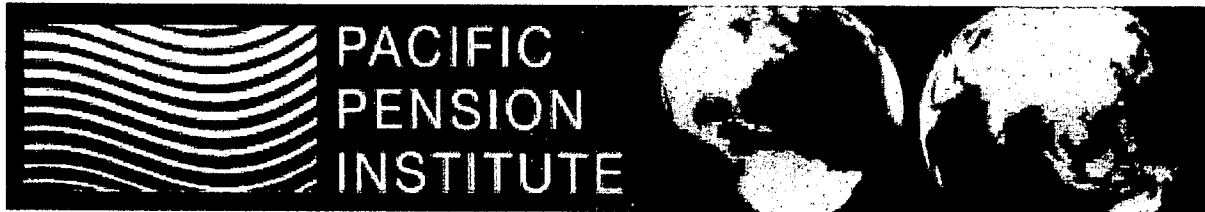


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PPI Member News

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PPI member and speaker at previous Roundtables Dr. Jeffrey Leonard is President & Founder of Global Environment Fund (GEF) and an investor in Asia for over two decades. Dr. Leonard shares his first-hand perspectives on the current state of India in preparation for the upcoming Summer Roundtable.

Impressions of India and the World Economic Situation

by Dr. Jeffrey Leonard

I am in Mumbai this week, and against a backdrop of considerable negative sentiment all around the world, the Indian economy feels increasingly vulnerable and in stasis. Your summer PPI meetings will come at an interesting time for the world in general and a critical crossroads for India. It will make for lively, if worrisome, deliberations!

Given that I am on three continents in the span of two weeks, I have had an opportunity to develop some interesting, pan-global perceptions of the world economic situation, and how India feels in relation to this. Being on the ground, dealing with operating businesses and a number of significant General Partners who are among our EMPEA members, in rapid succession on multiple continents leaves an indelible impression as to how delicate the world economic flower is right now. And, I have not even landed in Europe yet

First, all over my world, where GEF holds investments in operating companies sensitive to local economies, growth is losing steam. Weak jobs and uncertainty in US is not good news because as bad as it seems in America, the truth is that the Fed is pumping money to keep Europe afloat, and the rest of the world probably still depends on America as the engine to pull it all out of the mud.

From my vantage of the Chinese economy, the overall slowdown to lower than 8% growth is driven by weakening not only of demand for exports, but also by the fact that domestic demand has reached a saturation point. One indicator of this is that in the smaller private sector firms, those with less large government participation, and less exposure to export markets, the data are showing that contraction has definitely set in as the operating mode. We feel it in GEFs investments in China, which are all domestic market facing rather than exporters. The somewhat scary proposition is that Chinas surplus manufacturing capacity could be as much as 50%, not only in export-oriented industries, but also in many new domestically focused manufacturing industries. A lot of economic adjustment, and ripples into banking and finance portfolios.

In Africa last week, at the annual meeting of the African Development Bank, there is a sense that the bloom is off the newly flowered rose. Whereas, in February, when I spoke at a financial conference in Johannesburg, there were clear signs of growing optimism for key African economies, the situation is far more guarded today, with eyes on Europe and China as the most deflating potential influences. South African growth has slowed to 2.3%. Even in East Africa, where growth is highest in

30 years, the situation has turned, with currencies being crushed and economies face derailment as linkage with EU demand and Euro weighs heavy.

As for Brazil, where we hold a large energy supplier company that is extremely sensitive to corporate demand, the economy is spinning wheels, after several years of white hot growth, it is weighed down by the inability of the political elite to make structural adjustments and facing stagnating growth, inflation rising and interest rates high.

So, maybe I was already morose, even before my arrival in India, but I feel there is a fog that has set in here. I am really struck by the sense that recent economic data have sent shockwaves of alarm across Indian economists and corporate execs, on the one hand, and yet, on the other hand, the increased sense of unreality the political debate holds maybe a mirror of the US? The headline today: Jolted Government Swings into Action, is the sudden buzz, but in India action is usually deliberation, not concerted government measures to address the problem. The malaise just goes on. Early 1990s all over again?

This week, recent quarterly growth figures for India were slashed from 6.1% to 5.3%. Consensus estimates for this years economic growth rates keep being adjusted downward by economic analysts and the government economists.

Unfortunately, I see a confluence of a number of simmering challenges that are going to weigh down India.

1. **Crisis of Leadership.** There is no voice in the government that is exerting firm leadership, a coherent understanding of the challenges, or coordinated intervention.
2. **Stalled Reform.** Long-term reforms of tax policies, financial regulations, and many other areas of the economy have almost completely fallen by the wayside, except episodic, populist threats, such as to tax foreign flows.
3. **High Fiscal and Current Account Deficits.** Subsidies for all manner of commodities and fuels continue to increase, not decrease (up 200% since 2007-2008), and this weekend the government has had to rollback its efforts to reduce gasoline subsidies. The high fiscal subsidies continue to drive a current account deficit that was about 4% of GDP in the recently concluded fiscal year.
4. **Rising Inflation.** Despite cooling economic activity, domestic bottlenecks continue to drive excess demand and inflation is now approaching 7.5%.
5. **Prolonged Rupee Depreciation.** Having grown accustomed to a relatively stable currency, Indians seem deeply alarmed by the slide of the rupee against the dollar over the past 18 months. This is in spite of rather obvious reasons (deficits and high inflation) for the weakness of the currency.
6. **Interest Rates Remain High.** From under 5% in 2010, official government interest rates have hovered between 8 and 9% this year, inhibiting business expansion.
7. **Electricity Shortages are Rampant.** After several years of reform and renewed investment, the electricity sector is suddenly in shambles, with strikes and underproduction in the coal sector, lagging supplies of natural gas for new power plants, and state electricity boards returning to their old patterns of insolvency and abrogated payments for contracted power producers.
8. **Investment Rates are Falling.** Not surprisingly, with political uncertainty, high interest rates and shortages of electricity and infrastructure, overall investments have dropped to under 30% of GDP, the lowest rate in almost a decade.
9. **Declining Portfolio Inflows.** Portfolio inflows, evidencing both savings and FDI, have dropped by almost 50% from last year.

Much of this, alas, is par for the course in India, and I still remain very upbeat on the long term potential here, but I am struck by the considerable change in sentiment since the beginning of the year here. It may take time, patience, and a much more cohesive political response to right the ship of the Indian economy.

ABOUT JEFFREY LEONARD

Jeffrey Leonard is the president and founding partner of Global Environment Fund (GEF). Dr. Leonard is the primary architect of GEFs global private equity investment program, with a focus on clean technology, independent power, gas distribution, water treatment, consumer products, health care and forestry sectors. Dr. Leonard is the author of five books and numerous technical articles relating to world trade, technology development and global environmental industries. He served as a member of U.S. Department of Energys Hydrogen Technical Advisory Panel to the Secretary of Energy, and as an advisor or consultant to the World Bank, the U.S. Agency for International Development, the World Resources Institute, the U.S. Environmental Protection Agency, the U.S. Office of Technology Assessment and the Consultative Group on International Agriculture Research, and others. Dr. Leonard holds a bachelors degree, magna cum laude, from Harvard University, a masters degree from the London School of Economics and a Ph.D. from Princeton University. At the Winter Roundtable 2011, Dr. Leonard was a speaker for the session "Are the U.S. & China in a Footrace or a Marathon?"

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