

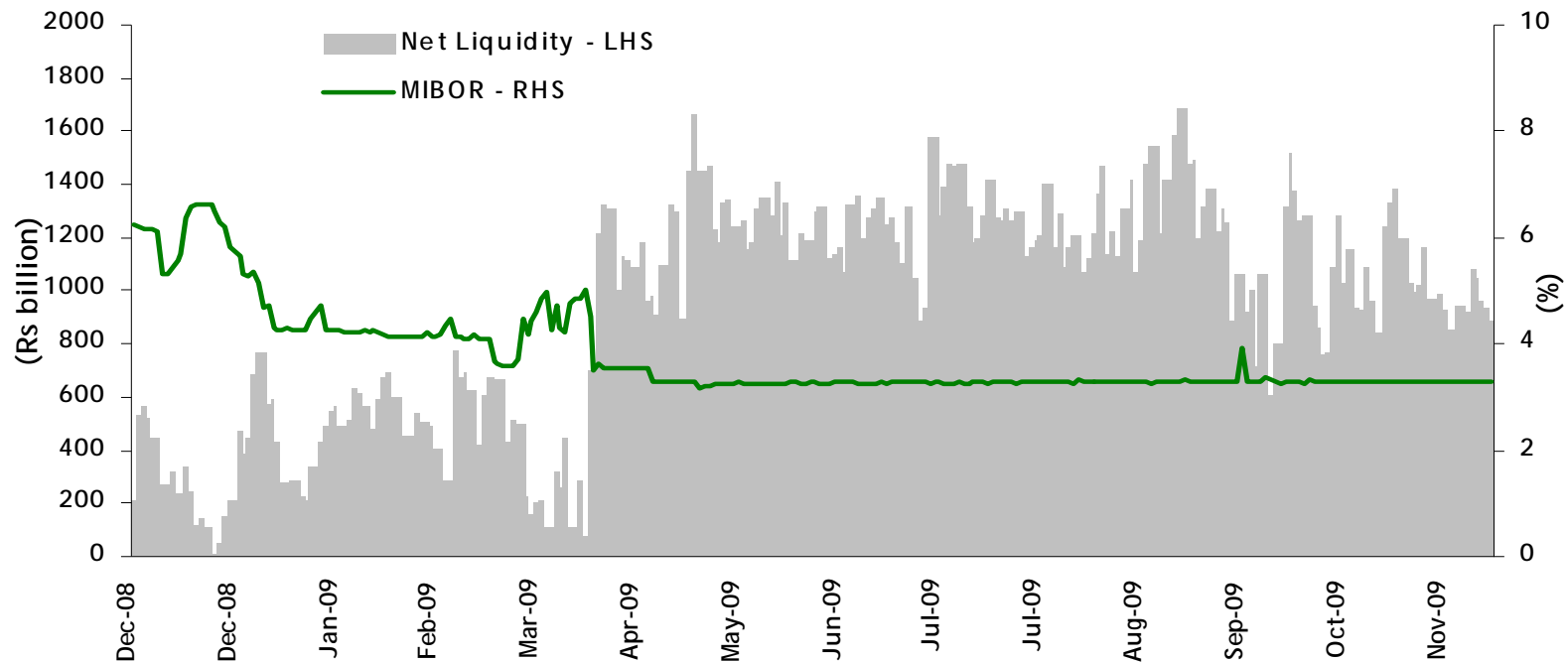
# Fixed Income Markets : Current Environment and Outlook

