Economics

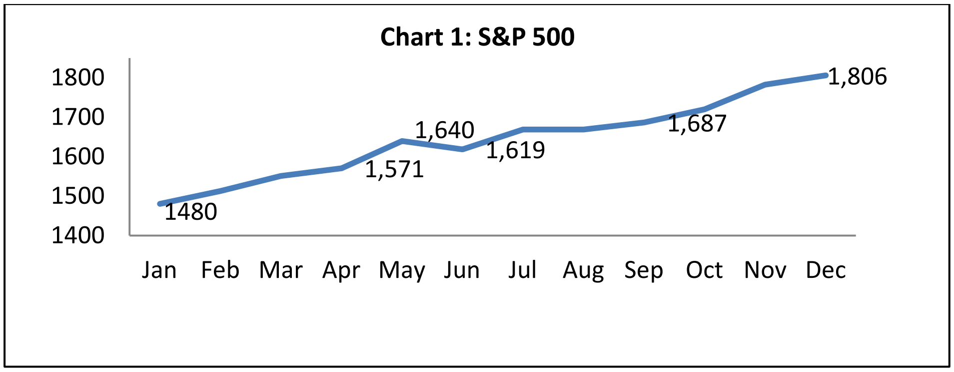
January 3, 2014

Markets Overview 2013

➢ Global Markets

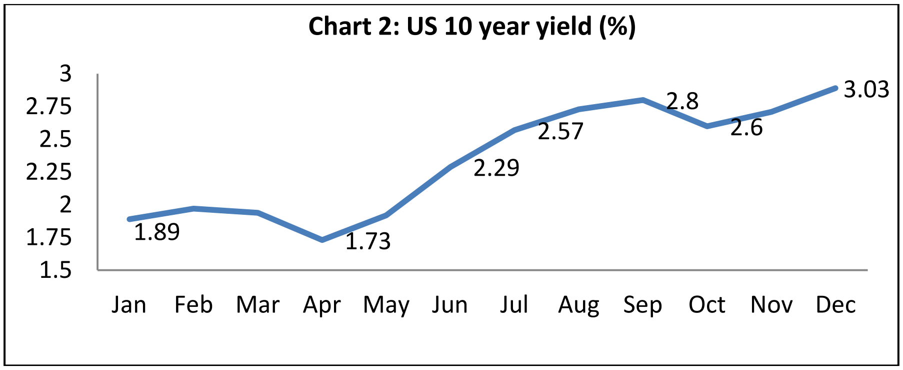
Stock markets on the rise

- The S&P 500 started at 1,480 on 2nd Jan 2013 and continued to rise almost continuously throughout the year to end at 1,806.
- It registered a sudden increase in May (1,640) on account of the speculation regarding commencement of the tapering program by the Federal Reserve, which was to be mainly on account of the US economy coming back on track.
- A large part of this optimism in the indices may be attributable to rising consumer confidence which was visible progressively in the USA. Housing prices too did tend to increase which added to the positive spirit in the markets.
- Overall global markets soared towards the closing of 2013 with Dow touching record high at 16,577 and NASDAQ at a 13 year high of 4,177 on 31st December 2013.



