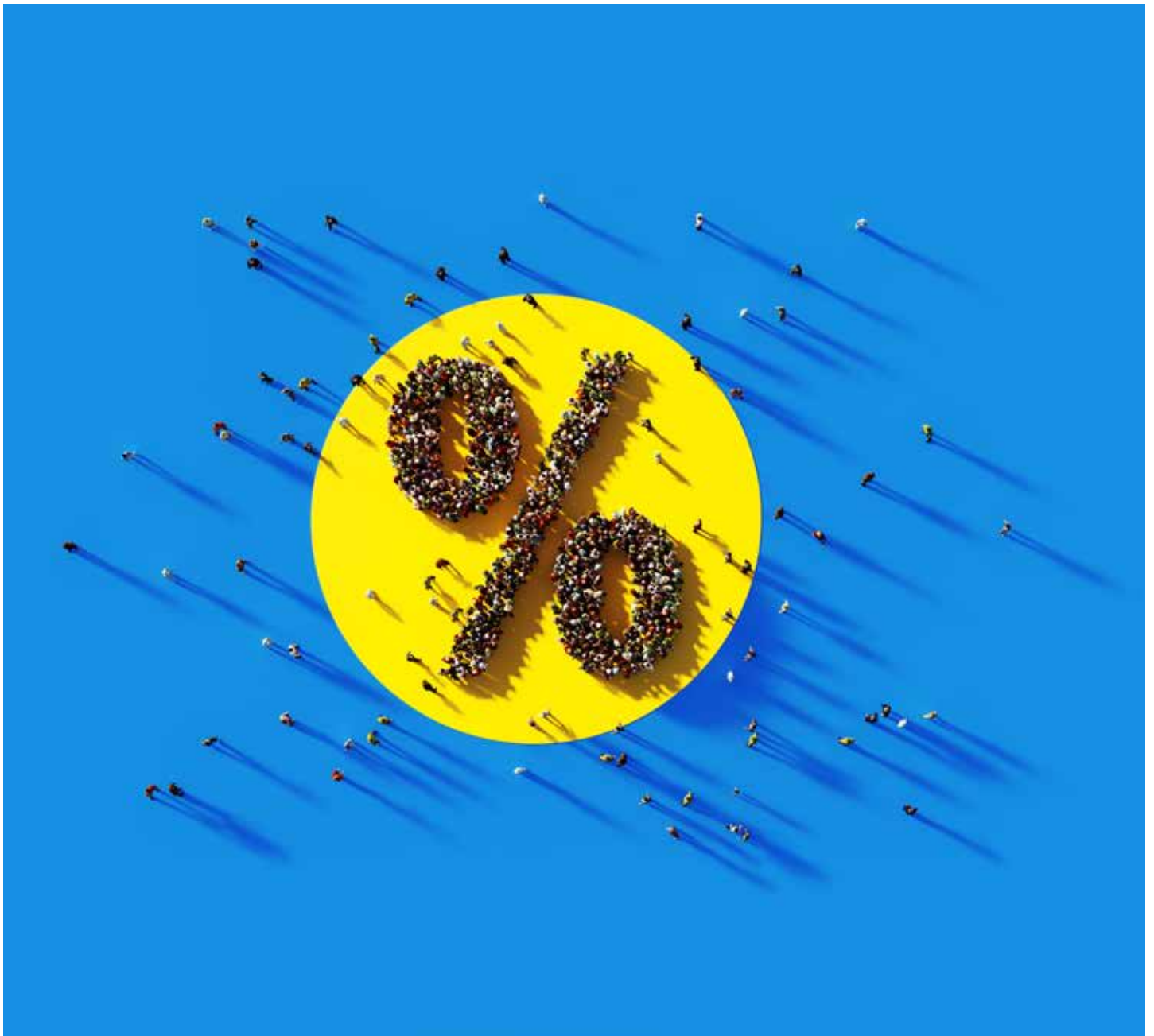


RateView

CRISIL's outlook on near-term rates

April 2020



Contents

Moody March	3
Factors influencing the outlook	4
March at a glance	6

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Moody March

Government security (G-sec) yields swung wildly in March, tracking both domestic and global events.

