

# THE WEEKLY BUZZ

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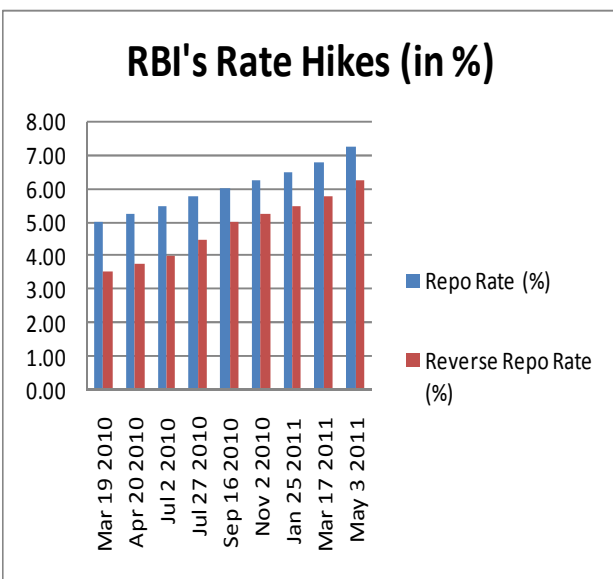
## RBI Increases Key Rates Sharply To Stem Inflation

The gloves are off. After a series of baby steps, the Reserve Bank of India (RBI) finally took a giant stride and raised key policy rates by half a percentage point on Tuesday, to make money more expensive and tame runaway inflation. The repo rate was hiked to 7.25% and the reverse repo rate to 6.25%. This is the 8th hike in these rates since March 2010.

### Inflation is RBI's top priority now

Fighting inflation is now at the top of the RBI's agenda and it is no longer trying to seek a balance between growth and inflation, which has been the case so far. Growth will suffer in the short-term, but the RBI feels that it is better to sacrifice growth in the near-term rather than allow high inflation to kill growth altogether. By stating that one cannot talk of growth and inflation numbers in isolation, the RBI governor has made it amply clear that there is no trade-off between the two and that the combination of high growth and high inflation is neither normal nor acceptable.

We believe this is a logical argument. High growth achieved during periods of high inflation tend to be pretty shallow, as most of the growth achieved will be due to increase in prices rather than increase in volumes. According to Jahangir Aziz, senior Asia economist at JPMorgan Chase, since 1972, the growth-inflation trade exists only when expectations are stable, not when they are rising as they are now, or falling as in Japan in the 1990s. He further states that since the late 1980s, such trade-offs have existed only when inflation is low, not when the quarterly rate of core inflation is over 11%.



### More hikes in the near future likely

However, the rate hike cycle doesn't seem to have peaked as yet, since the RBI has projected inflation to be around 9% till September and then tapering off to reach 6% by March 2012. So, more rate hikes are most certainly in the offing although they may not be as steep as the one seen now.

The last time that the central bank increased repo rates by 50 basis points (a basis point is 1/100th of a percentage point) two times in a row was in June and July 2008, when inflation was ruling at double digits.

Moreover, the RBI's primary concern about inflation is the high rate of non-food manufacturing inflation, which, at 7.1% in March, is at a 2 ½ year high. Till such time this figure doesn't fall to reasonable levels, the RBI will continue to raise interest rates.

Again, the RBI has projected India's GDP growth rate at 8% for 2011-12, a full percentage point lower than the 9% projected by the Finance Minister in his budget speech. This means that, in the coming months, unless there are clear indications that GDP growth may fall below 8%, the RBI is not likely to take its foot off the interest hike accelerator.

The rate hike and other measures such as increase in the savings bank interest to 4% and higher provisioning requirements for bad loans will push up the cost of funds for banks. Therefore, an increase in lending rates is a given. From an individual's point of view, interest rates on home loans, car loans and personal loans are expected to rise by 0.5%-1%.

## Central Banks On Bullion Buying Spree

Central banks of emerging economies have embarked on their biggest buying spree of gold in 40 years as they seek to diversify reserves away from the US dollar. Mexico purchased 100 metric tonnes in recent months, increasing holdings from about 6.9 tonnes. Russia bought 18.8 tonnes in March, increasing its reserves to 811.1 tonnes in March and Thailand bought 9.3 tonnes in the same month, expanding reserves to 108.9 tonnes. China and India have acquired large amounts of gold in recent years, while Sri Lanka and Bolivia have made smaller purchases. Incidentally, according to the World Gold Council, gold accounts for more than 70% of reserves of the U.S. and Germany, the biggest holders in the world.

As a result of Mexico's purchase, central banks, sovereign wealth funds and other so-called "official sector" buyers are on track to record their largest collective purchase of gold since the collapse of the Bretton Woods system (which pegged the value of the dollar to gold) in 1971.

The reversal of two decades of gold selling marks the end of an era characterized by widespread faith in paper currencies and sovereign debt. The US dollar has plunged 10% against the world's major currencies since January and is trading near an all-time low.

