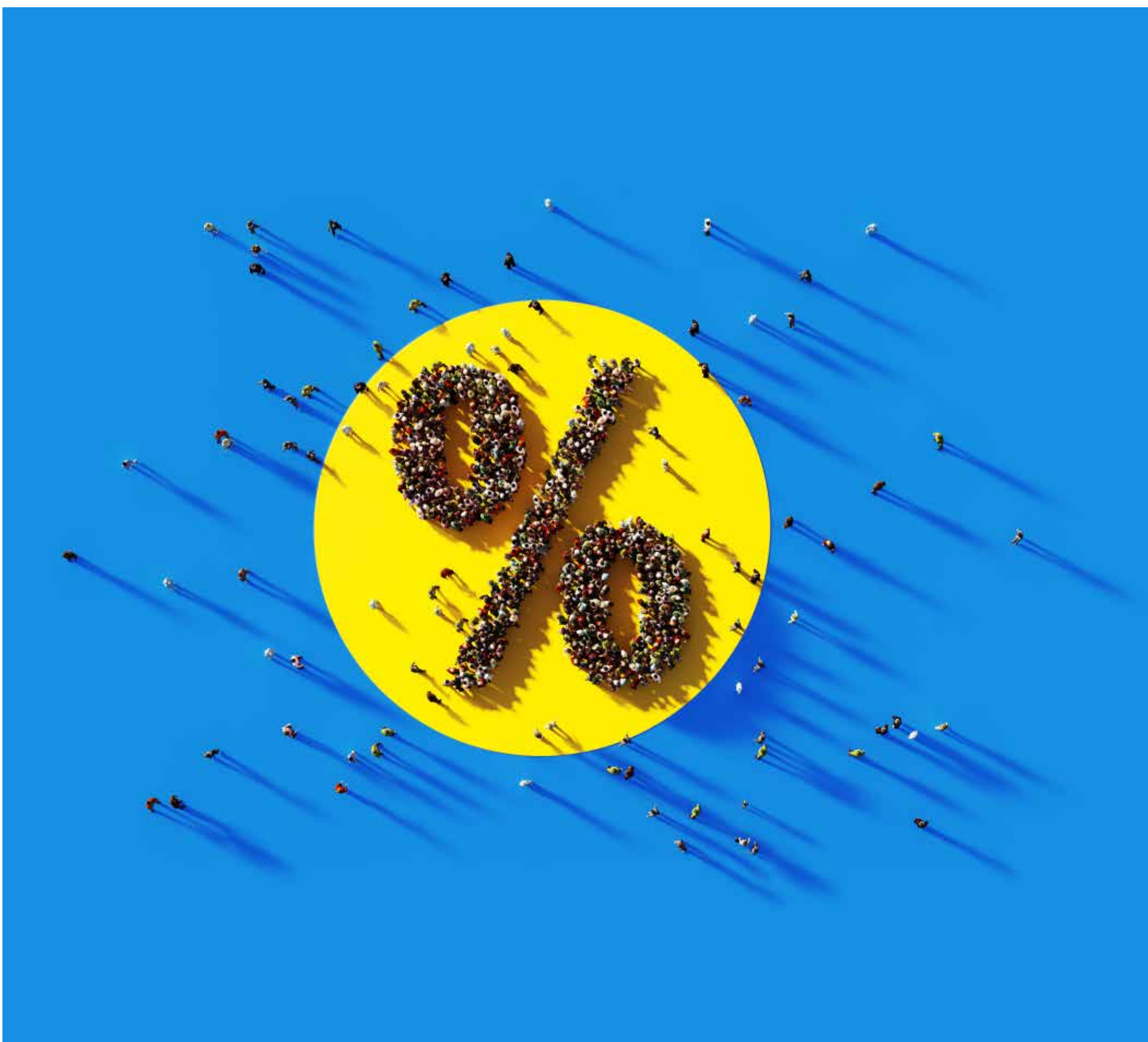
Research

CRISIL
An S&P Global Company

RateView

CRISIL's outlook on near-term rates

April 2022



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Analytical contacts

Bhoomika Dattani
Manager, Funds & Fixed Income Research
Bhoomika.Dattani@crisil.com

Purav Jagad
Senior Research Analyst, Funds & Fixed Income Research
purav.jagad@crisil.com

