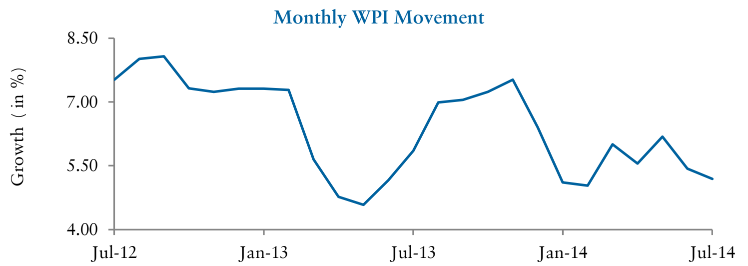
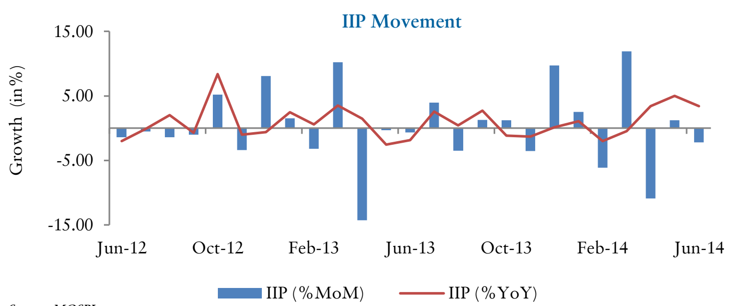
Indian Economy

Economic Releases in August-2014			
Policy Rates	**Period**	**Actual**	**Previous**
Repo Rate^	28-Aug-14	8.00%	8.00%
Reverse Repo^	28-Aug-14	7.00%	7.00%
CRR^	28-Aug-14	4.00%	4.00%
Key Indicators	**Actual**	**Previous**	
Index Of Industrial Production (IIP)	3.40%(Jun-14)	5.00%(May-14)	
Wholesale Price Index Inflation(WPI)	5.19%(Jul-14)	5.43%(Jun-14)	
Export (Y-o-Y)	7.33%(Jul-14)	10.22%(Jun-14)	
Import (Y-o-Y)	4.25%(Jul-14)	8.33%(Jun-14)	
Current Account Deficit ($ Billions)	-7.84(Jun-14)	-1.21(Mar-14)	
Fiscal Deficit FYTD (INR Trillion)	324.92(Jul-14)	297.86(Jun-14)	

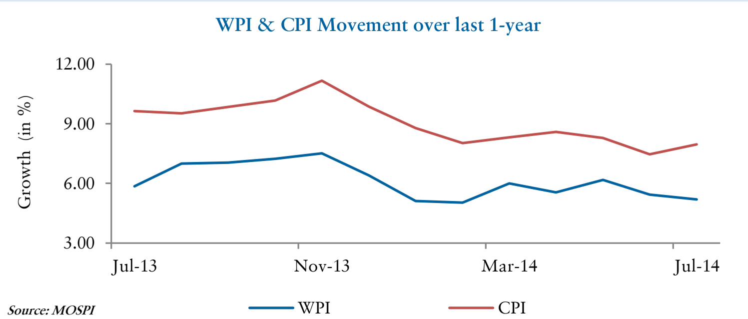
Source: RBI, Reuters; ^Based on Bi-monthly RBI Monetary Policy review released on 05-Aug-2014



Source: Office of the Economic Adviser, Ministry of Commerce & Industry



Source: MOSPI



Source: MOSPI

- *India's Gross Domestic Product (GDP) for the first quarter of the current financial year grew at a two-and-a-half year high rate of 5.7% compared to a growth of 4.6% in the previous quarter and 4.7% in the first quarter of the previous fiscal.* The Manufacturing sector expanded during the quarter and reported a growth of 3.5% against a contraction of 1.2% in the corresponding period last year. The sector has seen some revival as formation of a stable Government has raised expectations of reforms measures.

- *India's fiscal deficit during April-July period stood at Rs. 3.24 lakh crore or 61.2% of the full-year target. The deficit was 62.8% during the corresponding period in the previous fiscal.* The Government had put in place measures for fiscal consolidation to bring down the deficit to 3% of the GDP by 2016-17.

- *The industrial output in June expanded for the third consecutive month at 3.4% but lower than the upwardly revised growth of 5% in May due to slower growth in the manufacturing sector.* The manufacturing sector grew by 1.8% compared to 4.8% in the previous month. The mining sector grew 4.3% in June against 2.7% in May while the electricity sector jumped 15.7% against 6.3% in the similar comparable months.

- *The Consumer Price Index (CPI) based inflation grew 7.96% in July, higher than 7.46% witnessed in the last month due to rise in prices of food-related items.* With this, the Government also released new series, Consumer Food Price Index, which recorded a significant rise of 9.36% in July against 7.97% in the previous month.

