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THE RUNNING YIELD

WEEKLY REPORT

7th April 2025

Author:
Joydeep Sen

FIXED INCOME WEEKLY REPORT

The Running Yield

Fixed Income | Food For Thought

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INR pullback: Impact on markets

The level of the currency has impact on both equity and bond markets. When the currency is weakening, the landed cost of imports moves up. This is known as imported inflation. E.g. for crude oil, it is not only the import price, but the currency level as well.

Moreover, when INR is weakening at a fast pace, the RBI intervenes to defend. When the RBI supplies USD, it takes away rupee liquidity from the banking system. This leads to banking system liquidity tightness. Net-net a stable currency, or slowly weakening currency, is good for markets

> As we step into the next financial year, liquidity is expected to ease. This will ease money market yields

Summary

On the external front, things are manageable. CAD is estimated around the 1% handle for FY25 and FY26. This is better than much worse levels seen earlier. Forex reserves are USD 658.8 billion as on 28 March 2025.

The RBI has initiated the rate cut cycle in the policy review on 7th February 2025. Fiscal consolidation of the central government has been conducive for the RBI to initiate the rate reduction cycle. Going forward, in the next review meeting on 7th to 9th April 2025, a rate cut is on the cards, depending on variables like inflation.

While the market has priced in part of the gains from rate cut(s), 10-year G-Sec yield being around 6.5%, there are further opportunities. This is on corporate bonds with relatively higher yields and decent credit risk. It is advisable to lock in to higher yields available currently to capture the emerging capital gains potential.

For investments, the following may be considered:
1-year residual maturity AAA rated bonds are available at approx. 7.30% yield levels; 3-year maturity bonds AAA rated are available at approx. 7.40% and 10-year AAA at around 7.40%;

Tax-free AAA PSUs are at 5.20% to 5.35%, depending on maturity;

Our curated bond offers as available from time to time.

> When the currency is weakening, the landed cost of imports moves up. This is known as imported inflation.

> When INR is weakening at a fast pace, the RBI intervenes to defend. When the RBI supplies USD, it takes away rupee liquidity from the banking system.

> CAD is estimated around the 1% handle for FY25 and FY26. This is relatively better than much worse levels seen earlier.

USD-INR 6-month movement

(Source: tradingeconomics.com)

Our currency was impacted since the US presidential election in November 2024. The policies expected to be followed by the new regime led to reduced expectations of rate cut by US Fed, which led to strengthening of DXY. This put pressure of currencies globally.

INR weakened to 87.8 to the greenback on 8th February 2025, the high point in the graph above. Since then, the rupee has pulled back. Currently, it is at 85.49. In the few months prior to that, INR was weakening significantly. This led to concerns in markets, as well as intervention from the RBI in the forex market.

> INR weakened to 87.8 to the greenback on 8th February 2025, the high point in the graph.

REER valuation

Real Effective Exchange Rate (REER) of the Indian Rupee

Item	2022-23	2023-24	2024	2025	
			Feb	Jan	Feb
	1	2	3	4	5
40-Currency Basket (Base: 2015-16=100)					
1 Trade-Weighted					
1.1 NEER	91.20	90.75	91.94	90.88	89.36
1.2 REER	102.78	103.71	104.71	104.84	102.37

(Source: RBI Bulletin 19 Mar 2025)

The general view is that INR has weakened against the USD. However, there is another perspective to it, than conventional measure against the greenback. The level of the rupee is measured against 40 trading partners on a trade weighted basis.

Real effective exchange rate (REER) measures the level of INR, net of inflation, against this basket. As on end of February 2025, it is 102.37, slightly higher than the ballpark 100

