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GILTS MARKET UPDATE

February 27, 2023

(13/02/2023 – 17/02/2023): The G Secs yields traded little changed on Monday, as market participants awaited inflation data due later in the day. On Tuesday the yields ended marginally higher after consumer price inflation overshot the RBI's tolerance band for the month of January, cementing bets of one more rate hike by the RBI in April MPC meeting. Also, the sentiment was further dampened as the US-Treasury yields hardening up due to the higher than expected US inflation for January at 6.4% and on account of weak US initial jobless claims data which have triggered fears that the US Federal Reserve will keep raising rates for a longer period of time to tame their inflation. The G Sec yields ended lower in a quiet session on Wednesday as traders covered their short positions. There was some short-covering on Thursday as all the data points were behind us, and also the G Sec auction calendar was coming to an end with the last auction scheduled in the next week on Friday – February 24, 2023.

However, the G Sec yields surged up on Friday after the RBI devolved large amount of the New 10-year G Sec on the primary dealers at the weekly auction.

The benchmark 10-year 7.26% GS 2032 closed at 7.39 % as against the previous week (Friday – February 10, 2023) closing of 7.36%

Government Securities – Secondary Market Yields

	February 17, 2023	February 24, 2023
2 Years	7.21	7.27
5 Years	7.35	7.40
10 Years	7.39	7.42
14 Years	7.45	7.47
29 Years	7.40	7.40

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

February 17, 2023				February 24, 2023			
Nomenclature	Notified Amount	Cut Off (Yield)	Cut Off (Price)	Nomenclature	Notified Amount	Cut Off (Yield)	Cut Off (Price)
7.38% GS 2027	7000	7.3349	100.15	7.10% GS 2029	6000	7.4015	98.52
7.26% GS 2033	12000	7.3424	99.42	7.41% GS 2036	11000	7.4527	99.62
7.36% GS 2052	9000	7.3837	99.71	7.40% GS 2062	9000	7.3822	100.22

(20/02/2023 – 24/02/2023): The Govt Secs yields eased on Monday, after rising sharply in the last session of previous week amid sluggish trading activity in the absence of fresh cues. Tracking a sharp overnight fall in US yields, the trading opened on a bullish note. Also, softening of crude oil prices also supported the market sentiments. Meanwhile, the market was awaiting the minutes of the RBI's monetary policy meeting due to be released on Wednesday, and of the U.S. Federal Reserve due on Thursday. On Tuesday the yields ended marginally higher as the auction of SDLs added to the overall supply, while traders await the minutes of the RBI's latest monetary policy meeting. The G Sec yields rose on Wednesday with the benchmark yield at its highest in nearly four months as the upsurge in U.S. treasury yields added to the negative market sentiment. The market opened on a bearish note on overall hawkish commentary in the MPC minutes as most of the members were cautious about the high and sticky core inflation. While the US FOMC minutes were broadly in-line with the market expectations. However, towards the close of the day the yields softened due to short covering by the traders and also supported by the lower oil prices.

The G Sec yields ended higher on Friday as the financial year's last debt auction added to supply, pushing up the yields. The underlying sentiment remains bearish as we have a huge supply lined up next year. Liquidity has also tightened.

The benchmark 7.26% G S 2032 yield ended at 7.42%, 3 basis higher than the closing on last weekend (February 17, 2023)

State Government Securities

SDL - Primary Market Auction Cut off (Range - Yields)

	February 14, 2023	February 21, 2023
2 Years	--	--
5 Years	--	--
10 Years	7.66 – 7.72	7.65 – 7.71
15 Years	--	7.59
20 Years	--	--

SDL - Secondary Market (Range Yields)

	February 17, 2023	February 24, 2023
2 Years	--	--
5 Years	--	--
10 Years	7.64	7.61
15 Years	7.63	--
20 Years	--	--

