

Monthly Market Roundup - Debt

February 2009

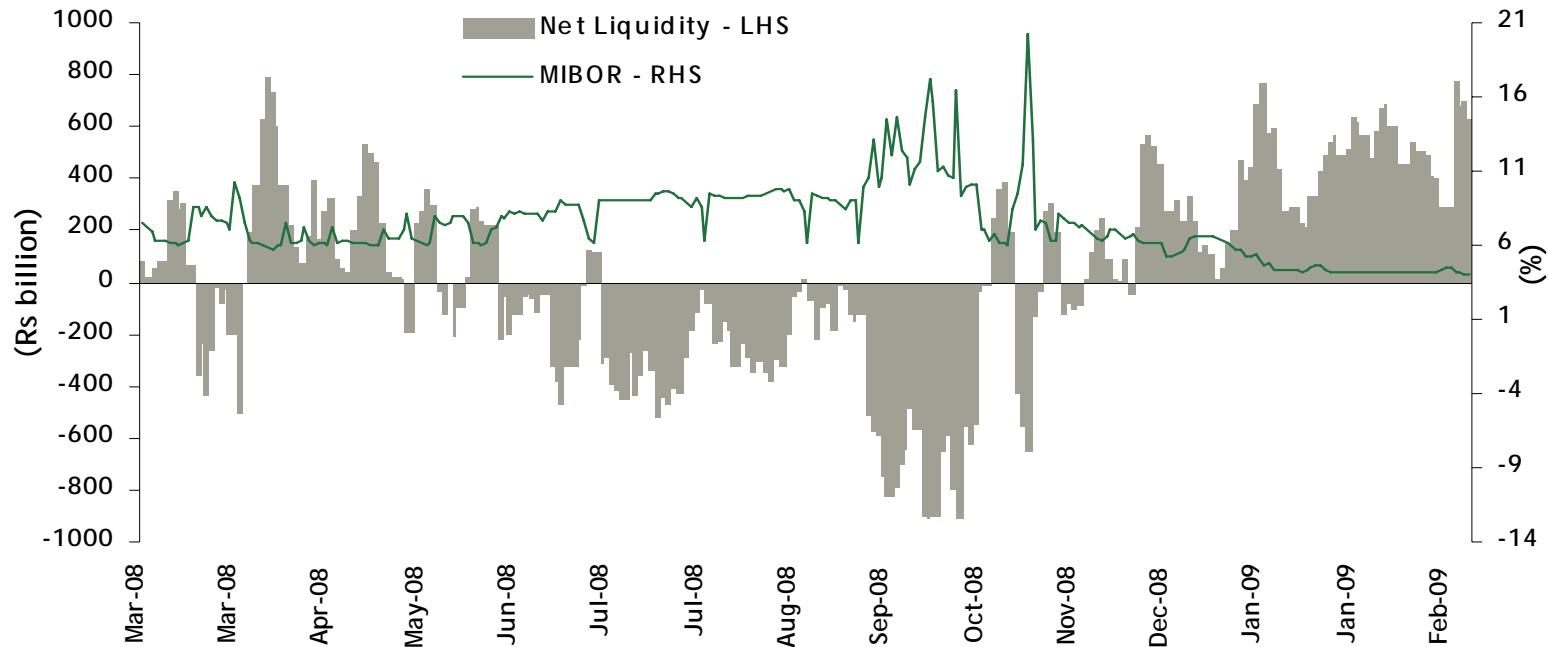
Key Events-Global

- The global recession intensified further, with economic growth in developed economies nose-diving in the most recent quarter with no sight of a recovery in the next few months
- The growth rate in US GDP was revised sharply lower to - 6.2% (from the initial 3.8% drop last month); the biggest decline since the first quarter of 1982
- The Japanese economy fell deeper into recession. Its GDP contracted at an annualized pace of 12.7 percent in the last quarter of 2008, the worst performance in nearly 35 years
- Europe's manufacturing industry shrank at a record pace in February as export demand collapsed and companies scaled back production. U.K. manufacturing too shrank for the 10th month and consumer lending rose at the slowest pace since at least 1993, evidence that Britain's recession is intensifying

