Debt Market Update

January 31, 2024 | Economics

Global: Key Developments

Recent data signalling moderation in inflation, robust economic growth and a resilient labour market have raised market expectations for a soft landing in the US. In December 2023, the Personal Consumption Expenditures (PCE) price index met market expectations with a 2.6% YoY increase, while the core PCE price index, the Fed's preferred gauge, dropped to 2.9% YoY, falling marginally below market expectations of 3% and marking the lowest reading since February 2021. The US economy exceeded forecasts, expanding at an annualised 3.3% rate in Q4 2023, driven by strong consumer and government spending. The full-year 2023 growth stood at 2.5%, defying initial recession concerns. The addition of 216k jobs in December, well above the expected 170k, underscored the strength of the labour market. Markets do not anticipate the **US Federal Reserve** to change the fed funds target range, currently at 5.25-5.50%, in the January 30-31 meeting. However, given the strong economic data and hawkish commentary from Fed officials, markets have scaled back their aggressive bets regarding the timing and quantum of rate cuts. Markets now project rate cuts to commence in May 2024 instead of March. The probability of a 125bps rate cut in 2024 is increasing, compared to the earlier expectation of a 150bps cut. The 10Y UST yield has risen by 25bps over the last month to 4.12% as on January 26, amidst the shift in market expectations.

In its January meeting, the **European Central Bank (ECB)** kept interest rates at record-high levels, as expected. The main refinancing operations rate remained at 4.5%, while the deposit facility rate stayed at 4%. In the press conference, President Lagarde stated that the ECB officials unanimously considered it premature to discuss rate cuts. Despite this, markets still expect the ECB to begin rate cuts in April 2024, anticipating a 150bps cut in 2024 amidst concerns of a looming recession and a significant decline in inflation since 2022 peaks.

The UK's inflation rate unexpectedly rose to 4% YoY in December 2023 from November's nearly two-year low of 3.9%, surpassing forecasts of 3.8%. This marks the first increase in 10 months, mainly due to a rise in tobacco duty. Core inflation in the UK reached 5.1% YoY in December, exceeding the anticipated 4.9%. Markets expect the **Bank of England (BoE)** to maintain the policy rate at 5.25% in the February 1 meeting. However, there is now an expectation of a 100bps rate cut in 2024, starting in June, lower than the previous expectation of a 125bps cut, given the persistent inflationary pressures.

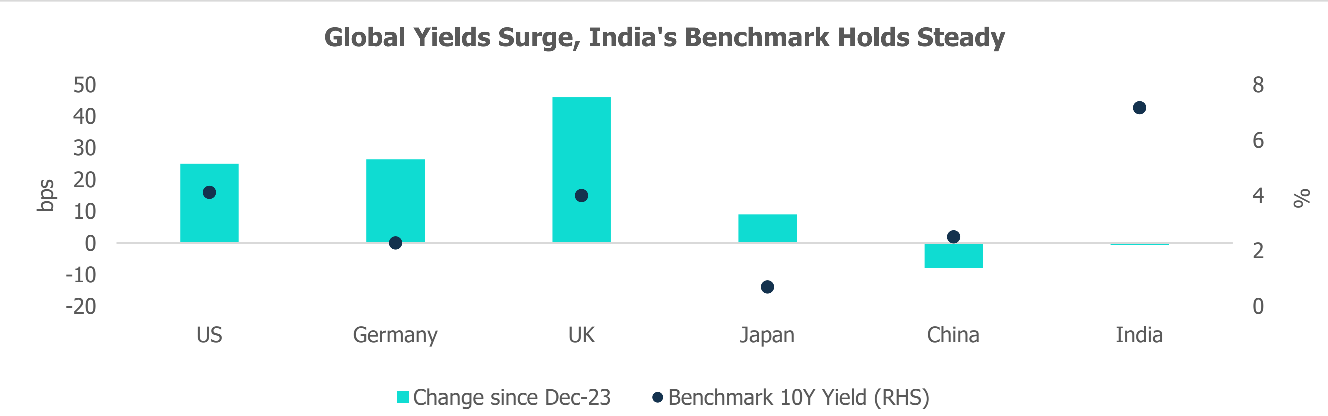
The **Bank of Japan (BoJ)** maintained its key short-term interest rate at -0.1% and the 10-year bond yields at around 0% during its January meeting, as expected. Governor Kazuo Ueda did not indicate whether BoJ would lift short-term rates from the negative territory in the upcoming meetings. However, he noted a growing likelihood of inflation in Japan remaining close to the 2% target, due to steady increases in the service sector prices. Consequently, markets have revised their rate hike expectations, now anticipating a 20bps rate increase in 2024 starting in April, as opposed to the earlier expectation of June 2024.

