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TARUN KATARIA/RELIGARE CAPITAL MARKETS

Interest rate cuts unlikely over next 6 months

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INTERVIEW

The Indian stock market could remain range bound for another six months given the domestic and global macro headwinds, said Tarun Kataria, chief executive officer at Religare Capital Markets, in an interview. Edited excerpts:

We spoke about a month-and-a half ago and I remember we started by talking about Europe and you said that there is bigger pain which is still underlying. Many experts have pointed out that the structural issues haven't really been addressed.

Well, I think what they have said is, we are working on fiscal union but I think it's seriously short on details and frankly the more you sort of delay this, the more the impact on the underlying economy tends to be negative which then itself sort of feeds into the banking system.

So, while the near-term excess volatility is probably gone because there is a sense people are sort of dealing with it, it's short on details, there is a lot more to do and as I think we discussed the last time, structurally you have got a problem. What do you do to get yourself out of a recession and I think Europe generally is looking petty weak from a macro perspective. You either let the currency go which in this case you can't do because Germany is pretty much in full employment, full productive capacity, the largest economy in Europe would be inflationary, that's an issue or you spend your way out of it and you have seen whether it's the US or whether it's Europe, your ability to create larger deficits is effectively been taken away from you.

So, the two things that could work you out of a recession have gone away.

Overriding all of this, is the fact that you have got a declining population, declining productive population, so this sort of gets exaggerated over time.

So Europe, I think continues to look bleak. In fact, I would like to say slightly bleaker than it was six or eight months ago because nothing has really happen since.

So, you are saying it's bleaker, you are not as optimistic as you were?

I think it's got long-term issues.

This is not something which some experts and pundits say will go away in three to six months and stabilize?

No, no. They might stabilize in the sense they might recap the banks, they would do as they did $650 billion dollars of liquidity into the system, that sort of stability might come because stability and the ability of the banks to finance themselves might change but the macro numbers or the macro outlook, the demographic problems, that doesn't change.

And there is bigger problem right, for Indian companies because Europe had a fair amount of exposure to India in terms of Indian companies taking debt from there and that's all dried up, I am told?

Yes, I am sure as part of this thing, banks reduce their lending. They will concentrate their lending in their own geography. It's not dissimilar to the Asian crisis, when banks sort of pull back into their own geographies and so you will see some of that and, therefore, credit spreads in Asia which we have all seen sort of blow out in the last six-12 months will continue to happen.

I think there is $11 billion ECB (European Central Bank) is to be refinanced next year. So, yes, they are pulling back and that's a natural tendency when you need to rebuild your balance sheet.

What about the US, we have all stopped talking about it ?

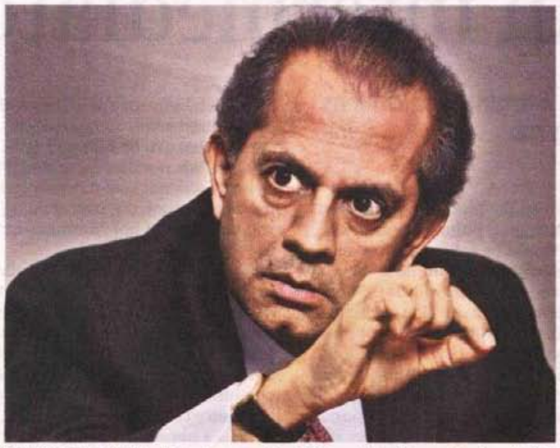
We stopped talking about it because it doesn't look as bad as it did a year ago.

The numbers seem reasonably sanguine. I mean we saw the sort of the housing numbers two days ago which gave us that sort of uplift in the markets. So the US is looking decent which is a good thing. I think China has sort of found its way into a soft landing which is a good outcome and I suspect in six months China will contribute a lot more to good macro feeling globally. But it will be a few months away.

What about India, terrible mood?

I think mood is mixed. If you talk to folks that are in the consumer sector they continue to be reasonably optimistic sanguine.

Folks that are on the industrial side, on the real estate



Brightening outlook: *Kataria says the US is not looking as bad as it did a year ago.*

side not very optimistic at the moment. So, it's kind of a mixed bag at the moment.

But the sentiment in the market, do you think sentiment is running ahead of the reality or is the reality justifying the kind of bad mood, the gloom-doom. Never mind that odd 500 point bump.

It's a tough market. Forget the 500, it shouldn't be read as the end of gloom and doom, I think it's going to be tough. The macro indicators haven't really changed materially, I think the sense that an interest rate cut is coming in the next 6-10 weeks or January or February.