Key Events-Domestic

- The government announced third round of stimulus package of Rs. 300 bn (0.3%) of GDP envisaging mainly cuts in excise duty and service tax
- India's economy continues to slow. GDP posted a lower than expected rise of just 5.3% in Q309, slowest pace since 2003, with a surprise 2.2% contraction in agriculture. Manufacturing sector contracted 0.2%
- Industrial production (IIP) fell back into negative territory; down -2% YoY in Dec from the 1.7% gain in Nov. Cumulatively during the current fiscal (Apr-Dec), production slowed to 3.2% v/s 9% during the same period last year
- Exports tumbled 15.9% in January – its fourth straight monthly fall. Imports also moved into negative territory for the first time this fiscal year, falling 18.1% in January, with non-oil imports slipping by 0.5%
- Inflation continued its decline falling further to a 15 month low of 3.03% from 5.64% a month ago

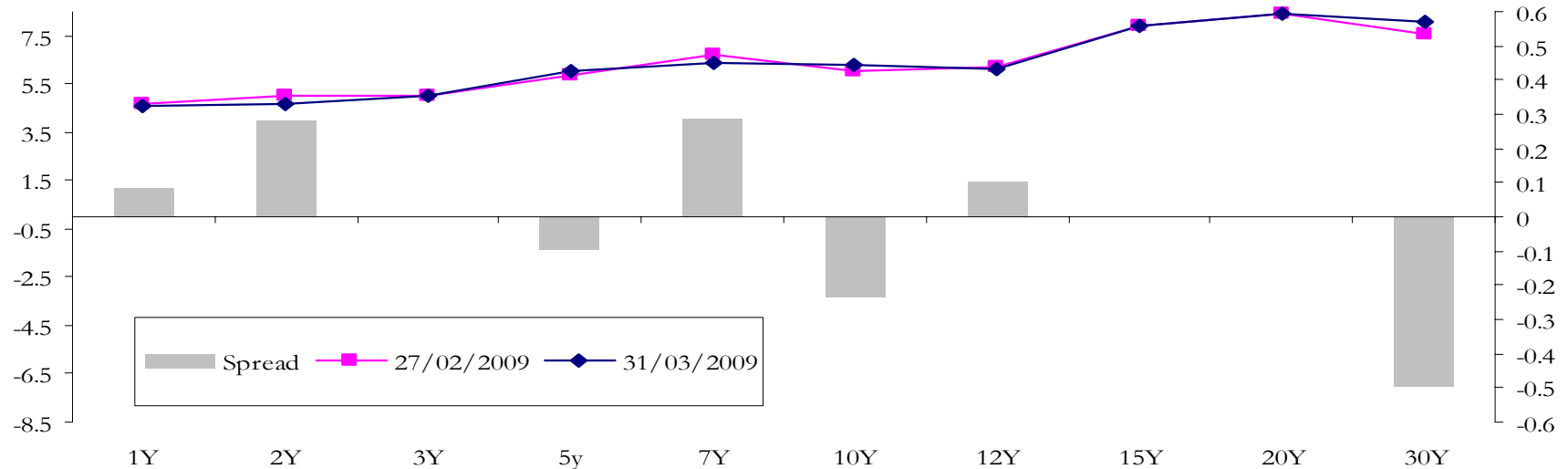
Liquidity – continues to remain comfortable



Source: Bloomberg

- Liquidity remained comfortable through the month of February
- MIBOR rates remained soft and traded in the 4.10% - 4.25% range for most of the month

