DEBT MARKET REVIEW

SEPTEMBER, 2021

L&T Financial Services
Mutual Fund

Benchmark 10-year yield closed at 6.24%, up by 02 bps from its previous close of 6.22%. The Reserve Bank of India's monetary policy committee kept key interest rates unchanged, while retaining an accommodative stance to help revive the economy, which is facing a slowdown due to the coronavirus pandemic. Repo rate and the reverse repo rate remain unchanged at 4% and 3.35%, respectively.

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 for FY22 have been retained, with real GDP growth for FY22 expected to be 9.5%. The Q1FY22 growth number was slightly below RBI's earlier estimate, however the growth numbers for the next two quarters have been revised upwards to 7.9% in Q2 and 6.8% in Q3, and the growth numbers for Q4FY22 and Q1FY23 retained at 6.1% and 17.2% respectively
- The projection for CPI inflation has been revised downward to 5.3% (from 5.7% in August policy) for FY22. The inflation projection for Q2 and Q3 have also been revised downwards to 5.1% and 4.5% respectively, while Q4 number is retained at 5.8%. CPI inflation for Q1FY23 is projected at 5.2%

READ THE FULL RBI REPORT WITH MARKET IMPACT

MARKET PERFORMANCE

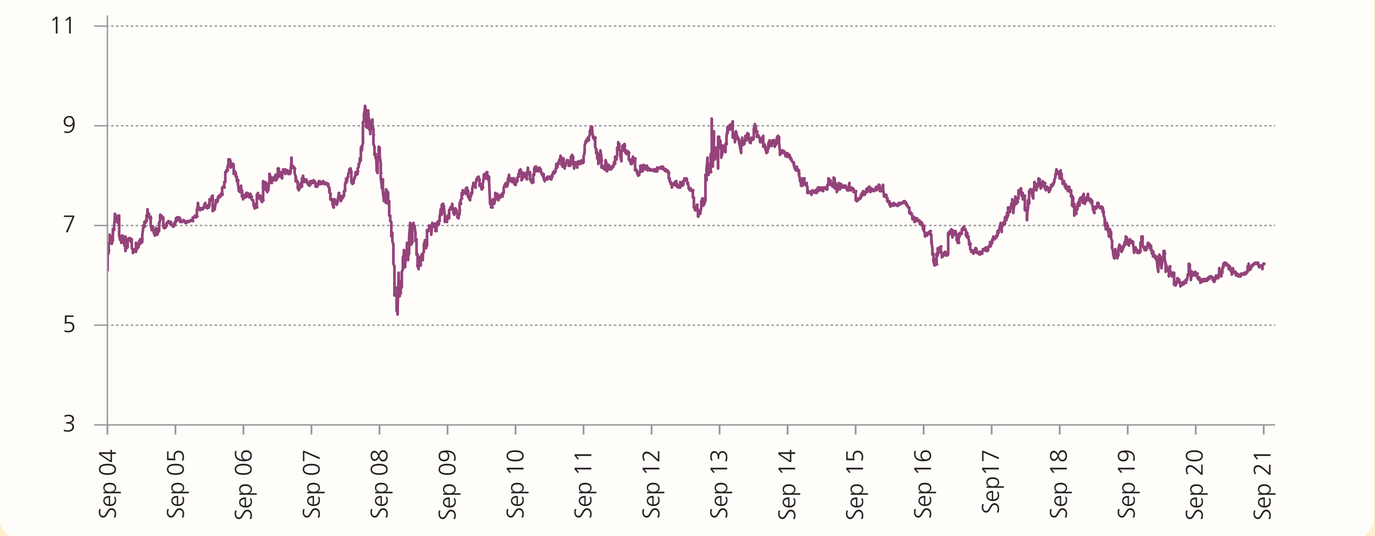
The 10-year benchmark G-Sec yield closed at 6.24%, up by 02 bps from its previous close of 6.22% while that on the short-term 1-year bond ended 10 bps higher at 3.95%.

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

The 10-year AAA bond yield ended flat at 6.86%, while the short-term 1-year AAA bond yield ended 12 bps up at 4.22%.