First, I don't see that happening for the next five or six months because structurally inflation is still there and there is a decent chance that actually it gets worse because as I said before, consumption remains unabated, industrial production has declined, infra spends, not really happening, so supply-side constrains continue to be a massive constraint. So you have got this imbalance which by definition is inflationary.

You had perhaps, ahead of many others, come down all the way to a 7% GDP growth, you still holding on to that or have you lowered it further?

I would say for this fiscal it could be 6.8-6.9% and the trend clearly is lower.

Will the last quarter fiscal be even lower, the answer is probably, yes. So the trend is clearly in the wrong direction.

Six months ago you were hopeful of a 23-24,000 on the Sensex, you reduced it when we last spoke to roughly around 20-21,000. You said if we get there, we would have done well. Has that been further lowered?

I was thinking to myself as I came to your show, I take it down by 10%, so I am going to keep my mouth shut but the answer is probably lower than that too.

By how much?

It's tough to say...I will say we get a 20, it's a good outcome.

5,000 points?

It's a long way away. So, it's looking tough. There is no catalyst right. My initial thought was inflation peaking, rates peaking will be a catalyst. I don't see that for the next five or six months, the rupee continues to be under pressure, so that in itself will have its sort of derivative impact on mark-to-market, on earnings, input costs, oil. So, there is no real catalyst to take this market materially high from here.

> Europe looks bleaker than it did six or eight months ago because nothing has really happened there

You mentioned rupee and I must tell our viewers that about over a month-and-a-half or two ago you had said that you expect the rupee to go all the way to 52 and that's pretty much where we went. Are you of the view that we have probably bottomed out on the rupee now or do you see things getting worse?

I don't think we have bottomed on the rupee and for really two reasons. One, if you hear what RBI is saying or the Planning Commission, it would suggest to me that they are reasonably sanguine with the continuing weakening rupee. So, I think that's the talk if you will suggest that there is no massive defending of the currency that's going to happen and probably shouldn't happen.

From talking to FIIs (foreign institutional investors) we don't really get a sense that come January there is going to be this huge allocation of money into India. So the bias clearly would be to see a 56 before you see a 48 or 49. So the weakening bias I think continues.

Are FIIs upset about the fact that while India may structurally still be growing at 7%, it has shot itself in the foot? We were lucky actually this year come to think of it that instead of outflows, despite what was happening globally we still ended net neutral.

To an emerging market that has a current account deficit to be net neutral is not a good outcome.

It's not a good outcome?

To my mind because that has its implications on growth and investment in the current scene. FIIs are still bearish, the one thing that they will say is oh my God, India had this great chance to stand out in a world that's falling apart and we have shot ourselves in the foot, that's the refrain that's coming through. We have got a conference in February in London, let's see how that goes. Corporates have lined up actually, we have got 20 guys coming with us and so far 50 investors have signed up, so will get a good sense from that but certainly from the team that we have in New York, a lot of people are looking because actually from a valuation perspective at 13 times next year, reasonably cheap, but there is a bit of a scare right. I mean should it be 11 times, who knows. So they are not really out there trying to sort of throw money at this.

So even at the current levels that we have reached, the valuations are not attractive according to you.

At 13 times they should be attractive, but given the absence of reform, what's happening in Delhi...

And what we have done with the FDI (foreign direct investment) in retail?

FDI in retail and pension reform and all that, so, there is nothing happening and that in as we discussed may be a year ago, FIIs look at the macro picture and then say okay, let's go to India. So that macro picture, the political picture, what's going to happen with the elections in the Punjab, what's going to happen with the elections in UP, will they be able to do anything in advance of that, the answer is probably no. So the good news factor of reform in the economy is not happening for six months or five months. So, I suspect they will hold back a bit.

From a retail investor point of view do you believe it's a good time to nibble away and enter, at these levels?

I would have thought so, I mean as I said we also discussed the last time we need to nibble into this market, equity should be part of people's portfolio. Now whether it's 60% or 40% is a function what you sort of see as the outlook going forward but nibbling into equity is nibbling into mutual fund and as individual equities are I think very hard for retail guys to follow and do their research on but on funds absolutely.

Just to get a more sectoral perspective, I know last time we talked about two sectors which you stuck your neck out and said I continue to be ok with them, even when the rest of the world was panning them which was banks and IT. Are you still confident that you took the right call?

I think so, I mean banks have probably got whacked since we spoke a little bit because there is the sense that the power sector, power loans are not looking so good. May be retail stressed a little bit but in an economy that even grows 5% or 6%, which is not out of the question over the next decade or so, you have to be in banks. Question of timing is there, do you do PSU or you do private sector. So, banks I think look good. IT remains something of interest to investors.

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