

## INDIA

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## CitiViews – India Market Watch

- **Spotlight on the Indian Judiciary:** India's legal system<sup>1</sup> – laws, regulation and their adjudication – has not kept pace with the burgeoning opening economy and remains one of the biggest obstacles to an easier business environment. The latest quarterly bulletin released by the Supreme Court, indicates that there are 40,000 pending cases at the Supreme Court, 3.6m in the high courts and 25m in the district and subordinate courts. An inefficient judiciary discourages investor interest- as is evident even in the World Bank's Doing Business Rankings<sup>2</sup>.
- **What's Behind the Backlog?** The key reasons for the enormous backlog are a shortage of staff, an absence of continuous trials and a large number of adjournments. An ADB Review points out that a termination dispute contested all the way can take up to 20 years to resolve. But, what is positive is that the government is taking steps to improve the situation by setting up evening courts in some states, revamping the judicial infrastructure, setting up mediation centers and establishing an International Centre for Alternative Disputes Resolution-, which seeks to sort out disputes through out-of-court settlement.
- **Forex Market:** The rupee weakened to Rs44.30/US\$ from Rs44.20/US\$ in the previous week. This was largely on the back of recent volatility in global financial markets, which also resulted in net FII sales of Indian equities. The rupee fell close to Rs44.40/\$ but edged back to Rs44.30/US\$ levels as state-run banks liquidated dollars with a view to control volatility. While near-term trends are likely to remain choppy, we are currently maintaining our 12M estimate of Rs43.2/US\$.
- **Bond Market:** The benchmark ten-year yield closed marginally higher at 7.94% from 7.93%. Though budget estimates were in line with the FRBM targets and measures to ease inflationary pressures continued, the RBI announced a series of measures on Friday to absorb excess liquidity to contain inflation – largely a result of the US\$13bn reserve accumulation the last month. Measures include: (1) Capping the amount of money they will absorb through reverse-repos to Rs30bn; and (2) Modifying the market stabilisation scheme (MSS scheme) – which would now use a mix of T-Bills and dated securities to and T-bills under the (MSS). These measures are likely to divert short-term liquidity to the inter-bank money market thus bringing down the overnight call money rate but also could have a currency implication as it would imply that the carry on being short USD/INR becomes less attractive.

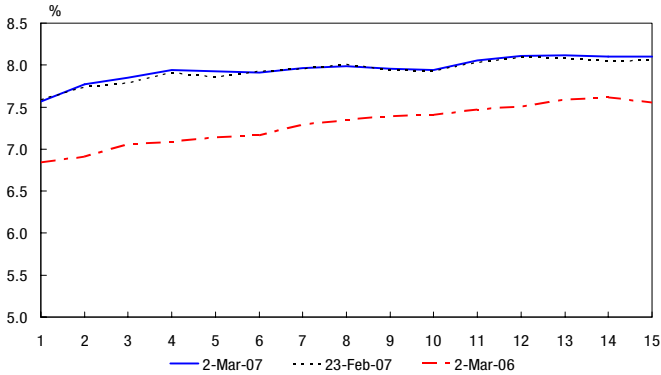
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<sup>1</sup> India's legal system is governed by the Supreme Court, High Courts at the state level, and District (for civil cases) and Sessions Courts (for criminal cases) at the district level. A Chief Justice and 25 associate justices, appointed by the President, head the Supreme Court. Similarly, each of the 21 High Courts in the country have a Chief Justice and other associates. Districts and Sessions Judges are appointed by the Governor of the State in consultation with the High Court.

<sup>2</sup> India is ranked 134 of 175 countries surveys. Speeding up contract enforcement and ensuring an efficient insolvency regime are ranked very low. For more details visit <http://www.doingbusiness.org/southasia>

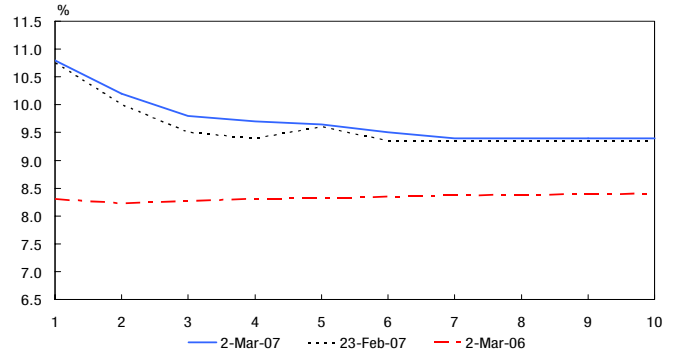
## India – Markets in Pictures

### Trends in GOI Yield Curve



The changing market sentiment resulted in the curve shifting direction. Short segment yields ended marginally higher while the spread between 2-year and 15-year yield was flat at 32 bps.

