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Fixed Income
Market Outlook
July 2024

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Fixed Income Market Update and Outlook

Market Update

India: Moderating Inflation, Bond inclusion, Improving Macro-stability

June 2024 saw range-bound financial market. While underlying narrative of slower and delayed start of rate cut cycle remains, ECB made an early start in June, with BoE indicating easing bias. Inflation across globe has been gradually coming down, while growth data continued to remain mixed.

Hi-frequency indicators for India indicates that Indian economy continued to better fiscal dynamics, easing inflationary pressure and improved external balances (ahead of bond inclusion).

India

Monetary Policy:

Taking comfort from the improving domestic macros, RBI, in June'24 meeting, maintained the status quo – in line with consensus expectations. In meeting and press conference that followed, RBI admitted that the domestic growth-inflation balance has moved favourably since last policy. While highlighting risk from geopolitical uncertainty, commodity price volatility, food shock, rising input prices, RBI upwardly revised FY25 economic growth projections, while retaining benign inflation outlook. June'24 policy saw divided MPC with two external members opting for rate cut and change in stance.

Inflation:

In May 2024, CPI inflation eased further to 4.75%y/y (Apr 2024: 4.83% y/y, Last year same period: 4.31%y/y), driven down by favourable base effect and sequential momentum better than seasonality (despite heatwave). Excluding vegetables, headline inflation eased further to 3.52%y/y (Apr'24: 3.57%y/y; May 2023: 5.04%y/y). Core inflation continued to edge down to record low 3.12%y/y (Apr 2024: 3.23%y/y; Last year same period: 5.05%y/y).

Fiscal:

April-May 24 gross tax receipts grew robustly by ~16%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 growth was flattish driven down primarily by muted revenue expenditure and degrowth in capex. As a result, Fiscal deficit stood at record low 3% of budget estimates (Previous year similar period: 12%). June-24 GST data continued to indicate buoyant tax collections (1QFY25: 10%y/y).

2Q FY2025 T-bill calendar stood at Rs. 2.6 trillion (~1Q issuances) - in line with expectations. That said, it is on lower side since pandemic - on backdrop of huge govt balances. Accordingly, weekly supply came in lower at Rs.20,000 cr (against post-pandemic normal avg: Rs. 23,0000 cr). 2Q FY25 SDL calendar came in at Rs. 2.64 trillion (~1Q issuances calendar) - with weekly average issuance size expected ~Rs.20,000 cr. That said, actual gross issuances in 1Q were much lower at Rs. 1.5 trn as against calendar (Rs. 2.5 trn).

External Sector:

May'24 Trade deficit rose to~US$24 bn (Apr 24: US$19 bn; May 23: US$23 bn). Apr-May 2024 export grew at 5%y/y, while imports grew at ~9%y/y. That said, core imports growth (non-oil non gold) were muted. Apr-May 2024-25 Net services exports grew robustly at 17%y/y (Apr-May 2023-24 growth:15%y/y).

FY24 CAD came in lower at 0.7% of GDP (FY23: 2%) - aided by moderation in goods trade deficit and buoyant services balances & strong NRI remittances. On the capital account, FDI moderated to multi-year low on global cues, but Foreign Portfolio Investment (FPI) was multi-year high on domestic cues and ahead of Bond inclusion. Bank capital flows were also robust. As a result, FY24 BoP inflows were robust at US$64 bn (FY23: -ve US$9 bn).

After outflows in Apr & May (primarily from equity), June-24 saw robust US$5 bn FPI flows (in both equity and debt). That said, 1Q FY25 FPI flows were muted at US$1.5 bn (4Q FY24: US$9 bn). Debt market, however, has witness robust FPI flows ahead of bond inclusion in current calendar year (Jan-June 2024: US$8 bn).

Rupee has remained largely flattish in May & June and stood at 83.47 against dollar during the month of June 2024.(May 2024: 83.39; Apr 2024: 83.41).

Bond Inclusion:

India became part of JP Morgan Bond Index since end of June 2024. Starting June 28, 2024, India is expected to reach a weight of 10% and 8.4% over a 10-month period, through March 31, 2025, in the Government Bond Index – Emerging Markets (GBI-EM) Global Diversified and GBI-EM Global Index, respectively. In run-up to Bond inclusion, robust flows into FPI debt in India. Total inflows since announcement have been to the tune of ~Rs.1 trn, out of which FAR (Fully Accessible Route) securities got inflows to tune of ~Rs.95 trn.

Liquidity:

Banking system liquidity eased during the month (avg -ve Rs. 50 bn as against May 2024 ~Rs.1.5 bn) on govt spending, lower T-bill issuances and lower cash requirement. Government balances continued to remain robust and stood on an average ~Rs. 4 trn (May 2024: Rs. 3.7 trn. Core liquidity (system liquidity + Government balances) stood at ~Rs.3.5 trn by June end (~Rs. 3.6 trn by May end).

Yield Levels & Spreads:

After easing by almost 15-20 bps during May month on easing global yields, fixed income yields were range-bound during June'24. 10-year G-sec yield moved in the range of 6.95-7.03% (May 2024: 6.98-7.16%). 10 yr G-sec closed the month marginally higher at 7.01% (May 2024: 6.99%, Apr 2024: 7.20%). Average 10-year term premia eased to average ~2 bps during the month (May 2024: 4 bps, Apr 2024: 13 bps).

Taking cues from G-sec, 10-year SDL yields were range-bound during the month (range of 7.30-7.42% as against 7.35-7.45% in May) to close the month lower at 7.33% (May 2024: 7.40%; Apr 2024: 7.47%). June SDL primary issuances stood ~ 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 rose to 37 bps during the month (May 2024: 34 bps; Apr 2024: 29 bps).

Like G-sec and SDLs, AAA bonds were range-bound during the month with 10 yr AAA PSU moving in the band of 7.47%-7.54% (Previous month: 7.46%-7.58%). It closed the month marginally higher at 7.49% (May 2024: 7.46%, Apr 2024: 7.56%).

Global

Monetary Policy:

June'24 saw couple of advanced economy Central banks shifting gear, with European Central Bank (ECB) taking lead and starting rate cut cycle, while Bank of England (BoE) indicated month of August as a start. That said, further moves from these central banks are likely to be data-dependent and lesser than initially expected. While US data has been on downside recently, US Fed wants more assurance from the upcoming data to the start the rate cut cycle and preferred to stay on hold in Jun'24 meeting.

Financial Markets:

During the month, US treasury yields eased on the back of moderating economic data and easing inflation. US 10 Yr Treasury bond (UST) yield were range-bound (4.20-4.47% as against 4.36-4.63% in May 2024) and closed the month lower 4.36% (May 2024: 4.51%, Apr 2024: 4.69%). Dollar Index was flattish in Jun'24 (May 2024: -ve 0.45%; Apr 2024: +ve 1.54%; CY2024 YTD: +ve 4.5%) on rising global uncertainty

Market View

- Start of rate cut cycle by some advanced economies and muted economic data from US (United State) may raise the hope of turn of monetary policy globally in coming quarters.
- Crucial event to look forward are: 1). Upcoming Budget (path of fiscal consolidation and quality of expenditure pattern); 2) FPI flows post Bond Inclusion.
- While Inflation has been trending downwards in recent months and is expected to ease further in FY25, the evolving food trajectory (driven by monsoon), strong domestic growth, high oil prices, global geo-political uncertainty have put RBI on hold.
- 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 FY25.

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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