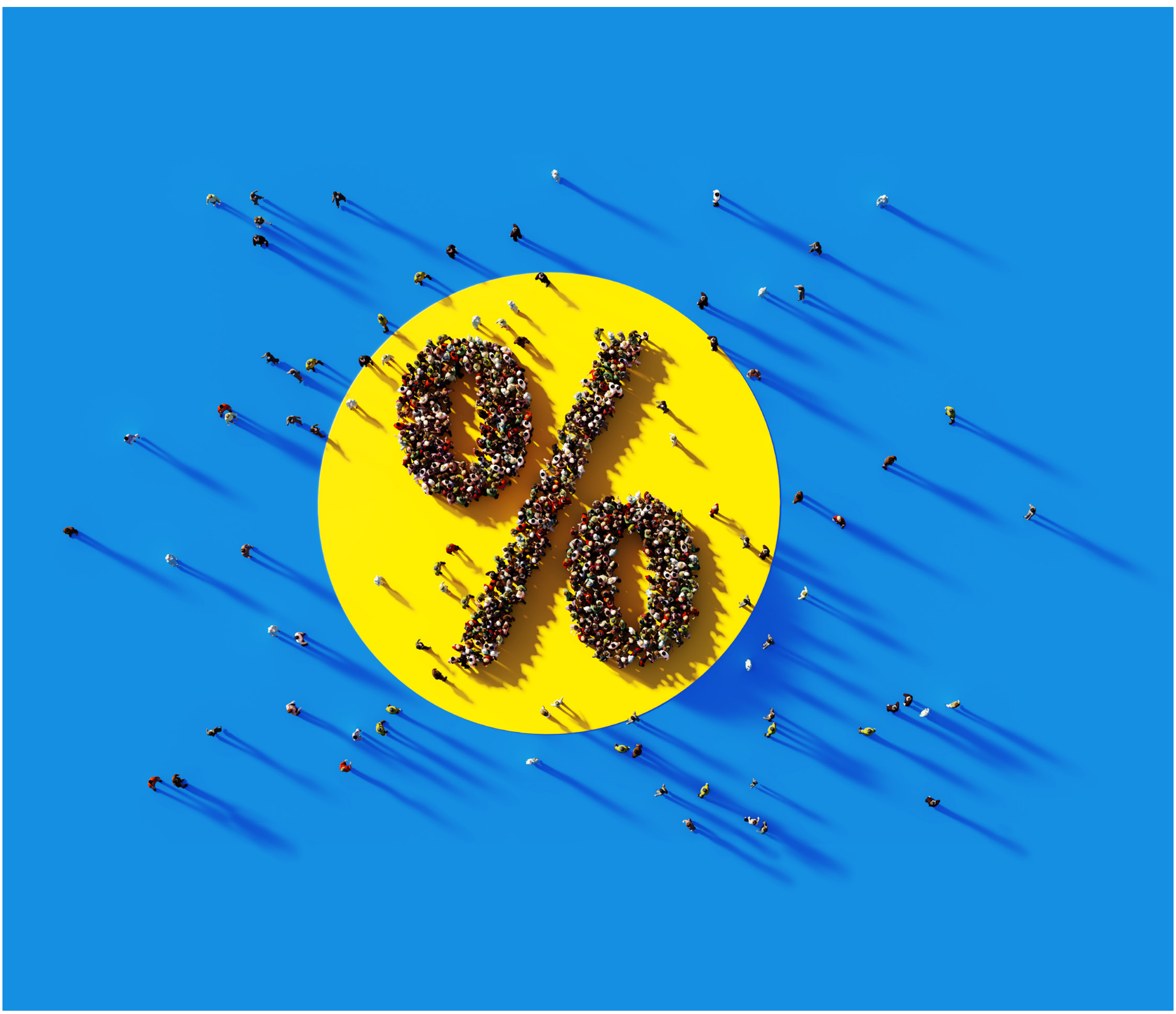
Market Intelligence
& Analytics

CRISIL
An S&P Global Company

RateView

CRISIL's outlook on near-term interest rates

July 2023



Research

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Jumpy June

The yield on the 10-year benchmark government security (G-sec; 7.26% GS 2033) opened June at 6.98% and closed at 7.11%, up 12 basis points (bps) from its May close of 6.99% and just outside CRISIL's forecast range of 7.00-7.10%.

