



Debt Market Outlook

July 2011

Recent interest rate movements and near term Outlook

Government securities

- The 10 yr Benchmark Government yield remained volatile in a narrow range of 20 bps from 8.20% to 8.40%.
- Higher than anticipated WPI reading for the month of May 11 at 9.06% as against most consensus estimates in the range of 8.75% led to yields moving up to around 8.40%.
- The RBI monetary actions were along expected lines and the RBI guided that the anti inflationary bias is likely to continue. Post the policy , the market yields came off to around 8.20% as global events led by the sharp drop in crude prices and the market anticipation of growth slowdown as evidenced by the OIS curve inversion took centre stage.
- However, the markets pared most of the gains following the Diesel, kerosene and LPG hikes. The hikes which were accompanied by duty cuts, focused market attention on the likely slippages on the fiscal side.

Rates* in %	31-May-11	30-Jun-11
1 yr T-bill	8.30	8.3
5 yr G-sec	8.45	8.36
10 yr G-sec	8.41	8.33
3 Mth CD	9.82	8.50
1 yr CD	10.00	9.83
3 yr Corp	9.75	9.6
5 yr Corp	9.74	9.56
10 yr Corp	9.78	9.62
1 yr IRS	8.17	8.08
5 yr IRS	8.13	7.77

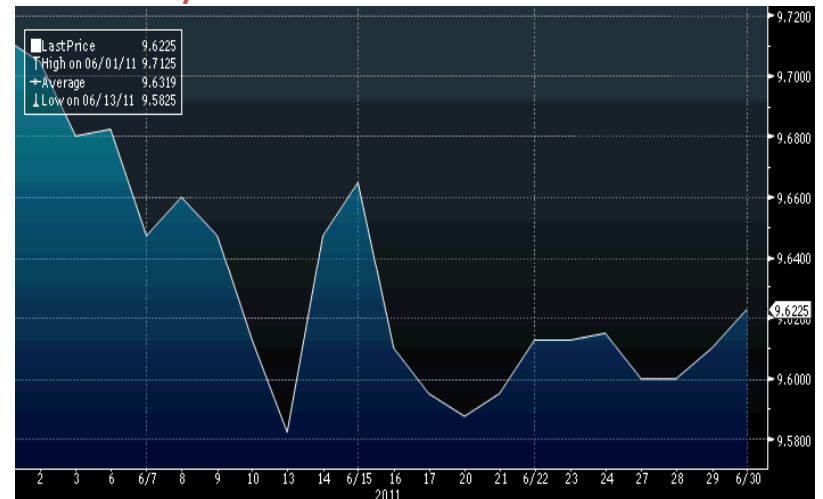
Credit Curves

- Average LAF borrowings moved up to Rs 72,000 cr in June from Rs 54,000 cr in May 11. The government borrowings under the WMA moved from around Rs 35000 cr in the beginning of the month to Rs 18429 cr by 10th June. Subsequent to the advance tax flows the GoI has cleared the WMA borrowings completely.
- 3 month bank CD's yields traded as high as 9.80% during the last week of May moved down to close at around 8.50%. Reduced CD issuances and the partial withdrawal of banks form MF's during the quarter resulted in a sharp rally in the money market segment , especially in the 3-6 month tenure. .
- Corporate Bonds outperformed the Gilt segment as spreads in the range of 120 bps attracted interest.

