Market Intelligence
& Analytics

RateView

CRISIL's outlook on near-term rates

May 2023

Research

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Atypical April

The yield on the 10-year benchmark government security (G-sec; 7.26% GS 2032) opened April at 7.32% and closed at 7.15%, down 16 basis points (bps) from its March close of 7.31% and outside CRISIL's forecast range of 7.25-7.40%.

The first week began on a negative note due to a sharp spike in crude oil prices after OPEC+ decided to cut daily output by ~1.15 million barrels per day. However, as the week progressed, yields softened as the Monetary Policy Committee (MPC) kept its repo rate unchanged at 6.50%, leading the domestic benchmark to close on a positive note, at 7.22%.

The second week opened on a negative note following a surge in US Treasury yields (3.30% to 3.41%). However, as the week progressed, bond yields fell on account of a lower-than-expected domestic Consumer Price Index (CPI)-based inflation print for March 2023 of 5.66%. On the global front, the US CPI-linked inflation eased to 5.00% in March, compared with 6.00% a month ago. The 10-year benchmark closed the week at 7.23%, up 1 bp from the previous week.

The third week started on a bearish note, tracking a surge in US Treasury yields. However, as the week progressed, bond yields softened due to a decline in overnight index swap rates and global crude oil prices. In addition, the minutes of the MPC meeting were in line with market expectations, which supported yields.

The last week of the month started on a positive note as market participants expected the MPC to continue with its pause in raising interest rates for the June policy. Bonds largely traded in a narrow price range ahead of the Federal Open Market Committee (FOMC) outcome. The 10-year benchmark G-sec closed the week at 7.15% compared with 7.18% a week ago.

CRISIL's outlook

On interest rates

Benchmark	April 30, 2023 (A)	May 31, 2023 (P)	July 31, 2023 (P)
10-year G-sec yield*	7.15%	7.11%-7.21%	7.18%-7.28%
10-year SDL yield	7.46%	7.44%-7.54%	7.53%-7.63%
10-year corporate bond yield	7.49%	7.46%-7.56%	7.55%-7.65%

A: Actual; P: Projected
**7.26% GS 2032 is the 10-year benchmark G-sec as on April 30th. Projections for new benchmark 7.26% GS 2033*

Source: CRISIL MI&A Research

One-month view

In May, factors that will influence domestic G-sec yields are crude prices, the inflation print for the month, rupee-dollar dynamics, global interest rates, investor appetite at G-sec auctions, announcements of variable reverse repo rate (VRRR) auctions, expectations of MPC outcome, heavy unseasonal rainfall, and foreign portfolio investor (FPI) flows.

Three-month view

During the three months through July, yields are likely to be impacted by crude price movements, inflation print, fiscal numbers, rate decisions by the FOMC and Reserve Bank of India's (RBI) MPC, India's gross domestic product (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

