CHALLENGES AND OUTLOOK

5.112 As the Indian economy has entered a higher growth trajectory, the investment demand is expected to remain strong in the short to medium term. The banking sector is equipped to meet the growing demand for resources; it is however, necessary that credit expansion is non-inflationary and the productive sectors receive adequate credit at a resonable cost. This may call for the banking sector to review the spreads suitably, thereby ensuring that credit offtake by productive sectors is maintained facilitating the growth momentum of the economy.

5.113 With a vibrant capital market, the Indian corporates would step up their access to the primary market to raise resources both through equity and debt issues. Alongside, the overseas issues (ADR/GDR) too are expected to gain in importance to supplement the domestic resource mobilization by the corporates. The Government's efforts to streamline the regulatory framework and to bring business transparency may enhance activity in the primary capital market in terms of increase in the number of debt and equity issues as well as larger participation of investors, particularly retail investors.

5.114 The performance of Indian stock prices in the secondary market hinges broadly on long-term and short-term factors. In the long run, strong world output growth is important to sustain the investment activity across the globe. Since India's growth performance is relatively better among the emerging economies, the country would continue to attract significant cross-border portfolio investments. In the short term, expectation of higher relative returns from investment in India, favourable risk perception of investors and improved global liquidity would help the country in being an attractive destination for investment. Going forward, despite the possible subdued global growth, the strong fundamentals of the Indian economy in tandem with higher growth would help in sustaining the interest of domestic and foreign investors in the Indian market.

5.115 Domestically, corporate earnings are expected to remain encouraging. Strong projected economic growth and supportive policy initiatives would enhance investors' preference to invest in financial instruments, such as equity and debt papers. If the recent pick-up in the amount of resource mobilization by mutual funds and the assets they manage are any indication reflecting increased preference for investment in the capital market via mutual funds, the resources available with the Indian financial institutions would increase. This would find its way to the capital market. The recent efforts of the insurance companies to broaden the geographical outreach and increase in innovative products would strengthen their resource base and may stimulate their participation in equity and debt markets. The continuation of initiatives towards policy reforms in the area of insurance and pension funds would provide the credibility to the Government's efforts to carry forward the economic reforms, auguring well for the capital market as well.

5.116 Against the backdrop of expected expansion of activity in the Indian capital market, the importance of ensuring healthy and orderly conditions in the market becomes more urgent. Ensuring stable conditions in the market is the responsibility of policymakers, regulators as well as market participants. While the policy initiatives are required to be well calibrated to transmit the right policy signals unambiguously, the regulators need to remain proactive and vigilant to obviate the occurrence of any irregularities in the conduct of business in the market. Investors' awareness is equally important from the market stability angle as investment in equities could be based on incomplete analysis and guided by short-term speculative gains. Individual investors need to take informed decisions and remain cautious. They would do well to resist from commonly observed "herd mentality" and "panic" in their buying and selling operations.

5.117 The growing importance of insurance and pension funds would provide impetus and broaden the horizon of the Government securities market. The provisions in the Government Securities Act, 2006, which allow nomination, pledging and stripping of securities are expected to expand the Government securities market, particularly its retail segment. With the RBI setting up a group to suggest measures to activate the interest rate futures market, the transparency and price discovery process of interest rates on the Government securities would be enhanced. However, a major policy challenge is in the area of corporate debt market. A high-level Committee on Corporate Bonds and Securitization set up by the Government had gone into the various issues relating to corporate debt market such as corporate debt issuance, pricing, trading and settlement. The various recommendations of the Committee are under different stages of implementation.

5.118 The commodity exchanges, which have grown from strength to strength in the last few years, measured in volume of turnover as well as number of transactions, are expected to perform well in the near to medium term also. In terms of transactions in the futures markets, besides gold and crude oil, other commodities, especially agricultural commodities, have gradually started gaining in importance. This would help in deepening the process of price discovery. While an Ordinance has been issued for ensuring autonomy to the Forward Markets Commission, the legislation for the purpose would further strengthen commodity futures trading in India and help the process of price discovery and provide an effective mechanism for price-risk management.