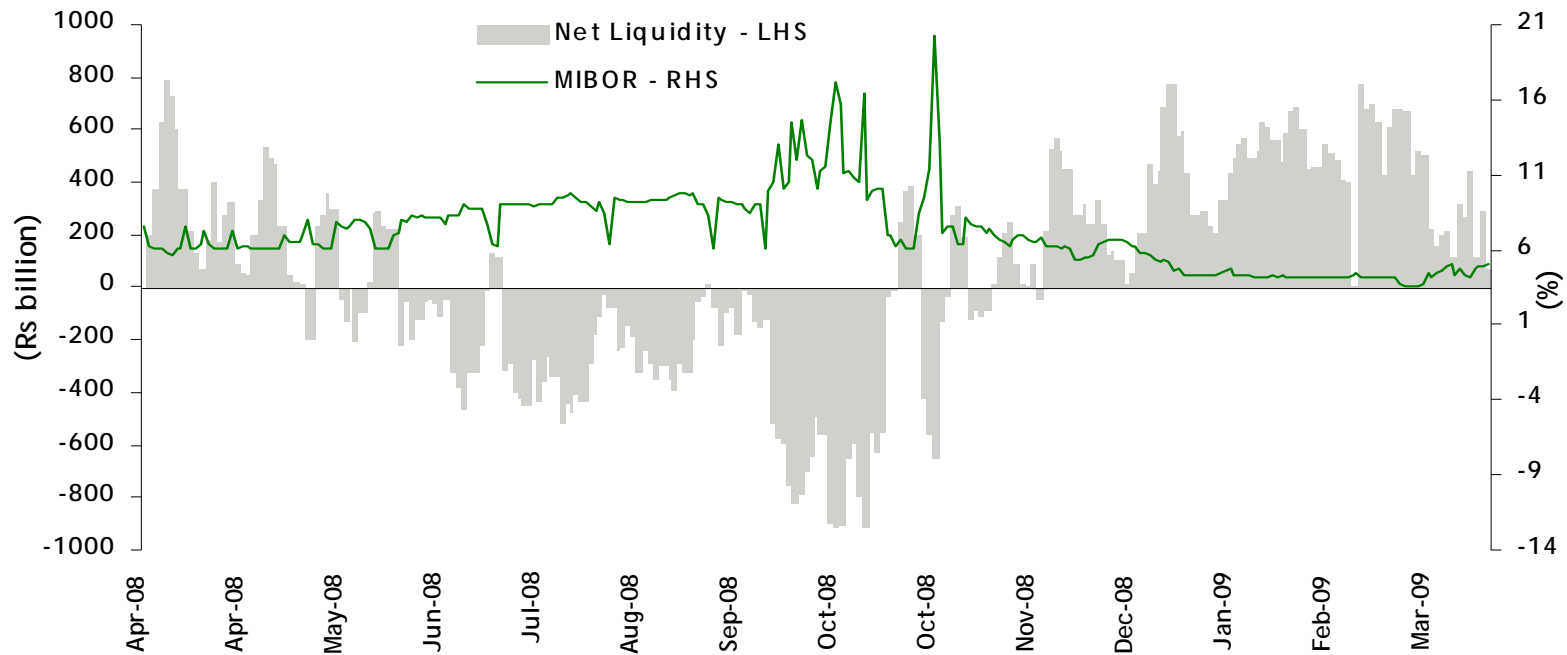


Fixed Income Markets : Current Environment and Outlook

Ashish Nigam, Head of Fixed Income
March 2009

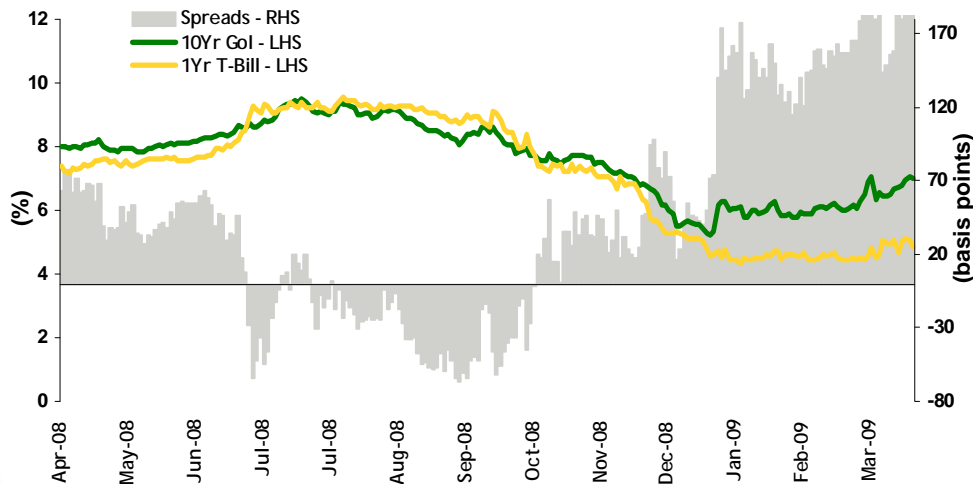
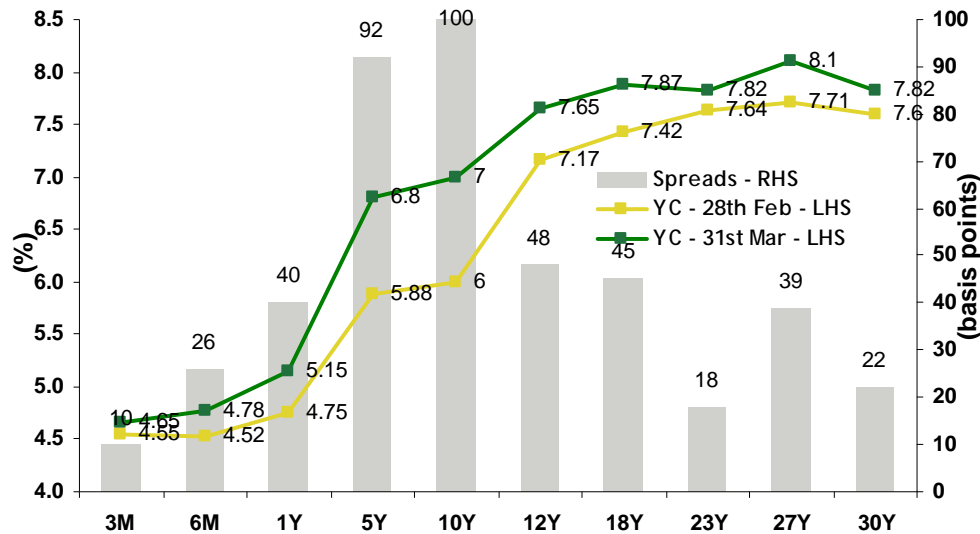
Liquidity - continues to be comfortable



Source: Bloomberg

- Despite advance tax outflows and year end balance sheet adjustments, liquidity in the system continues to be comfortable
- MIBOR rates remained within the 5% mark throughout the month

