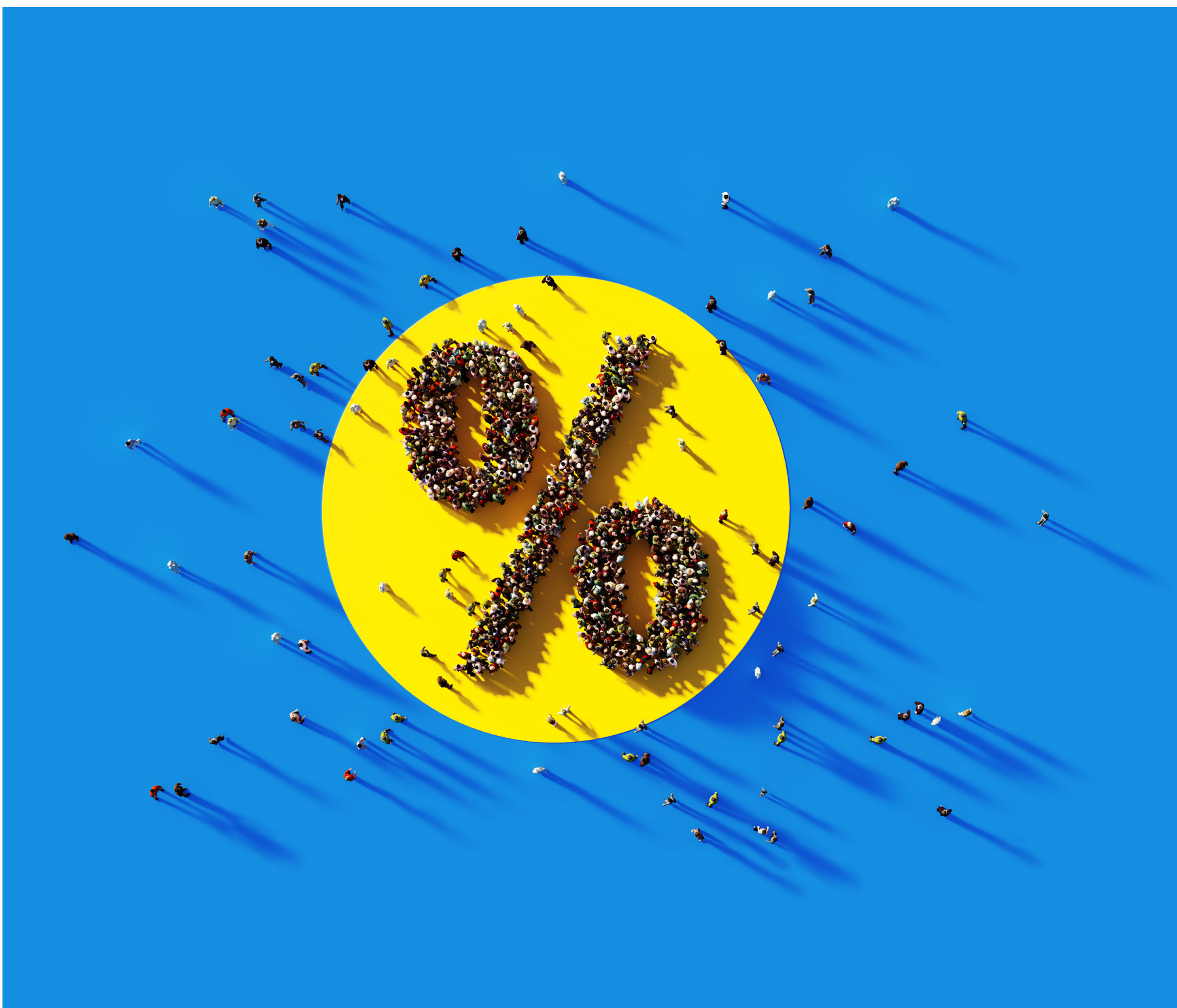
Market Intelligence
& Analytics

CRISIL
An S&P Global Company

# RateView

## CRISIL's outlook on near-term interest rates

July 2024



Research

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# June tune

The yield on the 10-year benchmark government security (G-sec; 7.10% GS 2034) opened June at 6.95% and closed at 7.01%, up 2 basis points (bps) from its May close of 6.99% and within CRISIL's forecast range of 7.01-7.11%.

