Rise and Fall Of INR"

Mr. Rana Kapoor – *Managing Director & CEO, Yes Bank (Moderator)*
Mr. Nilesh Shah - *Dy. Managing Director & CIO, Prudential ICICI AMC*
Mr. Hitendra Dave – *Head Of Global Markets India, HSBC*
Mr. Arun Kaul – *ED, Central Bank Of India*
Mr. Sujit Prasad – *GM and Head, Derivatives and New Products Development, SEBI*

Panel Discussion on: "The Green Shoots Of Recovery"

Ms. Roopa Kudva – *Managing Director& Chief Executive Officer, CRISIL & Region Head Standard & Poor's, South Asia*
Mr. A Subba Rao – *Group CFO, GMR Group*
Mr. Rahulkumar N. Baldota - *ED, MSPL Limited*
Mr. Ajay Gupta – *Head, Asia Equity Trading, Bank Of America – Merrill Lynch*
Mr.Amit Jatia – *Joint Venture Partner And MD, McDonald's, India(South & West)*

"Global Economy"

Interactive session with **Dr. Alan Greenspan** – *Chairman, Federal Reserve System (1987-2006)*
Dr. Nachiket Mor – *President ICICI Foundation (Moderator)*

Key takeaways

- Economic growth will remain strong as India has structurally moved to a higher growth phase with services contributing over 60% to GDP. However, growth needs to be more inclusive.
- Rural economy has largely been un-affected by global liquidity crisis and this has helped India grow at high rates. Significant increase in minimum support prices and government stimulus through loan waiver and NREGS schemes have led to ballooning fiscal deficit. The government has correctly focused on maintaining growth rates, however, they would have to, in the medium-term, ensure that fiscal deficit is brought down to reasonable levels.
- Government borrowings will be lower in the next few quarters easing interest rates. However, interest rates are expected to harden in 1QCY10 on the back of higher inflation. The INR is expected to appreciate given increase in global risk appetite.
- Multiple signs of green shoots across sectors - definitely a fact of life in India. However, markets and producers are perhaps more confident than consumers.

Key views of Dr. Alan Greenspan - Chairman, Federal Reserve System (1987-2006)

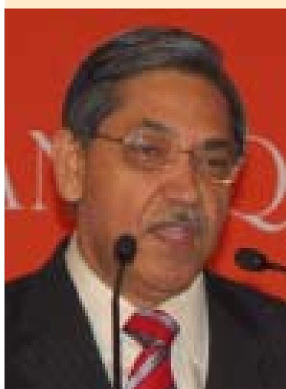
- The surge in economic growth post the cold war was so sharp that developing world did not have the infrastructure to spend due to high savings. Prices of real estate rose sharply and there were house price inflation in 20 countries. Major convergence in interest rates globally to single digit levels by the end of 2006 resulted in risk being significantly under priced. If it was not sub-prime, it would be something else.
- Bubbles can be curbed by monetary tightening. By raising the interest rates one can manage the bubble but that comes at a cost. Increasing interest rates is sometimes counter-productive. Bubbles are not easy to manage.
- This is a once in a century crisis and a rare phenomena and it happened because of structural change. The nature of risk management is such that there is no way you can provide adequate risk capital for all risks. Capital requirement at 10% is not sustainable and we need to have more capital.

View on India

- India escaped because of high regulations. If one is regulated heavily you can be insulated, but that is a policy issue not an economic issue. Heavy regulations come at a cost as you have to forgo the growth that is foregone. Open markets have benefited significantly by a high growth rates for a long periods but it also carries the risk that it breaks down occasionally.
- In order for India to improve its GDP growth and per capita income and narrow its gap with China, India needs to improve its farm productivity. Higher farm productivity in India will ensure that people move away from working in farms. India's success in technology should be used to reduce the differential in growth rates with China.

View on China

- China has successfully used the technology from the developed world along with low cost educated work force to create a mechanism for a strong export driven model. However, problems in China are not economic in nature but rather political. Its move towards market driven economy is likely to erode power of the state.



"Antique India Markets Conference 2009" was inaugurated by his Excellency Dr. K C Chakrabarty – Deputy Governor, RBI. Dr Chakrabarty in his keynote speech highlighted the spectacular transformation of India's economy over the last two decades due to structural reforms on multiple fronts. Further, he highlighted that despite increasing instability in political parties, regionalism and coalition politics, reform process is irreversible given stronger political will to boost growth. However, challenges and concerns on making this growth more inclusive and equitable continue to persist given that reallocation of surplus labor in agriculture to services has not yet happened. Key takeaways from his speech are highlighted below.

- **Unparalleled transformation in India economy.** Growth in India's economy has accelerated from a Hindu rate of growth of 3.5% till 1980 to an average 7.2% in the last decade resulting in substantial increase in per capital income. Further, the economy has shifted from agro-based economy to a more services based economy with contribution from manufacturing remaining steady.