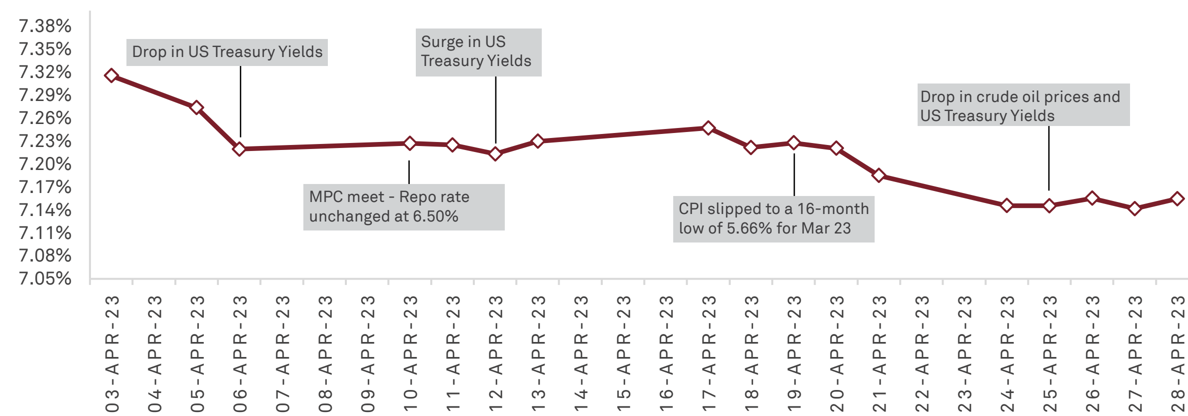
Economic parameter	Our view	Impact on yields
Gross domestic product (GDP) growth	• We expect India's real GDP growth to slow to 6.0% on-year in fiscal 2024 from 7.0[1]% a year ago • Slowing global growth will hit the economy through weaker exports. Domestic demand could face pressure from rising interest rates and waning catchup of contact-based services • GDP growth slowed to 4.4% on-year in the third quarter of fiscal 2023, from 6.3% the previous quarter	⬇
Consumer price index (CPI) inflation	• We expect consumer price index (CPI)-linked inflation to moderate to 5.0% in fiscal 2024 from 6.7% the previous year • Lower commodity prices than 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 weather disruptions and abnormal monsoon • CPI-based inflation eased to 5.7% in March from 6.4% the previous month, falling below the RBI's upper tolerance limit of 6%	⬇
RBI's monetary policy	• We believe the RBI will maintain its pause on rate hikes, provided inflation does not rise materially above its forecast levels. As the growth slowdown seeps in and inflation moderates, we expect the RBI to cut rates by this fiscal end • The central bank will evaluate the impact of past rate hikes on growth and inflation, and monitor spill overs from global market volatility, if any, even as a slowdown in rate hikes by major central banks offers partial relief • The MPC kept policy rates unchanged in the April meeting, while maintaining its stance on the withdrawal of accommodation	⬌
Fiscal health	• The budget has targeted a reduction in Centre's fiscal deficit to 5.9% of GDP next fiscal from 6.4% of GDP this year • Gross market borrowing is estimated at Rs 15.4 lakh crore for fiscal 2024, 8.4% higher on-year. This growth will be lower than nominal GDP growth of 10.5% expected next year	⬇
Crude oil prices	• Crude prices are expected to average ~$85 per barrel in fiscal 2024, compared with $95 per barrel a year ago • Brent crude prices increased to $84.1 per barrel, on average, in March, 7.1% higher on-month, but 20.4% lower on-year	⬇

[1]Second advance estimate by National Statistics Office

Economic parameter	Our view	Impact on yields
Current account balance	• We expect current account deficit (CAD) to average 2.0% of GDP in fiscal 2024 compared with an estimated 2.5% of GDP a year ago • Lower international commodity prices and moderating domestic demand ease, CAD will reduce the import bill this fiscal • CAD plummeted to 2.2% of GDP in third quarter of fiscal 2023 from 3.7% of GDP the previous quarter	↓
US Federal Reserve's stance	• S&P Global expects the US Federal Reserve's (Fed) policy rate to remain at the existing level for rest of this year. The first rate cut is expected in mid-2024 • The US growth slowdown expected this year, along with downside risks from the banking crisis, will prompt the Fed to slow monetary tightening. Yet, rates are expected to stay elevated for longer, given stubborn inflation • The Fed increased the policy rate by 25 bps in May, bringing it to 5.00-5.25%	↔
Liquidity indicators - Demand & Supply	Supply side • April witnessed reduction in SDL issuances ~ only 38% of the budgeted amount due to states opting for interest free loans. • CPCD also saw reduction in supply by ~12% and 77% respectively(new financial year phenomena) Demand side • Demand up for longer-end G-secs due to additional participation from pension funds and insurance players • New target maturity funds will create additional demand for G-secs and SDLs of select maturities	↔
- Call rates/LAF (liquidity adjustment facility)	• Interbank call money rates hovered above the repo rate since mid-April given the reduction in surplus liquidity in the system. The RBI intermittently conducted variable rate repo auctions during the month to infuse liquidity.	↑

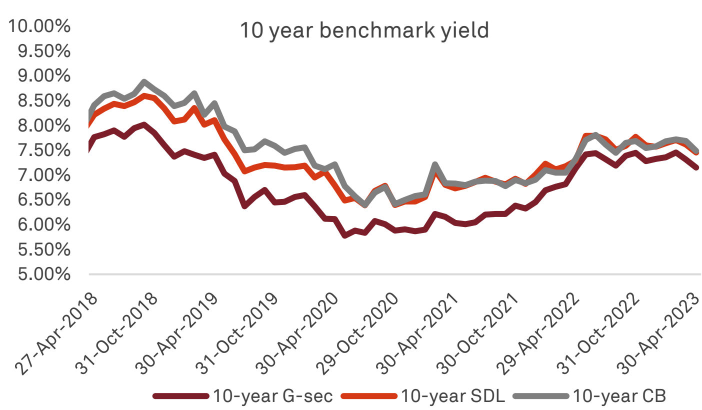
The month at a glance

10-year benchmark G-sec yield



Source: CRISIL MI&A Research

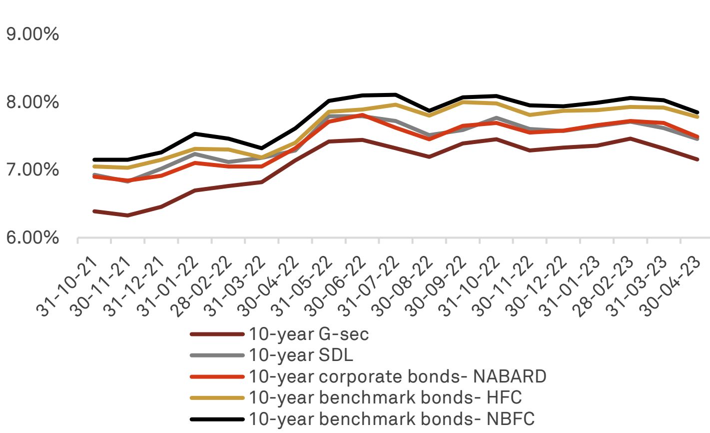
Benchmark yields soften



Source: CRISIL MI&A Research

Yield on the 10-year benchmark G-sec softened 16 bps to close April at 7.15%, on the 10-year SDL, 16 bps on-month, to close at 7.46%, and on corporate bonds (CBs; 10-year PSU FI), eased 20 bps, to close at 7.49%.

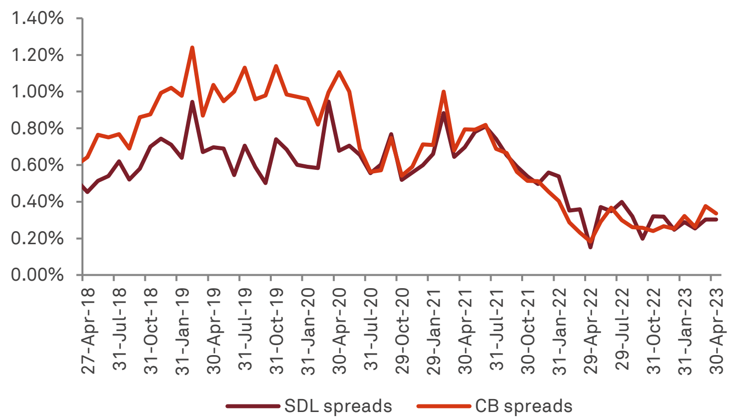
10 Year G-sec/SDL/CB



Source: CRISIL MI&A Research

Yield on the 10-year benchmark bonds- Housing Development Finance Corporation Ltd (HFC) decreased 7 bps to 7.85% from 7.92% in March. Yields on the 10-year benchmark bonds for AAA-rated NBFCs and AAA-rated PSU bonds closed at 7.78% and 7.49%, down from 8.03% and 7.69%, respectively, in March.

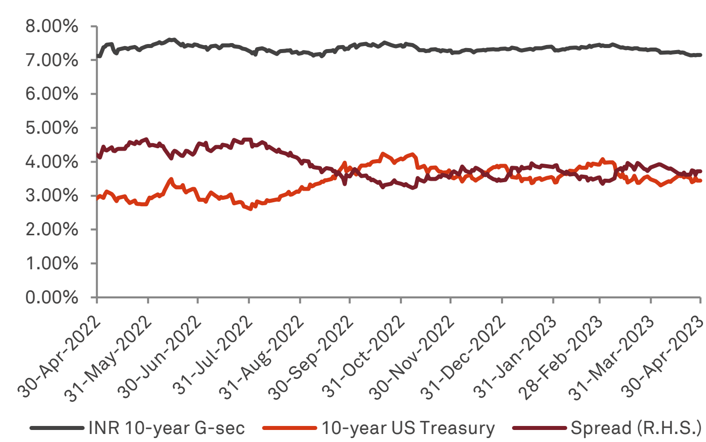
CB and SDL spreads over 10-year benchmark G-sec eased



Source: CRISIL MI&A Research

The spread of the 10-year benchmark SDL over the 10-year benchmark G-sec in April remained flat over March and closed at 30 bps. Meanwhile, the 10-year AAA-rated public sector CB spread eased from 38 bps to 34 bps. The 12-month average spreads for the 10-year benchmark SDL and CB over the 10-year benchmark G-sec were 31 bps and 29 bps, respectively.

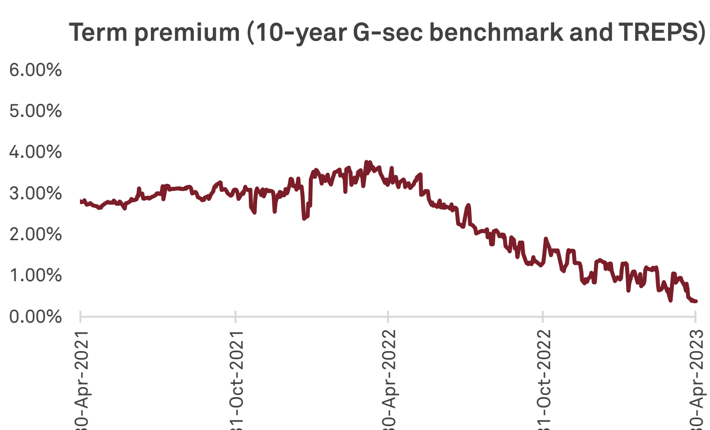
US Treasury yield spread eased



Source: CRISIL MI&A Research

The 10-year US Treasury yield closed at 3.44% in April, 4 bps lower than its March close of 3.48%. The monthly average spread between the domestic 10-year benchmark G-sec yield and 10-year US Treasury yield hardened to 3.74% from the previous month's 3.71%. The Fed raised the federal funds rate by 25 bps (in May), in line with market consensus, and signalled at a pause in further rate hikes.

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

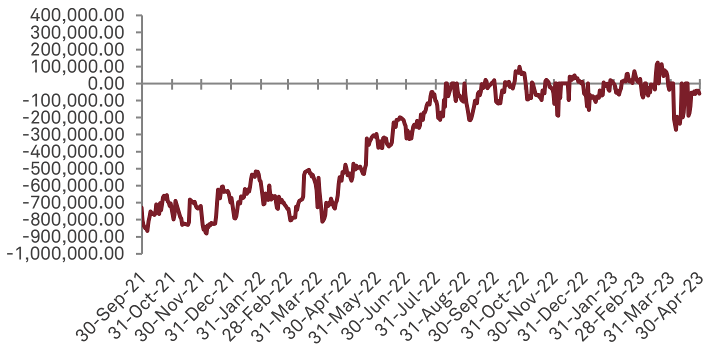


Source: CRISIL MI&A Research

The average spread between the 10-year benchmark G-sec yield and tri-party repos (TREPS) narrowed to ~68 bps in April from ~91 bps in March. The 12-month average spread stood at ~195 bps.

Systemic liquidity eased

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



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

In April, the average systemic liquidity surplus was ~Rs 1.32 lakh crore, higher than the previous month, where there was a deficit of ~Rs 0.15 lakh crore. Average surplus during the past 12 months stood at ~Rs 1.15 lakh crore. Systemic liquidity absorption as of April-end was at a high of ~Rs 2.72 lakh crore.

