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ECONOMY & GILT WATCH

(Subsidiary of Punjab National Bank)

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Indian Bonds' Index Inclusion

Indian bonds have officially been included in the JPM EM bond index on 28th June. Foreign investors bought close to $ 200 Million of Indian government bonds in a move that is expected to bring inflows of approximately $25 Billion over the next 10 months. Apart from the stipulated amount to be invested via the index tracking passive route, the inclusion serves as psychological assurance for the active investors. Going forward the traction and demand from foreign investors for both the eligible and non-eligible bonds is likely to increase. In this context some of the potential developments that we can foresee are as follows:

1. **Support for Rupee:** With the inflows coming in tranches at regular intervals Indian Rupee looks set for a year with appreciation bias. While RBI has officially mandated that they look to contain volatility and now adhere to foreign exchange accumulation as a stated policy, there is still room for more appreciation than depreciation. While active investors may redeem their holdings at some point but the passive net inflow of $25 Billion is likely to support. At a time when other EM currencies are going through a crisis of sorts currently which to a large extent is fuelled by China's economic woes and high UST leading to squeezed rates differentials, India provides a stable currency making it more attractive to investors which again supports the currency.

2. **Increased Liquidity in Bond Markets:** While in the initial cycle of investment inflows, the custodian banks had already bought some of the eligible bonds. Going forward increased participation will enhance market activity in the benchmark bonds leading to narrow spreads and potentially spur trading in relatively illiquid papers which change hands occasionally in the OTC market. As a spill over effect, trading volumes in Interest Rates Derivatives segment is going to rise as investors look to hedge their Interest Rate risk in an increasingly confusing Global Rates outlook.

3. **Narrowing spreads:** As foreign investors look to invest money, active managers are likely to be on the lookout for any extra yields. As a positive development, State Government securities as well as Corporate Bonds are going to see more interest from active investors who look to lock in extra yields. This is likely to lessen the spread in the above segments vis a vis

Bond inflows expected to be a continuous phenomenon going forward

Central Government securities. Even non benchmark bonds in the same tenor are likely to see increased appetite from foreign investors leading to a decrease in spreads in similar tenors.

4. **More index inclusions:** If the current exercise goes smoothly, going forward Indian Assets can see inclusion in other global indices. This is going to positively impact the sub-classes such as corporate debt, private credit and other such segments. These developments are going to further India's inclusion in the global financial system.

India Budget:

Budget is expected to focus on continuity

With the union budget to be tabled around 23rd July, the bond markets look keenly towards a re-affirmation of the policy continuity from new government that is more or less priced in by now. While equity market has reacted to the new government as a continuation of the previous setup with policy continuity at the core. It remains to be seen if going forward the Union Budget can provide similar indications for the bond market as well.

Points of interest for bond markets in the Union Budget –

- Changes in the borrowing program if any
- New schemes/programs that can lead to increase in borrowing or the other way around
- Changes in tax regime
- Change in rules regarding Green bonds, Infrastructure bonds, etc.
- Rules to encourage retail participation in the bond market
- Development of new segment such as municipal bonds
- Developments around raising money via offshore foreign bonds

Fixed Income Outlook

Fundamental View

Benchmark yields have traded in a range in the past 3 weeks between 6.95-7.05%. And have traded sideways with the ongoing downward bias to continue. In absence of any policy and geopolitical shocks the market is likely to remains range bound with continuous FPI buying interest to support the bullish outlook in the medium term.

Some of the concerns on the horizon that can lead to a spike in bond yields are the ongoing presidential elections in US, uptick in oil prices as well as possibility of RBI deploying OMO sales to manage liquidity. With the inflows from bond inclusion likely to continue, the RBI might just prefer OMO sales over FX Swaps to manage liquidity as it seeks to contain the volatility in currency markets at all costs.

Markets to remain flow driven remaining watchful of budget and other developments

Considering the above possibilities there is a chance of yields spiking to 7.10% levels in the medium term but claw their way back considering increased investor inflows, low inflation and strong growth outlook. The union budget slated towards the later part of month is going to give a medium to long term direction to the market with positive annoncements expected from the government.

