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Country Report of India

By Mr. Prasarn Trairatvorakul

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COUNTRY NOTE ON INDIA

SECURITIES AND EXCHANGE BOARD OF INDIA

MACROECONOMIC OVERVIEW FOR 2001-2002

The Indian economy responded to the economic reforms of the 1990s with a higher growth performance than in previous decades. The economy has, therefore, shown that it is capable of achieving high growth rates in response to the implementation of appropriate economic reform policies. Consequently, higher growth rates in the rest of the decade can indeed be achieved through further deepening of the economic reform process. Second generation reforms have been initiated already and, as their implementation proceeds, acceleration in economic growth can be expected in the coming years.

Economic reforms are a continuous process which need to be adjusted as the economic environment changes, both domestically and internationally. The year 2001 has been a difficult year for almost all economies of the world. World economic growth slowed down as did trade growth. The current signals are that recovery is expected in 2002. This should help in the expansion of international trade and in the rejuvenating of Indian export growth. As the world economy picks up, the deflationary trend experienced in the prices of commodities and manufactured products would also begin to be reversed enabling improved profitability in the Indian manufacturing sector as well. The continued implementation of reforms along with this upturn in the economic environment is likely to help in regeneration of economic activity in the months and years to come.

The Indian economy is passing through a difficult phase caused by several unfavorable domestic and external developments. Domestic output and demand conditions were adversely affected by poor performance in agriculture in the previous two years. The global economy experienced an overall deceleration and is estimated to record an output growth of 2.4 per cent during the past year. These tendencies were exacerbated in the aftermath of the terrorist attacks in United States in September 2001. Consequently export growth has suffered and industrial profitability has also been affected by the prevailing low commodity and product prices globally. Despite these constraints, growth in real GDP in 2001-02 is expected to be 5.4 per cent as estimated by the Central Statistical Organisation. This growth rate marks some recovery over the low growth of 4 per cent in 2000-01. It will also be one of the highest growth rates in the world in the current year.

SALIENT MACRO-ECONOMIC INDICATORS

The Indian economy grew at 5.4 percent in 2001-02 . This growth is supported by a growth rate of 5.7 percent in agriculture and allied sectors, 3.3 percent in industry and 6.5 percent in services.

The gross fiscal deficit as a proportion of GDP is now estimated at 5.5 per cent for 2000-01 and 5.1 per cent for 2001-02.

India's balance of payments remained reasonably comfortable in both 2000-01 and 2001-02. The current account deficit as a percentage of GDP declined from 1.1 per cent in 1999-2000 to about 0.5 per cent in 2000-01 due to a dynamic export performance and sustained buoyancy in invisible receipts.

SALIENT MACRO ECONOMIC INDICATORS

ECONOMIC INDICATORS	**1997-98**	**1998-99**	**1999-00**	**2000-01**	**2001-02**
GDP GROWTH %	**4.8**	**6.5**	**6.1**	**4**	**5.4**
INDUSTRIAL PRODUCTION GROWTH %	**6.7**	**4.1**	**6.7**	**5.0**	**2.3**
AGRICULTURAL PRODUCTION GROWTH %	**-2.4**	**6.2**	**1.3**	**-.2**	**5.7**
GROSS FISCAL DEFICIT (% OF GDP)	**4.8**	**5.1**	**5.4**	**5.5**	**5.1**
INFLATION RATE (BASED ON WPI)	**4.5**	**5.3**	**6.5**	**4.9**	**1.3**
GROSS DOMESTIC SAVINGS (% OF GDP)	**23.1**	**21.7**	**23.2**	**23.4**	**23**
EXPORT GROWTH RATE (%)	**4.6**	**-5.1**	**10.8**	**21**	**.6***
IMPORT GROWTH RATE (%)	**6**	**2.2**	**17.2**	**1.7**	**.3***
CURRENT A/C DEFICIT (% OF GDP)	**1.4**	**1.0**	**1.5**	**1.1**	**.5**
FOREIGN EXCHANGE RESERVES (US$ BN.)	**25.98**	**29.52**	**35.06**	**39.55**	**50**