In January, the **People's Bank of China (PBoC)** maintained the 1-year medium-term lending facility (MLF) rate at 2.50%, contrary to market expectations for a rate cut. It injected a net liquidity of 216 billion yuan into the banking system. The one-year loan prime rate (LPR) remained unchanged at a record low of 3.45% for the fifth straight month, and the five-year rate remained at 4.2% for the seventh consecutive month. However, in a surprise move, China announced a bigger than-expected reduction in banks' reserve ratio requirements (RRR) by 50bps from February 5, aiming to provide 1 trillion yuan in long-term capital and boost the slowing economy. This is the first RRR reduction this year, following two cuts last year.

After remaining stable at around ~USD 78 per barrel for over a month, Brent **crude oil** prices surged by 6% to ~USD 84 per barrel last week. The increase was driven by US crude stockpiles declining more than anticipated, alongside positive US growth data and China's economic stimulus measures, which boosted demand sentiment. Supply concerns were also heightened due to the Red Sea crisis.

The yield on India's 10Y GSec remained largely unchanged at ~7.17% over the past month (Refer to Exhibit 1). Consumer Price Index (CPI) inflation in India rose to a four-month high of 5.69% YoY in December, driven by elevated food prices and an unfavourable base, while core inflation moderated to 3.9% YoY, just below the RBI's 4% target. RBI Governor has been indicating that rate cuts will not be considered unless inflation firmly stays around the 4% target. We anticipate the **Reserve Bank of India (RBI)** to maintain the status quo in the February 6-8 meeting and expect rate cuts to begin in the September quarter. The expected rate cut cycle is likely to be shallow, totalling 50bps in CY24 (25bps each in Q3 and Q4).

Exhibit 1



Source: Refinitiv, CareEdge. Data as on January 26.

India: Money Markets & Interest Rate Transmission

Liquidity Deficit Persists for Fifth Straight Month & Surges to Record High

On January 24, the liquidity deficit reached an all-time high of ~Rs 3.46 lakh crore, driven by tax outflows and weak government spending. Consequently, the weighted average call rate (WACR) spread over the repo rate increased to 28 bps, compared to 15bps at December end (Refer to Exhibit 2). Some segments of the yield curve inverted as the yields on 6M and 12M T-bills exceeded those of 3Y and 5Y G-Secs (Refer to Exhibit 3). The yields on other money market instruments like commercial papers (CPs) and certificates of deposits (CDs) also increased in January (Refer to Table 1). Liquidity deficit has moderated since then to Rs 2.68 lakh crore as on January 29 but remains above Rs 1.56 lakh crore as on December end.

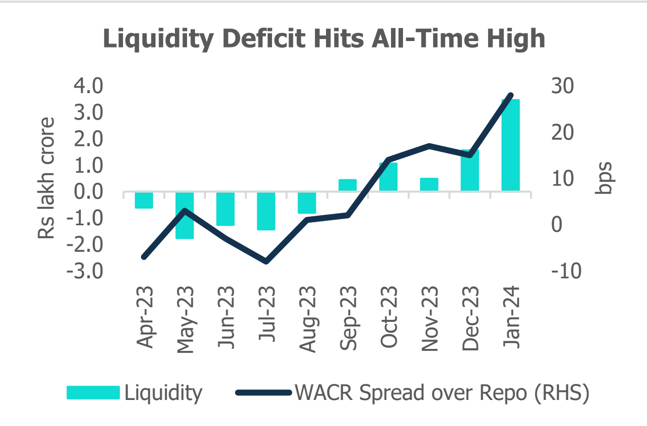
In January, RBI conducted seven variable rate repo (VRR) auctions, injecting Rs 7.50 lakh crore to alleviate tight liquidity conditions (on January 05, the 7-day VRR auction injected Rs 1 lakh crore; on January 12, the 13-day VRR auction injected Rs 1.75 lakh crore; on January 19, the 3-day VRR auction injected Rs 0.50 lakh crore; on January 23, the 2-day VRR auction injected Rs 1.25 lakh crore; on January 25, the 15-day VRR auction injected Rs 2.50

