MIRAE ASSET

Building on principles

Debt Market Outlook - 2015

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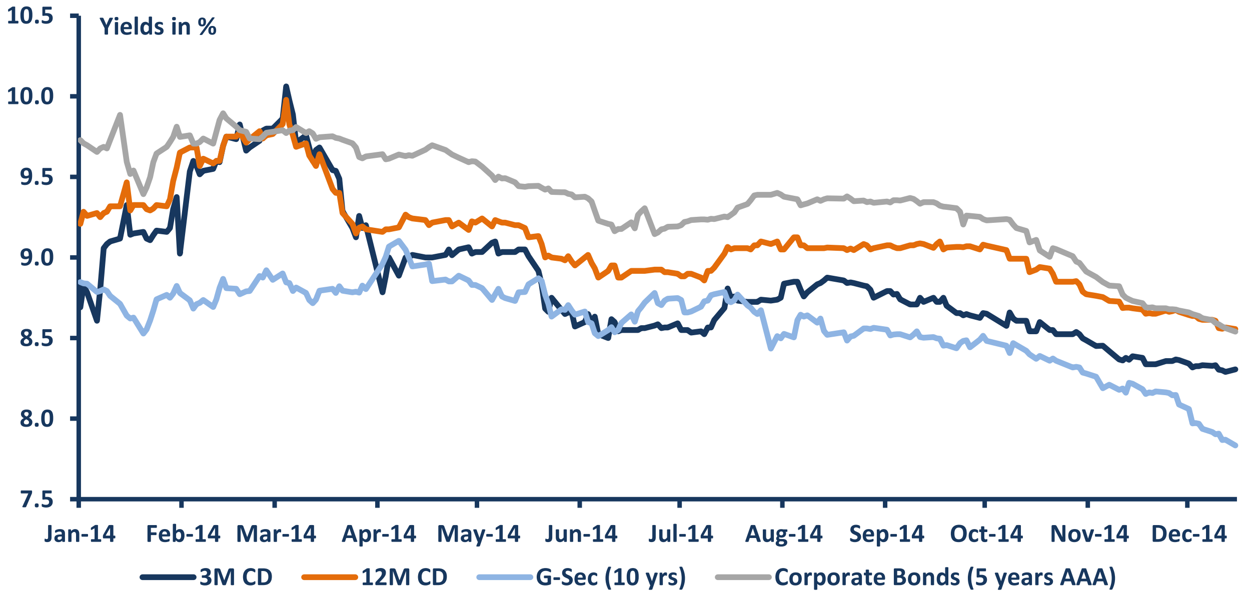
DEBT MARKET PERFORMANCE IN 2014

The Indian bond market saw a sharp rally in H2 of CY'14, inspite of absence of rate cuts. The bond market rallied due to the following factors.

- Sharp fall in crude oil prices which will help reduce Current Account Deficit (CAD)
- Sharp moderation in Inflation (both WPI and CPI) lower than market consensus.
- Strong FII demand for Indian G-Sec and Corporate Bonds.

Also the above factors along with RBI Commentary (mentioned below) are hinting at lower rates in 2015.

Fixed Income - Rates	15-Dec-14	31-Dec-13
Call Money	8.00	8.75
3 month CD	8.31	8.68
3 month CP	8.48	8.96
1 year CD	8.56	9.29
1 year CP	8.89	9.83
G-Sec (10 yrs)	7.83	8.83
Corporate Bond (5 year – AAA)	8.54	9.10



Source: Bloomberg, 15th December, 2014

RBI Policy Actions in 2014.

