Market Intelligence
& Analytics

# RateView

## CRISIL's outlook on near-term rates

August 2024

Research

CRISIL
An S&P Global Company

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## Analytical contacts

**Saumil Mahajan**
Manager, Fixed Income Research
saumil.mahajan@crisil.com

**With contributions from**
Aaditya Salve and Yash Rajput

**Dharmakirti Joshi**
Chief Economist, CRISIL Ltd
dharmakirti.joshi@crisil.com

**Dipti Deshpande**
Principal Economist, CRISIL Ltd
dipti.deshpande@crisil.com

**Pankhuri Tandon**
Senior Economist, CRISIL Ltd
pankhuri.tandon@crisil.com

## Media contacts

**Prakruti Jani**
Media Relations
CRISIL Limited
M: + 91 98678 68976
prakruti.jani@crisil.com

**Sanjay Lawrence**
Media Relations
CRISIL Limited
M: +91 89833 21061
sanjay.lawrence@crisil.com

**Roma Gurnani**
Media Relations
CRISIL Limited
M: +91 70662 92142
roma.gurnani@ext-crisil.com

# Jumpy July

The yield on the 10-year benchmark government security (G-sec; 7.10% GS 2034) opened July at 7.01% and closed at 6.92%, down 8 basis points (bps) from the previous month's close of 7.01% and below CRISIL's forecast range of 6.95-7.05%.

The first week opened with a negative bias due to a rise in US treasury yields. Trading volumes in the bond markets remained thin as traders avoided placing aggressive bets amid lack of firm domestic and offshore cues. The fall in US treasury yields ahead of US non-farm payroll and unemployment data release supported domestic bonds to some extent. Better-than-expected weekly auction results for G-secs had a positive impact on the market. The 10-year benchmark G-sec yield opened the week at 7.01% and closed at 6.99%.

In the second week, the domestic Consumer Price Index (CPI) for June printed at 5.08%, higher than the previous month's reading of 4.75%. The US CPI softened to a lower-than-expected 3.0% in June 2024 from 3.3% in May 2024. The Reserve Bank of India (RBI) continued to conduct multiple variable rate reverse repo (VRRR) auctions throughout the week to absorb surplus liquidity due to G-sec maturities. Following this, the 10-year benchmark G-sec yield closed the week at 6.99%.

The third week opened with a negative bias tracking higher-than-expected domestic CPI data for June 2024. Foreign investments in government bonds climbed more than $1 billion since domestic sovereign debt was included in the JP Morgan Index, adding to the $11 billion yield-influencing inflows since the inclusion was announced in September 2023. The RBI continued to conduct multiple VRRR auctions throughout the week due to surplus liquidity in the system. The 10-year benchmark G-sec yield closed the week at 6.96%.

The fourth week opened with a negative bias tracking an overnight rise in US treasury yields. Further, the RBI's open market operation (OMO) sales of Rs 0.03 lakh crore during the week ended July 12 weighed on yields. The downward revision in fiscal deficit to 4.9% in fiscal 2025 from 5.1% earlier, as per the Union Budget announcement, provided some comfort; however, a lower-than-expected borrowing cut disappointed market participants. Yields on short-term bonds witnessed some softening tracking the revision in the latest draft guidelines on the Basel III framework on the liquidity coverage ratio (LCR). This resulted in the 10-year benchmark G-sec yield closing at 6.92% in July.

In its third bi-monthly meet for this fiscal, the RBI's Monetary Policy Committee (MPC) kept the policy rate unchanged at 6.50% as a majority of its members voted to maintain status quo. The MPC's focus remains on aligning inflation to the target range.

# CRISIL's outlook

## On interest rates

| Benchmark | July 31, 2024 (A) | August 31, 2024 (P) | October 30, 2024 (P) |
|---|---|---|---|
| 10-year G-sec yield* | 6.92% | 6.88% - 6.98% | 6.85% - 6.95% |
| 10-year SDL yield | 7.29% | 7.26% - 7.36% | 7.25% - 7.35% |
| 10-year corporate bond yield | 7.46% | 7.38% - 7.48% | 7.37% - 7.47% |

*A: Actual; P: Projected; SDL: State development loan*
*Source: CRISIL MI&A Research*

### One-month view

In August, domestic G-sec yields are likely to be influenced by factors such as foreign portfolio investor (FPI) inflows and outflows, crude oil price movements, the rupee-dollar equation, the outcome of the RBI MPC meeting to be held in August and domestic inflows into the debt market.