Supriya Mahindrakar
Research Analyst, Funds & Fixed Income Research
Supriya.Mahindrakar@crisil.com

Aarti Yadav
Management Trainee, Funds & Fixed Income Research
aarti.yadav@crisil.com

Dharmakirti Joshi
Chief Economist
dharmakirti.joshi@crisil.com

Dipti Deshpande
Principal Economist
dipti.deshpande@crisil.com

Pankhuri Tandon
Economist
pankhuri.tandon@crisil.com

Peak oil moved the needle in March

The yield on the 10-year benchmark government security (G-sec; 6.54% GS 2032) opened March at 6.81% and closed at 6.82%, within CRISIL's forecast of 6.80-7.00%, and up 6 basis points (bps) from the February close of 6.76%.

The yield reached a high of 6.89% in the first week, in large part because of escalation of the war between Russia and Ukraine, and its effect on crude oil prices, which peaked at ~$139 per barrel. Also fraying sentiment was the Organization of the Petroleum Exporting Countries and its allies, or OPEC+, sticking to the schedule of increasing supply by 0.4 million barrels per day despite fears of a ban on Russian crude oil.

Between speculation of peace talks between the warring countries and elevated crude oil prices, the benchmark yield ranged 6.80-6.85% in the following week. Market participants also had to contend with a higher consumer price index (CPI) print for February of 6.07% — an 8-month high — thereby breaching the upper limit of the Reserve Bank of India's (RBI) comfort zone, indicating inflationary pressure in coming months.

Domestic trading activity was limited ahead of an extended weekend and as US treasury rates added pressure after the Federal Open Market Committee's decision of a 25-bps rate hike. Consequently, the benchmark was at 6.78% at the mid-month mark.

Towards the end of the month, while a hardening of US treasury yields on expectations of aggressive rate hikes in 2022 weighed on sentiment, peace talks between Russia and Ukraine tamped down a further hardening of yields in the domestic market. Crude oil prices settled at ~$120 per barrel as supply side worries eased amid lower-than-expected demand in China following a sharp rise in Covid-19 infections. Also putting downward pressure on crude oil prices was the US plan to supply 6 million barrels of the product from its reserves over six months. Added to this was the lack of significant domestic cues ahead of the financial year end. All this kept the yield ranged at 6.79-6.83% in the last week.

Meanwhile, market activity was limited ahead of the release of the government's borrowing calendar for the first half of fiscal 2023. The indicative calendar for the first half of fiscal 2023 was released after market hours on March 31, showing government borrowing at Rs 8.45 lakh crore (of Rs 14.31 lakh crore budgeted — a record high gross borrowing).

On April 8, the MPC decided to keep rates and stance unchanged, while announcing new collateral-free standing drawing facility with a floor of 3.75% to manage liquidity. Also, the inflation forecast was revised to 5.7%, up 120 bps, and gross domestic product (GDP) growth forecast was lowered to 7.2% from 7.8%.

CRISIL's outlook

On interest rates

Benchmark	March 31, 2022 (A)	April 29, 2022 (P)	June 30, 2022 (P)
10-year G-sec yield*	6.82%	7.00%-7.20%	7.05%-7.25%
10-year SDL yield	7.18%	7.40%-7.60%	7.45%-7.65%
10-year corporate bond yield	7.05%	7.30%-7.50%	7.35%-7.55%

A: Actual; F: Forecast
**6.54% GS 2032 as the 10-year G-sec benchmark*

Source: CRISIL Research

One-month view

In April, yields are likely to be impacted by the RBI Monetary Policy Committee's (MPC) stance and actions, status of the Russia-Ukraine war, crude oil prices, foreign portfolio investor (FPI) flows, investor appetite at G-sec auctions, further announcements of variable rate reverse repo (VRRR) auctions, announcements of open market operation/ G-Sec Acquisition Programme, and global interest rates.

Three-month view

During the three months through July, factors that will dictate yields are movement in crude oil prices due to geopolitical tensions, the FOMC's decision on rate hikes, the MPC's decision on rates, trend in domestic GDP, FPI flows, and inflation numbers.

Framework for outlook

CRISIL provides its outlook on key benchmark rates for different debt classes – 10-year G-secs, state-development loans (SDLs) and corporate bonds. The outlook is arrived at by combining statistical models with invaluable inputs from our experts. It also incorporates our view on policy expectations, macroeconomic outlook, key events (local and global), market factors (liquidity and demand-supply), etc.

