L&T Financial Services
Mutual Fund

The 10-year G-sec yield fell by 15 bps in the month from 6.18% on March 31, 2021, to 6.03% on April 30, 2021.

Positive movement in bonds in the last month could be attributed to a confluence of factors. It could be a sharp decline in the US treasury yields or the economic uncertainty caused by the second wave of covid-19 infections.

The announcement of a bond-buying program – GSAP (G-Sec Secondary Market Acquisition Program) at the start of the month, played a crucial role in turning the market sentiment. Under the GSAP 1.0, the RBI committed to purchasing Rs. 1 trillion worth of government bonds during April – June 2021. Out of this, the RBI purchased Rs. 250 billion of government bonds in April 2021.

MARKET PERFORMANCE

The 10-year benchmark G-Sec yield closed at 6.03%, down by 15 bps from its previous close of 6.18% while that on the short-term 1-year bond ended 05 bps lower at 3.80%.

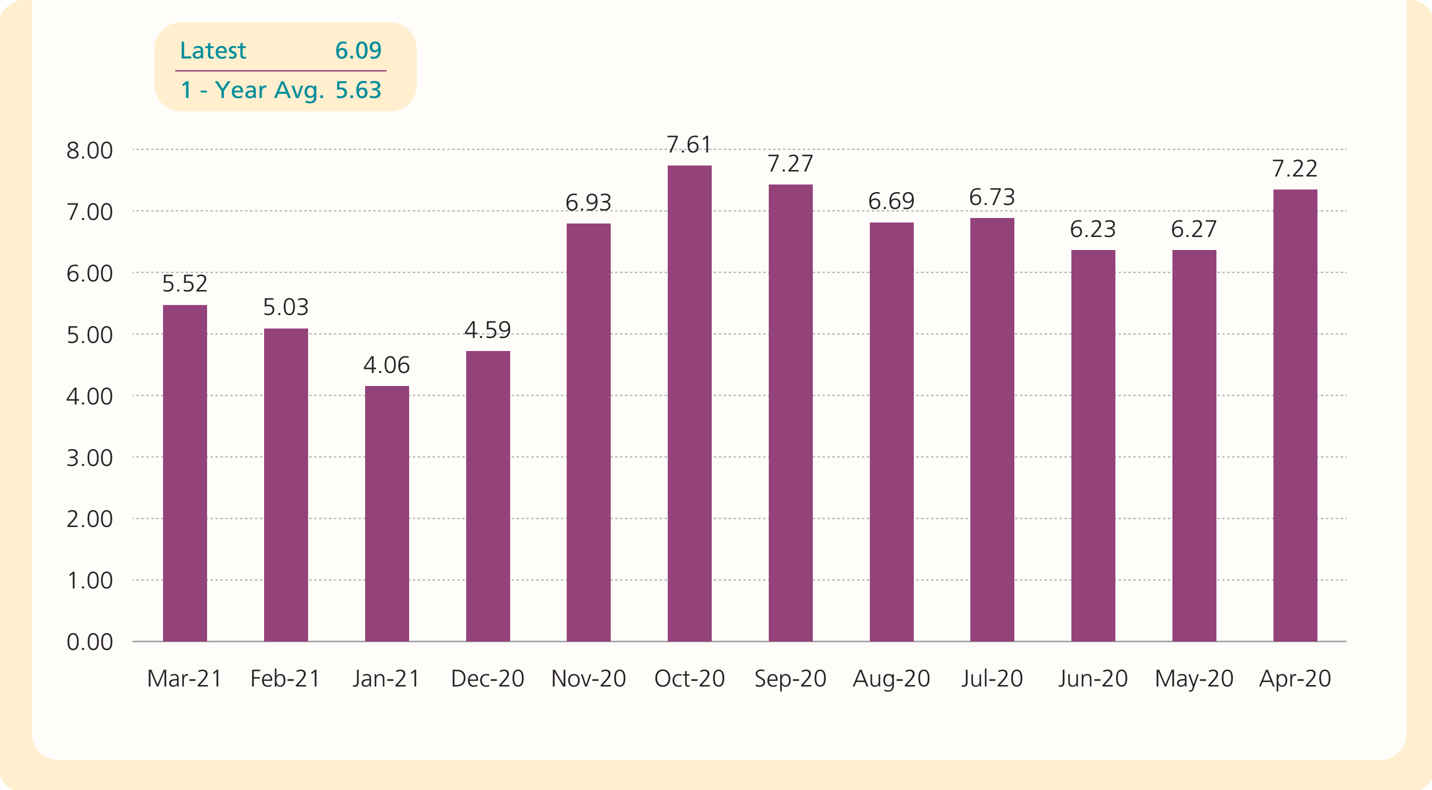
In the corporate bond segment, yields fell across the yield curve over the month. The 10-year AAA bond yield ended 03 bps lower at 6.82%, while the short-term 1-year AAA bond yield ended 03 bps down at 4.17%.