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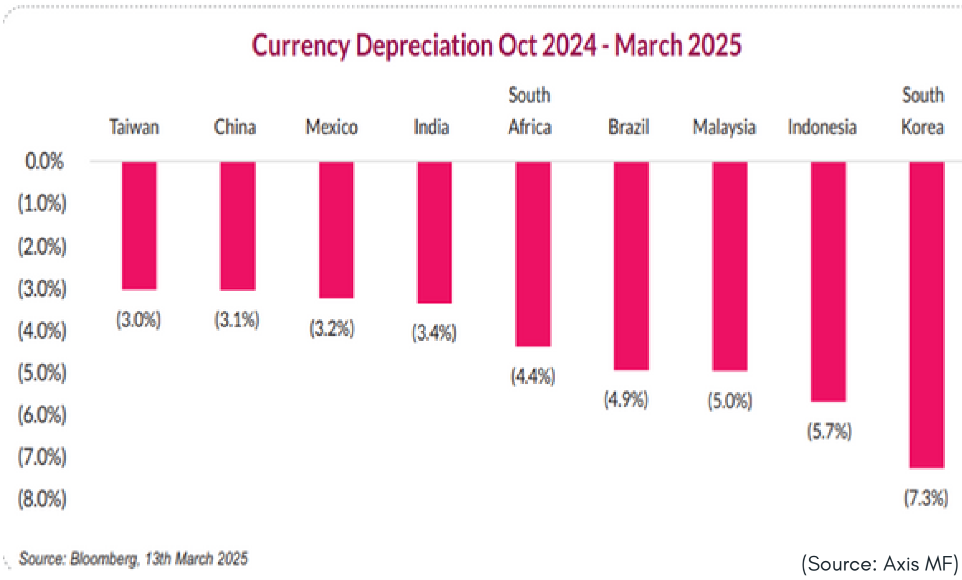
INR relative movement



(Source: Axis MF)

> From October 2024 to 13 March 2025, INR weakened 3.4%.

In the phase of DXY strengthening, while the INR did weaken, there was considerable support. Our external front is in manageable proportions. Hence our currency weakened less than comparable currencies.

As we can see in the chart above, from October 2024 to 13 March 2025, INR weakened 3.4%. In the same period, South Africa weakened 4.4%, Brazil 4.9%. Taiwan and China weakened relatively less, 3% and 3.1%. South Korean Won however gave up 7.3% against the greenback.

This shows relative strength of INR, though with RBI support.

DXY 6-month movement

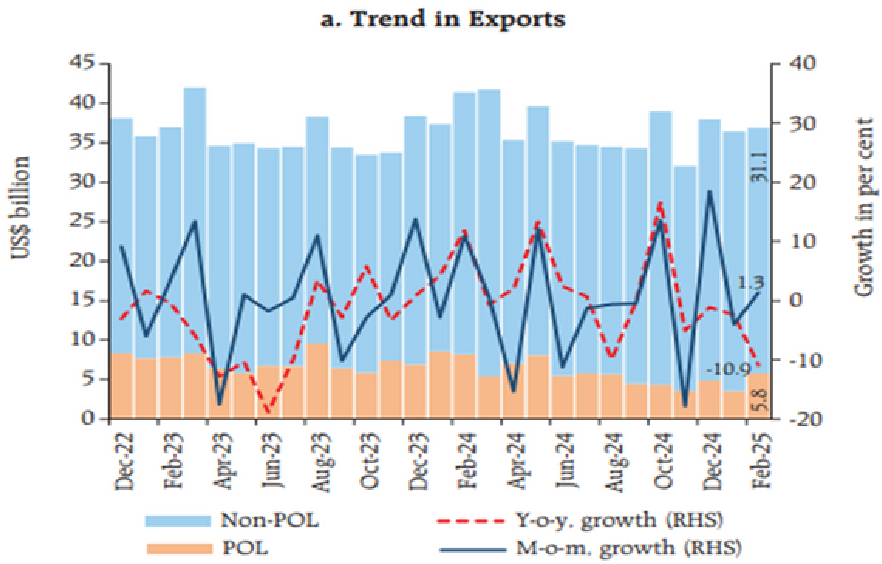
(Source: tradingeconomics.com)

> Easing of DXY has contributed to stability of INR.

Since our currency is measured against the USD, the strength / weakness of the USD is imperative. The level of the greenback is measured against a basket of six globally important currencies e.g. Euro, Yen, etc.

November 2024 onwards, DXY strengthened on reduced expectation of rate cut by US Fed. From 103.4 on 6 November 2024, DXY moved up to 110 in January 2025, the high point in the graph above. From 110 on 13 January 2025, DXY has eased to 102.5 now. Easing of DXY has contributed to stability of INR

Merchandize exports



(Source: RBI Bulletin 19 Mar 2025)