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November 2009

# Macro Events

- India's 2Q: FY10 (Jul-Sep) GDP growth came in at 7.9%, higher than estimates. While trends in industry (8.3%) and services (9.3%) were broadly in line, Agriculture surprised on the upside with a positive reading of 0.9%
- Industrial output continued to accelerate with the IIP Index showing a strong growth of 9.1% (yoy) in September. The Manufacturing sector led the revival with growth of 9.3% (yoy) during the month
- Inflation rate, as measured by the WPI, rose to 1.3% (yoy) in October from just 0.49% in the previous month. Food prices continue to push Inflation higher rising at a 17.5% (yoy) rate in the week ended Nov 21, 2009
- Global Macro data continues to suggest a favorable turnaround in economic output but the path to a full recovery is likely to be slow and bumpy. Revisions in Q2: CY09 data showed, Economic output in the U.S and Euro zone grew, while in the UK, GDP continued to contract.
- Recent data on US employment has been surprisingly strong. The long-suffering U.S. jobs market improved significantly in November, as employers trimmed fewer jobs since the start of the recession, and the unemployment rate posted the biggest one-month decline in more than three years

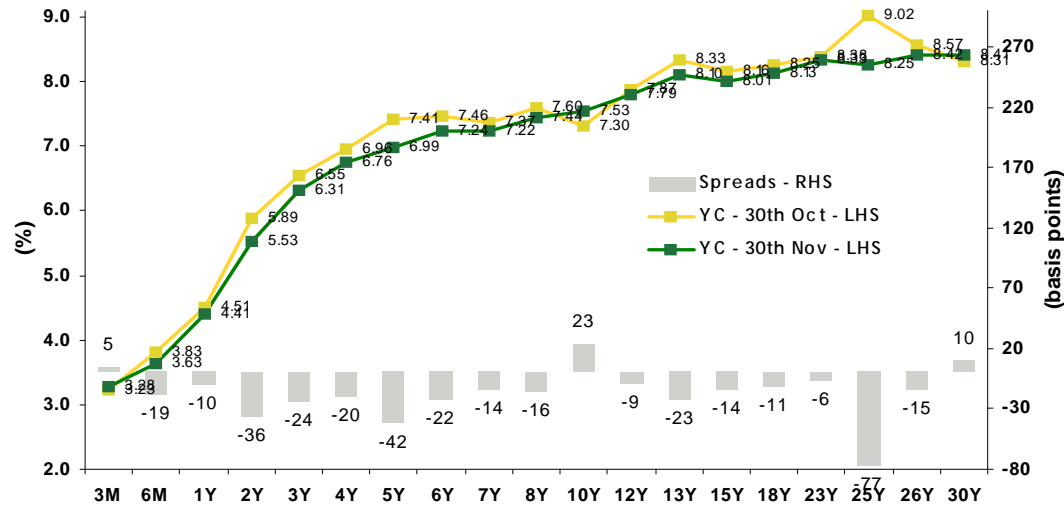
# Liquidity - remains abundant



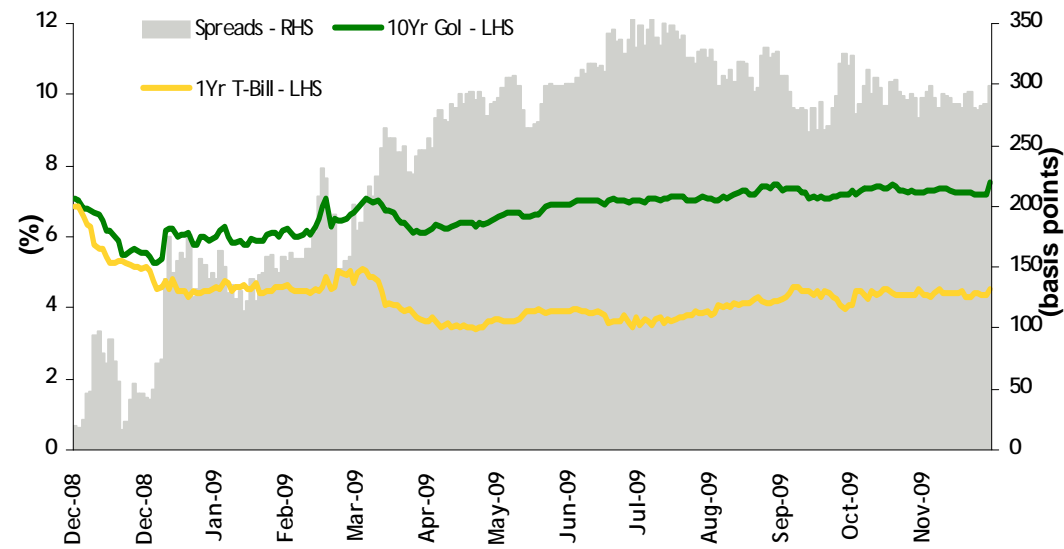
Source: Bloomberg

- The system remained flushed with liquidity in November with the daily RBI LAF reverse repo continuing to average over INR 1,00,000 crore during the month
- MIBOR rates remained comfortably low and flat at 3.2% during the month

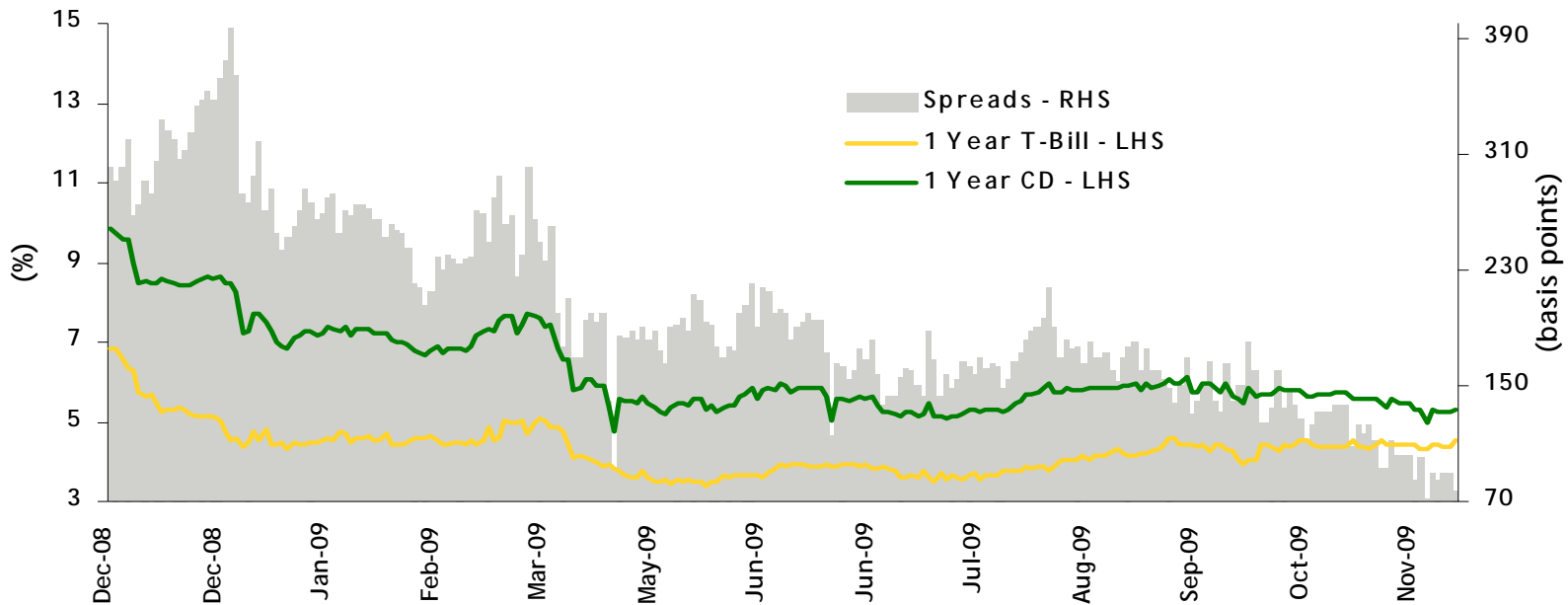
# G-Sec Yield Curve - shifts lower



- The G-Sec yield curve shifted lower during the month with rates softening across all the segments
- The yield on the new 10yr benchmark closed the month at 7.5%. The previous benchmark bond had started the month at a yield of 7.3%
- In the T-Bill Auction results on Dec 02, 91-day T-bill issued at 3.32% and the 364-day paper yielded 4.49%
- Current 1yr vs. 10yr GOI spread was at 300 basis points as against the mean spread of 190 basis point over the last 1 year. We expect the current spread to compress and revert to the mean



