

Surprise Cut

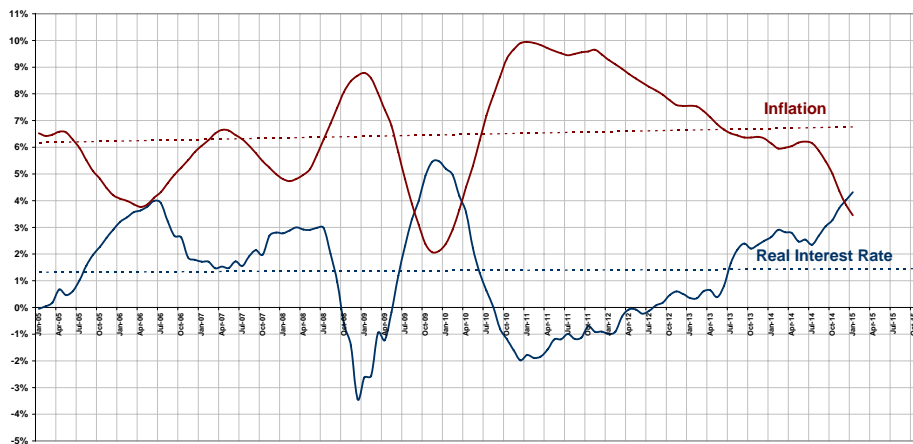
The Big Picture 15th January 2015

Overview

In our Market Outlook of 17th October 2014, we had said that *“As per our simulations, we expect the inflation rate to be in 4.0-4.5% range by end of FY:2014-15. Therefore the likelihood of rate cuts by RBI during this fiscal is very high...”*. WPI inflation for December-2014 stood at 3.84% (normalized) and looked to be heading for 3% mark by end of this fiscal.

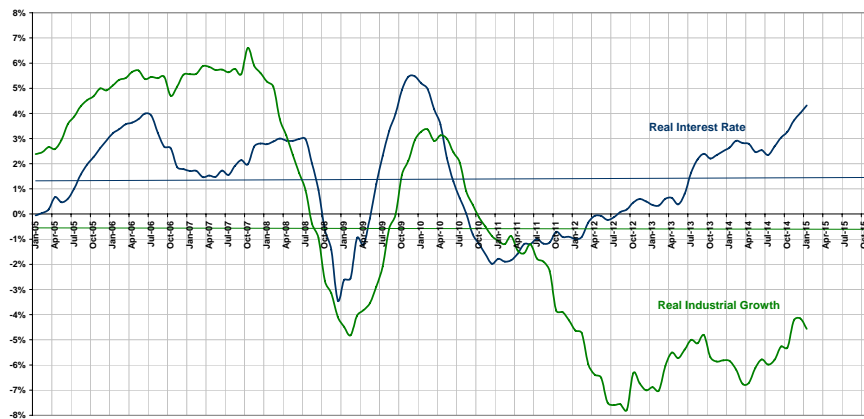
Therefore predictably, the Reserve Bank of India cut interest rate by 25 bps in an unscheduled review meeting. This move was hardly surprising (although the timing was) as in the recent past inflation had come off rapidly whilst the real interest rates have been shooting up. Therefore we are likely to see this monetary easing continuing for the rest of CY 2015.

Inflation and Real Interest rates in the last 10 years



More worryingly, manufacturing growth still appears to be caught in a rut. Although we have always believed that the investment cycle is largely a function of return-on-capital rather than the cost-of-capital, a combination of monetary easing and lower commodity prices could give a fillip to the economic cycle. But eventually, there needs to be a robust demand growth to sustain the uptrend.

Real Industrial growth and Real Interest rates in the last 10 years



2015 will continue to be a topsy-turvy year with positive domestic macro-economic environment on one hand and negative global environment on the other. The volatility is likely to present many opportunities for a long-short strategy.

Happy Investing.

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