

US Election is getting interesting with Kamala Harris coming to forefront after Joe Biden backed out. Interestingly, recent polls suggest Trump has 55% winning odds which has reduced from 62% after Biden backed out while Kamala Harris stands at 43% up from 35% a week ago. The Indian financial markets are in focus as the regulator (RBI) announced the revocation of unrestricted access for FPIs to the new issuances of 14-year and 30-year bonds. This led to some correction in bonds even as the Union Budget gave direction to the benchmark bond yields to soften further. Whereas, OMO sales started before the Budget by RBI kept the downward momentum in yields limited which were staying afloat via flows amounting to \$2Bn mark post IGBs index inclusion since 28th Jun-24. In the current week, global central banks (BoJ, BoE and Fed) announcing monetary policy decisions shall decide the fate of the flows.

US Fed in focus post BoJ rate hike:

- Bank of Japan (BoJ) for only the second time in 2 decades, raised interest rates in an attempt to curb rising inflation in the economy. The Japanese Central Bank increased its target policy rate to 0.25%, up from a range of 0 to 0.1%. This rate was last hiked 17 years ago in Mar-2007.
- US FOMC decision due tonight is likely to be a catalyst for markets to price in additional rate cuts. According to CME Group 30-Day Fed Fund futures prices, the likelihood of a 50bps rate cut in September has significantly increased.
- Today’s Fed meet will be watched for additional insights into the monetary policy outlook and its potential impact on the Dollar & US yields. The market is pricing in nearly 3 rate cuts by end of 2024.
- On the political front, with Kamala Harris coming to picture the ground now more intriguing with winning odds moving from 35% to 43% during a weeks’ time. This is in contrast to reduction of winning odds of Trump from 62% (before Biden backed out) to 55%.

Union Budget FY25 presented a fine balance bringing opportunities on the lower end:

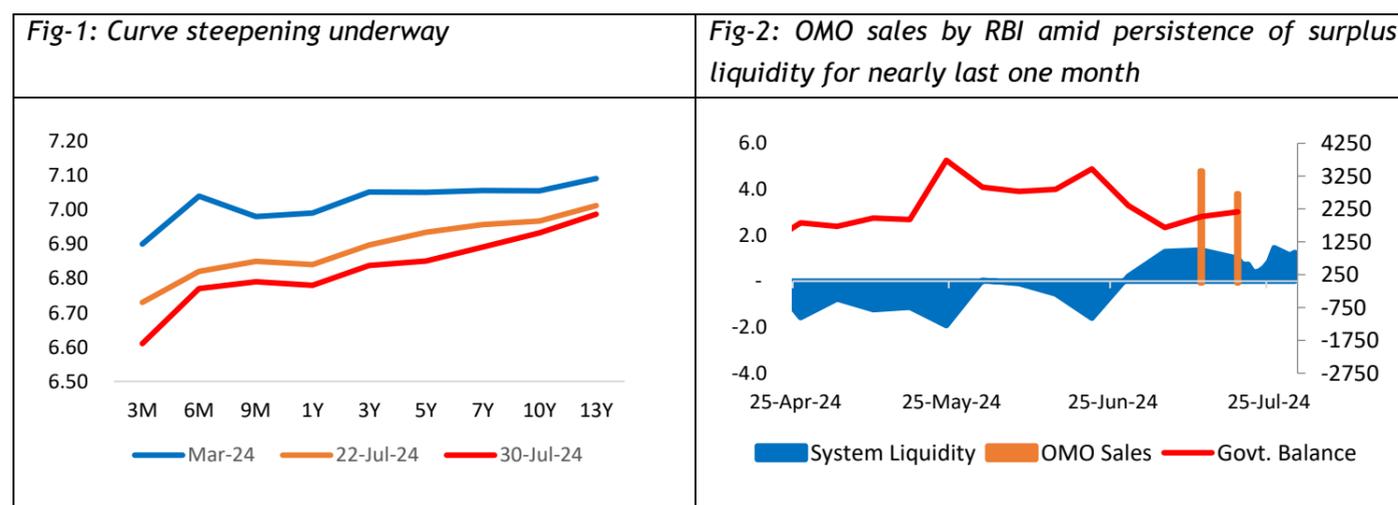
- The most important achievement of this Union Budget FY25 has been the focus on addressing all 3 together - i) macro stability - the sustained focus on fiscal consolidation; ii) financial stability - tax rationalization; and iii) debt sustainability - aim to reduce the government debt to GDP levels to 56.8% in FY25 from 58.1% last year. **(Watch: [Post Budget Fincast](#))**
- The headline FY 25 fiscal deficit number of 4.9% was in line with our expectations which was below market consensus at large.
- The Finance Minister chose to reduce fiscal deficit financing via T-bills reduction rather than dated securities as the bias of favorable demand remained high due to FPIs flows post global bond index inclusion. This choice of reduction in T-Bills borrowing by Rs.1 lakh crore vs interim budget and draw down of government cash balance to the tune of Rs.1.40 lakh crore gave an intricate perspective to the shorter end of the yield curve.
- Post budget, we saw a relative higher softening on the lower end vis-à-vis the longer tenure which is further supported by the FPIs flows in the debt segment (Fig. 1).

Foreign Flows in IGBs FAR securities surpassed \$2Bn mark:

- Foreign investment in Fully Accessible Route (FAR) securities has crossed over \$2Bn mark on 29th Jul 2024 since inception on 28th June. This is in line with the expectations of average inflows of \$2 Bn a month.
- RBI’s decision to withdraw free access to new 14-year and 30-year bonds under the FAR for foreign portfolio investors has received market reaction where the longer end yields have hardened by 3bps while benchmark 10-year witnessed 1 bps rise. Previously, FAR allowed foreign investors unrestricted access to these bonds, but the new measure is expected to redirect inflows towards bonds below 10-year tenor instead.

Liquidity in surplus, RBI market operations surprising the markets:

- As of 30th July, the system liquidity is in surplus, to the tune of Rs.1.25 lakh crore, attributable to higher Government spending on account of budgeted drawdown of cash balance as stated above and seasonal reversal of currency leakage.
- It is to be highlighted here that RBI has conducted OMO sales worth Rs.6,120 Crore during 09th Jul to 19th Jul 2024 (Fig.2). This reminds us of RBI’s announcement on 06th Oct’23 MPC policy about carrying out OMO sales coinciding with high government cash balance at that time. Hence, any announcement related to liquidity in monetary policy meeting next week will be closely watched.



Source: Bloomberg, CEIC, RBI and UBI Research

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