

Fixed Income Market in India – The Next Frontier

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Background

The Indian Market Realities

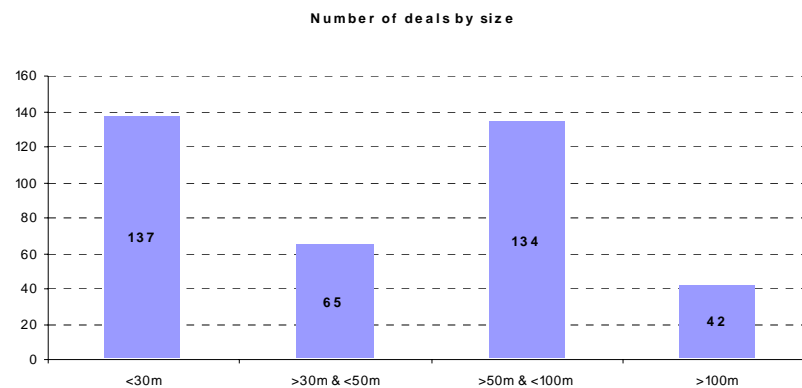
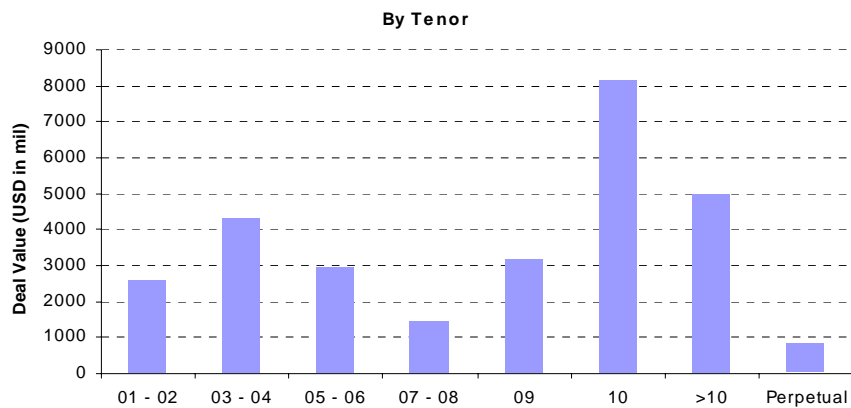
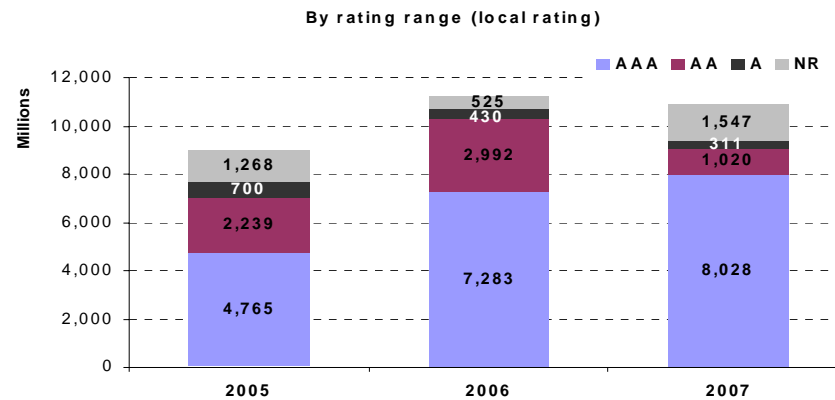
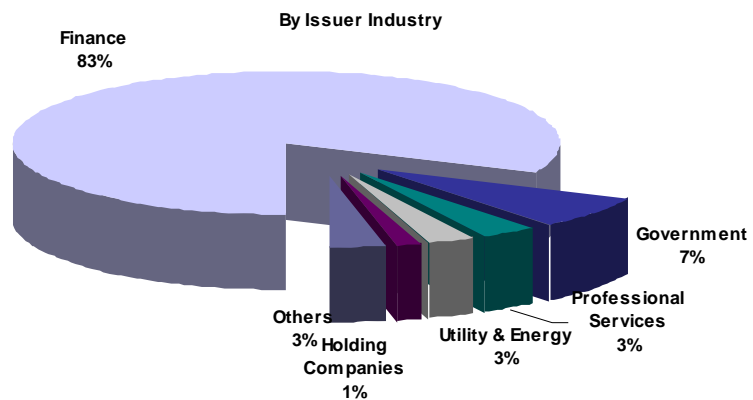
- **No Capital Account convertibility** – *Restricted access to overseas investor for local currency bonds*
- **Vibrant Derivatives Market**
- **Financial Institutions & Government of India active in domestic bond market as issuer** – *Together they comprise 90% of the issuances in 2007*
- **AA and above local rating** *comprises of more than 80% of domestic issuances*
- **Active investors** – *Banks, Insurance Companies, Pension Funds & Mutual Funds*
- **Bank Lending** – *The major source of debt funding for corporate sector*
- *Intermittent large issuances* by financial institutions and corporate sector *in overseas markets*
- **Most corporate issuances are** *private placements*

