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Fixed Income
Market Outlook
October 2024

Good gets better

Fixed Income Market Update and Outlook

Market Update

US Fed Recalibration, China Pivot & sharp rise in Global Political Uncertainty

Globally, major central bankers have already started monetary easing cycle, with US Fed latest member to join the club. Sep'24 saw Chinese policymakers acknowledging the need to support growth and have come out aggressively with slew of monetary measures with promise to provide fiscal support on priority.

Sep'24 also saw sharp rise in global geo-political uncertainty with war expanding in more countries. While global growth concerns dominating the most part of the month, war concerns resulted in asset price volatility towards end of the month.

India

Inflation:

CPI inflation rose marginally to 3.65%y/y in Aug (marginally upwardly revised Jul 2024: 5.60% y/y, Last year same period: 6.83%y/y). This was higher than the consensus (3.47%y/y). Excluding veggies, headline inflation continued to ease further to 3.12%y/y (Previous month: 3.29%y/y; Aug 2023: 5.46%y/y). Core inflation continued to remain muted at 3.40%y/y (July 2024: 3.39%y/y; Last year same period: 4.79%y/y). While Food inflation continues to remain ~5%y/y lvls, all other subindexes are below 4%y/y lvls. Apr-Aug avg CPI inflation was lower at 4.4%y/y (Last yr same period: 5.63%y/y).

Fiscal:

April-Aug 2024 gross tax receipts grew robustly by ~12%y/y - driven by buoyant direct tax collections and resilient indirect taxes. Record high RBI dividend resulted in sharp spike in non-tax receipts. While expenditure picked up in Aug, Apr-Aug expenditure growth was flattish due to muted growth in revenue expenditure and double-digit contraction in capex. As a result, Fiscal deficit stood at record low 27% of budget estimates (Previous year similar period: 36%).

While September advance taxes collection indicated buoyant growth, GST growth was muted at 6.5%y/y (Apr-Sep FY25 GST growth: 9.5%y/y).

External Sector:

August Trade deficit rose sharply to~US$29.6 bn (Jul 24: US$23.6 bn). Apr-Aug 2024 exports grew almost flattish due to contraction in oil exports & muted core exports growth, while imports grew at 7%y/y. Core import growth (non-oil non gold) was muted. While Aug net service exports was muted, Apr-Aug 2024 Net services exports grew robustly at ~12%y/y.

1Q (Apr-June) FY25 current account deficit rose to 1.1% of GDP as against current a/c surplus 0.6% in 4Q FY24. Rise in deficit was attributed to higher trade deficit, moderation in net services exports and secondary income (seasonality). On the capital account, FDI flows & short-term credit improved, while FPI flows were muted due to global asset repricing. As a result, BoP inflows moderated to US$5.6 bn during the quarter from record high US$31 bn in 4Q FY24.

FPI (debt and equity) inflows were buoyant at US$11 bn in Sep. 2Q FY25 FPI flows were buoyant at US$20 bn (1Q FY25: US$1 bn) aided by both equity and debt market inflows (especially related to bond inclusion index).

Rupee was flattish in Sep'24 as against marginal depreciation from June through Aug and stood at 83.81 against dollar (Aug: 83.90; July 2024: 83.59; June 2024: 83.47; May 2024: 83.39; Apr 2024: 83.41).

Bond Inclusion:

Total inflows since Sep'23 announcement have been to the tune of ~Rs.1.55 trn, out of which FAR (Fully Accessible Route) securities got inflows to the tune of ~Rs.1.54 trn. Sep saw ~Rs.18,000 cr in FAR securities (June 2024: ~Rs.17,000 cr; July 2024: ~Rs. 19,000 cr; Aug 2024: ~Rs. 24,000 cr).