lakh crore; on January 29, the 2-day VRR auction injected Rs 0.25 lakh crore; on January 30, the overnight VRR auction injected Rs 0.25 lakh crore).

According to RBI's Weekly Statistical Supplement (WSS), no OMO sales were conducted until January 21, with the last simultaneous OMO purchase and sale on December 21 amounting to Rs 10 crore, maintaining liquidity neutrality.

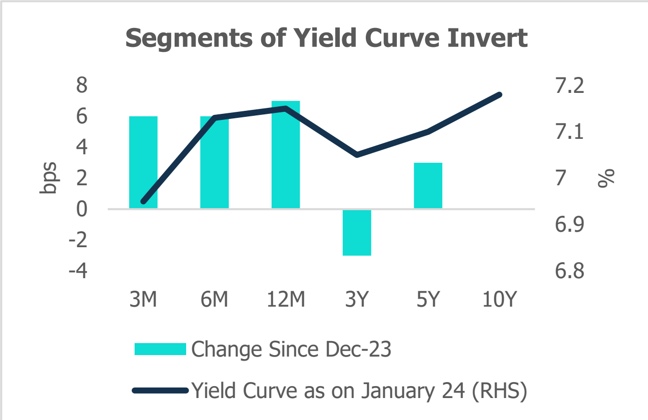
Looking ahead, liquidity conditions are expected to remain tight, aligning with the RBI's monetary policy stance of accommodation withdrawal. However, the liquidity deficit is likely to narrow with RBI's VRR auctions, an uptick in pre-election government spending and month-end inflows from salaries.

Exhibit 2



Source: CMIE. Note: Positive values imply liquidity deficit. Data as on January 24.

Exhibit 3



Source: CMIE, CareEdge.

Table 1: Monetary Policy Transmission

	Apr-22	Mar-23	Oct-23	Nov-23	Dec-23	Jan-24	Total Change in Current Tightening Cycle since May-22
	(Month-end*, %)						bps
Policy Rate							
Repo Rate	4.00	6.50	6.50	6.50	6.50	6.50	250
Money Market Rates							
WACR	3.44	6.40	6.64	6.67	6.65	6.78	334
3M Tbill Rate	3.96	6.83	6.88	6.93	6.93	7.03	307
CP Rate - Low	3.70	6.88	6.91	6.99	7.02	7.12	342
CD Rate - Low	3.85	7.07	6.83	6.70	7.06	7.08	323
Government and Corporate Bond Yields							
10Y Gsec	7.14	7.32	7.36	7.28	7.18	7.17	3
3Y AAA Corporate	6.45	7.77	7.84	7.81	7.80	7.93	148
Deposit and Lending Rates of SCBs							
WADTDR - Fresh	4.03	6.48	6.31	6.34	-	-	231
WADTDR - O/s	5.03	6.16	6.76	6.79	-	-	176
WALR - Fresh	7.51	9.32	9.50	9.34	-	-	183
WALR - O/s	8.72	9.72	9.82	9.78	-	-	106
1Y MCLR - Median	7.25	8.55	8.70	8.70	8.75	-	150

Source: CMIE, RBI, CareEdge. *Latest data as available on January 26.