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

Factors influencing outlook

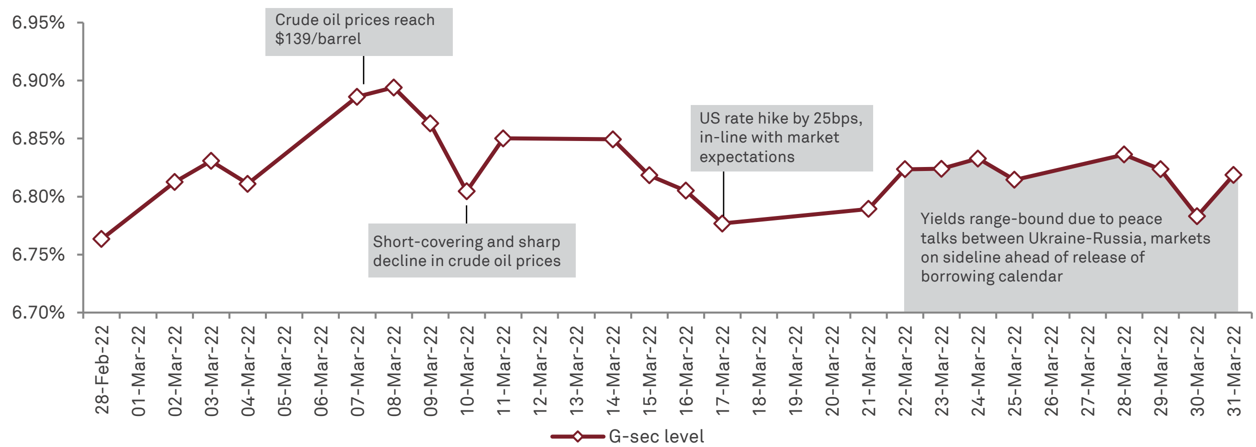
Economic parameter	Our view	Impact on yields
Gross domestic product (GDP) growth	• We expect India's real GDP to grow 7.8% on-year in this fiscal, compared with 8.9%[1] in the previous fiscal • Downside risks to growth have risen on account of surging commodity prices and global supply disruptions. That said, growth will receive support from improving prospects for contact-based services and pickup in investments • GDP growth slowed to 5.4% on-year in the third quarter of fiscal 2022 from 8.5% in the previous quarter	↑
Consumer price index (CPI) inflation	• We expect CPI-linked inflation to average 5.4% this fiscal, compared with an estimated 5.5% in fiscal 2022 • Our base forecast is based on average crude oil prices at $85-90 per barrel in the current fiscal, with upside risks if crude prices remain higher. Food and core inflation are also likely to rise due to surging international prices and input costs • CPI inflation rose for the fifth consecutive month, to 6.1% in February from 6.0% in January	↑
RBI's monetary policy	• We expect repo rate to rise 50-75 basis points (bps) this fiscal, with the first rate hike likely in June • With prolonged high inflation and rising external shocks, the RBI is expected to shift its focus from growth to inflation • The MPC kept repo rate unchanged at 4% and its stance accommodative in the April 2022 meeting. However, it announced a gradual withdrawal of accommodation in the coming months, and restored the policy corridor under liquidity adjustment facility (LAF) to the pre-pandemic width of 50 bps	↑
Fiscal health	• The budget has targeted a reduction in the centre's fiscal deficit to 6.4% of GDP this fiscal from 6.9% (revised estimate) in fiscal 2022 • The centre's gross market borrowing has been revised down to Rs 14.31 lakh crore from the budget estimate of Rs 14.95 lakh crore. About 59% of the borrowing (i.e. Rs 8.45 lakh crore) will take place in this fiscal's first half	↑
Crude oil prices	• CRISIL Research expects crude prices to average $85-90 per barrel this fiscal, compared with $80 per barrel previous year • Brent crude oil prices surged to $115.6 per barrel (average) in March, 20.7% higher on-month and 77.3% higher on-year	↑