Corporate Bond Market – India versus other markets – *The Opportunity*

	Private bonds outstanding / GDP%	Public bonds outstanding / GDP%
USA	111.8%	46.3%
UK	15.9%	31.1%
Germany	34.1%	41.0%
France	41.4%	53.8%
Spain	42.0%	38.9%
Korea	54.0%	21.1%
Japan	42.4%	150.2%
Thailand	20.2%	21.1%
India	1.0%	32.9%
China	10.4%	15.2%
Hong Kong	17.8%	9.1%
Singapore	18.8%	39.2%
Australia	39.3%	12.6%
Indonesia	2.4%	16.6%
Brazil	12.0%	44.6%

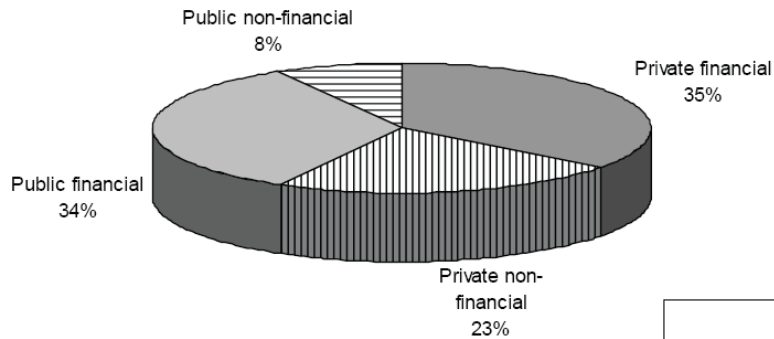
Source: *The Development of India's Corporate Market* (Table 2),
The City of London, February 2008.