- *The Wholesale Price Index (WPI)-based inflation eased to a five-month low of 5.19% in July against 5.43% in June.* The decline can be attributed to fall in prices of some food articles, vegetables and protein-rich items. However, inflation for the overall food articles basket, which account for 14% of the total WPI, stood at 8.43% in July compared to 8.14% in June. The WPI inflation data for May was revised upward from 6.01% to 6.18%.

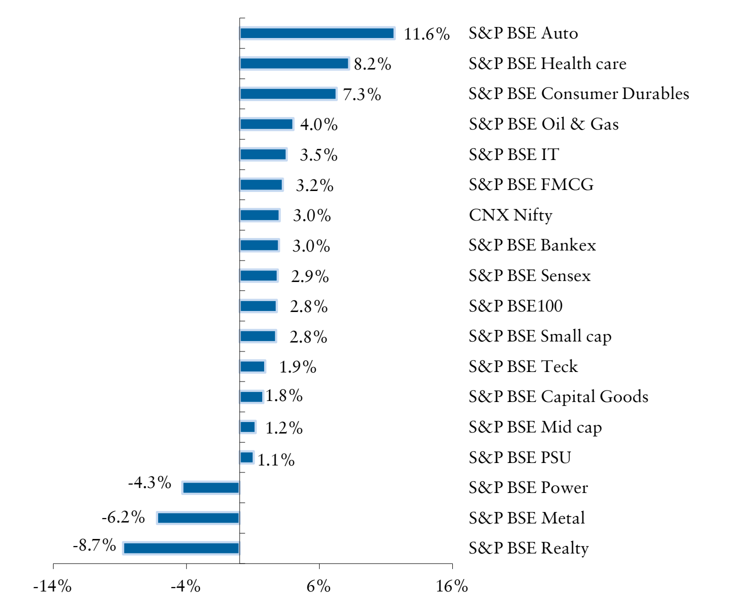
- *The Central Bank, in its third bi-monthly monetary policy review, kept the repo rate and reverse repo unchanged at 8% and 7%, respectively. The Cash Reserve Ratio stood at 4%.* However, the RBI has cut the Statutory Liquidity Ratio (SLR) of scheduled commercial banks by 50 basis points to 22% of Net Demand and Time Liabilities with effect from the fortnight beginning August 9. According to the RBI Governor, the SLR cut would create room for banks to lend more to productive sectors of the economy.

Indian Equity Market

Index PE Ratio & Returns	Closing Values#	1 Year	3 Year	5 Year
CNX Nifty*	7,954.35	45.37	16.71	11.27
CNX Nifty PE	15.99	13.60	14.72	18.57
S&P BSE Sensex*	26,638.11	43.06	16.88	11.19
S&P BSE Sensex PE	17.96	9.99	11.79	14.02

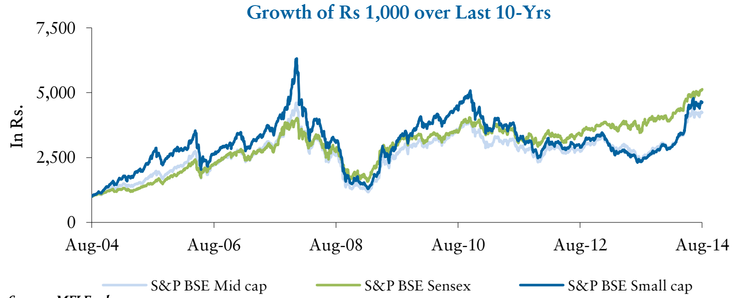
*Source: NSE, BSE, * Returns less than 1 year are absolute, greater than 1 year are Compounded Annualized , # As on 28-Aug-2014*

Monthly returns as on August 31, 2014



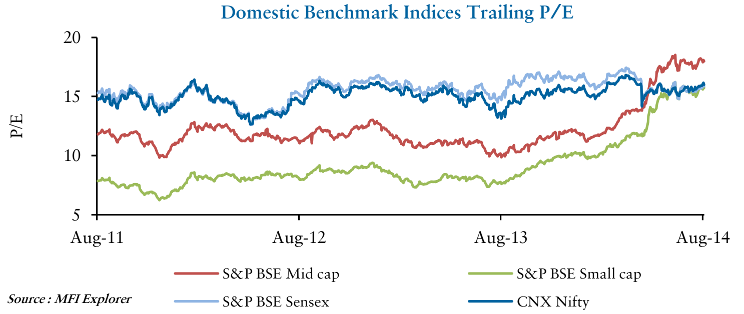
Source: MFI Explorer

Growth of Rs 1,000 over Last 10-Yrs



Source : MFI Explorer

Domestic Benchmark Indices Trailing P/E



Source : MFI Explorer

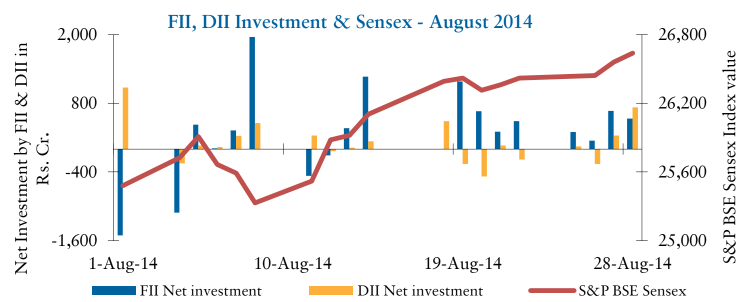
- Indian equity markets continued to scale new highs and *marked the seventh straight month of gains in August as investors welcomed the measures taken by the Government to bring the economy back on the growth track.* Strong buying of domestic stocks by foreign investors also boosted investor sentiments.

