April, 2020

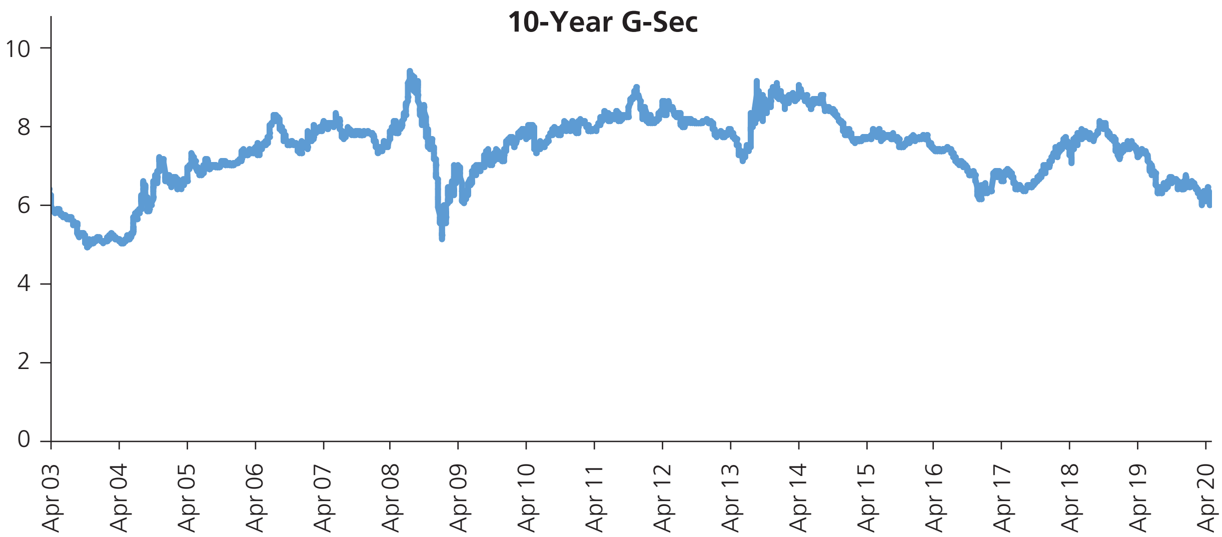
Indian sovereign bond was slightly down by 3 bps, on month on month basis, to close at 6.11% amid volatility, as the COVID-19 turmoil continues to roil markets.

The fluctuations in yields was perpetuated by a host of factors including rate cuts by the Reserve Bank of India (RBI), fluctuating rupee and oil prices, OMO operations, surplus liquidity in the banking system and expectation of additional measures by the RBI to support the relief measures already taken by the government.

Market Performance

The 10-year benchmark G-Sec yield closed at 6.11%, down by 03 bps from its previous close of 6.14% while that on the short-term 1-year bond ended 120 bps lower at 3.8%. In the corporate bond segment, yields rose across the yield curve, over the month.