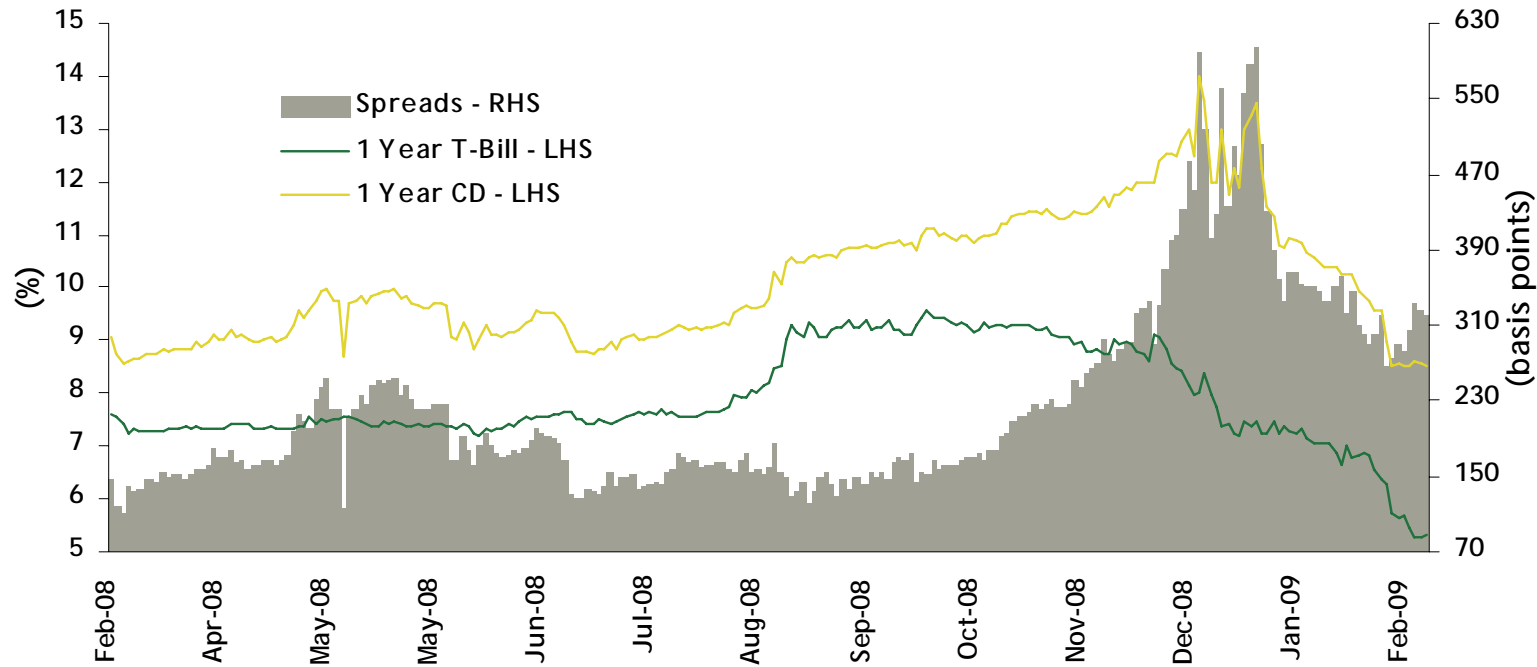
G-Sec Yield Curve – steepened during the month



Source: Bloomberg

- Gov continued to be volatile. The yield curve rose in 2y and 5y segment but with demand for long gilts, the 30y yield dipped marginally
- With borrowing numbers for next fiscal at INR 3.6 trln, the rally in the bonds was capped. 8.24% Gov 2018 yield rose to 6.67% before closing at 6.36%
- RBI rejected OMO bids, which led to negative sentiments in gilts

