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Fixed Income Market Snapshot

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Global long-term bond yields were down during March, primarily driven by region-specific cues. As expected by the market the U.S. Federal Reserve kept interest rates unchanged in its March meeting. This brings a three-year drive of monetary policy tightening to a halt. The dot plot, now indicates no more interest-rate hikes in 2019 and just one hike in 2020, amid signs of an economic slowdown. The Fed lowered its 2019 US growth forecast to 2.1% from its prior forecast of 2.3% and lowered its 2020 forecast to 1.9% from 2.0%. The 2019 inflation projection was also lowered to 1.8% from 1.9%. The projection for the unemployment rate edged up to 3.7% for 2019, from its prior projection of 3.5%. In its March 7th meeting, ECB kept the interest rates unchanged. The European Central Bank (ECB) delivered a fresh round of monetary stimulus in a bid to shore up the weakening economy as it cut its growth forecast by the most since the advent of its QE programme four years ago. ECB President expects the euro-zone economy to now expand only 1.1% this year, a drop of 0.6% point from forecasts just three months ago. It also mentioned a new series of quarterly targeted longer-term refinancing operations (TLTRO-III) will be launched, starting in September 2019 and ending in March 2021, each with a maturity of two years. Japan's GDP for the Oct-Dec'18 period expanded at an annualized rate of 1.9%, faster than initially reported and slightly above the median estimate from economists. Overall, economic activity recovered from a sharp contraction in the previous quarter, during which a string of natural disasters weighed on investment by businesses. China's trade surplus plunged to USD 4.12 billion in February 2019 from USD 32.3 billion a year ago, missing market forecasts of USD 26.38 billion. It was the smallest trade surplus since a rare deficit in March 2018. The exports fell the most in three years and imports dropped for a third straight month. The trade surplus with the US, China's largest export market, narrowed sharply to USD 14.72 billion in February 2019 from USD 27.30 billion a month earlier.

Domestic Market Scenario

First Bi-monthly Monetary Policy Review

The Reserve Bank of India (RBI) in its first monetary policy review for FY20 on April 4, 2019, reduced the repo rate by 25bps from 6.25% to 6.00%, which was in line with the market expectation. It maintained its policy stance as neutral. Inflation projection for H1FY20 is revised downward to 2.9-3.0% from an earlier estimate of 3.2-3.4% while H2FY20 has also been revised to 3.5-3.8%. The GDP growth projection for FY20 was revised downwards to 7.2% from earlier 7.4%. GDP growth for H1FY20 is projected in the range of 6.8-7.1% from earlier 7.2-7.4%. H2FY20 GDP growth is projected at 7.2-7.4%. The committee also mentioned that they would continue to maintain neutral liquidity in the system. The next Monetary Policy Committee (MPC) meeting is scheduled to be held from June 3, 4 and 6, 2019.

Yields : In March, 91-day T-Bill yield declined by 26bps and the 10-year government securities yield was down by 18bps. During the month, the 10-year made a low of 7.31%. On the corporate bonds, the spread between A+ and AAA bonds widened particularly on the one-year paper, possibly on the back of the RBI's USD Swap announcement.

Forex : In March, INR appreciated by 2.20% against the USD and 3.70% against the Euro. Year to date, INR has appreciated 0.50% against the USD and 2.80% against the Euro. During the month, INR traded in 68.53 to 70.91 range, on a daily closing basis. Forex reserves for the week ended 22nd March 2019, stood at USD 406bn.

Liquidity : Currency in circulation expanded sharply during February and March. From a daily net average surplus of INR 275 billion during February 1-6, 2019, systemic liquidity moved into deficit from February 7 to end of March, reflecting the build-up of government cash balances. RBI injected liquidity into the system by of Open Market Operations (OMOs) to the tune of INR 375 billion in February and INR 250 billion in March 2019. Total durable liquidity injected through OMOs has aggregated INR 2.98 trillion during FY19 so far. The weighted average call rate (WACR) remained broadly aligned with the policy repo rate in March.

Macro

Inflation: Headline CPI inflation rose to a four-month high of 2.57% YoY in February against 2.05% YoY in January, primarily led by base effect. Core inflation (excluding food) was up marginally to 5.40% in February (5.20% in January).

Inflation expectations of households, measured by the February 2019 round of the Reserve Bank's survey, softened by 40bps for the 3-month and 12-month ahead horizon over the last round, reflecting the continued decline in food and fuel prices.

WPI inflation rose to 2.93% in February (YoY) (against 2.76% in January), the acceleration was largely driven by a hardening of prices of primary articles especially food articles.

Fiscal Deficit:

India's fiscal deficit was at 134.2% of full year budgeted levels for the period April to February 2019 compared to 120.3% for the same period last year. This was primarily due to tepid growth in revenue collections. In absolute terms, the fiscal deficit for April-February 2018-19 was INR 8.51 trillion as against the revised estimate of INR.6.34 trillion for the entire year. In the interim budget FY19, the fiscal deficit was revised upwards to 3.40% of GDP from earlier figure of 3.30%.

Government borrowing calendar:

The government announced borrowing calendar for FY20, with gross borrowing pegged at INR 7.1 trillion, higher than INR 5.71 trillion estimated for the ongoing fiscal. Government will raise INR 4.42 trillion through gilts in the H1FY20 and INR 2.68 trillion in H2FY20. The government has repayment obligations of INR 1.02 trillion in the H1 and INR 1.35 trillion in H2. The Centre will auction INR 17000 crore of gilts weekly in H1. The government is planning to introduce new seven-year benchmark government security and may extend 15-19 year gilt maturity bracket to 15-24 years.

Outlook:

Economic activity in the US and Eurozone lost some steam in Q1CY19. In the Euro area slowdown was due to soft domestic demand and contracting manufacturing activity. In UK, growth slowed down on Brexit uncertainty. Major emerging markets economic activity decelerated. China's growth decelerated in Q4CY18.

The Monetary Policy Committee (MPC) voted 4-2 in favour of reducing policy rate by 25bps to 6.00%, in line with our and market expectations. It maintained its neutral policy stance. However, the RBI revised the inflation and growth projections downwards. The MPC's decision to cut rates reiterated the message that monetary policy will be conditioned as per the MPC's legislated mandate of keeping headline inflation close to 4% on a durable basis.

RBI permitted banks an additional 2.00% carve-out within the mandatory SLR requirement as Facility to Avail Liquidity for Liquidity Coverage Ratio (FALLCR) for the purpose of Liquidity Coverage Ratio (LCR) in a phased manner. This would reduce the demand from banks at the margin for government securities. Improved US dollar flows saw RBI using USD-INR swap to infuse liquidity in the system. This would mean that RBI may lower the use of OMOs. The government borrowing calendar shows higher supply in H1FY20 compared to last year which would put pressure on yields.

As inflation continues to remain benign and growth projection is revised downwards, we expect another rate cut of 25 bps. However, the timing of such a rate cut will be contingent on the incoming data. In line with the above, we expect the yield curve to steepen further. Even though additional rate cuts will bring down short-end rates, fiscal pressures are likely to keep the long bond yields at higher levels.

Short-term maturity instruments look attractive from a valuation perspective. We continue to remain positive on corporate bond funds and accrual strategies. Investors who are looking for accrual income opportunities may consider select corporate bond funds that offer higher yields.

	31-Dec-18	29-Mar-19
10Y Benchmark: 7.17% GS 2028	7.36	7.46
Call rates	6.85%	6.25%
Exchange rate	69.77	69.16