In the first week of the month, the 10-year benchmark bond yield remained volatile due to uncertainties related to fiscal policy and the political scenario amid general election results. The 10-year benchmark G-sec yield opened the week at 6.95%, down 4 bps from its previous close of 6.99%, and closed at 7.02%. An 8 bp decline in United States (US) Treasury yields provided some support to domestic bonds. Movement across the curve remained mixed after the Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) stood pat on both policy rates and its stance on Friday. The MPC kept the repo rate unchanged at 6.5%, raised the gross domestic product (GDP) growth forecast for fiscal 2025 to 7.2%, and kept the inflation forecast for the fiscal unchanged at 4.5%.

In the second week, domestic bond yields eased as inflation based on the Consumer Price Index (CPI) printed lower at 4.75% for May, compared with 4.83% the previous month. A decline in US Treasury yields due to lower-than-expected US CPI also provided some support to domestic bonds. Following this, the 10-year benchmark G-sec yield closed the week at 6.98%, down 4 bps on-week.

During the second half of the month, yields moved in a narrow range due to the absence of significant cues. Buying momentum from foreign portfolio investors (FPIs) remained strong as they invested ~9,900 crore ahead of the inclusion of Indian gilts in the JP Morgan Bond Index. However, a record-low rupee and redemption pressure drove mutual funds to sell, which weighed on bond yields.

Towards the end of the month, traders remained watchful of foreign exchange inflows and avoided placing aggressive bets. The cut-off prices at the weekly G-sec auction were below market expectations, and FPI purchases failed to lift prices following the inclusion of bonds in the JP Morgan Bond Index. This resulted in the 10-year benchmark G-sec yield closing June at 7.01%.

That said, the minutes of the MPC meeting were in line with market expectations. The committee maintained its stance on withdrawing accommodation to ensure inflation progressively aligns with the target while supporting economic growth.

# CRISIL's outlook

## On interest rates

| Benchmark | June 28, 2024 (A) | July 31, 2024 (P) | September 30, 2024 (P) |
|---|---|---|---|
| 10-year G-sec yield* | 7.01% | 6.95%-7.05% | 6.95%-7.05% |
| 10-year SDL yield | 7.35% | 7.30%-7.40% | 7.33%-7.43% |
| 10-year corporate bond yield | 7.50% | 7.39%-7.49% | 7.41%-7.51% |

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

### One-month view

In July, domestic G-sec yields are likely to be influenced by factors such as the upcoming Union Budget, FPI flows, crude oil price movements, the rupee-dollar equation, outcome of the US Federal Open Market Committee (FOMC) meeting to be held in July end, and domestic inflows into the debt market.

### Three-month view

The 10-year G-sec yield is expected to react to FPI flows, crude prices, global interest rates, the CPI inflation print, rate decisions by the RBI MPC and 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.*

