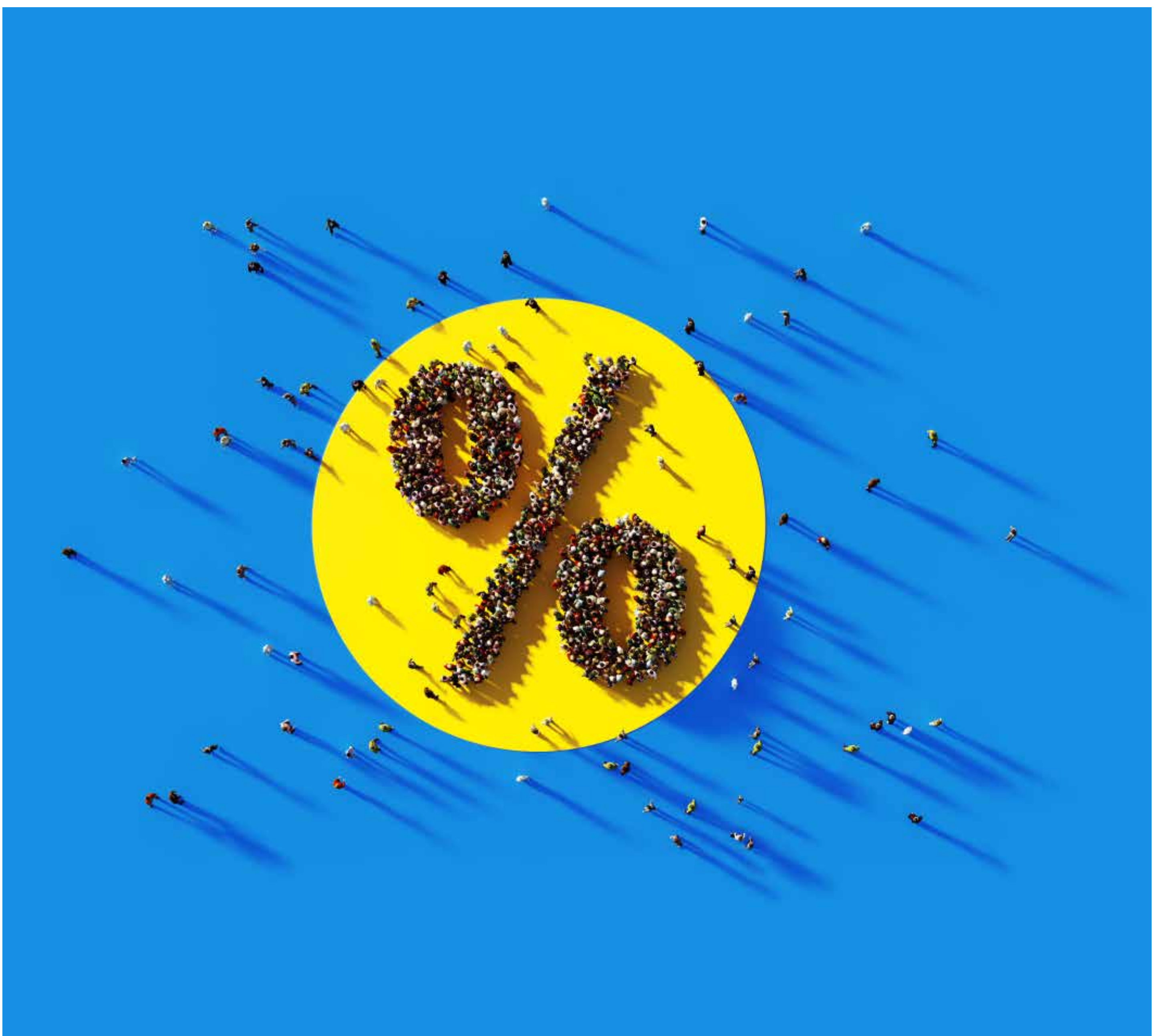
Research

RateView

CRISIL's outlook on near-term rates

July 2020



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Quiet June

Government security (G-sec) yields closed June up 10 basis points (bps) on-month after holding largely steady amid stress related to the Covid-19 pandemic, weak economic activity, cautious investment decisions, and increase in crude oil prices.

The 10-year benchmark changed from 6.45% GS 2029 to 5.79% GS 2030. Yield on the new benchmark opened June at 5.81%, reached 5.79% mid-month, and closed at 5.88% – up 10 bps from the close of 5.78% in May and within CRISIL's forecast range of 5.80-6.05%.

