

Emerging Insight

India Strategy – Positive triggers priced-in

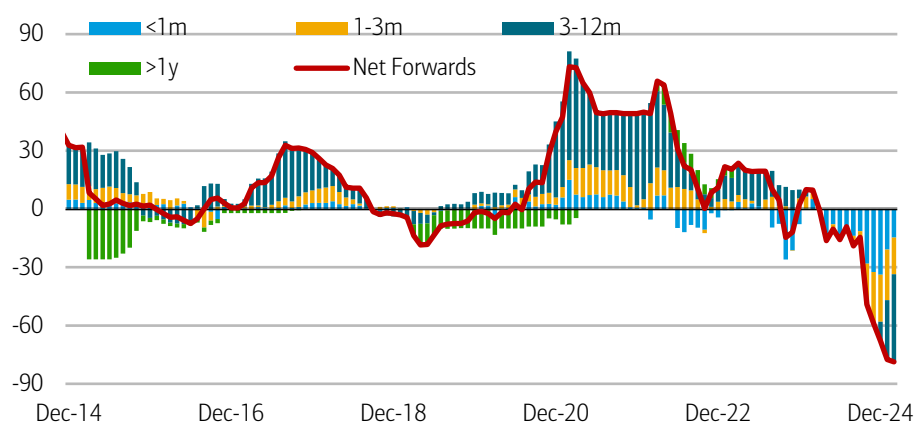
Key takeaways

- Swaps well-priced for further rate-cuts ahead of policy meeting next week, raising the bar for a dovish surprise.
- Bonds rallied on liquidity injections via OMOs and lower issuance; consolidation likely before resuming grind lower.
- INR - FY end seasonality behind us; tariff headline risk ahead; RBI forward position unwind possible but much lesser extent.

By Abhay Gupta

Exhibit of the day: Composition of RBI's short-USD forward position shifted to longer tenors

RBI's forward book split by tenors (USD Bn) as end-Feb'25



Source: BofA Global Research, Bloomberg

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India in Focus

IGBs have rallied as further easing in the upcoming policy meeting was priced into the curve. Large-scale liquidity injections via OMO purchases and FX swaps have supported bond demand, along with lower issuance plan. With swaps pricing-in almost 3x cuts, the bar for further dovish surprise has increased. We believe some consolidation is warranted around current levels before bond yields resuming a grind lower. INR's 1Q seasonality played-out well in March due to position unwind, improvement in trade data and EUR strength easing valuation concerns. Near-term risks from potential reserve accumulation remains but to a much-lesser extent after rollover of RBI's short forward USD positions to longer-tenors.

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For a full list of our open trade recommendations, as well as our trade recommendations closed over the past 12 months, please see [Global Emerging Markets Weekly: US exceptional downturn 20 March 2025](#)

Glossary:

CA: Current account

EM: Emerging markets

FDI: Foreign direct investment

FY: Fiscal year

IGB: Indian government INR bond

NDOIS: Non-deliverable overnight indexed swap

NEER: Nominal effective exchange rate

OMO: Open market operations

RBI: Reserve Bank of India

REER: Real effective exchange rate

SDL: State development loans

India – Positive triggers priced-in

IGB 10y has rallied towards our end-2025 forecast of 6.5% which was based on expectations of further easing to be priced-in the curve. We expect yields to continue grind lower over this year with more room for 5y due to relatively flat curve. But with most of the positive triggers priced-in, near-term consolidation is warranted before yields resume a grind lower. If growth fails to pick-up or downside risks increase, that could act as the next catalyst for bonds to rally further.

Bonds rallied on rate-cut expectations

While swaps have priced close to 3x cuts over next one year with some chance of terminal rate approaching 5.5%, bonds can continue to grind lower as easing is delivered. The market appears well-placed for the upcoming April policy meeting where consensus expects a 25bps cut to 6%. The bar for RBI to surprise more dovishly in this meeting is higher now which could limit the market reaction for now.

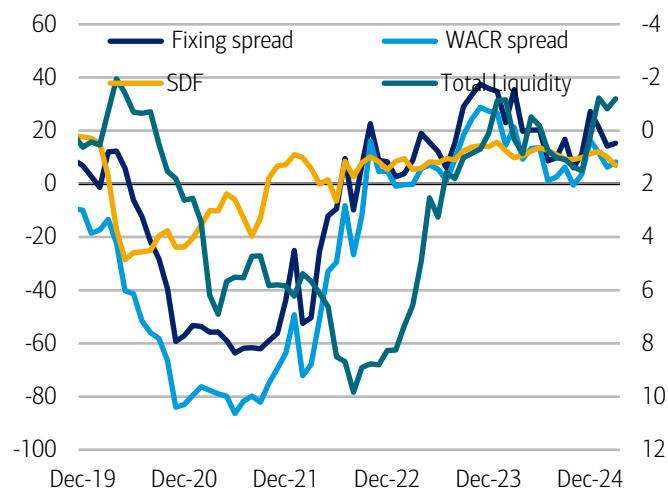
Along with large OMOs purchases this quarter

During the last policy meeting in February, the market was disappointed in RBI's retention of the neutral policy stance even as it delivered the rate cut. Since then, RBI has been actively injecting large amounts to liquidity to ease money market rates. Despite a seasonally high liquidity requirement in Mar'25 keeping average deficit at INR 1.2Tn, RBI brought durable liquidity to neutral by the end of the month (See Exhibit 1).