- **Stronger political processes in India have been primarily responsible for sustaining India's economic progress.** The breakdown of Soviet Union and demise of Communism and rapid development of socialist market economy of China has changed the perception of most political leaders across developing countries including India on the likely development strategy to promote growth. Further, continuity of reform process in India has been driven by three important events:

  - Emergence of regional parties and their increasing importance at the national level
  - Coalition government at the centre
  - Increasing acceptance that rapid economic growth can only be achieved by market reforms

- Hence, while political parties in India continue to remain unstable and ruling parties continue to change, political processes in the country have been strengthened, leading to more sustainable and irreversible economic reform process.

- **Reforms in real sector have been complimented by those in the financial sector.** Transformation in the real economy has been driven by an enhanced role of private sector, abolishment of License Raj, overhauling of PSU sector coupled with increase in FDI especially in the services sector. Higher telecom penetration is one such classic example of success of de-regulation. Further, financial sector reforms have not only increased depth but also reduced volatility, transaction costs and ensured smooth functioning of money markets, capital markets, government bond and foreign exchange markets. Development of robust payment systems have ensured faster money transfer at lower intermediation costs.

- **Challenges on financial inclusion and equitable growth remain.** Benefits of rapid economic progress witnessed by the country have not really percolated down leading to increase in income equality. Despite the migration of the economy from agri based to more services driven, reallocation of surplus labour in agriculture to services has not taken place due to poor skill formation and lack of education. 30% of graduates and 30% of engineers are unemployed. Despite 65% of the population deriving its livelihood from agriculture sector, investment in the sector continues to remain extremely poor.

Mr. K.V. Kamath – Chairman, ICICI Bank

Mr. Kamath spoke on ***"Resilience of Indian Companies in the Global downturn & Path Forward".*** He started the speech by describing the crisis and the events which lead to the crisis. This was followed by the resurgence of rural India. He believes that rural India will be the foundation of future growth as the market is highly untapped. He spoke on corporate health, liquidity and fiscal deficit. Key takeaways from his speech are as follows:

Global crisis; Clean up in progress: He believes the world faced two crisis:

- MTM crisis which is a very big and complex issue and we are still not able to resolve as no one knows what you MTM and how you MTM.
- NPA crisis is a cyclical thing and financial intermediaries are used to tackle this crisis.

Events which lead to this crisis were:

- Financial crisis because of high leverage
- Commodity crash
- Deflation in property prices

He believes that lot of clean up has been done but the exercise is still in progress and some more clean up has to be done on personal credit, property side and this will be done in a structured manner over time.

Resurgence of rural India: Rural market has kept us afloat and going forward rural demand will prove to be anti cyclical: He is very optimistic and confident on the resurgence of rural India and said that it will provide the foundation for future growth, some of his arguments in favor of rural India are:

- Rural market has kept us afloat during difficult times
- Economic activity in rural India is not getting captured and it is a huge untapped market
- Rural India is not only agriculture as it is only 17% of GDP; but rural contributes 45-50% of GDP
- Domestic demand lead by rural India has helped corporates to sustain operations
- Rural India will be the foundation on which we will grow
- Fruits of liberalization has not reached everyone so that needs to be looked upon as an opportunity for growth areas

Corporate India*: *Intentions turning into actual investments: Corporate India is returning back to normalcy as most of the projects which were in planning stage got shelved after September 2008 are now back on track, though, export led industries like textile and gems and auto ancillary are still facing challenges. Investment related demand will show the impact with a lag as they typically take 3 to 5 years to materalise but the consumers demand is coming back.

He also highlighted the fact that commodity prices have gone down 50% which has lead to reduction in working capital requirements, and financing cost for working capital funding has gone down so if the demand comes back to earlier level and margins are sustained corporate India will be much more competitive.

Liquidity position comfortable and will help keeping interest rates at manageable levels: Liquidity situation is good and is sufficient enough to provide sustenance to our corporate and consumers for their demand. As growth rate picks up so will savings grow and that too on a higher base which will provide the much needed liquidity. Liquidity to keep interest rates at manageable levels will help economy to grow at much faster pace.

Fiscal deficit not a matter of concern as government still has resources: He is not worried about deficit because government still has ammunition as if the government goes for even selling 10% stake in PSU at would fetch more than USD30bn to government and secondly the idle cash lying with the PSU is in excesses of INR3tn from which government can garner dividend.

Panel Discussion on: ‘The Rise and Fall Of INR”

Mr. Rana Kapoor - Managing Director & CEO, YES Bank

Historically India had managed a floating exchange rate regime since 1993.

A lot of developments have taken since then:

- **Current Account Convertibility was introduced in 1995**
- **Introduction of futures examining the possibility of Capital account convertibility**

Foreign flows vaulted from USD101m in 1991 to USD63 bn in 2008 falling again to USD21 bn in 2009, thereby affecting exchange rates.

This impacted the monitory policy, the management of inflation and correspondingly, interest rates.