SDL Overview

In last fortnight, CG benchmark 10 Yr traded in the range of 6.95%-7.02%, whereas, the 10Y SGS got dealt in the range of 7.32-7.39 i.e. the sdl spreads vis-a-vis their CG counterpart remained in the range of 33 - 38 bps. States ended their Q1 borrowing figure at 1,45,821 lakh crores vs the scheduled figure of 2,54,040 lakh crores (~43% lower). Borrowing calendar of Q2 is out and the figure stood at 2,63,562 lakh crores which is in line with market expectations. We expect States to stick with the calendar and borrow close to 85% of the scheduled figure in Q2. Since, election results are out. Our sense is that in the coming fortnight, spreads between SG & CG to remain status quo in the current band of 33-38 bps.

SDL spreads likely to remain flat

Technical View

Technical Synopsis 7.10% GS 2034 Yield:

7.10% G Sec 2034 paper settled at 7.01% on today's session. Passing fortnight benchmark yield broadly traded in the range of 6.95% to 7.04% zone. Momentum oscillator RSI is placed around 50 level. This was the second time we have witnessed bounce from 6.95% level indicating good supply zone. We still believe, this rally has further legs till Benchmark is holding below it's crucial resistance level of 7.02%-7.03% which coincide with 30EMA line and also presence of 23.6% retracement level at 7.02% strengthen the case.

With Bollinger width trading near 2024 lows indicates either side sharp moves possible in coming sessions. On higher side any sustainability above 7.03% may trigger sharp surge towards 7.10%-7.12% and on lower side any sustainability below 6.95% could trigger further softening towards 6.86%.

With Bollinger band width trading near year's low, either side sharp moves are possible

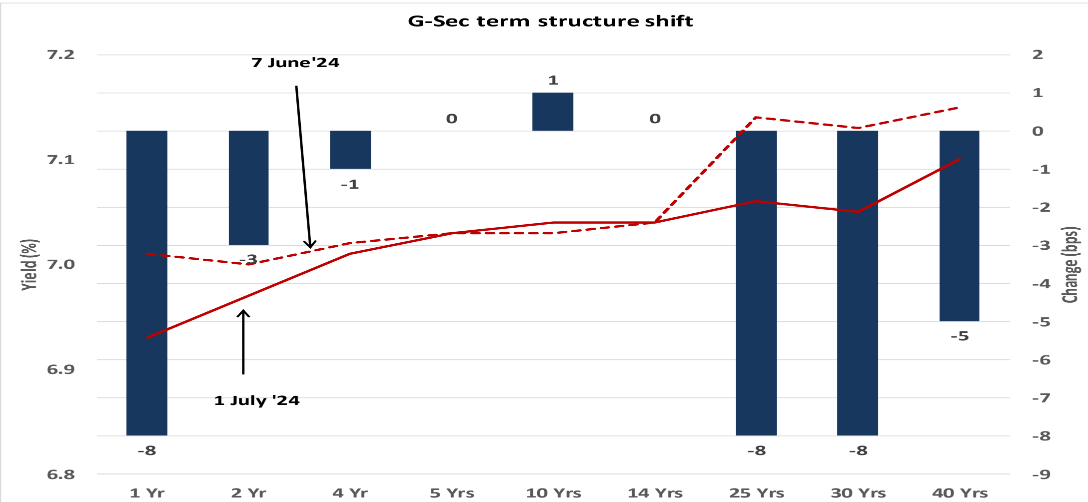
Running chart Daily: 10yr. Source: Tickerplant

