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Investor Update
February ,2010

India Notes

Monetary Policy Update: RBI raises CRR, Repo/Reverse-Repo Rates Unchanged

Contrary to street expectations, the RBI raised the CRR by 75bps v/s expectations of 50bps, and left the repo and reverse-repo rate unchanged at 3.25% and 4.75% respectively. The CRR hike will mop up liquidity to the tune of Rs360bn (€5.8 bn). Analysts expect that unchanged policy rates are a 'timing' issue as the RBI has simultaneously raised its FY10 GDP estimate to 7.5% (from 6%), its March-2010 inflation estimate to 8.5% (from 6.5%), as well as stating that inflation expectations are on the rise. It is expected that the RBI will hike by at least 125bps this year.

December Industrial Production registers a 16 year high

Dec'09 IIP jumped highest in sixteen years, at 16.8% YoY compared to decline of 0.2% in Dec'08. Cumulative IIP growth for Apr-Dec'09 accelerated to 8.6% compared to 3.6% Apr-Dec'08. Consumer durables and Capital goods, indicators of both private and industrial consumption, registered spectacular growth of 38.8% YoY as compared to 6.6% and 46.0% as compared to (4.2)% in Dec'08 respectively. All the core sectors Index outperformed MoM especially cement sector with 11.9% MoM growth thereby boosting the Infrastructure Index growth to 6.0% YoY

Home-loan disbursement growth indicate robust residential recovery

Residential demand has shown robust pick-up in FY2010 after announcement of 30% yoy growth in home loan disbursements in 3QFY10 by housing finance institutions (ICICI, HDFC, and LICHF). It should be noted that 3QFY10 cumulative home-loan disbursement was Rs193 bn versus Rs148 bn disbursement in 3QFY09. Home-loan disbursement has shown a yoy growth of 20%+ for 1Q-3QFY10 with 9MFY10 growth being 25%. HDFC management also indicated that there is high degree of confidence that 25%+ growth can be sustained for the next 12 months.

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Economy & Markets

Macro Economic Policy :- Tightening all round

RBI raises CRR, Repo/Reverse-Repo Rates Unchanged…But Not For Long CRR hiked by 75bps to 5.75%; Policy rates unchanged

Contrary to most analysts expectations, the RBI raised the CRR by 75bps v/s expectations of 50bps, and left the repo and reverse-repo rate unchanged at 3.25% and 4.75% respectively. The CRR hike will mop up liquidity to the tune of Rs360bn. The unchanged policy rates are a 'timing' issue as the RBI has simultaneously raised its FY10 GDP estimate to 7.5% (from 6%), its March-2010 inflation estimate to 8.5% (from 6.5%), as well as stating that inflation expectations are on the rise. It is expected thatthat the RBI will hike by at least 125bps this year with a high probability of an 'inter-policy' move post the budget.

The dots are a bit difficult to join — The facts at play appear to be a bit conflicting given: (1) The RBI's statement that 'the recovery is yet to fully take hold', yet its GDP estimate of 7.5% is the highest on the street. (2) Not only has the RBI raised its inflation projection, it has stated that inflation expectations are on the rise and warned of further upside risks emanating from: (a) oil, (b) below average monsoons in 2010, and (c) capital flows. (3) The RBI has highlighted its main policy instruments are all currently at levels more consistent with a crisis situation than with a fast recovering economy.

Is the Fiscal position the Real Factor? — Given the above, the RBI has put the onus on the government to lower its deficit, both in terms of revenues and expenditure compression to make monetary policy more effective. Key statements by the RBI pointing to this are: (1) The large fiscal deficit is a far bigger risk to both short-term and medium-term economic management, (2) It is important that there is co-ordination in the fiscal and monetary exits, and (3)
The reversal of monetary accommodation cannot be effective unless there is a roll back of government borrowing.

India IIP Growth Surges Again

The Dec IP growth shot up to 16.8% YoY, bringing the fiscal YTD increase to 8.6%. The Dec outcome was well ahead of Macq (+11.0%) and market (12.4%) expectations. Note that Dec tends to be a seasonally strong month, but the burst this Dec (+10.9% MoM, nsa) has been exceptionally strong. Manufacturing output surged 18.5% YoY, followed by mining production increasing 9.5%. Electricity output increased 5.4% in Dec. The jump in the headline IP was fuelled by a 46% surge in consumer durables and 38.8% jump in capital goods, partly inflated by last year's low base.