Currently, the need of the hour is to examine the impact of improving forex flows on the future of INR via-a-vis the USD and it’s impact on:

- **Capital account convertibility**
- **Stability of monetary policy**
- **Inflation management**

The previous instance of excess liquidity in the system resulted in RBI intervention in the form of hike in CRR, the fallout being increasing interest rates and rising inflation. Mr. Kapoor asked the panel to examine steps that need to be taken this time round in order to avoid a repetition of the events of FY08.

Mr. Arun Kaul- ED, Central bank of India

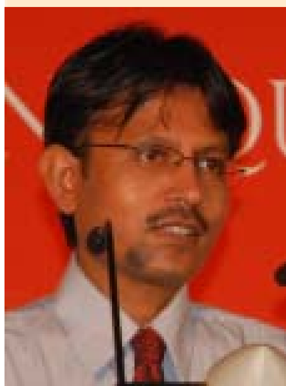
Demand and Supply issues in Forex and Money Markets

Mr. Kaul pointed out that 1993 – 94 saw a surge of GDR and FCCBs, which resulted in a large inflow of foreign exchange and the corresponding high liquidity led to a softening in government bond yields. This was followed by a second wave in 2003 wherein large forex inflows saw yields coming down. The 10 year yield came down to 4.5% in 2003 from ~9.5% in 2002.

The period 2003-06 witnessed most corporates raising foreign exchange funds through debt/ equity, thereby generating in excess liquidity and lower yields. Post the financial crisis, **starting 2007**, corporates found it difficult to raise funds outside India. This saw a jump in domestic credit growth by 35%. This drying up of foreign funds coupled with RBI’s monitory policy of liquidity tightening resulted in the yields going up. This led to a depreciation of the INR from 39.50 to 49.50 against the USD.

The ongoing stimulus by the government and RBI has led to an easing of the liquidity situation and volatility in yields but structurally the rates have not moved up. Banks have reduced deposit rates and have started lending at sub PLR rates

Indications are that inflation is going to move up, but with the liquidity again on the rise and sluggish credit offtake, bankers see interest rates softening in the coming quarter. If the inflation picks up on account rising commodity prices and low base effect, the RBI will find it difficult to keep interest rates low, thus leading to a hardening of interest rates post the coming quarter.



Mr. Nilesh Shah - Dy. Managing Director & CIO, Prudential ICICI AMC

Impact of Interest Rates and Currency on equity markets

Mr. Shah pointed out that the rise in India's fiscal deficit of India outpaced the growth in the GDP. He questioned the sustainability of debt growing at a faster pace than GDP.

One of the reasons of deficit going up is the huge growth in the government spending in the welfare schemes including the NREGS program (which has grown 3 times over the last 3 years) and the continuous rise in the MSP of various crops. This is a trend and hints at a structural nature of our fiscal deficit. The government has been paying the price of the same.

The major rise in the Indian stock market that was witnessed in the last bull run was predominantly on account of a re-rating of markets by virtue of a decrease in the fiscal deficit of India which lead to higher PE valuations for Indian stocks. The lower fiscal deficits lead to an increase in India's brand appeal. The current rise in the fiscal deficit can lead to a de-rating of Indian equities. Thus deficit needs to be controlled.

Another important component has been the deficit has become cyclical in last 2 years by virtue of the RBI support to fund government borrowing program, this is one important factor to be watched in the FY 11. If this goes up from the current estimates of 25% for FY10 then the interest rates will move up, rupee will depreciate and valuations will remain suppressed, however, if it decreases then it spells good news with lower interest rates, stronger rupee and higher valuations.

Current valuations of bonds have already priced in a rate hike, if RBI comes out with a communication that rate hike may not be required then the interest rates can soften.

Sometimes rate spikes happen for purely technical reasons like bunching of government's borrowing program, which can be better managed by the government but too much should not be read into it.

In his closing remarks he mentioned that in the near term he expects the interest rates to soften and INR to appreciate.

Mr. Hitendra Dave - Head Of Global Markets India, HSBC

He highlighted that Indian equity and commodity markets are linked to global equity markets however the total stake of international participants in the debt markets is very negligible hence in reality the debt market prices or yields are determined by the domestic players. Commenting on INR and government bond yields he mentioned that it is difficult to take out any theme and data points are currently mixed. The main determinant of USD/INR rates are the Current account surplus and balance of payments.

He believes that the INR will track the foreign inflows in domestic markets and flows as of now tend to suggest a bias to appreciate. He mentioned that in FY08 there were large inflows from FIIs

and lots of corporate sold their FY09 exports in the forward markets. However, this year there is complete change in this. He highlighted that with the last year volatility in foreign exchange markets and fear of MTM losses reported by the corporate, they are no more taking the forward looking view. From the quarterly results of large exporters, it is clear that export hedges by large exporters have come down significantly.

On interest rates he agrees with the panel's view that yields may soften in the near term.

