L&T Financial Services
Mutual Fund

Benchmark 10-year yield closed at 6.20%, up by 15 bps from its previous close of 6.05%. The Monetary Policy Committee (MPC) came out with their bi-monthly policy statement today. The central bank left interest rates unchanged at record lows while reiterating an accommodative stance as long as necessary to support growth. The repo rate remains at 4%. The reverse repo rate was held steady at 3.35%.

Some of the key announcements are as follows:

- The MPC members unanimously voted for keeping the policy rates unchanged
- The MPC decided with a 5 to 1 majority to continue with the accommodative stance as long as necessary to revive and sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy, while ensuring that inflation remained within the target going forward
- Growth projections have been retained, with real GP growth expected to be 9.5% in FY2022 (21.4% in Q1, 7.3% in Q2, 6.3% in Q3 and 6.1% in Q4 FY2022). Real GDP growth for Q1 FY2023 is projected at 17.2%
- The projection for CPI inflation has been revised upwards to 5.7% for FY2022 (5.9% in Q2, 5.3% in Q3 and 5.8% in Q4 FY2022), with risks broadly balanced. CPI inflation for Q1 FY2023 is projected at 5.1%

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MARKET PERFORMANCE

The 10-year benchmark G-Sec yield closed at 6.20%, up by 15 bps from its previous close of 6.05% while that on the short-term 1-year bond ended 10 bps lower at 3.90%.

In the corporate bond segment, yields rose across the yield curve over the month.

The 10-year AAA bond yield ended 4 bps higher at 6.92%, while the short-term 1-year AAA bond yield ended 15 bps down at 4.15%.

The spread between 1-year and 10-year AAA bond widened. Within the short-term segment, the yield on 3-month commercial paper (CP) was down 5 bps to 3.50% while 1-year CP yield was down 15 bps at 4.10%.

10-Year G-Sec

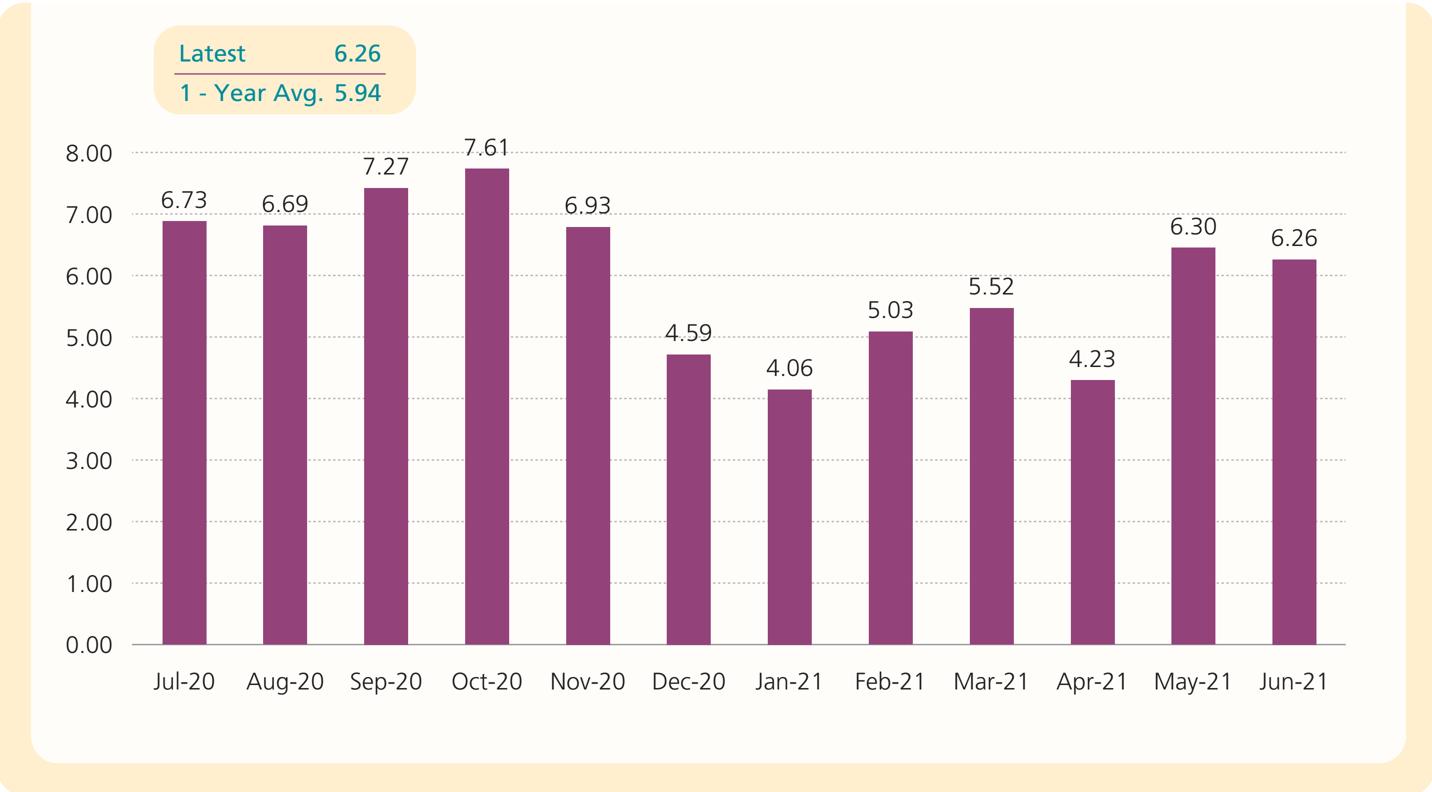
Past performance may or may not be sustained in the future.

