Monthly Debt Market Update

Aug 01, 2023 I Economics

Global Overview

US

- US Treasury yields rose over the last month as upbeat growth data defied market expectations that the 25-bps rate hike in July would be the last in the current tightening cycle. The Federal Reserve hiked its policy rate to the 5.25-5.50% range, remaining open to the possibility of a September rate hike if data warranted.
- Q2 GDP growth surprised on the upside. Preliminary estimates showed GDP grew at a faster pace of 2.4% in Q2, from 2% in Q1, and well above market expectations of 1.8%. Consumer spending powered the growth print, supported by increases in non-residential fixed investment, government spending and inventory growth. Meanwhile, initial jobless claims for the week ended July 22 fell to 221K as against expectations of 235K. Continuing jobless claims, which indicate the number of people receiving benefits after an initial week of aid, dropped 59,000 to 1.69 million during the week ending on July 15, implying that laid-off workers are quickly finding employment. Data thus suggests that the US economy is being anchored by a still-healthy labour market and businesses are optimistic on investment, potentially holding off a recession.
- We believe movement in US Treasury yields would remain data dependent going ahead. By the time we head into the September FOMC meeting, we would have two more jobs and inflation reports and more time for the lagged effect of rate hikes to have played through. However, the latest growth numbers suggest that it would take a deeper slowdown to get inflation back to the 2% target, with a still tight labour market contributing to core inflation remaining above 4%. In a scenario where economic activity remains healthier than expected another rate hike in September cannot be ruled out. These expectations could keep yields biased to the upside.

Europe (ex-UK)

- A 25-bps rate hike by the European Central Bank (ECB) and concerns over inflation, despite the recent moderation, saw European bond yields move higher through the month. ECB reiterated its expectations of inflation remaining too high for too long, leaving the door open to further tightening amidst growing risks of a recession.
- Although headline CPI eased (5.1% y-o-y in June vs 5.5% expected), underlying price pressures from core CPI remain a concern given that it firmed in June (5.5% y-o-y from 5.3% in May). Amongst other high-frequency indicators, industrial production contracted 2.2% in May, below market expectations of a 1.2% decline. Business activity in the region too has pointed to declines in major economies such as Germany and France, indicating increased chances of a recession this year. Results of the Q2 bank lending survey also showed that monetary tightening has had a significant effect on the lending channel, with demand for loans in the Eurozone dropping to an all-time low since the start of the survey in 2003.
- In the near term, we maintain an upside bias on European yields on prospects of the ECB continuing to raise rates at its September meeting as well. Although inflation in the Eurozone has been moderating, it has been slow to fall. Largely, markets expect the ECB to deliver a final 25 bps rate hike at the September meeting. Rate hikes beyond September will depend on incoming data and whether it would prompt ECB to revise its growth and inflation forecasts that will be released alongside the meeting. As per ECB's June forecasts, real GDP growth and average inflation for 2023 are seen at 0.9% and 5.4%, respectively.

UK

- UK gilt yields fell over the last month after softer-than-expected inflation numbers, raised bets that the Bank of England would end its rate hike cycle earlier than initially expected. Terminal rate expectations (bank rate currently at 5%), for end-2023 fell to 5.75% from 6.25% a month ago.
- CPI inflation rose 7.9% y-o-y in June, below forecasts of 8.2%, while core CPI eased to 6.9% against expectations of 7.1%. The latest release has however not altered bets of a hike in August as despite the moderation, Q2 inflation remains 20 bps above Bank of England's Q2 target of 8.2%. GDP contracted both sequentially (-0.1% m-o-m) and over last year (-0.4% y-o-y), in May, although marginally better than market estimates of -0.3% and -0.7%, respectively. Meanwhile, the labour market painted a mixed picture. Wage growth rose (7.3% in May vs 7.1% expected). The unemployment rate moved higher to 4.1% from 3.8% in April.
- With another rate hike on the cards in August, we believe UK gilt yields could move higher from current levels in the near term. However, the central bank is likely to revert to a smaller 25 bps rate hike, as compared to the surprise 50 bps hike seen in June. While markets are expecting further 75 bps in rate hikes (including August) this year, progress on services inflation and wages and the extent of slack in economic activity will be key in determining if BOE decides to pause on rates earlier.

