

INTERVIEW | A. BALASUBRAMANIAN
'Fixed income can also be volatile'

The crisis is done... we're at its peak

ASHISH RUKHAIYAR

The negative news flow and the record downgrades of debt instruments has made investors wary of investing in fixed income funds, but such schemes should still be a part of an investor's portfolio, says A. Balasubramanian, CEO, Aditya Birla Sun Life Asset Management Company. Mr. Balasubramanian, who manages assets totalling ₹2.65 lakh crore, believes that the ongoing crisis in the debt segment is at its peak and should subside soon as corporates are in the midst of resolution processes. Excerpts:

There have been a record number of debt downgrades in this year. Do you think debt schemes are going through their worst phase?

Definitely the last eight-nine months have been a tough time for mutual funds because of the fact that they have grown in size, and also because they've offered innovative products such as credit risk fund and accrual kind of funds. And these funds have a focus on investing in fixed income bearing securities.

And then if a downgrade happens, it has an effect on the price and the net asset value (NAV) of the scheme. Generally, people are not used to that kind of development under fixed income, as the assumption is that one will get linear return.

While you get return in the long run, you have to go through cycles because these schemes are completely pass through vehicles. While this is understood very well in equity, it's not so much understood in fixed income. But after the current mayhem, investors will understand that fixed income can also be volatile. Debt capital market is going through a tough time which is due to local issues or our country specific issues in the credit market.

Is it because of so many downgrades in the recent past such products have invited a lot of criticism though there are no fundamental issues with the products as such?

One must appreciate that mutual funds' 100% disclosure practice does enable a better understanding of the portfolios.

At the same time, given the 100% disclosure, analysis both on exposure and its impact on the NAV is quite instantaneous, which leads to increase in noise levels. The news flow too has been quite frequent.

Hence, one has to stay patient to such noise level, as the recovery of loss is

high due to the interest accrual component in a fixed income portfolio. As a result of this, if there is at all any loss, it is in the overall income or returns and not in the absolute value.

In May, the outflows from credit risk funds saw a three-fold rise compared to April. Do you expect a similar trend going ahead?

I think it's done. I think we are at the peak of the crisis. We might stay here for some time and then we will see that it is coming down. We need one or two resolutions. The moment Zee resolution happens, one problem will be out. NCLT is looking at IL&FS and once a resolution is done, that problem would be out. Similarly for DHFL and ADAG. All the processes are on track. But the question mark is on the time frame and hence we all need patience.

So, do you think this is a time when investors can look at debt funds or will they be better off with equity?

Fixed income has to be a part of the portfolio, without any doubt. Around 50% of the portfolio should be in fixed income and the other 50% in equity and one should be flexible in the allocation. And, both equity and debt should be looked upon as long term bets.

Both assets can lose money, but you should hold for long term. Debt should not be looked upon as something with a one-year horizon. So, while one should always have fixed income in the portfolio, one must also remember that fixed income can also stay volatile.

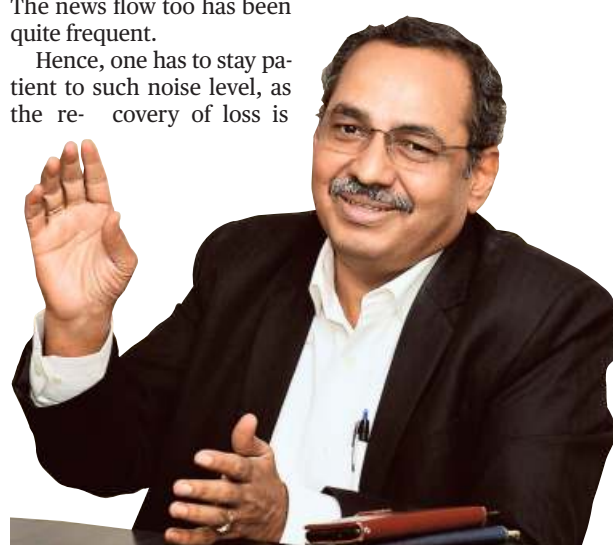
How do you see the inflows in MFs going ahead considering that the markets have been quite volatile?

We are seeing a very high level of commitment by the newly elected members to drive the Indian economy to the next level among emerging markets.

There is optimism returning to the market.

Now, the question is about earnings coming back, which takes time. But overseas investors look at India more seriously now because of political stability.

We might probably see a decade of stability. So, if you look at a decade of stability, then economic growth has to come back along with that. Therefore, my view is there will be an increase in flows into the mutual funds, both in equity and fixed income.