Indian Bond Market – Birds eye view

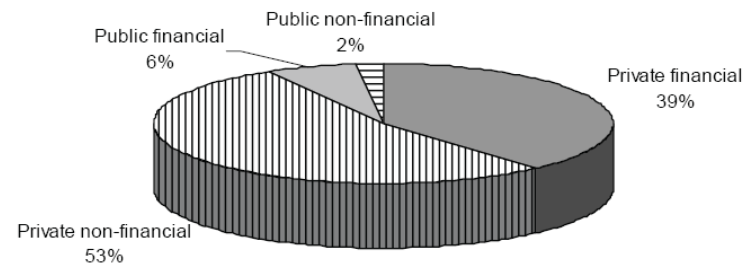


Indian Bond Market – Private Placement

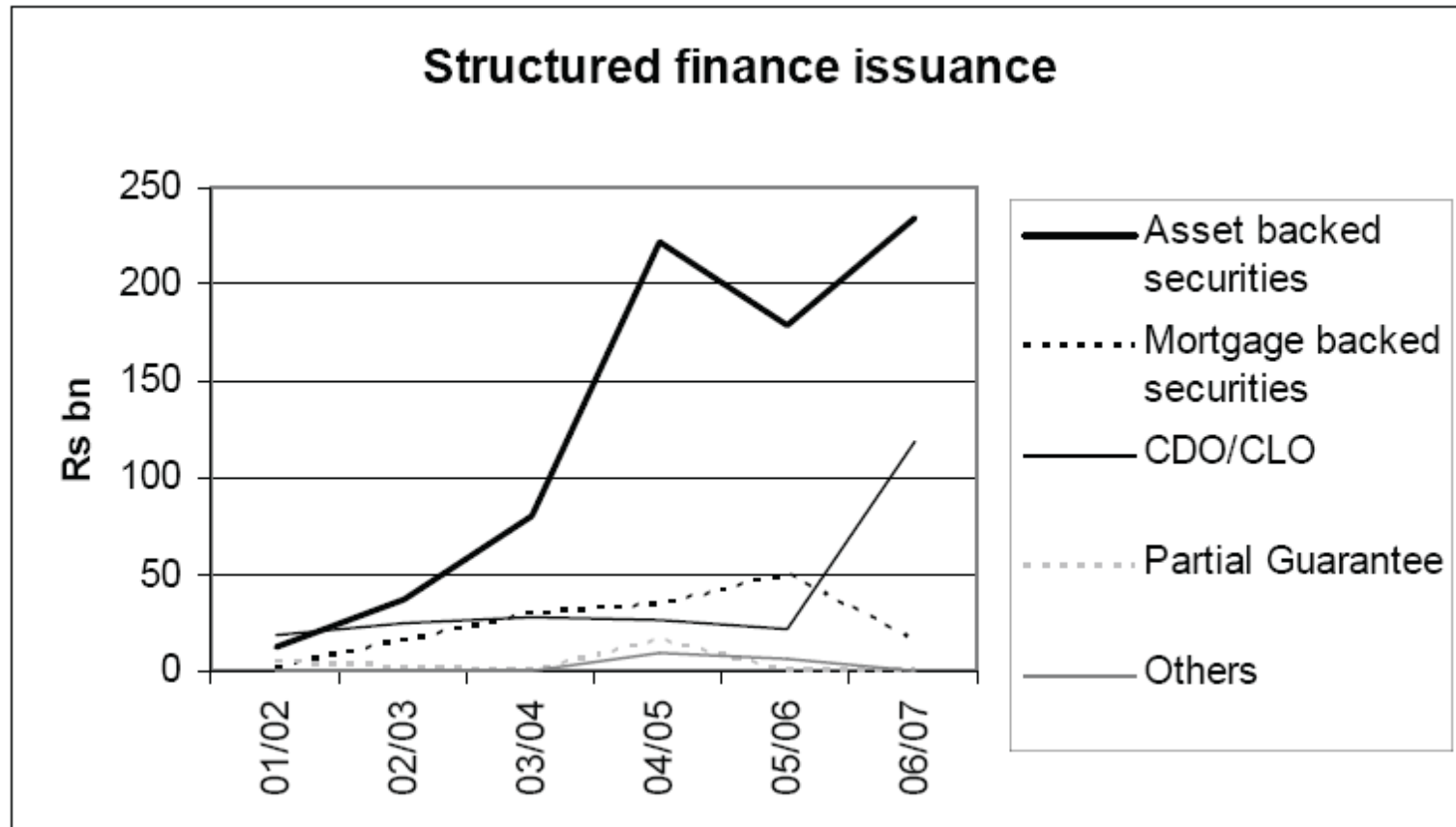
Value of private placements by issuer type



Number of private placements by issuer type



Indian Bond Market – Structured Finance Issuances



Source: *The Development of India's Corporate Market* (Chart 20), The City of London, February 2008.

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Following the Path of Indian Equity ?

