KEY DRIVERS AFFECTING G-SEC YIELDS

FEBRUARY 21

B&K

A Brief Introduction

Summary

Government securities (G-Secs) are debt instruments issued by the Indian government to finance its fiscal deficit. The yields on these securities are influenced by a combination of macroeconomic and microeconomic factors. A detailed View on the factors are presented in below section.

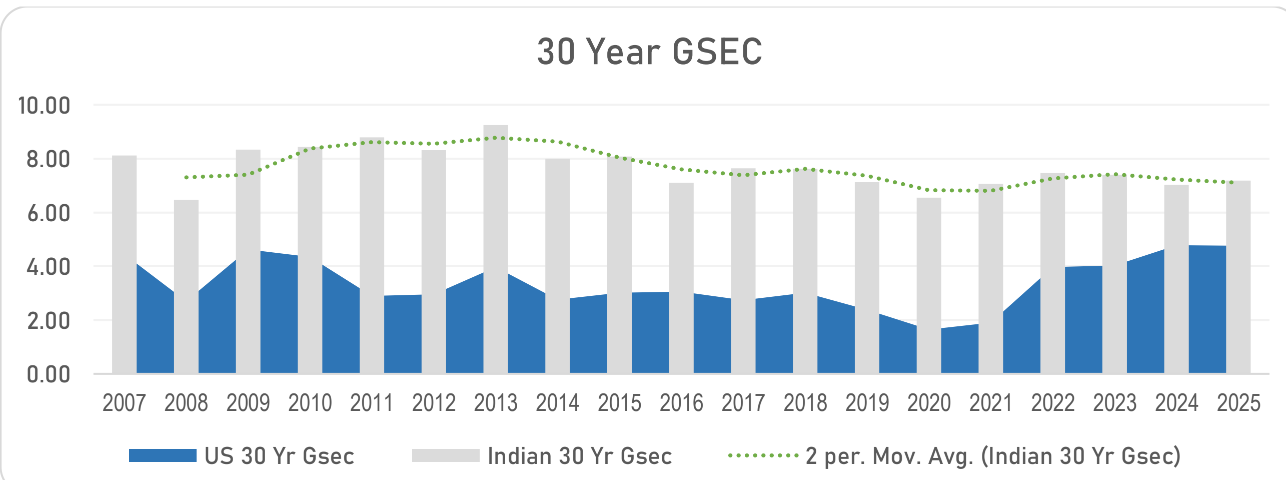
The Table below give a brief view on how does the current situation looks like.

