

GILT NEWS

for the fortnight ended 2 July, 2010

Economy & Financial Markets Review

Domestic Developments

RBI hikes repo and reverse repo rates by 25 bps each

Rise in non-food inflation prompts mid cycle action

High base pushes down food inflation to 12.92% in week ended 19th June'10

International Developments

Disappointing economic data releases drag down US treasury yields

Benchmark 10-yr US treasury yield plunge below 3% mark to end the fortnight at 2.98%

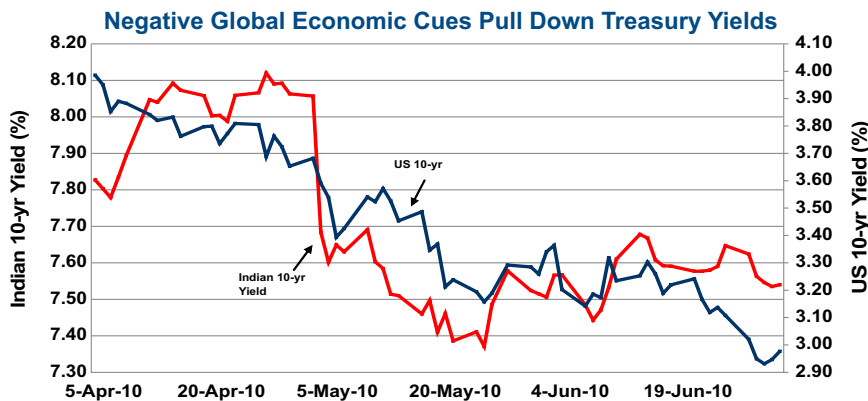
Crude oil closes the fortnight at USD 72.14 a barrel after touching USD 77.18 during the fortnight

G-sec Market

Bond yields retrace from around two month high after reduction in GOI auction quantum

Government borrows Rs. 25,000 crore during the fortnight

Yield on 7.80% GOI 2020 ends flat at 7.56% as compared to the previous fortnight



Money Market

Call and CBLO rates end the fortnight at 5.19% and 4.20% respectively

RBI injects funds to the tune of Rs. 66,493 crore on a daily average basis during the fortnight

Forex Market

Sell off in global equities and poor sentiments pull down rupee

Rupee ends the fortnight at 46.79/USD vis-à-vis previous fortnight's level of 46.18/USD

Fortnightly average of 3M & 6M fwd annualized premia at 3.98% & 3.56% as against previous fortnight's level of 3.48% & 3.08% respectively

Equity Market

Weak global cues weigh on domestic equities

Sensex and Nifty decline by 0.62% & 0.47% respectively

MACROECONOMIC INDICATORS

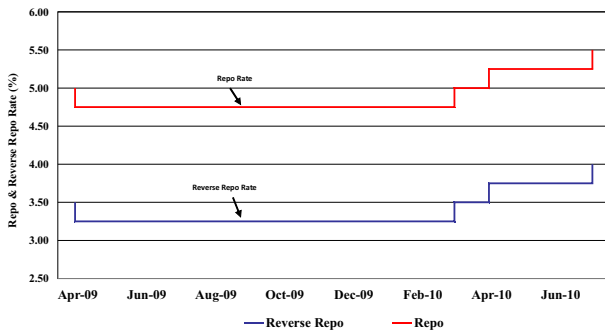
(Rs. Billion)

	As on 18th June'10	Variation over the fortnight	Variation over LRF of March	YOY % growth
Aggregate Deposits	45,175	(238)	247	13.92
Bank Credit	33,104	223	656	19.60
Non - food Credit	32,574	215	611	20.32
Banks Investment in G-Sec	14,067	(228)	283	9.74
Broad Money M3	56,771	(127)	773	14.49
Reserve Money 25/06	11,884	2	328	26.52
Market Stabilisation Scheme Outstanding 25/06	3	0		0.00
Forex Reserves (USD bn) 25/06	277	4.2	(2)	4.69
Credit - Deposit Ratio	73.28			
LAF Repo Rate (%)	5.25			
LAF Reverse Repo Rate (%)	3.75			
Cash Reserve Ratio (%)	6.00			



