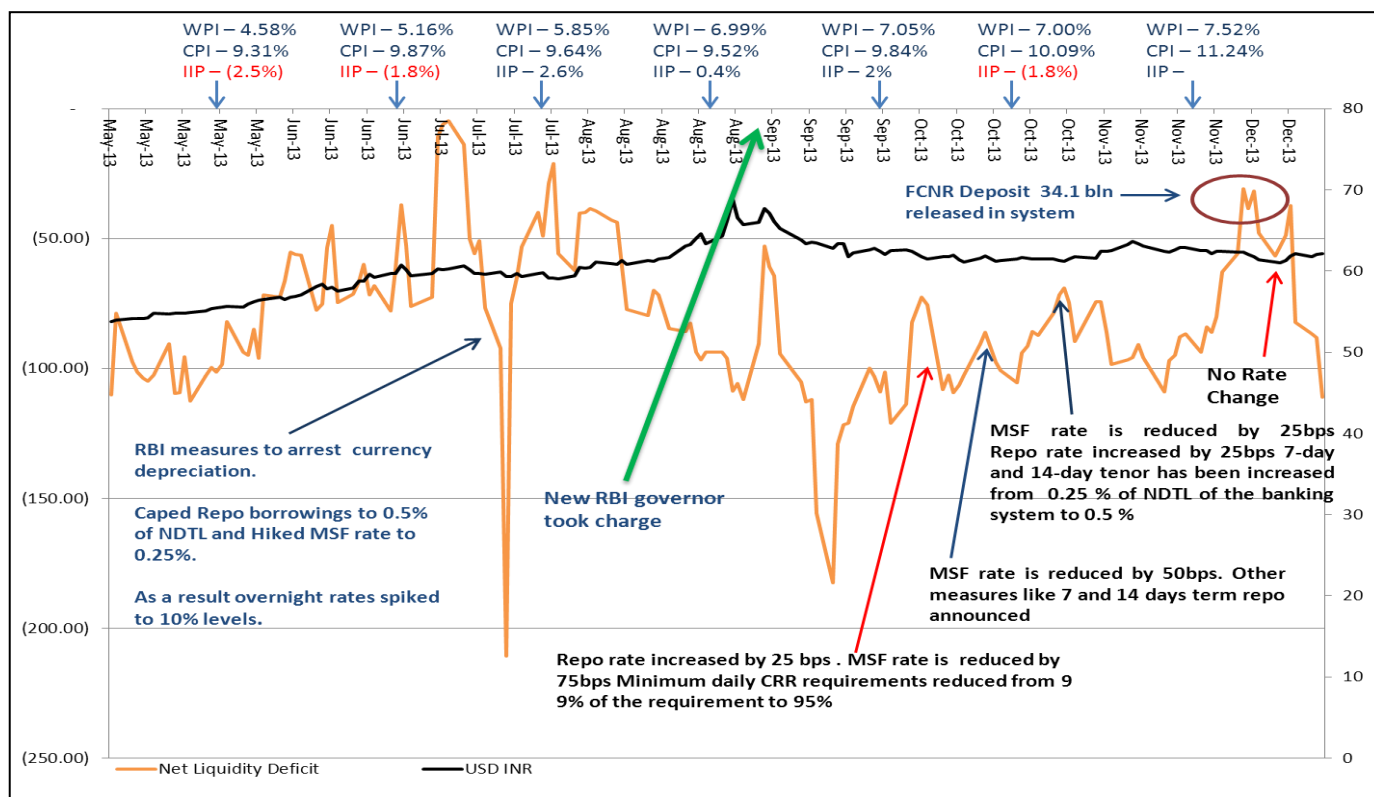




## Debt Market Performance in 2013

### Highlights of measures taken from RBI



Source: Bloomberg, 24<sup>th</sup> December 2013

### Pressure on Rupee has pushed yields higher....

From May-August 2013 the rupee had depreciated sharply against the US dollar, by 22%. The RBI has taken a number of measures to contain the sharp fall as highlighted above. These steps have been primarily focused on tightening liquidity to curb currency speculation and to increase short-term rates.

In response, the short-term yields have shot up by more than 65 bps while long-term yields have also gone up (10-year G-Sec yield hardening by 120 bps since mid-July). While RBI has reversed most of these measures (as highlighted above), it is difficult to see short and long-term yields falling below the levels prevailing on 15<sup>th</sup> July, 2013 when the RBI's tightening measures were unleashed.