The first week saw bond yields harden tracking a surge in United States (US) Treasury yields and crude oil prices. Oil prices rose after Saudi Arabia announced an additional voluntary cut of 1 million barrels per day in oil output from July, over and above the extended cut by OPEC+ into 2024. Domestic bond yields rose further as the Reserve Bank of India's (RBI) Monetary Policy Committee (MPC) opted for a 'hawkish' pause at the June policy meet, leaving the repo rate unchanged at 6.5%. The 10-year benchmark closed the week at 7.04%.

In the second week, bonds largely traded in a narrow price range. Domestic inflation printed at 4.25% for May, lower on-month. On the global front, inflation in the US printed at 4%, the lowest in two years. The 10-year US Treasury yield hardened 2 bps to close the week at 3.77% as the US Federal Reserve opted for a hawkish pause at its June policy meet. The 10-year benchmark paper closed at 7.03%.

G-secs witnessed volatility in the third week owing to the US Fed's hawkish comments on further rate hikes and hawkish minutes of the MPC meeting. The 10-year benchmark paper closed at 7.07%.

In the fourth week, yields hardened tracking the surge in US Treasury yields and crude prices. The 10-year US Treasury yield hardened 9 bps to close the week at 3.81% as stronger-than-expected US gross domestic product (GDP) print for the January-March quarter and jobs data intensified fears of rate hikes by the US Fed. The 10-year benchmark paper closed at 7.11%. In the Treasury bill (T-bill) calendar released during the week, the borrowing amount for T-bills has been reduced from Rs 32,000 crore per week to Rs 24,000 crore per week for this quarter. This will ease the pressure on T-bill yields.

CRISIL's outlook

On interest rates

Benchmark	June 30, 2023 (A)	July 31, 2023 (P)	September 30, 2023 (P)
10-year G-sec yield	7.11%	7.05% - 7.15%	7.05% - 7.15%
10-year SDL yield	7.39%	7.35% - 7.45%	7.40% - 7.50%
10-year corporate bond yield	7.49%	7.45% - 7.55%	7.50% - 7.60%

A: Actual; P: Projected
Source: CRISIL MI&A Research

One-month view

In July, domestic G-sec yields are likely to be influenced by crude prices, inflation print, rupee-dollar dynamics, global interest rates, investor appetite at G-sec auctions, announcements of variable reverse repo rate auctions, expectations of MPC outcome, heavy unseasonal rainfall, and foreign portfolio investment (FPI) flows.

Three-month view

During the three months through August, yields are likely to be impacted by crude price movements, inflation print, fiscal numbers, rate decisions by the Federal Open Market Committee and RBI MPC, India's GDP growth trend, and FPI flows.