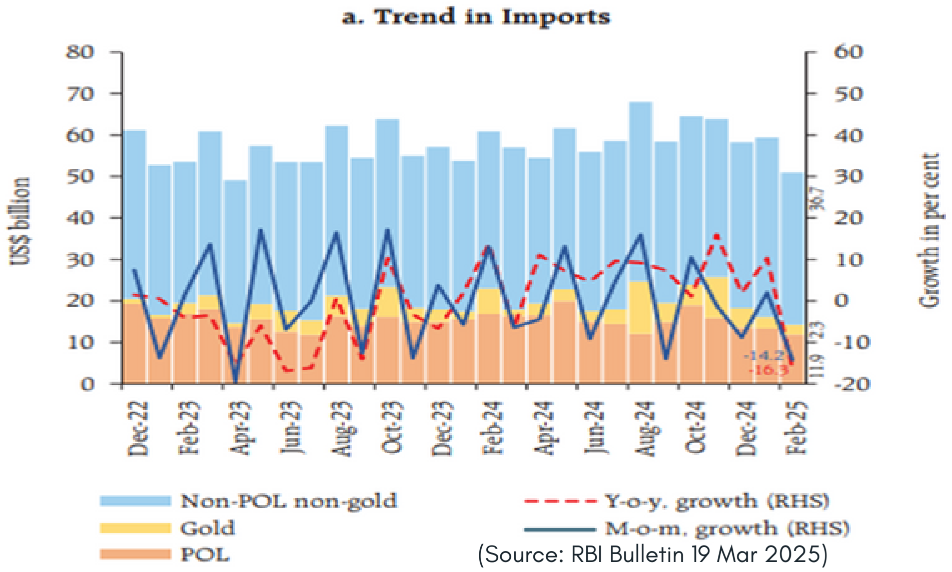
Our external sector influences our currency level. In the graph above, we see our export data. This is merchandize export i.e. apart from services.

The orange shaded portion of the bars represent petroleum (POL) exports and the blue shaded part is other than POL exports. The heights of the bars show exports in USD billion, on the left-hand scale. The red dotted curve shows year-on-year growth of exports, in percent, on the right-hand scale.

From December 2022 to February 2025, though the height of the bars are fluctuating somewhat, broadly, it is maintained. That is, there is no major pressure from the exports front on currency.

> From December 2022 to February 2025, quantum of exports is similar.

Merchandize imports



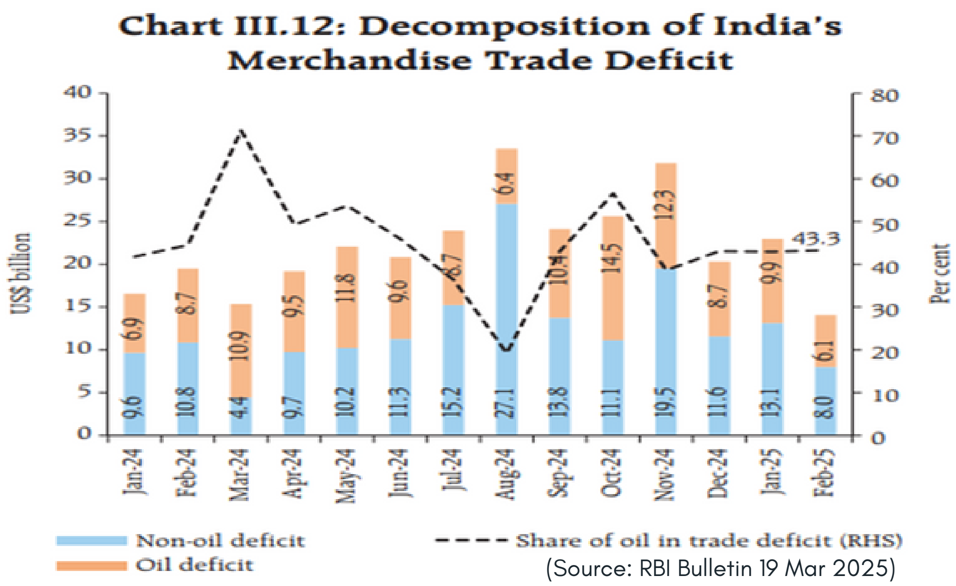
(Source: RBI Bulletin 19 Mar 2025)

> From December 2022 to February 2025, imports have come down.

Next to exports, we look at imports. The orange shaded portion of the bars represent petroleum (POL) imports and the blue shaded part is other than oil and gold imports. The heights of the bars show imports in USD billion, on the left-hand scale. The red dotted curve shows year-on-year growth of imports, in percent, on the right-hand scale.

From December 2022 to February 2025, the height of the bars has come down. Both oil imports and non-oil-non-gold imports have eased. It may happen due to volume coming down, or price coming down, or both. Imports coming down is a positive from the external front perspective.

