AXIS BANK

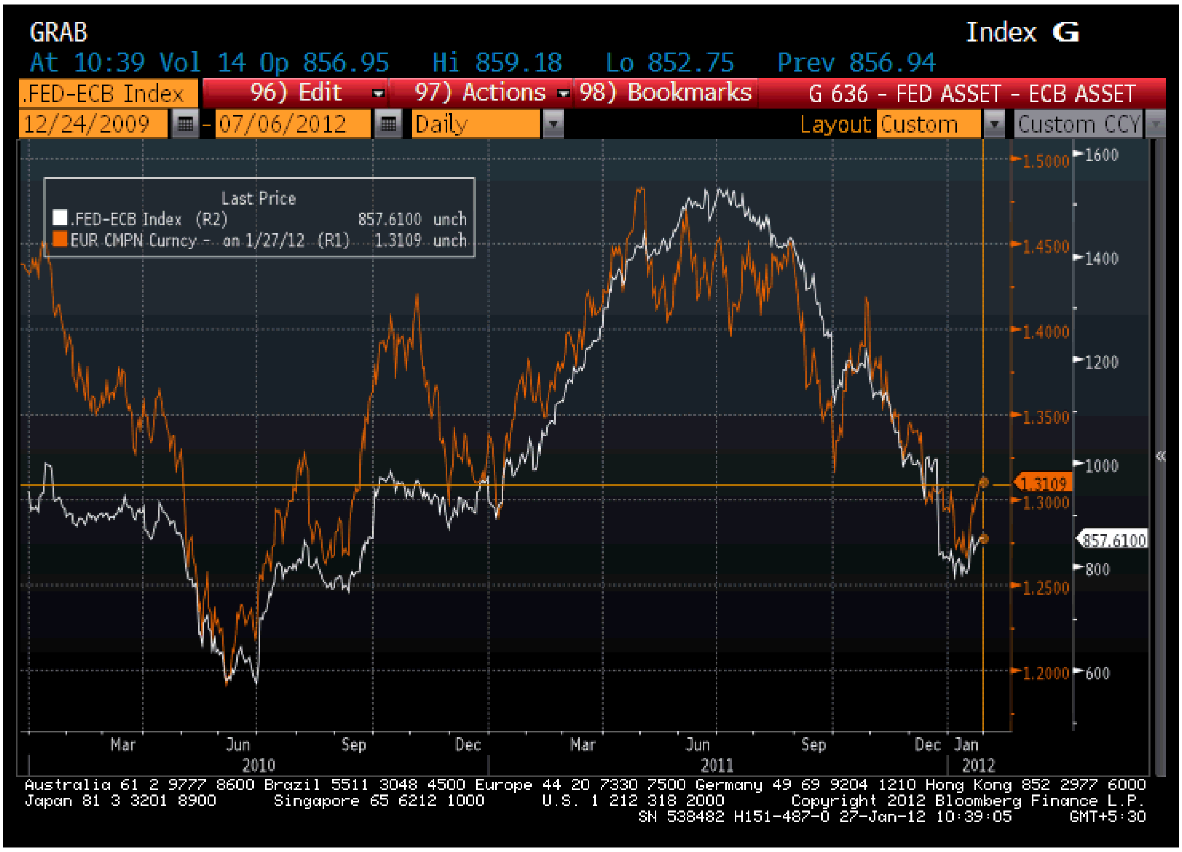
QE 2.75

The information contained here is based on or derived from information generally available to the public from sources believed to be reliable. No representation or warranty is made or implied that it is accurate or complete. This has been prepared solely for information purposes and for private circulation and does not constitute any solicitation to buy or sell any instrument, or to engage in any trading strategy. Markets can be volatile and opinions may change without notice. The opinion expressed here is solely that of the author and does not purport to represent the views of Axis Bank.

The explicit timeline provided by the US Fed not to hike rates untill late 2014 is another jab at backdoor QE without directly buying back bonds. The argument goes like this: Holders of UST's hold roughly USD 13 Trillion of Treasuries(excluding the US Fed which is itself one of the largest holders of US Treasury Bonds). By postponing the possibility of a rate hike untill late 2014, the yield curve came off by 5-15 bps, immediately post the FOMC statement, across the tenor. The average duration of all outstanding UST's is 5.5 years. The 5 year UST yield fell by 15 bps immediately post the FOMC statement. US Tips implied inflation went up by 2 bps. We extract the increase in inflation effect on the nominal yield and arrive at the net impact of the US Fed action 15+2 = 17 bps excluding the impact of increase in inflationary expectations. US Sovereign CDS has remained unchanged post the intervening event.

The positive portfolio wealth effect due to a 17 bps reduction in yields is 100 Billion USD. Not bad, considering that QE2 involved USD 600 Bio of bond buybacks over a more than 6 month period and had questionable impact on US Treasury yields. Also the last QE 2.5 by stealth(In the August 2011 FOMC when Fed said it will not raise rates until 2013), involved an impact through the same wealth effect of USD 170 Bio. So, this time the FOMC has continued with it's tradition of QE2 and QE2.5 by stealthily ushering in a new QE2.75 without the market embellishing it as such.

And has the market priced in this QE"2.75"? Indeed it has. The FX market has quantifiably priced it to the last cent. Presenting below is the EUR/USD chart along with the differential of the Central Bank Balance sheet sizes. The surge in the FX pair exactly corresponds to a USD 100 Billion increase in the US Fed Balance sheet size. Though QE2.75 is not officially included in the US Fed publication of it's Asset size , however the impact on markets, whether through the Bond markets, or by the FX market , or by the Equity markets is immediately apparent.



27th January 2012

<u>Strategy</u>

Anupam K Mitra, AVP

Axis Bank

Treasury, Global Markets Group

Contact details – 66043222, 42026622. anupam.mitra@axisbank.com