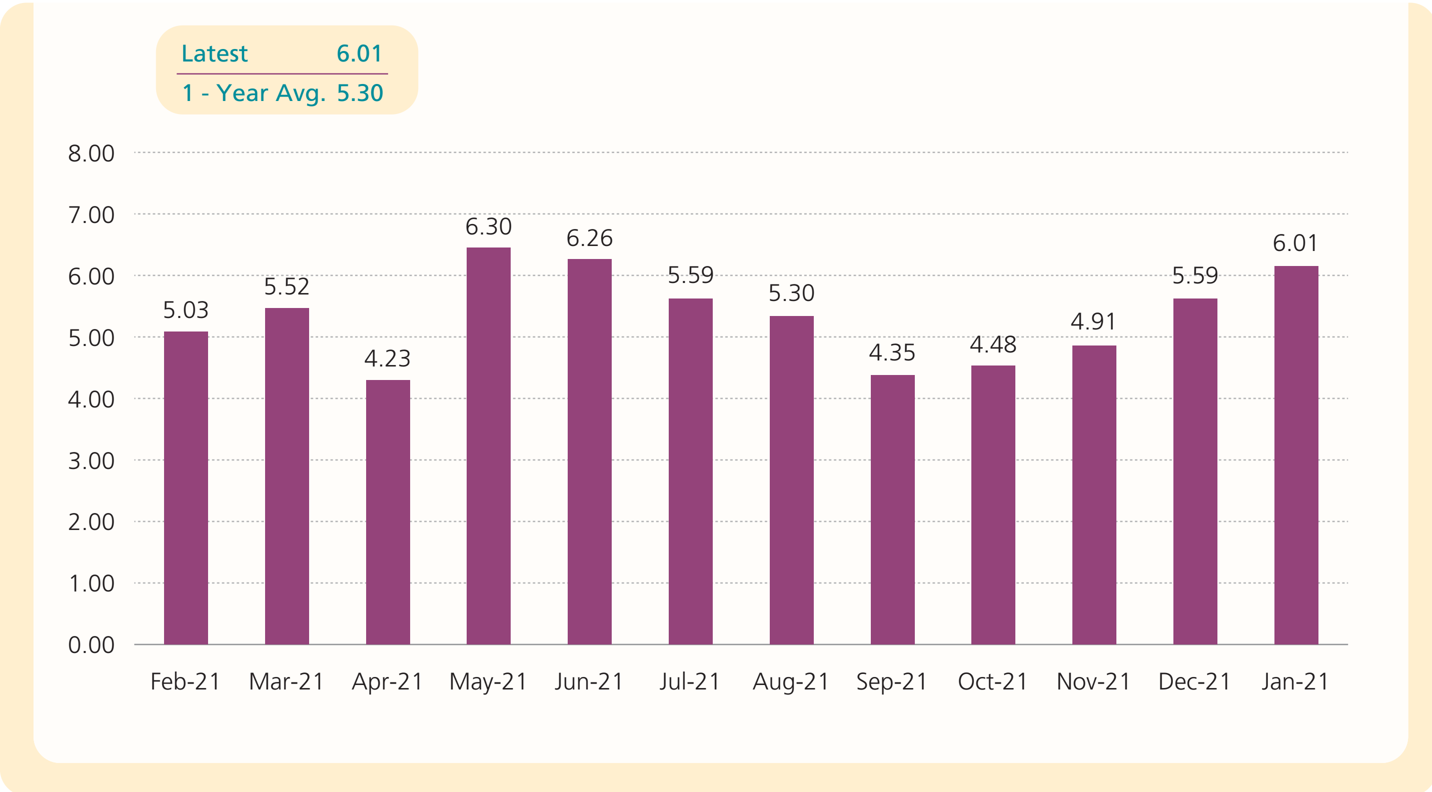
The past month has seen volatility across asset classes, with geopolitical tensions around Russia and Ukraine taking center stage and continues to remain the focal point going forward. Commodity prices and especially energy prices have seen an upsurge. Crude prices broke the psychological USD 100/bbl mark and are currently trading even higher at USD 115/bbl due to concerns around supply outage. Crude prices at such elevated levels for a prolonged period will feed into domestic inflation and further widen the Current Account Deficit.

Although, RBI had retained their inflation projections in the Feb 2022 MPC meeting, upside risks to the projections have meaningfully increased. Another fallout of the conflict in Ukraine is that Indian equity markets have seen FPIs pulling out money. This has resulted in some conversations around deferring the LIC IPO, although no concrete announcement to this effect has yet been made.

With inflation pressures being seen globally, markets continue to witness various economies exiting from ultra-easy monetary policies, with Central Banks globally hiking interest rates to stem the spiraling inflation. CPI print in the US for January 2022 came in at 7.5% (four-decade high), with Core CPI also edging higher to 6.0%.