Implications for GDP, monetary policy and the budget

The Dec IIP strong growth indicates that IIP grew 13.1% YoY in Oct-Dec, and should meaningfully offset the hit from lower agriculture output in that quarter owing to the drought. The Dec pace is unlikely to be sustained in the Jan-Mar quarter, and will likely ease to around 8.0% (Mar will be the weakest of the three months in 1Q10. With a upgrade in the expected GDP growth already coming in for the government most analysts are expected to upgrade GDP numbers as a strong performance should indicate the expected recovery to be faster and more robust than originally expected.

The key numerical risk to the forecast is the outcome for agriculture. The IP data does not alter most analysts' expectations of the start of the policy rate normalisation in April when the RBI will announce its policy for FY11. The industrial recovery remains narrowly based, despite its strength. The government is still likely to focus on only a gradual withdrawal of fiscal stimulus in the upcoming budget (26 Feb), and probably do the least possible on reforms, although it will offer a roadmap for fiscal consolidation.

It is likely to target a fiscal deficit of 5.5% in FY11, and partially reverse the 6ppt cut in excise duties by increasing them by 2ppt. The underlying recovery is becoming stronger, and offers the scope to fully reverse the 2ppt cut in the service tax that was announced to cushion the downturn.

Real Estate Update

RBI rules out allowing further restructuring of bad real estate loans Newspaper reports appear to indicate that Reserve Bank of India (RBI) has ruled out another round of restructuring for bad real estate loans. This is in response to banks seeking permission to continue classifying some bad real estate loans as standard assets even after developers failed to pay. The total outstanding loans of banks to the real estate sector stood at Rs 885.8bn (€ 14.3 bn) as of November 2009. In 2008, RBI allowed banks to restructure loans to both manufacturers and developers and continue showing bad loans as standard assets to save banks and developers from financial strain after the collapse of Lehman Brothers. However, this was for only those loans where the borrower was regular in repaying dues until September 1, 2008 and where the bank was able to restructure it by June 30, 2009.

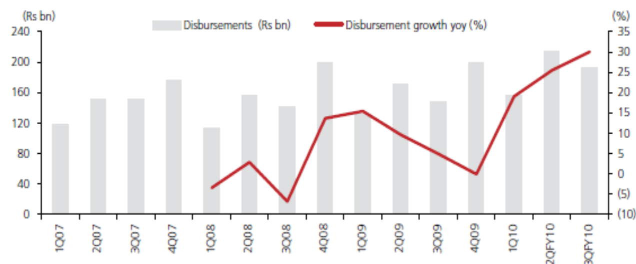
The suggested move is aimed at inducing developers, who are unable to meet their debt obligations, to bring down prices of properties and accelerate volumes to repay debt. The banks are wary of risk associated with commercial real estate loans as demand has not picked up. They are also cautious of residential demand tapering off as real estate companies have started increasing prices (given the strong demand momentum). As reported, RBI believes that the problem cannot be solved by repeated restructuring of loans, but through acceleration in residential volumes by maintaining prices (affordability being the key factor).

The suggested move by RBI is to indicate caution as there could be a stress in the system. However, the impact may not be substantial as most of the real estate companies (post the last restructuring) have managed to raise fresh capital through QIP, share sale, asset monetization etc and utilized the proceeds to retire the debt due in FY10. Also, the companies have, in the last six months, refinanced their short term debt (maturities in FY10 & FY11) with longer tenure debt. Resultantly, analysts believe that the amount of loan which would be due for repayment in Q4FY10 and FY11 may not be significant and internal accruals of the companies (given the pickup in volumes in the residential space) will be sufficient to repay the same.

Home-loan disbursement growth indicate robust residential recovery

Residential demand has shown robust pick-up in FY2010 after announcement of 30% yoy growth in home loan disbursements in 3QFY10 by housing finance institutions (ICICI, HDFC, and LICHF). It should be noted that 3QFY10 cumulative home-loan disbursement was Rs193 bn versus Rs148 bn disbursement in 3QFY09. The table below indicates that growth of 30% is its highest in three years and similar to growth seen in FY2005-06. Home-loan disbursement has shown a yoy growth of 20%+ for 1Q-3QFY10 with 9MFY10 growth being 25%. HDFC management also indicated that there is high degree of confidence that 25%+ growth can be sustained for the next 12 months. The management also indicated that there is a lag of 2-3 months between a change in pace of residential activity and home-loan disbursements.

Disbursements have picked up significantly in FYTD2010
Quarterly disbursements for housing and commercial construction by HDFC, ICICI Bank and LICHF (Rs bn)



RBI's loan outstanding data in indicates that retail housing loans have increased to Rs2.9 tn in November 2009, which implies a 10% annualized growth if compared to Rs2.8 tn in Aug 2009. Retail housing loans are currently around 10-11% of total credit— historically around ~12%. An increment in housing-loan disbursement equivalent to 1% of total credit would indicate an additional disbursement of ~Rs275 bn (as of Nov 2009). Another key highlight is that outstanding real estate corporate loans declined consecutively for the second time. This decline comes on the back of aggressive capital raising via the QIP route, equity issuances and also asset sales as developers look to reduce their debt burden.

