

Debt Market Review



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Market Review

- The month of March marks one year of Covid related lockdown in India. Though there were number of measures taken by RBI and GOI to ease the pain caused by lockdown and some of them still being in place, such as enormous amount of liquidity and accommodative stance, the market has finally come to accept the fact that going ahead yields would rise sharply due to the humongous supply and higher Inflationary expectations.
- This is further accentuated by the fact that RBI governor in one its press conferences mentioned that Yield curve is a public good and there should be an orderly evolution of the curve and hardening of bond yields is a global phenomenon. Though he also reiterated that central bank will support the market with adequate liquidity at appropriate places when required.
- RBI also announced government borrowing for the first half of the FY2021-22 where as expected almost 60% of the borrowing is in the 1st half of the fiscal year. While bond markets could get some respite in the near term amid RBI support, the gains are likely to be capped. We expect the 10-year yield to trade at 6-6.25% through 1QFY22, with the range shifting towards 6.25-6.50% in 2QFY22. Monthly data suggests that gross tax revenue collections for 11MFY21 were 88% of FY2021RE.
- On the other hand, expenditure targets (particularly revenue expenditure) seem difficult to achieve given that total expenditure for 11MFY21 is currently 82% of FY2021RE. With the cancellation of only one market borrowing auction, government might begin the year with a significantly huge cash balance (Rs2.5-3 tn), providing a cushion for lower borrowings in 2HFY22.
- February CPI inflation rose to 5.03% as against 4.1% in January. Sequentially, CPI inflation rose 0.2% after a fall of 0.6% in January. Food inflation rose to 3.9%. Core inflation (headline CPI inflation excluding food, fuel and pan, tobacco) came in at 5.7% (5.2% in January) and was led by inflation in the transport and communication segment (11.4%) and in the personal care segment (8.6%). On a sequential basis, core inflation grew 0.7%, owing to a 1.3% increase in the transport and communication segment (petrol and diesel prices) and 0.6% increase each in recreation and amusement, housing, and health. Economic activity remains patchy as reinforced by a lower IIP reading. January IIP fell by 1.6% as against a rise of 1.6% in December 2020. On a sequential basis, January IIP fell by 1%. On a sectoral basis, mining and manufacturing production fell by 3.7% and 2%, respectively, while electricity production registered a growth of 5.5%.
- In major development across the globe, post Biden stimulus package announcement, global investors are upwardly re-rating their outlook on the US economy. U.S. 10 year yield has moved higher by 40-50 bps over 2021 so far. The FED in its bi monthly meet emphasized the “contingent nature of the forward guidance implying there is nothing sacrosanct about the guidance provided in the data plot”. It appears that global central banks are not willing to interrupt the rise in longer end yields at the current juncture, given that it is being driven by a re-pricing of growth expectations than paper supply concerns ensuring that the upward bias in yields remains firmly in place.

Outlook

- We expect yields to inch higher in 2QFY22 (6.25-6.50%) given the surge in net supply to Rs3.4 trillion along with the challenges associated with higher inflation making it difficult for the MPC to continue with its accommodative stance unless the pace of economic recovery fades. Lower-than-budgeted borrowing in 2HFY22 along with possibility of inclusion in the bond index could provide some respite to the bond markets.
- FOMC appears to be focussed on ensuring that there is a persistent inflation overshoot before committing to hiking rates and FOMC will look not only at unemployment rate but also at a variety of labour market indicators to assess the extent of slack in the economy.

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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 and at the official points of acceptance of LIC Mutual Fund Asset Management Ltd.

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