GILT NEWS

for the fortnight ended 18 June, 2010

Economy & Financial Markets Review

Domestic Developments

IIP zooms to 17.6% in April '10, manufacturing grows by 19.4%

WPI inflation enters double digits, rises to 10.16% in May'10

Credit growth rate rose past 19.12%; Deposits register y-o-y growth of 14.34%

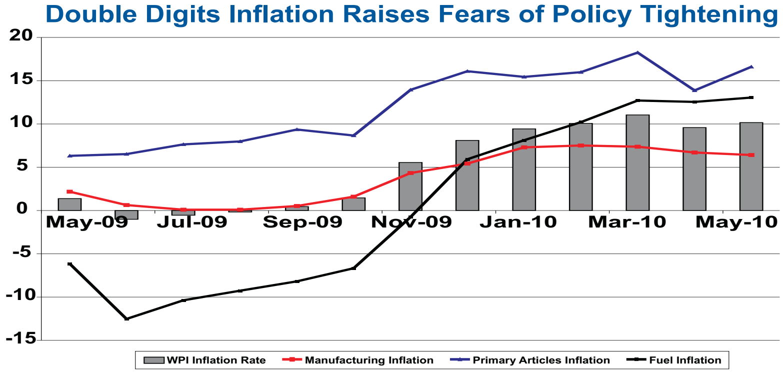
International Developments

Weak economic data releases help treasuries recover

Benchmark 10-yr US treasury yield firms up by 2 bps during the fortnight

Crude oil recovers supported by better economic data release in the Euro area to close at USD 77.18 as against USD 71.51 in the previous fortnight

Double Digits Inflation Raises Fears of Policy Tightening



MACROECONOMIC INDICATORS

(Rs. Billion)

	As on 4th June'10	Variation over the fortnight	Variation over LRF of March	YOY % growth
Aggregate Deposits	45,413	151	485	14.34
Bank Credit	32,881	579	433	19.12
Non - food Credit	32,359	552	396	19.80
Banks Investment in G-Sec	14,294	(89)	510	13.11
Broad Money M3	56,885	163	1,089	14.60
Reserve Money 11/06	11,883	17	330	22.82
Market Stabilisation Scheme Outstanding 11/06	3	0		0.00
Forex Reserves (USD bn) 11/06	273	0.8	(6)	3.47
Credit - Deposit Ratio	72.40			
LAF Repo Rate (%)	5.25			
LAF Reverse Repo Rate (%)	3.75			
Cash Reserve Ratio (%)	6.00			

G-sec Market

Surge in industrial activity and inflation push up bond yields

Government borrows Rs. 22,000 crore during the fortnight, Rs. 1,386 crore of securities devolved on Primary Dealers

After touching a high of 7.69%, 10-yr yield ends the fortnight at 7.56%

Money Market

Call and CBLO rates end the fortnight at 5.19% and 4.63% respectively

RBI injects funds to the tune of Rs. 47,257 crore on a daily average basis during the second week of fortnight

Forex Market

Strong growth prospects in the domestic economy push up rupee

Rupee ends the fortnight at 46.18/USD vis-à-vis previous fortnight's level of 46.84/USD

Fortnightly average of 3M & 6M fwd annualized premia at 3.48% & 3.08% as against previous fortnight's level of 3.13% & 2.56% respectively

Equity Market

Stabilizing global economic conditions & robust industrial boost investment

Sensex and Nifty rise by 2.65% & 2.46% respectively

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DOMESTIC DEVELOPMENTS

Strong Show by Manufacturing Keeps IIP on Double Digit Growth Track

Growth in industrial production soared with the beginning of the new fiscal and rose to near 20-yr high of 17.6% in April'10. The higher than estimated growth was aided by robust performance by the manufacturing sector and partly due to low base of the previous year. Manufacturing sector having a weightage of 80% in the IIP basket surged by a whopping 19.4% in April as against 0.40% in the corresponding period last year. Under use-based classification, 73% rise in capital goods output and 37% increase in consumer durable goods supported led the growth in manufacturing sector. On the other hand mining and electricity output too recorded significant growth figures of 11.40% and 6.00% respectively. Sharp surge in industrial production may result in build up of demand side pressures, which may fan inflation. Despite robust growth in industrial output, the central bank has remained reluctant in raising interest rates aggressively considering the continued uncertainty in global economy.