Money Market- marginal spread compression

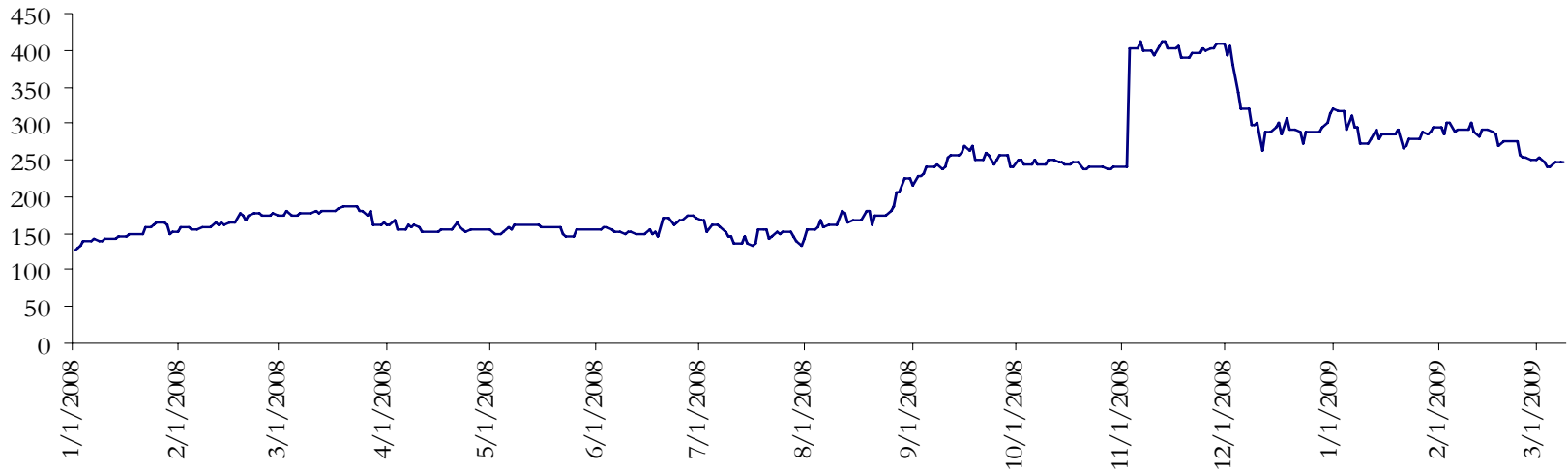


Source: Bloomberg

- Money Market rates eased by 25-50 basis points, given easy systemic liquidity
- Spreads between CP's and CD's continued to remain high, though sharply down from its peak seen in the 3Q FY 09, indicating continuing credit risk aversion

Corporate Bonds- marginal spread compression

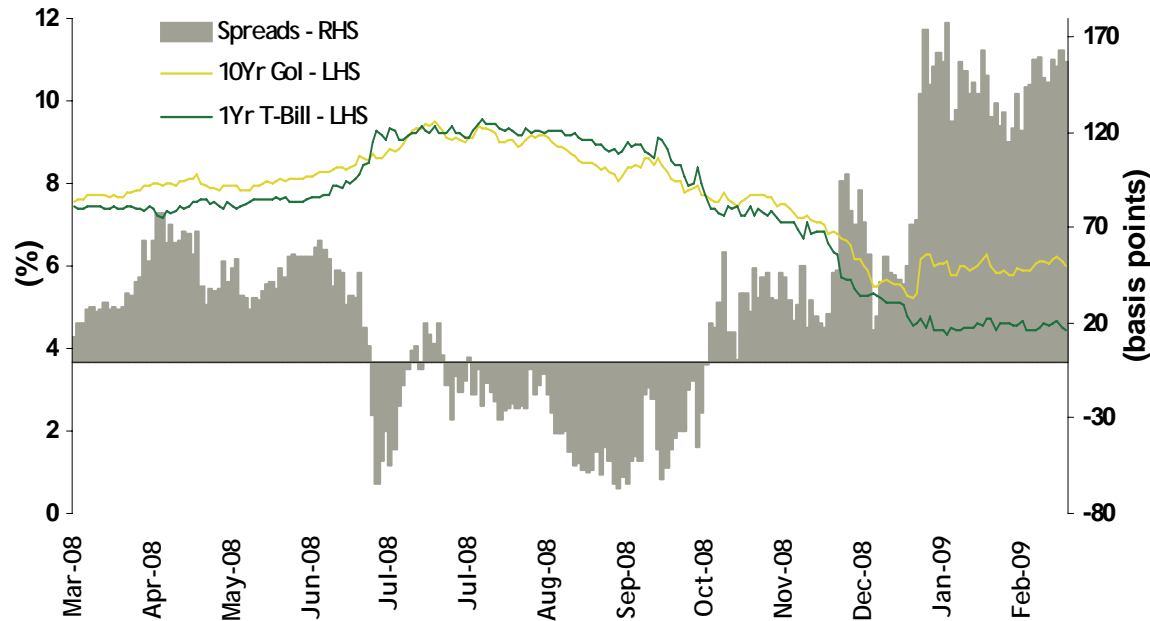
5yrAAA vs 5yr Gilt



Source: Bloomberg

- The spreads of corporate bonds over their corresponding benchmark sovereigns saw some spread compression due to the upward movement in G-Sec yields.
- Bonds reacted adversely to the rising sovereign yields with the 5 year paper's yield climbing by around 15 bps from intra month lows ending the month with a 10 bps month on month drop in yield.