### Three-month view

The 10-year G-sec yield is expected to hinge on FPI flows, crude prices, global interest rates, the CPI inflation print, the policy decisions of the RBI's MPC and the Federal Open Market Committee (FOMC), global cues and liquidity concerns.

### Framework for the outlook

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

*Note: All yields are volume-weighted averages during the last trading hour of that day.*

# Factors influencing the outlook

| Economic parameter | Our view | Impact on yields |
|---|---|---|
| **Gross domestic product (GDP) growth** | • We expect real GDP growth to moderate to 6.8% in fiscal 2025 from 8.2% in the previous fiscal.<br>• High interest rates and lower fiscal impulse (from reduction in the fiscal deficit) will temper growth. That said, the forecast of an above normal monsoon brings hope for the rural economy, which was a laggard in India's growth story last fiscal.<br>• Real GDP growth moderated to 7.8% on-year in the fourth quarter of fiscal 2024 from 8.6% in the previous quarter. | ↓ |
| **Consumer price index (CPI) inflation** | • We expect consumer price index (CPI)-linked inflation to soften to 4.5% in fiscal 2025 from 5.4% previous fiscal.<br>• Assuming an above-normal monsoon, we expect food inflation to soften. Non-food inflation could see a statistical uptick but is overall expected to remain soft on the back of benign commodity prices.<br>• CPI inflation eased sharply to 3.5% in July from 5.1% in June | ↓ |
| **RBI's monetary policy** | • We expect two policy rate cuts by the RBI this fiscal, starting October 2024 at the earliest.<br>• Inflation remains a key gauge for the RBI's MPC decision, with elevated food prices the biggest hurdle in shifting its stance. Food prices are still high, and the RBI remains cautious of its direct and indirect impact on disinflation process. However, better monsoon and higher kharif sowing vs last year is expected to ease food inflation this fiscal, with the picture becoming clearer by September.<br>• The MPC kept policy rates unchanged in its August meeting, while maintaining stance of withdrawal of accommodation. | ↓ |
| **Fiscal health** | • The budget has targeted a reduction in centre's fiscal deficit to 4.9% of GDP in fiscal 2025 from 5.6% of GDP past fiscal.<br>• In the first three months of this fiscal, centre's fiscal deficit stood at 8.1% of the budget target, compared with 25.3% in same period last year. Capital expenditure as a proportion of budget target has been lower relative to last year.<br>• Gross market borrowing is estimated at Rs. 14 lakh crore for fiscal 2025, 9.2% lower on-year. | ↓ |
| **Crude oil prices** | • We expect crude prices average \$83-\$88 per barrel range in fiscal 2025 compared to an average of \$83 per barrel previous fiscal.<br>• Brent crude oil prices increased in July to \$85.3 per barrel average, 3.3% higher on-month and 6.5% higher on-year. | ↑ |