Japan

- Japanese government bond yields rose after the Bank of Japan pledged to guide its yield curve control (YCC) policy with greater flexibility amidst an upward revision of its core inflation forecast for the current fiscal year. The move marks a potential shift in the BOJ's ultra-dovish stance, as it maintained guidance allowing the 10-year yield to move 0.5% around the 0% target but said those would be "references" rather than "rigid limits". BoJ's estimate for CPI and core CPI for the fiscal year 2023 now stand higher at 2.5% and 3.2%, up from April forecasts of 1.8% and 2.5%, respectively.
- The policy outcome aligned with the latest data releases that showed both headline and core inflation intensified in June, rising 3.3% y-o-y from 3.2% in May, pointing to unabating price pressures. Wages rose 2.5% y-o-y in May, beating forecasts of a 0.7% rise. However, households have remained cautious given that household spending continues to decline. Real household spending contracted for the third straight month, falling 4% y-o-y in May, more than estimates of a 2.4% decline.
- The July policy has signalled the possibility of a shift in the YCC framework sometime during the year. We could expect BoJ to widen the target band to 0.75% at its October or December meeting. As a result, we could see bond yields rise further, testing these limits in the coming months. However, scrapping the YCC is unlikely until the BoJ completes a policy review only later in 2024.

India Overview

- Indian bond yields rose over the last month on concerns that domestic inflation could remain higher than initially expected due to adverse weather-led disruptions. The upside was however capped on the possibility that Fed would stop raising rates beyond July.
- Headline CPI inflation rose to 4.81% y-o-y in June on the back of elevated food prices, with core inflation remaining above 5%. Food inflation accelerated to 4.6% in June from 3.3% a month ago, with inflation in items such as vegetables, cereals, pulses, and spices rising sharply. Amongst vegetables, a significant spike in prices of tomatoes was seen due to a shortage of the crop due to extreme weather conditions and pest attacks. Core inflation too remained elevated at 5.3% y-o-y in June. With spatial distribution of monsoon still skewed and some of the kharif sowing being impacted, upside risks to inflation are likely to intensify. Going ahead, we expect inflation to overshoot RBI's Q2 FY24 target of 5.2% by 40 bps, on account of weather-driven risks. We have thus revised FY24 inflation forecast to 5.3% from the previous projection of 5.1%. As a result, we expect RBI to maintain an extended pause in rates in FY24. The upside risks to inflation emanating from weather disruptions have also pushed back rate-cut expectations.
- Banking system liquidity remained in surplus through the month, at an average monthly surplus of around Rs 1.7 lakh crore in July. Surplus liquidity had touched Rs 2.4 lakh crore at the start of July, but GST outflows and RBI's intervention via variable rate reverse repo auctions saw excess liquidity shrink. RBI conducted

variable rate reverse repo auctions worth Rs 4.6 lakh crore in the month. Surplus liquidity conditions in the fiscal year so far are also in part reflective of healthy government spending.

- Going ahead, we maintain an upside bias on the 10-year bond yield on account of shrinking liquidity, inflation concerns and delayed prospects of rate cuts. With the spike in food inflation likely to be temporary, there may not be any need for rate hikes either. The 10-year benchmark bond yield is seen trading within 7-7.2% by end-FY24.