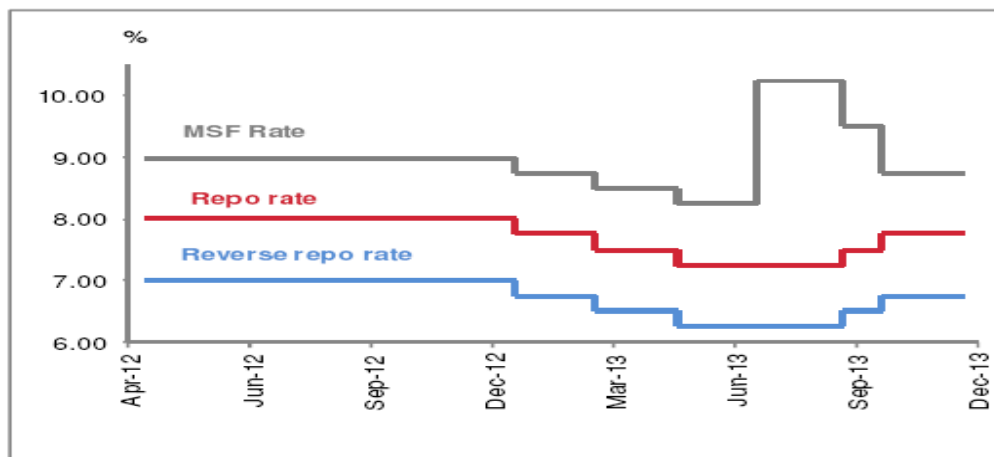
In other words, interest rate expectations had taken a U-turn in second half of 2013.

# Indian Debt Market Update & Outlook



## Inflation Expectations

After a gap of four months and three policy review meetings, in the December mid quarter review the RBI got a chance to maintain status quo. **(Policy Rates highlighted below)**

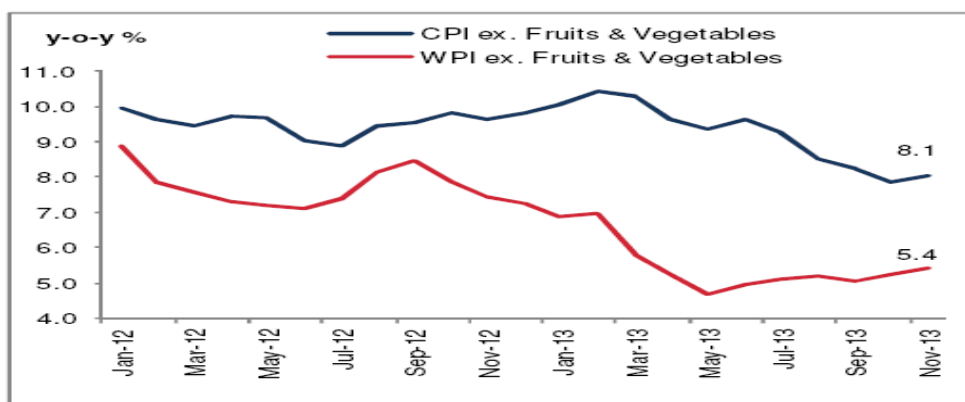


Source: RBI, Ministry of Commerce and Industry, CSO, CRISIL Research, 20<sup>th</sup> December 2013

While the expectation had clearly tilted for a rate hike after the huge unanticipated spike in both CPI and WPI inflation, the RBI judiciously opted for caution and avoided any premature reaction before it has concrete evidence of persistent inflationary pressures.

The recent spike in inflation was primarily driven by food prices, especially, vegetables. However, anecdotal evidence suggests sharp correction in prices of onion and tomato since the last week of November. This is expected to start reflecting in the inflation number from December onwards. In addition, the disinflationary impact of the recent exchange rate stability along with continued slack economy activity will help keep inflation expectations rooted.

## Inflation ex. fruits and vegetables



Source: RBI, Ministry of Commerce and Industry, CSO, CRISIL Research, 20<sup>th</sup> December 2013