DOMESTIC DEVELOPMENTS

RBI Hikes Repo and Reverse Repo Rate by 25 bps



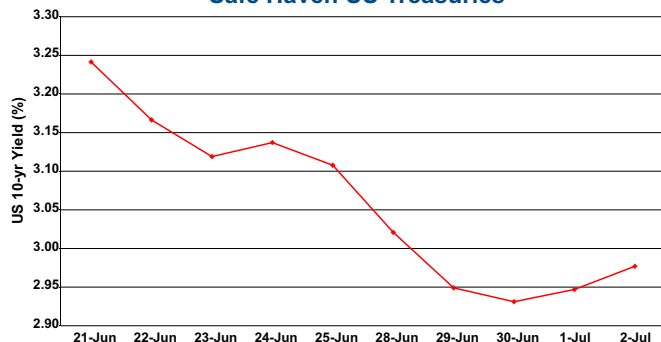
Key Interest Rates Hiked by 25 bps Each to Check Inflation

Stubborn inflation forced RBI to take an inter policy action and hike the key interest rates viz, repo and reverse repo rates by 25 bps each to 5.50% and 4.00% respectively. Cumulatively, during FY 2010-11, RBI has increased the rates by 50 bps each. The central bank had been under immense pressure to take a rate action, as inflation shows no signs of abatement whatsoever. The hike that comes almost a month ahead of the first quarter monetary policy review clearly reflects RBI discomfort with double-digit inflation figures. Rise in core inflation has been quite discernible indicating that the demand side pressure too is picking up fast. The decontrol of fuel prices shall result in further aggravation of inflation as rise in freight charges may have an adverse impact on prices of certain food items. Though the central bank has been maintaining that it would take on a calibrated approach while normalizing interest rates amid uncertain global economic conditions, flaring inflation and sustained domestic economic growth make the situation complex.

Food Inflation Falls to 12.92%

Food inflation broke its rising trend declining by a whopping 400 bps to 12.92% in the week ended 19th June'10 as against 16.9% in the previous week. The sharp decline is mainly attributed to high base of previous year and partly due to some decline in prices of certain food items such as cereals and poultry. However on a week on week basis the index has actually shown an uptick of 0.3% owing to rise in prices of fruits and vegetables. Primary articles inflation, which includes food inflation, came on expected lines at 14.75% as against 17.6% in the previous week. On the other hand fuel group inflation also slowed down to 12.90% as against 13.80% in the previous week. The recent decontrol of fuel prices is expected not only to push up fuel inflation it may also have an adverse effect on food inflation thereby aggravating the overall WPI inflation number.

Poor Economic Data Releases Spur Demand for Safe Haven US Treasuries



INTERNATIONAL DEVELOPMENTS

US Treasuries

US treasuries declined in the beginning of the fortnight as abandoning of Yuan –USD peg by China raised optimism towards recovery in global economy. This move is expected to reduce China's requirement to invest funds in US treasuries. However, yields eased throughout the fortnight thereafter as series of dismal data releases pushed investors to the safety of treasuries. While existing home sales remained considerably below expectation, new homes sales declined by around 200k from previous month's level. Apart from this, data releases for consumer

Global Economic Calendar

Date	Event
8-Jul	BoE & ECB Monetary Policy Meet
13-Jul	US Trade Balance, May (USD -40.3 bn)
14-Jul	US Advance Retail Sales, June (-1.2%)
	Minutes of FOMC Meet
	BoJ Monetary Policy Meet
15-Jul	US Industrial Production, June (1.2%)
	US Producer Price Index, June (5.3%)
16-Jul	US Consumer Price Index, June (2.0%)

