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GILTS MARKET UPDATE

DECEMBER 19, 2022

05/12/2022 – 09/12/2022) The G Sec yields ended largely unchanged on Monday, as traders waited for the MPC decision due later in the week, which analysts said was mostly priced into the market. Market was also cautious as oil prices gained on Monday, with the OPEC holding output targets steady ahead of the European Union ban and a price cap kicking in on Russian crude. G Sec yields tracked the U.S. yields to end higher on Tuesday, further propped by traders cutting positions ahead of the RBI's monetary policy decision due on Wednesday morning.

Treasury yields rose on Tuesday after the strong data from the services and manufacturing sectors and a solid non-farm payrolls report reinforced expectations of the U.S. Federal Reserve continuing to raise interest rates in 2023. Further, bond yields hardened on Wednesday after RBI hiked the policy Repo rate by 35 bps, in line with the market expectations. Later in the press media meeting, the hawkish commentary by the RBI governor also pushed up the G Sec yields.

The benchmark 10-year 7.26% GS 2032 closed at 7.30 % as against the previous week (Friday – December 2, 2022) closing of 7.22%

Government Securities – Secondary Market Yields

	December 9, 2022	December 16, 2022
2 Years	6.90	6.94
5 Years	7.21	7.16
10 Years	7.30	7.28
14 Years	7.41	7.40
29 Years	7.43	7.33

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

December 9, 2022				December 16, 2022			
Nomenclature	Notified Amount	Cut-off Yield	Cut-off Price	Nomenclature	Notified Amount	Cut-off Yield	Cut-off Price
7.38% GS 2027	7000	7.2004	100.68	6.69% GS 2024	4000	6.9416	99.64
7.26% GS 2032	12000	7.2985	99.72	7.10% GS 2029	6000	7.2791	99.09
7.36% GS 2052	9000	7.4383	99.05	New GS 2036	11000	7.41	100
				7.40% GS 2062	9000	7.4499	99.35

(12/12/2022 – 16/12/2022): G Sec yields ended marginally lower on Monday as market participants waited for the consumer price inflation due post market hours, which will help them assess the RBI's future path of rate hikes. The 10 yr benchmark 7.26% GS 2032 yields intraday touched 7.25 & ended marginally lower on Tuesday as inflation fell within the RBI's target range for the first time in 10 months and raised hopes that the RBI was nearing the end of its current repo rate hiking cycle but sticky core inflation weighed on investors sentiment and limited the fall in the yields. The G Sec yields fell for the third consecutive session on Wednesday, as easing inflation in the USA as well the fall in our CPI supported the expectations of a likely slowdown in interest rate hikes. The benchmark 10-year G Sec yield ended at 7.22% after closing at 7.27% on Tuesday. The benchmark 10-year G Sec yields ended higher at 7.27 on Thursday after U.S. Federal Reserve Chairman Jerome Powell took a hawkish stance and said that the interest rate hikes would continue for a longer period than the markets expected.

Thus, the G sec yields had eased for the first three days of this week, but reversed course on Thursday, after the U.S. Federal Reserve said it will deliver more hikes in the next year. The benchmark 10-year G Sec yields ended higher on Friday after weaker than expected demand at the weekly debt auction turned investors more cautious.

The benchmark 7.26% G S 2032 yield ended at 7.28%, 2 basis lower than the closing on last weekend (December 9, 2022)

State Government Securities

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

	December 6, 2022	December 13, 2022
2 Years	--	--
5 Years	--	**7.40**
10 Years	**7.55**	**7.55 – 7.57**
15 Years	--	**7.63**
20 Years	--	**7.61**

SDL - Secondary Market (Range Yields)

	December 9, 2022	December 16, 2022
2 Years	--	--
5 Years	--	**7.29 – 7.38**
10 Years	**7.54 – 7.56**	**7.53 – 7.56**
15 Years	**7.61**	--
20 Years	**7.62**	--

