MIRAE ASSET
Mutual Fund

Monthly Market Insight

June 2020

DEBT UPDATE

Global Events

Building wave of dichotomy between the markets and the macros, both moved in opposite directions. This might be the case of large flush of liquidity through the global central banks and less than normal economic activity levels. Major central banks around the world (top 4 central banks have increased the balance sheet by USD 5.5trn since beginning of March) have contributed to the substantial easing of financial conditions via interest rate cuts and a balance sheet expansion of over USD 6trn. Risky asset prices have rebounded since the precipitous fall in March, whereas the benchmark interest rates have fallen. Aggregate portfolio outflows have stabilized, and some countries have experienced some modest inflows again. India's flows have increased to 18 months high. Credit markets, spreads of investment-grade companies in advanced economies as well as EM are currently quite contained, contrary to the sharp widening seen during March-April.

Globally,

- FOMC indicated that rates would remain at 0-0.25% till the end of 2022.
- Financial conditions stress index has return back to normal levels.
- Real GDP projection have been revised downwards sharply to -6.5% in 2020 compared to 2% in Dec'19 projection. Such a sharp revision in projection is also reflected in unemployment which is likely to hit 9.3% in 2020. Unemployment rate improved to 11.1% in June. Fed governor, mentioned they would do whatever possible to bring the unemployment rate to as low as 3.5%.
- In Main Street Financing facility for MSME borrowers will get a 2 year moratorium on principal payments on a 5 year loan and 1 year deferral in interest payments. The registered lenders can sell 95% of the book to SPV of Fed. It is likely to support USD 600bn of fresh loans.
- ECB also revised the inflation downwards and increased the pandemic emergency purchase by EUR 600bn to EUR 1.35trn.Extension of purchase program is now till Jun'21. ECB's TLTRO expanded by EUR 380b. ECB has raised the maximum amount a single bank can borrow to 50% of banks outstanding consumer and business loans.

Indian Market Events

Following the government's Economic Package 2.0, the RBI reduced rates, extended the moratorium of term loans by three more months, extended liquidity support to some of the financial institutions and provided some relief to states. RBI measures would act as a support and not aid in salvaging the economic loss. Post-Covid-19, the RBI has reduced the repo rate by 115bps and reverse repo rate by 155bps (widening the gap to discourage banks from parking under LAF *Liquidity Adjustment Facility). We believe that so far, the transmission of the earlier rate cuts has been less than 60% (out of 210bps repo rate cut, only 120bps have been passed on), hence the impact of rate cuts would not have been meaningful.

The RBI has so far announced liquidity measures to the extent of Rs9.6trn, 4.6% of GDP (way higher than govt economic package of 1% of GDP). In its latest measure RBI announced special open market operations (operation twist) of government securities worth ₹10,000 crore. RBI governor also continued to stick to his phrase that "we would do whatever it takes". RBI's balance sheet expanded by Rs 13trn in FY21 till now. Largely on huge Reverse Repo balance parked with RBI (Rs 6.2trn) and increase in printing of currency by Rs 4.5trn. 60% of the expansion in the balance sheet is due to sharp increase in foreign exchange reserves. Based on high printing of the currency, huge transfers to the Rural economy and temp change in consumption pattern has resulted in sharp increase in currency in circulation to 19% YoY i.e. by Rs 2.0trn expansion. The fiscal deficit for April-May'20 expanded to 58.6% of FY21BE. Lower revenue realization was due to low economic activity and deferment of tax fillings. Also, the expenditure has been concentrated to MNREGA allocation, transfers to states and PM-Kisan. PM Gareeb Kalyan Scheme has been extended till Nov'20. This increases the food subsidy cost by another Rs900bn. Total increase in food subsidy due to various schemes is ~ Rs1.3trn.