Credit data shows housing loan disbursement has grown
Credit data released by RBI

	Outstanding credit (Rs bn)								Growth rate in outstanding credit (%)							
	Aug-07	Nov-07	Feb-08	Aug-08	Feb-09	May-09	Aug-09	Nov-09	Aug-07	Nov-07	Feb-08	Aug-08	Feb-09	May-09	Aug-09	Nov-09
Food credit	384	377	428	504	484	588	491	419	(35)	(7)	66	(26)	(26)	118	(51)	(47)
Agriculture	2,205	2,321	2,418	2,625	2,978	3,298	3,298	3,431	(3)	23	18	(3)	12	50	-	17
Industry total	7,110	7,544	8,150	9,323	10,398	10,404	10,968	11,537	22	27	36	39	9	0	24	22
Industry (medium & large)	5,916	6,242	6,737	8,018			8,190	8,181	24	24	36	91				
SSI	1,194	1,303	1,413	1,306			2,771	3,357	13	42	38	(70)				
Trade	1,049	1,118	1,189	1,294		1,420	1,474	1,561	(2)	29	28	25			16	26
Retail loans	4,641	4,884	5,037	5,521	5,554	5,575	5,047	5,677	8	23	13	20	(9)	2	(33)	60
Housing	2,352	2,467	2,517	2,688	2,724	2,755	2,847	2,918	8	21	8	10	1	5	14	10
Others	3,088	3,397	3,807	4,387	5,997	5,981	4,358	4,956	24	46	58	43	206	(1)	(72)	67
Real Estate loans	467	507	539	682	908	945	907	886	3	39	28	56	98	17	(15)	(9)
NBFCs	453	534	641	770	905	947	1,013	1,028	8	93	108	31	22	20	31	6
Total	**18,477**	**19,642**	**21,029**	**23,592**	**25,411**	**26,170**	**26,236**	**27,581**	**12**	**28**	**31**	**25**	**3**	**12**	**1**	**22**
Real estate loans + housing	**2,818**	**2,973**	**3,056**	**3,370**	**3,632**	**3,700**	**3,754**	**3,803**	**7**	**24**	**12**	**18**	**18**	**8**	**6**	**5**
Housing loans (% of total credit)	12.7	12.6	12.0	11.4	10.7	10.5	10.9	10.6								
Real estateloans(% of total credit)	2.5	2.6	2.6	2.9	3.6	3.6	3.5	3.2								

Pricing to be the driver of affordability
Measurement of affordability of housing in India, March fiscal year-ends, 1999-2010E

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	May-09	Current
Housing loan interest rates (%)	**14.5**	**13.9**	**12.8**	**12.1**	**10.4**	**8.9**	**8.0**	**8.5**	**9.5**	**10.5**	**10.5**	**8.50**
EMI per Rs100,000 on 20 yr loan (Rs)	1,366	1,240	1,160	1,110	995	895	836	868	932	998	998	850
Avg annual household income (for households with annual income > Rs200,000)		577,201	606,061	636,364	668,182	701,591	736,671	788,238	843,414	902,453	947,576	947,576
Income growth (%)			5.0%	5.0%	5.0%	5.0%	5.0%	7.0%	7.0%	7.0%	5.0%	0.0%
Taxes		115,440	121,212	127,273	133,636	140,318	147,334	157,648	168,683	180,491	142,136	142,136
Post tax income		461,761	484,849	509,091	534,546	561,273	589,337	630,590	674,731	721,963	805,439	805,439
Selling prices decline by 10% each in FY2009E and FY2010E												
Capital price in Koramangala,Bangalore		**1,900**	**1,800**	**1,750**	**1,900**	**2,350**	**2,800**	**4,500**	**4,750**	**4,750**	**3,600**	**3,600**
Price of 1,500 sq. ft house (Rs mn)		2.9	2.7	2.6	2.9	3.5	4.2	6.8	7.1	7.1	5.4	5.4
EMI payable assuming 70% LTV		24,738	21,924	20,396	19,850	22,084	24,578	41,013	46,484	49,775	37,724	32,130
Price/income ratio (X)		4.9	4.5	4.1	4.3	5.0	5.7	8.6	8.4	7.9	5.7	5.7
Affordability Index (assuming FY2000 as 100)		**100**	**84**	**75**	**69**	**73**	**78**	**121**	**129**	**129**	**87**	**74**
Capital price in Bandra, Mumbai		**7,992**	**8,791**	**8,000**	**8,500**	**8,500**	**10,000**	**13,000**	**16,000**	**20,000**	**14,000**	**17,000**
Affordability Index (assuming FY2000 as 100)		**100**	**98**	**81**	**74**	**63**	**66**	**83**	**103**	**129**	**81**	**84**

Pricing movement to determine residential affordability—stable pricing for robust volumes

Analysts believe that affordability will increasingly depend on price movements since the impact of a likely increase in interest rates will be offset by an increase in salaries. Affordability will likely decrease wherever prices are increased, which would result in a decline in volumes.

