LIC MUTUAL FUND

# Debt Market Review

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## Market Review

- In the Union Budget announced on 1st February 2020, The government has projected central government fiscal deficit for FY2020 at 3.8% as against earlier target of 3.3%. However net borrowing is capped at Rs.4.99trn almost similar to budgeted earlier. The government proposes to fund the difference from National Saving Scheme Fund (NSSF), hence no additional borrowing was announced in the budget. While the funding of the fiscal deficit assumes Rs.2.4trn from NSSF in FY2021 which is almost double from FY2020, there is a possibility of collections under the small-savings schemes coming down substantially.

- A majority of the small savings schemes are subscribed to by households to avail of income tax benefits which, if households, move towards the new income-tax regime will see sharp fall in collection. Consequently, additional market borrowing would be required to fund the shortfall. This is negative for the debt market. During FY2020, government bonds worth Rs.40000cr are up for redemption. Government plans to switch this 40000cr short bond and replace it by issuing longer tenure bonds.

- The government has projected central government fiscal deficit for FY2021 at 3.5% lower than 3.8% projected for FY2020. The gross borrowing and net borrowing are assumed at ₹ 7.8 trn and ₹ 5.36 trn respectively. We believe this could fall even further in the event of successful stake sell from LIC IPO. However, a significant higher bond redemption of ₹ 2.7trn in FY2021 will mean Government's switch program of close to 7 times of Fy2020.

- In the February policy, RBI maintained status quo in Feb MPC, keeps repo rate unchanged at 5.15% for the second consecutive time this fiscal in wake of rising inflation. Consequently, the reverse repo rate under the LAF will remain unchanged at 4.90 per cent, and the marginal standing facility (MSF) rate at 5.40 per cent. The bank rate remained unchanged at 5.40 per cent. The MPC decided to continue with the accommodative stance in order to revive growth, while ensuring that inflation remains within the target.

- The downward surprise to industrial production and the upward surprise to inflation continues to pose a challenge for policymakers. While we expect CPI inflation to have peaked in January, the trajectory will likely remain mostly above 6% through 1HFY21. Despite weak growth, MPC is expected to stay on hold in 1HFY21, with room for additional easing contingent on the evolution of the growth-inflation mix. RBI also decided to conduct Long term repos of 1and 3 year (LTRO) totaling up to 1 trillion at the policy rate.

- In another major development, India's GDP growth slipped to a nearly 7-year low of 4.7 per cent in October-December 2019, weighed by a contraction in manufacturing sector output. The GDP growth rate for the first quarter of 2019-20 has been revised to 5.6 per cent, and for the second quarter to 5.1 per cent. India's GDP growth for full FY19 had stood at 6.8 per cent. However, with a likely impact of the coronavirus beginning to play out in the last quarter and expenditure compression by the government, last quarter GDP growth could disappoint. This could mean that GDP for the year could be lower than 5%. The coronavirus remains the critical risk as India depends on China for both demand and supply of inputs.

- India's Retail Inflation CPI inched upwards to 7.59 per cent during January. This is the second month that inflation remained above the upper limit of 6 per cent set by Reserve Bank of India. It has maintained an upward trend since January 2019, when it was 1.97 per cent. In December 2019, consumer price inflation was pegged at 7.35 per cent. The uptick in inflation figures came on the back of sharp increase in food prices. Food price inflation for January 2020 stood at 13.63 per cent, in comparison to (-) 2.24 per cent recorded in January 2019. IIP in December grew (-)0.3%, primarily owing to an adverse base effect and weaker-than-expected manufacturing sector growth of (-)1.2%. Electricity output fell marginally by (-)0.1% while mining improved to 5.4%. Continued weakness in investment and consumption was reflected in contraction observed across capital goods (-)18.2%, infrastructure/construction goods (-)2.6%, consumer durables (-)6.7% and consumer non-durables (-)3.7%. Intermediates, however, posted strong gains at 12.5%. Factory output rose by 1.8 percent in November and manufacturing growth had stood at 2.7 percent.

## Outlook

- No cap on certain government securities is positive from PFI's point of view. Although clarity is awaited on this hence it will materialize over a period of time. Coronavirus outbreak has brought a large part of the world's second-largest economy China to a standstill and its impact has been felt across industries especially Electronics, Auto components, Pharma, Petroleum to name few. On January 30, the World Health Organization (WHO) declared the coronavirus outbreak a global health emergency.
- The virus is now in 54 countries and on nearly all continents. As on February 29, 85403 cases were confirmed globally including 79394 cases in China alone. Death toll as on date stands at 2924 globally including 2838 in China alone. India imports $70bn from China and exports $17bn. Indian Inc is believed to have stocked inventory till March 2020 in advance following Chinese New Year, hence inventory supply shock till then is unlikely. We expect temporary price increases likely to be accompanied by production delays if the pain spills over into 2Q20 (April-June).