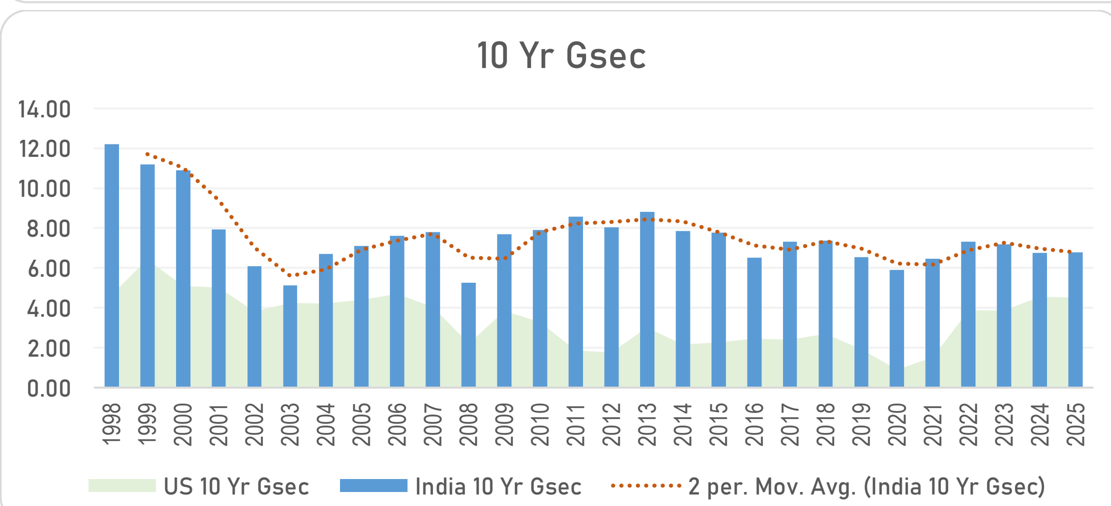
Factors	Current Position	Remarks	Current
Macro Factors			
Monetary Policy	↔	Recent measures, such as reducing the repo rate, have aimed at stabilizing the market but with growth slowing down and net liquidity going in defecit. A further rate cut will be required in Apr-June Period.	6.25%
Inflation-Interest Rate Outlook	↔	Inflation has been relatively under control, allowing the RBI to adopt a more accommodative stance. Further More If War in Middel East and Europe settels then Crude Oil Prices will stabalize.	4.33%
Macroeconomic Factors	↓	India's GDP growth has been slowing, and the fiscal deficit remains a concern. Govt Speding is seeing a consolidation not a good news for G Sec Yeilds.	6.5%- Growth Projection
Oil Prices	↓	Rising global oil prices have led to higher trade deficits, negatively impacting investor confidence and pushing G-Sec yields higher.	Current Oil Price- $72.18
Global Factors	↓	Geopolitical tensions, such as the Russia-Ukraine conflict and China's assertive behavior, have created uncertainties in global markets. These factors can lead to capital outflows from emerging markets like India, increasing G-Sec yields.	Net ouflow equity ₹ 1.06 Lakh Crs, Debt- 5800 Crs.
Micro Factors			
Liquidity Conditions	↓	Tightening of liquidity have reduce demand and push yields higher.	Net Deficit ₹ 1.77 Lakh Crs
Demand-Supply Dynamics	↓	At Current market Scenerio FPI have nearly sold 5800 Cr of Debt Papers looking for better oportunities in Developed economy.	Net Outflow Debt 5800 Crs

Macro-Economic Factors

1.) Monetary Policy:

- **a.) Role of RBI:** The Reserve Bank of India (RBI) is pivotal in controlling the money supply, interest rates, and liquidity in the economy. It uses tools like the repo rate, reverse repo rate, and open market operations (OMOs) to influence these factors.
- **b.) Impact on yields:** When the RBI tightens monetary policy by increasing the repo rate, borrowing costs rise. This leads to higher G-Sec yields as investors demand higher returns to compensate for the increased cost of money.
- **Current Situation:** RBI has reduced repo rate by 25 Bps Points. But More is required.
- **Positive Impact:** In hope of a rate cut expectation, the demand for G-sec will increase leading to generating more mark to market gain in this scenario.