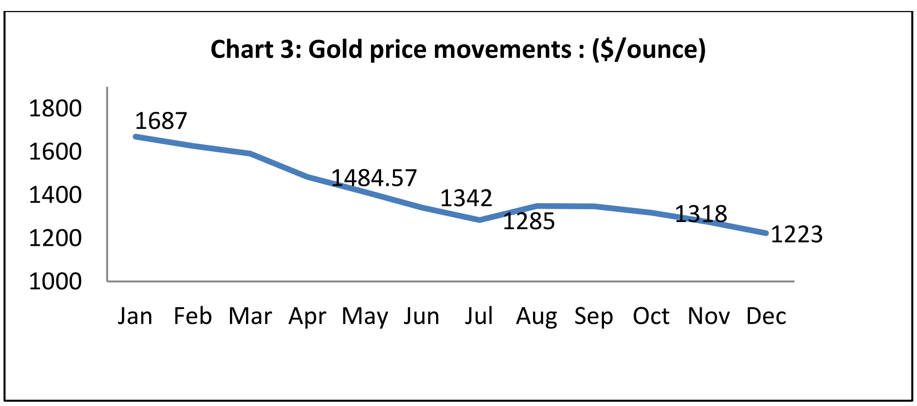
Bond Market remains volatile

- US 10 year yield had differential movements in 2013. It was on a downward move in the initial months. However the statement by Ben Bernanke, the Fed Chairman on supposed tapering off the quantitative easing program triggered a drop in bond prices which pushed up the yields in the month of May.
- The yields have been rising since May as the US economy continued its recovery. Finally, the withdrawal of $10 bn from the quantitative easing program caused yields to soar above 3.0% ending the year at 3.03% on 31st December 2013.
- Investment banks and other analysts expect this trend to continue into the New Year and the 10-year yield is expected to cross 3.5% even though it is expected that the Fed will keep short term yields low, which means that the Fed rate may not really change this year.
- The factors to watch out for would be the overall state of economy, trends in GDP growth and inflation which will largely determine Federal Reserve action.



Gold loses its lustre

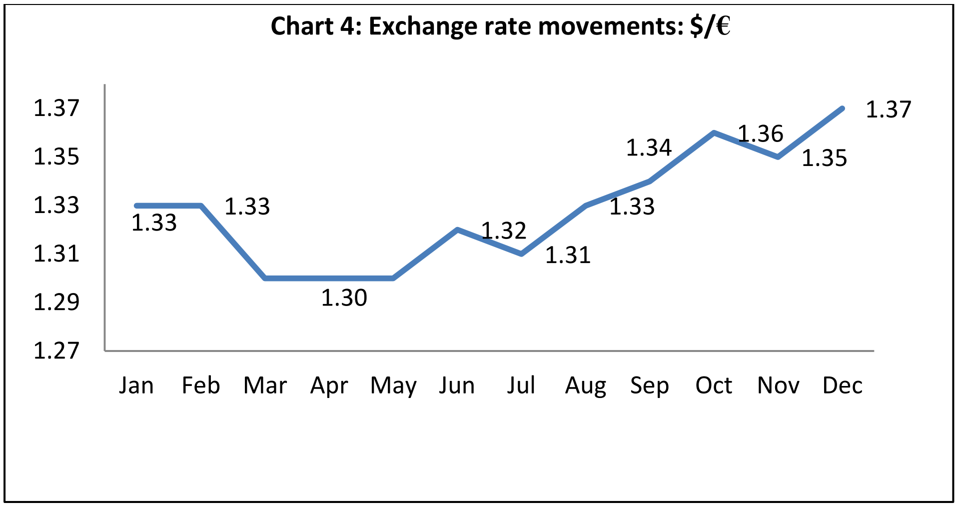
- Gold started the year on a high note at 1,687 on 2nd January 2013. However, the metal failed to retain this level in the year. It was subject to continuous fall in price ending at 1,223 on 31st December 2013.
- Gold became progressively less attractive as alternative avenues opened up such as dollar, bonds and even stocks. Further, with inflation being benign, there was no hedging incentive to buy gold.
- Central banks too stopped purchasing gold to shore up their reserves and demand from countries like India got curtailed through affirmative policy action.
- Gold prices were further affected by the tapering program of the Fed which was announced in December 2013. Increasing confidence in the recovery oriented US economy thereby curbed the need to hold attractive metal asset. Rising US yields and generally rising global interest rates increase the opportunity cost of holding the metal. This resulted in a fall in demand for gold which translated into lower price.
- The link between price of gold and dollar was severed, as the inverse relation no longer held between weak dollar and strong price of gold – both remained weak.



