Debt markets

The Indian bond markets witnessed a relief rally in the month of October. This softening in the yield was on back of fall in crude prices from $ 85 / barrel to $ 75 / barrel during the month. Further, the stability in the currency after touching an all-time low helped sentiments in the bond markets. RBI's announcement of OMO purchase of Rupees 400 bn allayed fears on illiquidity. The ten-year benchmark yield closed at 7.85% from 8.02% of last month after touching a high of 8.15% during the month.

The activity in the Money Market segment remained subdued for the month of October. Two month CD rates remained at previous months elevated levels of 7.05% to 7.15%. 3-6 months CD and CP rates remained range bound and traded respectively in the range of 7.30% to 7.50% and 8.30% to 8.50% levels. The direction of yield remained on upward path throughout the month.

Liquidity remained negative in the month of October at average of Rs -0.57 trillion from previous month's average of Rs -0.41 trillion (Rev Repo-Repo-Marginal Standing Facility-Standing Liquidity Facility + term repo/re-repo) mainly due to increase in currency in circulation due to festive season.

Domestic Macro Factors

Industrial Production

India's Industrial Production growth moderated to 4.3% y-o-y in August vs. 6.5% (revised from 6.6%) in July. This was higher than market expectation of 4.0%. The moderation was mainly due to deceleration in growth of sectors like Mining and Manufacturing which decreased respectively to -0.4% and 4.6% in August from 3.4% and 7% in July. Electricity sector growth increased to 7.6% in August vs. 6.7% in July. In terms of use-based classification, Capital goods production increased to 5.0% in August vs 2.8% in July. The consumer durables category fell drastically at 5.2% in August from 14.3% in July. Consumer non-durables sector growth printed at 6.3% in August vs. 5.5% in July. Infrastructure and Intermediate goods growth printed at 7.79% and 2.4% in August vs 9.23% and 1.0% respectively in July.

External Trade

India's external trade deficit narrowed $ 13.98 bn in September vs. $ 17.39 bn in August. This was much lower from market expectation of a deficit of $ 17.30 bn. The recovery was broad based. Import growth reduced to 10.5% in September vs. 25.4% in August. The moderation in import growth was across all segments. Exports growth jumped to 19.2% y-o-y in August vs. 18% in July. Imports printed at $ 41.9 billion in the month of September. Oil imports moderated to 33.5% in September from 51.6% in August. Gold imports growth also moderated to 51.5% in September vs 92.6% in August. Exports printed at $ 27.95 bn in September from $ 27.84 bn in August. Oil exports rose by 26.8% in September vs. 31.8% in August. Non-oil exports rose by 11.4% September vs. 36.2% in August.

INR continued to remain under pressure in the initial days of October and breached the level of 74/$ touching the all-time high of 74.3875/$. It continued to trade in the range of 72.91/$ to 74.39/$ and finally closed the month at 73.9500/$ in October vs 72.4900/$ in September. India's forex reserves reduced to $392.08 bn as on 26th October from $400.5 bn in last week of September.

The GST collection for the month of October increased to Rs 100,710 crore, from previous month's collection of Rs 94,442 crore. GST collection in October witnessed an uptick due to festive demand and anti-evasion measures. The Rs 100,710 crore collected includes Central GST of Rupees 16,464 crore, State GST of Rupees 22,826 crore, Integrated GST of Rs 53,419 crores and Cess of Rs 8,000 crores.

Inflation

Headline CPI inflation remained constant at 3.77% in September from 3.69% in August mainly due to stable food prices. This was below market expectation of 4.02%. Core inflation moderated slightly to 5.8% in September vs. 5.9% in August. Food and beverages inflation rose to 1.08% in September vs. 0.78% in August. Fuel & lighting inflation printed at 8.47% in September from 8.55% in August. Housing inflation moderated to 7.07% in September vs. 7.59% in August. Other miscellaneous inflation printed at 5.65% in September vs. 5.80% in August.

WPI inflation rose to 5.13% in September from 4.53% in August. This was above market expectation of 5.00%. This was largely due to increase in food and fuel prices. Primary articles inflation rose to 2.97% in September vs. -0.15% in August. Fuel and power sector combined inflation printed at 16.6% in September from 17.7% in August. Core WPI Inflation (manufactured product ex food inflation) further hardened to 5.8% in September from 5.0% in August. Coal mining sector inflation printed at 4.9% in September vs. 4.7% in August. Electricity sector inflation softened to 3.3% in September vs. 8.9% in August.

Outlook

Globally, the Federal Reserve Committee kept interest rates unchanged in its early November policy after raising rate for the third time this year in September 18.This leaves us with December policy where it can raise rates for the largely expected fourth rate hike.

ECB in its Monetary Policy left the benchmark rates unchanged. It continue to expect them to remain at their present levels at least through the summer of 2019 and in any case for as long as necessary

Locally the borrowing calendar released at the end of September brought cheer as the Government announced a Rs 700 billion cut in its gross borrowing target while sticking to the net borrowings planned in the budget. Yield on the 10-year benchmark G-sec opened October on a positive note, but was weighed down by rise in crude oil prices and weakness in the rupee as it touched the year's highest level. Later during the month as OPEC assured to increase supply to address supply cuts due to sanctions on Iran and later waiver to eight nations including India to buy oil from Iran led to drop in crude prices .This USD15/barrel drop in crude oil prices in the last month has brought in some respite and has led to an appreciation in the Rupee. This backed by series of OMOs brought some cheer to market leading to gains in G-Secs.

As Iran related uncertainties are sorted for India the focus will now shift once again to domestic factors. The upcoming Inflation number is largely expected to be below 4% and IIP near trend. Growth is largely expected to moderate in 2HFY19 due to adverse base effect. Now there is additional risk from NBFC sector post ILFS event and the liquidity situation are the key risks to the markets. RBI has taken a few measures to ease lending to NBFC/HFC sector but it has not come all out to address the issue. A certain degree of normalcy has returned back to markets as many of these companies have been able to raise money. The RBI board will meet on 19 Nov and it is expected to come up with some measures on this issue.

The Minutes of the October Monetary Policy meeting showed the RBI is concerned about the upside risks to inflation but awaiting clarity on price pressures. We believe that RBI will not waver from its durable 4% inflation target and tighten monetary policy exceptionally until and unless there is some adverse global event. We believe expected softness in domestic macro data, drop in crude prices, easing of pressure on local currency and tight liquidity conditions in credit market may push rate hikes further into the future than the next policy.

We continue to recommend Liquid, Money Market and Low duration funds for shorter holding periods. Short duration funds with accrual focus for investors with 9 to 12 months focus while we recommend mid duration and systematic deployments in long duration funds for investors with 36 months and greater investment horizon.