



Nippon *india* Mutual Fund

Wealth sets you free

Fixed Income

Market Outlook

June 2024



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Fixed Income Market Update and Outlook

Market Update

India: Robust Economic Growth, Easing Inflation and Better than Expected Fiscal Consolidation

May'24 saw financial market normalising after sharp repricing of assets seen in Apr'24. While underlying narrative of slower and delayed start of rate cut cycle continues, ECB is likely to make early start. Inflation across globe has been gradually coming down, while growth data continued to remain resilient.

Hi-frequency indicators for India indicates that Indian economy continued to grow robustly in FY24, with better-than-expected fiscal consolidation and easing inflationary pressure.

India

GDP:

Indian economy grew at robust 8.2%/y in FY24 (higher than advance estimates of 7.6%/y). Economic growth from supply side grew at 7.22%/y (Advance estimate for FY24: 6.9%/y). The robust growth is projected to be driven by buoyant capex growth from demand side and industry (construction, mining and manufacturing) & broad-based robust services growth (especially Financing, insurance, real estate & business services and public administration) from supply side. However, agriculture and consumption (private and government) growth were muted.

Fiscal:

FY24 fiscal deficit (% of GDP) came in lower at 5.6% as against downwardly revised 5.8% in revised estimates for FY24. Better than expected revenue receipts (tax and non-tax) and muted expenditure growth helped in faster fiscal consolidation. That said, capital expenditure continued to grow at higher double-digit indicating improved quality of fiscal expenditure. In fact, capital expenditure (on avg) has grown at buoyant ~30%/y annual over last three years (FY22-FY24).

Inflation:

In April 2024, CPI inflation marginally eased to 4.83%/y (Mar 2024: 4.85% y/y, Last year same period: 4.70%/y/y), driven down by favourable base effect and sequential momentum in line with seasonality. Excluding veggies, headline inflation remained steady at 3.56%/y (Previous month: 3.55%/y/y; Apr 2023: 5.44%/y/y). Core inflation continued to edge down to record low 3.23%/y (Mar 2024: 3.24%/y/y; Last year same period: 5.19%/y/y).

External Sector:

April 2024 Trade deficit rose to US\$19.1 bn (March 2024: US\$15.5 bn; Apr 2023: US\$14.4 bn; & slightly lower than monthly average FY24: ~US\$20bn). Higher imports (crude and gold) resulted in higher trade deficits. Although net services exports have moderated in absolute terms since February 2024, overall net services grew robustly at 16%/y.

After the robust inflows in Feb–March, FPI flows contracted in April and May. While May 2024 saw outlook of US\$1.5 bn, outflows were primarily from equity (US\$3 bn) ahead of election outcome and on global cues. Debt market saw positive FPI inflows (US\$1 bn) after witnessing outflows in April ahead of JP Morgan bond inclusion. That said, CY2024 saw overall robust inflows in first five months to the tune of US\$6 bn, driven primarily by debt inflows (US\$6.4 bn).

On back of depreciation of dollar, average Rupee remained largely flattish in May 2024 and stood at 83.39 against dollar during the month (Apr 2024: 83.41).

Liquidity:

Banking system liquidity was tight during the month (avg -ve Rs 1.5 trn) as against flattish liquidity in April (which typically is seasonally easy month). That said, lower T-bill issuances (Rs.20,000 cr) and G-sec buybacks (Rs. 23,000 cr) during the month helped in improving the liquidity, despite seasonally high cash demand. Government balances continued to remain robust and stood on an average ~Rs. 3.5 trn (excluding RBI dividend avg Rs. 2.75 trn) during May 2024 (Apr 2024: 1.8 trn). As a result of huge RBI dividend, Core liquidity (system liquidity + Government balances) increased sharply from Rs. 1.5 trn at April end to ~Rs. 3.6 trn by May end.

Yield Levels & Spreads:

After rising sharply in Apr'24 on global financial market repricing, Indian fixed income market yields eased by almost 15-20 bps during the month on easing global yields, muted inflation, record RBI dividend giving hope of faster fiscal consolidation and rising expectations of lower gross issuances.

In May 2024, 10-year G-sec yield moved in the range of 6.98-7.16% during the month. 10 yr G-sec closed the month lower at 6.99% (Apr 2024: 7.20%; March 2024: 7.05%; February 2024: 7.08%; January 2024: 7.14%). Average 10-year term premia eased to average ~4 bps during the month (Apr 2024: 13 bps).

Taking cues from G-sec, 10-year SDL yields eased during the months (range of 7.35-7.45%) to close the month higher at 7.40% (Apr 2024: 7.47%). May'24 SDL primary issuances stood ~ Rs.42,800 cr (Apr 2023: Rs. 51,200 cr). The average spread between 10 yr SDL over G-sec rose to 34 bps during the month (Apr 2024: 29 bps).

Like G-sec and SDLs, AAA bonds eased during the month with 10 yr AAA PSU moving in the band of 7.46%-7.58% (Previous month: 7.52%-7.59%). It closed the month lower at 7.46% (Apr 2024: 7.56%).



Global

Inflation:

US inflation eased marginally to 3.4%/y in April 2024 (Mar 2024: 3.5%/y; Feb 2024: 3.2%/y; Jan 2024: 3.1%/y); while core inflation eased a bit to 3.6%/y (Apr 2024: 3.8%/y). Sequential growth of headline & core inflation continued to remain high at 30 bps driven by sticky core services. Global food prices continued to remain in disinflation for seventeen consecutive months, (with IMF's FAO food index down to negative 7.5%/y in Apr 2024 vis-à-vis -ve 21.5%/y one year prior). Oil prices decreased sharply by 9%/m in May 2024, after rising 5% m/m in Apr, with May'24 Brent prices hovered on average ~ US\$81.75/barrel (Jan 2024: US\$80/barrel, Feb 2024: US\$83.5/barrel; Mar 2024: US\$85.41/barrel; Apr 2024: US\$ 89.9/barrel) on demand concerns.

Monetary Policy:

Resilient economic data, relatively tight labour market, high crude prices pickup in sequential momentum of headline inflation and sticky core services and expansionary fiscal policy have resulted in postponement of start of rate cut cycle and cutting down of market expectations of overall cut. US Fed Reserve Chairman Powell, in his early May'24 Fed meeting, has clearly indicated that monetary easing might take longer than initially indicated. Amongst the advanced economies, only ECB has indicated that they might start policy easing from June onwards.

Financial Markets:

During May'24, US treasury yields eased during the month after mixed economic data, easing inflation, easing crude prices and depreciating dollar index. US 10 Yr Treasury bond (UST) yield were volatile and moved in the range of 4.36-4.63% and closed the month lower 4.51% (Apr 2024: 4.69%). Dollar Index depreciated by 0.45% in May (Apr 2024: +ve 1.54%; CY2024 YTD: +ve 3.9%) on rising global uncertainty.

Market View

- » While Inflation has been trending downwards in recent months and is expected to ease further in FY25, the strong domestic growth, high oil prices, global geo-political uncertainty and postponement of rate cut cycle by major global central bankers 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 (Aug/Oct) of calendar year.
- » Better than expected FY24 fiscal performance (driven by robust revenues and muted expenditure growth) has raised the expectations of faster fiscal consolidation in FY25 - aided by more than anticipated RBI dividend. This in turn have raised the expectations of lower gross borrowing than budgeted for FY25. Already, government has cut down on 1Q FY25 T-bill issuance calendar.

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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