Search here











Five leading experts reveal the Secrets of securing a fortune in this volatile market Download the issue @ Rs. 40/-

<u>Home</u> » <u>Investment</u> » Invest in Short-Duration Papers for the Near Term

Invest in Short-Duration Papers for the Near Term

Reduce duration in your portfolio and the focus should remain on lower duration products



Invest in Short-Duration Papers for the Near Term

Rahul Singh - 27 August 2021

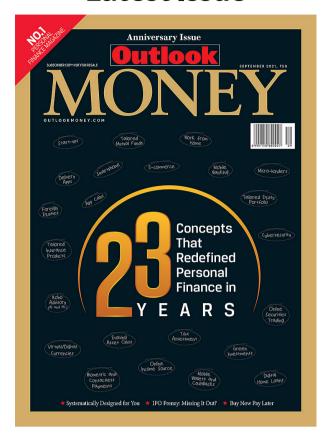


Central Banks across the globe have one common mandate i.e., to reduce volatility and provide stability to the financial market. An imminent response to the adverse market reaction to the impact of covid was to infuse the system with huge liquidity and provide avenues to every sector with easy borrowing conditions. This was a policy response of all the central banks across the globe.

RBI too followed the same policy response when they infused the system with surplus liquidity in the form of Repo and Reverse Repo cuts, Open Market Operations (OMOs), Long Term Repo Operation (LTRO), Loan Moratorium, etc. The idea was to ensure that every sector and Individuals has access to easy financing conditions. Hence, we saw that system liquidity which was either neutral or slight negative pre covid shot up to a surplus of almost 8 lakh crores (Source: RBI).

Even after 1 year of the covid outbreak, the system liquidity remains in surplus of 4–5 lakh crores (Source: RBI). However, one drawback of such an expansionary policy response is seen in the market yields of various debt instruments. Ignoring the hardening of yields at the outset of covid, the bond yields have dropped by a staggering 100 – 300 bps (Source: Bloomberg) across various tenures and instruments from pre-covid levels.

Latest Issue



SEPTEMBER 2021 OUTLOOK MONEY









Most Read

Even the overnight rates fell below 3 per cent when the Repo rate is at 4 per cent and the Reverse Repo rate is at 3.35 per cent (Source: Bloomberg). This kind of level is more of an outlier or can be viewed as an exception to the policy response to reduce the impact of the pandemic. However, as things start to settle down with more and more people getting vaccinated and economic activity touching pre-covid levels, the policy normalisation will start taking place and the yields will slowly start inching upwards. In such a scenario, the overnight rates will move towards the Repo rate as it is usually the operating rate in any financial market in normal times.

Another impact of covid that we experienced last year was a dip in economic activities due to a nationwide lockdown. Even after the lockdown was partially lifted, economic activity did not pick up the way it is during normal times. Hence the impact was seen in core CPI numbers, though overall CPI and WPI numbers saw a rise due to supply-side constraints which got impacted due to restrictions on movement during the nation-wide lockdown. Though inflation picks up due to supply-side constraints that can self-correct once lockdown is lifted, it is the demand-led inflation that impacts CPI inflation more and is sticky. This is something that we are seeing off late where CPI inflation is on the rise. RBI still believes it transient, however as vaccinations are on the rise and economic activity picking up, will gradually push CPI inflation towards that uncomfortable zone for the central bank. Further, the excess amount of liquidity in the system certainly gives fillip to CPI inflation. As per RBI's estimates, CPI Inflation will average around the 5 per cent mark for FY22.

Another factor that concerns the market is the huge borrowing program announced for the current financial year. The government took several steps last year to stimulate growth through higher spending in Healthcare, Food Subsidies, Infrastructure, MSME, and small-scale industries. This increased GOI spending coupled with lesser revenue generated due to a fall in economic activity last year shot up fiscal deficit numbers. Hence GOI had to borrow more than budgeted leading to ballooning fiscal deficit numbers. GOI's FY21 fiscal deficit shot up to 9.5 per cent against expectations of 7.5 per cent with a record borrowing calendar for FY22 (Source: PIB).

Although RBI has indicated that it would continue to focus on growth and will come up with OMOs and operation Twist to normalise the yields, the impact has already been seen in the way yields have gone up since the start of the calendar year. With the government aggressively vaccinating people and economic activity moving towards full capacity utilisation, it is a matter of time that RBI would gradually reverse the expansionary policy measures taken in the last 16 months.

Sooner or later the overnight rates will start moving towards the 4 per cent repo rate mark and the longer end yields too would start inching up due to higher borrowing and rising inflationary expectations. This rise in yields could further accentuate if we consider that there are already talks going on regarding taper tantrums in United States where US Fed was providing

An Introduction to Crypto Mining

How to File e-Nomination for PF Account

<u>Is gratuity taxable on superannuation?</u>

Is It a Good Idea to Invest in Gold Right Now?

How to Earn Money from Amazon?

Advertisement*



Khaja - the divine dessert... Every bite into its layers is akin to a step closer to the Lord.



liquidity by buying securities from the financial market. Once US Fed decides to stop giving liquidity there could be a sharp rise in yields like we saw in 2013.

Considering the domestic and Global scenario, it makes more sense to reduce duration in your portfolio and the focus should remain on lower duration products like Ultra Short Duration and Low Duration.

The author is Senior fund manager – Fixed Income, LIC Mutual Fund Asset Management Ltd.

DISCLAIMER: Views expressed are the author's own, and Outlook Money does not necessarily subscribe to them. Outlook Money shall not be responsible for any damage caused to any person/organisation directly or indirectly

Read More in:

Investments Economy

my RBI

Portfolio

Finance

Related Articles



<u>Is Investing in Gold a</u> <u>Good Option For You?</u>

<u>Savings</u>



Negative Real Return on Bank Deposits

Stock Updates

Contact us



AI & SSI for Portfolio
Diversification

Advertisement*

Quick Links	Features	Social Media	Newsletter	
<u>Magazine</u>	About us	<u>Facebook</u>	You can trust us. we only send	
Retirement	<u>Privacy</u>	<u>Twitter</u>	promo offers	
Investment	<u>RSS</u>	Linkedin	Your Email Address	
<u>Insurance</u>	<u>Videos</u>	<u>Youtube</u>		
<u>Expenses</u>	<u>Ask Moneypal</u>		Subscribe	

Copyright ©2016 Outlook Ltd. All rights reserved.Outlook Money® is a registered trademark owned by Hathway Industries.All content copyright of Outlook Money.com.