Tracker

Trackers	February 17, 2023	February 24, 2023
Average Call Rate (%)	6.33	6.72
Net Banking System liquidity - Deficit (-) Surplus(+) (Rs Crs)	(-20,418/13)	(-14,506/47)
Bank Deposit Growth (%)	10.50	10.20
Bank Credit Growth (%)	16.30	16.10

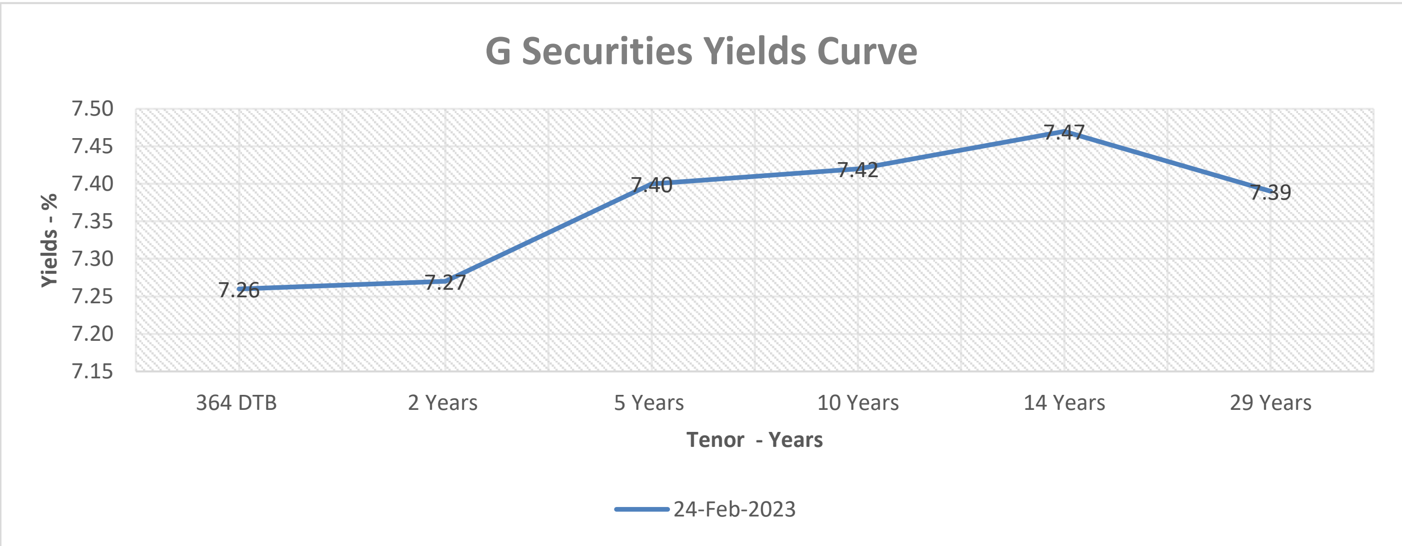
CPI (%)	**6.52**	**6.52**
Core Inflation (%)	**6.30**	**6.30**
WPI Inflation (%)	**4.73**	**4.73**

Nifty	**17,944.20**	**17,465.80**
Sensex	**61,002.57**	**59,463.93**

Re/US$	**82.72**	**82.93**
FPI Investments (US$ Bln) (Figures cumulative for Debt & Equity – Current FY)	**(-5.936)**	**(-5.823)**

Foreign Exchange Reserves (US$ Bln)	**566.95**	**561.27**

Gold/10 gm (Rs)	**56,730**	**56,810**
Gold/Oz (US$)	**1841.75**	**1810.97**
Crude Oil - Brent (US$/bbl)	**82.84**	**83.16**
2 Yr USA - Treasuries	**4.63**	**4.81**
10 Yr USA - Treasuries	**3.83**	**3.88**



Consumer Price Inflation jumped higher to 6.52% in January 2023 from 5.72% in December breaching RBI's upper tolerance level. Last two months of November and December had printed softening of the inflation below the RBI's upper tolerance level. The higher than anticipated CPI inflation was on account of an unexpectedly sharp surge in the food inflation. Vegetable prices continued to remain lower in January, due to a healthy winter harvest. However, the largest component of the food basket have been a key concern over the past few months. This was due to cereal prices rising in January and specifically wheat prices reported a rise of 25% on a year-on-year basis. However, these rising prices could reverse going ahead on account of improvement in acreage of the crop resulting in a good harvest. Also, the reduction in the government's reserve price for wheat and the announcement of a concessional rate for wheat offered by the Food Corporation of India could help in lowering of the wheat prices.