Policy Date	Policy Action	Development and Regulatory Measures	Policy Stance and Future Guidance
Apr-14	Repo: 8% Rev Repo: 7% MSF Rate: 9% CRR: 4% SLR: 23%	Liquidity management shifted from overnight to term repos with borrowing limit raised from 0.5% to 0.75% of NDTL.	The Reserve Bank's policy stance will be firmly focused on keeping the economy on a disinflationary glide path that is intended to hit 8% CPI inflation by Jan-15 and 6% by Jan-16. Further policy tightening in the near term is not anticipated at this juncture.
Jun-14	Repo: 8% Rev Repo: 7% MSF Rate: 9% CRR: 4% SLR: 22.5%	Provision of funding from ECR window reduced from 50% to 32% with commensurate hike on the term-repo window.	If the economy stays on course, further policy tightening will not be warranted. On the other hand, if disinflation, adjusting for base effects, is faster than currently anticipated, it will provide headroom for an easing of the policy stance.
Aug-14	Repo: 8% Rev Repo: 7% MSF Rate: 9% CRR: 4% SLR: 22%	HTM SLR limit lowered by 50 bps to 24%, but the overall HTM limit unchanged at 25%.	The upside risks to the target of ensuring CPI inflation at or below 8 per cent by Jan-15 remain, although overall risks are more balanced than in June policy. It is, therefore, appropriate to continue maintaining a vigilant monetary policy stance.
Sept -14	Repo: 8% Rev Repo: 7% MSF Rate: 9% CRR: 4% SLR: 22%	Roadmap for calibrated reduction in HTM SLR limit from the current 24% to 22%. Banks allowed including G- Sec held by them up to 7% of their NDTL within the mandatory SLR requirement vs. 2% earlier as Level 1 HQLA to help meet the LCR requirement. Cut in ECR limit from 32% of eligible export credit outstanding to 15%.	The balance of risks (to 6% target) is still to the upside, though somewhat lower than in the last policy statement. This continues to warrant policy preparedness to contain pressures if the risks materialize. Future policy stance will be influenced by the RBI's projections of inflation relative to the medium term objective, while being contingent on incoming data.
Dec-14	**Repo: 8% Rev Repo: 7% MSF Rate: 9% CRR: 4% SLR: 22%**		**The risks to the Jan-16 target of 6% appear evenly balanced under the current policy stance. If the current inflation momentum and changes in inflationary expectations continue and fiscal developments are encouraging, a change in the monetary policy stance is likely early next year, including outside the policy review cycle.**

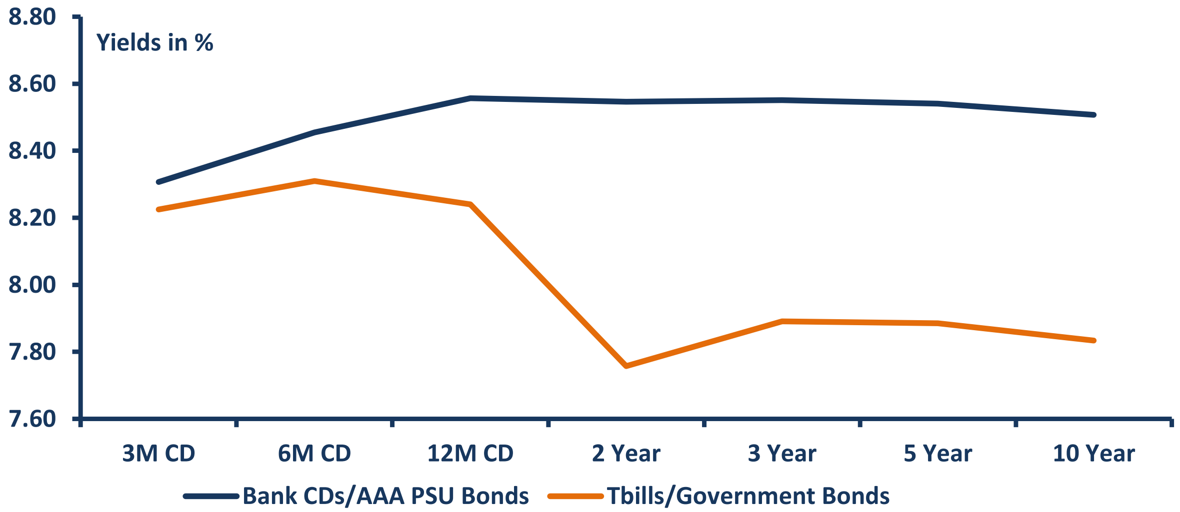
DEBT MARKET OUTLOOK FOR 2015

There are various factors which cast positive outlook Indian debt markets from softening commodity prices, stable exchange rate, credible fiscal consolidation plan and moderation in rural wage growth.

