

percentage points.

India's exports have noticeably weakened, while its appetite for imports has flourished undiminished. A weakened rupee has boosted remittances, although less than expected. Crude oil prices have remained far above the comfort level of \$100. Any spike in oil prices from the current levels - as could occur following a military confrontation in West Asia involving Iran - will have a cascading effect on the fiscal deficit and current account deficit, result in imported inflation and amplify the pressure on exchange rates.

This scenario spells continued weakness for the rupee. The speed and extent of worsening should make RBI wary of any more interventions to support the rupee. It has already used to \$20 billion over the past few months to defend the rupee. Unlike China, India's forex reserves consist largely of footloose capital inflows and not export earnings. This limits RBI's capability in defending the rupee, as the forex reserves are susceptible to withdrawal of foreign capital any time. Any effort by RBI to shore up the rupee will be futile due to the fact that when RBI sells dollars, it is in fact buying the rupee, the supply of which is practically unlimited.

Not just the current account deficit, but overall investment climate is also a cause for concern. India is losing its attractiveness as an investment destination. FII inflows rose to \$9.1bn between January and now. But with the budget now talking of taxing FII inflows, these could well flow out again. Vodafone has indicated that it might take legal action in international arbitration courts. There is a long list of other companies contemplating a similar action, such as Telenor, MTS and investment firm TCI.

A Stock Picker's Market

This is a formidable list of challenges facing the Indian economy at a time when the country is saddled with a weak, corrupt and indecisive leadership.

But is it all gloom and doom? The answer is No. "The negative factors you have mentioned are more or less priced in by the market. Now, even small positive developments will have a favourable impact on the market," says a stock broker.

"I think GDP growth of 7.5 per cent is achievable. Though



"Government bond yields have already risen to 8.6 per cent, showing the stress in the system".

— Lalit Kumar Dangi

manufacturing growth is slightly slow, its contribution to GDP is also very low. On the other side, services growth will help meet the GDP growth targets, in spite of challenges. Interest rates will definitely come down. Inflation will start coming down due to the higher base affect. Last year, we had seen food inflation not only in India but globally, exerting pressure. We may see much lower interest rates at the end of the year than what they are now," says an equity consultant.

"In view of the multiple challenges facing the economy, with no visible positive triggers in the short term, equity markets are likely to remain lacklustre and may witness a downside of around 10 per cent from current levels, as valuations at the long-term average P/E of 14x are not very demanding", says Mr. Motilal Oswal, chairman & MD, Motilal Oswal Securities.

He adds, however, that "looking at the broader indices would be misleading as I believe this is going to be

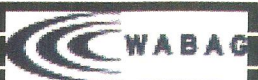
a stock pickers' and sector pickers' market. For instance, sectors that are structurally well placed, such as cement and auto have done well and will continue their upward trajectory over the medium to long term."

The market will most likely move in a range with the upside capped by some of the issues mentioned above and the floor provided by investors who still believe in the country's long-term future.

Indian stock markets are moving towards a phase in which a bottoms-up, stock-specific approach would be more appropriate. The macroeconomic outlook is mediocre and discounted and no one expects much improvement, but investors are willing to buy specific companies and their growth stories. There will be stocks in the sectors that will be attractive and can be picked.

Corporate India has identified some of these stocks for its readers. Here it goes.

Va Tech Wabag

Face value	: 2	
CMP	: 420.00	
52-week high/low	: 538/270	