Debt markets

The month of March is usually seen as volatile month for money market rates and liquidity however this time ten year government benchmark was more volatile. Month started continued selling from last month and 10 year yield touched the high of 7.77% vs. last month's closing of 7.72%. However announcement of a much favorable than expected borrowing calendar for first half of FY 2018-19 came as relief and yields rallied down all the way to 7.33% before closing the month at 7.38%.

Money market rates were high due busy credit season .Three month CD rates touched high of 7.25% before dropping to 6.80%.One year CD were traded at high of 7.50 before settling at 7.20%.

Liquidity remained negative in the month of March at average -0.30 trillion from previous month's average of -0.07 trillion (Rev Repo-Repo-Marginal Standing Facility-Standing Liquidity Facility + term repo/re-repo). This was mainly due to advance tax outflows & currency in circulation.

Domestic Macro Factors

Industrial Production

India's industrial production growth printed at 7.5% y-o-y in January versus 7.10% in December. This was higher than market expectation of 6.7%. This was mainly due to the increase in consumer durables category which printed at 8.0% y-o-y in January from 1.5% in December. On sectorial basis manufacturing activity remained neutral to 8.7% y-o-y in January from 8.5% in December. Mining and electricity grew at 0.1% and 7.6% in January from 1.2% and 4.4% respectively in December. In terms of use based classification, Capital goods production rose to 14.6% in January vs 14.4% in December. Other segments like Intermediate goods and consumer non-durables segments printed at 4.9% & 10.5% respectively.

External Trade

India's external trade deficit narrowed to $ 11.98 bn in February vs. $ 16.3 bn in January. This was much lower than market expectation of a deficit of $ 14.3 bn. Exports growth eased to 4.5% y-o-y in February vs. 9.1% in January. Exports increased to $ 25.8 bn in February from $ 24.4 bn in January. Oil exports printed at 27.4% in February compared to 39.5% in January. Imports moderated to 10.4% in February vs. 26.1% in January. Oil imports also moderated to 32.1% y-o-y in February vs. 42.6% y-o-y in January. Gold imports printed at -16.9% in the month of February vs. -22.1% in January. Non-oil, non-gold imports decreased at 7.3% in February vs 24.4% in January.

INR traded in the range of 64.80 to 65.21 during the month and finally closed the month at 65.1775/$ vs 65.1750/$ in March. India's forex reserves are more than $422.5 bn in the week ending March 23, 2018.

Current Account & BOP

The current account deficit (CAD) widened to $13.5 bn in Q3 2017 vs $7.2 bn in Q2 2017. This was better than market expectation of $15.3bn. This was largely due to decline in oil and non-oil imports. CAD increased to 2% of GDP compared to 1.2% in previous quarter. BOP remained nearly unchanged at $30.6 bn in Q3 2017 vs. $ 25.6 bn in Q2 2017.

Inflation

Headline CPI inflation decelerated to 4.44% y-o-y in February from 5.07% in January. This was well below the market expectation of 5.10%. The moderation in headline CPI was mainly contributed by lower food price inflation. Food inflation rose lower than previous month to 3.3% in February from 4.7% in January. Core CPI (i.e. CPI ex food & fuel) remained unchanged at 5.2% in February from 5.1% in January. Fuel price inflation moderated to 6.8% y-o-y in February from 7.7% in January.

WPI inflation decelerated to 2.48% in February from 2.84% in January, this was in line with the market expectation of 2.5%. It was the lowest wholesale inflation since July 2017. This downward movement was largely due to ease in food & fuel prices. Primary articles inflation moderated to 0.79% in February vs. 2.37% in January. Fuel and power inflation slowed to 3.8% in February from 4.1% in January. Core WPI Inflation (manufactured product ex food inflation) increased to 3.9% y-o-y in February from 3.4% in January.

Outlook

In global markets the US Federal Reserve in its monetary policy increased the policy rates by 25 bps as expected by market participants. All the committee members voted in favor of a rate hike. It was sixth rate hike since committee began raising rates in December 2015. Committee members also suggested that there could be more rate hikes for 2018. The benchmark federal reserve rates would now range between 1.5% and 1.75%.

The People's Bank of China (PBOC) in its monetary policy increased rates by 5 bps. This move has been widely predictable as PBOC was expected to follow a Federal Reserve hike with a 5-10 bps increase.

The Governing Council of the ECB kept interest rates unchanged on the marginal lending facility and the deposit facility. Governing council also suggested that they will continue the net asset purchases at 30 bn Euro per month until September 2018.

The bank of Japan kept its monetary policy rates unchanged. It was an expected move in which the BOJ maintained its stance of managing short-term interest rates at minus 0.1 percent and the 10-year government bond yields around zero percent. The decision comes as inflation remains low, with Japan struggling with the fears of deflation. The central bank has failed to achieve the 2% inflation rate target, which is however very crucial to boost their economy.

In domestic markets the change in Government borrowing plan, approval to banks for spreading MTM losses in four quarters and finally lowered inflation projection by MPC solved large part of deadlock Government bond markets were faced with. Banks which are single largest holders of G-sec were reluctant to increase their holdings in past few months leading to sharp uptick in yield and loss of volumes in markets .This was due to their huge MTM losses in last two quarters putting pressure on their balance sheet and excess SLR position at 29.5 % juxtaposed with upcoming huge borrowing calendar. Supply issues were addressed by Government by reducing -

1. The net borrowing by 50000 cr (funded by 25000 cr from small savings schemes + bond buyback reduction of 25000cr).
2. Issuance in first half of FY borrowing to ~48 % (historically 60 %) and
3. The duration of bonds issued (10-14 years issuance from 52% to 28 %)

Further MPC in line with expectation voted 5-1 in favour of leaving the repo rate unchanged at 6% with neutral stance,. It expects GDP growth to pick up to 7.4% for FY19 (vs 6.6% in FY18). However the real positive surprise is lowered inflation projection of 4.7-5.1% in H1 FY19 (versus 5.1-5.6% earlier) and to 4.4% in H2 (vs. 4.5-4.6% earlier) with risks tilted to the upside. MPC however highlighted multiple upside risks to inflation like minimum support prices (MSP), crude oil prices, fiscal slippage, and narrowing output gap. This downward inflation revision made policy outturn more dovish than expected. We feel with lowering of the RBI's inflation forecast there should not be imminent policy tightening on the horizon. However there are multiple upside risks to inflation as mentioned above along with sharp projection in growth recovery .We expect the RBI to remains in wait-and-see mode. With this view we advised investors with shorter horizon to invest in accrual products like Ultra short term Fund and Income Plus. Investors with a long term outlook can invest in short to mid duration products like Select Debt –Short term bond ,Bond Saver, Banking PSU and Flexible Income Plan.