The government once again uses state-run banks as tools to push its social agenda

Banks told to lend more to minority community borrowers. Target at 6% of total PSU bank loans

Banks will have to lend ₹1 lakh cr more to farmers. Total loans to touch ₹4.75 lakh cr

A new company will guarantee home loans taken by poor borrowers

RBI to sell stakes in Nabard, NHB to govt for ₹1,430 cr & ₹450 cr, respectively

Stocks to Trail Gold, Bonds

Stocks may take a further hit as spike in crude prices could trigger more sell-offs, warn fund managers

INVESTORS MAY HAVE to brace for more turbulence in the stock market next financial year, as unyielding inflation coupled with rising interest rates could slow economic growth and spark corporate earnings downgrades. While volatile stock market conditions would give value-hunters an opportunity to identify winners for the next three years, investments in short-term bonds and gold would help investors beat the possible gloom in the stock market this year.

"Equities look vulnerable from a one-year perspective, but investors should take advantage of this to buy quality stocks from a two or three year perspective," said Ashish Kehair, head, wealth management, ICICI Securities.

The benchmark Sensex closed 0.7% higher on Monday, before giving up on early gains as the Union Budget proposals for 2011-12 did not have enough steps to lift the sagging investor sentiment.

"There wasn't much in the Budget for us to change our view that there could be another 10-15% correction in the Sensex over the next three months," said Saurabh Mukherjea, equities head, Ambit Capital. "This correction will be driven by uncertainty on the political front, a growth scare in the fourth quarter of FY11 and compression of corporate profit margins in 2011-12 because high interest rates and input costs remain major concerns," he said.

The Sensex has fallen about 16% so far in 2011, led by foreign institutional investors selling equities worth ₹8,900 crore. Hopes of a rebound in the US economy, worries about a slowdown in India's economic and corporate earnings growth and corruption scandals involving ministers in the ruling coalition and top companies prompted foreign investors to pull money out of India after investing around $29 billion in 2010.

Fund managers and brokers warn the worst may not be over for Indian stocks as further spike in crude prices, in the event of more instances of political instability in oil-producing regions, could trigger more sell-offs.

Nandkumar Surti, chief investment officer at JP Morgan Asset Management India, said, equities would continue to be exposed to external challenges such as the US growth and rising oil prices. Crude oil prices hit a two-and-a-half-year high of $119.79 last week.

India, among other emerging markets, has been struggling to contain inflation, driven by higher food and commodity prices, forcing the Reserve Bank of India to raise policy rates seven times since March 2010. Finance minister Pranab Mukherjee said, in his Budget speech on Monday, inflation continues to remain a concern.

Ambit's Mukherjea recommends stocks of companies in consumer goods and durables, tobacco and paint sectors, which are less likely to be impacted by rising prices and would benefit from the government's rural spending. His least preferred stock picks are in media and entertainment, power generation and distribution and construction sectors. Wealth managers, including ICICI Securities' Kehair, advises investors to stay away from stocks or bonds of real estate companies. Firm interest rates and high prices may force property buyers to defer purchases that may impact companies' earnings.

Experts recommend locking money in short-term MF debt products

Investors should increase allocation to gold, but should not hope for great returns, Mr Kehair said. "It should be to hedge the portfolio against inflation," he said.

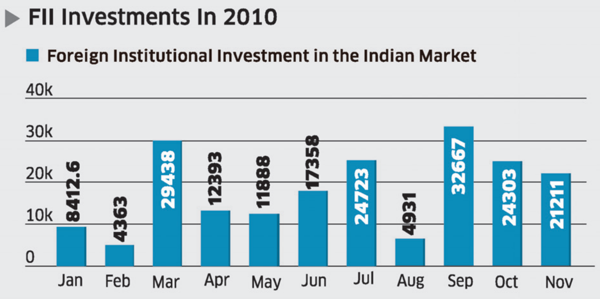
Most wealth and fund managers recommend locking money in short-term mutual fund debt products, such as fixed maturity plans, to benefit from higher interest rates. "Investors can park lumpsum money in fixed income schemes of shorter tenure and avoid long-term bonds. But, if oil prices fall, long-term bonds may appear attractive," Mr Surti said.