# Indian Debt Market Update & Outlook

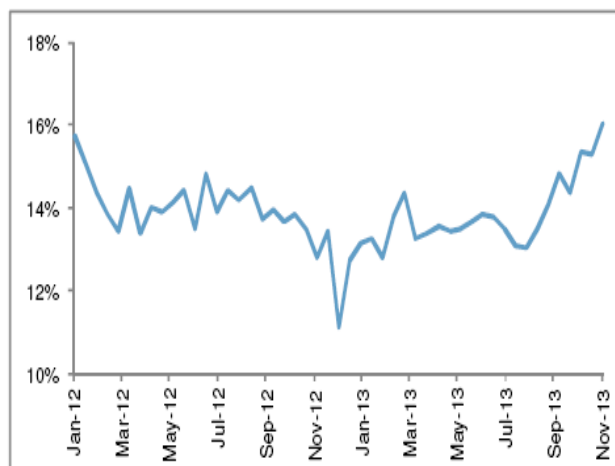


## Bank are expected to demand lesser deposits

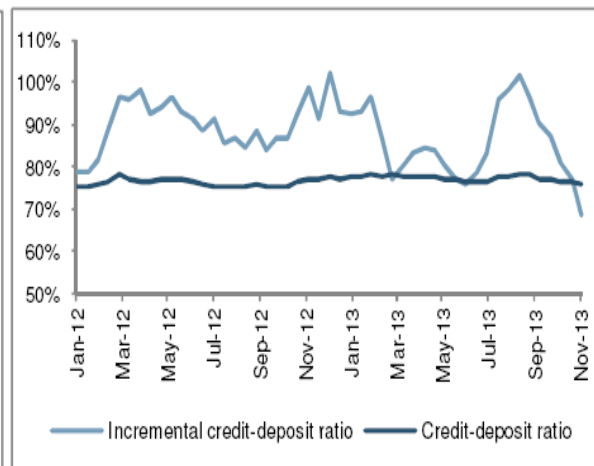
Dr. Raghuram Rajan took over as the new Governor of RBI on September 4, 2013, and announced a series of measures, which were generally well received by the markets. Among the measures, the announcement of a swap window for Foreign Currency Non-Repatriable (FCNR) (B) deposits and hike in banks' overseas borrowing (from 50% to 100% of Tier 1 capital) has resulted in significant dollar inflows into the country and helped in stabilizing the INR. Large capital inflows (US\$ 34bn through FCNR (B) deposits) have improved liquidity conditions and may reduce pressure on the banks to raise up deposit base.

- Growth in bank deposits accelerated to 16.1 per cent y-o-y, as of November 29, 2013, from 13.5 per cent as of end-March 2013 due to strong FCNR (B) flows.
- Credit growth in the banking sector, which grew by 17-18 per cent (y-o-y) during August – October 2013, moderated significantly in November 2013. With rates easing on the back of a cut in the Marginal Standing Facility (MSF) rate, commercial paper (CP) and certificate of deposits (CD) rates have also softened, pushing demand for short-term funds back into the money market from banks.

Deposit Growth, Y-o-Y



Trend in CD Ratio



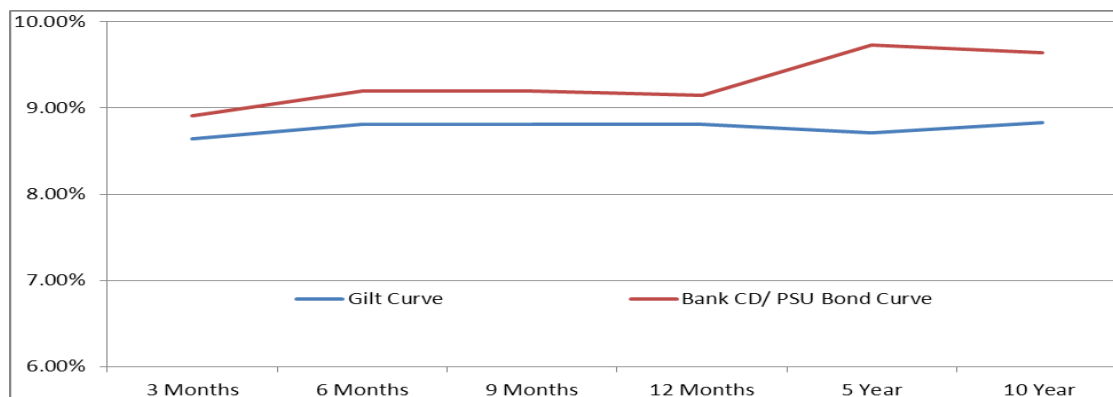
Source: RBI, CRISIL Research, 20<sup>th</sup> December 2013

# Indian Debt Market Update & Outlook



## Yield Curve has moved up and is decisively flattish

As RBI has reversed Rupee stabilization measures and overall outlook of rate is looking stable, in the near term shorter end of the yield curve should trend lower thus normalizing the flat shape of the curve.



Source: Bloomberg as on 24th December-2013

## Debt Market Rates

Fixed Income - Rates	23-Dec-13	31-Dec-12	Absolute Change
Call Money	8.66	9.00	0.34
3 month CD	8.60	8.49	-0.11
3 month CP	9.02	9.00	-0.02
1 year CD	9.08	8.82	-0.26
1 Year CP	9.84	9.45	-0.39
Corporate Bonds (5 years AAA)	9.71	9.10	-0.61
G-Sec (5 years)	8.77	8.03	-0.74
G-Sec (10 years)	8.82	8.05	-0.77

Source: Bloomberg as on 24th December-2013

# Indian Debt Market Update & Outlook



## Debt Market Outlook for 2014

Taking note of growth-inflation dynamics we would assign low probability of RBI increasing repo rate further in its upcoming policy review.

