

EXPECT WHIPLASH, BUT LOW RISK OF YIELD SPIKE

Budget and MPC reinforce our view: Yields will be volatile (our view for past few months), but should fall further (at least will not rise). After all, there is hardly a trigger for yields to rise meaningfully. And risks still remain lopsided for yields to fall - at some time.

- (i) Is it demand/supply mismatch? FY26 gross supply is higher by 6% (14% incl switch), net supply is lower. Against this, PF and insurance demand will grow by mid teens (empirically), banks by 10% (-nominal growth), Thus growth in demand outstrips supply.
- (ii) Is RBI going to be less dovish? RBI has come full guns blazing for liquidity - even when growth is expected to be robust (6.7%). Imagine in a tail risk, if growth were to surprise on downside!!! The tail risks from RBI are dovish, not hawkish.
- (iii) Are global risks high? We don't know. But a large part of tariff risks seem to be priced in, expectations from US FED have become tepid, and US fiscal risks seem evenly balanced. Unless there is a fiasco (we don't know), domestic factors should keep yields capped.
- (iv) Currency risks? We were concerned about rupee risk flowing into debt during Mr. Das' time. Not under Mr. Malhotra. If RBI is comfortable with market driven rupee levels, there is low chance for interest rates to be used to protect the currency.

Thus we are faced with sluggish market, with low chance of yield spike. Sooner or later yields will fall. But why not now?

Because the markets are tired! Traders have made money, so have MF. There is a time to take breather, especially when global noise (Trump?) is unpredictable. Moreover, we see PSU banks selling consistently - maybe locking in profit before year end.

OUR POSITION

Our view remains same - yields will fall. But with more volatility. So we remain long. But we will take more tactical calls in CY25.

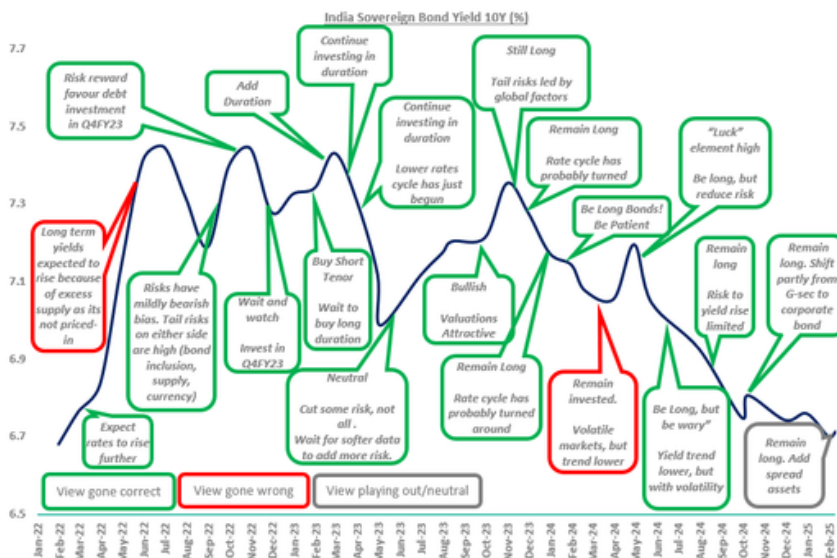
Strategic - Barbell: We prefer 20Y+ segment due to added duration and demand. We also like up to 5y corporate bonds as they will benefit from liquidity. We will switch to this barbell gradually.

Tactical - into 10Y: We will keep switching into 10Y Gsecs for short periods as RBI OMOs, will help 10Y Gsecs more.

DSP remains the fund house for those who have a view to buy bonds, but with risk in the rear view mirror.

Risks?

Rupee, and RBI stance spiking remain risks. But the major risk for us is US yields spiking up. In such lackluster & volatile market, US yields can be incendiary.



SNAPSHOT OF OUR VIEW

View complete DSP Converse presentation at dspim.com -> Tools and Resources -> Insights -> Converse

Q4FY25 Q1FY26 Q2FY26 H2FY26

RATES VIEW		Yields to move lower, though with some volatility.		SLIDES IN CONVERSE
MONETARY POLICY	INFLATION	Core inflation low. Worst in headline inflation is behind.	However, long term inflation visibility remains uncertain.	#13
	GROWTH	Weak growth	While growth is weak and may continue so, but there is uncertainty	#14
	CURRENCY	INR in freefall. Effect of Trump presidency still unpredictable.	Much uncertainty on global macros, risk appetite and capital flows	#9, #15, #16
FISCAL POLICY	SUPPLY	G-sec supply to end in Feb	FY26 budget to have higher supply than FY25.	#23, #24, #25, #26
	DEMAND	LIC joining the FRA bandwagon. Demand from RBI through OMOs to be significant in 2025		#23, #24, #25, #26
	FPI FLOWS	FPI inflows to be lesser (Bloomberg Index will be much smaller than JP). But at least no outflow.		NA
GLOBAL DRIVERS	COMMODITIES	Oil and other commodities have retraced to neutral zone. Future course difficult to ascertain.		NA
	GEO-POLITICS	Escalation of Ukraine, US-China and Gaza are uncertain as a lot hinges on Trump.		NA
	GLOBAL YIELD	Global rate cuts on pause.	Difficult to project macros too much in future	#7
OTHERS	ELECTIONS	Bihar elections might create political uncertainty, or fiscal slippage as JD(U) critical ally.		NA
	RBI REGIME	The most critical part of our analysis. RBI will have to increase the balance sheet. FX balance sheet may have tepid growth, and Rupee balance sheet will lead to need for OMO.		NA

- Why are the yields not falling?
- Is demand supply dynamics still good?
- How much and how long will the OMO last?
- But wait! Can't RBI continue FX swaps and VRR to infuse liquidity?
- So, are more RBI rate cuts expected?
- Is RBI Governor more important than macro data?
- So what will be our position ? Ans: Blended risk/reward.
- So, will rally of 2025 mimic 2024 rally, or will it be volatile?
- Why are the risks of US yields assymmetric? Ans: RBI's implicit put

Why are the yields not falling?

The good news is priced in! That's what you will hear in market.

But there is more to it. Let's break the good news.

One part of good news is RBI stance - rate cuts, liquidity & OMO.

Rate cuts are priced in.

But not liquidity. You can never price-in liquidity. When the liquidity hits the market, it leads to demand. Market cannot buy significant amount unless they have money with them. While traders can pre-empt and buy, but the quantum is going to be much insignificant compared to actual event of liquidity.

Same for OMO. When RBI consistently keeps buying, and the banks Gsec holding reduces that is when the banks will buy in markets and replenish the HTM. Traders can only position to some extent.

What about general demand/supply? Again, the demand supply does not get priced in, till the time mismatch actually occurs. And this year the demand will grow gradually rather than immediate one-time shock (like JPM index last year).

Finally, US yields and Rupee and global tensions are unknown risk. In such a scenario, the markets will wait for liquidity, OMO and demand supply to play out rather than pre-emp.

And so, we will see a bit of meandering yields, until they do not meander.

Is demand supply dynamics still good?

Yes.

PF/Insurance get maximum money in Q4 . Passive FPI inflows will continue, and active FPI outflows have probably run their course. The G-sec supply will be low as auction will end after Feb.

Next quarter FRA by insurance should increase, led by LIC which seems to have entered the market.

Lastly, the JPM Index flows will cease after March, but Bloomberg Index inflows (though sharply lower) will buffer the loss.

RBI will have to do significant OMO to replace the lost FX balance sheet with Rupee balance sheet. This will tip the demand/supply firmly in favor of the demand.

A time will come when India will see significant FX inflows, At that time RBI will reduce OMO. But that time is not now.

We see next few months demand/supply to be quite good.

How much and how long will the OMO last?

Lets put some numbers in perspective.

Currently the core liquidity (banking liquidity + govt cash balance) is near zero.

In a year we lose Rs. 2.5 lac cr. of liquidity to currency in circulation.

And we will lose Rs. 1.5 lac cr of liquidity as RBI's holding of GSEC expire.

If we have a decent Balance of Payment of say 10 billion dollars That means we get Rs. 1 lac cr. of inflow in liquidity. While a higher number is possible, but its too early to play for it. Especially, since stable FDI has reduced significantly and impact of Trump is unlikely to be hugely positive. In fact lower number is equally possible.

And RBI may give dividend of Rs. 2 lac cr, leading to that liquidity infusion.

That means that the net inflow and outflow by and large net off.

So, if RBI has to make surplus liquidity of Rs. 2 lac cr, OMO is the only option.

But wait. RBI has done long term VRR and FX swaps to the tune of Rs. 1.5 lac cr. These will expire next year. While RBI can again issue them, but its more possible that RBI would want to replace it with durable OMO.

Thus, RBI will have to infuse OMO for

- Targeted Rs 2 lac cr. of core liquidity
- Replace Rs. 1.5 lac cr. of FX swaps/VRR
- Infuse Rs. 1 lac cr. of filling the gap of CIC, maturing Gsec, dividend and BoP

That's comes to Rs. 4.5 lac cr of OMO. The number will of course not be exactly this - there are too many moving parts. But this is the anchor that we will work with.

But wait! Can't RBI continue FX swaps and VRR to infuse liquidity?

No. Not as a structural solution.

Because RBI needs to give permanent liquidity. If RBI were to do VRR or FX swaps, it infuses transient liquidity - only as long as the swaps or VRR unwind.

While it is ok to extract transient liquidity through FX swaps and VRRR (as RBI did post-covid), but it is risky to use the mirror tools to infuse transient liquidity.

Unless acted on by RBI, the liquidity keeps tightening as a trend. Thus, when the temporary liquidity through VRR or FX swaps expires, RBI may be faced with a headache of infusing not just (i) the expired liquidity, but also (ii) the natural trend liquidity tightening.

For the same reason, RBI could tighten temporary liquidity through VRRR last year, because of natural liquidity tightening with time.

However, it is not that RBI will not take temporary liquidity actions. It will continue to use it during advance tax, or bridging the gap to dividend payouts.

It's just that these cannot be structural solutions.

Note: Large scale FX swaps also have collateral damage of reducing forward points, reducing FX with banks and disincentivizing exporters to hedge.

So, are more RBI rate cuts expected?

Yes we do expect, but a large part depends upon the growth dynamics.

If real growth comes at 6.7% (RBI expectations) then the chances are not very bright. But we believe that there are downside risks to this number.

Especially, when rupee is not the primary driver under Gov. Malhotra. With rupee largely allowed to depreciate, the necessity to keep interest rates high is much lower.

Moreover, if global growth also reduces, then the chances are bright.

But having said so, even the fixed income markets are expecting rate cuts. There is 67% probability priced in by OIS market for a rate cut in next policy. And no more after that for the rest of the fiscal year.

However, we believe that under the current RBI regime the tail risks are that RBI will have to do more rate cuts. Especially, if growth falters.

Is RBI Governor more important than macro data?

Yes and always!

We have always maintained that predicting macro variables is a fools errand. And even if you are able to predict (?) what is more important is RBI Governor's thought process.

Thus under same constraints on BoP, inflation, growth - Gov. Das took different decisions than Gov. Malhotra.

That is to be expected. Its true for other central banks too.

People put too much thought to GDP, CPI, rates etc.

Eventually what matters is the RBI regime - and current regime is dovish.

So what will we position for? Blended risk/reward.

We don't know how much more rate cuts will come, when - sooner or later - or whether deep or shallow.

However, OMO will come and will be sizeable - even if the size will be dependent upon the FX flows.

Nonetheless, rate cuts, OMO, and liquidity infusion will continue.

At base case, maybe RBI actions will be as dovish as market expectations.

Strategic Position: Barbell with 30y Gsec and ~3Y Corporate Bond

The thing about demand is that it does not impact the market till the time the demand actually hits the market.

Why ~3y corporate bonds? The higher liquidity (when it comes) will lead to a rally in short tenor corporate bonds. These bonds have still not rallied as much, thanks to the continuation tight liquidity. But RBI has shown its intent to push in liquidity, and its a matter of time when these bonds rally.

Why 30Y Gsec? The share of ~30Y Gsec in the total borrowing is much higher than any other country. The risks of higher long term borrowing is quite high if India's nominal GDP stutters few years/decades down the line. Thus, we believe that the issuances of 30Y paper may not increase at same rate as in past. And even if it does, 30Y demand is still robust due to the (i) entrance of LIC in FRA world, and (ii) natural growth of PF, NPS, Insurance.