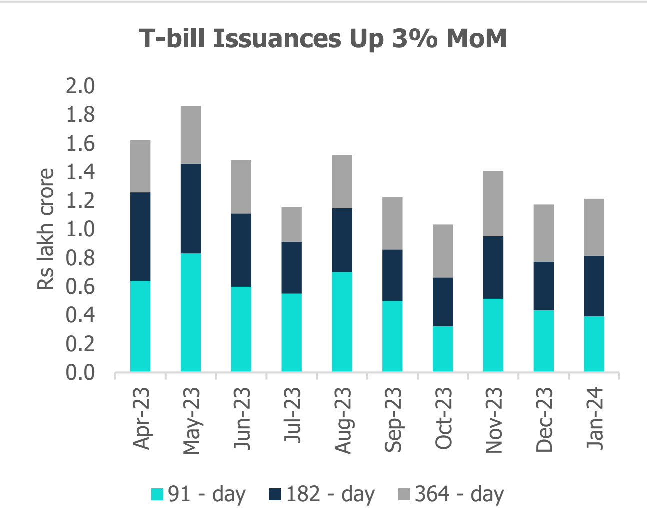
T-bill Yields Experience Uptick

So far in January, the government raised Rs 1.21 lakh crore through T-bills, marking a 3% increase from the previous month. Of this total, Rs 39,142 crore (32%) was raised through 91-day T-bills, Rs 42,325 crore (35%) through 182-day T-bills and Rs 39,805 crore (33%) through 364-day T-bills (Refer to Exhibit 4). Another T-bill auction is scheduled for January 31, with notified amount of Rs 27,000 crore (Rs 8,000 crore for 91-day; Rs 10,000 crore for 182-day; Rs 9,000 crore for 364-day).

The cut-off yields rose amidst tighter liquidity conditions (Refer to Exhibit 5). In the latest auction conducted on January 24, the cut-off yields were 7.02%, 7.19% and 7.17% for 91, 182 and 364 days, respectively. This reflected an increase of 9bps, 4bps and 4bps from the auction on December 27.

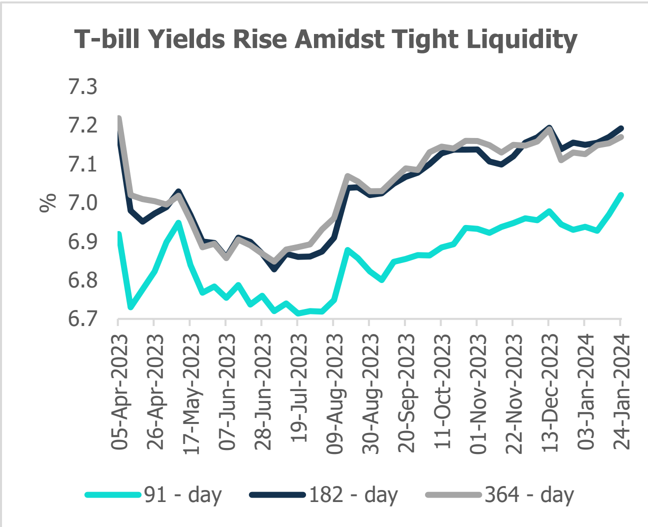
For the fiscal year to date (FYTD), T-bill borrowings amounted to Rs 13.68 lakh crore, with Rs 4.96 lakh crore borrowed in Q1FY24, Rs 3.90 lakh crore in Q2, Rs 3.61 lakh crore in Q3 and Rs 1.21 lakh crore in Q4 (as on January 24).

Exhibit 4



Source: RBI DBIE, CareEdge. Data as on January 24.

Exhibit 5

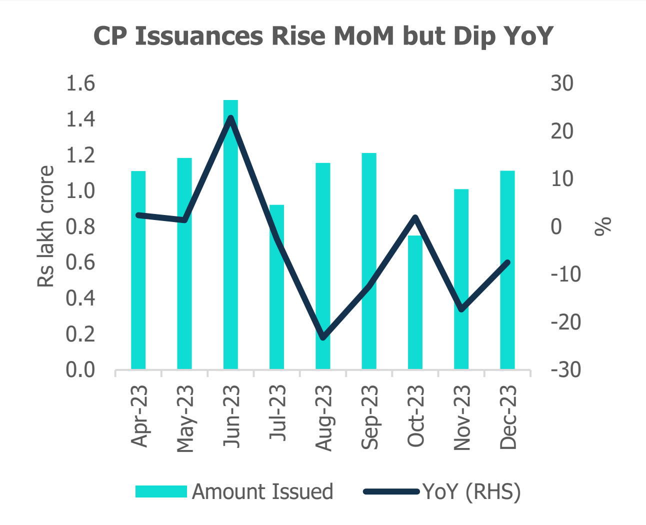


Source: RBI DBIE, CareEdge.

