

Key Market Highlights

- On July 29, 2011 RBI hiked the Repo rate by 50 bps to 8.00% (which was higher than expectation of 25 bps hike). The Reverse Repo Rate, which is at a fixed spread of 100 bps below Repo Rate moved up to 7.00%
- Marginal Standing Facility, which is at a fixed spread of 100 bps above the Repo Rate was adjusted to 9.00%
- CRR was unchanged at 6.00% and Bank Rate also kept unchanged at 6.00%
- RBI stated that inflation remains the biggest concern for the economy with the headline WPI inflation at near double digit mark in the last few months. Non-food manufacturing inflation, which shows the extent of demand pressures in the economy, has remained high at above 7% levels since April 2011. Also rise in administered fuel prices would add to inflation by way of direct contribution to the WPI number as well as through second order effect through increasing transportation costs in the economy.
- As indicated in its previous policy, RBI has maintained that inflation would be at elevated level of close to double digit mark for the first half of FY12. However, the RBI has revised upwards its WPI inflation projection for March 2012 from 6.00% to 7.00%.
- The Index of Industrial Production (IIP) grew by 5.6% during May 2011 as against expectation of 8.5%. This was led by Mining growth of 1.4%, manufacturing growth by 5.6% and Electricity by 10.3%. Due to higher base effect and moderation in growth due to tighter monetary policy, the growth in IIP is expected to remain in mid to high single digit numbers for the next few months.
- Inflation for the month of June 2011 came at 9.4% compared to market expectation of 9.7%. Also April WPI inflation was revised upwards from 8.7% to 9.7%. The increase in inflation during March was led by Fuel Index by 12.8%, Primary articles by 12.2% and Manufactured products 7.4%. Also, manufactured non-food products index rose by 7.3% compared with 7.2% in last month. Going forward, price hikes in domestic fuel prices will exert upward pressure on the headline inflation number.
- Export growth reduced to 46.5% for the month June 2011 compared to 56.9% for May 2011.
- Import growth also reduced to 42.5% for June 2011 compared with 54.1% for May 2011.
- Credit growth softened from 20.70% in mid June to 19.30% in mid July 2011.
- Deposit growth also dropped marginally from 18.21% in mid June 2011 to 17.85% in mid July 2011.

Source: www.rbi.org.in, Bloomberg

Market impact

Government securities market was volatile during the month of July 2011

Market sentiment was positive at the beginning of the month. With IIP number coming weaker than expected, the expectation was that RBI may take a pause in its rate hiking cycle or may be hike the policy rates by 25 basis points. Also the inflation number came at 9.4% which was marginally lower than expectation of 9.7%. This further built expectation of a dovish stance by RBI to support growth with inflation flattening out. As a result the yield on 10 year G sec touched a low of 8.24% around middle of the month.

However RBI in its quarterly monetary policy surprised the markets with a 50 bps rate hike in the Repo rate and the Reverse Repo Rate to 8.00% and 7.00% respectively. Also RBI indicated that it was worried with the trend of high 'non-food manufacturing' inflation at 7.3%, which gives an indication of demand pressures in the economy. RBI also reiterated that they would be ready to sacrifice growth in the short term to control inflation as in the long term higher inflation would be counterproductive. Due to this higher than expected rate hike as well as the hawkish statements made by RBI, yields hardened sharply and closed at 8.45%.

Liquidity in the system continued to tighten for most of the month due to the cash management bill and Gsec auctions in. The average net absorption by RBI under the LAF window for the month of July stood at INR 414.04 bn.

Due to tight liquidity situation, CD rates continued to be high during the month. During the beginning of the month, 3 month CD rates were at 8.40-45% while one year CD rates were at around 9.75-80% level. However, toward the middle of the month the three month rates hardened due to further tightening of liquidity. 3 month CD rates hardened to 8.60-65% levels and further to around 9.10-15% levels towards the

end of the month. 6 month and 1 year rates were at 9.63% and 9.80% respectively towards the end of the month.

INR Swap curve softened around the middle of the month due to expectation of end of the rate hiking cycle by the RBI. 1 year OIS softened from 8.07% by end of June 2011 to 7.92% by mid of June 2011 but hardened again to 8.31% due to aggressive rate hike by RBI in the July policy. However, the 5 year swap fell sharply from 7.83% at the end of the previous month to 7.52% by the end of July 2011.