*[Figures in () are prior readings]

confidence, GDP, employment and manufacturing remained below market expectations. Fed too maintained the dovish stance in its policy review and left the key interest rates unchanged at historic lows. In the second half of the fortnight, nervousness over adverse impact of European debt crisis on US economic growth pushed 10-yr yield to below 3% mark after a gap of over an year. Expiration of a European Central Bank lending facility and decline in index of leading indicators for China pushed short-term yields to record low levels. Subsiding of risk of inflation after release of weak economic data induced buying in medium and long term papers, thereby resulting in sharp decline in spread between 2-yr and 10-yr yield. Towards the end of the fortnight, profit booking resulted in marginal rise in yields. On the last day of the fortnight, better-than-expected payrolls data led to rise in yields. 10-yr paper ended the fortnight at 2.97% as against previous fortnight's close of 3.22%.

COMMODITIES

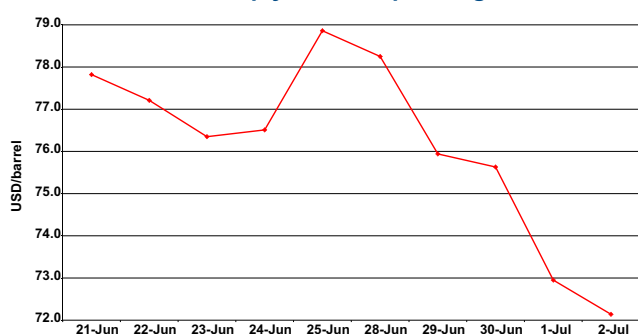
International Crude Oil

A slew of negative economic data releases kept oil prices under constant pressure during the fortnight. Crude oil traded with a downward bias as dollar strengthened against the euro reducing the appeal of commodities as an alternative investment. Unexpected decline in US home sales in May also weighed on sentiments. An increase in US stockpiles turned markets sentiments bearish as the same signaled towards subdued demand for fuel. Further, continued concerns over debt crisis in the euro region dragged down equities, which also pulled down oil prices for the third successive day. Prices recovered and rose sharply by more than two dollars at the end of first week helped by concerns that storm may disrupt output in Gulf of Mexico. However prices plunged thereafter in the second week of the fortnight sliding continuously on unfavorable data releases. Prices were dragged lower after the Chinese economy recorded the slowest expansion in five months. More than estimated decline in US consumer confidence an increase in US gasoline stockpiles further added on to the downward pressure. Poor US manufacturing the jobless claims data pushed oil prices below USD 73 a barrel on concerns that biggest economy may witness a double dip recovery. Falling by 6.5% crude oil closed the fortnight at USD 72.14 a barrel as against USD 77.18 in the previous fortnight.

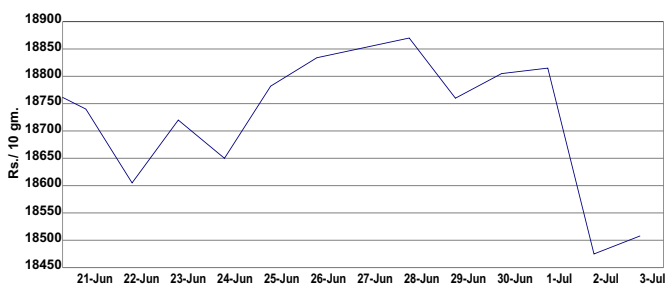
Gold

Gold traded in a range bound manner during the fortnight and buying interest remained steady as increased risk aversion induced demand for the precious metal. However the upward momentum remained limited, as investors refrained from building position at the current elevated prices. Towards the end of the fortnight, better-than-

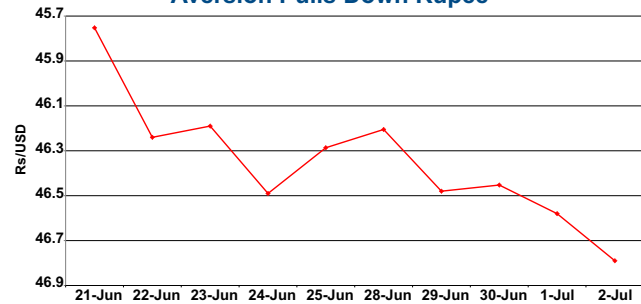
Crude Slides Sharply on Dissapointing Data Releases