Liquidity

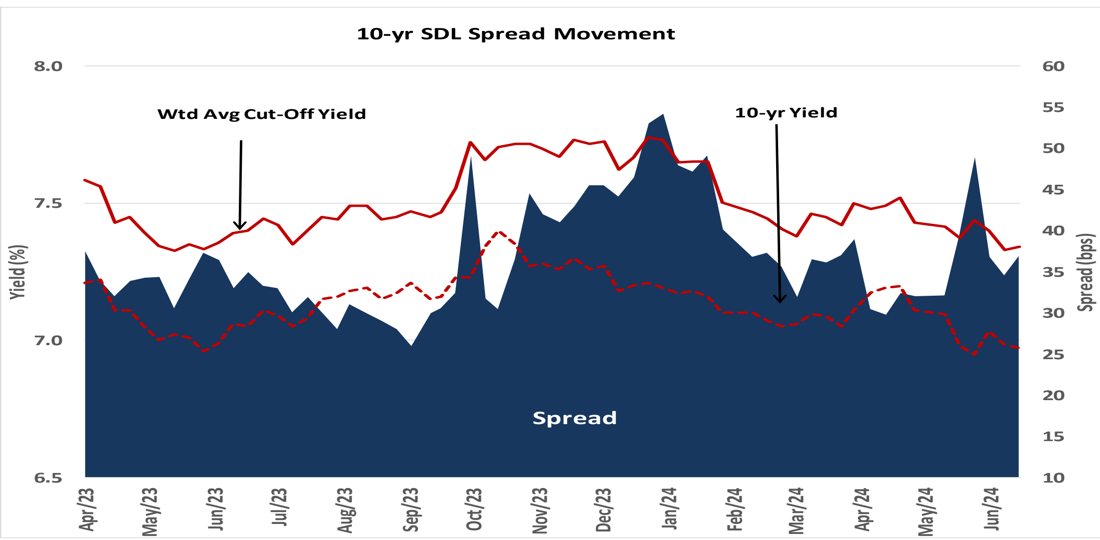
Liquidity is expected to increase

Money market rates remained under pressure in the past few weeks because of advance tax and GST outflows with MIBOR touching high of 6.86%. In the month of June 2025, average MIBOR was 6.70%. Expected GOI cash balance, as on 21st June was Rs 5.1 Lakh Crore. In the coming fortnight, money market rates are expected to hover around repo rate as increased government spending is expected to infuse liquidity in the system.

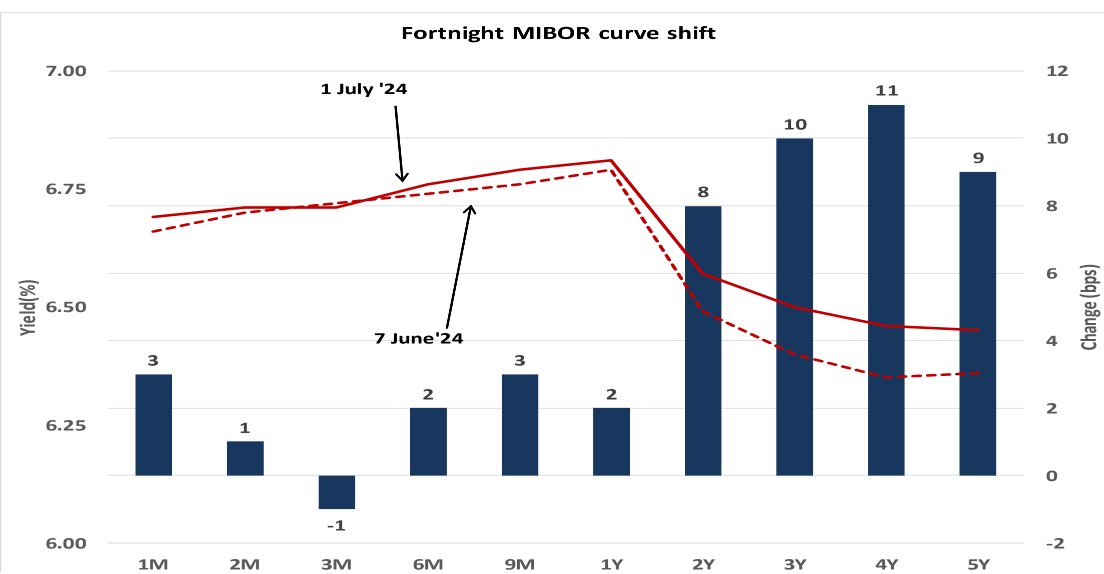
Spread Monitor



G-Sec yields have remained flat



SDL Spreads have come down slightly



OIS has trended up along with USTs

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