

# Inverted yield curve

*An investment opportunity in Fixed Income*

July 26, 2013

## RBI measures to control INR volatility

### Measures – 15<sup>th</sup> July 2013

- Size of Liquidity Adjustment facility (LAF) capped at Rs. 75,000 crs
- Marginal Standing Facility and Bank rates hiked by 200 bps to 10.25%
- Announced Open Market Sales of G-secs for Rs. 12,000 crs

### Measures – 23<sup>rd</sup> July 2013

- Daily LAF restricted to 0.5% of Net Demand and Time Liabilities (NDTL)
- Minimum daily balance requirement for the Cash Reserve Ratio (CRR) increased to 99% from 70% during a reporting fortnight
- Auction INR 6,000 Crs of GOI Cash Management Bills

## Impact of these measures

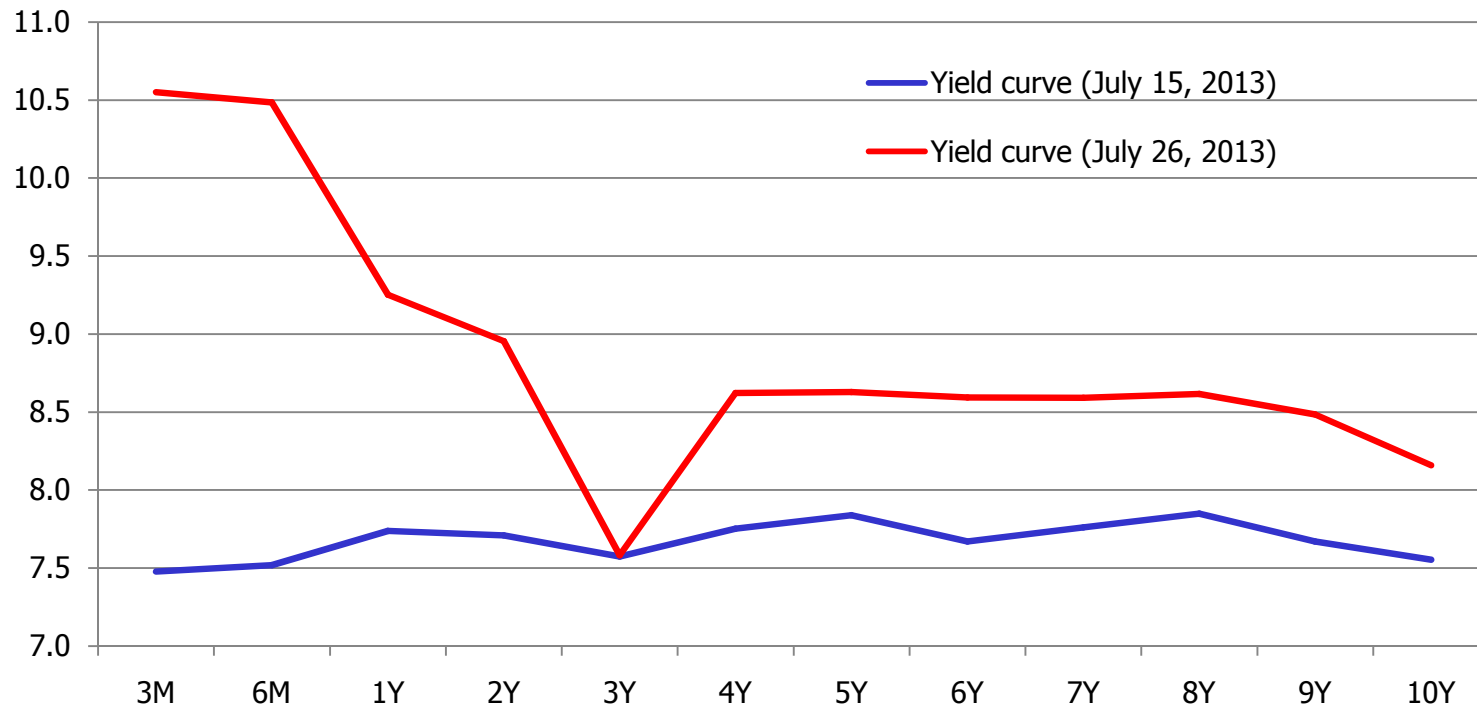
- Short term yields have increased by 250-300 bps and 10 year G-sec yields by ~ 60 bps
- Liquidity has / will tighten with overnight rates heading closer to Marginal Standing Facility Rate (MSF) of 10.25%

Tenor	Yields# (Pre - RBI Measures) - 12/7/13		Yields# (Post - RBI Measures) 25/7/13	
	T-bills / G-sec@	Certificate of Deposit / Corporate bonds*	T-bills / G-sec@	Certificate of Deposit / Corporate bonds*
3 months	7.46%	7.94%	10.58%	11.06%
12 months	7.70%	8.27%	9.95%	10.40%
5 year	7.79%	8.70%	8.70%	9.77%
10 year	7.53%	8.71%	8.20%	9.45%

@ Clearing Corporation of India Limited, \* Reuters CD and Corporate bond Benchmark/ NSE WDM Traded Prices

# *HDFC Mutual Fund/AMC is not guaranteeing/offering/ communicating any indicative yield on investments made in any of its existing/proposed schemes to be launched*

