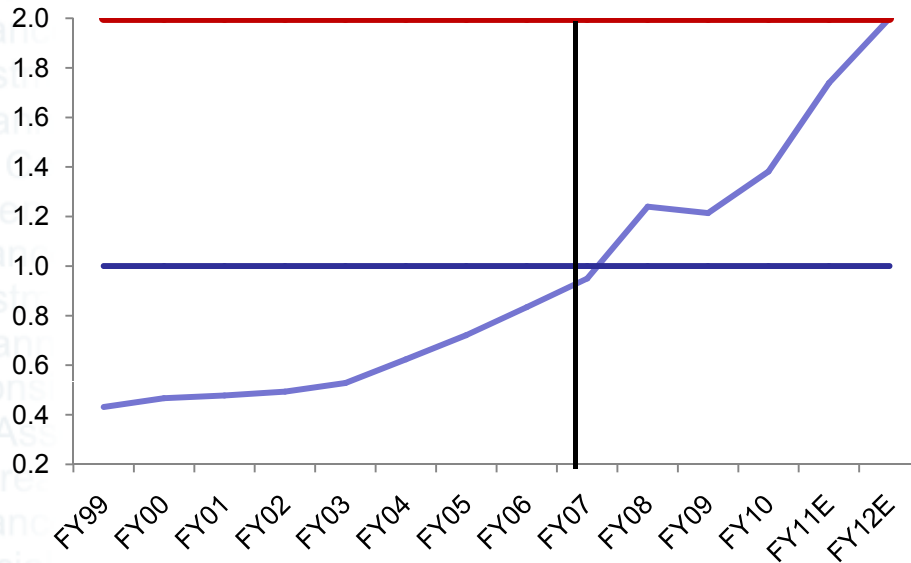




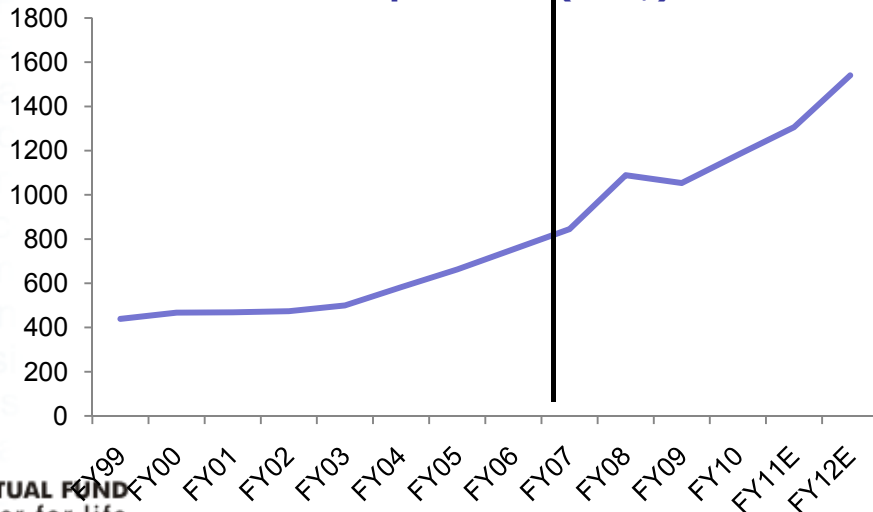
## Budget 2011 and markets...

# Yes, India would be a \$ 2 trillion economy in FY 12

**India Nominal GDP (US \$ trn. )**



**Per Capita GDP (US \$)**



**From \$ 500 billion to \$ 2 billion in a decade**

**Growth propelled by:**

**Capital formation**

**Resilience in consumption**

**Fiscal consolidation**

**Increase in savings rate**

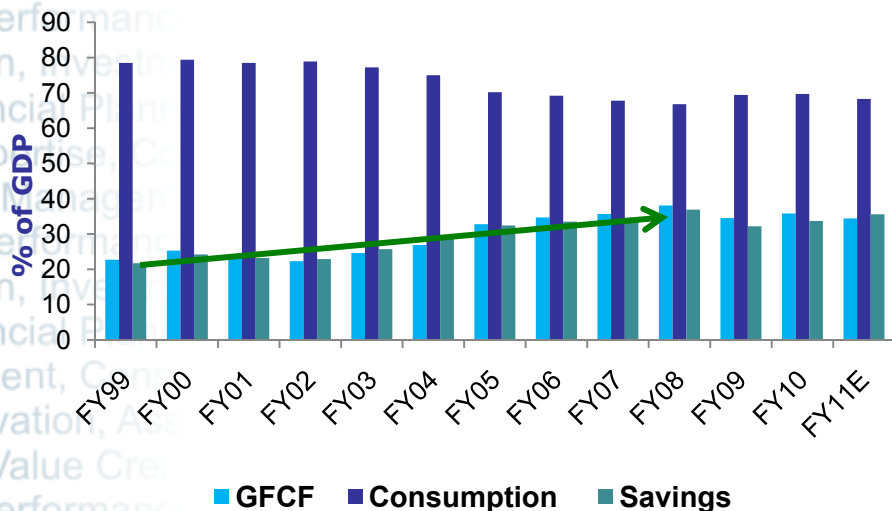
**Policy and technological changes: Telecom revolution**