- *The key benchmark indices, S&P BSE Sensex and CNX Nifty, recorded new closing highs of 26,638.11 and 7,954.35 points, respectively on August 28.* Both the indices remained strong during the month with S&P BSE Sensex and CNX Nifty gaining 2.87% and 3.02%, respectively. Meanwhile, S&P BSE Mid-Cap and S&P BSE Small-Cap rose 1.20% and 2.75%, respectively.

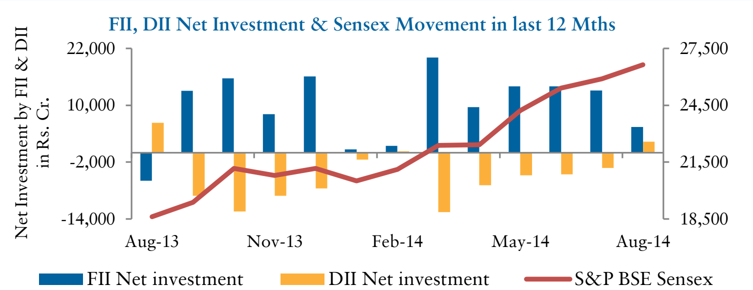
- Markets plunged on the first trading day of the month despite a survey by HSBC/Markit showing India's manufacturing sector growth jumped to a 17-month high in July. Heavy selling by institutional investors amid weak global cues and concerns that U.S. interest rates may move up on the back of strong economic data hit the bourses. Persisting geo-political tensions in Iraq and Ukraine also triggered selling pressure. However, the Central Bank's decision to keep the benchmark policy rates unchanged and to cut the SLR by 50 bps in its third bi-monthly monetary policy review provided some support to the bourses. Sentiments improved further after the Central Bank reiterated that it may cut rates in the near term if inflation continues to ease.

- Markets rose further on the back of fall in global crude oil prices. Investor sentiments improved after SEBI approved rules for the creation of real-estate investment trusts and infrastructure-investment trusts. Encouraging corporate earnings numbers from the Auto sector provided additional support. Sentiments improved further after data showed *India's wholesale inflation eased to the lowest level in five months in July.* However, gains were capped on the back of weak industrial production and higher consumer price inflation numbers. The country's industrial production growth slowed to 3.40% in June against 5.00% in May. Retail inflation rose to 7.96% in July compared to 7.46% in June.

- *Sentiments improved further after the Prime Minister introduced a new financial inclusion scheme for the poor.* He also emphasized on the need for better governance, which provided additional support. The risk appetite of investors improved after the Central Bank said that the country's economic growth is likely to improve amid possibility of further reforms measures, fiscal consolidation and projected improvement in investments.



Source: MFI Explorer



Source: MFI Explorer

- The Government's move to open up the Railways for private and foreign investments in select areas also boosted markets. Hopes of more monetary stimulus measures in the Euro zone provided additional support to the bourses.

- *Towards the end, markets rose further and recorded new all-time closing highs. Positive sentiments prevailed due to strong buying by foreign investors and an overall expectation of further reforms thrust by the new Government.* Moreover, the country's GDP data for the quarter ended June 2014 came better than expected. However, the positive impact of the same on the bourses is likely to be seen next month as the data came after last trading day of the month. India's economy grew at a nine-quarter high of 5.70% against 4.60% in last quarter.

- On the BSE sectoral front, barring S&P BSE Metal, S&P BSE Power and S&P BSE Realty, all other indices closed in green. S&P BSE Auto was the top gainer, rising by 11.64% followed by S&P BSE Healthcare and S&P BSE Consumer durables, which rose 8.23% and 7.29%, respectively.

Regulatory Update

- *The Central Bank clarified that small accounts with banks can be opened even without officially valid documents. The Central Bank said that a small account can be opened on the basis of a self-attested photograph and prospective account holders' signature or thumb print in the presence of a bank official.* However, such accounts have limitations regarding the aggregate credits (not more than Rs. 1 lakh in a year), aggregate withdrawals (not more than Rs. 10,000 in a month) and balance in the accounts (not more than Rs. 50,000 at any point of time). These small accounts would be valid normally for a period of one year.

- The Central Bank has tightened norms for asset reconstruction companies (ARCs) to improve discipline and bring about transparency in the sale and purchase of bad loans. According to new norms, ARCs will have to pay an upfront 15% of the bid value of non-performing loans, against 5% earlier. ARCs that are planning to buy bad loans will get more time (at least two weeks) to carry out due diligence before bidding for stressed assets. As of now, banks have enjoyed complete discretion in deciding the timeframe for due diligence.