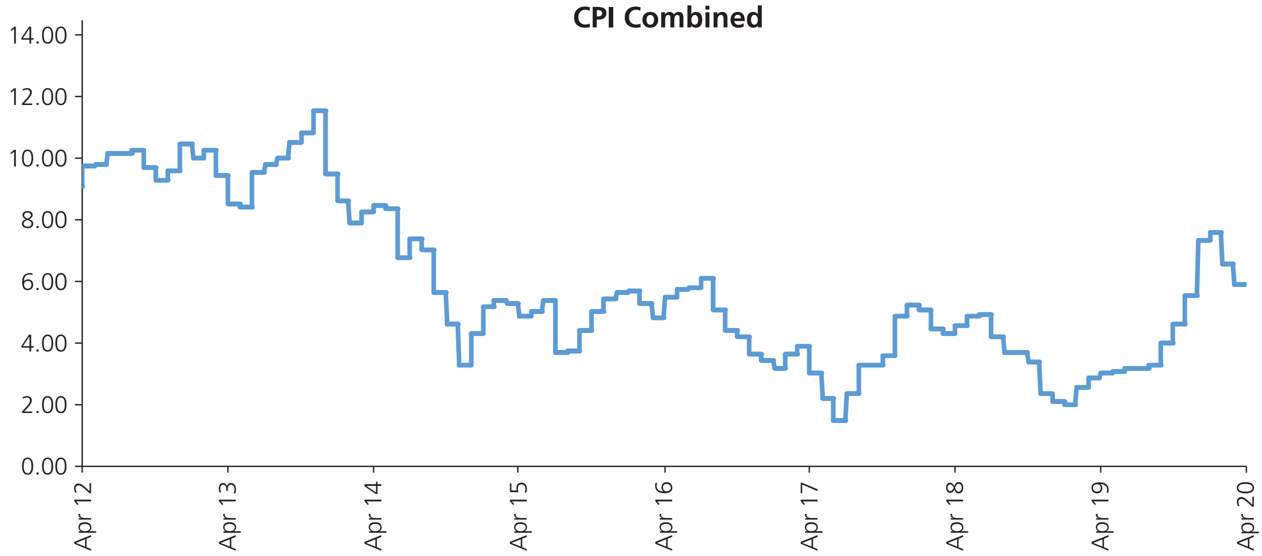
The 10-year AAA bond yield ended 05 bps higher at 7.15%, while the short-term 1-year AAA bond yield ended flat at 6%. The spread between 1-year and 10-year AAA bond widened. Within the short term segment, yield on 3-month commercial paper (CP) was up 25 bps to 5.5% while 1-year CP yield was up 05 bps at 6%.



Macro-Economic Developments

IIP & Inflation: India's factory output rose to a seven-month high of 4.5% in February, before the government imposed a nationwide lockdown in March that has crippled normal economic activity. The retail inflation stood at 6.58% in February 2020 and 2.86% in March 2019 while the wholesale price inflation dropped to just 1% vs 2.26% in February.

PMI: India's services PMI contracts to 49.3 in March, as firms cut workforce while the Manufacturing PMI for March declined to a four-month low of 51.8 from 54.5 in February.



Outlook

- Oil & commodity prices decline are hugely positive for rates market and containing domestic inflation
- COVID-19 will lead to a huge supply and demand shock leading to easier Monetary and Fiscal policy
- As the system moves towards accessing credit from banks, RBI will help in providing adequate liquidity and aid interest rate transmission

We have moved from a neutral view on interest rates to an overweight (positive) outlook. Interest rates can come down further as the Monetary Policy Committee (MPC) will look to cut rates, however, the yield curve will remain steep as there will be a realistic possibility of a miss in Fiscal Deficit targets and additional supply in the form of market borrowing from both state and centre. ***The yield curve has further steepened, thereby, providing relatively attractive carry for going longer in duration.***

Fund Strategy

We expect the RBI to cut Repo Rate further in the upcoming MPC by 25 to 40 bps. The corridor between Repo and Reverse Repo has been widened to 65 bps and surplus liquidity has ensured that Reverse Repo rate is the operational rate in the system. Thus, ***we expect the short end yields to remain low, due to large liquidity surplus and accommodative stance of RBI MPC.***

The government security yields are likely to trade in a range with downward bias, given balancing forces of Fiscal and G-Sec supply worries on the one hand and RBI keeping a check on any upward pressure of yields by purchase of securities, operation twist, LTRO at repo rates.

The AAA yield curve along with the G-Sec curve remains very steep, with relatively attractive carry for going longer in duration. Hence, with further monetary accommodation expected, ***we believe medium to longer end of corporate bond curve offers reasonably attractive carry as well as a good chance of capital gains.***

Credit spreads for non AAA bonds have widened significantly due to heightened worries about the deteriorating credit profile of corporates and financials on account of the economic shock caused by COVID-19.

Although there is good value in the better quality AA+/AA issuers, significant risk-off sentiment from investors have resulted in outflows from credit oriented funds and this has been accentuated by the winding up of certain schemes from one of the competitors. ***In this environment, preserving portfolio quality and having adequate liquidity in all the funds will be our topmost priority.***

Source: MOSPI, Internal, Bloomberg