The key risks to our view is

1. Inflation risks deepen further and December WPI & CPI numbers shows sharp increase
2. Any disruption in the global markets due to change in US fed stance.

As stability returns to the currency markets, RBI is gradually shifting its focus away from tactical measures (Forex swaps, MSF-Repo corridor) to more structural measures e.g. raising financial savings rate, opening up financial sector, adjusting monetary policy framework.

In 2014 we believe, that overall rates expectations would be derived from currency prospective and RBI may focus on real interest rate enjoyment in order to protect further currency depreciation. We believe emerging growth inflation dynamics and effect of upcoming elections on the fiscal situation may dictate the direction of interest rates.

### Longer Term Rates

The longer term G-Sec may continue to be under pressure because of the high government borrowing and rising concerns on fiscal slippages. **In this view we expect 10 years G-Sec to be range bound between 8.60-8.80 in medium term till elections in May 2014.**

### Short-Term Rates

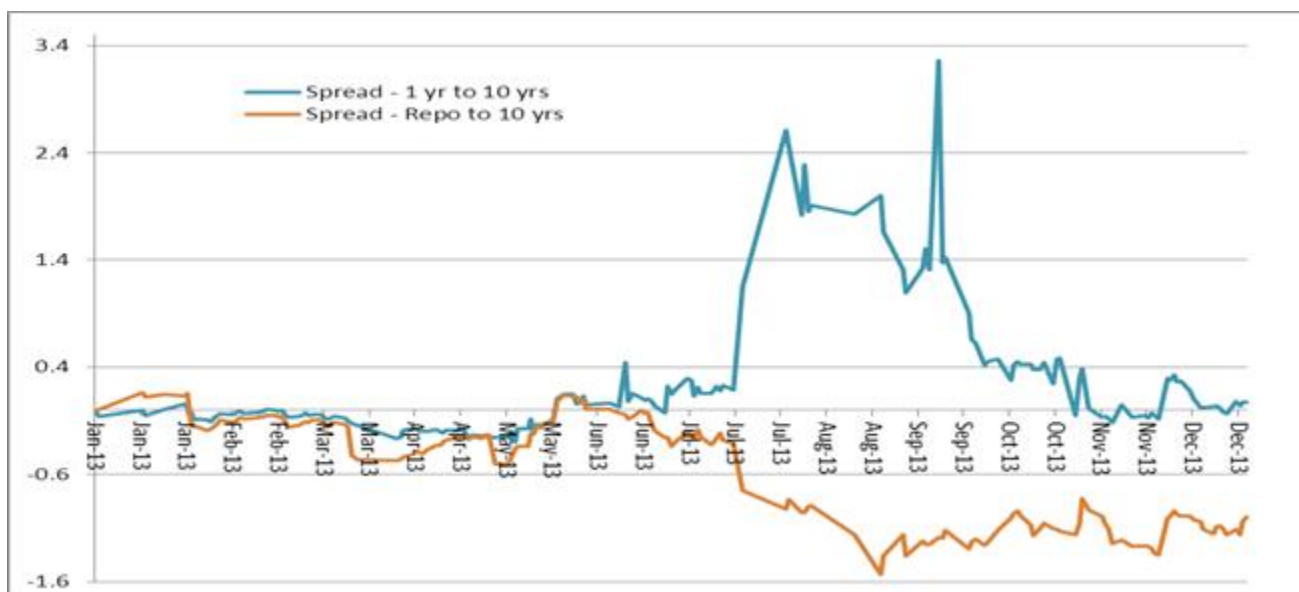
The election event may not affect short term yields in big way as RBI has clarified that cap on the repo will continue which will make the overnight rates dependent on overall liquidity conditions in the system with a upward cap of 8.75%.

# Indian Debt Market Update & Outlook



## Shorter end of the curve may outperform longer end...

Since the yield curve normalization has started as can be highlighted below, the spread between the shorter end and longer end may get reversed. In this scenario shorter end of the curve may outperform longer end.



Source: Bloomberg as on 24th December-2013

## Fund Investment Strategy

Our investment philosophy for fixed income investments follows from the objective to deliver optimal risk-adjusted returns across our products.

Local macro-economic variables such as growth indicators, inflation outlook, currency changes, liquidity, etc. are analyzed to determine the long-term and short-term trends.

In the current scenario we will maintain high credit quality portfolios across the board.

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.

# Indian Debt Market Update & Outlook



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**The data mentioned are as on 24th December, 2013.**

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