Evolving inflation dynamics calls for rate cuts RBI and the same may continue to get transmitted into debt markets along with improving liquidity conditions. As indicated in December policy we expect RBI to cut rates in next calendar year. At the same time, we continue to expect the Modi government to focus much more on supply-side measures to combat inflation.

In the near term we may see short term rates remaining range bound with downward bias as liquidity situation is structurally positive. Long term bond yields will trend downwards in reaction to rate action from RBI and taking cues from upcoming macro data prints. **We are more positive on the longer end of the Yield Curve.** In reaction to structurally positive liquidity situation short term rates are aligned near Repo rate.

Looking at current lower international commodity prices and improving domestic inflation expectations we expect 50 bps rate cut in 2015. We feel global developments due to sharp fall in Oil, movement of Rupee and persistence of FII interest in India can proved to be key risks to this view.

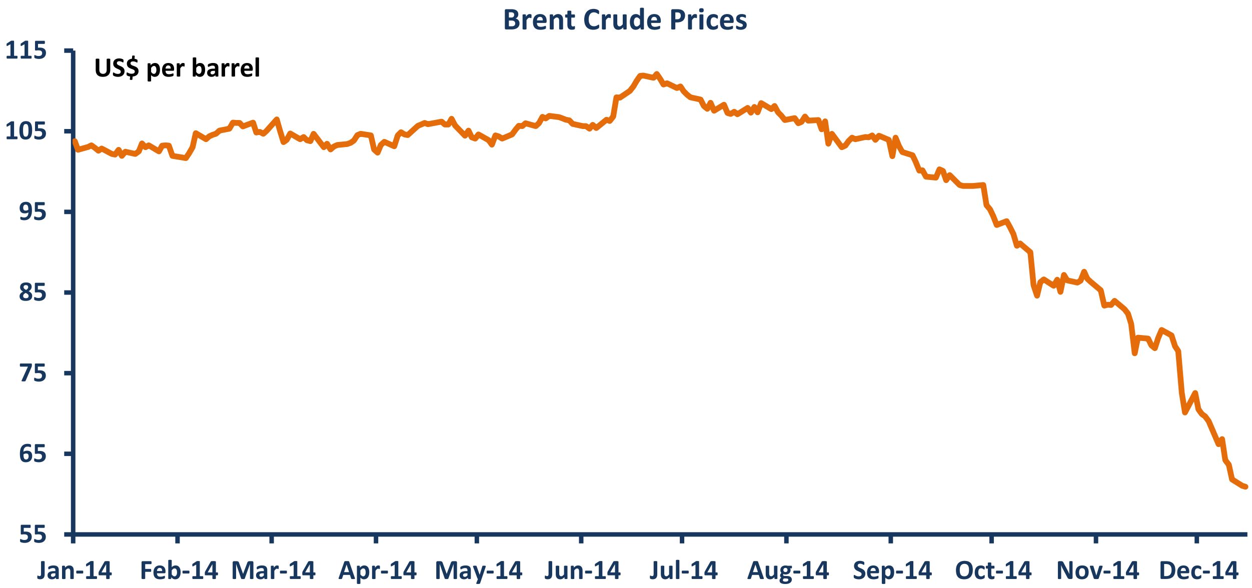


Source: Bloomberg, 15th December, 2014

- Government Bond Yield curve has become inverted sighting lower rate in near future.
- Corporate Bond spreads are very low at the shorter end of the curve due to comfortable liquidity conditions. The yield curve is flat.