This will be a tough budget to balance

Finance Minister Nirmala Sitharaman has the unenviable task of pushing growth, while maintaining fiscal discipline

TCA SHARAD RAGHAVAN

Over the next 20 days, two major policy events will take place – the Budget and a GST Council meeting – that will reveal the government's intent and vision for the next five years. While there are a number of issues that it can take up at both these events, there are three main problems that are relatively more noteworthy.

The first is the issue of private investment and how, despite the government's best efforts so far, it has not recovered enough to shoulder its share of the burden as a prime driver of economic growth. The second issue is the fiscal deficit and whether the government is artificially hamstringing itself by curtailing public expenditure in order to meet an arbitrary target. In other words, can the government afford to shift the target meaningfully to, say, 4% from the current 3.4%?

The third important policy element is whether the government can afford to reduce GST rates even further and whether there are any more steps it can take to widen the tax net. The first two issues are to be addressed in the Union Budget, while the third is the exclusive domain of the GST Council. However, in all three, it has only limited options.

Private performance

The consensus view among economists seems to be that the government has pretty much done all it can in terms of creating the right environment for the private sector to grow. Policy measures such as the Insolvency and Bankruptcy Code, the 'Make in India'

initiative, power sector reforms, easing of FDI norms, and the concerted effort to improve the ease of doing business are all considered welcome steps.

"All of these provide a better environment for the private sector to work in," Madan Sabnavis, chief economist at Care Ratings said. "One can't practically expect the government to come up with anything more in most of these areas."

In the Budget, however, there are a few steps the government can take that can make it more attractive for the private sector to invest.

"On the expenditure side, if it continues spending what

Capex undertaken in this financial year will begin to boost the private sector only in the next financial year

it has been on capital expenditure, it will definitely have a positive impact on the private sector," Mr. Sabnavis added. "For example, if the government spends on roads, it automatically creates demand for cement and steel, which is produced by the private sector. Similarly, if the government spends on power infrastructure."

However, the caveat here is that this positive impact on the private sector will not be felt in the very short term. That is, capital expenditure undertaken in this financial year will only begin to boost the private sector in the next financial year.

"The other thing the government can do in the Budget is giving certain kinds of tax concessions," Mr. Sabna-

vis added. "For example, if you're talking about the corporate tax rate, which was to be lowered to 25% from 30%, they have done it only for the smaller companies. They have said they would do it for the rest of the companies over a period of time, but there have not been any steps taken."

Here, too, while there is no guarantee that reducing corporate tax rate will definitely lead to increased investments, it is definitely seen as a good first step.

Fiscally constrained

So, if increased capital expenditure and reduced corporate tax collections are the major way private sector investment can be encouraged, then the natural extension of that argument should be that the government give itself some more flexibility when it comes to the fiscal deficit. While this might seem logical, the government's own actions have rendered this option nearly impractical.

"The central government is relying quite heavily on the public sector for its own infrastructure expansion programme," D.K. Srivastava, chief policy advisor at EY India, explained. "Last year, the increment in government debt was considerably higher than the fiscal deficit. The difference is about 1% of GDP, which are all extra budgetary resources. These constitute liabilities of the government, but are not includ-

ed in the fiscal deficit calculations."

"On the revenue side, a lot of the expenditure on food subsidies is being picked up by the Food Corporation of India (FCI), which has borrowed from the National Small Savings Fund on behalf of the government," Mr. Srivastava added. "And so, when FCI has to service that debt, the government will have to come to rescue. So, these are all government liabilities that are just gathering up."

In other words, since tax revenues either through direct taxes or indirect taxes did not meet their targets last year and don't look like they will this year, the only way the government can increase its expenditure is by borrow-

ing more. However, by committing to repay debt taken on by the public sector on its behalf, the government has tied its hands in this regard as well.

The only practical option before the government is for a favourable recommendation by the Bimal Jalan committee on the quantum of the Reserve Bank of India's reserves that can be transferred to the Centre.

"The information is that if you estimate how much of reserves the RBI has got based on its past profits, then that comes to about 28% of its total assets and the global norm is 14%," Mr. Srivastava said. "It looks like there is room available for it to transfer the excess to the government. That should close some of the shortfall in tax revenues that happened in 2018-19."

Boosting consumption

There is another engine of economic growth, which, while firing strongly so far, has now begun to show signs of weakness – private consumption expenditure. Individuals, driven by static salaries but increasing costs, have begun to defer purchases and this can be seen in a number of metrics that have slowed down, such as car sales. Boosting personal consumption can also

go a long way in reviving the private sector.