**Global tailwinds**

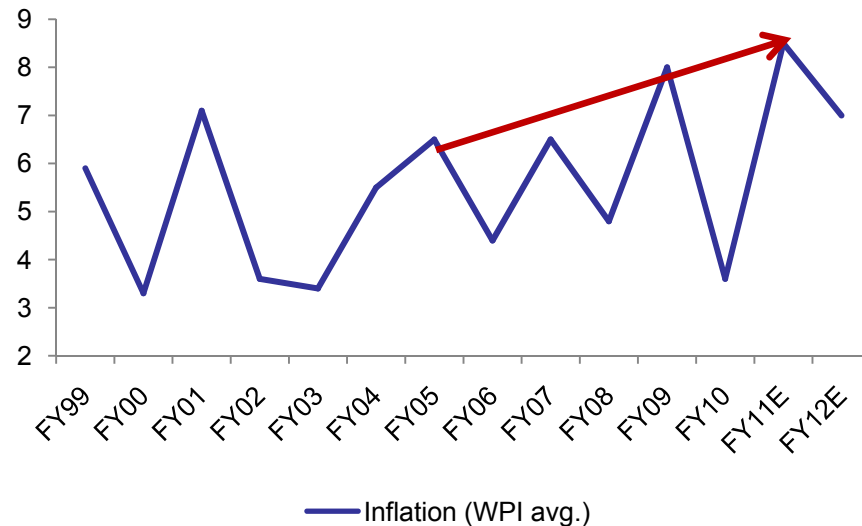


# Macro challenges currently....

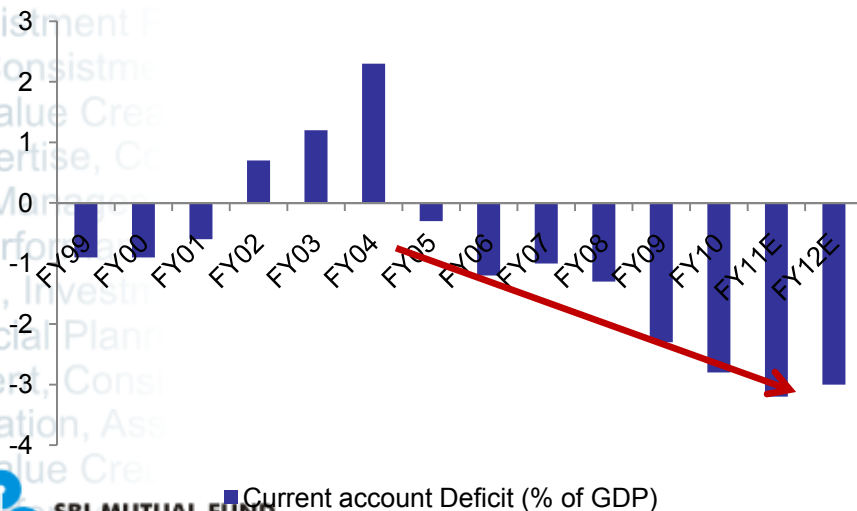
## Investment growth slowing down



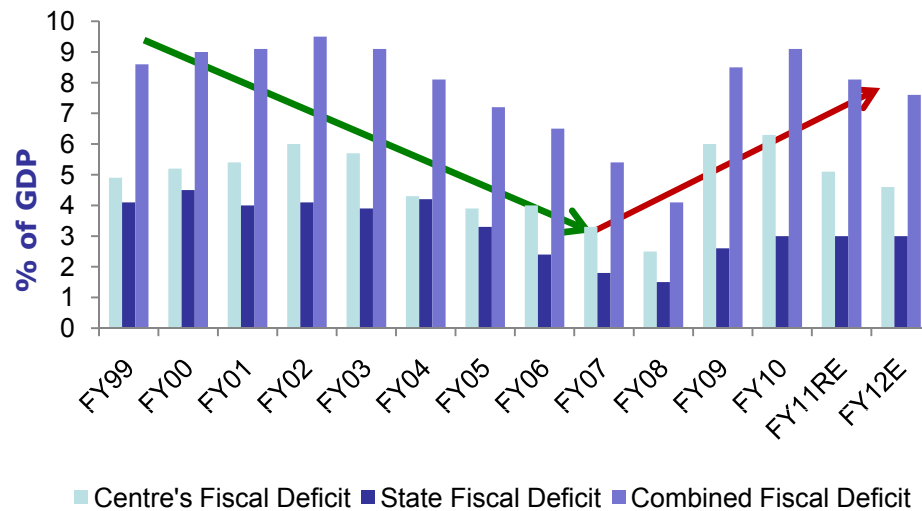
## Inflation on a higher trajectory



## Current account Balance



## Fiscal situation



# Union Budget: Macro economic backdrop

- **Economy showed huge resilience during the global downturn due to structural factors and policy stimulus. Though India largely a domestic driven economy but capital market linkages with rest of world are strong, impact real economy as well**
- **High savings rate, strong financial sector, Household gearing too low**
- **Corporate sector: manageable gearing, On track for robust earnings growth**
- **Consumption story intact but slowdown in investment cycle**
- **Inflation: Not merely a cyclical issue, needs structural reforms**
- **Pressure on Current account, funding pattern worrisome, but no cause to panic as comfortable Forex reserves**
- **RBI on path towards policy normalization. Inflationary pressures due to supply constraints and structural rigidities, increasing complexity for monetary policy management**
- **Political gridlock, serious governance deficit, upcoming state elections will add to uncertainties. Pace of reforms and execution has been slow**
- **Better than expected cyclical recovery in developed world, but recent events in MENA are cause of concern. Globally, withdrawal of policy stimulus and sovereign balance sheet issues could increase risk averseness and volatility in economic variables as well as asset**

# Heat in MENA, crude oil boils: The biggest risk for India

## Egypt –Tunisia Mayhem



## Sharp Upswing in Crude on the back of crisis in MENA region



### •Fiscal Risk

•Oil above US\$ 100/bbl resulting in higher under recoveries will hit the Fisc

### •Inflation risk

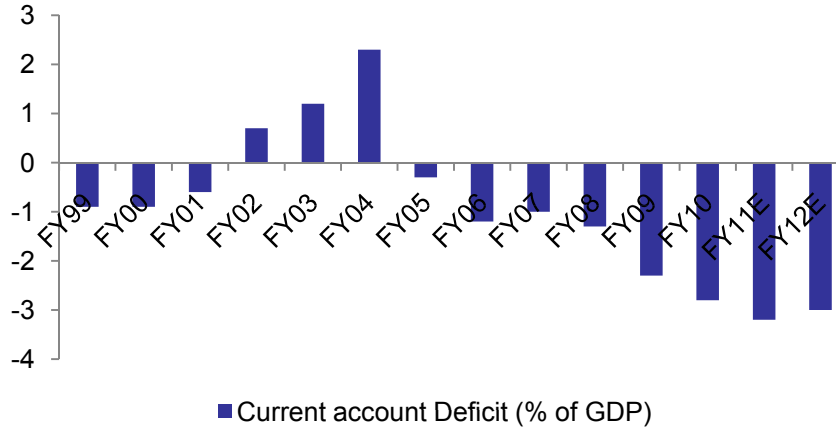
•Higher oil prices to result in rise in market determined fuel prices including Petrol, ATF etc, to add further inflationary pressures

### •BoP Risk

•Higher oil prices to result in higher Import bill  
•lower remittances from Indian workers in Middle East

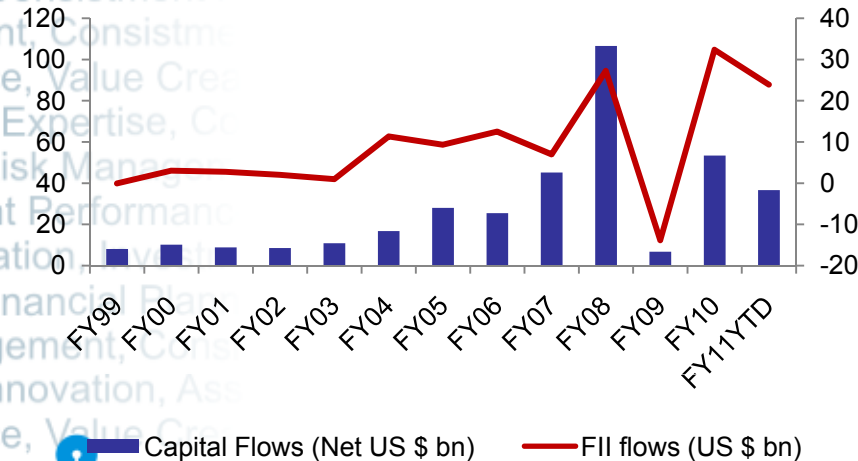
# Current account deficit: funding pattern makes us vulnerable to shift in global risk appetite

