

RateView

CRISIL's outlook on near-term interest rates

February 2024



Research

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January Jog

The yield on the 10-year benchmark government security (G-sec; 7.18% GS 2033) opened January at 7.20% and closed at 7.14%, down 4 basis points (bps) from its December close of 7.18% and below CRISIL's forecast range of 7.16-7.26%.

In the first two weeks of January, the 10-year domestic paper traded between 7.18% and 7.20%. Yields soared to a high of 7.24% following the rise in United States (US) Treasury yields and crude oil prices. However, the proposal by Bloomberg to include Indian government bonds in the Emerging Markets Local Currency Index kept market sentiment upbeat and yields low. The 10-year benchmark paper closed mid-month at 7.18%.

The second half of the month turned bullish due to lower US Treasury yields and lower-than-expected inflation print for December 2023, which stood at 5.7%, leading to a spike in bond prices. Furthermore, strong buying support from mutual funds and foreign banks supported the yields, and the month closed at 7.14%.

Market sentiment remained upbeat after the announcement of lower fiscal deficit, and lower-than-expected gross and net borrowings for fiscal 2025 in the interim budget, with a hint at inflation and interest rates being under control. The same was highlighted in the Reserve Bank of India's Monetary Policy on February 8, which kept the repo rate under the liquidity adjustment facility unchanged at 6.50%. A clear emphasis on withdrawal of accommodation to ensure alignment of inflation while supporting growth will keep the yields anchored going forward.

CRISIL's outlook

On interest rates

Benchmark	January 31, 2024 (A)	February 29, 2024 (P)	April 30, 2024 (P)
10-year G-sec yield*	7.14%	7.03%-7.13%	7.06%-7.16%
10-year SDL yield	7.64%	7.48%-7.58%	7.51%-7.61%
10-year corporate bond yield	7.64%	7.48%-7.58%	7.51%-7.61%

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

One-month view

In February, domestic G-sec yields are likely to be impacted by movement in crude prices and robust foreign portfolio investment (FPI) flows and domestic inflows into the debt market. The Consumer Price Index (CPI) inflation for February will determine the trajectory of yields for the coming month.

Three-month view

The 10-year G-sec yield is expected to soften through April, supported by fiscal consolidation, outcome of monetary policy, crude oil prices and continued foreign capital flows.