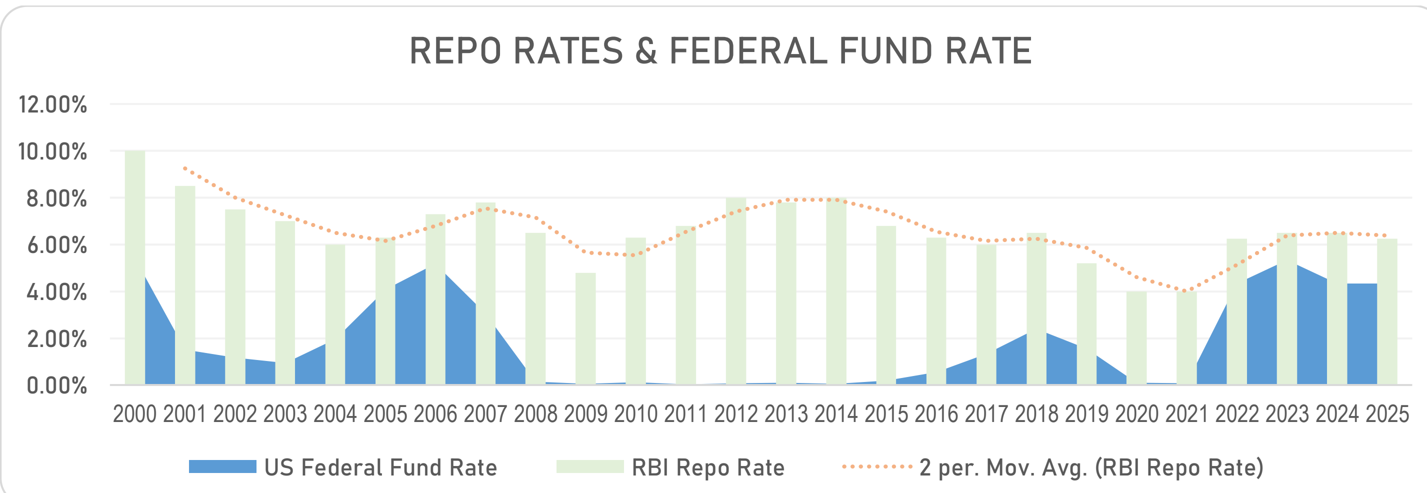


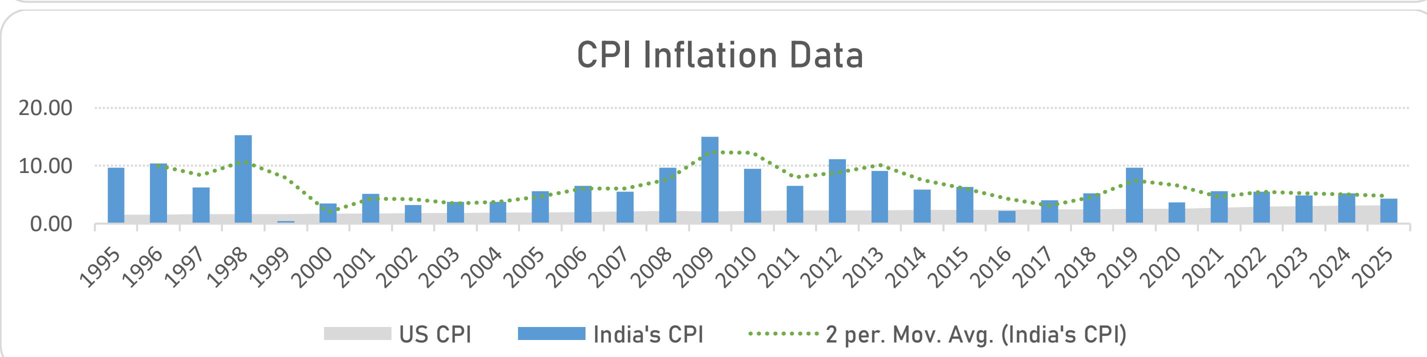
By looking at past data we can figure out that there is there is a positive correlation (Mostly) when US 10 & 30 Yr Treasury Yield and Indian 10 Yr & 30 Yr G Sec Yield. Leading to a possibility which suggest that when US Fed Cuts the Interest rates then India Follows the similar path too

2.) Inflation-Interest Rate Outlook:

a.) Investment Strategy: High inflation often leads to expectations of rising interest rates. Investors may demand higher yields on G-Secs to offset the anticipated loss of purchasing power. For example, if inflation is projected to rise, investors will expect higher returns on G-Secs to maintain their real returns.

- **Current Situation:** Inflation has been relatively under control. 4.33% thank to the under controlled vegetable prices.
- **Positive Impact:** Allows RBI to adopt an accommodative stance, keeping G-Sec yields stable.