Yield on the 6.45% 2029 G-sec, the 10-year benchmark, opened the month at 6.35%, reached 6.22% mid-month and closed at 6.12% – down 25 basis points (bps) compared with its February close of 6.37% and within CRISIL's forecast range of 5.90-6.20%.

The month started with an unexpected 50 bps rate cut by the US Federal Reserve (Fed) on March 3 – a move aimed at countering the economic impact of the rapid spread of Covid-19 – which led to a 12 bps fall in the yield to 6.23%.

Expectations of a similar rate cut by the Reserve Bank of India (RBI) and a sharp decline in crude oil prices pulled the yield down 10 bps on March 9 to 6.08% at close.

Over the next few sessions, domestic yields rose sharply following the trend in US Treasury yields and due to continued selling by foreign portfolio investors (FPIs), lifting the benchmark G-sec yield to 6.32%. Indeed, in the first half of the month, overseas investors pulled out a net Rs 24,776 crore from equities and Rs 13,199 crore from debt in India.

Then, with the threat of a recession due to Covid-19 mounting, the Fed and global central banks cut their policy rates in a concerted effort. On March 15, the Fed again cut its policy rate – by 100 bps this time. This raised expectation of a rate cut by the RBI on or before the Monetary Policy Committee's (MPC) scheduled meeting and the benchmark yield eased by 10 bps on March 16. The gain, however, reversed as the yield inched up to 6.40% on March 19 due to negative sentiment that turned investors risk off.

After the announcement of the lockdown on March 24, the Union Ministry of Finance announced a relief package of Rs 1.7 lakh crore on March 26. There was, however, no mention of additional market borrowings to fund the package, which eased the yield by 10 bps. Subsequently, the MPC meeting was advanced and it cut policy rate by 75 bps and also announced a host of other measures to boost liquidity. This tamped the yield down by a further 9 bps and the benchmark security finally closed the month at 6.12%.

CRISIL's forecast for the benchmark yield is 6.05-6.35% for April-end and 6.10-6.40% for June-end.

Corporate bond spreads over the 10-year benchmark G-sec yield were at 99 bps and that of state development loans (SDLs) at 94 bps – higher than CRISIL's forecast, as the easing in G-sec was not reflected in SDL and corporate bonds due to limited buying interest.

CRISIL's outlook

On interest rates

Benchmark	March 31, 2020 (A)	April 30, 2020 (F)	June 30, 2020 (F)
10-year G-sec yield	6.12%	6.05%- 6.35%	6.10%- 6.40%
10-year SDL yield	7.07%	6.90%- 7.20%	6.95%- 7.25%
10-year corporate bond yield	7.12%	7.00%- 7.30%	7.05%- 7.35%

A: Actual; F: Forecast
 Source: CRISIL Research

One-month view

In April 2020, yields are likely to be affected by global interest rates, crude oil prices, long-term repo operations (LTROs), FPI flows and global growth scenario amid the Covid-19 outbreak.

Three-month view

In the three months through June 2020, the actual fiscal deficit, global interest rates, crude oil prices, monetary policy decisions, open market operations (OMOs) by RBI and unravelling global growth amid Covid-19 will dictate the yields.

Framework for outlook

CRISIL provides its outlook on key benchmark rates for different debt classes – 10-year G-secs, corporate bonds, and SDLs. The outlook is arrived at by combining statistical models with inputs from our experts. The judgement incorporates our view on policy expectations, macroeconomic outlook, key events (Indian and global), market factors (liquidity and demand/supply), among others.