The Year of Equity Capital Markets - 2007

- *2007 was the year of Equity Markets in India*
- **Foreign currency reserves increased by USD 98.3 Billion - *Huge foreign investment in the economy primarily into equity markets***
- **Sensex – *Benchmark Indian Index gained 43.82%*, starting 13233 and closing 19032**
- *Record number of 96 IPO's*
- *Companies like ICICI Bank, DLF & Cairn Energy raised money in some of the largest Public Offerings in history of Indian Market*

Will 2008 be the year of Domestic Bond Markets?

- **SENSEX is down 15% *from the all time highs seen January 2008***
- ***Global Financial Crisis and US slowdown is putting* question mark on Equity Story**
- ***Blockbuster IPO* of Reliance Power *oversubscribed 72 times* is now trading at 20% lower than issue price; *several IPO's cancelled***
- ***Overseas borrowing very expensive* owing to credit crisis and RBI restrictions**
- ***Viable options are Bank Financing or Domestic Bonds***
- ***Bonds more attractive* in the falling interest rate scenario**

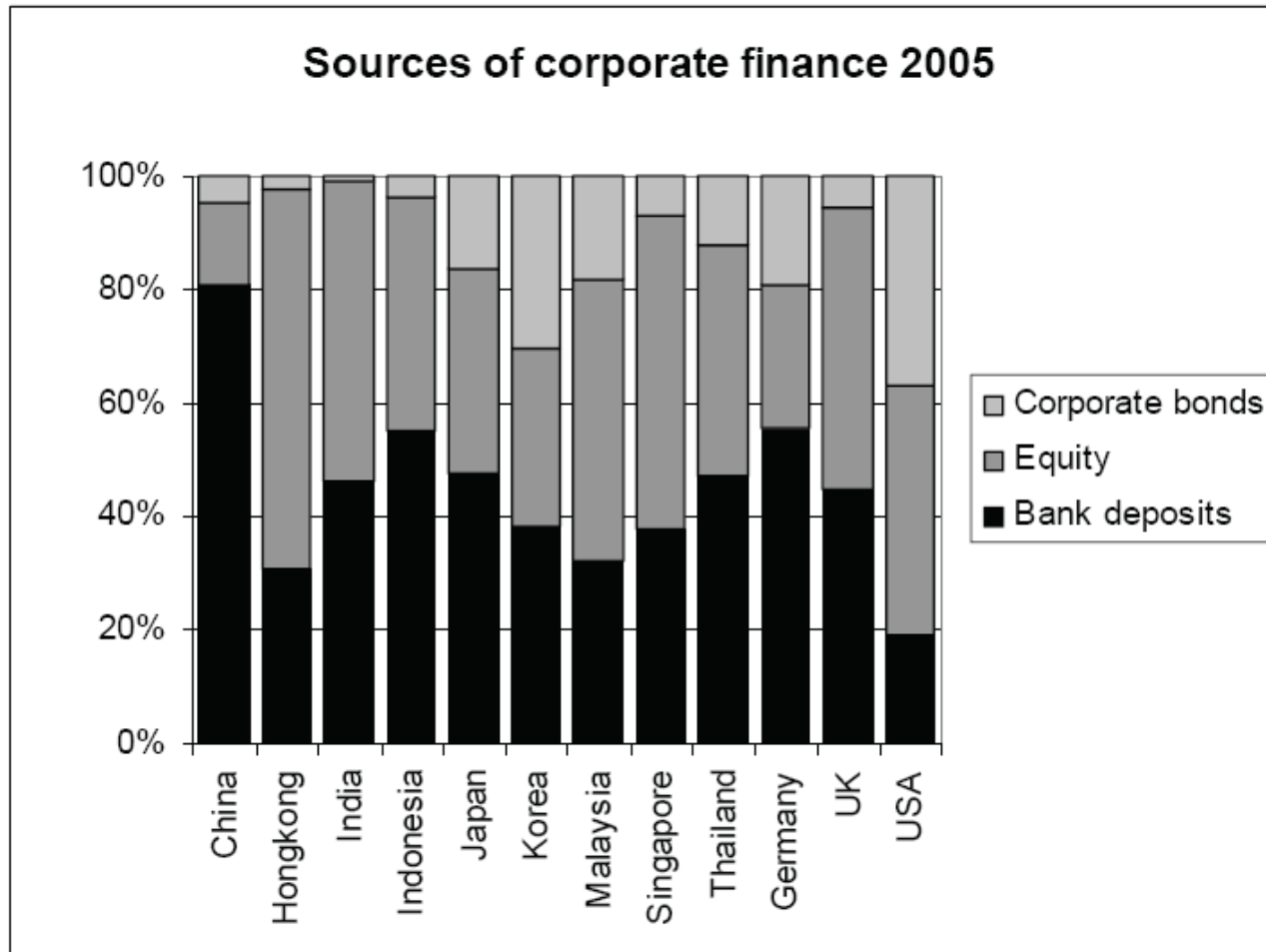
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Hunger for Cash & Growth