Current account balance continue to deteriorate

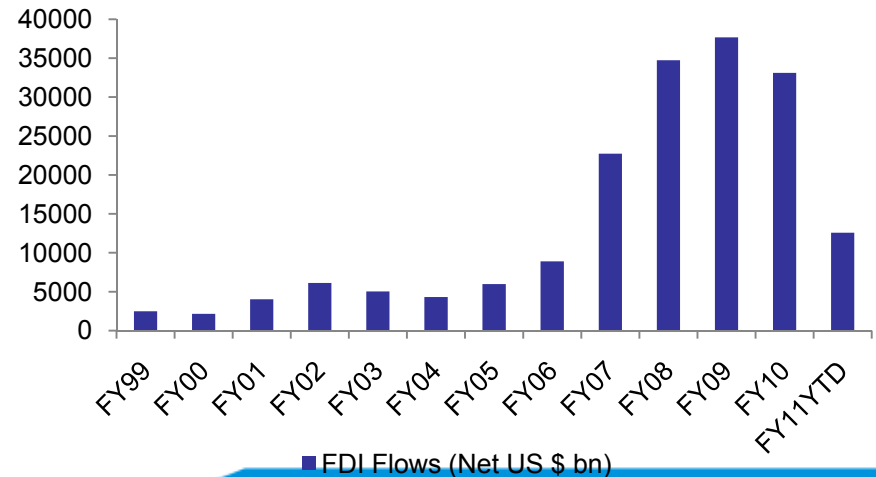


Deficit Financing composition poses further risk

Volatile FII flows; portfolio flows funding much higher proportion of deficit



FDI flows on the other hand witnessing a slowdown on the back of land acquisition/environment issues and slow progress on regulatory front



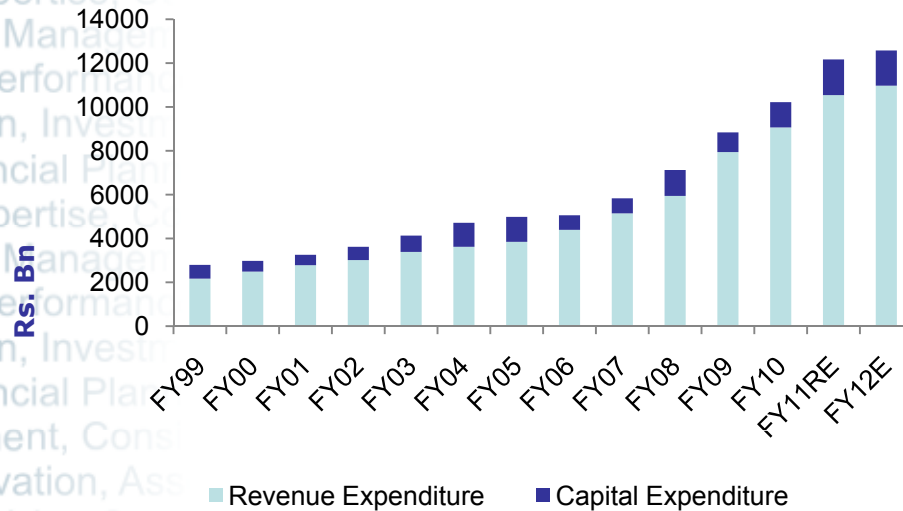
# Budget deficit: The devil is in detail

**FY 2010-11 (revised) fiscal deficit at 5.1% of GDP: Lower than expected on revenue buoyancy and one off bonanza on account of 3G auction receipts.**

**FY 2011-12 deficit target of 4.6% and net borrowing of Rs. 3.58 lakh crores (including T-bills of Rs. 15,000 crores) look difficult to achieve. Subsidies are seriously under-estimated. Revenue growth targets look achievable but expenditure containment would be challenging.**

**With enactment of food security act and given the political compulsions, achieving deficit targets of 4.1% in FY 12-13 and 3.5% in FY 13-14 would be challenging.**

# Quality of deficit deteriorates...

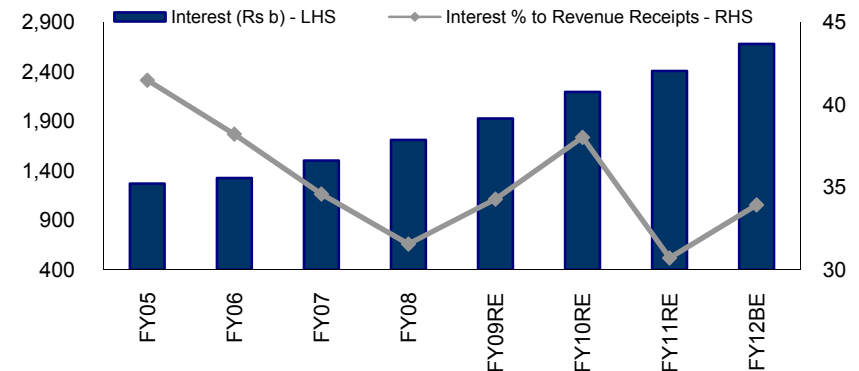
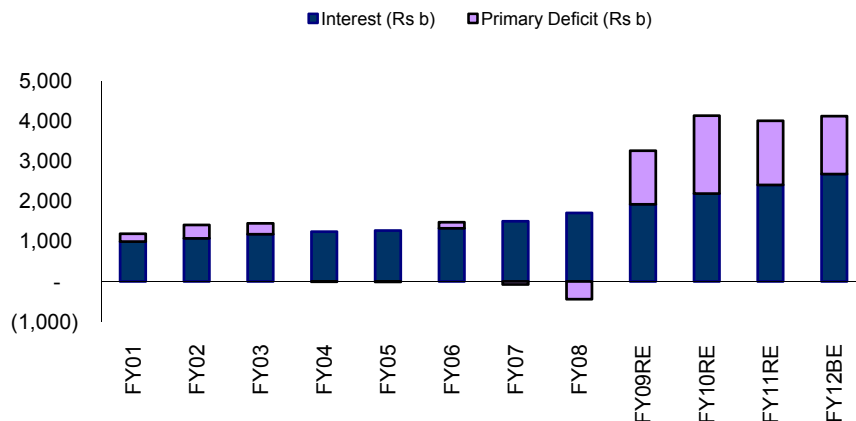


- Total expenditure that rose at a CAGR of 11% from FY00-05, increased from 19% from FY06-10

- 65% of expenditure remain sticky due to interest payments, defence subsidies and wages including the big ticket item of NREGA

- Expected increase in capital expenditure will add further pressure on Fisc

**Interest cost continue to rise as a proportion of overall fiscal deficit and remain at over 30% of total revenue receipts and 20% of revenue expenditure**



# Fiscal consolidation: Need to tackle issue of subsidies

Rs. Bn	FY05	FY06	FY07	FY08	FY09	FY10	FY11RE	FY12BE
Food	258	231	240	313	438	560	606	606
Fertilizer	159	185	262	325	766	530	550	500
Fuel	30	27	27	28	29	150	384	236
<b>Total Subsidies</b>	<b>460</b>	<b>475</b>	<b>571</b>	<b>709</b>	<b>1297</b>	<b>1310</b>	<b>1642</b>	<b>1436</b>
% yoy	3.7	3.30%	20.20%	24.20%	82.90%	1.00%	25.34%	-12.55%
% total expenditure	9.2	9.4	9.8	10	14.7	12.8	13.5	11.4
% GDP	1.4	1.3	1.3	1.4	2.3	2	2.08	1.6
Off balance items (% of GDP)								
Fuel		0.5	0.6	0.4	1.4	0.2		
Fertilizer				0.2	0.4			

• **Subsidies on account of food, fertilizers and Fuel at 2% of GDP**

• **Subsidy bill likely to overshoot on the back of higher global prices for crude oil, urea and food.**

• **Food subsidy bill could go up in case of implementation of National food security bill**