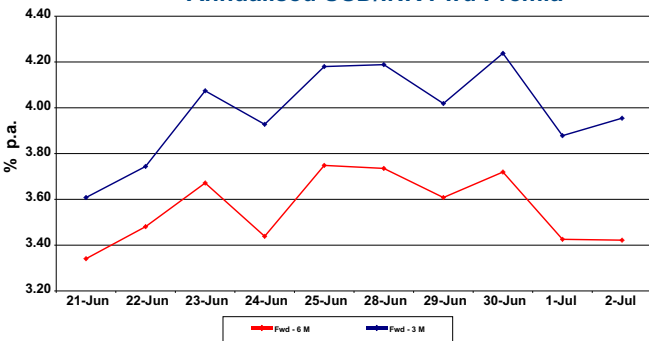
Price Movement of Gold



Weak Global Cues and Rise in Risk Aversion Pulls Down Rupee



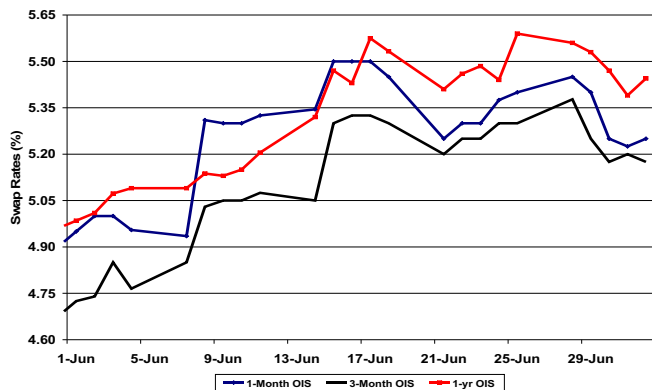
Annualised USD/INR Fwd Premia



Major Stock Indices

	18-Jun-10	2-Jul-10	% change
Indian Indices			
Sensex	17,570	17,461	-0.62%
Nifty	5,262	5,237	-0.47%
FMCG	3,119	3,219	3.21%
IT	5,401	5,238	-3.01%
Banking	10,880	10,664	-1.99%
Auto	8,135	8,184	0.60%
Capital Goods	14,551	14,494	-0.39%
Healthcare	5,603	5,708	1.87%
PSU	9,204	9,445	2.62%
World Indices			
Dow Jones	10,451	9,686	-7.31%
Nikkei	9,995	9,204	-7.92%
FTSE	5,251	4,838	-7.86%

Short-Term OIS Rates



expected economic data releases lowered the need of Gold as safe haven investment. Further, profit booking too pulled down prices sharply.

FOREX MARKET

With easing of China's exchange rate policy, optimism of benefits for local exporters led to a sharp rise in rupee value and it climbed to Rs. 45.75/USD. However, month-end dollar demand from importers after a sharp decline in dollar value led rupee to erase most of the gains. Rupee retreated above Rs. 46/USD level and traded in tight range for most part of first half of the fortnight. While foreign inflows in domestic equities prevented fall in rupee value, dollar buying by importers prevented steep rise. In the second week, rupee declined consistently as weak global economic outlook prompted investors to favor the perceived safety of the dollar over emerging-market assets. Stock markets too declined significantly stalling likelihood of foreign inflows. Release of data regarding widened trade deficit too had negative impact on rupee outlook. Rupee closed the fortnight at 46.79/USD as against previous fortnight's closing of 46.18/USD.

