Market Strategy 2013

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Beyond Mayan 2012: Soaked in $$$s; equities, growth to align

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House View: A year to remain stock specific!

After an appalling CY11 where Indian stock markets (falling 25%) were one of the worst performing the world over, Indian equities vaulted to a top of the league performance (up ~26% YTD) despite persistent anxiety over slowing growth, policy inaction, graft charges and other issues. While a global tsunami of liquidity guaranteed too much money chasing too little investment alternatives, the global growth scarcity ensured India's increasing share of world investment flows.

CY13 would see the world economies getting their act together to embark on the recovery path after major setbacks in 2012. Nevertheless, a revival in global growth will be painfully slow despite no apparent major debacle like those in last year. Threats of a eurozone break-up seem to be receding for now. US lawmakers are expected to work out a compromise to avoid fiscal cliff and negotiate growth concerns while signs of recovery in China have already refuted hard landing fears.

Liquidity is likely to remain the most favoured prescription globally for growth revival as it buys time for central banks to evolve a growth template. However, it also creates challenges by distorting the risk-return trade-off across asset classes (non-productive asset classes like gold are up 78%, riskier assets like equities (MSCI World Index) up 89%, crude up 163% while US treasury yields have trended downwards to 1.7% since QE1 in March 2009). A liquidity driven run up also poses challenges for commodity buyers like India (gold and oil forming ~57% of imports in FY12).

Even though India's GDP growth flattened to a decade low of 5.4% in H1FY13 and markets remained relatively expensive, the faster waning allure of other BRIC nations, in comparison, led to significant outperformance of Indian stock markets in CY12. Going ahead, liquidity would continue to act as a silver lining for Indian markets in CY13 as we establish the new sustainable growth normal after below par growth in FY13 and above par growth in FY04-11.

So far, the equity market performance (26% YTD) has eluded economic (5.7–5.9% in FY13E) and corporate earnings growth (4% Sensex EPS growth in FY13E). Going ahead, as we discover the new normal growth, Indian equity markets are likely to align more closely with the economic and broader earnings growth. Accordingly, we have built in a base case scenario for the Sensex at 21200, upside of 10% (15x FY14E EPS of ₹ 1415, 17% growth). Our bull and bear case estimates stand at 24400 and 16100, respectively. Parallel levels for the Nifty would be 6400 in the base case and 7300 and 4800 in the bull and bear case, respectively.

However, the unpredictable nature of RBI's policy may give rise to a concern. The RBI may choose to continue its long wait for inflation to subside. Otherwise, the government may wave off its fiscal consolidation plan in favour of populist measures in an election year. In either case, the RBI may not deliver a rate cut in the January–March 2013

quarter, thereby taking market participants by surprise. This may also coincide with markets taking a breather after ~26% plus up move, which together could lead to a low double digit correction.

We believe the relatively safer sectors would continue to lure investors as the capital preservation albeit lower returns theme will continue to find favour among investors.

Accordingly, we prefer pharma (growth story intact, PEG within comfortable range), banking (PSU banks asset quality concerns to peak out, rate cut expectations, reasonable valuations), telecom (reducing regulatory uncertainty, cheaper valuation) and auto (four wheeler segment to grow, easing rate cycle, favourable currency and declining raw material to support).

We are neutral on IT (cloudy growth outlook though valuation reasonable,) FMCG (consumption story intact but astronomical valuations in comparison to long term growth), cement (pricing discipline to support earnings, midcaps may continue to catch up with expensive valuations of large caps), aviation (favourable government stance though leverage remains high amid elevated crude prices).

We have a negative bias on oil & gas (under recoveries could come back to haunt, populist measures could impact earnings growth) infra (leverage continues to remain high, possibility of valuation trap), capital goods (declining order inflow, though valuations attractive), metals (uncertain demand outlook, Chinese growth concerns) and shipping (poor earning visibility but cheap valuations).

Our top picks for the year are Cadila Healthcare, Idea Cellular, Tata Consultancy Services, Tata Motors, Tech Mahindra, Zee Entertainment in the large cap space and Balkrishna Industries, Heidelberg Cement, InfoEdge, Kansai Nerolac, Mahindra Lifespace Developers, Page Industries in the midcap space.

Buy Ideas for 2013

Balkrishna Industries (BALIND)

Company	Buying range	TP
Balkrishna Industries	255-275	356

(₹ crore)	FY12	FY13E	FY14E	FY15E
Revenues	2795	3286	3636	4102
EBITDA	506	650	796	873
Net Profit	268	346	396	396
EPS (₹)	27.8	35.8	41.0	41.0
PE (x)	10.1	7.8	6.8	6.8
EV/EBITDA (x)	7.9	6.4	5.6	4.7
Debt/EBITDA (x)	3.3	3.1	2.9	2.2
RoNW (%)	24.9	24.6	22.1	17.2
RoCE(%)	15.4	15.6	15.6	16.6

- Balkrishna Industries (BIL) is a leading producer and exporter of off-highway (OHT) tyres. The industry is controlled by a few global players. BIL derives ~90% of revenues from exports to ~120 countries. The company has an achievable capacity of 166,000 MT and holds 3.5% of the global OHT market

- Important triggers for BIL are: capacity expansion at the Bhuj facility, which will add 120,000 MT on becoming operational by FY15E. The company has been able to maintain margins amid soaring international rubber prices. With a decline in prices and firming of the rupee, we expect BIL to be able to sustain high margins. Key risks: Weak recovery in the agricultural segment in Europe, US

- BIL has a strong track record of meeting volume guidance and maintaining robust margins. We expect the company to clock revenue, EPS CAGR of ~13%, 8%, respectively, in FY12-15E. Margins are expected to remain at ~20% for FY14E and FY15E. We have valued the stock at 9.0x FY14E EPS with a target price of ₹ 356

Cadila Healthcare (CADHEA)

Company	Buying range	TP
Cadila Healthcare	840-880	1069

(₹ crore)	FY12	FY13E	FY14E	FY15E
Revenues	5219	6383	7810	9251
EBITDA	1039	1305	1713	2074
Net Profit	653	662	1033	1289
EPS (₹)	31.9	32.3	50.4	62.9
PE (x)	29.6	25.0	17.6	14.1
EV/EBITDA (x)	19.2	15.2	11.2	9.0
Debt/EBITDA (x)	2.2	1.5	0.9	0.6
RoNW (%)	28.7	24.8	31.4	30.8
RoCE(%)	21.7	22.9	28.7	31.4

- Cadila Healthcare (CHL) is a leading pharma company with a presence in core pharmaceuticals across the value chain besides the wellness and animal healthcare business. CHL has a dominant presence in the Indian formulations market with a market share of ~3.8%. It is improving its market share by launching more than ~40 products per year. We expect new product launches to drive the domestic business and grow at a CAGR of 19% between FY12 and FY15E

- The resolution of USFDA CGMP issues at the Sarkhej facility has opened up avenues for the high margin injectable business of the company. It is looking to launch at least five to 10 injectables (including launches via Hospira JV) per year in the US. Besides, it has a strong pipeline of ~150 ANDAs in the US with only ~50 launches. Key risks: Delay in USFDA approvals and pricing pressure in domestic formulations especially in acute therapies

- The management has set a revenue target of US$3 billion by FY16 from US$1 billion in FY11. We expect revenues, EBITDA and PAT to grow at a CAGR of 19%, 23% and 23%, respectively, in FY12-15E driven by a robust pipeline across geographies and required capabilities. We have ascribed a value of ₹ 1069, based on 17x FY15E EPS of ₹ 62.9

Heidelberg Cement (MYSCEM)

Company	Buying range	TP
Heidelberg Cement	50-53	69

(₹ crore)	CY11	CY12E	CY13E	CY14E
Revenues	1127	1151	1883	2053
EBITDA	60	95	212	290
Net Profit	29	44	52	112
EPS (₹)	1.3	1.9	2.3	5.0
PE (x)	42.8	28.5	24.0	11.1
EV/EBITDA (x)	28.3	18.9	8.5	6.2
EV/Tonne (US$)	102.3	55.3	55.9	55.7
Debt/EBITDA (x)	7.7	5.8	2.7	1.9
RoNW (%)	3.6	5.1	5.8	11.2
RoCE(%)	1.8	3.6	8.7	13.6

- Heidelberg Cement (HCIL) is player with cement manufacturing capacity of 3.1 million tonnes. Its two units at Damoh and Jhansi together constitute 58% of its total capacity in central region. The company is a subsidiary of Cementrum I BV, which is 100% controlled by HeidelbergCement AG

- HCIL's new additional clinker & grinding capacities of 1.9 MTPA & 2.9 MTPA, respectively, are all set to commence operations from December-January 2013 onwards. This will increase its total cement and clinker capacity to 6.0 MTPA and 3.1 MTPA, respectively. This would enable the company to increase its market share and enjoy the economies of scale. In addition to this, the company has also invested ~₹ 200 crore in setting up a conveyor belt to bring down the cost of transporting limestone

- With majority of the capex plans almost over, we believe, return ratios would start improving from CY13E onwards. Currently, the stock is trading at P/BV of 1.4x and EV/EBITDA of 6.2x its CY14E earnings. On an EV/tonne basis, the stock is trading at US$56/tonne on full capacity, which is ~50% discount to its current replacement cost. We have assigned a target price of ₹ 69 based on FY14E EV/tonne of US$65

Idea Cellular (IDECEL)

Company	Buying range	TP
Idea Cellular	97-98	120

(₹ crore)	FY12	FY13E	FY14E	FY15E
Revenues	19489	21798	22791	23825
EBITDA	5040	5875	6345	7033
Net Profit	723	1046	1337	1912
EPS (₹)	2.2	3.2	4.0	5.8
PE (x)	55.0	38.0	29.7	20.8
EV/EBITDA (x)	10.1	8.4	7.4	6.3
Debt/EBITDA (x)	2.2	1.7	1.2	0.8
RoNW (%)	5.5	7.4	8.7	11.0
RoCE(%)	8.5	10.4	11.8	13.8

- The recent cut in reserve price in four circles augurs well for Idea Cellular as it reduces its one-time spectrum fees and spectrum renewal charges when its licenses come up for renewal. Moreover, unlike other incumbents, Idea has no licenses coming up for renewal till FY15, which makes it least susceptible to any regulatory uncertainty

- Only two new operators entered the industry again in the recent auctions. Also, they have won spectrum in only six circles further reducing the possibility of price wars. We believe the financial outgo for incumbents and new operators alike call for a tariff hike. Idea has already hiked tariffs in Madhya Pradesh. Key risks: excessive bidding in forthcoming auctions

- We expect the EPS to more than double from FY12-15 to ₹ 5.8. We have not factored in any tariff hike in our financials. A tariff hike, however, is likely in the industry and can provide further upside to our estimates. We have valued the stock using the DCF methodology to arrive at a target price of ₹ 120.

InfoEdge (INFEDG)

Company	Buying range	TP
Info Edge	330-350	415

(₹ crore)	FY12	FY13E	FY14E	FY15E
Revenues	377	443	553	676
EBITDA	142	155	193	237
Net Profit	123	136	171	201
EPS (₹)	11.3	12.4	15.6	18.4
PE (x)	31.9	28.9	23.0	19.6
EV/EBITDA (x)	26.2	23.2	17.2	14.5
Debt/EBITDA (x)	0.0	0.0	0.0	0.0
RoNW (%)	21.3	19.5	20.0	19.0
RoCE(%)	23.4	21.0	21.5	21.5

- InfoEdge is among the leading internet companies in India. The company runs Naukri, India's no.1 job site along with 99acres.com (real estate portal), Jeevansathi.com (matrimonial portal). The company also has significant investments in emerging internet companies – meritnation, policybazaar, zomato, mydala, floost, 99labels, canvera and happilyunmarried
- The recent government reforms could improve the investment and, thus, the hiring climate in India. Being the market leader (~60% market share), Naukri could be a key beneficiary in this recovery similar to the post-2008 period when it improved its market share. The growth in other business has accelerated, which could also boost revenues in FY14E and FY15E. Key risks: overall weakness in the job market and delays in IT spending patterns could impact the hiring patterns of Indian IT companies. InfoEdge earns 25% of its revenues in the recruitment business catering to IT sector demand.
- We expect revenues, EPS to grow 24.7%, 25.8% in FY14E and 22.4%, 17.6% in FY15E, respectively. This translates to revenue, EPS CAGR of 23.3%, 24.4% for FY11-15E. We have arrived at our DCF based target price of ₹ 415, which discounts our CY14E EPS estimate of ₹ 17.7 by 23.4x

Kansai Nerolac (GOONER)

Company	Buying range	TP
Kansai Nerolac	1040-1100	1335

(₹ crore)	FY12	FY13E	FY14E	FY15E
Revenues	2586	2872	3230	3567
EBITDA	337	365	437	521
Net Profit	216	234	278	334
EPS (₹)	40.1	43.5	51.5	62.1
PE (x)	27.4	25.3	21.3	17.7
EV/EBITDA (x)	17.6	16.2	13.5	11.3
Debt/EBITDA (x)	0.2	0.2	0.2	0.1
RoNW (%)	20.3	19.2	19.6	20.2
RoCE(%)	24.8	23.4	24.1	25.1

- Kansai Nerolac Paints (KNPL), a market leader in the industrial/automotive paint segment (~35% of the ₹ 29100 crore paint market), supplies over 90% of OEM requirements. The company is expanding its presence in the decorative paint segment through the launch of an eco-friendly range of products
- Being the dominant player in the automotive segment and largest supplier to Maruti Suzuki (paints), we believe growth of the automobile sector (~10% CAGR FY12-15E) would drive KNPL's sales growth at 11.3% CAGR in FY12-15E. Further, as the outlook for crude oil (key raw material) remains grim, we expect KNPL's EBITDA to increase at ~16% CAGR over FY12-15E and margins to improve to ~15% by FY15E from ~13% in FY12. Key risks: Slowdown in automobile sector, particularly Maruti
- KNPL's strong position in the industrial segment would aid the company to capitalise on the improving economic conditions and revival in industrial growth. Further, with input prices expected to stabilise, we expect KNPL's earnings to grow at a healthy CAGR of ~16% in FY12-15E

Mahindra Lifespace Developers (GESCOR)

Company	Buying range	TP
Mahindra Life Space	380-410	505

(₹ crore)	FY12	FY13E	FY14E	FY15E
Revenues	701	710	900	1174
EBITDA	191	189	268	378
Net Profit	119	101	119	190
EPS (₹)	29.2	24.8	29.2	46.5
PE (x)	14.2	17.0	14.4	9.0
EV/EBITDA (x)	11.5	12.1	8.4	5.8
Debt/EBITDA (x)	3.5	3.5	2.3	1.5
RoNW (%)	10.3	8.2	9.0	12.9
RoCE(%)	9.5	8.7	12.3	16.8

- Mahindra Lifespace Developers (MLDL) is a leading real estate developer with a presence in SEZ & DTA development and residential segment. Leveraging on the success of the Chennai SEZ totalling ~1550 acres and Jaipur SEZ aggregating ~3000 acres, it is also planning its second integrated business city in north Chennai over 750 acres. Furthermore, with the Land Acquisition Bill on the radar, MLDL will have early mover advantage in terms of prices as it owns huge large tracts of land in SEZs

- MLDL has ramped up its residential portfolio with a robust residential development pipeline (total developable land bank of 22.2 million sq ft (including ongoing projects of 4.0 million sq ft). Furthermore, the standalone level (which carries residential development) is net-debt free, giving us further confidence on the balance sheet front while it is developing a sustainable residential project portfolio in the long run. Key risks: clarity over tax rates for its SEZ business, retrospective effect in land acquisition bill

- At the CMP, the stock is currently available at 0.6x its FY14 potential NAV and 1.5x FY14E P/BV. MLDL is one of our picks in the real estate space considering the quality of management with better execution exhibits, strong balance sheet and 37.6% CAGR during FY13E-15E.

Page Industries (PAGIND)

Company	Buying range	TP
Page Industries	3210-3320	4109

(₹ crore)	FY12	FY13E	FY14E	FY15E
Revenues	683	868	1076	1399
EBITDA	133	174	222	287
Net Profit	90	117	151	196
EPS (₹)	80.7	104.7	135.4	175.6
PE (x)	41.2	31.7	24.5	18.9
EV/EBITDA (x)	28.3	21.7	17.0	13.3
Debt/EBITDA (x)	0.5	0.5	0.5	0.5
RoNW (%)	54.3	52.8	51.6	50.2
RoCE(%)	53.2	52.3	53.0	53.1

- Page Industries (Page), the sole domestic licensee of the Jockey brand, manufactures and distributes innerwear and leisurewear (men and women). In July 2011, it acquired the exclusive license to manufacture and distribute Speedo brand swimwear, apparel, equipment and footwear

- Page has the license to sell Jockey's products in India, Nepal, Sri Lanka, Bangladesh and UAE. Despite operating at 85-90% utilisation levels, the company was unable to export due to strong domestic demand. Page has been consistently expanding its capacity by ~30% each year. Its capacity has increased from 2.2 crore pieces (FY07) to 10.9 crore pieces (FY12). Key risks: Lower demand, competition eating Page's share and non-renewal of licensing agreement (post 2030)

- Over the years, the sales, EBITDA and PAT have grown at a CAGR of 35-40%. Conservatively, we expect the company to report revenue, EBITDA and PAT CAGR of 27.0%, 29.2% and 29.6% during FY12-15E, respectively. Considering the healthy return ratios, consistent dividend payout (45-50%) and negligible leverage, we believe Page is a good play on the Indian consumption story

Company	Buying range	TP
TCS	1210-1260	1450

(₹ crore)	FY12	FY13E	FY14E	FY15E
Revenues	48894	61535	67575	75256
EBITDA	14418	17674	19382	21376
Net Profit	10638	13194	14330	15766
EPS (₹)	54.4	67.4	73.2	80.6
PE (x)	22.7	18.3	16.8	15.3
EV/EBITDA (x)	16.1	13.2	12.0	10.9
Debt/EBITDA (x)	0.0	0.0	0.0	0.0
RoNW (%)	36.0	33.9	29.1	25.8
RoCE(%)	47.7	44.7	38.8	34.6

Tata Consultancy services (TCS)

- TCS has consistently outperformed its peers and is likely to exceed Nasscom's industry growth guidance of 11% in FY13E. Initial FY14E hiring guidance (25,000 campus hires; 12,000 offers made) and management commentary indicates continued momentum in FY14E. TCS' ability to win large deals (Friends life, UK government contracts, etc.) helps improve pipeline visibility while scale and efficiency help in flawless execution. This coupled with non linear initiatives such as iON, platform BPO and products could help sustain revenue growth momentum and margin profile
- Key risks: CY13 IT budget decision delays led by fiscal cliff could alter spending patterns and impact growth assumptions given TCS earns 53% of its revenues from the US. Further, deterioration in Europe could lead to projects ramp downs, budget freezes and cross currency volatility
- We expect revenues, EPS to grow at 9.8%, 8.6% in FY14E and 11.4%, 10% in FY15E, respectively, translating to revenue, EPS CAGR of 19.2%, 15.9% during FY11-15E. TCS is currently trading at 16.3x our CY14E EPS estimate of ₹ 78.7 and provides 15% upside relative to our target price of ₹ 1450 (18.5x CY14E EPS)

Company	Buying range	TP
Tata Motors	290-305	360

(₹ crore)	FY12	FY13E	FY14E	FY15E
Revenues	164855	186545	215892	244985
EBITDA	23701	25718	29975	32956
Net Profit	13517	10466	13159	17021
EPS (₹)	42.6	32.8	41.3	53.4
PE (x)	7.2	9.4	7.4	5.7
EV/EBITDA (x)	4.5	4.3	3.6	3.3
Debt/EBITDA (x)	1.6	1.6	1.3	1.2
RoNW (%)	40.8	25.6	25.8	26.5
RoCE(%)	25.0	23.7	24.7	25.5

Tata Motors (TELCO)

- Tata Motors (TML) is India's largest commercial vehicle manufacturer with a market share of ~60% and third largest passenger vehicle maker with a market share of ~13%. The company also owns the iconic brands Jaguar and Land Rover (JLR). With the rate cycle reversal in India and product up-cycle in JLR, we believe FY14E will clock a significant performance
- Launch of the new Jaguar F-type will add significantly to flagging Jaguar volumes while there will be margin accretion due to the launch of the new Range Rover. A better-than-expected recovery in the US, coupled with high growth in Chinese markets will augur well for JLR. On the domestic front, we believe the earnings cycle has reached a nadir and a revival in industrial activity will boost the domestic performance. Key risks: significant slowdown in Chinese markets
- Valuations remain attractive at 3.5x EV/EBITDA JLR vis-à-vis higher cash rich peers, strong RoEs (>20%) on consolidated business. Thus, post JLR multiple rerating, we arrive at an SOTP target price of ₹ 360

Tech Mahindra (TECMAH)

Company	Buying range	TP
Tech Mahindra	880-915	1150

(₹ crore)	FY12	FY13E	FY14E	FY15E
Revenues	5490	6807	7334	7760
EBITDA	919	1131	1216	1275
Net Profit	1095	1198	1269	1410
EPS (₹)	83.0	90.7	96.0	106.7
PE (x)	11.4	10.4	9.8	8.8
EV/EBITDA (x)	13.9	11.3	10.5	10.0
Debt/EBITDA (x)	1.1	0.8	0.6	0.6
RoNW (%)	29.6	25.9	21.9	19.9
RoCE(%)	16.0	17.0	15.4	13.8

PAT includes Satyam s earnings as profits from associates

- The combined entity (TechM + MSat) could likely earn ~ $2.8 billion in revenues with ~90,000 employees and service 489 clients. The EBITDA margin profile is on the rise with both companies reporting margins of ~20% in Q2FY13 (aptly aided by rupee tailwinds). Cost synergies from the impending merger and employee pyramid rationalisation could likely help sustain the current margin profile. PE multiple re-rating is likely as the combined entity – sixth largest in size – could fill the gap between HCL Tech (~$4.6 billion FY13E revenues) and a number of Indian vendors with revenues of ~$1 billion
- Key risks: Demand slowdown from its largest client BT. CY13 IT budget decision delays led by fiscal cliff could alter spending patterns and impact growth assumptions. Deterioration in Europe could lead to projects ramp downs, budget freezes and cross currency volatility. Though MSat has settled all its external legal disputes, an adverse ruling in income tax and ED disputes could lead to cash outflows
- We expect revenues, EPS to grow 7.7%, 5.9% in FY14E and 5.8%, 11.2% in FY15E, respectively, translating to revenue, EPS CAGR of 12.5%, 21.5% during FY11-15E. TechM is currently trading at 8.8x our CY14E EPS estimate of ₹ 104.1 and provides 27% upside relative to our target price of ₹ 1150

Zee Entertainment Enterprise (ZEETEL)

Company	Buying range	TP
Zee Entertainment	180-200	268

(₹ crore)	FY12	FY13E	FY14E	FY15E
Revenues	3041	3569	4160	5005
EBITDA	739	876	1083	1508
Net Profit	589	676	825	1117
EPS (₹)	6.1	7.1	8.6	11.6
PE (x)	36.8	32.1	26.3	19.4
EV/EBITDA (x)	28.9	24.3	19.4	13.7
Debt/EBITDA (x)	0.0	0.0	0.0	0.0
RoNW (%)	17.1	17.1	17.9	20.1
RoCE(%)	20.5	21.1	22.4	26.1