- FY20 tax collection of 11 states fell sharply by 3%, leading to sharp curtailment in capital spending of these states. High frequency data showed some improvement but is still lower than the normal level, like Vahaan sales (particularly tractor sales) slightly lower than normal
- Electricity consumption (down 6%), stamp duty registration is still 60% lower than Feb'20 levels
- Work place mobility has deteriorated (compared to last week)
- e-Way bill generation is 25% lower than Feb'20 levels etc.
- India's manufacturing PMI hits recovered to 47.2 India's manufacturing sector moved towards stabilisation in June, with both output and new orders contracting at much softer rates than seen in April and May.

Following these developments the India 10Y dropped below 6.0% levels to close the month at 5.88%. Corporate bonds witnessed yields dropping by 35-40bps due to lack of issuances and demand from the institutions. Money Markets continued its rally and moved lower by 40-50bps mainly due to ample liquidity with Mfs and the deployment options remain low due to lower issuances.

Source: Bloomberg and Investing.com, data as of 30th June, 2020.

Market Outlook

A quarter into to pandemic now, still there is no certainty about the when the economies will be fully functional. While central banks continue to focus on maintaining financial stability, governments struggle with putting a plan in place to restart with the new normal. With this yields are expected to trade in narrow range with a positive bias.

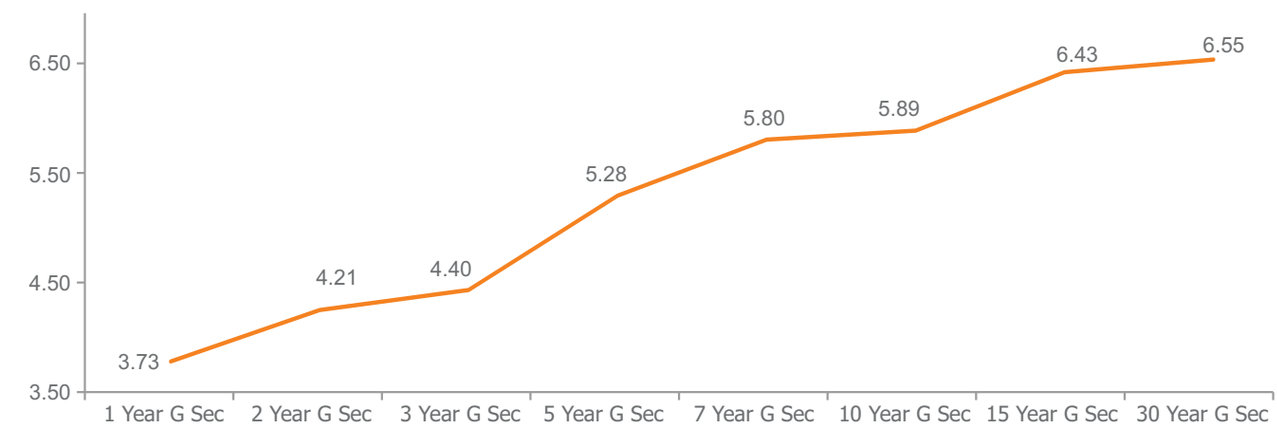
Fixed Income - Yields		
	30th June 2020	1st June 2020
Call Money	3.64	3.59
TREPS	3.06	3.14
3 months CD	3.15	3.40
3 months CP	3.70	4.42
1 year CD	4.10	4.30
1 year CP	5.20	5.85
3 Years G Sec	4.40	4.62
5 Years G Sec	5.28	5.46
10 Years G Sec	5.89	5.78

All Values are percentage (%) terms

Currency Markets			
Forex	Value	MTD	YTD
$ / Re	75.51	-0.05%	6.01%
£ / Re	92.80	-0.95%	-1.76%
€ / Re	84.78	0.80%	6.16%
KRW / Re	0.06	1.80%	1.78%

Source: Bloomberg, 30th June, 2020.

G Sec Yield Curve (in%)



Source: Bloomberg, 30th June, 2020.

Macro Economic Indicators (India)				
Indicators	Current Period	Value	YoY Comparison	Value
GDP (%)	Q4 2019-20	3.10%	Q4 2018-19	5.80%
IIP (%)	April 2020	-55.49%	April 2019	3.18%
Inflation (CPI %)	March 2020	5.84%	March 2019	2.86%

Source: CCIL, data as of 30th June, 2020.