EQUITY MARKET

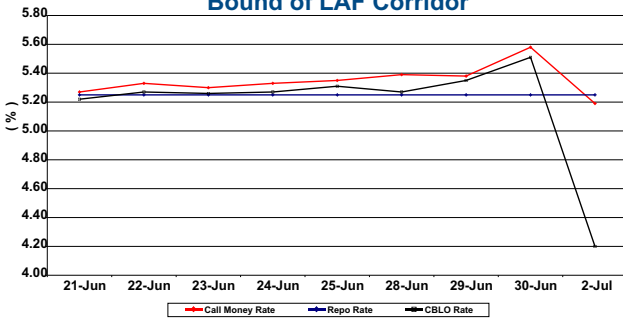
Equity markets rose in the beginning of the fortnight as releasing control on its currency by China and settlement of dispute over jurisdiction of ULIPS improved markets sentiments considerably. Weak global sentiments, however, curbed the further rise. Emergence of profit booking followed by high weekly inflation figures led to a sharp decline in market index. Towards the end of the first week, buying in fundamentally strong shares helped Sensex recover slightly. Fear of rate hike in immediate future led to shedding off of financial shares by investors. However, buying by foreign investors remained high and reached record high levels. Deregulation of petrol prices by Govt. also induced strong buying in oil & gas stocks. Towards the end of the fortnight, market undertone turned cautious owing to weak global cues. Series of weak economic data releases in US and concerns over Chinese economic growth led traders to reduce holdings. Sensex and Nifty declined by 0.62% and 0.47% respectively during the fortnight.

In global markets, all major indices witnessed huge losses owing to rising risk aversion amid investors. Dow Jones shed 7.31% during the fortnight while Nikkei declined by 7.92%.

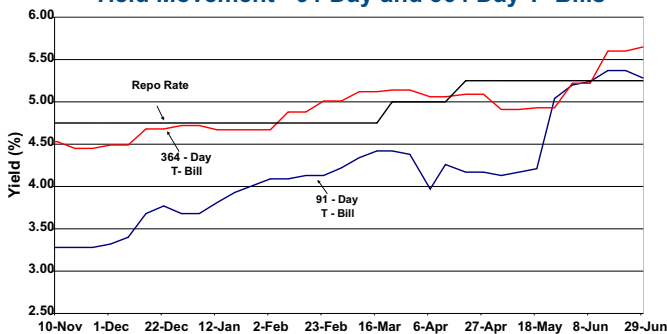
INTEREST RATE DERIVATIVES

Swap rates eased across the curve during the fortnight on reduced hedging owing to decline in G-sec yields. 5-yr swaps used mainly for hedging of G-sec declined from high of 6.87% to 6.66% as yields on 10-yr bond declined during

Money Market Rates Remain Above the Upper Bound of LAF Corridor



Yield Movement - 91 Day and 364 Day T-Bills



the fortnight. Short-term rates too eased on subsiding of fears of rate hike after an official hinted that cash shortage will be considered before any hike in interest rates. 1-month OIS rates eased to 5.53% to 5.45%. However, with hike in short-term policy rates by RBI, swap rates are expected to rise in next fortnight. 5-year MIFOR rate eased by 3 bps to 5.27% from 5.30% during the previous fortnight.

MONEY MARKET

Money market rates charted upwards during the fortnight as huge outflow of Rs. 38,500 crore on account of payment of BWA license fees sucked out considerable liquidity from the system. The call rate remained above the upper bound of the LAF corridor reflecting the crunch in liquidity. Repo injection rose to more than a year's high at Rs. 82,915 crore as most of the players remained on the borrowing side. In order to provide some respite from the tight liquidity conditions, RBI reduced the GOI auction quantum by Rs. 3,000 crore. During the fortnight, RBI injected liquidity to the tune of Rs. 66,493 crore on a daily average basis. Call rates ended the fortnight flat at 5.19% as compared to the previous fortnight. While CBLO rates ended the fortnight at 4.20% vis-à-vis previous fortnight's closing of 4.63%.