Framework for outlook

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

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

Factors influencing the outlook

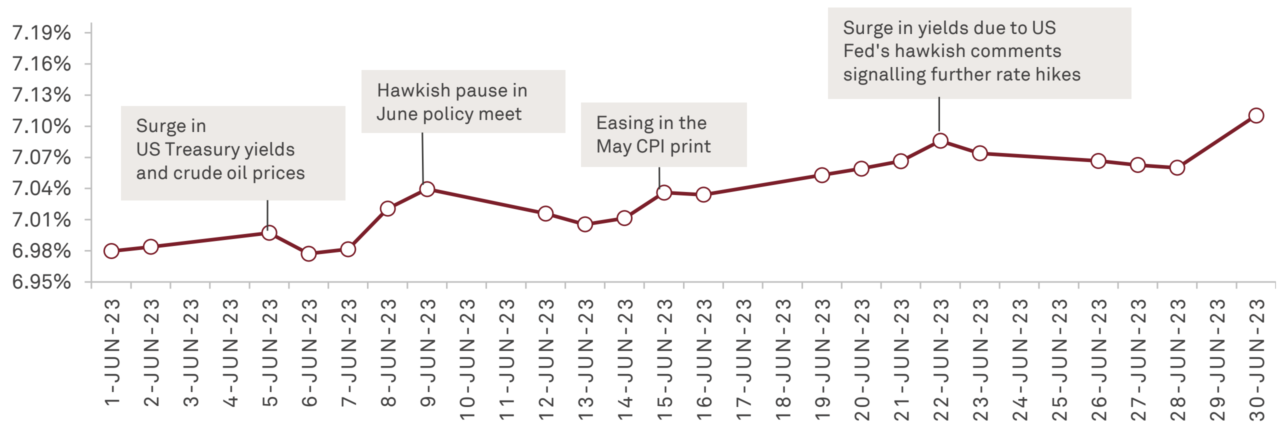
Economic parameter	Our view	Impact on yields
GDP growth	• We expect India's real GDP growth to slow to 6.0% on-year in fiscal 2024 from 7.2%[1] previous year • Slowing global growth will hit Indian economy through weaker exports. Domestic demand could face pressure from rising interest rates and waning recovery of contact-based services • GDP growth accelerated to 6.1% on-year in the fourth quarter of fiscal 2023, from 4.5% in the previous quarter	↓
CPI inflation	• We expect Consumer Price Index (CPI) inflation to moderate to 5.0% in fiscal 2024 from 6.7% previous year • Lower commodity prices compared with last year are expected to ease fuel and core inflation. Moderating domestic demand could further reduce pressure on core inflation. However, food inflation faces risks from El Nino this year. Progress and distribution of monsoon will also be a monitorable • CPI inflation eased to 4.3% in May from 4.7% previous month	↓
RBI's monetary policy	• We expect the RBI to maintain status quo on rates in the next few meetings. The central bank will evaluate impact of past rate hikes on growth and inflation. It will also monitor weather-related risks on food inflation and any spillovers from global market volatility • We expect the RBC to initiate cuts in the January-March quarter of 2024, as growth moderates and inflation softens • The MPC kept policy rates unchanged in its June meeting while maintaining the stance of withdrawal of accommodation	↔
Fiscal health	• The budget has targeted a reduction in the Centre's fiscal deficit to 5.9% of GDP this fiscal from 6.4% of GDP in previous year • In the first two months of this fiscal, fiscal deficit stood at 11.8% of the budget target, compared with 12.3% in the same period last year • Gross market borrowing is projected at Rs 15.4 lakh crore for fiscal 2024, 8.4% higher on-year, but lower than nominal GDP growth of 10.5% expected for next year	↓
Crude oil prices	• We expect crude prices to average $75-80 per barrel in fiscal 2024 compared with $95 per barrel previous year • Brent crude oil prices decreased to $74.9 per barrel average in June, 1.1% lower on-month and 37.6% lower on-year	↓

[1]Provisional estimate by National Statistics Office

Economic parameter	Our view	Impact on yields
Current account balance	• We expect current account deficit (CAD) to average 1.8% of GDP in fiscal 2024 compared with 2.0% of GDP in fiscal 2023 • Correction in international commodity prices and support from healthy services exports and remittances will help CAD narrow this fiscal • CAD fell sharply to 0.2% of GDP in the fourth quarter of fiscal 2023 from 2.0% of GDP previous quarter	↓
US Federal Reserve's stance	• S&P Global sees the fed policy rates remaining higher for longer • Successive upside surprises to output, a robust labour market, and sticky inflation have bolstered the view that inflation may not come down as quickly as previously thought • The Fed kept its policy rates unchanged in June at 5.0-5.25%, but lifted its outlook on policy rate levels. Its latest projections foresee two more 25-bps hikes in 2023	↑
Liquidity indicators - Demand & supply	Supply side • T-bills saw reduction in supply by ~25% (from Rs 32,000 crore per week to Rs 24,000 crore per week) • June witnessed heavy CB issuances due to favourable domestic market conditions. Issuances of ~Rs 1.2 lakh crore were raised through the domestic market Demand side • Demand for longer tenor G-secs increased due to additional participation from insurance players and pension funds	↔
- Call rates/ liquidity adjustment facility (LAF)	• Average of interbank call money rates remained below the RBI's repo rate of 6.50% in June due comfortable liquidity in the system. Meanwhile, the central bank intermittently conducted variable rate repo auctions during the month to infuse more liquidity	↔

