



Nippon **india** Mutual Fund

Wealth sets you free

# Fixed Income

Market Outlook

April 2024



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# Fixed Income Market Update and Outlook

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## Market Update

### **Status quo in Monetary policy on robust growth and improving domestic inflation and external balances**

Status quo in monetary policy, robust domestic growth outlook, easing headline and core inflation pressure and manageable external balances were key macro data-points for Indian fixed income markets during the month.

## **India**

### Monetary Policy:

In early April policy, RBI maintain status quo on policy rate and stance – in line with expectations. While RBI expect growth to be robust and inflation to edge down in FY25, it highlighted the upside risk to inflation from food inflation, climate shock, rising geo-political risks and crude prices.

### Inflation:

In February 2024, CPI inflation remained steady at 5.09% y/y (Jan 2024: 5.10% y/y, Last year same period: 6.44%y/y), driven down primarily by favourable base effect and broad-based easing in sequential momentum. Excluding veggies, headline inflation eased to 3.71%y/y (Previous month: 3.91%y/y; Feb 2023: 7.59%y/y). This is lowest level since Nov 2019. Core inflation continued to edge down to record low 3.34%y/y (Jan 2024: 3.59%y/y; Last year same period: 6.10%y/y).

### Fiscal:

April-Feb 2023-24 gross grew robustly by ~13%y/y – driven by buoyant direct tax collections. Expenditure growth was muted at ~7%y/y driven down primarily by almost flattish revenue expenditure. That said, capital expenditure continued to grow at higher double-digit. As a result, Fiscal deficit stood at ~86% of budget estimates (Previous year similar period: 82%). March GST data continued to indicate buoyant tax collections (Avg FY24: 11.5%y/y).

First half (1H) FY25 G-sec borrowing calendar came better than expected at Rs. 7.5 trn (1H FY24: Rs. 8.88 trn). First quarter (1Q) T-bill auction calendar was also lower than previous year at Rs. 3.2 trn (1H FY24: Rs. 4.16 trn; 1H FY23: Rs. 4.32 trn). 1Q FY25 SDL auction calendar came bit higher than last year's at Rs. 2.54 trn (1Q FY24: Rs. 2 trn; 1Q FY23: Rs. 1.9 trn).

## External Sector:

February-24 Trade deficit stood at ~US\$18.7 bn (Lower than monthly average Oct-Dec 2023: ~US\$23bn, July-Sep 2023:US\$21 bn). Both exports as well as imports increased. That said, core imports (non-oil non gold imports) continued to decline on a sequential basis. Net services exports grew robustly at 18%/y/y (Apr-Feb 2023-24 growth:16%/y/y).

3Q FY24 (Oct-Dec 2023) current account deficit (CAD) stood at 1.2% of GDP (1Q FY24: ~1%; 3Q FY24: 2%) aided by robust services and remittances. Although FPI flows were buoyant, Balance of Payment (BoP) flows during the quarter were muted on account of muted FDI flows, negative short-term credit and ECBs.

After marginally contracting in January 2024, FPI inflows grew robustly in Feb and March. FY24 saw overall strong inflows of ~US\$41 bn (Equity: US\$25 bn; Debt:US\$14 bn). Post bond inclusion announcement, the FPI flows in debt have picked up (2H 2023-24 cumulative flows: US\$11bn).

On back of strong dollar, average Rupee marginally depreciated against US dollar in Mar 2024 and stood at 83 during the month (Feb: 82.96). Rupee has depreciated by ~1.4% in FY24 (FY23: -ve 8.5%).

## Liquidity:

Core liquidity (system liquidity + Government balances) improved from 2 trn at Feb-24 end to ~2.4 trn by Mar-24 end, driven by RBI's actions (intervention and forex swap maturities). After remaining tight for most part of 2H FY24, System liquidity eased in March to average -ve ~Rs. 43,000 cr (Jan 2024: avg -ve Rs. 2.1 trn; Feb 2024: -ve 1.9 trn) on back of robust government spending and forex related inflows.

