



**PNB GILTS LTD**  
HO: New Delhi

**July 19, 2010**

**Debt Market Update**  
**(For the week ended 16<sup>th</sup> July'10)**

**WPI Inflation**

The WPI inflation rate nudged higher as a result of pass through of fuel price hike announced at the end of June'10. The sharp upward revision in fuel prices was reflected in the June's fuel group inflation index as the same grew at annual rate of 14.32% as against 13.05% in the month of May'10. Manufacturing inflation too inched up to 6.66% in June'10 as against 6.41% in May'10. On the other hand, primary articles inflation witnessed marginal moderation to 16.28% as against 16.60% in the month of May. In food articles, the price increase was a marginal 0.20% during the month as cereals turned cheaper. The full impact of the fuel price hike is expected to reflect in the July inflation numbers as the effect of the same percolates to the other categories. Though the inflation figure at 10.55% came a tad lower than expectations, the sharp upward revision of April inflation figure raises concern about revision of the June figure as well. The inflation for April has been revised to 11.23% from initial estimate of 9.59%.

**Money Market**

Money rates remained at elevated levels during the week and adjusted with the new LAF corridor. Call rates continued to trade above the upper bound of the corridor as liquidity conditions remained little changed compared to the previous week. CBLO rates too hovered close to the repo rate and daily average volume in the same remained low at Rs. 30,799 crore. RBI injected liquidity to the tune of Rs. 54,101 crore on a daily average basis. Call rate ended the week at 5.50% vis-à-vis previous week's close of 5.60%, while CBLO rates ended the week at 4.70% vis-à-vis previous week's level of 5.49%.

**G-sec Primary Market**

During the week, GOI raised Rs. 13000 crore through issue of 7-yr paper, 7.46% GOI 2017 for Rs. 5000 crore, 12-yr paper, 8.20% GOI 2022 for Rs. 5,000 crore and 17-yr paper, 8.26% GOI 2027 Rs. 3,000 crore. 7-yr paper and 17-yr papers were underwritten at a fee of 0.93 paise and 0.95 paise. 12-yr paper witnessed highest underwriting fee at 1.04 paise. Bid-to-cover ratio of all papers remained above 2. 7-yr paper was subscribed at cut-off price of Rs. 99.13 (YTM: 7.62%). 12-yr and 17-yr papers were subscribed at Rs.101.50 (YTM: 8.0%) and Rs. 100.20 (YTM: 8.24%).

**G-sec Secondary Market**

Snapping the rise witnessed in the previous week, yields dropped in reaction to the lower than expected IIP growth rate for the month of May. In May industrial output grew at an annual pace of 11.5% as against expectation of over 16%. Thereafter yields traded in a narrow range with an upward bias as continued rise in inflation and expectation of further rise in the same owing to the recent hike in fuel prices weighed on

sentiments. Inflation showing no signs of abatement rose in the month of June'10 to 10.55% as fuel group inflation quickened. During the week 10-yr yield declined by 1 bps to close at 7.64%.

### **Crude Oil**

With the start of the week, oil witnessed marginal downward correction as dollar strengthened against euro on renewed concerns regarding the health of the European economy. However, oil pared losses and rose again tracking surge in equities and decline in dollar. More than expected decline in US stockpiles and increase in operating rates by oil refiners too turned market sentiments positive. However at the end of the week, oil prices treaded downwards on concerns that the US economic recovery will be slow. Oil closed the week at USD 76.01 a barrel as against USD 76.09 a barrel in the previous week.

### **US Treasury Market**

US treasury yields traded firm in the beginning of the week as constant supply in the primary market weighed on sentiments. Huge auction supply in 3-yr, 10-yr and 30-yr segment resulted in steepening of yield curve. Rally in the stock market too deterred investments in treasuries pushing 10-yr yield to rise to 3.12%. However, towards the end of the week, 10-yr yield slipped below 3.0% again as decline in retail sales followed by release of Fed minutes stating risks to the recovery has increased, triggered buying. Expectation of Fed maintaining rates at record low levels for a very long time supported treasuries. On the last trading day, release of showing declining inflation and tumbling consumer confidence enhanced the allure of treasuries. Yield on 10-yr benchmark paper ended the week at 2.92% as against 3.05% during the previous week.

### **Forex Market**

After rallying for 3-days at the end of the previous week, rupee weakened on announcement of lower-than-expected industrial production growth in month of May followed by dismal quarterly performance report by IT major. Rupee stabilized towards the end of the week as rise in global markets and strengthening of Euro spurred optimism that the economic impact of Europe's debt crisis will be contained and investors will return to emerging markets. Rupee closed the week at 46.78/USD as against 46.67/USD in the previous week.

### **Outlook**

In the coming week, yields are expected to open lower taking cues from sharp decline in US treasury yields. Absence of G-sec auction in the next week may also induce demand in secondary market. However, apprehensions regarding action in first quarter policy review may cap sharp decline in yields. Though the market has discounted another 25 bps hike in the key interest rates, inflation figures released during the previous week have raised expectations of a steeper hike in the policy rates be RBI.

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