Taking a cue from the past he highlighted that banks saw lot of liquidity in FY05 and slower credit off take, banks deployed that excess liquidity in bonds and when prices crashed for bonds, there were massive MTM losses for banks. This time around despite very high liquidity in the markets, the banks are parking funds below there cost of funds largely because of this fear. He highlighted that the key determinant would be credit off take in next 3-4 months, if it doesn't pick interest rates are going to soften.

Mr. Sujit Prasad - GM and Head, Derivatives and New Products Development, SEBI

He mentioned that USD/ INR futures have been launched less than a year ago. The volumes in the USD/INR futures are at 30% of the daily volumes of OTC markets. It shows that people are graduating from OTC to futures markets. In addition, an important aspect is bid-offer spread which also shows that on an average 70-75% of the trades on the exchange are happening at INR0.005 spread which is very healthy. On the other hand 14-15% trades in OTC market happen at that price. The third parameter is with regard to the volatility. However the daily volatility in USD/INR is at 0.6-0.7% in last one year.

On the aspects of further development he highlighted that the SEBI, in consultation with RBI, would launch the options in USD/INR, and futures on other currencies like Euro and Yen. He mentioned that interest rate futures have already been launched 10-year notional coupon bonds with plain vanilla futures with lot of optionality features. He mentioned that it's not really a product to play on yield curve. However, in consultation with RBI, SEBI would be launching couple of products in short term interest rates side like futures on short term interest rates or call money market futures.

This was followed by the Q&A session.

The Q& A session was focused on the direction of the INR and the interest rates in the near term since the present need of the Indian economy is liquidity and low interest rates.

The consensus opinion of the panel was that the chances of INR appreciation in the near term were bright on account of the following:

1. India's balance of payments has a surplus at present.
2. Furthermore, the oil prices seem to be capped at the present levels of USD75/bbl.
3. The invisibles sector has picked up strongly on account of the overseas banks providing credit at very low rates and strong net remittances.

However, the same would be punctuated by the RBI's efforts to build national forex reserves, while balancing out the needs of the exporting industries like textiles, gems and jewellery, etc.

The broad opinion of the panel was inclined towards the INR being in the band of 47-49 v/s the USD with bias towards appreciation.

Interest Rates

The government is currently borrowing ~INR500bn/month, which is expected to slow down from the next month onwards to ~INR240bn/month. Additionally, banks today have surplus liquidity of ~INR3000bn, with very sluggish demand in credit growth at 14.8% in FY10 (v/s 24.8% in FY09).Therefore, a softening of the yield curve is expected in short term but interest rates are expected to strengthen as the inflationary pressures build up in 1QCY10.

Panel Discussion on: “The Green Shoots Of Recovery”

Ms. Roopa Kudva – Managing Director & Chief Executive Officer,CRISIL Group & Region Head, Standard & Poor’s, South Asia

Ms. Roopa Kudva summarized the current scenario faced by the Indian economy by stating that while extreme pressures are behind us and green shoots are visible, some key risks remain and it is too early to conclude that recovery in demand is sustainable.

Green shoots are visible in the form of:

- **Uptick in industrial activity –** after moving into negative territory in October last year, IIP has picked up to 7.8% in June this year.
- **Growth in infrastructure spending –** Infrastructure spending is expected to increase largely driven by spending on roads, power and telecommunications. Higher spending on infrastructure is also resulting in increased demand for cement and steel in India.
- **Moderation in credit spreads –** Spread of AAA paper to 10-yr G-Sec has declined from 4% in Oct 2008 to 1.4% currently indicating that the period of extreme credit stress has declined.
- **Increased access to funding –**. Appetite for risk is coming back and access to overseas funds is increasing. ECBs worth USD2bn were raised in each month in Jun and Jul 2009 which is equal to the average monthly amount raised in the first 9 months of 2008.
- **Better profitability –** Net profit margin of 403 companies out of the S&P CNX 500 has improved since Dec 2008 helped by lower commodity prices and lower interest rates.
- **Increase in upgrades** - Crisil upgraded 13 companies YTD in FY10 against only 2 in FY09.

While domestic consumption related sectors have seen a pick up in demand (especially automobiles), it is too early to conclude that growth is not patchy and that demand has recovered on a sustainable basis.

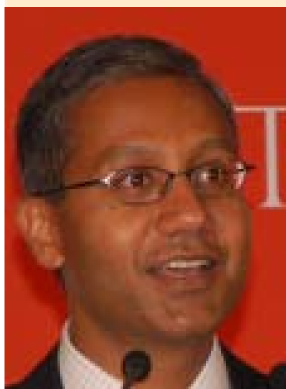
While there are visible signs of recovery, risks remain:

- **Poor monsoons** - resulting in high food prices and consumer price inflation. Poor monsoons (75% of normal levels till 26 Aug) pose a higher risk to inflation than to GDP growth.
- **Concerns on export demand** - The slowdown in exports is underscored by the fact that growth in IT exports is estimated to have reduced to 12% in FY09 from 38% in FY05 and textile exports are estimated to decline 7.1% in the current fiscal compared to 9.6% in FY06.