OUTLOOK

The Federal Open Market Committee (FOMC) in its July meeting maintained status quo (in line with market expectations) on policy rates and also maintained their Quantitative Easing (QE) purchase program unchanged at USD 120 bn per month. The FOMC acknowledged that progress in the vaccination program and adequate policy support has strengthened indicators of economic activity and employment, however, risks to economic outlook remain. The FOMC Chairman indicated that the timing and the pace of tapering were discussed in the meeting, however further progress on achieving maximum employment and price stability goals needed to be seen before they took any steps towards it. He ruled out any possibility of rate hikes before the tapering process was completed, giving clear guidance on the sequence of events. Incoming data will be key for any signaling pertaining to the tapering of asset purchase program in the September policy. CPI Inflation for June came in at 5.4% (vs 5.0% in May) and Core Inflation at 4.5% (vs 3.8% in May). These inflation prints are at multi-year highs. Although the Fed Chair referred to inflationary pressures being transitory he also indicated that risks to inflation turning persistent remained. 10-year US Treasury moved from 1.47% to 1.22% over the month.

Crude prices remained above USD 70/bbl for most of the month. With economic activity picking up and Crude prices moving higher, the OPEC decided to increase supply by 400,000 barrels per day from August on a monthly basis. The OPEC aims at phasing out the production cuts done last year by September 2022. This helped Crude prices fall below USD 70/bbl, however, prices moved back up thereafter.

CPI Combined (YoY)



On the domestic front, CPI Inflation for June 2021 came in at 6.26% (lower than market expectations) due to a slower rise in food prices. Core CPI also cooled off to 6.16%. However, this is the second month where CPI print came in higher than the upper bound of the inflation target. WPI Inflation came in at 12.07% (vs 12.94% in May), this being the third consecutive month of a print above 10%. Higher prints are attributed to base effect and supply-side disruptions and inflation is expected to soften over the next few months. However, Crude prices continuing to trade above USD 70/bbl, will put pressure on inflation. IIP for May came in at 29.27% (vs 134.63% in April) due to a favourable base.

The Government released an amount of INR 75,000 Crs to States as GST compensation. The total GST shortfall expected for FY2022 is INR 1.6 Lakh Crs. The current payment made to States has been funded through the borrowing in the 2-year and 5-year securities during the weekly auctions and no additional borrowing towards this is expected in H1 FY2022. The gross borrowing by States for Q2 FY2022 was revised upwards to INR 1.92 Lakh Crs (from INR 1.70 Lakh Crs announced earlier).

In order to incentivise PDs and investors to bid aggressively in G-Sec auctions, RBI announced that all benchmark securities will be auctioned under uniform price method (unlike multiple price method earlier) and only the extreme long end securities will continue to be borrowed through multiple price methods.

The RBI conducted two tranches (of INR 20,000 Crs each) of G-SAP 2.0 auction in July. However, the securities selected for G-SAP auction 2.0 were mostly illiquid, unlike previous months which also included the liquid benchmark. This in conjunction with the absence of any OT auctions has resulted in auction bidding in the 5-year and 10-year securities at higher levels. RBI continued to show discomfort over higher auction cut-offs on benchmark securities and devolved ~ INR 29,000 Crs worth of 5-year and 10-year securities on PDs (devolvement in 3 out of the 5 auctions conducted in July). The 5-year G-Sec remained broadly unchanged over the month, however, the 10-year G-Sec moved up by 15 bps. Liquidity continued to remain in surplus, which resulted in 2-3 year G-Sec falling by ~10 bps. Corporate bond spreads compressed in the shorter end, as 2-3 year corporate bond yields fell by 15-20 bps. The 5-year OIS curve moved down by 17 bps.

With the spread of the Delta variant across the globe and the impact felt in India, it will have to be seen how Central Banks react, however, the impact is not expected to be as severe as the first wave and economies currently seem much better placed to tackle any adverse impact.

Source: MOSPI, Internal, Bloomberg