- The successful implementation of digital cable in Delhi and Mumbai along with good progress in other metros suggests that sooner or later the whole country would be digitised, with revenue leakage being plugged, thus benefiting broadcasters. With a strong portfolio of channels and bargaining power of Media Pro, we expect subscription revenues of ZEEL to more than double from FY12-15
- ZEEL has posted a strong turnaround in ad revenue growth since it started investing in high cost content including reality shows and newly released movies. The company posted an ad growth of 26.1% in H1FY13 as against 6.9% de growth in FY12. Also, likely rate cuts from the RBI would improve the ad environment for companies across the media sector. We expect ad revenues to grow at a CAGR of 12.5% in FY12-15. Key risks: Slower-than-expected rollout of digitisation
- Revenue is expected to grow at a CAGR of 18.1% in FY12-15. Given that majority of operational costs are fixed in nature, the spurt in subscription revenue will bring in higher operating leverage. We have valued the stock at 23x FY15E EPS to arrive at a target price of ₹ 268

Macros global & domestic: Growth taking baby steps

Continued downward global GDP revisions by IMF

	CY 2012E		
	Apr-12	Jul-12	Oct-12
World	3.5	3.5	3.3
Advanced Economies			
United States	2.1	2.0	2.2
Euro	-0.3	-0.3	-0.4
Germany	0.6	1.0	0.9
France	0.5	0.3	0.1
Italy	-1.9	-1.9	-2.3
Japan	2.0	2.4	2.2
BRIC nations			
Brazil	3.0	2.5	1.5
Russia	4.0	4.0	3.7
India	6.9	6.1	4.9
China	8.2	8.0	7.8

	CY 2013E		
	Apr-12	Jul-12	Oct-12
World	4.1	3.9	3.6
Advanced Economies			
United States	2.4	2.3	2.1
Euro	0.9	0.7	0.2
Germany	1.5	1.4	0.9
France	1.0	0.8	0.4
Italy	-0.3	-0.3	-0.7
Japan	1.7	1.5	1.2
BRIC nations			
Brazil	4.1	4.6	4.0
Russia	3.9	3.9	3.8
India	7.3	6.5	6.0
China	8.8	8.5	8.2

Source (for all charts): International Monetary Fund (IMF), ICICIdirect.com Research

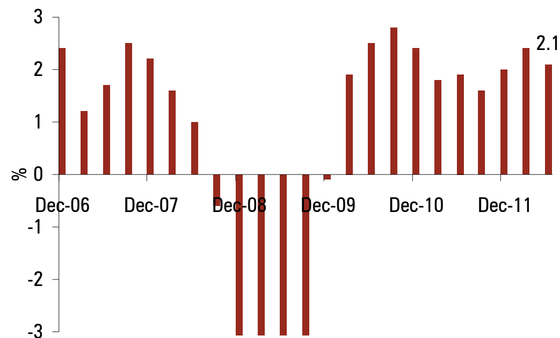
Global economy - Identical servings but with unlimited liquidity toppings…

- CY12 had soap opera like unpredictability led by growing concerns related to a eurozone break-up, Greece aid or no-aid, outcome of presidential elections in the US and France, parliamentary election and re-election in Greece and a regime change in China and Japan
- CY13 could be another impulsive year as economic recovery remains the main motive but with lack of apparent consensus on how to achieve it and easy money policy regime continuing. Noticeably, major central banks have announced practically unlimited quantitative easing albeit with different nomenclature
- While predicting the outcome of the fiscal cliff (rising taxes, spending cuts and a corresponding reduction in the US budget deficit beginning in 2013) is difficult, we believe, automatic increase in taxes for all could undermine US economic growth. However, near zero short-term interest rates could help offset the likely impact
- In Europe, the focus shifted from "Grexit" to Spain and Italy. Italian borrowing costs rose led by news of the Italian PM resigning while the banking crisis and rift between Madrid and Catalonia kept Spain on tenterhooks. The European Central Bank (ECB), besides bringing interest rate down to 0.75%, announced an unlimited but sterilised bond-buying programme in order to control unwarranted money supply. ECB also received International Monetary Fund (IMF) booster in case its firepower falls short. However, the mother of all deals was to bring all eurozone banks under the supervision of the ECB, thus giving it the power to supervise the region's lenders
- Across Asia, the territorial row over the tiny Senkaku islands in the East China Sea echoed, thus hampering Japanese exports to one of its largest partner China. A regime change in China raised hopes of macroeconomic stabilisation, gradual recovery led by revival in reforms and streamlining of bureaucracy.

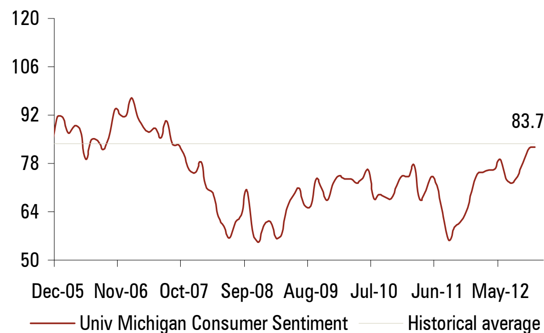
US – Bumpy ride amid liquidity expectation…

CY12 witnessed a mixed set of economic data (manufacturing and unemployment pressure persists) despite the Fed's easing efforts. Among key positives, the residential market has shown some green shoots

US GDP growth moderating; fiscal cliff remains a challenge



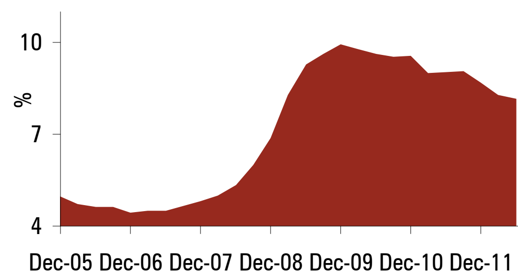
Consumer confidence still below its historical average



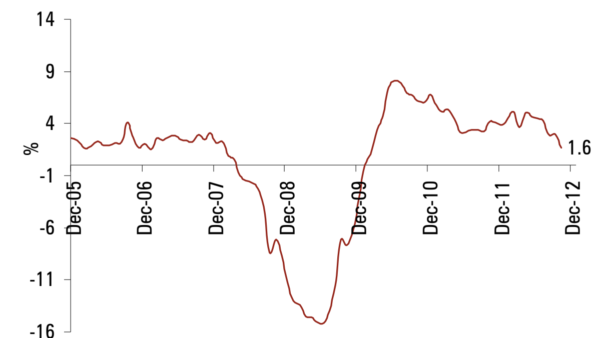
Source (for all charts): Bloomberg, ICICIdirect.com Research

- US manufacturing output grew at its slowest pace in the last 18 months
- The residential sector showed initial signs of recovery as reflected in the home builder confidence index that is at a six-year high while building permits grew ~24% YTD (October 2012). Also, the Case Shiller index turned positive in CY12 vs. negative in CY11
- Obama returning to power for a second consecutive term has set the tone for the fiscal cliff - US$600 billion in tax raise and spending cuts - in CY13. This could lead to a recessionary environment at least during H1CY13. However, liquidity, driven by continued easy money policy, may arrest the fall

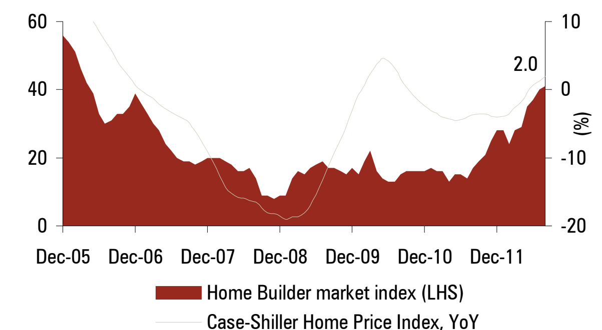
Unemployment continues to remain at elevated levels



IIP growth remains weak throughout CY12



Green shoots in residential market



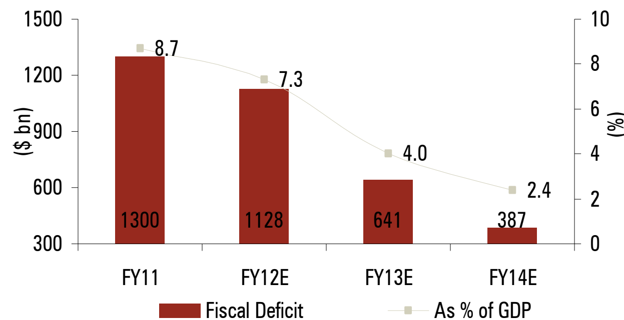
Fiscal cliff – a hanging sword; shale gas – potential game changer

Though the terms and outcome of fiscal cliff are being debated between Democrats and Republicans, the FOMC and CBO have already indicated that the US economy could slip into a recession for a good part of CY13.

Impact of fiscal cliff in CY13

	US$ (bn)
Revenues	
Expiry of Bush tax cut and indexing of Alernative Minimum Tax	221
Payroll tax cut expiry	95
Other provision expires	65
Taxes included in Affordable Care Act	18
Total (A)	399
Spending	
Sequester	65
Extended jobless benefits expiry	26
Physician rate cut	11
Total (B)	102
Other changes in Revenues & spending (C)	105
Total (A+B+C)	606

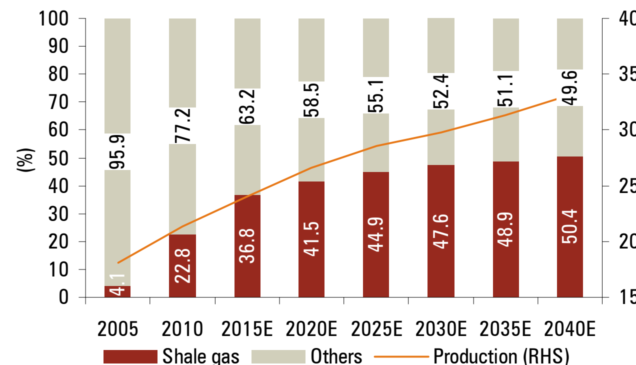
Fiscal deficit could halve due to fiscal cliff



*For detailed view on fiscal cliff please refer slide 47

- Nonetheless, the Fed could likely continue with its monetary easing (US$85 billion/month buying of MBBS & long dated securities) throughout 2013 albeit in a measured manner (till unemployment rate declines) given its already stretched balance sheet
- On a different tangent, US shale gas discovery could be the potential game changer in the longer run as it will not only attract investment in the US (US$90 billion already announced largely in petrochemicals) but also reduce its dependency on oil imports leading to a lower import bill

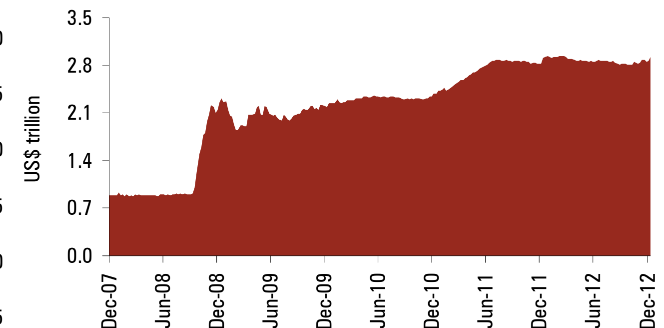
Shale gas to drive incremental production in the US



Chronological sequence of FED easing

	Date	US$ (bn)	Comment
QE1	Nov-08	600	MBS & debt purchase announced
	Mar-09	1050	Additional purchase of MBS ($750 billion) & Treasuries ($300 billion)
QE2	Nov-10	600	$75 bn/month long dated treasury purchase announced
Operation Twist (OT)	Sep-11	405	Replace short maturity treasuries with long dated ones (US$45 bn/month)
	Jun-12	270	OT extended by six months (US$45 bn/month)
QE3	Sep-12	40 bn/mth	Committment to purchase $40 bn/month MBS until labour market improves 'substantially'
	Dec-12	45 bn/mth	Purchase incremental $45 bn/month long dated securities

Fed balance sheet expanded ~3x since Lehman at $2.9tr

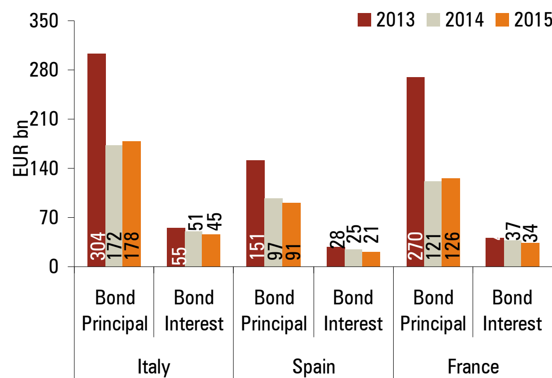


Source: US (EIA), CBO, ICICIdirect.com Research

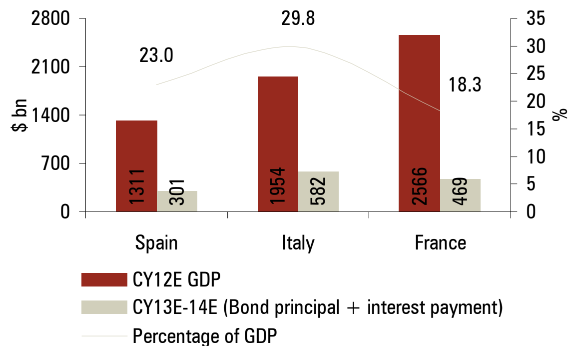
Europe – confidence building at epic high…

H2CY12 for the eurozone unfolded to be the remedial year led by unlimited ECB+IMF easing and waning German resistance. CY13E could further alleviate confusion and uncertainty, which prevailed during CY08-11

Mounting repayment schedule



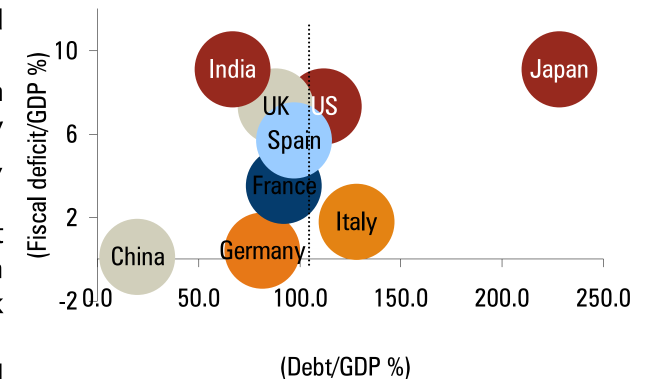
Significant interest payment could pressurise yields



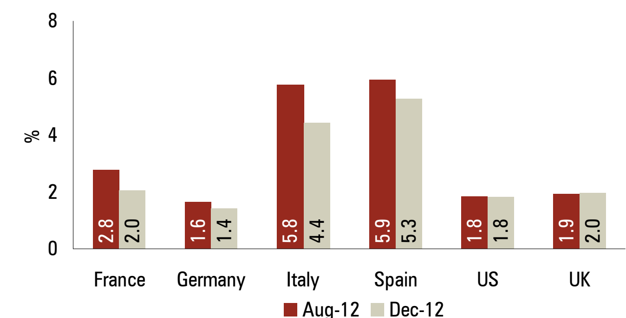
Source (for all charts): IMF, Reuters, Bloomberg, ICICIdirect.com Research

- H2CY12 saw the focus shifting from Greece to saving Italy and Spain after Greece managed to strike its debt deal with austerity compliance and incremental hair-cuts
- Spain and Italy, both >$1 trillion economies, were in the limelight led by the banking crisis and political turmoil, respectively
- This led to ECB stepping in to arrest the spike in bond yields as Spain officially asked for €100 billion bank capitalisation aid from the ECB
- Italy went through political turmoil when its Prime Minister Mario Monti was neutralised for want of political support threatening the recovery
- The European Stability Mechanism (ESM), the €500 billion permanent bailout fund to capitalise banks in troubled European regions, became reality after initial German resistance
- Going ahead, we expect these measures to alleviate confusion and uncertainty, which prevailed during CY08-11. That said, though these steps taken could contain the break-up risks growth pick-up is unlikely in near term

Except China, all sailing in the same boat*



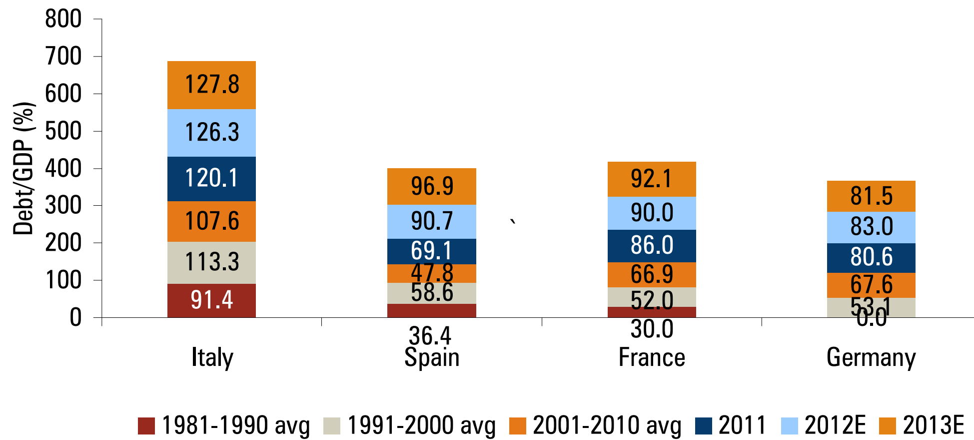
Central bank steps in to arrest rising bond yields



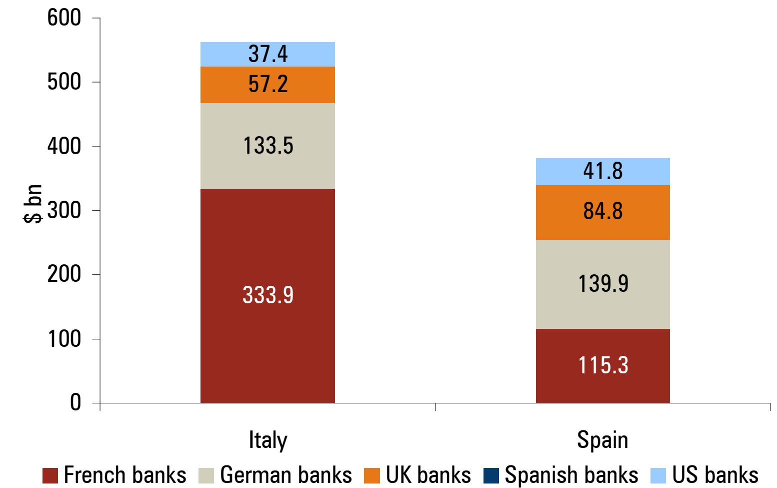
**The fiscal deficit includes state deficit along with central deficit*

Focus shifts from "Grexit" to Spain and Italy…Long term issues still linger

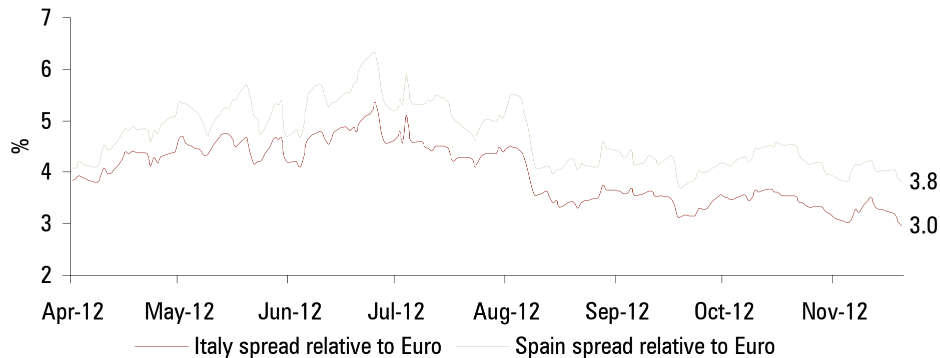
Italy leading with highest debt/GDP ratio; Spain not far behind



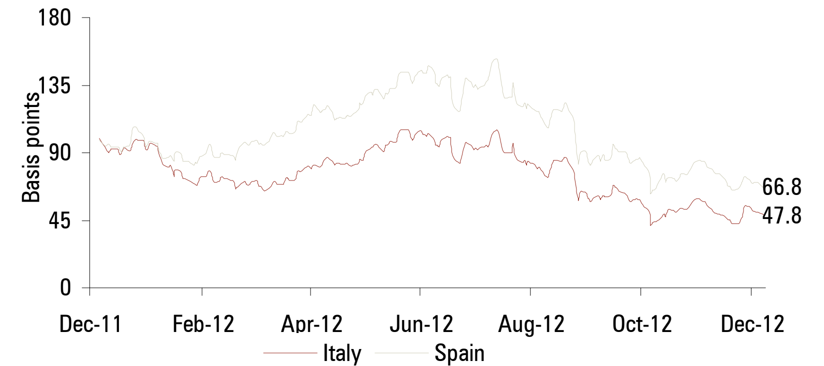
Bank exposure to Italy/Spain debt



ECB backing helping easing of Italian and Spanish government yields relative to Euro generic



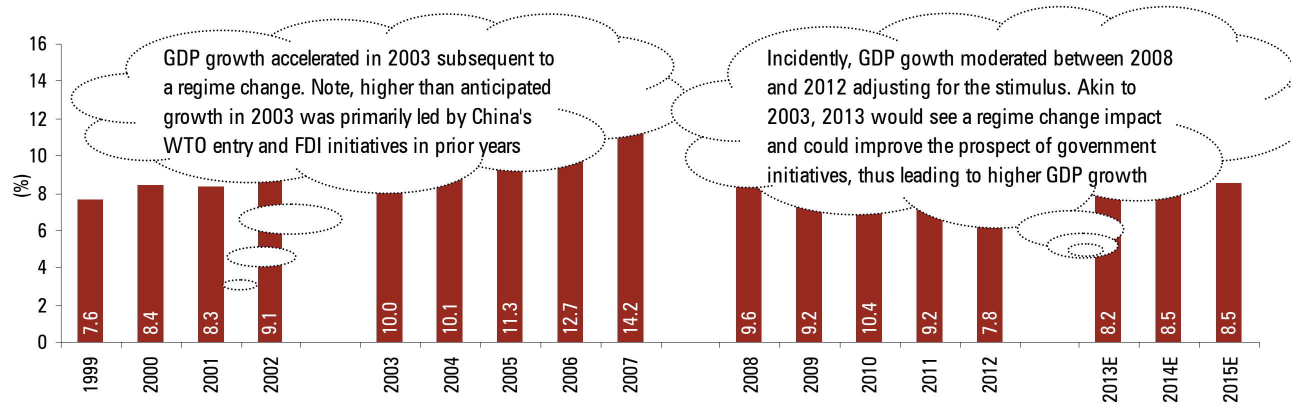
…and also their CDS spread



Source (for all charts): IMF, Reuters, Bloomberg, ICICIdirect.com Research

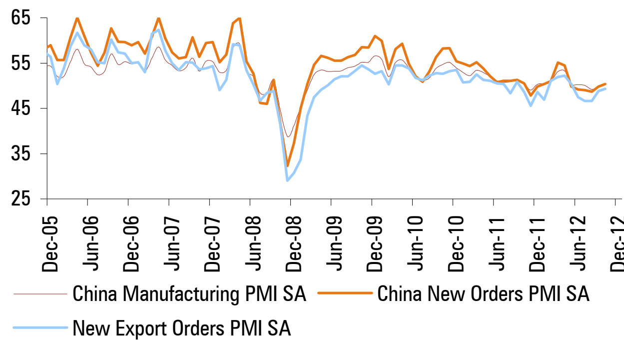
China - Will 2013 replicate 2003?

