Debt Markets

Market Summary

The month of April witnessed a volatile fixed income markets with the one end being driven by the intensifying pandemic, supply pressures and denouncing the positives of RBI actions. The other end was primarily due to RBI's support in the form its own QE (quantitative easing via GSAP), OMOs and auction cancellations. Heading into the RBI policy and post policy, market witnessed a strong rally with the benchmark touching 6% at one point. However, the euphoria of the G-SAP and RBI sending a strong message reiterating its commitment was short-lived. With the 2nd wave of the pandemic intensifying coupled with the fear of lockdown, benchmark once again touched a peak at 6.15 in the middle of the month and the first G-sec auction of the year witnessing devolvement. In the 2nd half of the month, market saw some relief supported by RBI with the benchmark closing ~6.03%. RBI cancelled auctions when perhaps the expected yield was too high and towards the end of the month also announced an additional Operation Twist for INR 100 bn. Also, while RBI stated in its policy that they intended to conduct longer dated variable repo auctions, they did not implement the same and stuck to 14-day tenor only. Furthermore, very low issuance of SDLs lent some support to the G-sec supply for the month. Overall, we saw steepening of the curve with up to 5-year rallying 20-25bps and 5 – 10 year witnessing 10-15bps of rally. The longer end beyond 10 year witnessed up to 10bps of rally.

The last auction of the month went better than expected with RBI exercising the green shoe option for ~INR 48 bn. This along with the twist operations announced, strong GST collections has improved market confidence with the benchmark going back to ~6% levels on the first trading day of May 2021.

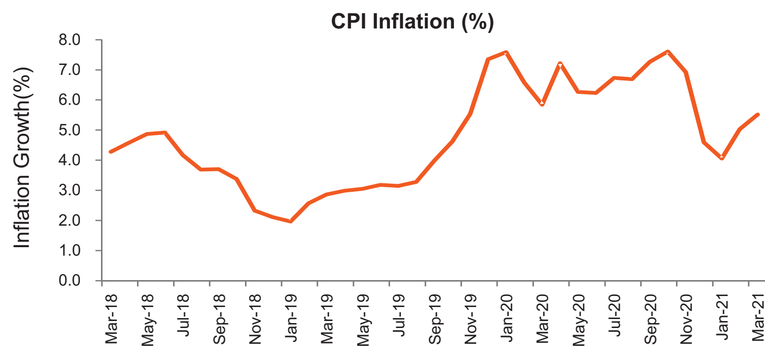
While the increase in incidence of Covid cases is definitely a cause of concern, so far since the incidence is more concentrated, it is not expected to have a deeper economic impact. Therefore, markets so far have shrugged off any potential for shocks on the fixed income side as any adverse economic impact requiring any one-off fiscal stimulus may not arise.

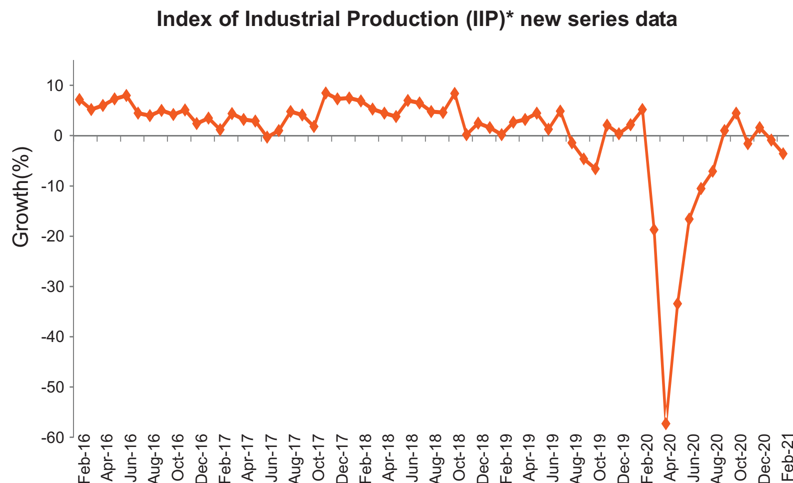
Outlook

While the pandemic has intensified and we are seeing the disruption in economic activity intensifying, it is still not expected to be as widespread and deep as the last year. The key reason being the a) vaccination is ongoing and b) lockdowns are more localized and not broad based. In addition, government so far does not seem to be in the mood to give any financial sops that would derail the fiscal commitments. The revenue side may be pressurized, but given the estimates were conservative on the outset, it suggests that at least meeting the fiscal targets should not be a challenge and therefore no additional borrowing is envisaged. Furthermore, RBI's actions post policy with an Operation Twist in addition to its planned G-SAP program suggests that RBI will remain committed to being accommodative and manage the borrowing program in a non-disruptive manner.

The recent GST numbers suggest that once growth resumes, tax collections are likely to grow in a robust fashion and should provide relief to the bond markets. Besides, forecast of a normal monsoon this year by the IMD bodes well for retaining rural growth. Nevertheless, one cannot overlook the heavy supply in the near term and the emerging pandemic jitters. In addition, inflation risks and its associated impact on central bank's rate and policy action will linger. Therefore, pressure on yields would continue to remain preventing any strong rally. On the liquidity front, RBI's OMO actions should be supportive for liquidity. In addition, government spending will add to the system liquidity. Therefore, we expect the short-medium part of the curve to outperform the longer end going ahead.

In the corporate space, we did not see as much of a volatility as in the G-secs as seasonally supply has been low and will remain low for the first six months. Therefore, we should see the spreads remaining stable in the short to medium part of the curve.