Financial Market Performance

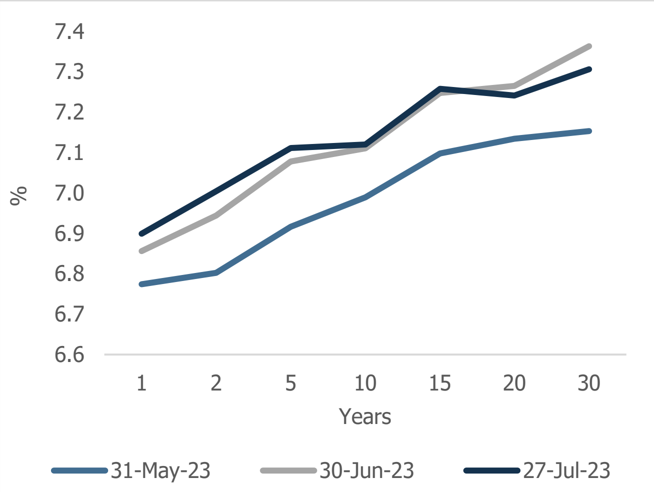
	Close	MOM	YOY
Global indices			
S&P 500	4,537	4%	11%
Nasdaq	15,465	3%	22%
Dow Jones	35,283	4%	8%
FTSE 100	7,693	3%	5%
Euro Stoxx	470	4%	16%
DAX	16,406	4%	24%
CAC40	7,465	3%	18%
Nikkei 225	32,891	1%	18%
Hang Seng	19,639	3%	-5%
Sensex	66,267	4%	17%
NIFTY	19,660	4%	16%

	Close	MOM	YOY
Treasuries		**(bps)**	**(bps)**
10-yr UST	4.01%	24	133
10-yr Bund	2.45%	15	159
UK 10-yr Gilt	4.28%	-7	234
10-yr JGB	0.44%	7	24
India 10-yr G-sec	7.16%	10	-18
Currencies			
DXY	101.7	-1%	-5%
EUR/USD	1.1	0%	9%
GBP/USD	1.3	1%	7%
USD/JPY*	141.3	-2%	3%
USD/CNY*	7.1	-1%	6%
USD/INR*	81.9	0%	3%
*(+) indicates weakening and (-) denotes strengthening			
Commodities			
Gold ($/Oz)	1,945	1%	12%
Silver ($/Oz)	24	6%	26%
Brent ($/bbl)	84	14%	-21%
WTI ($/bbl)	80	15%	-18%
Aluminium($/mt)	2,161	2%	-11%
Copper($/mt)	8,528	1%	12%

Source: Refinitiv (Closing values are as on July 28)

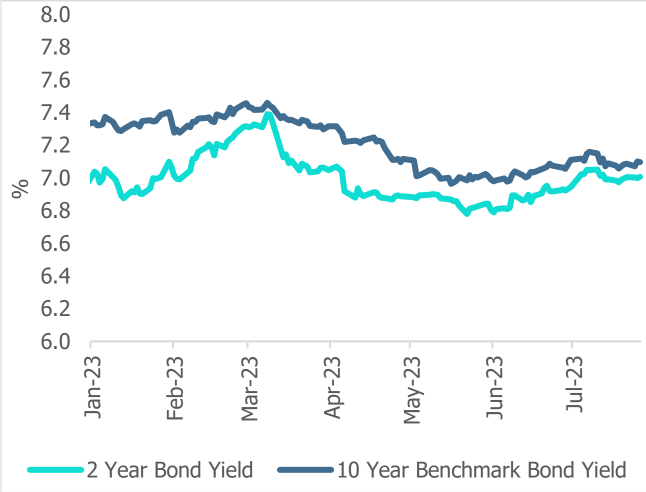
Indian Debt Market Chartbook

Bond Yields Rise



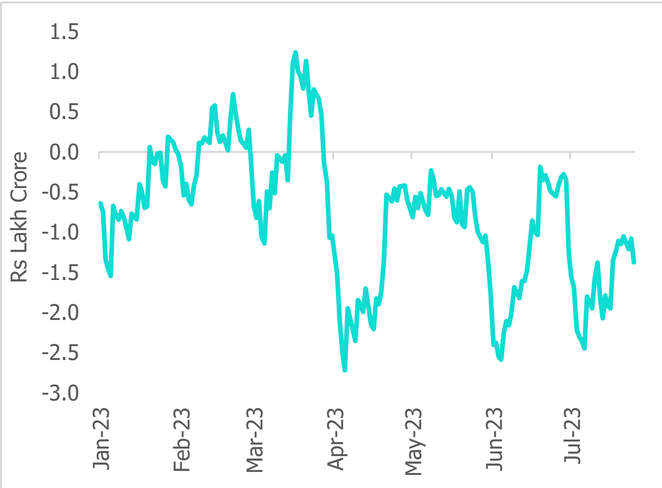
The 10-year benchmark bond yield rose as high as 7.16% in the last month on account of incoming debt supply and concerns over inflationary pressures ahead of the RBI August MPC meeting.

G-Sec Spreads Steady



The spread between the 10-2 year bond yield narrowed to as low as 8 bps over the last month, from around 18 bps a month ago on rising bets of RBI keeping rates higher for longer.

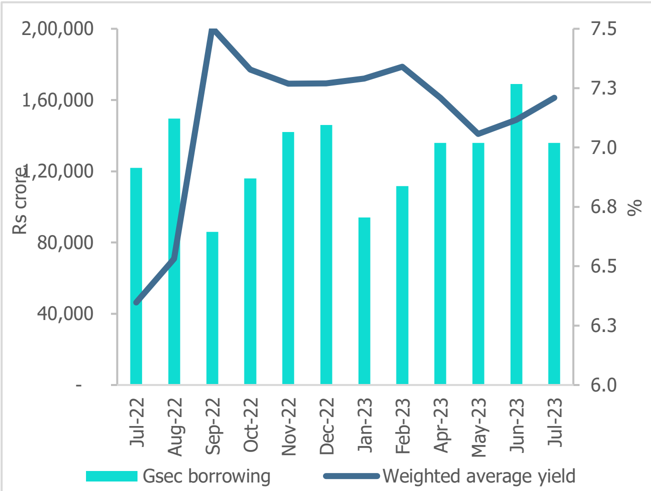
Banking System Liquidity Remains in Surplus



(+ indicates deficit/- denotes surplus)

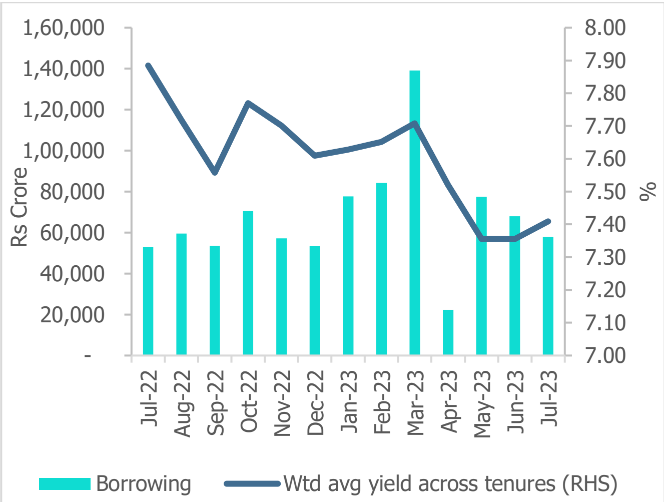
The banking system liquidity saw an average monthly surplus of around Rs 1.6 lakh crore over the past month. The surplus however was lower than the surfeit of over Rs 2.5 lakh crore seen in June. RBI withdrew around Rs 4.6 lakh crore in the month via VRRR auctions.

G-Sec Borrowing Meets Calendar Target

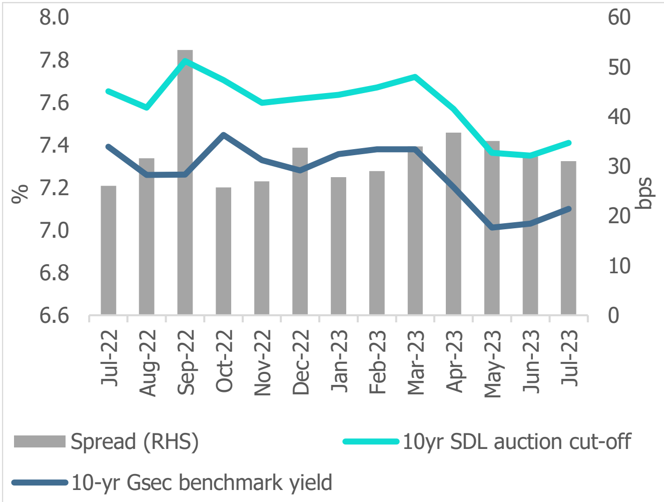


The government raised Rs 1.36 lakh crore in July through its market borrowing programme, in line with the amount set out in the indicative calendar. Weighted average yields across tenures rose by 9 bps to 7.24% in July.