Liquidity:

Banking system liquidity moderated and averaged Rs. 1 trn on advance tax & GST related outflows, LTRO maturity and CRR requirement (Aug 2024: Rs. 1.5 trn; Jul 2024: Rs. 1.1 trn; Jun 2024: -ve Rs. 50,000 cr). Government balances continued to remain robust and stood on an average ~Rs. 2.9 trn (Aug 2024: Rs. 2.6 trn; July 2024: Rs. 2.9 trn; June 2024: Rs. 4.2 trn). Core liquidity (system liquidity + Government balances) improved marginally to ~Rs.4.2 trn by Sep end (Aug end: Rs. 4.1 trn; July end: Rs. 4.5 trn; June end: ~Rs. 3.5 trn).

Yield Levels & Spreads:

Fixed income market yields eased during the month of Sep'24 on global cues (US CPI print & Fed rate cut, global growth concerns, sharp decline in crude oil prices etc). 10-year G-sec yield moved in the narrow range of 6.85%-6.88% during first ten days and thereafter rallied over the next 20 days to move in range of 6.72%-6.83% (Aug 2024: 6.85%-6.92%;). 10 yr G-sec closed the month lower at 6.75% (Aug 2024: 6.86%). Average 10-year term premia increased to average~17 bps during the month (Aug 2024: 14 bps).

Taking cues from G-sec, 10-year SDL yields eased further and moved in the range of 7.05%-7.22% as against 7.19-7.26% in August to close the month lower at 7.08% (Aug 2024: 7.21%). September SDL primary issuances stood Rs.82,243 cr (Aug 2024: Rs. 89,690 cr; July 2024: Rs. 68,400 cr). The average spread between 10 yr SDL over G-sec stood at 34 bps during the month (June-Aug 2024: 35-37 bps).

Like G-sec and SDLs, AAA bonds rallied, with 10 yr AAA PSU moving in the band of 7.24%-7.40% (Previous month: 7.40%-7.45%). It closed the month lower at 7.24% (Aug 2024: 7.40%; July 2024: 7.46%).

Global

Monetary Policy:

Backed by macro data (easing inflation and loosening labour market), US Fed kickstarted monetary easing cycle in mid-Sep, by cutting the policy rate aggressively by 50 bps. While US Fed chairman indicated further rate actions to be data-dependent, dot plot clearly indicated additional 50 bps cut in 4Q CY2024. ECB also cut its policy rate for second time aided by growth concerns and moderating monthly inflation prints. To support economic growth, China has begun aggressively with slews of monetary easing measures (from rate cut to supporting property markets), with assurance of policy makers to provide fiscal support.

Financial Markets:

During the month of Sep'24, US treasury yields rallied on weak labour data, easing inflation pressure and dovish US Fed. US 10 Yr Treasury bond (UST) yield moved in the range of 3.63%-3.84% (as against 3.78%-3.99% in Aug 2024) and closed the month lower 3.81% (Aug 2024: 3.91%; Jul 2024: 4.09%). War related uncertainty pushed up the yields towards the end of the month. Dollar Index continued to depreciate in Sep by ~1.2%m/m after depreciating by 2.3%m/m in Aug (CY2024 YTD: -ve 0.5%) on dovish US Fed.

Market View

- Indian bonds are likely to be supported by easing global yield bias, global growth moderation expectations, lower core inflation and improved demand (bond inclusion). That said, the sharp rise in geo-political uncertainty (War, China stimulus, commodities including crude oil) might keep financial markets volatile.
- Sep/Oct'24 inflation is likely to be ~5% on unfavourable base effect, food inflation (due to erratic rains). RBI may continue to watch out for food inflation volatility, although good monsoon provide respite.
- Amidst the global central banker's easing bias and improving macros, we continue to expect rate cut in 3Q FY25 policy. The risk to projections is curve volatility.
- Longer end of the curve well supported by good macro & lower core inflation, while shorter end of the curve is supported by net lower supply of T-bills and RBI's liquidity management.

Common Source:
RBI, CSO, FAO, CEIC, NSO, JP Morgan, US Federal Reserve, US Treasury department, Commerce Ministry of India, NIMF Internal Research.