Dollar against Euro: fluctuating in downward direction

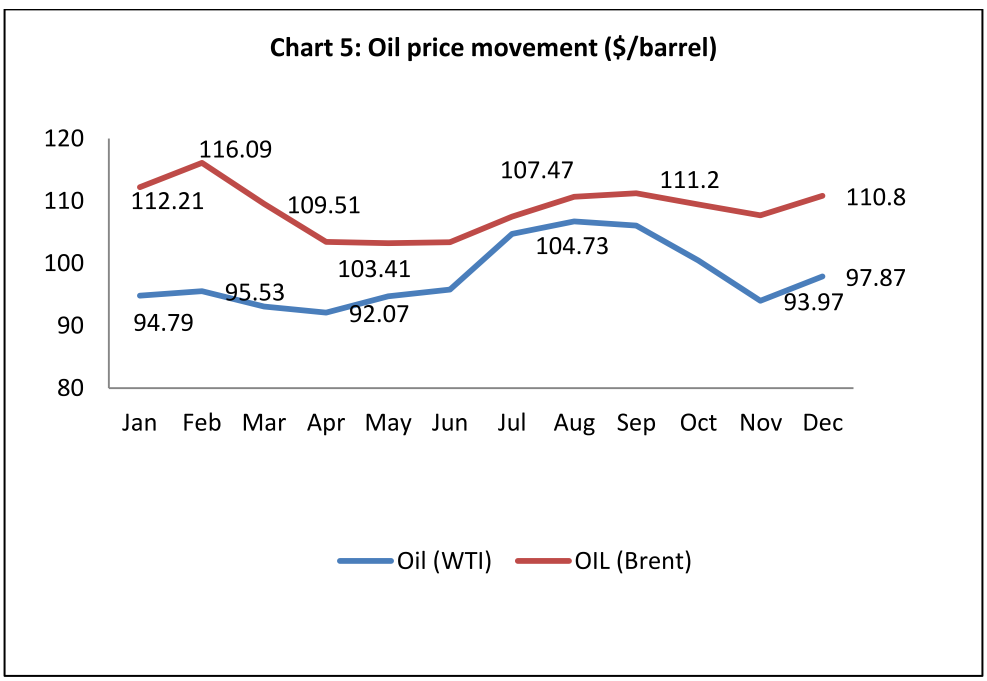
- There was no drastic movement in the US dollar. It began at 1.33 against a euro in January 2013 and had a high of 1.30.
- However, the dollar depreciated towards the end of the year to close at 1.37 against a Euro.

- The weak dollar reflected to a large extent the high twin deficits of the USA.



Oil, volatile but range bound

- Oil prices remained relatively volatile in 2013 with Oil (WTI) starting at $94.79 per barrell and Oil (Brent) at $112.21 per barrell. The prices were rangebound till July 2013.
- The Syrian crisis in August led to spikes in oil prices taking Oil (WTI) upto $104.73 per barrell and Oil (Brent) upto $107.47 per barrell. Prices subsequently eased down in November. However they remained high at $98.42 (WTI) and $110.80 (Brent) on 31st December 2013.

