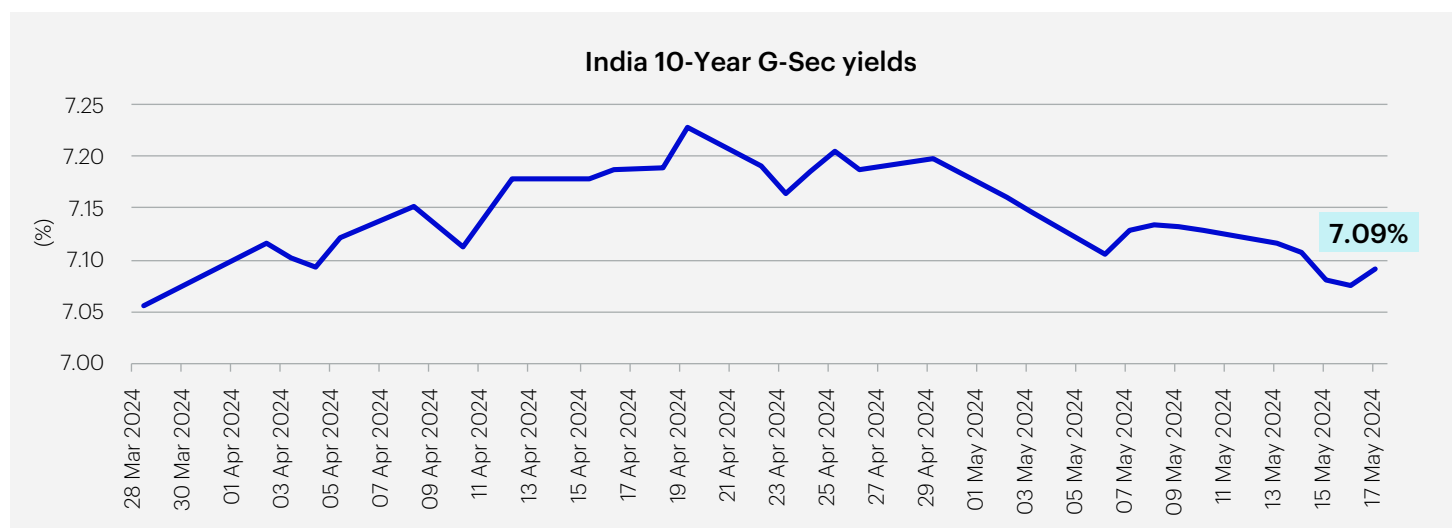


Active duration strategies poised for outperformance in June

As we approach the inclusion of Indian Government Bonds into the JP Morgan Index in just a few days, the conditions are ripe for duration strategies to rally in subsequent months. Although the new financial year has been volatile, with India 10 year G-sec yields peaking at 7.23% due to global macroeconomic uncertainties, currently the pricing is at 7.09% (as on May 17, 2024) compared to 7.05% at the end of March. This is despite the U.S. Treasury yields rising by 22 basis points during the same period, reinforcing our confidence in the domestic market and our belief that Indian duration bonds will outperform their U.S. counterparts.



Source- Bloomberg

Here's a recap of what went by in this financial year and why we feel June could be an inflection point for Indian Bonds and is an **ideal time to invest in Indian Fixed Income products with an active duration strategy.**

Duration supply falls short: Even lower than expected!

The fiscal year 2025 began on a positive note, with the finance minister projecting fiscal deficit at 5.1% for the year. The gross and net supply figures were set at Rs.14,30,000 crore and Rs.11,75,000 crore, respectively. These figures were encouraging, as the market had anticipated much higher numbers before the budget. The RBI added to this positive sentiment by distributing the borrowing in a 53:47 ratio between the first and second halves of the year. A closer look at the monthly gross and net supply of G-Sec, as shown in the table below, reveals that the net supply for June will be only ~Rs. 9,160 crore.

Month-wise G-Sec Borrowing (Rs. Cr.)

