FIIs keen on India, govt FY14 borrowing eyed: Nirmal Jain

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In an interview to ***moneycontrol.com***, he says that the market will be closing watching how realistic the government's revenue and expenditure assumptions are, instead of just the absolute number. Jain says foreign institutional investors will continue to remain positive on Indian shares unless there is some policy or political disaster.

Edited excerpts of the interview:

Q: Has the market lowered its expectations from the Budget because of the depressing economic data of late?

A: No, in fact because of this, market's expectation from Budget will increase further. The new finance minister and the government seem committed to make sure that the economy comes back on the revival path and that is the key challenge for the government today. These numbers will further reinforce that there are urgent and very strong measures required from the government.

Q: There are also concerns that because this is the last Budget in UPA's current term, it could be slightly populist. How much does that worry you?

A: Under normal circumstances what you are saying is right. If you see what government has done in last three to four months, they have taken very difficult steps which are not populist, like railway tariff hike, diesel price increase or reduction in subsidy on liquefied petroleum gas (LPG). These are very difficult steps for a

populist government particularly in an election year. So, government seems determined because they have been pushed to the wall by rating agencies, by other various kind of analyst and every economist that things are really getting our of control. It looks like the government is determined to make sure that things come back.

Finance minister has traveled abroad and met foreign investors and he has promised them that this will be a responsible Budget, it will not be a populist Budget. This year's fiscal deficit will end somewhere in terms of revised estimates at 5.3 percent and next year targeted at 4.8 percent.

What market will look forward to is, how realistic the assumptions about revenue and cost are. It is a very challenging Budget because on one hand you have election coming, on the other hand you have to put your expectations of financial investors and foreign institutional investors (FIIs) to be met, current account deficit is at record high, fiscal deficit is also threatening to get out of control. So, it is a very challenging Budget.

We have probably the most competent finance manager for this. In a very paradoxical manner it makes his job easier because everybody expects him to take tough decisions and he can take them.

Q: Which are the two or three key areas that the market you think would be focusing on?

A: Market will look at the fiscal deficit and therefore government borrowing because more than interest rate, it is the government borrowing which elbows out the private investor. Private sector entrepreneurs, they can't borrow at reasonable rates. Investment cycle has collapsed and that has a cascading impact on output, employment, income everything. It goes down to all the levels and employment numbers in India are not tracked by Reserve Bank of India (RBI) or any responsible agency which is one of the key data points which you should be looking particularly in a country like ours.

So, one would look at fiscal deficit and how one controls it. As I said difficult steps are required, which is cut down in your fertiliser subsidy, controlling your food subsidy, they are talking about direct cash transfer; probably that will reduce your leakages and may be bring down the subsidy burden, continue with the diesel price increase which they started last month. So, there are things like these and of course have a more realistic plan to raise money.

What government may do this time is - not only disinvestment of companies but they may sell land. Government has lot of land in urban areas and they may auction it

and raise lot of resources to meet the deficit. One should not forget that these are one time steps. Unless government structurally changes its expenditure and revenue on one hand and more export and import on the other hand because we meet our import requirement from FII money which is volatile, which is not a long term healthy situation.

So, there are quite a few structural changes required in the way we look at our exports. We need to give them impetus, we need to worry about the government expenditure which has always gone out of control. All these steps are required. One has to make some very firm progress towards goods and services tax (GST) also. So, these steps have been long pending and they have leakages and damages at small micro levels all through. So, it is difficult to measure the impact but it is significant.

Q: What is the feedback that you are getting from your institutional clients?

A: All of them are excited about India. As finance minister in one of the recent meetings rightly said that foreign investors are more enthusiastic and optimistic compared to people back at home whether it is media or analysts.

When they are looking at the world things aren't rosy anywhere. It is not that things are hunky-dory everywhere. If you look at China growth is slowing down. There are many concerns there. Other than that there are two smaller countries like Philippines and Indonesia that are growing faster, but otherwise nobody is growing even at 5 percent or 5.5 percent per annum.

So, they are looking at India with lot of interest and lot of curiosity and intend to invest. A lot of surplus money is generated globally for investable surplus because there are lots of pension funds, they are lot of savings that come to mutual funds, they need to invest and they need to chase growth stories and the growth economies and the growth sectors.

If you look at Brazil, Russia none of them is growing. Their growth has slowed down significantly, there are concerns all over. So, they are very keen to invest in India; unless you do something which is disastrous in terms of policy or politics, the money will continue to flow in.

