



Nippon **india** Mutual Fund

Wealth sets you free

# Fixed Income

## Market Outlook

March 2024



Good gets *better*

# Fixed Income Market Update and Outlook

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## Market Update

### **Robust Growth, improving domestic Inflation Dynamics, on-track fiscal consolidation and improving external balances.**

Better than expected domestic growth outlook (supported by hi-frequency data), easing headline and core inflation pressure, clear roadmap for rapid fiscal consolidation and manageable external balances were key macro data-points for Indian fixed income markets during the month (Feb'24)

## **India**

### Economic Growth:

Second advance estimates of National Statistical Office (NSO), released Feb end, revised up FY24 growth estimate to 7.6%y/y (Previous estimate: 7.3%y/y & higher than RBI's expectations of 7% y/y). Economic growth from supply side grew at 6.9%y/y (FY23: 6.7%y/y). The robust growth is projected to be driven by double-digit capex growth from demand side and industry (construction, electricity and manufacturing) & broad-based robust services growth (especially trade, hotels, transportation) from supply side. Agriculture and private consumption growth were muted.

### Inflation:

In January 2024, CPI inflation eased to 5.10% y/y (Dec 2023: 5.69% y/y, Last year same period: 6.52%y/y), driven down primarily by favourable base effect and broad-based easing in sequential momentum. Excluding vegetables, headline inflation eased to 3.91%y/y (Previous month: 4.48%y/y; January 2023: 7.69%y/y). This is lowest level since Nov 2019. Core inflation continued to edge down to record low 3.59%y/y (December 2023: 3.89%y/y; Last year same period: 6.10%y/y).

### Monetary Policy:

In early February 2024 meeting, RBI retained status quo on policy rate and stance – in line with market expectations. While the inflation has gradually come down over the period, it is still above RBI's medium-term target of 4%. This, in addition to robust domestic growth outlook, rising geopolitical uncertainty, cautious global central bankers', volatility in domestic food inflation trajectory kept RBI cautious on overall inflation outlook. RBI has revised downward FY25 inflation projections, while being bullish on growth outlook. Further, as against the market expectations for easing system liquidity, RBI only promised to actively manage liquidity – *with no concentrate measures announced*.

## Fiscal:

April-Jan 2023-24 gross & net tax collections grew robustly by 14.5%/y and 11.3%/y respectively - driven by buoyant direct tax collections. Expenditure growth was muted at ~6%/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 ~64% of budget estimates (Previous year similar period: 68%). February GST data continued to indicate buoyant tax collections (Apr-Feb FY24: 11.5%/y).

## External Sector:

January'24 Trade deficit eased to ~US\$17.5 bn (monthly average Oct-Dec 2023: ~US\$23bn, July-Sep 2023:US\$21 bn, Apr-Jun 2023: US\$18.7 bn)) driven down mainly by contraction in imports (especially non-oil non-gold). Net services exports grew robustly at 23%/y (Apr-Jan 2023-24 growth:17%/y).

After marginally contracting in January 2024, FPI inflows rose robustly by ~US\$4 bn in February 2024, with more than 70% inflows in debt. With this, Apr-February FY24 saw overall strong inflows of ~US\$35 bn (Equity: US\$21 bn; Debt:US\$13 bn). Post bond inclusion announcement, the flows in debt have picked up with Oct-Feb 2023-24 flows to the tune of US\$10 bn.

On back of strong dollar, average Rupee was marginally depreciated against US dollar in February 2024 and stood at 83.96 during the month (Jan: 83.12). Rupee has appreciated by ~1% in FY YTD (Apr-February 2023-24).

## Liquidity:

February 2024 saw core liquidity (system liquidity + Government balances) declined from daily average of 2 trn in January to ~1.7 trn in February, on back of seasonally high cash demand & credit pick-up. Negative System liquidity eased in February (daily average -ve Rs. 1.9 trn) as against daily average of -ve Rs. 2.1 trn in January 2024.

## Yield Levels & Spreads:

Fixed income yields ease during the Feb'24 - driven by faster than expected fiscal consolidation, lower than expected FY25 gross borrowings number and easing monthly inflation print. 10-year G-sec yield moved in the range of 7.05-7.11% during the month. 10 yr G-sec closed the month lower at 7.08% (January 2024:7.14%, Dec 2023: 7.18%, Nov 2023: 7.28%). While money market rates eased a bit during the month on government spending, relative faster easing of yields in benchmark, the 10 year term premia was flattish to small negative.

Taking cues from Gsec, 10-year SDL yields eased a bit and remained range-bound during the month (range of 7.41-7.54% to close the month lower at 7.43% (Jan 2024: 7.45%). February SDL primary supply continued to remain high at Rs.1,06,259 cr (January 2024: Rs. 1,04,521 cr). The average spread between 10 yr SDL over G-sec eased to 37 bps during the month (January 2024: 48 bps).

In Feb'24, AAA bonds eased during the month with 10 yr AAA PSU moving in the band of 7.54%-7.58% (Previous month: 7.65%-7.74%). It closed the month lower at 7.54% (Jan 2024: 7.63%).



# **Global**

## Monetary Policy:

February-24 saw global central bankers' sounding cautious on early rate cut cycle and preferred to remain on hold before evidencing sustainable decline in inflation. In case of US, strong growth print (non-farm numbers, GDP, PMI etc) and pick-up inflation momentum has made FOMC members extra cautious.

## Inflation:

US inflation eased to 3.1%/y in February 2024 (Jan 2024: 3.4%/y). Sequential growth in headline was higher at 30 bps driven by food, fuel and core services (Read: Shelter). Global food prices continued to remain in double-digit disinflation for fourteen consecutive months, (with IMF's FAO food index down to negative 10.3%/y in January 2024 vis-à-vis -ve 3.1%/y one year prior).. Oil prices continued to rise for second month in row and average ~US\$ 83.5/barrel (Jan 2024: US\$80/barrel), on supply concerns (Red Sea issue, middle east war etc)

## Financial Markets:

During Feb'24, US treasury yields rose during the month on revised down expectations on rate cut in 2024; expectations of rate cut shifting to later part of year, strong non-farm employment data, higher-than-expected monthly inflation print and pickup in core inflation. US 10 Yr Treasury bond (UST) yield moved in the range of 3.87-4.33% and closed the month higher at 4.25% (January 2024: 3.99%). After appreciating in January, Dollar Index appreciated further by 1.14% in February 2024 (CY2024 YTD: 2.8%).

# Market View

- » RBI left policy rate unchanged in February 2024 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 may cut the rates in second half of the calendar year 2024.
- » Core inflation came below 4% in Dec-Jan 2023-2024 and expected to remain muted in Feb-March 2024 helped by favourable base effect and muted sequential momentum.
- » Policymakers clear intend to adhere to medium term fiscal trajectory (4.5% by FY26), without any compromise on quality of expenditure (i.e capex focus) indicates fiscal support is likely to be non-inflationary and medium-term growth supportive.
- » Better than expected 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 benefit short to intermediate duration funds. Absolute fall in yields may provide capital gains to long duration funds.

## **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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