Sovereign Spreads

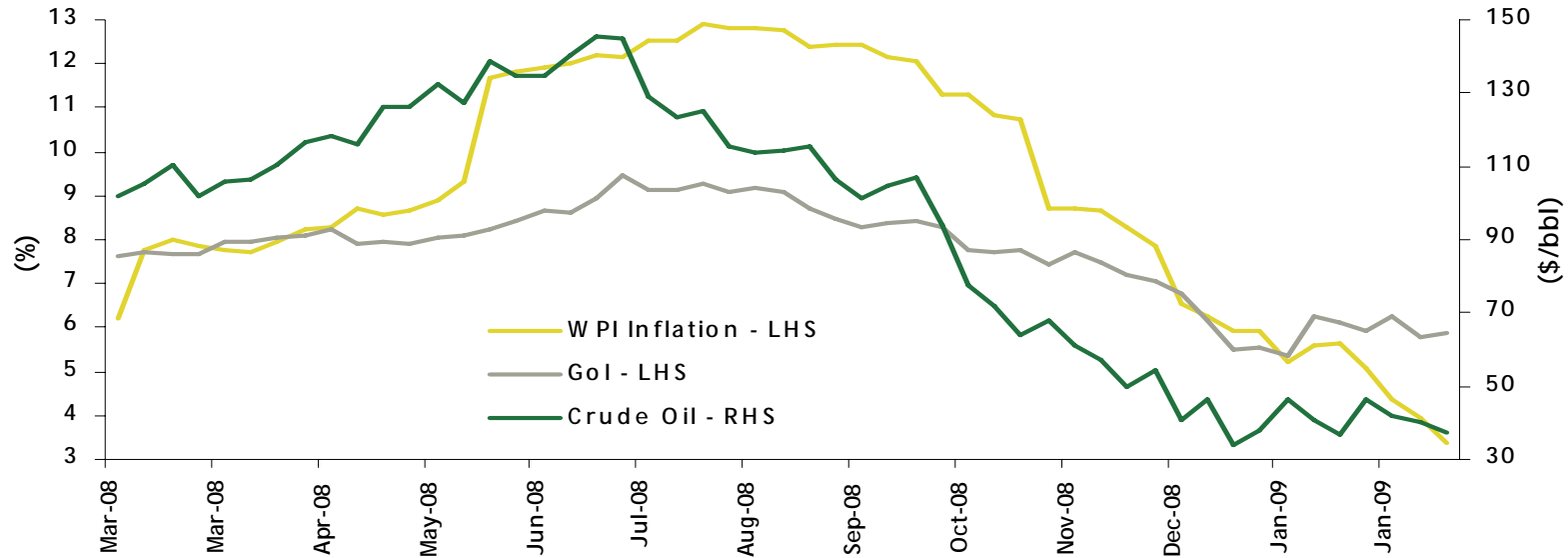


SPREAD SUMMARY	Last 1 year	Last 1 month
Last (bps)	157.65	133.42
Mean (bps)	30.00	133.867
Off Avg (bps)	127.644	-0.4475
Median (bps)	20.91	134.04
StDev	57.6892	9.9124
Off Avg StDev	2.21	-0.05
High (bps)	165.18	165.18
Low (bps)	-70.10	121.50

Source: Bloomberg

- The T-bill auctions held on 25th Feb reported nearly unchanged cut-offs; the 91-day bill was issued at 4.75% and the 364-day paper yielded higher at 4.65%
- The spreads saw a 8 bps downward movement in the shorter end of the curve (3-5 year segment) while the rest of the curve moved up by 8-10 bps

