

MONTHLY DEBT OUTLOOK

July 2025

As per the central government fiscal data for April-May, gross tax revenue growth was 12.1% y/y, driven by a positive IGST number vs. last year. Income tax collection grew 6.4%, corporate tax fell 0.8% and net Central GST fell 2.4%. Net tax revenue growth was 10%. Total expenditure was up 19.7% y/y, with revenue expenditure up 9.4% and capital expenditure up 54.1%. However, this is also due to base effect because total expenditure during the same period last year was down 0.4% y/y. Overall, fiscal deficit for April-May of FY26 was 0.8% of the budget estimate vs. 3.2% last year (latter as % of provisional actuals).

In May, momentum in CPI food prices turned marginally positive after being negative for six months. Momentum in core inflation (CPI excluding food and beverages, fuel and light) moderated after inching up in April. Food price momentum was negative for cereals, pulses, fruits and spices but it turned positive for vegetables and was buoyant for vegetable oils, meat & fish, egg, milk, sugar, etc. Real time data mainly suggests an uptick mainly in tomato prices. The IMD's (India Meteorological Department) forecast for the southwest monsoon season rainfall is 'above-normal', at 6% above the Long Period Average (LPA). Rainfall in July is also forecast to be above normal, exceeding 6% above LPA. Overall, the outlook for CPI inflation in the next few months is benign. Further, the government has also taken various supply side measures on procurement, open market sales, trade, price rise mitigation, etc. as needed in previous years.

Industrial production (IP) growth was +1.2% y/y in May after +2.6% in April. However, on a seasonally adjusted month-on-month basis, this was 0% in May after -0.8% in April. In May, output momentum picked up further for capital goods and consumer non-durable goods, and turned positive for infrastructure & construction goods. However, it was negative for consumer durable, primary and intermediate goods.

Bank credit outstanding as on 13th June was 9.6% y/y while bank deposit growth was 10.4%. Total credit flow in FY25 eased, after picking up strongly in FY24. In terms of sectoral share in credit flow, Industry was 17% (11% in FY24), Services 34% (33% in FY24), Personal loans 37% (43% in FY24), and Agriculture 13% (same as in FY24). On 16th November 2023, the RBI had raised risk weights for commercial banks' and NBFCs' categories of unsecured personal loans (including bank credit to NBFCs), which was subsequently restored to the original weights from 01st April 2025. As at the end of May 2025, growth of credit outstanding as personal loans was 11.1% y/y, that to services was 8.7% and that to industry was 4.8%.

May goods trade deficit eased to USD 21.9bn, after picking up in the previous two months to USD 26.4bn in April. The May print was mainly driven by a drop in oil imports, with non-oil exports also rising. However, oil exports fell and non-oil-non-gold imports picked up further. Services trade surplus was USD 15.9bn in April and USD 15.8bn in May, down from USD 18.1bn in March. This averaged USD 17.8bn in Q4 FY25 (vs. USD 17.1bn in Q3). It surprised to the upside from late 2022 with an average monthly surplus of USD 11.9bn in FY23 (after USD 9bn in FY22), USD 13.6bn in FY24 and now USD 15.7bn in FY25.

Among higher-frequency variables, number of two-wheelers registered continued to remain moderate, despite a marginal uptick in recent weeks. Energy consumption levels averaged +7% y/y during the week ending 08th July 2025. Monthly number of GST e-way bills was 11.9cr units in June, after 12.3cr in May, and averaging 12cr in the June quarter (after 11.8cr in the March quarter).

US headline CPI was 2.4% y/y in May, after 2.3% in April. In May, price momentum in energy and apparel were negative, while that in housing (both rent of primary residence and owner's equivalent rent of residence) and medical care eased. However, price momentum in food, recreation, education & communication moved up. Overall, price momentum in goods-excluding-food-and-energy turned mildly negative and that in services eased. Momentum in non-housing-core-services also moderated. Core CPI was flat at 2.8% y/y from March to May. In the labour market, US non-farm payroll addition in June (147,000 persons) was above expectation, after 144,000 in May, but the largest job addition was by the government. Private non-farm payroll addition was only 74,000 in June, after 138,000 in May. Some of the previous monthly numbers have also been subsequently revised down. The June unemployment rate inched down to 4.1%, and the growth in average hourly earnings (0.2% m/m) was also lower from the previous month (0.4%).

The June US FOMC (Federal Open Market Committee) meeting kept policy rate on hold again at 4.25-4.50%, after cutting by a total of 100bps from September to December. It said labour market remains solid and that uncertainty about the economic outlook has diminished but remains elevated. It also said near-term measures of inflation expectations have moved up due to tariffs but long-term expectations remain consistent with 2% inflation. It is expecting impact of tariffs on consumer prices (based on forecasts, surveys, etc.), although there is uncertainty on when, by how much and for how long. As per the June Summary of Economic Projection, it again cut its 2025 real GDP growth forecast and increased its 2025 inflation forecast. The median federal funds rate continued to imply 50bps rate cuts this year. From April, it slowed the pace of decline of its securities holdings by reducing the monthly redemption cap on treasury securities (from USD 25bn to USD 5bn), while it continues to maintain the monthly redemption cap on agency debt and agency mortgage-backed securities (at USD 35bn).

