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Update

- Indian fixed income market investors has started differentiating between high quality credits and lower order credits. The spreads have widened by 30-50bps over the last few weeks. The demand for AAA credits remain the highest.
- The valuation of AT1 bonds has also got stretched with investors noticing additional risk in these bonds.
- In order to reduce the pain RBI has been infusing liquidity for the last few quarters into the banks for further lending to the tune of ~INR 4 trillion. However Banks have not stepped up the lending due to lower credit demand and fears of rising NPLs (Non Performing Loans).
- The banks credit growth moves lower and presently at ~6.5% which is a 3 decade low.
- This low level of credit growth points at a heightened stress in the re-financing of debt and leading to spreads widening for inferior credits.
- This stress in re-financing will continue to be worry for all the low rated credits. The 'jump to default' possibilities remain high in this environment.
- RBI has swiftly intervened in the FX market to keep the INR stable and also announced USD INR swaps. With the forex reserves at an all-time high they have enough ammunition to keep the currency stable.
- Indian debt market remains largely insulated from the global risk-off trade on EM (Emerging Markets) bonds due to:
 - Low participation of foreign investments as part of the overall market (under 5%).
 - Indian bonds are not part of any international bond benchmark.
 - India is largely a domestic consumer driven economy led by high savings and investment and a young population.
- RBI remains committed to be an enabler amidst slowing growth and the panic due to COVID-19 pandemic.

Outlook

- We expect RBI's support in terms of liquidity infusion and low rate environment. We expect rates and yields to move southwards swiftly as the surplus liquidity within the banking system keep chasing high credit quality assets particularly sovereign and AAA credits.
- We expect 50-100bps of repo rate reduction anytime between now and April 3rd (when the Monetary Policy Committee(MPC) meets).
- Continuation of liquidity infusion measures.
- Expect yields of sovereign and AAA credits to move lower over the months.
- INR should be relatively stable (as compared to other EMs) over the medium term.
- Based on our current views, the funds' durations have been extended so as to capture the most as yields soften in future.
- The real yields are above 100bps and slated to widen further as monetary easing unfolds over the weeks.
- There may be a policy change to include Indian Bonds in the global bond indices. The relative high yields of Indian bonds and high real yields could be a big potential catalyst for the debt market to rally.

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