Tactical Trade: Opportunistically enter and exit 10Y

OMO will lead to rally in 10Y. Firstly, RBI is purchasing 10Y paper - be it in through auctions, or secondary market purchases. Secondly, when RBI purchases other bonds in OMO auctions, the sellers are the bank HTM books. These books will purchase 10Y paper, if not now then a bit later.

Thus there will be off-and-on opportunistic (not core position) trades in 10Y.

In summary, the blend of short term corporate papers and long term Gsec enhances risk reward with a mix of accrual and capital gains. Finally, in a volatile year it is important to hit-and-run at times in the 10Y Gsec.

So, will rally of 2025 mimic 2024 rally, or will it be volatile?

Volatile. Much more volatile.

Why?

Because 2024 rally was driven by market demand/supply mismatch: It was driven by “non-discretionary” demand - regulatory/balance sheet/index demand.

Year 2025 rally should be driven largely by rate cut expectations. The market demand/supply mismatch is much lesser. Thus rally will be driven by “discretionary” demand - investors looking for profit, and not regulatory needs.

What is the difference between these rallies?

The “discretionary” based rally is more volatile and front-loaded than “non-discretionary” based rally due to “market efficiency”.

Why?

Because if a rally is led by traders (discretionary), then the market prices-in new data quite quickly.

On the other hand a balance sheet/regulatory demand hits market at its own pace, and while traders can at times front run it, but their volumes cannot sustain the rallies. Mostly the yields falls at its own pace as and when the demand flows in.

Moreover as yields have already gravitated closer to repo rate, there will be more resistance to yield fall - leading to volatile path.

Thus in 2024 large part of bond inclusion rally occurred only after inflows. The rally was largely one sided, with few hiccups.

Year 2025 should see a different type of rally. Markets will efficiently price changes in data. This will mean more volatility as market swings with data swings. This will also mean frontloading of expectations (inlike CY25 when major rally occurred after inclusion).

Why are the risks of US yields asymmetric? Ans: RBI's implicit put

How do US yields impact our yields.

1. The Indian traders short/sell Indian bonds - looking for quick gains.
2. The FPI sell India as they find (i) more lucrative debt markets elsewhere, or (ii) risk-off sentiment globally and flight of capital to home, or (iii) higher cost of capital.
3. FPI sell-off in other rupee assets (equity, FDI etc.) and lower external commercial borrowing (ECB) leading to rupee depreciation. This may lead to more hawkish RBI.

This time there is low risk of FPI exiting India debt (like it happened in Q4CY24). There is hardly any hot FPI money left in Indian bonds anymore. The major money is passive - and its not going to go out so easy.

Indian traders are quite light - and even if they do sell a Rs. 40,000 cr. OMO is enough to absorb their shorts.

The exodus from other rupee assets is quite likely. This will put pressure on currency. And thus a bit negative for yields. However, we have see that this RBI regime is less worrisome than the previous one, and the likelihood of rupee risk percolating to the rates is much lesser.

Lastly, there is one positive aspect of higher US yields. Higher FX outflows from India (other assets) means that RBI will need to sell the dollars and shrink its balance sheet, It will need to do OMO to replenish the balance sheet - thus providing an implicit put on Indian bonds.

Thus higher US yields will impact India. After all, global markets are correlated. Its just that they will impact much lesser and asymmetric - especially after the announcement of RBI's OMO.

DSP

#INVESTFORGOOD

February 2025

Remain long – but add spread assets

Volatile yields: low risk of spike

DSP CONVERSE



Our Framework

Monetary Policy

Inflation

- Jan CPI at 4.31% (P 5.22%)
- Core CPI comfortable at 3.7%
- Food prices eased sequentially
- *RBI comfortable with inflation*

Growth

- Tepid govt capex & urban consumption
- Credit losses in unsecured loans
- Credit growth continues to moderate
- *RBI: paying attention to slower growth, and liquidity*

Currency/CAD/BOP

- Stable brent, thus CAD not a worry
- Stronger INR has not protected FPI outflows – so why keep it?
- Weaker INR keeps exports competitive
- *RBI: Change from old regime, Rupee is market driven so risks not to hit debt 'for now'*

Fiscal Policy

Supply

- G-sec auction to end in Feb
- FY26 Gsec borrowing low (although slightly higher vs expectations)
- No increase in T-bill supply
- SDL supply to remain muted
- *RBI: Old regime put a large issuance in 20y+ bonds. Probable reduction in H1FY26*

Demand

- Non-discretionary demand adequate to absorb supply in FY26. Delay in LCR norms led to some disappointment
- Demand from RBI OMO to be significant in CY25
- FPI demand to lessen, but outflows unlikely
- *RBI: After RBI's new stance on liquidity, OMO purchases to be large*

Miscellaneous

Global Yields

- Risks evenly balanced:
 - US FED rate cuts on pause
 - FF Futures: No rate cut for next 4 policies
- Difficult to project macros much in future

Geopolitics

- Protectionist trade policies seem priced-in
- Uncertainty in Ukraine, US-China & Gaza
- Risks emanate from Trump uncertainties

Commodities

- Prices have hardened

Positive

Negative

Neutral

Takeaway:

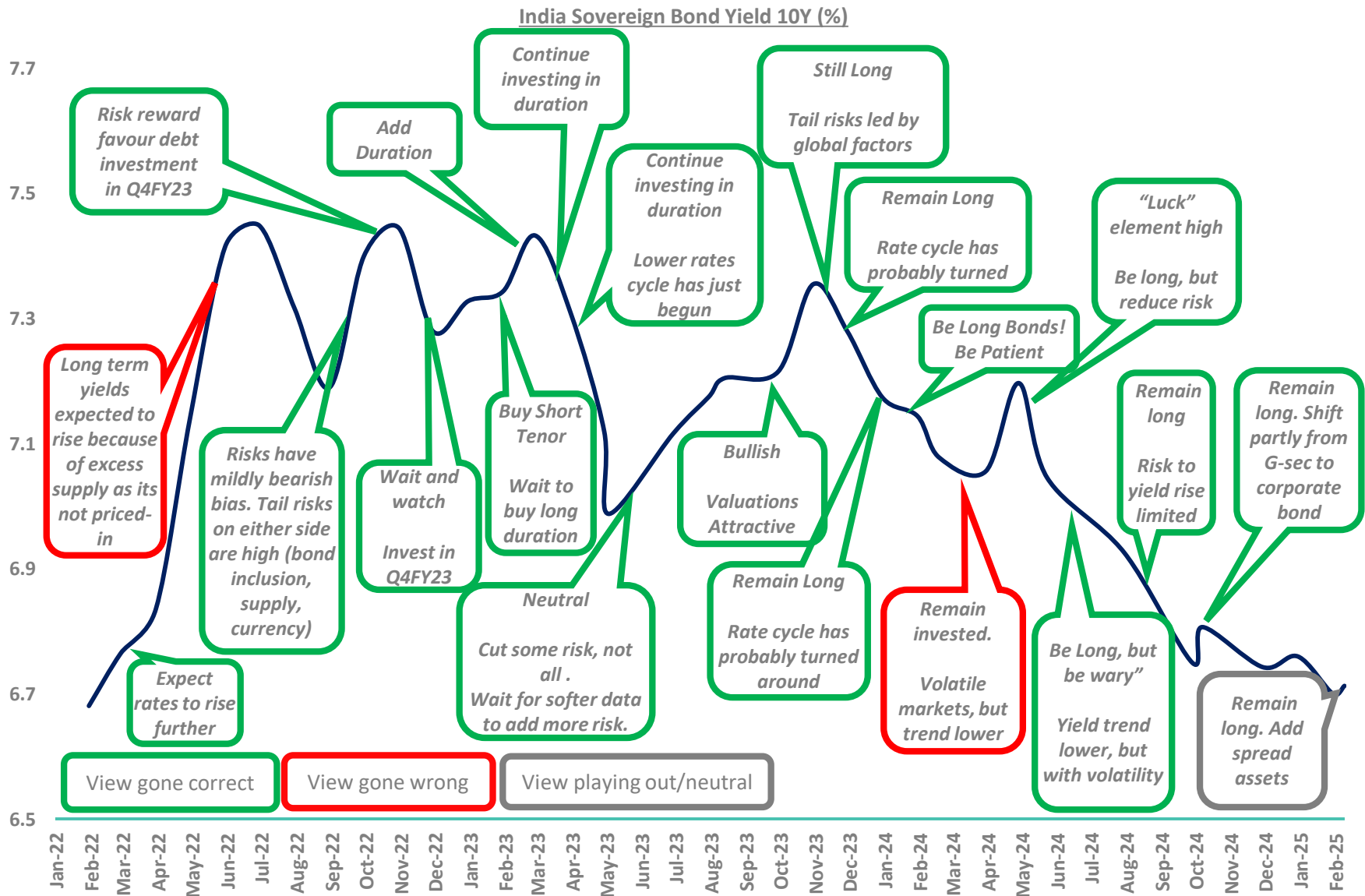
Domestic macros supportive of lower yields amidst geopolitical uncertainty and Fed willing to maintain policy restraint for longer

Be Long

1. Domestic **macros** support lower yields
2. Comfortable **demand/supply** dynamics
3. Fed has already cut by 100 bps. **Expected to pause in the near future**
4. RBI delivered its **first rate cut**

Let's revisit our rates call trajectory

TRAJECTORY



To start with,

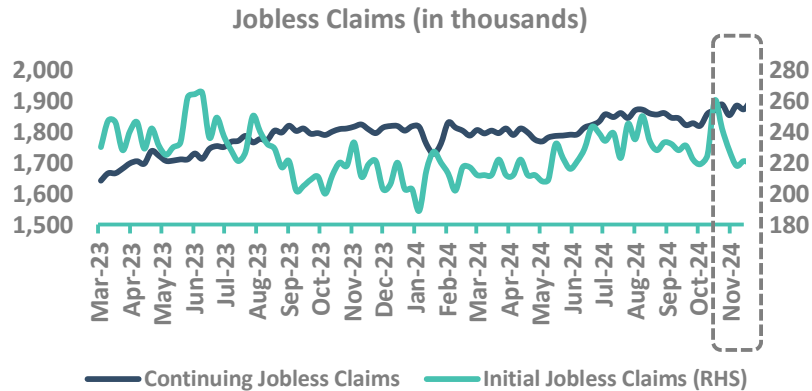
**Recap of events since last
DSP CONVERSE release**

1. Fed to **pause** for now
2. RBI **cuts Repo rate** by 25 bps
3. Budget FY26 released – **lower fiscal deficit**
4. INR has **depreciated**, still looks **expensive**

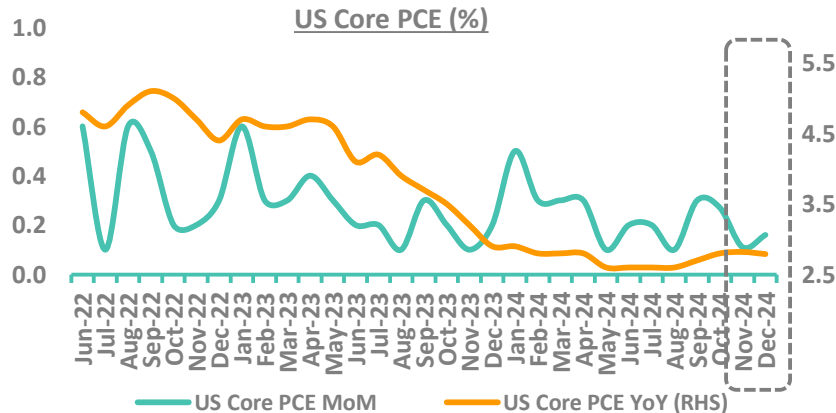
A "patient" Fed watching data

WHAT HAS CHANGED

➤ The US labor market tightness easing gradually



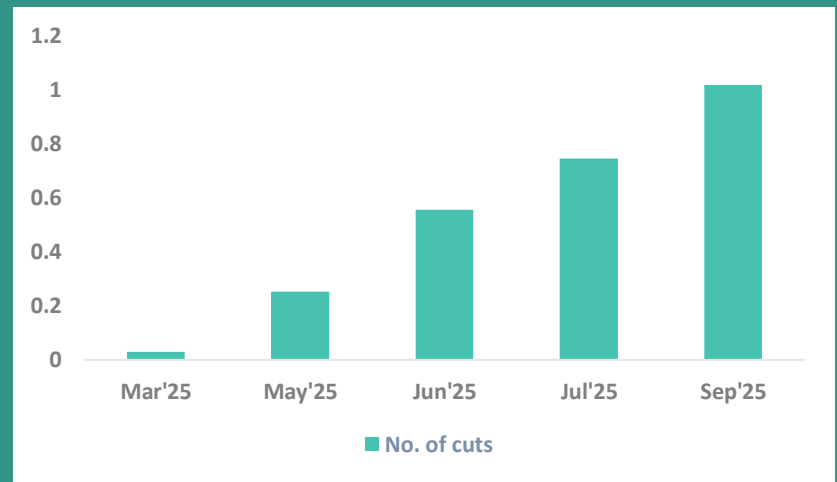
➤ Last mile inflation battle still ongoing