Outlook:

Ever since the rate cut that didn't feel at all like a rate cut, bond markets have been finding it difficult to regain their footing. While RBI maintains that bond prices find their own level, there are nevertheless plenty of signals here for the central bank to infer that something hasn't gone as per plan. Even the 5-year government bond yield, which should be one of the greatest beneficiaries of the rate cuts, has steadily risen post rate cut and was around 20 bps higher in Mid-June from the lows touched in early June. Meanwhile, the long end of the curve seems to have achieved escape velocity yield-wise. This is all the more strange given the hard work government has done over the past few years to clean up fiscal accounts, consolidate the deficit, and provide a credible road-map on debt to GDP management for the future. Not just that, India continues to be globally considered favorably macro-stability wise and is now a top 5 market economy. One must confess, therefore, to being a trifle disappointed when the RBI leadership recently compared current term spreads with history when the context, in no small part due to committed efforts from the government, is now quite different. Also, the point about term spreads being much lower than the pandemic period is of little solace: term spreads over the pandemic were exceptionally high since the government had to double its deficit whereas RBI had cut effective overnight rate to the mid-3s.

A point of clarification before we proceed: one doesn't imply here that Indian bonds should be immune to global volatility including the recent escalation in geo-political risks. However, what is happening in the market seems beyond that and has been underway largely since the June RBI policy.

Unlike for example the US, long end yields in India aren't rising for any fundamental reason like fiscal concerns. Quite the contrary, as noted above, the Indian government has been exemplary with its commitment to fiscal consolidation. Neither is there any serious market expectation that any revision to the fiscal approach is imminent. Instead, long end yields in India are rising simply because supply of such bonds was raised over the past few years to accommodate larger demand from provident funds and insurers but hasn't been readjusted back even as that demand has tapered. The lack of more

active recalibration of supply, despite (one hears) feedback from the market, is thus the reason for this aggressive curve steepening and not any 'penalty' that the market is levying for fiscal uncertainties. Not that anyone is looking, but the valuation distortion here can be measured in other ways as well. Example: Spreads on SDLs are quite thin at the long end over central government bonds. Also, if the RBI continues to get the transmission it wants, you may be able to raise a home loan within 75 bps of where the sovereign is borrowing long term money.

To reiterate then, the fundamental reasons for holding the long end remain intact: India has credible macros and Indian bonds are still in FPI discovery phase, even as flows here have temporarily halted. We fully expect a period over the next few quarters where, as hard US data starts breaking, US bond yields will likely fall alongside the US dollar (the latter is already in play). This should start pushing back flows into emerging market duration bonds. Put another way, and this is true for local investors as well, we are just entering the phase where you buy fixed income for relative value versus other assets given the overall macro-cycle context, as well as for the starting valuations that bonds offer relative to your economic fundamentals. As against that, so far most of the bond story has been purely about rate cuts. The obvious underlying point is that term spreads keep fluctuating basis other factors and are currently quite high. Thus there is enough room for bonds to perform with no further cuts to the overnight rate, even as further such cuts may very well be forthcoming if the global growth cycle continues slowing.

A final point about relative value. The first flush of commentary post the last 50 bps rate cut was centered around advocating 3 year corporate bonds. 3 year PSU corporate bonds were circa 6.35 – 40% in the immediate aftermath of the rate cut. However, credit growth in India isn't falling off even as it has weakened. Hence demand for funds will sustain, even as the pressure on funding has been completely removed with proactive steps from RBI. Thus there is a floor to 1 year bank CDs. Given that it is logical to expect some steepness towards the bottom of the repo cut cycle, and also accounting for relatively less liquidity in corporate bonds when compared with CDs, it is difficult to envisage 3 year PSU corporate bond yields sustaining meaningfully below 6.35%. Correspondingly, one should expect reasonable NBFC spreads over underlying PSU bonds when rates are low, since NBFC business models are fund intensive and their lending spread cushions are high.

That said, yields even on 3 year corporate bonds have retraced substantially since the RBI policy and now offer reasonable value, so long as one expects limited mark-to-market gains. If the pursuit is mark-to-market gains, however, then government bonds seem much better poised with the recent sell off having revealed clear value in 2 segments, in our view: 6 – 8 years and 30 years. The former is good consideration space for short and mid duration funds to play whereas the latter remains our segment of choice for dynamic and gilt funds.

Source: CEIC, PIB, RBI, US Federal Reserve, Bank of England, Bank of Japan and US Bureau of Economic Analysis, Bandhan MF Research. Data as on latest available.

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