Table 1

The exchange rate of the rupee in terms of the major currencies of the world remained reasonably stable during the year, despite occasional fluctuations caused by normal market forces of supply and demand. Foreign exchange reserves (including gold and SDR) reached a record level of nearly US$50 billion at the

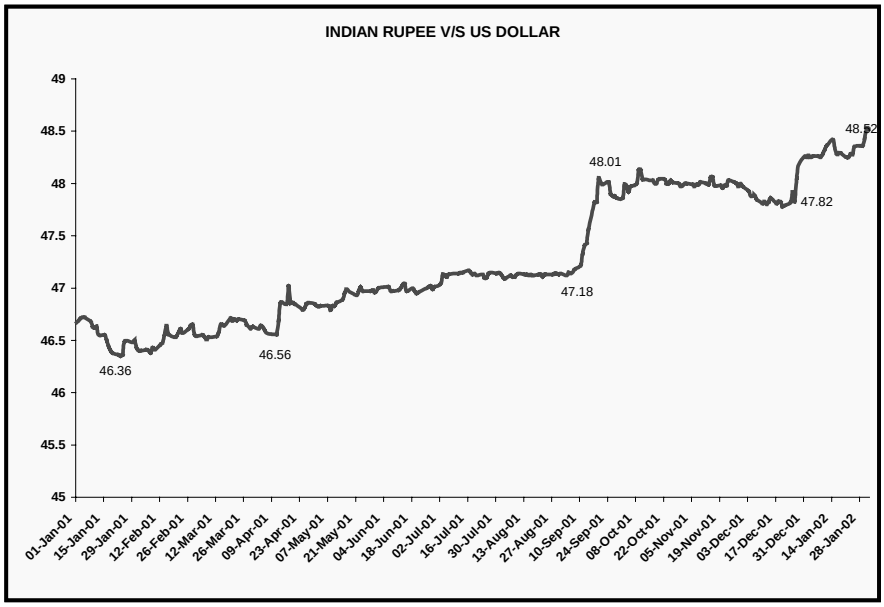

Figure 1

end of January 2002, which is equivalent to almost 10 months of estimated imports for the current year.

India's external debt situation has improved significantly in recent years as a result of effective external debt management by the Government. The external debt-GDP ratio decreased from 28.7 per cent at the end of March 1991 to 22.3 per cent at end-March 2001 and further to 21 per cent at the end of September 2001. The debt service ratio declined from a peak level of 35.3 per cent of current receipts in 1990-91 to 16.3 per cent in 2000-01. It is particularly noteworthy that for the first time, the World Bank has classified India as a less-indebted country.

DEVELOPMENTS IN THE FINANCIAL SECTOR

The process of financial sector reforms has been carried forward in the current year with particular focus on banking and financial institutions. The measures pertaining to financial institutions included operational and regulatory issues concerning transition to universal banking, a transparent mechanism for corporate debt restructuring, coordination between banks and financial institutions, amended guidelines for Asset-Liability Management and classification and valuation of investments.

DEVELOPMENTS IN THE INDIAN SECURITIES MARKETS

The current financial year witnessed significant improvements to institutional mechanisms, where the equity market achieved major milestones in the form of complete switchover to rolling settlement and the extension of derivatives trading in equity to index options, stock options and stock futures. The Indian Stock Exchanges are to be demutualised in order to enhance corporate governance at the stock exchanges.

PRIMARY MARKET

The resource mobilization through public slowed down due to adverse market sentiments. The total mobilization from the primary market is shown in Figure 2.