➤ Fed Funds Futures not pricing any rate cut for next 4 policies

➤ With policy stance now less restrictive, Fed in no hurry to further adjust its policy stance

➤ Can maintain policy restraint for longer if inflation doesn't move sustainably towards 2%

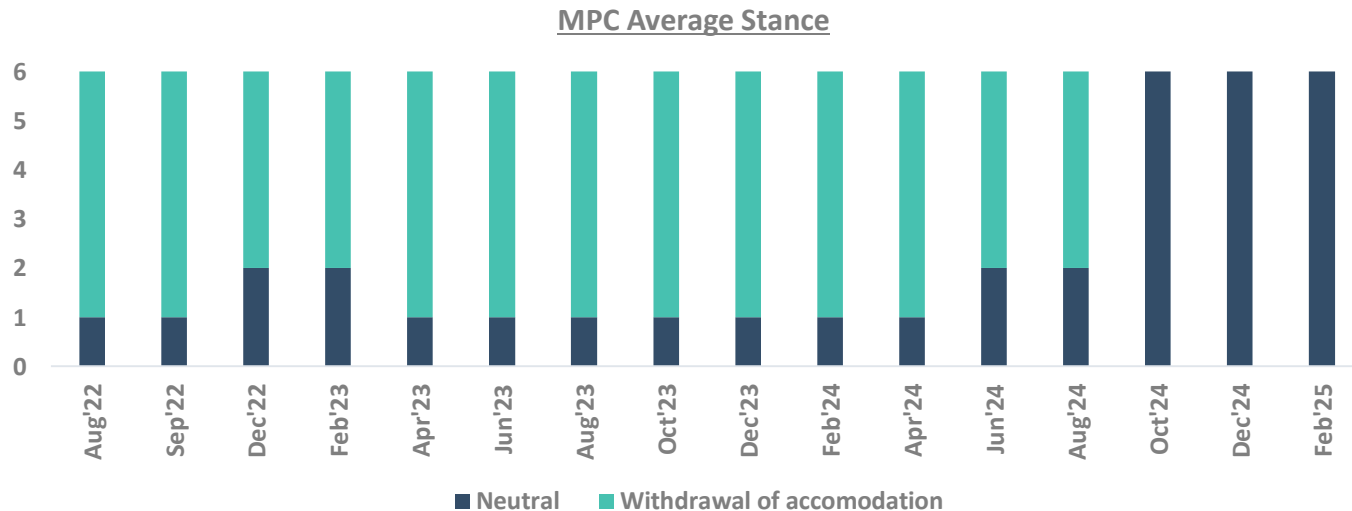


Takeaway:

Fed to be in wait and watch mode for now

RBI delivers its first rate cut

- REPO rate reduced by 25bps to 6.25% and stance unchanged at “NEUTRAL”
- CPI projections for FY25 unchanged at 4.8%
 - ✓ Good kharif production and favorable rabi crop prospects
 - ✗ Volatility in energy prices and continued uncertainty in global financial markets
- Real GDP growth projection for FY26 at 6.7%
 - ✓ Healthy rabi prospects, expected recovery in industrial activity and household consumption aided by tax relief
 - ✗ Volatility in commodity prices and protectionist trade policies



Takeaway:

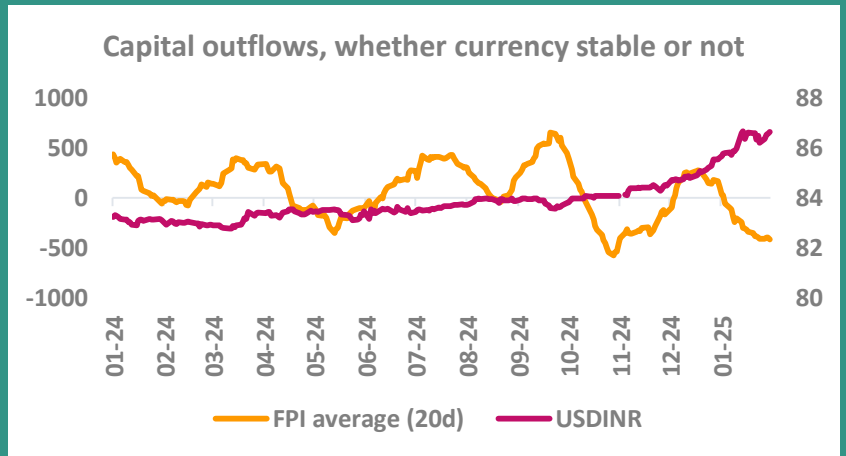
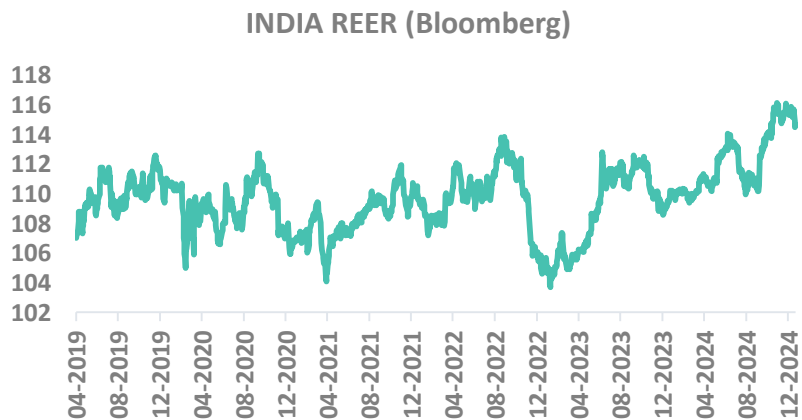
Regime Change: New Governor more dovish. Rate cut announced despite INR depreciation

Why is RBI letting rupee depreciate? *Governor dependent!*

WHAT HAS CHANGED

- Because rupee was very expensive
- India REER near all time high
 - Even after INR depreciation, it remains expensive
- Expensive Rupee hurts exports
 - Even though it reduces imported inflation

- Expensive rupee didn't protect capital outflows in Q4CY24
 - Rupee depreciation, or not -> FPI outflows occur
- With Brent stable and CAD not a worry, imported inflation to occur, but less worrisome



Takeaway:

Domestic growth seems to be slowing, but seasonal factors also played a role. Watch for post festive season demand.

Now our framework

And

What we track

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Takeaway:

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Growth remains tepid

Inflationary pressures seems contained

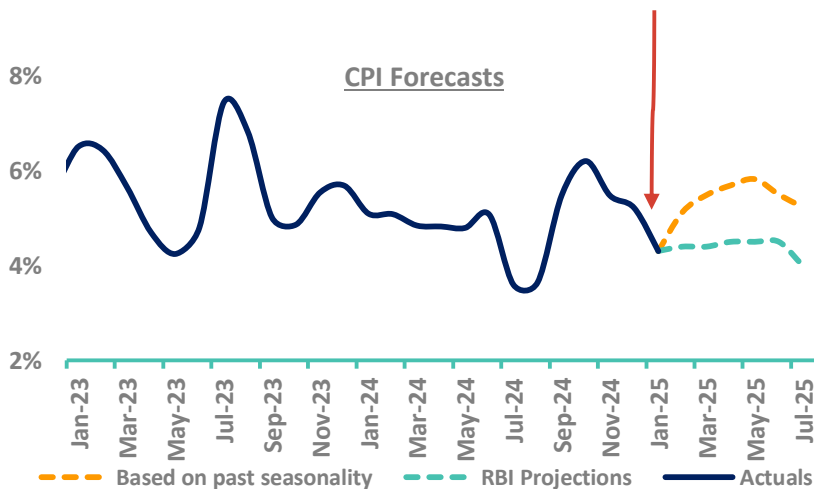
RBI delivered 25bps rate cut

Core CPI remains comfortable. Risks seem contained

➤ CPI risks remain muted

- Jan CPI moderates further to 4.31% vs 5.22% in Dec
- Led by sharp sequential decline in food prices
- Vegetable & pulses price continue to show softening trend

➤ Core inflation inched up marginally to 3.7% led by Gold prices, still remains comfortable



➤ Do yields track inflation projection? No.

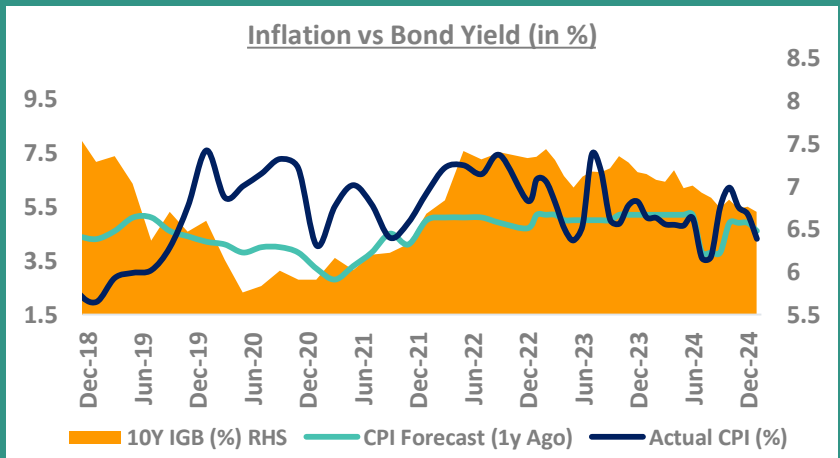
- Orange area (chart) is 10Y yields, Blue line is CPI

➤ Can forecasters predict Indian CPI? No.

- Green line is forecasters CPI 1-Yr ahead prediction
- Blue line is where inflation actually came
- Guess the error of margin!

➤ CPI forecast correlated (not causality) to yields

- Low predictive power, high current correlation



Takeaway:

Domestic inflation risks seem contained enabling a dovish policy

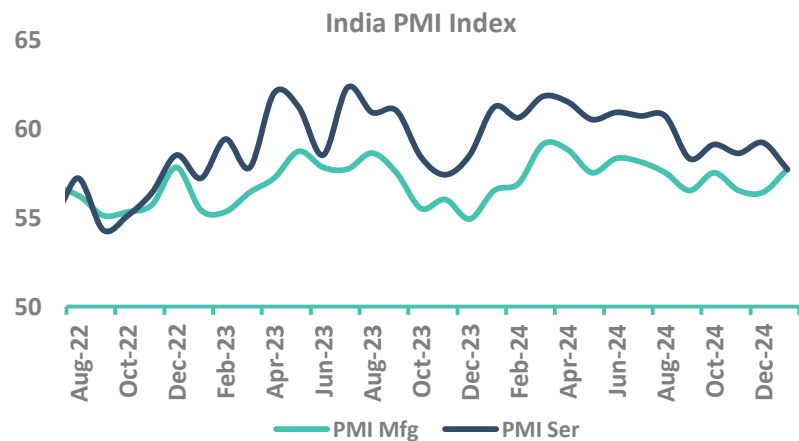
Domestic growth hits rough patch: remain watchful

➤ Watch out for domestic growth

- Tepid Govt capex till Nov (46% of BE vs 59% last year). December growth better with 9m utilization at 62% vs 67% last year
- Consumption demand weak as unsecured retail loans seen credit losses – lenders to be cautious

➤ Credit growth continues to moderate

- Unsecured PL (10% YoY vs 23% YoY PY) and loan to NBFCs (7% YoY vs 15% YoY PY) have moderated
- Housing loan growth moderated to 11% vs 35% PY
- Credit to industry has remained stable at 7.2%

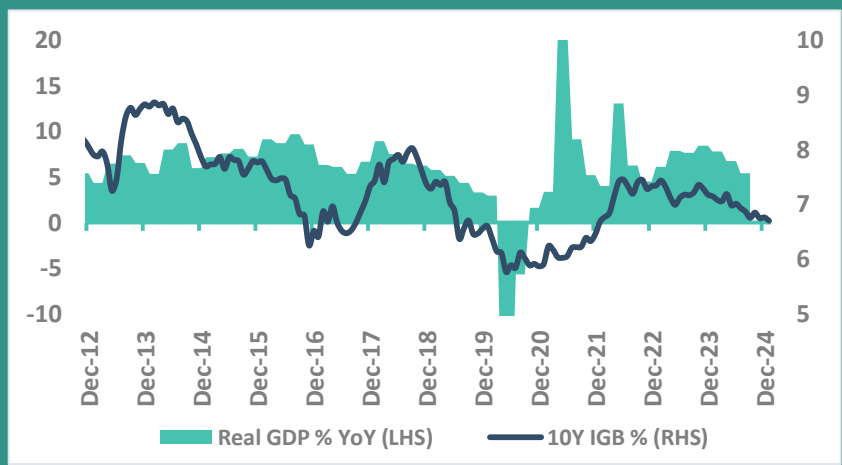


➤ How closely do yields track growth?