- *The Central Bank has relaxed norms for refinancing of infrastructure.* The central bank has allowed banks to classify infrastructure loans as standard assets if half of the outstanding loans are refinanced by a new set of lenders in the form of take-out financing.

- The Union Cabinet has allowed 100% foreign investment in railway infrastructure projects for the first time. Foreign investment will be allowed in railway infrastructure segments such as electrification, signalling, high speed and suburban corridors. However, the Government has clarified that foreign investment would not be allowed in the operations sector of the national transporter. The Union Cabinet has also allowed raising the limit for foreign investment in defence sector from the current 26% to 49%. The hike is expected to cut imports by indigenising defence production.

- *According to the Central Bank, there would be a change in methodology while calculating the daily rupee reference rate. This would be effective from September 1.* The reference rate for the dollar/rupee would be computed by polling from a select list of contributing banks at a randomly chosen five-minute window between 11:30 to 12:30 Indian Standard Time. This marks a deviation from the previous 11:45 to 12:15 window.

Source : Reuters

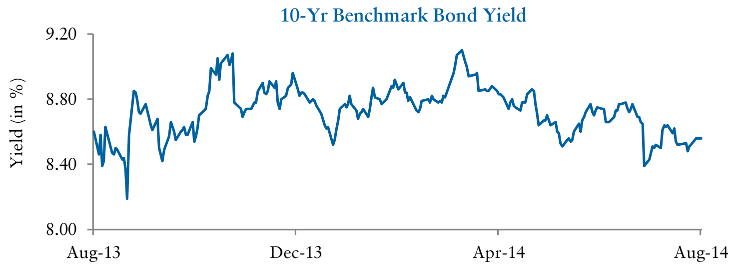
Indian Fixed Income

RBI Policy Rates		
Key Rates (%)	**Current^**	**Previous**
Reverse Repo Rate	7.00	7.00
Repo Rate	8.00	8.00
CRR	4.00	4.00
SLR	22.00	22.50
Bank Rate	9.00	9.00

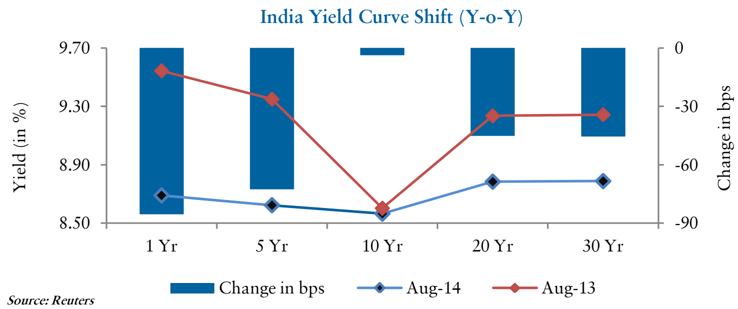
^Based on Bi-monthly RBI Monetary Policy review released on 05-Aug-2014
Source: RBI

Debt Indicators (Yield %)	Aug-14	Jul-14
Call Rate	8.24%	8.05%
1 Mn NSE Mibor	8.67%	8.69%
10-Yr Benchmark Bond	8.56%	8.50%
91-Day T-Bill#	8.64%	8.59%
182- Day T-Bill#	8.69%	8.66%
364-Day T-Bill#	8.71%	8.68%

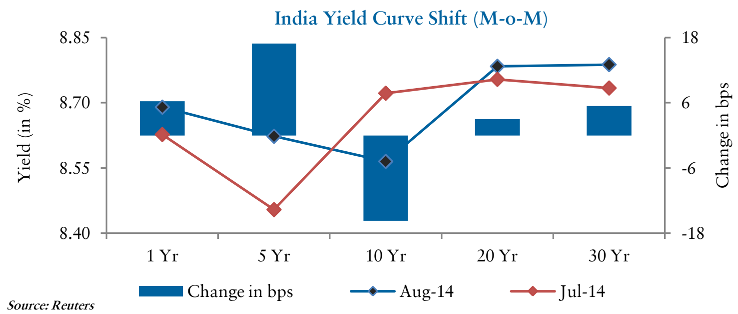
 # Indicates Monthly Average cut off during Auction
Source: RBI



Source: CCIL



Source: Reuters



Source: Reuters

- Bond yields closed higher after witnessing major volatility in the first half of the month and a range-bound movement later. Yields rose on the back of reduction in SLR and Held to Maturity (HTM) by the Central Bank, devolvement in weekly Government bond auction and global cues. However, cut in the Government's debt borrowing and fresh buying by Foreign Portfolio Investors (FPI) provided some support to the bond markets.