Q: Domestic investors still don't appear to be convinced about the market as can be seen from the persistent net outflows. What do you think will change that?

A: I think it is a long story of the woes of mutual fund and insurance, how these two sectors that are so good have slowed down in last 4-5 years and it has become a complicated subject now because regulators and government have taken socialistic stand on this.

To put it very simply you can make product very good for the consumer but who will sell it? They think that our responsibility is only customer but they don't realise the entire supply chain. That unless there are manufacturer, there are distributor, there are suppliers and everything else customer doesn't get good product.

You go back to 80s and 90s they used to control prices of cement, steel, edible oil, match boxes, cigarette and you name the product. What happened was no new capacity, no new talent, no new innovation and actually consumer was getting a raw deal when the entire policy framework was to ensure that the fair price is given to customer. Unfortunately bit of a licence raj and the socialistic thinking has come back into financial services. There are lots of media people who write about this without understanding how the industry works.

We should understand that this country - private sector is servicing customers and they will be driven by profit motives. Why will anybody else setup an enterprise and take risk? So, unless you respect that, that profit motive is something which is good and what we need to do is we need to make disclosures and transparency rather than trying to say that profit by itself is bad. If profit by itself is bad then only public sector should do and we realise that even public sector organisations can't survive without profit. Today if you meet public sector undertakings (PSU) bank chief executive officers (CEOs) or PSU oil companies they all understand that business enterprises run with profit. So, there is a bit of a muddled thinking in this.

Our regulators are responsible to make sure that no misunderstanding takes place, no scams are there, but they are not responsible whether the industry grows or not and which is a pity.

The good things which investors are deprived off that nobody actually measures or calculates. Equity has given 17-18 percent compounded return tax free because of

the tax structure, but retail investors have not been getting it and who is responsible for this? Lot of introspection is required so most of these people have good intent. If you meet them, they are intelligent people, honest and high levels of integrity, competence and governance, but somewhere there is a disconnect between how the businesses work and what they expect them to do.

Q: Do you see the government announcing anything to spur investment in the capital markets?

A: Rajiv Gandhi Equity Savings Scheme (RGESS) is a good scheme. It is a good and desirable but by no means an adequate step. Another thing which people must understand that retail investors will come to the market only when there is liquidity. Liquidity will happen only when there are speculators and intraday traders. So, you can't say that I want to increase delivery based trades because that goes for investors and I want to discourage intraday trades. What happens when you discourage intraday trading the liquidity is sucked out of the market, the impact cost and the entry exit becomes difficult, market looks hollow and somehow a typical retail investor is not attracted because he thinks risk is very high, that if he buys and when you ask to sell because of the price gap, he loses a lot of money.

The stock markets work in a different manner, it is a risk capital and people who invest also want to leverage because they take risk by nature and unless you promote that - there are many people, senior level officers they think that stock market investing is like casino and gambling and it is very bad. They don't realise that this country can't run without stock market because that is a vehicle which gets you equity capital. Unless you have equity capital you can't get debt capital and if you don't have debt capital and equity capital there is no new capital formation, no new investment, no new jobs nothing.

So, the entire way the stock markets are looked at by regulators and policy makers needs a radical change if you want retail investors to participate in a significant manner.

Q: What is your outlook on the market over the next three to six months?

A: I think markets are positive. My outlook is positive although USD 7 billion of money has flown into the country but stock markets have still not given good returns in 2013 calendar year because there is a lot of selling by domestic institutional

investors (DIIs). Maybe they were selling to build cushion for subscribing to a government offer for sale (OFS). They are also not getting fresh money but these things will change. Once the sentiment stabilises we will see people coming back.

When I talk about retail investors they may come back but given the potential of the country and what we see today - supposing that out of 100 today there are only one or two investors in the market, that becomes three then it is 50 percent growth but still it is not 10, 15 or 20 percentage wise what it ought to be.

So, I am quite optimistic that retail investors at least relative terms from the brokerages or from the stock market volume point of view after the Budget or after March we should see them coming back hesitantly, not in big numbers or whatever but they will come back.

Another implication of retail investor not in the market is we are overly dependent on FIIs. We are so excessively dependent FIIs that for some reason, for some trigger if there is USD 1 billion or USD 2 billion selling by FIIs markets will crash and which is a pity because USD 25 billion come from FIIs and retail investors save more than USD 350 million in a year.

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