



Rate Regime Gear Change Answer to Muted Earnings

Corporate results for the April-June 2011 period declared till date have been a mixed bag. Performance of companies in sectors like information technology, or IT, fast moving consumer goods, or FMCG, and private banks have been in line or above expectations. However, capital goods, infrastructure and cement sectors put up a below-expectations show.

While volume growth for most IT companies was in line and broad-based, renewed weakness in the developed markets has raised concerns on the demand scenario. However, in my opinion, only a double-dip recession will impact the demand for Indian IT companies. In fact, a period of slow growth in developed economies will lead to greater demand.

While most private banks also put up a show along expected lines, their net interest margin was lower due to higher cost of funds. With credit growth slowing down for the sector, we have to watch out for future growth. The recent global weakness and any consequent pressure on commodity prices may influence the Reserve Bank of India's future policy decisions.

FMCG companies reported a decent set of numbers on the back of sustained demand and pricing power. On the other hand, quarterly numbers from capital goods companies turned out to be a disappointment. Numbers reflected erosion in margins across product lines as companies were not able to pass on the higher raw material costs. There are also concerns about significantly lower order intake reported by companies, which is likely due to delays in decision making in the public sector. Even private sector companies have reportedly delayed decision making following the lack of clearer policies on issues like land acquisition and fuel linkages, to name a few.

Several infrastructure companies also reported below-the-line numbers as costly

raw material and higher interest costs impacted margins. The power sector continues to be plagued by fuel linkages and the lack of demand from the state electricity boards. The proposal for restructuring of the state electricity boards is a significant reform which will facilitate more power buying from generating companies, in turn lending support to spot power tariffs.

The quarterly results also reflect the impact of higher interest rates: most debt-heavy companies have reported higher interest burden. The RBI, in its bid to cool down inflation, has increased interest rates 11 times in the past 15 months and this has led to increased interest costs.

The apex bank's hawkish stance came as a negative surprise for most participants. While RBI's priority is clear – it remains committed to curb inflation – we now need to see its stance after the recent weakness in the global economy.

Going ahead, we believe, Corporate India is hoping for lower inflation and consequently, a benign interest rate environment. The recent weakness in the global economy may reflect in lower commodity prices, including crude. This will be a huge positive from the inflationary expectations and interest rates perspective.

On growth, we expect the government to take further steps to remove the operational and administrative bottlenecks. We are also hopeful that reforms, which have been long-pending, will be taken up and enacted during the current fiscal year.

Quick action on the fiscal side and a fall in crude prices will be the prerequisites for the markets to sustain current levels and move up in the medium to long term. Needless to say, any major negative global event will have its repercussions on the Indian markets as well. ♦

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