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# 'Delay in tapering is a window of opportunity'

*Since financial services are linked to and reflective of the real economy, the slowdown in economic growth is impacting this sector also. Ajay Srinivasan, CEO, financial services, Aditya Birla Group, in an interaction with* **Ira Dugal**, *says that structurally India is still a big market given its demography and savings rate.*

**The market sentiment seems to be improving...**

I think the sentiment in the economy has improved with the way the rupee has stabilised as a result of the capital flows that have come in. The recent estimates of the CAD have been better than the $70 billion estimated earlier. Globally, the delay in Fed tapering and better numbers from China have improved capital flows into the financial markets and have taken the stock market higher. But I think improvement in economic growth per se is still some distance away and the challenges of inflation and employment remain.

**So, do you feel the fears of capital outflows have eased?**

I think those have partly eased because of what happened with the currency and the external account since all countries with high CAD were thought to be at higher risk. But they have also partly eased because of the delay in Fed tapering. Expectations are that tapering might be pushed back further. Therefore, global liquidity is still benign. So, I believe, it's a combination of global liquidity and domestic factors that have helped. We must be clear, though, that this is a window which is open till tapering actually starts and that we will have to set things in order by then.

**But the growth and, hence, the demand picture hasn't changed. Has it?**

No, it hasn't. I think we will have some benefit this year from better agriculture, but both industry and services continue to slow down. If you look at it from the demand side, consumption demand is hurting because of inflation and high interest rates. At the same time, investment demand is hurting because of general sentiment, the policy framework and the relatively high interest rates. So, in that sense, growth has not come back yet.

Having said that, there have been positive developments. For instance, the CCI clearing stalled projects is an important move. The question is, once these projects are cleared, how do you make sure they get off the ground. If that happens, you will start to derive ancillary benefits and it will have a multiplier effect.

**The growth-inflation trade-off seems to have come back to haunt us given the recent RBI policy. What is your view on inflation?**

I think inflation is a bit dichotomous because you are continuing to see inflation even against the backdrop of a weak economy. Some amount of inflation was "imported" through the rupee depreciation but a lot of it does seem to be supply-led and, in that sense, maybe monetary policy is not the only way to deal with it.

You have to have a mix of different policies including supply-led, improving capacities, improving efficiencies. We have done a good job protecting the external value of the rupee and are focused on protecting its internal value too. But without growth, we are not going to achieve employment, poverty reduction and other things that we want as a nation.

**The Aditya Birla Financial Services Group (ABFSG) has businesses across a number of financial service segments—what to your mind is the biggest issue for financial services? Is it the lack of underlying economic activity, is it high interest rates/liquidity or is it sentiment?**

Clearly, financial services are linked to and reflective of the real economy. With the slowdown in our economic growth, there is bound to be a slowdown in financial services. Second, the low real rates have led to money going into assets like real estate and gold and a drop in flows to financial assets. Third, distribution economics have taken a beating over the last few years and we are seeing a reduction in distribution capacity outside of banks. Fourth, volatility has played its role in keeping investors on the sidelines.

**Which of the business lines are seeing the maximum stress and which ones are improving, even if marginally?**

Stress is a bit of a strong word to use here as, structurally, India is still a big market for financial services given our population size, demography, savings rate and low penetration of most financial services products. Having said that, our fee-based retail businesses are facing some headwinds from the general sentiment—the lower growth and the distribution issues I mentioned. Life insurance industry has declined in terms of new business from FY10 to FY13. The mutual fund business was growing fixed income assets (equity flows have been negative from FY10) until the moves to protect the rupee led to a fall in bonds. Wealth management has faced the brunt of falling insurance and mutual fund sales and in broking, retail cash volumes have fallen by over 50% over the past 3 years. Fund-based businesses have fared better but with falling corporate margins, strained working capital and growing leverage, we need to be circumspective here.