The Reserve Bank of India may have been the smartest of the lot, since it bought 200 tonnes from the IMF in November 2009 at a price of \$1045 per ounce. Gold closed at \$1541 per ounce on May 4. That's a neat profit of Rs.17,800 cr. in 17 months!

## Black Nights In The Near Future?

India's power woes are set to continue. India has been chronically short of power for many years now. So, fresh capacity of 62,680 MW over the next 5 years should be welcome news. Unfortunately, a coal crunch of enormous proportions threatens to trip the power sector with a cascading impact on the country's growth story.

With domestic coal production floundering amid a sharp upsurge in power capacity addition, over 40,000 MW of new generation capacity could get stranded over years for want of fuel. This is 64% of the power capacity slated to come up during the next 5 years, most of which is being set up by private developers.

The 62,680 MW of new power generation capacity requires 313 million tones of coal. Against this, the incremental coal availability indicated by Coal India is only 100 million tonnes. The shortfall can't really be made up by importing coal since there are technical limitations to blending high-calorific imported coal in the typical boilers used in domestic projects. Besides, blending of costlier imported coal involves a trade off in terms of higher generation costs.

## Using Technology To Penetrate Rural India

From low-cost handsets to tablet PCs, the Indian FMCG and retail sectors are latching on to technology and applications to increase penetration to rural India. Marico is using mobile technology innovatively to arm its field representatives in their procurement process of safflower seeds for its main product, Sunflower oil. Using an in-house developed mobile application for Nokia 5235 handsets, Marico monitors purchase of safflower seeds from 80,000 acres of farmland spread across 7 states. Hindustan Unilever uses tablet PCs to reach out to 500,000 rural outlets.

The biggest initiative has been taken by FMCG powerhouse, ITC through "e-choupal". Through "e-choupal", ITC leverages the power of the Internet to empower 4 million small and marginal farmers by providing them with farming know-how and services, timely and relevant weather information, transparent price discovery and access to wider markets. The network of 6,500 e-Choupal centres spread across 40,000 villages has emerged as the gateway of an expanding spectrum of commodities leaving farms—

wheat, rice, pulses, soya, maize, spices, coffee, aqua-products. The reverse flow carries FMCG, durables, automobiles and banking services back to villages. LG recently committed Rs.100 cr. to push its products in the rural sector through ITC's "e-choupals".

Rural India represents a huge opportunity. The lack of physical infrastructure has meant that this opportunity has not been tapped to its full potential all these years. If virtual infrastructure can bridge the gap of demand and supply, the results can be nothing short of revolutionary.

## LIC Continues To Rule The Roost In Life Insurance

When the insurance industry in India was thrown open to the private sector, it was widely believed that it was only a matter of time before the PSU life insurance behemoth, Life Insurance Corporation of India (LIC), which had a 100% monopoly of the business, would become marginalized, much like how BSNL in the telecom sector and Air India in the airline sector have become. However, LIC continues to dominate the life insurance business. In 2010-11, when all major private life insurers lost market share, LIC gained market share of almost 4% to 68.7% in terms of premium income during the year. LIC garnered premiums of Rs.86,445 cr. in 2010-11 while the combined premium income of the 22 private sector life insurance companies was Rs.38,391 cr., less than half of LIC's!

### Did You Know?

According to Standard & Poor's Valuation and Risk Strategies Group, the company with the largest cash reserves in the world is General Electric Co. with a whopping \$78.4 billion. The cash holdings of the top 50 companies totals \$1.08 trillion. To put this in perspective, the 15th largest country in the world, South Korea, has a GDP of \$1.01 trillion!

## Weekly Spotlight

	Apr 28/29	May 6	% chg
Sensex	19,135.96	18,518.81	↓ (3.23)
Nifty	5,749.50	5,551.45	↓ (3.44)
US	12,763.31	12,638.74	↓ (0.98)
China	2,911.51	2,863.89	↓ (1.64)
Japan	9,849.74	9,859.20	↑ 0.10
Hong Kong	23,720.81	23,159.14	↓ (2.37)
Germany	7,475.22	7,492.25	↑ 0.23
UK	6,069.90	5,976.77	↓ (1.53)
Brazil	65,673.21	64,417.34	↓ (1.91)
NYMEX Crude (\$ per barrel)	112.90	97.20	↓ (13.91)
Gold (\$ per oz)	1,535.50	1,486.50	↓ (3.19)
Weekly DII Inflow (Rs.cr)	1,230.31	3,264.62	
Weekly FII Inflow (\$ mn)	(285.46)	(681.22)	
Cumulative DII Inflow - YTD (Rs.cr)	10,578.74	13,483.36	
Cumulative FII Inflow - YTD (\$ mn)	1,158.81	477.59	
Food Inflation (%)	8.76	8.53	

False conclusions that have been reasoned out are infinitely worse than blind impulse.  
- Horace Mann

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