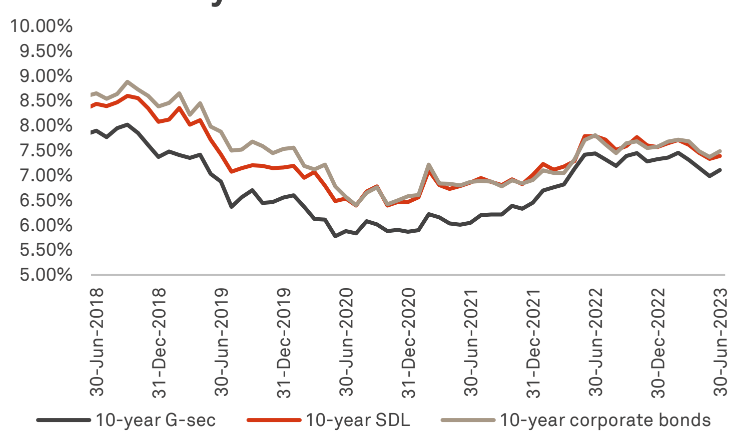
June at a glance

10-year G-sec benchmark yield



Source: CRISIL MI&A Research

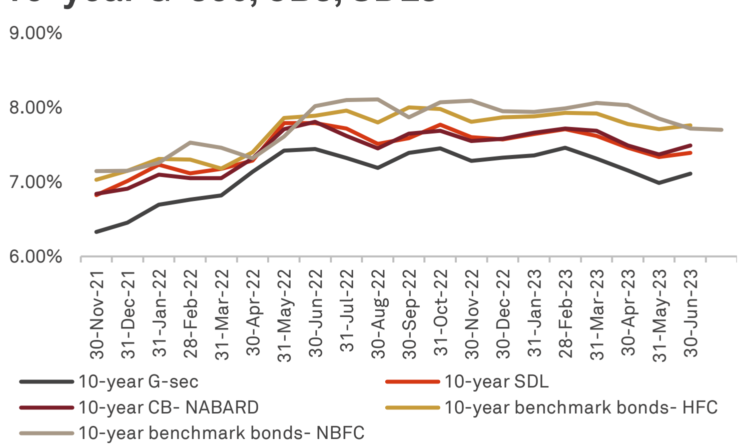
Benchmark yields harden



Source: CRISIL MI&A Research

Yield on the 10-year benchmark G-sec hardened 12 bps to close June at 7.11%; on the 10-year SDL hardened 5 bps to 7.39%; and on CBs (10-year PSU FI) hardened 12 bps to 7.49%.

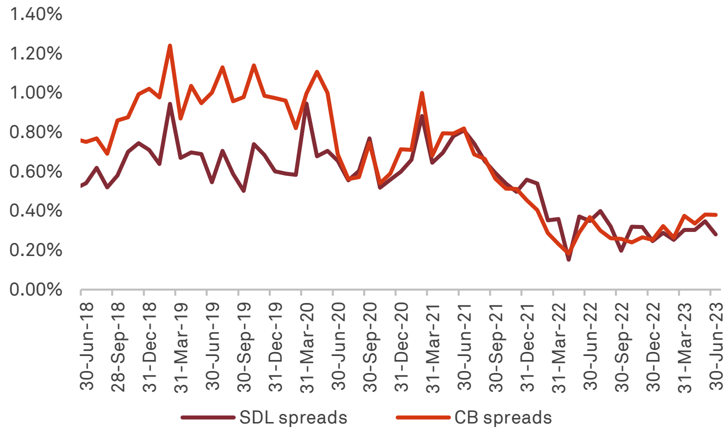
10-year G-sec, CBs, SDLs



Source: CRISIL MI&A Research

Yield on the 10-year benchmark bonds - Housing Development Finance Corporation Ltd (HFC) increased 5 bps to 7.76% in June from 7.71% in May. Yields on the 10-year benchmark bonds for AAA-rated NBFCs and AAA-rated PSU bonds closed at 7.70% and 7.49%, down from 7.72% and 7.37%, respectively.