[1] *Provisional estimate*

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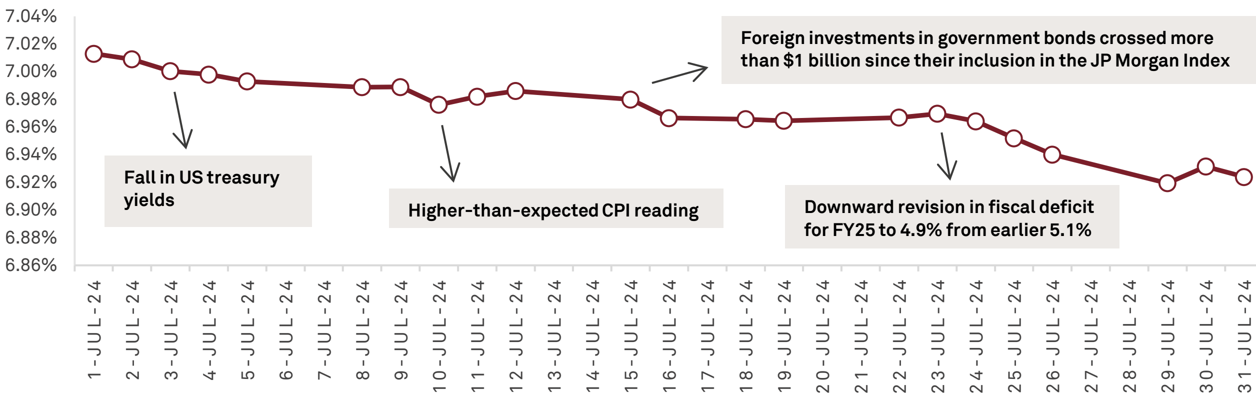
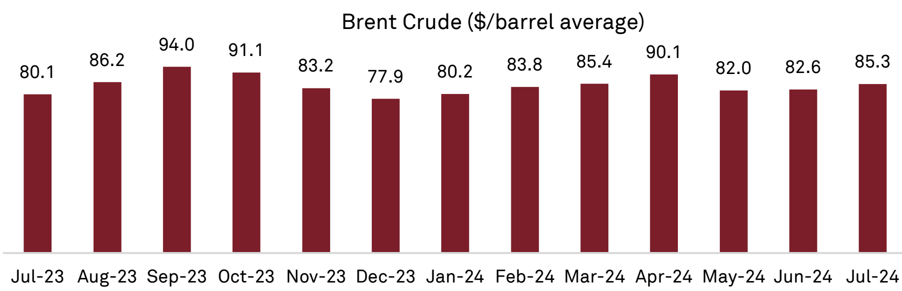
| Economic parameter | Our view | Impact on yields |
|---|---|---|
| **Current account balance** | • We expect the current account deficit (CAD) to average 1.0% of GDP in fiscal 2025 compared to 0.7% of GDP in fiscal 2024.<br>• Healthy momentum in goods exports and expected moderation in imports (with slowing growth) suggest the current account deficit (CAD) is likely to remain manageable this fiscal as well.<br>• India's current account recorded a surplus of 0.6% of GDP in the fourth quarter of fiscal 2024 vs a deficit of 1.0% of GDP in the third quarter. | ↔ |
| **US Federal Reserve's stance** | • S&P Global expects the Fed to start cutting rates in September 2024 compared to their earlier forecast of December. Now it expects two rate cuts totaling 50 bps in 2024 calendar year, and 100 bps cut in 2025.<br>• The Fed kept its policy rate unchanged at 5.25-5.50% for the eighth consecutive time at its July meeting. | ↓ |
| **Liquidity indicators**<br>**i) Demand and supply** | **Supply:**<br>• RBI has excluded the new 14-year and 30-year G-secs from the list of securities in the full accessible route<br>• Gross market borrowings of the central government are estimated at Rs 14.01 lakh for fiscal 2025, lower than the interim budget estimate of Rs 14.13 lakh crore<br>• Net market borrowings for fiscal 2025 are estimated at Rs 11.63 lakh crore, lower than the interim budget estimate of Rs 11.75 lakh crore<br><br>**Demand:**<br>• Demand for shorter tenure G-secs rose due to draft guidelines on the Basel III framework on LCR | ↔ |
| **ii)** Call rates/ liquidity-adjustment facility | • The Indian banking system had surplus liquidity for the entire month of July 2024. The surplus peaked to a three-month high of Rs 1.56 lakh crore on July 31 due to increased central spending after the polls and the redemption of government securities worth ~Rs 60,000 crore during the month. Hence, overnight borrowing rates fell, with the interbank weighted average call rate (WACR) hovering around 6.6% in May and June 2024 and at 6.52%, averaging close to the RBI's repo rate of 6.5% in July | ↑ |