**Protection as a concept is still evolving in India. We are much more savings and investment focused. Income levels have gone up substantially in India, but we haven't seen protection levels keep pace with that**

**Has the last quarter been difficult across business lines given the volatility we have seen across assets classes, particularly the debt segment?**

Of all the businesses we operate in, the mutual fund business was most impacted because of the way the interest rates moved. You had liquidity sucked out, you had an inverted yield curve and you had a reasonable amount of mark-to-market across the curve. So, definitely, the fixed income side of the mutual fund business had a challenging quarter though now some normalcy has returned.

**What about financing businesses?**

There is a general economic slowdown so a lot of the business is refinancing rather than new demand. But we are a smaller NBFC relative to some others. So, we are able to pick and choose what we want to do and still grow as we would like.

**How is the insurance business doing?**

We are close to the bottom there. There have been major product changes with a host of new product guidelines. Each time that happens, it takes the industry a while to readjust to the new products. But the good thing is that we still have a large population and insurance penetration is low. So, it is really a question of figuring out how you can tap into that growth.

**What about leveraging that...**

We have had so many things that have led us to where we are. We had real rates being negative for a while, which led people to move towards gold and real estate. Volatility also scares the retail investor, whether it is volatility in equity markets or currency markets or fixed income markets. We have had tax-free bonds providing good returns over a longish period.

While in terms of savings instruments there are alternate options, in terms of protection we still are under-penetrated. I don't understand why we don't protect ourselves more. Maybe there is a basic optimism within us. We are under-insured in terms of life, we are desperately under-insured for health, and if you take property, personal lines, etc, there is hardly any insurance. So, protection as a concept is still evolving in India. We are much more savings and investment focused. Income levels have gone up substantially in India, but we haven't seen protection levels keep pace with that.

**What is your sense of the corporate balance sheets, stressed corporate earnings and what that could mean for the markets? For instance, do we need to re-evaluate trading multiples given the weaker GDP growth?**

I think the danger there is looking at aggregates. So, if you look at leverage, there are definitely some sectors where leverage has become considerable and you have to worry about those sectors. But that's not true across the spectrum. The same holds for earnings. I think a number of companies would be facing a slowdown for various reasons, but not all.

I think the market is hoping that we are close to a bottom and that we will start to see a pick-up. The market is, therefore, probably discounting near-term earnings and focusing on FY15. Additionally, I think we should not forget global liquidity. Our markets are still extremely driven by foreign flows. The correlation between the Sensex and FII flows is very strong. So, if the liquidity situation is benign and money is flowing towards emerging markets, some of that can also distort valuations for some time.

**But there is no pick-up in retail interest towards equity markets, is there?**

Retail participation in equity has generally been quite low, and now it has fallen even more. Earlier, money was flowing towards gold and real estate but that has slowed to an extent. But you are not seeing money flow towards bank deposits in a big way either. We are not seeing huge amounts of funds flowing into mutual funds or life insurance. It could be that inflation is really biting and, therefore, the part available for saving is coming down.

**Do you expect margins and profitability in the banking sector to come under pressure as new competition comes in and as growth slows down?**

The view that growth is not there is a short-term view. If you look at the credit-to-GDP ratio, the banking penetration ratios, all of these are very low. So, in that sense, the slowdown is temporary and growth will come back. In terms of new banks, as you get more players in any business, customers benefit from better service and producers start to see some reduction in margins. That's inevitable. It's difficult to say how far it will go. I believe there is enough underlying demand and the pie-size will increase.

**Getting back to policy, what else do you think needs to be done right now to better the environment?**

We need to be able to attract long-term foreign capital given our CAD situation and given the global liquidity picture. We need to do more in terms of curtailing the fiscal deficit. We are running ahead of the expenditure targets. So, there is a concern on how we will meet the fiscal deficit targets for the year. The third concern is how do we kick-start investments and savings. To my mind, both of these are, in some way, linked to interest rates. Our high growth in the early-2000s was driven by investment demand which we need to resume. We also need to find ways of tapping domestic savings for productive uses. And finally we need to think about employment given our demographics. Our growth needs to come with job creation to leverage our workforce and our workforce will need to be adequately skilled to step up to the task.