

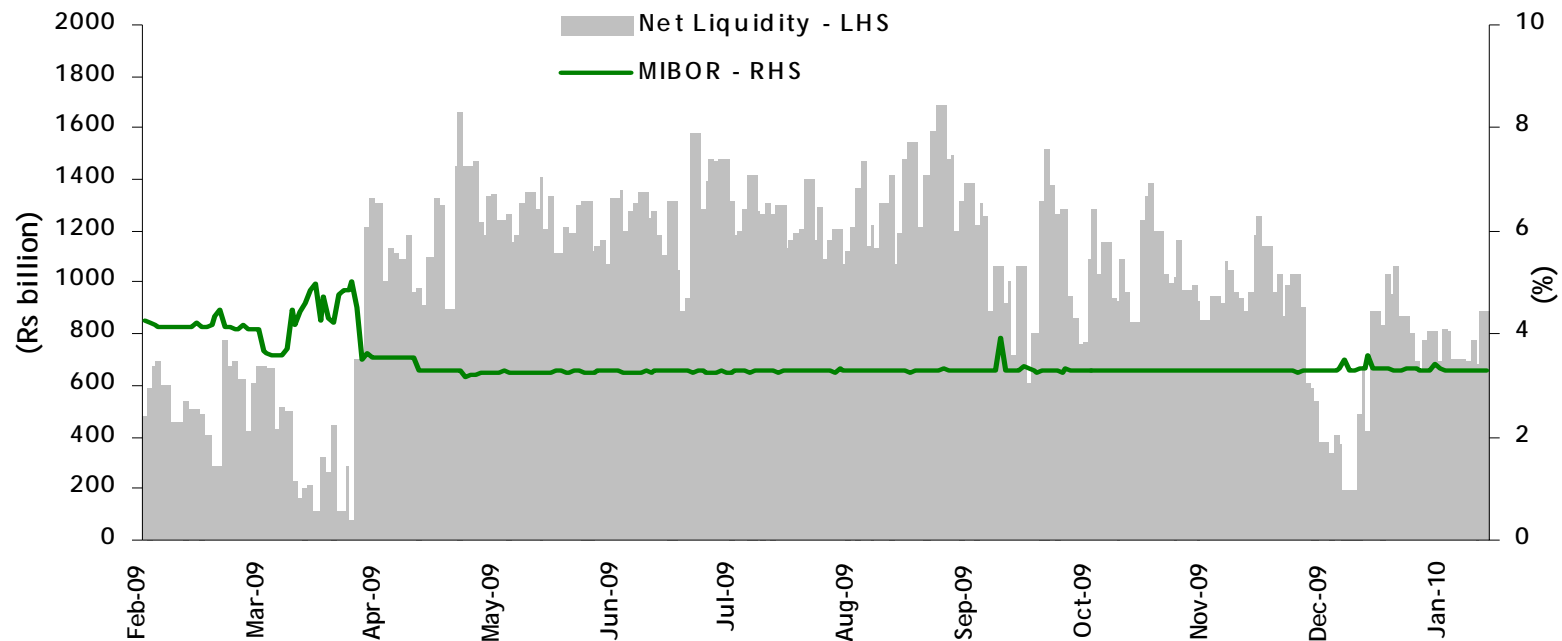
# Fixed Income Markets : Current Environment and Outlook

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# Macro Events

- In the Credit Policy Review held on Jan 29<sup>th</sup> 2010, RBI raised the CRR by 75bps and left the repo and reverse-repo rate unchanged at 3.25% and 4.75% respectively. The CRR hike will mop up liquidity to the tune of Rs.36,000 crore.
- RBI has raised its FY10 GDP estimate to 7.5% (from 6%), its Mar-10 inflation estimate to 8.5% (from 6.5%).
- Industrial Production (IIP) rose impressively in Oct 09, to 11.7% (YoY), the fastest pace in over two years. Growth was broad based with 14 of the 17 sectors showing an expansion (YoY). On a cumulative basis, growth during Apr-Nov 09-10 was 7.6% vs. 4.1% last year.
- Inflation rate, as measured by the WPI, rose sharply to 7.31% (YoY) in December 09 from 4.78% in the previous month.
- Economic growth measured by GDP is now in the positive territory for the US, UK and the Eurozone. US GDP grew a strong 5.7% in Q4'09 helped mainly by the restocking of their inventory levels, by corporates, which were at historic lows. GDP growth in the UK moved into positive territory in Q4'09, following six consecutive quarters of contraction.