Index of Industrial Production

	Y-O-Y % Growth over Corresponding Period in Previous Year		
	April		March
	2010-11	2009 - 10	2009 - 10
Mining	11.40	3.40	11.77
Manufacturing	19.40	0.40	14.68
Electricity	6.00	6.70	7.75
Overall	**17.60**	**1.10**	**13.93**

Costlier Primary Articles And Fuel Products Push Up WPI Inflation Into Double Digits

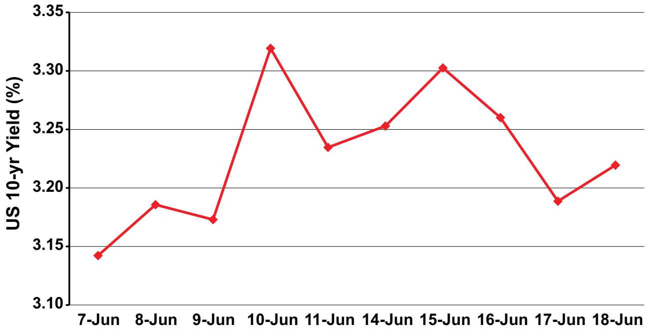
WPI inflation rate accelerated further to enter double digits mounting further pressure on the central bank to take action. Rising by 10.16% in May which is the highest in almost 19 months, inflation rate surpassed market expectations driven by surge in prices of both food and non food items. May's figure gives ample evidence that inflation which had remained confined to food articles, is now gradually spreading to manufactured items. On a disaggregated basis primary articles inflation rose to 16.60%, while fuel inflation surged to 13.05% during the month. On the other hand manufactured products inflation rose to 6.41% a little below 6.70% recorded in April. The estimate figure for the month of March'10 was also revised sharply upwards from 9.90% to 11.04%.

Name of commodity	Weights	Index as on		Y-O-Y % increase	
		31-May-10	30-Apr-10	31-May-10	30-Apr-10
All commodities (WPI)	100.00	258.1	253.7	10.16%	9.59%
Primary Articles	22.02	299.9	289.7	16.60%	13.88%
Fuel, Power, Light & Lubricants	14.23	368.2	364.0	13.05%	12.55%
Manufactured Products	63.75	219.1	216.6	6.41%	6.70%

Bank Credit Growth Rate Touches 19.12%

Bank credit growth surged to impressive 19.12% during the week ended 4th June'10 mainly on the back of demand from telecom companies to fund their license fees. Banks loan disbursal rose by Rs. 579 billion during the fortnight. The outstanding credit stood at Rs 32,881 billion. Non food credit registered growth of 19.80%. During the fortnight, banks mobilized Rs. 151 billion resulting in total deposit base rising to Rs. 45,413 billion. On y-o-y basis, aggregate deposit growth rate stood at 14.34%. Despite growth in deposit growth, banks investments in G-sec declined by Rs. 89 billion.