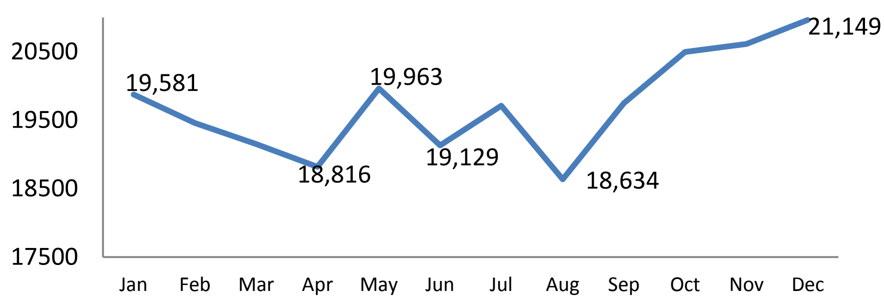


➢ Domestic Markets

Indian stocks grow by 8%

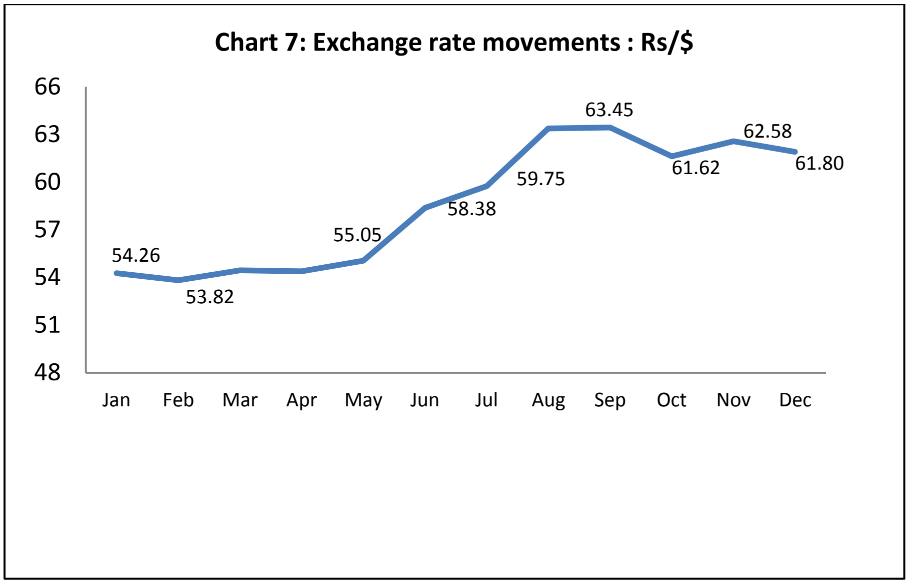
- Sensex opened at 19,581 on 1st Jan 2013 and remained largely range bound up to 20,000 during the year. It crossed 21,000 in the last few days of the year closing at 21,149 on 31st December 2013. The increase in the stock index was of a lower magnitude than that of the global stock indices. Clearly, domestic conditions prevailed over global developments.
- It was guided overall by a variety of sentiments ranging from business and economics to political issues. Global factors also played their role though domestic conditions tended to predominate.

Chart 6: Movements in Sensex



Exchange rate, the most worrisome factor

- Rupee started 2013 positively at Rs 54.26 against a USD on 1st Jan 2013. However, the year witnessed drastic decline in the currency. Rupee depreciated for the third consecutive year ending at Rs 61.80 on 31st December 2013.
- Major drivers for this decline were fundamentals as well as sentiment.
- Deterioration in the current account deficit due to high imports of gold especially in the first 2 months of the financial year caused the rupee to decline.
- Conditions were aggrandized when the FIIs withdrew as the Fed made its announcement on tapering in May. This also spurred speculative activity in the NDF market.
- The continuous fall since then was reversed when the RBI intervened in different ways such as sale of dollars, curbs on use of forex, higher repo and MSF rates, curbs on liquidity with the final act coming through the swap facility for banks on FCNR deposits and bank capital.
    - This reversed the decline of the rupee which was synchronous with the improvement in the trade numbers which stabilized the rupee.

