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LIQUIDITY TRENDS AND G-SEC OUTLOOK

Tight liquidity conditions likely to prevail until July 2024 before Government spending picks up; 10-year yield to trade between 6.80% and 7.15% in H1 FY2025

MAY 2024

Highlights

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Sizeable GoI cash balances, owing to tepid spending during Elections, triggered a cutback in planned T-bill issuance and buyback of G-secs.

An unexpectedly high dividend pay-out by the RBI along with quarter-end tax inflows and likely slow GoI spending until July 2024 would keep GoI cash balances high in the immediate term; systemic liquidity conditions may remain tight.

10-year yield to trade between 6.80-7.15% in remainder of H1 FY2025.

- After a surplus during the April 1-19, 2024, systemic liquidity reverted to a deficit during April 20-May 24, 2024, amid a build-up in the Government of India's (GoI's) cash balances from Rs. 1.1 trillion as on April 5, 2024 to Rs. 1.5 trillion by April 19, 2024 and further to Rs. 2.4 trillion by May 3, 2024. This rise was led by slower spending amid the Model Code of Conduct and the Parliamentary Elections, and healthy GST inflows.
- The GoI's sizeable cash position appears to be the trigger for two recent developments: a cutback in its planned gross Treasury bill issuances for Q1 FY2025 by Rs. 600 billion and announcements of three rounds of buybacks of G-secs worth Rs. 1.6 trillion. Interestingly, the total accepted amount across the three auctions in May 2024 was limited to Rs. 178.5 billion, just 11.2% of the notified amount.
- On May 22, 2024, the RBI announced a surprisingly large dividend pay-out of Rs. 2.11 trillion to the GoI in FY2025 (highest till date; Rs. 0.9 trillion in FY2024). This amount is well above the Rs. 1.5 trillion budgeted for the aggregate dividends and profits for FY2025, which also includes dividends from PSUs (Rs. 0.5 trillion) and is likely to exert upward pressure on the GoI cash balances in the near term, until spending picks up.
- Given the sizeable RBI dividend pay-out and the typical quarter-end tax inflows along with the expectations that the GoI's spending will remain sluggish until the full budget in July 2024, the GoI's cash balances may remain substantial. Consequently, systemic liquidity is likely to remain tight through the next two months, suggesting that the RBI would continue to conduct variable rate repos (VRR) in the near term.
- The windfall arising from the larger-than-budgeted RBI dividend is likely to provide additional leeway of ~Rs. 1.0 trillion to the GoI for enhanced expenditures or a sharper fiscal consolidation than what was pencilled in the Interim Budget for FY2025. The latter would likely imply lower G-sec issuances in H2 FY2025, compared to what was anticipated after the Interim Budget for FY2025, which would augur favourably for bond yields.
- The 10-year G-sec yield has eased by 8 bps in FY2025 so far (till May 27, 2024). ICRA expects the yield to ease further in the run-up to the inclusion of IGBs in the J.P. Morgan Government Bond Index, amid the possibility of a cut in the budgeted market borrowings for FY2025. The yield is likely to trade between 6.80% and 7.15% in the remainder of H1 FY2025, with a hardening close to the upper limit of this range, if the expectations about the timing of rate cuts by the US Fed and MPC are pushed out beyond Q3 FY2025.

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Thank You!