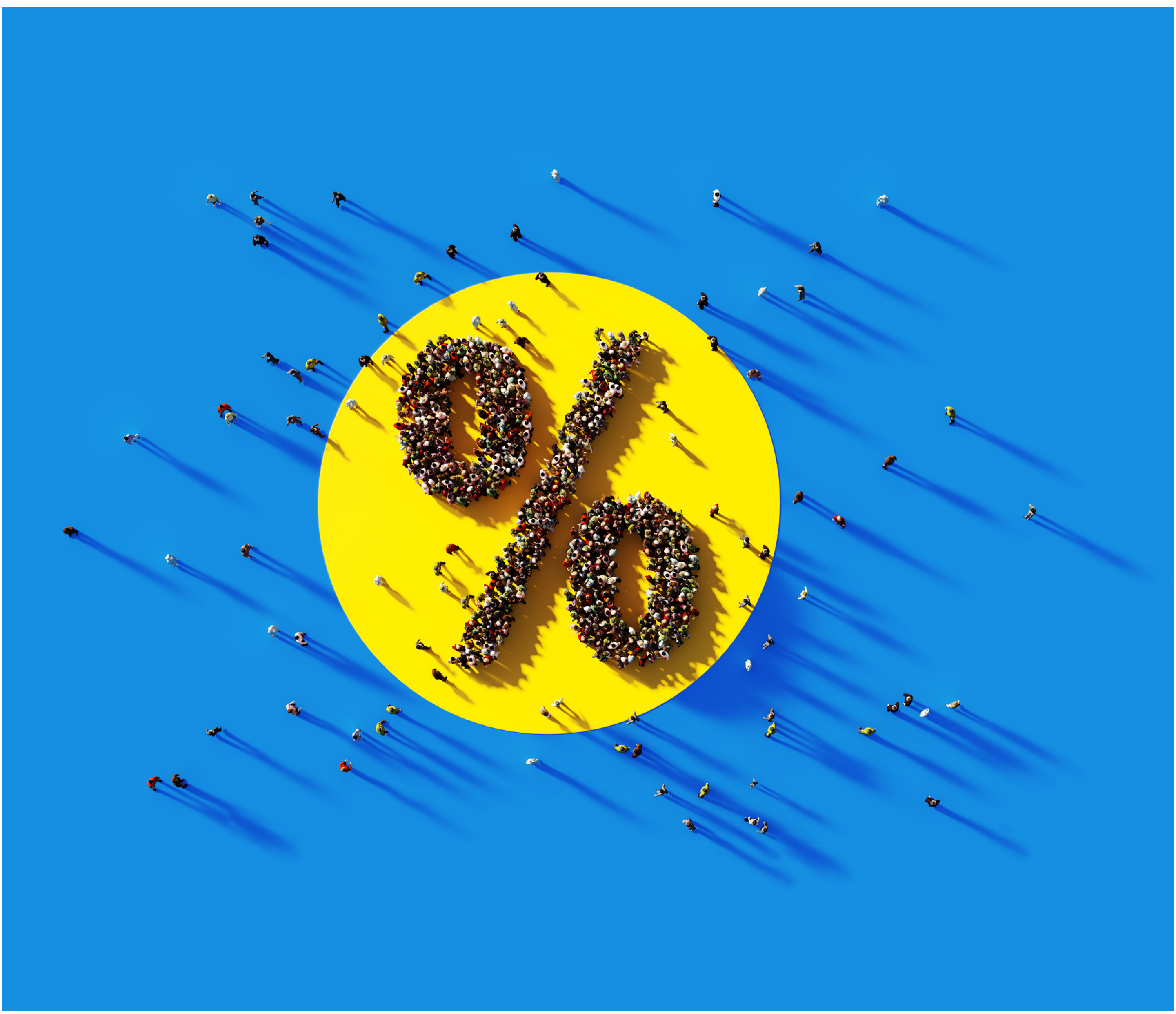
Market Intelligence
& Analytics

CRISIL
An S&P Global Company

RateView

CRISIL's outlook on near-term interest rates

October 2023



Research

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Sanguine September

The yield on the new 10-year benchmark government security (G-sec; 7.18% GS 2033) opened September at 7.14% and closed at 7.21%, up 4 basis points (bps) from its August closing of 7.17% and within CRISIL's forecast range of 7.15-7.25%.