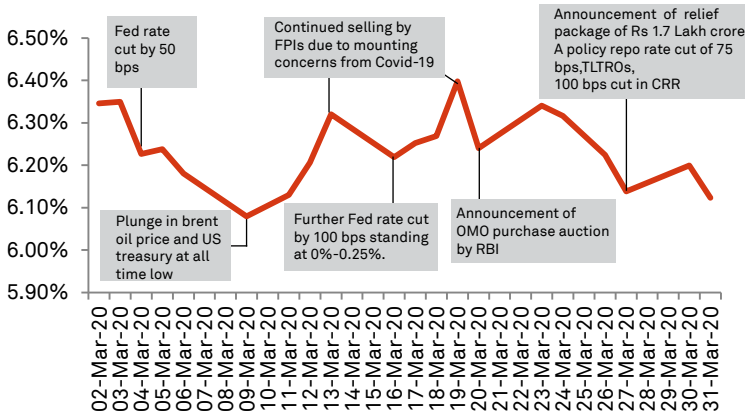
Factors influencing outlook

Economic parameter	Our view	Impact on yields
GDP growth	<ul style="list-style-type: none"> We expect GDP growth to drop to 3.5% in fiscal 2021 compared with an estimated 5% in fiscal 2020 The rapid spread of Covid-19 has disrupted economic activity across the globe, including India. Social distancing and reduction in discretionary spending have hit demand, while halting of business activity, including transport, has disrupted supplies S&P Global expects world GDP to grow just 0.4% in calendar 2020. While drop in external demand will hurt India's export prospects, its own 21-day lockdown has crimped domestic demand and business activity. Assuming the pandemic will subside by June, we expect the growth slump to be concentrated in the first half of this fiscal India's GDP growth slowed to 4.7% on-year in the third quarter of fiscal 2020 from 5.1% in the previous quarter and 5.6% in the first quarter of fiscal 2019 	↑
CPI inflation	<ul style="list-style-type: none"> Inflation is expected to moderate to 4.4% in fiscal 2021 from an estimated 4.7% in fiscal 2020 Correction in food inflation, moderate core inflation (given mild economic recovery) and high base effect in the second half will moderate headline inflation next fiscal CPI inflation slowed to 6.6% in February from 7.6% in the previous month 	↓
RBI's monetary policy	<ul style="list-style-type: none"> RBI advanced its April monetary policy to March 27. The MPC announced a slew of measures to provide monetary support to the economy. The steps included the 75 basis points (bps) cut in repo rate; 90 bps cut in reverse repo rate; 100 bps cut in banks' cash reserve ratio (CRR); targeted long-term repo operations (TLTROs); three-month moratorium on term loans; and deferment of interest on working capital Along with lower interest rates, these measures should enable better monetary policy transmission and availability of credit to segments starved by the Covid-19 lockdown in the near term. Moreover, these measures would turn growth-supportive once the economy starts recovering from the impact 	↓
Fiscal deficit	<ul style="list-style-type: none"> The central government has budgeted fiscal deficit at 3.5% of GDP in fiscal 2021 compared with 3.8% in fiscal 2020 Gross market borrowing is estimated to rise to Rs 7.8 lakh crore from Rs 7.1 lakh crore last fiscal. The government plans to raise 62.6% of fiscal 2021 borrowing in the first half, similar to the proportion borrowed in the previous fiscal A sharp reduction in nominal GDP growth, slow tax collection growth and ambitious disinvestment target could be challenges to meeting the fiscal deficit target for fiscal 2021. The impact of the Rs 1.7 lakh crore (~0.8% of GDP) stimulus is difficult to ascertain now since it depends on the extent of the government's reorientation and successful implementation 	↑