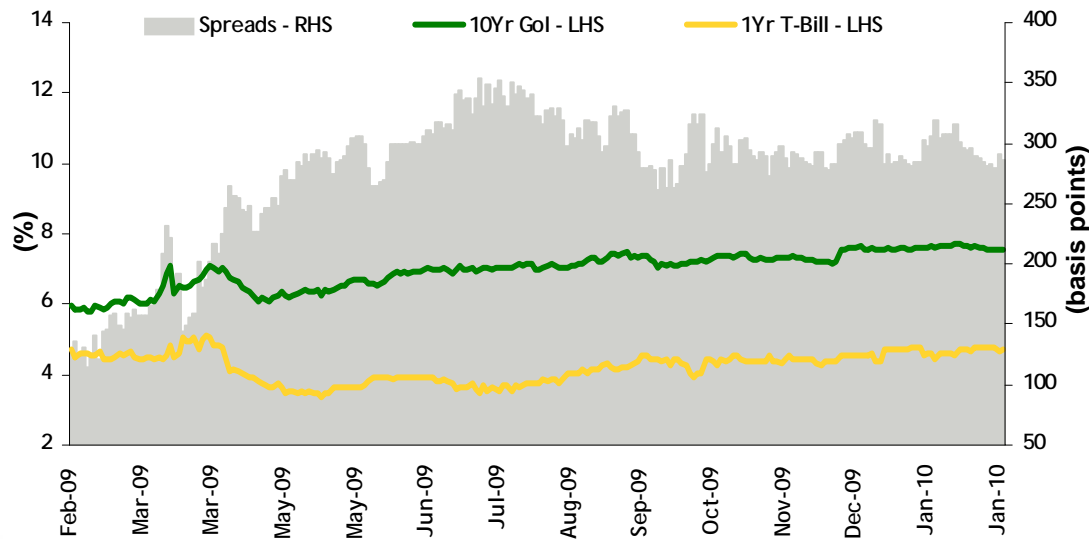
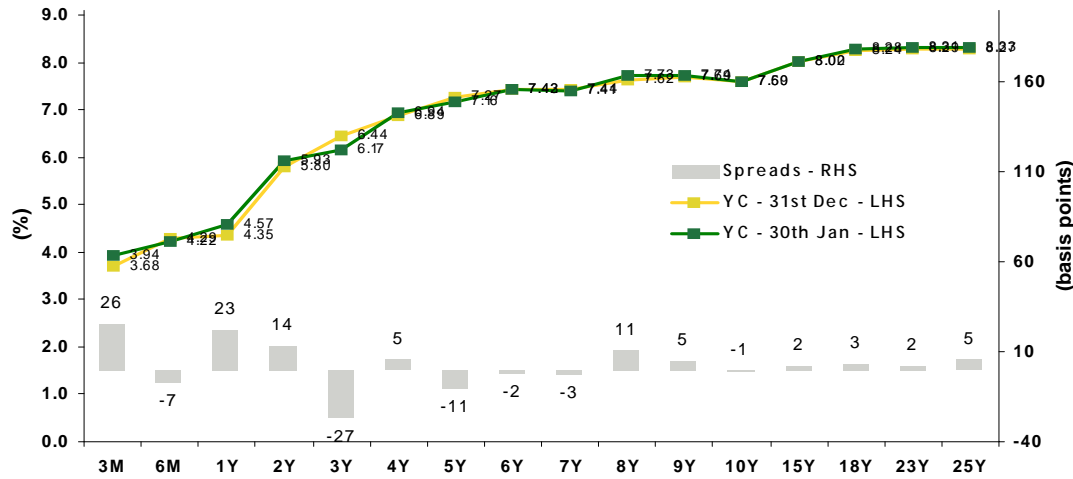
# Liquidity - remains comfortable



