

Indian Fixed Income Market

January 2010

DSP BLACKROCK
INVESTMENT MANAGERS

Fixed Income Update

- Benchmark 10 Yr Government Bond yield moved up 7 basis points to close the month of December at 7.59% pa on concerns of high inflation and expectations of policy changes by the RBI. As of Jan 6, 2010, the Benchmark 10 Yr was at 7.64% pa.
- Money market rates have begun to factor-in the possibilities of RBI action in the near-term to contain rising inflationary expectations. 3M bank CD rates have moved up from around 3.35% pa at the beginning of the month to around 3.85% pa on December 31, 2009 and 4.2% pa on Jan 6, 2010, while the 12 month Bank CD rates moved from 5.30% pa to 5.85% pa during the same period. Advance Tax outflows had affected the level of surplus liquidity in the banking system which had dropped from around Rs. 1 lac crore to around Rs. 65,000 crore as on December 31, 2009 but have subsequently moved upto Rs. 1,06,000 crore as of Jan 6, 2010.
- Benchmark 10Y AAA PSU Bond moved from 8.55% pa in the beginning of the month to 8.64% pa at the end of the month tracking upside movement in the government securities and tightness in the money market. The Benchmark 10Y AAA PSU Bond is currently at 8.7% pa as of Jan 6, 2010.
- Surplus cash deployed with the central bank had gone down from levels of Rs. 1 lac crore to Rs. 65,000 crore as of December end due to advance tax related outflows and holiday season, but have now moved back upto Rs. 1,06,000 crore due to government expenditure and interest payments (as of Jan 6, 2010).

Macro-economic Review

- **The Index of Industrial Production (IIP)** for the month of October rose by a 10.3% y-o-y, compared to 9.6% y-o-y (revised upwards from 9.1% y-o-y) in September and 11.0% y-o-y in August. The cumulative growth for the period April-October 2009-10 stood at 7.1% over the same period last year. Growth in the electricity sector moderated to 4.75% y-o-y while growth in the mining and manufacturing sectors accelerated to 8.7% and 11.1% compared to the same period last year. As per used based classification, growth in intermediate and consumer goods was good, while that in basic and capital goods was moderate.
- **Headline inflation**, as measured by the monthly Wholesale Price Index (WPI), stood at 4.78% y-o-y for November 2009, based on higher manufactured products prices. On a month on month basis, the Index for primary articles increased by 2.6% with the food articles group rising by 3.2%, the manufacturing products index, which has a 63.75% weight, rose by 1.25% while the fuel, power, light and lubricant index showed a marginal decline.
- **Balance of Payments** surplus increased to US\$ 9.4 billion for the quarter ending September 2009 compared to a surplus of US\$ 0.1 billion in the previous quarter. The current account deficit increased significantly during the September quarter, increasing from US\$ 5.9 billion to US\$ 12.6 billion while the trade deficit widened to US\$ 32 billion during the same period from US\$ 26 billion in the previous quarter. Net invisibles declined by 25% y-o-y for the quarter ended September 2009, while the capital account balance increased sharply to US\$ 23.6 billion compared to a surplus of US\$ 6 billion in the previous quarter.
- **Exports** for the month of November increased by 18.2% to US\$13.2 billion y-o-y while **imports** declined by 2.6% to US\$ 22.9 billion y-o-y during the same month. The trade deficit for the period April-November 2009 was estimated at US\$66.2 billion which was lower than the deficit of US\$100.2 billion, for the same period last year.
- **Currency:** In December, the Indian Rupee depreciated by approximately 0.02% against the US Dollar and appreciated by 4.62% against the EURO. On a yearly basis, the Rupee has appreciated by 4.67% against the US Dollar and by 2.06% against the EURO. The USD/INR FX rate closed the month at 46.53 against 46.52 as at previous month end. The EURO/INR FX rate closed the month at 66.61 against 69.84 as at the previous month end.
- **Gold prices** were lower by 7.01% during December, to close the month at US\$ 1,097/ounce.
- **Oil prices** went up 2.7% during December to close the month at USD 79.36 per barrel.

Fixed Income Outlook

- We expect government bond yields remain range-bound with a hardening bias. Although the government is consistently denying the possibilities of extra government borrowing, the bond market appears to be slightly skeptical about the same due to shortfall in the indirect tax revenue collection to the tune of around Rs. 30,000 crore. The bond market is also a bit confused with hawkish tone from a section of economists for a monetary policy action to stem the rising food prices.
- Money market rates are likely to trend up higher in the near-term as market participants have begun to factor-in a possible hike in CRR. We expect money market rates to come off a bit in early January 2010 temporarily.
- Corporate bond yields are expected to track the movement in government bonds, and can be expected to harden in the near term. The spread between PSU Bond yields and government bond yields can be expected to widen due to tighter money market conditions.

Disclaimer:

Statutory Details: DSP BlackRock Mutual Fund was set up as a Trust and the settlors/sponsors are DSP ADIKO Holdings Pvt. Ltd. & DSP HMK Holdings Pvt. Ltd. (collectively) and BlackRock Inc. (Combined liability restricted to Rs. 1 lakh).

Trustee: DSP BlackRock Trustee Company Pvt. Ltd. Investment Manager: DSP BlackRock Investment Managers Pvt. Ltd.

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