CP & CD Issuances Increase Despite Elevated Costs

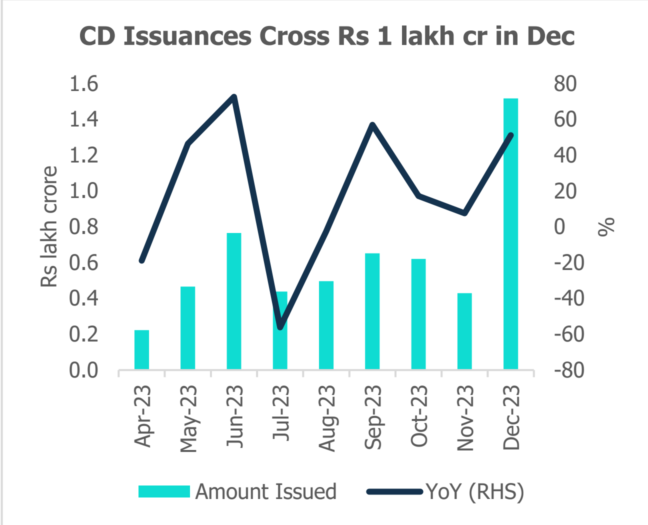
In December, CP issuances stood at Rs 1.11 lakh crore, marking a 10% increase from November (Refer to Exhibit 6). CD issuances surged to Rs 1.52 lakh crore in December, the highest monthly figure in FY24, driven by quarter-end requirements and the need to bridge the gap between credit growth and trailing deposit growth (Refer to Exhibit 7). FYTD CP issuances amounted to Rs 9.96 lakh crore and CD issuances amounted to Rs 5.62 lakh crore.

Exhibit 6



Source: CMIE, RBI, CareEdge.

Exhibit 7



Source: CMIE, RBI, CareEdge.

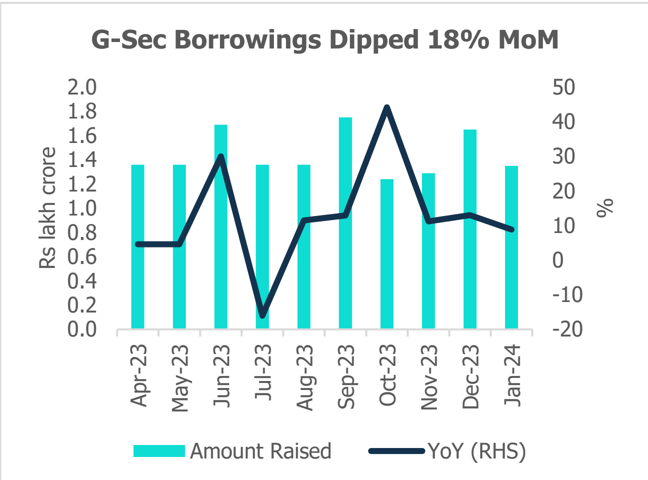
India: Debt Capital Market

Central Government's Borrowings Fall

In January, four G-Sec auctions raised Rs 1.35 lakh crore, up 9% from a year ago but lower than previous month's Rs 1.65 lakh crore (Refer to Exhibit 8). The amount matched planned borrowings, with no devolvement on primary dealers or greenshoe options exercised. Of the total, 24% was raised through the benchmark 10Y G-Sec, and 4% through green bond (Refer to Table 2). Weighted average maturity increased to ~19 years from ~18 years in December. Weighted average borrowing cost was 7.27% in January, down from 7.30% in December.