Source: Bloomberg

- Liquidity remained comfortable with the daily RBI LAF reverse repo average at around INR 80,000 crore during January.
- MIBOR averaged around 3.2% during the month.

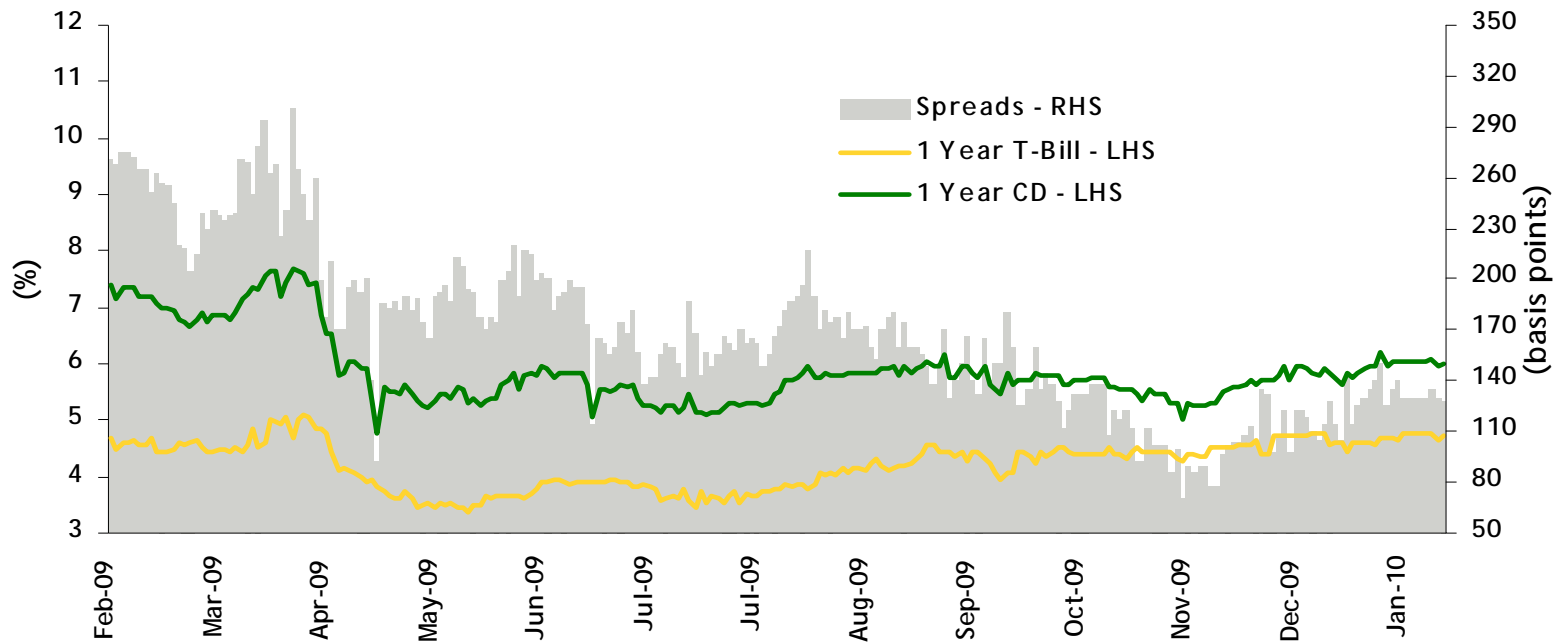
# G-Sec Yield Curve - flattening



- The G-Sec yield curve flattened due to a rise in yields at the short end of the curve.
- The yield on the 10yr benchmark closed relatively unchanged from last month at 7.6%.
- In the T-Bill Auction held on Jan 27, the 91-day T-bill was issued sharply higher at 4.01% and the 364-day paper yielded 4.67%.
- Current 1yr vs. 10yr Gol spread was at 300 basis points as against the mean spread of 200 basis point over the last 1 year. We expect the current spread to compress and revert to the mean.



