Market Intelligence
& Analytics

CRISIL
An S&P Global Company

RateView

CRISIL's outlook on near-term rates

August 2023

Research

Contents

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July jog

The yield on the 10-year benchmark government security (G-sec; 7.26% GS 2033) opened July at 7.12% and closed at 7.17%, up 6 basis points (bps) from its June close of 7.11%, and within CRISIL's forecast range of 7.07-7.17%.

The first week of the month saw yields harden, tracking a surge in United States (US) Treasury yields and crude oil prices. Crude prices rose as the market assessed supply cuts announced by Saudi Arabia and Russia for August. The 10-year US Treasury yield hardened 25 bps to close the week at 4.06% due to stronger-than-expected labour market and economic data. In India, the 10-year benchmark paper 7.26% GS 2033 closed the week at 7.16%

In the second week, yields softened, tracking a decline in US Treasury yields. The 10-year US Treasury yield eased 23 bps to close at 3.83%, due to lower-than-expected US Consumer Price Index (CPI) inflation print. The US headline inflation fell to 3.0% on-year in June from 4.0% in May, while the domestic CPI inflation rose to 4.81% after hitting a 25-month low of 4.25%. The 10-year benchmark paper closed at 7.09%.

In the third week, bonds traded in a narrow price range owing to lack of firm cues. Market participants refrained from placing large bets ahead of the US Federal Open Market Committee (FOMC) monetary policy decision due the following week. The United Kingdom's CPI inflation rose 7.9% in June, lower than in the previous month. In India, the 10-year benchmark paper closed at 7.09%.

In the fourth week, yields hardened again, tracking a surge in US Treasury yields and crude prices. The 10-year US Treasury yield firmed up 12 bps to close at 3.96% as the FOMC raised the federal funds target range by 25 bps to a 22-year high of 5.25-5.50%, US gross domestic product and goods order data came in above expectations, and The Bank of Japan made a surprise decision on July 28 to loosen its yield curve control policy. The market also expected a spike in domestic inflation owing to inclement weather affecting food prices. The 10-year benchmark paper closed higher at 7.16%.

Coming into August, the Reserve Bank of India's (RBI) Monetary Policy Committee kept the repo rate unchanged at 6.5% and maintained its policy stance at 'withdrawal of accommodation'. However, the RBI raised its inflation projection for this fiscal to 5.4%, after having lowered it in June to 5.1% from 5.2%. The RBI has also asked banks to maintain a 10% incremental cash reserve ratio from August 12.

CRISIL's outlook

On interest rates

Benchmark	July 31, 2023 (A)	August 31, 2023 (P)	October 31, 2023 (P)
10-year G-sec yield*	7.17%	7.12-7.22%	7.11-7.21%
10-year SDL yield	7.46%	7.43-7.53%	7.42-7.52%
10-year corporate bond yield	7.55%	7.53-7.63%	7.52-7.62%

A: Actual; F: Forecast
Source: CRISIL MI&A Research

One-month view

For August, we expect the 10-year G-sec yield to stay elevated for some time owing to the inflation data surprise, but thereafter, soften a bit as the RBI keeps liquidity conditions comfortable. We forecast it to be in the range of 7.12 -7.22% by month-end, compared with 7.17% as of July-end.

Three-month view

Beyond August, we expect the yield to show stability until October. Food price pressures might linger for a couple of months, after which government intervention and fresh crop arrivals should help bring down prices and cool headline inflation. Liquidity should remain comfortable, not adding much pressure in the longer segment.

Framework for outlook

CRISIL provides its outlook on key benchmark rates for different debt classes — 10-year G-sec, state development loans (SDLs), and corporate bonds — based on statistical models and inputs from its in-house experts. We also offer our views on policy expectations, macroeconomic outlook, key events (local and global), and market factors (liquidity and demand/supply).