# Fuel Price Inflation: Serious political will needed

Crude prices continue to inch up on the back of crisis in MENA region



Fuel Index-WPI (% wt)	Wts
<b>Coal</b>	<b>2.1</b>
<b>Mineral Oils</b>	<b>9.4</b>
<i>of which: Controlled Fuels</i>	
LPG	0.9
Kerosene	0.7
High Speed Diesel Oil	4.7
<i>Market Determined Fuels</i>	
Petrol	1.1
Light Diesel Oil	0.1
Aviation Turbine Fuel	0.3
Naphtha	0.8
Bitumen	0.2
Furnace Oil	0.5
Lubricants	0.2
<b>Electricity</b>	<b>3.5</b>
<b>Fuel Index</b>	<b>14.9</b>

- Market determined fuel including Petrol, Naphtha and ATF will push up WPI
- Given the current higher inflationary environment and upcoming state elections, not much expected on of further oil price de-regulation front

# Increased outlay on social infrastructure (healthcare and education)

Plan expenditure on Central Plan	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11RE	FY12 BE	FY11	FY12
Agriculture and Allied Activities	40	51	69	81	93	106	114	147	152	28.8%	3.8%
Rural development	122	95	158	165	199	403	386	461	463	19.5%	0.4%
Transport	162	177	241	279	288	302	446	581	597	30.3%	2.6%
Water supply, sanitation, urban development	76	87	102	97	140	220	239	254	258	5.9%	1.7%
Education, Art, Culture	79	108	153	211	242	312	332	425	487	28.1%	14.6%
Health, Family welfare	59	70	83	98	129	160	176	194	241	9.7%	24.3%
Science, Technology, Environment	38	52	55	64	73	88	99	127	162	28.3%	27.9%
<b>Total plan expenditure (excl assistance for State/UT plans)</b>	<b>725</b>	<b>805</b>	<b>1,057</b>	<b>1,243</b>	<b>1,435</b>	<b>1,982</b>	<b>2,189</b>	<b>2,986</b>	<b>3,355</b>	36.4%	12.4%

**Key change was the increased allocation towards healthcare and education and lower towards rural and agriculture sector. India needs massive investment in education and healthcare to leverage the demographic potential.**

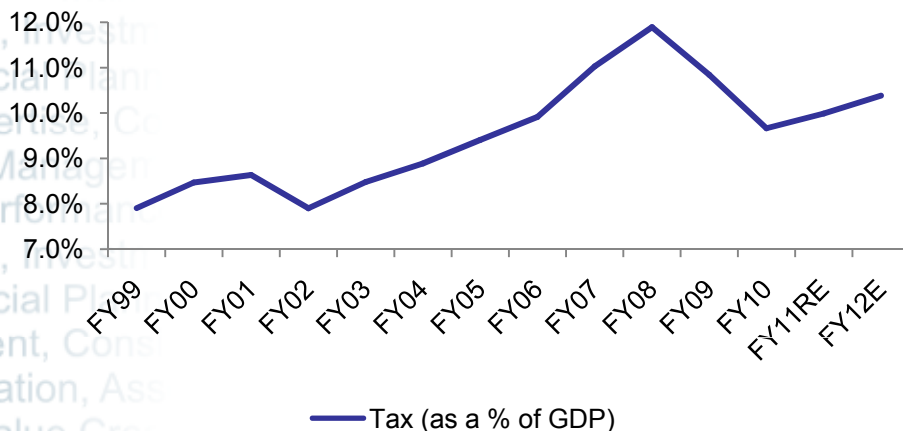
# Infrastructure: strong moves to enhance availability of finance

- **Allocation of over Rs. 2,14,000 crore allocated towards Infrastructure, 23.3 per cent higher than current year and amounts to 48.5 per cent of the Gross Budgetary Support to plan expenditure.**
- **FII limit for investment in corporate bonds, with residual maturity of over five years issued by companies in infrastructure sector raised by an additional limit of US \$ 20 billion taking the total limit available to US \$40 billion**
- **Tax free bonds of Rs. 30000 crores to be allowed to boost infrastructure development in railways, ports, housing & highways development.**
- **Creation of notified infrastructure debt funds to attract foreign funds for infrastructure financing.**
- **Additional deduction of Rs. 20000 for investment in long term infrastructure bonds extended in 2011-12.**

***But Execution will be the key***

# Fiscal consolidation: some reasons to be optimistic

## Tax to GDP ratio remain low



## Services tax still account for a small share of overall taxes



- **Unique Identification System:** Could reduce the subsidy burden by plugging the leakages

- **Tax reforms though GST and Direct Tax Code** and improvement in tax compliance expected to boost the revenues.

- **Increase in services tax net** will further add to the revenues

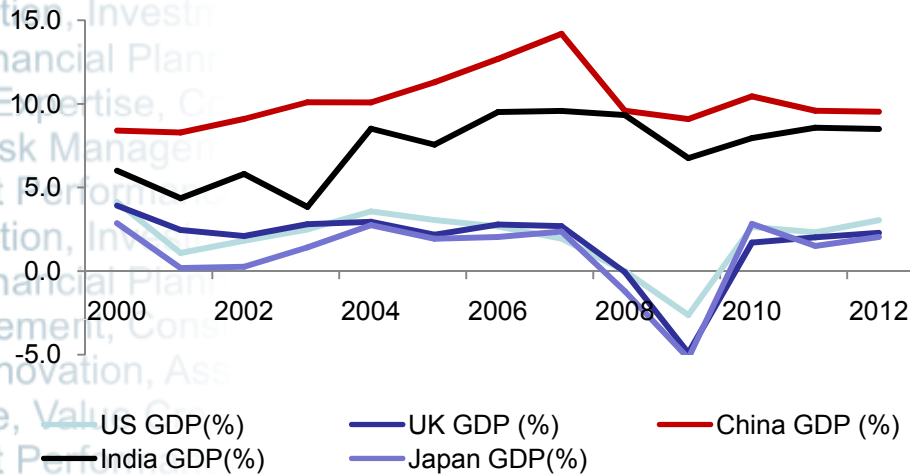
- **Stake sale in PSUs and auction of natural resources**

- **Public debt to GDP ratio has declined..** Central government debt to GDP at 44.2% against XIII Finance commission's recommendation of 52.5%.

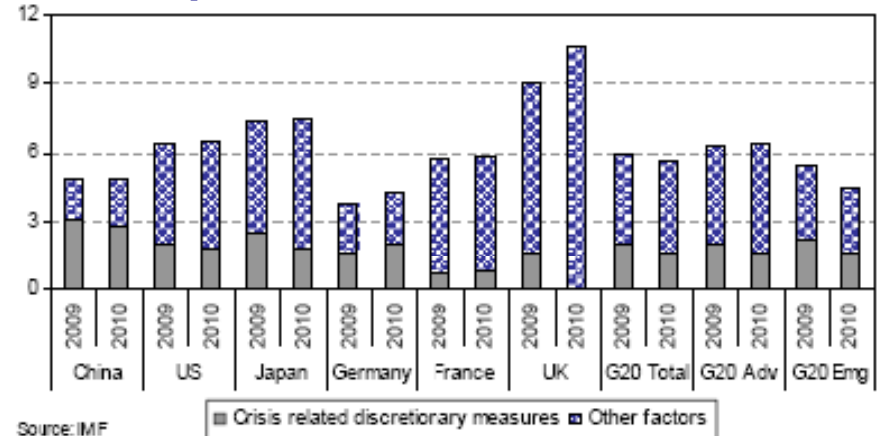
# Fiscal deficit: Relatively India on improved trajectory