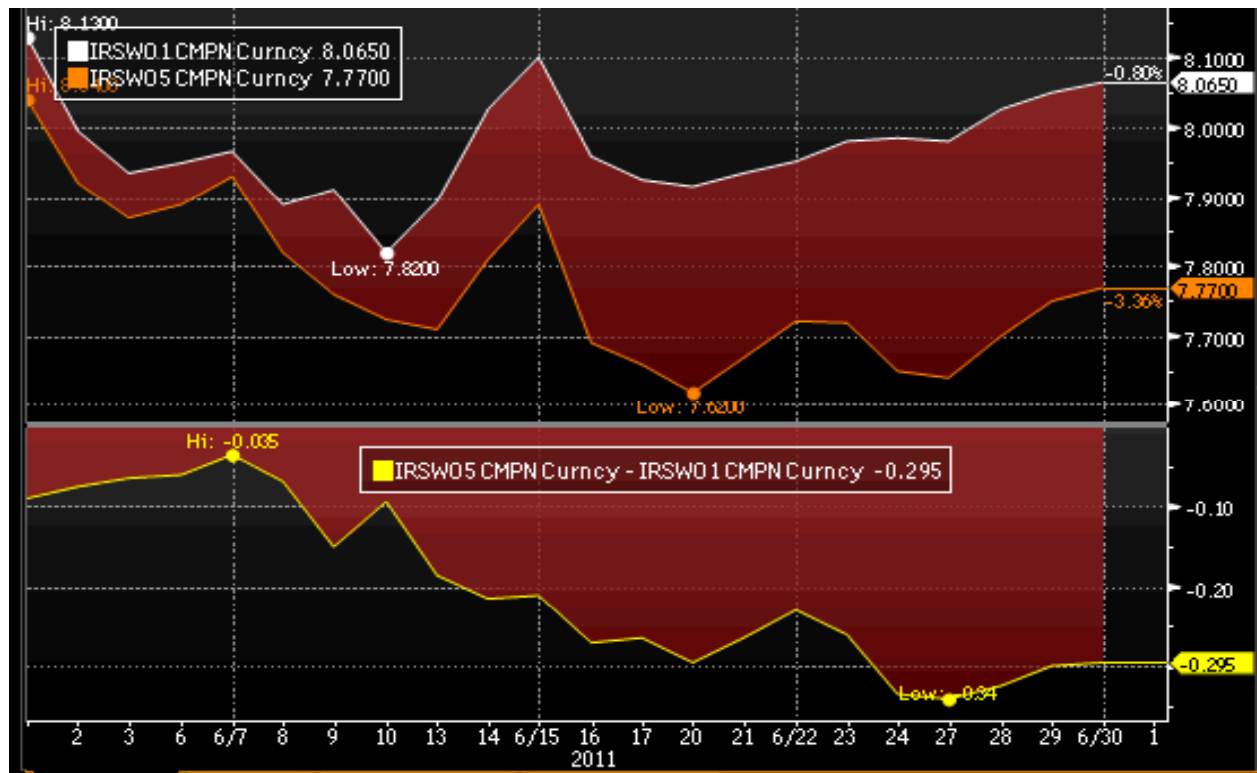
PSU CD 3 month rate



PSU CD 10 yr AAA rates

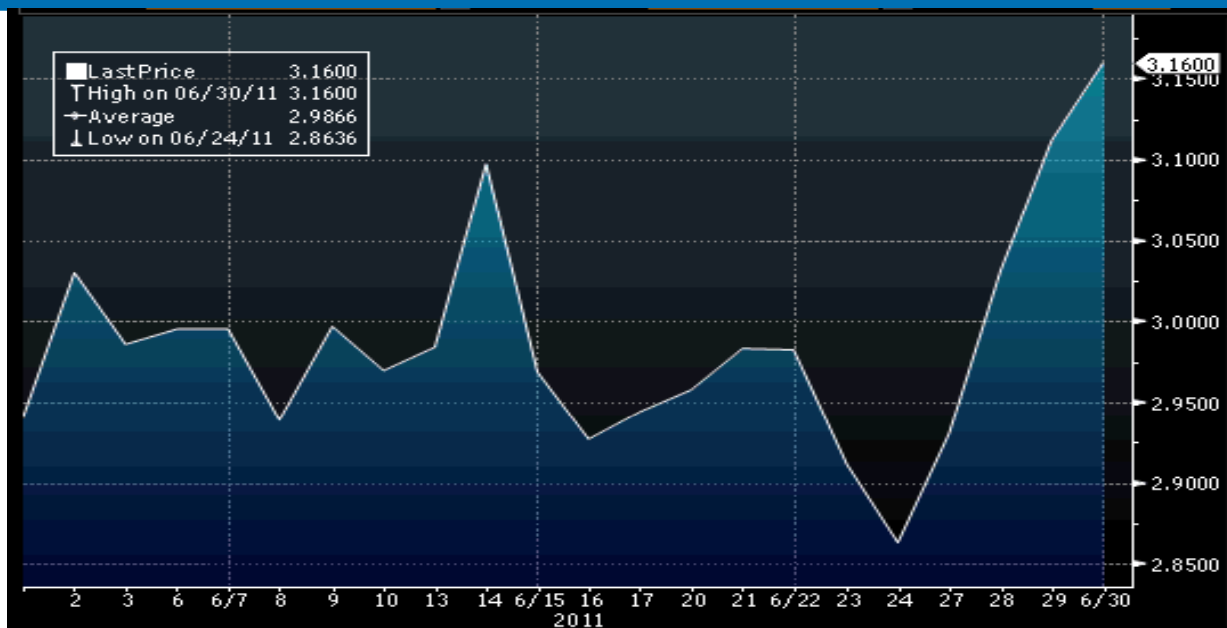


OIS Curve- 1 year Vs 5 Year /(1y-5y) Spread



- Anticipation of growth slow down and expectation of RBI rate hikes having run its course led markets to receive 5 yr OIS causing an inversion in the curve. The short end of the curve which reacts more to the liquidity scenario eased marginally over the month.
- Relatively soft global macro data also weighed on the broader positive rate view as expressed by the movements in the 5 y swap rates.