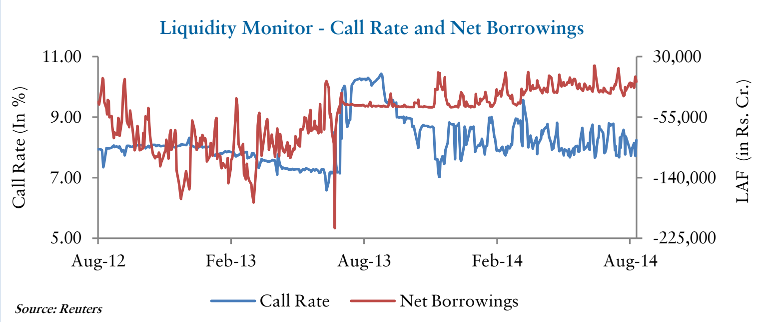
- The yield on the 10-year benchmark bond increased marginally by 6 bps to close at 8.56% against the previous month's close of 8.50%. It hovered in the range of 8.48% to 8.64% over the month.

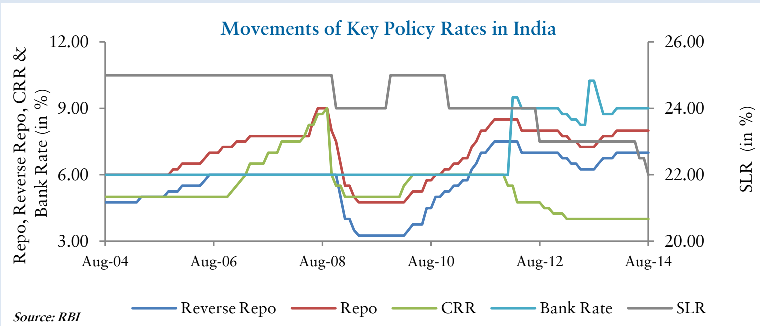
- Bond yields started rising after the *Central Bank cut the SLR (banks' minimum bond holding requirements) for the second consecutive time by 50 bps to 22%. The RBI also bought down the ceiling on debt that must be held to maturity by lenders by another 50 bps to 24%.* Investors became concerned that reduction in SLR and HTM limits may result in lower demand for Government Securities .

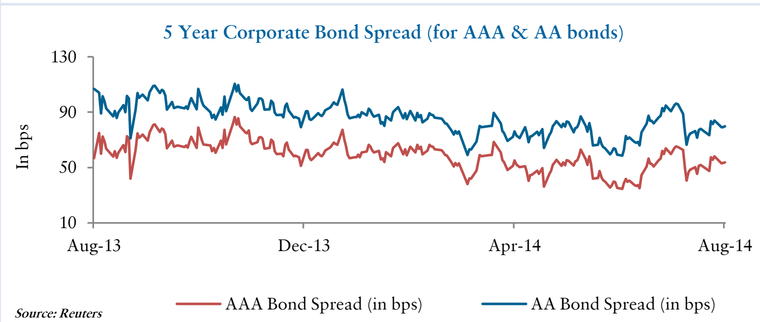
- Sentiments improved later after the *Central Bank approved the transfer of its surplus profits* to the Government and trimmed the size of one of its weekly debt sale by 43%. *The Central Bank also cut the Government's planned debt borrowings over the next two months.*

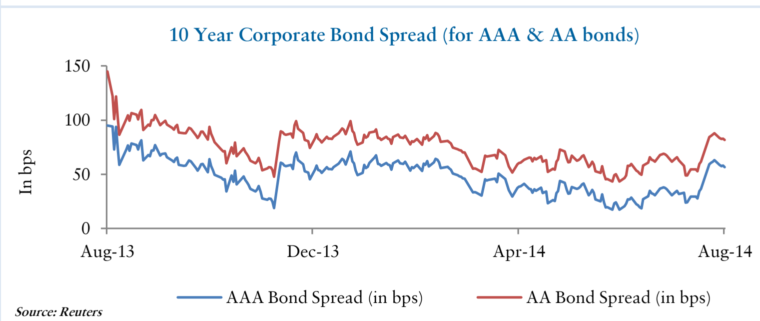
- The Central Bank, in consultation with the Government, has revised the auction calendar for the issuance of Government dated securities for the remaining part of the first half of this fiscal. *The amount of Marketable Dated Securities, to be conducted from August 18 to September 30, has been cut from Rs. 14,000 crore to Rs. 12,000 crore per week.*

- Bond yields fell further as FPIs showed fresh interest in the market which indicated an improvement in global risk appetite and a positive outlook on Indian bonds. This was reflected in the total trading volume on August 20 (Gilt, T-bills and SDL), which was the highest during the month and stood at Rs. 69,701.90 crore with 6,645 trades, as per data from the Clearing Corporation of India Ltd. Buying in Government debt by foreign funds stood at Rs. 16,703.93 crore in August, taking the total inflows in 2014 to Rs. 1,00,698.12 crore.









- However, the trend reversed due to rising tensions between Russia and the West and concerns over the interest rate outlook in the U.S.