Merchandize deficit



(Source: RBI Bulletin 19 Mar 2025)

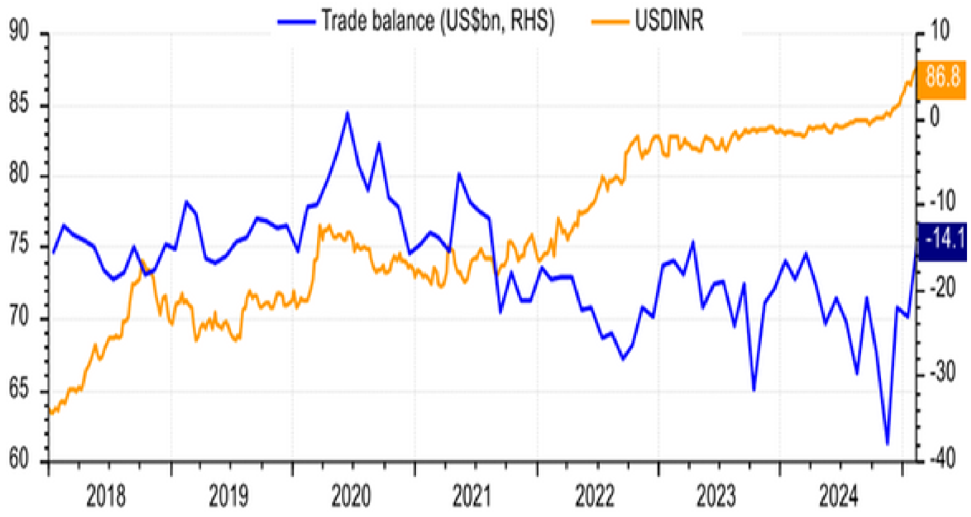
> Trade deficit has eased from USD 33.5 billion in August 2024 to USD 14.1 billion in February 2025.

The summation of merchandize exports and imports is merchandize trade deficit. Lower the deficit, better it is for currency, as it puts less pressure.

In the graph above, the height of the bars represent trade deficit in USD billion, on the left-hand scale. In August 2024, trade deficit was USD 33.5 billion. In February 2025, merchandize deficit has eased to US 14.1 billion.

The black dotted curve shows the share of oil in trade deficit, on the right-hand scale. In August 2024, share of oil in deficit was approx. 20% i.e. non-oil deficit was higher. In February 2025 it is 43.3% i.e. non-oil deficit has come down. In August 2024, non-oil deficit was USD 27.1 billion; in February 2025 it was USD 8 billion

USD-INR and trade balance



(Source: NSE Market Pulse March 2025)

The correlation is obvious. 2020 onwards: weakening INR and dipping trade balance.

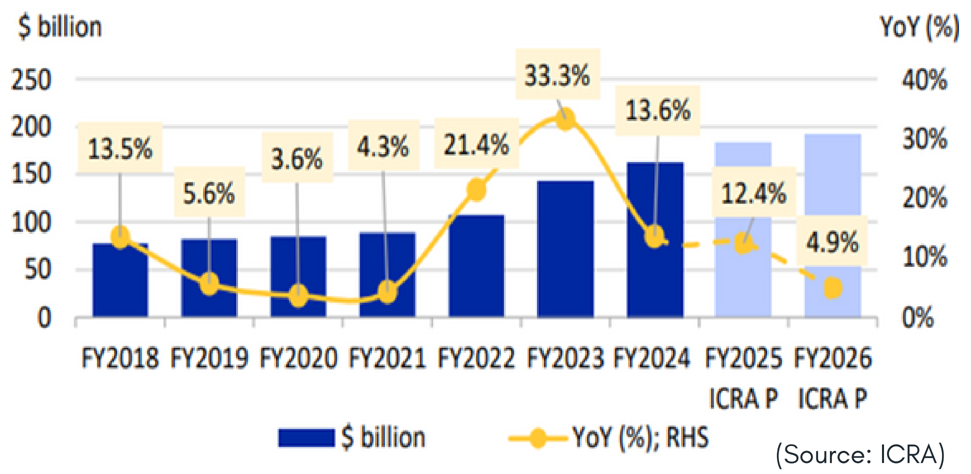
In the graph above, the blue curve shows trade balance, monthly, in USD billion on the right-hand scale. The orange curve shows USD-INR level on the left-hand scale.