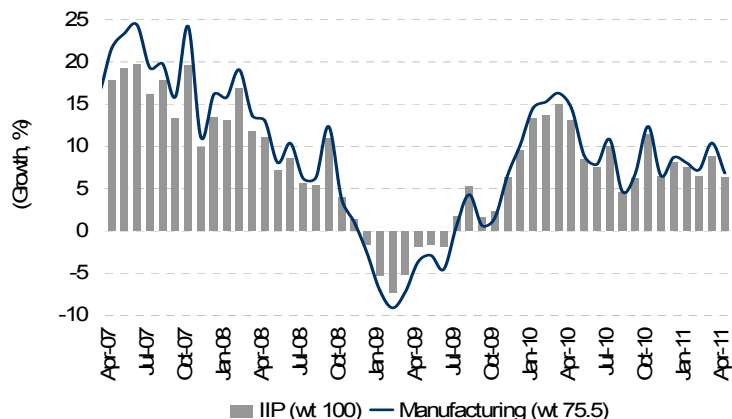
US Treasuries



- US treasury yields moved in a wide range during the month with yields moving up to 3.16% towards the month end from the lower range of 2.86%.
- FOMC provided no indication of additional QE measures, while reiterating that the FED balance sheet would be maintained by reinvesting proceeds of maturing debt.
- Data on Non Farm Payrolls , unemployment and ISM Manufacturing came below expectations, whereas inflation data, both the CPI & PPI was above the survey levels.
- The Greek Parliament successful voting on the austerity plan also led to upmove in yields towards the month end.

Industrial production showing signs of weakness

IIP growth decelerates in Apr '11



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- The new IIP series (base: 2004-05) posts 6.3% industrial growth in Apr '11, following 8.8% growth in Mar '11
- Since the new IIP series takes into account the item basket as per the more recent production behavior, this series indicates a much closer reflection of the present industrial scenario.
- However the volatility in the data series , especially the Capital goods segment continues to pose policy dilemmas for the RBI.

Manufacturing PMI indicate deceleration



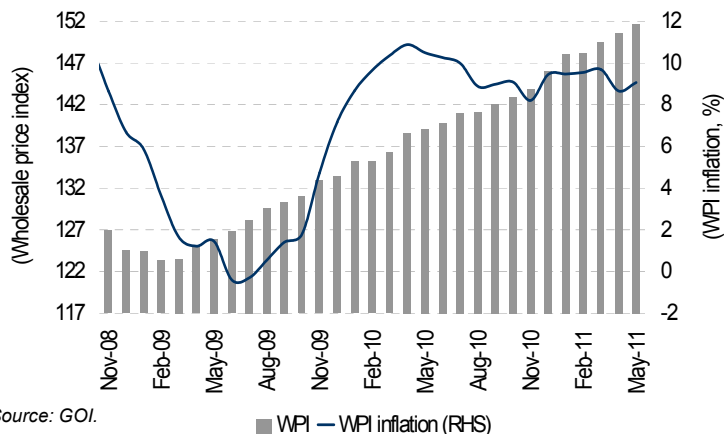
Manufacturing PMI indicates deceleration

- Manufacturing PMI declined to 55.3 in Jun '11 from 57.5 in May '11, indication deceleration in manufacturing activities in the country
- The Index of eight core industries (weight: 37.9% in IIP) registered a growth of 5.3% in May '11 compared to 7.4% registered in May' 10

Source: GOI, , SBIMF Research

Inflation remains sticky and pose major policy challenge

WPI inflation up again



Food-fed inflation

- WPI inflation rose to 9.1% in May '11 from 8.7% in Apr '11
- While price indices for primary articles and fuel increased 0.3% (m-o-m) each in May '11, that for manufactured products continued to witness a sharp upward trend (1%)
- Hike in retail fuel prices would push inflation higher in next 2 months

Core inflation inching up again

Core inflation inching up



Source: GOI, SBIMF Research

- Non-food manufactured products inflation – an indicator of demand-side and generalized pressures on inflation – rose to 7.3% in May '11, up from 6.3% in Apr '11
- With RBI increasingly using this measure as a proxy for demand side inflation, the data prints in the coming months could guide RBI policy moves incrementally.
- Also, food inflation – both primary and manufactured – rose to 8% in May '11 from 7.6% in Apr '11