The spread between 1-year and 10-year AAA bond narrowed. Within the short-term segment, the yield on 3-month commercial paper (CP) was up 15 bps to 3.55% while 1-year CP yield was up 15 bps at 4.20%.

10-Year G-Sec



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

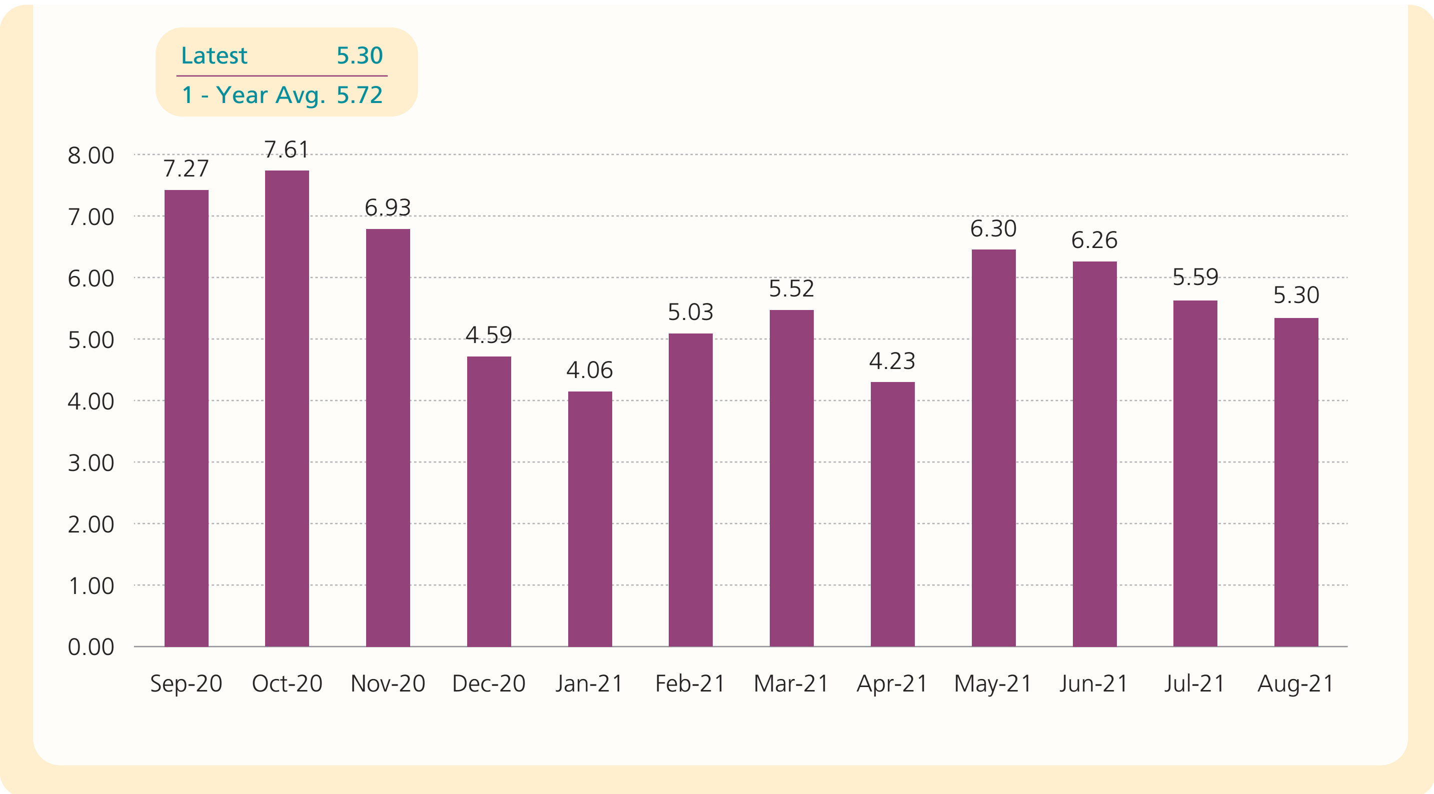
OUTLOOK

The Federal Open Market Committee (FOMC) in its September meeting, maintained status quo on policy rates and also maintained their QE purchase program unchanged at USD 120 bn per month. The FOMC acknowledged that progress in the vaccination program and adequate policy support have continued to strengthen indicators of economic activity and employment. With markets widely anticipating some guidance on tapering of the asset purchase program, the Fed indicated that if progress on achieving employment and price stability goals were to continue as expected, "moderation in the pace of asset purchases may soon be warranted". Markets are now expecting tapering to commence as early as November and end by mid-2022. The Fed Chair however reiterated that tapering should be not considered as a signal for interest rate hikes and both events are essentially delinked.

The Dot plot now indicates policy rate hikes expected over 2022 to 2024, with Median policy rate projected at 0.25% (from earlier 0.125%) for 2022, 1.0% (from earlier 0.625%) for 2023 and 1.75% for 2024, with long term policy rate unchanged at 2.5%. The Fed Chair acknowledged that inflation has been elevated and might continue to see upward pressures due to supply-side bottlenecks. Although, these effects are expected to subdue over time, however, sustained higher inflation concerns would be adequately tackled by the Fed. 10-year US Treasury moved from 1.31% to 1.49% over the month, with the majority of the move up happening post the FOMC meeting.

Crude prices remained above USD 70/bbl for the entire month, and have now breached the USD 80/bbl mark for the first time in over 3 years as OPEC decided to stick to their existing plan of gradual increase of supply by 400,000 barrels per day, amid calls for further supply increases from major oil-consuming nations. High energy prices would fuel inflation and derail the economic recovery process. Sustained period of high Crude prices would remain a key monitorable going forward.

CPI Combined (YoY)



