MARKET REVIEW

India Debt Market Performance

Debt market indicators

Money market				
Tenure	**CD**	**Change**	**CP**	**Change**
1M	3.34	9	3.58	18
3M	3.42	8	3.65	10
6M	3.65	9	3.98	3
12M	4.03	-2	4.50	0
Bond market				
Tenure	**G-Sec***	**Change**	**AAA CB**	**Change**
1Y	3.77	-5	4.25	7
3Y	4.70	-7	5.27	17
5Y	5.59	17	5.90	0
10Y	6.01	-3	6.83	3

Data Source – RBI, Mospi.Nic.in, CRISIL Fixed Income Database,

CP - Commercial Paper, CD – Certificate of Deposit, CB – Corporate Bond, *Weighted Average Yield

Corporate bond yields

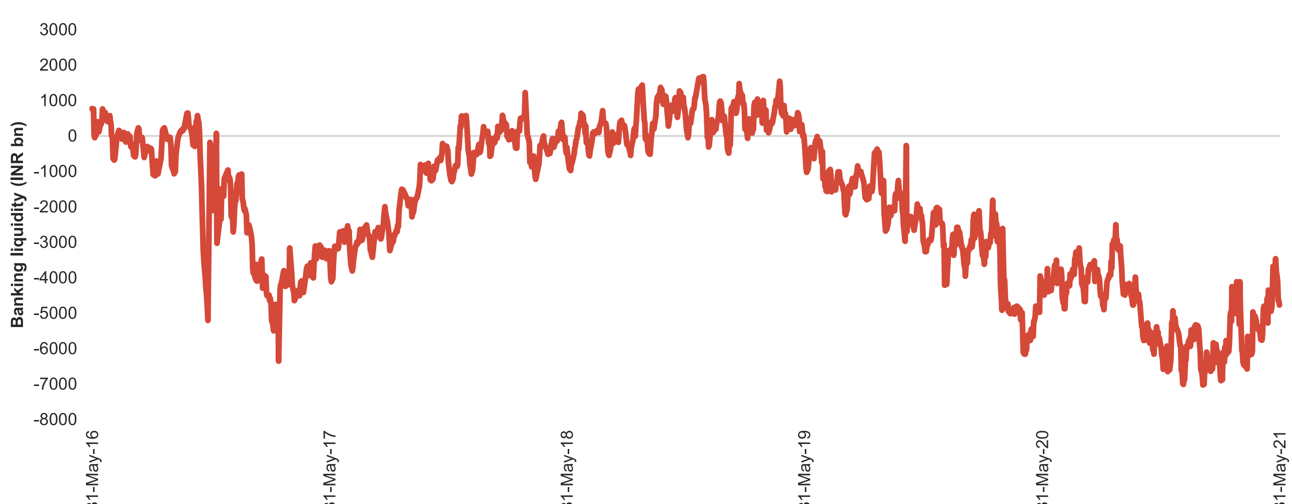
Tenure	6M	1Y	2Y	3Y	5Y	7Y	10Y
AAA	0.33	0.59	0.37	0.50	0.24	0.54	0.73
AA+	1.63	1.89	1.67	1.80	2.14	2.45	2.64
AA	3.00	3.26	3.03	3.17	3.51	3.82	4.01
AA-	3.66	3.91	3.69	3.83	4.17	4.47	4.66
A+	4.47	4.73	4.50	4.64	5.03	5.33	5.52
A	5.00	5.25	5.03	5.16	5.56	5.86	6.05
A-	5.30	5.56	5.34	5.47	5.87	6.17	6.36

G-sec and corporate bonds data as of May 31

*Weighted average yields for G-sec data

6 month G-sec: 182 day T-Bill rate; 1 year G-Sec: 5.09% GS 2022; 3 year G-Sec: 7.32% GS 2024; 5 year G-Sec: 5.63% GS 2026; 10 year G-Sec: 5.85% GS 2030

