Indian bonds may not be impacted much by downgrade of US credit ratings, say experts

Dealers expect the benchmark bond yield to range between 7.15 percent and 7.20 percent.

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Government bonds

Indian bonds are unlikely to face much of an impact from Fitch ratings downgrading the US' sovereign credit grade by one level from AAA to AA+, as this is already well discounted by the market, experts said. US inflation, the budget deficit and higher yield on US treasuries is already discounted by the traders and investors in the Indian market, they added. The focus is more on Indian inflation and monetary policy decisions, the dealers said.

"The underlying environment is already well discounted by the market and may not have much impact going ahead," said Mahendra Kumar Jajoo, Chief Investment Officer – Fixed Income at Mirae Asset Investment Managers (India).

Further, Venkatakrishnan Srinivasan, founder and managing partner, Rockfort Fincorp, said there could be some short-term impact in Indian Markets, too, but the volatility may be shortlived as "our bond market is now more focussed on our MPC policy and inflation projections".

Srinivasan added that market traders opine that there won't be any pressure on US treasury investors to sell their stock as the majority of the investors have recently moved to US treasuries, considering them a safe haven when 1-2 of their banks went bankrupt. "Hence, we don't foresee any major impact on Indian government bonds due to this downgrade," he said.

According to the Bloomberg report, Fitch Ratings downgraded the US' sovereign credit grade by one level due to "ballooning fiscal deficits and erosion of governance", which have led to repeated debt limit emergencies over the past two decades.

The yield on the 10-year benchmark 7.26 percent bond opened marginally higher than its previous close, but is currently trading at 7.1567 percent. On August 1, the benchmark bond yield closed at 7.16 percent.

Why did Fitch downgrade the US' ratings?

The ratings agency cited the likely increase in the US fiscal deficit over the next three years, elevated and rising public debt levels, as well as weak governance as key reasons for the downgrade.

The Fitch downgrade echoes a similar move by Standard & Poor's Global Ratings in 2011 due to the government's borrowing limit, as per an Associated Press report. The standoff then had raised the US Treasury's borrowing costs by $1.3 billion that year, as per a 2012 report by the Government Accountability Office.

"Tax cuts and new spending initiatives coupled with multiple economic shocks have swelled budget deficits, while medium-term challenges related to rising entitlement costs remain largely unaddressed. The rating downgrade of the United States reflects the expected fiscal deterioration over the next three years, a high and growing general government debt burden, and the erosion of governance relative to 'AA' and 'AAA' rated peers over the last two decades," Fitch said in a statement.

Will bond yields move higher from here?

According to the experts, the yield on Indian bonds may rise a bit in the coming days if there is any major impact on the US treasury yields.

"What actually may happen in the coming time is that yields in the US may stay elevated for long and that's likely to affect global bond issuances by Indian names," said Ajay Manglunia, Managing Director, JM Financial.

In the last two months, the 10-year benchmark bond yield rose around 17 basis points (bps) due to the uptick in US Treasury yields, rising crude oil prices, domestic and international cues, dealers said.

Going ahead, dealers expect the benchmark bond yield to range between 7.15 percent and 7.20 percent.

The new benchmark, which is expected to be announced in the next week, will also attract a similar coupon, between 7.15 percent and 7.20 percent.

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