[1]Second advance estimate by the National Statistical Office

Economic parameter	Our view	Impact on yields
Current account balance	• We expect the current account deficit (CAD) to rise to 2.4% of GDP this fiscal compared with an estimated 1.6% in the previous year • Surging international commodity prices, particularly of crude, will push up import growth. Export growth is likely to face headwinds with slowing global growth • CAD widened sharply to 2.7% of GDP in the third quarter of fiscal 2022 from 1.3% in the previous quarter	↑
US Federal Reserve's stance	• S&P Global expects a total of seven rate hikes by the US Fed in 2022, including a 50 bps hike in May. Balance sheet reduction is also expected to begin this May • The Fed raised policy rate by 25 bps to 0.25-0.50% in March and indicated a reduction of its bond holdings would begin soon. Purchases under its quantitative easing programme ended in March too	↑
Liquidity indicators - Demand & Supply	Supply side • H1FY2023 G-sec borrowing announced for 8.45 lakh crore-(~59% of total borrowing for the year to be done in first half) • Budgeted t-bill supply for Q1FY23 is Rs 4.32 lakh crore, while the actual supply in Q4FY22 was Rs. ~3.06 lakh crore • SDL supply for Q1FY23 budgeted will be Rs 1,90,375 crs increased by 7% over Q1FY22. Demand side • Muted demand will be seen in SDLs in some tenors due to cancellation of NFOs by SEBI. • CDs issuances crossed ~Rs 73,000 crores in March due to pick up in economic activities and demand for funds from banking system	↑
- Call rates/LAF (liquidity adjustment facility)	• Interbank call money rates hovered below the Reserve Bank of India (RBI)'s repo rate of 4% in March amid ample liquidity in the system. The RBI sporadically conducted variable-rate reverse repo auctions during the month to absorb excess liquidity in the system.	↑

March at a glance

10-year benchmark G-sec yield



Note: 6.54% GS 2032 movement

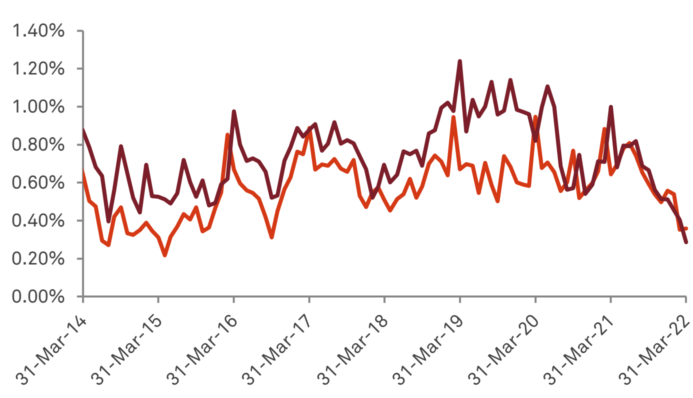
Source: CRISIL Research

10-year benchmark yield harden for SDL

Source: CRISIL Research

Yields on corporate bonds (10-year PSU FI) remained flat on-month, closing at 7.05%, while those on SDLs hardened 6 bps on-month to 7.18%.

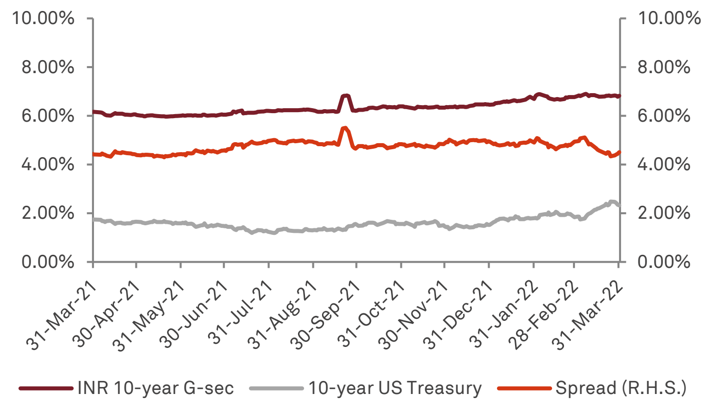
Spread narrows for corporate bonds



Source: CRISIL Research

For the 10-year benchmark SDL, spread over the benchmark G-sec widened by 1 bp over the past month to 36 bps. Meanwhile, 10-year AAA-rated public-sector corporate bond spread narrowed 6 bps over the past month to 23 bps, which was the lowest in eight years. Lack of supply of corporate bonds (longer tenure) and higher G-sec borrowings shrunk spreads. The 12-month average spread between yields on the 10-year benchmark SDL was 59 bps and corporate bonds over that of G-secs was 56 bps.