Liquidity in the banking system



Source: RBI

- Interbank call money rates remained below the RBI's repo rate of 4% in May as the overall systemic liquidity remained in surplus
- Considering the liquidity conditions, the RBI conducted a 14-day variable rate reverse repo auction for a notified Rs 2 trillion on May 7
- Gilts ended slightly higher with the yield of the 10-year benchmark 5.85% 2030 paper settling at 6.02% on May 31, 2021, compared with 6.03% on April 30
- Prices rose earlier as market players expected the central bank to support the bond market in the wake of the second wave of the Covid-19 pandemic
- The RBI announced a higher-than-expected quantum of debt purchases of Rs 350 billion under the second leg of government securities acquisition programme (G-SAP)
- However, further gains were capped as market players trimmed positions ahead of some of the weekly debt sales
- The partial devolvement of the 10-year benchmark on primary dealerships in the gilt auction was conducted on May 28, resulting in some yield hardening
- Sentiment was also dented by the central government's announcement regarding additional borrowing of Rs 1.58 trillion on behalf of states to bridge the shortfall in compensation

MARKET OUTLOOK | Fixed Income Outlook

Fixed Income Outlook

Gilts prices ended slightly higher with the yield on the 10-year benchmark 5.85% 2030 paper settling at 6.02% on May 31, 2021, compared with 6.03% on April 30.(Source:CRISIL)

The decline in the benchmark bond yields despite the underlying inflationary pressures and huge supply of government securities can primarily be attributed to the RBI's announcement in early April to purchase sizeable quantities of government securities from the secondary market under the G-sec acquisition or G-SAP 1.0 program in conjunction with the regular open market operation, to limit the rise in bond yields.

In the wake of the pandemic the RBI Governor, in an unscheduled announcement enumerated a number of liquidity boosting measures including special liquidity facility to the emergency health services, small finance banks for on-lending, relaxation of OD (Overdraft) facility for state governments, resolution framework 2.0 and additional relaxation on the KYC norms. The Governor added that the RBI will continue monitoring the emerging situation and deploy the necessary resources to mitigate the impact of the second wave.(Source:RBI)

The RBI also undertook the second auction under the GSAP 1.0 program of Rs 35,000 crs on May 20, 2021 after the strong- response witnessed in the first auction of Rs 25,000 crs undertaken in April 2021. The RBI has been aiming to keep yields in check as that reduces borrowing costs for the government while preventing any upward movement in yields at the longer end of the curve. RBI's guidance may foster an orderly normalization and smoother transition between the shorter and longer end of the yield curve, albeit it may bring along bond market volatility. (Source:RBI)

Going forward, RBI may have to do a fine balancing act. On one hand, there is a possibility of further downside risk to the growth recovery due to second wave, which in normal conditions would have warranted for easing of monetary condition and on the other hand RBI would need to keep an eye on upside risk to inflation due to: 1. Reflationary global environment with US-Dollar weakness 2. Commodity prices getting heated up 3. Monetary policy is already expansionary with 115 bps rate cut in last CY-2020 and ample system liquidity. And these reasons in normal conditions would have warranted for normalization of expansionary policy measures. (Source:RBI)

So, currently the fixed income market has to navigate between growth getting interrupted due to second wave and upside risk to inflation due to commodities heating-up and various monetary and fiscal stimulus measures announced globally and domestically. Hence, we believe the above evolving conditions points towards a more nimble and active duration management strategy which may help in navigating higher interest rate sensitive period. Also, as communicated earlier, we believe that we are at the fag-end of interest rate cycle and the above mentioned strategy would provide better accrual (active strategy which may take advantage of higher term premium) and would help in mitigating mark-to-market impact (active strategy of having adequate short duration instruments). It may be an opportune time to invest in floating rate bond in this interest rate scenario with expected volatility.

In our Outlook 2021*, we have highlighted that the capital gains strategy has played out meaningfully and going forward return expectations need to be rationalized. RBI is expected to continue gradual normalization of liquidity management operations as the growth & economic activity picks-up.