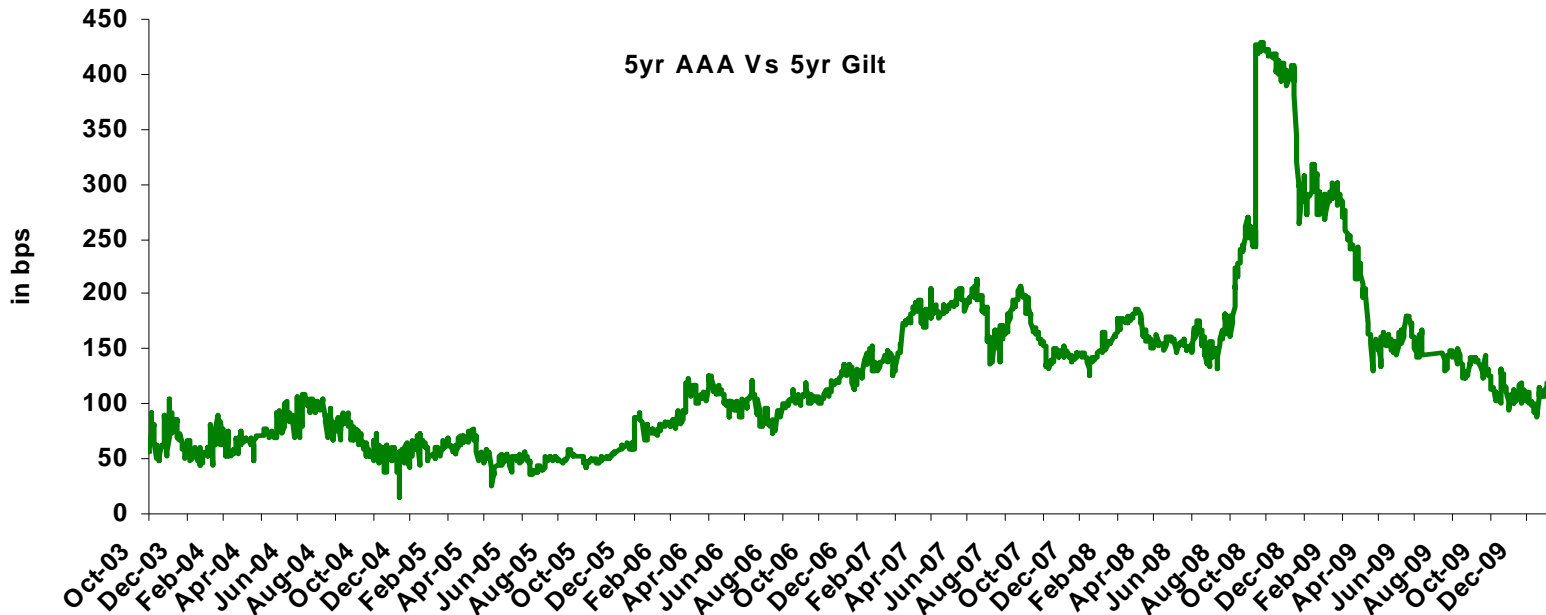
# Money Market - low rates and easy liquidity



Source: Bloomberg

- Money market rates traded at extremely low levels due to ample liquidity in the system.
- Spreads between 1 Year CD's and T-Bill's widened 25-30 bps during the month, while the spreads between CP's and CD's widened by 15 bps. Overall, 1 Year CP spreads over 1 Year T-Bills widened by 40-45 bps over the month.