- *Liquidity situation remained at comfortable level, which was reflected in the fall in borrowing under the Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF) coupled with decline in term repo and call rates.* The interbank call money rates moved in the range of 7.67% to 8.58% during the month, against 7.66% to 8.79% recorded in the previous month. Banks' net average borrowings through the LAF window declined to Rs. 9,222.83 crore compared to the previous month's average borrowing of Rs. 13,159.05 crore. Under the Central Bank's MSF window, the average borrowing stood at Rs. 726.61 crore, much lower than the previous month's average of Rs. 3,468.14 crore .

- *The Central Bank conducted the auction of dated securities worth Rs. 60,000 crore, lower than the scheduled Rs. 70,000 crore. There was devolvement on primary dealers cumulatively of Rs. 3,445.50 crore. The cut-off yield remained in the range of 8.52% to 8.95% during the month.* The Central Bank also conducted auctions of 91-days, 182-days and 364-days T-bills worth Rs. 34,000 crore, Rs. 11,000 crore and Rs. 11,000 crore, respectively during the month. The cut-off yield stood in the range of 8.60% to 8.74%, slightly higher than the previous month. The Central Bank also conducted auctions of SDL for a notified amount of Rs. 12,930 crore and was fully subscribed. The cut-off stood in the range of 8.85% to 9.11% compared to the previous month when yields stood in the range of 8.78% to 8.99%. The Central Bank also conducted term repo auctions for a notified amount of Rs. 1,37,500 crore, for which the cut-off stood in the range of 8.07% to 8.26%.

- Yield on the Gilt Securities increased across the maturities in the range of 2 bps to 19 bps, except 3, 6 and 10-year papers where yields declined by up to 16 bps. Yields surged the most on 4-year maturity. Similarly, corporate bond yields increased on the entire segment in the range of 2 bps to 7 bps, barring 2 and 4-year papers, where yields eased up to 3 bps. The spread between AAA corporate bond and Gilt witnessed a mixed trend as 4, 5 and 7-year papers contracted in the range of 14 to 22 bps, while 3, 9 and 10-year maturities expanded in the range of 9 to 20 bps.

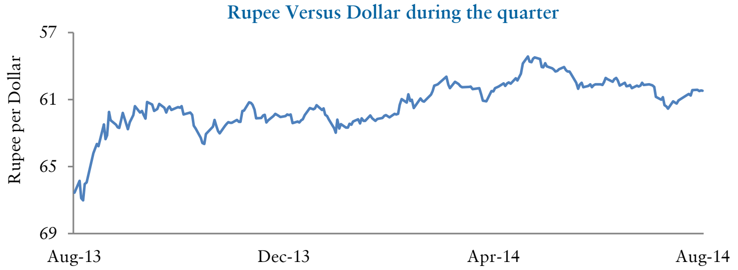
- The External Commercial Borrowings and Foreign Currency Convertible Bonds (FCCB) for July stood at $3.72 billion against $1.89 billion recorded in the previous month.

Currency

Movement of Major Currencies (Denominated in Indian Rupee)				
Currency	Value(as of 31-Aug-2014)	1 Mth Ago	3 Mths Ago	1 Year Ago
INR/1 USD	60.47	60.25	59.03	66.57
INR/1 EURO	79.86	80.70	80.33	88.16
INR/1 GBP	100.35	101.92	98.91	103.34
INR/ 100 YEN	58.00	59.00	58.00	68.00

Source: RBI

Rupee Versus Dollar during the quarter



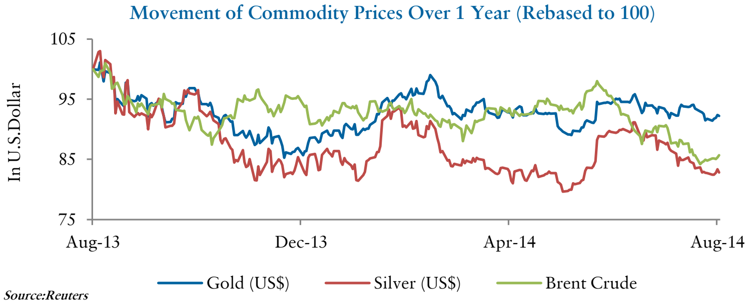
Source: RBI

Commodity

Performance of various Commodities					
Commodities	Value(as of 31-Aug-2014)	Returns (in %)			
		1 Wk Ago	1 Mth Ago	6 Mths Ago	1 Year Ago
Crude Brent ($/Barrel)	101.02	1.03	-3.64	-7.98	-14.33
Gold ($/Oz)	1287.07	0.49	0.39	-2.92	-7.78
Gold (Rs./10 gm)	27923.00	0.84	0.06	-8.41	-13.30
Silver ($/Oz)	19.43	0.15	-4.52	-8.31	-17.18
Silver (Rs./Kg)	42673.00	1.27	-4.20	-8.40	-20.54

Source: Reuters, MCX

Movement of Commodity Prices Over 1 Year (Rebased to 100)



Source:Reuters

INR

- The rupee inched up 0.091% to close at 60.50 against the dollar compared to the last month's close of 60.55. *Strong foreign fund inflows into the Indian equity and debt markets supported the currency.* The rupee rose further on dollar sales by corporates, exporters and custodian banks. However, gains were capped due to rising tensions between Russia and Ukraine. Minutes of the Federal Reserve's (Fed) July meeting and comments by the Fed Chief, which suggested that interest rates in the U.S. may rise soon, also hit the rupee.