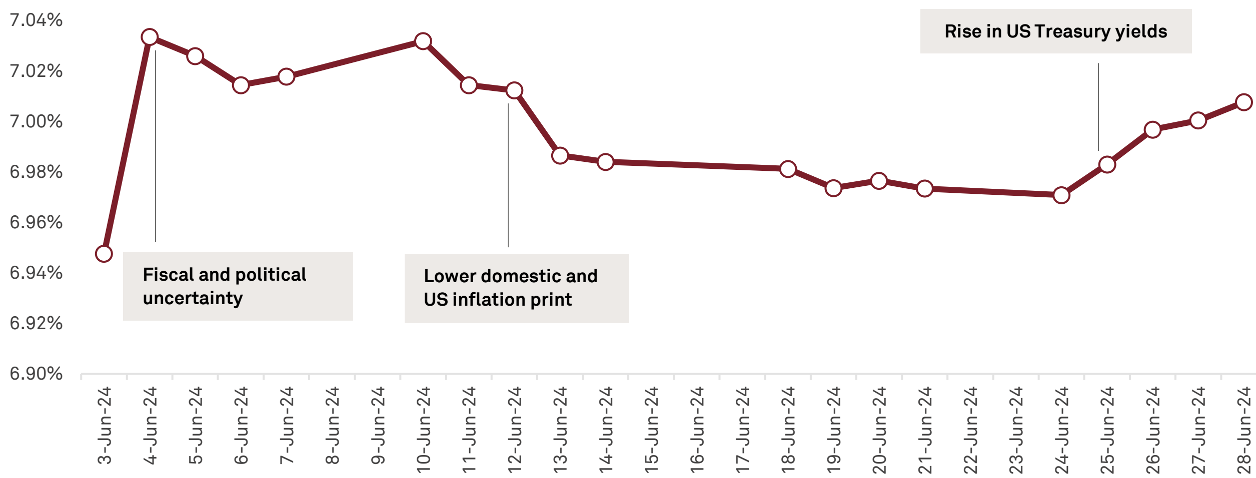
# Factors influencing the outlook

| Economic parameter | Our view | Impact on yields |
|---|---|---|
| **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 fiscal deficit) will temper growth. That said, the forecast for 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 | ↓ |
| **CPI inflation** | • We expect CPI-linked inflation to soften to 4.5% in fiscal 2025 from 5.4% in the previous fiscal<br>• Assuming a 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 marginally to 4.75% in May from 4.83% in the previous month | ↓ |
| **RBI's monetary policy** | • We expect two policy rate cuts by the RBI this fiscal, starting October 2024 at the earliest<br>• Amid strong economic growth momentum, the MPC aims to see a durable reduction in inflation to 4% for easing monetary policy. It will monitor monsoon in the next two months, which is critical for easing food and overall inflation. Other extreme weather events and geopolitical shocks will also be monitored<br>• The MPC kept policy rates unchanged in its June meeting, while maintaining its stance of withdrawal of accommodation | ↓ |
| **Fiscal health** | • The budget targets a reduction in the centre's fiscal deficit to 5.1% of GDP in fiscal 2025 from 5.6%[1] last fiscal<br>• In the first two months of this fiscal, the centre's fiscal deficit stood at 3% of the budget target, compared with 11.8% during the same period last fiscal<br>• Gross market borrowing is estimated at Rs 14.1 lakh crore for fiscal 2025, 8.4% lower on-year. The government plans to borrow 53.1% of the budgeted amount in the first half of the fiscal | ↓ |
| **Crude oil prices** | • We expect crude prices to average \$83-\$88 per barrel in fiscal 2025, compared with an average of \$83 per barrel the previous fiscal<br>• Brent crude oil prices were broadly stable in June at \$82.6 per barrel on average, 0.7% higher on-month and 10.2% higher on-year | ↑ |

[1] *Provisional estimate*

| 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 with 0.7% of GDP in fiscal 2024<br>• Healthy momentum in goods exports and an expected moderation in imports suggest 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 December 2024, compared with its earlier forecast of July<br>• The Fed kept its policy rate unchanged at 5.25-5.50% for the seventh consecutive time at its June meeting | ↓ |
| **Liquidity indicators<br>i) Demand and supply** | **Supply:**<br>• The RBI announced the SDL calendar for the second quarter of fiscal 2025 amounting to Rs 2.64 lakh crore, compared with Rs 2.54 lakh crore in the first quarter<br>• The RBI announced the T-bill calendar for the second quarter of fiscal 2025 amounting to Rs 2.60 lakh crore, compared with Rs 2.61 lakh crore in the first quarter<br>• Higher CD supply of Rs 150,000 crore was seen in June — an 86% jump over the previous month — to meet bank credit demand amid tight liquidity in the system<br><br>**Demand:**<br>• Demand was up for G-secs and SDLs due to participation from insurance players | ↔ |
| **ii) Call rates/ liquidity adjustment facility** | • A brief spell of liquidity surplus at the beginning of the month shifted to a deficit by mid-June, before eventually returning to a surplus by month-end. The deficit was primarily the outcome of lower government spending post-elections. The tight liquidity conditions prevailing through most of the month pushed the interbank weighted average call rate (WACR) to 6.60%, higher than the RBI's repo rate of 6.5%. To address the shortage, the RBI conducted several VRR and VRRR auctions during the course of the month | ↑ |