## Shift in the global growth engines

World Real GDP YoY, by region

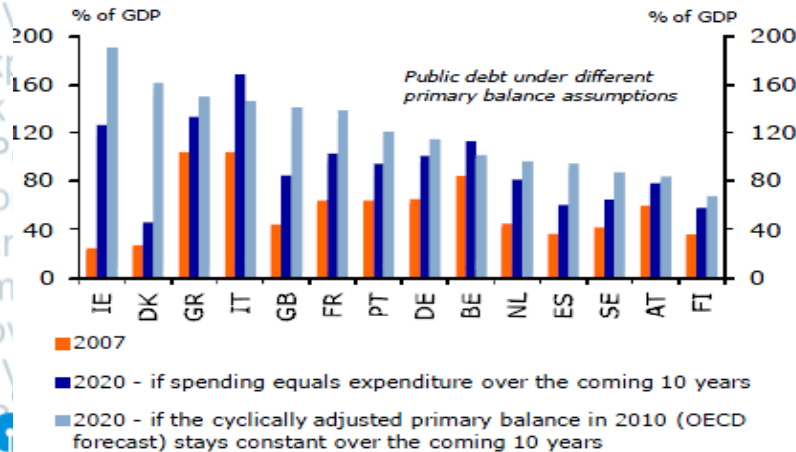


## Relatively to rest of world, India is better placed..

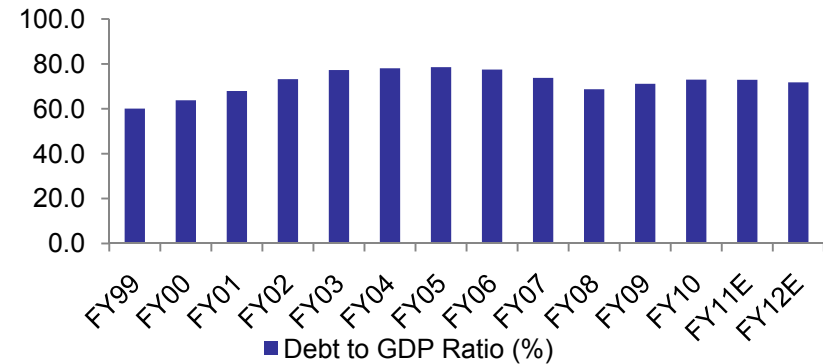


Source: IMF

## Globally public debt ratios on the rise ...

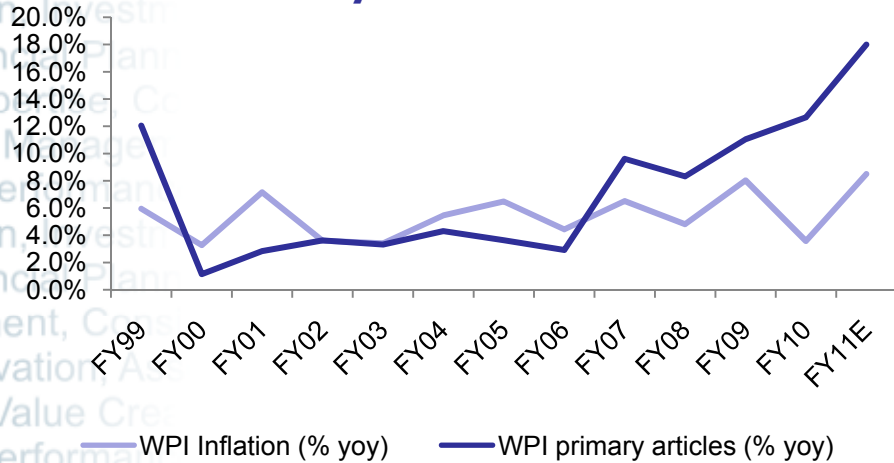


## India Debt to GDP Ratio looks much stable Central and state governments Combined



# Food inflation is structural....

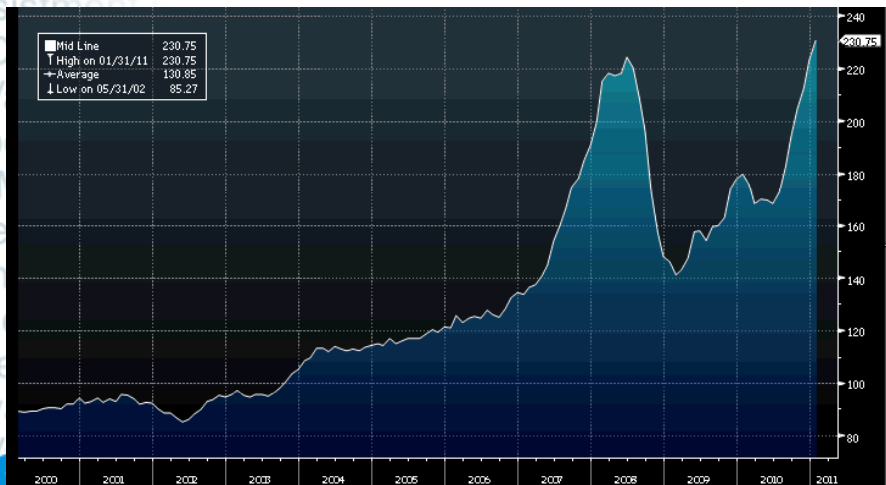
**Primary article inflation continue to remain high driven by combination of structural and cyclical factors**



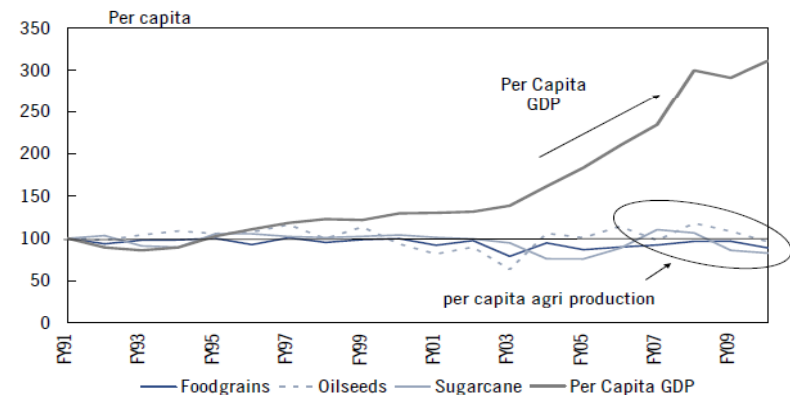
•Domestic Structural issues remain

- ✓ Inefficient distribution chain
- ✓ Demographic & income changes resulting in consumption of more protein rich diets
- ✓ Declining agriculture productivity and stagnating yields
- ✓ Higher rural incomes on the back of schemes like NREGA and greater demand
- ✓ Global food price shocks due to extreme weather patterns across the globe posing further risk