In 2020, the blue curve is nudging the zero line, which is an exception. Imports were low as the economy was in lockdown and crude oil prices were low. Since then, it has dipped in the negative zone. There is some pullback, as we can see on the right-hand end of the graph. That apart, trade balance remains in negative zone.

The orange curve has been consistently moving upwards, signifying INR weakness. The correlation is obvious. 2020 onwards, trade balance is deteriorating and INR has been weakening. Hence stable currency or at least less-weakening currency is desirable.

Services trade surplus

EXHIBIT: Annual trends in services trade surplus



(Source: ICRA)

> From FY17 to FY25 (estimate), services trade surplus has grown significantly.

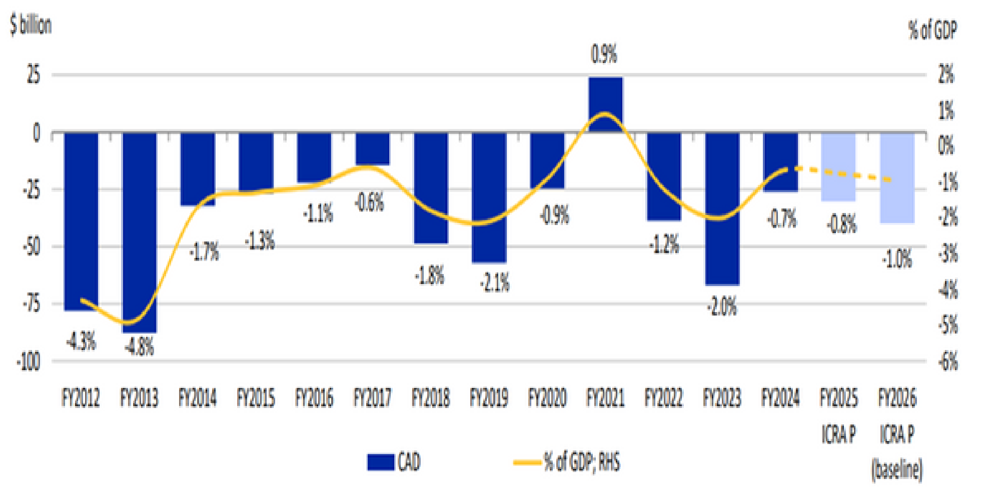
The saving grace on our external front is services trade surplus. This helps mitigate the impact of merchandize trade deficit.

In the graph above, the height of the bars show services trade surplus in USD billion on the left-hand scale. The yellow curve shows year-on-year growth rate, in percentage, on the right-hand scale.

In FY24, services trade surplus was USD 163 billion. In FY25, data for full year is not available yet; it is estimated to grow 12.4%. As we can see in the graph above, from FY17 to FY25 (estimate), it has grown significantly.

CAD projection

EXHIBIT: Trends in India's Current Account Balance



(Source: ICRA)

> CAD, as estimated by the research house, is manageable.

The final metric, after merchandize trade deficit and services surplus, is current account deficit (CAD). As long as CAD is manageable, it does not put pressure on the currency. We usually receive positive flows from FDI and FPI, though FPI flows sometimes turn negative.

In the graph above, the bars show CAD in USD billion on the left-hand scale. The yellow curve shows percentage of GDP, on the right-hand scale.

In FY25, CAD as estimated by the research house, would be 0.8% of GDP and in FY26 it would be 1% of GDP. This is manageable; in FY13 it was 4.8% of GDP and in FY23 it was 2% of GDP.

Forex reserves rundown

2. Foreign Exchange Reserves*

Item	As on Sep. 27, 2024		Variation over					
			Week		End-March 2024		Year	
	₹ Cr.	US$ Mn.	₹ Cr.	US$ Mn.	₹ Cr.	US$ Mn.	₹ Cr.	US$ Mn.
	1	2	3	4	5	6	7	8
1 Total Reserves	**5900138**	**704885**	**114432**	**12588**	**508882**	**58466**	**1017355**	**117977**
1.1 Foreign Currency Assets #	5157443	616154	95529	10468	395599	45204	829319	95918
1.2 Gold	550741	65796	19108	2184	111422	13122	186917	22065
1.3 SDRs	155249	18547	308	8	4025	416	6006	609
1.4 Reserve Position in the IMF	36706	4387	-512	-71	-2163	-275	-4887	-615