In the first week, domestic yields tracked higher US Treasury (UST) yields and crude oil prices. OPEC+, mainly Russia and Saudi Arabia, agreed to extend the cut in oil exports. Overall, the domestic 10-year benchmark yield closed higher for the week at 7.20%.

On September 8, the Reserve Bank of India (RBI) decided to discontinue the incremental cash reserve ratio (I-CRR) and release the amount impounded under it in a phased manner — 25% each on September 9 and 23, and 50% on October 7.

In the second week, a lower-than-expected domestic Consumer Price Index (CPI) print for August, at 6.83% vs 7.44% for July, pulled down G-sec yields. The 10-year benchmark yield slipped for the week to close at 7.17%.

The weighted average call rate remained higher than the repo rate. The US CPI increased 3.7% on-year in August, slightly faster than the consensus expectation of a 3.6% rise.

In the third week, J.P. Morgan announced that it will include Indian government bonds EM Index from June 2024. The US Fed kept its interest rates unchanged at 5.5%, though Fed's dot plot indicated that rates would remain higher for longer. The domestic benchmark yield closed the third week at 7.18%.

In the fourth week, domestic bond yields tracked the rise in UST yields, which hit their highest level since October 2007, especially at the longer end of the curve. The RBI released the calendar for issuance of dated Government of India securities between October 1, 2023 and March 31, 2024. The amount declared, at Rs 655,000 crore, was as per the budgeted estimate. The RBI said a new 50-year dated security will be introduced to cater to demand in the Ultra Long space. The domestic 10-year benchmark yield closed at 7.21% for the week.

In October first week, the RBI kept its repo rate unchanged at 6.50% and maintained its fiscal 2024 inflation forecast at 5.40%. The central bank hinted at sales as a part of the open market operations (OMO) to curb any potential excess liquidity. As a result, the 10-year benchmark yield shot up to almost 7.40% at close on Monday, October 9.

CRISIL's outlook

On interest rates

Benchmark	Sep. 30, 2023 (A)	Oct. 31, 2023 (P)	Dec. 31, 2023 (P)
10-year G-sec yield*	7.21%	7.23%-7.33%	7.20%-7.30%
10-year SDL yield	7.46%	7.50%-7.60%	7.51%-7.61%
10-year corporate bond yield	7.62%	7.63%-7.73%	7.61%-7.71%

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

One-month view

In October, the 10-year benchmark G-sec yield is expected to stay range-bound. Food inflation can take cues from Kharif sowing in the short run. Oil prices, UST yields and geopolitical tensions due to Middle East conflicts can put upward pressure on yields.

Three-month view

Domestic factors such as spike in food prices and excess money-market liquidity and external factors such as global oil prices, capital flows, UST yields and geopolitical tensions are expected to exert upward pressure for a couple of months. OMO sales could kick in if there is any surplus in money-market liquidity.

Framework for outlook

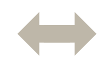
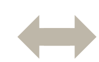
CRISIL provides its outlook on key benchmark rates for different debt classes — 10-year G-secs, state-development loans (SDLs), and corporate bonds (CBs) — based on statistical models and inputs from our in-house experts. We also incorporate our policy expectations, macroeconomic outlook, and views on 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

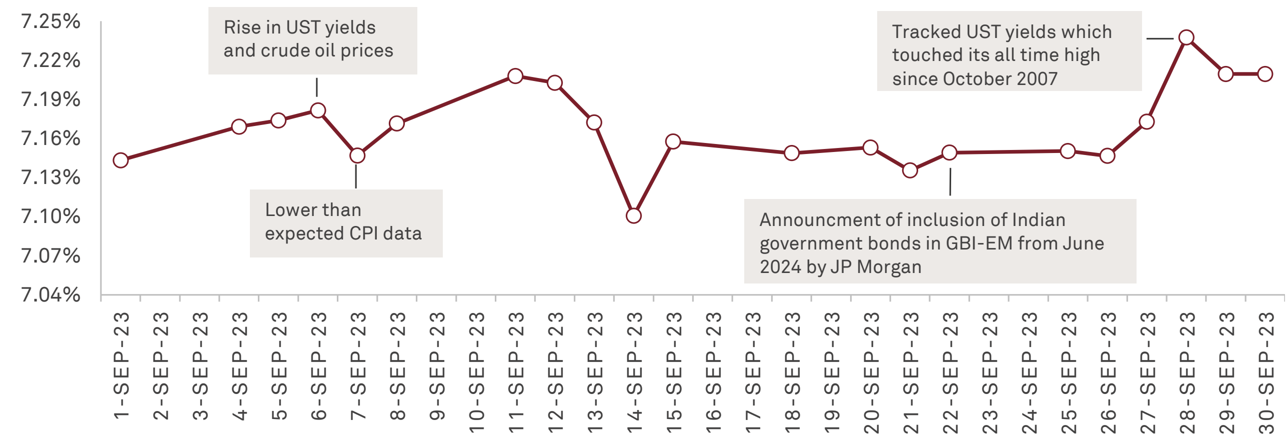
Economic parameter	Our view	Impact on yields
GDP growth	• We expect India's real GDP growth to slow to 6.0% on-year in fiscal 2024 from 7.2[1]% previous year. • Slowing global growth is expected to hit Indian economy through weaker exports. Domestic demand expected to be mildly impacted from lagged impact of RBI's past rate hikes. • Real GDP growth accelerated to 7.8% on-year in the first quarter of fiscal 2024, from 6.1% in the previous quarter	↓
CPI inflation	• We expect consumer price index (CPI)-linked inflation to moderate to 5.5% in fiscal 2024 from 6.7% previous year • Uneven distribution of rainfall during the monsoon season, rising crude oil prices and tight global food supplies pose upside risks to inflation this fiscal. However, easing input cost pressures for manufacturers and moderating domestic demand are expected to ease core inflation. • CPI inflation eased to 6.8% in August from 7.4% in July	↓
RBI's monetary policy	• We expect the RBI to keep rates unchanged for the remainder of this fiscal. • We expect a rate cut only in the first quarter of next fiscal, assuming normalising inflation and slowing growth. • The MPC kept policy rates unchanged in its October meeting, while maintaining stance of withdrawal of accommodation.	↔
Fiscal health	• The budget has targeted a reduction in centre's fiscal deficit to 5.9% of GDP this fiscal from 6.4% of GDP in the previous • In the first five months of this fiscal, centre's fiscal deficit stood at 36% of the budget target, compared with 34.6% in same period last year. Capital and revenue expenditure as a proportion of budget target has been higher relative to last year.	↓
Crude oil prices	• We expect crude prices to average $80-$85 per barrel in fiscal 2024 compared with $95 per barrel previous year • Brent crude oil prices increased to $94 per barrel average in September, 9.1% higher on-month and 4.3% higher on-year	↓
Current account balance	• We expect current account deficit (CAD) average 1.8% of GDP in fiscal 2024 compared with 2.0% of GDP in fiscal 2023. • Lower international commodity prices on-year and support from healthy services exports and remittances will help CAD narrow this fiscal. The recent uptick in crude oil prices poses an upside risk to our forecast for fiscal 2024 • CAD rose to 1.1% of GDP in the first of fiscal 2024 from 0.2% of GDP previous quarter.	↓

[1]Provisional estimate by National Statistics Office

Economic parameter	Our view	Impact on yields
US Federal Reserve's stance	• S&P Global expect one more rate hike by the Fed in November 2023. It sees the Fed policy rates remaining higher for longer and does not expect the first rate cut till June 2024 • The Fed kept its policy rate unchanged at 5.25-5.50% in its September meeting, following a 25-bps rate hike in July.	
Liquidity indicators - Demand and supply	Supply side • Issuance calendar for GOI securities for October 2023 – March 2024: An amount of 6,55,000 crore has been notified. • Indicative calendar of market borrowings by state governments / Union Territories for the October–December quarter of 2023: An amount of 2,37,263 crore has been notified, similar to the previous quarter Demand side • CD issuances crossed ~Rs 74,000 crore in September 2023 due to the demand for funds from the banking system.	
- Call rates/ liquidity-adjustment facility (LAF)	• Notably, the Indian banking system witnessed a deficit in liquidity later during the month, following the RBI's direction to banks to set aside 10% of their incremental deposits as I-CRR. However, the RBI eventually decided to discontinue the I-CRR by releasing 25% of the I-CRR maintained on September 9, another 25% on September 23 and balance 50% on October 7. • Outflows related to advance-tax payments and preparations for Goods and Services Tax (GST) collection also led to a deficit in liquidity during September	

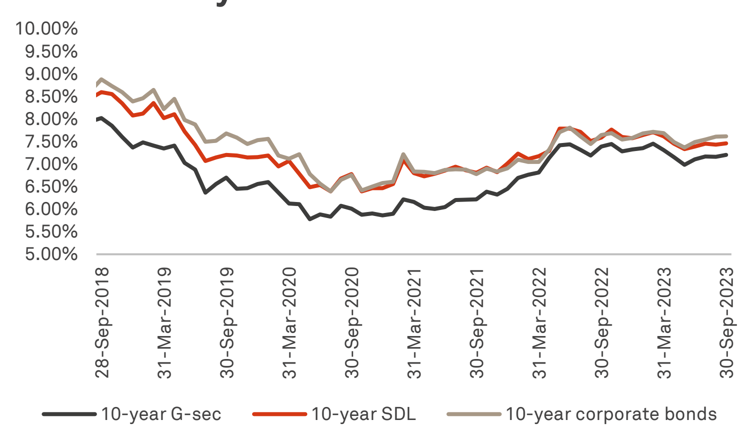
September at a glance

10-year G-sec benchmark yield



Source: CRISIL MI&A Research

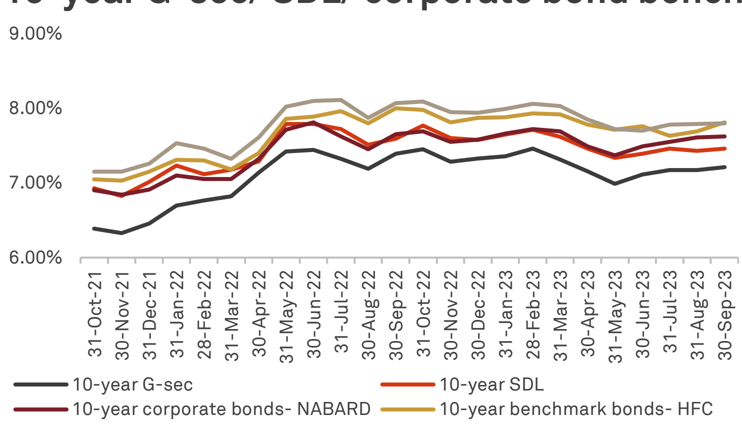
Benchmark yields



Source: CRISIL MI&A Research

In September, the yield on the 10-year benchmark G-sec closed at 7.21%, 4bps above August close, while that on the 10-year SDL hardened 3 bps to 7.46% from 7.43%. The yield on corporate bonds (CBs; 10-year PSU FI) closed at 7.62%, up 1bp from 7.61% a month ago.

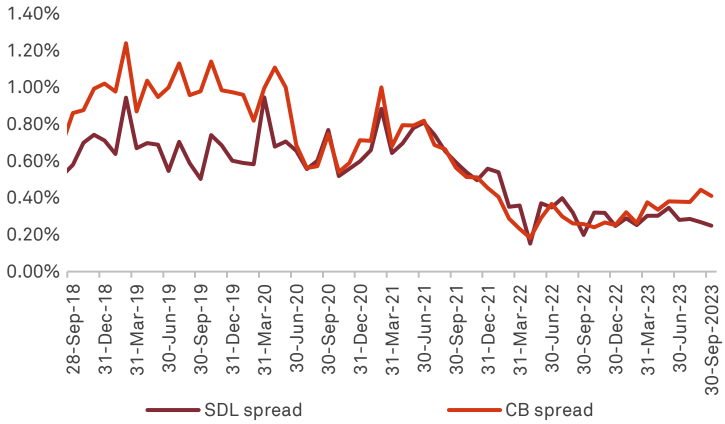
10-year G-sec/ SDL/ corporate bond benchmark yields



Source: CRISIL MI&A Research

The yield on the 10-year benchmark bonds — Housing Finance Company (HFC) — hardened 12 bps on-month to 7.81% in September. Yields on the 10-year benchmark bonds for AAA-rated NBFCs and AAA-rated PSU bonds closed at 7.80% and 7.62%, respectively, up from 7.79% and 7.61% in August.

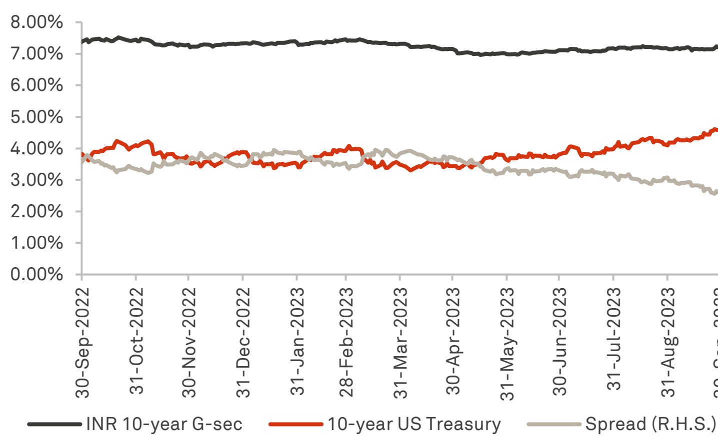
SDL spreads over 10-year benchmark G-sec soften



Source: CRISIL MI&A Research

The spread of the 10-year benchmark SDL over the 10-year benchmark G-sec closed at 25bps in September, down from 27bps in August. Meanwhile, the spread of the 10-year AAA-rated public sector CB contracted from 44bps to 41bps. The 12-month average spreads for the 10-year benchmark SDL and CB over the 10-year benchmark G-sec were 29bps and 34bps, respectively.

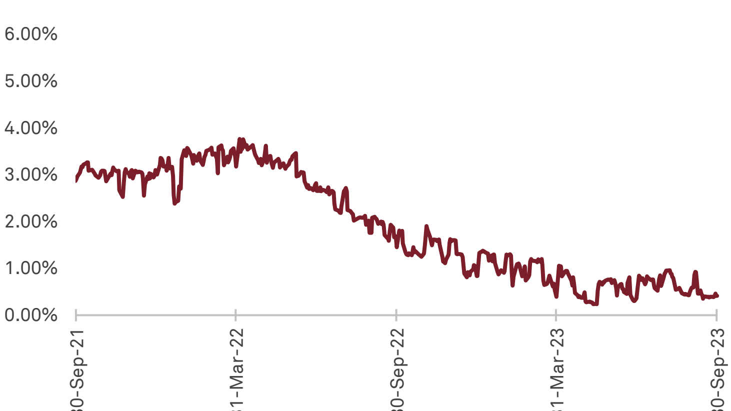
US Treasury yield spread soften



Source: CRISIL MI&A Research

The 10-year UST yield closed at 4.59% in September, 50bps higher from its August close of 4.09%. The monthly average spread between the domestic 10-year benchmark G-sec yield and the 10-year UST yield eased to 262 Bps from the previous month's 308 Bps. The surge in UST yields reflected the rise in crude oil prices, due to the extended production cuts by Russia and Saudi Arabia, hawkish message coming from the FOMC meeting in September. A rise in term premia contributed to the increase in long-term yields.

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

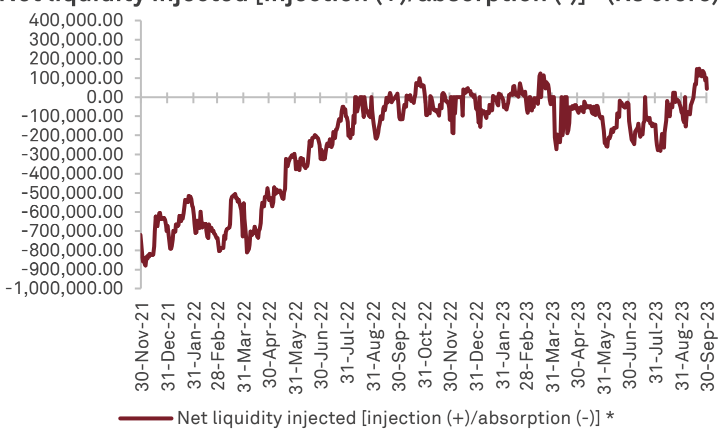


Source: CRISIL MI&A Research

The average spread between the 10-year benchmark G-sec yield and tri-party repos (TREPS) narrowed to ~41 bps in September from ~55 bps in August. The 12-month average spread was at ~88 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

In September, the average systemic-liquidity deficit was ~Rs 0.24 lakh crore, as against the previous month's surplus of ~Rs 1.17 lakh crore. The average surplus over the past 12 months was ~Rs 0.57 lakh crore. Systemic liquidity injected as of September-end was at ~Rs 0.44 lakh crore. The RBI's I-CRR move seems to have worked in draining the liquidity out of the system for an extended period. A lacklustre response continues on the variable-rate reverse repo (VRRR) front.

Benchmark spreads over G-secs

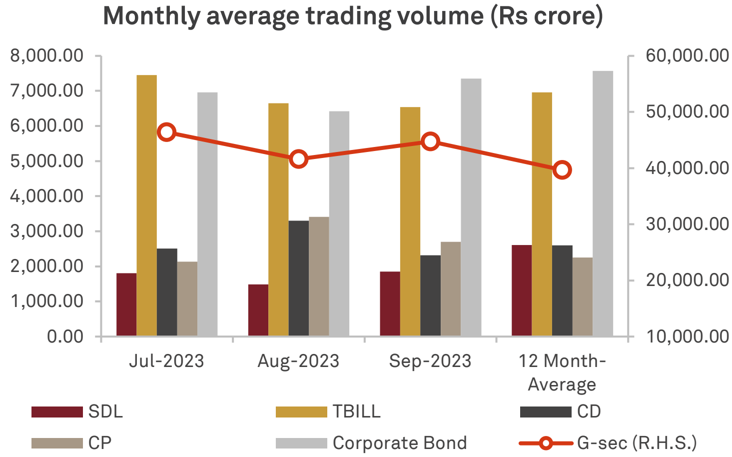
Spreads over G-Sec*

Rating category	Date	PSU / corporates	NBFC	Housing finance companies
AAA	31-Aug-23	0.39%	0.56%	0.49%
	30-Sep-23	0.32%	0.50%	0.43%
AA+	31-Aug-23	0.59%	1.11%	1.03%
	30-Sep-23	0.56%	0.97%	0.93%
AA	31-Aug-23	1.15%	1.91%	1.50%
	30-Sep-23	1.15%	1.72%	1.42%
AA-	31-Aug-23	1.96%	3.18%	2.49%
	30-Sep-23	1.89%	3.15%	2.30%

*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 across securities

Monthly average trading volume (Rs crore)

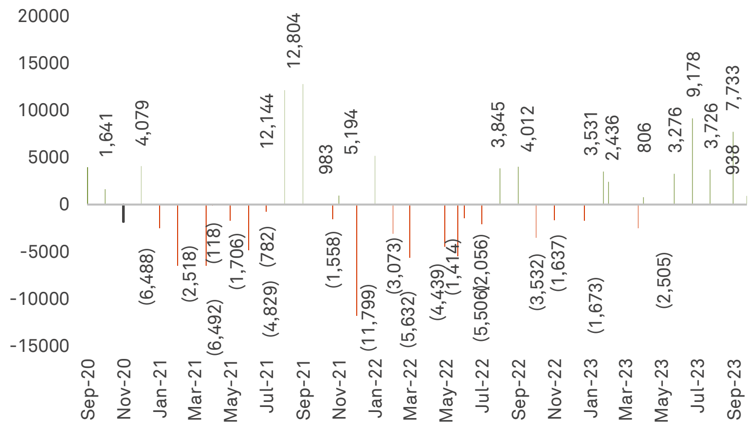


Source: CRISIL MI&A Research

While the trading volume in G-secs rose ~7.55%, that in SDLs increased ~24.77% due to huge supply in the market and corporate bonds raised by ~14.53%. Volume in T-bills fell ~1.64%, while that in commercial paper (CPs) and certificates of deposit (CDs) declined ~20.85% and ~29.65%, respectively due to liquidity crunch in money market.

FPIs continues to be net buyers in debt

(Rs crore)



Source: CRISIL M&IA Research

The net FPI inflow into debt was Rs 938 crore in September, compared with a net inflow of Rs 7,733 crore in August. Equity witnessed an outflow of Rs 14,768 crore. Before the outflow, FPIs were incessantly buying Indian equities in the last six months from March to August and brought in Rs 1.74 lakh crore during. The outflow was primarily due to rising US interest rates making them attractive and the wait and watch approach towards emerging markets.

Key upgrades

Upgrades		
Issuer name	**Old rating as per CRISIL**	**New rating**
Epimoney Pvt. Ltd.	CRISIL BBB-	CRISIL BBB
Auxilo Finserve Pvt. Ltd.	CARE PP-MLD A	CARE PP-MLD A+
Mahindra Rural Housing Finance Ltd.	CARE AA+	CARE AAA
Krazybee Services Pvt. Ltd.	CRISIL BBB+	CRISIL A-
GMR Goa International Airport Ltd.	CARE BBB+	CARE A
GMR Warora Energy Ltd.	CARE D	CARE BBB-
Jindal Saw Ltd.	CARE AA-	CARE AA
SK Finance Ltd.	[ICRA]A+	[ICRA]AA-
Punjab National Bank (Tier-II/Infrastrucutre bonds)	CARE AA+	CARE AAA
Punjab National Bank (Tier-I bonds)	CARE AA	CARE AA+
Union Bank Of India (Tier-I Bonds)	CARE AA	CARE AA+
Union Bank Of India (Tier-II Bonds)	CARE AA+	CARE AAA
Bangalore International Airport Ltd.	CRISIL AA	CRISIL AA+
Light Microfinance Pvt. Ltd.	CRISIL BBB	CRISIL BBB+
Utkarsh Small Finance Bank Ltd.	CARE A	CARE A+
South Indian Bank Ltd.	CARE A	CARE A+
Si Creva Capital Services Pvt.Ltd.	CRISIL BBB	CRISIL BBB+

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