# CRISIL's outlook on interest rates




*Source: CRISIL MI&A Research*

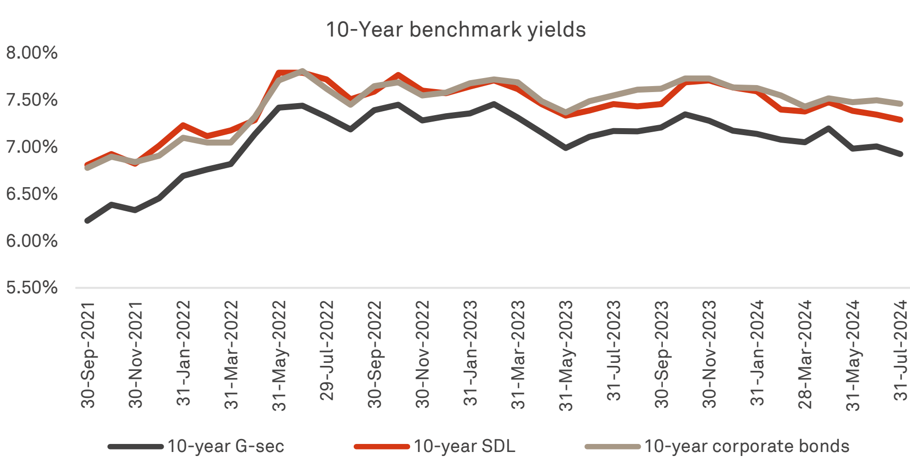
## Crude oil prices rose in July




*Source: CRISIL MI&A Research*

Brent crude prices increased to $85.3 per barrel on average in July, up 3.3% on-month.

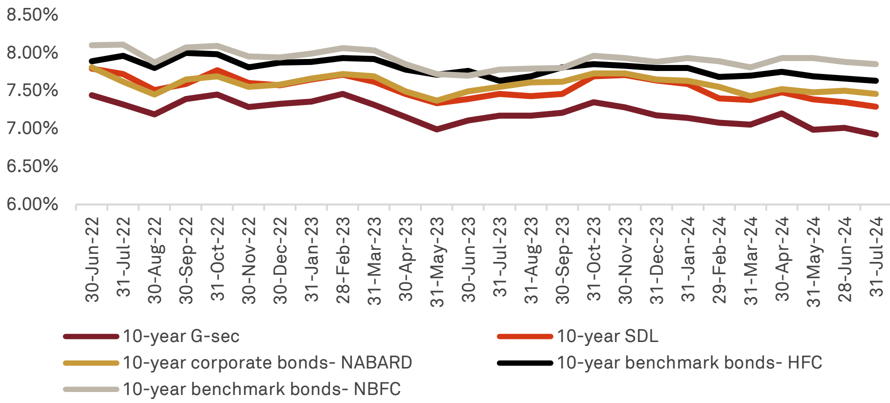
## Benchmark yields ease for SDLs, G-secs and CBs




*Source: CRISIL MI&A Research*

The yield on the 10-year benchmark G-sec closed at 6.92% in July, down 8 bps from the previous month's close. The yield on the 10-year SDL eased 6 bps to 7.29% from 7.35% in June and that on the 10-year CB (10-year PSU FI) eased 4 bps to 7.46%.

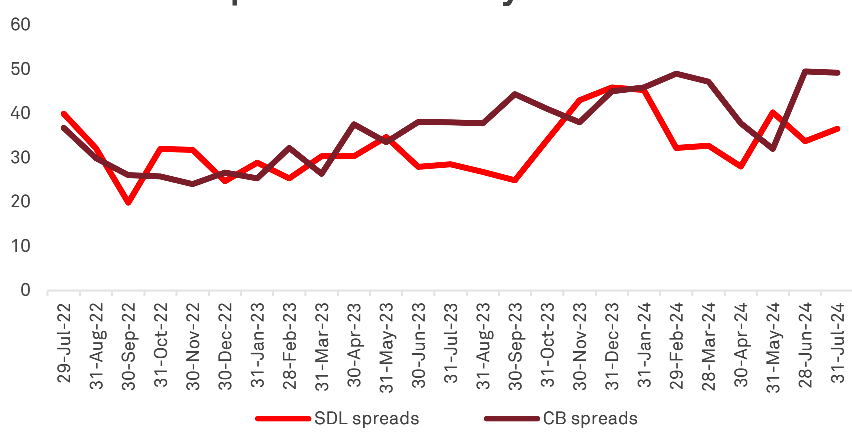
## 10-year G-sec/SDL/CB benchmark yields




*Source: CRISIL MI&A Research*

The yields on 10-year benchmark AAA-rated public sector undertaking (PSU) bonds decreased to 7.46% from 7.50% in June. Meanwhile, AAA-rated non-bank financial companies (NBFCs) saw a three-basis point drop in yields to 7.85%. Yields for housing finance companies also declined, closing at 7.63%, down from the previous month's close of 7.66%.