Factoring in these risks, Crisil has recently reduced its GDP forecast for FY10 to 5.7-6.2% Vs. 6.7% in FY09.

Pressures have abated and with this Crisil expects to see more upgrades this year than last year. That said, on an overall basis, downgrades this year will be significantly more than the number of upgrades. Further defaults are also expected to be high. So far 26 companies have defaulted in the current fiscal compared to 12 last year.

Key factors that Crisil will be watching out for going forward include domestic and export demand, availability and cost of money and exchange rate.



Mr. Ajay Gupta – Head, Asia Equity Trading, Bank Of America – Merrill Lynch

Ajay Gupta graphically presented the data points comparing 2008 market crash and recovery with 2001 technology burst and recovery cycle. He painted a global trading view considering the impact of global economic data on the markets and the subsequent shift in the asset allocation policy.

Data supporting the green shoots

Chicago purchasing manager has risen to 50, the equilibrium point, rising through the shambles of the 2008 market crash.

ISM factory index was at 53 compared to 55 post technology bubble extrapolating to 6% US GDP growth in 3QCY09.

Concerns

US consumer index is still at low 60's compared to 80 during tech burst due to high unemployment level (@9.7%), housing prices are barely stabilizing even after significant stimulus showing mild recovery and urban consumer price index is at -2.2% YoY, not seen even during tech bubble burst but consumer economy is still not picking up though India is insulated.

Indian and Chinese economies

Chinese exports and imports are down 23% and 15% YoY respectively; implying Chinese growth is driven by high end domestic consumption supported by fiscal stimulus. India's 6.1% GDP growth is phenomenal in global comparison, particularly with lower fiscal stimulus. The phenomenon points to the better Indian consumption demand compared to the state controlled and funded Chinese economy.

Impact on market

US and Chinese markets have responded to the recovery with significant bounce from the lows seen in 2008 and early 2009 compared to range bound Japanese markets in 1985-95.

The stock market recovery had been partially driven by central bank liquidity and has signs of inflating asset bubbles. The greatest concern going forward would be policy stance of the central banks and green shoots would be dependent on unwinding of Fed balance sheet of USD0.8tn, reversal of low interest rate regime to counter future asset bubble thereby tightening liquidity. Overall, the eastern consumer demand (India and China) has been much more resilient than western counter part and the asset allocation policies would see a shift towards products and geographies gaining by the above phenomenon.

Mr. Rahul Kumar Baldota – ED, MSPL

"If you don't grow it or hunt it, you have to mine it".

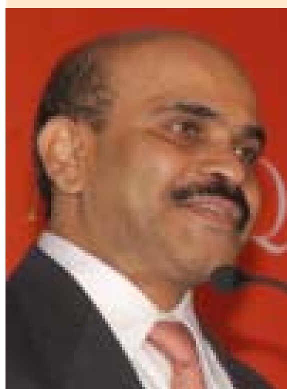
Metals and mining form a very important sector in the economic development of any country. Global economic slowdown is slowing down and encouraging economic data has started to flow in from developed economies. Developed economies dominated the world economic growth in the last century, however, post financial crisis the focus has clearly shifted to the developing economies especially China and India which has evolved as the next growth driver of global economy. China

posted a GDP growth of 6.1% in 1Q and 7.9% in 2Q and targets to achieve 10% GDP growth in 4Q. Similarly India recorded a 6.1% growth in 1Q and expects 6.5% growth in 2H. While developed economies are still reeling under the pressure of negative economic growth, China and India clearly lead the show with robust growth rates.

Commodities, especially metal have emerged first from the global financial crisis. This was primarily driven by the massive stimulus package announced by various central governments' which boosted demand. China once again led the show with its massive 4 trillion Yuan stimulus package which boosted demand for housing, automobile and consumer durables thus expanding consumption of metals. China is the largest producer and consumer of metals in the world. They dominate more than 50% of the global iron ore sea borne trade and produced more than 50% of the total global steel production in 1HCY09. End of destocking in developed economies and production cut by high cost producers have led to price stability globally however rising demand in China and re-stocking demand in some parts of the world has pushed up steel prices by 10-15% in the last few months

India today remains the bright spot in the global steel industry. Robust rural demand led by wealth creation at grass root level and revival of monsoon should provide an upward bias to the domestic steel prices. Most of the mines are located in rural India. Mining industry has played an important role in curbing migration of rural population to urban India and proving wealth creating opportunity at the grassroots level. The same has been supported by corporate social responsibility by various corporate in the areas of health, education and women empowerment. India has a long way to achieve global scale in terms of its metal production capacity. It is rich in natural resources which can sustain its production capacity for years to come. Rich mineral reserves, low production cost and huge demand potential make it one of the most attractive metal production and consumption destination in the world.