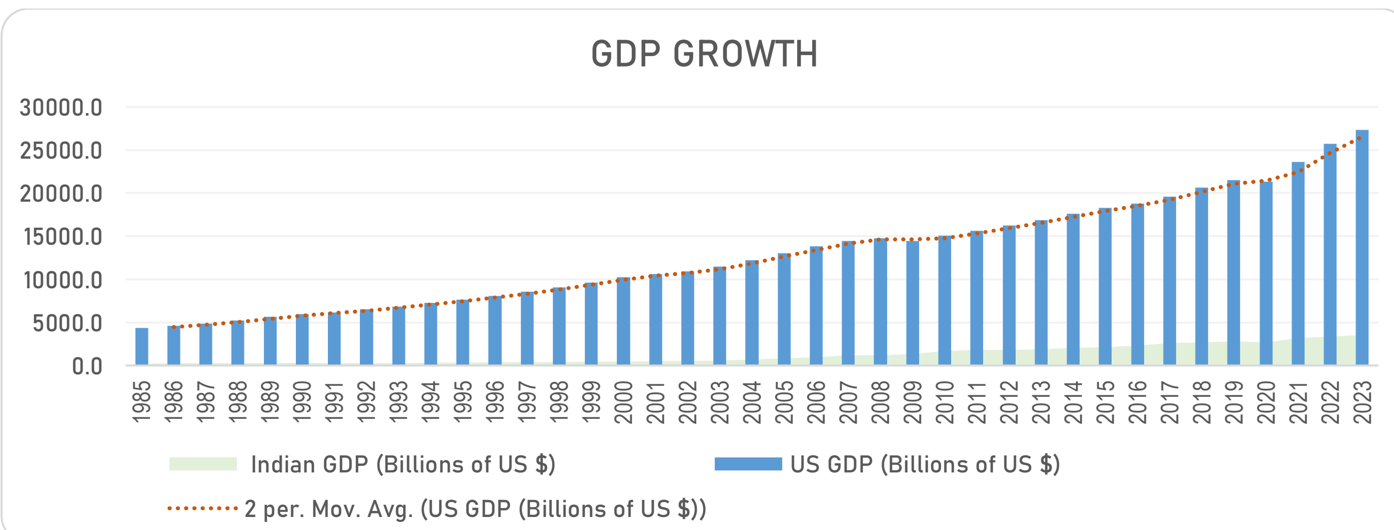


3.) Macroeconomic Factors:

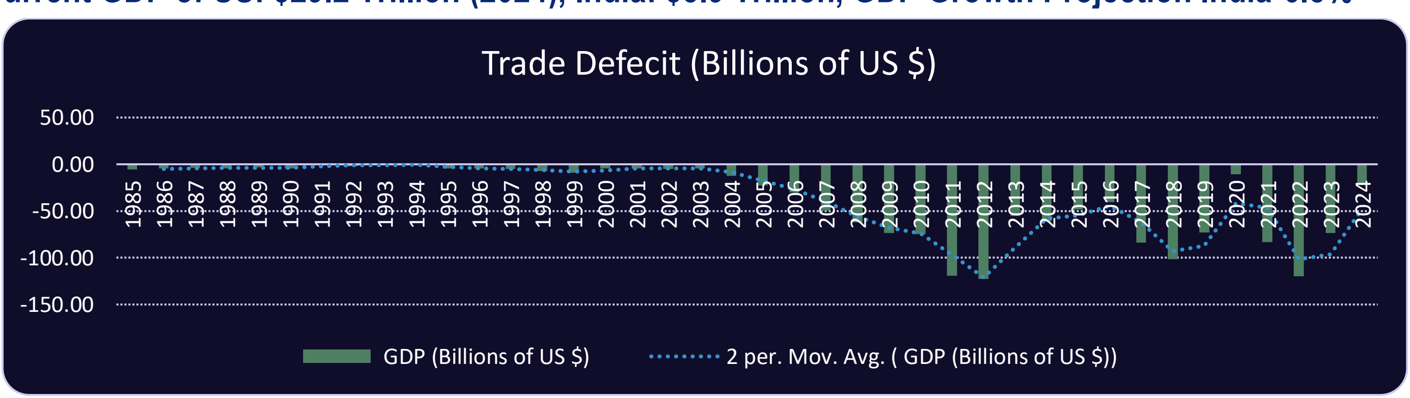
a.) Key Parameters: GDP growth projections, fiscal deficit, trade deficit, and currency fluctuations are crucial determinants of the bond market outlook.

b.) Fiscal Deficit Example: A higher fiscal deficit indicates increased government borrowing. This can lead to an oversupply of G-Secs, pushing yields up as the government competes for funds in the market. For instance, if the fiscal deficit widens due to increased government spending, G-Sec yields may rise to attract more investors.