Tracker

Trackers	December 9, 2022	December 16, 2022
Average Call Rate (%)	**6.10**	**6.32**
Net Banking System liquidity - Deficit (-) Surplus(+) (Rs Crs)	**1,54,918**	**40,853**
Bank Deposit Growth (%)	**9.60**	**9.90**
Bank Credit Growth (%)	**17.20**	**17.50**

CPI (%)	**6.77**	**5.88**
Core Inflation (%)	**6.00**	**6.00**
WPI Inflation (%)	**8.39**	**5.85**

Nifty	**18,496**	**18,269**
Sensex	**62,181**	**61,337**

Re/US$	**82.41**	**82.71**
FPI Investments (US$ Bln) (Figures cumulative for Debt & Equity – Current FY)	**(-2.776)**	**(-2.553)**

Foreign Exchange Reserves (US$ Bln)	**561.16**	**564.07**

Gold/10 gm (Rs)	**54,280**	**54,220**
Gold/Oz (US$)	**1796.62**	**1792.34**
Crude Oil - Brent (US$/bbl)	**76.10**	**79.04**
2 Yr USA - Treasuries	**4.34**	**4.18**
10 Yr USA - Treasuries	**3.59**	**3.49**

In the 6th Monetary Policy Committee meeting of December 5 – 7, 2022 the MPC decided to hike the policy Repo rate by 35 basis points. The Repo Rate now stands at 6.25%. The Reserve Bank said the worst of inflation is behind us, but there is no room for complacency.

RBI kept its inflation projection for the current financial year unchanged at 6.7% and in addition, revised upwards the inflation forecast for Q2 and Q3 FY23 by 10 bps. RBI lowered its growth forecast by 20 bps to 6.80%. RBI remains comfortable on the growth front for now, though seeing risks to the outlook from the external sources.

On liquidity management, RBI is expected to be nimble footed and flexible in its approach. RBI decided to focus on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

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The policy sounded slightly hawkish given the concerns on inflation, especially as core inflation is likely to come within RBI's target range by Q 1 FY 24. RBI emphasized three key risks of anchoring inflation expectations, stickiness in core inflation and second round impact of higher inflation. RBI indicated that future policy would be data dependent and based on the evolving outlook of the economy and also on developments on the global front.

The CPI inflation fell more-than-expected to an 11-month low of 5.88% (y-o-y) in November from 6.77% in October led by a notable drop in food inflation and a favourable base effect. The retail inflation has fallen into RBI's tolerance band of 2 -6% earlier than expected. The decline in food inflation was particularly on account of vegetables and edible oil prices coming down. Inflation has moderated in November 2022 but remains above RBI's tolerance band since January 2022. Core inflation, however, was above 6% in November2022. The core inflation is expected to remain sticky in the coming months as price pressures continue in health, education, clothing and personal care. Even though there are signs that consumer price inflation is easing supported by base effect and the relief provided by easing global commodity prices, the RBI Governor in his press media meeting was hawkish and clearly stated that the battle against inflation is not over. The stickiness of core inflation despite moderation in headline inflation is one of the key concerns regarding the durable nature of core inflation and its second-round effects on the overall prices. Persistence in the core inflation could force the central bank towards another rate hike in February 2023.

The Index of Industrial Production contracted by 4.00% in October from a growth of 3.10% in September due to a high base effect and a disappointing performance in the manufacturing sector. This was the worst figure in more than two years down due to the drop in orders from the foreign markets, softening demand and weak domestic investment.

With softening of the US dollar, the weakening pressure on rupee has lowered. However, the consistent widening of CAD amid global slowdown remains a cause of concern. The external sector i.e. net exports remains a cause of concern though manageable. Therefore, while the situation is looking relatively better, the RBI will remain vigilant of external developments and implications on the domestic economy.

Thus in this backdrop of the looming uncertainties on inflation front, we feel there is a possibility of a further 25 bps rate hike in the February 2023 MPC meeting, taking the terminal repo rate to 6.50% - the peak policy rate seems to be now very near. We expect the RBI to hike the interest rate by another 25 basis points depending on inflation and growth data. 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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