Presentation -1

Inflation Indexed Bonds: Challenges & Opportunities in India

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International Flavour

- Total market is in the region of USD 2 Trillion.
- The first to issue was Israel.
- US issued the maximum volume, followed by U.K, France, Italy.
- Among the EMEs, Brazil ,Mexico, Turkey and South Africa issued the linked bonds.
- India introduced linked bonds on WPI.
- Conceived to show commitment of the Govt/Central bank to contain Inflation.

Italian Bonds

- Italy raised a record 22.3 billion euros from the sale of a four-year inflation-linked bond at 2.15% with institutional players snapping up paper aimed at small investors.
- It was the biggest single bond sale by a European government, beating the 18 billion euros.
- Italy has now met nearly 95 percent of its annual funding goal .

Italian Bonds

- It is a higher return than that offered by the conventional inflation-linked bonds Italy sells.
- The bond also offers protection against deflation.
- Italy's annual inflation rate slowed to a four-year low of 0.7 percent in October, same in November and 0.66% in December 2013. The price index to which these linker bonds are tied stood at 0.8 percent.
- GDP is stagnant at -0.1%, but ending 8 qtrs of contraction.

U.K inflation Bonds

- The DMO intended to sell £13.25bn of index-linked gilts via syndication during the 2013/14 financial year, up from an earlier target of £12.5bn.
- U.K inflation is at a four year low of 2% in December 2013, 2.1% in November 2013. 2 years ago it was at above 5%.
- U.K is one of the first to introduce R©PI linked IIBs.(1981). The bonds were issued at rates 0-1%.

U.S TIPS

- U.S inflation is at 1.5% in December 2013.
- Economy expanded at 3.4% in Q4.
- Job less rates, consumer confidence, etc waxing and waning in the data but there is a overall improvement which led the FED to start ‘tapering’ during end 2013 and one more early this year.

US Tips

- Bond markets around the world have been rocked by the shift in thinking from the U.S. Federal Reserve.
- TIPS have been strong performers in recent years as investors sought protection on the expectation that bond purchases would increase inflation.
- That hasn't happened, however, and the bonds dramatically worsened after Bernanke downplayed concerns about low inflation.

Indian scene

- IIBs were introduced in June 2013 at 1.44% based on WPI. There have been 7 issues totaling Rs 6500Cr.
- RBI introduced Inflation indexed national savings Securities in December 2013 based on CPI(with a 3-mth lag). The full details are on the website of RBI. FAQs are made available with BC. Premature redemption, collaterisation and Tax benefits are available.

<u>Presentation-2</u>

Inflation Indexed National Savings Securities – Cumulative (IINSS-C)

Issues and Way ahead!!

Product

- Eligible Investors - individuals, HUF, charitable institutions registered under section 25 of the Indian Companies Act and Universities incorporated by Central, State or Provincial Act or declared to be a university under section 3 of the University Grants Commission Act, 1956 (3 of 1956)
- Min Investment – Rs. 5,000
- Max Investment – Rs. 5,00,000
- Rate of Interest – 1.5% + CPI (Compounding half yearly)
- Final CPI (Combined) with a lag of three months to be used as the reference
- Interest + Principal to be paid at maturity
- Tenor – 10yrs
- Early Redemption – After one year from date of issue for citizens above 65yrs and after three years for all others
- Penalty@50% of last coupon payable for early redemption.
- Transferability limited to nominees on death of holder.

Product

- ☐ Eligible as collateral for loans from banks, NBFCs and FIs.
- ☐ Tax treatment on interest and principal repayment would be as per the extant taxation provision.
- ☐ Sale of bonds would be through branches of SBI, its associates, other nationalised banks, HDFC, ICICI, Axis and Stock Holding Corporation of India (SHCIL).
- ☐ Banks, including SHCIL, would act as interface for all customer services related to these bonds (such as receipts, repayments, recording change of address, nomination, transfer, early redemption, lien marking, etc.).
- ☐ Deadline for sale recently increased from December 31 2013 to March 31, 2014.