A regime change in China led to accelerated growth during CY03-07. Predicting a repeat of 2003 in 2013 is premature but a regime change has raised hopes of macroeconomic stabilisation, gradual recovery led by revival in reforms, and streamlining of bureaucracy.

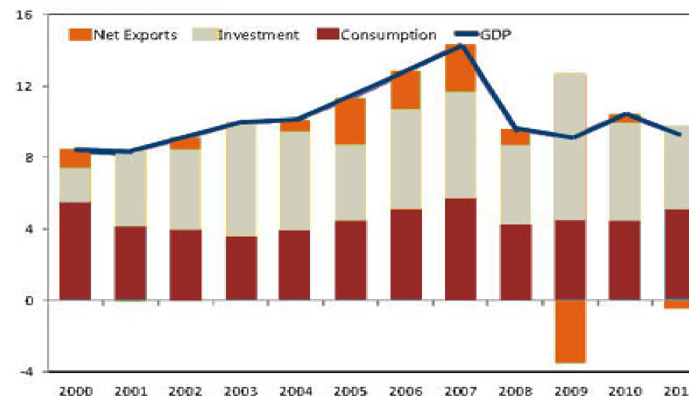


- The year 2012 saw Chinese factory orders shrinking for eight consecutive months in June while export orders fell to their early 2009 levels while the central bank had to lower lending rates twice in CY12 to 6%
- Nevertheless, 2013 will see a new regime in China akin to 2003, when the then new leaders came on board
- Macroeconomic stability suggests GDP growth has bottomed out and could accelerate in 2013. However, the pace of growth could be modest relative to 2003 as factors such as 1) accelerated exports led by China's WTO entry; 2) integration of China into global production process; 3) property boom; 4) FDI in competitive industries in China, which drove higher than anticipated growth in 2003, are missing today. That said, the new government's focus on reviving reforms, consumption led growth, streamlining bureaucracy and divestment of state controlled units could be viewed as key positives

Commodity check: Moderate PMI, new & export order print to help



Consumption contribution to Chinese GDP growth rising

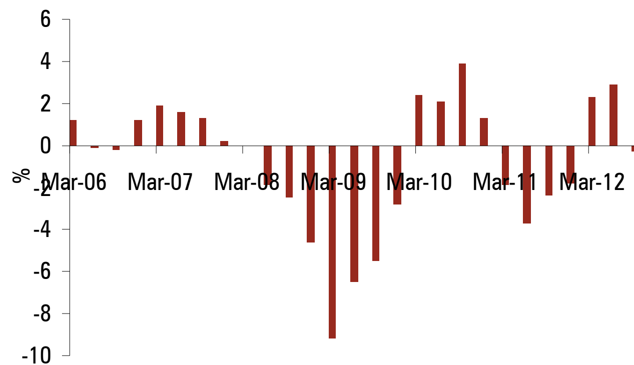


Source: IMF, Bloomberg, ICICIdirect.com Research

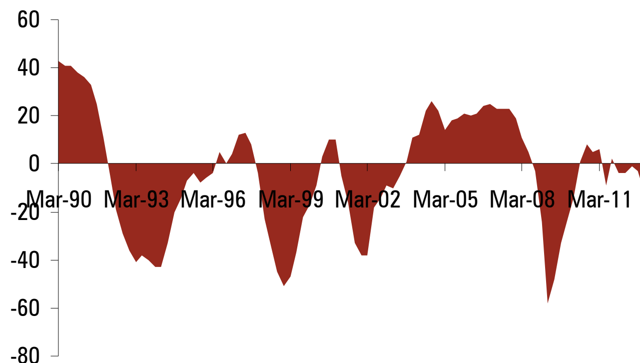
Japan – light at the end of tunnel

Dwindling growth, Chinese confrontation, BoJ/politicians rift and demographics remain disadvantage while regime change and liquidity stimulus could set the tone for recovery in CY13

GDP growth remains lumpy



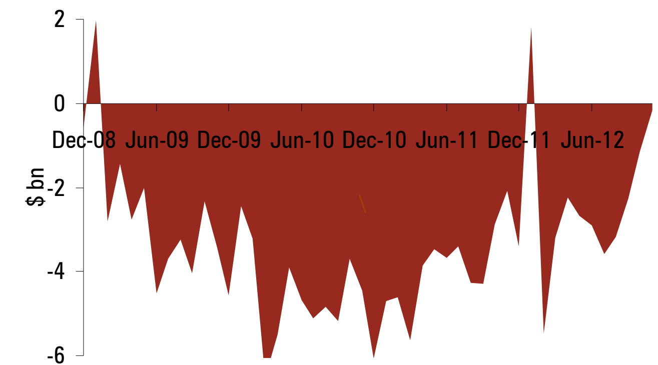
Bank of Japan-Tankan survey portrays weak confidence depreciation



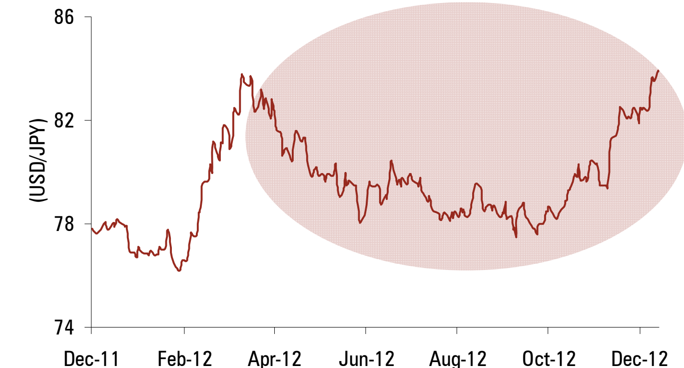
Source (for all charts): BOJ, Bloomberg, ICICIdirect.com Research

- The Japanese economy continues to reel under the tsunami impact while demographic disadvantage (23% population >65 years) leads to declining productivity
- Separately, confrontation with China has negatively impacted exports to one of its largest trading partner China, which constituted ~20% of overall exports in 2011
- Cumulative BoJ stimulus since October 2010 stands at ~101 trillion Yen aided by easing policy rates (four times in 2012). Japan has no option but to maintain the policy easing mechanism as continued liquidity push in the US could led to yen appreciation, a negative for exports
- Positively, former PM Shinzo Abe – pro-growth advocate - returned to power and is talking of spending 200 trillion yen on public projects over the next decade. The regime change may just be the required adrenaline for waning growth

Trade deficit with China could get aggravated on conflict



BoJ's reciprocal action leads to modest JPY-Yen



IMF GDP growth estimates as on Oct 2012 (%)

	CY2013 E	CY2014 E
World	3.6	4.2
Advanced Economies		
United States	2.1	2.9
Euro	0.2	1.2
Germany	0.9	1.4
France	0.4	1.1
Italy	-0.7	0.5
Japan	1.2	1.0
BRIC nations		
Brazil	4.0	4.2
Russia	3.8	3.9
India	6.0	6.4
China	8.2	8.5

Source: International Monetary Fund (IMF)

Indian economy anecdote – what we foresee on macro scenario

Despite macro headwinds, the India story is still strong with gross domestic savings at 31.8% of GDP (H1FY13) and faith in the buying power of India's emerging middleclass. The expected GDP growth for CY13E, as indicated by IMF, is 6%; by no means a lower growth in global context. However, with our population of ~1.3 billion and a strong demographic profile, the country strives to achieve higher growth and reverts back to 8% growth sooner than later.

(%)	FY12	FY13E	FY14E
Inflation (March)	7.7	6.5	6.0-6.5
Real GDP	6.5	5.5	6.5
Nominal GDP (MP)	15.0	13.0	13.5
Repo rate (March)	8.5	7.5	7.0
G-Sec (March)	8.5	7.9-8.0	7.6-7.7
INR (Avg ₹ / $)	48.1	53-54	50-52
Trade Deficit	-10.3	-11.1	-9.3
Current account deficit	-4.2	-4.1	-3.1
Capital account deficit/surplus	3.7	3.1	2.8
Fiscal deficit	5.8*	5.6#	5.3#

** Provisional, # ICICIdirect.com Estimates*

Baby steps have started…passing of Companies Bill, Banking Amendment Bill, FDI in retail, postponement of GAAR to boost confidence, etc. are steps in the right direction.

The macro is evolving with every passing day. YTD average inflation is at 7.6% but the latest November 2012 print is 7.24% paving the way for rate cuts by the RBI. H1FY12 GDP at 5.5% has led to the stance shifting to growth even for the RBI. We expect a rate cut of 50 bps in Q4FY13 and another 50 bps till December 2013. The cuts will improve corporate profitability and help revive their delayed expansion plans. The government borrowing programme is almost complete and balance can sail with marginal OMOs of ₹ 15,000-20,000 crore in the remaining financial year. Along with support of rate cut, 10 year G-sec is expected to trend down accordingly to 7.9-8%.

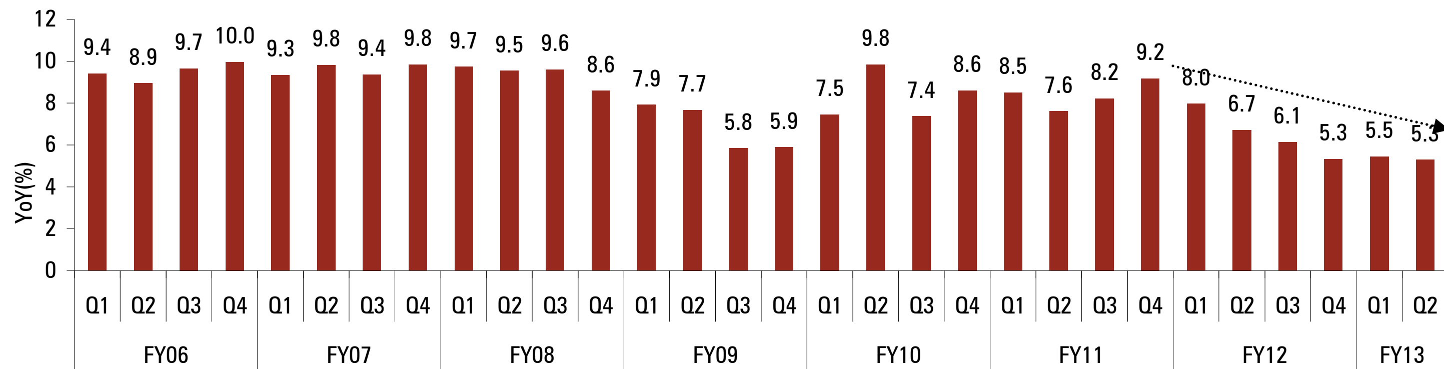
Fiscal prudence is the need of the hour to contain deficit at ~ 5.3% for FY14E (ICICIdirect.com estimate) as INR currency and, thereby, BoP is dependent on the same. Along with rate cuts, as we enter the election year a stable FY14E budget is needed to revive GDP growth to 6.5% and bring back investor confidence.

Indian economy – enjoys unique position in acronym "BRIC"

The unique position that India enjoyed since BRICS came into existence was driven by strong decadal (2004) GDP growth of ~8.1%. However, it is now passing a challenging phase with "Hindu" GDP growth staring in our face that too at a decade low of 5.3%. However, we feel that with possible reforms and RBI's focus on growth, the Indian economy seems to be near a turnaround with modest growth expectations pegged at 6-7% in the coming years.

GDP growth slowdown has been largely impacted by the crippling of the investment cycle and slowdown in the industrial segment. The legs of consumption also seem to losing steam.

Is Indian GDP bottoming out?



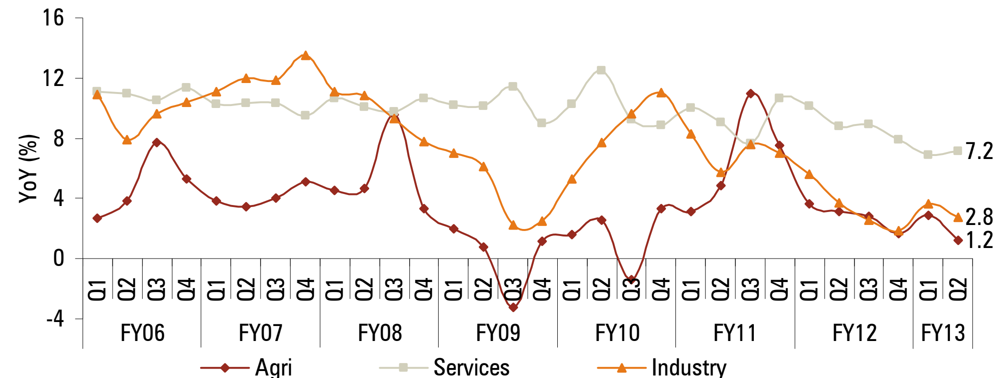
GDP growth in India is still strong compared to global peers. Other BRIC nations have seen higher erosion of growth than India

However, with the awakening of the Indian government to act and slowly easing inflation we believe rate cuts would follow suit. Thus, GDP growth is expected to be better with~ 5.7% growth for H2FY13E

GDP growth rates amongst BRICs

Country	Q4CY11	Q1CY12	Q2CY12	Q3CY12
India	6.1	5.3	5.5	5.3
Brazil	1.4	0.8	0.5	0.9
Russia	4.8	4.9	4.0	2.9
Taiwan	4.8	0.6	-0.1	1.0

Segmental GDP growth



Source: MOSPI, IMF, ICICIdirect.com Research

What held RBI's hands... sticky inflation & inflationary expectations…will it shift its stance?

Despite a growth slowdown, stubborn WPI inflation (average 7.5% CY12) and double digit retail inflation tied RBI's hands from providing the much needed rate cuts. RBI, while holding its anti-inflationary stance, did provide support by infusing liquidity via reducing the cash reserve ratio (CRR) by 175 bps in CY12 and conducting ~₹ 1,04,000 crore of OMOs till date. Stability in commodity prices is expected to help ease inflation towards 6.5% by March 2013.

Inflation –Will the demon ease off?

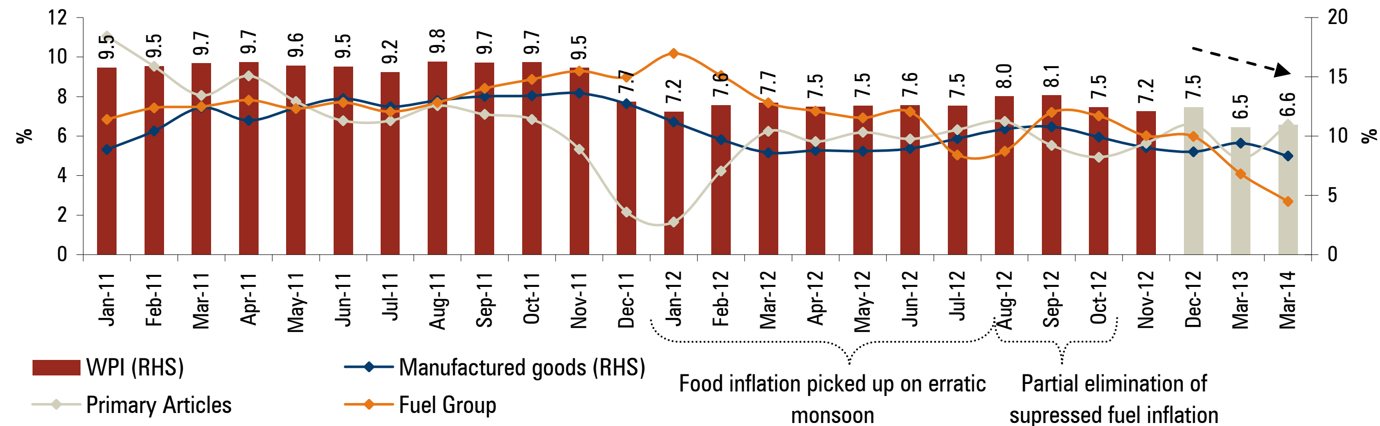
Erratic monsoons led to higher food inflation while elimination of suppressed inflation in the fuel group & rupee depreciation added to imported inflation

CY12 inflation moderated to average 7.5% but was above RBI's medium-term comfort zone of ~5%. Reducing inflation and inflationary expectations, therefore, remained RBI's focus area for the whole of CY12 and prevented it from announcing major interest rate cuts in CY12 except pre-emptive cut of 50 bps in April 2012

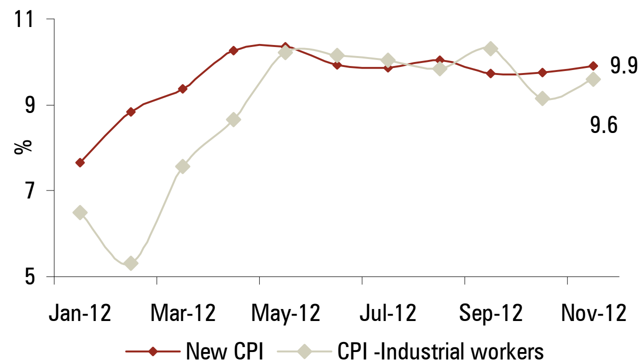
Expected higher MSPs ahead of elections may keep food prices higher. However, core inflation may slow down due to abating demand side price pressures on sluggish domestic as well as global growth

We expect average inflation for 2013 to be in the range of 6-6.5% lower than 7.5% average in 2012, unless there are any commodity price shocks, monsoon gets erratic or the rupee depreciates sharply

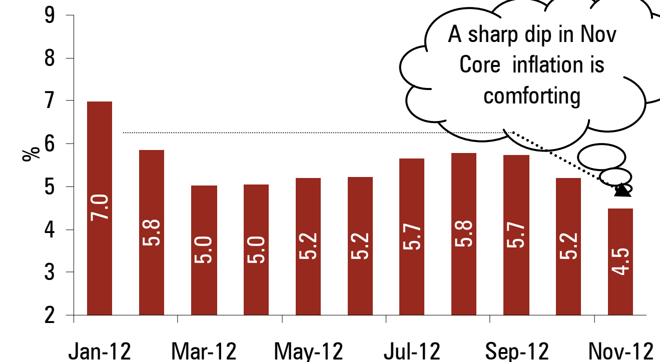
CY12 WPI inflation stays sticky at 7.5% …



Retail inflation close to double digits …



Core inflation sliding trending to RBI's comfort zone



Source: CSO; ICICIdirect.com Research

Advent of softening inflation provides comfort…interest rates to move south

WPI inflation softened in the last two months from ~8%to ~7.2%. Core inflation has also drifted below 5% and should provide comfort to the RBI to focus on growth as inflationary pressure abates. We expect the RBI to cut the repo rate by 50 bps in Q4FY13 and another 50 bps till December 2013 to 7% to support growth

Demand slowdown is clearly reflected in lower IIP, multi-year low GDP growth and slowing core inflation

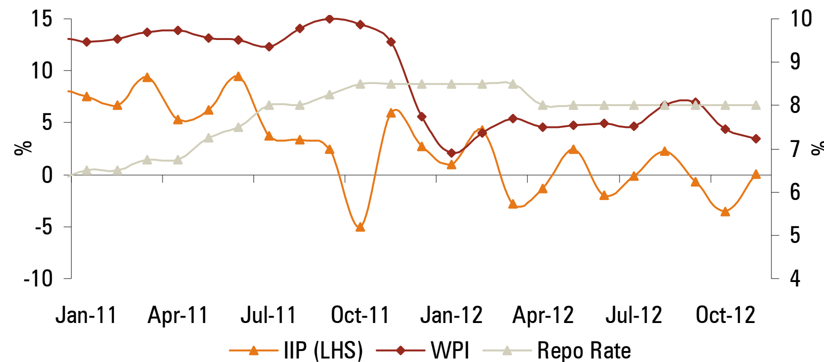
We expect the RBI to provide a boost to growth by announcing a 50 bps repo rate cut by March 2013 and another 50 bps by December 2013

G-sec yields softened on the back of improved liquidity via CRR cuts and OMOs. Short-term rates also peaked off their high. Repo rate cuts will provide another leg down. We expect the 10 year G-sec to trend down by 25-30 bps to ~7.9-8% by March 2013

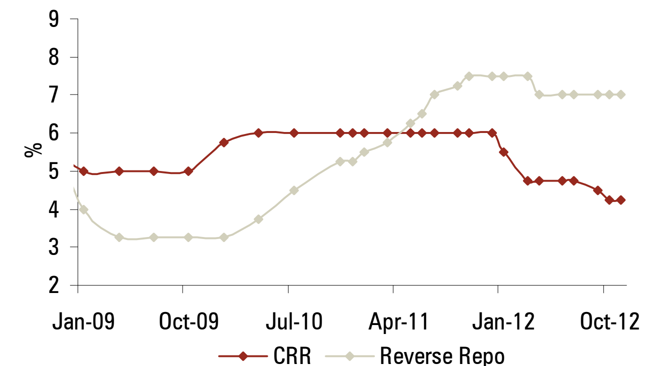
Lower interest rates, in turn, will improve corporate profitability and help revive their delayed expansion plans

Lower system rates act as a positive not only for finance companies but will also provide much needed catalyst for interest sensitive sectors, consumer discretionary like auto, consumer durables, real estate and infrastructure finance companies

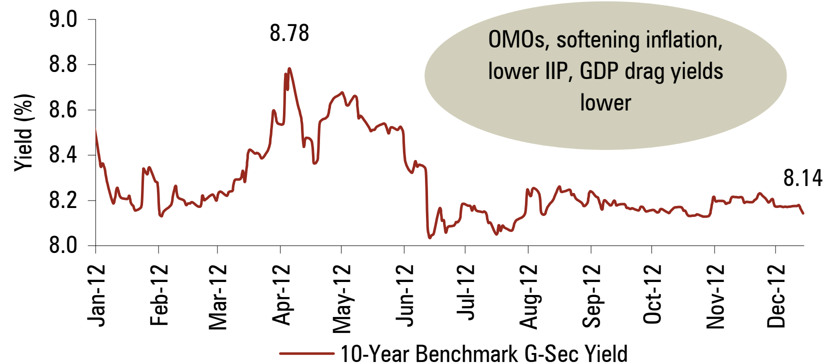
Softening inflation to provide comfort…



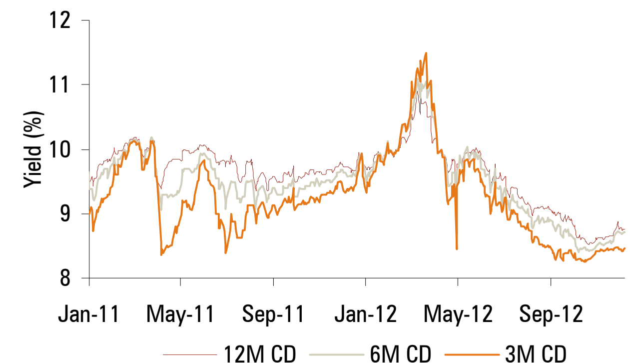
… expect 50 bps repo rate cut by March 2013