Our assessment

INR Yields softened during the middle of the month, however they hardened towards the end of July on account of:

1. IIP reading for May 2011 came at 5.6% which was lower than expectation of 8.5%. This raised concerns about the growth in the economy slowing down and a possibility of the end of the rate hiking cycle by the RBI.
2. Towards the end of the month RBI in its quarterly monetary policy surprised the markets with a 50 bps rate hike in the Repo rate and the Reverse Repo Rate to 8.00% and 7.00% respectively.
3. Crude oil prices also softened due to possibility of weakness in global markets and concerns on growth in the developed economies.

Going Forward

1. Government securities market is expected to remain range bound due to possibility of weaker growth going forward globally as well as domestically, which would be positive for the bond markets as RBI may have to follow a more accommodative monetary policy stance.
2. On the other hand, inflation is expected to remain at higher levels for the next few months, which could push yields higher.
3. There is weekly supply of INR 11,000-12,000 till the end of first half of FY12. Also, the borrowing in the second half of the financial year could be higher than budgeted number due to possibility of higher food and oil subsidy, which seem to be insufficiently provided for in the budget.

Our portfolio strategy

Recap –July 2011

1. In the ING Income Fund and ING Gilt Fund Provident Fund Dynamic Plan, we had low duration at the beginning of the month. However, we increased duration moderately in the second half of the month with emerging concerns on global growth.
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. If the yields harden significantly, we may add duration and the yields soften substantially, we would reduce duration.
2. In the ING Short Term Income Fund we would continue to have around 15-20% exposure to 1-2 year papers as there is good carry in these assets. We would continue to have 60-70% exposure to accrual assets, which are being traded at higher rates due to tight liquidity situation.
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 Asset Liability Management (ALM) for these funds.

Gilt Outlook Matrix

	Outlook	Key Drivers	Key Risks
Short Term	➤ Neutral	<ul style="list-style-type: none"> ➤ Fall in global commodity prices, which would result in lower inflation number domestically 	<ul style="list-style-type: none"> ➤ Rebound in global or domestic growth ➤ Inflation continue to be at higher levels
Long Term	➤ Neutral	<ul style="list-style-type: none"> ➤ Slow down in the developed economies as well as the domestic economy ➤ Moderation in inflation due to lower commodity prices and higher base effect coming into play ➤ Expectation of moderation in the RBI monetary policy stance to support growth 	<ul style="list-style-type: none"> ➤ Inflation continues to remain at elevated levels ➤ Stronger than expected rebound in global or domestic growth ➤ Crude oil or commodity prices increase due to supply problems or stronger demand ➤ Higher than expected borrowing in second half of FY12 due to under-provisioning of fuel and food subsidy

Corporate bond outlook matrix

	Outlook	Key Drivers	Key Risks
Short Term	➤ Negative	<ul style="list-style-type: none"> ➤ Expectation of liquidity remaining in strained ➤ Outflows in the month of September due to advance tax outflows may exert further pressure. 	<ul style="list-style-type: none"> ➤ Significant deterioration in liquidity ➤ Increase in spreads due to higher than expected supply of corporate bonds in the market
Long Term	➤ Neutral	<ul style="list-style-type: none"> ➤ Expectation of stability in the base G-sec Curve ➤ Improvement in liquidity expected over longer horizon due to government expenditure. 	<ul style="list-style-type: none"> ➤ Inflation continues to remain high ➤ Stronger than expected global / domestic growth numbers ➤ Higher supply of G sec could lead to crowding out effect for corporate bonds

Month end levels

Sovereign: The 10 year benchmark bond i.e 7.80% Govt bond maturing in 2021 closed at 8.45% by end of July 2011 compared to 8.33% by end of the previous month.

Credits: 1 year CDs were at 9.75-80% by end of July 2011 as against 9.75-80% by end of June 2011. During the month, the yield on a 10 year AAA corporate bond softened to 9.46% compared with 9.62% at the end of the previous month

OIS: INR Swap curve hardened due to the aggressive rate hike done by the RBI in the first quarter monetary policy. 1 year OIS softened from 8.07% by end of June 2011 to 8.31% by end of July 2011. However, the 5 year swap softened by a larger magnitude i.e. from 7.77% at the end of the previous month to 7.52% by the end of July 2011.



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INVESTMENT MANAGEMENT



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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