LIC MUTUAL FUND

Debt Market Review

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Market Review

- Though number of measures have been taken by RBI to contain the yields going upwards, fiscal worries coupled with rising corona virus cases across the country has put pressure on the yields across the curve. In a surprising move, government kept it borrowing for H2 in line with its initial estimates. The government will raise Rs4.34 trillion in 2HFY21 until January-end, taking the cumulative FY2021 borrowing to Rs12 trillion. Supply concerns will however continue to linger, and much will depend on the evolution of Covid and its impact on fiscal slippages.

- While the center could diversify its borrowings, concerns remain about the states, especially given the shortfall in compensation cess. A sharper recovery in exports relative to imports led to a moderation in the trade deficit in September. Localized lockdowns continue, even though there has been a moderation in the number of daily Covid cases recently. Preliminary estimates suggest that exports grew 5.3% in September ((-)12.7% in August) to US$27.4 bn, and 20.7% mom. This bounce in export activity is a reflection of pick-up in economic activity in economies that have opened up after the lockdowns. September imports contracted 19.6% to US$30.3 bn but registered a sequential growth of 2.8% as domestic economic activity continued to normalize. Import recovery in FY2021 will lag behind the export recovery given the relative weakness of domestic demand versus global demand.

- Despite the moderation in the number of daily Covid cases, localized lockdowns continue and will weigh on domestic economic activity. With oil prices likely to remain in check in FY2021E, (expect average crude oil price of US$40/bbl), we maintain our estimate of current account surplus of 1.1% of GDP. The capital account will be well supported by FDI flows.

- August CPI inflation moderated to 6.69% as against a downward revised print of 6.73% for July. Food inflation came in at 9.1% (9.3% in July), fueled by meat and fish (16.5%), vegetables (11.4%), pulses and products (14.4%), oils and fats (12.4%), and spices (12.3%). Core inflation remained unchanged at 5.3% and was led by inflation in the personal care segment (14.5%) and in the transport and communication segment (11%). August WPI inflation rose to 0.2% ((-)0.6% in July) on the back of higher core WPI of 0.6% ((-)0.4% in July). Bulk of the sequential momentum in core WPI came from basic metals (2.3% mom). Food WPI moderated to 3.8% (4.1% in July).

- On the global front, The Fed kept its policy rate unchanged and expects them to stay there until at least the end of 2023, and until the economy returns to maximum employment and inflation has risen to 2% and is on track to moderately exceed 2% for some time. BOE voted unanimously to leave the policy rate at 0.1% and to continue with its existing program of UK government bond and sterling non-financial investment-grade corporate bond purchases (GBP745 bn). BOE does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably. Bank of Japan retained its policy rate at (-)0.1% and to continue to cap 10-year government bond yields at around 0%. It pointed out that Japan's economic activity has started to pick up, although it remains in a severe situation due to the impact of Covid at home and abroad. It also expects short and long-term policy interest rates to remain at their present or lower levels.
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Outlook

- Even as the slight moderation in August CPI inflation is encouraging, it remains elevated and well above the RBI's upper limit of 6%. Food inflation remains high. The trajectory of food prices over the next few months would therefore be crucial for pushing headline CPI inflation back into the RBI's comfortable range.

- At the same time, other factors like gold along with excise duty hikes may continue to weigh on the core CPI inflation trajectory. Taking these factors into consideration, we reiterate our belief that the RBI will await a durable reduction in inflation before easing its repo rate further.

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For further details, please refer to the Scheme Information Document, Statement of Additional Information & Key Information Memorandum cum Application forms, available on our website www.licmf.com and at the official points of acceptance of LIC Mutual Fund Asset Management Ltd.