Month	Gross	Maturities	Net	Month	Gross	Maturities	Net
Apr-24	1,24,000	0	1,24,000	Jul-24	1,16,000	66,265	49,735
May-24	1,37,000	0	1,37,000	Aug-24	1,40,000	0	1,40,000
Jun-24	1,17,000	1,07,838	9,162	Sep-24	1,16,000	0	1,16,000

Source- RBI

At the beginning of the fiscal year, a notable development occurred when State Governments unveiled extensive auction schedules for the first quarter, forecasting borrowings of Rs.2,54,040 crores during the April-June 2024 period. However, as previously noted, State Governments lack precise clarity on their funding needs, as a significant portion of their revenue comes from the Central Government through tax devolutions. Upon analyzing the borrowing activities of State Governments thus far, it becomes apparent that they have only secured 48% of their originally projected amount. The reduced State Development Loans (SDL) supply bodes well for long-term G-Sec, as they compete with such long-term bonds for investments by Provident and Pension Funds.

The table below provides a breakdown of the variance between the scheduled and actual borrowings by States in auctions.

State Government Borrowing pattern in Q1FY25 so far

Date	Calendar Amount (Rs. Cr.)	Announced Borrowing (Rs. Cr.)	Actual Borrowing (Rs. Cr.)	Actual borrowing as % of Calendar
02-Apr-24	16,100	16,100	16,100	100%
08-Apr-24	21,240	6,500	6,500	31%
16-Apr-24	16,400	1,900	1,900	12%
23-Apr-24	19,000	12,000	12,000	63%
30-Apr-24	25,400	14,700	14,700	58%
07-May-24	23,400	9,900	9,900	42%
14-May-24	15,400	6,500	6,500	42%
21-May-24	14,750	5,200	5,200	35%
Total	1,51,690	72,800	72,800	48%

Source - RBI

Apart from the sovereign supply, corporate borrowers have also remained slow in their borrowing requirements with borrowing numbers tracking almost half of what they borrowed in the similar time last year. Public Sector Undertakings (PSU) which forms the largest part of the active corporate bonds segment have also remained slow in their borrowing so far; borrowing in April 2024 was Rs. 13,443 crores which is 64% of borrowing seen in April 2023. This trend is seen to be continuing in the month of May 2024. Following table outlines those numbers.

Month	Total Supply of Corporate Bonds (Rs. Cr.)		PSU Bond Supply (Rs. Cr.)	
	FY24	FY25	FY24	FY25
April	55,338	28,327	20,976	13,443
May	86,701	36,378*	26,259	11,106*
June	1,02,148	NA	40,731	NA
Total	2,44,187	64,705	87,966	24,549

*Data till week ending May 17, 2024. Source - NSE and BSE

To summarize G-Sec, State Government Securities, and Corporate Bonds supply has surprised on the downside and is anticipated to continue in the coming months. This would limit upside in yields in the event of global volatility as witnessed in last two months.

Demand expected to pick up pace from June

Index Inclusion and FPI flows:

In September 2023, JP Morgan announced the inclusion of Indian Government Bonds (IGBs) into their Bonds indices, scheduled to begin in June 2024. It's understood that many of the larger Foreign Portfolio Investors (FPIs) tracking the JP Morgan Index are now prepared to trade in IGBs, signaling the commencement of flows from June 2024. We anticipate, the commencement of JP Morgan Index inclusion is set to begin in June, with a 1% inclusion rate each month. This inclusion is projected to bring inflows of approximately USD 25 billion over the next 10 months.

Since October 01, 2023 till May 22, 2024, Foreign Portfolio Investments (FPIs) have shown significant interest in the Indian G-Sec market, acquiring Fully Accessible Route (FAR) securities worth approximately Rs. 72,000 crore. Their net buy for the same period stands at Rs. 66,380 crore, suggesting the sale of non-FAR securities.

Top 10 G-Secs purchased by FPIs since October 2023

Security	Amount (Rs. Cr.)
07.18 GS 2033	22,262
07.18 GS 2037	8,785
07.06 GS 2028	7,377
07.37 GS 2028	6,747
07.30 GS 2053	5,906
05.63 GS 2026	4,033
07.38 GS 2027	3,565
06.54 GS 2032	3,470
05.74 GS 2026	2,111
07.32 GS 2030	1,770

Source - CCIL. Data from October 01, 2023 to May 22, 2024

Since January 2024, we have maintained a bullish stance on 10-Year, 14-Year, and 30-Year G-secs. With repo rate currently at the peak of the cycle and favorable macroeconomic backdrop, longer duration securities hold the maximum potential. Moreover, these three securities are typically sought after by long-term investors such as Insurers, Pensions, and Provident Funds. Alongside these significant investors, FPIs have also favored these three securities, ranking them among the top 5 of their purchases. We expect this trend to continue going ahead.