### Trends in AAA Yield Curve



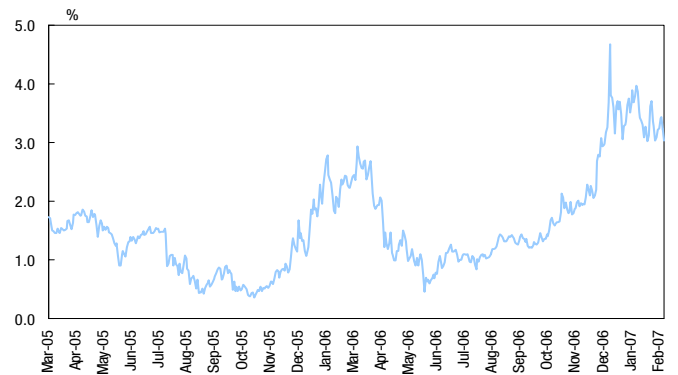
The curve remained inverted with yields rising across the curve. The 5-year benchmark yield rose to 9.65% from 9.60% last week while the credit spread was 156 bps from 154 bps.

### Trends in Exchange Rate - Rs/US\$



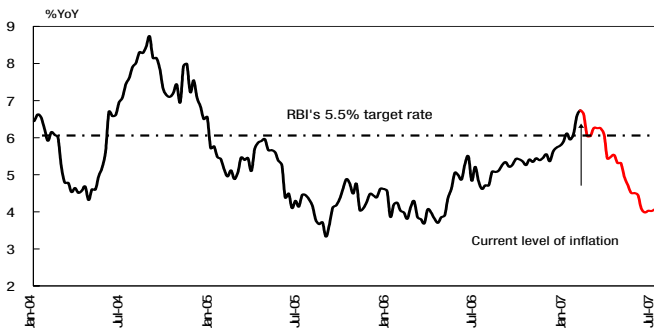
Rupee weakened to Rs44.30/US\$ from Rs44.20/US\$ on the back of volatility in global financial markets which resulted in selling of emerging market assets mirrored by FI selling in local stocks.

### Trends in 6 Month Premiums (%)



Premium fell to 3.03% from 3.22%. Apart from profit booking, levels dipped as traders entered buy-sell swap contracts as dollar inflows receded.

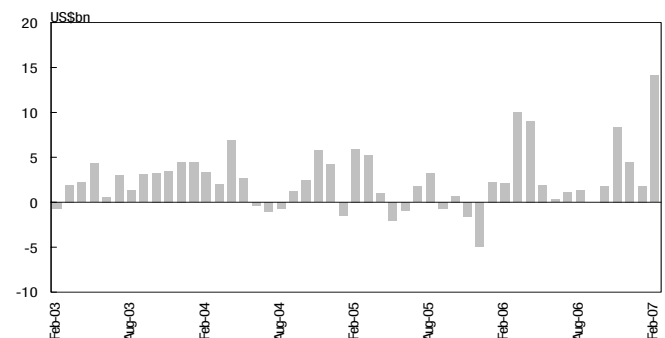
### Trends in Inflation (% YoY)



Inflation came off marginally to 6.05% yoy, for the week ended February 17, from 6.63% last week. While the Index for Primary Articles was up 11.5%, Manufactured Products saw a 5.9% rise and the Fuel Index was up by just 1.1%. We expect inflation to trend to 5% by May. For a details see <https://www.citigroupgeo.com/pdf/SAP03261.pdf>

Source: Reuters, Bloomberg

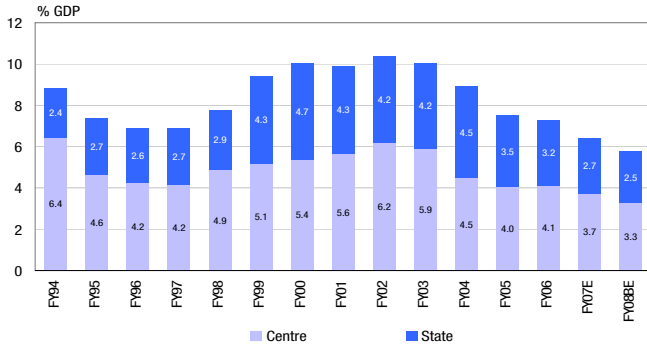
### Monthly Increase in Forex Reserves (US\$bn)



Total forex reserves, including gold, rose by US\$4.2bn for the week ended Feb 23rd. Fiscal YTD, foreign currency assets have also increased by US\$41bn and currently stand at US\$186bn as compared to US\$135bn the previous year. Forex reserves including gold stand at US\$193bn.

