GILTS MARKET UPDATE

January 2, 2023

(19/12/2022 – 23/12/2022) All major triggers such as central bank policy announcements and inflation data are behind us, and nothing major is expected till the end of December, so traders largely remained on the sidelines and volumes were also low.

On Tuesday, the Bank of Japan said it has widened the band in which it allows the 10-year bond to move up to 0.50% from 0.25% previously, in an unexpected hawkish tweak to policy. Japan's central bank said the policy board decided unanimously to review the operation of its yield curve control, which pins short-term yields at - 0.1% and the long-term yield around zero. U.S. Treasury prices fell after this decision with the 10-year yield US10YT jumping by 12 basis points to 3.70%.

10 year 7.26% G Sec 2032 yields rose for the week after the RBI highlighted inflation concerns in its MPC Minutes of the December 2022 meeting and said a premature pause in monetary policy action would be a costly error at this juncture.

The benchmark 10-year 7.26% GS 2032 closed at 7.32 % as against the previous week (Friday – December 16, 2022) closing of 7.28%

Government Securities – Secondary Market Yields

	December 23, 2022	December 30, 2022
2 Years	6.94	6.96
5 Years	7.23	7.19
10 Years	7.32	7.33
14 Years	7.43	7.43
29 Years	7.43	7.42

Government Securities - Primary Market Auction Cut Off (Yields & Price)

December 23, 2022				December 30, 2022			
Nomenclature	Notified Amount	Cut Off (Yield)	Cut Off (Price)	Nomenclature	Notified Amount	Cut Off (Yield)	Cut Off (Price)
7.38% GS 2027	7000	7.2283	100.57	6.69% GS 2024	4000	6.9769	99.60
7.26% GS 2032	12000	7.3179	99.59	7.10% GS 2029	6000	7.3282	98.85
7.36% GS 2052	9000	7.4681	98.70	7.41% GS 2036	11000	7.4269	99.85
				7.40% GS 2062	9000	7.4698	99.10

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(26/12/2022 – 30/12/2022): G Sec yields ended marginally up on very low-volumes on Monday as most market participants remained on the sidelines ahead of the end of the calendar year. Yields were marginally higher earlier in the day as the 10-year U.S. yield rose to 3.75% for the first time in nearly four weeks on bets of more rate hikes by the Fed in 2023, while the benchmark Brent crude gained 10% in the last two weeks, most recently as Russia said it could cut crude output. 10 year 7.26% G Sec 2032 yields ended marginally lower by 1 basis on Tuesday after staying steady for the last two days, as the SDL auction had strong demand in the bidding, though volumes were shallow as a majority of the traders stayed on the sidelines. The 10 year 7.26% G Sec 2032 yields ended marginally higher up by 1 bps on Wednesday tracking the rise in U.S. yields, while market trading volumes were low, with most traders staying on the sidelines ahead of the quarter-end.

Many factors like crude oil, U.S. yields, global central banks financial tightening and the concerns of higher spending in the upcoming budget will continue to weaken the appetite for G Secs and yields can see an upside bias in the near term. The trading activity was low and dull with the benchmark 10 year 7.26% G Sec 2032 trading in a very narrow range in the remaining two trading days of the week.

The benchmark 7.26% GS 2032 yield ended at 7.33%, 1 basis higher than the closing on last weekend (December 23, 2022)

State Government Securities

SDL - Primary Market Auction Cut off (Range - Yields)		
	December 20, 2022	**December 27, 2022**
2 Years	--	--
5 Years	**7.49**	--
10 Years	**7.60 – 7.65**	**7.60 – 7.63**
15 Years	**7.67**	**7.69 – 7.70**
20 Years	**--**	--

SDL - Secondary Market (Range Yields)		
	December 23, 2022	**December 30, 2022**
2 Years	**--**	**--**
5 Years	**7.34 – 7.40**	**--**
10 Years	**7.57 – 7.63**	**7.57 – 7.58**
15 Years	**7.66**	**7.63 – 7.64**
20 Years	**--**	**--**

Tracker

Trackers	**December 23, 2022**	**December 30, 2022**
Average Call Rate (%)	**6.46**	**6.34**
Net Banking System liquidity - Deficit (-) Surplus(+) (Rs Crs)	**-31,745**	**10,145**
Bank Deposit Growth (%)	**9.90**	**9.40**
Bank Credit Growth (%)	**17.50**	**17.40**