Liquidity tends to ease from May as outflows from currency leakage return to the system and April-September period sees a net liquidity improvement on quarterly basis (See Exhibit 2). After having done OMO purchases of INR 2.4Tn over 1Q, the need for further OMOs to inject durable liquidity has reduced unless RBI wishes to maintain a surplus system liquidity.

Exhibit 1: Durable liquidity shortage in March addressed by RBI

Fixing and WACR (Weighted average call rate) spreads over policy rate (%), lhs). SDF (standing deposit facility) and total liquidity operations monthly average (INR Tn, rhs, inverted).

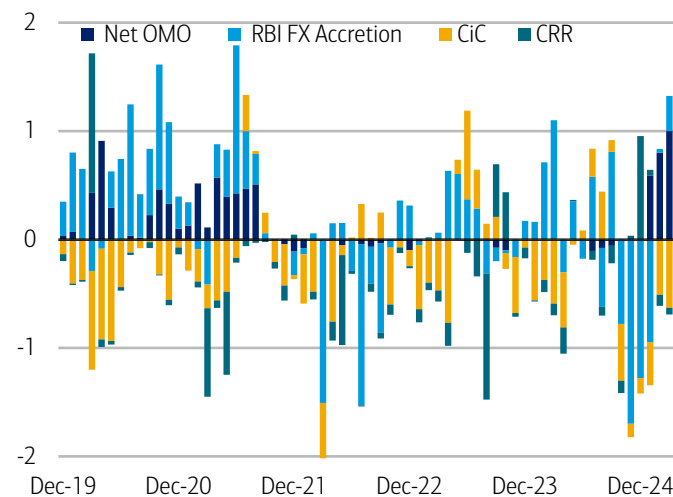


Source: BofA Global Research, Bloomberg

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Exhibit 2: Injections likely from OMOs driving liquidity

Net monthly liquidity injection from OMO (Open market operations), FX accretion, CiC (currency) and CRR (Cash reserve ratio) (INR Tn)



Source: BofA Global Research, Bloomberg

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... while avoiding the drain from FX

FX accumulation has been the key instrument for injection of durable liquidity over the last few years but that trend reversed since 2H24 due to RBI's reserves drawdown. With recently announced FX swap auctions to inject over USD 35Bn, RBI has stalled that trend and sterilized the net absorption due to FX intervention.



Amid benign supply outlook in 1HFY26

Government announced a relatively benign supply outlook for 1H of FY26 with only INR 8Tn issuance, indicating a lesser extent of front-loading of issuance vs usual 60%. As highlighted previously, issuance for FY26 was quite well-contained (See [Emerging Insight: India – Bonds supported by monetary policy pivot 10 February 2025](#)). While this helps support the bonds at the start of the FY when banks' demand for bonds is seasonally strong, the risk of higher issuance in 2H FY26 remains.

And stabilization in INR supporting debt inflows

INR stabilization brought debt inflows which were earlier discouraged by high FX hedging costs. With end of passive index inclusion related flows last month, the hurdle for debt flows to beat last FY mark is high. But INR's stable carry profile and monetary policy cycle would attract more active flows. Moreover, RBI's OMOs would more than make-up for these flows as bond purchases become the primary channel of reserve money injection.

INR – Seasonality over; headline risks near-term

Favorable 1Q seasonality played out in March

INR's 1Q seasonality played-out well over March as CAD improved even more-than-usual due to lower oil prices, normalization of gold imports and strong services exports. YTD trade deficit across goods and services, as of Feb'25, has declined to USD 2Bn compared to USD 9Bn all of 1Q'24 when India posted a CA surplus of USD 4.6Bn. Stronger remittance flows since then point towards flattish or possibly surplus CA this quarter. However, the seasonality begins to reverse from 1Q when CA tends to widen.