The world is under going rapid changes in the current environment. Capacity glut in global metal industry remains a key near term risk however combination of strong Chinese demand, end of inventory destocking, production cutbacks and credit constraints for new projects will play an important role in price recovery in the quarters ahead.



Mr. A Subba Rao – Group CFO, GMR Group

There are green shoots in the infrastructure sector but at the same time Mr. Subba Rao expressed his concern that the need of the hour is to be cautious than being very bullish.

Typically as the infrastructure projects are of long gestation with high funding requirement especially from the debt side, lack of liquidity has been the key factor impacting the completion of the project or pick up in case of new assignments. Hence there were only few projects for bidding while some projects were even abandoned.

The impact of the financial crisis was more pronounced in the global context. While an estimated USD110bn projects under PPP was delayed, additional USD 70bn projects are at risk.

The recent fiscal incentives given by the government can in the near term lead to high inflation and hardening of the interest rates.

More recently the risk aversion seems to have come back and banks have started funding a large number of projects which was missing in the last 6 months.

He emphasized that the key sectors which would see huge investment included roads, power and airports.

- In the road sector NHAI has restructured 48 projects and plan to award project worth INR750bn in the current fiscal.
- In the shipping sector INR560bn is expected to be invested in the next 3-4 years.
- Airports sector would see investment of the order of USD110bn by 2020 as there is plan to modernize 35 non metro airports.
- Energy sector primarily power generation would see investment of USD150bn while the transmission sector has started seeing projects under BOT route.

Overall, Mr. Rao expressed his view that although the infrastructure sector has started seeing green shoots but going forward sustainability would be the key question and hence he was optimistically cautious.

Mr. Amit Jatia – Joint Venture Partner And MD, McDonald's, India (South & West)

Informal eating out industry well positioned to gauze the consumer confidence

The Informal eating out (IEO) industry in India stands at USD53bn (Hawkers to fine dining, excluding five star hotels). QSR (Quick service restaurants) a subset of the IEO stands at 18% of IEO in India. Quick service restaurants could be related to the fast food restaurants.

The informal eating out industry in India has during the last 7-8 years (2000-2007) grown at a strong pace with instances of eating out increasing from 3 times per month to 6 times per month in the urban markets.

McDonalds a part of the QSR industry has about 180 restaurants spread across 30 cities. It serves about 180-200m people per annum, which drops down to about 500,000 people per day. Therefore the impact of any slowdown in the economy could be witnessed on the off-take of McDonalds and the other constituents of the informal eating out industry.

The slowdown in the economy impacted IEO sales during 2008

During 2008, the IEO industry witnessed a drop of 25% with family visits dropping by 34% while teenage visits dropped by 29%. Yanks dropped by 13% during the period.

The QSR industry however due to its lower priced and better value offering was able to outperform the industry as a whole, by recording about 15% growth during the period. About 37% of the consumers from the IEO industry shifted to QSR thus aiding its out-performance over the industry as a whole.

McDonalds grew by 22% largely driven by Yanks (young adults no kids). However during the second half of 2008, McDonalds same growth slowed down to single digit growth rates.

However green shoots of recovery witnessed during 2009

During 2009, from the single digit same store sales growth from August 2008 McDonalds witnessed an improvement to strong double digit sames store growth from April 2009.

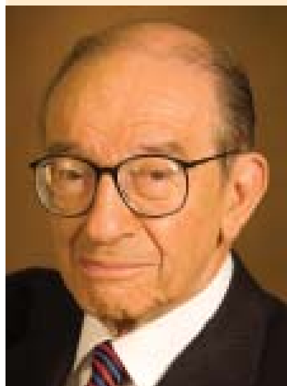
The improvement was witnessed both in the case of the tier 1 and tier 2 cities. Further the offtake of premium products also increased during the period.

During May– July 2009, average consumer visit increased to 1.9x from 1.35x in the corresponding period in the previous year.

The slowdown witnessed in the business from families also improved over the previous corresponding period.

Huge potential for growth in the long term

Eating out habit has a huge potential for growth in India as consumption levels in the IEO in India is very low as compared to global standards. Globally, for example in Bangkok and Jakarta, consumers eat out 42 times and 14 times a month respectively as compared to about 5-6 times a month in India in the urban markets. Further the Indian QSR industry too has a strong potential to grow with the global QSR industry at 40-60% of IEO as compared to 18% in India. Further the strong base of young consumers would also aid long term growth with 60% of population below 30 years of age.



Dr. Alan Greenspan - Chairman, Federal Reserve System (1987-2006)

Dr. Nachiket Mor

"Global Economy"

Interactive session with Dr. Alan Greenspan – Chairman, Federal Reserve System (1987-2006)

Dr. Nachiket Mor – President ICICI Foundation (Moderator)

The roots of current crisis?