Note: All levels quoted are volume-weighted average yields during the last trading hour of the day

Factors influencing the outlook

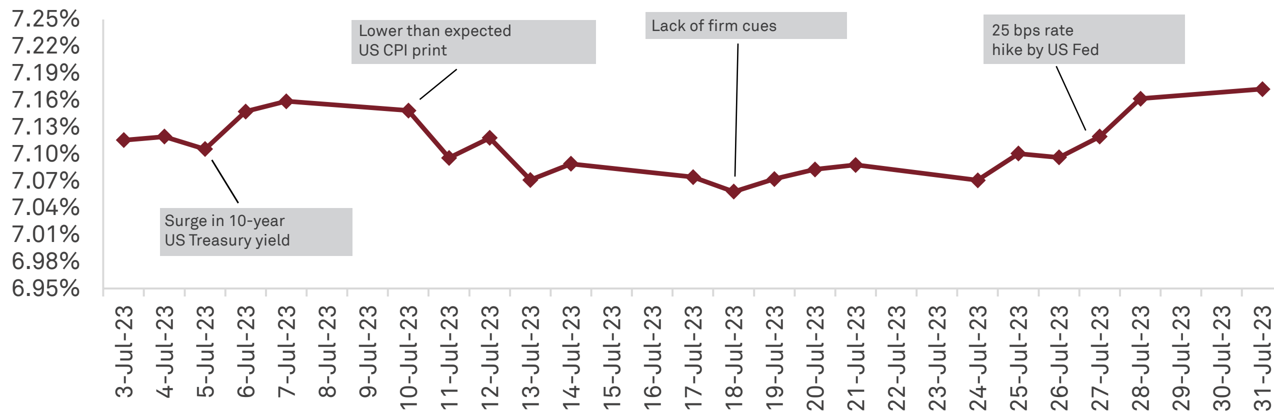
Economic parameter	Our view	Impact on yields
Gross domestic product (GDP) growth	• We expect India's real GDP growth to slow to 6.0% on-year in fiscal 2024 from 7.2[1] % previous year • lowing global growth is expected to hit the Indian economy through weaker exports. Domestic demand prospects will depend on monsoon performance and impact of El Niño • GDP growth accelerated to 6.1% on-year in the fourth quarter of fiscal 2023, from 4.5% in the previous quarter	↓
Consumer price index (CPI) inflation	• We expect consumer price index (CPI)-based inflation to moderate to 5.5% in fiscal 2024 from 6.7% in the previous year • With the sharp surge in the July CPI print, and early signs that August would see minimum relief on food prices, the upside risks to our inflation forecast have materialised. We have, therefore, markedly revised upwards our inflation forecast for this fiscal to 5.5% from our earlier estimates of 5% • CPI inflation surged to 7.4% in July from 4.9% in June	↓
RBI's monetary policy	• We expect the MPC to hold policy rates in the next meeting, as it awaits a clearer picture on inflation path. Uncertainty on the inflation trajectory has increased with the recent flare up in food prices. Monsoon and weather disruptions, along with government interventions and global food supply will influence inflation outcome • A 25 bps rate cut in early 2024 is a conditional possibility for now • The MPC kept policy rates unchanged in August meeting, while maintaining its stance of 'withdrawal of accommodation'. However, it introduced Incremental Cash Reserve Ratio (I-CRR) as a temporary measure for liquidity management	↔
Fiscal health	• The budget has targeted a reduction in the centre's fiscal deficit to 5.9% of GDP this fiscal from 6.4% of GDP in the previous fiscal • In the first three months of this fiscal, the centre's fiscal deficit stood at 25.3% of the target, compared with 21.2% in same period last year • Gross market borrowing is estimated at Rs 15.4 lakh crore for fiscal 2024, 8.4% higher on-year. This growth will be lower than nominal GDP growth of 10.5% expected next year	↓
Crude oil prices	• We expect crude prices to average $75-$80 per barrel in fiscal 2024 compared with $95 per barrel previous year • Brent crude oil prices increased to $80.1 per barrel average in July, 7.0% higher on-month but 26.5% lower on-year	↓

[1]Provisional estimate by National Statistics Office

Economic parameter	Our view	Impact on yields
Current account balance	• We expect current account deficit (CAD) average 1.8% of GDP in fiscal 2024 compared with 2.0% of GDP in fiscal 2023 • Correction in international commodity prices and support from healthy services exports and remittances will help CAD narrow this fiscal • CAD fell sharply to 0.2% of GDP in fourth quarter of fiscal 2023 from 2.0% of GDP previous quarter	↓
US Federal Reserve's stance	• S&P Global sees the Fed policy rates remaining higher for longer and does not expect the first rate cut till June 2024 • The statement and comments made by the Fed chair after the July meeting suggest the possibility of another rate hike this year • The Fed raised its policy rate by 25 bps in July to 5.25-5.50%	↑
Liquidity indicators **i) Demand and supply**	• SDL saw reduction in supply, owing to the more-than-expected transfer of instalment by the centre to states towards capex loan for 50 years (expected: ~Rs 33,000 crore, actual: ~Rs 66,000 crore) • The RBI announced a new 10-year G-sec maturing in 2033, through which it will raise Rs 14,000 crore	↔
ii) Call rates/ liquidity adjustment facility (LAF)	• Average interbank call money rate slipped below the RBI's repo rate of 6.50%. This was due to excess liquidity in the system (ranging from ~Rs 48,000 crore to Rs 2.4 lakh crore). Meanwhile, several variable-rate repo auctions were intermittently conducted by the RBI through the month	↔