**Global food prices at record high....**



**Trend in Per capita income growth and agriculture products**



Source: Ministry of Agriculture ; CSO

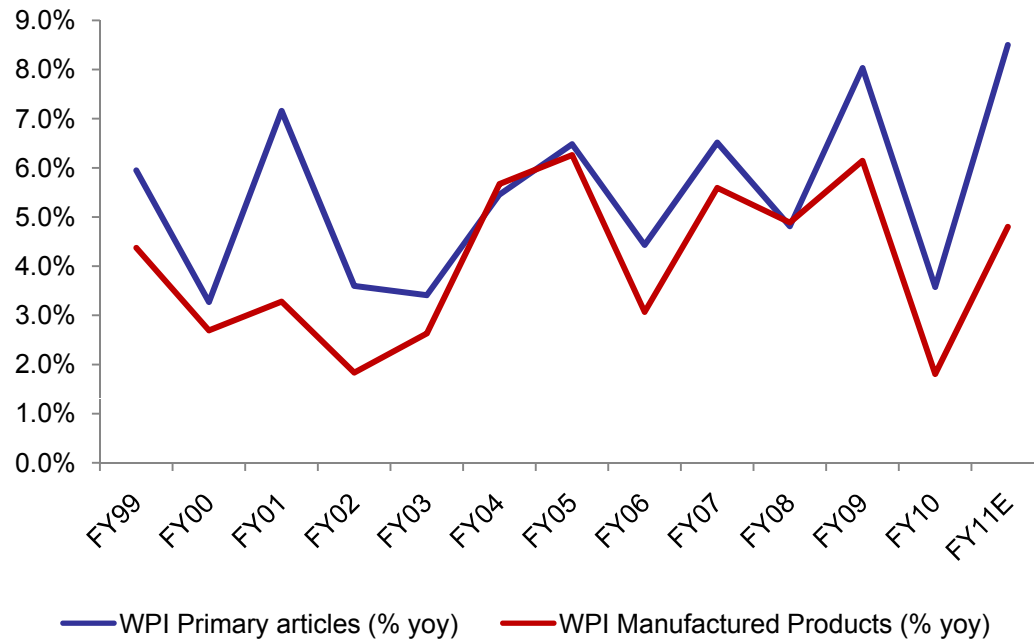
## **Budget measures for agriculture: Incremental approach**

- **Target of credit flow to the farmers from Rs. 3,75,000 crores this year to Rs. 4,75,000 crores in 2011-12.**
- **Interest subvention scheme to continue in 2011-12 with additional subvention increased to 3% from 2% earlier.**
- **Capital investment in fertilizer production to be treated as Infra sub-sector.**
- **Recognize cold chains and post-harvest storage as an infrastructure sub-sector.**
- **Exemptions and concessional excise and custom rates on certain agricultural equipments.**
- **Outlays for specific crops like Palm oil, pulses etc.**

# Food inflation... needs bold moves, more than a green revolution

- **Ensure higher prices reach farmer to incentivize higher production**
- **Remove structural bottlenecks, inter-state movement**
- **Massive investment in boosting agriculture productivity**
- **FDI in retail: cut intermediation cost, invest in supply-chain, logistics, warehouses**
- **Allowing Corporate farming, consolidation of land holding**
- **Soil and water issues**
- **Credit availability**
- **Fertilizer policy, procurement policy (cut wastage)**

# Higher primary articles may drive manufacturing inflation higher...



**Raw material price pressures already beginning to get visible in corporate profitability**

# Budget 2010-11: some of the Tax measures..

- Reiterated the commitment to implement Direct Taxes code (DTC) from April 1, 2012.
- Exemption limit for general taxpayers increased from Rs. 160,000 to Rs. 180,000. This will provide a uniform tax relief of Rs. 2000 to every tax payer of this category. Senior citizens qualifying age reduced from 65 years to 60 year with exemption limit raised from Rs. 240,000 to Rs. 250,000 and another very senior citizen category introduced with higher exemption limit of Rs. 500000.
- Selective changes in excise and custom duties to bring them in line with the proposed GST regime, Peak customs duties maintained at 10% while General CENVAT rate retained at 10% (it was expected to be raised to 12%);
- Service tax maintained at 10% while its scope has been widened to include more services under the tax net.
- MAT increased from 18% to 18.5% while surcharge reduced from 7.5% to 5% keeping the effective rate at the same levels.
- Dividends from overseas subsidiaries will be taxed at concessional rate of 15%.
- Dividend Distribution Tax applicable to corporates for dividend on debt funds at 30%

# Budget by numbers

Budget 2011-12 (Rs. Bn)	FY10RE	FY11RE	FY12BE
a. Gross Tax Revenue	6,331	7,869	9,324
% to GDP	9.5%	10.0%	10.4%
c. Net tax revenues	5,341	5,637	6,645
d. Non tax revenues	1,122	5,637	6,645
f. Non-debt capital receipts	302	2,201	1,254
<b>TOTAL REVENUES</b>	<b>6,075</b>	<b>8,156</b>	<b>8,449</b>
% YoY	11.1%	34.3%	3.6%
h. Revenue expenditure	9,064	10,537	10,972
Plan expenditure	2,644	3,269	3,636
Non-Plan expenditure	6,419	7,267	7,336
i. Capital expenditure	1,152	1628.99	1605.67
Plan expenditure	508	680.96	779.43
Non-Plan Expenditure	644	948	826
<b>Total Expenditure</b>	<b>10,215</b>	<b>12,166</b>	<b>12,577</b>
<b>Fiscal Balance</b>	<b>-4,140</b>	<b>-4,010</b>	<b>-4,128</b>
% to GDP	-6.3%	-5.1%	-4.6%
Revenue Balance	-3,291	-2,698	-3,073
% to GDP	-5.0%	-3.4%	-3.4%
Primary Balance	-1,945	-1,602	-1,448
% to GDP	-3.0%	-2.0%	-1.6%

•Assumes 9% (real) and 14% (nominal) growth

•Only 3.4% increase in expenditure as against 18.5% revenue growth looks aggressive

•Subsidy provisions are aggressive, we believe they are hugely under-estimated. Probably, there are some reforms to be undertaken during the year leading to FM's confidence on low payout on subsidies.

# In a nutshell: Union Budget 2011-12 ...

- **Incremental approach, focus on growth with inclusion**
- **Path towards Fiscal consolidation (peak deficit (incl bonds) was 7.8% in 2008-09)**
- **Vision statement on manufacturing sector**
- **Bold moves on capital account: increase in limit for FII investment in infrastructure bonds and foreign citizens allowed to invest in MFs**
- **Continues to bet on growth: tax measures**
- **Deadlines on GST, DTC, Bank licenses and beginning of move towards cash transfer against subsidies**
- **Legislative reforms in financial sector underway**
- **Increased availability of finance for infrastructure**
- **Good to hear!: Five pronged strategy on tackling the issue of black money**

# **In the long run: We will grow at 7-8% against all odds; Unlikely to grow at 10% despite all Gods!**

## **What needs to be done to achieve sustainable growth rate at 9% or so**

- **Fiscal consolidation: Expenditure management, tax reforms**
- **Financial sector and capital market reforms**
- **Massive Investment in physical infrastructure**
- **Removing structural rigidities**
- **Further opening up of external sector, capital and technology import in critical sectors**
- **Focus on employment creation and investment in social infrastructure (education, healthcare) to capitalize on demographic dividend**
- **Labor market and land reforms**
- **Governance: Government's focus needs to move from outlay to outcome, Judicial and administrative reforms are critical for efficient delivery**
- **Urbanization to move excess labor from agriculture**
- **Substantial improvement in agriculture productivity**
- **Sustainable development, energy and water management**