G-sec yields soften on back of improved liquidity;



Short-term rates also peak off their high…



Source: Bloomberg, ICICIdirect.com Research

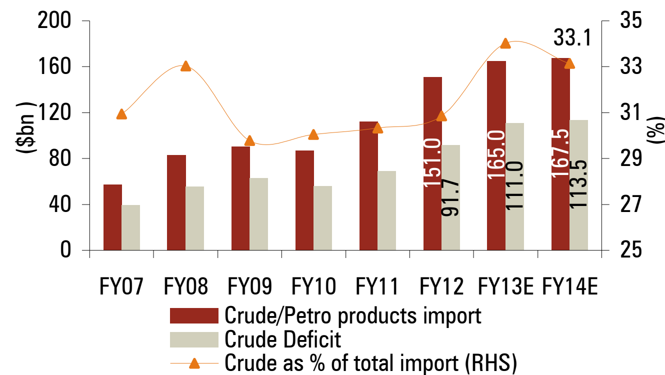
Oil & gold imports restrained…to ease current account deficit in FY14E

Pressure on CAD to ease, going forward, on account of stable crude oil and gold prices

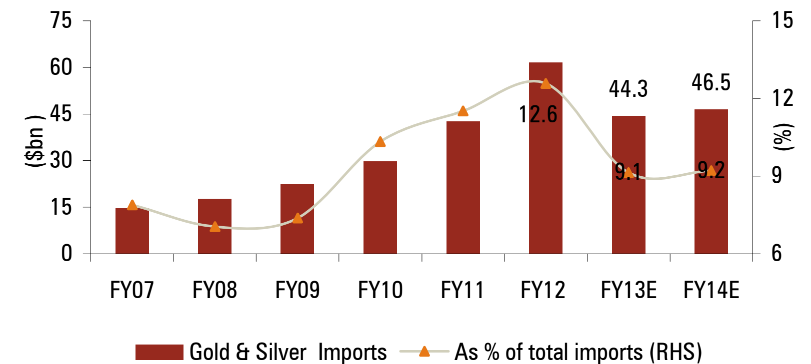
Average Price	Gold*	Silver*	Crude**
FY11	1295.3	23.9	85.1
FY12	1647.7	35.5	114.3
FY13 YTD	1661.8	30.69	109.7

* $/ounce, ** $/ bbl

Stable crude to provide respite for CAD in FY14E



Gold/silver import curbs to aid incrementally

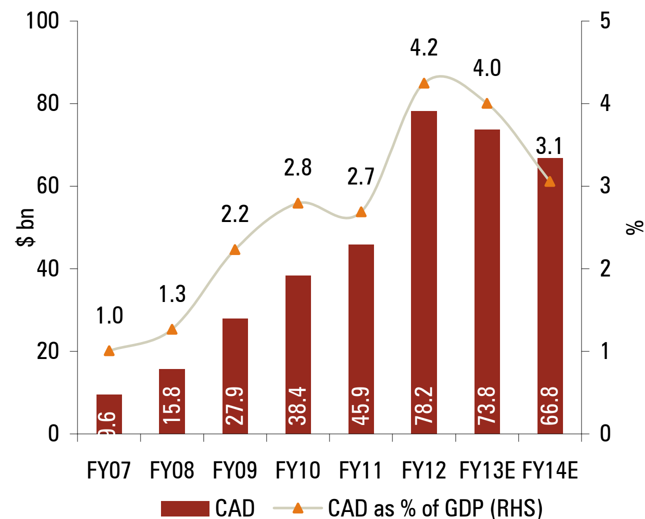


Invisibles (software services and transfers) and capital flows hold the key in improving India's BoP. We believe higher invisibles of US$135.7 billion in FY14E against US$111.6 billion in FY12 and strong capital inflows of US$62.8 billion in FY14E would improve the BOP situation

(% of GDP)	FY12	FY13E	FY14E
Trade Deficit	10.3	11.1	9.3
Current Account Deficit	4.2	4.0	3.1
Capital Account Surplus	3.7	3.2	2.9

Improvement in current account would help the Indian rupee to remain stable

…..CAD to reduce to 3.1% of GDP in FY14E



Source: RBI Handbook 2012; ICICIdirect.com Research

BoP to surprise positively on account of strong capital inflows

($ billion)	FY07	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E
Trade Balance (a)	-61.8	-91.5	-119.5	-118.4	-130.5	-189.8	-203.8	-202.4
Invisibles (b)	52.2	75.7	91.6	80.0	84.7	111.6	130.0	135.7
-Software services	29.0	36.9	43.7	48.2	53.3	61.0	67.7	75.2
-Transfers	30.1	41.9	44.8	52.0	53.1	63.5	74.3	76.5
-Others	-6.9	-3.2	3.1	-20.3	-21.8	-12.9	-12.0	-16.0
Current Account (c=a+b)	-9.6	-15.8	-27.9	-38.4	-45.8	-78.2	-73.8	-66.8
Foreign Investment (i)	14.8	43.3	8.3	50.4	39.7	39.2	40.9	39.7
-FDI	7.7	15.9	22.4	18.0	9.4	22.1	17.9	19.7
-FII	7.1	27.4	-14.0	32.4	30.3	17.2	23.0	20.0
Loans (ii)	24.5	40.7	8.3	12.4	28.4	19.3	20.0	22.0
Bank Capital (iii)	1.9	11.8	-3.2	2.1	5.0	16.2	5.0	8.0
Rupee Debt Service (iv)	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0
Other Capital (v)	4.2	11.0	-5.9	-13.2	-11.0	-6.9	-6.9	-6.9
Capital Account (i-v) (d)	45.2	106.6	7.4	51.6	62.0	67.8	59.0	62.8
Errors and Omissions (e)	1.0	1.3	0.4	0.0	-3.0	-2.4	-2.0	-2.0
Balance of payments (c+d+e	36.6	92.2	-20.1	13.4	13.1	-12.8	-16.8	-6.0

*Source: RBI Handbook 2012; ICICIdirect.com Research, *Nasscom numbers differs from RBI*

The fiscal deficit till October 2012 has already crossed 71% of the govt's budgeted target for FY13. With lower than projected cash inflow from disinvestments and economic services, the fiscal deficit is further likely to exceed by 30 bps to 5.6% from the revised fiscal deficit target of 5.3% this fiscal

Tough CAD situation, fiscal deficit report of government for FY13 says same story…

Particulars (₹ crore)	FY12RE	FY12P	FY13BE	YoY %	FY13IE	FY13 YTD (Till Oct 12)	Comments/ Assumptions
1 Total Receipts (2+13+14)	1318720	1298444	1490925	14.8	1478456	779467	
2 Net Tax receipts (3-12)	642252	631886	771071	22.0	758910	333883	Net tax receipts during April-October totalled just 43.3% of budgeted target vs. 46.1% of budgeted targets achieved during the same period last year mainly on account of lower indirect taxes
3 Tax revenue (Gross) (4+7)	901664	890622	1077612	21.0	1068888	486825	
4 Direct Tax Revenue (5+6)	499559	488526	569013	16.5	570747	248724	We believe direct tax collection figure for FY13E would meet the target considering the healthy trend till date vs. the last year
5 Corporation Tax	327680	323250	373227	15.5	373555	153176	
6 Income tax	171879	165276	195786	18.5	197192	95548	
7 Indirect Tax Revenue	406103	402096	513219	27.6	498141	238101	While service tax is likely to exceed the budgeted target this fiscal due to broadening of tax base from July onwards, custom and excise duty target may fall short of the target given lower imports of precious metals including capital goods and lead to lower GDP
8 Customs Duty	153000	149489	186694	24.9	178952	91776	
9 Excise Duty	150696	145205	194350	33.8	181354	80008	
10 Service Tax	95000	97579	124000	27.1	126853	61334	
11 Others	7407	9823	8174	-16.8	10982	4983	
12 (-) Share of States in revenues	259412	258736	306541	18.5	309977	152942	
13 Non-tax revenue	124737	124307	164614	32.4	127280	70414	Of the budgeted ₹ 1,64,614 crore of non-tax revenues, the government has garnered only ~₹ 70414 crore (including ₹ 21,772 crore from economic service) as of October 2012
14 Capital Receipts (15+16)	551730	542251	555241	2.4	592266	375170	
15 Borrowings	521980	509731	513590	0.8	556266	367920	
16 Others	29750	32520	41650	28.1	36000	7250	We have factored in disinvestment proceeds of ~₹ 25,000 crore, ie. a shorfall of ₹ 5,000 crore from govt's disinvestment target of ₹ 30,000 crore
17 Non-plan expenditure	892116	884931	969900	9.6	1018456	554518	
18 Plan expenditure	426604	413513	521025	26.0	460000	224949	We build in higher non plan expenditure mainly due to higher petroleum and fertiliser subsidy burden
19 Total expenditure (17+18)	1318720	1298444	1490925	14.8	1478456	779467	
20 Fiscal deficit (1-2-13-16)	521980	509731	513590	0.8	556266	367920	Considering nominal GDP growth of 11.7% in H1FY13, we build in nominal GDP growth rate of 13% for FY13E assuming GDP growth rate of 14% in H2FY13E
21 Fiscal Deficit as % of GDP	5.9	5.8	5.1		5.6		We expect deficit slippage of around ~50 bps (~30 bps from revised government guidance) on account of low revenue from economic services (spectrum fee) and additional burden on the subsidy front (mainly petroleum and fertilisers) coupled with higher other non-planned expenditure
22 Nominal GDP (₹ trillion)	8.9	8.9	10.2		10.0		

Source: Budget documents -cga.nic.in, ICICIdirect.com Research

We build-in FY14E fiscal deficit target of 5.3%, assuming 12.4% growth in total receipts along with disinvestment target of ₹ 25,000 crore

What's not factored in

While introduction of the food security bill and higher crude prices remain a key upside risk to our fiscal deficit target, additional revenue from spectrum sale and a further hike in diesel prices would aid in containing the fiscal deficit to some extent

Fiscal deficit – What's in store for FY14??

We build in FY14E fiscal deficit target of 5.3%, assuming 12.4% growth in total receipts along with disinvestment target of ₹ 25,000 crore.

Particulars (₹ crore)	FY13BE	FY13IE	FY14IE	YoY %	Comments/Assumptions
1 Total Receipts (2+13+14)	1490925	1478456	1662133	12.4	
2 Net Tax receipts (3-12)	771071	758910	888604	17.1	
3 Tax revenue (Gross) (4+7)	1077612	1068888	1242803	16.3	
4 Direct Tax Revenue (5+6)	569013	570747	665802	16.7	
5 Corporation Tax	373227	373555	437060	17.0	We build in 16.7% growth in direct taxes revenues led by 16% growth in income tax and 17% increase in corporate taxes
6 Income tax	195786	197192	228742	16.0	
7 Indirect Tax Revenue	513219	498141	577001	15.8	
8 Customs Duty	186694	178952	186558	4.2	
9 Excise Duty	194350	181354	213998	18.0	Indirect taxes are expected to grow by 15.8% contributed mainly by 32% growth in service taxes (due to widening of service tax net)
10 Service Tax	124000	126853	167446	32.0	
11 Others	8174	10982	9000	-18.0	
12 (-) Share of States in revenues	306541	309977	354199	14.3	
13 Non-tax revenue	164614	127280	136740	7.4	We have not factored in any additional revenues from possible 4G auctions due to lack of clarity
14 Capital Receipts (15+16)	555241	592266	636789	7.5	
15 Borrowings	513590	556266	601789	8.2	
16 Others	41650	36000	35000	-2.8	We have factored in ₹ 25000 crore from disinvestment in FY14E
17 Non-plan expenditure	969900	1018456	1091733	7.2	Introduction of the food security bill and higher crude prices from current levels could further increase the subsidy bill and remains key upside risk to the fiscal deficit target
18 Plan expenditure	521025	460000	570400	24.0	
19 Total expenditure (17+18)	1490925	1478456	1662133	12.4	
20 Fiscal deficit (1-2-13-16)	513590	556266	601789	8.2	
21 Fiscal Deficit as % of GDP	5.1	5.6	5.3		We expect fiscal deficit of ~5.3% assuming nominal GDP growth rate of 13.5% in FY14E
22 Nominal GDP (₹ trillion)	10.2	10.0	11.4		

Source: Budget documents -cga.nic, ICICIdirect.com Research

Fiscal deficit – Sensitivity to disinvestment and crude prices

Sensitivity to disinvestment

FY13IE (₹ crore)			
Disinvesment Proceeds (₹ crore)	15,000	25,000	30,000
Fiscal Deficit (%)	5.66	5.56	5.51
Deviation from base case	(10) bps	0	5 bps

FY14IE (₹ crore)			
Disinvesment Proceeds (₹ crore)	10,000	25,000	40,000
Fiscal Deficit (%)	5.43	5.30	5.17
Deviation from base case	(13) bps	0	13 bps

We have assumed a shortfall of ₹ 5,000 crore in government's disinvestment target of ₹ 30,000 crore in our base case scenario. If the government succeeds in achieving its target (i.e. ₹ 30,000 crore) in FY13E, then fiscal deficit for FY13E would come down to 5.51% from our estimate of 5.56%. On the other hand, if the government falls short of budgeted disinvestment target by ~₹ 15,000 crore, then fiscal deficit would further increase by 10 bps to 5.66% compared to our estimate of 5.56%. For FY14, we have assumed disinvestment target of ₹ 25,000 crore in our base case. Any variation in disinvestment target by ₹ 15,000 crore on either side could lead to slippage/improvement in our fiscal deficit estimates by 13 bps from our base case.

Sensitivity to oil subsidy

We have assumed oil subsidy burden of ₹ 88,337 crore considering average crude oil prices at US$110/barrel, exchange rate of ₹ 54.5/US$ and government's share of 55% in gross under recoveries. An extremely positive scenario (i.e. exchange rate of ₹ 50/US$ and average crude price of US$90/barrel) would help the government in bringing down fiscal deficit by 58 bps from our base case. In contrast, it would impact fiscal deficit negatively by 59 bps if crude inches up to US$130/barrel along with exchange rate of ₹ 58/US$.

FY14E Gross underrecoveries under different scenarios…

	(₹ crore)	US $ exchange rate				
		50	52	54	56	58
Average Crude prices (In US$)	90	40,685	56,226	71,766	87,307	102,847
	95	59,987	76,300	92,613	108,925	125,238
	100	79,290	96,374	113,459	130,544	147,629
	105	98,592	116,449	134,306	152,162	170,019
	110	117,894	136,523	155,152	173,781	192,410
	115	137,196	156,597	175,998	195,399	214,800
	120	156,499	176,672	196,845	217,018	237,191
	125	175,801	196,746	217,691	238,636	259,582
	130	195,103	216,820	238,538	260,255	281,972

Source: ICICIdirect.com Research

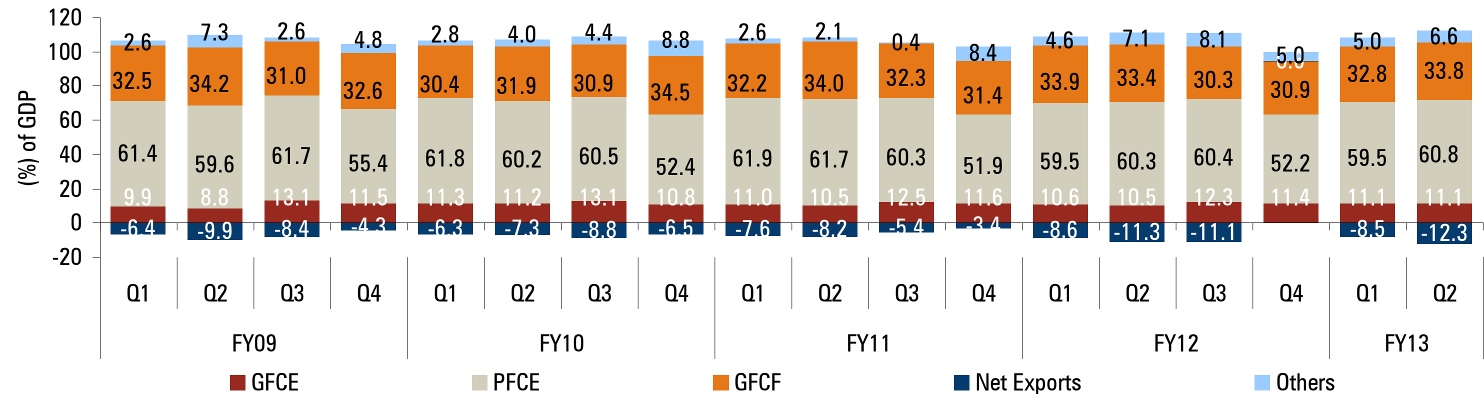
…Impact on fiscal deficit

	(In bps)	US $ exchange rate				
		50	52	54	56	58
Average Crude prices (In US$)	90	(58.1)	(50.5)	(43.0)	(35.5)	(28.0)
	95	(48.7)	(40.8)	(32.9)	(25.0)	(17.1)
	100	(39.4)	(31.1)	(22.8)	(14.6)	(6.3)
	105	(30.0)	(21.4)	(12.7)	(4.1)	4.6
	110	(20.7)	(11.7)	(2.6)	6.4	15.4
	115	(11.3)	(1.9)	7.5	16.8	26.2
	120	(2.0)	7.8	17.5	27.3	37.1
	125	7.4	17.5	27.6	37.8	47.9
	130	16.7	27.2	37.7	48.3	58.8

Source: ICICIdirect.com Research

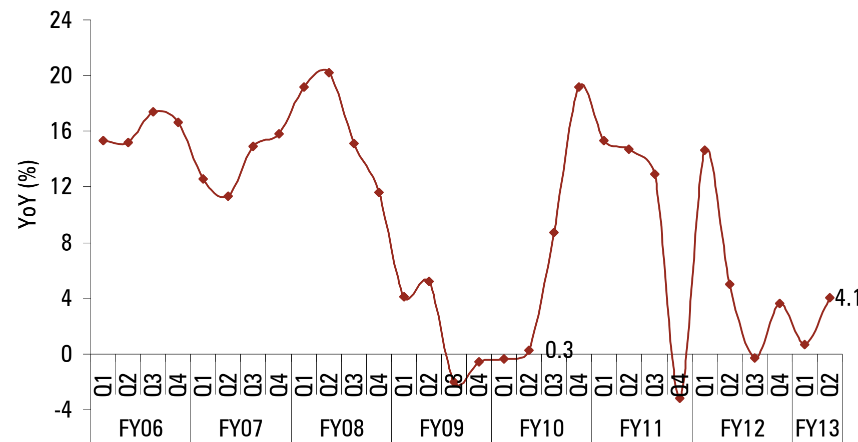
Consumption leg also weak…we need fresh investment drive for long term growth

A weak global economy led to a decline in exports even as INR depreciation aided it. However, elevated crude and gold prices kept the net export component of GDP down, further pulling down incremental GDP growth

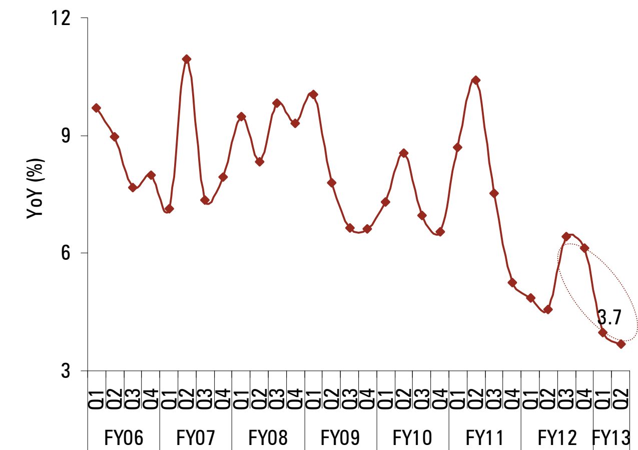


The expenditure side GDP growth moderated sharply to 2.8% in Q2FY13 from 6.9% in the corresponding quarter of the previous year. Private final consumption expenditure and gross fixed capital formation, which account for around 60% and 30%, respectively, of GDP and which had both decelerated in the previous year, slackened further in 2012-13

Capital formation -GFCF takes a beating



Consumption-PFCE also touches record lows



The investment drive has remained muted. There was meagre 4.1% YoY growth in GFCF in Q2FY13, the impact of which may have dire consequences as fresh capacity expansion continues to face a slowdown

Source for all charts: MOSPI, ICICIdirect.com Research

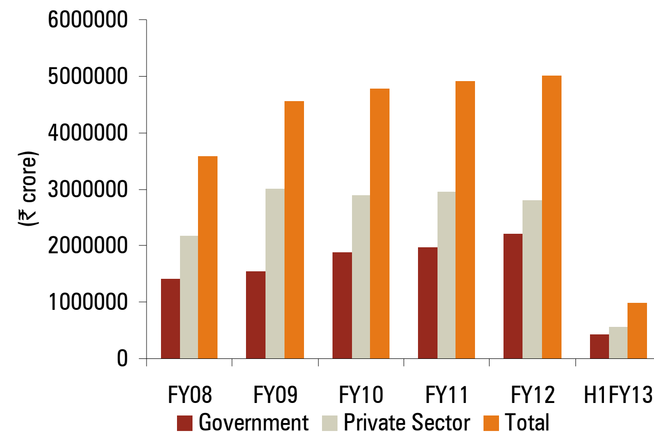
Infrastructure investment remains dismal…stalled/shelved projects at all-time high

- Unresolved structural issues in infrastructure such as lack of clarity over fuel linkage in the power vertical, ADF issue and real estate monetization ambiguity in the airport vertical coupled with an already stretched balance sheet of most infrastructure players in the high interest rate scenario led to a sharp rise in the level of stalled shelved project and a decline in new investment in the sector
- As per CMIE capital expenditure data, the aggregate stalled/shelved projects remained at an all-time high level at ₹ 477203 crore in FY12 and ₹ 202,992 crore in H1FY13. Furthermore, new project announcements have declined to ₹ 991,675 crore in H1FY13 vs. ₹ 50,21,500 crore in FY12
- The year also saw public-private partnership projects (such as DIAL, Mumbai Pune Project, etc.) coming under scrutiny, which has further added to the woes in infrastructure

Given the unresolved structural issues in infrastructure coupled with a stretched balance sheet in a high interest rate scenario, the project shelved/stalled has reached an all-time high level whereas the new project investment is at a lower level indicating lower confidence for investment in the economy

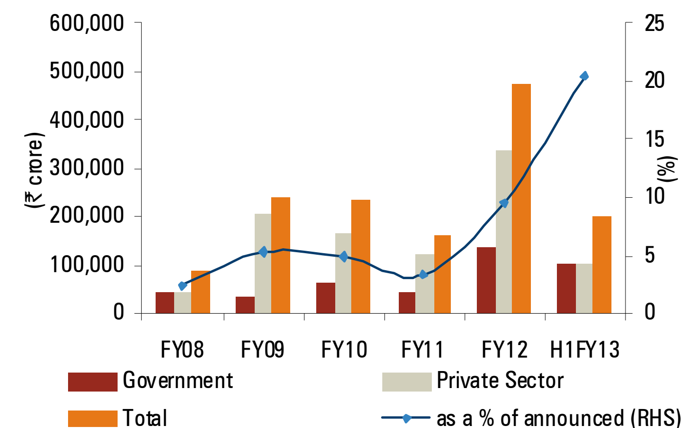
Unresolved structural issues lead to delays in investments across sectors…

New project announcement remains muted



Source: CMIE, ICICIdirect.com Research

Stalled/shelved projects at all-time high



Source: CMIE, ICICIdirect.com Research

Infrastructure reforms drive, rate cut needed to prop up GFCF/investments

The easing of repo rates would be the biggest catalyst for execution pick-up in the infrastructure space because the interest rate pain is the biggest deterrent as projects become unviable. We believe the government would act in FY14E to promote the Infrastructure space

We expect the performance of the infrastructure sector in CY13 to be mainly driven by implementation of key reforms, such as setting up of Cabinet Committee on Infrastructure (CCI) coupled with anticipated reduction in the interest rate that would expedite the approval process – a key problem faced by all projects. MOSPI data reveals that out of 198 mega projects (investment exceeding ₹ 1,000 crore), 36% witnessed cost overrun while 46% witnessed time overrun. Some of these projects witnessed a time delay as high as 15 years and cost escalation as high as 133% greater than projected and have been getting executed since 1997. Hence, expediting of approval process is the key not only for the new investment but also for revival of stalled/shelved projects.