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CPI (%)	**5.88**	**5.88**
Core Inflation (%)	**6.00**	**6.00**
WPI Inflation (%)	**5.85**	**5.85**
Nifty	**17,806**	**18,105**
Sensex	**59,845**	**60,840**
Re/US$	**82.78**	**82.72**
FPI Investments (US$ Bln) (Figures cumulative for Debt & Equity – Current FY)	**(-2.593)**	**(-2.489)**
Foreign Exchange Reserves (US$ Bln)	**563.50**	**562.81**
Gold/10 gm (Rs)	**55,925**	**56,300**
Gold/Oz (US$)	**1797.91**	**1824.40**
Crude Oil - Brent (US$/bbl)	**83.97**	**85.91**
2 Yr USA - Treasuries	**4.33**	**4.43**
10 Yr USA - Treasuries	**3.75**	**3.88**

The biggest headwind that still remains is that of inflation because the latest Consumer price inflation data shows that while the headline is showing a visible trend line decline, the core inflation still remains to be sticky.

The persistent stickiness in core inflation, which is elevated at 6% remains the major risk to the headline. This was amply pointed out by the RBI governor in his December statement. Sticky core inflation is partly due to pass through of elevated input prices to consumers. Despite wholesale input prices coming down since last quarter, wholesale output prices remain elevated implying the passthrough to retail prices will continue if demand continues to recover.

Core inflation remains the biggest worry as producers continue to pass on the elevated input prices to the consumers. Core inflation has remained sticky around 6% for the last one year or so. While supply related inflationary pressures are likely to reverse as the bottlenecks have eased, core inflation becomes difficult to reverse as it gets entrenched in the system.

CPI inflation is likely to move below 6% by the end of FY23, it can be a difficult task to move it to the target of 4%. RBI said it cannot afford to prematurely pause its rate-tightening cycle, with inflation staying above the central bank's tolerance limit and core inflation remaining sharply elevated.

The industrial sector faces a grim external outlook as aggressive rate hikes and elevated inflation hit growth in major advanced economies and global demand. This can put pressure on the rupee and also due to how the crude oil prices emerge.

Domestic demand indicators are showing resilience, with bounce back in sectors like travel, tourism and hospitality supported by pent up demand. Other high frequency indicators like GST collection, PMI (Manufacturing and Services), passenger vehicles sales, bank credit offtake are also indicating healthy domestic demand recovery. However, external demand is likely to weaken further, and domestic demand could also see some moderation as pent-up demand fizzles out and financing conditions tighten.

Our indicator of CAD is also a cause of concern now. India recorded a current account deficit of 3.3 per cent of GDP in H1:2022-23 on the back of a sharp increase in the merchandise trade deficit, as compared with 0.2 per cent in H1:2021-22. As we move into 2023, the external environment will remain challenging, with major global economies projected to record a sharp deceleration in their growth. This implies that external demand for India will remain weak. The tightening of financing conditions globally will continue to impede growth while causing volatility in the financial markets. And now the fears of a resurgence of Covid cases in China have also brought back the concerns of the global supply chains to the forefront. Given the volatile and uncertain global environment, our economy’s growth may have challenges and can be under pressure in these tough times.

While there is no denying that India is a bright spot currently in midst of the global turmoil, it cannot remain unscathed from the global slowdown.

The RBI slowed its pace of rate hikes to 35 bps in December from 50 bps each in the previous three meetings. Between now and the next policy, the RBI has said it would closely monitor the impact of its previous rate hikes on domestic demand and core inflation as well as the actions of Federal Reserve. We expect the RBI to tighten monetary policy further if inflation stays elevated. However, the important aspect to note is that RBI has emphasized on the need to “keep inflationary expectations anchored, break core inflation and contain the second-round effects” of inflation.

Even if monetary policies may be reaching the end of the rate hike cycle, the transmission of existing rate hikes to bank lending rates will continue. This could take some steam off credit growth next fiscal year. As the RBI governor signalled in the December policy, liquidity conditions will not return to surplus as seen in the pandemic years. This will also maintain the upward pressure further on the domestic interest rates next year too.

Expect the central bank to hike repo rate by 25 bps to 6.50% in February 2023, expects a pause thereafter and look at how the inflation turns out and then take the future course in light of the overall emerging developments. We expect the 10 year to trade within the range of 7.15-7.40% in the short - term period till March 2023.

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