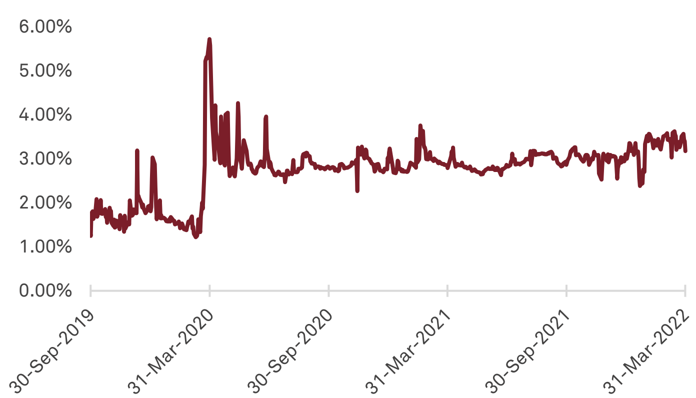
Spread over US Treasury narrows



Source: CRISIL Research

The 10-year US Treasury yield closed at 2.32% in March, 49 bps higher than the February close of 1.83%. Monthly average spread between the domestic 10-year benchmark G-sec yield and the 10-year US Treasury yield narrowed to 4.68% from 4.82%. US Federal Reserve rate hike along with the Russia-Ukraine war pulled up the US Treasury yield.

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

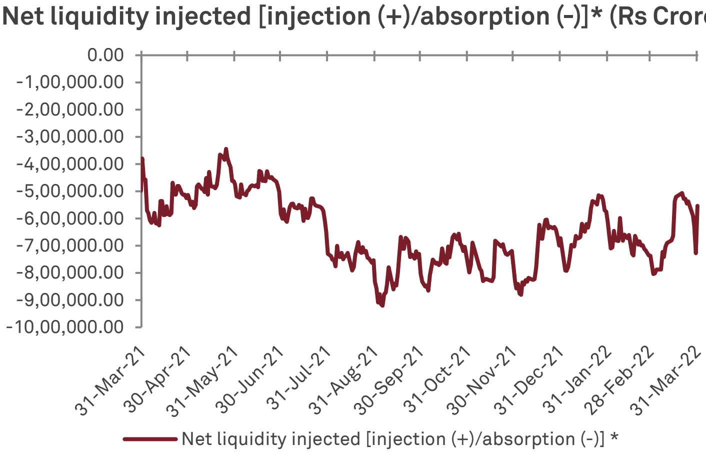


Source: CRISIL Research

Average spread between the 10-year benchmark G-sec yield and the tri-party repo (TREPS) widened to ~342 bps in March from ~340 bps in February. The 12-month average spread stood at ~303 bps.

Systemic liquidity remains in surplus

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



*Note: *Net liquidity is calculated as Repo + Marginal standing facility + Standing liquidity facility - Reverse repo*

Source: CRISIL Research

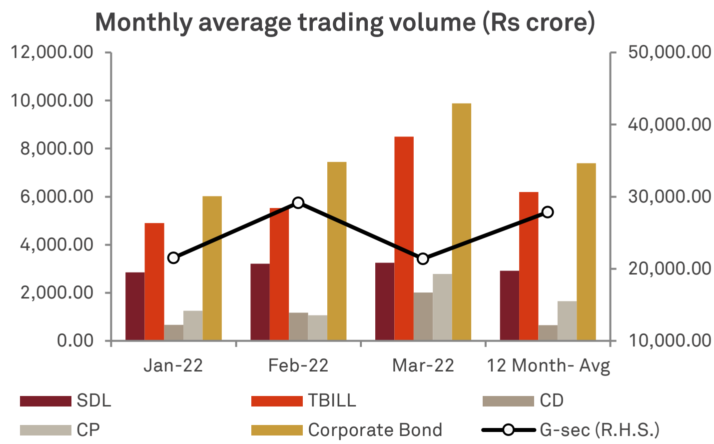
In March, average systemic liquidity was ~Rs 6.47 lakh crore, lower than the previous month's ~Rs 6.88 lakh crore, owing to continued VRRR operations. Daily surplus liquidity hit a high of Rs ~5.06 lakh crore during the month. Average surplus for the past 12 months stood at ~Rs 6.45 lakh crore. The RBI reinstated the liquidity adjustment facility (LAF) corridor to 50 basis points by kick-starting the Standing Deposit Facility (SDF) at 3.75% and Marginal Standing Facility (MSF) at 4.25%. Money market participants can now place deposits with the RBI on an overnight basis at the fixed SDF rate. The shift from reverse repo to SDF is thus a step towards aligning RBI's liquidity management more with market conditions. In light of increased global market volatility, it could allow RBI for a proactive management of liquidity conditions, which augurs well for stability of domestic financial markets.