Strong primary as well as secondary demand for G-secs:

There has been a notable surge in demand for Indian Government Bonds, evident in both primary auctions and secondary markets since the beginning of the current fiscal. This demand is emanating from a diverse range of investor classes, reflecting a well-distributed interest.

Analysis of auction data indicates robust demand in each auction, with the bid-to-cover ratio consistently exceeding 3 across different parts of the yield curve. Furthermore, the weighted average cut-off yield for the auctioned papers has been 0.6 basis points better compared to the cut-off yields.

In the secondary markets, we observe substantial buying activity from Mutual Funds, PSU and Private banks, along with long-term investors categorized under "Others." The following tables provide a detailed breakdown of the same:

Participant	Buy (Rs. Crs.)	Sell (Rs. Cr.)	Net (Rs. Cr)
Foreign Bank	2,72,645	2,87,717	-15,072
PSU	2,04,173	1,85,417	18,756
Private Bank	4,43,197	4,28,779	14,418
Mutual Fund	94,621	77,143	17,478
Others	1,61,976	1,32,434	29,542
Primary Dealers	2,38,969	3,04,088	-65,119
Constituent	2,02,875	1,47,217	55,658

Source - CCIL. Data from April 01, 2024 to May 17, 2024.

G-Sec (Rs. Cr.)	Auctioned	Bids Received	Bid-to- Cover
< 10 - Year	46,000	1,42,571	3.10
10-Year	60,000	1,91,717	3.20
15-Year	20,000	62,994	3.15
> 15 - Year	77,000	2,49,209	3.24

Source - RBI. Data from April 01, 2024 to May 17, 2024.

Does high cash balance with Government owing to record dividend payment by RBI and robust tax collections pave the way for reduction in Government borrowing program?

In contrast to seasonal trends, banking liquidity has remained tight since the third week of April. This situation has led RBI to consistently support the banking system through liquidity operations such as Variable Rate Repos (VRRs). Banking liquidity has further worsened as a result of buildup of cash reserves with the Government due to robust tax collections.

Given that it is an election year, with general elections commencing in late April and concluding in the first week of June, the Government is constrained from undertaking any non-routine expenditure, leaving Government cash balances idle.

In response to this scenario, RBI, in consultation with the Government of India, announced buybacks of short-dated government securities maturing in the same financial year. Despite three attempts at such buybacks this month, the market response has been tepid, resulting in failed attempts. Consequently, the Government of India has decided to reduce its T-Bill borrowing program for this quarter by Rs.60,000 crore.

On May 22, 2024, RBI has announced a dividend to Government of Rs. 2.1 lakh crore, with this inflow Government will be sitting with even higher level of cash balance. Will this now trigger reduction in the Government borrowing program through G-Sec?