- Yields have usually tracked GDP growth, with correlation stronger when growth slows, barring
 - ✓ 2013, rupee depreciation and debt outflows
 - ✓ 2017, during demonetization

➤ FY26, growth may not be big driver for yields

- Q2FY25 GDP Growth came in at 5.4%.

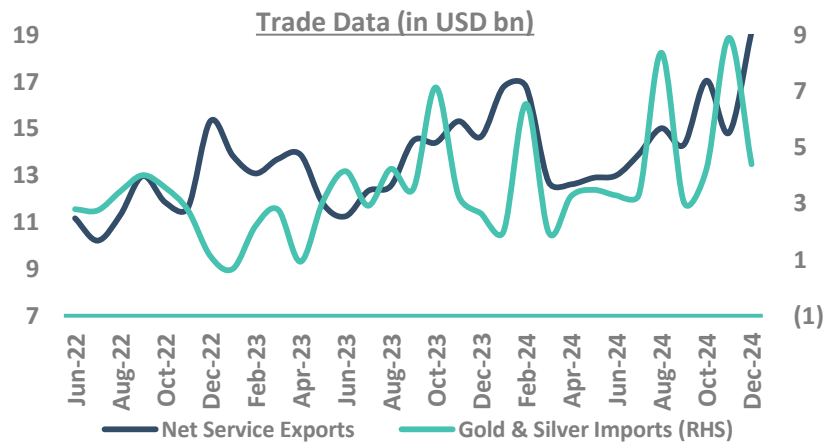


Takeaway:

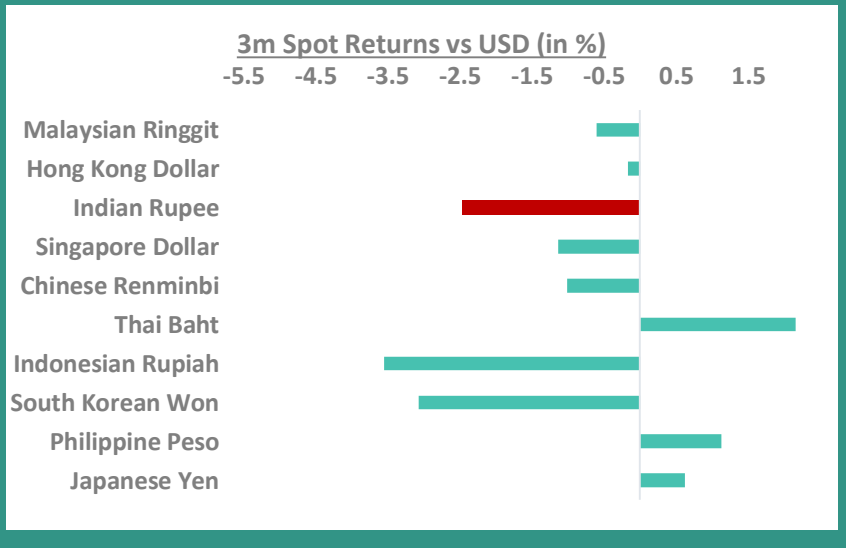
Growth again hits a rough patch post festive season pick-up

External sector metrics remain volatile – but not a worry!

- **FX reserves have declined to \$638 bn from record high levels from \$700 bn**
- **Jan trade deficit widens to US\$23 bn**
 - As exports fell 2.4% YoY while imports grew by 10.3% led by gold and electronics
 - Services trade surplus continues to hold steady



- **Rupee has lost value as compared to its Asian counterparts**

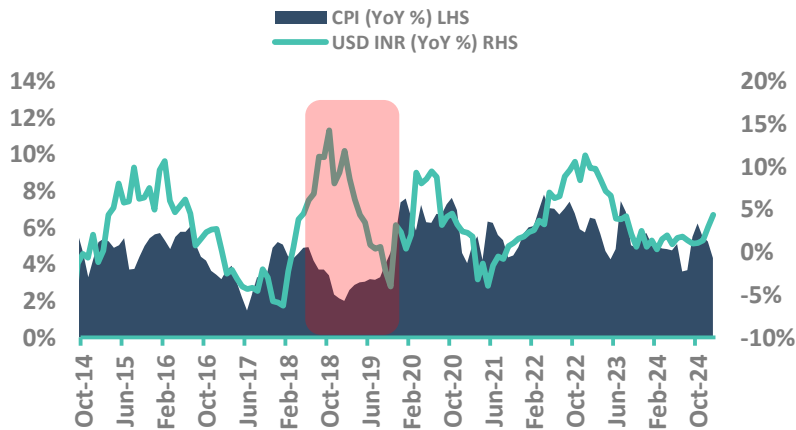


Takeaway:
Forex reserves still at comfortable level. But watch-out for further currency depreciation

Rupee depreciation to pose mild inflationary pressure

Rupee and Inflation have a strong correlation

- There is a strong correlation between rupee movement and CPI (barring 2018-2019)
- Reaffirms that India bears risk of imported inflation
- India CPI to face upward pressure due to higher rupee

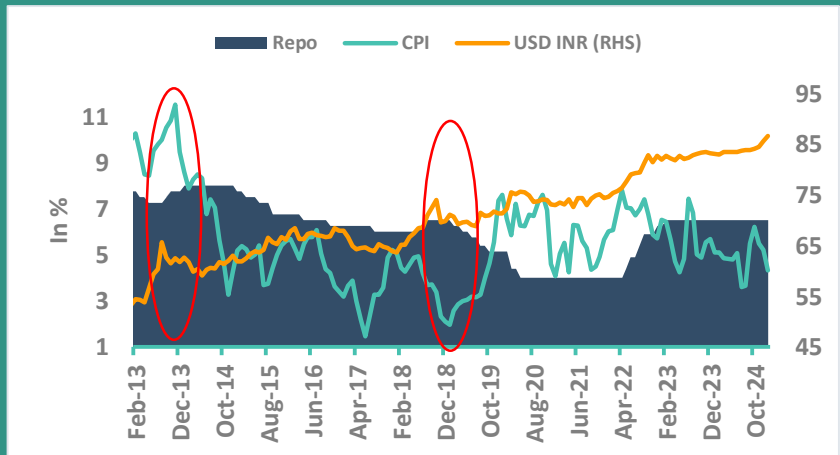


RBI has in past acted swifter to protect currency than inflation

- In 2013 and 2018 RBI increased rates when rupee depreciated
- In 2018, inflation was within RBI's target levels

This time it's different?

- RBI comfortable with notion of (orderly) INR depreciation) and yet provide rate/liquidity succour
- Volatile geopolitics may affect BoP in the near term
- Global yield movements key

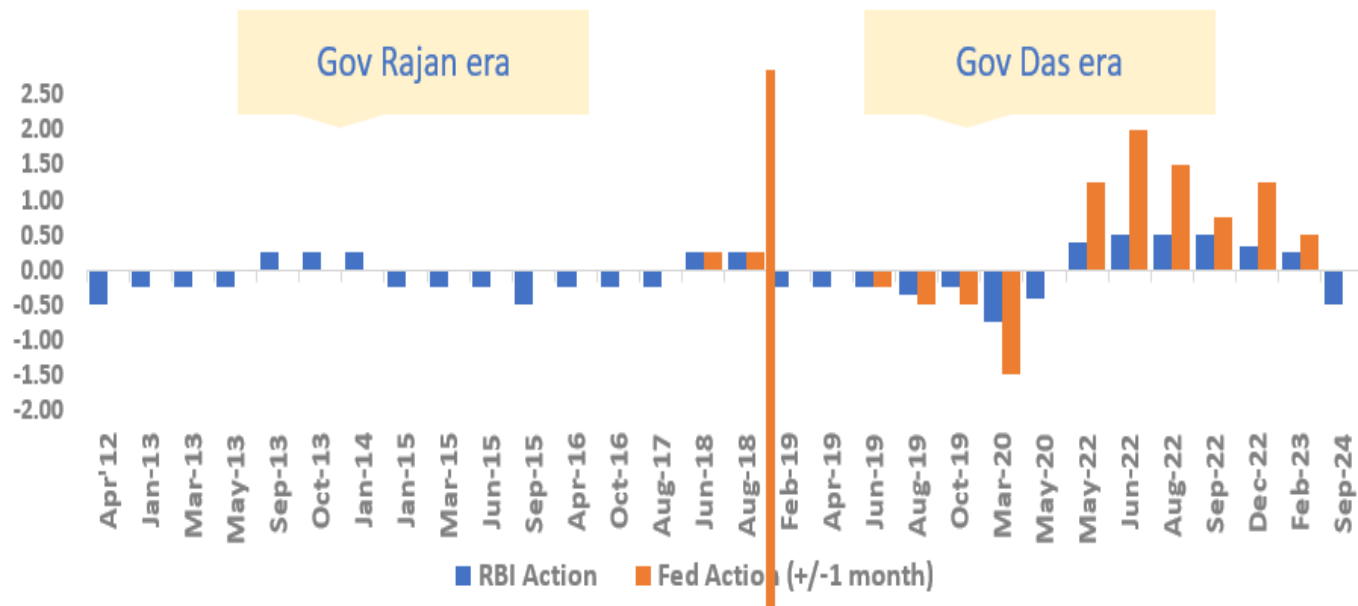


Takeaway:

RBI to look through imported inflation unless it becomes extreme

RBI is (as other central banks) driven by the Governor

- Governor Rajan and Governor Das had different decisions based on same data
- Governor Malhotra has hitherto been more dovish based on same data



Core CPI remains comfortable

Growth hits a soft patch

RBI has begun with **rate cut**

Generally, it drives the long bond yields

It is reflected in demand/supply equation

Fiscal policy is favouring bonds right now

**Only a small part of bond buyers are
discretionary buyers**

They drive yields

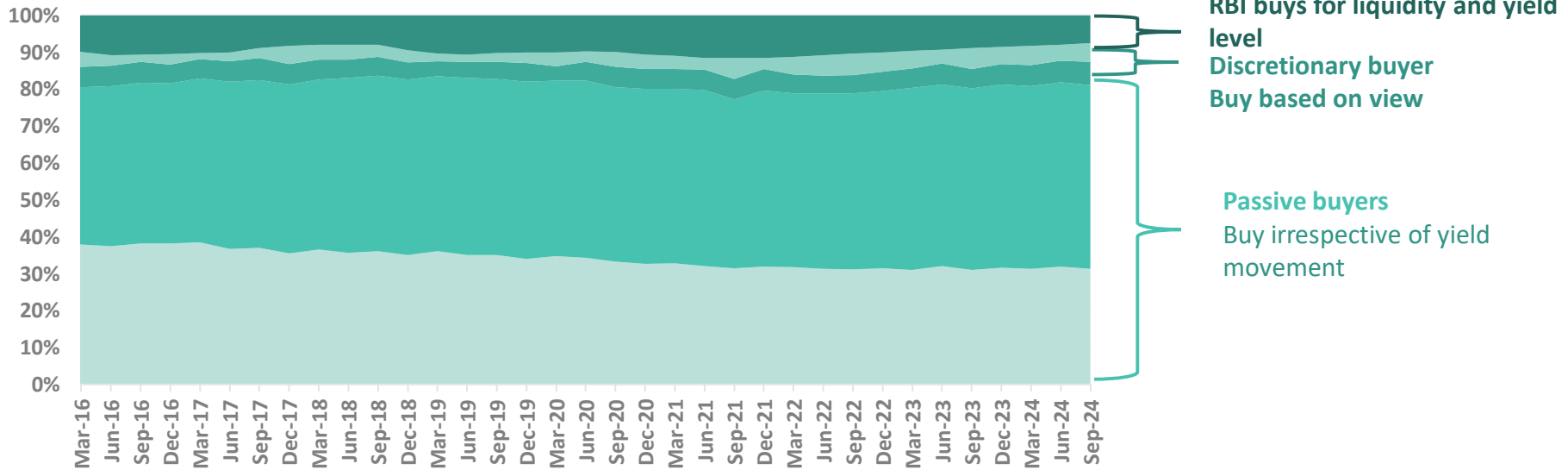
Supply fluctuation is borne by these buyers