Rationale

- Protect savings from inflation, especially the savings of poor and middle class
- Channelize the savings towards development and reduction of Currency in Circulation
- Alternative to gold/real estate assets which are considered as hedge against inflation
- Reduced gold imports to improve CAD and support domestic currency

Lack of interest – Why?

- ☐ Lack of investor awareness – most of the target audience don't know what are bonds, what is CPI, its components, how is it calculated etc
- ☐ Too complex – CPI index to be tracked, 0.75% to be added every six months to the CPI, semi annual compounding
- ☐ No interim cash flows
- ☐ Tax free bonds better option than IINSS for higher tax slabs as they offer better post tax yields
- ☐ Lack of immediate/favorable exit when compared with gold
- ☐ Uncertainty in cash flows due to floating rate

Lack of interest – Why?

- ☐ Lack of transferability.
- ☐ No scope for capital gains when compared with tax free and other coupon bearing bonds.
- ☐ Difficult to predict inflation trajectory for a 10yr period.
- ☐ 10yr period to get back interest + principal too long.
- ☐ Since it’s a floating product, in case CPI enters deflation, investor would get only 1.5% as against fixed coupon bonds which would provide higher yield.
- ☐ HNIs and Institutions such as Pension funds, Insurance Companies, Provident Funds who could be the biggest investors are ineligible.