Indian Economy – Growth Story Intact

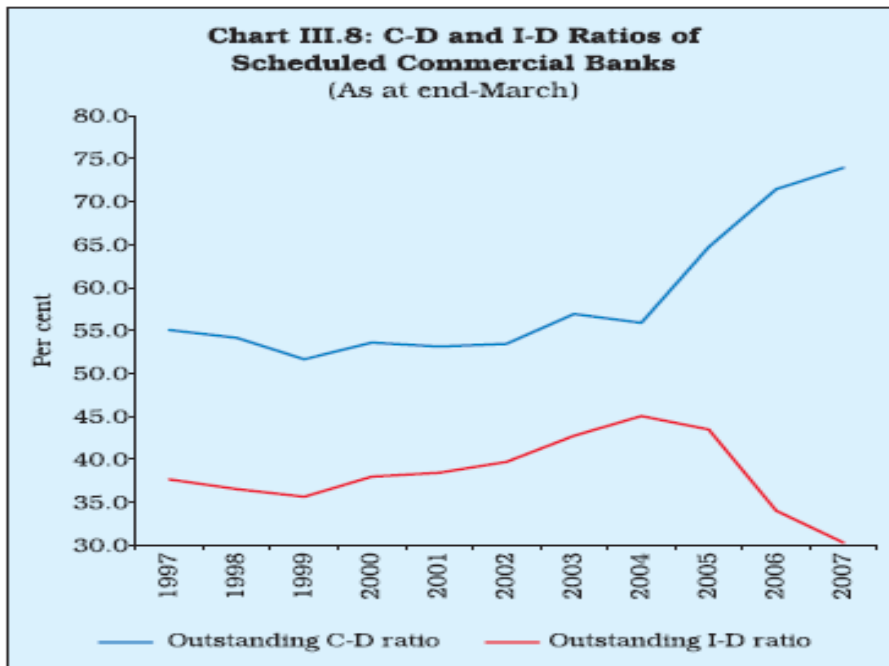
- **Slowdown? What Slowdown!!** – *We expect growth to be around 8% in 2008 owing to monetary measures taken by Reserve Bank of India (down from 9%)*
- **Indian corporate sector looking to *expand organically as well as inorganically* – *domestically and overseas***
- ***Infrastructure development* is the key theme with the Industry as well as Government – *huge investment needs***
- **With *equity markets not willing to pump more money and global credit crisis*, prospects of local Bond issuance looks good**
- **From investor perspective *right time to go long bonds with interest rates beginning to fall* – **arbitrage opportunity****

