

Solid gains for the MSCI India Index

The MSCI India Index USD registered the fourth highest monthly gain ever in January, rising 21% over the month. Equity market gains were accentuated in the USD index due to an historically high monthly Indian rupee (INR) appreciation of 6.8% versus the US dollar. News flow from developed economies, particularly the US, remained supportive of higher risk assets. The increased likelihood of a continuation in the quantitative easing cycle by the ECB also fuelled equity gains. The macro picture in India also incrementally improved, with December inflation falling below 8% and the Reserve Bank of India (RBI) starting the easing cycle. Government policy also appeared to take a turn.

RBI kicks-off monetary easing

In the January quarterly credit policy meeting, the RBI commenced monetary easing with a Cash Reserve Ratio (CRR) cut of 50 bps. While hinting at continued easing, the Central Bank opined that the timing and extent of cuts in benchmark rates would be dependent on the trend in inflation and fiscal consolidation.

Government policy with regard to non-domestic investor access to capital markets also appeared to be evolving: International investors are now being allowed greater access to the Indian market via the Qualified Financial Investor (QFI) route and the procedure for block deals has been simplified. There

appears to be greater resolve to fast track infrastructure investments, particularly in the Road, Power and Coal sectors. Consensus has also been reached with state governing bodies on a 'Negative List' of services to be taxed.

Inflation moderates

In December, Wholesale Price Index (WPI) inflation reached 7.5%, dipping below 8% for the first time in two years. The fall was largely on account of a favorable base effect and easing food price inflation. However, core inflation appears to be doggedly sticking to current levels for the time being.

Foreign Institutional Investors (FIIs) aggressive buyers in January

FIIs bought a significant volume of equities over the month, totaling around US \$2 bn. Domestic investors sold US \$1.3bn over the same period. Insurance companies and mutual funds sold US \$937m and US \$381m, respectively.

Other key developments over the month:

- Industrial Production (IP) for November recovered and grew at 5.9% oya
- 10 year Treasury yield decreased 30 bps to 8.27%
- INR appreciated a significant 6.8% vs. the USD

Consumption and infrastructure trends

Consumption is holding up well, with rural demand the main driving force. In addition, banks are not seeing delinquencies in their retail portfolios, so urban incomes are not stretched.

Infrastructure trends are mixed; old projects are facing problems and creating stress for banks. However, project pipelines are gradually getting filled, with road contracts leading the way. Whether or not this can change will depend largely on global oil prices, which will directly impact India as the country is a net oil importer.

Strong export growth

Export growth rates are looking decent. The one major challenge India faces on the macro front is its rising fiscal deficit, which hinders the government's ability to spend on capacity creation in the economy.

Supportive valuations

Valuations have become progressively more attractive over the past few months, and we have seen many investors start to invest much more aggressively so far in 2012 ■

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