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Fixed Income
Market Outlook
December 2024

Good gets better

Fixed Income Market Update and Outlook

Market Update

Growth Moderation, Higher Inflation, Currency Pressure and Liquidity squeeze

Globally, Nov'24 saw sharp rise in geo-political risk on US president elections with strong implications on global yields, forex flows and currency. While the major central bankers continued with monetary easing cycle with the forward guidance of gradually policy actions - dependent on evolving data.

In India, the month (Nov'24) saw inflation above 6% mark, slowdown in quarterly growth numbers, Trump win resulting in pressure on INR resulting in aggressive RBI intervention – thereby resulting in sharp reduction in core system liquidity.

<u>India</u>

Monetary Policy:

On 6th of Dec'24, the RBI left the policy rate unchanged, while cutting the cash reserve ratio (CRR) by 50 bps to 4%. Both these measures were in line with consensus expectations. RBI emphasised that rate action was more of the balancing act towards inflation/growth mix. With latest monthly inflation print above 6% mark (above RBI's upward bound of inflation target) and RBI's revised 3Q inflation projection at 5.7% (Oct projection: 4.8%), RBI had limited space to cut the policy rate in current policy. That said, lower than expected 2Q GDP print and RBI's downwardly revised GDP projections for 2H and FY25 has opened up the space for policy cut. With inflation expected to be ~4% by 2Q FY26, RBI is expected to cut the policy rate in Feb'25 policy.

Economic Growth:

2Q FY25 GDP growth moderated sharply to 5.4%y/y (1Q FY25: 6.7%y/y; 2Q FY24: 8.08%y/y) on moderation in private consumption, capex and govt spending. The print was much lower than consensus expectations of 6.5%y/y. On supply side, manufacturing, mining and electricity were laggard, while agriculture and services sector grew robustly. 1H FY25, GDP growth was muted at 6%y/y as against ~8%y/ in 1H FY24.

Inflation:

CPI inflation rose sharply to 6.21%y/y in October (Sep 2024: 5.49% y/y, Last year same period: 4.87%y/y). This was higher than the consensus (5.9%y/y). Food inflation and gold were major contributor of inflation. Core inflation increased to 3.67%y/y (Sep 2024: 3.49%y/y; Last year same period: 4.26%y/y). While Food inflation rose to ~10% lvls (from previous month's 8.4%y/y), all other subindexes continued to remain below/~ 4%y/y lvls, with fuel index in deflation for last thirteen consecutive month. Excluding veggies, headline inflation rose to 3.58%y/y (Previous month: 3.33%y/y; Oct 2023: 5.04%y/y). Apr-Oct 2024 avg CPI inflation was lower at 4.8%y/y (Last yr same period: 5.4%y/y).

Fiscal:

April-Oct 2024 gross tax receipts grew robustly by ~11%y/y - driven by buoyant direct tax collections and resilient indirect taxes. However, net tax receipts growth was flattish on record high devolution to states YTD. Record high RBI dividend resulted in sharp spike in non-tax receipts. During same period, expenditure growth was muted, While the revenue expenditure has picked up in recent months, capex continues to contract by double-digit. As a result, Fiscal deficit stood modest at 47% of budget estimates (Previous year similar period: 45%). November GST print was third highest in fiscal year at Rs. 1.8 trn, with Apr-Nov FY25 GST growth at 9.3%y/y.

External Sector:

Oct'24 Trade deficit rose to~US$27 bn (Sep 24: US$21 bn), on festive season demand. While the Apr-Oct 2024 exports growth was muted due to drag from oil exports, core exports (excludes oil and gold) grew at resilient 9%y/y. Similarly, imports were muted at 6%y/y driven down by core import growth. Oct 2024 net service exports was robust at 17%y/y, with Apr-Oct 2024 Net services exports growth at ~13%y/y.

Nov 2024 continued to witness outflow for second consecutive month to the tune of US$2.5 bn (Oct 2024: outflow of US$11.5 bn) driven down by equity outflows - on global financial market volatility and rising geopolitical uncertainty. Despite this, Apr-Nov 2024 witnessed robust inflows of US$18 bn (mainly through debt).

Aided by RBI's active intervention in forex market, Rupee continued to depreciate marginally in Nov on strong dollar bias and stood on average 84.36 against dollar (Oct: 83.81; Sep: 83.81; Aug: 83.90; July 2024: 83.59).

