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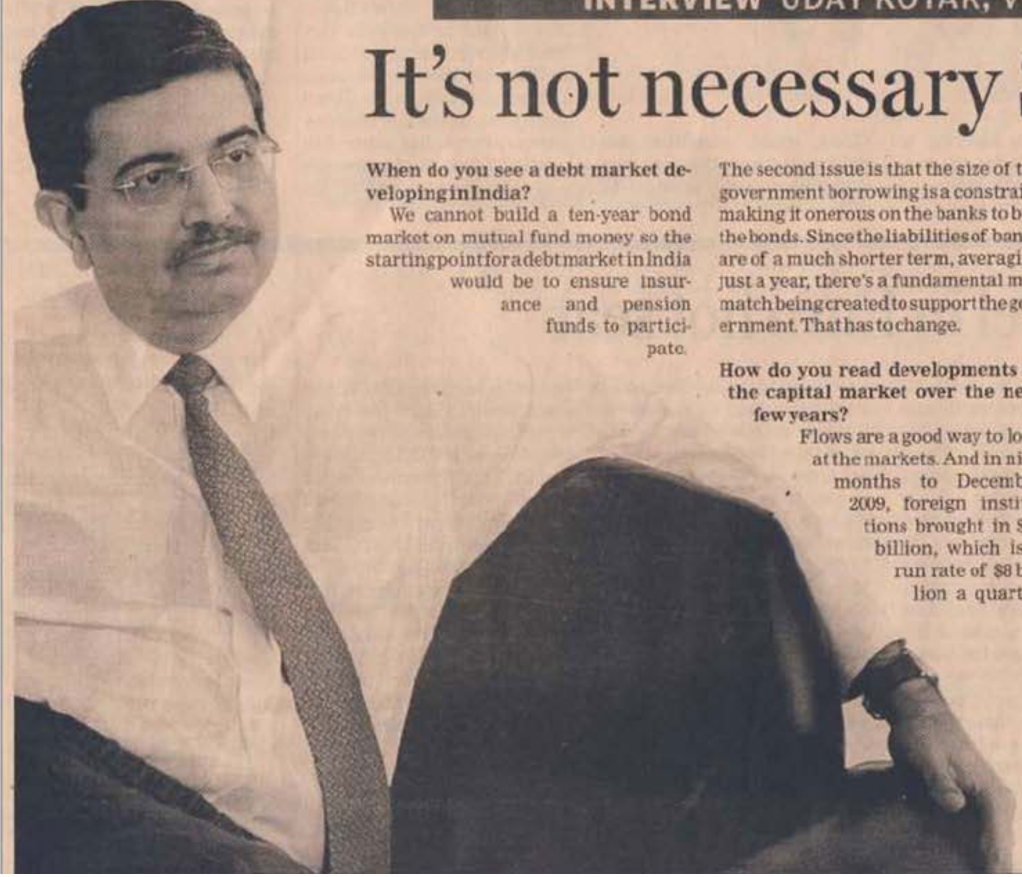
INTERVIEW UDAY KOTAK, VC & MD, KOTAK MAHINDRA BANK

It's not necessary SBI will set the benchmark



When do you see a debt market developing in India?

We cannot build a ten-year bond market on mutual fund money so the starting point for a debt market in India would be to ensure insurance and pension funds to participate.

The second issue is that the size of the government borrowing is a constraint making it onerous on the banks to buy the bonds. Since the liabilities of banks are of a much shorter term, averaging just a year, there's a fundamental mismatch being created to support the government. That has to change.

How do you read developments in the capital market over the next few years?

Flows are a good way to look at the markets. And in nine months to December 2009, foreign institutions brought in $24 billion, which is a run rate of $8 billion a quarter.

Our view is that FIIs will bring in around $15 to $17 billion this year, so the run rate will be slightly lower. But the big change that I see is a dramatic increase in the money coming in from the domestic life insurance companies which we estimate at $15-18 billion. In 2010, FIIs flows and life insurance flows will match; domestic money will balance foreign portfolio money.

Also, I think some foreign companies will get listed on the Indian stock exchanges perhaps through IDRs. Mutual funds could also float schemes for buying into international stocks so there will be diversification opportunities for Indian investors across the globe. But the fact of the matter is that the Indian investor's best returns, in the last few years, have been from the Indian market and I think the best returns are probably still in India.

Any clouds on the horizon?

I have three worries. The first is high oil prices because they hurt India more, a one-dollar increase in oil prices is equal to $600 million in balance of payments. The second is that we cannot choose our neighbours and it will be a challenge for us to manage them.

Third, managing the equation between growth, inflation and interest rates is challenging and we don't want any disruptive shocks at this stage.

How do you view the fact that government-owned institutions are bailing out disinvestment issues?

Ultimately, as a principle, markets must be the clearing ground for deals. Deals must be cleared on the basis of a fair market valuation.

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What do you make of the base rate concept?

It is an opportunity for banks to look at their cost of funds and one can't say whether every bank will follow SBI because the RBI says each bank has the flexibility to fix the rate. Don't underestimate Axis Bank, HDFC Bank or even ICICI Bank; it's not necessary SBI will set the benchmark.

Also, keep in mind that there's some serious competition from mutual funds at the short end; since they have a tax advantage, their ability to price at the short-end is very high. Systemically, the risk is that banks could be out of the short end of the AAA market because they will lose out to mutual funds. We need to be careful that the base rate does not export the market out of banks to mutual funds.

Will new bank licences help?

I think any move that broadens the role of the private sector is welcome. Some of the new private banks have gone out of business through mergers like Times Bank, Centurion BoP and Global Trust Bank, making the existing banks larger. So there may be room for looking at some new banks.