RESOURCE MOBILIZATION FROM PUBLIC ISSUES

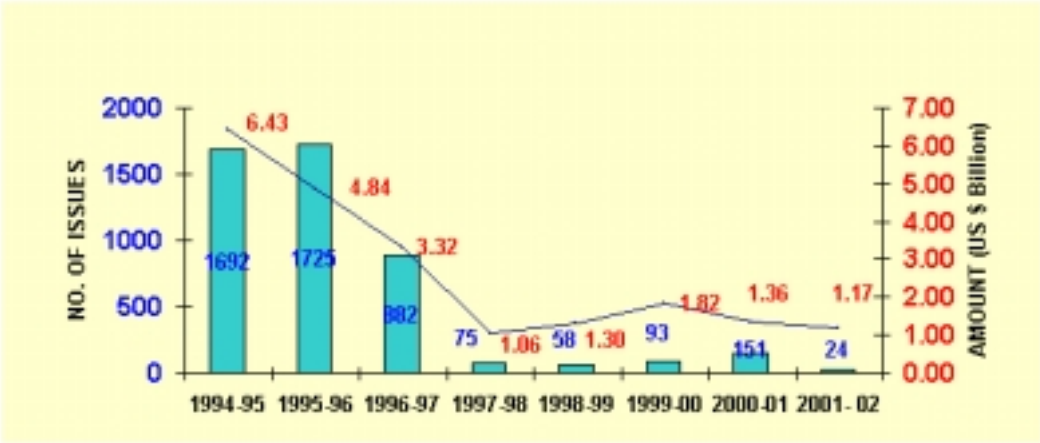

Figure 2

The Indian mutual fund industry has grown considerably during the last five years. The resource mobilization by the mutual fund has increased from US$1.5 bn in 1995 to 26.48 bn. (Figure 3). 40 mutual funds with 417 schemes are active in the Indian markets.

RESOURCE MOBILIZATION BY MUTUAL FUNDS

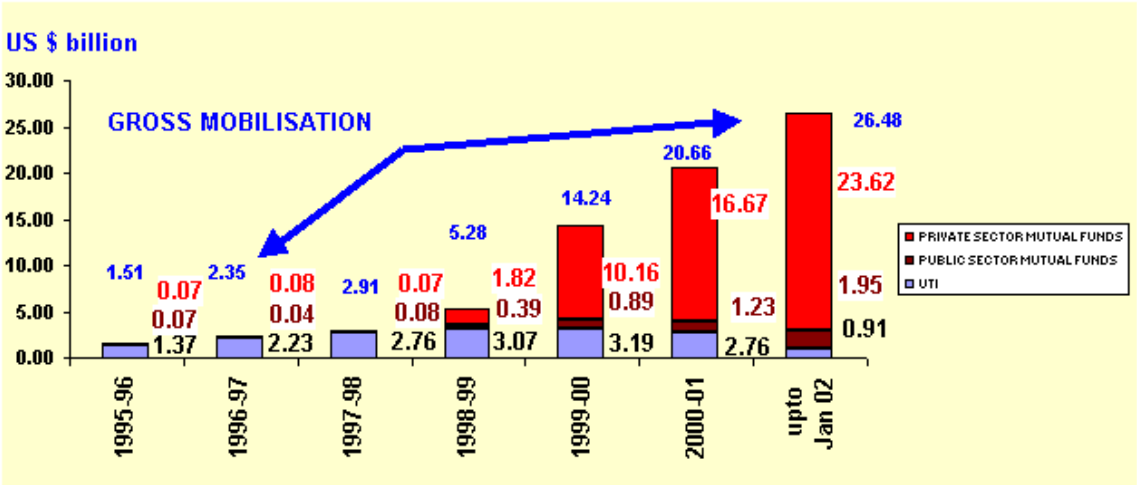

Figure 3

Some of the salient reforms in the Primary markets the this period are:

- Adoption of free market economy principle
- Disclosures in consonance with international standards.
- Entry norms and track record criteria to ensure quality IPOs
- Buy-back of Securities permitted
- Employee Stock Option scheme now being used extensively by the corporate.
- Introduction of Book Building process
- Trading of IPOs in dematerialized Form

The reforms initiated by SEBI have made the markets transparent and investor friendly. This has resulted in the spread on investment cult in the country (Box 1) . There has been a shift in the public towards risk bearing instruments during the last decade. With the convergence of technology and financial markets , the equity culture has spread to remote corners of the country . The exchanges have terminals in over 400 cities and with the advent of internet trading has become seamless and transparent. The investor base in the country is expanding and SEBI is committed to make efforts for increasing public participation in the securities markets.