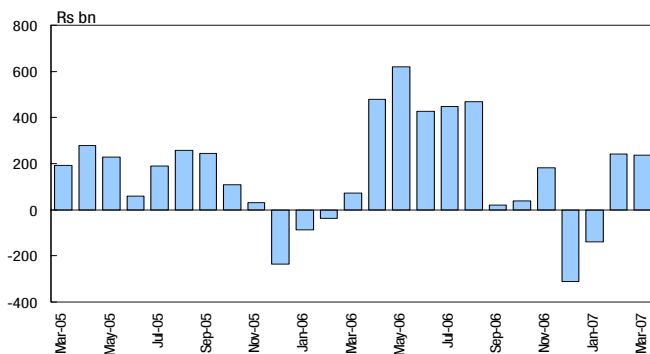
## India – Markets in Pictures

### FY08 Union Budget: Focuses on Fiscal Consolidation, Inflation and Inclusive Growth \*



The FY08 budget posted no surprises on the macro front and continued with the process of fiscal consolidation measures to tame inflation and efforts towards inclusive growth through initiatives on the rural, agri and social front. We believe the assumptions behind the FY08 deficit target of 3.3% of nominal GDP growth at 13% and gross tax collections at 17% are realistic.

### Trends in Reverse Repos/Repos (Rs bn)



Dollar absorption to the tune of US\$13bn during the last month resulted in the liquidity increasing with the average daily reverse repo bids being to the tune of Rs238bn from Rs40bn earlier.

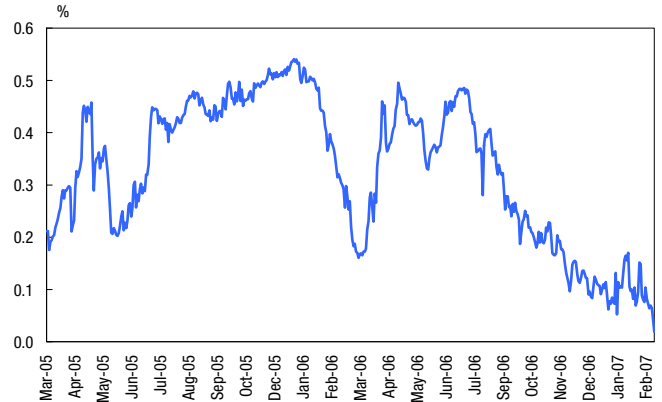
### Trends in Commodities – Gold(US\$/Oz)



Gold dropped to US\$642.95/oz from US\$682.85/oz despite massive selling in equities across regions. The safe haven faced liquidation as investors saw opportunity to cover losses made in equities with gold having touched 9-month highs recently.

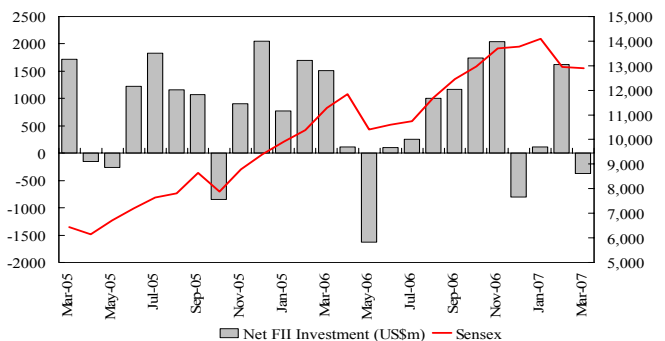
\* For the detailed note see <https://www.citigroupgeo.com/pdf/SAP03172.pdf>. Source: Reuters; Bloomberg; Citigroup

### Trends in 10 Year GOI over 5 Year Spread



The spread came off as 5-year yield ended higher in the volatile trading week. The 10-year ended 2 bps above the 5-year yield.

### 2 Yrs - Trends in FII Flows (US\$ m)



Equities saw FII outflows to the tune of US\$695m for the trading week ended 2<sup>nd</sup> March. Feb MTD, total flows amounted to US\$1.6bn, as compared with US\$1.7bn during the same period last year. Fiscal YTD, flows total US\$5.4bn.