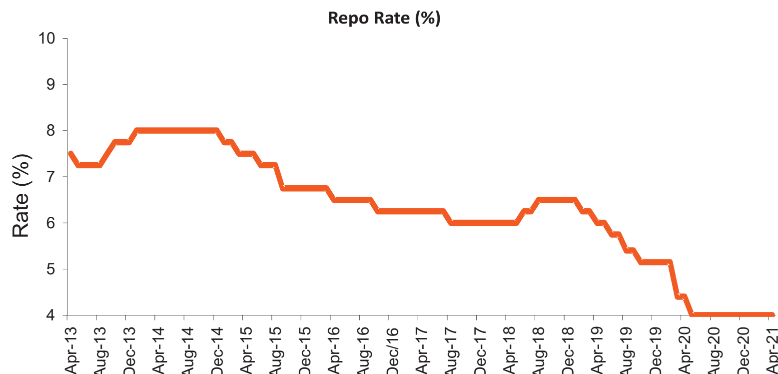
RBI Policy – Support for growth continues

RBI in its first monetary policy for FY22, reiterated their priority for growth; support via unconventional policy measures such as the G-SAP announced in this policy. It was once again a testimony that RBI will maintain its accommodative rate stance using unconventional measures to keep the rates stable. In addition, with the onus to manage a borrowing program to ensure an orderly evolution of yield curve, and therefore congenial financial conditions, RBI has announced a balance sheet expansionary policy with committed volume of direct open market operations. This has been an ask for quite some time and RBI delivering on this front as well, is a strong signal that RBI will do what it takes to preserve financial stability and a testimony that RBI will not let go of its reins on the financial market. This is despite being constrained on the inflation front an expansionary balance sheet program is a bold move.

Also, while the increase in quantum and tenor of VRRR limits could have increased the short term rates, liquidity infused via G-SAP should reasonably balance the pressure. In summary, we believe that RBI is in no rush for any direct rate actions or liquidity withdrawal mode. RBI has time and again used unconventional policy measures which have an implicit impact on rates.

Key policy actions were as follows:

- Repo rate at 4.0%; Reverse Repo at 3.35% and Marginal Standing Facility rate at 4.25%.
- Announced a G-Sec Acquisition Program, G-SAP 1.0 targeting INR 1 trillion for Q1FY22 with first purchase of INR 250 billion on April 15, 2021
- Reiterated commitment to maintaining surplus liquidity
- Longer tenor Variable Rate Reverse Repo auctions to be undertaken based on market conditions
- FY22 GDP growth retained at 10.5%; Inflation estimates revised marginally upwardscollections will be strong. Until then RBI support may be vital to keep the rates contained.



Key rates (in %)	Current	Previous month
3M T-Bill	3.30	3.27
1Y G-Sec	3.76	3.75
3Y G-Sec	4.77	4.93
5Y G-Sec	5.77	5.97
10Y G-sec	6.03	6.17
AAA 5Yr Corp Bond	5.90 - 6.10	6.00 - 6.20
AAA 10yr Corp Bond	6.70 - 6.90	6.70 - 6.90
USDINR	74.09	73.11
Brent Oil (USD Per Barrel)	67.25	63.54
Repo rate	4.00	4.00
1Y OIS	3.75	3.86
5Y OIS	5.19	5.25

GST collections: Record collections raising hopes of better than expected tax collections once growth resumes

April GST collections came in at the highest number so far at INR 1.41 lakh crore, with seven consecutive months reporting over INR 1 lakh crores. While this collection is of March 2021 before the lockdown and larger impact of pandemic, the collection could reiterate the fact that once the impact of the second wave subsides, growth recovery and the resultant tax collections will be strong. Until then RBI support may be vital to keep the rates contained.

Inflation Outlook: Near term favorable, but supply side pressures can resurface

Headline CPI inflation for March came in at 5.5% y-o-y in line with market consensus estimates. This compares to 5.03% in February, 4.06% in January and 4.59% in December. While food inflation remains subdued, core inflation remains pressured with idiosyncratic increases across segments such as fats, fuel, transport and communication. While the second wave may slow down the demand side pressures, supply side pressures can resurface. Also higher oil prices will pose a risk to inflation. Overall, inflation risks are likely to linger on.

External Factors – Oil inching upwards while currency has been supported by flows

- **Oil:** : Oil prices have been gradually inching upwards during the month starting from USD63.5/barrel and closing at USD67.3/barrel. While we saw oil peaking towards similar levels in previous month, this time demand recovery in US and China are now balanced by concern from the India side. Once demand recovers and economy recovers, the risk of oil price increase eventually translate into feeding into inflation remains as petrol/diesel prices in India are close to the record high. Diesel being the primary fuel for transportation could eventually feed domestic CPI across the board.

- **Currency:** USDINR depreciated during the month starting from 73.11 touching a high of 75.05 during the course of the month before closing the month at 74.1. While the initial sell-off may have been triggered by RBI's asset purchase announcement, the impact got magnified as the pandemic intensified resulting in weaker growth which triggered a sell off from the equity side (~$1.5bn). However, with RBI holding $584bn of reserves we do not anticipate any currency shocks as RBI has enough reserves to step in to contain any undue volatility.

Source: Bloomberg, for all data except where mentioned otherwise

Data as on 30 April 2021

This document provides a high level overview of the recent economic environment. It is for marketing purposes and does not constitute investment research, investment advice or a recommendation to any reader of this content to buy or sell investments. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination.