

## Key Market Highlights

- Reserve Bank of India (RBI) hiked the Repo Rate by 25 bps to 8.25% in its mid-quarter policy on September 16, 2011
- Accordingly the Reverse Repo Rate gets adjusted to 7.25%, while the Marginal Standing Facility (MSF) gets adjusted to 9.25%.
- RBI stated that food price continue to be at elevated levels and non-food manufacturing inflation which shows demand pressures in the economy continued to show momentum.
- While RBI acknowledged that the developments in global economy were a matter of serious concern, it continued with its stance of combating inflation and inflationary expectation.
- Borrowing number for second half of FY12 was announced at INR 2.20 tn, which was much higher than expectation of INR 1.67tn. The reason cited for the additional borrowing by the finance ministry was shortfall in small saving scheme mobilization and the need to have a moderate cash balance with the government.
- The Index of Industrial Production (IIP) slowed down to 3.3% during July 2011 as against consensus expectation of 6.2% and previous month growth of 8.8%. This was due to slowdown in Manufacturing sector which rose by 2.3%, Mining also grew sluggishly by 2.8% while Electricity remained buoyant at 13.1%. Due to moderation in growth and tight monetary policy, the growth in IIP is expected to remain in mid to high single digit numbers for the next few months.
- WPI Inflation for the month of August 2011 came at 9.78% which was marginally higher than consensus expectation at 9.6%. While June WPI inflation was revised upwards from 9.4% to 9.5%, the magnitude of revision was much lower than previous occasions, when it has been around 50 to 100 bps. Food inflation increased again to 9.6% for August from 8.2% in the previous month while fuel inflation increased to 12.8%. Non-food manufactured products inflation, which measures demand pressures in the economy rose to 7.8% in August compared to 7.5% for July. With high base effect coming in December, inflation is expected to moderate to around 7% by March 2012.
- Export growth dropped from 81.8% for the month July 2011 to 44.3% for August 2011.
- Import growth also fell from 47.9% for July 2011 to 41.8% for August 2011.
- Credit growth rose from 20.22% in early August 2011 to 20.42% in early September 2011.
- Deposit growth reduced from 18.37% in early August 2011 to 17.54% in early September 2011.

[Source: www.rbi.org.in](http://www.rbi.org.in), [Bloomberg](#)

## Market impact

Government securities market was volatile during the month of September 2011.

Market sentiment was bearish at the beginning of the month. However, with IIP growth for July coming to a mere 3.3%, the sentiment improved as there was expectation that the RBI may look at the faltering growth and may choose to pause the rate hiking cycle. The yield on 10 year G sec touched 8.29%. However, in the middle of the month when WPI inflation number came at 9.78%, which was higher than consensus expectation, the bearish sentiment returned. The non-food manufacturing inflation, which is seen as indicating "demand pressure" in the economy rose from 7.5% in the previous month to 7.8%, which further worsened the sentiment. RBI in its mid quarter policy hiked rates as expected by 25 bps to fight inflation.

The yield on 10 year G sec moved in narrow range of 8.29-8.35% for some time due to opposing forces of global weakness and the concerns of sovereign default in the Euro region on the one hand; and the hawkish stance of RBI on the other hand. However, at the end of the month, the borrowing number for October-March was announced which was higher by INR530 bn than what was expected by the market. As a result, the yield on 10 year G sec spiked up to 8.44%.

Liquidity in the system tightened during the month due to advance tax outflow from the system. RBI injected more than INR 1 tn into the system through the LAF window immediately post the advance tax outflow in mid of the month. On the whole, RBI injected INR 500-800 bn on a daily basis in the second half of the month.

Due to tight liquidity situation, CD rates continued to remain high during the month. At the beginning of the month, 3 month CD rates were at 9.10-15%. With advance tax flows going out of the system, three month rates rose to 9.30-40%, while 1 year rates moved up to 9.65-70%. However, by the end of the month, the rates stabilized at around 9.15-20% for three months and around 9.55-60% for 1 year CD.

INR Swap curve was range bound during the month. 1 year OIS softened from 7.84% by end of August 2011 to 7.61% by mid of September 2011. However, due to RBI hiking Repo Rate and higher borrowing programme, 1 year OIS closed at 7.79% by the end of the month. The 5 year OIS rate rose from 7.02% at the beginning of the month to 7.19% by the end of September 2011.

## Our assessment

INR Yields were volatile during the month on account of:

1. IIP reading for July 2011 came at 3.3% which was much lower than consensus expectation of 6.2%. As a result there was expectation of a pause in rate hiking cycle by RBI.
2. WPI Inflation for the month of August 2011 came at 9.78% which was higher than expectation. This brought back fears of rate hike by RBI.
3. RBI hiked policy rates by 25 bps which was as per market expectation. As a result, rates moved in a narrow range for some time.
4. The borrowing programme announced for second half of FY12 was of INR 2.20 tn as against expectation of INR 1.67 tn. Due to the prospect of increase in weekly supply, the rates moved up sharply by the end of the month.

## Going Forward

1. Government securities market is expected to remain volatile as higher weekly supply will start from October, which would push yields upwards.
2. Also RBI may continue with its rate hiking cycle till the time inflation continues to be above its comfort zone.
3. On the other hand, the global weakness may continue or there could be shocks coming from the Euro zone due to sovereign debt problem. This could cause the yields to soften.

## Our portfolio strategy

### Recap – September 2011

1. In the ING Income Fund and ING Gilt Fund – Provident Fund Dynamic Plan, we had moderate duration at the beginning of the month. However, we increased duration in the second half of the month with emerging concerns on in the Euro Region.
2. In the ING Short Term Income Fund we continued with higher exposure to 3-6 months money market papers as the yields were attractive in that segment due to strained liquidity.
3. In ING Liquid Fund and ING Treasury Advantage Fund, we maintained judicious mix of cash and very short term instruments.