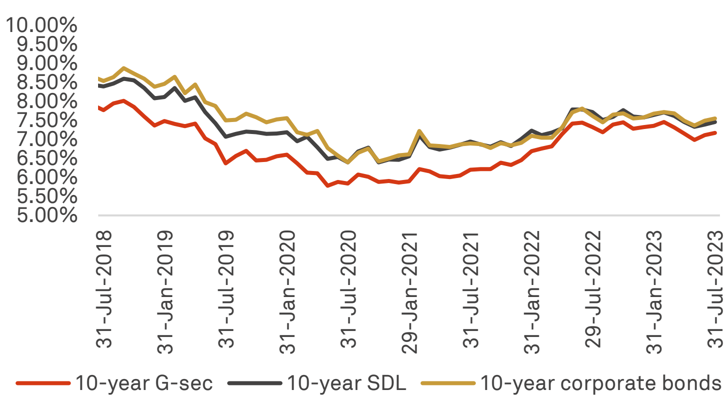
CRISIL's outlook on interest rates

10-year benchmark G-sec yield



Source: CRISIL MI&A Research

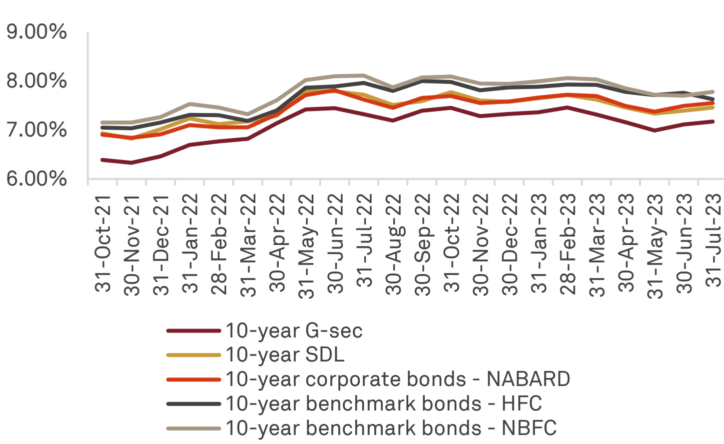
Benchmark yields harden



Source: CRISIL MI&A Research

Yield on the 10-year benchmark G-sec hardened 6 bps to close July at 7.17%, the 10-year SDL hardened 7 bps to close at 7.46%, and corporate bonds (10-year PSU FI) hardened 6 bps to close at 7.55%.

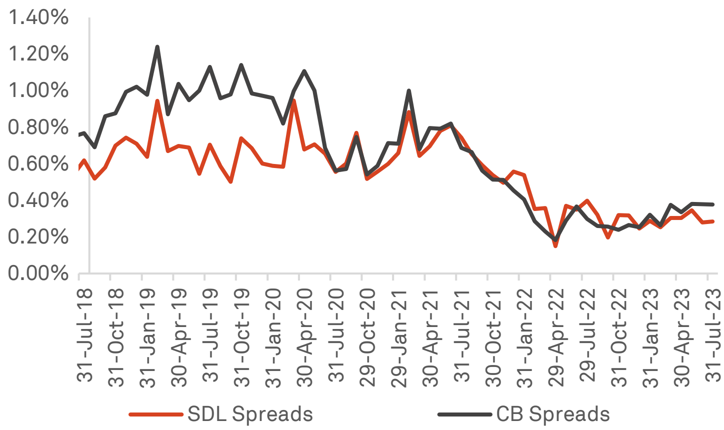
10-year G-sec/SDL/corporate bond benchmark yields



Source: CRISIL MI&A Research

Yield on the 10-year benchmark bonds Housing Development Finance Corporation Ltd (HDFC) decreased 13 bps to 7.63% in July from 7.76% in June. Yields on the 10-year benchmark bonds for AAA-rated non-banking financial companies (NBFCs) and AAA-rated PSU bonds closed at 7.78% and 7.55%, up from 7.70% and 7.49%, respectively, in July.