SDL Borrowing and Weighted Average Yields



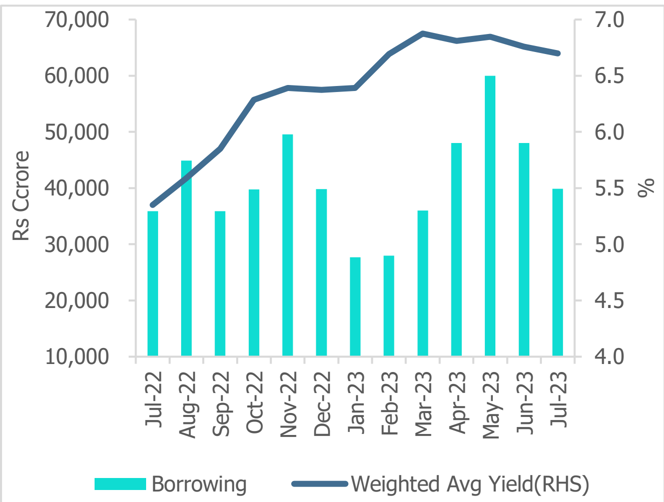
10-year SDL-G-sec Spread Steady



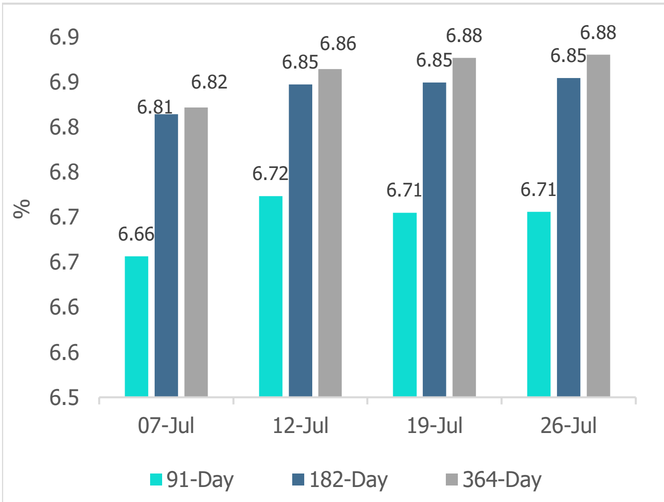
SDL issuances fell 15% from a month ago to Rs 58,030 crore in July, while borrowing costs rose to an average of 7.41%. The amount borrowed by states in July is 15% lower than the amount indicated at the start of the quarter. Tamil Nadu stood as the top borrower in the month, accounting for 26% of the total borrowing in July. For August, states are expected to borrow Rs 91,130 crore.

State governments' borrowing costs remained steady in July, with the spread however narrowing marginally for the fourth straight month. The spread between 10-year SDL and comparable G-sec yields narrowed to 31 bps in July.