Gsec market is still driven by lumpy institution purchases

FISCAL POLICY

Gsec +SDL Holding

- RBI
- Banks excess holding
- Dynamic (PD, MF, FPI, FI)
- Passive (Insurance, Coop Banks, Corporates, PF, Others)
- Banks LCR demand



Takeaway:

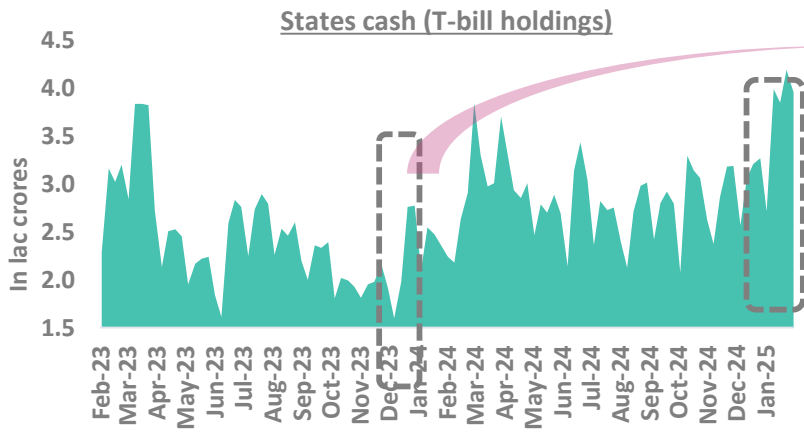
Increase in supply impacts the discretionary buying. Banks excess holding, passive buyers have been absorbing the supply

Comfortable demand/supply dynamics for FY26

SDL supply only increases when states cash dip

➤ **FY26 borrowing also expected to remain comfortable due to**

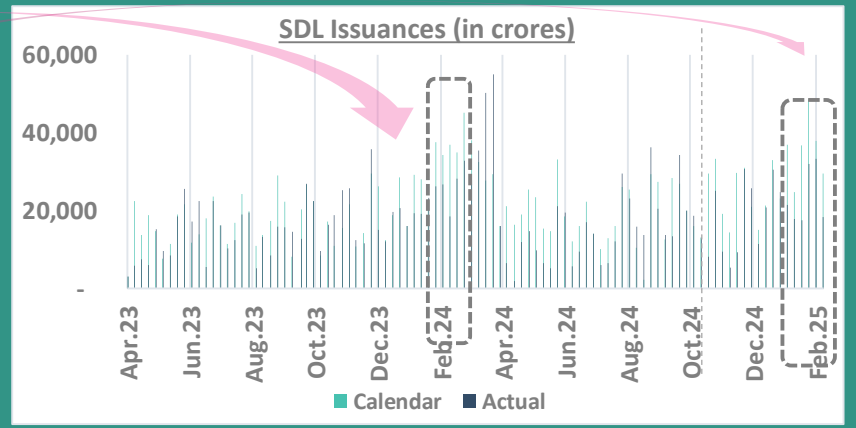
- High cash balance with states at ~4 lac crores
- No elections next year



➤ **Actual SDL borrowing in line with expectations**

- Borrowing higher than the calendar only when state cash balances dipped
- YTFY25 issuance 26% lower than calendarized
- For Q4FY25 its 35% lower so far

➤ **With high states cash balances SDL issuance impact is expected to be limited**

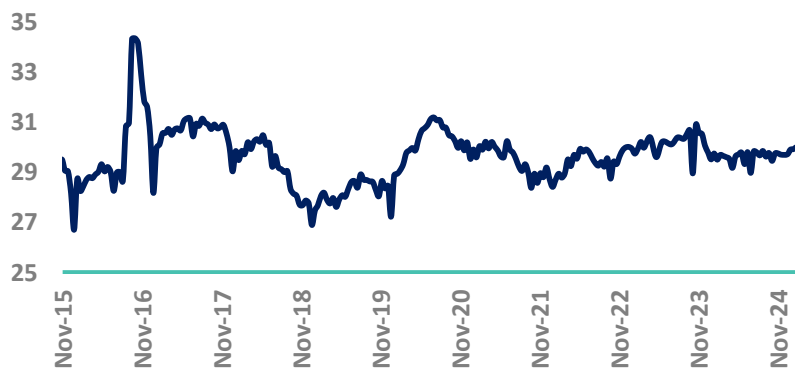


Takeaway:
SDL demand-supply to remain well-matched in FY26 as well

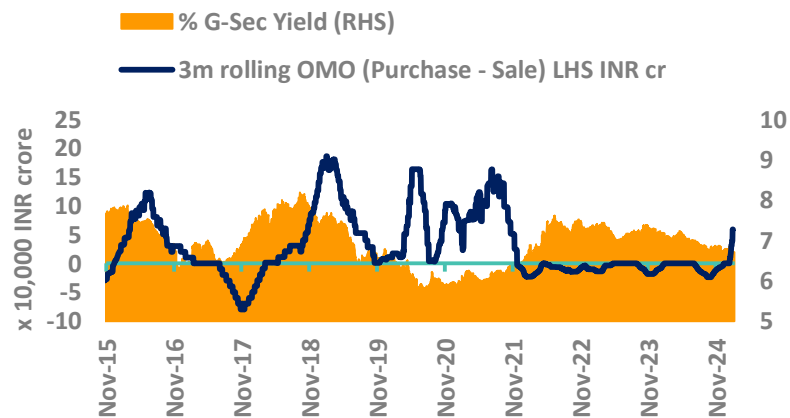
Banks SLR holdings has increased again

- **Banks SLR holdings has increased to 29.98%**
- **The current pace of purchases is expected to continue**
 - As natural NDTL growth will still lead to demand
 - Market will look past the delay in LCR implementation norms

Banks SLR (in %)(SCBs Investment-Deposit Ratio)



- **Yields usually track RBI OMO purchases**
 - Yields have strong correlation with RBI OMO
 - Demand/Supply mismatch is filled in by RBI
- **RBI willing to provide both structural and frictional liquidity**
 - OMO purchases of INR 1.37 lac crs and may do more
 - Buy/sell FX swaps, Overnight VRR & Term VRR



Takeaway:

NDTL growth will lead to Bank's demand and RBI's rupee balance sheet increase will necessitate OMOs

FY26 Gsec supply only marginally higher vs expectations

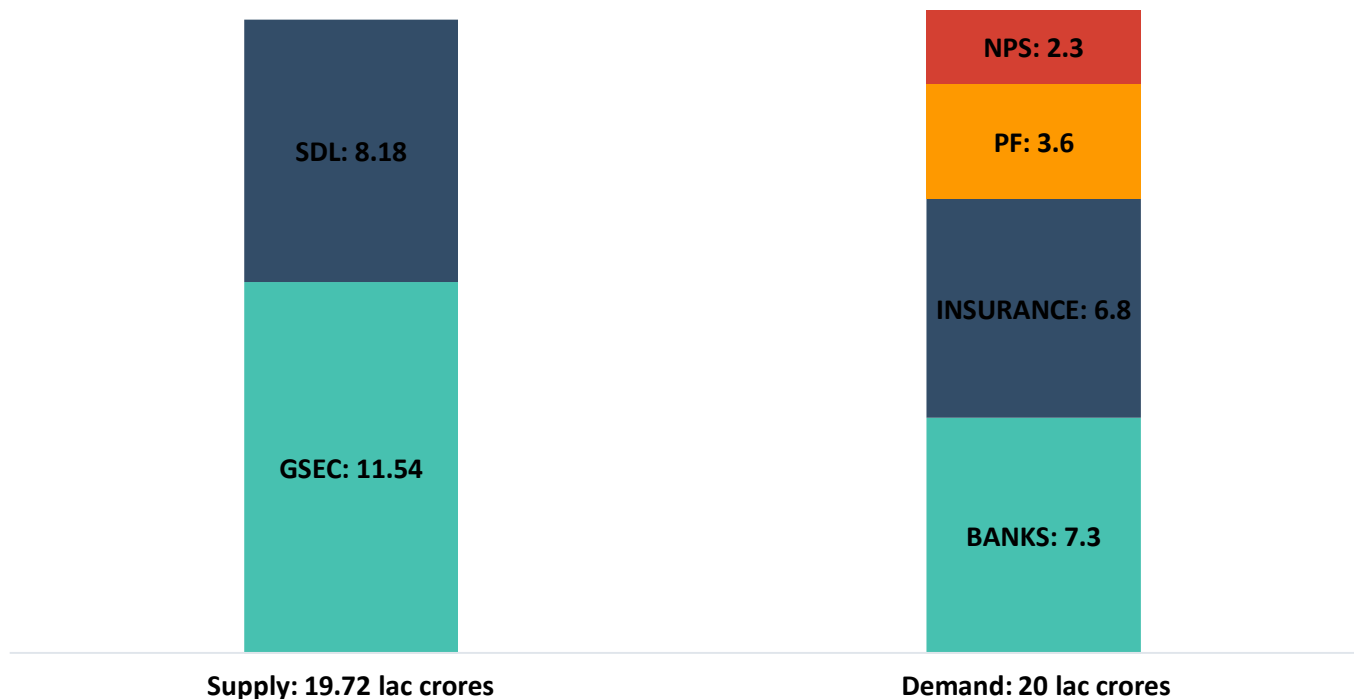
- Supply increases by just 6%
- But demand by greater than 10%
- Bond demand/supply still favorable
- Not accounting for RBI OMO

	2023-24	2024-25	2025-26 (DSP estimates)	2025-26 (B)
Funding of fiscal deficit				
G-sec Market Borrowings	11,77,754	11,63,182	11,75,000	11,53,834
G-sec Gross Borrowing (add redemption)	15,43,000	14,01,000	14,30,000	14,82,000
Short term Borrowing (T-Bills etc.)	53,205	-1,00,000	50,000	-
Securities against Small Savings	4,51,399	4,20,063	4,20,000	3,43,382
State Provident Funds	5,070	5,000	5000	5,000
Other Rcpts (Internal Debts & Public Acct)	83,293	-81,282	-50,000	40,746
External Debt	55,121	15,952	16,000	23,490
Draw Down of Cash Balance	-1,72,172	1,42,172	0	2,484
Fiscal deficit	16,53,670	15,65,087	16,16,000	15,68,936
Fiscal deficit (in %)	5.60%	4.80%	4.50%	4.40%
Nominal GDP Growth			10.50%	10.10%