2. Foreign Exchange Reserves*

Item	As on March 21, 2025		Variation over					
			Week		End-March 2024		Year	
	₹ Cr.	US$ Mn.	₹ Cr.	US$ Mn.	₹ Cr.	US$ Mn.	₹ Cr.	US$ Mn.
	1	2	3	4	5	6	7	8
1 Total Reserves	**5662867**	**658800**	**-29923**	**4529**	**271611**	**12381**	**303259**	**16168**
1.1 Foreign Currency Assets #	4803678	558856	-44357	1669	41834	-12094	64285	-9408
1.2 Gold	664219	77275	16946	2883	224900	24600	234809	25788
1.3 SDRs	156784	18240	-2110	-22	5561	108	4838	21
1.4 Reserve Position in the IMF	38186	4429	-402	-2	-683	-233	-674	-233

(Source: RBI WSS)

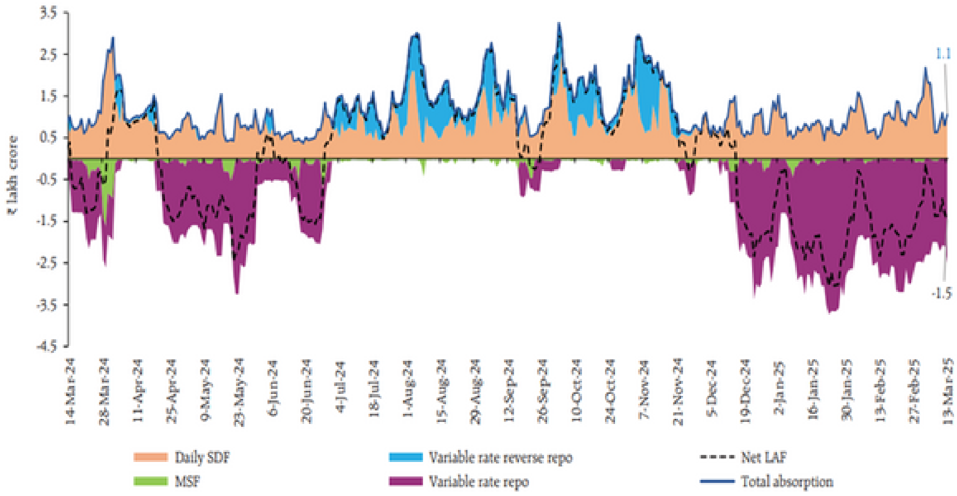
> The unusual reduction in forex reserves implies the RBI intervened significantly.

The weakening of INR November 2024 onwards pushed the RBI to intervene extensively in the forex market. There is no exact data on how much USD was made available by the RBI; we can form a ballpark estimate. This is not an exact measure, as there are multiple inflows and outflows of forex.

As we can see in the table above, as on 27 September 2024, our forex reserves were USD 705 billion. As on 21 March 2025, it is USD 658.8 billion. The reduction from 705 to 658.8 billion includes other outflows like FPI selling in equity, apart from the usual trade-related flows. But we can infer that the RBI intervened significantly, as this much of reduction in forex is unusual.

System liquidity was tight

Chart IV.1: Liquidity Operations



(Source: RBI Bulletin 19 Mar 2025)

When the RBI intervened in the forex market to support INR, by supplying USD, it took away rupee liquidity from the banking system. The banking system liquidity tightness we witnessed, was in spite of CRR cut of 50 bps implemented in December 2024 and multiple liquidity injection measures like variable rate repo (VRR) and OMO purchases.

It is estimated that the liquidity injections measures like OMO purchases, VRR and FX swap deals with Banks have infused upwards of Rs 6 lakh crore. The implication is that the significant tightness in liquidity is due to RBI intervention in the forex market.

In the graph above, the black dotted curve shows the net quantum under liquidity adjustment facility (LAF). It has been in negative zone December 2024 onwards

> Net LAF has been negative December 2024 onwards.

Implication on inflation

moderate. Continued uncertainty in global financial markets coupled with volatility in energy prices and adverse weather events presents upside risks to the inflation trajectory. Taking all these factors into consideration, CPI inflation for 2024-25 is projected at 4.8 per cent with Q4 at 4.4 per cent. Assuming a normal monsoon next year, CPI inflation for 2025-26 is projected at 4.2 per cent with Q1 at 4.5 per cent; Q2 at 4.0 per cent; Q3 at 3.8 per cent; and Q4 at 4.2 per cent (Chart 2). The risks are evenly balanced.

