



PNB GILTS LTD

HO: New Delhi

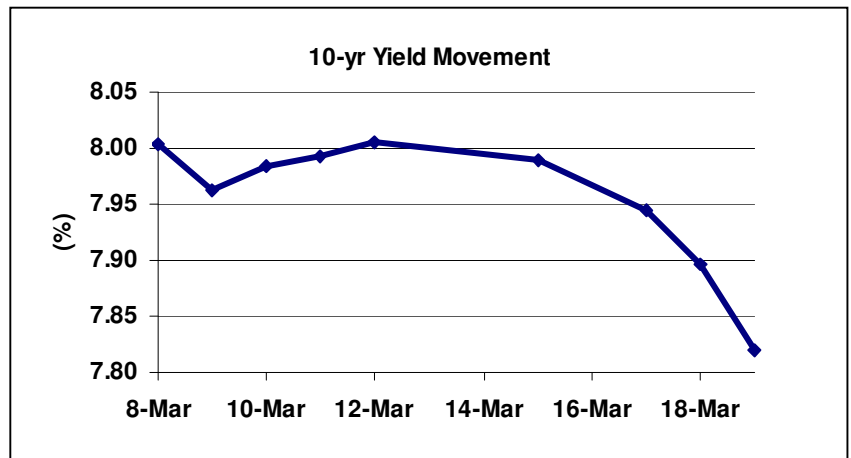
**Debt/Equity Market Update
(For the week ended 19th March'10)**

RBI Hikes Repo & Reverse Repo Rate by 25 bps each

In a move which surprised most of the market participants, RBI embarked upon with the interest rate tightening cycle, hiking the repo and reverse repo rate by 25 bps each. Though interest rate hike by RBI was widely anticipated, the timing of the same came as a huge surprise. Impressive growth of the Indian industry as witnessed in the recent months and consistent hardening of inflation formed the basis of the rate hike. The central bank displayed great discomfort with inflation almost nearing double digits and also with inflationary pressures spilling over to a wider base. RBI also stated that firming up of demand side pressures may push WPI inflation beyond double digits by March itself. 75 bps hike in CRR in the third quarter policy review and now 25 bps hike in key policy rates indicate that RBI's focus has clearly turned from supporting economic recovery to containing inflation and anchoring inflationary pressures. At the same time, RBI also acknowledged that it may not resort to strong rate hikes and may prefer to take small steps in the process of normalization of interest rates. With this, probability of another rate hike in the annual monetary policy in the month of April for FY 2010-11 remains strong.

G-sec Secondary Market

Bond yields eased considerably during the week with 10-yr yield falling by 19 bps as banks purchased securities to complete SLR requirements at the end of the financial year. Upward revision of India's debt rating from negative to stable by S&P also boosted market sentiments which had remained largely subdued owing to huge government borrowings and rising inflation. Marked decline in week on week food inflation rate too induced buying. Market volumes remained healthy despite a decline in liquidity level in the system. Yield on 6.35% GOI 2020 declined to 7.82% from 8.01% in the previous week.



Money Market

Money market rates rose sharply during the week as advance tax outflows drained out considerable amount of liquidity from the system. Call rate shot up by almost 50 to 60 bps while reverse repo absorptions plunged drastically reflecting the strain in liquidity. However, overnight rates inched lower towards the end of the week with completion of advance tax payments. Absorption under the reverse repo averaged at Rs. 10,327 crore during the week. Call rates ended the week at 3.45% vis-à-vis previous week's close of 3.27%, while CBLO rates ended the week at 3.05% vis-à-vis previous week's level of 2.38%

Crude Oil

During the week, crude oil price remained largely guided by dollar movement against major currencies. After a weak opening, oil price inched upwards as dollar declined against the euro raising demand for commodities as an alternative investment. Prices rose past USD 82 a barrel as a decline in fuel stockpiles further boosted sentiments. However, oil pared the gains and plunged USD 80 a barrel levels as dollar rebounded and US equities fell curbing demand for commodities. Crude oil closed the week at USD 80.68 a barrel as against USD 81.24 in the previous week.

US Treasury Market

US treasury yields eased in the beginning of the week after Fed maintained its dovish stance to support the economy. Sentiments were boosted after Fed reiterated that the recovery process is slow and that interest rates shall remain benign for further period. Though, decline in initial jobless claims put upward pressure on yields, expectation of rise in demand for safe haven treasuries on account of poor financial health of Greece prevented sharp slide in US treasury prices. Yield on 10-yr paper closed the week at 3.69% after touching an intra week low of 3.64% as against previous close of 3.70%.

Outlook

Indian bonds are expected to pare gains made in the previous week on unexpected timing of the first interest rate hike by RBI in nearly two years. However, yields are not expected to surge sharply as the hike was mostly discounted by the market and that the same is expected to counter spiraling inflation. Nevertheless, market sentiments are expected to remain cautious hereon as year end concerns and strong probability of another round of rate hike in April policy shall deter traders from building up fresh positions.