- **Current Situation: Cyclical slowdown in GDP growth. However, fiscal deficit, has been steadily declining from 6.4% in FY2022-23 to below 4.5% in FY2025-26, indicating the Government's unwavering focus on fiscal consolidation.**
- **Yield Impact: This declining deficit trajectory supports lower G-Sec issuances, easing supply-side pressure and aiding yield stability.**



Current GDP of US: $29.2 Trillion (2024), India: $3.9 Trillion, GDP Growth Projection India-6.5%

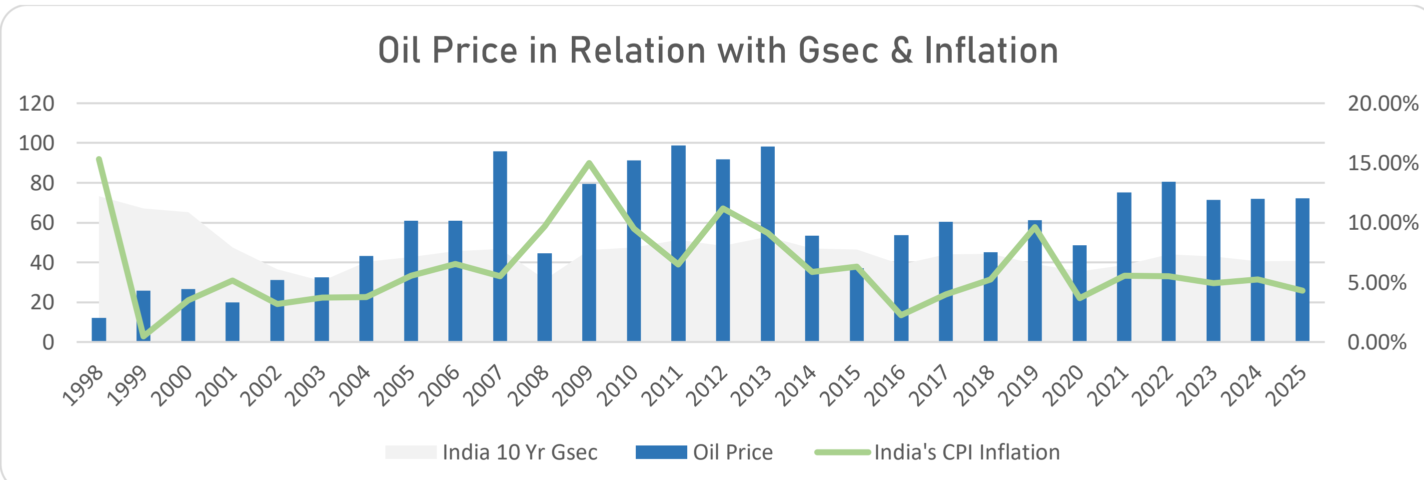


4.) Oil Prices:

a.) **Impact on Trade Deficit**: India is a major importer of crude oil. Rising global oil prices can lead to higher trade deficits, as more foreign exchange is spent on oil imports.(At the start of FY25, Icra had projected India's net crude oil import bill to reach $101-104 billion).

b.) **Investor Demand:** High trade deficits can dampen investor demand for bonds, leading to higher G-Sec yields. For example, if oil prices surge, the increased trade deficit may reduce investor confidence, pushing G-Sec yields higher.