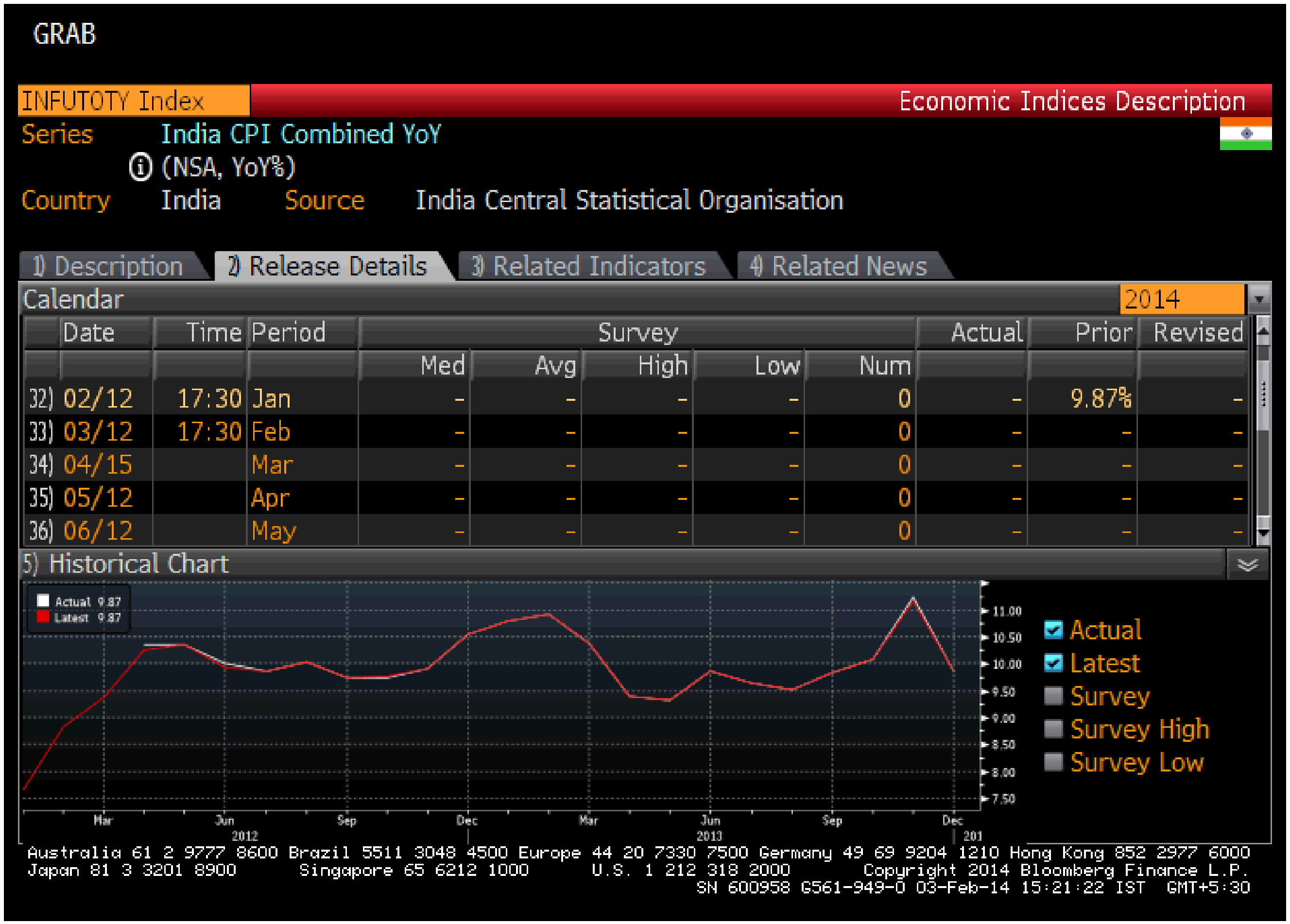
How to attract investors

- Tax free
- Part of 80C/ increase the limit in 80C with additional investment only in IINSS
- Reduce the tenor to 5yrs
- Keep it on tap
- Increase the limit to 10yrs
- Incorporate factors like transferability/ tradability
- Interim cash flows

How to attract investors

- ☐Allow Insurance, Pension and Provident funds as eligible investors with higher investment limits
- ☐Increase Investor awareness by holding investor camps
- ☐Allow Mutual Funds to invest in IINSS as they can significantly help mobilize investor money and can also help increasing awareness about the product
- ☐Provide incentives to distribution agents (predominantly banks) to push the product
- ☐Floor rate – say 6% to ensure investors remain invested during times of low inflation.

CPI


GRAB
INFUTOTY Index
Economic Indices Description
Series India CPI Combined YoY
(NSA, YoY%)
Country India Source India Central Statistical Organisation
1) Description
2) Release Details
3) Related Indicators
4) Related News
Calendar 2014
	Date	Time	Period	Survey Med	Avg	High	Low	Num	Actual	Prior	Revised
32)	02/12	17:30	Jan	-	-	-	-	0	-	9.87%	-
33)	03/12	17:30	Feb	-	-	-	-	0	-	-	-
34)	04/15		Mar	-	-	-	-	0	-	-	-
35)	05/12		Apr	-	-	-	-	0	-	-	-
36)	06/12		May	-	-	-	-	0	-	-	-
5) Historical Chart
Actual 9.87
Latest 9.87
11.00
10.50
10.00
9.50
9.00
8.50
8.00
7.50
Mar Jun Sep Dec Mar Jun Sep Dec
2012 2013 201
Actual
Latest
Survey
Survey High
Survey Low
Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2014 Bloomberg Finance L.P.
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10 Year


GRAB
GIND10YR Index
95) Save As
96) Actions
97) Edit
98) Table
Line Chart
02/04/2004 - 02/03/2014
Mid Yield
Line
11) Compare
Mov. Avgs
No Lower Chart
INR
1D 3D 1M 6M YTD 1Y 5Y Max Daily
Security/Study
Event
Last Price 8.762
High on 07/15/08 9.474
Average 7.581
Low on 04/20/04 5.066
9.000
8.762
8.000
7.000
6.000
5.000
2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014
Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2014 Bloomberg Finance L.P.
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Thank you!!!