India Market Strategy ---Maintain OVERWEIGHT

Risks: growth revival is still not given; list of things to watch out for

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- Election results or positive policy announcements themselves will not automatically generate economic acceleration. Money must flow in to ensure an immediate pick-up in activities.
- We show that unless corporate India raises around US$10-15 bn through equity sales, most of the amount raised will simply go into de-leveraging activities and not into new investment projects.
- To make sure that the amount needed by the private sector from equity markets is available without undue pressure on secondary markets, a reasonably good dose of reform-oriented policy and stable global markets or risk appetite will remain essential.
- Additionally, the Union Budget must give equal importance to the issue of fiscal deficit, as it is likely to give to rural India, to ensure that rating agencies and investors do not suddenly take a fright.
- Monetary imbalances too are rising: prices in currency, interest rate, bond and property/equity markets, along with the money supply rise, are bound to make the RBI worried. However, for growth to be cemented, the first tightening should happen only after a few months.

Money still needs to come in

For the market to remain at the current levels or go further higher, the economy, investment activities and various asset markets must show accelerating growth trends. Despite all the optimism with the clean mandate for the new government and dip in the global risk aversion, this recovery is not given. It is perhaps appropriate to list the risks given where valuations have reached.

1) Equity issuance must exceed at least US$10-15 bn

In the last three weeks, Indian companies or their majority shareholders (promoters) have raised US$3 bn from investors globally and locally, either through the transfer of existing stock or by issuing new shares. Plans are being prepared for an amount at least four-five times high.

Figure 1: Money raised by corporate India from investor instruments

(US$ bn)	Follow-on	IPO	ECB	FCCB	Total
2002	-	0.2	-	-	0.2
2003	0.3	0.3	-	-	0.5
2004	3.2	2.7	0.1	-	6.0
2005	3.5	1.6	8.5	3.4	17.0
2006	5.8	4.7	17.2	6.0	33.6
2007	8.3	9.4	26.8	8.1	52.5
2008	1.8	4.8	21.2	1.5	29.3
2009	2.4	0.0	2.9	-	5.3

Source: RBI, Bloomberg, Credit Suisse estimates.

We strongly believe that as more equity funds are raised, Indian private sector's risk appetite would increase. Reduction of political risks and possibly better policies may not only induce corporates to undertake more projects, but also incite investors globally to invest much more money. All this said, while most institutional investor groups appear underinvested in India currently, there is no way to know for how long they can keep subscribing to new issues averaging US$1 bn-plus a week.

As Figure 1 shows, until corporate India raises US$10-15 bn in equities, it is mostly funding deterioration in gearing caused by little equity raising and lesser profits of 2008 that is likely to be addressed. We think that only if global and local investors show sufficient appetite to transfer over US$15 bn to private sector India, one might be able to claim that the additional funds would go on to spur the genuine economic activities rather than just for the purpose of de-leveraging.

2) Policy and global markets must hold optimism for months

For such a large amount of funding to transpire, and for more than 20-40 business groups to raise money, the market must remain reasonably positive for a considerable period. The role played by global markets is as critical as that of local policymakers. On the former, CS global strategists are generally sanguine. On the latter, the government must show some market-satisfying initiatives to sustain the positive mood.

If the upcoming Union Budget mostly focuses on non-private sector India, the risk of a sudden stop in investor flows could certainly rise. The government must enact at least one of the insurance, pension, oil price decontrol or similar reform to prove its medium-term intent.

3) Fiscal deficit must be at least solved on paper

We are sure of two things: as growth returns, "the bad economy problems" like weak industrial production and fiscal deficit will rapidly evaporate and be replaced by "the good economy problems" of inflation and current account deficit. Yet, to make sure that the rating agencies remain at bay in the near term, the Union Budget must show that the current high fiscal deficit is going to be much less next year.

We do not think this is possible without the government declaring new initiatives on disinvestment. Whether the disinvestment eventually happens or not may depend on the market, but it is almost imperative for the government to lay out a credible programme soon to make sure that rating agencies that are looking to downgrade many sovereigns around the world keep their focus away from India.

4) RBI patience critical despite monetary variable volatility

Appreciating currency, surging flows and impact on money supply, falling appetite to fund the government and rising monetisation are all monetary trends that the RBI must worry about at some point or the other. Given that the central bank's various objectives are contradictory within themselves (for example interest rate cuts versus reduction in money supply), it might be tempted to use unconventional measures too.

However, any premature action – even with the inflow of first US$10-20 bn of capital over the next two months – could jeopardise the entire growth story that is just entering a flow-driven virtuous cycle. The central bank's headaches on inflation front are almost bound to soar later in the year, more so because of the rising asset prices now, but the pre-emptive action from the stock investor viewpoint would perhaps be better once the growth momentum is sufficiently cemented.

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