

Economics

Indian Markets Outlook and Strategy

- **Special focus:** Weakness in global economic activity along with tighter credit markets will likely weaken the pace of economic activity, especially in the 2HFY09. J.P. Morgan has cut its growth forecast across most-advanced and emerging market economies, including US and China. We have revised down our GDP forecast to 6.7% Y/Y for the current fiscal year, from our earlier estimate of 7.0%, and expect growth to moderate thereafter to 6.2% in 2009-10 compared to our earlier projection of 6.8%. However, based on the projected trajectory for global growth and assuming that the financing gridlock is short-lived, the slowdown is unlikely to be protracted and the pace of activity should see a significant turnaround in the second half of 2009.
- **Macroeconomic outlook:** The central bank implemented further steps to unclog the financial gridlock by easing sector-specific liquidity and credit bottlenecks. The sharp decline in the inflation rate has raised the probability of aggressive and faster pace of cuts in the policy rates. If the decline in the inflation rate is broadly sustained in the coming weeks, the rate cuts could come soon. On the industrial front, September industrial production recovered from its August low. The revival was concentrated in a few sectors, partly supported by stock building ahead of the October holidays.
- **Currency:** USD/INR traded a rather large range in the past few weeks, perhaps reflecting continued uncertainty on the flow outlook. We are increasingly optimistic INR owing to the improving current account outcome, potentially reduced pace of outflows from foreign portfolio investors, and credible policy steps. Still, the short-term outlook remains uncertain, as it might take a while for financial markets to stabilize and de-leveraging to turn a smaller influence in determining asset market direction. We recommend a short TWD/INR to position for diverging growth prospects in the region.
- **Fixed income:** Rate markets continued to rally on the realized and anticipated policy rate cuts by the RBI. We believe the ongoing moderation in growth together with the swift decline in inflation will pave the way for further monetary accommodation from the RBI. As such, we remain bullish and recommend holding positions at the very long-end of the government bond curve. On OIS, we hold a tactical curve flattener on the view that uncertainty on liquidity and little likelihood of a further widening in the policy corridor will enable a greater downmove in long-end rates.

India

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