Euro

- *The euro weakened against the dollar initially after the European Central Bank (ECB) kept interest rates unchanged. The currency fell further following lower-than-expected German economic sentiment data and the ECB chief's hints of additional measures to support growth in the Euro region.* The greenback got more support as the U.S. economy grew faster than expected in the second quarter. The euro closed the month at 1.3132 against the dollar, down 1.91%, compared to the previous month's close of 1.3388.

Crude

- *Oil prices declined 3.64% during the month as supply concerns eased.* Initially, prices moved up following the U.S.-led military intervention in Iraq. The trend reversed later as supply concerns eased after situation in Ukraine and Iraq improved to some extent. Besides, higher output from Libya also weighed on prices. However, the fall was restricted as economic data from the U.S. indicated that demand outlook in the region is set to improve further.

Gold

- *Gold prices inched up by 0.39% amid geo-political tensions in Ukraine and the Middle East. However, gains were capped as economic data from the U.S. suggested that interest rate in the region may move up earlier than expected.* Initially, gold prices remained under pressure as a bailout agreement to rescue Portugal's largest-listed bank and positive global economic data prompted investors to go for equities. The trend reversed and prices rose on the back of weak Chinese economic data, which improved the safe-haven appeal of the bullion.

Principal Monthly Insight

Global Equity Market

Performance of Major International Markets (as on August 31, 2014)		
Indices	**Country**	**1 Mth**
United States		
Nasdaq 100	U.S.	4.88
S&P 500	U.S.	3.77
DJ Industrial Average	U.S.	3.23
Asia Pacific		
SET IDX	Thailand	3.94
JSX Composite	Indonesia	0.94
FTSE Straits Times	Singapore	-1.39
KOSPI	S. Korea	-0.37
Hang Seng	Hong Kong	-0.06
NIKKEI 225	Japan	-1.26
Shanghai SE Composite	China	0.71
S&P BSE Sensex	India	2.87
S&P/ASX 200	Australia	-0.12
Europe		
FTSE 100	U.K.	1.33
CAC 40	France	3.18
FSE DAX	Germany	0.67

Source: MFI Explorer & Reuters

United States

- *U.S. markets rose on the back of a series of upbeat economic data.* While, consumer confidence in the U.S. improved for the fourth consecutive month in August, durable goods order rose in July. *Sentiments improved after minutes of the Federal Reserve's July meeting eased worries over an imminent rate hike.* However, fresh concerns over Ukraine crisis towards the end of the month capped the gains to some extent.

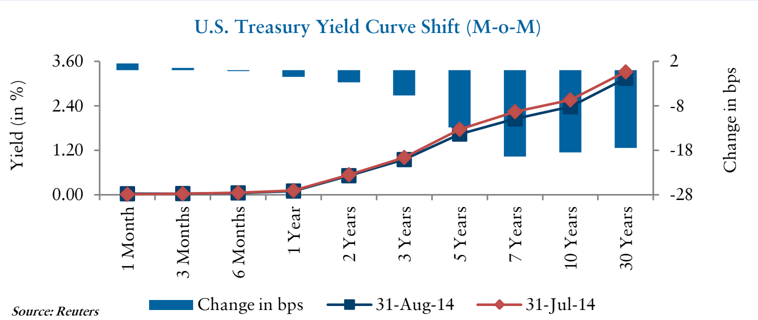
Europe

- *European markets moved up amid concerns over deflation and a series of weak economic data from Germany.* Hopes of stimulus measures from the Bank of England and the ECB to fight deflation coupled with encouraging U.S. economic data supported the bourses. The ECB Chief's comments that quantitative easing would be continued unless inflation rises provided additional support. *Gains were capped later during the month on renewed concerns over geo-political crisis in Ukraine.*

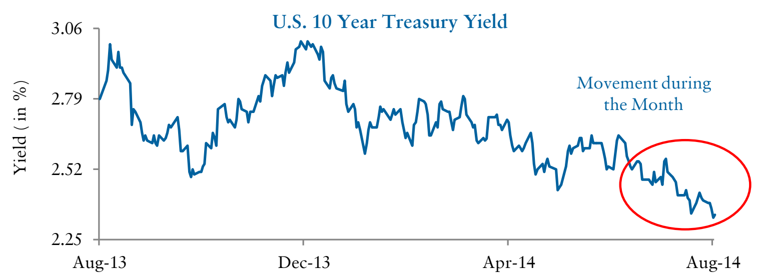
Asia

- *Asian markets bucked the global trend with headline indices coming under pressure as investors continued to track developments in Ukraine and Gaza.* Besides, weak economic data from China and Japan dampened market sentiments.