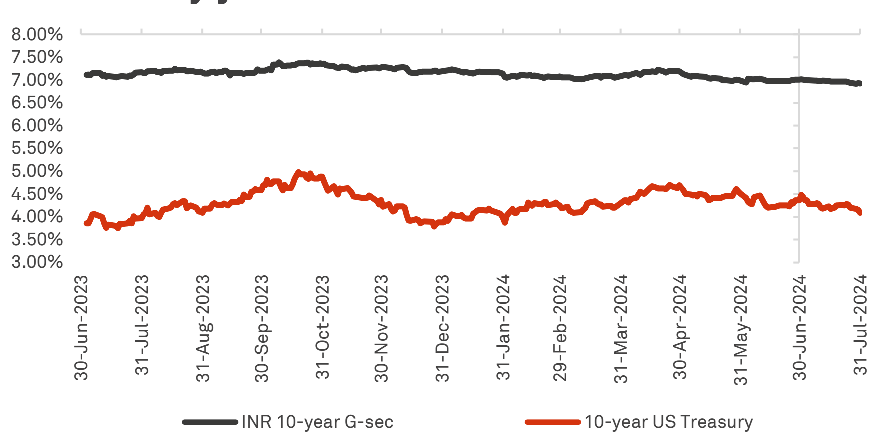
## CB and SDL spreads over 10-year benchmark G-secs




*Source: CRISIL MI&A Research*

The spread on the 10-year benchmark SDL over the 10-year benchmark G-sec closed at 37 bps in July, up 3 bps from the previous month's close, while that on the 10-year AAA-rated public sector CB increased to 54 bps, up 5 bps from the previous month's close. The 12-month average spreads for the 10-year benchmark SDL and CB over the 10-year benchmark G-sec were ~35 bps and ~44 bps, respectively.

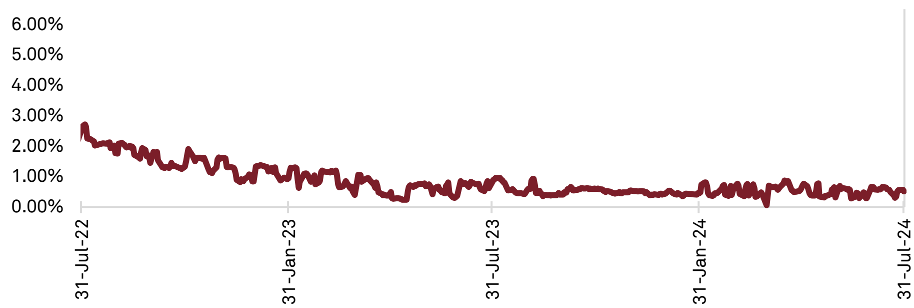
## US treasury yields dive




*Source: CRISIL MI&A Research*

The 10-year US treasury yield dropped sharply after a weaker-than-expected jobs report heightened concerns over slowing economic growth. Yields ended at 4.09%, down 27 bps from the previous month's close. As a result, monthly spread between the domestic benchmark 10-year G-sec and the 10-year treasury yields widened to 283 bps.

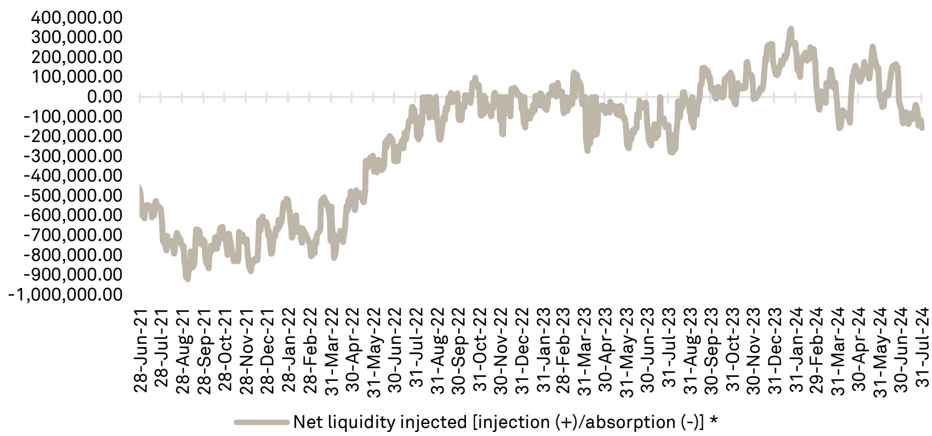
## Term premium between 10-year benchmark G-sec and TREPS widens




The average spread between the 10-year benchmark G-sec yield and the tri-party repo (TREPS) increased to ~55 bps in July from ~48 bps in June. The 12-month average spread was ~53 bps.