INVESTORS IN INDIAN SECURITIES MARKETS

19mn individuals invest in securities market

- **Urban investors - 12.73mn**
- **Rural investors - 6.27mn**

18mn individuals owned equity

- **Urban investors - 12.09mn**
- **Rural investors - 5.01mn**

23mn unit holders in Mutual Funds

Investor households grew at the rate of 22% between 1985 - 1999

- **Urban investor increasing at 19%**
- **Rural investor increasing at 30%**

Box 1

SECONDARY MARKET

SEBI continued with its efforts to make the Indian markets for efficient, transparent and investor friendly. The basic statistics for the market infrastructure are provided in Box 2

INDIAN SECURITIES MARKETS- STATISTICS

No of Stock Exchanges	**24**	
All India Market Cap(at BSE) as on December 31 , 2001	**160**	**(USD Bn)**
Annual Turnover at all stock exchanges (US$ bn)		
• **1997-98** -	**216**	
• **1998-99** -	**235**	
• **1999-00** -	**475**	
• **2000-01** -	**600**	
• **2001-02** -	**300**	
Present Average daily turnover(US$bn)	**1.5**	
No. of Stock Brokers	**9192**	
No. of Listed Companies	**9922**	
No. of Depositories	**2**	
No. of Depository Participants	**212**	
No. of Account Holders	**4.4 million**	

Box 2

As series of reforms have been initiated in the Indian markets over the last decade. The primary objective of these reform measures was to make the Indian markets market modern, efficient, in terms of infrastructure and best practices, competition, transparency; vibrant, safe, more global and investor friendly.

Some of the reforms measures carried out by SEBI to make To make the market modern, efficient, in terms of infrastructure and best practices, competition, transparency; vibrant, safe, more global and investor friendly are shown in Box 3 .

REFORMS IN THE SECONDARY MARKET

- **Automated trading in all 24 stock exchanges**
- **Extension of terminals of BSE and NSE to about 400 cities**
- **Easy access of stock markets for investors**
- **Stricter norms for continuing disclosure- quarterly results, segment reporting compulsory.**
- **Enforcing Corporate Governance Code to maximise shareholder value and increase investor confidence**
- **Setting up of Depositories**
- **Introduction of Rolling Settlement**
- **Setting up of Clearing Houses**
- **Setting up of trade /settlement guarantee funds**
- **Efficient margining system (based on Value - at - risk approach)**
- **Surveillance systems at all the exchanges**
- **Large scale action against erring intermediaries**
- **Investor Protection measures**

Box 3

These reform measures have resulted in the following:

- Reduced settlement cycle
- Wider access to markets for investors across India
- Increase in investor base
- Dematerialization and automation have lowered transaction costs
- Indian markets amongst the least volatile

- Prompt detection of market manipulations
- Efficient risk containment measures

Due to the various reform measures carried out , transaction costs in the Indian markets are one of the lowest in the world. (Table 2)

COMPARISON OF TRANSACTION COSTS

International Comparison of Transaction Costs (In basis points)								
	USA	Australia	Malaysia	Hongkong	Singapore	Thailand	India MF	India FII
Brokerage	0.6	50	87.5	25	61.5	50	25	32
Regulator's fee	0.03	-	-	1.1	5	-		-
Custody	0.006	1	-	5	5	-	6	
Clearing	0.01	-	-	0.3	1	-		8
Stamp duty	-	30	10	11.63	3	10		-
Total	0.646	81	97.5	43.03	75.5	60	31	40

Table 2

The Indian securities markets are not insulated form the global financial environment. With the global economy undergoing a phase of turbulence and volatility, the Indian indices also went through a topsy-turvy ride during this phase. A comparison of MSCI indices (Figure 4) shows that the Indian markets have not fared badly in comparison with other global markets.