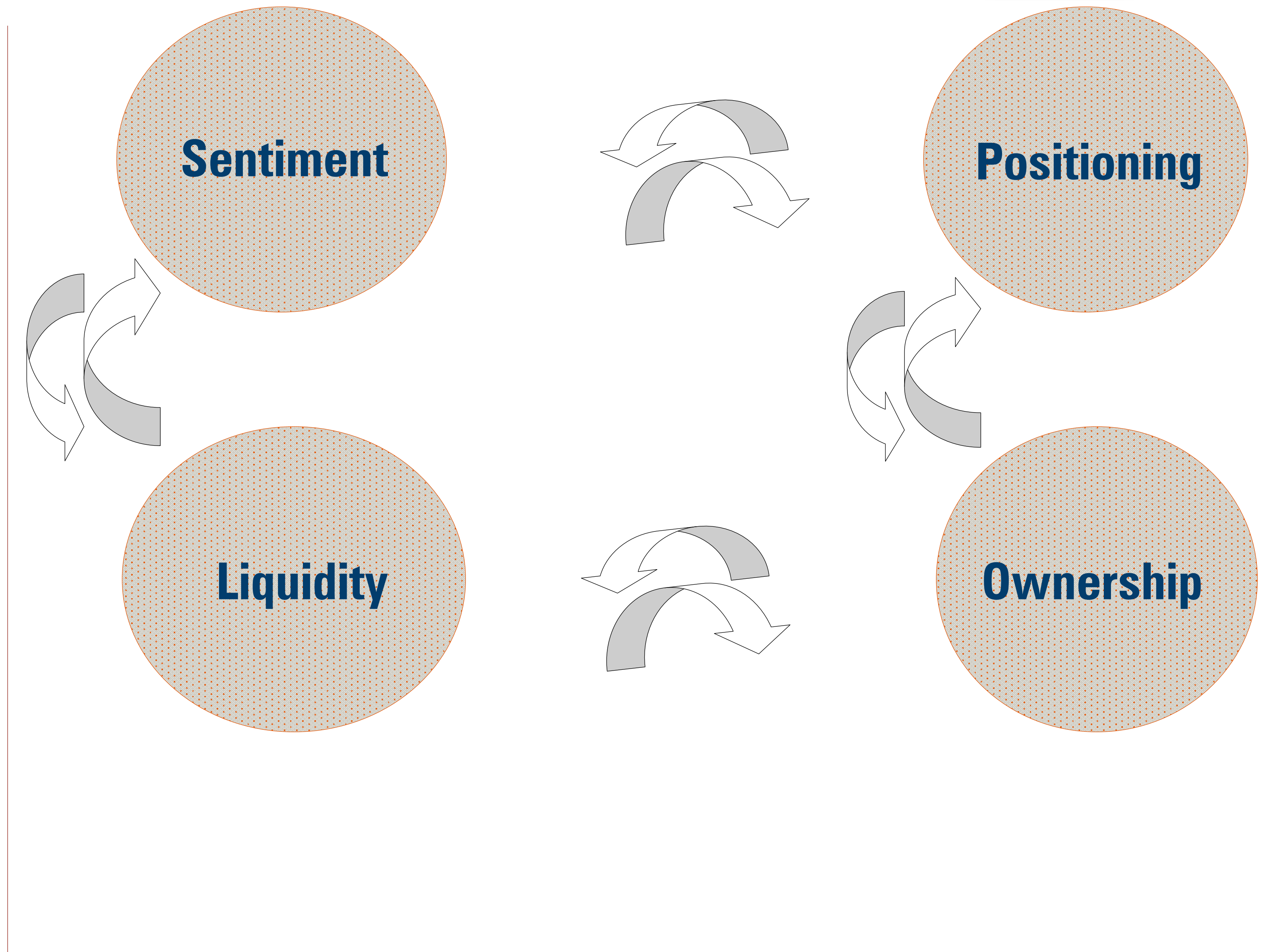
- The Cabinet has approved setting up of Cabinet Committee on Infrastructure (CCI) headed by the Prime Minister, which will monitor and advise ministries on expediting projects entailing investments in excess of ₹ 1,000 crore. This move, we believe, would be a key trigger for an improvement in the investment environment as CCI will monitor and closely follow up with various clearances once the set deadline for the clearance is over. As a result, project execution can be put on the fast track

The MOSPI data shows that out of 198 large size projects (project cost over ₹ 1000 crore), 91 have seen time overruns while 72 have witnessed cost escalations due to such delays

Status on 198 mega projects with investment over ₹ 1000 crore stuck beyond one-year

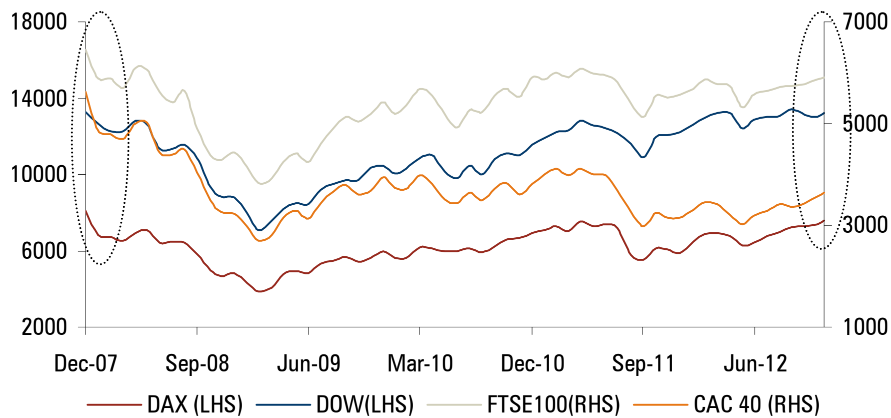
Sectors	No. of projects	Original cost(₹ crore)	Anticipated Cost (₹ crore)	Cost overruns (%)	No. of projects with cost escalation	No. of projects with time overrun	Range of time overruns (months)
Atomic Energy	5	41548	47832	15.1	2	3	3 - 51
Civil	2	3751	4340	15.7	2	1	17 - 17
Coal	9	22364	23157	3.5	2	3	24 - 45
Fertilisers	3	4066	4066	0.0	0	0	0
Steel	6	61412	66976	9.1	2	5	3 - 41
Petrochemicals	1	5461	8920	63.4	1	0	-
Petroleum	35	141231	150556	6.6	9	18	3 - 120
Power	60	218267	231158	5.9	13	33	3 - 99
Railways	40	41460	96482	132.7	35	17	1 - 201
Road Transport & Highways	27	41723	42903	2.8	1	6	5 - 21
Shipping & Ports	5	9066	10126	11.7	3	3	9 - 34
Telecommunications	1	1077	1077	0.0	0	0	-
Urban Development	3	44131	49345	11.8	1	1	15 - 15
Water Resources	1	543	1187	118.6	1	1	60 - 60
Total	198	636098	738125	16.0	72	91	

Source: MOSPI (up to July, 2012), ICICIdirect.com Research

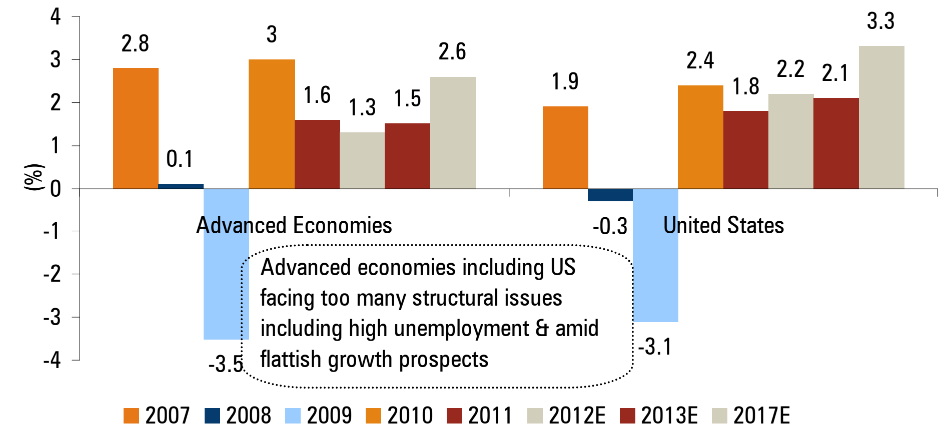

Sentiment
Positioning
Liquidity
Ownership

Rising markets…falling/flattish growth rates!!!

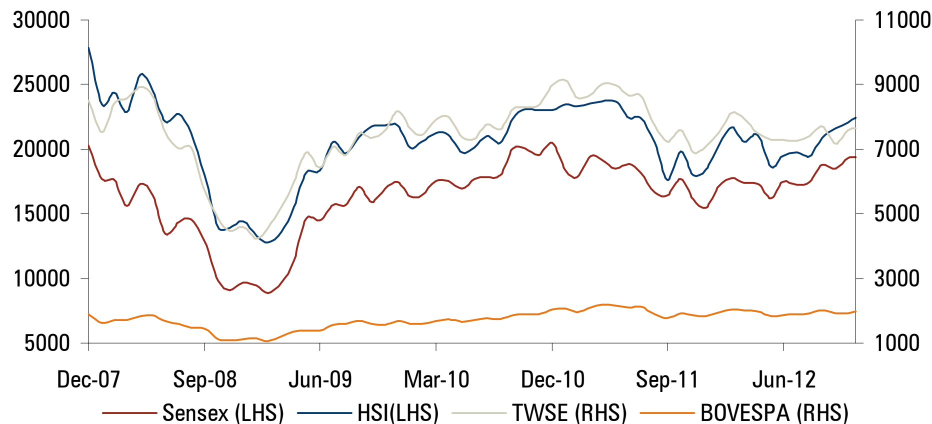
Advanced economy stock markets approaching 2008 high…



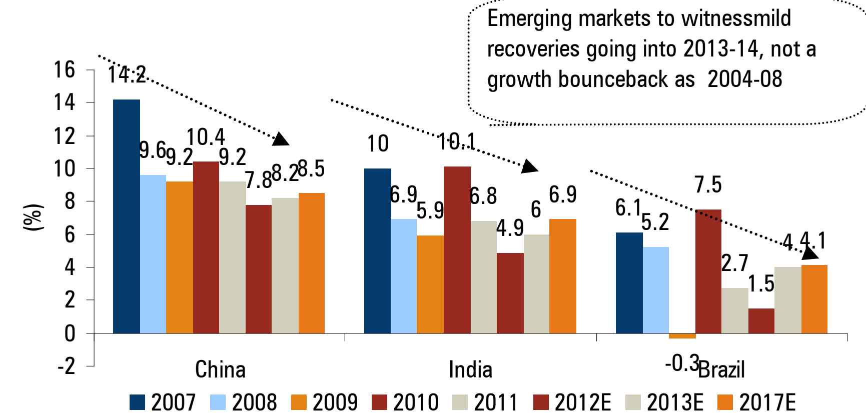
…but GDP growth outlook dismal going into 2013



Emerging markets more volatile but still high



…as their economies recovering moderately out of cyclical headwinds



Source for all charts: Bloomberg, IMF, ICICIdirect.com Research

…as cheap money party continues to augment global liquidity and "Risk on Trade"

Bernanke's QE inflates financial assets across cycles …

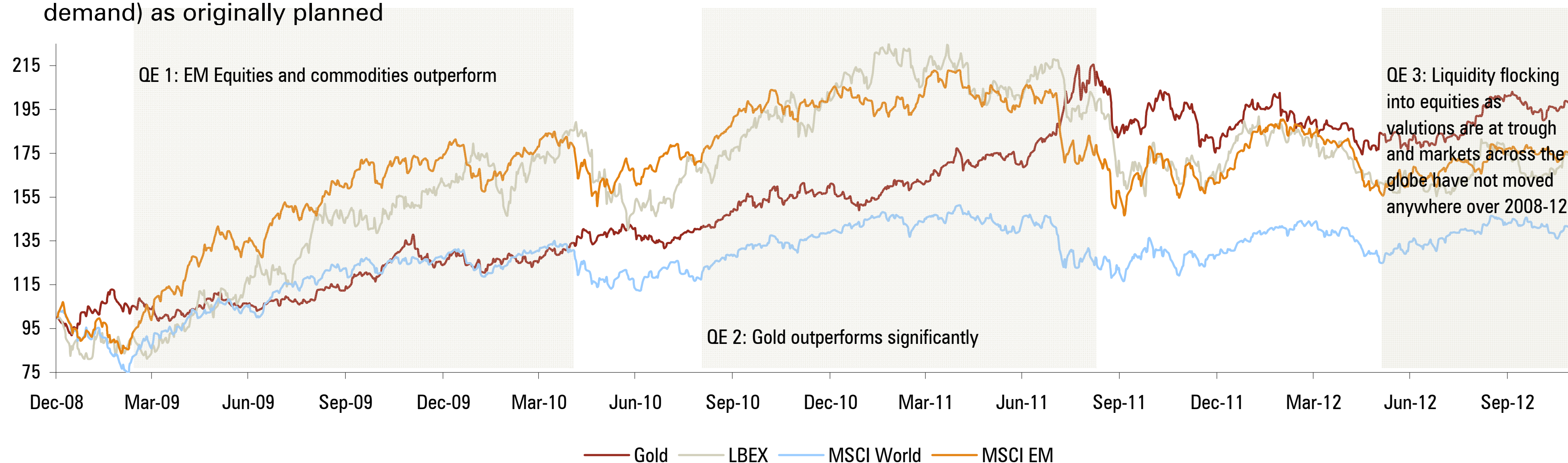
- QE1 (March 2009): Spends $1 trillion to resuscitate the recession-hit US economy, including buying billions of dollars of government debt
- QE2 (November 2010): Buys $600 bn in long term treasuries over next few months along with reinvestment of additional $250-300 billion. Total easing was around $900 billion
- QE3: (September 2012): Open-ended and involves purchase of mortgage backed securities (MBS) at a pace of US$40 billion/month. The Fed also decided to continue its maturity extension programme (MEP), (or Operation Twist, buying higher maturity securities to lower long term rates to spur demand) as originally planned

…and so does Super Mario's LTROs

LTRO 1 (December 2011): European banks borrowed €489 billion from the ECB. The loans are due to be repaid within three years
LTRO 2 (February 2012): ECB offered another unlimited three-year LTRO, at a cost of 1%. In this operation, banks raised €529.5 billion

Even BoJ on same page as its Western counterparts

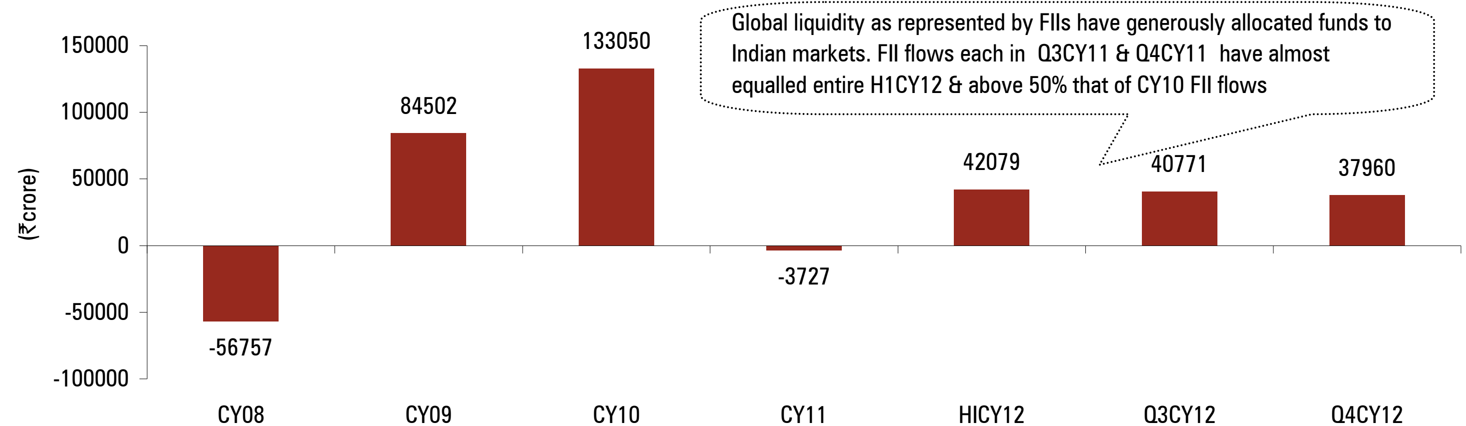
- During the later part of the year, Bank of Japan expanded its asset purchase programme to ¥76 trillion while a separate credit loan programme was made available at ¥25 trillion



Source: Bloomberg, ICICIdirect.com Research

H2CY13: Massive Allocation of FII, sign of liquidity chasing assets or fundamentals???

Q3CY12 and Q4CY12 each witness equivalent FII flows of what was invested in H1CY12...



...but other Asian counterparts have also witnessed strong global liquidity

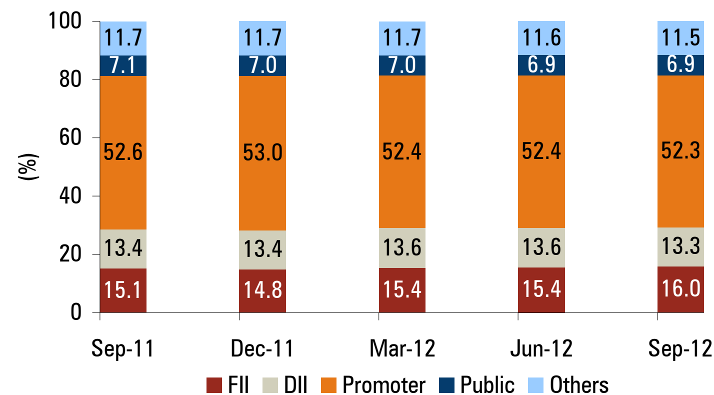
Asia	(Mil US$)	YoY%
India	22526	5042.90%
Indonesia	1611	-42.10%
Japan	11359	401.40%
Pakistan	133	212.70%
Philippines	2426	91.60%
S. Korea	14156	246.00%
Sri Lanka	284	599.40%
Taiwan	4602	146.60%
Thailand	2267	605.40%
Vietnam	101	13.20%

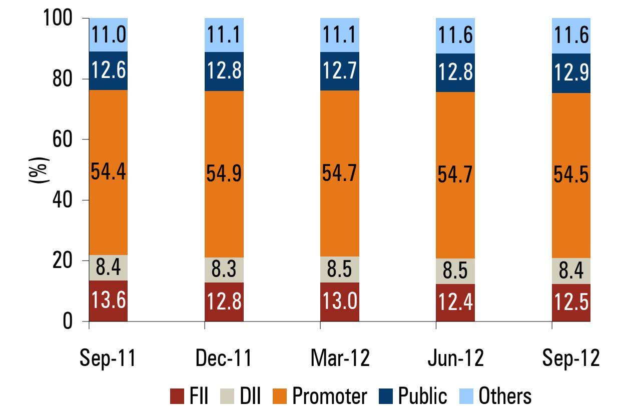
Source: Bloomberg, ICICIdirect.com Research

- Apart from India, many other Asian economies have witnessed 2-6x rise in FII flows. This reiterates our sense that this time around risk on trade/cheap money is chasing equities unlike previous allocation wherein commodity/bullion/treasuries outperformed

- In case of India, the above holds true but inflows are more severe (50x rise in CY12) given the uptick in reforms that has begun/inexpensive valuations/relatively better country economics

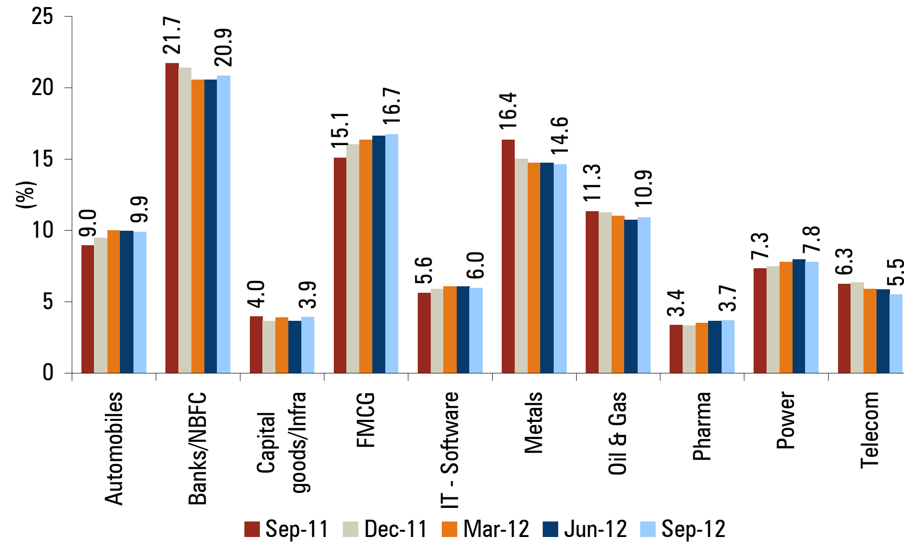
Cues from FII shareholding pattern



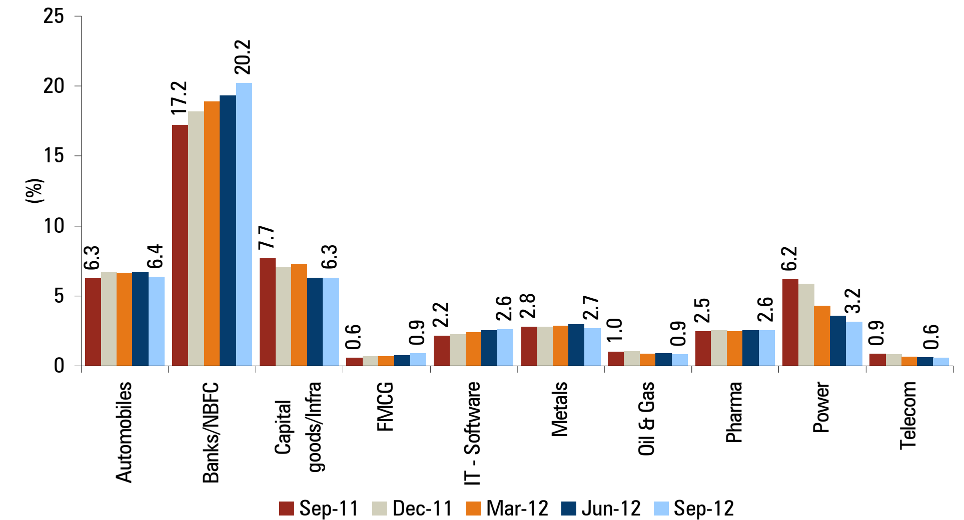


- On a YoY basis, FIIs have shown a preference for large cap stocks, while they have pared their holdings in midcaps.
- On a QoQ basis there has been a marginally higher allocation to midcaps by FIIs yet they appear to be under owned. However this could see higher allocation from FIIs going ahead as broader market starts to consolidate.