# Money Market - low rates amidst easy liquidity

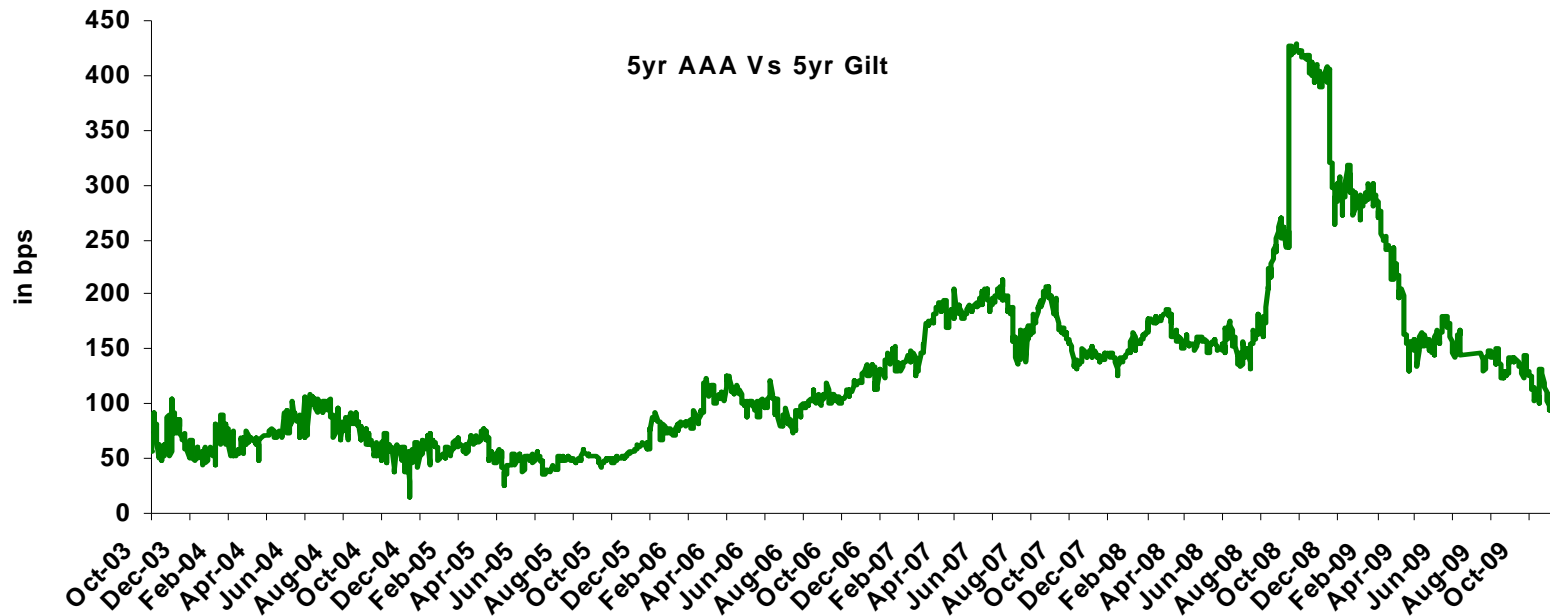


Source: Bloomberg

- 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 75 bps during the month, while the spreads between CP's and CD's compressed by 100 bps. Overall, 1 Year CP spreads over 1 Year T-Bills compressed by 25 bps over the month.
- Spread compression indicates reduced risk aversion and demand for short-term assets.