Framework for outlook

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

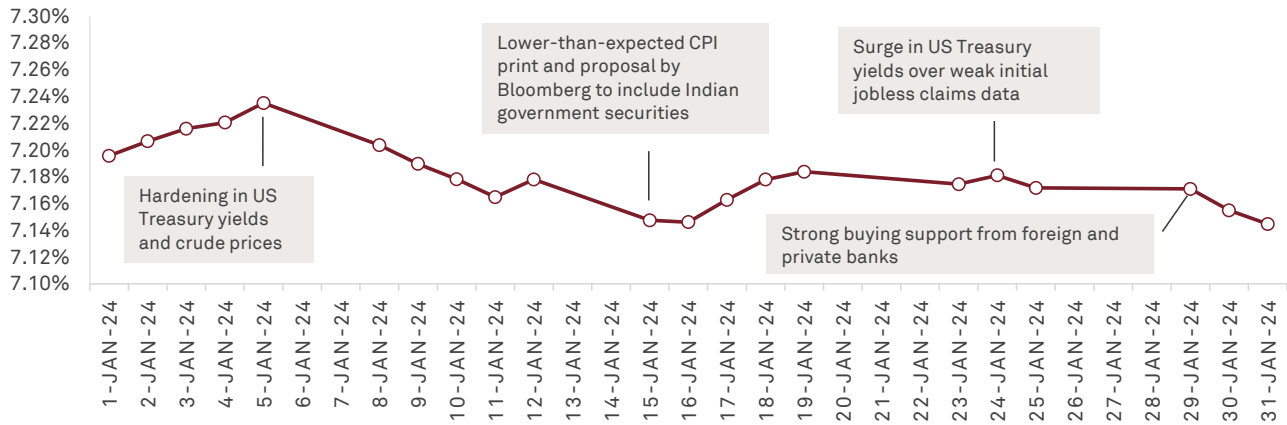
Economic parameter	Our view	Impact on yields
GDP growth	<ul style="list-style-type: none"> We expect real GDP growth to moderate to 6.4% in fiscal 2025 from the estimated 7.3¹% this fiscal. The National Statistical Office's (NSO) first advance estimates project India's real GDP growth at 7.3% on-year for this fiscal, marginally higher than 7.2% in the previous. Stronger growth seen in the first half (H1) 7.7% is projected to moderate to 6.9% in H2. We expect this slowdown to continue as global growth slows and the lagged impact of RBIs rate hikes slows domestic demand. 	↓
CPI inflation	<ul style="list-style-type: none"> We expect consumer price index (CPI)-linked inflation to soften to 4.5% in fiscal 2025 from an estimated 5.5% this fiscal. Cooling domestic demand and a higher base for food inflation will help moderate inflation next fiscal. A non-inflationary budget that focusses on asset-creation rather than direct cash support bodes well for core inflation. CPI inflation inched up to 5.7% in December from 5.6% the previous month. 	↓
RBI's monetary policy	<ul style="list-style-type: none"> We believe that an interest rate cut is unlikely in the April monetary policy review and would most probably come in June, if not later. While fiscal prudence has smoothed the path for monetary policy, the RBI is wary of cutting rates or changing stance too soon given inflation is not fully tamed yet. The MPC kept policy rates unchanged in its February meeting, while maintaining stance of withdrawal of accommodation. 	↔
Fiscal health	<ul style="list-style-type: none"> The budget has targeted a reduction in centre's fiscal deficit to 5.1% of GDP in fiscal 2025 from 5.8% of GDP this fiscal Gross market borrowing is estimated at Rs. 14.1 lakh crore for fiscal 2025, 8.4% lower on-year. 	↓
Crude oil prices	<ul style="list-style-type: none"> We expect crude prices to average \$80-\$85 per barrel in fiscal 2025 compared with \$82.7 per barrel in this fiscal so far Brent crude oil prices increased to \$80.2 per barrel average in January, 3% higher on-month but 3.4% lower on-year. 	↔

¹NSO First Advance Estimate

Economic parameter	Our view	Impact on yields
Current account balance	<ul style="list-style-type: none"> 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 trade surplus and remittances will keep CAD in check. CAD narrowed to 1% of GDP in the second quarter of fiscal 2024 from 1.1% of GDP previous quarter. 	↓
US Federal Reserve's stance	<ul style="list-style-type: none"> S&P Global expects the Fed to start cutting rates around mid-2024 The Fed kept its policy rate unchanged at 5.25-5.50% for the fourth consecutive time at its January meeting. It has indicated a more aggressive easing path in 2024, with year-end policy rate reaching 4.6% compared with 5.1% projected previously 	↔
Liquidity indicators	<ul style="list-style-type: none"> During the month ~77% of the announced amount was accepted at the weekly SDL auction indicating low demand from the states. 	↔
- Demand and supply	<ul style="list-style-type: none"> Demand up for longer-end G-secs due to additional participation from pension funds and insurance players. 	↔
- Call rates/ liquidity-adjustment facility	<ul style="list-style-type: none"> In January 2024, interbank call money rates averaged 6.52%, marginally higher than the RBI's repo rate of 6.50% This was due to liquidity levels hitting record highs during the month on account of advance tax outflows and slowdown in government spending. To address the escalating liquidity deficit within the banking system, the RBI conducted several variable-rate repo auctions during the month 	↓

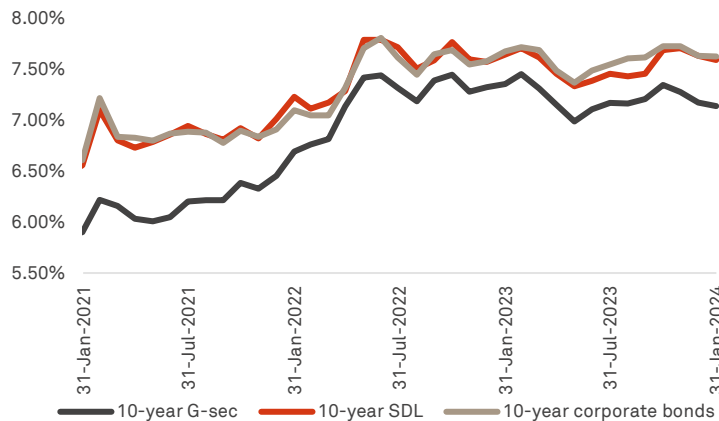
January at a glance

10-year G-sec benchmark yield



Source: CRISIL MI&A Research

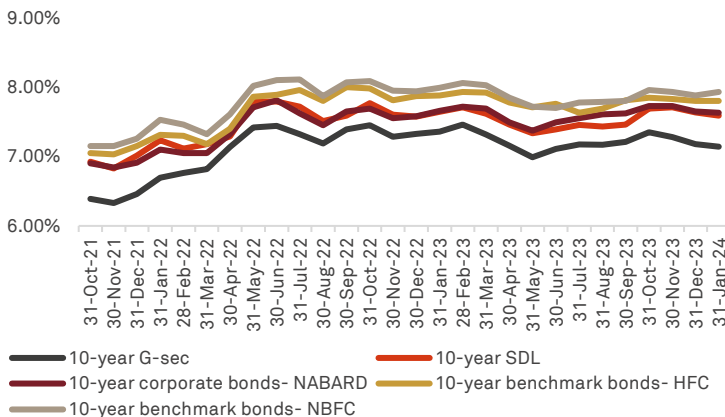
Benchmark yields ease across securities



Source: CRISIL MI&A Research

Yield on the 10-year benchmark G-sec closed January at 7.14%, down 4 bps from its December close, and that on the 10-year SDL was down 4 bps to 7.59% from 7.64%. Yield on CBs (10-year PSU FI) also eased 1 bps to close at 7.63%.

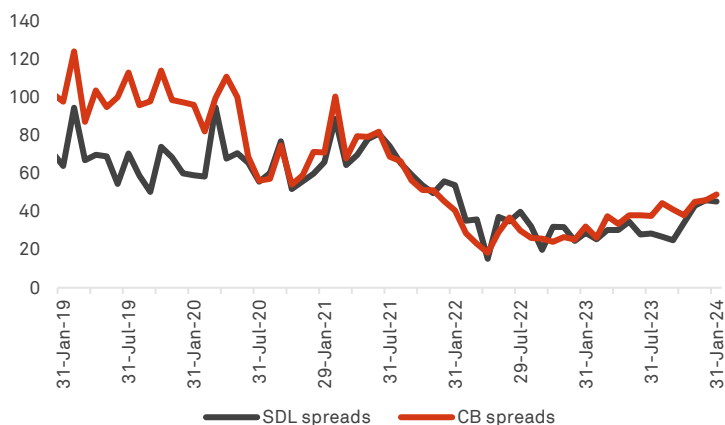
10-year G-sec/SDL/CB benchmark yields



Source: CRISIL MI&A Research

Yield on the 10-year benchmark bonds for AAA-rated PSU bonds closed at 7.63%, down from December's 7.65%, and that on AAA-rated NBFCs hardened by 5 bps on-month to 7.93% in January. Housing finance companies closed at 7.80% in January.

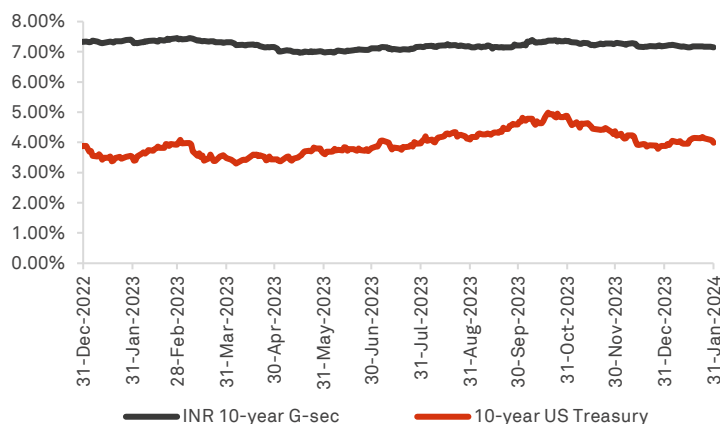
SDL spreads over 10-year benchmark G-sec eased



Source: CRISIL MI&A Research

The spread on the 10-year benchmark SDL over the 10-year benchmark G-sec closed January at 45 bps, down from December's 46 bps. The widening was due to higher cut-off yields at the primary auction. That on the 10-year AAA-rated public sector CB increased from 46 bps to 49 bps. The 12-month average spreads for the 10-year benchmark SDL and CB over the 10-year benchmark G-sec were ~33 bps and ~40 bps, respectively.

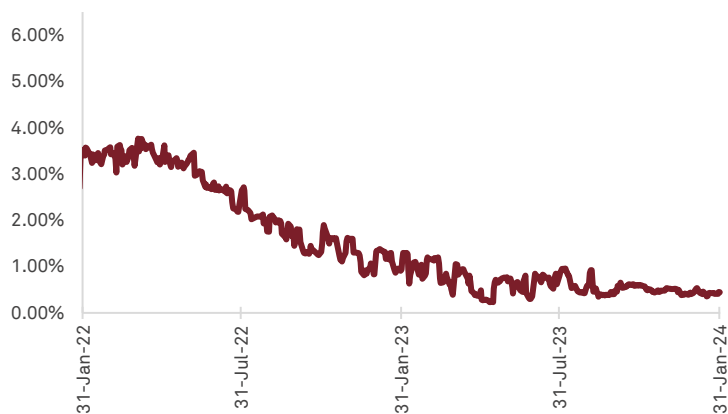
US Treasury yields harden



Source: CRISIL MI&A Research

The 10-year Treasury yield closed January at 3.99%, up 11 bps from December's 3.88%. The monthly average spread between the domestic 10-year benchmark G-sec yield and the 10-year Treasury yield eased to 315 bps from 330 bps.

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

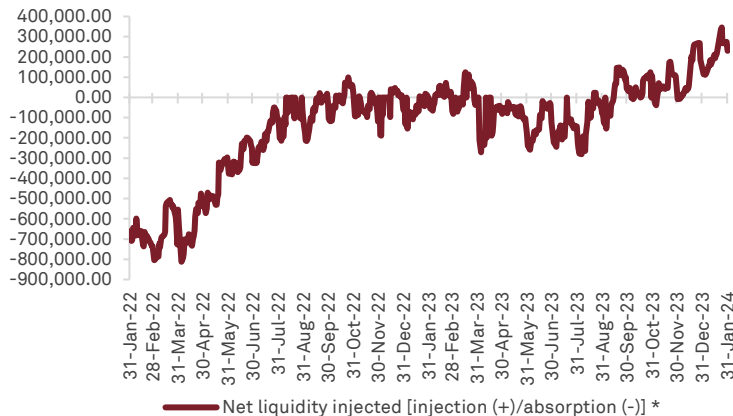


Source: CRISIL MI&A Research

The average spread between the 10-year benchmark G-sec yield and the tri-party repos (TREPS) increased to ~44 bps in January from ~41 bps in December. The 12-month average spread was ~62 bps.

Systemic liquidity

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



Average deficit in systemic liquidity was ~Rs 2.09 lakh crore in January, as against ~Rs 1.17 lakh crore in December. Average surplus over the past 12 months was ~Rs 0.15 lakh crore. Systemic liquidity remained in large deficit during the month due to advance tax outflows and slowdown in government spending. To address the escalating liquidity deficit within the banking system, the Reserve Bank of India (RBI) conducted several variable rate repo auctions during the month.

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

Benchmark spreads over G-secs

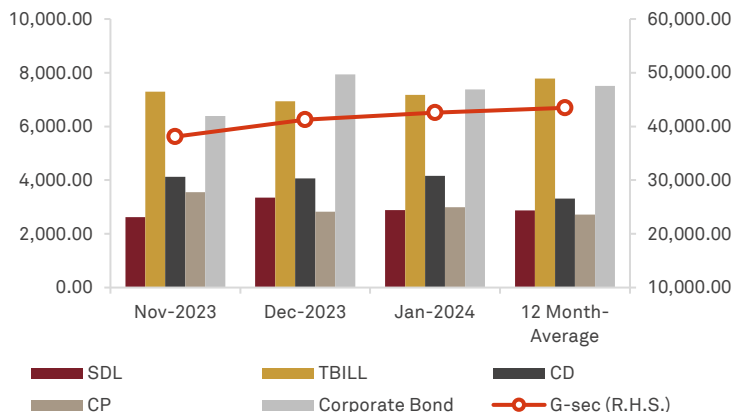
Spreads over G-Sec*

Rating Category	Date	PSU / Corporates	NBFC	Housing Finance Companies
AAA	31-Dec-23	0.54%	0.78%	0.62%
	31-Jan-24	0.53%	0.94%	0.68%
AA+	31-Dec-23	0.77%	1.32%	1.09%
	31-Jan-24	0.86%	1.45%	1.26%
AA	31-Dec-23	1.16%	1.97%	1.68%
	31-Jan-24	1.19%	2.17%	1.84%
AA-	31-Dec-23	2.04%	3.51%	2.47%
	31-Jan-24	2.11%	3.64%	2.59%

Note: * Spreads are for 5-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)

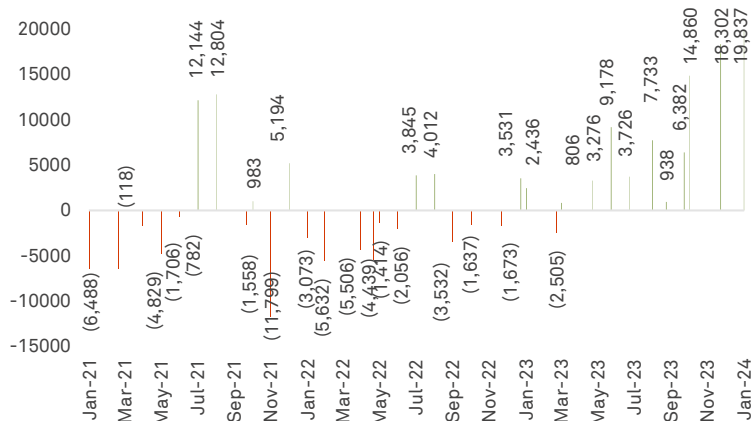


In January, trading volume in G-secs increased 3.21% and in T-Bills increased 3.44%. In SDLs, however, it declined ~14%. Volume in commercial papers (CPs) and CDs increased ~6% and ~2.38%, respectively, while that in corporate bonds declined ~7%.

Source: CRISIL MI&A Research

FPI net investments in debt

(Rs crore)



Source: CRISIL M&IA Research

Net FPI in debt was Rs 19,837 crore in January, compared with Rs 18,302 crore in December. The inclusion of Indian G-secs in the JP Morgan Government Bond Index-Emerging Markets along with the proposed inclusion of Indian bonds in Bloomberg's Emerging Markets Local Currency Indices starting September 2024, may attract further debt inflows. The momentum is anticipated to continue throughout 2024.

Rating upgrades and downgrades in January 2024

Upgrades

Issuer name	Old rating	New rating
PNB Housing Finance Ltd	IND AA	IND AA+
GMR Hyderabad International Airport Ltd	[ICRA]AA	[ICRA]AA+
Fedbank Financial Services Ltd	CARE AA	CARE AA+
Arohan Financial Services Ltd	[ICRA]A-	[ICRA]A
Poonawalla Fincorp Ltd	ACUITE AA+	ACUITE AAA
IDBI Bank Ltd	CRISIL A+	CRISIL AA-
Fusion Micro Finance Ltd	[ICRA]A	[ICRA]A+
Avanse Financial Services Ltd	BWR A+	BWR AA-
Aryadhan Financial Solutions Pvt Ltd	CRISIL BBB-	CRISIL BBB
Tata Power Co Ltd	IND AA	IND AA+
Tata Power Renewable Energy Ltd	IND AA	IND AA+
Delhi International Airport Ltd	IND A+	IND AA-

Downgrades

Issuer name	Old rating	New rating
NIDO Home Finance Ltd	CARE A+	CARE A
Edelweiss Financial Services Ltd	CARE A+	CARE A
ECL Finance Ltd	CARE A+	CARE A
Edelweiss Asset Reconstruction Co Ltd	CARE A+(CE)	CARE A
Vedanta Ltd	IND AA-	IND A+
Mangloor Highways Pvt Ltd	IND AAA	IND AA+

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