- **Current Situation: Rising global oil prices have led to higher trade deficits.**
- **Negative Impact: Reduces investor confidence and pushes G-Sec yields higher due to increased import costs.**

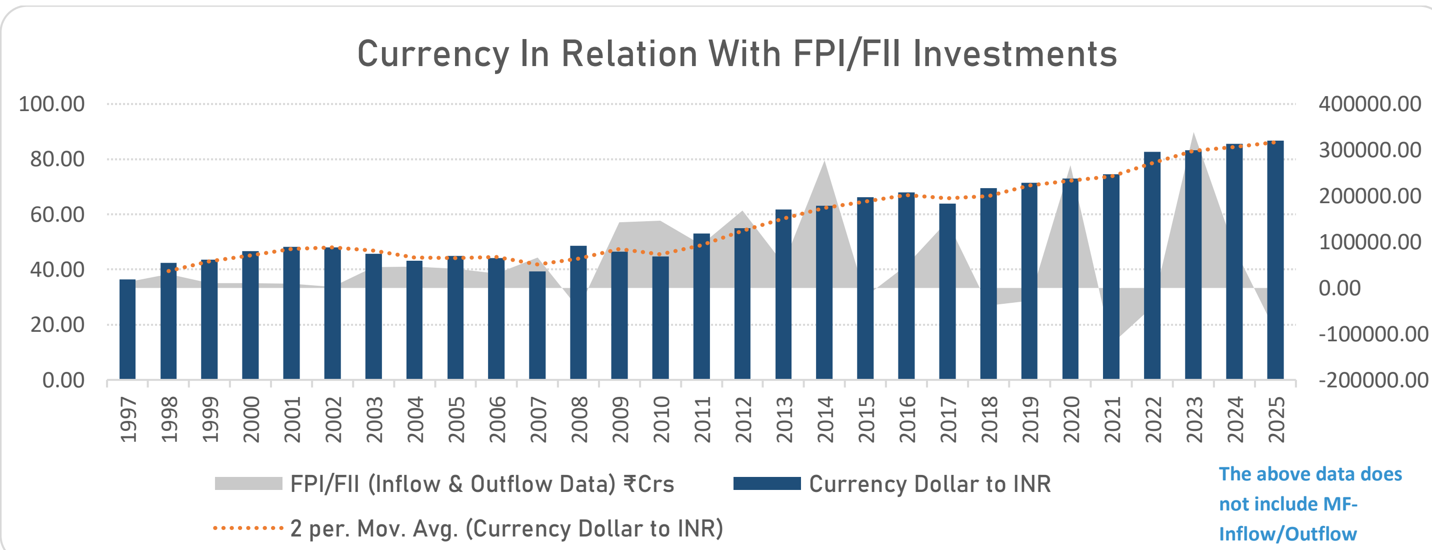


Recent News: President Putin & Trump could meet with each other to discuss about Ukraine War, if settled the energy price would drastically come down giving a further relief in India's Crude oil import bills.

5.) Global Factors:

a.) Risk Appetite: Changes in global economic conditions and policies can affect investor risk appetite. For instance, if the US Federal Reserve raises interest rates, it can lead to capital outflows from emerging markets like India, increasing G-Sec yields.

- Current Situation: **Geopolitical tensions, such as the Russia-Ukraine conflict and China's assertive behaviour.**
- Opportunity: **India's strategic partnerships and growing geopolitical importance provide some stability.**
- Negative Impact: **Can lead to capital outflows from emerging markets like India, increasing G-Sec yields.**



Recent News: **The Indian rupee surged the most in over two years, likely due to strong intervention by the country's central bank.**

- **The currency gained nearly 1%, marking its biggest jump since November 2022, reaching 86.6362 per dollar. The rupee rose to as high as 86.69 in early trading before trimming its gains, up 0.7% from its previous close of 87.4750. The rupee rose to as high as 86.69 in early trading before trimming its gains, up 0.7% from its previous close of 87.4750.**