TEAM ET

OVERCOMING FISCAL CHALLENGE

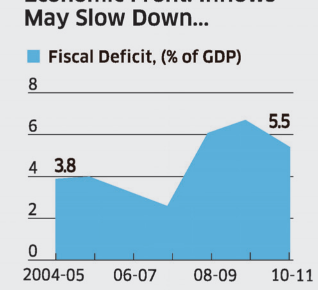
Foreign inflows took a toll in the latter part of 2010 due to scams & inflation. FM promised to cut fiscal deficit, but will he be able to deliver on it?

▶ FII Investments In 2010



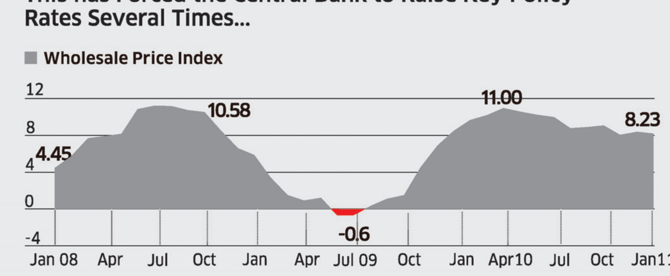
▶ On the Back of the India Growth Story & Rising Flows to Emerging Market Economies...

▶ However, There are Many Concerns on the Macro Economic Front. Inflows May Slow Down...

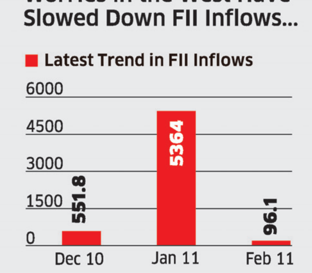


▶ The Rising Current Account Deficit is Being Financed by Short-term Inflows, Adding to Policy Makers Woes...

▶ High Inflation's Pinching the Pockets of the Common Man. This has Forced the Central Bank to Raise Key Policy Rates Several Times...



▶ Policy Paralysis, Recovery Worries in the West Have Slowed Down FII Inflows...



More Reforms Needed to Juice Up Markets

By Invite

RUCHIR SHARMA

HEAD, EMERGING MARKETS, MORGAN STANLEY

FOR A BUDGET THAT BEAT the rather low expectations of most analysts, the market's muted reaction indicates just how difficult Indian authorities' work will be in the coming year.

Investors were intensely focused on the government's finances before the Budget speech and to their surprise, finance minister Pranab Muhkerjee seemed to chart a path of fiscal responsibility by increasing total spending a mere 3.4% and projecting a 5% reduction in the government's borrowing programme.

But the financial markets were not impressed by the Budget arithmetic as they doubt whether the government can keep spending on such a tight leash and cut the subsidy bill by the promised 12%.

Doubts also prevail over whether the government will be able to meet its revenue targets, with the increase in tax receipts based on an economic growth assumption of 9% in fiscal year 2012.

An inadequately appreciated aspect of the country's growth resilience, following the global financial crisis, is that both fiscal and monetary stimulus played a major role.

The stimulus effects are now beginning to fade. In order for India to achieve its ambitious growth target, the private sector has to pick up the baton from the government.

The high investment ratio has been propped up by government spending of late, rather than a major pick-up in private sector capital outlays.

After many years of rapid growth over the past decade, aided in part by the boom across emerging markets, there is a sense of complacency that India is destined to grow at a trend rate of 8-9%, come what may.

Policymakers have had little incentive to carry out meaningful economic reform when growth seemed to chug along at 8%, as was the case for much of the past decade. But in recent months, cracks have begun to show up in the much-touted 'India story' with inflation surfacing as a major issue and the private sector showing more inclination to invest abroad than at home.

After many years of rapid growth, there is a sense of complacency that India is destined to grow at a trend rate of 8-9%

By not carrying on with its streak of populist announcements, the government did show greater sensitivity in its Budget to the changed economic environment where investors are more circumspect about India's growth profile.

But the less-than-remarkable reaction from the international community shows that a lot more economic reform must happen for the bid to come back into India's markets.