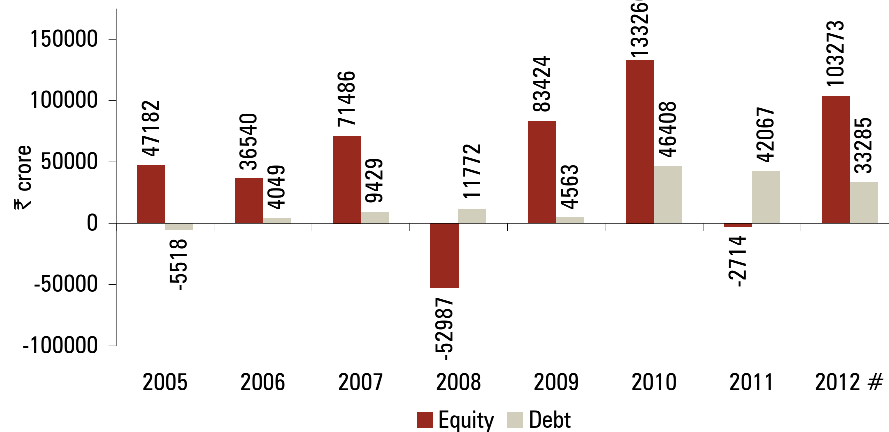
BSE Sensex Companies - FII Holding



BSE Midcap Companies – FII Holding



FII Net Investment in Equity and Debt (Yearly)



- Sectors like capital goods and power, where project execution is a key concern, have seen FIIs maintaining their holding in large caps and reducing their exposure in midcaps YoY

- FIIs have balanced their proportion of investment in banking/NBFC companies by reducing their holding in large caps and aggressively adding midcap banking/NBFCs in their portfolio. The rate sensitive play seems to be playing out through this path

Source: Capitaline, Sebi, ICICIdirect.com Research, # -Data for 2012 is for 11 months ended CY12 (Jan to Nov'12)

Reverse the climate of pessimism... Revive the animal spirit in the country's economy,"

I will personally review the performance of the infrastructure ministries compared with targets at the end of the first six months"

"The Cabinet has taken many decisions today to bolster economic growth and make India a more attractive destination for foreign investment

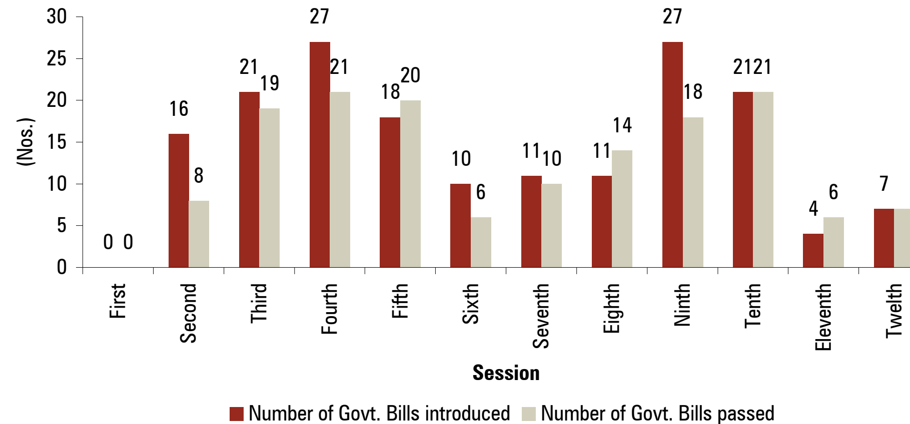
On fiscal deficit, "if unchecked, this would lead to a further steep rise in prices and a loss of confidence in our economy"

Late up-tick in reforms: Will it revive animal spirits???

Reforms / Bills	Status	Impact
Petrol de-control	Partially Implemented	Petrol decontrol resulted in elimination of subsidy on petrol, which was ₹ 5000 crore in FY11 and ₹ 2000 crore in FY12
Diesel price hike by ₹ 5 /. Litre	Implemented	Petroleum subsidy reduced by ₹ 20000 crore
FDI in retail	Allowed	The benefits of this will flow in the longer term (5-7 years)
FDI in aviation	Allowed	Opening up new window for fund raising, a positive move for the sector
FDI in broadcasting carrier services raised from 49% to 74%	Allowed	Cable & satellite industries especially cable companies would attract FDI, which would help them fund the Phase II of impending digitisation
Cut 2G auction base price by ~30% for four circles; to auction spectrum in 900 MHz in three circles	Implemented	The reserve price still remains high in metro circles of Delhi and Mumbai. The government expects to collect ₹ 20000 crore from these auctions
Set up Cabinet Committee on Infrastructure (CCI)	Implemented	The body would be key in expediting clearance mechanism of mega infrastructure projects worth ₹ 1000 crore, most of which are facing delays due to slow moving clearance mechanism
Banking Law Amendment Bill	Passed	RBI will start the process of issuing new bank licenses, voting rights increase will also be positive for PSU banks
Enforcement of Security Interest and Recovery of Debts Laws	Passed	Enhances bank's recovery power
Insurance Law Amendment Bill	Pending	Raise the FDI cap in private insurers to 49% from the existing 26% and would lead to additional flow of funds in to the sector, more players, better products and will augment flow of long term resources for financing infrastructure
Micro Finance Institutions (Development and Regulation) Bill	Pending	It would make the microfinance industry more regulated; however will impact margins and profitability of the sector
Pension Fund Regulatory and Development Authority Bill	Pending	It would give statutory powers to the interim pension regulator and open the sector to FDI, augment flow of long term resources for financing infrastructure
Land Acquisition Bill	Pending	It would lead to increase in cost across projects. However, the process of acquisition would be streamlined and would help reduce delays
Mineral and Mining Bill	Pending	Though the proposed MMRDA bill will lead to additional expenditure for the minerals mining industry, in the long run it is likely to benefit the industry by way of swift processing of mining applications, which will indeed bring some amount of transparency & accountability in the system

Source: ICICIdirect.com Research

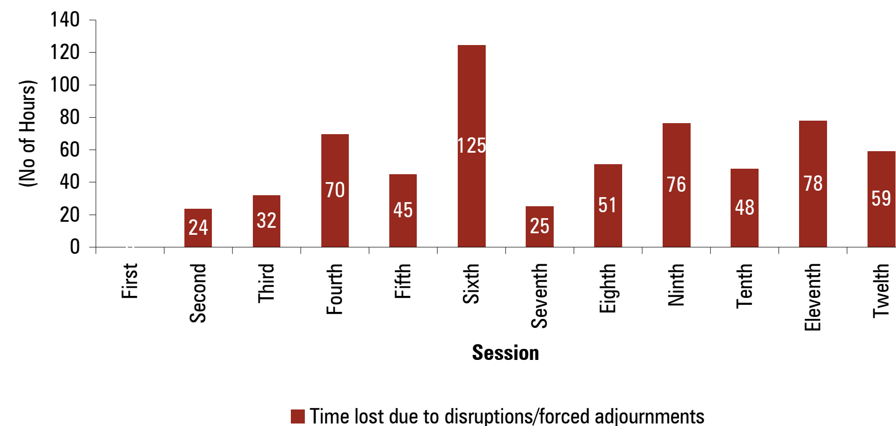
Parliament passed some important amendments in the current winter session…



Major Bills Passed in winter session of Lok Sabha (LS)

- Banking Law Amendment Bill
- The companies Amendment Bill
  The Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Bill, 2011

Parliament starts functioning after obstructions in previous sessions …

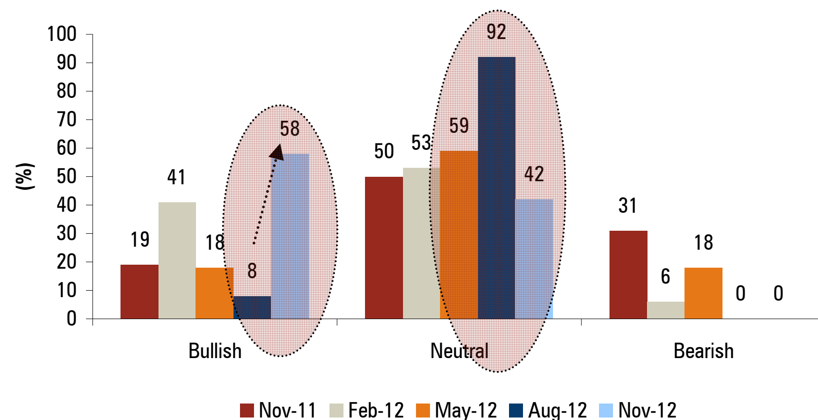


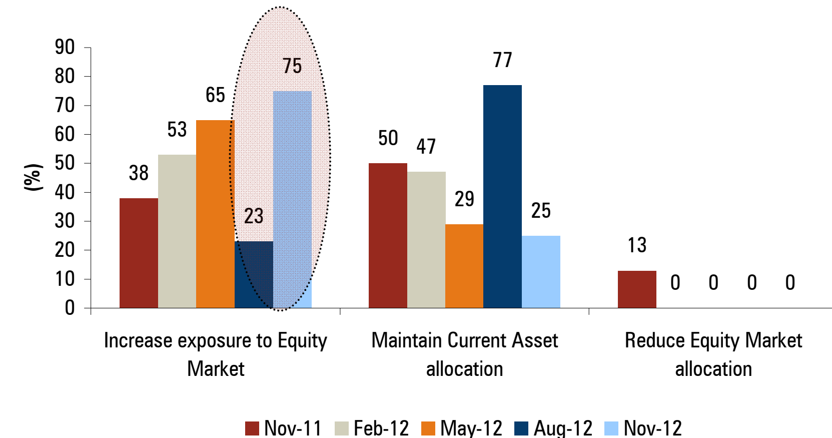
Assembly Elections in 2013

States	Elections Due	Incumbent Government
Meghalaya	Mar-13	MPA
Nagaland	Mar-13	DAN
Tripura	Mar-13	CPI(M)
Karnataka	Jun-13	BJP
Mizoram	Dec-13	INC
Delhi	Dec-13	INC
MP	Dec-13	BJP
Chattisgarh	Dec-13	BJP
Rajasthan	Dec-13	INC

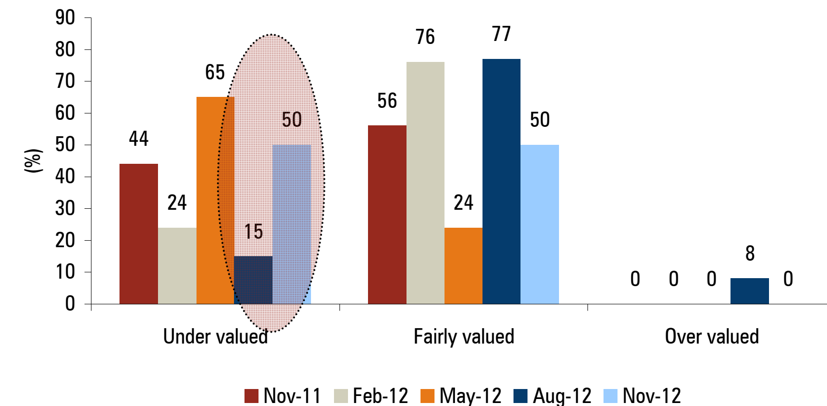
Source: www.parliamentofindia.nic.in

Domestic institutional investors turning positive sentimentally…





- The key takeaway of our survey is that domestic fund managers have turned more confident on the Indian equity market especially after the recent reform announcement by the government
- The near term bullish outlook on the Indian equity market has increased significantly with 58% of the respondent as against only 8% in the August survey now bullish in the near term
- On the valuation front, opinion seems divided over whether the markets are under valued or fairly valued with 50% of them expecting markets to be under valued while the remaining 50% believe it to be fairly valued. However, nobody believe that markets are over valued
- Total 75% of the fund managers advise investors to increase allocation towards the equity market

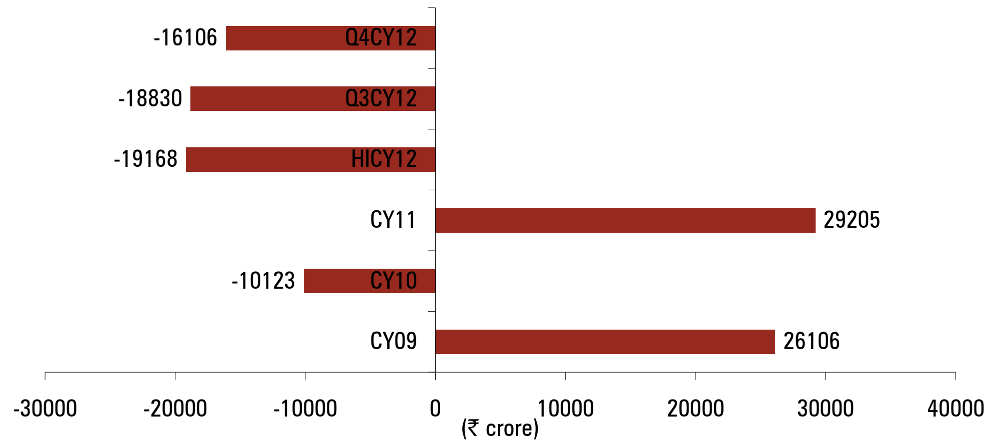


Source: ICICIdirect.com Research

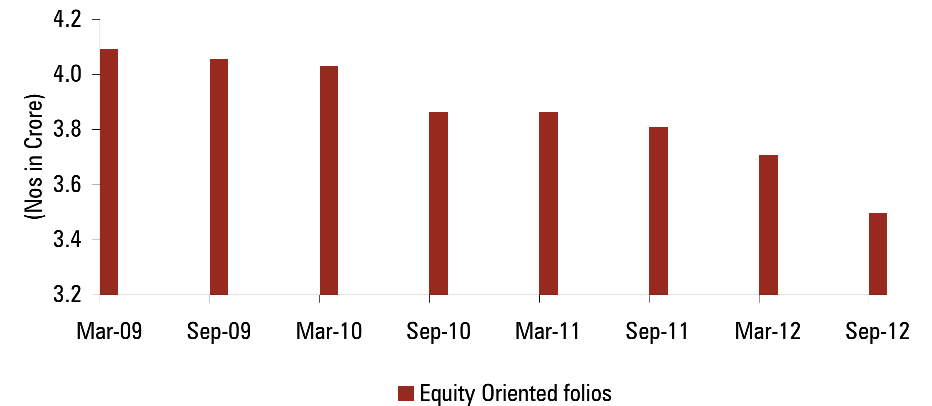
**The above results are part of the survey done by ICICI Securities every quarter among top domestic mutual fund managers*

Woo retail investors as sentiments are still mixed there…

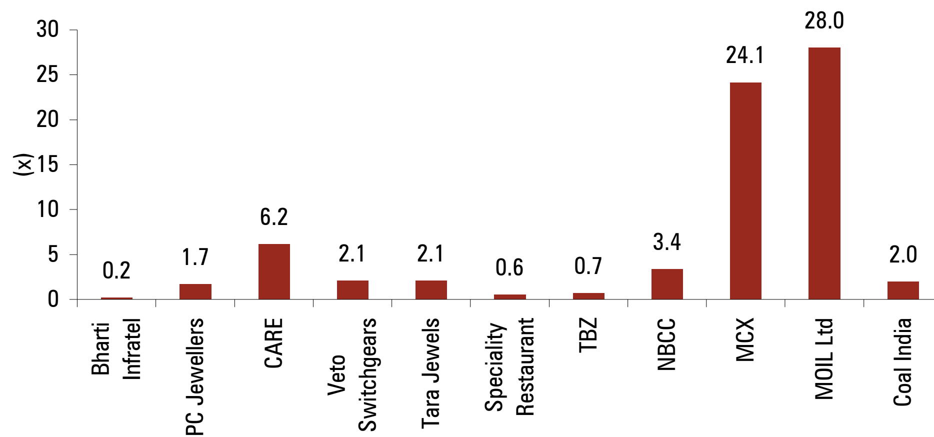
MFs have been sheer sellers owing to redemption pressures …



…as number of equity portfolios has shown sharp declines



Trend in retail participation in direct equity improving… but no way near historical higher levels



Source: Bloomberg, AMFI, NSE, Money control ICICIdirect.com Research

Market Outlook & Corporate Fundamentals

Broader market outlook for CY13!

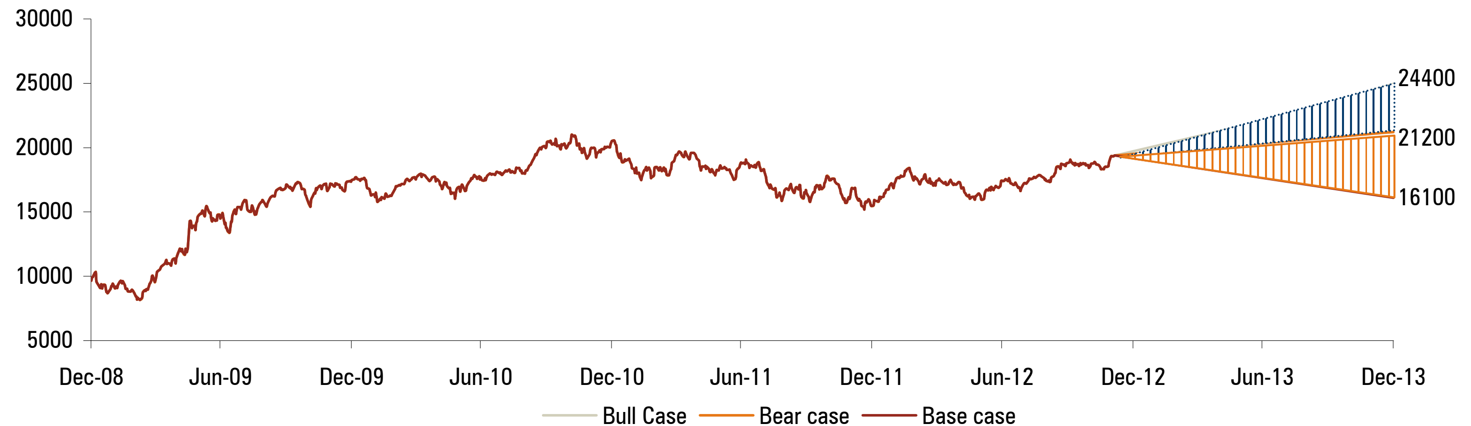
The picture today as we end CY12 is vastly different to the way we had entered it. The market has rallied ~25% this year and we stand with another question as to what now?

We believe the year would be more of a consolidation with H1CY13 leading a cyclical rally on rate cut expectations and then the Union Budget becoming imperative for further upsides in the broader market.

In terms of Sensex earnings, we believe earnings growth in base case should be ~17% for FY14E trading with 15x PE multiple. We have assigned a 70% probability for the same. We have also assigned 15% each probability for the bull/bear cases, which we feel remains slightly far-fetched but could pan out in case of stellar domestic reforms/rate cuts along with a steep fall in commodities or vice versa

On a cumulative basis, we feel the broader market would have limited upside of ~8% with a target of 20,900

Where our "beloved" Sensex could be heading?



Case	Probability	Sensex EPS FY14E	PE(x)	Sensex levels	Remarks	Cumulative Sensex target
Bull case	15%	1477	16.5	24400	The bull case scenario has been built on the premise of ~150 bps of repo rate cut primarily frontloaded leading to a decline of cost of debt impacting overall profits (ex-banks) by 80 bps. This along with GDP growth in excess of 6.5%, lower commodity costs will add another ~200 bps on the bottomline from base case. This equates to Sensex EPS growth of 22% for FY14E	
Base case	70%	1415	15	21200	The base case scenario has been built on the premise of ~100 bps of repo rate cut through CY13E leading to slower impact cost of debt, overall impact on profits (ex-banks) by 50 bps, commodities to remain stable .GDP growth expected to be ~6.5%. This equates to Sensex EPS growth of 17.3% for FY14E	20900
Bear case	15%	1193	13.5	16100	The bear case scenario has been built on the premise of only ~50 bps of repo rate cut as inflation rises again beyond 8% in H1FY14E. Slower GDP growth below 5.5%, higher commodity prices coupled with higher working capital requirements could lead to impact of 500 bps on bottomline. This equates to Sensex EPS de-growth of 1% for FY14E	

Source (for all charts): Bloomberg, ICICIdirect.com Research

Perennial challenge of valuations!

The absolute valuations of the Indian market (Sensex) remain attractive at 14.2x price earnings one-year forward, which are still at ~17% discount to its six-year mean. Though growth has also slowed down on an absolute basis, domestically it is still relatively better than globally.

The story of attractiveness of multiples becomes even stronger when we analyze on a price to book basis. Here, the market multiple is trading at 2.3x which is close to the 2.2x floor multiple witnessed in the last 6-years. The mean multiple for the same period remains at 2.7x.

On the flip side, the book value growth is expected to outpace EPS growth by~ 220bps at 12.4% CAGR FY12-14E.

This provides us with some confidence in an uncertain earnings environment that Sensex P/BV multiple seems to reasonable with steady book value accretion.