Economic parameter	Our view	Impact on yields
Crude oil prices	<ul style="list-style-type: none"> CRISIL Research expects crude prices to be in the range of \$35-\$40 per barrel in 2020 (calendar year), compared with an average of \$64 per barrel in 2019 Brent crude oil price averaged \$33 per barrel in March, 40% lower on-month and 50.3% lower on-year 	↓
Current account deficit	<ul style="list-style-type: none"> Current account deficit (CAD) is expected to narrow further to 0.7% of GDP in fiscal 2021, from an estimated 1% in fiscal 2020 While exports face significant risks from weak global environment, a sharp drop in crude oil prices and weak domestic demand will pull down imports further CAD narrowed sharply to 0.2% of GDP in the third quarter of fiscal 2020 compared with 0.9% in the previous quarter and 2.7% a year ago 	↓
US Federal Reserve's stance	<ul style="list-style-type: none"> The Fed cut its policy rate twice in March to alleviate tightening financial conditions as investors braced for the Coronavirus impact. The federal funds rate now stands at 0-0.25% The Fed also widened its quantitative easing programme to include investment-grade corporate debt. It is also expanding its money market lending facility and opening its commercial paper funding facility to high-quality municipal debt. In addition, it has enhanced swap lines with half a dozen central banks globally to ensure smooth functioning of dollar funding 	↓
Liquidity indicators	<p>Supply side</p> <ul style="list-style-type: none"> Borrowing calendar was laid out on Tuesday; the Centre will conduct 62.6% of its total gross borrowing for fiscal 2021 (Rs 7.80 trillion) in April-September SDL borrowing during the first quarter will be Rs 1.27 trillion <p>Demand side</p> <ul style="list-style-type: none"> LTROs for three-year tenures in corporate bond providing more durable liquidity Opening up key G-secs to full foreign investment via fully accessible route (FAR) 	↓
- Demand & Supply		
- Call rates/LAF (liquidity adjustment facility)	<ul style="list-style-type: none"> Interbank call money rates remained below RBI's repo rate for most of the month amid comfortable liquidity in the system. The central bank periodically infused funds via discretionary term repo auctions and TLTROs, though overall liquidity remained in surplus. It also announced TLTRO of three-year duration for a total notified Rs 250 billion to be conducted on April 3, and notified it would be extending fixed rate reverse repo and the Marginal Standing Facility (MSF) to provide eligible market participants greater flexibility in their liquidity management 	↓

March at a glance

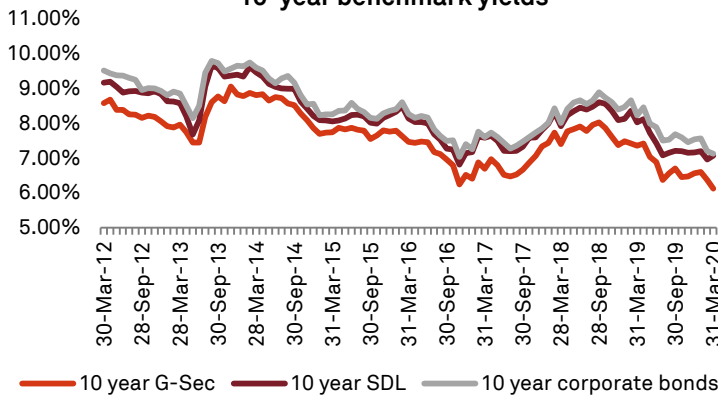
10 year G-sec benchmark yield



Source: CRISIL Research

The Covid-19 pandemic; selling by FPIs; steps taken by various central banks; and announcement of stimulus packages – all swung yields both ways during the month. The 10-year benchmark G-sec yield started the month at 6.35% and reached 6.22% near mid-month. Thereafter, it traded in the 6.24-6.34% range and even rose to 6.40%, revealing the bearish sentiment due to mounting concerns over Covid-19. After the MPC’s announcement of 75 bps rate cut, 90 bps cut in reverse repo rate, 100 bps cut in CRR, TLTROs, three-month moratorium on term loans and deferment of interest on working capital in its seventh bi-monthly policy meeting, the yield closed the month at 6.12%.