FM Goes Easy on Service Tax, Excise to Keep Up the Tempo

Expert Take

Nirmal Jain

Chairman, India Infoline

FOR THE PAST COUPLE OF months, markets and governance have been reeling under a negative sentiment. This Budget can prove to be a sentiment changer.

The biggest surprise is the finance minister's attempt to contain fiscal deficit at 4.6% in FY12. The bounty of 3G receipts in FY11, at ₹1.1 lakh crore, has been used astutely to help control next year's deficit. The current year's deficit, which most analysts were expecting to be at 4.7%, has jumped to 5.1%. This is due to the lower roll-over of subsidies and some advancement of expenses to this year. Further, he has bet on continued robust growth to drive tax revenues, the way it has been in the current year. Although the market sentiment for the past few weeks would make one feel nervous about the ₹40,000-crore disinvestment target, it could be easily surpassed if the sentiment changes.

The government borrowing programme, at ₹3.4 lakh crore, a good 15% lower than market expectations, will ensure private investment is not crowded out and growth momentum is sustained.

Despite experts sermonising him to compromise growth and contain deficit and inflation, the FM has refrained from increasing excise duty and service tax rates. This will help maintain the tempo of domestic consumption, which is the key to sustaining growth.

Allowing a sharp rise in FII investment limit in corporate bonds in the infrastructure space to $25 billion from $5 billion will not only spur investments in the sector, but will also have a cascading impact on other sectors.

Other measures like the reduction in excise by 7.5% on larger power plants will make local players more competitive.

While the finance minister has disappointed insurance and retail sectors by not allowing more FDI flow, there was a pleasant surprise in the form of direct FII investment in mutual funds. He has also moved forward on Goods & Service Tax and Direct Taxes Code.

Those who would not be happy with the Budget are SEZ players and iron ore exporters. Units in SEZs will be subject to MAT, which can impact tax liability.

Big Push

- **Attempts to** cut fiscal deficit to 4.6% in FY12
- **Rise in** FII investment limit in corp bonds in infra

STOCKS TO *WATCH OUT* FOR

ITC | MARUTI | MAHINDRA & MAHINDRA

A few sectors prepared for excise increase have been pleasantly surprised. For instance, cigarettes, diesel cars, etc, making investors in ITC, Maruti and M&M smile.

Growth's Back on the Agenda, and Markets are Happy, Relieved

Expert Take

Motilal Oswal

CMD, Motilal Oswal Financial Services

I HAD BEEN DREADING THE possibility of an aggressive rollback of the stimulus package, given last year's experience and other initiatives during the current year. But the finance minister has chosen not to do so, making Mr Market relieved and happy.

He has retained the standard rate of central excise duty at 10%. Even on the direct tax front, the FM has chosen to maintain a benign environment. The reduction of surcharge on domestic companies is a positive step. The exemption limit for individual tax payers has also been raised. The Budget is growth-oriented — the FM used the word 'growth' 21 times in his speech. He is aiming for 9% real GDP growth in FY12, with an ambitious gross tax revenue increase of 24.8%. But he seems confident of reining in fiscal deficit at 4.6%. The banking sector remains one of our favourites, especially given the reined-in fiscal deficit.

The government's focus on infrastructure and rural development is clear from the increased allocations. The enhancement of FII limit for investment in corporate bonds issued by infrastructure companies will boost flow of funds to the sector.

Inflation was a key theme of the speech, and understandably so. The recognition that there are shortcomings in distribution and marketing systems and the government's resolve to take corrective measures are key positives.

On the reforms front, DTC and GST now appear set for implementation. RBI has proposed amendments to the Banking Regulation Act and will issue the guidelines for licences during this fiscal. The FM has also left indirect taxes largely untouched, which is good for many sectors. While one might be tempted to say there is nothing new in the Budget, one did not expect much, to begin with.

(The author, through indirect investments, holds shares of SBI)

Fast Lane

- **Reduction of** surcharge on domestic companies
- **Focus on** infrastructure and rural development

STOCKS TO *WATCH OUT* FOR

SBI | ICICI BANK | L&T | BHEL

M&M and Bajaj Auto in the automotive segment, ITC in the consumer space, SBI and ICICI Bank in the banking segment, and L&T and Bhel in the infrastructure sector.