TREASURY BILLS

Primary Market

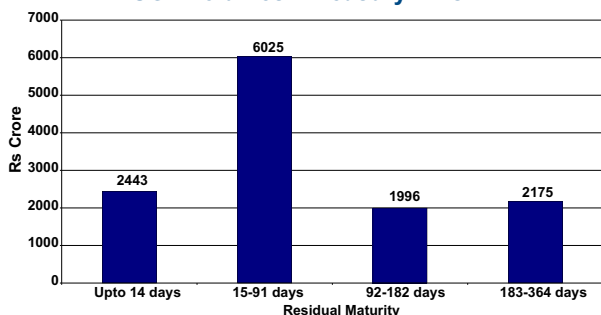
During the fortnight, yield in T-bill auctions rose considerably owing to tight liquidity conditions. While demand in the auctions remained high, investors demanded higher yields to compensate for higher borrowing rates. In the first week, Cut off yield on 91-day T-bill stood at 5.37% higher than yield during the previous week at 5.20%. 182-day T-bill was also subscribed at cut-off of 5.37% similar to that of 91-day T-bill. In the second week, owing to G-sec redemption inflow, yield on 91-day

Details of all the Treasury bill auctions held in the fortnight ended 2nd July 2010 have been tabulated as under:

(Rs. Crore)

Particulars	91 Day		182 Day	364 Day
	23 Jun	30 Jun	23 Jun	30 Jun
Date Of Auction	23 Jun	30 Jun	23 Jun	30 Jun
Cut-off Price (Rs)	98.68	98.70	97.39	94.67
Implicit Yield (%)	5.37	5.28	5.37	5.65
Weighted Avg. Yield (%)	5.32	5.24	5.35	5.59
Competitive Bids Received	8671.30	7854.20	3460.00	2065.00
Competitive Bids Accepted	2000.00	2000.00	1000.00	1000.00
Non-Competitive Bids Accepted	500.00	500.00	Nil	194.00
Total Bills Issued	2500.00	2500.00	1000.00	1194.00
Of which MSS	Nil	Nil	Nil	Nil

SGL Volumes - Treasury Bills



GOI cuts borrowing amount by Rs. 3,000 crore

T-bill declined to 5.28% while 364-day T-bill was subscribed at 5.65%.

Secondary Market

Trading volumes during the fortnight rose to Rs. 12,640 crore vis-à-vis previous fortnight's level of Rs. 9,307 crore. Average daily trading volume stood at Rs. 1,264 crore. Segment wise trades in treasury bills are given in the exhibit. Highest volume of Rs 6,025 crore was witnessed in the 15 - 91 days residual maturity bucket. During the fortnight Foreign Banks, Public Sector Banks and Private Sector Banks were net buyers while Mutual Funds and Primary Dealers were net sellers.

GOVERNMENT SECURITIES

Primary Market

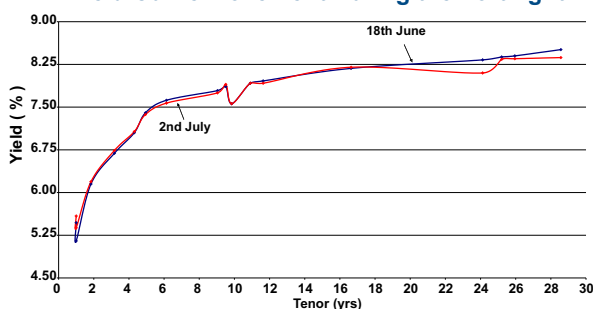
During the first week, GOI raised Rs. 15,000 crore through issue of new 5-yr paper, 7.17% GOI 2015 (Rs. 5,000 crore), 10-yr paper 7.80% GOI 2020 (Rs. 5,000 crore), 17-yr paper 8.26% GOI 2027 (Rs. 2,000 crore) and 22-yr paper 8.28% GOI 2032 (Rs. 3,000 crore). The short term paper, 7.17% GOI 2015 witnessed weakest demand with bid to cover ratio at 1.39. Due to tight liquidity conditions, players demanded higher yield on the paper. The cut off on the same was set much higher than market expectation at 7.40% (Rs. 99.05). The 10-yr paper also witnessed subdued demand and the same was subscribed at a yield of 7.62% (Rs. 101.20). The long term papers witnessed good demand with bid to cover ratio of over 2 times. 8.26% GOI 2027 was sold at a yield of 8.20% (Rs. 100.50), whereas 8.28% GOI 2032 was subscribed at 8.28% (Rs. 100.00).