The Reserve Bank of India (RBI) was scheduled to borrow Rs 1.5 lakh crore in the month, but managed only Rs 1.2 lakh crore (Rs 1.32 lakh crore including green shoe option).

Towards the end of the month, yields edged up slowly as supply of G-secs increased and volatile crude oil prices swayed from $42.03/barrel at the beginning to $41.15/barrel at month-end, up from $35.33/barrel in May. This led to the benchmark yield closing the month at 5.88%.

CRISIL's outlook

On interest rates

Benchmark	June 31, 2020 (A)	July 30, 2020 (F)	September 30, 2020 (F)
10-year G-sec yield	5.88%	5.85 - 6.05%	6.05 - 6.35%
10-year SDL yield	6.54%	6.60 - 6.80%	6.80 - 7.10%
10-year corporate bond yield	6.57%	6.85 - 7.05%	7.05 - 7.35%

A: Actual; F: Forecast
Source: CRISIL Research

One-month view

In July, yields are likely to be affected by local and global growth scenarios as countries ease business and movement restrictions, fiscal and monetary developments, measures announced by the government/ regulators, movement in global interest rates and crude oil prices, and foreign portfolio investment (FPI) flows.

Three-month view

In the three months through September, pressure on fiscal deficit due to increase in local and global borrowing programmes, movement in global interest rates and crude oil prices, and open market operations by the RBI will dictate yields.

Framework for outlook

CRISIL provides its outlook on key benchmark rates for different debt classes – 10-year G-secs, corporate bonds, and state development loans (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.

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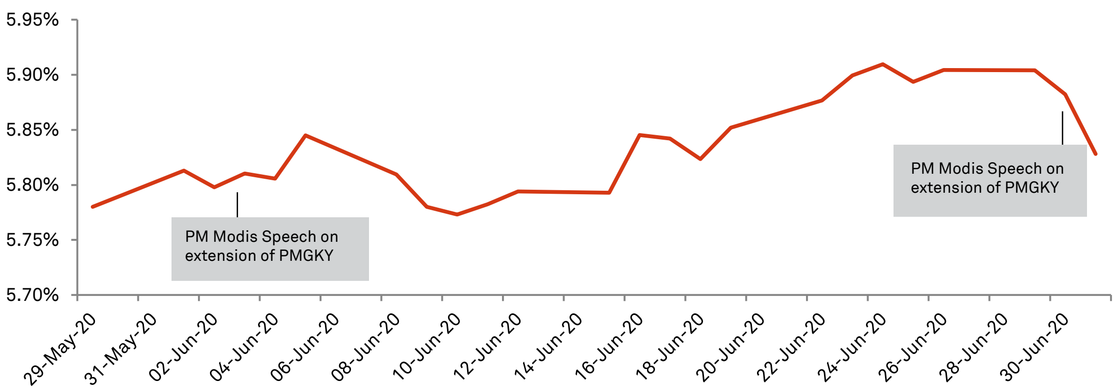
Factors influencing outlook

Economic parameter	Our view	Impact on yields
Gross domestic product (GDP) growth	• We expect India's gross domestic product (GDP) to decline 5% on-year in fiscal 2021 from 4.2% growth in fiscal 2020 • Extended lockdown, higher-than-expected economic cost, and smaller-than-expected policy push to revive demand in the short term will weigh on growth outlook. This is in addition to the external headwinds. Growth in agriculture is expected to shadow its historical trend • GDP growth slowed to 3.1% in the fourth quarter of fiscal 2020 from 4.1% in the previous quarter. The fiscal 2020 growth estimate is now 4.2% compared with 6.1% in fiscal 2019	↓
Consumer price index (CPI) inflation	• Inflation is expected to moderate to 4% in fiscal 2021 from 4.8% in fiscal 2020 • Lockdown-induced poor demand will put significant downward pressure on core inflation this fiscal. Fuel inflation, too, is expected to remain soft. Food inflation, though, may limit the downside to inflation • The National Statistical Office's release of Consumer Price Index (CPI) inflation for May was devoid of a headline number due to partial data availability. Like for April, May data largely captured food prices. CPI food inflation softened to 9.3% in May from 10.5% in April	↓
RBI's monetary policy	• The RBI is expected to maintain an extremely accommodative monetary policy stance this fiscal given the sharp decline in growth. Inflation is expected to remain in the safe zone • The RBI cut its policy rate by 40 bps in its monetary policy meeting, which was preponed to May 22. The repo rate currently stands at 4%, reverse repo rate at 3.35% and marginal standing facility rate at 4.25%	↓
Fiscal health	• Strain on government finances will intensify with falling GDP and tax revenues. The impact of the economic stimulus is expected to be small at ~1.2% of GDP in fiscal 2021 • The Centre has estimated its gross market borrowing at Rs 12 lakh crore for this fiscal compared with Rs 7.1 lakh crore in fiscal 2020 • Fiscal stress is being felt by all states in the backdrop of the pandemic fight; their revenues are drying up. The increase in states' borrowing limits by at least 0.5% of state domestic product will add to bond market supply	↑
Crude oil prices	• CRISIL Research expects crude prices to average $30 per barrel in 2020 (calendar year) compared with an average of $64 per barrel in 2019 • Brent crude oil prices rose in June for the second consecutive month, averaging $39.9 per barrel, 28.7% higher on-month, but 36.9% lower on-year	↓

