

In conversation with Marzban Irani Chief Investment Officer (Fixed Income), LIC Mutual Fund



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"As Liquidity Comes Back Into The System, Short-Term Yields May Decline"

The Reserve Bank of India (RBI) Governor Shaktikanta Das has described the fall in inflation as very satisfying and that it gives confidence that the monetary policy is on the right track. What are your views on the same?

Inflation has been declining from its peak due to a favourable base effect and fall in food prices. Core inflation which was sticky at 6 per cent for a long time has also declined, which is also comforting for the RBI. CPI has come down and might settle in the range of 4-6 per cent. The RBI may have the necessary comfort to keep rates static as of now. The latest CPI print came at 4.7 per cent which is way below RBI's projection of 5.1 per cent for the first quarter. With an expectation of normal monsoon, inflation may remain closer to 5 per cent in the near future which is very much within RBI's tolerance band of 2-6 per cent. In the policy of June we are expecting the RBI to continue to keep the repo rate unchanged at 6.5 per cent as the current inflation print is comfortably below its first quarter projection. Also, they might wait to see how the monsoon turns up while also gauging the effect of previous hikes

on growth.

How do you compare the yield movements in Indian bond markets with those in developed markets? What are the key factors driving yield movements in developed markets, especially the US and Europe?

Yields in the domestic market as well as global markets have declined after inflation has started coming down. Although there can be some challenges in the short term, in the medium term yields maybe expected to decline globally as well as in the domestic markets. Liquidity was one more factor why yields went up at the short end of the yield curve. As liquidity comes back into the system, short-term yields may decline. We are seeing flat to inverted yield curves across the markets now. The curve gets upward sloping in a rising interest rate scenario and as the hike cycle comes to a halt, the curve starts getting flatter.

And eventually it gets inverted as the expectations of rate cut sets in. In the current scenario, both domestic and in the US, we are nearing the rate hike cycle and so the curve has started getting flatter in certain duration buckets and inverted in some other duration buckets. The current scenario may continue to hold on for some more time due to inflation still on the higher side although it has come down from its peak. The moment CPI numbers start printing on the lower side on the comfort band of the central bank, the curve will start getting inverted across all maturity buckets as expectations of rate cut will start building in.

Following the RBI's recent decision to pause its policy rates, what is your perspective on the Indian debt markets and yield curve? Additionally, do you anticipate that the RBI will maintain this stance for the rest of 2023?

In the last policy the RBI had paused. The decision to pause was driven by increased financial stability risks facing the global economy and assessing the impact of the past rate hikes. Also, the situation on the real rates' front has improved as compared to the February 2023 policy after RBI revised its CPI inflation forecast. Considering this, the RBI is expected to remain on the pause mode for the next 2-3 policy meetings since headline inflation is expected to remain within RBI's target band. However, upside risks to inflation could stem due to OPEC+ supply cuts and rebound in Chinese growth on crude prices and uneven monsoons with the likelihood El Nino conditions.

The actual impact on food inflation may depend not only on the absolute level of rainfall but also on distribution. We feel the MPC might be through with the rate hike cycles. Globally too, the central banks are reducing the pace of rate hikes and expect that future rate actions will be data-dependent. Inflation is also showing sign of cooling off which is also providing positive signs for the market and hence we feel the yields may remain supported. In the current year the stance might not change immediately as a neutral stance might give a signal of early rate cuts. Hence, MPC might stay put.

Given the recent announcement regarding debt indexation, what is your recommendation for retail investors regarding their approach to [Debt Funds](#)?

Indexation benefit was an added advantage for investors to invest in debt funds. However, despite the withdrawal of LTCG, I believe investors will still prefer investing through mutual funds for multiple

reasons. Firstly, debt mutual funds offer easy liquidity as most schemes do not have exit load and one can put part or full redemption any time unlike traditional instruments where an investor can't get part payment. Also, in case of traditional instruments, one may have to bear pre-closure penalty. Secondly, debt mutual fund portfolios are updated on respective AMC's websites every fortnight. Investors can easily view where their money is deployed, thus resulting in the highest level of transparency.

Debt funds offer a variety of options across the spectrum including duration, credit, passives, open-ended, close-ended, etc. Lastly, in a falling interest rate scenario an investor may get the benefit of capital appreciation as the portfolio is valued mark to market daily. This may not be possible in case of traditional instruments. Also, savvy investors who want to time the market and invest for a shorter timeframe may prefer the MF route because of liquidity and scope of capital gain. Currently, the yields are at reasonable levels due to huge borrowing programme with the government spending on health, education, etc. Hence, a retail investor may invest in debt mutual funds depending on their risk appetite and investment horizon.

With inflation and interest rate slated to come down and bond yields also softening, does it make sense to invest in long duration debt mutual funds?

Inflation and interest rates are declining in a structural manner. A similar thing will happen in the bond market and hence an investor may invest in long-term funds. Higher the duration higher will be the price sensitivity and hence in a falling rate scenario long duration funds tend to benefit more. As the rate cut cycle starts, investors may benefit via capital appreciation also. Thus, we believe that the bond yields have started correcting and are trading in the range of 6.95-7.10 per cent and believe that it provides a good opportunity to invest in medium to long duration funds, gilt funds, BPSUs, debt ETFs and at the shorter end in liquid funds and money market funds.

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