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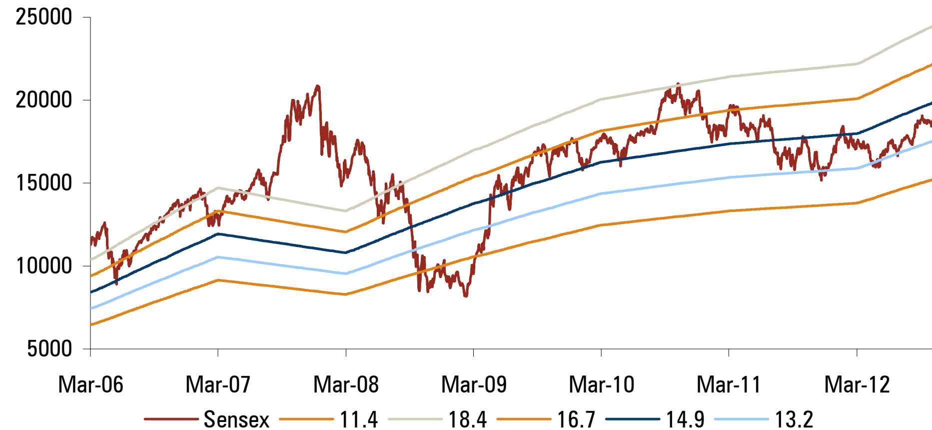
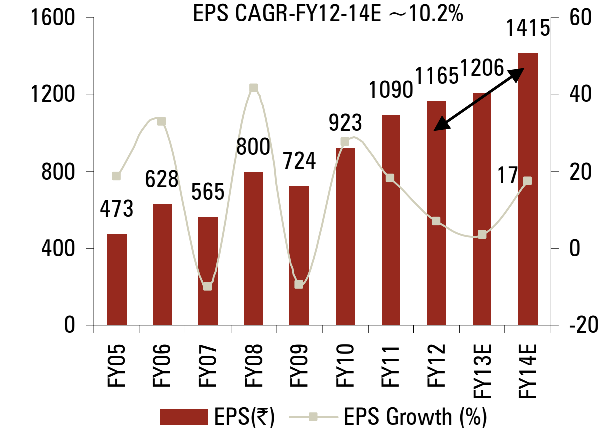
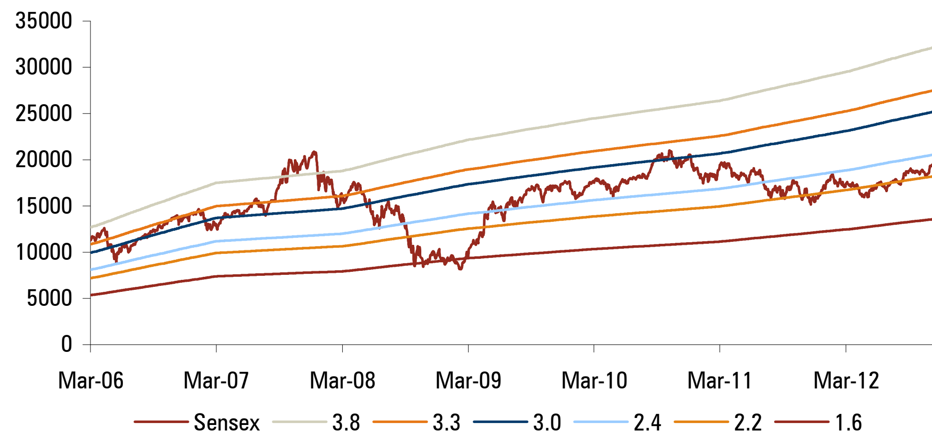
One-year forward PE multiples remain subdued



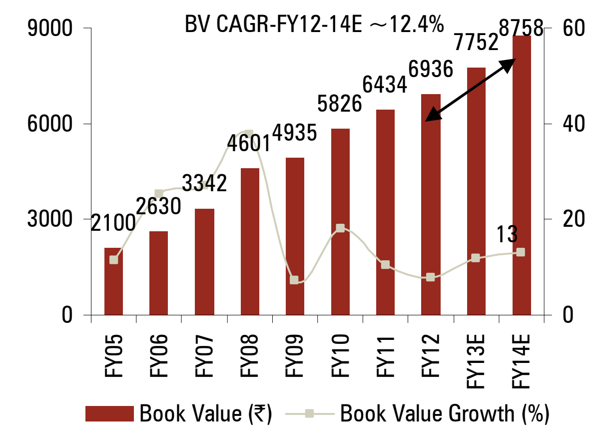
Earnings trend improving



One-year forward P/BV multiples make Indian case enticing



Book value accretion remains strong

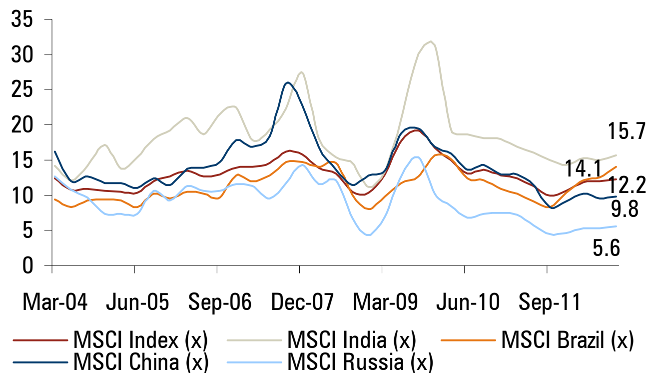


Source (for all charts): Capitaline, ICICIdirect.com Research

How do we fare against our EM peers…

India as a market has received more than $22 billion in terms of flows, the second largest in the history of capital markets. Some key reasons elucidated below make the Indian story attractive to the *global liquidity seeking a home.*

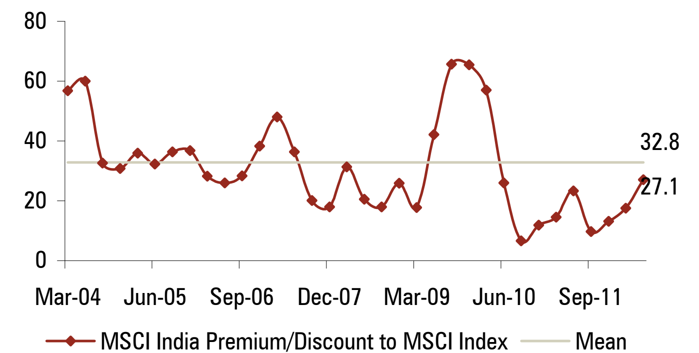
Trailing 12 month PE multiples for MSCI comparables



On trailing PE multiples, historically India has always enjoyed a strong premium to its peers. The premium vis-à-vis MSCI has averaged ~40% for the last eight years.

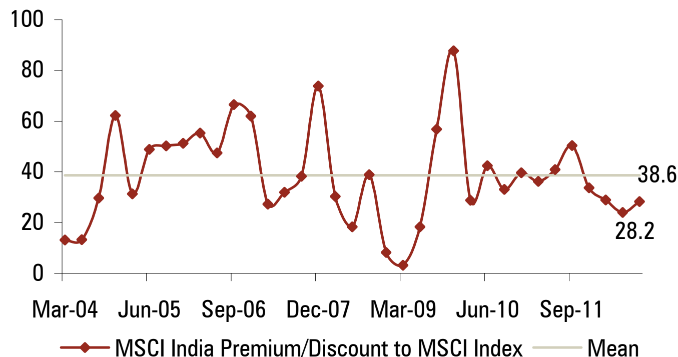
If we look back in this time frame, only during the Lehmann crisis has this premium shrunk below double digits. The current mid-year reversal of premium from the early 20s has signs of flows being aided by valuations.

RoEs growth trending towards mean!



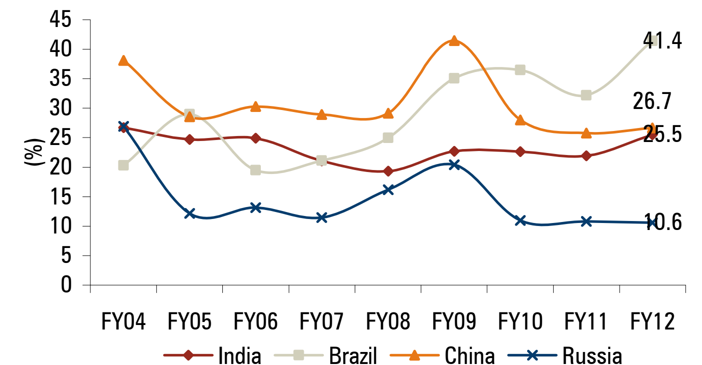
Traditionally, the RoE performance, which India delivered, had been strong. However, at present, it remains close to its nine-year low with early signs that an improvement on earnings RoE could aid it in bouncing back fast.

Can the PE multiples re-rate? Still considerable discount visi



The dividend payout ratio of India (~25%) remains very stable highlighting strong minority shareholder rewarding practice. In comparison to MSCI peers, the payout has steadily has become similar to MSCI China with Brazil remaining higher with liberal dividend tax regime

Dividend payout stability commendable …



Source (for all charts): Bloomberg, ICICIdirect.com Research

The market has witnessed a stellar run-up in pure defensive stocks (FMCG-HUL & ITC) whose one-year forward PE multiples have risen in excess of 30x which remains close to its all time high.

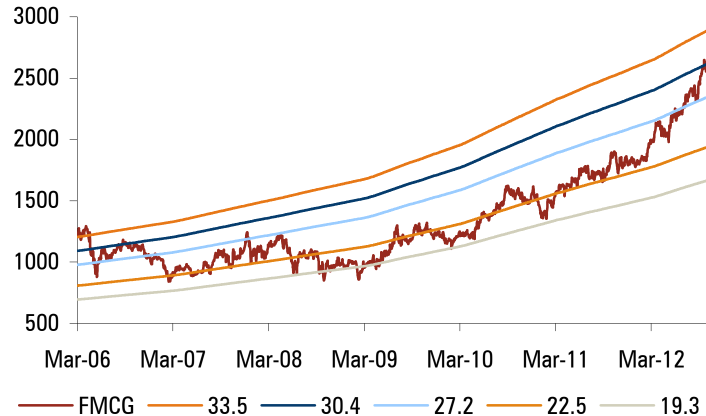
In comparison to this the market (ex-FMCG) is trading at close to multi-year low at ~12.5x PE multiple. The only prior exception to multiples falling below 12.5x was during the Lehman crisis. Thus, valuations provide a case for cautious optimism even post the recent rally

We analysed one-year forward premium of both FMCG/ex-FMCG with their respective mean multiples for last 6-years. A startling revelation we came across was that the gap between these individual premiums has arrived at the bull market levels of FY08 when defensives were out of favour and cyclicals ruled the roost.

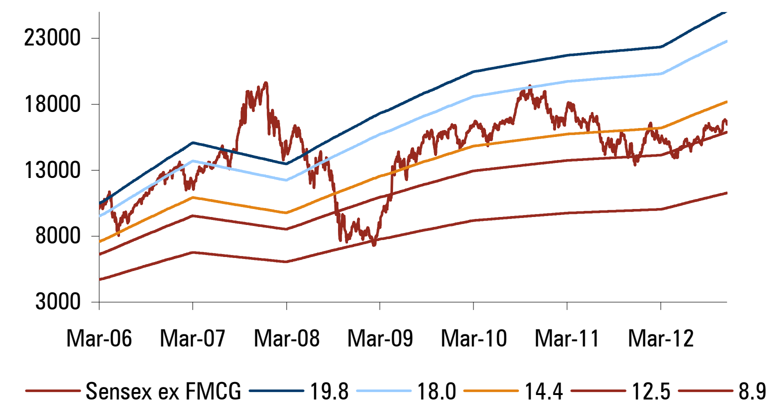
Thus, slowly but surely this trade of Ex-FMCG is becoming increasingly *"commonsensical"*.

Can cyclical make a case for buying cyclicals vis-à-vis defensives?

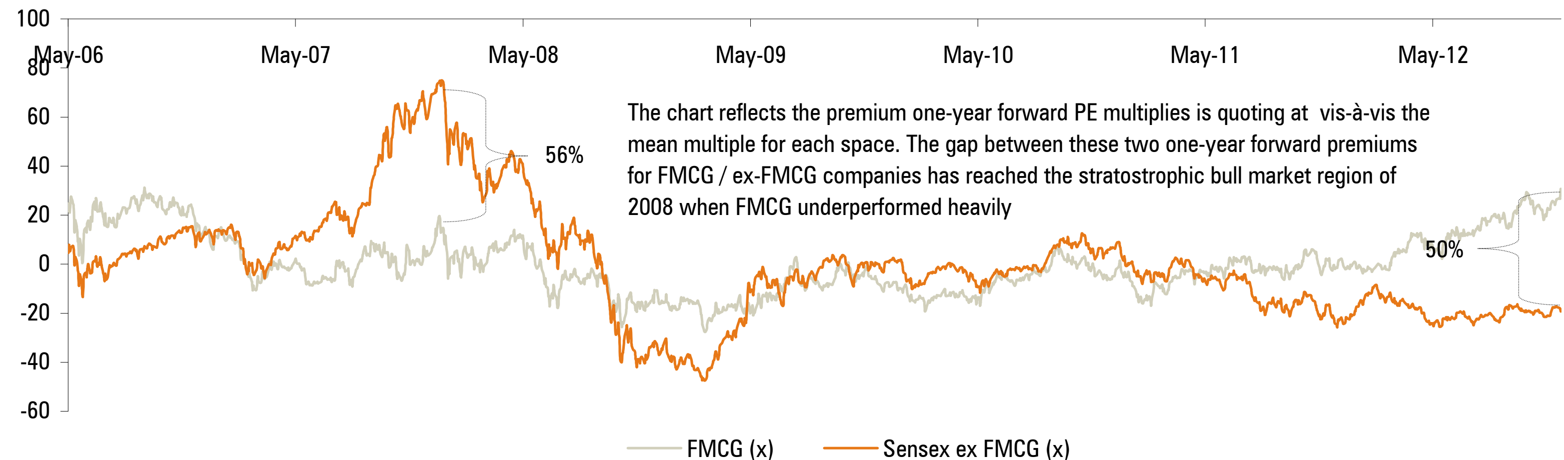
History says one-year forward PE multiple for FMCG space defying gravity…



History also says cyclical multiples to trend up a decent trade!



Premium of multiples FMCG/ex-FMCG Sensex with its mean are showing a certain degree of over-optimism like 2008!

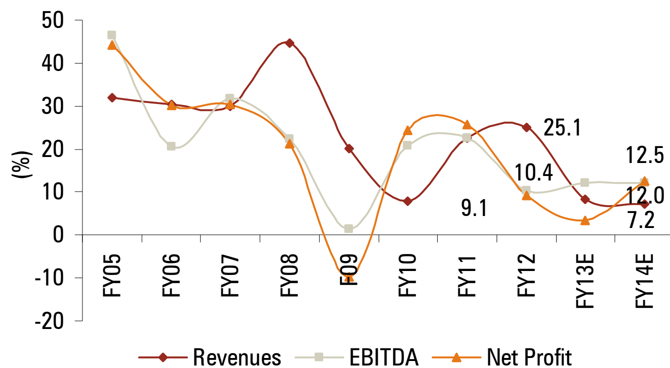


Source (for all charts): Bloomberg, BSE, ICICIdirect.com Research

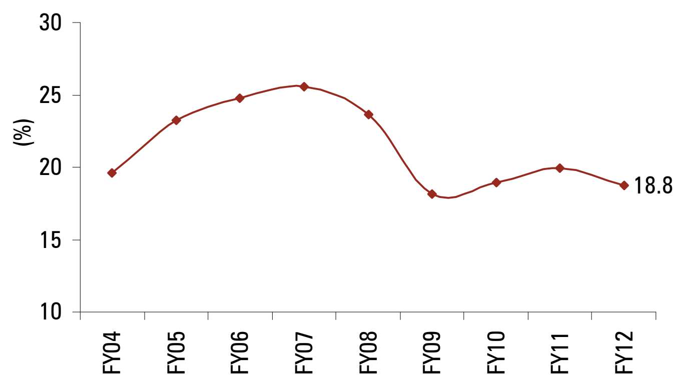
Dissecting Corporate India's performance…

In our top down analysis, we have seen Sensex company's fundamentals witnessing some deterioration in the last two years. However, signs of bottoming out are clearly visible as margins and RoEs have started to stabilise/improve.

How has headline numbers growth panned



Market awaiting more RoE juice



Source: Capitaline, ICICIdirect.com Research; data in charts is ex-banks

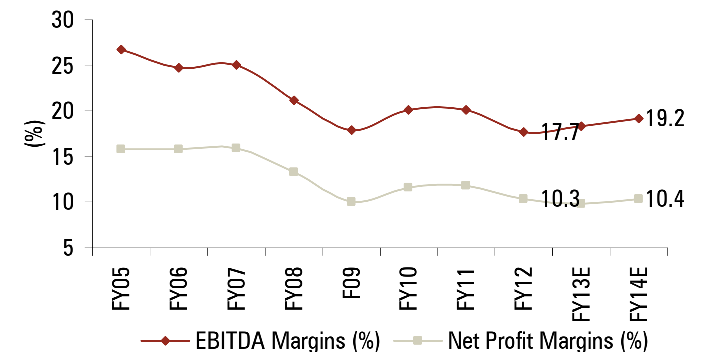
The Sensex-30 stocks have witnessed strong topline, EBITDA growth in excess of 20% in FY12 but the bottomline growth has been hit due to steep INR depreciation of ~20% in FY12 along with other factors

The GDP slowdown in H1FY13 has affected the topline, EBITDA, which grew only ~ 16% while bottomline grew ~5%. The outlook for the same in FY14E is relatively better on the bottomline front as margins seem to have stabilised with commodity and currency outlook seems relatively stable.

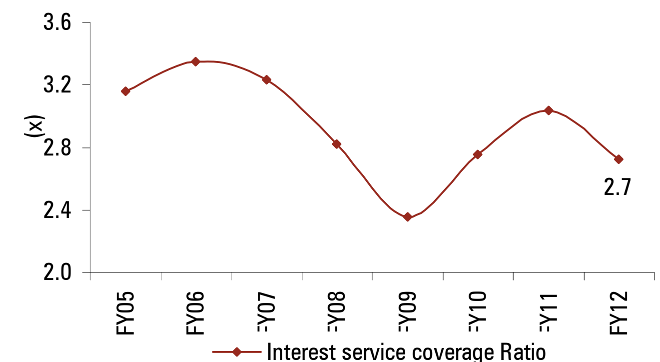
Traditionally, the RoE performance, which India delivered, had been strong. However, at present, it remains close to its nine-year low with early signs of an improvement on earnings RoE and of it also bouncing back fast.

One of the major drags on the business since FY11 has been rising debt levels, which is in the face of higher cost of debt. Though the interest coverage seems to trending down in FY12, ~41% of the debt increase has been driven by higher business investments by companies like L&T, Tata Motors and Hindalco.

Margins decline seems to be have been arrested



Debt concern remain…



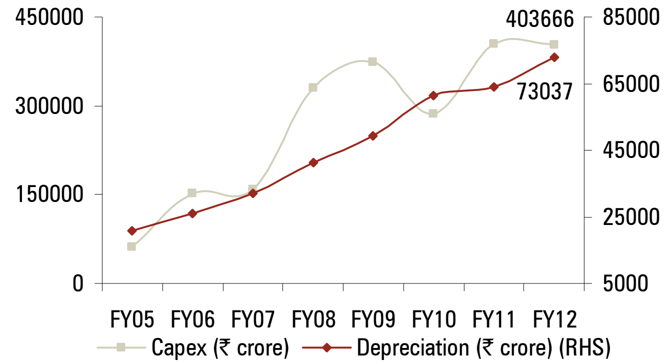
The capital expenditure spend has slowed down with annual expenditure flat at ~₹ 40,000 crore. However, the depreciation is increasing in absolute terms as previous capital expenditure comes on stream. This remains a concern ahead as revenue growth would be hampered in case capex does not revive.

On the flip side, Corporate India's balance sheet is not highly levered as on an absolute basis the incremental debt increase remains similar since FY08. However, vis-à-vis the share of cash in the same, it is up ~280 bps to 8.7%.

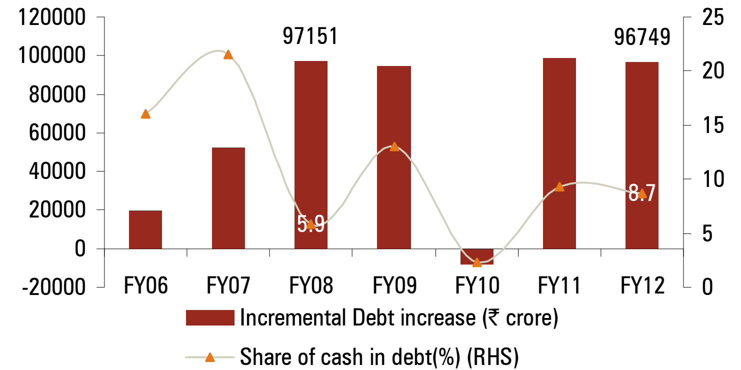
The operational reflections are also decent as asset turnover ratio also has improved .since FY10 to 2.4x

The numbers suggest that corporate India has enough levers to enter into fresh capital expenditure mode if investment sentiment gets improved in FY14E/15E.

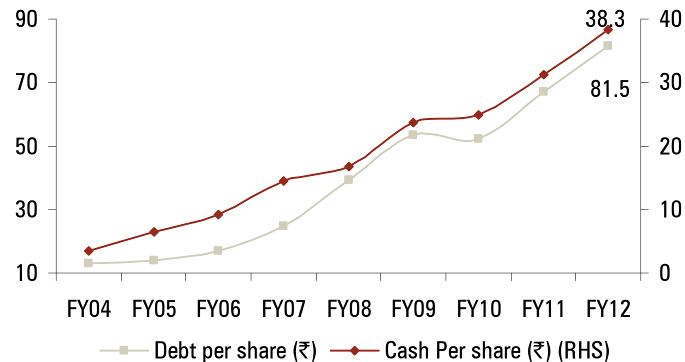
Capex growth slow down worrying



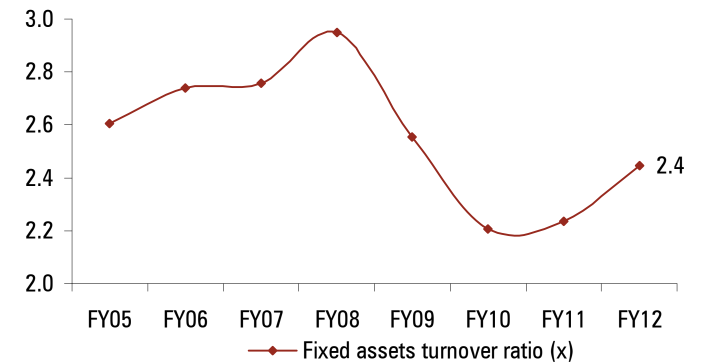
Incremental share of cash in debt up 280 bps/as debt unchanged since FY08



…as cash grows faster than debt per share



Fixed asset turnover bounces as efficiencies rise…



Source (for all charts): Capitaline, ICICIdirect.com Research

What's not in the price? -Domestic & Global

Domestic factors

Reformist agenda key to market performance, halt may dent investor confidence…

The Indian benchmark index has been one of the best performing indices in 2012 even though earning expectations have been cut several times. This is primarily on the back of several reformist measures announced post Mr Chidambaram assuming office as Finance minister.