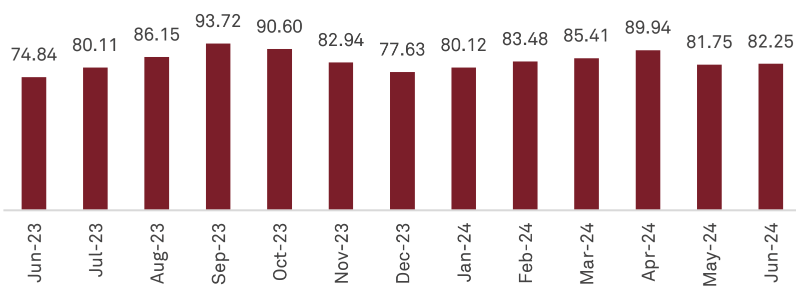
# CRISIL's outlook on interest rates




*Source: CRISIL MI&A Research*

## Rise in crude oil prices in June drove G-sec yields upwards

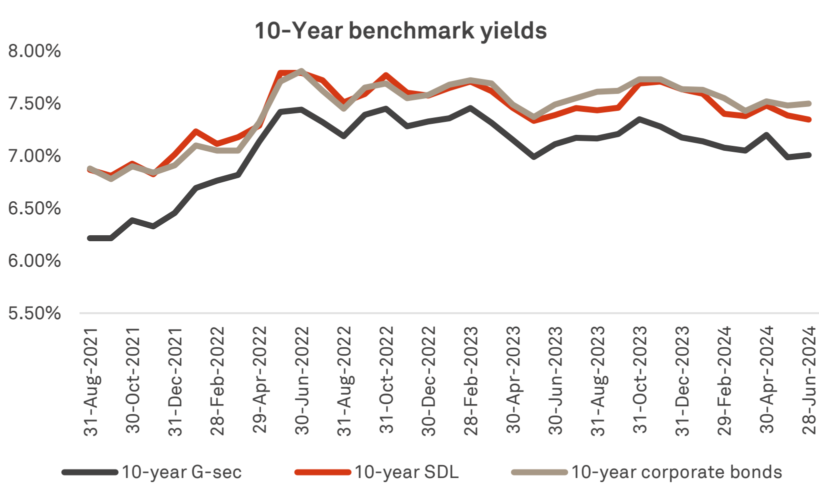
Brent Crude ($/barrel average)




Brent crude prices increased to $82.6 per barrel on average in June, up 0.7% on-month. This exerted upward pressure on G-sec yields.

*Source: CRISIL MI&A Research*

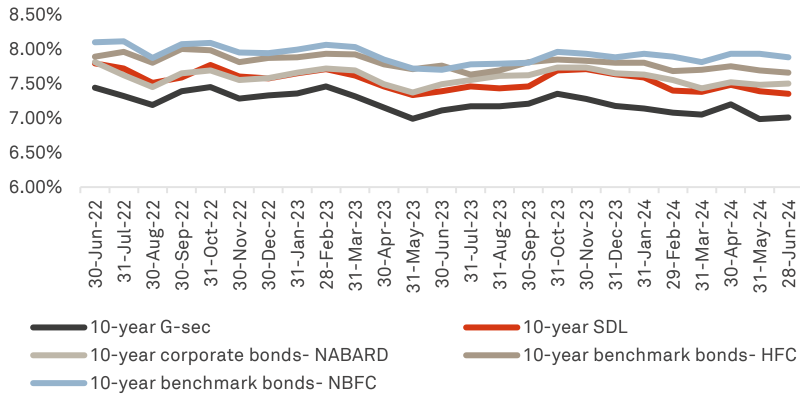
## Benchmark yields ease for SDLs and harden for G-secs and CBs




The yield on the 10-year benchmark G-sec closed June at 7.01%, up 2 bps from its May close. The yield on the 10-year SDL eased 4 bps to 7.35% from 7.39% and that on the 10-year CB (10-year PSU FI) hardened 2 bps to 7.50%.

*Source: CRISIL MI&A Research*

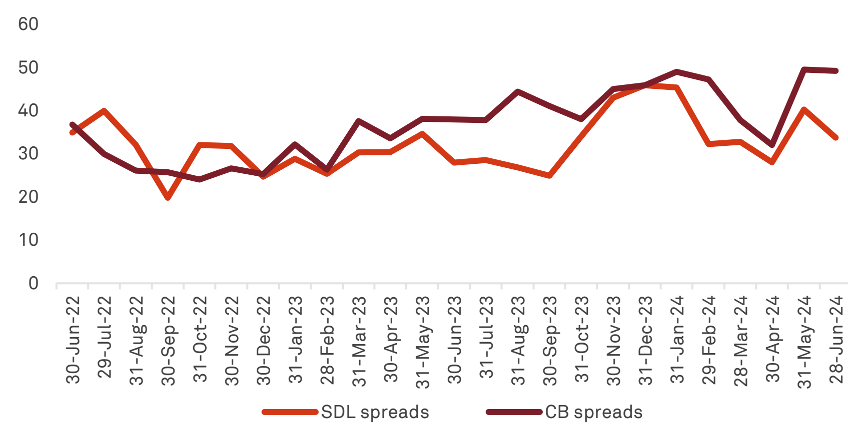
## 10-year G-sec/SDL/CB benchmark yields




*Source: CRISIL MI&A Research*

The yield on the 10-year benchmark AAA-rated PSU bonds closed at 7.50%, up from 7.48% in May, and that on AAA-rated NBFCs eased to 7.88% from 7.93%. Housing finance companies closed at 7.66% in June, down 3 bps from 7.69% in May.