*Source: CRISIL MI&A Research*

## Systemic liquidity




The average systemic liquidity surplus was ~Rs 1.02 lakh crore in July compared with a deficit of ~Rs 0.58 lakh crore in June. The average liquidity over the past 12 months was Rs 0.47 lakh crore. The banking system's liquidity has improved significantly due to government spending.

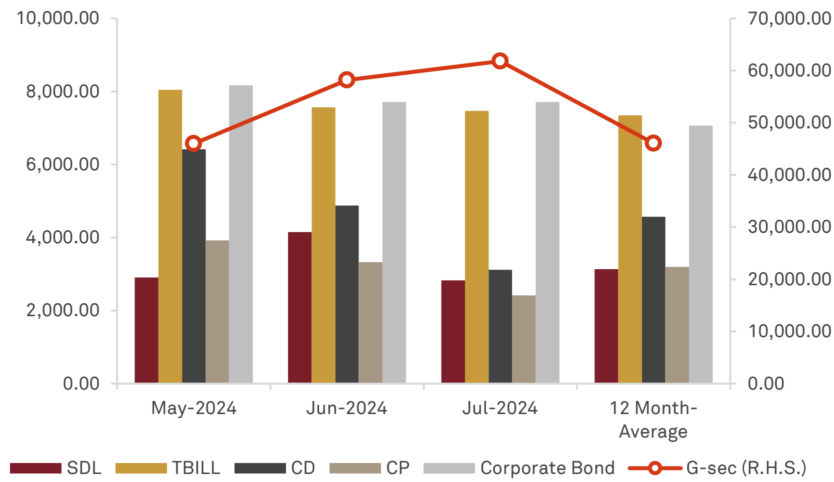
**Net liquidity is calculated as repo + marginal standing facility + standing liquidity facility - reverse repo*
*Source: CRISIL MI&A Research*

## Benchmark spreads over G-secs

| Spreads over G-sec* | | | | |
|---|---|---|---|---|
| **Rating category** | **Date** | **PSU/Corporates** | **NBFC** | **Housing finance companies** |
| AAA | 30-Jun-24 | 0.57% | 1.02% | 0.80% |
| | 31-Jul-24 | 0.57% | 1.02% | 0.80% |
| AA+ | 30-Jun-24 | 0.93% | 1.50% | 1.43% |
| | 31-Jul-24 | 0.97% | 1.46% | 1.35% |
| AA | 30-Jun-24 | 1.18% | 2.49% | 1.91% |
| | 31-Jul-24 | 1.13% | 2.48% | 1.93% |
| AA- | 30-Jun-24 | 2.20% | 3.58% | 2.57% |
| | 31-Jul-24 | 2.13% | 3.51% | 2.60% |

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

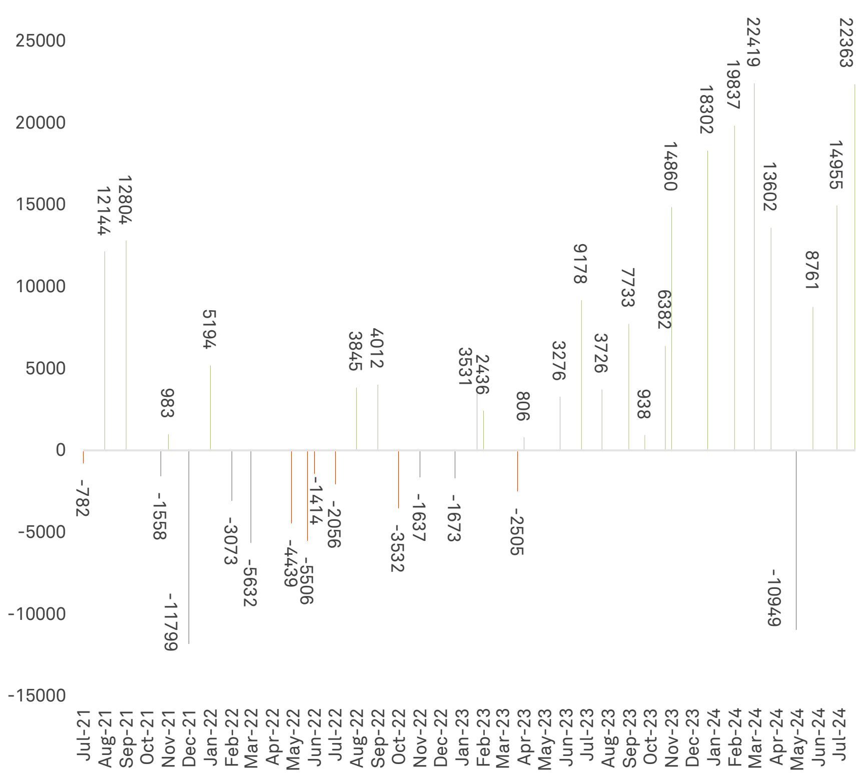
## Trading volume decreases across securities, except Corporate Bonds and G-sec