One way to encourage individuals to spend more is to increase the amount of money in their pockets. That is, reduce the tax burden. There is some talk in the Finance Ministry about reducing GST rates and addressing the revenue shortfall by widening the tax net. The view among tax experts is that the tax rates currently are already significantly lower than those in the pre-GST era. And, while the impact of a cut in rates affects revenues immediately, the positive impact of trying to increase tax compliance is felt with a delay.

"While the existing GST rates for products are generally lower or at par with the rates prevailing prior to the introduction of GST, there could be some cases where there is scope for further reductions, keeping in mind the revenue implications," M.S. Mani, Partner at Deloitte India said.

"While rate reductions would lead to an expansion of the tax base in the medium term, it needs to be noted that collections go down immediately while the compliance and expansion of the tax base happens over a period of time," Mr. Mani added.

"In the next one year or so, the government could look at collapsing the 12% and 18% categories into a 15-16% single category," Pratik Jain, partner and national leader of Indirect Tax at PwC India, said. "While there is scope for expanding the tax base by plugging the tax leakages, that is a process and cannot happen immediately."

Sugar industry needs a shot of insulin

Current year expected to end with a high closing stock of 14.5 MT; industry urges government to facilitate higher exports

M. SOUNDARIYA PREETHA

It is one of the unprecedented years for the sugar industry in the country, as the sugar season of 2018-2019 is expected to end in September with a high closing stock of nearly 14.5 million tonnes. Though sugar production in the next season might be lower compared with the current one, the focus of the industry and the government will largely be on reducing the inventory.

The estimated sugar production this year (October 2018 to September 2019) is 32.9 million tonnes as against the domestic consumption of 26 million tonnes. Exports are likely to be three million tonnes, according to data available with the Indian Sugar Mills' Association (ISMA). The government had targetted five million tonnes for export.

Sugar exports will have to continue next year too and the government should facilitate higher exports, say industry sources.

With deficit rains, sugar production may drop next season in Maharashtra and north Karnataka.

Even if there is a decline next year, the association ex-



Fair share: Apart from revising the minimum selling price to ₹35 a kg, the government should come out with a revenue-sharing formula for sugarcane price. ■ REUTERS

pects the total production to be higher than the consumption. The 2019-2020 season will commence with an opening stock of 14.62 million tonnes, one of the highest. As sugar will start flowing into the market in the new season only from mid-November, it is better to retain two months' stock (about five million tonnes). So, about seven million tonnes should be exported next season and the govern-

ment should come out with a policy for this in July 2019. Only then, the mills can plan and go ahead with contracts,

GREEN SHOOTS

says Abinash Verma, Director General of ISMA.

International price International price for sugar (white sugar) in the current season is nearly ₹10 a kg less compared to the domestic

price. In an effort to encourage exports and to make it attractive, the government had not only fixed mill-wise export quota, but also linked some of the subsidy schemes to exports.

Yet, almost 35% of the industry did not participate for various reasons such as lack of adequate production or stringent conditions to avail the subsidy.

As such, the industry has suggested to the government

to make the export quota as an industry-wide quota, rather than mill-specific, and to modify the subsidy schemes, so that they are WTO-compatible. "There are mills that are unable to meet the export quota and some mills that want to export more than the quota. So, the government should leave it open," says Mr. Verma.

On the international front, next season, a deficit of nearly four million tonnes is expected. But its impact on the price will be known only later. If the norms are relaxed for the subsidy schemes, more mills will get into exports. There will be no delay in getting the subsidy and the cash flow will improve for the mills. In March this year, the cane arrears pending for farmers was expected to be almost ₹30,000 crore. This should be lesser now. "The policies of the government should attempt to solve both problems – cane price payment and sugar inventory," according to ISMA.

Industry sources point out that the production cost works out to ₹34 a kg, while the minimum selling price in the domestic market fixed by the government is ₹31 a kg. Apart from revising the mini-

mum selling price upward to ₹35 a kg, it should come out with a revenue-sharing formula for cane price. If India should export sugar, it should be competitive.

In Tamil Nadu, the industry points out that the support schemes of the Central Government are all oriented to surplus production States. The mills in Tamil Nadu, numbering about 40, face a peculiar situation of low capacity utilisation (35%) due to reduction in cane production. The mills cannot export sugar as the production (8.5 lakh tonnes) is not adequate even to meet the domestic needs of the State (18 lakh tonnes).

Tamil Nadu was the third or fourth largest producer of sugar in the country five years ago, with an annual production of 23 lakh tonnes. Now, it is just one-third of that. "We have created capacities and invested substantially. Tamil Nadu mills should be exempted from the mandatory exports and the norms for subsidy schemes should be relaxed to benefit the mills in the State," says Palani G. Periasamy, chairman of the South India Sugar Mills' Association.