FACTORS THAT WILL DRIVE DEBT MARKET IN 2015

1. Lower Crude Prices



Source: Bloomberg, 15th December, 2014

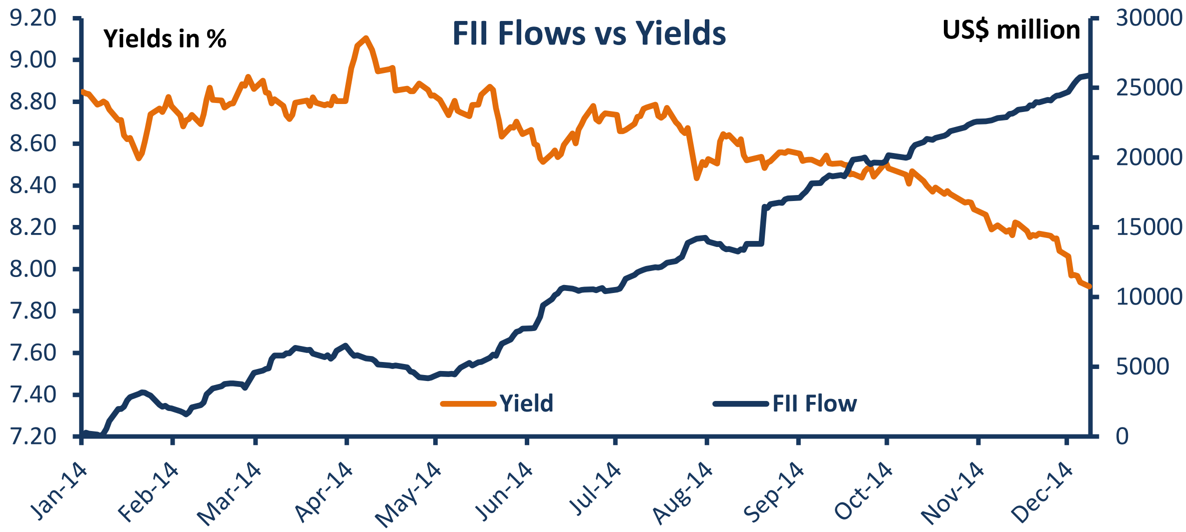
Oil prices have corrected significantly from their recent peak (Oil is down more than 40%), which is hugely positive for India as highlighted below.

- Every USD 10/bbl. fall in crude oil price improves India's Current Account Deficit by around USD 9 billion or 0.5% of GDP.
- Every USD 10/bbl. fall in oil price can boost GDP growth by around 10 bps and reduce fiscal deficit by 0.10 %
- USD 10/bbl. fall in crude oil prices lowers CPI inflation by 20 bps and WPI Inflation by 50 bps

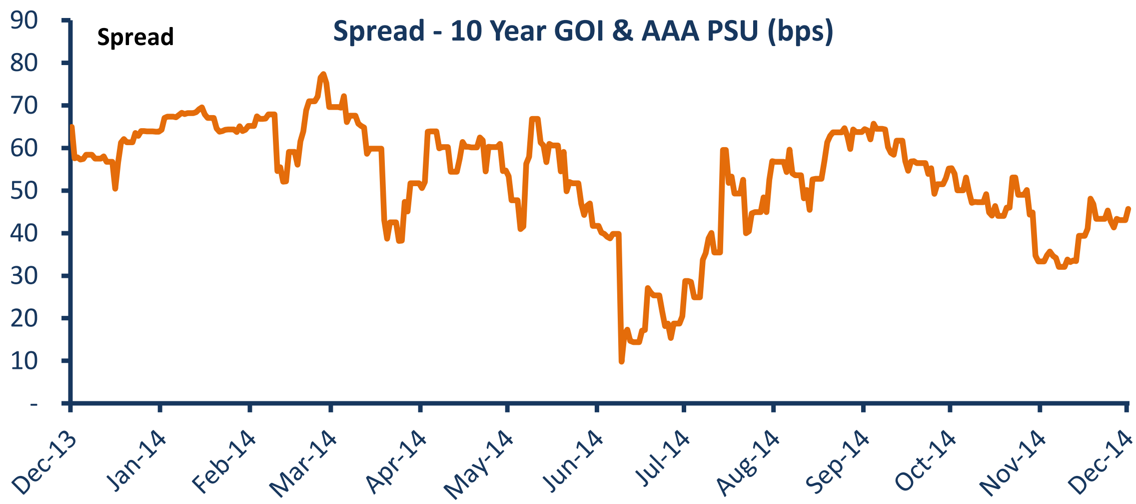
Source: Asia Economic Outlook, Nomura, 24th November, 2014

2. FII Flows can they continue in 2015:

A small recap of 2014 first. FII flows into Indian Debt instruments crossed 24 billion USD (YTD in 2014). FII limits for Government securities are almost full. Corporate bonds are attracting a lot of FII attention which has brought down the credit spread to 45 bps in Dec'14 from ~120 bps seen in Sept'13. The demand for Indian Bonds has helped pushed the yields lower.