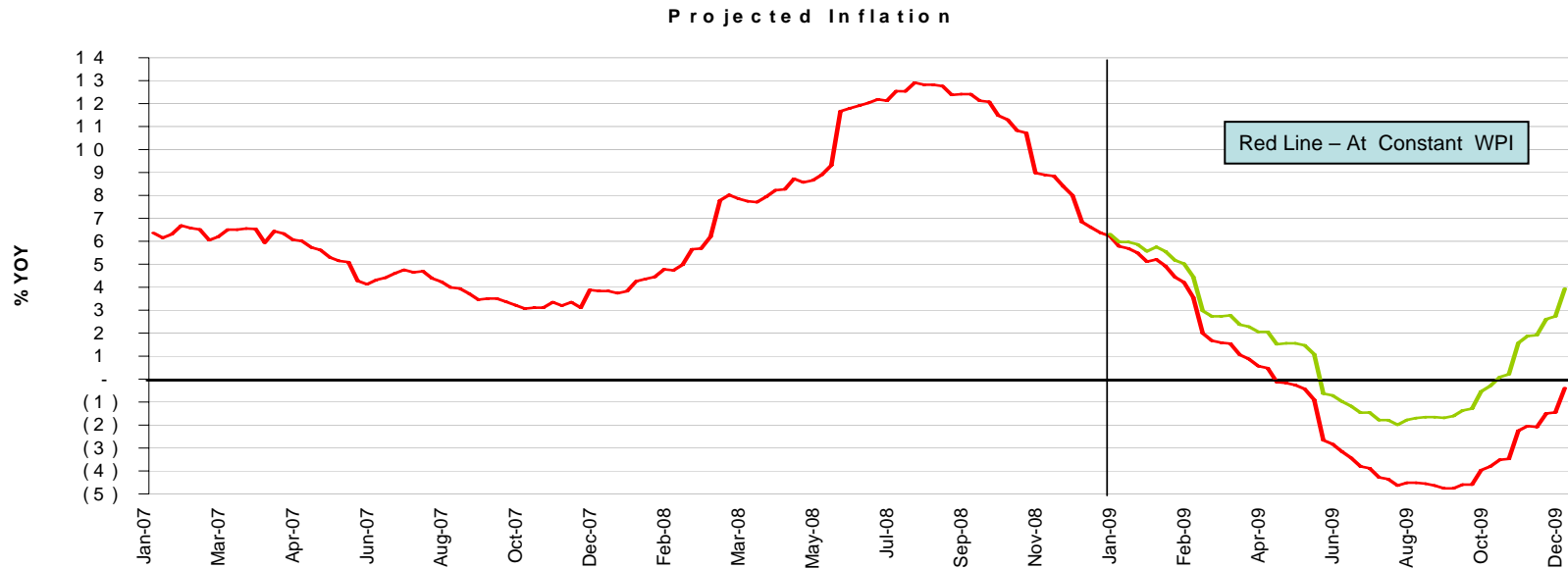
Crude and Inflation Dynamics



Source: Bloomberg

- Crude continued to be easy and remained close to USD 40 per barrel amidst continuing weak global demand
- Inflation continues to move downwards with inflation printing at 3.03% for the week ended 21st Feb '09. A drop in prices was seen in Food articles, Textiles, Basic metal alloys & metal products and Transport equipment & parts
- Inflation is expected to venture into negative territory in the first week of April

Projected inflation – likely to enter negative territory



Source: Bloomberg

- The impact of the fuel price cuts and falling global commodity prices continued to pull down the WPI inflation
- Inflation likely to head sharply lower in the coming months
- Might even enter negative territory (Deflation) as early as the next quarter. Q1, 10

The month ahead...Global

- **US:** Financial and economic weakness continues in the US despite improving credit conditions. Fiscal measures and continuing financial and monetary policy efforts will likely buoy U.S. demand, but risks of deflation remain elevated. The numbers would continue to disappoint
- **Euro Area:** Euro zone expected to face deeper recession. We expect the ECB to cut rates to 0.5% in mid-2009 and to take more unconventional monetary measures. Fiscal policy is also set to take unconventional measures in trying to support euro area countries with financing difficulties
- **Japan:** The BoJ will likely focus on supporting financial markets by assuming credit risk and pushing down longer interest rates
- **China:** China may have passed its cyclical bottom, but hurdles remain on the path to recovery

The month ahead...Domestic

- All eyes are on RBI, expectation of rate cut (with moral code of conduct in force, government cannot take any further fiscal measures)
- IIP numbers expected to disappoint, Jan IIP numbers expected to be (-)1.2 - (-)1.5%
- RBI to ensure easy liquidity in the system
- Auction coupled with OMO to provide some respite to the gilt market, but fiscal deficit remains a big concern
- Gilts to remain volatile
- Yield curve expected to steepen
- With next fiscal borrowing at INR 3.6 trln, RBI expected to balance the borrowing through OMO, MSS and monetization

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