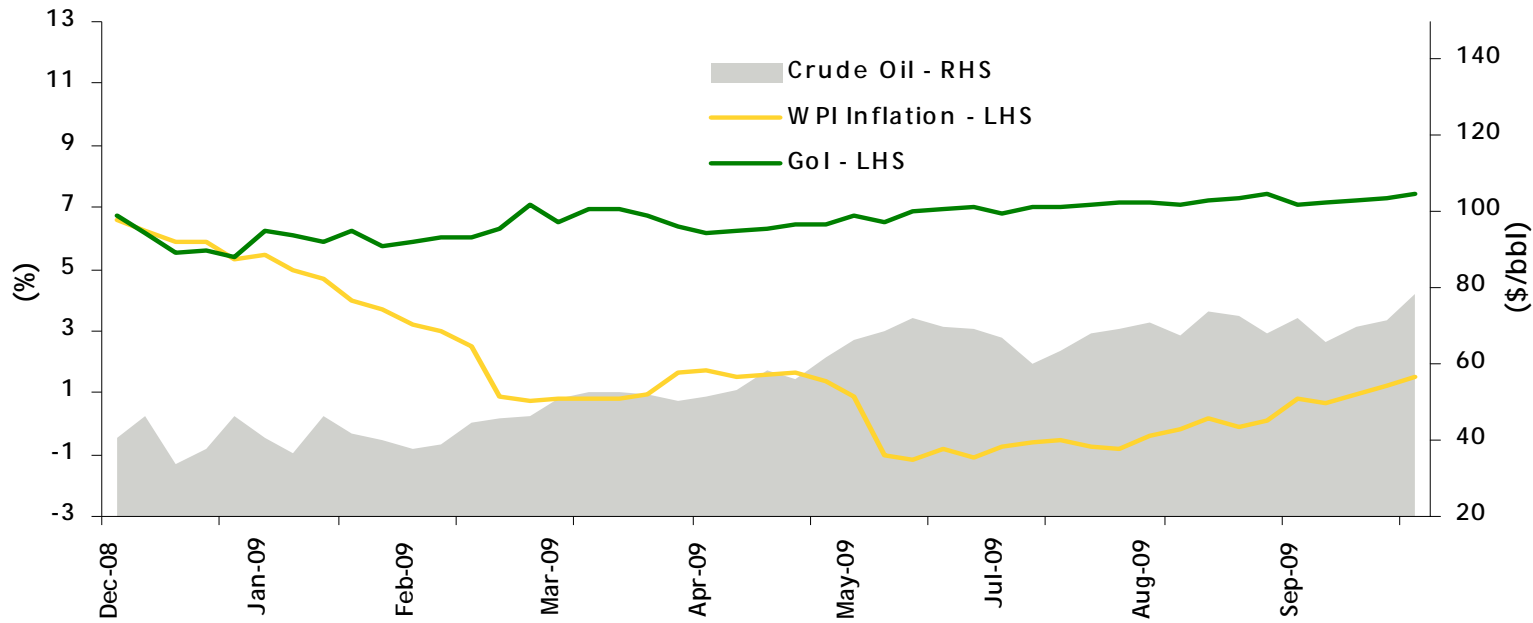
# Corporate Bonds spread - compress further



Source: Bloomberg

- Spreads of 5-Year AAA corporate bonds over their corresponding benchmark sovereigns, compressed further by 3-4 bps during the month to under 105 bps, with corporate bond spreads falling more than sovereign spreads
- The 5 year AAA corporate paper yield dropped 40bps to 8.05% during the month