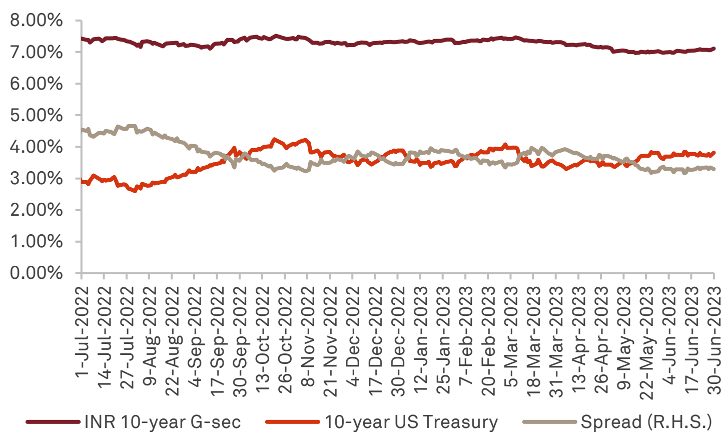
CB and SDL spreads over 10-year benchmark G-sec soften



Source: CRISIL MI&A Research

The spread of the 10-year benchmark SDL over the 10-year benchmark G-sec eased in June and closed at 28 bps. Meanwhile, spread of the 10-year AAA-rated public sector CB remained the same at 38 bps. The 12-month average spreads for the 10-year benchmark SDL and CB over the 10-year benchmark G-sec were 30 bps and 30 bps, respectively.

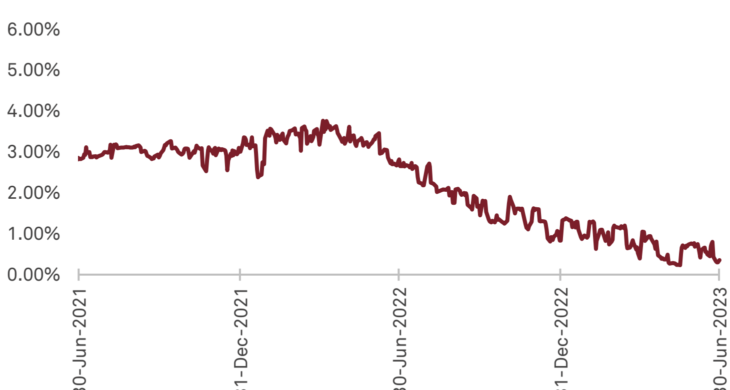
US Treasury yield spread eases



Source: CRISIL MI&A Research

The 10-year US Treasury yield closed at 3.81% in June, 17 bps higher than its May close of 3.64%. The monthly average spread between the domestic 10-year benchmark G-sec yield and the 10-year US Treasury yield eased to 3.30% from the previous month's 3.35%.

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

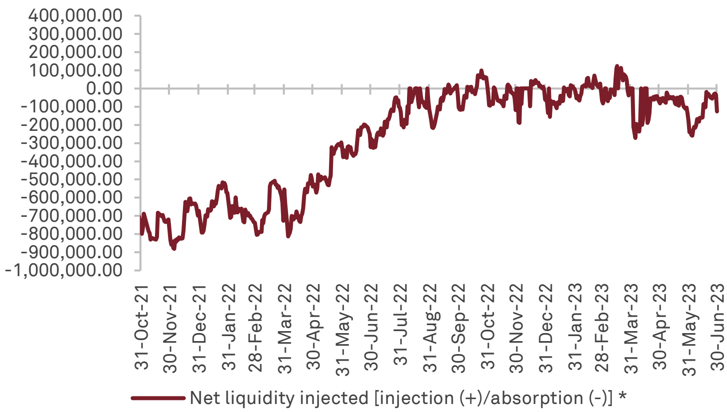


Source: CRISIL MI&A Research

The average spread between the 10-year benchmark G-sec yield and tri-party repos (TREPS) widened to ~56 bps in June from ~50 bps in May. The 12-month average spread stood at ~143 bps.

Surplus systemic liquidity

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



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

The average systemic liquidity surplus was ~Rs 1.29 lakh crore in June, higher than the previous month, surplus of ~Rs 0.72 lakh crore. Average surplus during the past 12 months stood at ~Rs 0.68 lakh crore. Systemic liquidity absorption as of June-end was at a high of ~Rs 1.26 lakh crore.