COMPARISON OF GLOBAL INDICES

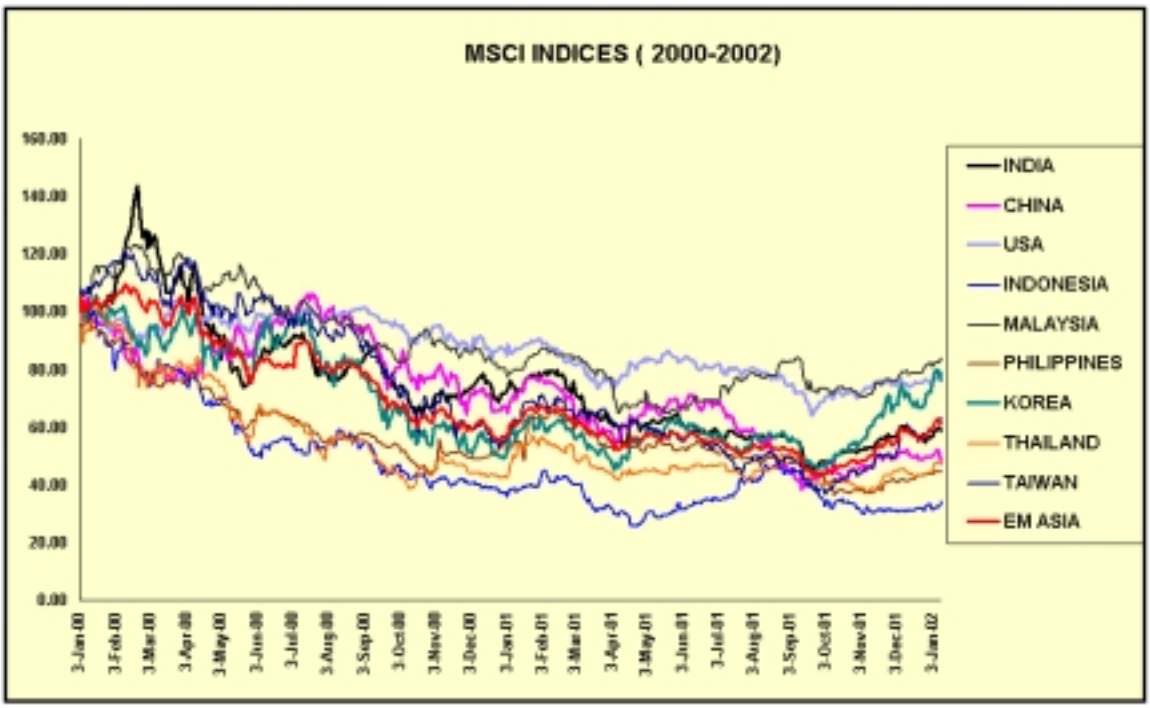

FIGURE 4

However, during the Indian markets remained attractive to the foreign investors and the Foreign Institutional Investors (FIIs) invested US$ 2 billion during the last year. The cumulative net investment made by the FIIs since 1991 stands at US$ 15.27 billion. (Figure 5)