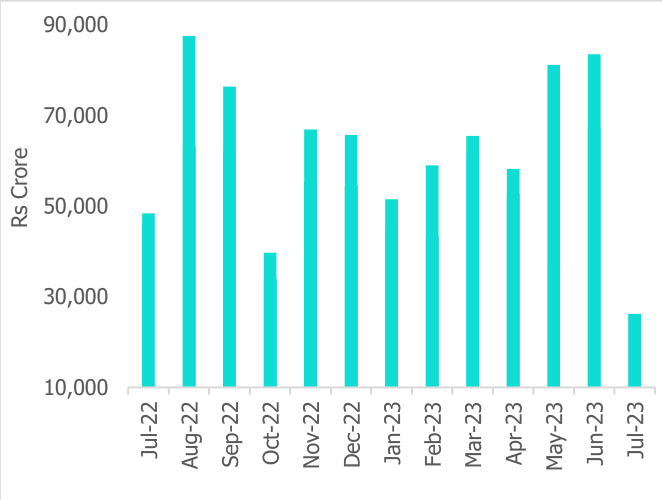
91-day T-bill Borrowing and Yields



T-bill Yields at Auction in July



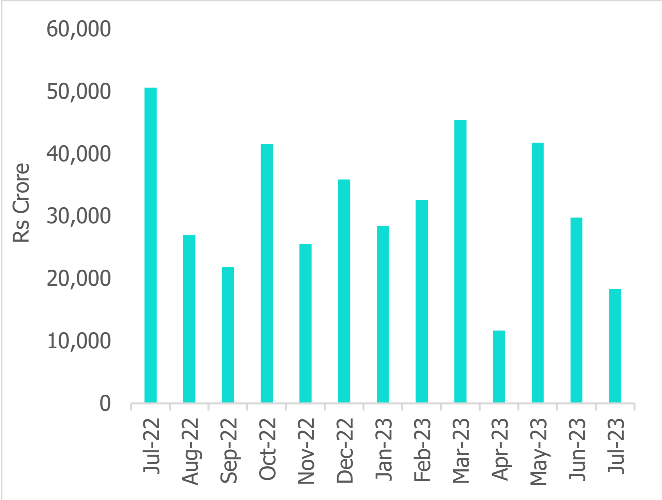
CP Issuances Drop in July



(Data for July 2023 up to fortnight ending July 15)

CPs issued during the fortnight ending July 15 fell to Rs 26,230 crore, from Rs 83,468 crore in the same period a month ago. A sharp rise in CP issuances seen in the previous month was however on account of surplus liquidity that lowered short-term rates.

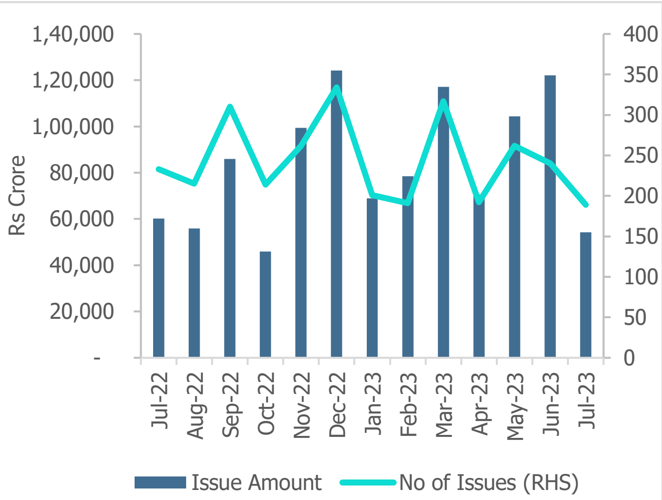
CD Issuances Lose Momentum



(Data for July 2023 up to fortnight ending July 14)

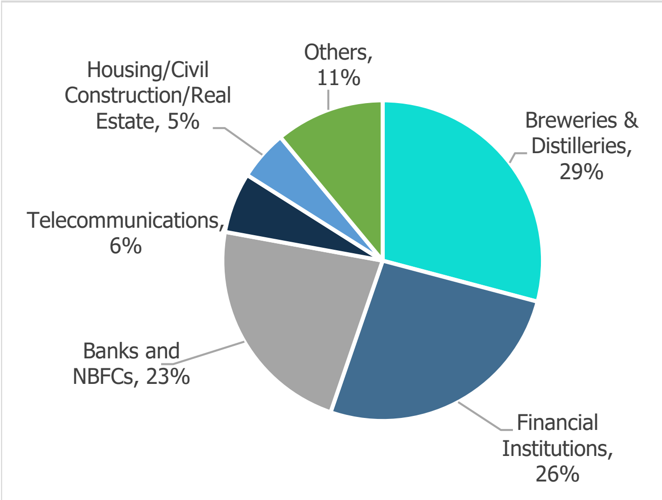
CD issuances stood at Rs 18,265 crore in the fortnight ending July 14, down from issuances worth Rs 29,746 crore in the same period in a month ago. In the last twelve months, outstanding CD issuances have risen over 26% to Rs 2.9 lakh crore, reflecting strong credit demand in the economy.