## Yield Levels & Spreads:

Fixed income yields remained range-bound during the month of Mar-24. 10-year G-sec yield took cues from global cues (crude prices, US Fed policy, US treasury yields movement) and moved in the range of 7.03-7.10% during the month. 10 yr G-sec closed the month lower at 7.05% (February 2024: 7.08%; January 2024:7.14%). 10-year term premia were flattish to small negative.

10-year SDL yields remained range-bound during the month, with easing bias (range of 7.36-7.44%) to close the month lower at 7.38% (Feb 2024: 7.43%). March SDL primary supply was high at Rs.1,92,763 cr (February 2024: Rs. 1,06,259 cr; January 2024: Rs. 1,04,521 cr). The average spread between 10 yr SDL over G-sec eased to 34 bps during the month (February 2024: 37 bps).

Like SDLs, AAA bonds were range-bound with easing bias during the month with 10 yr AAA PSU moving in the band of 7.44%-7.55% (Previous month: 7.54%-7.58%). It closed the month lower at 7.44% (Feb 2024: 7.54%).



# **Global**

## Monetary Policy:

March-24 continued to see global central bankers' remaining cautious and preferred to remain on hold before evidencing sustainable decline in inflation. While US monthly inflation print has been moving side-ways over last couple of months and growth robust, US Federal Reserve dot-plot continued to indicate three rate cuts in calendar year 2024, with US Federal reserve chairman asserting the need for getting more confidence over the disinflationary process before starting the rate cut cycle. Month also saw Bank of Japan hiking policy rate for first time in eight years and ended negative rate interest regime.

## Inflation:

US inflation rose marginally to 3.2%/y in March 2024 (Feb 2024: 3.1%/y; Jan 2024: 3.4%/y). Sequential growth in headline was higher at 40 bps driven by food, fuel and core services. Global food prices continued to remain in double-digit disinflation for fifteen consecutive months, (with IMF's FAO food index down to negative 10.5%/y in February 2024 vis-à-vis -ve 7.5%/y one year prior). Oil prices have increased sharply since the start of calendar year, with March Brent prices hovering on average ~ US\$85.4/barrel (Jan 2024: US\$80/barrel, Feb 2024: US\$83.5/barrel), on supply concerns (Red Sea issue, middle east war, geo-political risk escalation, OPEC plus extending the supply cuts)

## Financial Markets:

During the month, US treasury yields were volatile during the month driven by non-farm data, monthly inflation print, oil movement, US Fed policy and rising geo-political concerns. US 10 Yr Treasury bond (UST) yield moved in the range of 4.09-4.34% and closed the month lower 4.20% (February 2024: 4.25%). Dollar Index appreciated by 0.54% in March (CY2024 YTD: +ve 3.1%) on rising global uncertainty.

# Market View

- » RBI left policy rate unchanged in April 2024 policy, in line with expectations. Going forward, the RBI rate cut cycle size and timing may be influenced by evolving domestic inflation outlook along with global policymakers' actions timeline. We believe RBI to cut the rates in 2H (Aug/Oct) of calendar year 2024.
- » Core inflation came below 4% in Dec-Feb 2023-2024 and expected to remain muted in March through June 2024 helped by favourable base effect and muted sequential momentum.
- » Expectations of robust growth numbers, moderation in inflation and improving external balances provides RBI leeway to hold rate for longer, while assessing global uncertainty.
- » Currently, the curve is very flat in both corporate and G-secs. Going forward, we expect curve steepening bias likely to prevail in run-up to RBI rate cut. This may positively impact short to intermediate duration funds. In near term, fixed income market yields are likely to be influenced by lower supply (primary issuances of G-sec & T-bills) and improving demand (FPI led bond inclusion related flows).

## **Common Source:**

RBI, CSO, FAO, CEIC, NSO, JP Morgan, US Federal Reserve, US Treasury department, Commerce Ministry of India, NIMF internal research.

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