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Fixed Income
Market Outlook
August 2024

Good gets better

Fixed Income Market Update and Outlook

Market Update

Changing Global Narrative, Fast Track Fiscal Consolidation and Bond Inclusion

July-24 saw more and more global central banks changing policy narrative driven by their domestic macros (Inflation, growth). While there has been rise in geo-political uncertainty, the fear of moderation in global growth is on rise. Back home, the final FY25 budget promised faster fiscal consolidation without comprising on capex. Hi-frequency indicators for India continued to indicate robust fiscal dynamics, easing inflationary pressure and improved external balances.

India

Union Budget:

Union Budget FY25 indicated that the government has moved from gradual fiscal consolidation path (growth supportive fiscal policy) to fiscal normalisation (by fast-tracking fiscal consolidation process). Earlier in the year, FY24 fiscal deficit (as % of GDP) came in much lower at 5.6% of GDP as against revised estimate (RE). This, despite, moderation in nominal GDP growth. In FY25, fiscal deficit is expected to improve further to 4.9% of GDP (Interim Budget FY25: 5.1%) aided by - buoyant non-tax revenue and modest expenditure growth.

Inflation:

After remaining ~4.8%y/y levels from March through May 2024, CPI inflation rose in Jun'24 to 5.08%y/y (May 2024: 4.80% y/y, Last year same period: 4.87%y/y), driven mainly by food inflation. Excluding veggies, headline inflation remained muted at 3.53%y/y (Previous month: 3.53%y/y; June 2023: 5.21%y/y). Core inflation continued to remain muted at 3.14%y/y (May 2024: 3.12%y/y; Last year same period: 5.11%y/y).

Fiscal:

April-June 24 gross tax receipts grew robustly by ~24%y/y - driven by buoyant direct tax collections and resilient indirect taxes. Record high RBI dividend resulted in sharp spike in non-tax receipts. Expenditure registered degrowth driven down primarily by muted revenue expenditure and sharp contraction in capex. As a result, Fiscal deficit stood at record low 3% of budget estimates (Previous year similar period: 12%). July GST data registered record third highest tax collections (Apr-July FY25: 10%y/y).

External Sector:

June Trade deficit moderated to~US$21 bn (Apr 24: US$19 bn; May 24: US$24 bn; Jun 24: US$21 bn). 1Q FY25 (Apr-Jun 2024) exports grew at muted 4.6%y/y, while imports grew at ~8%y/y. Core imports growth (non-oil non gold) were muted. 1Q FY25 Net services exports grew robustly at 13%y/y (1Q FY25 growth:15%y/y).

FPI (debt and equity) saw robust flows in June and July (cumulative: US$~11 bn) led by bond inclusion rally. That said, Apr-July FY25 FPI flows were relatively muted at US$7.3 bn (4Q FY24: US$9 bn) on account of global asset repricing in the initial months of the fiscal year.

Rupee marginally depreciated in May'24 through Jul'24 and stood at 83.59 against dollar during July (June 2024: 83.47; May 2024: 83.39; Apr 2024: 83.41).

Bond Inclusion:

India became part of JP Morgan Bond index since end June 2024. In run-up to Bond inclusion, robust FPI inflows into Indian G-sec market. Total inflows since Sep 2023 announcement have been to the tune of ~Rs.1.2 trn, out of which FAR (Fully Accessible Route) securities got inflows to the tune of ~Rs.1.12 trn. July saw ~Rs.19,000 cr in FAR securities (June 2024: ~Rs.17,000 cr).

Liquidity:

Banking system liquidity was positive during the month and eased to Rs. 1.1 trn (Jun 2024: -ve Rs. 50,000 cr; May 2024 ~-ve Rs.1.4 bn) on govt spending and lower cash requirement. Government balances continued to remain robust and stood on an average ~Rs. 3 trn (June 2024: Rs. 4.2 trn; May 2024: Rs. 3.5 trn). Core liquidity (system liquidity + Government balances) stood at ~Rs.4.25 trn by July end (June end: ~Rs. 3.5 trn; May end: ~Rs. 3.6 trn).

Yield Levels & Spreads:

Fixed income market yields continued to remain range-bound during the month with easing bias witness in second half of the month - on lower budgeted FY25 fiscal deficit and global cues. 10-year G-sec yield moved in the narrow range of 6.98%-7.01% in first fortnight and eased in second half to move in the range of 6.92-6.97% (June 2024: 6.95%-7.03%; May 2024: 6.98-7.16%). 10 yr G-sec closed the month lower at 6.92% (June 2024: 7.02%; May 2024: 6.99%, Apr 2024: 7.20%). Average 10-year term premia increased to average~11 bps during the month (June 2024: 2 bps; May 2024: 4 bps, Apr 2024: 13 bps) – on relatively faster easing of short-term rates aided by improved liquidity and lower issuances.

Taking cues from G-sec, 10-year SDL yields eased a bit and were range-bound during the month (range of 7.28-7.36% as against 7.30-7.42% in June) to close the month lower at 7.28% (June 2024: 7.33%; May 2024: 7.40%; Apr 2024: 7.47%). July SDL primary issuances stood ~ Rs.68,400 cr (June 2024: Rs. 52,000 cr; May 2024: Rs. 42,800 cr; Apr 2023: Rs. 51,200 cr). The average spread between 10 yr SDL over G-sec stood at 36 bps during the month (June 2024: 37 bps; May 2024: 34 bps; Apr 2024: 29 bps).

Like G-sec and SDLs, AAA bonds were range-bound with easing bias, with 10 yr AAA PSU moving in the band of 7.45%-7.49% (Previous month: 7.47%-7.54%). It closed the month lower at 7.46% (June 2024: 7.49%; May 2024: 7.46%, Apr 2024: 7.56%).

Global

Monetary Policy:

Recently many global advanced economies (BoC, ECB etc) have shifted gear and started rate cut cycle. The month saw Bank of England starting rate cut cycle, with US federal reserve indicating rate cut cycle to begin from September onwards. With US macro data, post meeting, coming lower rate than expectations raising the market expectations of earlier rate cut. However, Bank of Japan hike the policy rate and announced its quantitative tightening programme.

Financial Markets:

During the month of Jul'24, US treasury yields continued to ease further and rallied in expectations of rate cut on the back of moderating economic data, easing inflation and dovish US Fed. US 10 Yr Treasury bond (UST) yield moved in the range of 4.09%-4.48% (as against 4.36-4.63% in May 2024) and closed the month lower 4.09% (June 2024: 4.36%; May 2024: 4.51%, Apr 2024: 4.69%). Dollar Index depreciated by 1%m/m in Jul (June 2024: flattish; May 2024: -ve 0.45%; Apr 2024: +ve 1.54%; CY2024 YTD: +ve 4.5%) on rate cut expectations.

Market View

- Going forward, the start of rate cut cycle by major advanced economies, coupled with rising expectations of early start of rate cut cycle in US is expected to provide further down-side bias to global fixed income yields.
- Indian bonds are likely to be supported by easing global yield bias, good macro, lower core inflation, reduced supply and improved demand (bond inclusion).
- Money markets are well-supported by ample system liquidity (seasonality, lower T-bill supply, FPI flows etc).
- While Inflation is expected to ease in 2Q FY25, the volatile food prices, strong domestic growth, global geo-political uncertainty is likely to keep RBI on hold in August'24 policy.
- 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 (Oct/Dec) of the FY25.

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