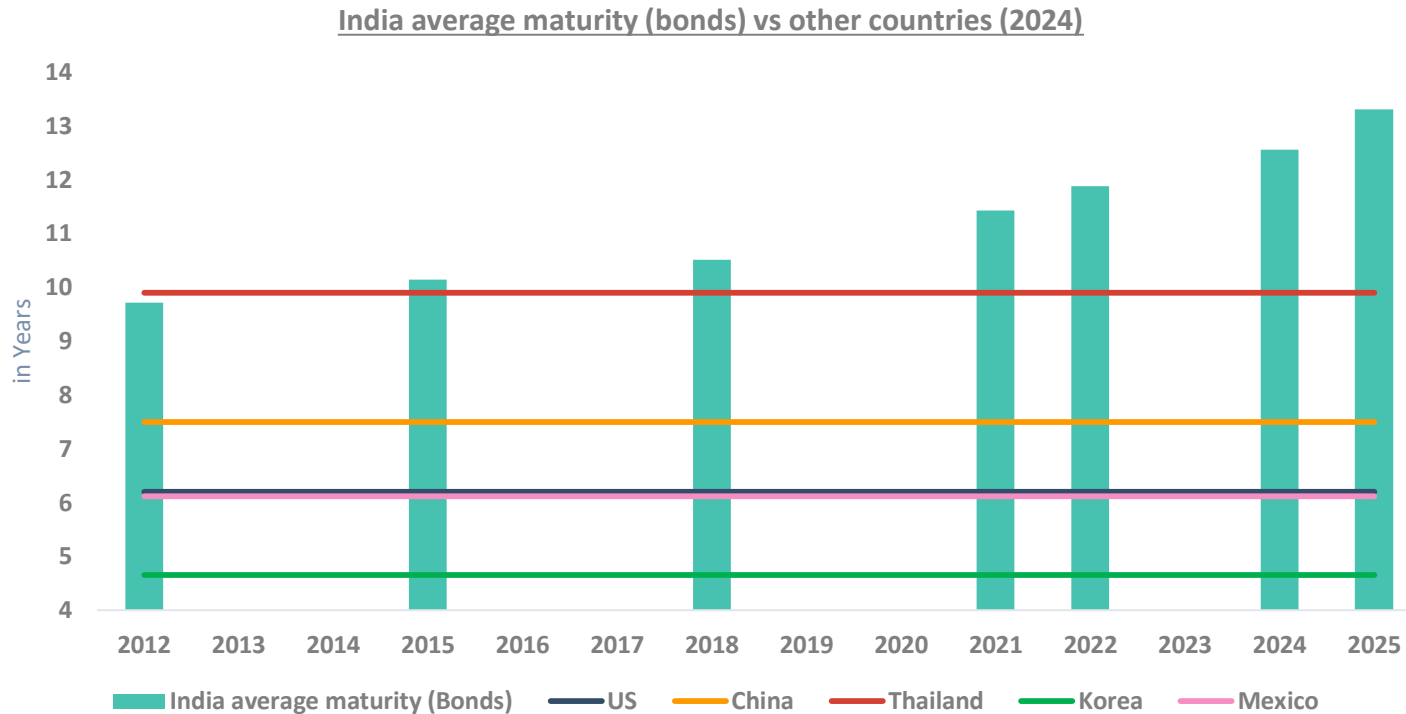
Non-discretionary demand sufficient to absorb FY26 supply

➤ Demand to outpace supply in FY26 as well

- ✓ G-sec *plus* SDL supply (internal estimates) is higher only by 1.5% over FY25
- ✓ Natural demand to come from non-discretionary buyers like Insurance, PF, NPS, etc.



Takeaway:
Demand-Supply favourable in FY26



We could see further steepening for next few days

- But we do not expect the H1 calendar to be harsh on long term bonds
- We expect RBI to ease the long bond supply in H1, leading to spread compression.

For asset manager longer end is better even in a bull steepening scenario

Indian yields tracking Global yields

But with lopsided beta lately!

Indian yields driven by US Fed and not US Fiscal

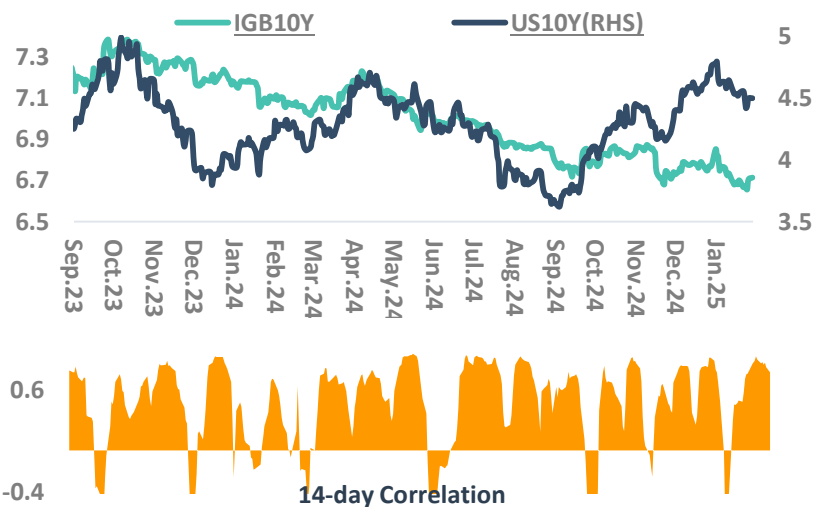
GLOBAL DRIVERS

➤ So far Indian 10Y yields tracked US 10Y

- Except for times when UST has risen sharply

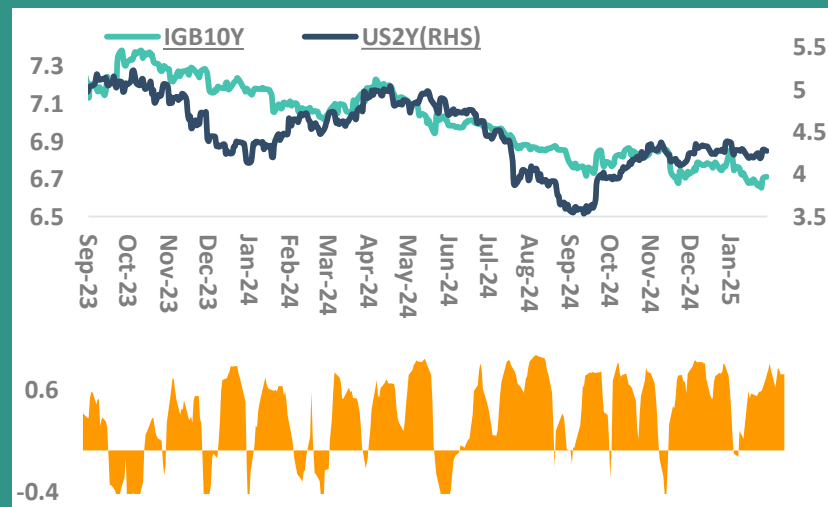
➤ Correlation only broke due to RBI actions

- Higher yields -> OMO announcement (Oct'23)
- Lower yields -> Liquidity infusion - VRR (Dec'23)



➤ Going forward, India 10Y to track US 2Y

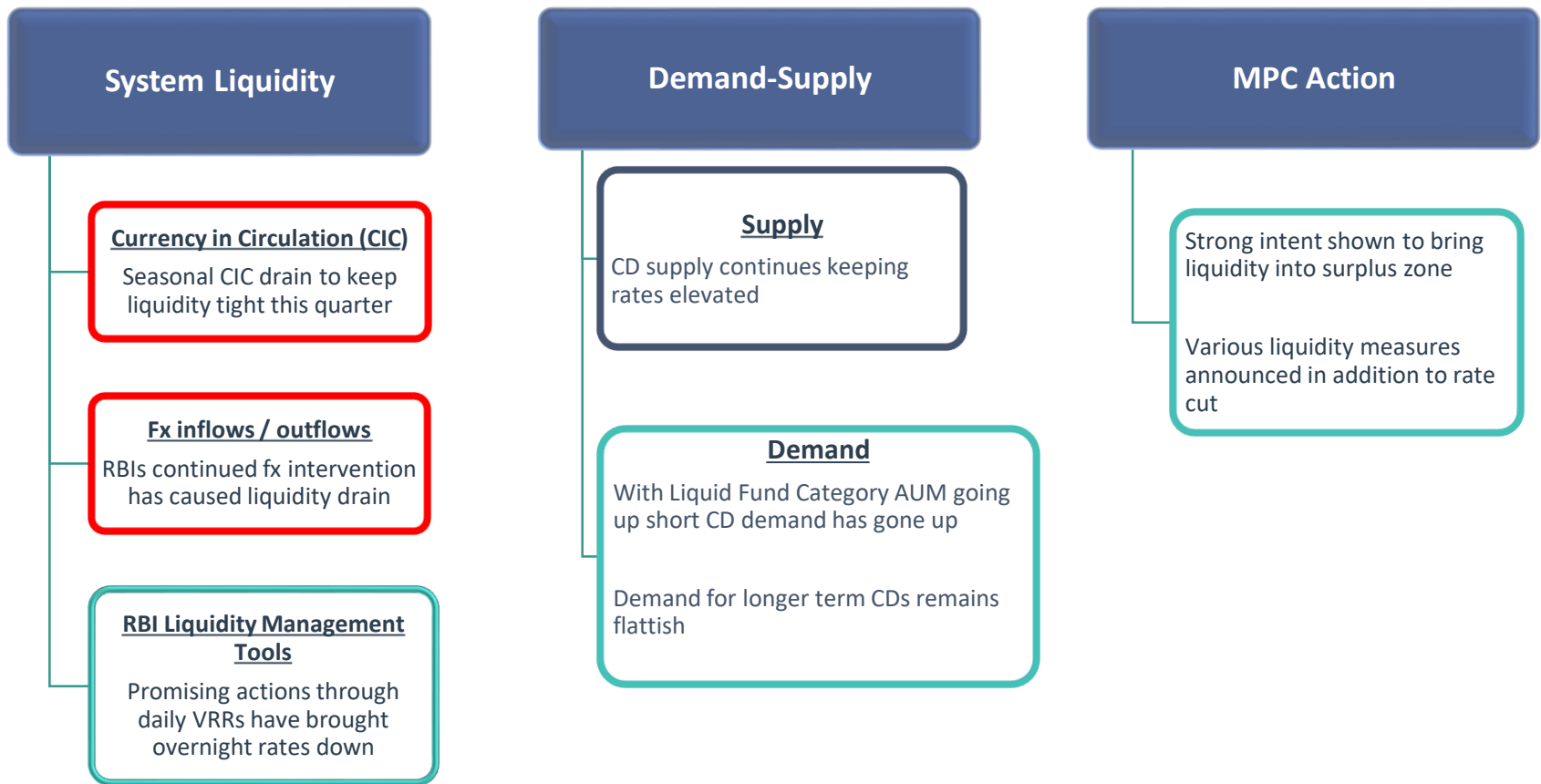
- Rate expectations in US gets priced-in in US2Y
- Rate expectations in US to mirror in India, thus getting priced-in in India 10Y



Takeaway:

Expect India 10Y to closely track US2Y

Money Market Assessment Framework



Takeaway:
We draw comfort from RBIs stated intent to “proactively provide durable liquidity as and when needed”.

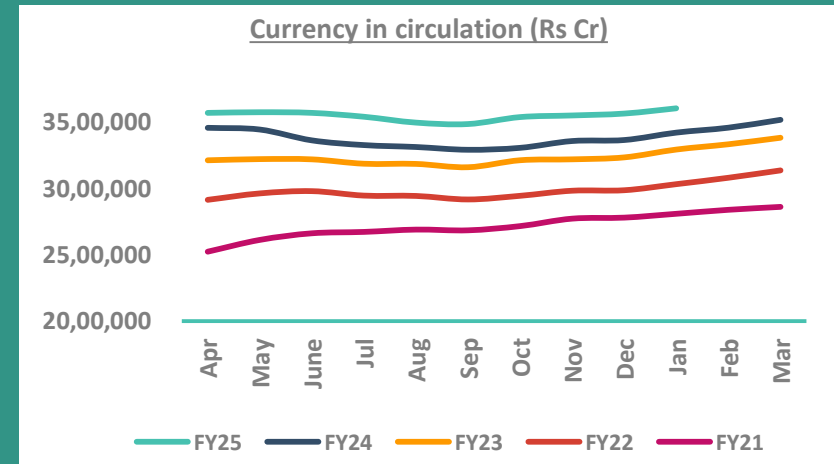
RBI acts in full force to bring liquidity in surplus zone; expect more to come

- Variable liquidity measures announced by RBI – daily VRRs; OMO purchases of INR 11k cr; secondary market purchases of INR 37k cr; USD/INR buy sell swap of 5bn USD; longer tenure VRR of INR 1.251k cr
- Despite these, we have seen core liquidity remain near zero at the end of January due to continued fx interventions and seasonal CIC build up

(in lakh cr)	CIC Leakage	CRR Increase	RBI dividend	FX Intervention	FX Swaps	Long Term VRR	RBI OMO	Core Liquidity
Jan	0	-			0			-0.07
Feb	-0.55	-0.09		-0.783	0.45	1.25	0.8	1.007
Mar	-0.59	-0.09						0.327
Apr	-0.74	-0.09				-1.25		-1.753
May	-0.08	-0.09	2.3					0.377
Jun	0.29	-0.09						0.577
Jul	0.32	-0.1			-0.45			0.347
Aug	0.16	-0.1						0.407
Sep	0.12	-0.1						0.427
Oct	-0.64	-0.1						-0.313
Nov	-0.2	-0.1						-0.613
Dec	-0.16	-0.1						-0.873