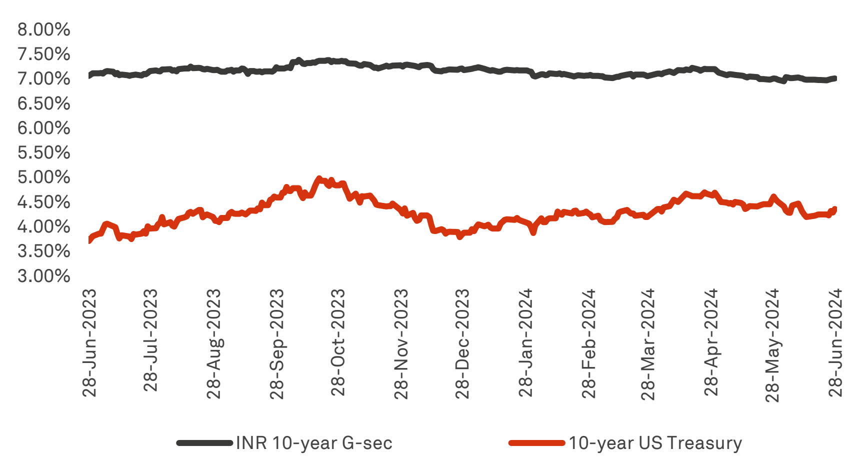
## CB and SDL spreads over 10-year benchmark G-sec




*Source: CRISIL MI&A Research*

The spread on the 10-year benchmark SDL over the 10-year benchmark G-sec closed June at 34 bps, down 6 bps from May. The spread on the 10-year AAA-rated public sector CB remained flattish at 49 bps. The 12-month average spreads for the 10-year benchmark SDL and CB over the 10-year benchmark G-sec were ~35 bps and ~43 bps, respectively.

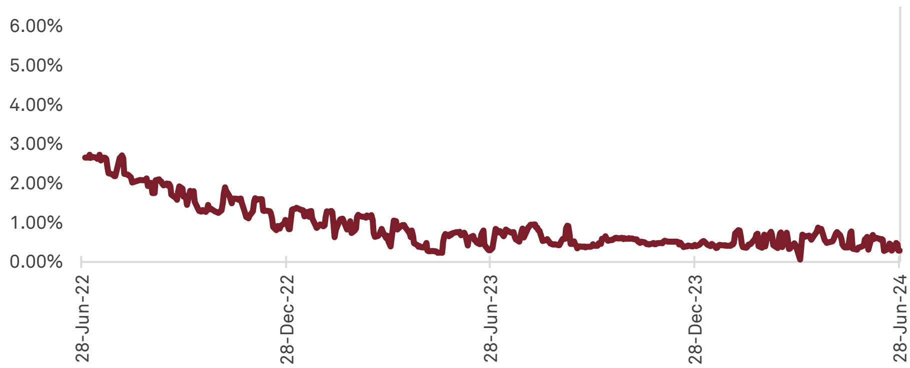
## US Treasury yields ease




*Source: CRISIL MI&A Research*

The 10-year US Treasury yield eased as softer economic data bolstered expectations of rate cuts by the Federal Reserve this year. It closed June at 4.36%, down 15 bps from May's 4.51%. The monthly spread between the domestic benchmark 10-year G-sec yield and the 10-year Treasury yield hardened to 265 bps.