10-year benchmark yields

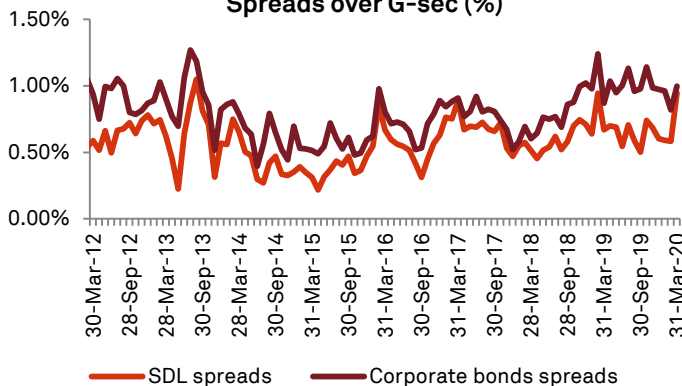


Source: CRISIL Research

Corporate bonds and SDLs ended the month at 7.12% and 7.07%, respectively. Yields on corporate bonds eased 7 bps from February close, while that on SDLs hardened 12 bps to 7.07% due to low demand.

Spreads increase for corporate bonds and SDLs

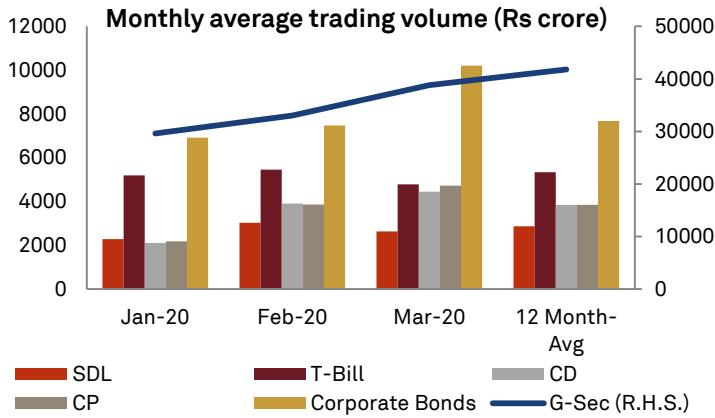
Spreads over G-sec (%)



Source: CRISIL Research

The spreads of 10-year SDLs over G-sec widened to 36 bps. For AAA-rated public sector corporate bonds, they widened to 18 bps. Low demand for SDL was also visible at the auction with limited competitive bids leading to very high cut-offs. Corporate bonds spreads increased due to restricted demand from mutual funds amid selling pressures due to year-end redemptions and profit booking.

Average trading volume increased across all securities

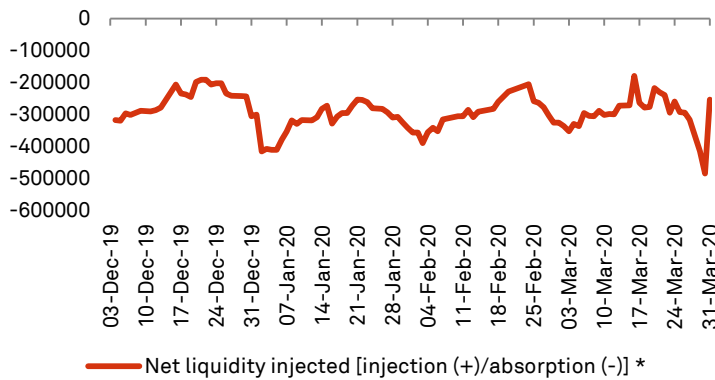


Source: CRISIL Research

Trading volume of commercial papers (CPs) in March increased ~13% and that of certificates of deposit (CDs) ~22% on month. Meanwhile, trading volume of G-secs increased ~17%. In corporate bonds, the increase was a considerable ~36% due to profit booking and continuous selling pressure. The volumes in treasury bills and SDLs were, however, down ~13%.