Weak Economic Data Releases Help US Treasuries Recover

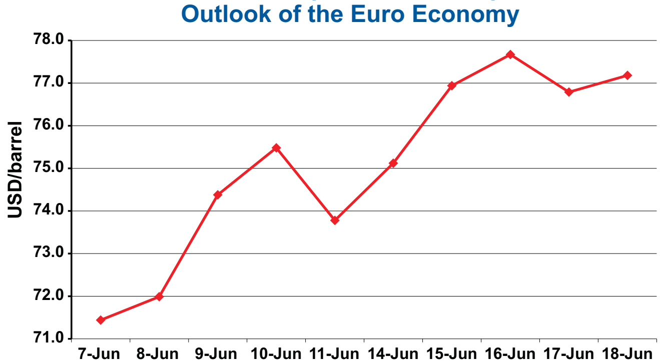


Global Economic Calendar

Date	Event
22-Jun	US Existing Home Sales, May (5.77M)
23-Jun	US New Home Sales, May (504K)
	US FOMC Meet
24-Jun	US Durable Goods Orders, May (2.9%)
25-Jun	US Core PCE QoQ, 1Q (0.6%)
	US GDP QoQ, 1Q (3.0%)
29-Jun	US Consumer Confidence, June (63.3)
1-Jul	US ISM Manufacturing, June (59.7)
	US Pending Home Sales YoY, May (24.6%)
2-Jul	US Factory Orders, May (1.2%)
	US Unemployment Rate, June (9.7%)
	US Non Farm Payrolls, May (431K)

*[Figures in () are prior readings]

Crude Climbs Up on Back of Improved Outlook of the Euro Economy



INTERNATIONAL DEVELOPMENTS

US Treasuries

After the sell-off witnessed towards the end of the previous fortnight, treasuries started on a positive note on emergence of buying at low levels. However, auction of securities during the first week led to continuous rise in yields. While the amount of securities to be auctioned was lower and demand as gauged by bid-to-cover ratio was also robust, still yields treaded upwards as market demanded higher yields given the amount of bond supply in market. Further, with Fed chairman stating that the impact of Europe's sovereign-debt crisis on the US is likely to be modest, yields shot up. Unexpected decline in US retail sales encouraged demand for the relative safety of government debt which pulled down yields momentarily. Treasuries continued to weaken during the second half as well. Signals of stabilization of European economies led to a recovery in stock markets which reduced demand for bonds. However, yields stabilized towards the end of the fortnight as decline in housing starts, unexpected jump in jobless-benefit claims and a drop in consumer prices spurred expectations of Federal Reserve maintaining interest rates at historic lows. On the last trading day, yields firmed up as investors shed treasuries following rise in stocks and commodities. Yield on 10-yr paper firmed up to 3.22% as against previous fortnight's close of 3.20%.

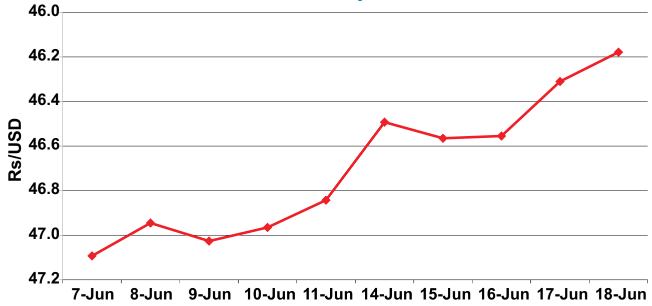
International Crude Oil

Crude oil prices recuperated after falling sharply in the previous fortnight and climbed up steadily from a weeks lows triggered by positive comments from the Fed chief on economic recovery. Significant pull down in dollar on speculation that US interest rates may remain at record lows also boosted demand for crude oil. Oil breached the psychological mark of USD 75 a barrel after a long gap as equities surged on back of strong economic data releases in China and Japan. Though an unexpected drop in US retail sales in the month of May took the market by surprise pushing oil prices lower by almost 3%, oil pared losses after a rise in US consumer confidence to the highest level in two years was reported. In the second week, oil continued to strengthen after industrial activity in Europe was reported to pick up easing concerns of crisis in the area. However, oil could not sustain the one month high levels and tumbled on back of unexpected increase in US jobless claims. Rise in dollar near the end of the fortnight also dampened sentiments and subsequently oil closed the fortnight at USD 77.18 a barrel as against USD 71.51 a barrel in the previous fortnight.

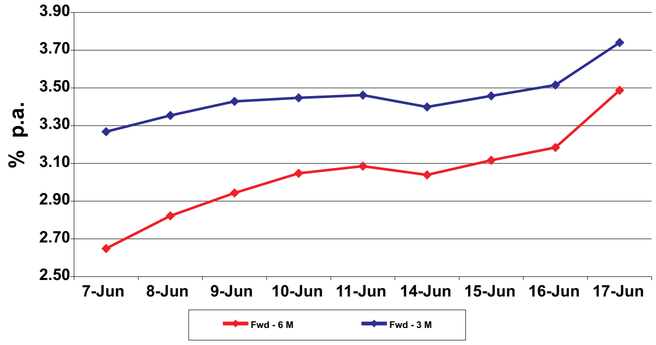
FOREX MARKET

Rupee remained weak during the first half of the fortnight on speculation that fund outflows from domestic stock market will continue amid increased risk aversion among investors. Rupee soon weakened above 47/USD levels.