Economic parameter	Our view	Impact on yields
Current account balance	• We expect the current account balance to turn surplus this fiscal at an average 0.8% of GDP compared with a deficit of 0.9% of GDP in fiscal 2020 • While exports face downside pressure from weaker external growth, import demand is expected to get hit by a triple whammy - a sharp decline in domestic growth, rupee depreciation and low crude oil prices • India's current account balance came in at a small surplus 0.1% of GDP in the fourth quarter of fiscal 2020 – the first time since 2007. It compares with a deficit of 0.4% of GDP in the previous quarter and 0.7% of GDP deficit in the fourth quarter of fiscal 2019	↓
US Federal Reserve's stance	• The Fed is expected to maintain its ultra-accommodative monetary policy given the weak growth outlook • The Fed maintained the policy rate at 0-0.25% in its June meeting and indicated it would maintain this range until it is confident the pandemic-induced economic shock has weathered out	↓
Liquidity indicators - Demand & Supply	**Supply side** • As per the revised first-half borrowing calendar, borrowing of Rs 1.2 lakh crore is scheduled to take place in July 2020 through papers of various tenures **Demand side** • Demand is expected to remain strong on account of excess liquidity in the system, weak credit environment and preference for safer investments	↑
- Call rates/LAF (liquidity adjustment facility)	• Interbank call money rates remained mostly below the RBI's repo rate of 4% in June as overall systemic liquidity remained in surplus. Meanwhile, the RBI decided to extend the enhanced borrowing facility provided to banks to meet their liquidity shortages till September 30. It also extended the relaxation relating to maintenance of the cash reserve ratio by banks for three months up to September 25	↓

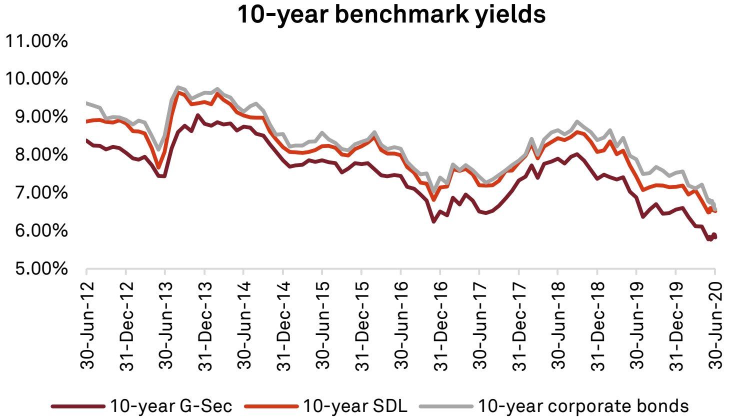
June at a glance

10-year benchmark G-sec yield



Source: CRISIL Research

10-year benchmark yields

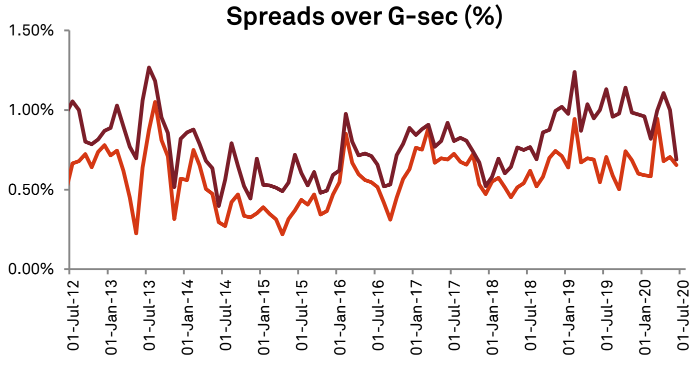


Source: CRISIL Research

Yields on corporate bonds eased -21 bps to 6.57% from 6.78% last month, while those of SDLs hardened by 5 bps to 6.54% from 6.49% last month. The easing in AAA-rated public sector corporate bond yield was due to mutual funds shifting from illiquid to a liquid portfolio.