Benchmark spreads over G-sec widened

Spreads over G-sec*				
Rating category	Date	PSUs/ corporates	NBFCs	Housing finance companies
AAA	28-Feb-22	0.07%	0.57%	0.22%
	31-Mar-22	0.11%	0.61%	0.36%
AA+	28-Feb-22	1.09%	1.93%	1.09%
	31-Mar-22	1.16%	1.97%	1.14%
AA	28-Feb-22	1.57%	4.59%	3.29%
	31-Mar-22	1.49%	4.63%	3.38%
AA-	28-Feb-22	2.33%	5.20%	4.39%
	31-Mar-22	2.24%	5.03%	4.53%

*Note: *Spreads are for five-year securities over annualised G-sec yield*
Source: CRISIL Research

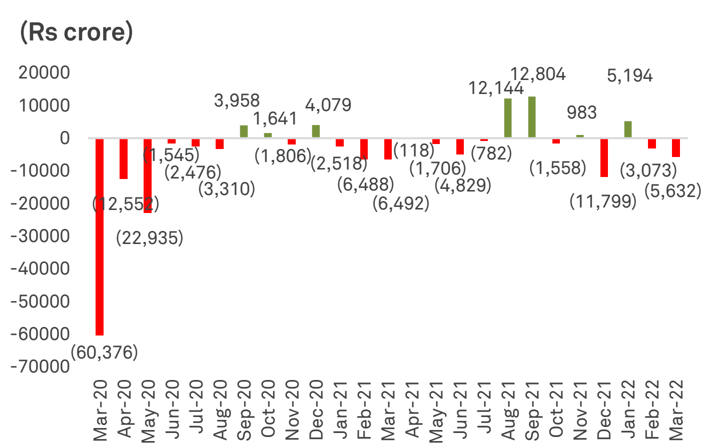
Average trading volume



Source: CRISIL Research

Trading volume in SDLs remained flat and that in T-bills rose ~54%. In G-secs, though, the trading volume decreased ~27% owing to the absence of primary auctions. In commercial papers, CDs and corporate bonds, volume increased a sharp ~160%, ~71% and ~33%, respectively, owing to the March book management by mutual funds and other entities.

FPI investments in debt saw outflow



Source: CRISIL Research

In March, net FPI outflow was Rs 50,068 crore compared with net outflow of Rs 38,068 crore in February. Within this, net outflow in the debt segment was Rs 5,632 crore and in equities, Rs 41,123 crore. The increase in outflow was because of FPIs concerned with the impact of crude oil and other commodity price increases on India, which is a major importer.

Key downgrades and upgrades in March 2022

Downgrades		
Issuer name	**Old rating**	**New rating**
Dilip Buildcon Ltd	CARE A	CARE A-
Future Enterprises Ltd	CARE C	CARE D
Hindustan Cleanenergy Ltd	IND BB	IND D
Home Credit India Finance Pvt Ltd	CRISIL BBB+	CRISIL BBB
Nayara Energy Ltd	CARE AA	CARE AA-
Reliance Mediaworks Financial Services Pvt Ltd	CARE C	CARE D

Upgrades		
Issuer name	**Old rating**	**New rating**
Bhilangana Hydro Power Ltd	CARE A	CARE A+
Capsave Finance Pvt Ltd	CRISIL A-	CRISIL A
DLF Cyber City Developers Ltd	[ICRA]AA-	[ICRA]AA
Ess Kay Fincorp Ltd	CARE A	CARE A+
North Eastern Electric Power Corporation Ltd	CRISIL AA	CRISIL AA+
Sankhya Financial Services Pvt Ltd	CARE A-	CARE A
T-Hills Pvt Ltd	IND BBB	IND BBB+
Trust Investment Advisors Pvt Ltd	CARE A	CARE A+

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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
/company/crisil @CRISILLimited /CRISILLimited /user/CRISILLimited /lifeatcrisil