In July, trading volumes of G-secs rose 6.25% on-month, while that of SDL dropped 32% on-month. Further, trading volumes of T-bills, certificates of deposit (CDs), commercial papers (CPs) declined 1.35%, 36% and 27.35%, respectively. Meanwhile, CB trading volumes remained relatively stable.

*Source: CRISIL MI&A Research*

## FPIs continue to be net buyers




FPI inflows into the domestic debt market surged to Rs 22,363 crore in July from Rs 14,955 crore in June. The positive outlook for Indian bonds was bolstered by the country's consistent economic performance, mainly due to the inclusion of Indian government bonds in the JP Morgan Government Bond Index-Emerging Markets and low US bond yields, which relieved pressure from Indian markets. Meanwhile, weaker-than-expected US employment data and hints of a potential economic slowdown are raising the possibility of rate cuts by the Fed. Such developments have made Indian market more lucrative to investors, resulting in FPIs being net buyers in July.

*Source: CRISIL MI&A Research*

## Rating upgrades and downgrades in July 2024

### Upgrades

| Issuer Name | Old Rating as per CRISIL | New Rating |
|---|---|---|
| Union Bank Of India | IND AA | IND AA+ |
| Shilpa Pharma Lifesciences Ltd. | IND A | IND A+ |
| Shilpa Biologicals Pvt. Ltd. | IND A- | IND A |
| Tata Motors Finance Ltd. | [ICRA]AA | [ICRA]AA+ |
| Tata Motors Ltd. | [ICRA]AA | [ICRA]AA+ |
| Mahaveer Finance (India) Ltd. | CARE BBB | CARE BBB+ |
| Samvardhana Motherson International Ltd. | CRISIL AA+ | CRISIL AAA |
| Electronica Finance Ltd. | IND A- | IND A |
| Spandana Sphoorty Financial Ltd. | [ICRA]A | [ICRA]A+ |
| Adani Ports & Special Economic Zone Ltd. | [ICRA]AA+ | [ICRA]AAA |
| Arka Fincap Ltd. | CRISIL AA- | CRISIL AA |
| Yes Bank Ltd. | [ICRA]A- | [ICRA]A |
| Aye Finance Pvt. Ltd. | IND A- | IND A |
| Onesource Speciality Pharma Ltd. | CARE BBB+(CE) | CARE A(CE) |
| Force Motors Ltd. | CRISIL AA | CRISIL AA+ |
| Seeds Fincap Pvt. Ltd. | CRISIL BB+ | CRISIL BBB- |
| Hazaribagh Ranchi Expressway Ltd. | IND BB- | IND BBB |
| NeoGrowth Credit Pvt. Ltd. | CARE BBB | CARE BBB+ |
| U GRO Capital Ltd. | IND A | IND A+ |

### Downgrades

| Issuer name | Old rating as per CRISIL | New rating |
|---|---|---|
| Guruvayoor Infrastructure Pvt. Ltd. | [ICRA]B- | [ICRA]D |
| Twenty Five South Realty Ltd. | BWR B+ | BWR B |
| Gujarat State Investments Ltd. | BWR AA | BWR BB+ |

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CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India
Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com

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