### Trends in Commodities – Oil (US\$/bbl)



Brent rose to US\$61.92/bbl from US\$60.08/bbl last week. Drop in US inventories, supply snags amidst continued tension over Iran's nuclear program sustained pressure on oil.

## India- Market Monitor

	Units	Latest	Previous	1M ago	3M ago	12M ago
<b>Interest Rates</b>						
Overnight	%	6.10	6.4	8.50	6.10	6.50
1 year Treasury Bill	%	7.73	7.84	7.70	6.94	6.80
1 year OIS	%	7.84	7.88	7.37	7.84	6.50
1 year MIFOR	%	8.50	8.42	8.38	8.50	7.20
5 year Corp AAA spread over GOI	%	1.56	1.25	1.56	1.52	1.07
10 year GOI	%	7.94	7.93	7.53	7.93	7.41
<b>Currency &amp; Reserves</b>						
USD/INR		44.30	44.20	44.25	44.27	44.37
EUR/USD		1.32	1.31	1.33	1.32	1.19
USD/JPY		117.20	121.45	118.85	118.12	116.18
12 Month INR Forward Premium	%	3.15	2.93	3.08	1.98	1.93
FX Assets As On (23 Feb 07)	US\$ bn.	186.1	181.9	172.0	166.1	135.2
<b>Money &amp; Banking</b>						
Credit-Deposit Ratio	%	74.0	74.0	73.9	73.8	70.4
Money Supply - M3	% YoY	21.8	19.2	21.1	19.4	16.3
Inflation - WPI (17 Feb 07)	% YoY	6.05	6.63	6.11	5.56	4.02

Source: Citigroup; RBI.

## Financial Market Forecasts

### Currency Forecasts and Forwards

	Range in Feb	Spot	1 Month		3 Months		6 Months		12 Months	
		1-Mar	Forecast	Forward	Forecast	Forward	Forecast	Forward	Forecast	Forward
Versus USD										
Japan YEN	118.49-121.81	118.44	119.00	117.97	120.00	117.05	120.00	115.74	118.00	113.38
Euro EUR	1.2926-1.3245	1.3232	1.2800	1.3249	1.2600	1.3281	1.2600	1.3320	1.2400	1.3379
<b>India INR</b>	<b>43.95-44.18</b>	<b>44.07</b>	<b>44.50</b>	<b>44.50</b>	<b>44.00</b>	<b>44.69</b>	<b>43.50</b>	<b>44.90</b>	<b>43.00</b>	<b>45.32</b>
China RMB	7.7396-7.7662	7.7425	7.7000	7.7105	7.6300	7.6448	7.4700	7.5470	7.3000	7.3600

Source: Reuters, Citigroup estimates.

### Interest Rate Forecasts

		Range in Feb	1-Mar	1Q07	2Q07	3Q07	4Q07
US	Fed Fund Rate	5.25 - 5.25	5.25	5.25	5.25	5.00	5.00
	10-Year Treasuries	4.51 - 4.83	4.55	4.80	4.90	4.95	4.95
EU	Repo Rate	3.5 - 3.5	3.50	3.75	3.75	4.00	4.00
	10-Year Bunds	3.95 - 4.12	3.96	3.90	3.90	3.95	3.95
JP	Call Money	0.25 - 0.705	0.49	0.50	0.50	0.50	0.75
	10-Year JGBs	1.63 - 1.75	1.66	1.70	1.80	1.90	2.00
IN	<b>Overnight Reverse Repo Rate</b>	<b>6 - 6</b>	<b>6.00</b>	<b>6.00</b>	<b>6.25</b>	<b>6.25</b>	<b>6.25</b>
	<b>91-Day T Bill</b>	<b>7.47 - 8.10</b>	<b>7.48</b>	<b>7.50</b>	<b>7.50</b>	<b>7.50</b>	<b>7.50</b>
	<b>10-Year Gilt</b>	<b>7.69 - 8.08</b>	<b>7.98</b>	<b>8.00</b>	<b>8.00</b>	<b>8.00</b>	<b>8.00</b>
CN	1-year lending rate	6.12 - 6.12	6.12	6.12	6.39	6.39	6.39
	Bond repo rate (7-Day)	1.94 - 4.38	1.94	1.90	2.00	2.20	2.50
	Government bond yield (5-Year)	2.68 - 2.76	2.73	2.75	2.80	2.95	3.12

Source: Datastream, CEIC Data Company Limited, Bloomberg, Moneyline Telerate, Citigroup estimates.

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