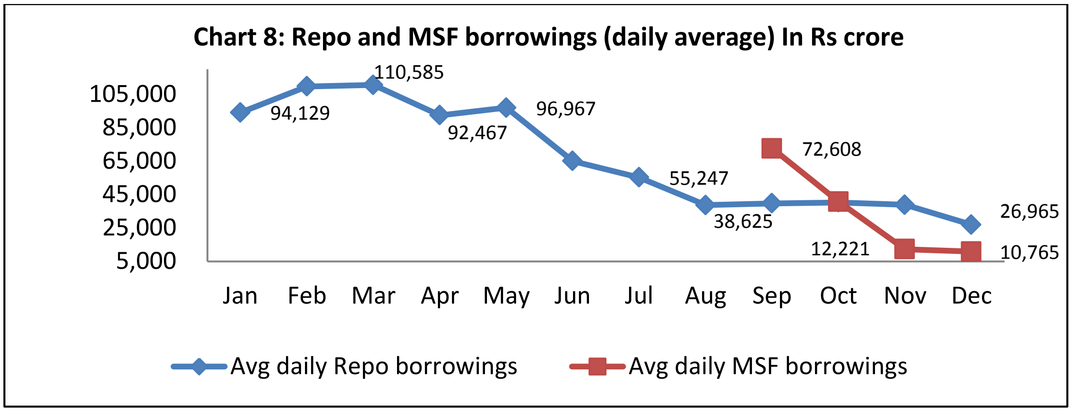


Money market and monetary policy

- The year started with a relatively easy monetary policy stance by the RBI with average daily repo borrowings at Rs 94,129 Cr in January 2013.
- The repo rate was reduced by 25 bps in March and a further 50 bps in May 2013. However, rising inflation reversed RBI's policy resulting in a tight monetary policy stance. Hence, the repo rate was hiked in September and October by 25 bps each to stand at 7.75% at the year end.
- The MSF was hiked up to 300 bps above the repo rate in July 2013. However, RBI lowered this difference and brought it back to 100 bps above the repo rate as of 31st December 2013.
    - The funds availed under MSF (daily average) have declined from Rs 72,608 Cr in September to Rs 10,765 Cr in December 2013.
- The RBI has indicated that the repo rate will be guided by the twin factors of inflation as well as developments in the global space – meaning thereby, the Fed's actions.

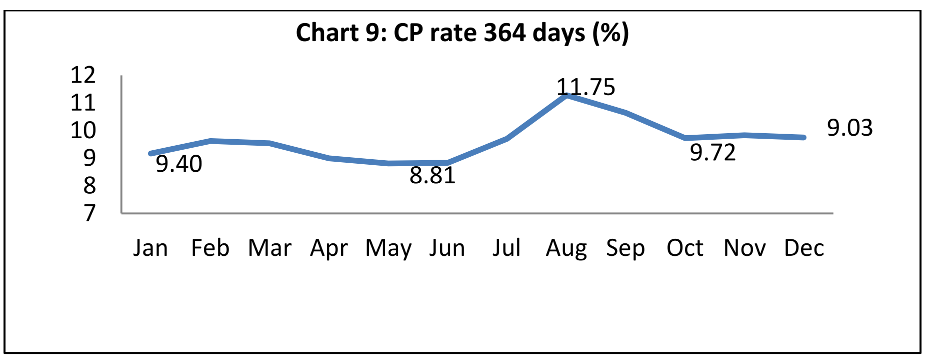
Table 1: Key rates of Monetary Policy Announcements in 2013

Date	Repo rate	MSF rate
29th January 2013	7.75	8.75
19th March 2013	7.50	8.50
3rd May 2013	7.25	8.25
15th July 2013	7.25	10.25
20th September 2013	7.50	9.50
7th October 2013	7.50	9.00
29th October 2013	7.75	8.75
18th December 2013	7.75	8.75



Commercial paper, moves with liquidity and RBI stance

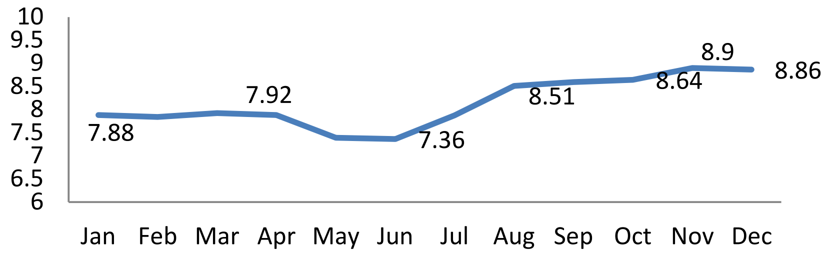
- 364 days Commercial paper was at 9.40% on 1st January 2013 and showed an upward tendency till around August.
- Higher rates were due to a combination of low liquidity conditions and higher interest rates as RBI did invoke measures to increase short term rates and lower long term rates through calibrated OMOs. This was done more to curb speculative activity in the forex market. The consequence was that the corporate sector had to pay much higher rates on the CPs.
- The CP rates came down as liquidity increased in the system with deposits growing on account of the NRI deposits as well as moderation in interest rates.



GSec Yields, ultimately trend upwards

- Government securities yield were trending downwards in the early half of the year when conditions were stable.
- However, the tight monetary policy stance maintained by the RBI post August has accounted for a reversal in trend pushing GSec yields to rise consistently.
- GSec yields stand at 8.86% as of 31st December 2013.

Chart 10: Gsec 10 year yields



**Gsec benchmark is 8.15% till 17th May 2013, 7.16 % till 22nd Nov 2013 and 8.83% since 22nd Nov 2013*

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