Further accentuated by unwinding of bearish positions

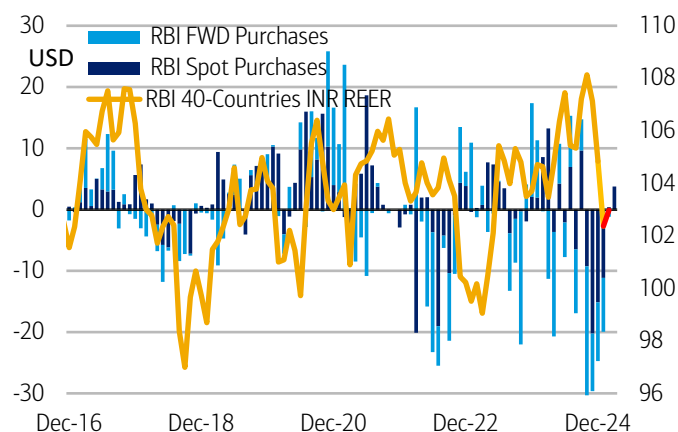
Unwinding of bearish INR positions likely made the move sharper as exporters likely rushed to hedge closer to the fiscal year-end. The reversal in equity flows during March and possible unwinding of FX hedges by debt investors added to the momentum.

Valuation concerns in check due to EUR strength

RBI's REER measure shows that INR's valuation corrected earlier this year (See Exhibit 3). INR's lower volatility and beta to USD moves usually leads to a decline in INR NEER when USD is weakening. Even as Asia complex has not responded as well to the EUR strength in March, it has still kept INR valuation concerns in check despite INR's appreciation vs USD.

Exhibit 3: INR valuation concerns in check due to EUR strength

RBI's estimated monthly spot and forward USD purchases (USD Bn, lhs) and RBI's 40-country INR REER (rhs)

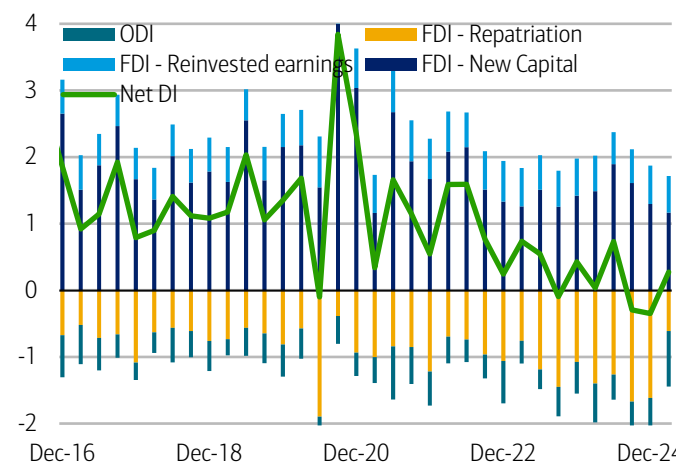


Source: BofA Global Research, RBI, Bloomberg

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Exhibit 4: FDI still weak while outflows have increased

Net DI and breakdown of FDI and ODI (% of GDP)



Source: BofA Global Research, RBI, Bloomberg

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Now turning to near-term tariff headline risks

While there are ongoing negotiations with the US, the recent guidance indicates possibility of first tranche of an agreement in 4Q. Any near-term relief on reciprocal tariffs looks less likely as India screens unfavorably on tariff differentials with the US, despite recent concessions. While medium-term impact may be limited, the headline risks from tariff announcements remains.

And headwinds from reserves accumulation, albeit much smaller now

RBI's overall forward short positions remained relatively stable at USD -79Bn as of end-Feb'25 vs USD -78Bn in Jan'25. However, the composition has shifted further towards longer tenors with USD -45bn positions in 3m-12m bucket. During Mar'25, an additional USD 30Bn were rolled into 3y tenor using FX swap auctions, bringing the total to USD 75Bn in longer-tenors. During 2020-2021, the large positive forward book in longer-tenors was utilized to absorb banking liquidity. Similarly, RBI can maintain short positions for longer to sterilize intervention which reduces the risk of near-term unwind.

While FDI flows still remain weak

Net direct investment flows (DI) registered a USD -6.3Bn deficit in 2H24 due to both slower FDI and larger outward DI flows over the last few years (See Exhibit 4). While growth is beginning to stabilize recently, much more improvement in the FDI trends would be needed to turn basic balance back into a surplus going ahead.

Offshore yields likely to stay elevated

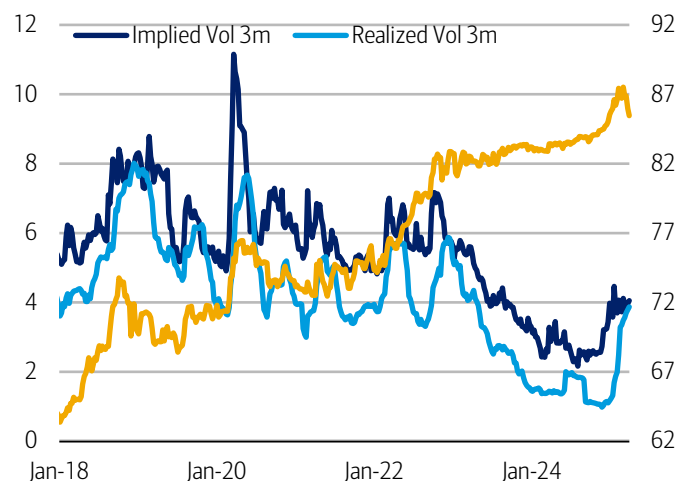
We expect NDF yields to stay elevated as the supply of forward USD sales dwindles and even more so in the offshore market. RBI has shown a greater tolerance towards higher FX implied yields to raise hedging costs and defend INR during market turmoil. Paid positions in front-end NDF points could offer low-cost hedge against INR weakness.