# Budget announcement's sectoral impact

Sector	Impact
<b>Metals</b>	20% export duty imposed on iron ore exports, to negatively impact iron ore fines exporters like Sesa Goa and lumps exporters like NMDC
<b>Cement</b>	Excise duty increased with differential treatment to be calculated on ad valorem value, effectively increasing 3-3.5%, to negatively impact all cement companies marginally
<b>Cons Staples</b>	Status Quo on expected increase in excise duty on cigarettes very positive for ITC with growth in cigarette EBIT to increase from 15-22%
	Status Quo on excise rates expected to increase by 2%, to positively impact all FMCG companies which are already facing rising raw material price pressures
	Reduction in excise duty on sanitary napkins and diapers from 10% to 1% to positively impact companies like P&G Hygeine
	1% additional excise duty imposed on various consumer staple items to marginally impact companies including HUVR, Nestle, Dabur & Titan negatively
	Custom duty on Crude Palm Stearin imported for the manufacture of laundry soap reduced from 20% to nil to positively impact all FMCG companies exposed to import of Palm Oil including HUVR & GCPL
<b>Retail</b>	Expected liberalisation of FDI for different retail formats to negatively impact more leveraged players like Pantaloon
<b>Hotels</b>	Service tax on hotel accommodation in excess of declared tariff of Rs. 1000/day with an abatement of 50% to negatively impact IHCL, Royal Orchid, ITC's hotel business, though with effective burden of only 5% of the amount charged

# Budget announcement's sectoral impact

Sector	Impact
<b>IT</b>	MAT applicable on companies operating out of SEZ to result in 4-5% increase in cash out go with no impact on EPS
<b>Pharma</b>	Weighted deduction outsourced R&D increased from 175% to 200% to positively impact all pharma companies
	MAT applicable on companies operating out of SEZ to negatively impact all pharma companies
	EOU benefits not extended beyond 2011 to negatively impact companies operating in EOU with their effective tax rates to go up
	Service tax of 10% on all services provided by hospitals with 25 or more beds with facility of central air conditioning to negatively impact the sector with overall cost of healthcare for people to go up
<b>Financials</b>	Rs.6000 crores provided to PSU banks to attain 8% Tier 1 capital to positively impact PSU banks with low CAR & Govt. holding close to 51% including Dena Bank, Andhra Bank, UBI among others
	Ticket size for loans eligible for priority sector status raised from Rs 20 lacs to Rs 25 lacs. Also the subvention of 1% has been allowed for housing loans upto 15 lacs (as against Rs 10 lacs earlier). This would positively impact all Banks and HFC's
	Lower than expected market borrowing number to positively impact all banks due to their large G-Sec holdings
<b>Auto &amp; Auto Ancillaries</b>	No change in duty structure as against expected hike of 2-4% in excise rates across products and special additional duty on diesel vehicles, to positively impact all auto & auto ancillaries
<b>Power-Capital Goods</b>	Excise duty exemption for capital goods used for expansion of existing mega and ultra mega power projects, marginally positive for domestic power equipment manufacturers
<b>Textiles</b>	Levy of 10% excise duty on 60% of retail price of labeled garments & made ups to negatively impact garment and made up manufacturers

# Budget announcement's sectoral impact

Sector	Impact
Oil & Gas	No change in duty structure as against expected reduction in excise rates on Petrol & diesel to negatively impact the OMCs which would have helped reducing the under recoveries
Construction/Infra	Expansion of FII investment limit in corporate bonds, Allowing tax free bonds of Rs. 30000 crores, creation of notified infrastructure debt funds & extending additional deduction of Rs. 20000 for investment in infra bonds to positively impact all companies
Real Estate	MAT applicable on SEZs (both developers & units operating in SEZs) to negatively impact developers including Mundra Port
Media	Priority sector housing loan limit increased from Rs. 2m to 2.5m and interest subvention of 1% extended to housing loans of up to Rs. 1.5m, where the cost of house is lower than Rs. 2.5m marginally positive for the sector
Fertilizers	MAT applicable on SEZs (both developers and units operating in SEZs) to negatively impact the developers
	Reduction in customs duty on Jumbo films to positively impact film producers reducing their cost of film production
	Direct payment of cash subsidy though positive for the overall system but will impact the companies negatively due to the overstatement of demand to the tune of 15-25% on the subsidized volumes which will stop post UID activation & direct subsidy payment thus depressing the industry's as well as individual companies volumes.

# Budget and equity markets

- **Budget 2011-12 presented in the backdrop of macro challenges of Triple deficits (governance, fiscal and current account) and higher inflation. Investor sentiments have been depressed**
- **The fiscal deficit at 4.6% of GDP and market borrowing for the next year are better than expectations which will sooth fears of crowding out and sharp spike in interest rates**
- **Measures on the personal taxation & increased spending on Govt. programmes to keep the consumption story intact.**
- **Continued support to Agriculture, Education, Rural development and social sector augurs well for economy. Increased availability of finance for infrastructure is positive**
- **The long ranging reforms like roll out of GST, Direct tax code, further opening of banking sector, reforms on the subsidy front will assist in removing the structural rigidities & increase the growth potential of the Indian Economy. Moves on capital account are quite positive.**
- **Allowing foreign citizens in domestic equity funds is positive**
- **Though no major surprise, budget is positive for the equity market. As the event is behind us, the market would now focus on cues from global markets, incremental economic data and corporate earnings.**

# Equity market Outlook

- Equity markets have corrected almost 15% as investors got jittery about the macro situation & political gridlock after unearthing of a spate of corruption scandals with the legislative business in a complete halt. The need of the hour for the government is to move fast on implementing the reform agenda
- There are fears that high fiscal deficit along with tight monetary policy which works with lag could seriously impact the growth prospects in FY 12 and beyond. There are early signs of a slowdown in growth momentum as witnessed in declining imports, industrial activity and crawling pace of execution on the infrastructure front.
- Given the backdrop of macro concerns, outlook on corporate earnings growth has weakened. Margins could be under pressure due to increase in raw material prices, wages and interest rates. Higher inflation, rising rates and tight liquidity could also impact discretionary spending. For these reasons, investors have preferred global cyclical sectors like technology and metal stocks
- Looking at the sentiments in equity market, there is a sense of gloom which is in stark contrast to the exuberance witnessed in early November. Undoubtedly, the macro picture has deteriorated and there are dark clouds looming on political and economic front. However, we believe that valuations are turning attractive and investors should use this as an opportunity to enter the market.
- Foreign investors poured in \$ 29 billion last year and we highlighted the risk of some of the money moving out. However, we believe that domestic investors would return to equity markets at lower levels as relative attraction of real estate and gold fades. Indeed, higher interest rates would lure investors towards safe deposits; one must not forget that timing the investment in equity market is easier said than done.
- **The long term fundamentals of Indian economy remain absolutely intact. Till few months back, markets were pricing in all the possible positives with the economy and individual companies while ignoring any risk. But now, fear is likely to overtake greed as markets would price in every possible bad news. Surely, corporate earnings growth will take a hit but what we need to assess is how much of it is already in the price. Most important thing for investors is valuations and we believe that large part of froth has been taken away and as markets focus more on near term macro, great long term opportunities are emerging for a patient investor.**

# Interest rate movement and bond market

## Government securities

- **G-sec yields eased marginally over the last few weeks of the month as no additional borrowing was announced for the fiscal year ending March 11. The markets were also supported by the talk of possible RBI secondary market purchases. As per the WSS data for the week ending Feb 18<sup>th</sup>, the RBI bought around Rs1614 cr net government securities in the secondary market.**

- **The Union Budget has estimated the Fiscal deficit at 4.6%, with gross market borrowings at Rs 4,17,128 cr and net borrowings at Rs 3,43,000 cr. Bond yields rallied on the announcement as these numbers were at the lower end of most market polls. These numbers have been on the back of robust revenue growth assumptions at 18.5% over the RE of 2010-11 and disinvestment target of Rs 40000 cr for FY12.**