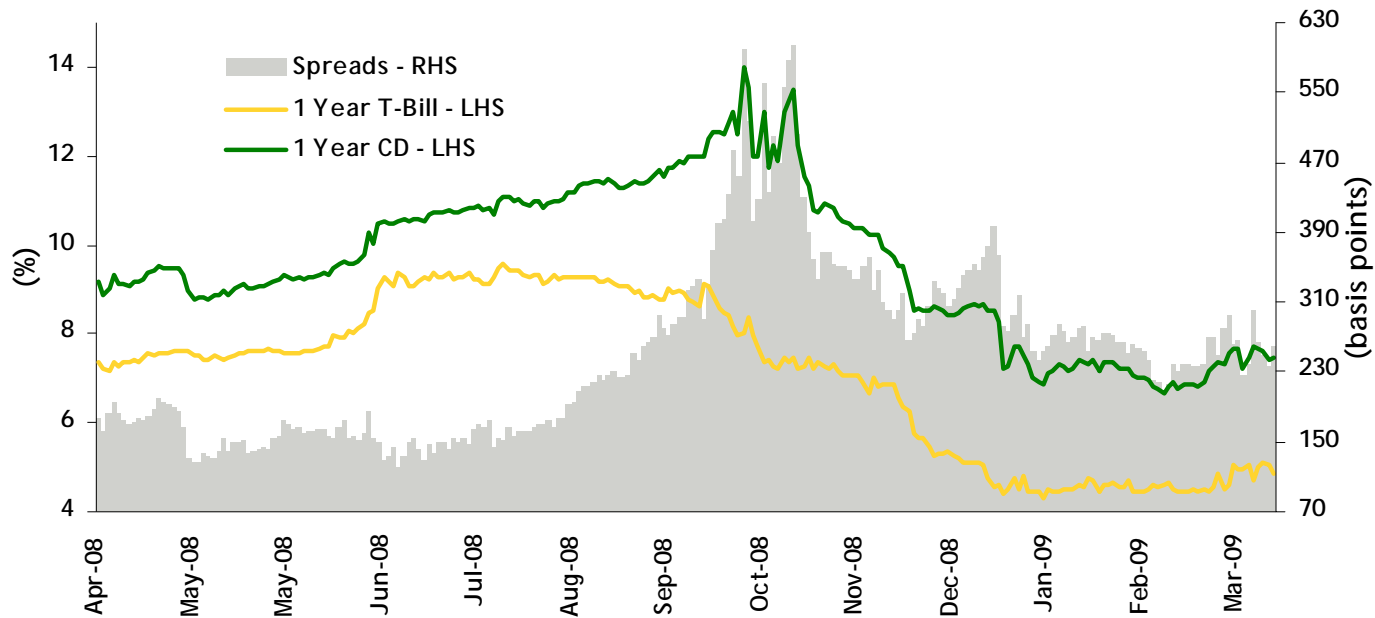
G-Sec Yield Curve - steepened further



- GoI yields continue to be volatile with supply concerns dominating, with an upward bias
- Yield curve steepened further, longer term G-Sec yields rose with the release of RBI's borrowing programme calendar for H1 FY10, while short-end yields eased amidst easy liquidity
- 10Yr yield above 7% compared to 6.25% at the start of this month
- 91-day bill issued at 4.95% and the 364-day paper yielded at 5.50%, reporting higher cut-offs
- Current 1Y vs. 10Y GoI spread at 216 basis point as against mean spread of 47 basis point over last 1 year. We expect the current spread to compress and revert to the mean