# Inverted yield curve

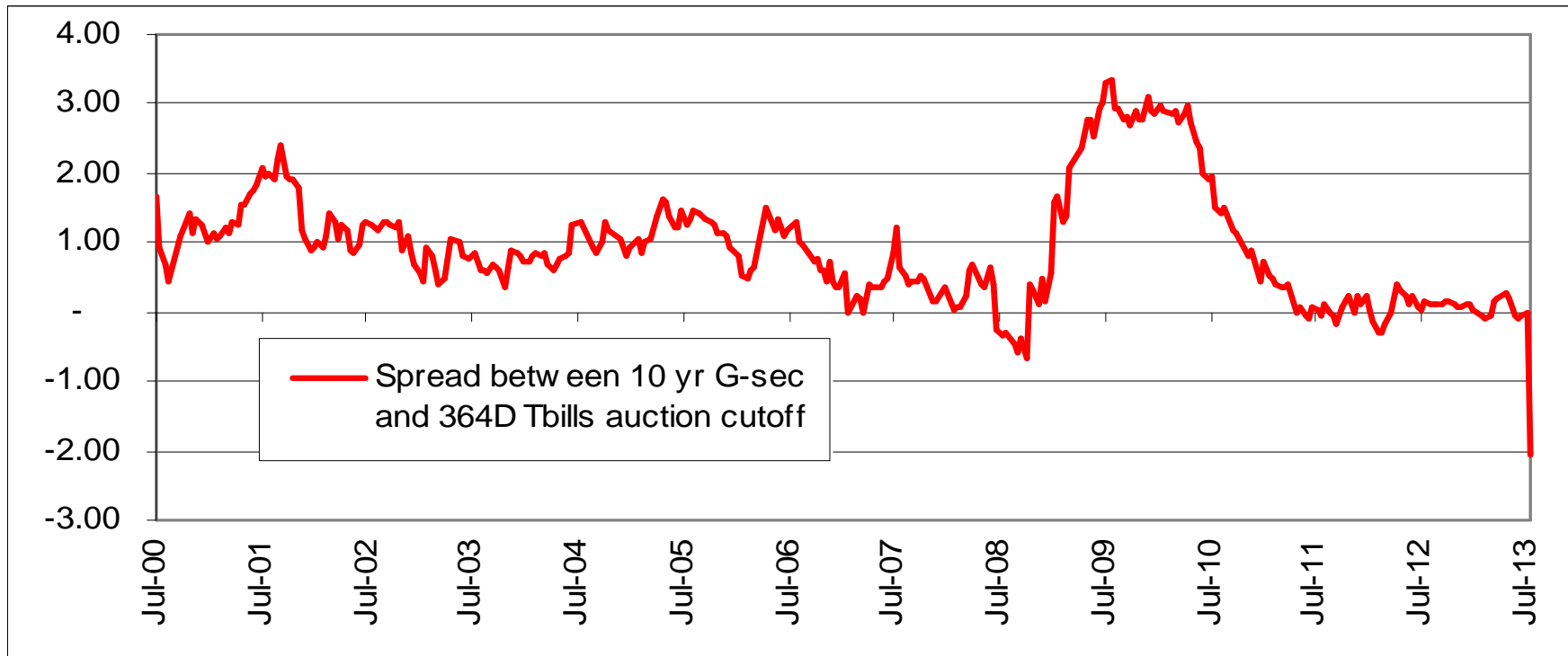


As can be seen above, the yield curve has become inverted due to recent RBI actions

\* Inverted Yield Curve occurs when short tenure yields are higher than long tenure yield

Source: Bloomberg

# Inverted yield curve spread between 10 year G-Sec and 364 D T-Bills



Source: Bloomberg

The yield curve is inverted and inversion (July 24, 2013) of ~200 bps between 364 day T-Bill auction cut off and 10 year G-Secs is highest in the last 13 years

## Historic perspective of inverted yield curve

Historically, inverted yield curves have not lasted for long as can be seen from table below:

Inversion Period	Inversion (bps)
June 2008 – October 2008	~ 60
January 2012 – March 2012	~ 30
July 2013 - ?	~ 170*

\* As on July 25, 2013

Source: Bloomberg, CCIL

## Favourable Risk Reward across the Yield curve

- High gold imports and FII debt outflows led to sharp INR depreciation between April 2013 – June 2013 which should not be extrapolated
- RBI measures do not indicate a change in monetary policy stance and are likely to last for a short period
- Trade deficit in June has fallen compared to May; July data will be keenly watched
- High interest rates should make INR debt more attractive to FIIs
- Focus on reviving economic growth should lead to lower interest rates across the yield curve in the medium term
- Short term volatility cannot be ruled out, however **risk reward has become favourable across entire yield curve and all fixed income products in our opinion**

## Strategy & Recommendation

- HDFC MF's Fixed Income investment philosophy has always emphasized ***Safety, Liquidity & Returns***
- In the current challenging environment, high credit quality and the consequent good liquidity of our portfolios is a sound strategy
- Based on our view of lower yields\* over the medium term and favourable risk-reward across the entire yield curve, we recommend the following :

Investment Horizon	Recommended Product category
Up to 2 months	Liquid Funds / Ultra Short term Funds
6 – 12 months	Short term Funds
Over 12 months	Dynamic / Income Funds/Gilt Funds

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Thank You

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