

## Debt Market Review



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### Market Review

- Amidst the pandemic scare and falling growth, CPI inflation surprised by growing to 7.2% in April and 6.09% in the month of June. Though data collection was a challenge in the month of April, May and June and some of it may have been caused due to supply disruptions caused by the lockdown, the CPI data is a cause of concern. July has seen a huge jump in the vegetable prices due to supply distortions – up by 32% as per Ministry of Consumer Affairs and this is expected to lead to Headline inflation to print beyond the 6.5% mark. Even as we feel that inflation would moderate beyond July and into March 2021, the average Headline CPI for Q4FY21 could be at around 3.5%. With the expected July reading, Headline CPI inflation will be higher than the 6% mark for 4 consecutive months. Further with real interest rate currently in the negative zone coupled with High Inflation data would force MPC to focus more on inflation than growth. This is also attributed to the fact that Policy rate transmission has always remained a challenge in India. Despite a 115bps repo rate cut, Weighted Average Lending Rate (WALR) for outstanding loans has come down by 37bps from February 2020 to June 2020 while WALR for fresh loans has come down by 91bps. However, this has not been effective in pushing credit growth. Credit growth by 17 July has slumped to 5.8% (in absolute terms, credit growth is down by INR1514bn in FY21 till date compared to a drop of INR1133bn in the same period last year. It is unlikely that any further rate easing by the RBI (even as it is transmitted) can lead to a rise in credit offtake as (a) demand for credit remains muted, given that working capital needs as also funding needs for expansion would be low and (b) system suffers from a huge risk aversion. RBI in its latest Financial Stability Report has pointed out that GNPA could increase sharply by 400bps to 12.5% by March 2021, even at the baseline real GDP contraction of 4.4%, thus leading to a continuation of risk aversion to lending.

- The Reserve Bank of India's financial stability report has raised concerns about the risks of rising debt levels across the world particularly for emerging markets. According to the regulator's report, the global debt is now more than that seen during the 2008 global financial crisis (GFC). The report states that global debt has increased across all sectors and stood at \$255 trillion in the December quarter of 2019. At over 322% of the gross domestic product (GDP), global debt is currently almost 40% or \$87 trillion more than that seen during the onset of the global financial crisis in 2008. In Global developments, The European Central Bank left its key interest rates and the size of asset purchases unchanged as policymakers weigh the effect of the previous actions. The rate was left unchanged at a record low zero and the deposit rate at -0.50 %, in line with economists' expectations. The Federal Reserve kept policy rates unchanged at 0-0.25% and reiterated its commitment to maintain bond purchases and the gamut of lending and liquidity programs associated with the response of Covid. The policy statement highlighted that "the path of the economy will depend significantly on the course of the virus". The statement also highlighted "following sharp declines, economic activity and employment have picked up somewhat in recent months but remain well below their levels at the beginning of the year."

- In another developments, Rainfall in July was 9% below LTA. On a cumulative basis, spatial distribution of monsoon has been normal though over the last couple of weeks rainfall has weakened in across India. Out of the 36 sub-divisions across India, till date, seven have received deficient rainfall, 17 have received normal rainfall, and 12 have received excess rainfall. Overall, basins and reservoirs were around 2.5% above long-term average for week ending July 30.

### Outlook

- The MPC took proactive measures following the steps of global central banks by cutting Repo Rate by 115 bps since Feb 2020 since the time India entered a lockdown. The RBI has already done much to support growth but could be close to the limit now. At this juncture, real interest rates are in the negative and this could be hurting the savers but also not leading to any credit growth due to the continuing risk aversion in the system.

- The challenge is from the inflation front as the Headline CPI had been firmer than expected and this is likely to put RBI in a difficult position of choosing between growth and inflation. Being a targeting central bank, we feel there would be a pause from the MPC at its August policy and the next move could come at a later stage after it is able to assess the inflation dynamics better. Short Term Yields would remain volatile depending the system liquidity and MPC's stance on Reverse Repo rate. However we expect long end of the curve to stay protected due to RBI support, as long as the virus scare remains.

Statutory Details Sponsor: Life Insurance Corporation of India.

Investment manager: LIC Mutual Fund Asset Management Ltd. CIN: U67190MH1994PLC077858

For further details, please refer to the Scheme Information Document, Statement of Additional Information & Key Information Memorandum cum Application forms, available on our website [www.licmf.com](http://www.licmf.com) and at the official points of acceptance of LIC Mutual Fund Asset Management Ltd.

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