- The roots of current global economic crisis popularly known as the subprime crisis or the credit crisis goes back to the end of cold war when there was major shift in economic policy from Central Eastern Europe & Russia towards competitive market economies. This shift lead to millions of people migrating from these countries from central planned growth to competitive market dynamics resulting in a remarkable surge in economic growth.
- The surge was so sharp and the developing world did not have the infrastructure to spend due to high savings in developing world. As a result prices of real estate rose sharply and there was house price inflation in 20 countries. We saw a major global convergence in interest rates which lead to single digit interest rates and inflation by the end of 2006 as a result risk became significantly under priced and risk seemed negligible.
- 2004-05 saw the beginning of a massive securitization of the small market of sub-prime securities but the demand was very high as these securities yielded very high return. The mismatch in demand supply of these securities led to investors putting pressure on underwriters which in turn led to deterioration in the quality of these securities. In addition, half of the Collateral debt obligations were sold abroad and in Aug 2007 a triple A rated fund of BNP Paribas collapsed and was followed by the chain of events.
- Frankly, if it was not sub-prime, it would be something else.

Can bubbles be ever managed?

- Bubbles can be curbed by monetary tightening by raising the interest rates you can manage the bubble but that comes at a cost of growth. Monetary tightening can deflate the asset bubble but it is a mistake to believe that you can regulate the bubble. In 2003 stock prices were euphoric but the tightening lead the stock market to go down but they were actually testing the strength of the economy. Increasing interest rates is sometimes counter-productive. Bubbles are not easy to manage.

What lies ahead? How do we see this particular crisis and what is the endgame?

- This is a once in a century crisis and is a rare phenomena and it happened because of structural change. The nature of risk management is such that there is no way you can provide adequate risk capital. Capital requirement has to be raised and adequate buffer in 1840 to be a commercial bank you needed 50% capital and throughout 19th century and early 20th century, capital requirement were at 20% and now it is at 10% which is not sustainable and we need to have buffer capital.

Does TARP address the problem? Can the economy survive if we take the respirator away?

- TARP was successful as it brought us from extreme risk of insolvency to lesser problems. TARP brought down LIBOR spreads from alarming level. The global stock markets were depressed by USD35tn loss in equities.

- The combination of sharply lower debt and equity saw a point where system could not function but there is a limit to how far it can go and after sometimes it adjusts naturally. As the market adjusted we saw sharp rise in stock prices which lead to stock valuations rise by USD15tn in global equities. Market value of equities has risen so significantly that it opened the corporate debt market in the US. The highest returns were seen in long dated low credit rated paper as equity valuations of these companies also rose sharply. Surge in stock prices coupled with fiscal stimulus has proved to be an extraordinary stimulus for the economy

Is there is a case for introduction of Glass-Steagall Act? How much capital is required for financial intermediaries?

- In 1930 banks were segregated from securities companies as those banks which were in securities business created the problems. In 1980' banks also started issuing the securities and the act evaporated itself. Glass Steagall act alone cannot solve the problem we need to have buffer capital for financial intermediaries as there is no substitute for capital.

India felt the tremors of all crisis but escaped on a relative basis?

- India escaped because of high regulations. If one is regulated heavily you can be insulated, but that is a policy issue not an economic issue. Heavy regulations come at a cost as you have to forgo the growth that is foregone. Open markets have benefited significantly by a high growth rates for a long periods but it also carries the risk that it breaks down occasionally.

Is the global economy out of recession? What is the global economic outlook in the near term?

- Dr. Greenspan believes that the world has come out of recession faster than expected. Further, three countries China, India and Australia have come out relatively unscathed from the global meltdown. The US economy is likely to show positive GDP growth in 3Q CY09. The biggest gains for the US economy have come from rapid inventory liquidation as a consequence of global meltdown. Current output in the US is 1% below actual consumption. Hence as the rate of inventory liquidation slows, we are likely to see a positive impact on GDP growth.
- The extent of recovery in US economy is likely to be driven by the stability in housing prices and peaking of foreclosures. Potential unrecognized losses in the housing market are likely to be tune of ~USD 500 bn based on the assumption that housing prices are likely to decline further. However, with the initial signs of current stability in housing prices, losses are likely to be lower than expected.
- Post the gains from inventory liquidation; key thing to watch out for is the actual underlying demand. Historically recovery in US economy has been driven by the housing and auto sector. However this time around these two sectors have been laggards.

What is the outlook on oil and metal in the short term and long term?

- Dr. Greenspan believes that while alternative sources of energy have made some minor dents to oil usage as a fuel, oil continues to remain preferred fuel for consumption. There is a high co-relation between surges in oil and GDP growth. On the demand side, oil per unit of GDP is gradually reducing due to structural changes in GDP from energy and commodity intensive sectors to a more conceptual sector. However, while there have several sources of undiscovered oil in the world leading to huge potential for supply, funding for exploration continues to remain a huge challenge. Further paper trading in oil is inducing consumers and producers of oil to

push oil prices higher than they should be as new investors are holding on to physical form. However, prices could correct if these investors decide to liquidate their holdings.