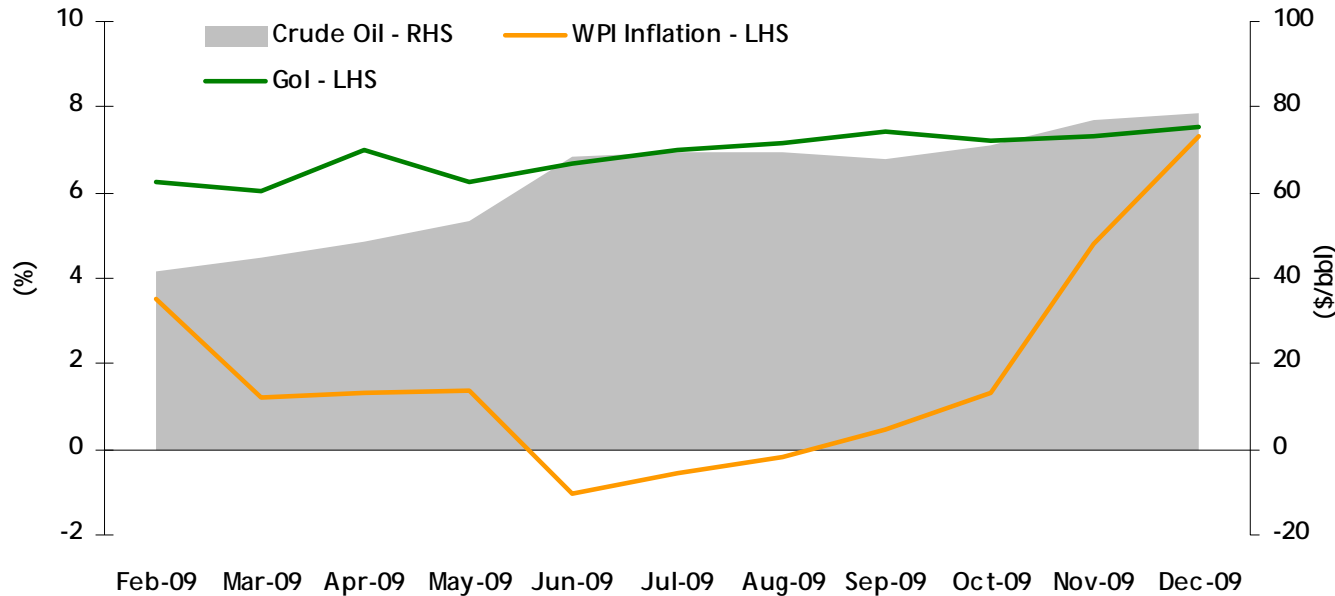
# Corporate Bonds spread - widening



Source: Bloomberg

- Spreads of 5-Year AAA corporate bonds over their corresponding benchmark sovereigns, widened by 20 bps during the month to over 120 bps, with the fall in sovereign rates contributing more to this widening than the rise in corporate bond yields.
- The 5 year AAA corporate paper yield was higher at 8.3% during the month.