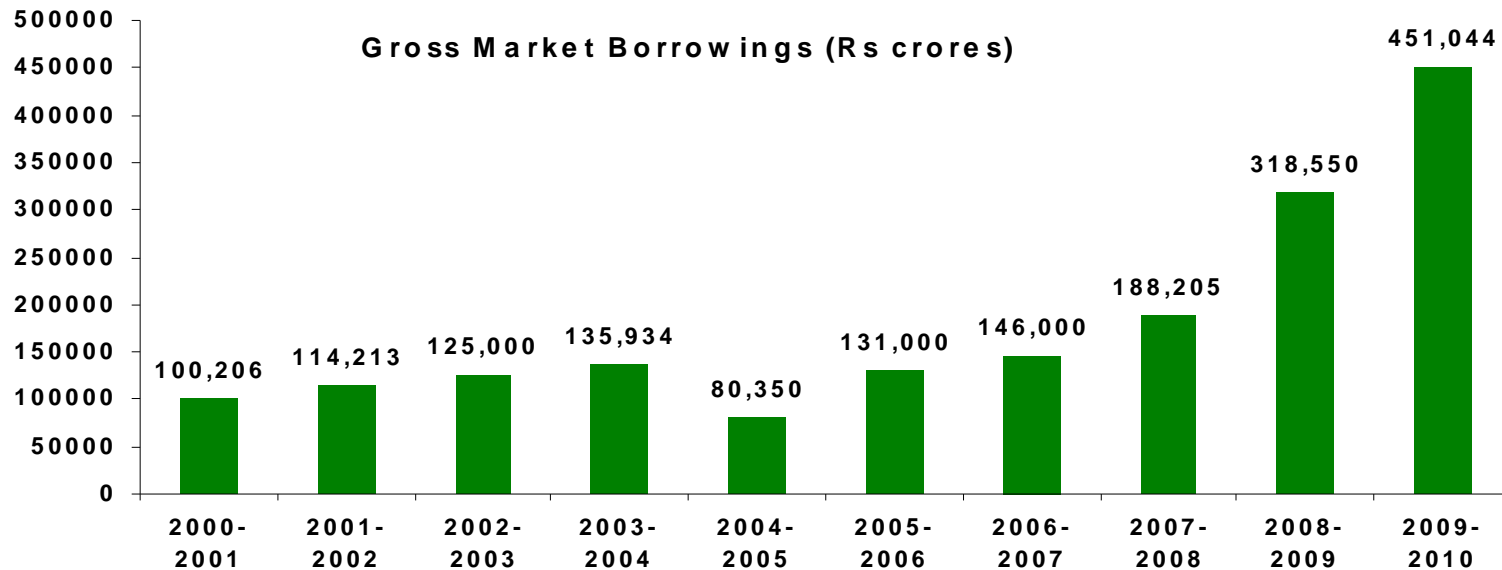
# Crude and Inflation Dynamics



Source: Bloomberg

- Crude Oil prices traded in a thin band with the NYMEX Crude Oil Barrel averaging \$78 during November.
- WPI Inflation was higher at 1.3% (yoy) in October from 0.49% in the previous month. Rising prices of food articles threaten to accelerate the level of overall inflation. Food prices were up sharply to a 17.5% (yoy) rate in the week ended Nov 21, 2009

# Government's borrowing program



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

- The market will continue to witness volatility though the RBI is to ensure “non-disruptive” borrowing program
- OMO to be used only in case there is substantial hindrance in the auction process

# Religare MF: Fixed Income Outlook and Opportunities

# Fixed Income Market Outlook

- Global economic data continues to surprise positively
- Risk trades continue to be in favor leading to increase in global stocks and commodities
- Inflationary pressures likely to build in the coming months taking into account – a) pressure from global commodity price rise b) faltering monsoon situation and c) dwindling base effect of past year
- Liquidity conditions are likely to remain comfortable on a) RBI maintaining status quo on policy rates in calendar 09 b) weak credit pick up as corporates going slow on CAPEX plans and c) RBI dollar intervention on FII/FDI inflows
- With the 2<sup>nd</sup> half borrowing program being front loaded and RBI hinting at withdrawal of OMO program, all eyes would be on the monetary and credit policy review later in October. The market is likely to remain range bound in the meantime.
- In the medium term, macro conditions are likely to lead RBI to hike interest rates. We believe RBI may deliver a rate hike in the first quarter of calendar 2010

# Ideas for investors

- Risk-averse investors should continue to look at the short end of the yield curve
- Yields have moved up sharply post the 2Q GDP data release and at this point look attractive. We would suggest investment in long duration products to investors who have a commensurate risk-return profile.
- 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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