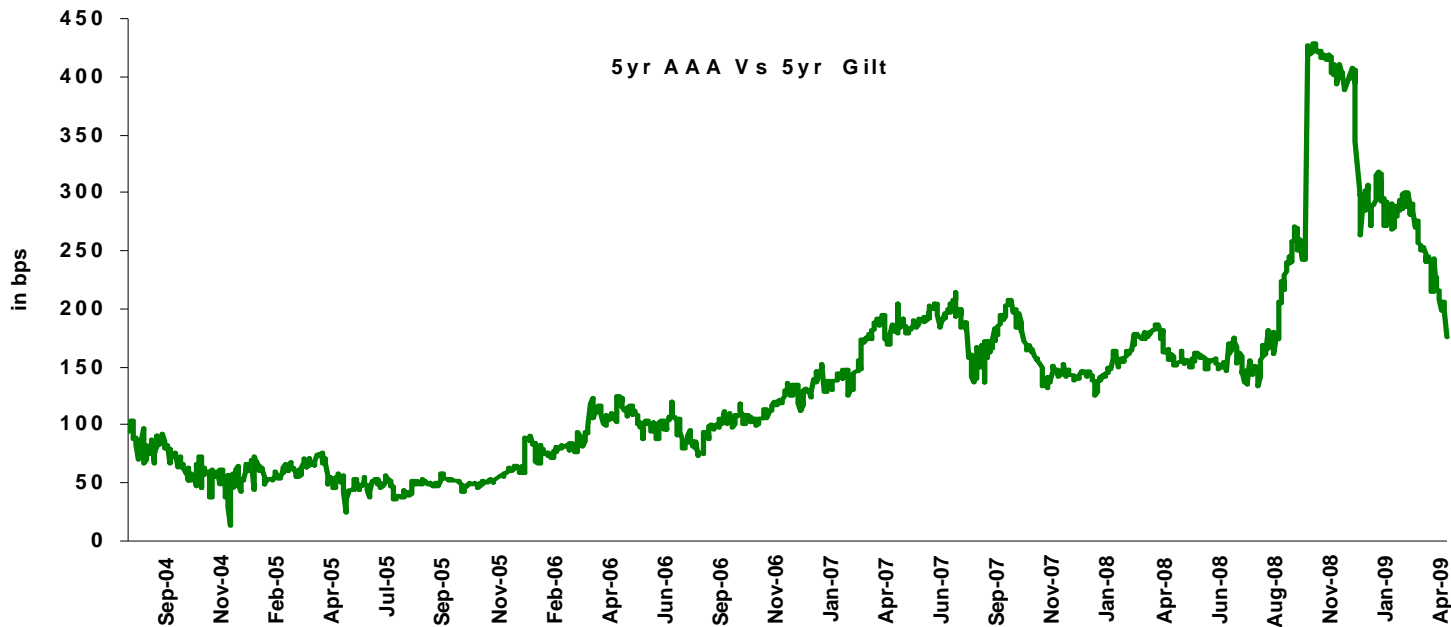
Money Market- spreads compress further



Source: Bloomberg

- Money market rates increased by 50-60 basis points on heavy CD supply from banks, but came down sharply towards the month end
- Spreads between CD's and T-Bill eased by 50-75 basis points, CP's and CD's also contracted from earlier levels of about 200-250 bps to 100-150 bps
- Spread compression indicates reduced risk aversion and demand for short-term assets

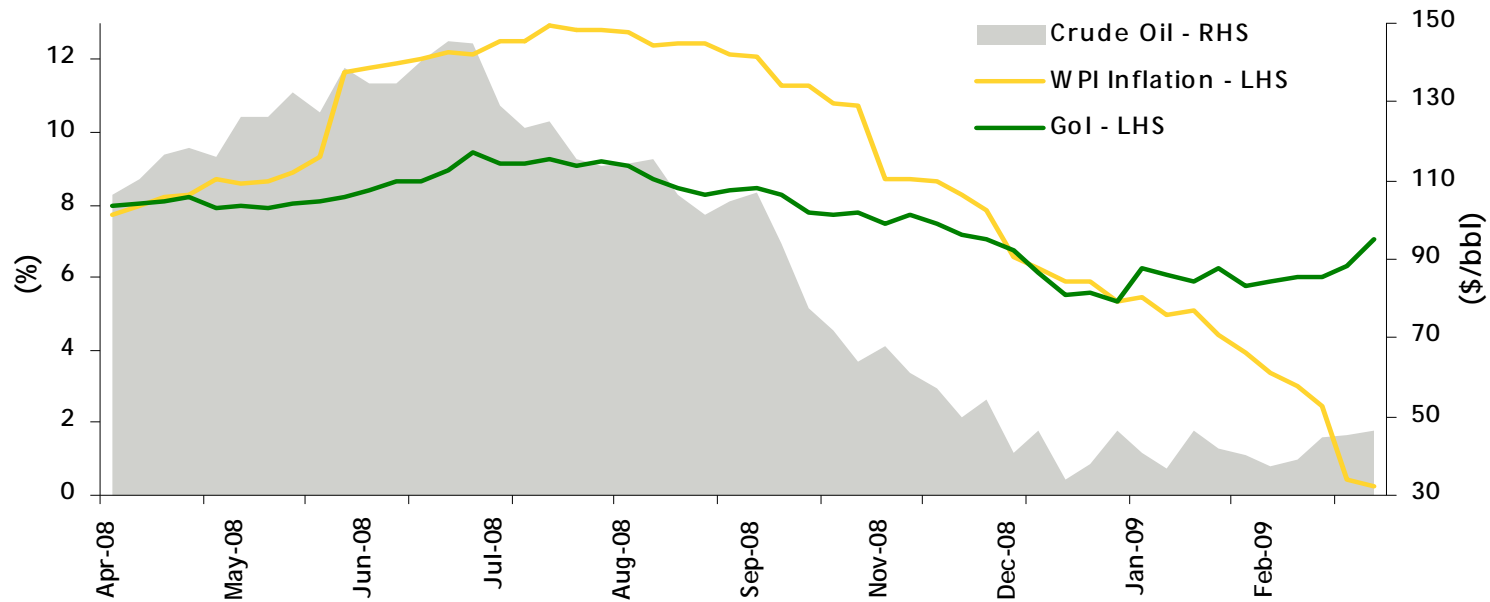
Corporate Bonds- compression in spreads



Source: Bloomberg

- Spreads of corporate bonds over their corresponding benchmark sovereigns saw some compression due to the upward movement in G-Sec yields indicating higher risk appetite
- The 5 year corporate paper's yield remained flat during the month at 8.1%, though climbing to a high of 8.6% in the middle of the month