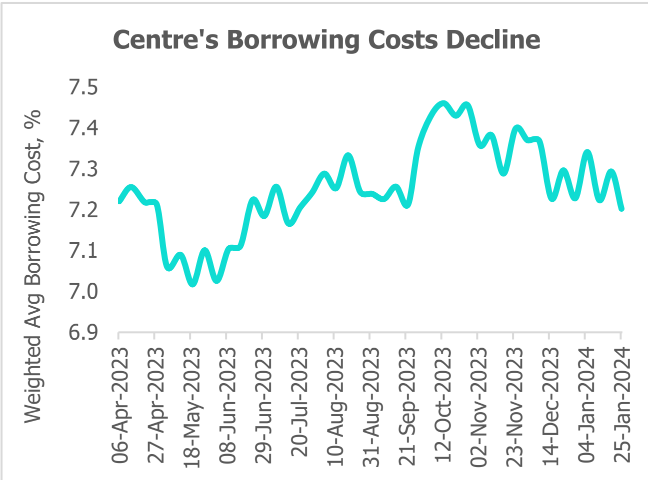
FYTD government borrowing reached Rs 14.41 lakh crore, with Rs 4.41 lakh crore in Q1 (equivalent to 100% of planned borrowings), Rs 4.47 lakh crore in Q2 (100%), Rs 4.18 lakh crore in Q3 (100%) and Rs 1.35 lakh crore in Q4 as on January 25 (57%).

Exhibit 8



Source: RBI DBIE, CareEdge Calculations.

Exhibit 9



Source: RBI DBIE, CareEdge Calculations

Table 2: Details of Central Government Borrowings

	Tenor	Issuance Amount	Planned Borrowing	Weighted Avg Yield	Share in Issuance
	Years	Rs lakh cr	Rs lakh cr	%	%
Q1FY24	**All**	**4.41**	**4.41**	**7.14**	**100**
Q2FY24	**All**	**4.47**	**4.47**	**7.25**	**100**
Q3FY24	**All**	**4.18**	**4.18**	**7.36**	**100**
	3	0.24	0.24	7.23	6
	5	0.49	0.49	7.24	12
	7	0.36	0.36	7.33	9
	10	0.97	0.97	7.27	23
	14	0.60	0.60	7.40	14
	30	0.50	0.50	7.51	12
	40	0.72	0.72	7.50	17
	50	0.20	0.20	7.43	5
	SGrB 5	0.05	0.05	7.25	1
	SGrB 10	0.05	0.05	7.24	1
Q4FY24*	**All**	**1.35**	**2.37**	**7.27**	**100**
	3	0.08	0.16	7.05	6
	5	0.14	0.21	7.06	10
	7	0.12	0.24	7.19	9
	10	0.32	0.48	7.18	24
	14	0.20	0.40	7.33	15
	30	0.10	0.20	7.41	7
	40	0.24	0.48	7.45	18
	50	0.10	0.10	7.35	7
	SGrB 30	0.05	0.10	7.37	4

Source: RBI DBIE, CareEdge Calculations. SGrB stands for Sovereign Green Bonds. *Q4 data as of January 25.

SDL Spreads Widen as State Governments Signal Higher Borrowings

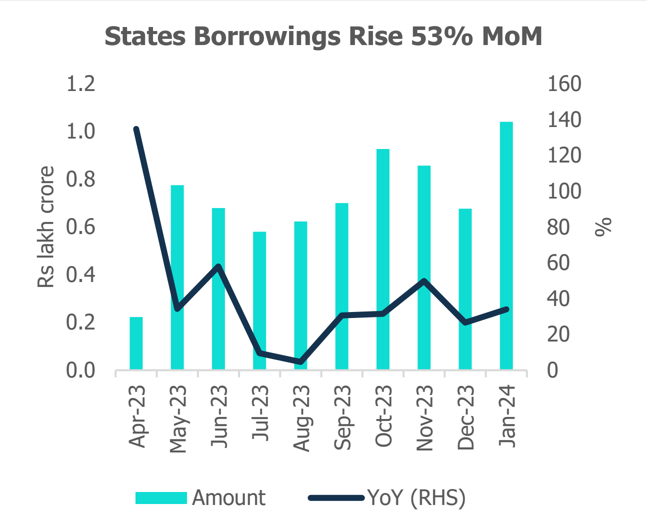
State governments indicated borrowing of Rs 4.1 lakh crore for Q4FY24, marking a 37% increase from the previous year and surpassing market expectations.