CPI Combined (YoY)



In one of the recent interactions, the Fed Chairman has reaffirmed that the FOMC is on track to raise interest rates this month with expectations of a 25 bps hike this policy, followed by further hikes through the course of the year. He also indicated that the FOMC will decide the pace of reduction of the Fed's balance sheet in this policy. The 10-year US Treasury yields breached the 2.0% mark during the month with expectations of higher rate hikes and faster policy normalization during the year than earlier expected. However, with the ongoing geopolitical crisis picking up and risk-off sentiment setting in, the 10-year US Treasury yields have fallen to 1.70%.

In the wake of the ongoing crisis, US, UK, EU and other nations have imposed economic sanctions on Russia, including removing major Russian banks from the SWIFT system. Rating Agencies have cut Russia's credit rating to junk. With a sharp depreciation witnessed in the Ruble, Russia's Central Bank has raised key interest rates sharply from 9.5% to 20.0%. Any embargo imposed on Russian Crude will remain a key monitorable going forward in determining the future course for Crude prices.

MARKET PERFORMANCE

The 10-year benchmark G-Sec yield closed at 6.77%, up by 09 bps from its previous close of 6.68% while that on the short-term 1-year bond ended 10 bps higher at 4.60%.

In the corporate bond segment, yields rose across the yield curve over the month. The 10-year AAA bond yield ended 01 bps higher at 7.11%, while the short-term 1-year AAA bond yield ended 10 bps up at 4.95%.

The spread between 1-year and 10-year AAA bonds narrowed. Within the short-term segment, the yield on 3-month commercial paper (CP) was up 10 bps to 4.05% while 1-year CP yield was up 15 bps at 4.95%.

10-Year G-Sec

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

MACRO-ECONOMIC DEVELOPMENTS

On the domestic front, CPI inflation for January 2022 came in at 6.01% (vs 5.66% in December 2021) due to an unfavorable base effect in vegetable prices pushing food inflation higher, with Core inflation continuing to remain sticky. WPI inflation for January remained elevated at 12.96% (vs 13.56% in December 2021). This was the tenth consecutive month with WPI print in double digits.

IIP data for December 2021 came in weak at 0.4% (vs 1.3% in November) partly due to a higher base.

Trade deficit for January 2022 came in at USD 17.42 billion, with exports falling m-o-m to USD 34.50 billion. Manufacturing PMI rose to 54.9 as compared to 54.0 the previous month.

GST collections continue to remain robust with revenues for February 2022 at INR 1.33 trillion (higher by 18% y-o-y). This is the fifth instance where collections have been above INR 1.3 trillion.

GDP growth number for Q3 FY2022 came in lower than expected at 5.4%. For the full year, advance estimate for GDP growth number has been revised downwards from 9.2% to 8.9%.

OUTLOOK & STRATEGY

To address market worries about the demand-supply mismatch for G-Secs, RBI did not accept any bids in the 2026 and 2035 securities in the first weekly G-Sec auction of the month. The subsequent two weekly auctions were cancelled citing a high cash balance with the GOI. Additionally, the G-Sec switch auctions scheduled for February and March were also cancelled. A revised calendar for T-Bill auctions in March 2022 was announced, with the weekly auction amounts increased by INR 12,000 Crs.

In order to elongate the maturity profile of RBI's forward book and smoothen the receivables relating to forward assets, RBI in a surprise move announced a USD/INR 2-year Sell Buy Swap auction worth USD 5 billion to be conducted on March 08, 2022. This can be viewed as another tool used by the RBI for sucking out surplus liquidity from the system. Whether this eventually results in RBI buying bonds through OMOs to absorb some of the supply due to the heavy Government borrowing expected in FY2023, will have to be seen.

Yields across the curve, which had shot up post the Budget announcement, saw a relief rally post the dovish MPC policy. However, pressure remained on longer end G-Sec due to rising Crude prices with the benchmark 10-year security moving higher during the month. With pick up in Bank CD issuances in the 1-year segment and higher borrowing through T-Bill auctions, money market rates in that segment have moved up by 5-10 bps.

Once the state elections are behind us, fuel price hikes along with a mix of tax cuts are inevitable given the move in oil prices over the past few months. Markets are clearly looking towards the central bank for some support, in an environment where oil prices are zooming up vertically, US Fed policy normalisation remains on course despite the risk-off environment and domestic inflation remains in uncomfortable territory.

For RBI, the coming months and quarters will be a testing time, in terms of balancing out its various mandates – managing the growth inflation tradeoffs, managing the government's borrowing programme smoothly, and all this while still maintaining its hard-earned credibility. ***On our side - for now - we remain cautious in our positioning across our actively managed funds till further clarity emerges on the global front, oil prices and also RBI's tolerance levels for yields before they come in to support the markets.***

Source: MOSPI, Internal, Bloomberg