The spread between 1-year and 10-year AAA bond was flat. Within the short-term segment, the yield on 3-month commercial paper (CP) was down 05 bps to 3.45% while 1-year CP yield was down 05 bps at 4.20%.

10-Year G-Sec

Past performance may or may not be sustained in the future.

CPI Combined (YoY)



MACRO-ECONOMIC DEVELOPMENT

IIP & Inflation: The Index of Industrial Production (IIP) contracted 3.6% for February 2021, mainly on account of a steep contraction in the manufacturing output. Retail inflation rose to a four-month high of 5.52% in March as food prices soared while the WPI inflation spiked to over 8-year high of 7.39%.

PMI: Purchasing managers' index (PMI) for April marginally rose to 55.5 after declining to a seven-month low in March at 55.4.

Export: India's exports in April rose 197% with growth across sectors. Imports increase 165.99&, trade deficit widens

OUTLOOK

The Federal Open Market Committee (FOMC) in its April meeting, maintained the status quo on policy rates, as was broadly expected by the market. They also kept their Quantitative Easing (QE) purchase program unchanged at $120 bn per month. Although, the Central Bank acknowledged that adequate policy support and progress on vaccinations had improved outlook, however, risks to the economy emanating from the pandemic were not over and any discussions pertaining to tapering would only be considered once progress in economic objectives was imminent. The Fed acknowledged that inflation has risen, however, this is due to temporary factors and is expected to moderate over the year. US Treasury 10 years yields have fallen ~ 11 bps over the month.

On the domestic front, headline inflation inched higher to 5.52% (vs 5.03% in February 2021) led by a rise in food and fuel components. Core inflation continued to remain sticky at 5.96% vs 5.88% the previous month. WPI inflation spiked to an eight-year high of 7.39%, driven by pick-up in fuel and power inflation and indicating persistent input price pressures. The Index of Industrial Production (IIP) contracted by 3.6% for February 2021, mainly on account of a steep contraction in manufacturing output.

In the April meeting of the Monetary Policy Committee (MPC), members unanimously voted for keeping policy rates unchanged. They also unanimously decided to continue with an accommodative stance as long as necessary to sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy. This was the first time that the MPC members moved from time-based guidance to state-based guidance on the accommodative stance. The Governor also announced a secondary market Government Securities Acquisition Programme (G-SAP 1.0), where the Reserve Bank of India (RBI) upfront committed to buying INR 1 lakh Crs of G-Sec through open market purchases. The first such auction worth INR 25,000 Crs was conducted on April 15, 2021. The minutes of the MPC meeting continued to detail the need for continued accommodation as growth remained uncertain given the second wave of the pandemic and any calibrated exit from the current stance has gotten pushed forward.

RBI has shown discomfort over higher yields in the medium to the longer end of the curve, and the same has been evident from RBI's action in the weekly auctions. In the very first auction of the financial year, RBI devolved almost the entire amount in the 5-year security on primary dealers (PDs). In the corresponding two auctions, RBI did not accept any bids in the 10-year and 5-year security respectively, resulting in some short covering. Meanwhile, RBI also announced an Operation Twist worth INR 10,000 Crs to be conducted on May 06, 2021. RBI will buy securities in the 2026-2030 bucket from the market and sell 6-month T-Bills (issued in the previous two weeks). All these measures ensured that G-Sec across the curve rallied by 10-20 bps.

State Development Loans (SDLs) supply in the month remained extremely muted. However, with the impact of the second wave hitting the country and partial lockdowns being announced in various States, it will be important to see if States end up borrowing higher than the scheduled amount of INR 1.78 lakh Crs for the quarter.

In an address to the markets, the RBI Governor announced a few other measures, to tackle the risks posed by the second wave of the pandemic on economic activity:

- Second tranche of the G-Sec purchase under G-SAP 1.0 to be conducted on May 20, 2021, for an amount of INR 35,000 Crs
- On-tap liquidity facility of INR 50,000 Crs for ramping up healthcare infrastructure
- Special Long Term Repo Operations (SLTRO) of INR 10,000 Crs for Small Finance Banks
- Lending by Small Finance Banks to MFIs for on-lending to be classified as Priority Sector Lending
- Extension of incentive provided to Banks (NDTL deduction) for lending to new MSME borrowers

With the devastating impact that the pandemic's second wave is unleashing and the resultant lockdowns in various cities and districts, there is likely to be a significant impact on growth atleast for this quarter, with risks of a more meaningful impact in the next quarter as well. In such a scenario, the RBI and the MPC – both already growth focused in their approach, are likely to become even more dovish in their assessment of growth – inflation tradeoff and in the upcoming June MPC we expect them to signal their readiness to act swiftly to support growth, provide adequate liquidity and ensure that yields do not move sharply higher on account of international or domestic factors. In such an environment, we expect yields to have a downward bias – at the short end (1-3 year segment) driven by expectations of a delay in policy normalization by the RBI / MPC, and at the longer end (5-10 year segment) driven by increased RBI support through OTs and G-SAP, thereby ensuring that G-Sec and hence corporate bond yields remain soft.

Source: MOSPI, Internal, Bloomberg