FII INVESTMENT IN INDIA

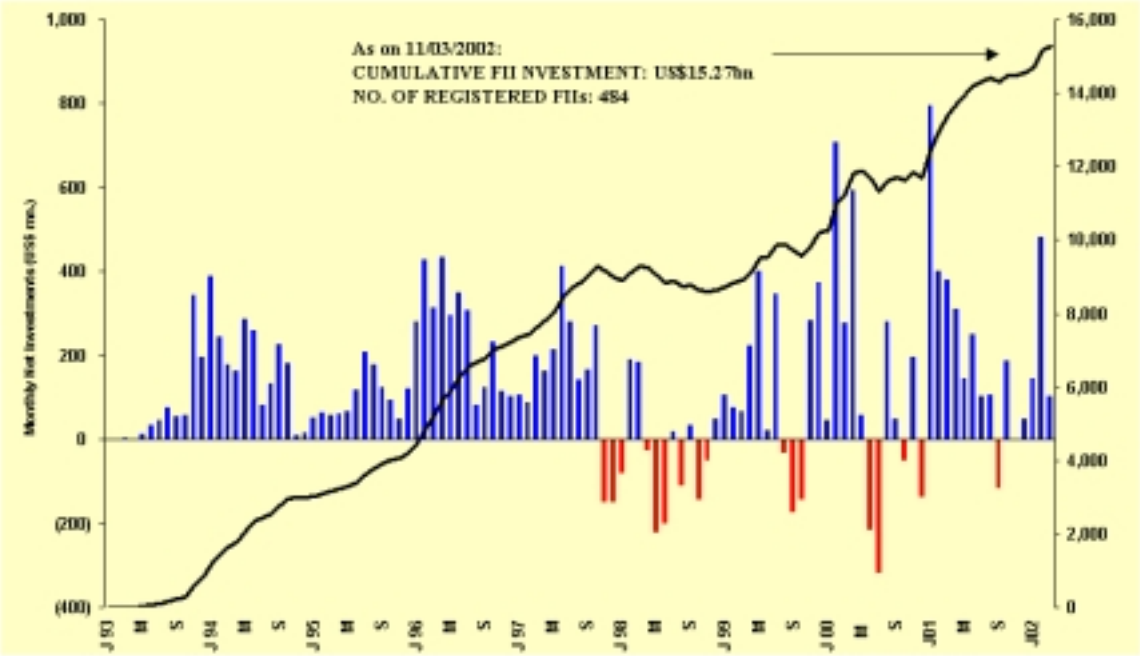

Figure 5

Some of the salient measures taken during last year to make the Indian securities market more efficient were :

- Compulsory Rolling Settlement on T + 5 basis was introduced for 414 scrips since July 02, 2001 on all exchanges. The remaining listed scrips began trading on T + 5 compulsory rolling settlement on all exchanges from January 02, 2002. Compulsory rolling settlement in all listed scrips on all exchanges would be introduced on T + 3 basis from April 01, 2002.

- In order to provide new instruments, equity derivatives were introduced in the Indian markets . Some of the products which were introduced were options on indices and stocks, stock futures, which can perform hedging functions hitherto performed by the deferral products. The equity derivatives market is an important new milestone - in offering a new set of vehicles for risk management and for speculation to all economic agents in the country. The rapid takeoff of liquidity on the equity derivatives market, by world standards, is a reminder of the vitality and sophistication of the financial sector.

- In order to segregate ownership, management and trading rights, it was decided to coporatise the Indian stock exchanges. Demutualisation of stock exchanges would make the functioning of exchanges more transparent and efficient.
- Establishment of Investor Education and Protection Fund

Strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. (SEBI) appointed the Committee on Corporate Governance under the Chairmanship of Shri Kumar Mangalam Birla, member SEBI Board, to promote and raise the standards of Corporate Governance. The objective was of the Committee was, "enhancement of the long-term shareholder value while at the same time protecting the interests of other stakeholders."

Based on the recommendations of the Committee SEBI introduced the following measures to enhance corporate governance practices amongst the Indian companies:

- Introduction of Corporate Governance code to maximise shareholder value and investor confidence.
- Phased program of Corporate Governance for all listed companies.
- Companies to restructure Boards to make them independent, have independent audit committees and have higher accounting standards and disclosures
- Additional financial disclosure standards

FUTURE AGENDA

Financial markets do not operate in vacuum . They operate in a dynamic environment, which is constantly changing because of internal and external factors. Change is the only constant in these turbulent times. In order to make the Indian markets more dynamic and efficient and transparent , SEBI intends to work upon the following areas:

- Simplification of Issue Procedures
- Financial Disclosures comparable to International standards
- Development of Secondary Debt Market
- Asset securitisation
- Encouraging Venture Capital Funds
- Introduction of new products in Futures Markets
- Spreading the equity cult to interior cities by usage of Internet and VSAT
- Online Trading-Seamless Trading

- Strengthening insider trading regulations
- Enforcement of corporate governance code

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