- On metals, demand in China is likely to be key determinant of prices. Till about 5- 6 years ago metals as a % of GDP had been declining but that has changed post rapid surge in demand in China. Further strong relationship between copper and aluminum has broken down due to huge demand in commodities from China.

Is China's growth sustainable or a giant bubble?

- China has successfully used the technology from the developed world along with low cost educated work force to create a mechanism for a strong export driven model. However, problems in China are not economic in nature but rather are political. Rampant capitalism resulting in a market driven economy is likely erode power of state.

What should be India do narrow gap with China ?

- In order for India to improve its GDP growth and per capita income and narrow its gap with China, India needs to improve its farm productivity. China has significantly improved its farm productivity through the agriculture revolution in the early 1980's.Higher farm productivity in India will ensure that people move from working in farms to urban areas and special economic zones.

- The US has about one and half million Indian's as residents who have contributed remarkably to the economic development in the US. India's success in technology should be used to reduce the differential in growth rates with China.

Equity Sales		
Mr. Anish Jhaveri	91-22-4031-3330	anish@antiquelimited.com
Mr. Dharmesh Dalal	91-22-4031-3331	dharmesh@antiquelimited.com
Mr. Manish Shah	91-22-4031-3332	manish@antiquelimited.com
Mr. Shiv Diwan	91-22-4031-3346	shiv.diwan@antiquelimited.com
Mr. Viraaj Teckchandani	91-22-4031-3327	viraaj@antiquelimited.com
Mr. Pradip Seth	91-22-4031-3393	pradip.seth@antiquelimited.com
Mr. Chaitanya Kotadia	91-22-4031-3336	chaitanya@antiquelimited.com
Mr. Anuj Sonpal	91-22-4031-3326	anuj@antiquelimited.com
Derivative Sales		
Mr. Ashish Maheshwari	91-22-4031-3350	ashish.maheshwari@antiquelimited.com
Mr. Jatin Dedhia	91-22-4031-3344	jatin@antiquelimited.com
Mr. Gaurav Kedia	91-22-4031-3349	gaurav.kedia@antiquelimited.com
Research		
Mr. Krish Shanbhag	91-22-4031-3440	krish@antiquelimited.com
Mr. Sandeep Shenoy	91-22-4031-3436	sandeep.shenoy@antiquelimited.com
Mr. Ashish Nigam	91-22-4031-3443	ashish.nigam@antiquelimited.com
Mr. Abhijeet Kundu	91-22-4031-3430	abhijeet@antiquelimited.com
Mr. Abhineet Anand	91-22-4031-3441	abhineet@antiquelimited.com
Mr. Amit Rustagi	91-22-4031-3434	amitr@antiquelimited.com
Mr. Alok Kapadia	91-22-4031-3442	alok.kapadia@antiquelimited.com
Mr. Amol Rao	91-22-4031-3435	amol.rao@antiquelimited.com
Ms.Karishma Solanki	91-22-4031-3446	karishma.solanki@antiquelimited.com
Mr. Mohit Gulati	91-22-4031-3429	mohit.gulati@antiquelimited.com
Mr. Miten Vora	91-22-4031-3447	miten.vora@antiquelimited.com
Mr. Nitin Johar	91-22-4031-3432	nitin.johar@antiquelimited.com
Mr. Nirav Shah	91-22-4031-3473	nirav.shah@antiquelimited.com
Mr.Rajesh Zawar	91-22-4031-3450	rajesh.zawar@antiquelimited.com
Mr. Sumeet Singhania	91-22-4031-3431	sumeet@antiquelimited.com
Mr. Sunesh Khanna	91-22-4031-3234	sunesh.khanna@antiquelimited.com

Important Disclaimer:

This report is prepared and published on behalf of the research team of Antique Stock Broking Limited (ASBL). This is intended for private circulation and should not be taken as recommendation to trade in the securities mentioned.We have exercised due diligence in checking the correctness and authenticity of the information contained herein,so far as it relates to current and historical information, but do not guarantee its accuracy or completeness. Theopinions expressed are our current opinions as of the date appearing in the material and may be subject to changefrom time to time without notice. ASBL or any persons connected with it do not accept any liability arising from theuse of this document. The recipients of this material should rely on their own judgment and take their own professionaladvice before acting on this information. ASBL or any of its connected persons including its directors orsubsidiaries or associates or employees shall not be in any way responsible for any loss or damage that may arise toany person from any inadvertent error in the information contained, views and opinions expressed in this publication.ASBL and/or its affiliate companies may deal in the securities mentioned herein as a broker or for any othertransaction as a Market Maker, Investment Advisor, etc. to the issuer company or its connected persons.

Antique Stock Broking Limited

Nirmal, 2nd Floor, Nariman Point, Mumbai 400 021.

Tel. : +91 22 4031 3444 • Fax : +91 22 4031 3445

www.antiquelimited.com