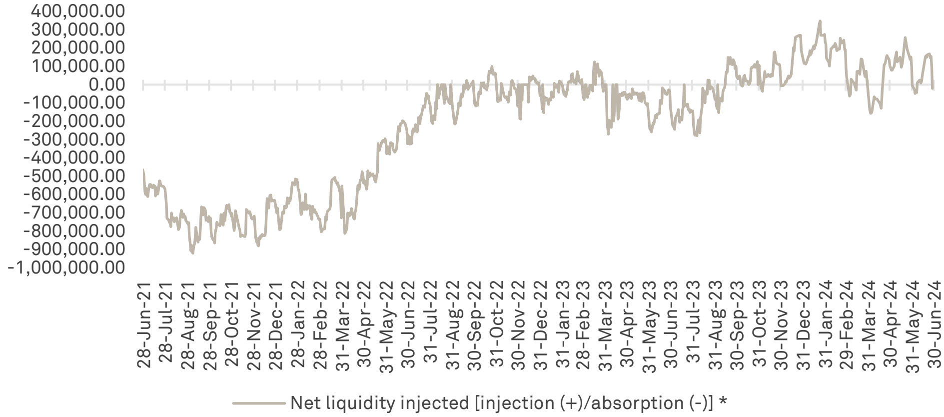
## Term premium between 10-year benchmark G-sec and TREPS narrows




The average spread between the 10-year benchmark G-sec yield and the tri-party repo (TREPS) decreased to ~48 bps in June from ~52 bps in May. The 12-month average spread was ~55 bps.

*Source: CRISIL MI&A Research*

## Systemic liquidity




The average systemic liquidity deficit was ~Rs 0.58 lakh crore in June, compared with a deficit of ~Rs 1.35 lakh crore in May. The average liquidity over the past 12 months was Rs 0.41 lakh crore. Tight liquidity was seen this month as well due to lower government spending following the elections. The RBI also conducted several VRR auctions during the month to manage liquidity in the system.

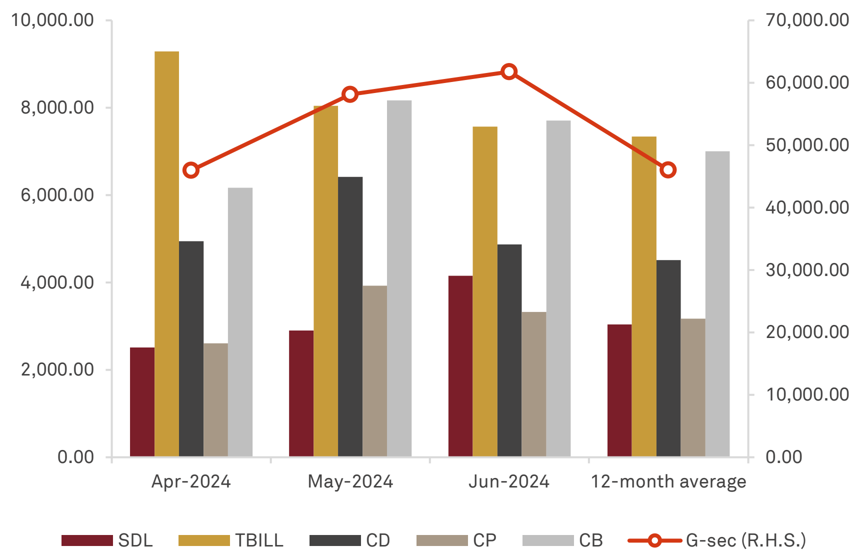
**Net liquidity is calculated as repo + marginal standing facility + standing liquidity facility - reverse repo*
*Source: CRISIL MI&A Research*

## Benchmark spreads over G-secs

| Spreads over G-sec* | | | | |
|---|---|---|---|---|
| **Rating category** | **Date** | **PSUs / Corporates** | **NBFCs** | **Housing finance companies** |
| AAA | 31-May-24 | 0.51% | 0.88% | 0.70% |
| | 30-Jun-24 | 0.51% | 0.84% | 0.69% |
| AA+ | 31-May-24 | 0.80% | 1.35% | 1.26% |
| | 30-Jun-24 | 0.78% | 1.33% | 1.27% |
| AA | 31-May-24 | 1.06% | 2.26% | 2.01% |
| | 30-Jun-24 | 1.03% | 2.32% | 1.74% |
| AA- | 31-May-24 | 2.01% | 3.52% | 2.59% |
| | 30-Jun-24 | 2.01% | 3.41% | 2.40% |

