Through the Lens - Fixed Income Outlook

July 2021

TATA MUTUAL FUND

Due to the second wave of Covid-19, Rate hike expectation have been pushed into next financial year provided we do not have a severe third wave and we are able to vaccinate majority of the population. The RBI governor has indicated that premature withdrawal of accommodative monetary policy stance can reverse the trepid growth momentum which has built up in the economy.

RBI Objectives and Actions

RBI's main objective is to Foster economic growth over the coming financial year while keeping a close watch on inflation. RBI has stated its intention to ensure orderly evolution of the G-Sec curve, reduce volatility to ensure a stable rate structure and is expected to support the government borrowing program.

RBI is expected to intervene decisively, especially in the short end of the curve to support bond prices as the government and corporates are expected to borrow in this segment.

RBI Interventions

- RBI bought almost Rs 27,000 crores worth of 10-year G-Sec and canceled an auction during the month. With this buying, RBI now holds more than 65% of 10-year papers. RBI has bought Rs 1.73 Lakhs crores worth of G-Secs, of which Rs 1.20 Lakhs were through G-SAP (Government Securities Acquisition Program), Rs 43,000 crores in secondary market and Rs 10,000 crores in Operation Twist.
- RBI has also changed the primary auction up to 14 years to uniform price auction from multiple price auction. In uniform price auction, all the successful bidders will get the cut off price unlike the multiple price auction, in which successful bidders got at the price at which they had bid in the auction. This is expected to lower the borrowing cost of the government in a rising interest rate scenario.
- In the MPC, governor announced GSAP-2 worth Rs 1.2 trillion for the Jul-Sep quarter which was expected. Adding Rs. 10,000 crores of state loans in GSAP-1 gave expectations that RBI might add another Rs.10-20,000 crores of SDL buy back in GSAP-2 as well.
- As per RBI and the Government, the additional borrowing due to GST Compensation Cess has already been borrowed for the first half of this financial year. There is no additional borrowing for the first half of the financial year.
- RBI Governor has stated higher CPI inflation is transient in nature and CPI inflation will moderate from September 2021 onwards. RBI will look through this CPI inflation numbers as right now the focus is on getting growth back on track.

Continued

Inflation and Growth Discussion

Inflation

India's Wholesale Price Inflation (WPI) Index came in at 12.07% YoY during the current month as compared to 12.94 % for the previous month on account of rising fuel, food, and commodity prices.

The Consumer Price Inflation index remained in a range from previous months and came at 6.26% YoY in the current month as compared to 6.30% in the previous month due to higher fuel, commodity prices and lower fruits and vegetable inflation.

Going forward for next two months, CPI inflation is expected to be around 6 %. It is expected to come down from September 2021 due to favorable base effect.

Growth

India's Real Gross Domestic Product (GDP) growth for FY21 came at -7.3% compared to estimated -8% with 2H growth turning positive. Q4FY21 GDP growth was reported at +1.6%, higher than estimated 1% growth.

The recovery of the Indian economy seems to be pushed back due to the second wave of the pandemic, which has seen record level of infections and deaths. 40 % to 50 % of the population is likely to get vaccinated should take another 6 months, in the best-case scenario.

The economy is expected to improve from the second half onwards provided we do not have a third wave. Given weak consumer sentiments and high leverage of household full recovery of economy is expected only in the next financial year.

Global macro-economic environment continues to be growth positive, with most advanced economy expected to start withdrawing monetary accommodation from next year onwards. The US is expected to at the forefront with Federal Reserve expected to hike rates in the second half of 2023.

Source: RBI/MOSPI

Currency and Forex

RBI comfortable forex Reserve of USD 611 billion and forward purchase of USD 60 Billion means RBI can follow its own independent monetary policy and take monetary policy action independently at least in the short term. RBI has also been buying heavily in the forex market due to IPO related flows in the Indian market.

Source: RBI Statistical Supplement

Liquidity

RBI has endeavored to reduce borrowing costs of the Govt. and corporates through OMOs, Operations Twist and G-SAP. These actions have infused liquidity in the system.

In light of RBI actions to support growth and maintain an accommodative monetary policy stance, Liquidity is expected to remain in surplus mode over the medium term. Surplus Liquidity in the system is at ~7 lakh crores.

Source: RBI Bulletin/ MPC Announcement

Our View on Rates

We expect RBI to intervene decisively, especially in the short end of the yield curve to support bond prices. Additional borrowing for GST compensation cess and stimulus package announced by the government is expected to happen in less than 7-year segment in the second half of the financial year. We are positioned in the short to medium end of the yield curve in all our funds to take advantage of carry and expected RBI intervention.

Yield Movements

G-Sec Yields

Yield increase across the tenure during the month of June 2021. An up move in rates in the month of June was triggered mainly by shockingly higher CPI print of 6.30 % (exp 5.4%), higher Brent oil prices and fear of extra borrowing towards GST shortfall. Sharp recovery in covid scenario also triggered fears that pro-growth stance may not remain longer given the inflation trajectory. Higher movement were seen in 3-5years tenure as 10year was supported by RBI via Gsap1.0 auction

Corporate Yields

Similar movement were seen in corporate bonds, where 3-5 years segment saw higher rise in yields (25-30bps) from its lowest levels in earlier month.

Source: Bloomberg/RBI

Portfolio Positioning*

RBI is expected to intervene decisively to stabilize the yield curve, especially in the shorter end of the curve.

We are positioned in the short to medium end of the yield curve in all our funds to take advantage of carry (return accruing from holding a higher yielding security over deploying in call money at reverse repo rate of 3.35 %) and expected RBI intervention. We will continue to focus on the quality of securities across portfolios

**Based on current market scenario. Strategy is subject to change without notice*

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