Indian Economy – Way forward is Bonds

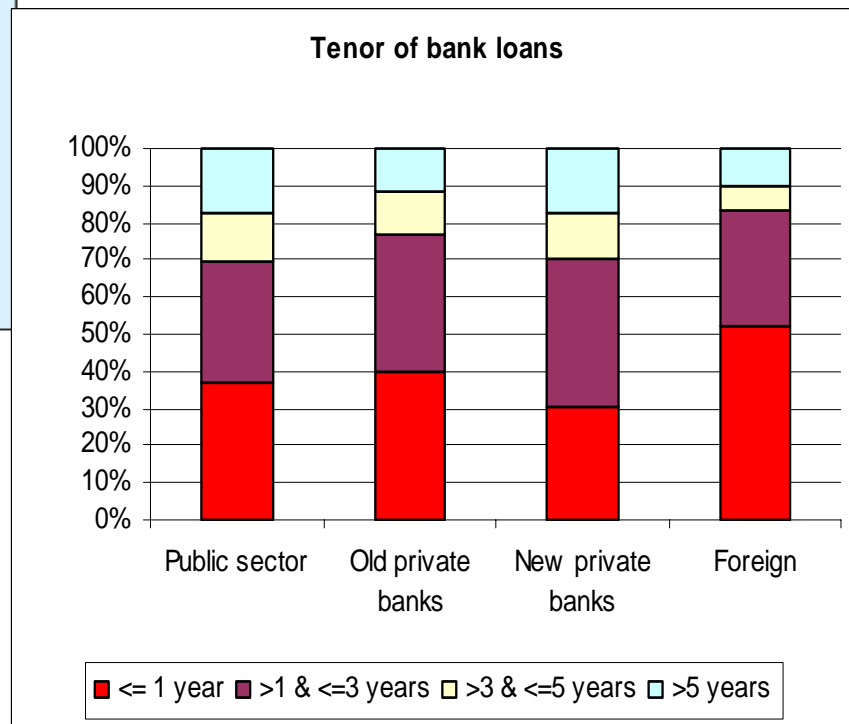


Source: *The Development of India's Corporate Market* (Chart 14), The City of London, February 2008.

Indian Economy – Banks have done their bit



Source: Report on Trend and Progress of Banking in India, 2006-07, Reserve Bank of India.



Indian Economy – Bonds will have their day

- **Rated debentures** *provide an avenue for disbursement of credit to blue-chip customers at below PLR interest rates*
- *Dependence of internal accruals barrier to rapid growth, especially for big projects and big ticket acquisitions*
- *Move to fully funded pension system for government employees, from pay-as-you-go system*
- **Increase in the proportion of formal sector in the economy,** *bringing more people into the pension net*
- *Increase in rate of penetration of life insurance products*

Indian Domestic Bonds – The Current Arbitrage for Offshore Investors

Free Lunch - The Idiot Proof Math

AAA (Domestic Rating) 5-year Bond Yield	: 9.25%	(INR)
Assumed cost of borrowing for Investor	: Libor + 100 bps	(USD)
Fully Hedged Cost	: 6.00%	(INR)
Yield Pick-Up	: 325 bps p.a.	

The Lunch is Free right now, but its not a Buffet

- The SEBI has a global cap of USD 1.5 billion on Corporate Bond investments by FII's (Foreign Institutional Investors).
- FII's need to be registered with SEBI and seek allocation for every investment from the Cap.

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Foreign Currency Issuances – Alive & Kicking

Global Bond Markets & Indian Companies

- *A few large Indian names already active in off-shore bond market - ICICI, Reliance, Bank of India, Canara Bank, SBI, Vedanta, IDBI*
- *Large number of Convertible Bonds done in the last 2-years*
- *Primarily these issues have been used to fund overseas expansion or acquisition by Corporates and capital injection by banks*
- *RBI restrictions make it tough to use proceeds of above issue for domestic purposes*
- *More Indian Companies looking for overseas funding, and Basel 2 norms hitting Indian banks next year, bonds become necessary*
- *The Credit Crisis and blown-out spreads have temporarily turned off the tap on this funding*

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Derivatives Market –Controlled but Vibrant