In January, five auctions raised a total of Rs 1.04 lakh crore, 54% higher than in December but below the indicated amount of Rs 1.34 lakh crore (Refer to Exhibit 10). The weighted average maturity increased to ~14 years from ~13 years in December. The weighted average borrowing cost was 7.67% in January, higher than 7.65% in December.

10Y State Development Loan (SDL) spread over G-Sec reached ~50ps in mid-January, the highest in two years, driven by a large indicated supply of SDLs. Although it has since decreased to 44bps, it remains elevated (Refer to Exhibit 12).

FYTD states have borrowed Rs 7.1 lakh crore, with Rs 1.7 lakh crore in Q1 (equivalent to 83.9% of planned borrowings), Rs 1.9 lakh crore in Q2 (80.2%), Rs 2.5 lakh crore in Q3 (103.9%) and ~Rs 1 lakh crore in Q4 as on January 30 (25.2%).

Exhibit 10



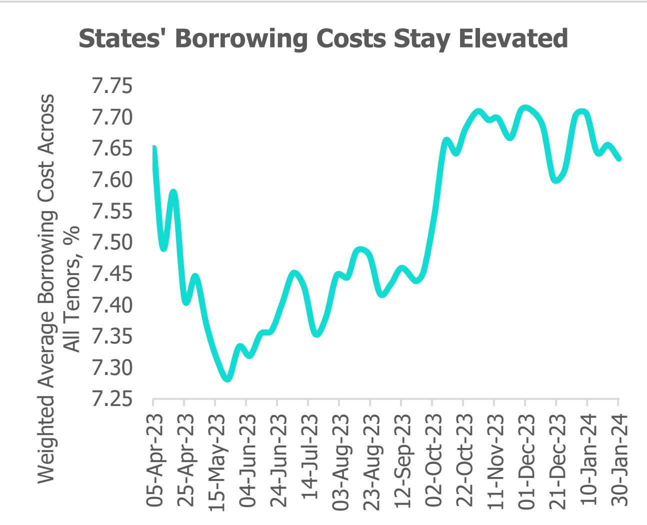
Source: RBI DBIE, CareEdge. Data as on January 30.

Table 3: State Government Borrowings

	Actual Borrowing Rs lakh cr	Planned Borrowing Rs lakh cr
Q1FY24	1.7	2.0
Q2FY24	1.9	2.4
Q3FY24	2.5	2.4
Q4FY24*	1.0	4.1
Total	7.1	10.9

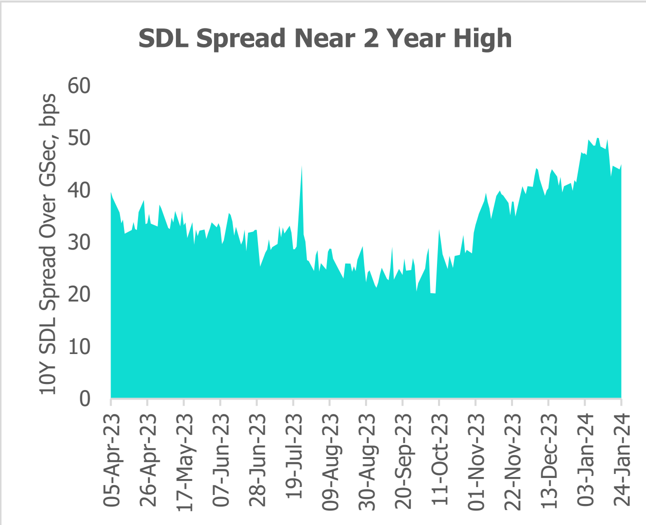
Source: RBI DBIE, CareEdge. *Data as on January 30.

Exhibit 11



Source: RBI DBIE, CareEdge Calculations.

Exhibit 12



Source: CCIL, Refinitiv, CareEdge Calculations.