Spreads narrowed for corporate bonds and SDLs

Spreads over G-sec (%)



Source: CRISIL Research

Spreads of 10-year SDLs over G-sec narrowed by 5 bps over the previous month. Despite increase in Covid-19 cases and Moody's downgrade on Government of India's foreign and local currency long-term issuer ratings (conservative rating did not change), AAA-rated public sector corporate bonds witnessed narrowing of 31 bps due to the continuing trend of portfolio shift from illiquid to liquid securities by mutual funds since April. Long-term repo operations (LTRO) conducted by the RBI also narrowed spreads.

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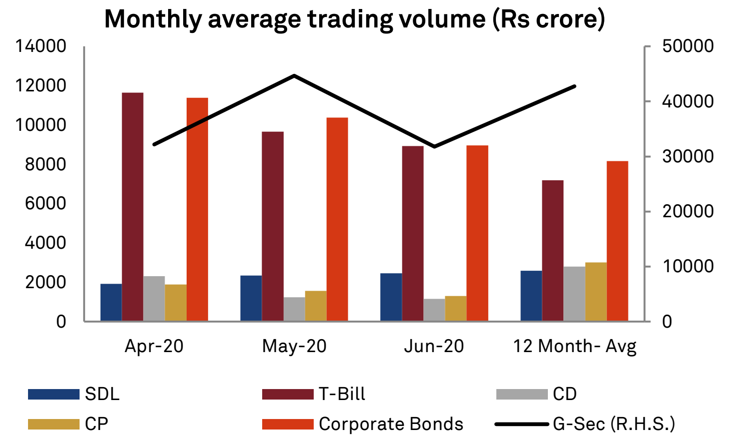
Average trading volume down across securities except SDLs

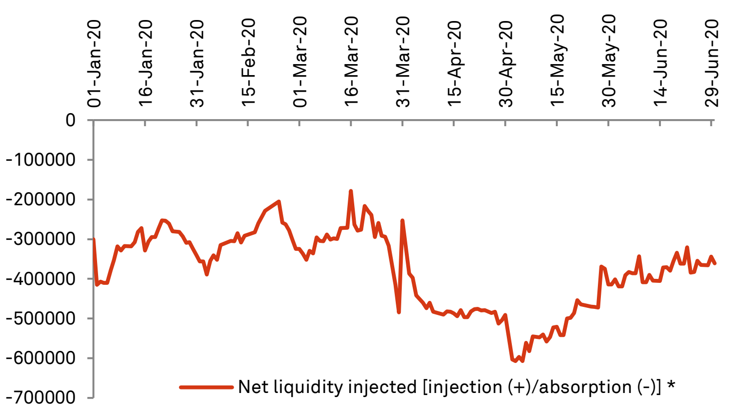


Source: CRISIL Research

Trading volume across almost all securities trended down on-month: G-secs ~28.9%, treasury bills ~7.6%, certificates of deposit (CD) ~6.4%, commercial papers (CPs) ~16.6% and corporate bonds ~13.7%. Trading volume of only SDLs increased ~4.8%. G-sec volume for this month is trading below the 12-monthly average.

Systemic liquidity

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



** Net liquidity is calculated as repo + MSF (marginal standing facility) + SLF (standing liquidity facility) - reverse repo*

Source: CRISIL Research

Interbank call money rates remained below the RBI's repo rate of 4% in June owing to comfortable liquidity in the system. Systemic liquidity averaged ~Rs 3.77 lakh crore due to higher liquidity at the beginning and ended the month at ~Rs 3.60 lakh crore.

Spreads narrow for most sector-rating categories with the announcement of fiscal stimulus

Spreads over G-sec*				
Rating category	**Date**	**PSUs / corporates**	**NBFC**	**Housing finance companies**
AAA	31-May-20	0.21%	2.01%	1.46%
	30-Jun-20	0.35%	1.95%	0.95%
AA+	31-May-20	1.80%	5.40%	2.81%
	30-Jun-20	1.96%	4.90%	2.95%
AA	31-May-20	3.00%	7.60%	4.93%
	30-Jun-20	2.76%	7.47%	5.21%
AA-	31-May-20	4.19%	8.01%	7.06%
	30-Jun-20	3.89%	8.05%	6.65%

**Spreads are for five-year securities over annualised G-sec yields. The five-year G-sec benchmark yield has changed from 6.18% GS 2024 to 7.72% GS 2025*

Source: CRISIL Research

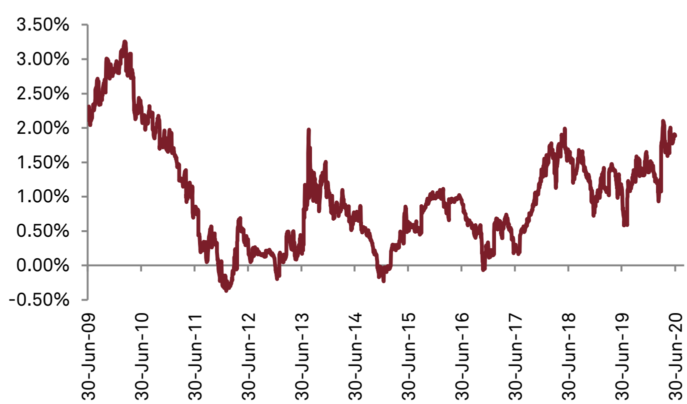
Spread over US Treasury narrows

Benchmark yields – 10-year G-sec and US Treasury

Source: CRISIL Research

Spread between the 10-year benchmark G-sec and 10-year US Treasury yields narrowed by 14 bps to 5.22%. The US Treasury yield closed at 0.66% in June.

Historical term premium

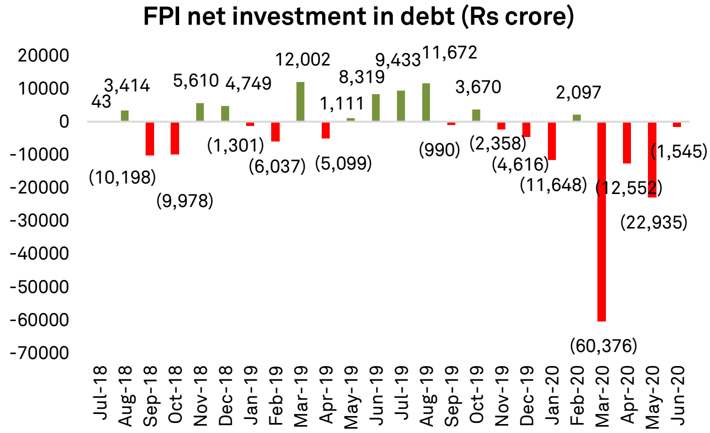


Source: CRISIL Research

The average spread between the repo rate and the 10-year benchmark G-sec yield was ~184 bps in June (~175 bps in May), which is wider than the 12-month average spread of ~139 bps and the 10-year average of ~85 bps. The new benchmark had a spread of ~188 bps over the repo rate at the end of June.

FPI outflows from debt continue

FPI net investment in debt (Rs crore)



Source: CRISIL Research

In June, FPI inflows were Rs 26,009 crore due to high equity inflows and low debt outflows. Net outflow from debt added to Rs 1,545 crore, whereas inflows to equities amounted to Rs 21,832 crore.

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Key downgrades and upgrades in the past one month

Downgrades

Issuer name	Old rating	New rating
Western India Transport Finance Co. Pvt Ltd	CARE BBB-	CARE BB
IIERT	CRISIL AA(SO)	CRISIL A+(SO)
Alliance Infrastructure Projects Pvt Ltd	CRISIL BB+	CRISIL B+
Indiabulls Real Estate Ltd	CARE AA-	CARE A+
Madhya Pradesh Financial Corporation	CARE A-(CE)	CARE BBB(CE)
Sansar Trust	[ICRA]AAA(SO)	[ICRA]AA(SO)
Talwandi Sabo Power Ltd	IND AA(CE)	IND AA-(CE)
Yes Bank	CARE C	CARE D
Western India Transport Finance Co. Pvt Ltd	CARE BB	CARE D
Yes Bank	[ICRA]BB	[ICRA]D
Clix Capital Services Pvt Ltd	CARE AA-	CARE A+
Clix Finance India Pvt Ltd	CARE AA-	CARE A+

Upgrades

Issuer name	Old rating	New rating
Syndicate Bank	IND A+	IND AA
Syndicate Bank	IND AA	IND AAA
Union Bank Of India	IND AA-	IND AA+
GMR Warora Energy Ltd	IND D	IND B
Syndicate Bank	CRISIL AA	CRISIL AAA
Vastu Housing Finance Corporation Ltd	BWR A	BWR A+
Jharkhand Road Projects Implementation Co. Ltd	CARE D	CARE C

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