Indian Derivative Market: Enigma in itself

- **Regulated market and as of now *only vanilla swaps & vanilla options in local currency permitted, but tenor is not a restriction; 10-year liquid.***
- **G-7 exotics are permitted**
- **Primarily a liability side business. *Issue Swaps are becoming increasingly common and longer in tenor***
- **Local currency FX Options are also *quote up to 10 years but liquidity goes down after 5 years***
- **Asset side market *restricted to few issuances linked to G-Sec or Money Market benchmark***

But despite the odds *one of the fastest growing markets for G7 exotic and vanilla derivatives*

Indian Derivative Market: The Participants

- **Top Tier Corporates** like **Reliance & Tata Group** *run their own Global Dealing rooms out of Mumbai*
- **The Foreign Banks** – *very active in the Domestic Currency market, and in the G-7 Exotic business. Calyon is one of the market leaders in the Interest Rate Derivatives space*
- **The Local Government owned banks** – *very active in the Domestic Currency market, increasingly taking on the role of “Intermediaries” in the G-7 Exotic business*
- **The Local Private Banks** – *very active in the “Intermediary (White Business)” in the G-7 Exotic space*
- **Asset side market** *restricted to few issuances linked to G-Sec or Money Market benchmark*

Calyon in India – It's the Size that matters!

www.calyon.com



CAPITAL MARKETS

Biggest Swap Traded in India

At Calyon, We Provide Solutions

Derivatives, Foreign Exchange,
Debt Securitization, Debt Origination,
Structured Credit

January 2007



USD 1 Billion

5 Years & 10 Years
Interest Rate Swaps



Swap Counterparty :
Calyon Capital Markets - India

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Structured Notes – Regulatory Hurdle

When shall we see Structured Notes?

- *No capital account convertibility* so domestic investors can't invest in FC notes
- *No optionality allowed on INR interest rates* so non existence of Local Structured notes
- *Expect INR interest rates options to be allowed in next 1-2 years*
- *Corporate Sector currently can invest unutilized proceeds of Loans/CB/ADR/GDR issue* in principal protected structured notes
- *Individuals are allowed to remit upto USD 200K per person per annum outside the country* which they can invest in Structured notes
- *Not many have actually used the above facility* owing to low awareness about foreign markets and products available. Also domestic returns much higher currently
- However, *Private Banks are already selling Notes* to people with wealth outside India and to Non Resident Indians

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Credit Derivatives – Just Around the Corner