The government has not only tapped the low hanging fruits in the form of PSU disinvestments, FDI in single brand retail, etc, but also shown political manoeuvrability to introduce tricky measures like diesel and LPG price hike, multi brand retail, banking bill, direct cash transfer and constitution of Cabinet committee on investment. Though the recent measures will start showing on-ground improvement only in the medium term, the quick pace of reforms in the recent past has been a sentiment booster for the Indian indices.

However, the coalition status of the government may give it limited room to introduce unpopular measures going ahead. Moreover, a slate full of state elections in late 2013 and general election in 2014 may prevent the government from taking new reforms.

There is a possibility that elections would gain the focus and reformist agenda may take a back seat in 2013. A political setback or rollback of reforms could further dent investor confidence.

Nevertheless, we believe, the government realises that maintaining the pace of reforms and timely implementation remains the key driver of enhancing the growth trajectory of the Indian Economy.

Government presents a highly populist budget

We do not anticipate the government presenting a highly populist budget in 2013 due to limited tax revenue growth and low probability of windfall gains from disinvestment and spectrum auction.

However, losing grip in key states in assembly elections and upcoming 2014 general elections may tempt the government to introduce a populist budget similar to that in 2008. In 2008, the government introduced measures like farm loan waiver, increase in outlay for MGNREGA, cut in excise duty etc, which led to fiscal deficit ballooning from 2.5% of GDP in budget estimates to 6.0% in actual.

This time the fiscal deficit already remains upwards of 5% of GDP. If the government chooses to introduce measures like Food Subsidy Bill, loan waiver, higher spending in social welfare schemes etc, it may further bloat the fiscal deficit.

RBI fails to deliver rate cut in first half of 2013…

Post the 50 bps repo rate cut in April 2012, the RBI has resisted industry and government pressure for further rate cuts due to persistently high inflation, even though GDP growth continues to be below satisfactory levels.

Going forward, there is a firm expectation that the RBI would reduce repo rates and further cut the CRR in H1CY13. The argument is further augmented by RBI governor statement about shifting focus to growth from now on and expectation of inflation moderating from January 2013 onwards.

GDP growth in H1FY13 is at 5.4% while the government's targets for GDP growth in H2FY13 stand between 5.7% and 5.9%. Moreover, the latest IIP figure at 8.2% for October indicates that worst may be behind us for GDP growth. Also, if China starts recovering at a rapid pace, commodities may run up, further fuelling the Inflation in India. In this backdrop, although unlikely, there exists a possibility wherein the RBI may maintain status quo in first half of 2013 and postpone rate cuts to second half of the year.

In such a scenario, the very foundation of our thesis about interest rate sensitive consumer discretionary and capital intensive sectors (banking, auto, etc.) outperforming the defensive ones may get upset.

On upside risk, a strong majority government in 2014 would be a big push to investor sentiment…

UPA II has lost a key alliance partner in West Bengal, and is facing a threat in Tamil Nadu and Andhra Pradesh. On the other hand, NDA lacks large alliance partners and Uttar Pradesh is no more a bastion of BJP. Owing to fractured mandate, the government in 2014 would be much weaker which will start reflecting as early as 2013 with many state elections due this year.

However, contrary to the belief, if NDA/UPA comes back to power with a clearer mandate and stronger coalition government, it would give the government even higher manoeuvrability to take reforms process ahead. This could change the investment cycle faster than anticipated and be a big push to investor sentiment.

International Factors

US unable to negotiate fiscal cliff…

At the end of 2012, the terms of the Budget Control Act of 2011 are scheduled to come into effect. This would include spending cuts amounting to roughly $100 billion in 2013 while the higher taxes and revenues amount to another $500 billion.

The additional revenue would come from the end of last years' temporary payroll tax cuts, end of certain tax breaks for businesses, shift in the alternative minimum tax and end of 'Bush-era tax cuts' from 2001-03. This year would also include President Obama's health care law taxes.

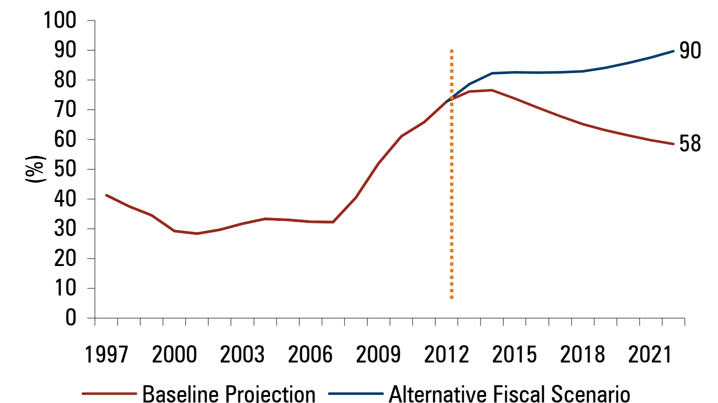
Though currently uncertainty looms large on possible resolution or an alternate plan to avoid the fiscal cliff, it is widely believed that US lawmakers would reach a compromise to limit the impact of tax increases and spending cuts. According to an Alternative Fiscal Scenario proposed by the Congressional Budget Office (CBO), the fiscal deficit would reduce marginally by 8% and GDP growth for 2013 could stand at 1.7% with 8.0% unemployment.

CY 2013	Baseline	Alternative Scenario
GDP growth (%)	-0.5	1.7
Unemployment (%)	9.1	8.0

Source: CBO, ICICIdirect.com Research

However, if the government fails to come up with an alternative plan before January 1, 2013 the spending cuts and higher taxes would come into effect. Though this is expected to cut the US fiscal deficit by more than 50%, it could push the US economy into a painful recession with 0.5% GDP de-growth and unemployment rate of 9.1% (CBO estimates) in 2013. Such an outcome could result in a challenging environment for global growth and stock markets across the globe could witness a correction.

US Federal debt under different fiscal scenarios (%GDP)



Source: CBO, ICICIdirect.com Research

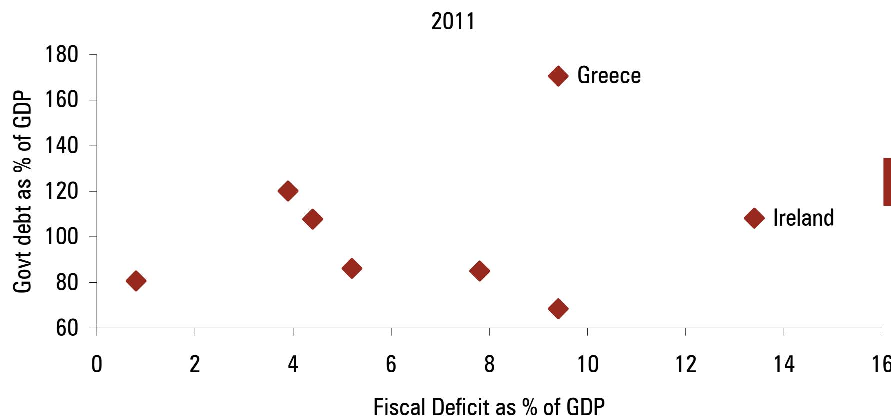
Financial impact of fiscal cliff

Tax increases and Spending cuts		From	To	CY13 Impact
Bush tax cuts expires in 2012 & subsequent growth in alternative minimum tax (AMT)	Income Tax	35%	39.6%	$221billion
	Low-income earners tax rate	10%	15%	
	LT Capital Gains Tax	15%	20%	
	Dividend Tax	-	15 -39.6%	
	Estate taxes	35%	55%	
	No. of tax payers paying AMT to swell from 4.3 mn to 31.4 mn			
	Child tax credit to halve to $ 500			
Expiry of insurance contribution	Employee's payroll tax rate	4.2%	6.2%	$95 billion
Taxes in the Affordable Care Act	Dividend / Capital Gains	-	3.8%	$18 billion
	Wage above $250,000	-	0.9%	
Expiry of other tax benefits				$65 billion
Budget Control Act (Sequestration)	Spending cuts of $1.2 trillion over 10 years to start from Jan 2013			$65 billion
	9.4% reduction in defence spends			
	8.2% reduction in non-defence spends			
Expiry of emergency unemployment benefits	Weeks for which unemployment insurance can be claimed fall			$26 billion
Reduction in Medicare rates for physicians	Rates cut by 27%			$11 billion
Other spending and revenue cuts	As projected by Congressional Budget Office (CBO)			$105 billion
Total				$606 billion

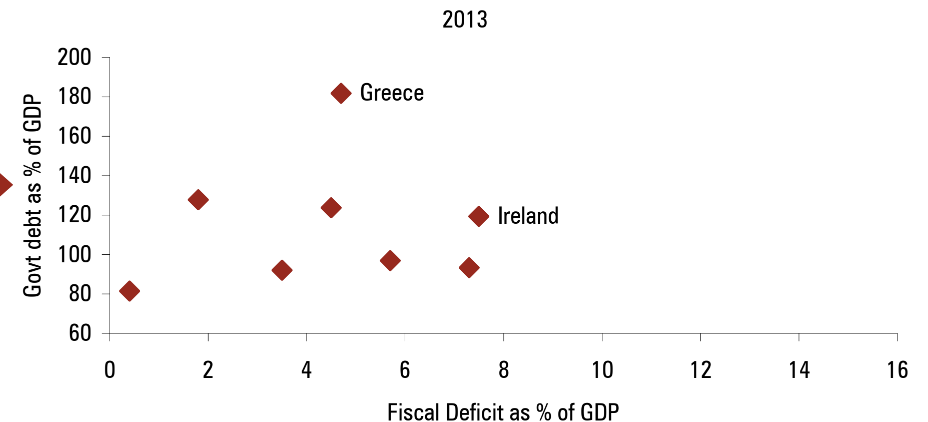
Crisis persists in eurozone…

- Though the Euro area composite of manufacturing and services PMI showed an advanced 47.3 this month (nine-month high) it is the 11th straight month of contraction. Industrial production fell 1.4% in October after falling 2.3% in September. Also, the unemployment rate in the eurozone has also been on the rise with another 173,000 falling out of employment bringing the total to 18.7 million. These indicators underscore the feeble domestic demand and may lead to deep contraction in forth quarter after witnessing a double dip recession.

Government debt and fiscal deficit as percentage of GDP of key European economies

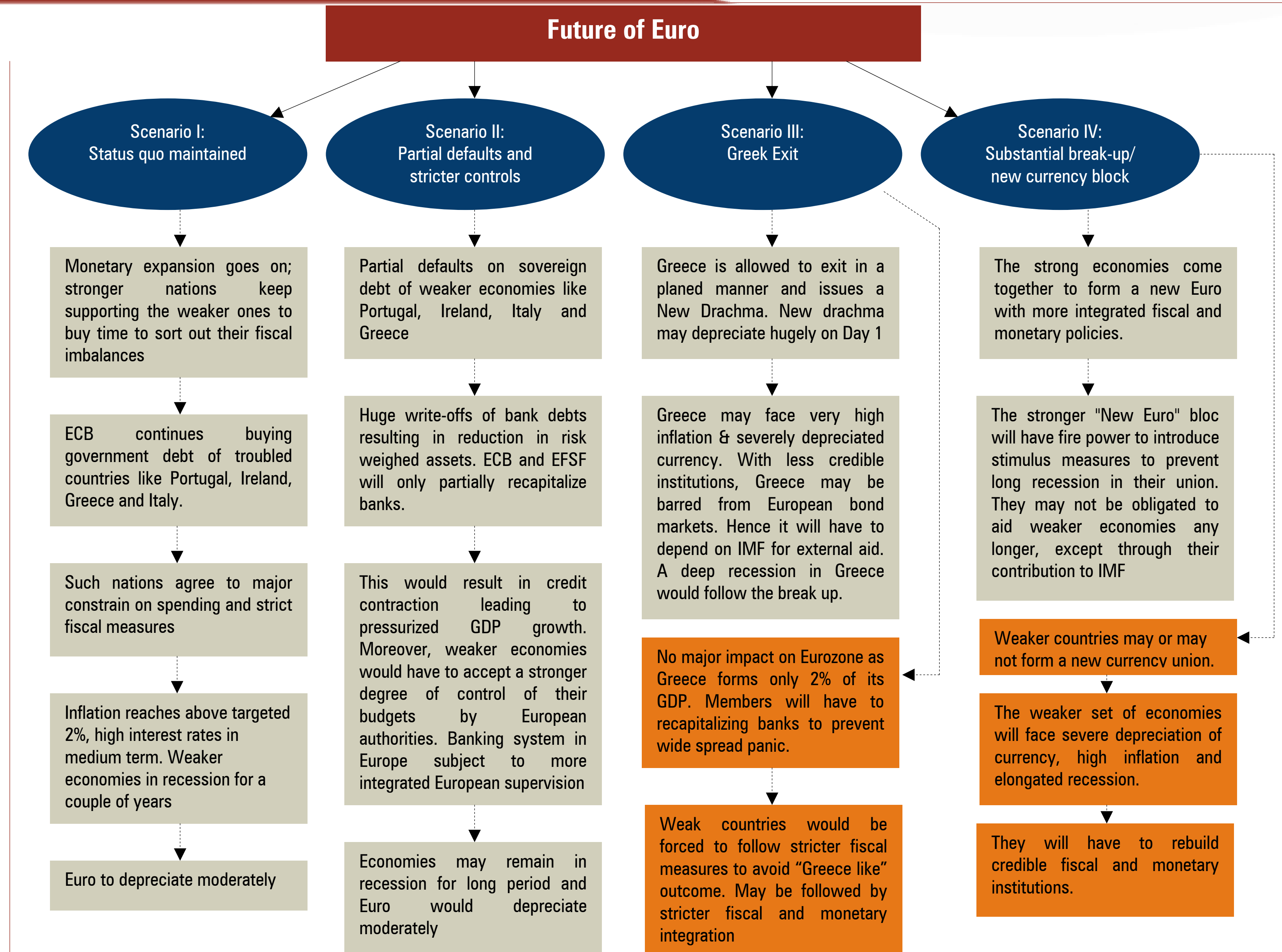


Source: Bloomberg, ICICIdirect.com Research



Source: Bloomberg, ICICIdirect.com Research

- Though the eurozone is going through an uncertain phase, we believe, break up of the Euro may not be a likely scenario. The current period of low growth/recession would continue in the near future
- It is clear from the charts above that though the government debt as a percentage of GDP is expected to go up in 2013, in almost all economies, the fiscal deficit would come down considerably across the board
- However, eurozone finance ministers may have to enact more stringent fiscal measures, which may involve higher degree of integration of fiscal policies to ensure Euro stability. In the next chart, we try to analyse possible scenarios for the future of Euro


Future of Euro
Scenario I: Status quo maintained
Scenario II: Partial defaults and stricter controls
Scenario III: Greek Exit
Scenario IV: Substantial break-up/ new currency block
Monetary expansion goes on; stronger nations keep supporting the weaker ones to buy time to sort out their fiscal imbalances
ECB continues buying government debt of troubled countries like Portugal, Ireland, Greece and Italy.
Such nations agree to major constrain on spending and strict fiscal measures
Inflation reaches above targeted 2%, high interest rates in medium term. Weaker economies in recession for a couple of years
Euro to depreciate moderately
Partial defaults on sovereign debt of weaker economies like Portugal, Ireland, Italy and Greece
Huge write-offs of bank debts resulting in reduction in risk weighed assets. ECB and EFSF will only partially recapitalize banks.
This would result in credit contraction leading to pressurized GDP growth. Moreover, weaker economies would have to accept a stronger degree of control of their budgets by European authorities. Banking system in Europe subject to more integrated European supervision
Economies may remain in recession for long period and Euro would depreciate moderately
Greece is allowed to exit in a planed manner and issues a New Drachma. New drachma may depreciate hugely on Day 1
Greece may face very high inflation & severely depreciated currency. With less credible institutions, Greece may be barred from European bond markets. Hence it will have to depend on IMF for external aid. A deep recession in Greece would follow the break up.
No major impact on Eurozone as Greece forms only 2% of its GDP. Members will have recapitalizing banks to prevent wide spread panic.
Weak countries would be forced to follow stricter fiscal measures to avoid “Greece like” outcome. May be followed by stricter fiscal and monetary integration
The strong economies come together to form a new Euro with more integrated fiscal and monetary policies.
The stronger "New Euro" bloc will have fire power to introduce stimulus measures to prevent long recession in their union. They may not be obligated to aid weaker economies any longer, except through their contribution to IMF
Weaker countries may or may not form a new currency union.
The weaker set of economies will face severe depreciation of currency, high inflation and elongated recession.
They will have to rebuild credible fiscal and monetary institutions.

Chinese dragon may snarl louder…

In the last 30 years, China has undergone the greatest economic boom in the history of the world. However, as the country prepares to transfer leadership, growth seems to be slowing down. The World Bank estimates that the Chinese economy will grow at 7.9% in 2012 (8.9% in 2011). However, owing to the fiscal stimulus (RMB 1 trillion - $158 billion), monetary easing measures, accelerated approval of investment projects and an upswing in business cycle, the World Bank has upgraded the growth forecast for 2013 to 8.4% (8.1% earlier).

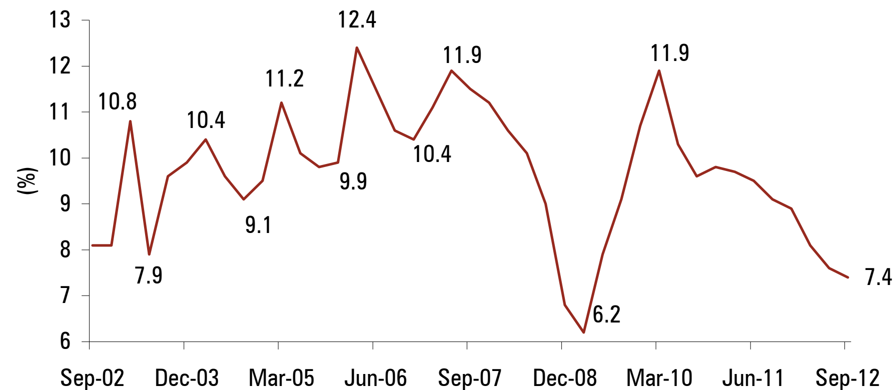
China growth could stoke up our inflation

Commodity	Weightage in Indian Inflation Basket	Share in global demand
Textiles	7.3	~50%*
Steel (all types)	5.5	~46%
Edible Oils	3.0	World's largest importer
Crude Oil	0.9	~12%
Aluminium	0.5	~43%
Gold	0.4	~25%
Copper	0.3	~41%
Zinc	0.0	~43%

Source: CBO, ICICIdirect.com Research
** China accounts for ~50% of the global garment production*

Accelerated growth in China could spur Indian inflation considering it is amongst the leading consumers of commodities.

China – quarterly GDP growth (%)

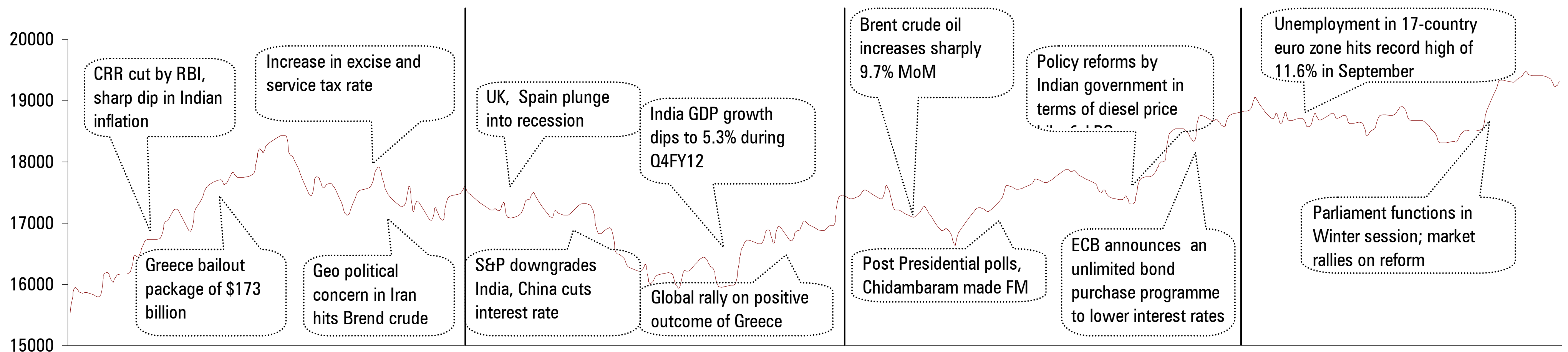


Source: Bloomberg, ICICIdirect.com Research

The Chinese government has enough headroom for cutting the reserve ratio (inflation stands at 2.0% - November 2012). These liquidity boosts could lead to a faster than anticipated recovery for the Chinese economy. In the past also, China has bounced back from a low GDP growth of 6.8% (CY08) to 10.7% in CY09. While a faster recovery of the Chinese economy augurs well for global economic growth, it may work to India's disadvantage. A stronger recovery in China will lead to higher commodity prices, which would further fuel inflation in the Indian economy. Moreover, a strong industrial performance in China may also divert foreign fund flow to the Chinese markets, thereby cannibalising inflows in the Indian markets.

Flashback 2012

What was 2012 all about?



Q1CY12 (12.2%)	Q2CY12 (-0.3%)	Q3CY12 (7.8%)	Q4CY12 QTD (7.3%)
RBI cuts CRR by 50 bps to 5.5% from 6%	UK and Spain plunge into recession during Q1CY12	Contraction in Chinese GDP backed by sharp drop in export	Global equity markets subdued in October on disappointment over quarterly results
Sharp reduction of inflation in India to 7.47% from 9.11% in November 2011	S&P revises its outlook from 'stable' to 'negative' for India while retaining 'investment grade' rating,	India's industrial production contracts 1.8% in June	Unemployment in 17-country euro zone hits record high of 11.6% in September
US GDP rises by 2.8% QoQ (annualised) in Q4CY11 following 1.8% QoQ gain in Q3CY11	India witnesses its first fall in exports by 5.7%, since 2009, citing weak global cues	Brent crude oil price increases sharply by 9.7% MoM moving from $96.6/barrel to $105.9/barrel	Barack Obama re-elected as US President, results in fall in crude oil price
Europe approves $173 billion bailout package for Greece	RBI cuts repo rate by 50 bps to 8%	ECB announces unlimited bond purchase programme to lower interest rates	Expansion in US GDP to 2% QoQ in Q3CY12, higher than expectations
India IIP for December notches 1.8% YoY growth as against 5.9% YoY growth in previous month	People's Bank of China cuts interest rates by 25 bps for first time since 2008	Indian Presidential elections; Chidambaram made FM	India's industrial production for August reported at 2.7% YoY, much more than expectation
Geo-political concerns in Iran; Brent oil price at nine month high in February	India's Q4FY12 GDP at 5.3%, significantly lower than market expectation of around 6.1%	Policy reforms by Indian government in terms of diesel price hike & LPG cap	RBI cuts CRR by 25 bps to 4.25% while keeping other rates unchanged
Announcement of increase in excise and service tax rates by 2% each in Union Budget '12-13	Unemployment in euro zone hits 11.1% in May, highest in history of single currency	Indian government approves 51% FDI in multi-brand retail	ECB holds its main interest rate unchanged at record low of 0.75%, in line with expectations

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