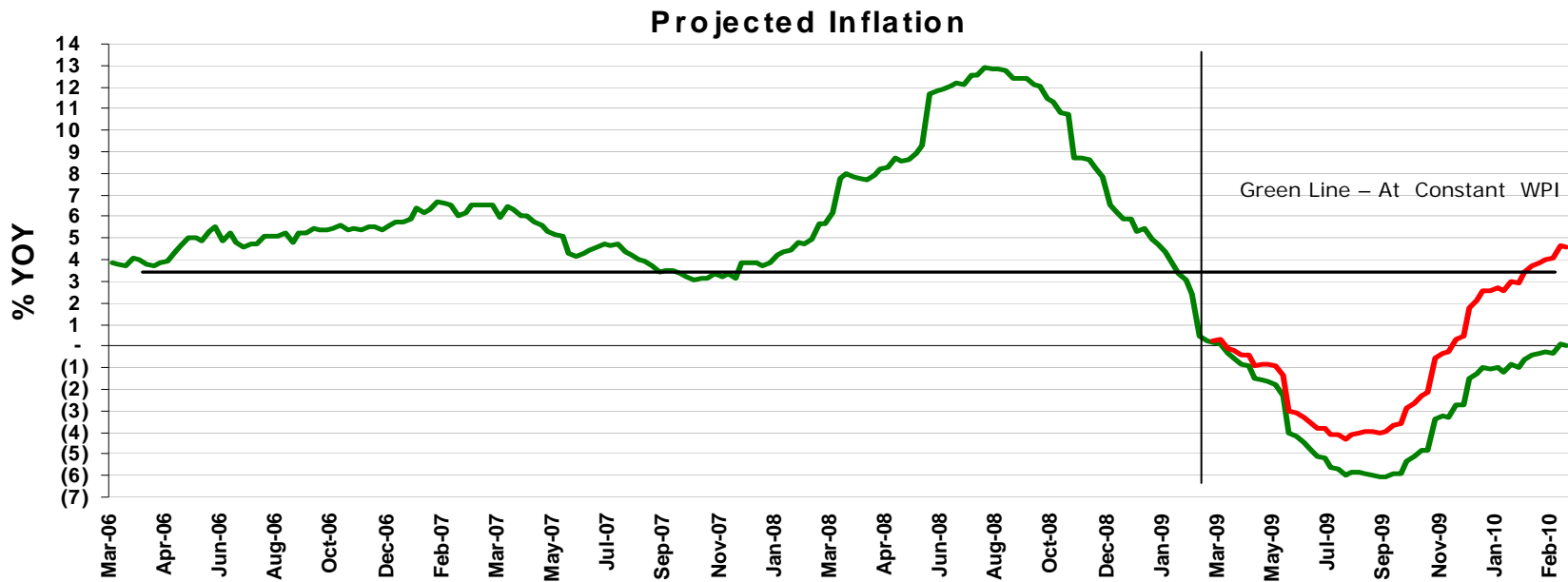
Crude and Inflation Dynamics



Source: Bloomberg

- Crude prices rose up from multi year lows on the back of supply cuts by OPEC and a weakening of the US Dollar against other major currencies. Nymex Crude closed the month at around \$50 from \$40 at the start of the month
- However, the WPI Inflation rate in India continued its decline with the rate at just 0.31% for the week ended 21st Mar '09