On the domestic front, CPI inflation for August 2021 came in at 5.30% (vs 5.59% in July), lower than market expectations, due to a favourable base and lower food prices. Core CPI also cooled off marginally to 5.80% (vs 6.00% in July). WPI inflation for August 2021 rose to 11.39% (from 11.16% in July) due to higher prices of fuel and non-food articles. This is the fifth consecutive month of WPI print above 10%. IIP for July 2021 came in at 11.5% (vs a contraction of 10.5% last year), signalling a pick-up in economic activity. Trade deficit for August 2021 came in at USD 13.81 bn (vs USD 10.97 in July) with exports continuing to remain resilient. However, the trade deficit is expected to widen as the economy opens up further and if the surge in Crude prices continues.

The borrowing calendar for H2 FY2022 was announced, with Gross G-Sec borrowing of INR 5.03 Lakh Crs resulting in weekly auctions of INR 24,000 Crs. This borrowing number factors in the GST compensation to be paid to States and is in line with Budget estimates. With buoyant tax collections, fears around extra borrowing have been allayed. The T-Bill borrowing number announced for H3 FY2022 was INR 2.6 Lakh Crs, with a weekly borrowing number of INR 20,000 Crs. SDL borrowings for Q3 FY2022 was announced to be INR 2.02 Lakh Crs.

Although RBI had earlier upfront announced a calendarized gradual increase in the amount of VRRR auctions, ad hoc shorter tenor (3-7 day) VRRR auctions were conducted over the month to pull out surplus liquidity from the system. In a couple of auctions, the entire amount announced under the VRRR auction could not garner bids from the market, resulting in higher than expected VRRR cut-offs which put pressure on short tenor rates. The RBI shifted from the earlier outright G-SAP purchase auctions to Operation Twist in September, thereby signalling that any support towards absorbing longer end G-Sec would be liquidity neutral. T-Bills and shorter tenor G-Sec moved up by 10-20 bps, whereas shorter tenor Corporate bonds moved up by 20-30 bps. OIS levels also moved up by 10-15 bps over the month. 5-10 year G-Sec remained broadly unchanged over the month and Corporate bonds of similar maturity closed neutral to positive. Higher US Treasury yields and Crude prices continue to exert upward pressure on domestic yields, while timely progress and completion of bond index inclusion would have a positive impact on the demand-supply imbalance and will provide a positive sentiment in an otherwise cautious market environment.

Source: MOSPI, Internal, Bloomberg