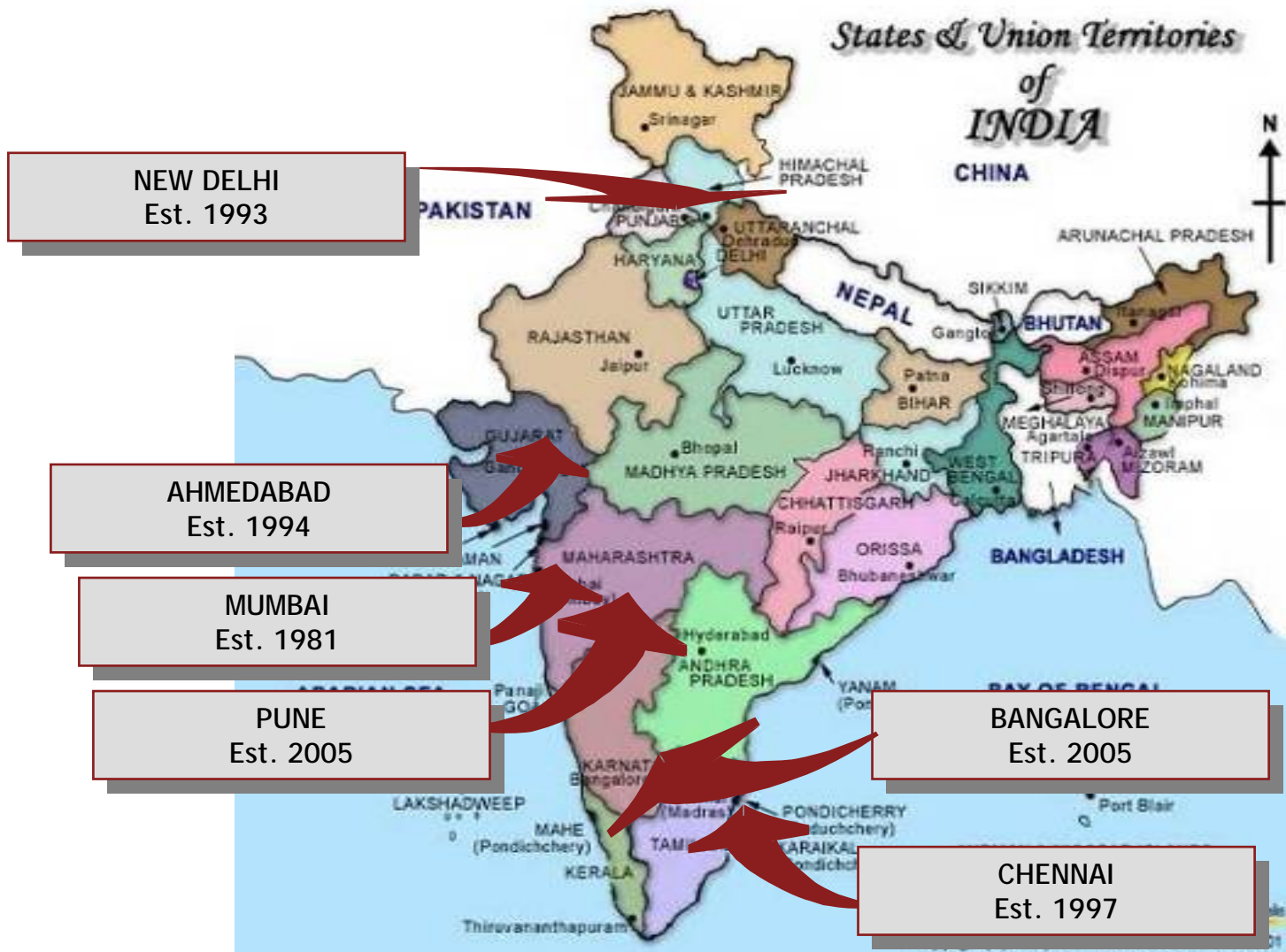
Credit Default Swaps – Coming soon to a theatre near you.....

- *RBI has already issued Draft Guidelines for the INR CDS market (Single name only)*
- **Final guidelines were earlier expected to come out in 2007 but have been held back due to US Sub prime crisis. *Expect a Vanilla CDS market to start by the end of 2008 or early 2009***
- *Initially only Banks and Financial Institutions will be allowed in the market with rated paper as obligations*
- *The next step will clearly be baskets, but may still be restricted to banks*
- *In a couple of years, the market may be opened to others* **via structured notes**

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Calyon in India – A Partner in Growth

Calyon – A Pan India Presence



Calyon in India – A Partner in Growth

- **India's *Leading Bank* in *Interest Rate Derivatives***
- **India's *Leading Bank* for *Foreign Currency Loans***
- **India's *Leading Equity Broker* (CLSA)**
- **An *Emerging Leader* in the *Local Bond Markets***
- **A *Fast Increasing Presence* in *Project and Structured Finance***

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Conclusions

Conclusions

- *2008 is when the Indian Debt Markets will come of age*
- *The huge funding needs of local Corporates and Infrastructure Companies provides very interesting investment opportunities in the Indian market*
- *Rate Arbitrage exists for foreign investors*
- *The well developed and deep Derivatives market allows investment returns to be hedged and locked in*
- *A local CDS market expected to start within 12-months is the precursor to a Structured Notes market*

The 20th Century Mirage – India's Potential



The 21st Century Reality –India’s Time in the Sun!



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Namaste