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Fixed Income
Market Outlook
November 2024

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Fixed Income Market Update and Outlook

Market Update

RBI's change of stance and inflation concerns amid global uncertainty and monetary easing cycle

Globally, major central bankers continuing with monetary easing cycle. Oct'24 saw rise in global uncertainty (geopolitical, US elections, commodities) leading to volatility in global financial market. In India, rise in food inflation, neutral stance of RBI, robust fiscal and easing external balances concerns were the key highlights as of Oct'24.

India

Monetary Policy:

In Oct'24 RBI left Policy rate unchanged at 6.50% and change stance to "Neutral" from earlier "Focus on withdrawal of accommodation" – signalling RBI's openness to move in either direction now. Reason for change of stance were as follows: Greater clarity on inflation outlook; Food inflation is likely to come down by 4Q on improved food production projections; and Stable Growth outlook. With inflation & growth risks evenly balanced (expectations of stable growth and moderation in inflation), RBI Governor, in press conference, highlighted that future RBI actions will be in sync with evolving conditions & macro-outlook

Inflation:

CPI inflation rose sharply to 5.49%y/y in Sep'24 (Aug 2024: 3.65% y/y, Last year same period: 5.02%y/y). This was higher than the consensus (5.1%y/y). Adverse base effect and food inflation (especially veggies, edible oil & cereals) pushed up inflation during the month. Core inflation increased to 3.50%y/y (Aug 2024: 3.40%y/y; Last year same period: 4.52%y/y). While Food inflation rose to 8% plus lvls, all other subindexes are below/~ 4%y/y lvls, with fuel index in deflation for third consecutive month. Excluding veggies, headline inflation rose to 3.34%y/y (Previous month: 3.12%y/y; Sep 2023: 5.13%y/y). That said, Apr-Sep 2024 avg CPI inflation was lower at 4.6%y/y (Last yr same period: 5.5%y/y).

Fiscal:

April-Sep 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. During same period, expenditure growth was flattish due to muted growth in revenue expenditure and mid-teen contraction in capex. As a result, Fiscal deficit stood at record low 29% of budget estimates (Previous year similar period: 39%). Oct GST growth was at record second high lvls since inception at Rs. 1.87 trn with Apr-Oct FY25 GST growth at 9.5%y/y.

External Sector:

Sep'24 Trade deficit eased to~US$21 bn (Aug 24: US$29 bn). Apr-Sep 2024 exports grew almost flattish due to contraction in oil exports & muted core exports growth. Similarly, imports were also muted at 6%y/y drag down by both oil and core import growth. Sep 2024 net service exports was robust at 16%y/y, with Apr-Sep 2024 Net services exports growth at ~12%y/y.

Oct'24 witnessed US$11.5 bn FPI outflows (especially equity) on global financial market volatility and rising geopolitical uncertainty (Sep inflows: US11 bn). Despite this, Apr-Oct 2024 witnessed robust inflows of US$10 bn (mainly through debt).

Rupee was depreciated marginally in October'24 after remaining flattish in Sep'24 and stood on average 84.03 against dollar (Sep: 83.81; Aug: 83.90; July 2024: 83.59).

Liquidity:

Banking system liquidity improved further to average Rs. 1.53 trn during October on government spending (Sep 2024: Rs. 1 trn; Aug 2024: Rs. 1.5 trn; Jul 2024: Rs. 1.1 trn; Jun 2024: -ve Rs. 50,000 cr). Government balances moderated a bit, yet remained robust at average ~Rs. 2.3 trn (Sep 2024: Rs. 2.9 trn; Aug 2024: Rs. 2.6 trn). Core liquidity (system liquidity + Government balances) moderated marginally to ~ average Rs.4.1 trn by Oct end (Sep end: Rs. 4.3 trn; Aug end: Rs. 4.1 trn).

Yield Levels & Spreads:

Fixed income market yields eased a bit and remained range-bound during first half of the month - on change in monetary policy stance and picked up a bit in second half on rising global uncertainty (geopolitical and US elections). 10-year G-sec yield moved in the range of 6.72%-6.85% during the month (Sep 2024: 6.72%-6.88%;). 10 yr G-sec closed the month higher at 6.81% (Sep 2024: 6.75%) on global cues. Average 10-year term premia increased to average~23 bps during the month (Sep 2024: 17 bps).

Taking cues from G-sec, 10-year SDL yields moved in the narrow range of 7.05%-7.14% as against 7.05%-7.22% in Sep'24 to close the month at 7.11% (Sep 2024: 7.08%). Oct'24 SDL primary issuances stood at Rs.84,892 cr (Sep 2024: Rs. 82,243 cr; 2Q FY25: ~Rs.80,000 cr). The average spread between 10 yr SDL over G-sec stood lower at 31 bps during the Oct'24 (Jul-Sep 2024: 35 bps).

Like SDLs, AAA bonds moved in the narrow range with 10 yr AAA PSU moving in the band of 7.23%-7.27% (Previous month: 7.24%-7.40%). It closed the month at 7.26% (Sep 2024: 7.24%; Aug 2024: 7.40%).

Global

Monetary Policy:

Oct'24 saw further easing from central banks globally. Among major advance economies, ECB and Bank of Canada continued to cut the policy rates.

Financial Markets:

After rallying in Sep'24, US treasury yields harden in Oct'24 on rising geopolitical uncertainty and ahead of US general elections. US 10 Yr Treasury bond (UST) yield moved in the range of 3.74%-4.29% (as against 3.63%-3.84% in Sep 2024) and closed the month much higher at 4.28% (Sep 2024: 3.81%; Aug 2024: 3.91%; Jul 2024: 4.09%). This resulted in appreciation of Dollar Index (2.2%m/m after depreciating by ~1.2%m/m in Sep 2024 (CY2024 YTD: +2.6%) on global risk-off backdrop.

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 (US elections, China stimulus, commodities including crude oil, war etc) might keep financial markets volatile in near term.
- Oct'24 inflation is likely to be ~6% on unfavourable base effect, food inflation (festive season demand; supply issues) and gold prices (global cues).
- Although RBI has changed stance to neutral in Oct'24 policy, it may continue to watch out for food inflation volatility
- Amidst the global central banker's easing bias and improving macros, we continue to expect rate cut in 4Q 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