➤ We are in the phase of high CIC build up, leading to liquidity drain

- Typically, Jan-Apr sees a seasonal CIC build up close to INR 2tn – 2.25tn
- We have already seen a drain of ~INR 75k crore
- We expect liquidity to further drain by INR 1.5tn until April

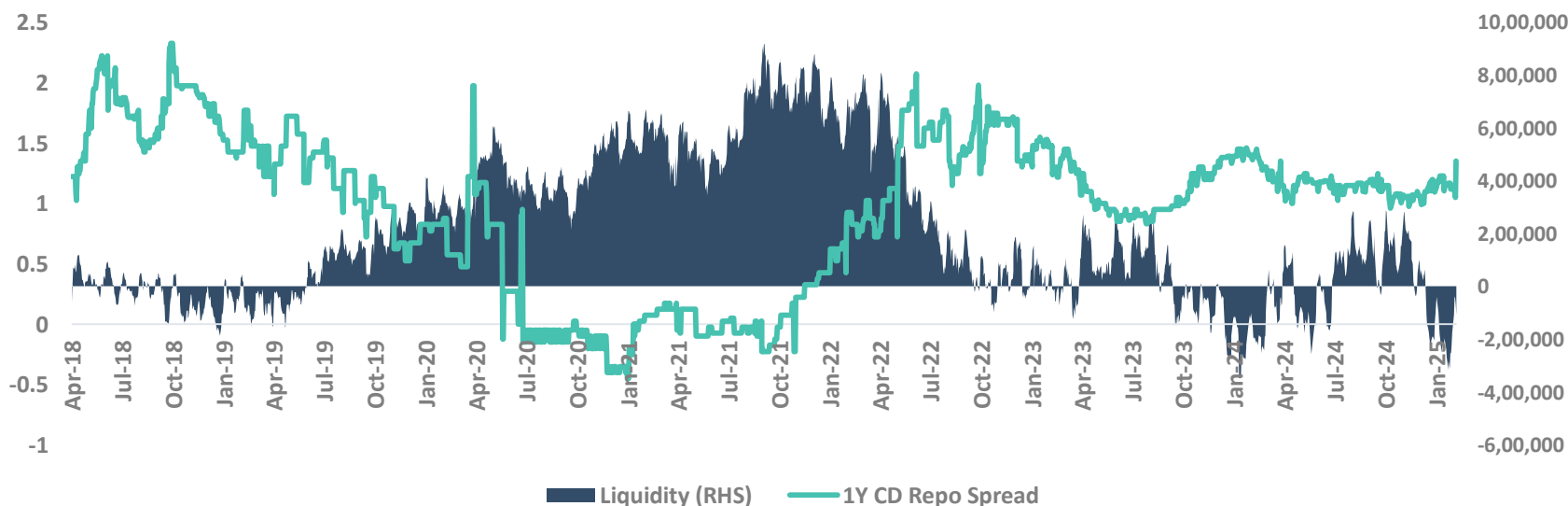


Takeaway:

RBI has shown intent to bring liquidity in surplus through multiple actions. We expect more such actions as core liquidity remains negative

Taking cues from RBIs liquidity actions expect CD-Repo spreads to compress

- **MPC announced the much awaited policy repo cut of 25bps in Feb 25 policy**
 - We have seen 1Y CD rates move from highs at 7.65% to 7.60% currently
 - Despite a rate cut in the last policy, we have not seen CD rates adjust to the new policy rate
 - This has largely been on account of the liquidity crunch in the system
- **Expect CD-repo spreads to compress with RBIs intent and actions towards bringing liquidity back to surplus**
 - CD-Repo spreads remain attractive at close to 135bps
 - We remain long across our money market funds as we expect rates to come down with liquidity coming in



Takeaway:

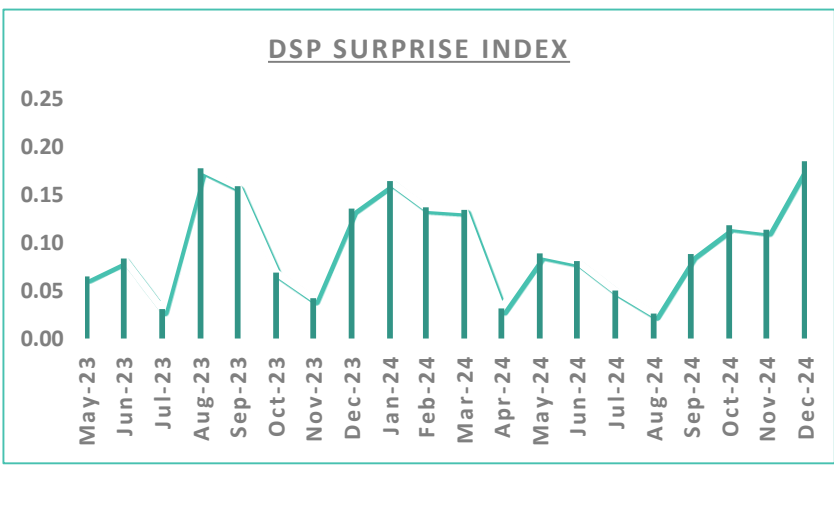
We remain long across our money market fund taking cues from RBIs actions on liquidity

DSP “SURPRISE” Index

DSP Surprise Index: Again pointing towards some volatility

➤ In last 2-Years

- The index spiked in Aug'23, Dec'23, May'24 and Dec'24
- During these times, the markets were most volatile



➤ DSP Surprise Index to identify high risk times

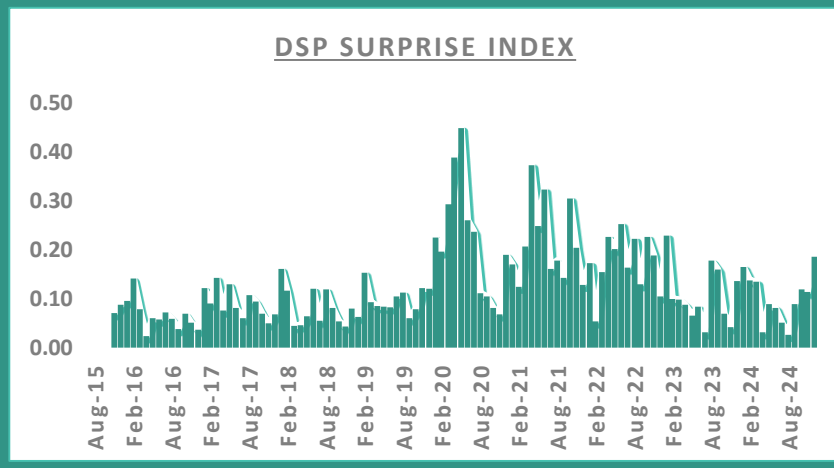
- During these times, “random” and unpredictable risks are higher than usual.

➤ DSP Surprise Index identifies when the markets are surprised by data (US)

- Chose 8 indicators from inflation, growth and labor.
- Currently, we are in low uncertainty phase

➤ Interpretation

- During high DSP Surprise Index times, we would prefer to rationalize our risks.
- During low DSP Surprise Index times, we would prefer to run conviction trades



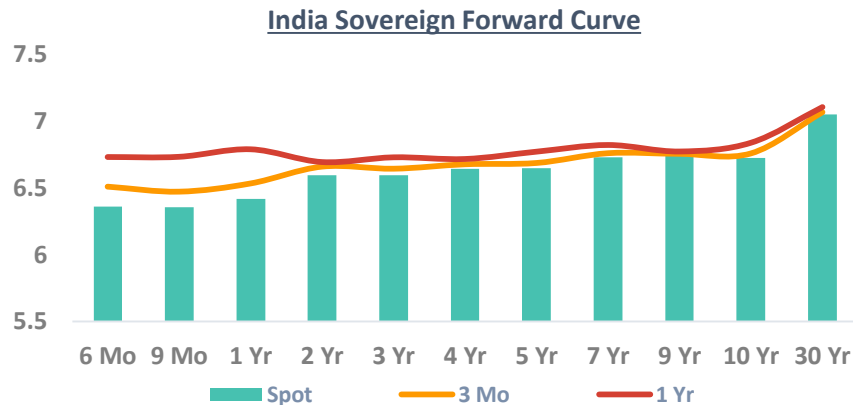
Takeaway:

Increasing surprise factor in US data pointing out towards some volatility

DSP FI Framework checklist

Drivers	1Y	5Y	10Y	>10Y	Remarks
Monetary Policy	Positive	Positive	Positive	Positive	
Inflation	Positive	Positive	Positive	Positive	Inflationary risks seem contained
Growth	Positive	Positive	Neutral	Neutral	Growth again hits a rough patch post festive season pick-up
CAD/BOP/ Currency	Neutral	Neutral	Neutral	Neutral	External sector remains volatile but not a worry as of now
Fiscal Policy	Positive	Positive	Positive	Positive	
Supply	Positive	Positive	Positive	Positive	Marginal increase in FY26 supply. Demand growth to outpace
Demand	Neutral	Positive	Positive	Positive	Non-discretionary buying and RBI OMOs to support demand
FPI Flows	Neutral	Neutral	Neutral	Neutral	FPI demand to lessen but outflows unlikely
Global	Neutral	Neutral	Neutral	Neutral	
Global yields	Neutral	Neutral	Neutral	Neutral	Fed to be in wait and watch mode
Geopolitics	Negative	Negative	Negative	Negative	A lot depends on Trump
Commodities	Neutral	Neutral	Neutral	Neutral	Risks balanced, but volatility increased
Others	Neutral	Neutral	Neutral	Neutral	
RBI Regime	Positive	Positive	Positive	Positive	Regime change with a rate cut
Total	Positive	Positive	Positive	Positive	

DSP Duration decision:



The chart shows how much expected yield fall/rise is already priced in the current curve.

Large gap between the spot yield and forward yield shows that yield change is priced in – and thus yield change will give capital gain/loss.

Similarly small gap means that the market is not pricing change in yields.

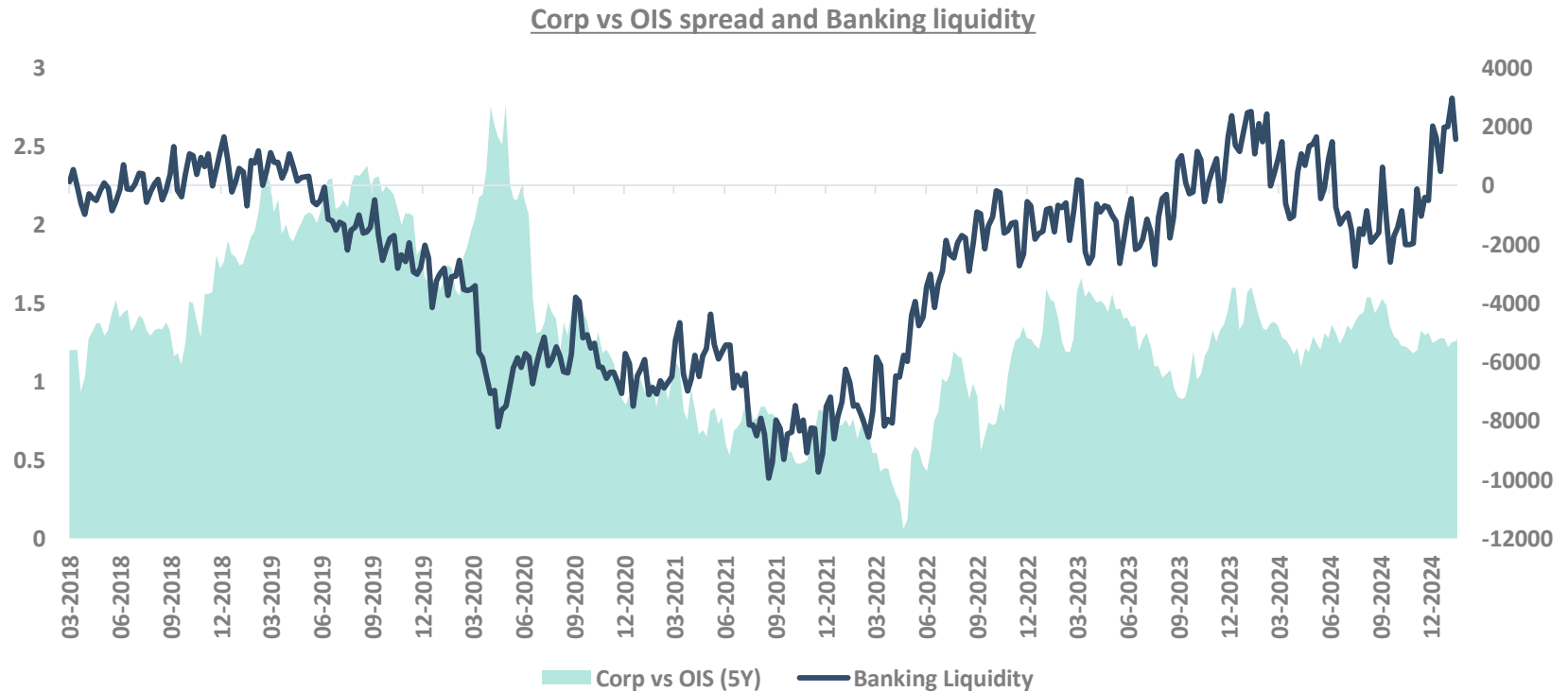
- **The forward curve is already upward sloping, we expect it to shift downward or steepen marginally**
- **Yet, long term yields may end up making more money**
 - *The duration of 30Y is 4x the duration of 4Y bond*
 - *i.e. for every 40bp fall of 4Y, the 30Y bond needs to fall only 10bp*
 - *Even if curve bull steepens by 30bp, long bonds give similar value*