In the coming years, we recommend following strategies: Accrual Strategy and Active Duration strategy. Accrual strategy due to high spread premium which is still prevalent between the spread assets and AAA & MMI instruments, as going forward capital appreciation strategy may take a back seat due to limited rate cuts. Term premiums (spread between longer and shorter end of the yield curve) remains one of the highest seen historically, because of which active duration strategy is recommended to benefit from the high term premium. In our portfolios, we may follow barbell strategy i.e having high exposure to extreme short-end instruments with an aim to protect the portfolio from interest rate movements and high exposure to long-end instruments with an aim to benefit from higher carry.

OMO - Open Market Operations; MMI - Money Market instruments,

*https://www.icicipruamc.com/docs/default-source/default-document-library/icici-prudential-outlook-2021---investor-ppt.pdf?sfvrsn=f9a51a98_2)

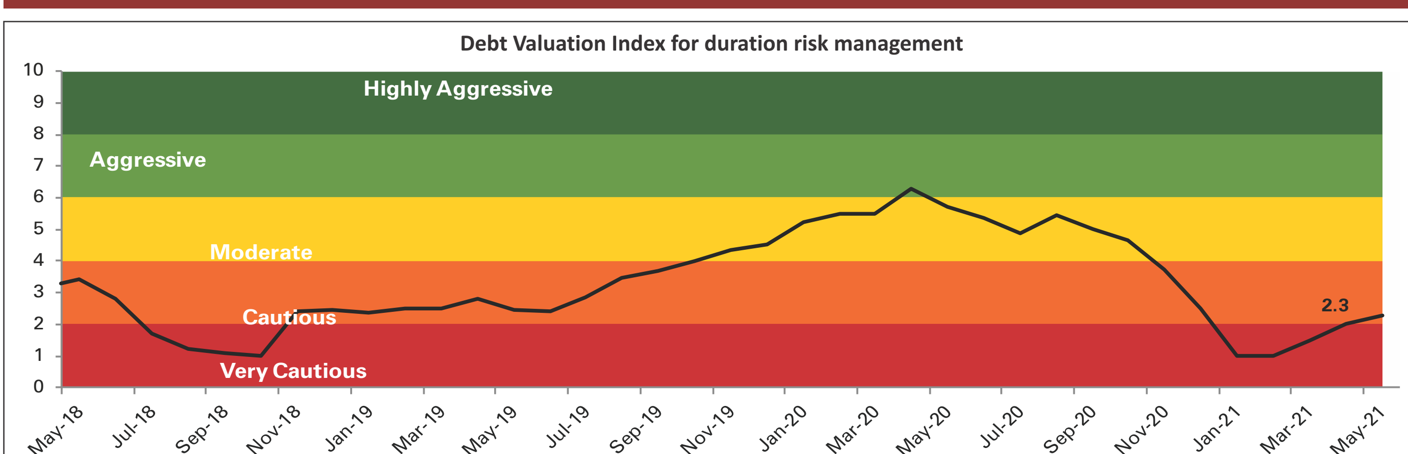
Fixed Income Recommendations

Approach	Scheme Name	Call to Action	Rationale
Arbitrage	ICICI Prudential Equity Arbitrage Fund	Invest with 3 Months & above horizon	Spreads at reasonable levels
Short Duration	ICICI Prudential Savings Fund ICICI Prudential Ultra Short Term Fund ICICI Prudential Floating Interest Fund	Invest for parking surplus funds	Accrual + Moderate Volatility
Accrual Schemes	ICICI Prudential Credit Risk Fund ICICI Prudential Medium Term Bond Fund	Core Portfolio with >1 Yr investment horizon	Better Accrual
Dynamic Duration	ICICI Prudential All Seasons Bond Fund	Long Term Approach with >3 Yrs investment horizon	Active Duration and Better Accrual

None of the aforesaid recommendations are based on any assumptions. These are purely for reference and the investors are requested to consult their financial advisors before investing.

Note: The Macaulay duration is the weighted average term to maturity of the cash flows from a bond. The weight of each cash flow is determined by dividing the present value of the cash flow by the price.