Rupee Strengthens on Back of Interest Rate Hike Expectations



Annualised USD/INR Fwd Premia



Major Stock Indices

	4-Jun-10	18-Jun-10	% change
Indian Indices			
Sensex	17,117	17,570	2.65%
Nifty	5,136	5,262	2.46%
Banking	3,069	3,119	1.62%
Healthcare	5,296	5,401	1.98%
FMCG	10,773	10,880	0.99%
IT	7,894	8,135	3.05%
PSU	13,809	14,551	5.38%
Auto	5,509	5,603	1.71%
Capital Goods	9,171	9,204	0.36%
World Indices			
Dow Jones	9,932	10,451	5.22%
Nikkei	9,901	9,995	0.95%
FTSE	5,126	5,251	2.44%

However prospects of faster growth in Asian economies helped in easing of rupee. An optimistic forecast of growth in the Euro region by the ECB also boosted sentiments. In the second week, rupee surged sharply rising by the most in almost two weeks on expectations that RBI would raise interest rates to stall shooting inflation. The WPI inflation rate for the month of May was reported at 10.16% and the same for March was also revised upwards to 11.04%. Rupee snapped four days of consecutive rise after Moody's lowered Greece's debt rating to non-investment grade renewing concerns about the Euro crisis. However strong outlook of growth in the domestic economy helped rupee climb back near the close of the fortnight. Sentiments were also boosted after Fitch raised India's debt rating from “negative” to “stable” as robust spectrum auction collections may help in reducing the fiscal deficit. Rupee closed the fortnight at 46.18/USD as against previous fortnight's closing of 46.84/USD.

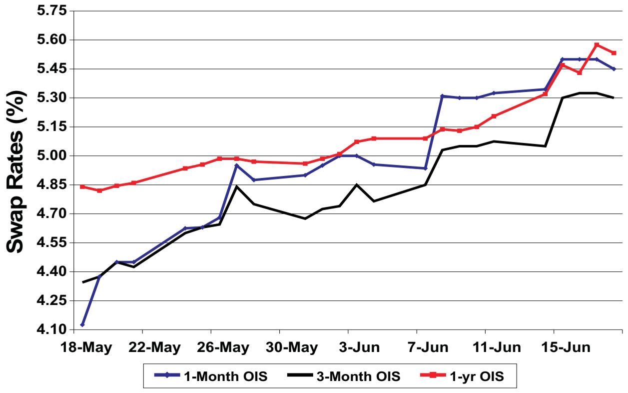
EQUITY MARKET

Equity markets remained in the positive territory for most part of the fortnight on the back of increased buying by foreign and domestic fund houses following reports of improvement in global economy. Market started the fortnight with a decline of around 500-points in first two trading sessions owing to weak global cues and likelihood of huge public offers in the market. However, improvement in global conditions led market to recover gradually. Higher-than-expected IIP figure of over 17% boosted investor confidence. Expansion plans by major corporates also induced buying. Double digit inflation figure had limited impact amid forecast of normal monsoons. Market witnessed regular bouts of profit booking. However, with underlying market sentiments remaining positive, market recovered soon enough. On the last trading day, market declined as a major foreign player offloaded its shares in two Indian companies. Sensex and Nifty rose by 2.65% and 2.46% during the fortnight. In global markets, Dow Jones rose by 5.22% on signs of stability in debt-stricken Europe.

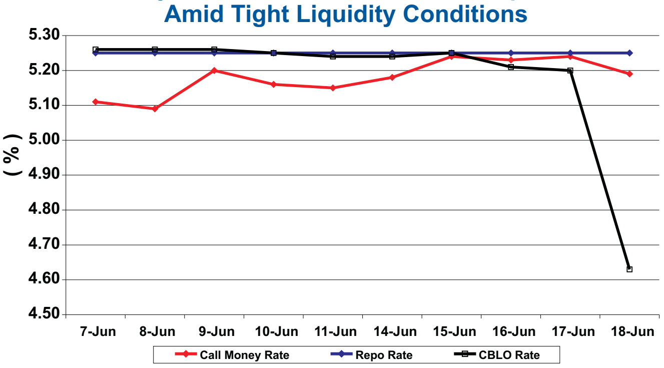
INTEREST RATE DERIVATIVES

Swap rates inched up gradually during the fortnight under tight liquidity condition. Liquidity conditions tightened towards the end of the previous month after telecom companies made payment of Rs.67,000 crore for 3-G license fee. Swap rates traded firm as liquidity was expected to tighten further after payment of advance tax outflows and license fee for broadband. 1-month OIS rate firmed up further during the fortnight and rose from 4.96% to 5.45%. 1-month rate remained constantly above 2-month and 3-month rates. 5-yr swaps used mostly for hedging of G-sec too rose by 30 bps to 6.87% tracking consistent rise in G-sec yields. 5-year MIFOR rate too rose from 5.15% during the previous week to 5.30%.

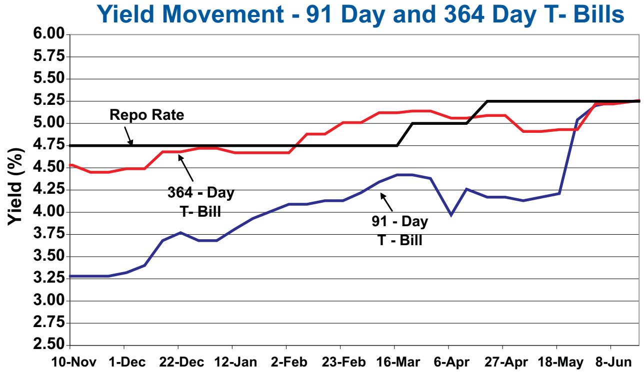
OIS Rates Continue to Rise Amid Tight Liquidity Conditions



Money Market Rates Traded Near Repo Rate Amid Tight Liquidity Conditions



Yield Movement - 91 Day and 364 Day T- Bills



MONEY MARKET

Money market rates continued to remain firm during the fortnight on account of squeeze in liquidity. Robust advance tax outflows put further pressure on the money market rates. Both Call and CBLO rates traded near the upper bound of the LAF corridor during the fortnight. Near the end of the month, heavy outflow of Rs. 38,500 crore on account of BWA auction is likely to put further pressure on money market rates. In order to ease pressure on the tightened liquidity RBI conducted a security buyback auction at the end of the fortnight to the tune of Rs. 10,000 crore. During the fortnight net repo injection remained heavy averaging at Rs. 47,257.50 crore. Call rates ended the fortnight at 5.19% versus previous fortnight's level at 4.89%. While CBLO rates ended the fortnight at 4.63% vis-à-vis previous fortnight's closing of 4.46%.

TREASURY BILLS

Primary Market

During the fortnight, government raised Rs. 6,000 crore through issuance of T-bills. Despite reduction in auction quantum demand in auction remained subdued as players feared that hike in interest rates may result in sharp rise in short term rates. Cut off yields continued to rise as players demanded higher yields in expectation of hike in interest rates. Cut off yield on 91-day T-bill rose from 5.24% in the first week to 5.37% in the second week. On the other hand, 182 day T-bill was auctioned at a yield of 5.25% as against 4.97% in the previous fortnight. While yield on 364 day T-bill surged sharply to 5.60% from 5.22% in the previous fortnight.

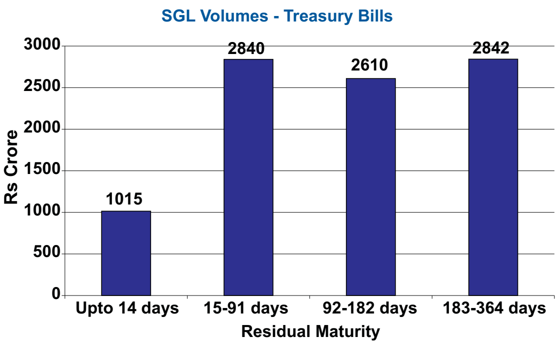
Secondary Market

T-bill trading volumes declined significantly during the fortnight owing to tight liquidity conditions as well as

Details of all the Treasury bill auctions held in the fortnight ended 18th June 2010 have been tabulated as under:

(Rs. Crore)

Particulars	91 Day		182 Day	364 Day
Date Of Auction	**09 Jun**	**16 Jun**	**09 Jun**	**16 Jun**
Cut-off Price (Rs)	98.71	98.68	97.45	94.71
Implicit Yield (%)	5.24	5.37	5.25	5.60
Weighted Avg. Yield (%)	5.20	5.32	5.23	5.48
Competitive Bids Received	4931.10	6441.50	3580.55	1930.25
Competitive Bids Accepted	2000.00	2000.00	1000.00	1000.00
Non-Competitive Bids Accepted	Nil	500.00	Nil	157.00
Total Bills Issued	2000.00	2500.00	1000.00	1157.00
Of which MSS	Nil	Nil	Nil	Nil



Repurchase Auction Details

Security	Bids Received (Rs. Cr)	Amount Accepted (Rs. Cr)	Cut-off Price (Rs.)
11.30% GOI 2010	8926.1	3110.0	100.61
12.25% GOI 2010	4467.0	3622.0	100.21
6.57% GOI 2011	6158.0	1575.0	100.84
Total	**19551.1**	**8307.0**	**-**

decline in auction quantum. Trading volumes during the fortnight stood at Rs. 9,307 crore as against previous fortnight's level of Rs. 20,985 crore. Average daily trading volume stood at Rs. 931 crore. Segment wise trades in treasury bills are given in the exhibit. Highest volume of Rs 2,842 crore was witnessed in the 183 - 364 days residual maturity bucket. During the fortnight Foreign Banks and Public Sector Banks were net buyers while Private Sector Banks, Mutual Funds and Primary Dealers were net sellers.

GOVERNMENT SECURITIES
Primary Market

During the week, GOI raised Rs. 11,000 crore through issue of new 5-yr paper (Rs. 4,000 crore), 10-yr paper 7.80% GOI 2020 (Rs. 5,000 crore) and 22-yr paper 8.32% GOI 2032 (Rs. 2,000 crore). 5-yr paper witnessed strong demand and bid to cover ratio of the same stood at 3.87. The cut off yield on the same was much below market expectations at 7.17%. On the other hand 7.80% GOI 2020 witnessed moderate demand and the same was sold at a yield of 7.57% (Price: Rs. 101.50). The 22 year paper was subscribed at 8.22% (Price: Rs. 101).

In the second week, GOI raised Rs. 11,000 through issue of 2-yr paper 6.85% GOI 2012 (Rs. 6,000 crore) and 12-yr paper 8.20% GOI 2022 (Rs. 5,000 crore). The short term paper witnessed poor demand in the auction owing to liquidity concerns and the same was devolved for an aggregate amount of Rs. 1,386 crore on primary dealers at a cut off yield of 6.21% (Price: Rs. 101.10). The medium term paper witnessed good demand from players and the cut off yield of the same was slightly below market expectations at 7.98% (Price: Rs. 101.60). Bid to cover ratio in 6.85% GOI 2012 and 8.20% GOI 2020 stood at 1.76 and 2.63 respectively.