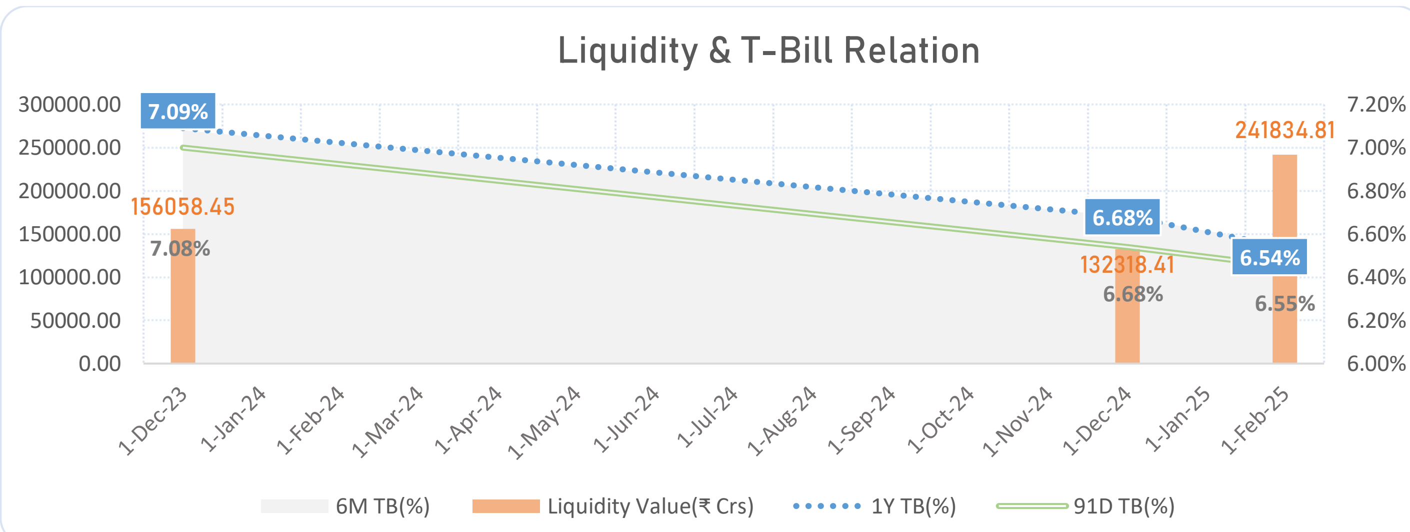
Micro-Economic Factors

1.) Liquidity Conditions:

a.) **Systemic Liquidity: When liquidity in the financial system is abundant, demand for T-Bills is typically strong, leading to lower yields.**

b.) **Narrow Liquidity: Tight liquidity constrains T-Bills demand, increasing yields and funding costs. Without liquidity support, sovereign issuances face weaker absorption, requiring higher rates to clear auctions.**

- **Current Situation:** Liquidity as on 19th Feb Stood at a deficit of Rs 177120.71 Crs.
- **Negative Impact:** Tightening of liquidity could reduce absorption of auctions and push yields higher.



➢ The Liquidity mentioned in above graph seems to be in positive value but it is the deficit which is being inducted by RBI in to the banking system

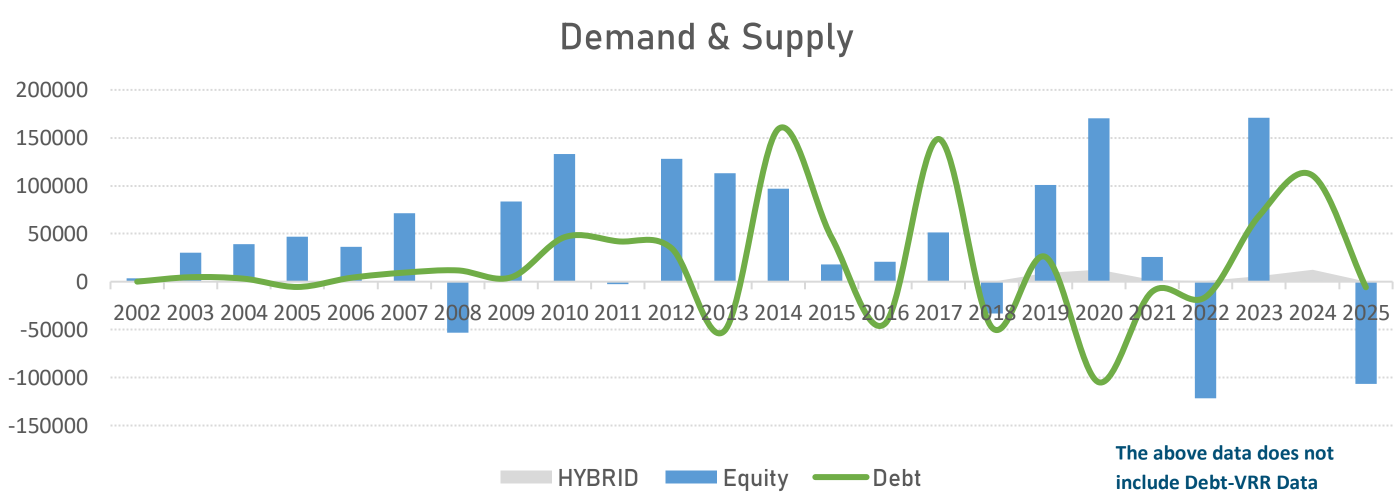
Recent News: **Reserve Bank of India (RBI) will inject a $16 billion liquidity boost into the banking system next week amid tax outflows. RBI has infused around ₹2.68 trillion into the system in the last one-month period.**