(Source: RBI Policy 7 Feb 2025)

> The favourable movement of INR since February 2025 projection is a mild positive for our inflation.

Another implication of currency level is “imported inflation” i.e. landed price of imported stuff. The weaker the currency, higher is the prices, with consequent impact on inflation.

When the RBI projects inflation, for policy formulation purposes, there are assumptions around crude oil price, exchange rate, etc. For the projections communicated on 7 February 2025, the assumption was around the then prevailing exchange rate.

The favourable movement of INR since then is a mild positive for our inflation, depending on movement going forward. We are calling it mild because the major component of the CPI basket is food.

Conclusion

Current account deficit (CAD) is estimated around the 1% handle for FY25 and FY26. This is relatively better than much worse levels seen earlier. Our forex reserves are USD 658.8 billion as on 21st March 2025

When INR weakens, we get what is known as 'imported inflation' as the landed cost of imports are that much higher. High inflation is bad for both equity and bond markets. However, to put in perspective, during independence in 1947, the exchange rate was somewhere around 1:1. Rupee has depreciated consistently. The returns achieved from equity and debt markets are in spite of INR weakening. That is, it is not a major issue.

"INR has depreciated consistently. The returns achieved from equity and debt markets are in spite of INR weakening.

When rupee depreciation is orderly and gradual, it is absorbed. When it is sudden, referred to as volatility, it impacts market sentiments. The impact may be higher than usual. From that perspective, INR moved from 82.7 in March 2024 to 87.8 to the greenback on 8th February 2025. This was more than usual, 6.1% depreciation. This led to concerns.

"INR moved from 82.7 in March 2024 to 87.8 on 8 February 2025. This was more than usual, 6.1% depreciation.

What we are discussing today is the pullback. From 87.8 on 8th February 2025, it has strengthened to 85.49. This has assuaged the concerns of fast depreciation. There is no need for interest rate defense of the currency. Even after the weakening, it is marginally overvalued as per real effective exchange rate (REER).

"From 87.8 on 8 February 2025, it has strengthened to 85.49.

In REER, the level of the rupee is measured against 40 trading partners on a trade weighted basis. REER measures the level of INR, net of inflation, against this basket. As of the end of February 2025, it is 102.37, slightly higher than the ballpark 100.

On the external front, things are under control. Current account deficit (CAD) is estimated around the 1% handle for FY25 and FY26. This is relatively better than much worse levels seen earlier. Our forex reserves are USD 658.8 billion as on 21st March 2025.

Going forward, the level of USD-INR is anyone's call, but it is expected to be reasonably stable. The rationale is, in the US, rate cut expectations by the Fed are very much there. Hence DXY is not expected to strengthen to any significant extent in the near to medium term. If that be the case, and our external front being under control, INR should be in a range

The implications for the bond market are (a) RBI intervention in the forex market would not be imperative, hence it would not put pressure on banking system liquidity and (b) RBI's inflation projection of 4.2% for FY26 is under certain assumptions like normal monsoon, a certain level of INR etc. – that assumption would be valid.

> RBI intervention in the forex market would not be imperative, hence it would not put pressure on banking system liquidity.

The RBI has initiated the rate cut cycle in the policy review on 7th February 2025. Fiscal consolidation of the central government has been conducive for the RBI to initiate the rate reduction cycle. Going forward, in the next review meeting on 7th to 9th April 2025, the second rate rate cut of this cycle is 'alive'.

While the market has priced in part of the gains from rate cut(s), 10-year G-Sec yield being around 6.5%, there are further opportunities. This is on corporate bonds with relatively higher yields and decent credit risk. It is advisable to lock in to higher yields available currently to capture the emerging capital gains potential.

For investments, the following may be considered:

> RBI's inflation projection of 4.2% for FY26 is under assumptions of a level of INR; that would be valid.

1-year residual maturity AAA rated bonds are available at approx. 7.30% yield levels; 3-year maturity bonds AAA rated are available at approx. 7.40% and 10-year AAA at around 7.40%;

Tax-free AAA PSUs are at 5.20% to 5.35%, depending on maturity;

Our curated bond offers as available from time to time

Contact Us

Talk To Phillip

Report Author

Joydeep Sen | sjoydeep@phillipcapital.in | 9819132553

Business Head

Kunal Kochar | kkochar@phillipcapital.in | 9892864028

Business Development

Sunil Jani | sujani@phillipcapital.in | 8928632577