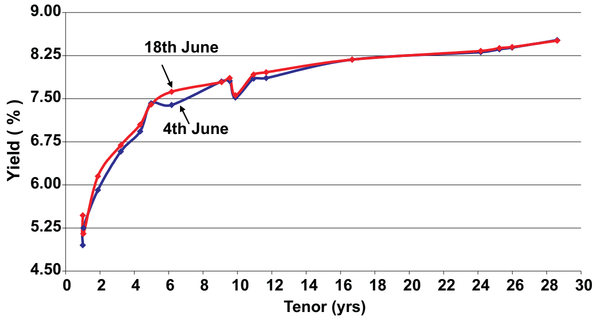
Repurchase Auction

During the fortnight, GOI announced repurchase auction worth Rs. 10,000 crore for 3- short term securities as part of their cash management operations. These repurchase operations were purely of *ad hoc* nature and will be funded through the current surplus cash balances of the Government. Through these auctions, GOI repurchased 11.30% GOI 2010 for an aggregate quantum of Rs.3,110 crore, 12.25% GOI 2010 for Rs. 3,622 crore and 6.57% GOI 2011 for Rs. 1,575 crore. The details of the same are given in the exhibit.

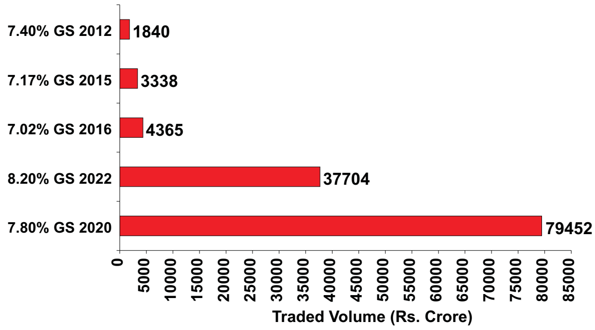
Secondary Market Developments

During the fortnight, bond market came under pressure and sentiments turned cautious in expectation of an inter policy interest rate hike by the central bank. The tightness in liquidity also continued to put upward pressure on yields. Robust IIP and inflation numbers turned market sentiments jittery, which was earlier drawing comfort from bleak global economic outlook. Both the IIP and inflation figures turned out to be much higher than market estimates at 17.6% and 10.16% respectively. Sharp surge in core inflation pushed up 10-yr yield to a six week high. Bonds yields snapped five days of rise on speculation that the current squeeze in liquidity conditions and

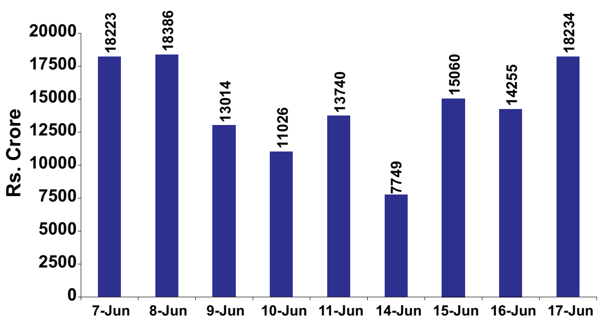
Short Term Yields Rise During the Fortnight



Most Traded Securities



Dated Securities Trading Volumes



the ongoing crisis in the Euro region may refrain RBI from raising rates before the policy. However sharp fall in yields was not witnessed as liquidity crunch in the system resulted in subdued buying by players. After declining by almost 10 bps in the second week, 10-yr yield faced stiff resistance at 7.60% levels. Though announcement of OMO buyback auction by RBI and decline in US treasury yields boosted sentiments to some extent, traders remained in a wait and watch mode ahead of G-sec supplies of Rs. 11,000 crore. Yields ended lower supported by favourable comments from the central bank governor who reiterated that the exit from the policy will be done in a calibrated manner. Yield on the 10-yr benchmark paper 7.80% GOI 2020 closed at 7.56% after touching a high of 7.69% during the fortnight as against 7.52% during the previous fortnight. Spread between 30-yr and 1-yr papers declines to 304 bps from 357 bps in the previous fortnight.

Trading Volumes

Total trading volumes declined during the fortnight to Rs. 1,41,157 crore as against Rs. 1,66,579 crore in the previous fortnight. The first week's average daily trading volume stood at Rs 14,878 crore vis-à-vis second week's level of Rs. 13,354 crore. The highest single day trading volume was Rs. 18,386 crore. Top two traded securities 7.80% GOI 2020 and 8.20% GOI 2020 cornered 92.47% of the top five traded securities volume. During the fortnight Public Sector Banks were net buyers while Private Sector Banks, Foreign Banks, Mutual Funds and Primary Dealers were net sellers.