Maturity	1Y	5Y	10Y	>10Y
What's expected (Total)	Positive	Positive	Positive	Positive
Is expectation (above row) priced in ?	No	No	No	No

We have discussed duration and yield movement.

How do we choose corporates and credit?

Which trades to benefit most from such expectations?



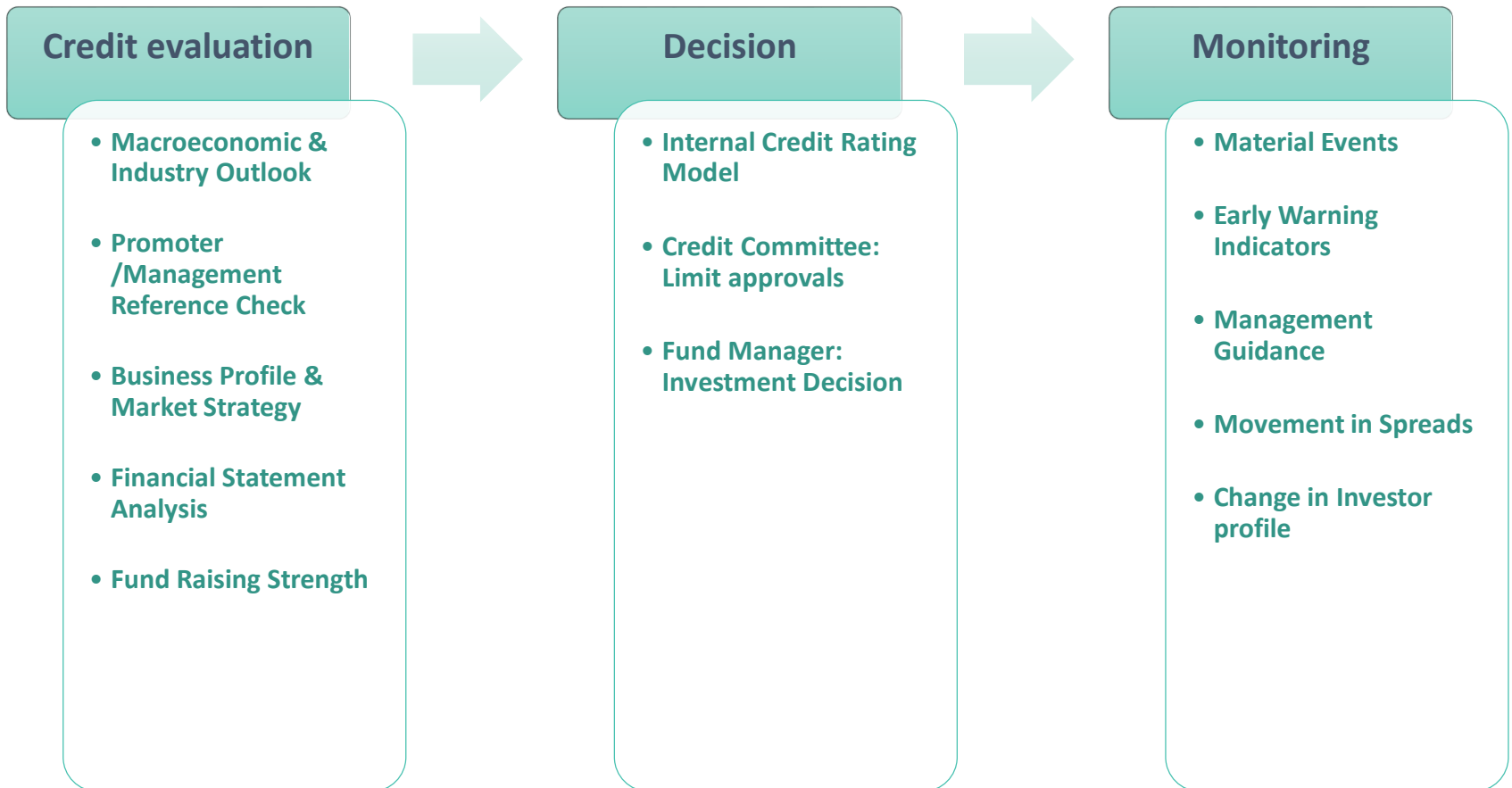
In near future: the liquidity surplus to benefit spread assets

- Corporate bonds/ CP/ CD
- Until the demand flows in, their rally will be muted. The demand will flow in after liquidity.

Once the rate cut expectations are built in more, probably after policy

- OIS to be a good pay

DSP Credit Investment Process – Focus on Governance



Information sources: Financial results, Management Discussion, Rating Agency Feedback, Sell Side Research, Equity analyst feedback, Lender’s feedback, etc.

DSP Credit view on sectors

Sector	Cash Flow Strength	Balance Sheet Strength	Outlook	Remarks
Automobile and Auto Components	●	●	●	The majors have all shown strong balance sheet strength despite varying growth across segments
Capital Goods	●	●	●	Infrastructure thrust by the Government has supported companies – state government spending to be watched
Chemicals	●	●	●	Continues to be weak both on demand as well as oversupply situation. Longer term prospects are good
Construction, Metals	●	●	●	Commodity cycle has by and large been stable. Spread and volume trends are evolving, but are within acceptable credit parameters. Cement is showing some slackness due to overcapacity.
Consumer Services	●	●	●	Weak consumer demand still placing pressure.
FMCG	●	●	●	Volume growth has been modest overall. But balance sheet and cashflows are strong
Financial Services	●	●	●	Asset quality has weakened in the unsecured segment led by heat-wave, elections and over-leveraging in some pockets. Thus far secured segments seem isolated thus far.
Media, Entertainment & Publication	●	●	●	Exposure only towards are large private conglomerate and comfort out of its parentage as well as leadership position
Oil, Gas & Consumable Fuels	●	●	●	While profitability is volatile with end product pricing being fixed, the Companies that operate in this segment are largely PSUs or strong private sector companies.
Power	●	●	●	Power demand and need for renewable energy is continuing. We are constantly watching signs of over stretch on balance sheet or evolution of receivables.
Realty	●	●	●	Strong real estate cycle has positively impacted residential companies as well as for REITs. We watch presales and balance sheet evolution – companies risk taking have hitherto paid off
Telecommunication	●	●	●	Virtually a two company story in India, we expect credit profiles of those two to remain solid.

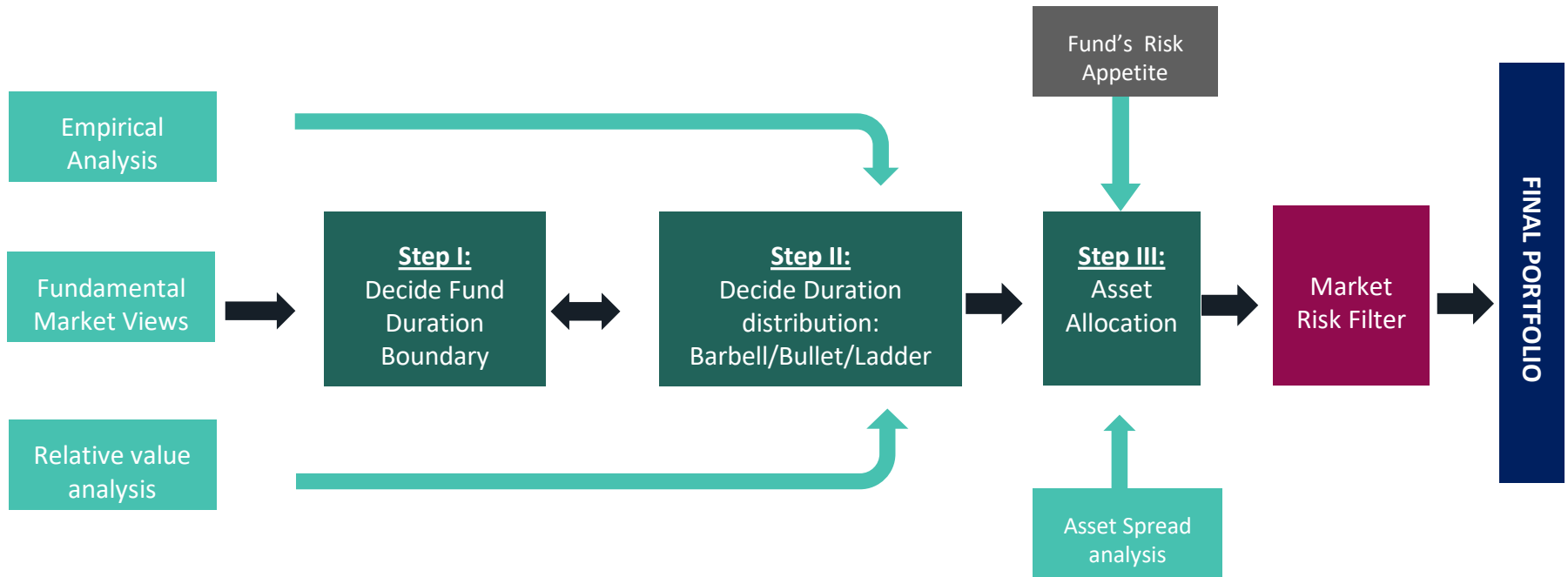
Done with our market view framework?

Now

Our Portfolio creation framework

DSP Portfolio Creation: Multi-step process

DSP Fixed Income Funds follow a defined methodology for fund portfolio construction



- We apply market risk filter which can help the Fund Managers not to take extreme risks. Thus, Value at Risk is limited by ensuring the positions are balanced.

Key Risks associated with investing in Fixed Income Schemes

Interest Rate Risk - When interest rates rise, bond prices fall, meaning the bonds you hold lose value. Interest rate movements are the major cause of price volatility in bond markets.

Credit risk - If you invest in corporate bonds, you take on credit risk in addition to interest rate risk. Credit risk is the possibility that an issuer could default on its debt obligation. If this happens, the investor may not receive the full value of their principal investment.

Market Liquidity risk - Liquidity risk is the chance that an investor might want to sell a fixed income asset, but they're unable to find a buyer.

Re-investment Risk: If the bonds are callable, the bond issuer reserves the right to "call" the bond before maturity and pay off the debt. That can lead to reinvestment risk especially in a falling interest rate scenario.

Rating Migration Risk - If the credit rating agencies lower their ratings on a bond, the price of those bonds will fall.

Other Risks

Risk associated with

- floating rate securities
- derivatives
- transaction in units through stock exchange Mechanism
- investments in Securitized Assets
- Overseas Investments
- Real Estate Investment Trust (REIT) and Infrastructure Investment Trust (InvIT)
- investments in repo of corporate debt securities
- Imperfect Hedging using Interest Rate Futures
- investments in Perpetual Debt Instrument (PDI)

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