Liquidity:

Banking system liquidity on an average remained robust at Rs. 1.42 trn (Oct 2024: Rs. 1.53 trn; Sep 2024: Rs. 1 trn; Aug 2024: Rs. 1.5 trn; Jul 2024: Rs. 1.1 trn; Jun 2024: -ve Rs. 50,000 cr) on government spending. Average Government balances moderated to below Rs. 1 trn as against average Rs. 2.3 trn in Oct and average Rs. 2.8 trn during Apr-Oct 2024. In fact, monthly average govt balances were lowest since May 2023. That said, Oct through Nov 22, 2024, saw sharp decline in Core liquidity (system liquidity + Government balances) to ~ Rs. 1.4 trn as against Rs. 3.2 trn at Oct end and Rs. 4.3 trn at Sep end. This decline was primarily due to RBI's intervention in forex market (on currency pressures) and demand for cash in festive season.

Yield Levels & Spreads:

Fixed income market yields remained range-bound during Nov'24, although it picked up a bit after higher-than-expected monthly inflation print – only to decline towards month end on lower-than-expected GDP numbers. 10-year G-sec yield moved in the range of 6.75%-6.85% during the month (Oct 2024: 6.72%-6.85%;). 10 yr G-sec closed the month lower at 6.75% (Oct 2024: 6.81%). Average 10-year term premia decreased marginally to average~21 bps during the month (Oct 2024: 23 bps).

Taking cues from G-sec, 10-year SDL yields moved in the narrow range of 7.09%-7.16% as against 7.05%-7.14% in October to close the month at 7.14% (Oct 2024: 7.11%). October SDL primary issuances stood lower at Rs.55,006 cr (Oct 2024: Rs. 84,892 cr; 2Q FY25: ~Rs.80,000 cr). The average spread between 10 yr SDL over G-sec stood at 32 bps during the month (Oct 2024: 31 bps; Jul-Sep 2024: 35 bps).

AAA bonds moved in the narrow range with 10 yr AAA PSU moving in the band of 7.26%-7.32% (Previous month: 7.23%-7.27%). It closed the month higher at 7.31% (Oct 2024: 7.26%, Sep 2024: 7.24%; Aug 2024: 7.40%).

Global

Monetary Policy:

November-24 saw further easing from central banks globally. Among major advance economies, US Fed and Bank of England continued to cut the policy rates, with policy outlook of being data-dependent and gradual rate cutting cycle.

Financial Markets:

After rising sharply in October-24 on trump trade, US treasury yields continued to harden further post US election results on rising geopolitical uncertainty. US 10 Yr Treasury bond (UST) yield moved in the range of 4.18%-4.44% (as against 3.74%-4.29% in Oct 2024), although closed the month lower at 4.18% (Oct end: 4.28%; Sep 2024: 3.81%; Aug 2024: 3.91%). After appreciating by 2.2%m/m, the dollar appreciated by 1.8%m/m in Nov 2024 on risk aversion (CY2024 YTD: +4.4%) on global risk-off backdrop.

Market View

- Going forward, Indian bonds are likely to be supported by domestic growth moderation, expectations of easing inflationary pressure in coming months and improved demand (bond inclusion). That said, the sharp rise in geo-political uncertainty (US Tariffs & fiscal dynamics, strong dollar resulting in pressure on INR, China stimulus, commodities including crude oil, war etc) might keep financial markets volatile in near term.
- Nov’24 inflation is expected to remain elevated after sharp rise to 6.2% in Oct’24 on gradual decline in food inflation.
- Going forward, we expect RBI to cut the policy rate in Feb’25, since there may be more clarity on growth trajectory (FY25 advance GDP estimates), inflation trends (Nov-Dec’24 print will be out, with estimates for Jan’25 print), fiscal consolidation (Budget FY26) and hopefully some stability on foreign flows and INR.
- Active Liquidity Management to remain crucial given the uncertainty related to currency volatility.
- Amidst the global central banker’s easing bias and supportive macros, we continue to expect rate cut in 4Q FY25 policy. The risk to projections is curve volatility.

Common Source:
RBI, CSO, FAO, CEIC, NSO, JP Morgan, US Federal Reserve, US Treasury department, Commerce Ministry of India, NIMF Internal Research