- **The central bank has doubled the amount of government securities that the nation aims to buy to $4.61 billion (₹400 billion), based on a review of current and evolving liquidity conditions in India, as per the report.**

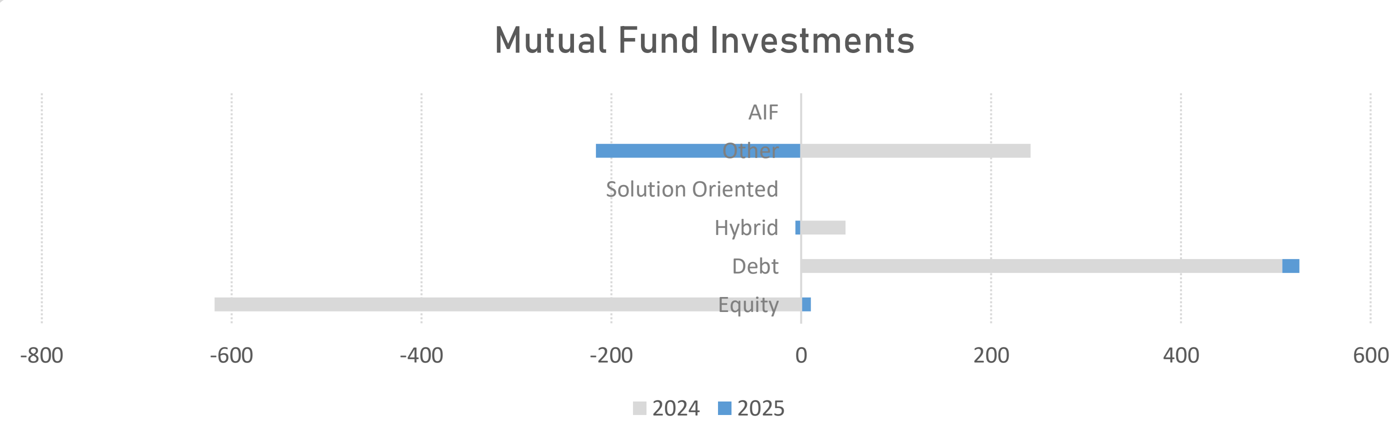
2.) Demand-Supply Dynamics:

a.) Price Movements: **High demand relative to supply drives prices up and yields down, while low demand with high supply leads to lower prices and higher yields. For instance, if the government issues a large number of G-Secs to finance its deficit, the increased supply can push yields higher unless there is sufficient demand to absorb the new issuance.**

- Current Situation: **Balance between issuance of G-Secs and investor demand remains crucial.**
- Negative Impact: **Increased market borrowings by the government could lead to higher yields if demand does not keep pace.**



The above data does not include Debt-VRR Data



Fully Accessible Route: Investments by NRI's In to FAR were 28962 Crs and 15159 Crs in the Year 2024 & 2025(JAN&FEB) respectively.