Benchmark spreads over G-sec widened

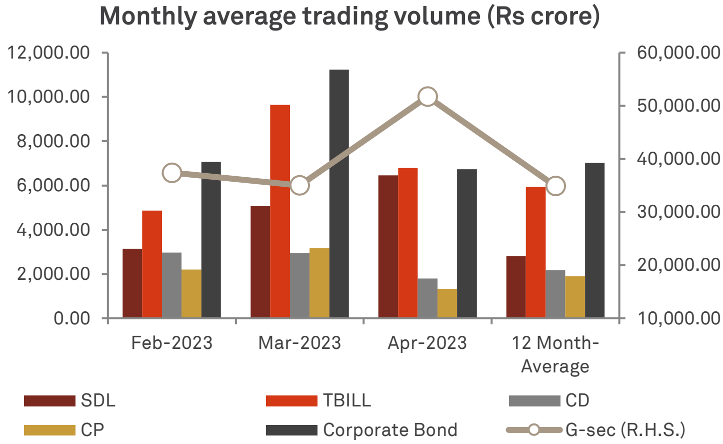
Spreads over G-sec*

Rating category	Date	PSUs/ corporates	NBFCs	Housing finance companies
AAA	31-Mar-23	0.33%	0.63%	0.59%
	30-Apr-23	0.34%	0.71%	0.61%
AA+	31-Mar-23	0.71%	1.16%	1.15%
	30-Apr-23	0.53%	1.29%	1.28%
AA	31-Mar-23	1.00%	2.01%	1.75%
	30-Apr-23	0.99%	2.18%	1.85%
AA-	31-Mar-23	1.82%	3.01%	2.84%
	30-Apr-23	1.74%	3.02%	2.86%

*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

Decline in average trading volume across securities barring G-sec and SDLs

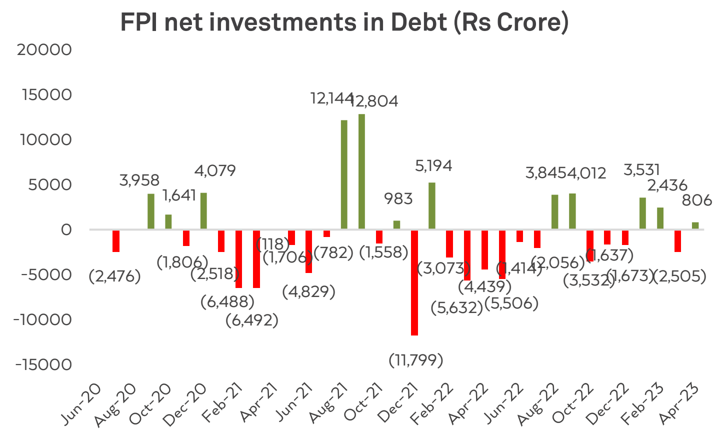
Monthly average trading volume (Rs crore)



Source: CRISIL MI&A Research

Trading volume in G-secs rose ~48%(with newly added supply) and in SDLs ~27%(due to attractive yields), but in corporate bonds, fell ~40%. Meanwhile, volume in T-bills declined ~30%, in CPs ~58%, and in CDs ~39%.

FPIs turned net buyers in debt



Source: CRISIL MI&A Research

Net FPI inflow into debt stood at Rs 806 crore in April, compared with a net outflow of Rs 2,505 crore in March. Equity saw an inflow of Rs 11,631 crore. It was the highest FPI inflow in the past four months, aided by a stronger rupee, reasonable valuation of stocks, and surge in buying in sectors such as automobiles, financial services, information technology, and capital goods. 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 this context.

Key downgrades and upgrades

Upgrades

Issuer name	Old rating	New rating
Poonawalla Fincorp Ltd.	CRISIL AA+	CRISIL AAA
SK Finance Ltd.	CRISIL AA(CE)	CRISIL AA+(CE)

Downgrades

Issuer name	Old rating	New rating
Rajasthan Rajya Vidyut Prasaran Nigam Ltd.	BWR A-(CE)	BWR BBB+(CE)
The Oriental Insurance Co. Ltd.	CRISIL AAA	CRISIL AA+
Suguna Foods Pvt. Ltd.	[ICRA]A-	[ICRA]BBB+

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