India' s Not All Doom and Gloom – by Will Freeman

India's RBI cut policy rates by 50bp yesterday, and, to our knowledge, not a single newspaper or brokerage reported this news in a positive light. True, the cut is marginal and will probably not cause a significant uptick in growth given poor sentiment, high inflation and commodity prices, and an incontinent fiscal policy. But it is important to keep things in perspective. Indian growth estimates still range around 7%. Structurally, India is still on the path to decent catch-up growth.

The current slowdown is just the normal result of high rates and poor external conditions rather than some looming structural crisis in the current account or internal banking system. The benchmark WPI inflation gauge is still high at just under 7%, and could get higher later in the year as base effects become less favorable, but we expect FY13 inflation to come in at around 7% which is significantly lower than the 9-10% range in most of FY12. Also, the rupee has recovered somewhat from the major hit it took in the second half of 2011. Falling investment is the result of sustained high interest rates (and poor sentiment), but the RBI expects industry to rebound and do better this fiscal year than last. The point is that India's overall macro outlook is stable, which may not be heartening for investors, but is certainly no disaster.

India is not coming up on any sort of structural crisis. The widening current account deficit may be a growth risk, but foreign flows have thus far funded the deficit, there is no significant external debt exposure, foreign reserves have remained between US$250-$300bn, and the rupee's current level (at 51/US$ versus 44/US$ before last August) continues to reflect this risk. Likewise, there has been no tell-tale sharp rise in the loan-to-deposit ratio or the credit-to-GDP ratio, and external borrowing remains low.

In savings, investment and exports, India is following the development path laid out by successful north-Asian countries. By that we mean that the savings, investment and exports shares of GDP broadly match the paths trod by Korea, Taiwan and now also China, at similar stages of development (see chart on **web** version). India is missing some key ingredients to the north-Asian development serum — like effective land reform and export manufacturing — but urbanization is occurring and services exports have thus far filled in for merchandise.

Often the best time to invest comes when the market is so mesmerized by short term negative news, that it has forgotten the more positive long term structural story. India's NIFTY is trading at 15.4x forward earnings, below the median of 18x since 2006. And the rupee is trading below PPP. With a cheaper currency and decently valued equities, now looks like one of those times when it is good to deploy capital. After all, there is now a clear case for good news – whether lower oil prices, a step toward fiscal consolidation, or external improvements – to boost Indian markets.