Benchmark spreads over G-sec narrows

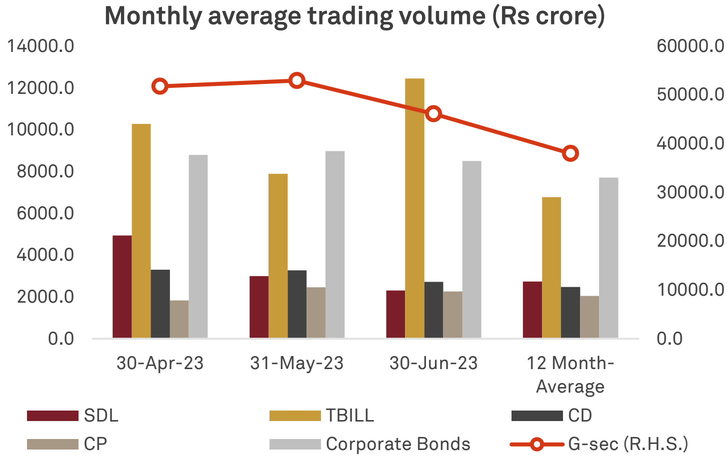
Spreads over G-Sec*

Rating category	Date	PSU / corporates	NBFC	Housing finance companies
AAA	31-May-23	0.37%	0.68%	0.66%
	30-Jun-23	0.33%	0.58%	0.62%
AA+	31-May-23	0.57%	1.29%	1.30%
	30-Jun-23	0.52%	1.09%	1.20%
AA	31-May-23	1.08%	2.15%	1.83%
	30-Jun-23	1.02%	1.91%	1.63%
AA-	31-May-23	1.80%	3.05%	2.76%
	30-Jun-23	1.74%	2.94%	2.71%

*Note: * Spreads are for five-year securities over 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, barring T-bills

Monthly average trading volume (Rs crore)

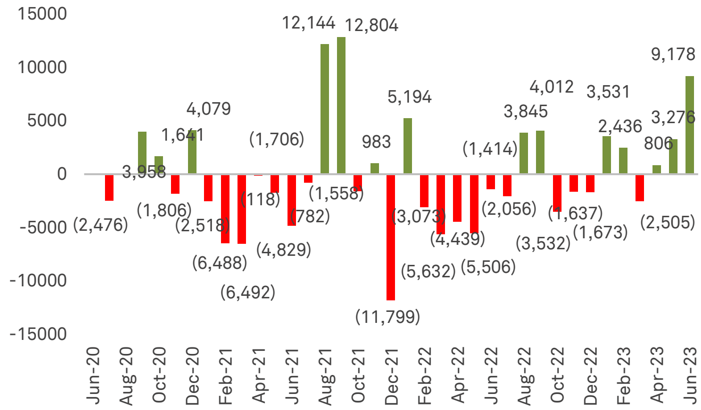


Source: CRISIL MI&A Research

Trading volume in G-secs and SDLs declined ~12.82% and ~22.92%, respectively. Corporate bonds also declined by ~5.27%. Trading volume in T-bills increased ~58%, while that in CPs and CDs decreased ~8.37% and ~16.8%, respectively.

Foreign portfolio investors turn net buyers in debt

(Rs crore)



Source: CRISIL M&IA Research

Net FPI inflow into debt stood at Rs 9,178 crore in June, compared with a net inflow of Rs 3,276 crore in May. Equity saw an inflow of Rs 47,148 crore. It was the highest FPI inflow in the past five months, aided by a stronger rupee, reasonable valuation of stocks, and surge in buying in sectors such as automobiles, financial services, information technology, capital goods, pharma, and chemicals. India's CAD is declining, and if this trend continues, the rupee may appreciate further. FPIs are likely to bring more inflows into India in such a scenario.

Key upgrades and downgrades

Upgrades

Issuer name	Old rating as per CRISIL	New rating
Mintifi Finserve Pvt Ltd	CRISIL BBB	CRISIL BBB+
Central Bank of India	[ICRA]A+	[ICRA]AA-
Tata Motors Ltd	CARE AA-	CARE AA
Midland Microfin Ltd	CARE BBB	CARE BBB+
GRIDCO Ltd	IND A-(CE)	IND A(CE)
Tata Motors Finance Ltd	CARE AA-	CARE AA
Tata Motors Finance Solutions Ltd	CARE AA-	CARE AA

Downgrades

Issuer name	Old rating as per CRISIL	New rating
Sanghi Industries Ltd	IND BB+	IND BB
Sadbhav Engineering Ltd	IND C	IND D

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