Global Fixed Income - U.S.



Source: Reuters



Source: Reuters

- After moving in the range of 2.33% to 2.51%, the yield on the 10-year U.S. Treasury bond fell 21 bps in August to close at 2.35% against the previous month's close of 2.56%.
- *The U.S. Treasury yields fell earlier during the month after the non-farm payroll employment came below expectations.*
- The safe-haven appeal of the U.S. bonds improved further on rising tensions between Russia and the West after an Ukranian fighter jet was allegedly shot down. Unrest in Iraq and Gaza also improved demand for the U.S. debt paper.
- *U.S. Treasury yields continued to fall after weak retail sales data in the U.S. region for July revived the possibility that the Fed may keep its interest rate at lower levels for a considerable period of time.*

Investment Classroom

Understanding Core Inflation

The measurement of inflation has become a major issue in India of late following increasing volatility in headline inflation rate measured by year-to-year variation in Wholesale Price Index (WPI). The WPI-based inflation rate has traditionally been referred while preparing the country's monetary policies. But the recent volatility has prompted policymakers to look for alternative inflation measures which would give a better understanding of future price trend. Core inflation is considered by many as the best alternative to headline inflation in gauging the probable future price movement.

What is core inflation?

Core inflation is a measure that excludes transitory or temporary price volatility – as in the case of commodities such as food items or energy products — from the price level. It reflects the inflation trend in an economy without transitory effects on prices. A dynamic consumption basket is considered the basis to measure the core inflation. Some goods and commodities have extremely volatile price movements. If temporary price volatility are taken into account, they may affect the estimated overall inflation numbers in such a way that they are different from actual inflation. To eliminate this possibility, core inflation is calculated to gauge the actual inflation apart from temporary shocks and volatility.

The term was coined by German-born economist Eckstein who defined it as 'the trend increase of the cost of factors of production' that 'originates in the long-term expectations of inflation in the minds of households and businesses, in the contractual arrangements which sustain the wage-price momentum, and in the tax system'. The concept of core inflation became popular in the 1970s during periods of high inflation and now normally refers to that component of inflation that is likely to persist for a long term.

Why core inflation?

In view of increasing emphasis on 'price stability' in the formulation of monetary policy and sharp volatility in the WPI headline inflation rate, the policymakers felt the need for measures of underlying inflation rates. This is because the WPI-based measure does not provide a reliable gauge of inflation at any point of time. Monetary policy generally works by influencing aggregate demand in the economy. That is the general practice but sometimes the economy faces supply side shocks too, leading to large variations in relative prices of commodities, as has been the case in India in recent years. In such cases, WPI-based headline inflation data can be misleading for policy making. Thus, a proper analysis of the price changes as to which are transitory and which are permanent is critical. To deal with such situations, many central banks use measures of core inflation that are designed to filter the transitory price movements. Core inflation, by eliminating the volatile components from the headline, helps in identifying the underlying trend in headline inflation and is believed to give a better understanding of its future trend.

Central Bank and its efforts to tame inflation

Since the scope of the inflation measured by the Indian Central Bank is very wide, inflation rate of late seems to have not responded either to the increase in interest rate or control of money supply in the financial system. Therefore, experts believe that the Central Bank's policy must target the index of inflation on which it has better ex ante control. For example, monetary policy cannot possibly influence the price of cereals if the price rise occurs due to supply constraints. Core inflation reflects the broad underlying long-term trend of prices. If it is more than the target rate it would be because the economy is getting overheated and needs correction through monetary policy. At present, there is no assessment or use of core inflation, but it can certainly be measured from the available indices by eliminating volatile prices which exaggerate WPI.

Experts believe that the Central Bank should not target inflation measured by WPI alone. A more relevant operative target for monetary policy – as it is for many central banks in countries such as Canada, Finland, Thailand or South Africa – is core inflation. In India, core inflation – which can exclude fruits and vegetables, milk and edible oils – would measure the imbalance in the economy and thus, the central bank may at least use core inflation as a supplementary indicator while targeting WPI.

A plea of caution

Measures of core inflation, however, could not serve as a basis for inflation measurement that could possibly replace the theory of the cost of living. Measures of core inflation are thus no substitute for headline inflation. Focusing on core inflation does not mean that the Central Bank should not be concerned about inflation in the components excluded from this measure (that is, food, energy, etc), which represent a significant proportion of the consumer basket. Core inflation is simply a convenient guide to help the Central Bank achieve its objective of controlling total inflation. Most countries use measures of core inflation in addition to headline measures of inflation and not as a substitute.

Monthly inflation rate (%)			
Month	**WPI**	**CPI**	**Core**
April	5.55	8.59	3.40
May	6.18	8.28	3.80
June	5.43	7.31	3.80
July	5.19	7.96	3.32

Source: Office of the Economic Adviser, Ministry of Commerce & Industry / Newspaper reports

Source for data, graphs and analysis, unless otherwise specified: ICRA Online Research

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