- **The government has also kept the option of borrowing the remaining Rs 10000 cr for the fiscal year 2010-11, which marginally dampened the market sentiments.**

Rates* in %	31 <sup>st</sup> Jan 11	28 Feb 11
1 yr T-bill	7.65	7.68
5 yr G-sec	8.14	8.01
10 yr G-sec	8.16	8.09
1 yr CD	9.85	10.20
3 yr Corp	9.25	9.40
5 yr Corp	9.20	9.20
10 yr Corp	9.10	9.15
1 yr IRS	7.43	7.50
5 yr IRS	7.98	8.10

## 10 yr G-Sec



\*Source: Bloomberg & Internal estimates

# Interest rate movements and bond market

## Credit markets

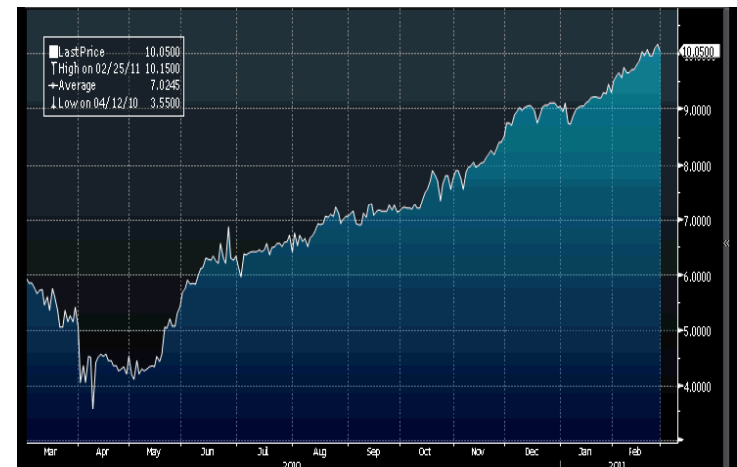
- The pressure on money market rates continued as the huge supply combined with tight liquidity resulted in funding costs moving up in the short term money markets. The money market curve flattened with the 3mth to 1 yr spread closing at below 10bps as compared to around 45 bps last month. The 3 month bank CD rates moved up close to 60 bps over the month and traded at close to 10.10%, whereas the 1 yr CD's traded at close to 10.20%. Bank inflows into MF's went up to Rs 95,018 cr as on 11<sup>h</sup> Feb 11 from about Rs 13,483 cr on 31<sup>st</sup> Dec10. Investor sentiment in the money market remained cautious on account of tightness expected during the month of March on the back of Tax related outflows and quarter end redemptions.

- The government has budgeted carry over of cash balances of Rs 20000 cr (surplus of Rs 97,000 cr as on Feb 18<sup>th</sup>, as per WSS data) into FY12, which could potentially result in substantial unwinding of government cash surpluses by the fiscal year end. This enhanced spending and postponement of disinvestments into the next fiscal could cap further large up move in short term yields from current levels. The Budget has also increased the DDT applicable for Institutional investments into Liquid and debt funds to 30% from 25% and 20% respectively. This could potentially impact the pattern of incremental flows into short term money market schemes.

### PSU CD 12M



### PSU CD 3M



# Fixed Income Fund strategy

## Long term funds

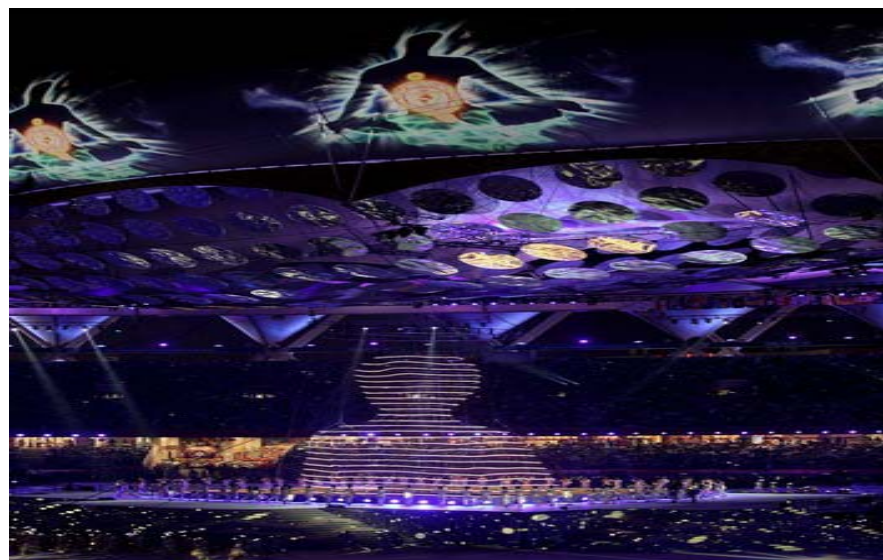
- **We had stayed on a low duration strategy in the long term funds and MIP's on account of:**
  - **Tensions in the Middle East resulted in crude prices moving up to above \$100/barrel. This could result in further inflationary concerns and even pressure on the fiscal side since under recoveries could remain elevated.**
  - **Expectations of the gross borrowing amount for the coming fiscal year likely to remain under strain on account of the structural nature of government expenditure.**
  - **Looking at the absolute attractiveness of G sec yields and the lack of fresh supply in the coming month, we have continued to maintain moderate positions and opportunistically trade in Government securities**
- **The borrowing numbers for FY12 surprised by being at the lower end of most market polls. The government would face a stiff challenge on maintaining the commitment to fiscal discipline as**
  - **Subsidy requirements can surprise on the upside if international commodity prices remain elevated as at present.**
  - **Large part of revenue mobilisations would be on the Tax revenue side (projected to grow at 18.5%) and the absence of one off windfall gains as compared to FY11.**
  - **We would continue to maintain a moderately invested position in G secs, with a largely trading focus, till the supply resumes in April 11.**

# Fixed Income Fund strategy – contd.

## Short term funds

- **With 3 month PSU bank CD rates currently trading closer to 10.10%, we have been redeploying cash/ Maturities in the 3 month segment across Liquid / Ultra Short term funds. In spite of further expected supply, current market yields remain attractive on an absolute level and provides high accrual. This provides a good opportunity to revalue our portfolios to current elevated market levels. Ultra Short term would continue to focus on  $\leq 3$  month segment as the 3 mth-1 yr money market curve is relatively flat and a low duration non m-t-m strategy focusing on high accrual remains the optimal strategy.**
- **Even as market levels continue to remain attractive, broadly a cautious stance is warranted with adequate cash and maturities in the schemes in the coming month on account of the short term nature of the incremental flows received which would be redeemed on the quarter end and Advance Tax related outflows in Mid March.**
- **Money market funds would focus on generating consistent returns and would strive to contain volatility. Particular emphasis will be laid on security / portfolio liquidity and credit quality.**
- **Short horizon fund had been maintaining a lower duration strategy with around 40% invested in non m-t-m money market securities. The fund would seek to move into the 6mths to 1 yr bank CD space as spreads in this segment are attractive at 250 bps above G secs and provides better relative value and higher accrual, while maintaining scheme liquidity through investments in 3mth money market securities.**

**While there are clouds of gloom, CWG -2010 captures the India story, and that is , against all odds, we ultimately make it happen!**



Keep the faith....

Thank You

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