Are we losing the opportunity to seize global liquidity?

The Indian Capital markets have received one of the highest quarterly foreign capital inflows in the first quarter of the fiscal year 2012, whopping Rs: 45000 crore or US $ 9 bn. If this momentum sustains, then 2012 will be a year marked with record FII inflows and in all probability would have seen an all-time high in our indices.

Will this happen?

At a time when India needs huge money for its infrastructure development; and also our current account deficit widening with the Rupee depreciating, the need of the hour is more foreign investments. But contrary of aiding foreign investment, the recent union budget has administered two blows which will have a huge impact on foreign inflows, both in the longer and shorter term. The slowdown in foreign inflows in the last part of March is a clear indication of the same.

Let us analyze the current burning issues.

The Union budget was a non issue. Though no one ever expected any bold steps from the Finance Minister, the budget fell below our expectations. The Budget lacked any long term road map or for that matter any short term measures to reduce fiscal deficit meaningfully. The borrowings of our government is an enormous 64% of the GDP as per IMF, in the year 2010. If you extrapolate it to current GDP it can come to anywhere between 60 to 70 lakh crore. Not to take into account the individual debts of the states. And the fiscal deficit of 2011-12 is 5.9% of our GDP, Rs: 5,22,000 crore. Now let us add up all the subsidies the government gives; the food subsidy, fertilizer subsidy, oil subsidy together comes to 208000 crore in 2011-12, almost 40% of our fiscal deficit.

If the government had taken some one time measures like the voluntary disclosure scheme (similar to the one in 1997) to garner one time revenues; created a conductive atmosphere for a buoyant capital market for PSU disinvestment; and reduced subsidies, it could have reduced its borrowing and wiped out the fiscal deficit. But political compulsions will not allow any government to take such bold decisions, especially the present government after having taken such a beating in the recent assembly elections.

On stock market point of view, the market was expecting a substantial cut in STT, which is eating into the profits of traders (the few who do make profits) and adding on to the woes of majority of traders, who trade only to lose money. But the FM just made a token cut of 20% on delivery STT, which makes no difference to traders where it matters most and little to investors where it does not matter much. Amending Income Tax Act retrospectively from 1962, to tax transactions between foreign companies in Indian assets, with the hidden objective of taxing Vodafone after losing its case in the Supreme Court has created a very negative image among foreign investors and has shattered their faith in our policy makers.

The finance minister introduced GAAR (General Anti Avoidance Rule) which mentions that Government will override tax treaties we have with countries like Mauritius and will tax FIIs and foreign companies if Government feels that money is being routed through these tax haven countries only for getting tax benefits. Till now no clear clarifications has been given and statements from tax authorities and finance ministry are still confusing. Rules and guidelines of GAAR will be framed only after the budget is passed in parliament, and this will greatly impact future foreign flows into the country. One thing foreign investors never like, for that matter any investor, is uncertainty, which the budget proposal has brought in by way of the GAAR.

FIIs have already started raising concerns about GAAR. The Asia Securities Industry and Financial Markets Association(ASIFMA), which has Citibank, Credit Suisse and Goldman Sachs, Morgan Stanley (among others) as its members, has written a letter to finance minister warning that investments in India will get affected because of GAAR. Some FII's have already stopped taking new positions in India on scare of the same.

On top of all these, the decades old issue of corporate governance in state owned companies has recently flared up with the Coal India issue. The UK based hedge fund, The Children Investment Fund Management (TCI) who holds 1 % in Coal India, has accused the government of India and Coal India's directors for not protecting minority shareholder interests. TCI charges Coal India in blindly following Government instructions without seeing the interest of the company. They feel that Coal India signing Fuel Supply Agreements (FSA) with power companies on Government instructions will be negative for the company. Concerns raised by the hedge fund will echo negativity among global investor community.

The foreign investors are now lush with investable funds. In order to provide liquidity to cash starved European banks, the ECB has announced LTRO(Long Term Refinance Operation) in two stages (December and February) totaling 1.01 trillion Euro at an interest rate of 1% for three years. The injection of one trillion Euros will definitely improve the liquidity condition among European banks and will solve European sovereign debt crisis at least for near term and also provide investable funds with global investors. Combined with the US$ 2 trillion from the US quantitative easing (QE) announced earlier, the global investors are flush with funds and are searching for growth stories, and India fits in most of the criteria set by them. The flow of US$ 9Bn in three months, as mentioned earlier, is only the tip of the iceberg. Unfortunately, by creating unnecessary issues we are really shooting our selves in the foot. The Railway minister being asked to resign for hiking fare by a very reasonable percentage after nine years, issues like retrospective taxation, GAAR, 2G license cancellation, withdrawal of FDI in multi brand retail immediately after its announcement, all have already spoiled the investments environment in India.

Currently India needs huge money for its infrastructure development, without which we cannot go forward. Every body is talking about India becoming a developed country or even a superpower in the next decade. But as Sadhguru Jaggi Vasudev said in his recent interaction with Infosys Chairman Mr Kamath, on CNBC TV18, it is like wanting to climb Mount Everest with out having legs.

Let us hope that sanity prevails in the minds of our policy makers, as it is still not too late to make amendments. Technically speaking, the markets have bounced off from very strong support levels which exist on the upper band of the down ward sloping channel, at 5050-5150 levels, which also happens to be the 200 DMA. So as long as the markets trade above these levels a move above the recent highs of 5650 levels in Nifty can still be expected in the near future.