Meanwhile, core inflation still remained sticky at above 6.00% in January on account of further strengthening of price pressures in categories such as housing, healthcare and personal care. This was one of the main factors that led the RBI to hike interest rates at the February MPC meeting. Core inflation remains the biggest concern as also highlighted by the RBI governor in the latest monetary policy statement with continued passthrough of input costs and domestic demand proving to be resilient

Wholesale price inflation for January 2023, printed lower at 4.73% on a year-on-year basis, as compared to the previous month's reading of 4.95%. This can be attributed to a softening trend in manufactured products and a moderation in the fuel inflation. As stated, food inflation has inched up in both WPI and CPI and should have remained a cause of concern for the RBI to stick to its hawkish outlook.

Growth impulses have remained resilient to an extent with some high frequency indicators showing markedly strong momentum while some exports are showing the strains of global headwinds. However, the almost synchronous monetary tightening across the globe will have further effects through monetary and thus on our exports.

India's merchandise trade deficit dropped to a 12-month low of $17.7 billion in January, while the services trade surplus rose to an all-time high of $16.5 billion last month. The sizeable decline in the trade deficit was fuelled by a 15.8% month on month slump in imports, mainly of oil, while overall exports dropped 13.4% month on month.

With the narrowing of merchandise trade deficit and widening of the services' trade surplus we can expect our current account deficit to narrow going ahead. The declining trade deficit indicates the pressure on Current Account Deficit is easing. Exports are expected to face headwinds from the anticipated slowdown in global growth due to lower growth in advanced economies. Also, deceleration in domestic growth could cause some softening in imports.

As per the RBI's MPC minutes the outlook for inflation is mixed. While prospects for the rabi crop even though have improved, but risks from adverse weather could be possible. The global commodity price outlook, including crude oil, is subject to uncertainties on demand prospects as well as from risks of supply disruptions due to geopolitical tensions. Commodity prices are expected to face upward pressures with the easing of COVID-related restrictions in some parts of the world. The ongoing pass-through of input costs to output prices, especially in services, could continue to exert pressures on core inflation.

The major advanced economies have seen their inflation softening from very high levels, but still elevated beyond their targets. This have prompt these central banks to moderate the size and pace of increase in their policy rates. However, central banks are reiterating their commitment to bring down inflation close to their targets.

Moreover, in the near-term high core inflation and risk of a rise in global commodity price will keep the RBI cautious. The pass-through of input costs is still playing out, which could pose an upside risk. RBI will nevertheless remain vigilant of incoming data as well as global developments, before shifting its stance to neutral. Clearly, the inflation fight is not over yet and the moderation seen at the end of 2022 was neither broad based nor durable. The commentary in the RBI's MPC meeting minutes was hawkish as was expected. Breaking the persistence of core inflation remains a major cause of concern for the central bank.

If the RBI's yardstick of durable disinflation is the movement in core inflation – then the terminal policy rate could be higher, that is another rate hike may be a possibility. Even as headline inflation is likely to moderate over the coming months, core inflation could remain sticky and if the RBI chooses to continue seeing signs of durable moderation in core inflation as an indicator for policy tightening, then another 25 bps rate hike in the next MPC Meeting in April could be a possibility. We think that a change in stance to neutral is unlikely until the RBI pauses its rate hike cycle.

Bond yields are likely to remain volatile. We expect the 10 year to trade within the range of 7.25-7.50% in the short - term period till March 2023.

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