OUTLOOK

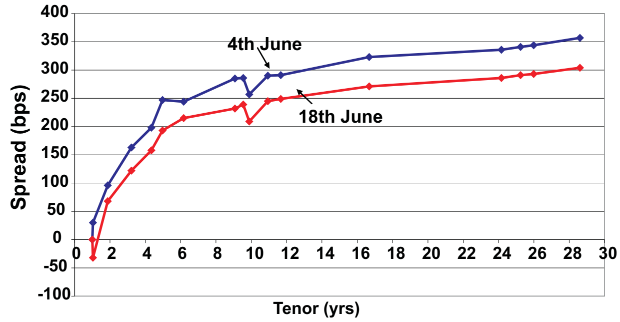
Tight liquidity conditions along with robust economic data release pushed 10-yr yield to nearly a month high during the fortnight. Outflows towards 3-G license fee and advance tax payment are holding short end of the curve at above repo rate levels, while expectations of rate hike to curb rising inflation drove up medium and long term yields. However, 10-yr bond is showing strong support at near 7.70% and reverted from this level twice during the fortnight. At the same time, benchmark bond failed to breach below 7.52% levels owing to selling pressure. Improvement witnessed during the last two trading sessions has resulted in relative strength index rising above 60 after remaining below 50 for most part of the fortnight.

In the coming fortnight, liquidity is expected to remain tight owing to auction outflow aggregating Rs.36,000 crore clubbed with Rs. 38,500 crore to be paid for broadband license fee. However, repurchase of securities worth Rs. 10,000 crore by Govt. is expected to provide some support. Liquidity condition is expected to improve towards the end of fortnight following coupon payment and redemption inflows worth Rs. 18,000 crore on 2nd July. Global cues will also be tracked closely as the global economic outlook continues to remain uncertain. Fed meet on 23rd June will be crucial to access direction of interest rates in global economy.

SPREAD MONITOR

	TTM (yrs)	YTM		Change in YTM (bps)
		4-Jun	18-Jun	
364 Day T Bill	1.00	4.95	5.47	52
9.39% GOI 2011	1.04	5.25	5.15	-10
7.40% GOI 2012	1.88	5.91	6.15	24
7.32% GOI 2014	4.34	6.93	7.05	12
6.49% GOI 2015	4.98	7.42	7.40	-2
7.02% GOI 2016	6.17	7.39	7.62	23
6.90% GOI 2019	9.07	7.80	7.79	-1
6.35% GOI 2020	9.55	7.81	7.86	5
7.80% GOI 2020	9.88	7.52	7.56	4
7.94% GOI 2021	10.94	7.85	7.92	7
8.20% GOI 2022	11.67	7.86	7.96	10
8.24% GOI 2027	16.67	8.18	8.18	0
7.50% GOI 2034	24.16	8.31	8.33	2
7.40% GOI 2035	25.24	8.36	8.38	2
6.83% GOI 2039	28.61	8.52	8.51	-1

Spread Over One-Year Paper



CASH FLOWS FOR THE FORTHCOMING FORTNIGHT GOVERNMENT SECURITIES

(Rs. crore)

INFLOWS				OUTFLOWS		
Date	Security	Coupon Receipts	Redemptions	Date	Security	Scheduled auction amount
22-Jun	7.35% GS 2024	368		June 21 - 25	5-9 year	6000-7000
27-Jun	11.60% GS 2020	290			10-14 year	5000-6000
2-Jul	12.25% GS 2010	728	11893		15-19 year	2000-3000
	9.39% GS 2011	1737			20-yr and above	2000-3000
	4.11% FRB, 2015	123		June 28 - July 2	5-9 year	5000-6000
	12.30% GS 2016	807			10-14 year	5000-6000
	4.90% FRB 2017	74			20-yr and above	2000-3000
	6.25% GS 2018	528				
	5.64% GS 2019	282				
	6.35% GS 2020	1937				
Total Inflows		6,874	11,893	Total Outflows		28,000

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