Debt Valuation Index



Data as on May 31, 2021. Debt Valuation Index considers WPI, CPI, Sensex returns, Gold returns and Real estate returns over G-Sec yield, Current Account Balance and Crude Oil Movement for calculation.

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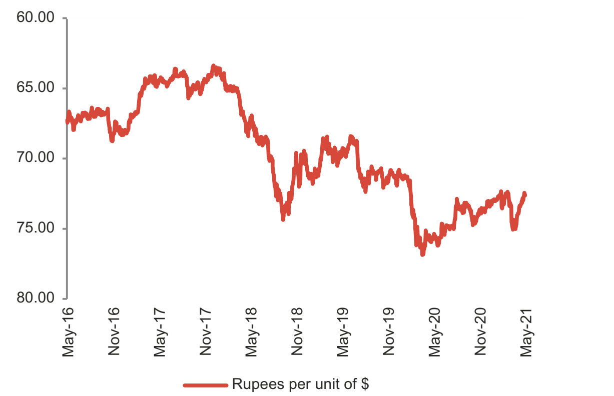
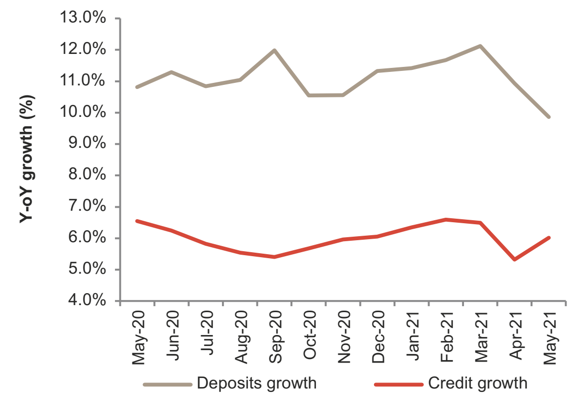
Other Market Indicators

Rupee rose 2.0% to settle at Rs 72.62 per dollar on May 31 from Rs 74.06 per dollar on April 30

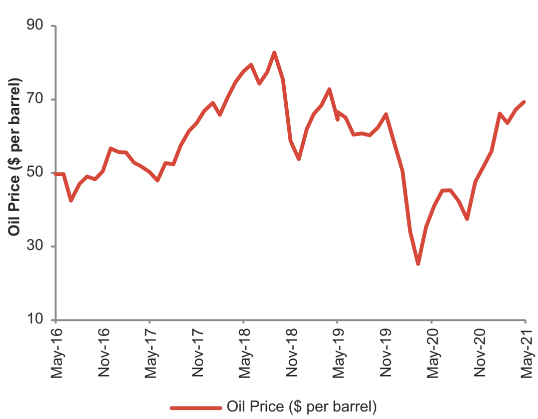


Bank deposit and credit growth rose 9.9% and 6.0% on-year in May 2021* compared with 10.9% and 5.3% in April, respectively

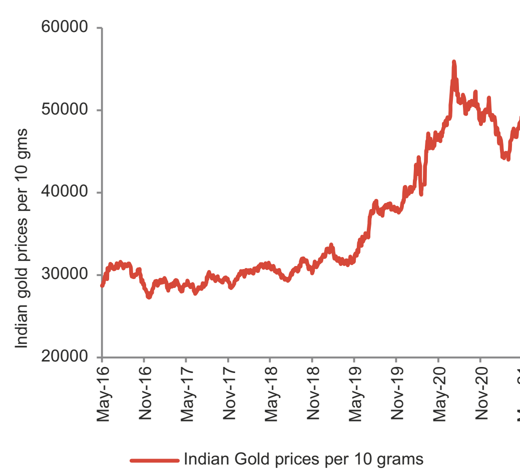


*Data as of May 7, 2021

Brent crude prices rose nearly 3.1% to close at $69.32 per barrel on May 31, 2021, vis-à-vis $67.25 per barrel on April 30, 2021



Indian gold prices rose nearly 5% in May to close at Rs 49032 per 10 grams on May 31, 2021, vis-à-vis Rs 46791 per 10 grams on April 30, 2021



Source: RBI, IBJA, financial websites