DHFL Pramerica MUTUAL FUND

Near Term Cheer for the Bond markets

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The first half borrowing calendar announced by the government yesterday has brought cheer for the bond markets as not only the gross borrowing amount was reduced by INR 500 bn but also the distribution of the borrowings has been tweaked to meet the demands of the market. The belly of the curve (the most liquid part of the curve) will see reduced issuances with the government going for a new bucket of 1-4 yr.

	Borrowing	1-4 years	5-9 years	10-14 years	15-19 years	20 years+
April	480	40	120	140	60	120
May	480	40	120	140	60	120
June	480	40	120	140	70	110
July	480	40	120	140	80	100
August	480	40	120	140	80	100
September	480	40	120	140	80	100
Total	**2880**	**240**	**720**	**840**	**430**	**650**
% of Total	**100**	**8.3**	**25.0**	**29.2**	**14.9**	**22.6**

Source: RBI, Kotak Economics Research | Figures in INR Billion

The gross borrowing shall now be INR 5.56 tn with the government budgeting an additional 250 bn from higher collection in small saving schemes and reducing the buyback by 250 bn, thus reducing the overall gross borrowing by INR 500 bn. The gross borrowing for the first half will be INR 2.88 tn, which shall be 51.8% of the revised gross borrowing. This is against the normal trend of first half borrowing being in the vicinity of 60-65% of the total gross borrowing for the year.

Market Implications and our Outlook

The maturity profile of the first half borrowings and the reduction in the gross borrowing will support the market yields and it will lead to flattening of the curve but at the same time we think that headwinds will continue for the bond markets going ahead. The reduction in the gross borrowing may not sustain and it is very likely that the second half of the year will see higher supply of bonds. Apart from the prospect of higher yields internationally and higher commodity prices, this being an election year , it is very likely that the government will not reduce the expenditure if there is a revenue / expenditure mismatch later on.

The new range for the benchmark 10 yr bond will be 7.20%-7.60% and we do not envisage the yields going back to the highs of 7.75% over the next two quarters. We also believe that sovereign bonds will outperform AAA corporate bonds.

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