GOI Buyback (May 09, 2024) Rs. 10,513 cr against Rs. 40,000 cr announced	GOI Buyback (May 16, 2024) Rs. 2,070 cr against Rs. 60,000 cr announced	GOI Buyback (May 21, 2024) Rs. 5,266 cr against Rs. 60,000 cr announced	T-Bill Auction reduction (May 22, 2024) Rs. 60,000 cr in rest of the quarter	Is G-sec Auction reduction next?
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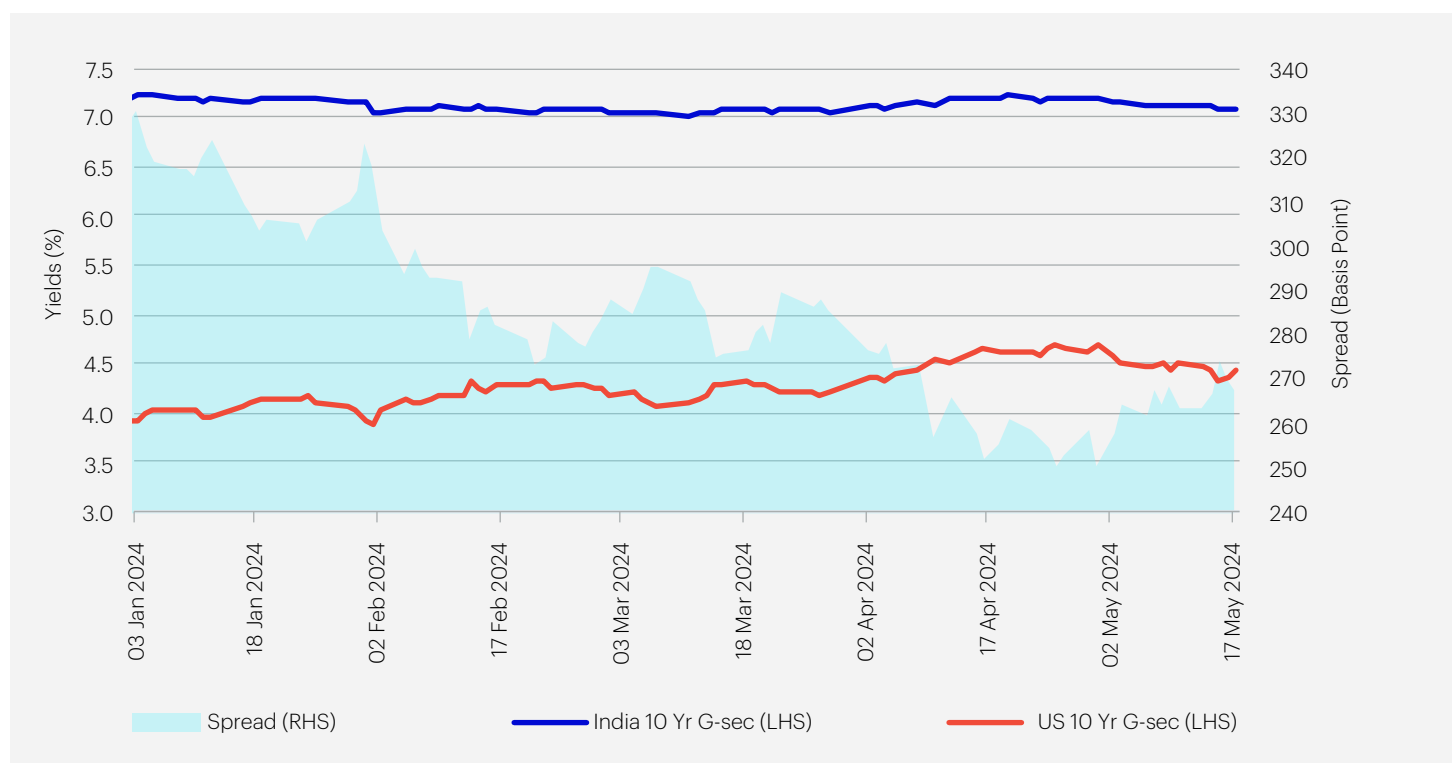
Source - RBI

Indian 10-Year G-sec diverging from the US 10-Year G-sec:

The recent rise in local yields can be primarily attributed to stubborn inflation data from the US and a temporary increase in crude oil prices observed in April. However, domestic macroeconomic indicators have remained robust, with inflation staying within the target band and core inflation reaching lows of 3.2%. Food inflation has consistently been the primary contributor to the headline number.

The stability in domestic macroeconomic factors, contrasted with uncertain global macroeconomic conditions, has led to a divergence in the Indian 10-Year Government bond yields compared to its US counterpart. The accompanying chart illustrates that the spread between US 10 year G-sec and India 10 year G-sec has narrowed from 328 basis points to 267 basis points since the beginning of this calendar year.

This contraction can be attributed partly to stable domestic macroeconomic conditions and partly to the strong demand dynamics in India, as opposed to weaker demand-supply dynamics in the US. In line with the broad street expectations, we anticipate current ruling party to form the Government hence continuing the fiscal consolidation roadmap. Hence, we anticipate that such divergence will persist going forward, particularly as we expect the Government to adhere to a stringent fiscal policy.



Source- Bloomberg

Now is not the time to time the market:

Given the current domestic macro backdrop and robust demand-supply dynamics, we recommend maintaining investments in active duration strategies. In an environment where the upside risk to yields is limited and there are numerous downside opportunities, timing the market is not feasible. For instance, the RBI dividend announced on May 22, 2024, was an unexpected event that triggered a rally in duration. **With just a few trading days left before the eventful month of June begins, staying invested in active duration strategies is advisable.**

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