Fixed Income Funds Strategy- Long Term Funds

- **With markets being volatile, duration in long term funds was actively managed. Also with attractive absolute yield levels we continued to stay moderately invested. :**
 - **Replacement demand from Banks on account of large bond maturity has capped bond yields from rising.**
 - **Continued concerns on global economic growth and moderating domestic growth warrants moderate duration levels to be maintained.**
 - **Global Commodity prices remain volatile with news flows from Europe & United states. Crude prices soften on news of higher supplies from IEA.**
 - **Any major fall in yields would be capped due to the fresh supply every week & concerns of overshooting the Fiscal Deficit. Also, with expectations of nearing the rate hiking cycle, yields are expected to trade in a range.**
 - **We would maintain moderately invested positions and continue to actively manage duration.**
 - **In MIP's and balanced fund we have built a core portfolio of high quality with relatively moderate duration (1-3 yrs). With moderating growth expectations & expectations of nearing the rate hiking cycle we would gradually increase duration through government & corporate bonds**

Fixed Income Funds Strategy- Short Term-Money Market Funds

- The Liquid and Ultra Short Term funds have been fully invested by the close of the quarter. Short term yields peaked in the beginning of the month and subsequently came off as the normal quarter end withdrawal of banks were subdued and on account of relatively less issuances of CD's.
 - The liquid schemes have increased the overall portfolio maturity as we have reinvested a large part of the portfolio in the Sep maturity segment. We anticipate that the liquidity scenario could stay within the RBI comfort zone of +/- 1% of NDTL at least till the month of September. Large G sec redemptions of around Rs 40000 cr including the coupon flow in the beginning of July could keep liquidity conditions stable in the month of July.
 - Issuances of Cash Management Bills, higher T-bill auctions and continuous G sec supply could keep draining liquidity from the system, capping any sharp downward movement in short term rates.
 - However, reduced issuances of CD's by banks due to higher deposit growth vis a vis the incremental credit growth in this fiscal so far could structurally cap sharp upmove in short term yields.
 - With the new RBI regulations governing the exposure of banks in debt MF's, the volatility of flows into the schemes could be substantially lower going forward, thereby keeping volatility in returns under control.
 - We have increased mark to market exposure in Ultra Short on anticipation that a relatively steep money market curve could provide trading gains in the backdrop of an improved liquidity situation in the month of July. We intend to trade out the same in July.
 - Short term fund has increased duration via one year CD's & government bonds from a trading perspective.



SBIFM Fixed Income

Investment Process and strategy

DEBT PRODUCTS

Scheme	Nature of scheme
SBI Premier Liquid Fund – IP & Super IP	Institutional Liquid
Magnum Instacash	Retail Liquid
SBI Short Horizon Fund	Ultra Short Term plan & Short Term Plan
Magnum Insta cash-Liquid Floater	Floating Rate – (Liquid)
Magnum IF – Floating. Rate Short Term	Floating Rate – Short Term (non-liquid)
Magnum IF – Floating. Rate Long Term	Floating Rate – Long Term (non-liquid)
Magnum Income Fund	Debt – Medium & Long
Magnum Gilt Long Term / Magnum Gilt Short Term	Gilt – Medium & Long / Short durations
Magnum Monthly Income Plan Magnum Monthly Income Plan- Floater Magnum Income Plus - Investment	Marginal Equity Funds (MIP)
SBI Dynamic Bond Fund	Dynamic / Flexi Debt
Magnum Children’s Benefit Plan	Hybrid scheme
SBI Debt Fund Series	Fixed Maturity Plans

Fixed Income Funds –Maturity Positions

	Average Maturity (in years)	Fund Category	Asset Allocation	Maturity Range-Yrs
SBI Premier Liquid Fund	0.20	Liquid	Money Market Instruments	Max 0.25
Magnum Insta Cash Plan	0.20	Liquid	Money Market Instruments	Max 0.25
SBI- SHF Ultra Short Term Fund	0.23	Ultra Short Term Fund	MM/ NCD / Securitised paper	Max 0.50
Magnum Gilt-LT	7.5	Gilt Long Term Fund	Gsecs/ Tbills	NA
Magnum Gilt-ST	1.34	Gilt Short Term Fund	Gsecs/ Tbills	Max 3 yrs
Magnum Income Fund	2.21	Long Term Income Fund	Gsecs/ Tbills/ Bonds/MM	NA
SBI- SHF Short Term Fund	2.72	Short Term Income Fund	MM/ NCD	Max 3yrs