Volatility normalization to continue

Volatility levels have normalized towards lower-end of the last 10 years' range (See Exhibit 5). We expect volatility to pick-up further as RBI takes a more hands-off approach on daily-basis as visible in restoration of INR's correlation to portfolio flows recently (See Exhibit 6). RBI smoothing is only likely on signs of excessive speculative positions and one-way moves. Going back to historical implied volatility levels around 6-7% is feasible while still being within tolerance for RBI at 35-40bps daily volatility.

Exhibit 5: Volatility has normalized but is still low

USDINR level and implied and realized volatility on 3-month tenor

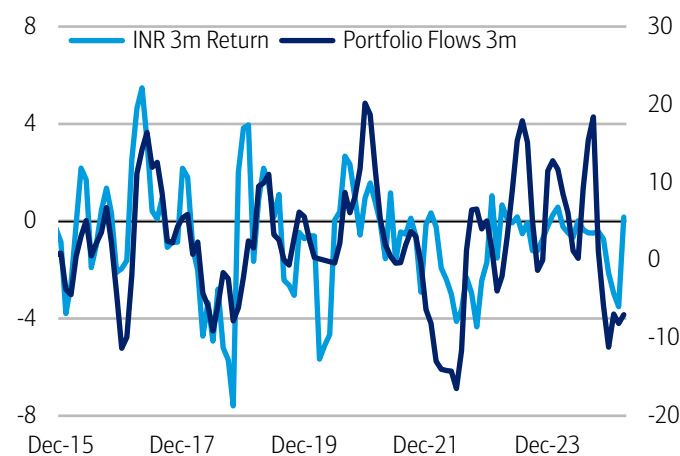


Source: BofA Global Research, Bloomberg

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Exhibit 6: Correlation to portfolio flows restored

INR 3m returns (%), lhs and portfolio flows into India (USD Bn, rhs) as of Mar'25



Source: BofA Global Research, Bloomberg

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News and Views

Mexico: Consumer credit rose 14.3% in February

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Total financing in Mexico as of February (both performing and non-performing loans) increased 7.3% yoy in real terms (vs 5.3% last year and 9.0% last month). Performing loans to the private sector rose 9.7% yoy in real terms (vs 5.6% last year and 10.1% last month) mainly due to consumer credit at 14.3% yoy (vs 11.1% last year and 14.6% last month). The monetary base rose 3.2% yoy in real terms (vs 9.3% last year and 6.6% last month), while M1 rose 4.5% yoy in real terms (vs 7.1% last year and 7.1% last month).

- **To follow:** High consumer credit growth will continue to support private consumption, which is likely to [outpace GDP growth in 2025](#) (see report).

Mexico: Remittances fell -0.8% yoy in February

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Remittances in February surprised to the downside at US\$4.4bn (E. US\$4.6bn, BofA US\$4.4bn). In annual terms, remittances fell -0.8% yoy (vs +1.9% in January; +3.4% last year). The number of remittances fell -0.2% yoy (vs +2.9% in January; +1.2% last year) while the average remittance fell -0.5% yoy (vs -1.0% in January; +2.1% last year) to US\$381. In MXN, remittances increased 18.7% yoy (vs 22.5% in January; -5.0% last year). Year to date, remittances totaled US\$9.1bn (+0.6% ytd) or MXN\$187.0bn (+20.7% ytd).

- **To follow:** Despite the fall in USD terms, remittances keep growing in MXN terms, which will likely continue to support [consumption](#) (see report).

Mexico: Banxico survey shows analysts expect growth in 2025 at 0.5%

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Banxico's survey of professional forecasters shows that consensus (median) cut its GDP growth forecast for 2025 to 0.5% from 0.8% a month ago, as well as its forecast for 2026 to 1.6% from 1.7% a month ago. Another notable change is the expectation of one more 25bp cut this year, with a terminal rate of 8.00% (8.25% before).

- **To follow:** Consensus continues to downgrade its growth expectation for 2025 and we believe it will eventually converge to our forecast of zero growth in 2025%, as the economy continues to show signs of weakness, uncertainty affects investment decisions and tariffs disrupt trade relations between Mexico and the US. We expect Banxico to cut to 8.00% this year as well, with downside risks.

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