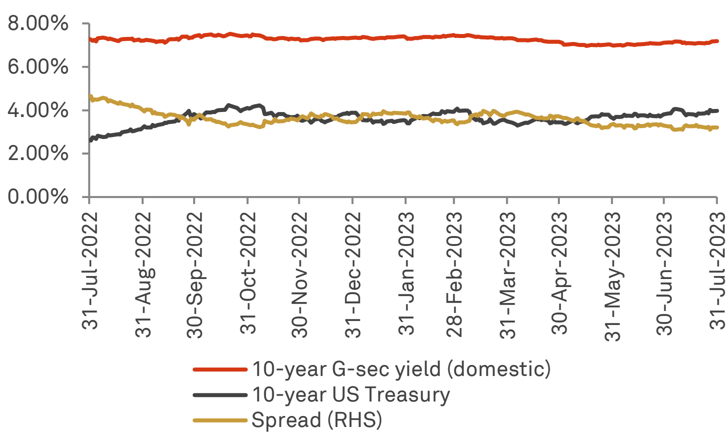
SDL spread over 10-year benchmark G-sec softens



Source: CRISIL MI&A Research

The spread of the 10-year benchmark SDL over the 10-year benchmark G-sec eased in July and closed at 29 bps. Meanwhile, spread of the 10-year AAA-rated public sector corporate bond remained the same at 38 bps. The 12-month average spreads for the 10-year benchmark SDL and corporate bond over the 10-year benchmark G-sec were 29 bps and 31 bps, respectively.

US Treasury yield spread eases

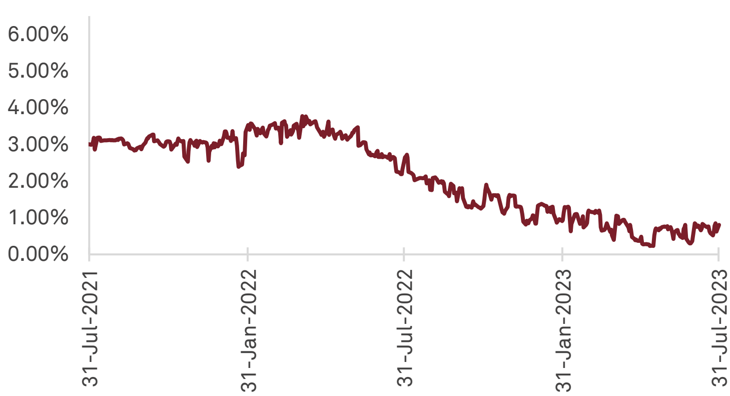


Source: CRISIL MI&A Research

The 10-year US Treasury yield closed at 3.97% in July, 16 bps higher than its June close of 3.81%. The monthly average spread between the domestic 10-year benchmark G-sec yield and the 10-year US Treasury yield eased to 3.20% from the previous month's 3.30%.

Term premium between 10-year benchmark G-sec and TREPS widens

Term premium (10-year G-sec benchmark and TREPS)

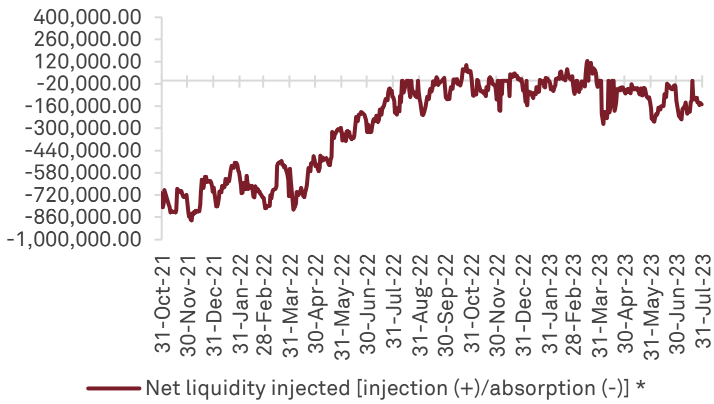


Source: CRISIL MI&A Research

The average spread between the 10-year benchmark G-sec yield and tri-party repos (TREPS) widened to ~73 bps in July from ~56 bps in June. The 12-month average spread stood at ~113 bps.