In the second week, in view of the cash rich position of GOI, the auction size was reduced from Rs. 13,000 crore to Rs. 10,000 crore to be raised through issuance of 7.46% GOI 2017 for Rs. 3,000 crore, 8.20% GOI 2022 for Rs. 4,000 crore and new 30-yr paper for Rs. 3,000 crore. While PDs demanded highest underwriting fee of 1-paisa for 7-yr paper, it witnessed highest demand in the auction with bid to cover ratio at 3.56 and the cut-off price for the same was set considerably above the market expectations at Rs. 99.51 (YTM: 7.51%). Liquid 12-yr paper too witnessed robust demand and was subscribed at Rs. 102.09 (YTM: 7.92%). New 30-yr paper too witnessed good buying interest and the cut-off of the same was set at 8.30%.

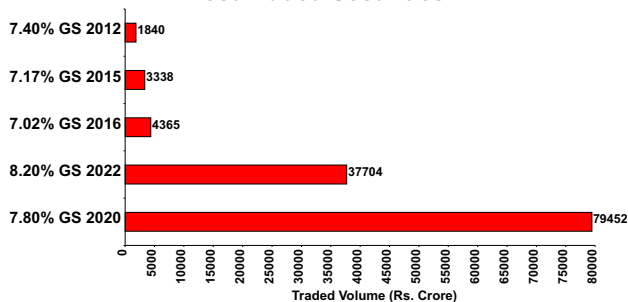
Secondary Market Developments

Rate hike concerns propagating from unabated rise in inflation continued to weigh on G-sec market. Discernible rise in core inflation fuelled fears that the central bank may hasten interest rate hike to curb the spike in prices. Yields movement remained largely range bound with an upward bias in the first week as traders refrained from building up substantial position ahead of uncertainty on the interest rate front. Continued crunch in cash in the system too led to reduced trading volumes. Though expectation of monsoons capping sharp surge in food prices helped in marginal decline in yields, the same could not be sustained after the government raised fuel prices. Yields surged to their highest level in two weeks after government hiked fuel

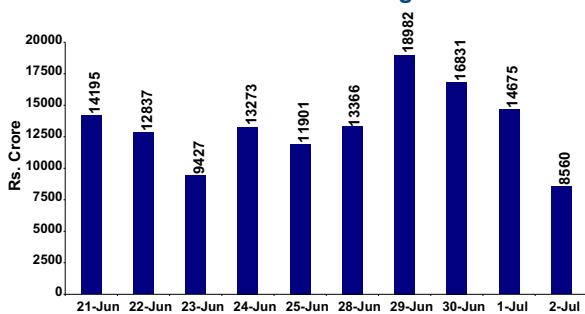
Yield Curve Movement During the Fortnight



Most Traded Securities



Dated Securities Trading Volumes



prices considerably. In reaction to the decontrol of fuel prices, 10-yr yield spiked to an intra day high of 7.68%. However in the second week, yields declined on optimism that the decontrol of fuel prices and robust telecom fee collection would help in considerable reduction in the budget deficit. Favourable global cues as US treasuries plunged sharply on poor economic data release also boosted demand for domestic treasuries. Further surprise reduction in GOI auction quantum by Rs 3,000 crore also helped in easing of yields. 10-yr yield declined below 7.55% mark as rout in global equities fuelled demand for safe haven assets.

Yield on the 10-yr benchmark paper 7.80% GOI 2020 ended flat at 7.56% as compared to the previous fortnight. Spread between 30-yr and 1-yr papers declined to 278 bps from 304 bps in the previous fortnight.

