

RBI will have to consider buying corporate bonds directly from market, says Dhawal Dalal

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Published: April 4, 2020 9:16:04 AM



Dhawal Dalal, CIO-Fixed Income at Edelweiss AMC says that if targeted LTRO doesn't work out, the [RBI](#) will have to review the scheme and consider buying corporate bonds directly from the markets.

Global central bankers like US Federal Reserve (Fed) and European Central Bank (ECB) have announced facilities to buy corporate bonds from the markets, unlike in India where the Reserve Bank of India (RBI) has asked banks to buy corporate bonds. **Dhawal Dalal,**

CIO-Fixed Income at Edelweiss AMC in an interview with Chirag Madia says that if targeted LTRO doesn't work out, the RBI will have to review the scheme and consider buying corporate bonds directly from the markets. Edited excerpts:

What is your outlook on debt markets, post the RBI policy?

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The Reserve Bank of India (RBI) has clearly articulated that they are “in-charge” and they will do whatever it takes to ensure India’s financial stability and protect economic growth. The RBI has already cut the repo rate and reserve repo rate sharply and the reverse repo rate has been made the operational rate. Secondly, they also infused liquidity worth Rs 3.7 lakh crore, to help the economy cope with the novel coronavirus related economic slowdown. That said, from April, we are going to see massive primary supply of government bonds and to some extent 10-year benchmark yields are reflecting that nervousness as they refuse to decline below 6%. Yields would have fallen twice below 6%, but failed because market participants believe that the fiscal deficit for FY 21 is likely to be substantially higher than the projected 3.5% of gross domestic product (GDP), on account of heavy borrowing requirements by the government as well as state borrowing, due to the likely shortfall in Goods and Services Tax (GST) collections in FY21. So, heavy supply pressure is likely to keep the yield curve steeper, that is short term yields anchored by the reverse repo rate, while long-end of the yield curve will reflect the demand-supply mismatch.

With announcement of measures such as Targeted Long-Term Repo Operations (TLTRO) by RBI, how much debt papers are you planning to sell to banks?

For Edelweiss AMC, March witnessed net inflows in non-liquid schemes. As of now, we are satisfied with our portfolio positions and liquidity levels.

Based on that, we are not actively planning to offer anything under the targeted LTRO. Having said that, we will scan through some of our non-AAA bond holdings and check if banks are interested in them. Most of our exposure is at the short-end of the money market assets

and high-quality AAA-rated bonds of public sector undertaking (PSUs) and public financial institutions (PFIs). That said, we welcome banks' bidding interest in the corporate bonds, as it is likely to increase liquidity in the corporate bond market.

Do you think more TLTRO will be announced by the RBI?

Globally, the US Federal Reserve (Fed), the European Central Bank (ECB) and other central banks have announced facilities to buy corporate bonds from the markets. Here in India, the RBI has decided to give money to banks and have asked them to go and buy corporate bonds — 50% through the primary markets and 50% from the secondary markets. I think this may add an additional layer of complexity. Banks will likely use their own credit evaluation process and risk management practices to find out which corporate credit to invest in and their levels. If targeted LTRO doesn't work out, my sense is that RBI will have to review the scheme and consider buying corporate bonds directly from the markets.

What kind of strategy are you adopting at this point of time?

Whenever yield curves are steep (difference between overnight rates and 10-year G-Sec yields) with almost 150-200 basis point gap, investors will try to figure out what will happen going forward. Based on the experience of 2008-09 and 2013, we believe that whenever the banking system is flushed with excess liquidity for a long period of time, at some point in time it could turn out to be inflationary. This kind of investment landscape requires careful observation of inflation / reversal of RBI's easy monetary policy and expected total returns from rolling down the yield curves until they start to flatten again. Bond investors will likely evaluate various strategies that could involve higher cash allocation and exposure to long-maturity bonds (seven year plus).

As a fund manager what are the key risks or concerns in the debt market?

Before the RBI's surprise rate cut, the concern with mutual funds was on the liability side. Now, the worry is what if investors don't return to debt mutual funds in April due to "Sudden-Stop" in economic activities & cash flows and their percolating impact amid the RBI-sponsored moratorium. We are in regular touch with our clients to understand their thinking and their investment strategy. In March, MF industry had seen net outflows from debt funds as many institutional investors had redeemed money to pay for the last tranche of advance tax, as well

as unscheduled interim dividend after the changes in the dividend distribution tax (DDT), from the start of this fiscal. As a fund manager, it is our endeavour to understand what our clients want and offer them suitable investment solutions.

Given the current situation what strategy should investors adopt at this point of time?

Based on our current assessment of the situation, investors should continue to focus on fixed income funds which invest only in AAA rated liquid corporate bonds. We believe that the time is not right to look at credit funds because the ongoing crisis may put further upward pressure on credit spreads. Investors must be cognisant of the novel Coronavirus induced challenging investment landscape and ensure that the 'return of capital' is perhaps more important than the 'return on capital' in our opinion.



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