Surplus systemic liquidity

Net liquidity injected in Rs crore [injection (+)/absorption (-)]*



** Net liquidity is calculated as repo + MSF + standing liquidity facility - reverse repo*
Source: CRISIL MI&A Research

In July, the average systemic liquidity surplus was ~Rs 1.64 lakh crore, higher than the previous month's surplus of ~Rs 1.29 lakh crore. Average surplus during the past 12 months stood at ~Rs 0.64 lakh crore. Systemic liquidity absorption as of July-end was at a high of ~Rs 1.43 lakh crore.

Benchmark spreads over G-sec

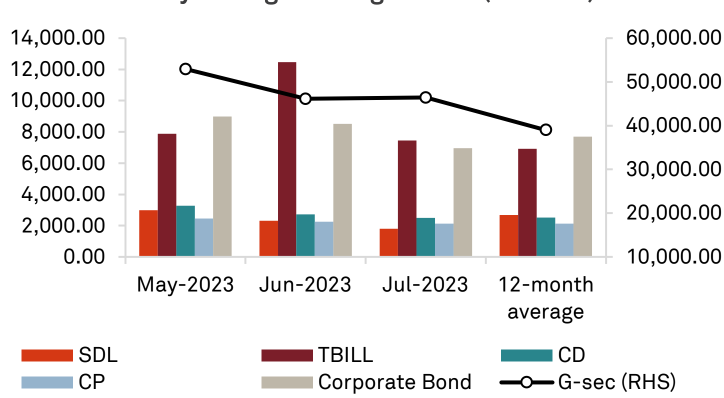
Spreads over G-sec*

Rating category	Date	PSUs/ corporates	NBFCs	Housing finance companies
AAA	30-June-2023	0.33%	0.58%	0.62%
	31-July-2023	0.32%	0.56%	0.46%
AA+	30-June-2023	0.52%	1.09%	1.20%
	31-July-2023	0.49%	1.10%	1.18%
AA	30-June-2023	1.02%	1.91%	1.63%
	31-July-2023	1.06%	1.91%	1.47%
AA-	30-June-2023	1.74%	2.94%	2.71%
	31-July-2023	1.88%	2.55%	2.46%

**Spreads are for 5-year securities over annualised G-sec yield*
Note: Selection of representative issuers has been re-evaluated as per periodic review
Source: CRISIL MI&A Research

Trading volume decreases across securities, barring G-secs

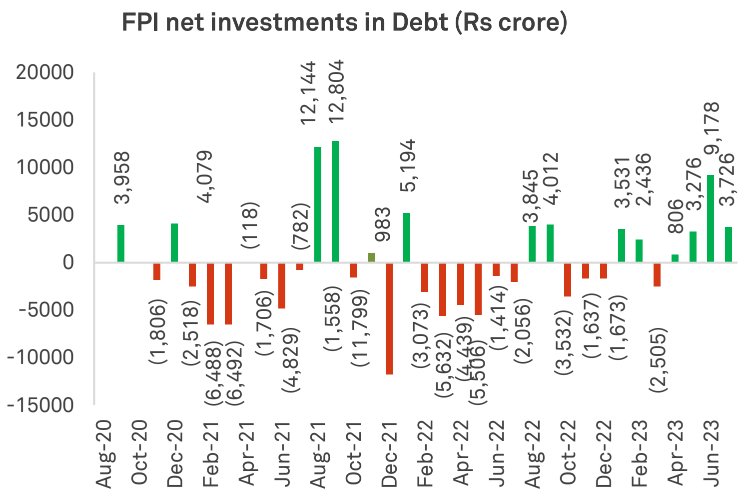
Monthly average trading volume (Rs crore)



Source: CRISIL MI&A Research

Trading volume in G-secs rose 0.63% in G-secs and fell 21.98% in SDLs and 18.26% for corporate bonds. Volume in T-bills, CPs, and CDs fell 40%, 5.13%, and 8.10%, respectively.

FPIs turned net buyers in debt



Source: CRISIL M&IA Research

Net FPI inflow into debt was Rs 3,726 crore in July compared with Rs 9,178 crore in June. Equity saw an inflow of Rs 46,618 crore.

Key downgrades and upgrades

Upgrades

Issuer name	Old rating	New rating
Tata Motors Finance Ltd	[ICRA]AA-	[ICRA]AA
Capsave Finance Pvt Ltd	CRISIL A	CRISIL AA+
Macrotech Developers Ltd	IND A	IND A+
Tata Motors Finance Ltd (P)	[ICRA]A	[ICRA]A+
Tata Motors Ltd	[ICRA]AA-	[ICRA]AA

Downgrades

Issuer name	Old rating	New rating
Sanghi Industries Ltd	IND BB	IND D

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