As prices and interest rates dropped, affordability improved by 40% during Jan-May 2009, triggering the sharp pickup in demand.

Data has shown that there is good volume offtake in NCR and Mumbai. Bangalore has also seen a pick-up in residential volumes on the back of improvement in IT/ITeS business. However, it should also be noted that volumes have declined in Mumbai post the 25-30% increase in prices from the bottom in early-CY2009.

	Pricing	Volume
Bangalore	Stable	Medium
Chennai	Stable	Medium
Delhi	Up 15%	High
Hyderabad	Down	Low
Kolkatta	Down	Medium
Mumbai	Up 20%	Medium (Volumes were high before the price increase)
NCR	Stable	High
Pune	Stable	Medium

Commercial Real Estate

Although there was an increase in the level of both enquiries and transactional volume during 4Q2009, leasing trends in India remain mixed. Despite the prevailing positive market sentiment and the reported growth in hiring expectations in individual companies, office occupiers remained largely cautious about any significant capital expenditure. Although there was demand attributed to office consolidation and relocations, the pace of growth in expansionary floor area requirements is yet to catch up with the sales market.

During the results season numerous IT /ITES companies have announced plans to resume hiring and consequently are also expected to consider taking up more commercial office space. Trends reveal that the immediate beneficiary of these expansion plans is constructed assets lying vacant. The rentals in such properties are attractive and the vacancy rates in major micro markets are expected to reduce pre crisis levels of 5% to 7%. However with the supply overhang of commercial property projects which were postponed will translate in some more time gap before the commercial property rentals bounce back completely.

Retail Sector

The retail sector exhibited strong results in the last quarter with most retail led companies exhibiting strong revival in consumer demand. Domestic demand for fast moving consumer goods and other domestic consumption items has picked up exhibiting a return of confidence amongst the retail buyer. The revenue share models implemented during the down turn have started exhibiting results as lower over head costs have translated in better performance amongst retail player. The retail business which was amongst worst impacted during the downturn due to high debt burdens and poor supply chain management coupled with fall in demand has seen two quarters with better than expected results. Same store sales have started reflecting month on month growth rates in double digits which has translated in Retailers beginning to consider expansion options albeit in circumspect manner.

It would be too early to comment on whether the trends reflect a recovery or a mere stabilization but either would be good for the sector. Visibility of cash flows, lower over heads and better future prospects should assist companies in the sector to focus on sustainable expansion plans.

Real estate sector stabilising but risks remain: Fitch

Fitch Ratings' outlook for the Indian real estate sector in 2010 is negative, with a slight stable bias. Overall, the fundamentals of the real estate sector are improving, as seen by better liquidity and improved demand in the residential segment. Fitch expects growth in 2010 to be driven by government support (especially for the affordable segment), improved access to debt and capital markets, and the recovery of real estate demand. However, there might be some moderately adverse policy actions during the year when economic conditions should have reached a point of greater stabilisation.

The government may also find it politically difficult to provide a supportive environment if developers continue to increase prices. Fitch would look for sustainability of operating performance, and continued deleveraging over a longer period, to take a favorable view on the sector — which the agency expects to happen during the course of the year.

Demand slowed down considerably in H109, both in the residential and commercial real estate segments, with a significant drop in property prices. However, H209 witnessed some recovery, particularly in the residential segment. Enhanced affordability, lower mortgage rates, and better job security have helped revive demand for homes.

The commercial segment continues to remain weak, primarily impacted by oversupply and the scale-back of expansion plans by corporate India. The Information Technology/Information Technology Enabled Services (IT/ITeS) sector, which accounts for most commercial office space, adopted a conservative staffing approach during the slowdown, which resulted in demand for office space lagging supply. Fitch expects this demand for commercial space to marginally improve from H210.

Outlook

Overall the encouraging results from corporate India and the strong Macroeconomic indicators point in the positive direction for real estate. Residential sector has started turning the corner with growth in sales happening mainly in the mid income asset sales. However the growth is being noticed in specific pockets and markets and is not an evenly spread out growth.