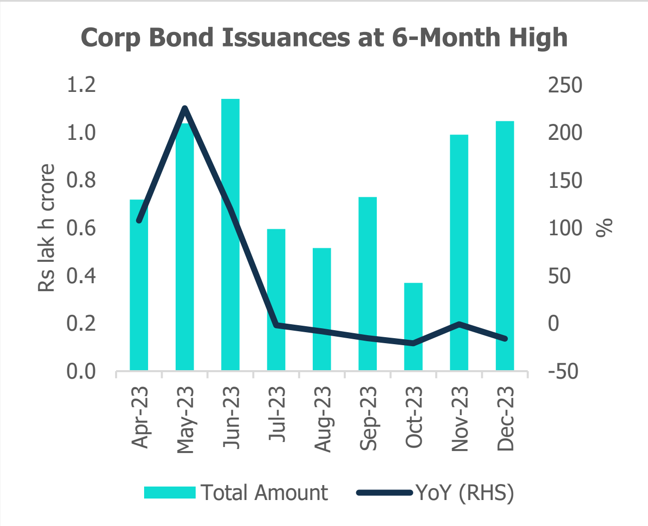
Corporate Bond Issuances Highest since June

In December, private placements of corporate bonds reached Rs 1.04 lakh crore, the highest since June but were 16% lower than the previous year (Refer to Exhibit 13). The increase in corporate bond issuances can be attributed to factors such as quarter-end fund demand, higher bank borrowing costs and market stability, among other things.

FPI Inflows in Debt Highest in Over Six Years

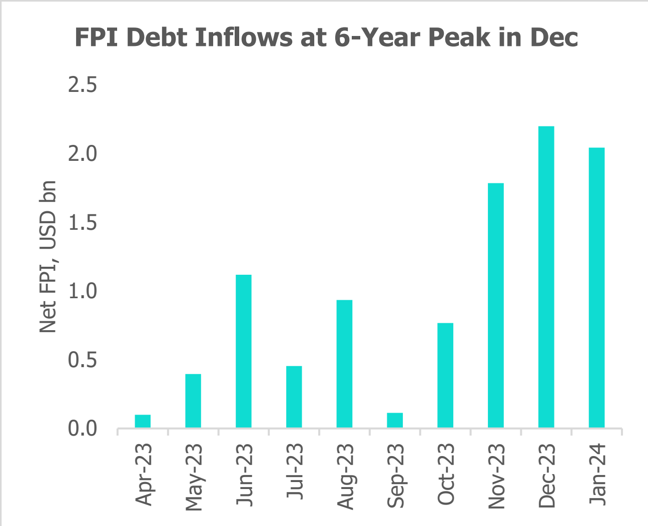
December witnessed the highest net FPI inflows in debt in six years at ~USD 2.2 billion, and so far, January has seen inflows of ~USD 2 billion (Refer to Exhibit 14). Market sentiment has been positively influenced by India's potential inclusion in Bloomberg EM indices. FYTD FPI debt net inflows reached ~USD 10 billion, with 70% occurring since October 2023, following the announcement of India's inclusion in the JP Morgan bond index.

Exhibit 13



Source: Prime Database, CareEdge Calculations.

Exhibit 14



Source: CMIE, NSDL, CareEdge. Data as on January 25.

Outlook

The upcoming Interim Union budget is a crucial event for debt markets. Fiscal deficit for FY25 is projected to be at 5.3% of GDP, down from projected 6% in FY24 and in line with the Centre's glide path towards a 4.5% deficit by FY26. In FY24, the central government announced gross market borrowings amounting to Rs 15.4 lakh crore, with net borrowing at Rs 11.8 lakh crore. FY25 gross borrowing is expected to be in the range of Rs 15-15.3 lakh crore. RBI's data on outstanding G-Secs indicates redemptions worth Rs 3.7 lakh crore in FY25, with 52.7% scheduled in the second half. This leads to an expected net borrowing of around Rs 11.3-11.6 lakh crore in FY25. Government borrowing is likely to be frontloaded in the first half, allowing states/corporates room to borrow in the second half. Overall, a marginally lower G-Sec supply, coupled with increased FPI demand after India's inclusion in global bond indices, is anticipated to ease G-Sec yields in FY25. Lower G-Sec yields are likely to transmit to corporate issuances. The expectation of RBI initiating policy rate cuts after the first quarter of the next fiscal may further push borrowing costs downward.

We expect benchmark 10Y G-Sec to trade between 7-7.20% in the near term. In addition to the Union budget, the Fed's interest rate trajectory, crude oil prices and domestic inflation remain key factors to monitor for India's debt markets.

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