

RBI's Annual Monetary Policy Review Update

May 03, 2011

www.dspblackrock.com

DSP BLACKROCK
MUTUAL FUND



Dhawal Dalal

Senior Vice President,
Head - Fixed Income

In its Annual Monetary Policy Review on May 3, 2011, the RBI has made the following announcements:

- Repo Rate, a Policy Rate, is increased by 50 basis points to 7.25% with immediate effect
- Reverse Repo Rate is increased by 50 basis points to 6.25% with immediate effect
- In line with the Deepak Mohanty Committee's recommendations, the RBI has introduced a new Marginal Standing Facility (MSF) for banks to borrow up to 1% of their NDTL at 100 basis points over the new Repo Rate. This may enable banks who do not have surplus SLR to borrow over-night money from the RBI at 8.25% pa
- Savings Rate has been hiked from 3.5% pa to 4% pa
- Both CRR and Bank Rate has been left unchanged at 6%

Market Reaction:

Market participants found the RBI's tone and language a bit hawkish than past credit policy tones. Clearly, for the RBI, the priority is to rein in headline inflation as early as they can even at the cost of lower growth going forward. This is a marked departure from their previous Monetary Policy stance of supporting growth while containing inflationary pressures. The RBI has acknowledged that apart from higher global commodity prices, the single important risk may be higher oil prices that will test the assumptions of the budget estimates for the FY2011-12. The RBI is cognizant of the fact that if global commodity prices remain at current level for a longer period, then it will have significant negative implications on government finances going forward.

Given this backdrop, the bond market's initial reaction was cautious. The benchmark 10Y yield hardened from 8.14% pa before the Policy to 8.21% pa after the Policy. The 5Y OIS level also hardened by 10 basis points to 8.35% pa.

We expect bond prices to remain range-bound with a declining bias in the near-term as market participants may await a revision in the fuel prices and its impact on headline inflation. A lot depends on the trajectory of economic growth and the monsoon, going forward. Although there is perception of a slowdown in the overall economy, market participants are not sure if it is a mid-cycle slowdown, which may result in more rate hikes later when economy accelerates or a cyclical slowdown, which may result in the rates being closer to their peak levels.

What should an investor do?

We expect the yield curve to flatten more in the near-term. A 50 basis-point hike will gradually push short-term rates higher. We expect 3M bank CD yields to gradually trend towards 9.50-9.75% pa from their current levels of 9% pa. 12M bank CD yields may touch 10% pa in the near-term. Given the fact that banking system is likely to see pressure on their profitability due to the Credit Policy, we expect banks to raise both deposit rates as well as lending rates in a gradual manner. Therefore, it makes sense to remain invested in low duration funds at the moment and wait for money market rates to peak out in the next three to six months before seeking to extend the duration of investments.

DSP BlackRock Liquidity Fund as well as DSP BlackRock Money Manager Fund are, we believe, well positioned to benefit from a rising interest rate scenario in the near-term. Both these schemes have around 40% of net assets maturing in the month of May 2011, with an average maturity of 29 days and 33 days respectively.

DSP BlackRock Liquidity Fund (DSPBRLF) is an open ended income Scheme, seeking to generate a reasonable return commensurate with low risk and a high degree of liquidity, from a portfolio constituted of money market securities and high quality debt securities. **Asset Allocation:** Money market securities and/or Debt securities* with maturity of 91 days - 80% - 100% (* Debt securities may include securitised debts upto 30% of the net assets.). **Features:** Entry/Exit Load- Nil. **DSP BlackRock Money Manager Fund (DSPBRMMF)** is an open ended income Scheme, seeking to generate reasonable returns commensurate with low risk and a high degree of liquidity, from a portfolio constituted of money market securities and high quality debt securities. **Asset Allocation:** Money market securities and/or debt securities which at the time of purchase have residual or average maturity of less than or equal to 367 days or have put options within a period not exceeding 367 days: 65%-100%; Debt securities, which, at the time of purchase have residual or average maturity of more than 367 days: 0%-50% (Debt securities may include securitised debts up to 75% of net assets). **Features:** Entry/Exit Load- Nil. **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. **Risk Factors:** Mutual funds, like securities investments, are subject to market and other risks and there can be no assurance that the Scheme's objectives will be achieved. As with any investment in securities, the NAV of Units issued under the Scheme can go up or down depending on the factors and forces affecting capital markets. Past performance of the sponsor/AMC/mutual fund does not indicate the future performance of the Scheme. Investors in the Scheme are not being offered a guaranteed or assured rate of return. Each Scheme/Plan is required to have (i) minimum 20 investors and (ii) no single investor holding >25% of corpus. If the aforesaid point (i) is not fulfilled within the prescribed time, the Scheme/Plan concerned will be wound up and in case of breach of the aforesaid point (ii) at the end of the prescribed period, the investor's holding in excess of 25% of the corpus will be redeemed as per SEBI guidelines. **DSPBRLF and DSPBRMMF are the names of the Schemes and do not in any manner indicate the quality of the Schemes, their future prospects or returns.** For scheme specific risk factors, please refer the Scheme Information Document (SID). For more details, please refer the Key Information Memorandum cum Application Forms, which are available on the website, www.dspblackrock.com, and at the ISCs/Distributors. **Please read the Scheme Information Document and Statement of Additional Information carefully before investing.**