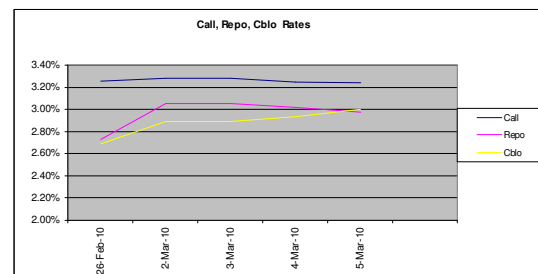


## Weekly Money Markets – Week Ended 05<sup>th</sup> March 2010

### Ten year is not the ten year

The market has started to look forward to April 2010 when the government borrowing for fiscal 2010-11 will commence. The new borrowing program of the government will see the issuance of a new ten year benchmark security. The market, anticipating a new benchmark bond, has started to offload the current ten year bond the 6.35% 2020 bond. The bond is no longer the ten year on the run bond and the right levels of the ten year bond will only be known in April when the first of the ten year benchmark bond issuances begin. The market offloading of the 6.35% 2020 bond has taken the yield up by 14bps week on week to 8% levels. The market, given lack of alternatives for the 6.35% 2020 bond, is shifting to the 7.02% 2016 bond as a substitute. Trading volumes in the 7.02% 2016 bond has moved higher than the volumes in the 6.35% 2020 bond. The spread between the 6.35% 2020 bond and the 7.02% 2016 bond has widened from 17bps to 30bps over the last one month. It may be noted that the 6.35% 2020 bond came in as a replacement on the run bond to the benchmark ten year bond the 6.90% 2019 bond. Trading in 6.90% 2019 bond has virtually stopped from the time the market embraced the 6.35% 2020 bond as a replacement benchmark bond. The 6.35% 2020 bond will suffer a similar fate to that of the 6.90% 2019 bond and it is advisable for market participants to exit the bond before liquidity vanishes.

The Union Budget for fiscal 2010-11 which was presented to the parliament on the 26th of February 2010 set the direction for bond yields. The budget is seen as inflationary with rise in government spending and rise in excise duties. Fuel prices were raised immediately after the budget leading to expectations that inflation as measured by the WPI (Wholesale Price Index) will touch double digit levels in the next couple of months. The budget has also unveiled a Rs 457,000 crores gross borrowing program of the government for fiscal 2010-11. The government has



Source: CCIL

indicated that the borrowing will be front loaded with 70% of the borrowing being completed in the April-September period. The average weekly issuance of Rs 13,000 crores will have to be absorbed by the market in an environment of rising inflation expectations and expectations of policy rate hikes by the RBI (Reserve Bank of India). The market is decidedly nervous on the levels of yields at which the auctions are likely to get cleared and has started taking up bond yields as a preemptive measure.

Liquidity, as measured by bids for reverse repo/ repo in the LAF (Liquidity Adjustment Facility) auction of the RBI was comfortable with bids for reverse repo at 3.25% at around Rs 70,000 crores. Liquidity was comfortable despite the CRR (Cash Reserve Ratio) hike of 25bps sucking out Rs 13,000 crores from the system. Overnight rates were at reverse repo levels of 3.25%. Overnight rates are likely to remain around reverse repo rates till such time as advance tax outflows hit the system (third week of March).

## Government Bonds

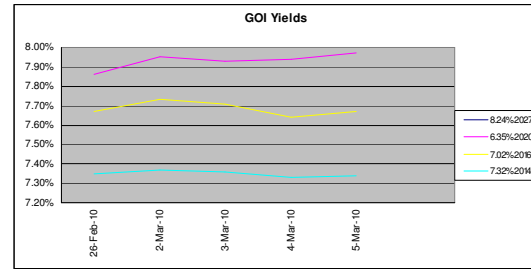
Government bonds saw bond yields move up across the curve on inflation and government borrowing worries. The ten year bond the 6.35% 2020 bond saw yields close the week at 7.97% levels up 11bps week on week while the five year bond, the 7.32% 2014 bond saw yields close up 2bps at 7.34% levels. The 7.02% 2016 bond saw yields close flat at 7.67% levels and the 8.24% 2027 bond yield closed higher by 4bps at 8.40% levels.

## Treasury Bills, Corporate Bonds and Overnight Index Swaps

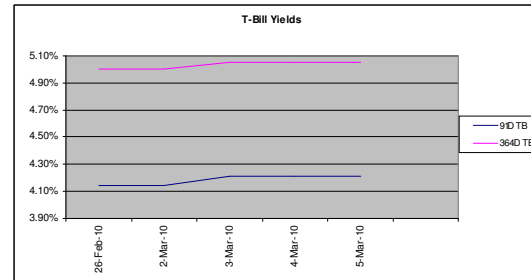
Treasury bills (T-bills) yields were higher in the 91 day T-bill auction held last week with the cut off on the 91 day T-bill auction held on the 3rd of March 2010 coming in at 4.22% against a cut off of 4.13% seen in the previous auction. The 182 day T-bill auction saw the cut off coming in at 4.70% against a cut off of 4.55% seen in the previous auction. The RBI is auctioning Rs 5000 crores of 91 day T-bills and Rs 3000 crores of 364 day T-bills this week.

Corporate bonds saw yields close flat week on week at the longer end of the curve. Five and ten year corporate bond yields closed last week at 8.65% and 8.95% levels respectively. Primary supply and muted investor demand will keep corporate bond yields pressured at the long end of the curve. The corporate bond yield curve steepened with one and three year corporate bond yields coming off by around 15bps. The market saw good bidding interest in these segments on reduced fears of a liquidity crunch in March.

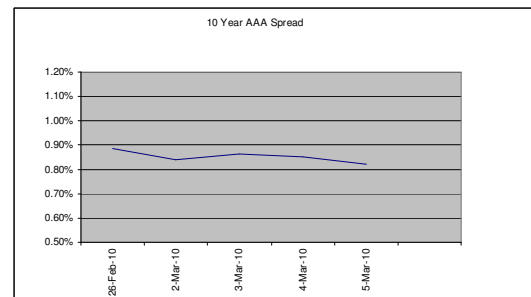
Overnight Index Swaps (OIS) saw the curve move up week on week The five year OIS yield closed higher by 2bps at 7.04% levels while the one year OIS yield closed up 4bps at 5.01% levels. The one over five spread closed down 2bps at 203bps levels. OIS curve is likely to trade in a tight range given high carry costs deterring payers and inflation and rate hike worries deterring receivers.



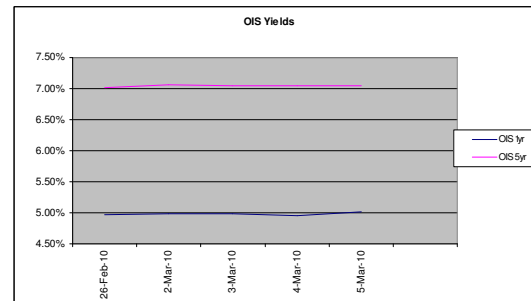
Source: CCIL



source CCIL



source: Market Quotes



source: bloomberg

**Disclaimer : The author is Senior Fund Manager – Fixed Income IDFC Mutual Fund and views are personal.**