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

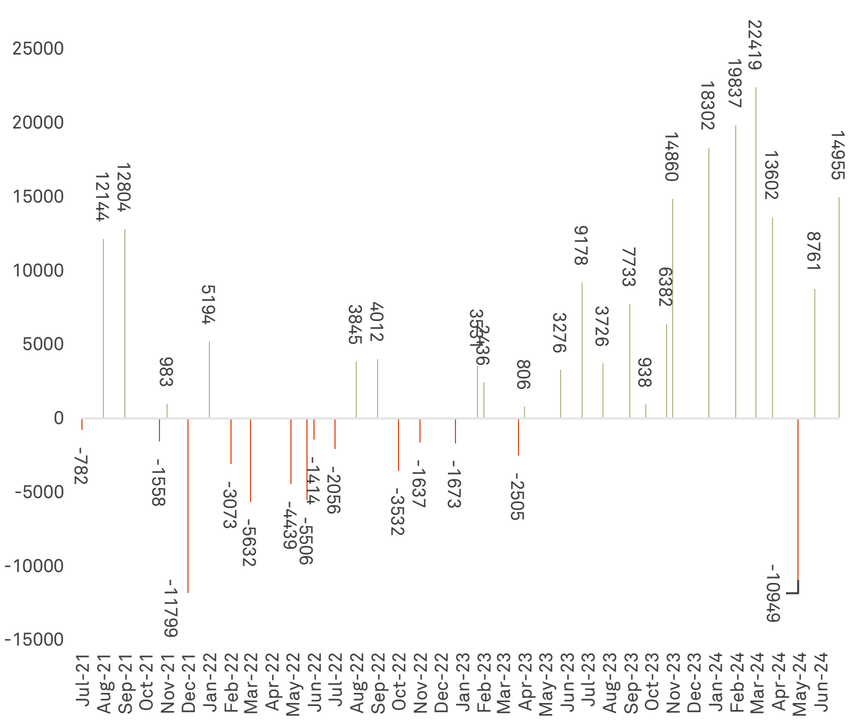
## Trading volume decreases across securities, except SDL and G-sec




*Source: CRISIL MI&A Research*

In June, G-sec and SDL trading volumes increased 6.25% and 43% on-month, respectively. Meanwhile, trading volumes of T-bills, CPs, CDs and CBs declined 6%, 15%, 24% and 6%, respectively.

## FPIs continue to be net buyers




*Source: CRISIL MI&A Research*

Net FPI inflow in debt was Rs 14,955 crore in June, compared with an inflow of Rs 8,761 crore in May. FPIs were overall net buyers in June, 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.

## Rating upgrades and downgrades in June 2024

**Upgrades**

| Issuer name | Old rating as per CRISIL | New rating |
|---|---|---|
| Vivriti Capital Ltd | [ICRA]A | [ICRA]A+ |
| SV Creditline Ltd | IND BBB- | IND BBB |
| Mangloor Highways Pvt Ltd | IND AA+ | IND AAA |
| Tata Motors Finance Ltd | CRISIL A+ | CRISIL AA- |
| TMF Holdings Ltd | CRISIL A+ | CRISIL AA- |
| Moneyboxx Finance Ltd | IND BBB- | IND BBB |
| Tata Power Co Ltd | CARE AA | CARE AA+ |
| Tata Power Renewable Energy Ltd | CARE AA | CARE AA+ |
| U. P. Power Corporation Ltd | IND A+(CE) | IND AA(CE) |
| Sunflower Trust | [ICRA]A-(SO) | [ICRA]AA-(SO) |
| Indian Renewable Energy Development Agency Ltd | CARE AA+ | CARE AAA |
| Criss Financial Ltd | IND BBB+ | IND A |
| Spandana Sphoorty Financial Ltd | IND A | IND A+ |
| Altum Credo Home Finance Pvt Ltd | CARE BBB | CARE BBB+ |
| Indian Overseas Bank | CRISIL AA- | CRISIL AA |
| SK Finance Ltd | CRISIL A+ | CRISIL AA- |

**Downgrades**

| Issuer name | Old rating | New rating |
|---|---|---|
| Edelweiss Asset Reconstruction Co Ltd | ACUITE A+(CE) | ACUITE A(CE) |
| Edel Finance Co Ltd | BWR AA- | BWR A+ |
| Edelweiss Retail Finance Ltd | BWR A+ | BWR A |
| NIDO Home Finance Ltd | BWR AA- | BWR A+ |
| Edelweiss Financial Services Ltd | BWR AA- | BWR A+ |
| ECL Finance Ltd | BWR AA- | BWR A+ |
| PTC India Financial Services Ltd | [ICRA]A+ | [ICRA]A- |
| Origo Commodities India Pvt Ltd | CARE BB+ | CARE BB- |

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