Systemic liquidity

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



* Net liquidity is calculated as Repo + MSF + SLF - Reverse repo Source: CRISIL Research

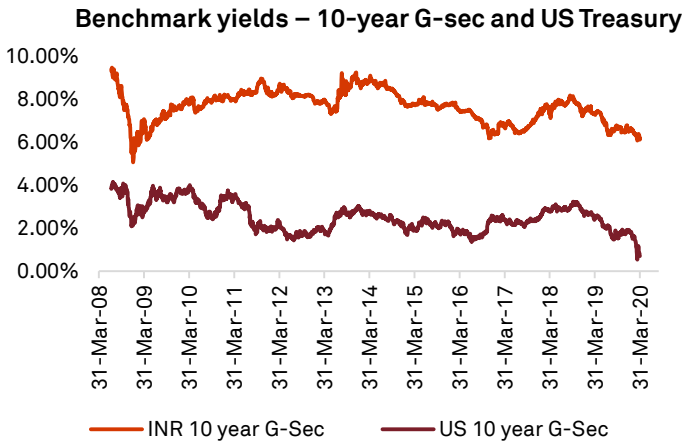
Liquidity in the banking system has been in surplus over the past 10 months. In order to maintain stability in the financial system in the wake of Covid-19, RBI announced 75 bps cut in repo rate and 90 bps cut in reverse repo. It also injected additional liquidity through various measures such as TLTROs and 100 bps cut in CRR. In March, the liquidity averaged at Rs 3 lakh crore. Towards the end of the month, it hit a high of Rs ~4.8 lakh crore.

Spreads widened across all issuer categories owing to credit concerns and reduced demand from lockdown

Spreads over G-sec*				
Rating category	Date	PSUs / corporates	NBFC	Housing finance companies
AAA	28-Feb-20	0.64%	1.44%	1.24%
	31-Mar-20	0.93%	1.88%	1.68%
AA+	28-Feb-20	1.91%	2.70%	3.31%
	31-Mar-20	2.57%	3.85%	3.63%
AA	28-Feb-20	2.26%	5.34%	4.28%
	31-Mar-20	2.98%	5.69%	4.66%
AA-	28-Feb-20	2.89%	6.88%	5.24%
	31-Mar-20	3.48%	7.33%	5.68%

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

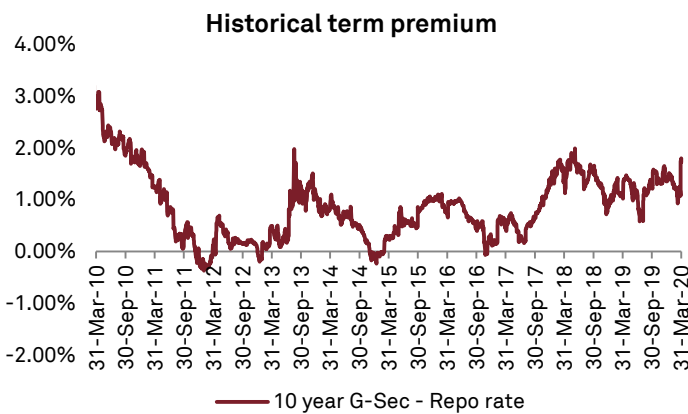
Spread over US Treasury yield widens



Source: CRISIL Research

The spreads between the 10-year benchmark G-sec yield and 10-year US Treasury yield widened by 18 bps to 5.42%. The US Treasury yield closed lower in March at 0.70%, compared with 1.13% in February, owing to safe-haven demand amid contagion fears surrounding the coronavirus and federal funds standing at 0%-0.25%.