Trading Volumes

Total trading volumes declined during the fortnight to Rs. 1,34,046 crore as against Rs. 1,41,157 crore in the previous fortnight. The first week's average daily trading volume stood at Rs 12,327 crore vis-à-vis second week's level of Rs. 14,483 crore. The highest single day trading volume was Rs. 18,982 crore. Top two traded securities 7.80% GOI 2020 and 8.20% GOI 2020 cornered 92% of the top five traded securities volume. During the fortnight Foreign Banks, Private Sector Banks, Primary Dealers and Mutual Funds were net buyers while Public Sector Banks were net sellers.

OUTLOOK

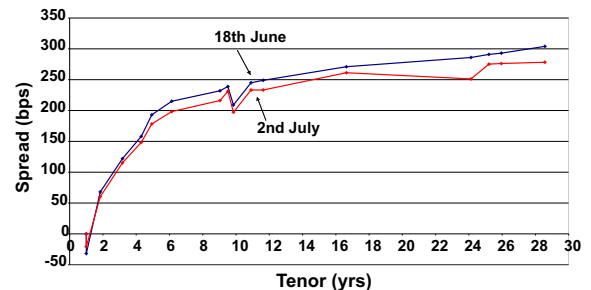
Despite tight liquidity conditions, Indian Central Bank buckled under inflationary pressures and in a mid cycle policy announcement hiked the short-term rates by 25 bps each. Citing the developments on the inflation front as the underlying reason for the step, RBI displayed great discomfort with acceleration in non-food inflation in recent months. RBI's move is largely in line with market expectations given the strong economic data releases in the recent past and the recent deregulation of petrol prices which is expected to aggravate the inflationary pressures.

In reaction to the unscheduled rate hike by RBI, bond yields are expected to open gap up in the new fortnight. Apart from the recent hike, expectations of further monetary actions in the policy meet have gone up substantially and same is likely to be discounted by the market. Bond market is expected to trade with a cautious undertone as the weak global cues which triggered a rally in US treasuries in the previous fortnight, have improved and fears of Euro crisis are subsiding gradually. IIP and monthly inflation numbers to be released in the coming fortnight will be watched keenly as the same will set the tone for the upcoming policy review meet.

SPREAD MONITOR

	TTM (yrs)	YTM		Change in YTM (bps)
		18-Jun	2-Jul	
364 Day T Bill	1.00	5.47	5.59	12
9.39% GOI 2011	1.00	5.15	5.38	23
7.40% GOI 2012	1.84	6.15	6.19	4
7.32% GOI 2014	4.30	7.05	7.07	2
6.49% GOI 2015	4.94	7.40	7.37	-3
7.02% GOI 2016	6.13	7.62	7.57	-5
6.90% GOI 2019	9.04	7.79	7.75	-4
6.35% GOI 2020	9.51	7.86	7.90	4
7.80% GOI 2020	9.84	7.56	7.56	0
7.94% GOI 2021	10.90	7.92	7.92	0
8.20% GOI 2022	11.63	7.96	7.92	-4
8.24% GOI 2027	16.64	8.18	8.20	2
7.50% GOI 2034	24.12	8.33	8.10	-23
7.40% GOI 2035	25.21	8.38	8.34	-4
6.83% GOI 2039	28.57	8.51	8.37	-14

Spread Over One-Year Paper



CASH FLOWS FOR THE FORTHCOMING FORTNIGHT GOVERNMENT SECURITIES

(Rs. crore)

INFLOWS			OUTFLOWS		
Date	Security	Coupon Receipts	Date	Security	Scheduled auction amount
9-Jul	7.99% GS 2017	1358	July 5 - 9	5-9 year	5000-6000
13-Jul	6.9% GS 2019	1553		10-14 year	4000-5000
15-Jul	8.07% GS 2017	1977		20-yr and above	2000-3000
			July 12 - 16	5-9 year	6000-7000
				10-14 year	5000-6000
				15-19 year	2000-3000
Total Inflows		4,888	Total Outflows		25,000



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