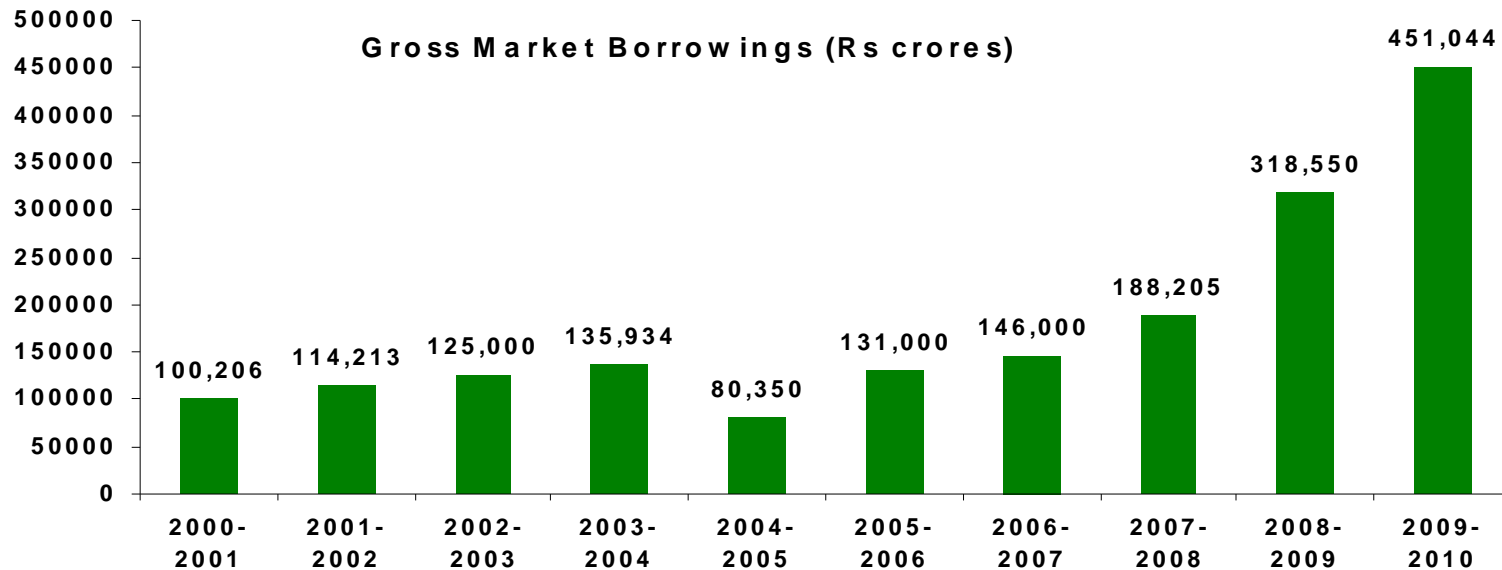
# Crude and Inflation Dynamics



Source: Bloomberg

- Crude Oil prices (NYMEX Crude Oil Barrel) drifted lower to \$72 at the end of January from \$82 at the start of the month.
- WPI Inflation climbed sharply to 7.31% in December from 4.78% in the previous month. Food prices moderated but the rise in inflation was more widespread.

# Government's borrowing program



Source: [indiabudget.nic.in](http://indiabudget.nic.in)

- The scheduled Government borrowing program is now complete.
- There is expectation that the Government may resort to some additional borrowing though the Finance Ministry has categorically denied the same.

# Religare MF: Fixed Income Outlook and Opportunities

# Fixed Income Market Outlook

- Global economic data continues to point towards recovery gaining traction.
- Risk trades are off as concerns over sovereign balance sheets take centre-stage with Greece being the eye of the storm.
- Euro is likely to continue to be under pressure leading to further correction in stocks and commodities as carry trades are unwound.
- Domestically, inflationary pressures likely to continue to build in the coming months taking into account – a) pressure from global commodity price rise b) high food inflation and c) base effect of past year.
- Liquidity conditions are likely to remain comfortable on a) alternative sources of funding available to corporates (equity/ECBs) b) weak credit pick up as Corporates going slow on CAPEX plans and c) RBI dollar intervention on FII/FDI inflows.
- In the medium term, macro conditions are likely to lead RBI to hike interest rates. However, we believe that after raising the reserve requirement in January policy, the Central Bank may revisit policy rates only in April 2010.

# Ideas for investors

- Risk-averse investors should continue to look at short end of the yield curve
- The market would be looking at the FY11 budget numbers likely to be presented by end February. Investors should take a call at that point in time regarding investments at the long end
- Investors with an investment horizon of 3-6 months may also look at investment in Short Term Fund and Credit Opportunities Fund

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