### Strategy going forward

1. In the ING Income Fund and ING Gilt Fund – Provident Fund Dynamic Plan, we would look to actively manage duration to take advantage of any mispricing. We would continue to have moderate duration as there is global fear of sovereign default in the Euro region. If the yields become very attractive, we may add duration and if yields fall substantially, we may reduce duration.
2. In the ING Short Term Income Fund we would continue to have around 25-30% exposure to 1-2 year papers as there is good carry in these assets. We would continue to have 50-60% exposure to accrual assets, which are being traded at high rates.
3. In ING Liquid Fund and ING Treasury Advantage Fund, we would continue to maintain a judicious mix of cash and very short term instruments. However, we would continue to give higher importance to ALM for these funds.

## Gilt Outlook Matrix

	Outlook	Key Drivers	Key Risks
<b>Short Term</b>	➤ Neutral	<ul style="list-style-type: none"> <li>➤ Opposing forces of global fears in Euro Region and higher inflation would keep market range bound</li> <li>➤ However, higher inflation could keep monetary policy stance towards fighting inflation</li> <li>➤ If there is any additional borrowing due to lower than budgeted tax revenues or disinvestment, rates could move higher</li> <li>➤ Any announcement of OMO by RBI may lead to softening of rates</li> </ul>	<ul style="list-style-type: none"> <li>➤ Rebound in global or domestic growth</li> <li>➤ Inflation continue to be at higher levels</li> <li>➤ RBI may keep its stance hawkish for a long period of time to fight inflation and to anchor inflationary expectations</li> </ul>
<b>Long Term</b>	➤ Positive	<ul style="list-style-type: none"> <li>➤ Slow down in the developed economies as well as the domestic economy</li> <li>➤ Moderation in inflation due to lower commodity prices and higher base effect coming into play</li> <li>➤ Expectation of change in RBI monetary policy stance to support growth</li> </ul>	<ul style="list-style-type: none"> <li>➤ Inflation continues to remain at elevated levels</li> <li>➤ Stronger than expected rebound in global or domestic growth</li> <li>➤ Crude oil or commodity prices increase due to supply problems or stonger demand</li> <li>➤ Higher than expected borrowing due to under-provisioning of fuel and food subsidy and /or disinvestment target not being met</li> </ul>

## Corporate bond outlook matrix

	Outlook	Key Drivers	Key Risks
<b>Short Term</b>	➤ Neutral	<ul style="list-style-type: none"> <li>➤ Expectation of liquidity remaining in strained</li> <li>➤ Expectation of range bound movement in the base G sec curve</li> </ul>	<ul style="list-style-type: none"> <li>➤ Significant improvement in liquidity</li> <li>➤ Contraction in spreads due to lower than expected supply of corporate bonds in the market</li> </ul>
<b>Long Term</b>	➤ Positive	<ul style="list-style-type: none"> <li>➤ Expectation of positive movement in the base G-sec Curve</li> <li>➤ Improvement in liquidity expected over longer horizon due to government expenditure.</li> </ul>	<ul style="list-style-type: none"> <li>➤ Inflation continues to remain high</li> <li>➤ Stronger than expected global / domestic growth numbers</li> <li>➤ Higher supply of G sec could lead to crowding out effect for corporate bonds</li> </ul>

## Month end levels

**Sovereign:** The 10 year benchmark bond i.e 7.80% Govt bond maturing in 2021 closed at 8.44% by end of September 2011 compared to 8.32% by end of August 2011.

**Credits:** 1 year CD were at 9.55-60% by end of September 2011 which was similar to levels as on end of August 2011. During the month, the yield on a 10 year AAA corporate bond rose to 9.55% compared to 9.38% at the end of the previous month.

**OIS:** INR Swap curve was range bound during the month due to expectation of a dovish policy stance from RBI. 1 year OIS softened from 7.84% by end of August 2011 to 7.61% by mid of September 2011. However, due to RBI hiking Repo Rate and higher borrowing programme, 1 year OIS closed at 7.79% by the end of the month. The 5 year OIS rate rose from 7.02% at the beginning of the month to 7.19% by the end of September 2011.



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INVESTMENT MANAGEMENT



[www.ingim.co.in](http://www.ingim.co.in)

**Nature & Investment Objective:** **ING Income Fund:** An open ended income scheme which seeks to generate attractive income by investing in a diversified portfolio of debt and money market instruments of varying maturities, and at the same time provide continuous liquidity along with adequate safety. **ING Gilt Fund Provident Fund Dynamic Plan:** An open ended gilt scheme which seeks to generate relatively risk free return by investing in sovereign instruments issued by the central/state government as defined under section 2 of Public Debt Act, 1944. The scheme will not make investments in any other type of security such as shares, debentures etc. **ING Short Term Income Fund:** An open ended income scheme which seeks to generate an attractive return for its investors consistent with capital preservation and liquidity by investing in portfolio of quality debt securities, money market instruments and structured obligation. **ING Treasury Advantage Fund:** An open ended income scheme which seeks to provide an investment avenue for investors preferring good liquidity and an investment horizon of 2 – 6 months. The scheme would be able to achieve its objectives by investing in a portfolio of money market and debt instruments. **ING Liquid Fund:** An open ended liquid scheme which seeks to provide reasonable returns while providing a high level of liquidity and low risk by investing primarily in money market securities. The aim is to optimize returns while providing liquidity. **Statutory Details: Sponsor:** ING Group, through its wholly owned subsidiary, Nationale Nederlanden Interfinance B.V., **Trustee:** Board of Trustees of ING Mutual Fund, **Investment Manager:** ING Investment Management (India) Private Limited.

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