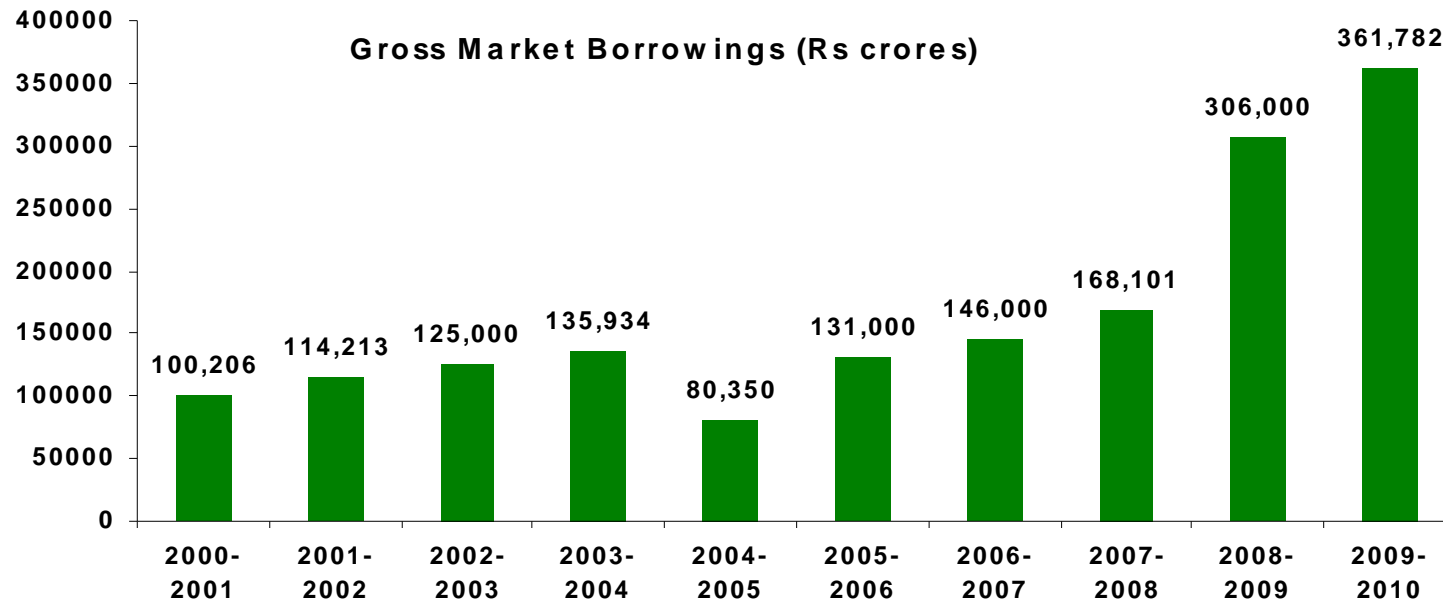
Projected inflation - likely to enter negative territory



Source: Bloomberg

- Excise duty cuts, fall in prices of Manufactured, Fuel Products and Primary articles lead to further fall in inflation
- Inflation likely to enter negative territory (Deflation) in the month of April, this is purely technical due to higher base effect. CPI (Consumer Price Index) still continue to remain high (close to 10%)

Government's borrowing program



Source: indiabudget.nic.in

- GoI to borrow INR 2.41 trln for H1 F of 2009/10, prompting bond yields to jump in anticipation of the supply surge
- With unprecedented government borrowing numbers, markets would eye RBI for monetary measures to ensure smooth and "undisruptive" borrowing program

Religare MF: Fixed Income Outlook and Opportunities

Fixed Income Market Outlook

- RBI likely to cut repo, reverse repo rates in its April policy in a bid to push growth momentum
- Macro data likely to continue to disappoint with economy entering the slack season
- RBI to ensure easy liquidity in the system
- Though RBI has tried to soften the impact of a huge GoI borrowing program by announcing corresponding OMO buyback, market remains concerned on fiscal deficit
- Election uncertainties also weigh in on the market sentiment
- Yield curve expected to steepen further unless there is clear signal from the RBI to the contrary
- Short end of the yield curve expected to ease sharply
- Marginal spread compression expected for corporate bonds over GoI securities in the next two quarters

Ideas for investors

- Consider investing in portfolio with a mix of PSU corporate bonds and gilts
- Income Funds expected to deliver double digit returns over 1 year horizon
- Volatility to continue in bond market, investors could consider Short Term Plan to avail superior returns than Ultra Short Term, while looking to hedge on volatility

Disclaimer

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