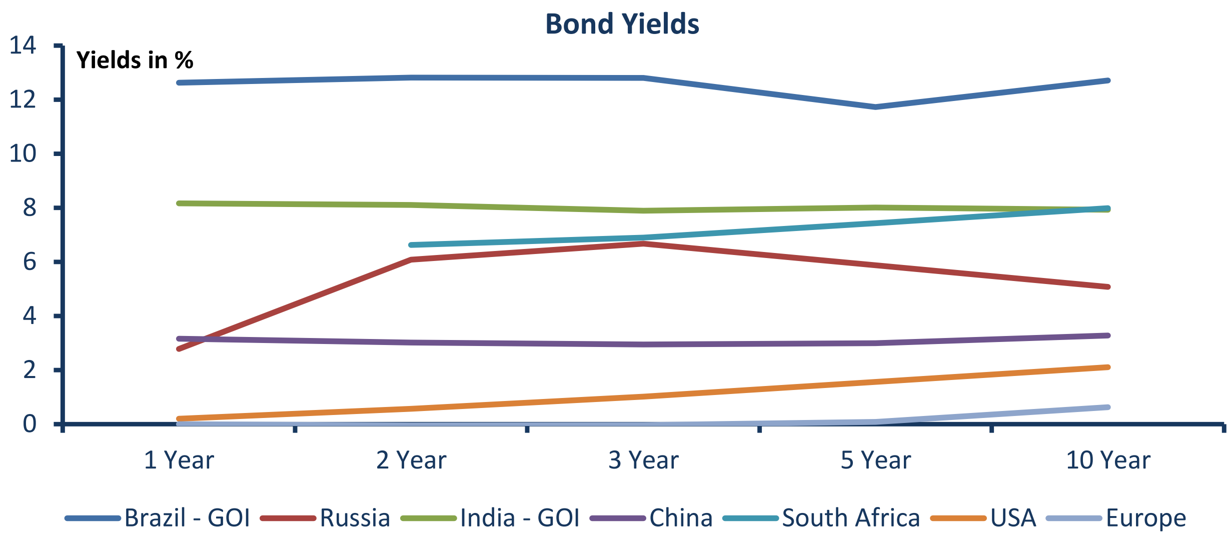


Source: Bloomberg, 15th December, 2014



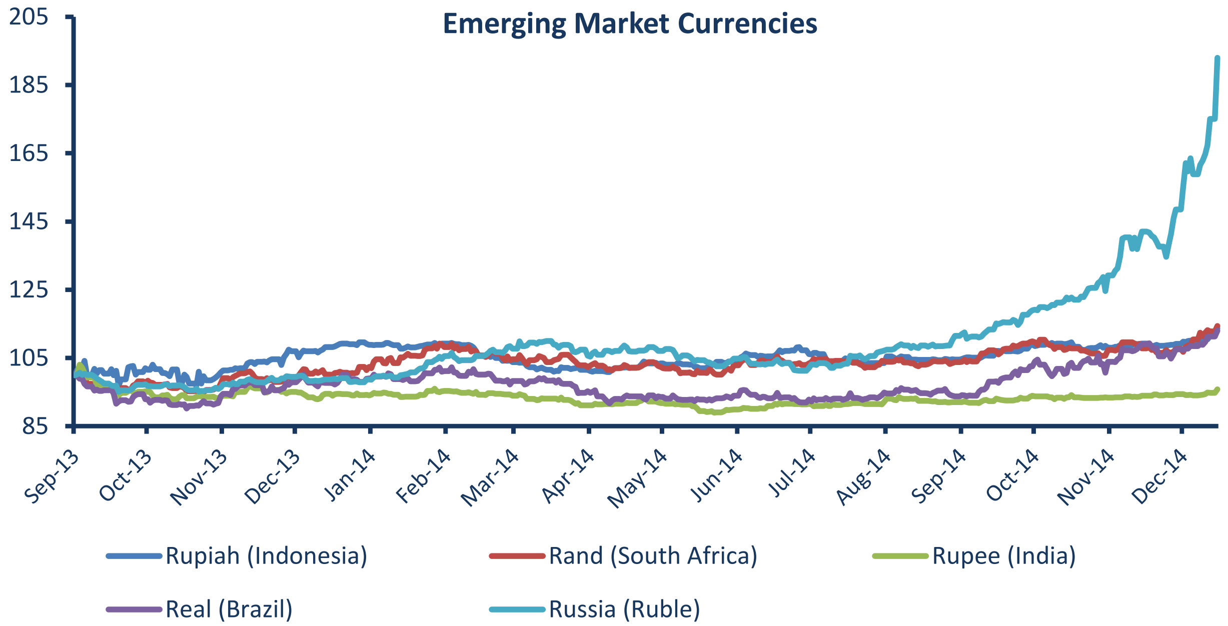
Source: Bloomberg, 15th December, 2014

Attractive Yields and Stable Currency – makes India attractively placed:



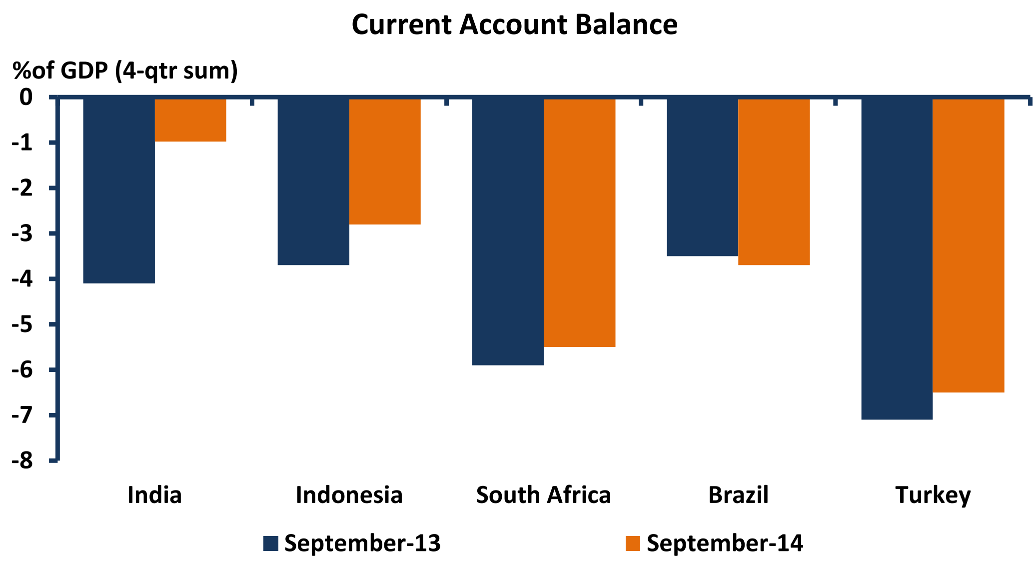
Source: Bloomberg, 15th December, 2014

Indian Bond yields are very attractive compared to Global yields especially considering that the Indian INR is the most stable currency among these emerging markets. This is due to improving current and fiscal deficit (boosted by sharp correction on crude oil prices).



Source: Bloomberg, 15th December, 2014

CAD – India best placed:

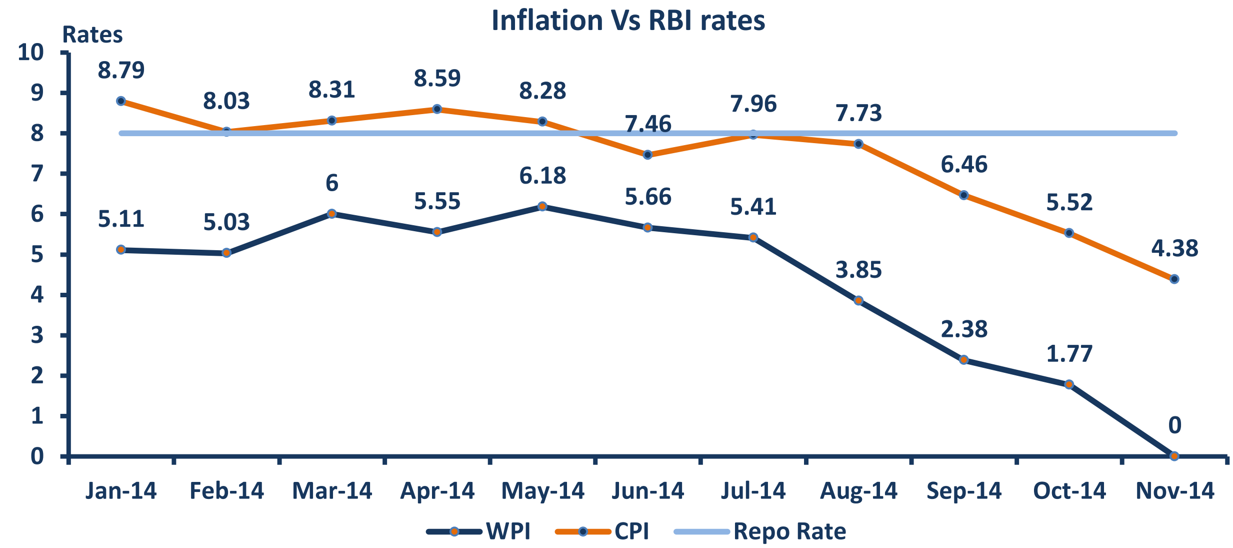


Source: Nomura, Asia Research, November 2014

In FY14 when oil was at $108/bbl, India reported CAD of $ 32.4 billion with the help of restricting gold import to the tune of 350MT (assuming on the higher side). Taking gold at $1200/oz, the actual reported CAD would have been $ 46.4 billion. In FY16, if we take average crude oil price at $80/bbl, the petroleum, crude and other products import would be $76 billion against worth $102 billion in FY14. It will results in savings of $ 26 billion. So CAD in FY16E would only be $ 20 billion, which can be easily funded by capital flows

3. Inflation and RBI monetary policy expectations going forward:

- India's WPI Inflation is at a 5 year low of 0%.
- India's CPI Inflation (the number keenly monitored by RBI) came at 4.38%, which is at lowest level since the new series of Consumer Price Index was released in January 2012.



Source: Bloomberg, 30th November, 2014

- We expect inflation trend lower because of lower global commodity prices, lower minimum support prices and other supply side measures taken by RBI.

Variables affecting inflation in 2015	
Crude oil prices	Recent fall in crude oil prices should ↓ CPI inflation by 60-80 bps.
Minimum Support Prices	Fall in MSP increases from 22% to 5% should help lower CPI inflation by around 2pp over the two year period.
Supply side measures by govt	Measures to boost supply of fresh food can have considerable impact on CPI inflation in the near term
Other commodity prices	Marginal direct impact. Limited second round impact on lower input cost for manufactured goods

In the December credit policy review, RBI kept the repo and reverse repo rates on hold at 8% and 7% respectively in line with consensus expectations. The RBI has maintained its estimate for real GDP growth in 2014-15 at 5.5% and expects only a gradual pick-up in growth momentum in 2015-16. RBI has acknowledged the recent deceleration in inflation and has revised downwards its March 2015 CPI Inflation projection to 6% from 8% and its January 2016 inflation projection has also been kept at 6%. RBI now sees the medium term risks around its January 2016 target of 6% as evenly balanced rather than to the upside as in the last policy meeting.

RBI`s policy guidance removes uncertainties, despite the decision to keep rates on hold, Governor Rajan has laid the foundations for future rate cuts. Looking at current lower international commodity prices and improving domestic inflation expectations we expect 50 bps rate cut in 2015. We feel global developments due to sharp fall in Oil, movement of Rupee and persistence of FII interest in India can proved to be key risks to this view.

FUND INVESTMENT STRATEGY

- In the current market conditions we will maintain high credit quality portfolios across the board sighting lower credit spreads. (no adequate rewards for higher credit risks)
- We are more positive on long duration government securities, which can provide opportunities for capital gains.
- Our investment philosophy for fixed income investments follows from the objective to deliver optimal risk-adjusted returns across our products.
- The investment strategy of individual funds follows from the investment philosophy enunciated above and is fine tuned to suit the respective investment objectives of the funds.

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The data mentioned are as on 15th December, 2014.

Mutual fund investments are subject to market risks, read all scheme related documents carefully