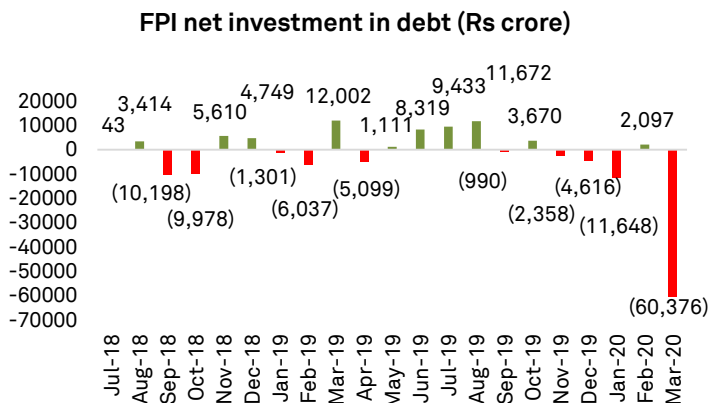
Spread over repo rate substantially widens



Source: CRISIL Research

The average spread between the repo rate and the yield on the 10-year benchmark G-sec was ~120 bps in March (~127 bps in February), which is lower compared with the 12-month average spread of ~126 bps and wider than 10-year average of ~89 bps. However, the term premium closed the month at ~172 bps owing to RBI's repo rate cut (G-sec benchmark yield declined 9 bps on the policy day).

Investment by FPIs



Source: CRISIL Research, National Securities Depository Ltd

In March, FPI outflows were a whopping Rs 118,203 crore due to the prevailing negative sentiment. The net outflow from debt stood at Rs 60,376 crore and from equities Rs 61,973 crore.

Key downgrades and upgrades in the past one month

Downgrades		
Issuer name	Old rating	New rating
Amba River Coke Ltd.	CARE AA	CARE AA-
Air India Ltd.	CRISIL AAA(CE)	CRISIL BB+(CE)
Bright Buildtech Pvt. Ltd.	BWR C	BWR D
Future Enterprises Ltd.	CARE AA-	CARE A
Future Retail Ltd.	CARE AA-	CARE A+
Future Supply Chain Solutions Ltd.	CARE AA-	CARE A+
JSW Steel Ltd.	[ICRA]AA	[ICRA]AA-
JSW Steel Ltd.	CARE AA	CARE AA-
Morgan Credits Pvt. Ltd.	CARE BBB-	CARE BB
Maharashtra Airport Development Co. Ltd.	IND A-	IND BBB
PNB Housing Finance Ltd.	IND AA+	IND AA
National Insurance Co. Ltd.	[ICRA]AA	[ICRA]AA-
National Insurance Co. Ltd.	CRISIL AA+	CRISIL AA
Reliance Broadcast Network Ltd.	CARE C	CARE D
Reliance Mediaworks Financial Services Pvt. Ltd.	CARE B-	CARE C
Saija Finance Pvt. Ltd.	CARE BBB-	CARE BB+
Sadbhav Engineering Ltd.	CARE A	CARE A-
Yes Bank Ltd. (Tier I)	[ICRA]BBB-	[ICRA]D
Yes Bank Ltd. (Tier II)	[ICRA]BBB+	[ICRA]D
Yes Bank Ltd. (Tier I)	CARE BBB-	CARE D
Yes Bank Ltd. (Tier II)	CARE BBB+	CARE C
Yes Bank Ltd. (Tier I)	IND BBB-	IND C
Yes Bank Ltd. (Tier II)	IND A-	IND B+
West Bengal State Electricity Distribution Co. Ltd.	CARE BBB-	CARE B

Upgrades		
Issuer name	Old rating	New rating
Welspun Corp Ltd.	CARE AA-	CARE AA
Micro Housing Finance Corporation Ltd.	CARE A-	CARE A+
Yes Bank Ltd. (Basel III Tier II)	[ICRA]D	[ICRA]BB
Yes Bank Ltd.(Upper Tier II)	[ICRA]D	[ICRA]BB
Yes Bank Ltd.(Lower Tier II)	[ICRA]D	[ICRA]BB+
Yes Bank Ltd. (Subordinated Lower Tier II)	[ICRA]D	[ICRA]BB+

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