Corporate Bond Issuances Nosedive



Private placement of corporate debt amounted to Rs 54,273 crore in July, from Rs 1.2 lakh crore in the previous month.

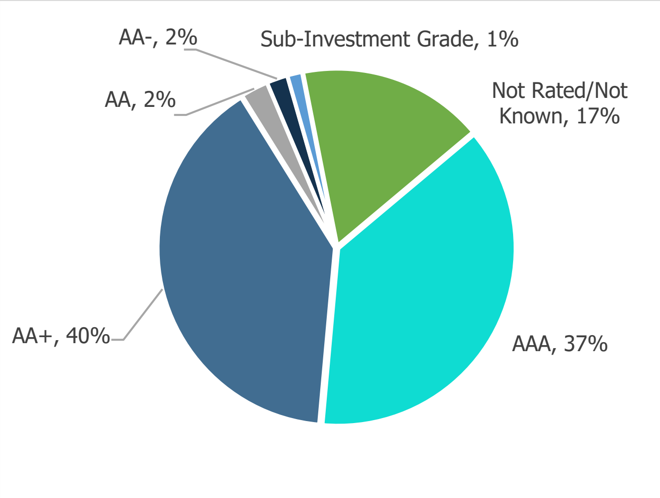
Corporate Bond Issuance by Industry - July



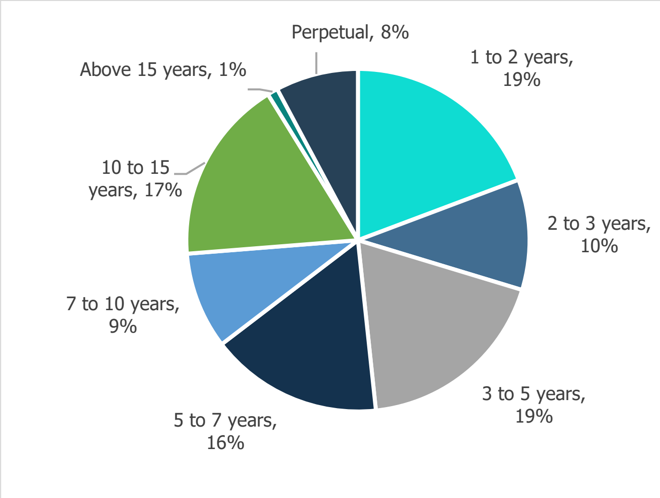
(Others include housing finance, travel & transportation, etc),

In terms of value, breweries & distilleries, financial institutions and NBFCs made up nearly 80% of the issuer base in July.

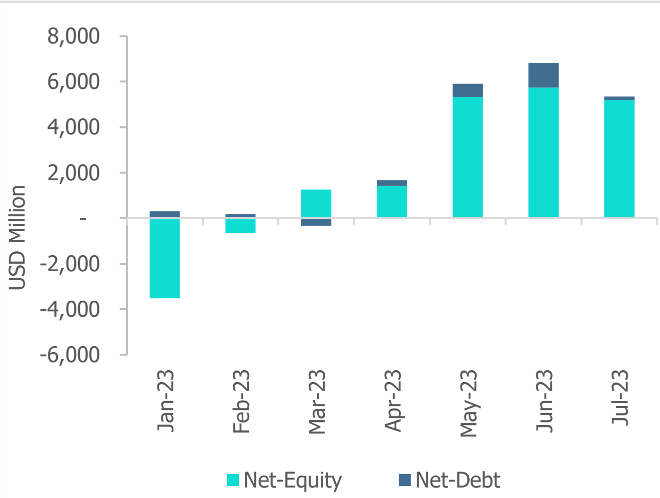
Corporate Bond Issuance by Rating-July



Corporate Bond Issuance by Tenor-July



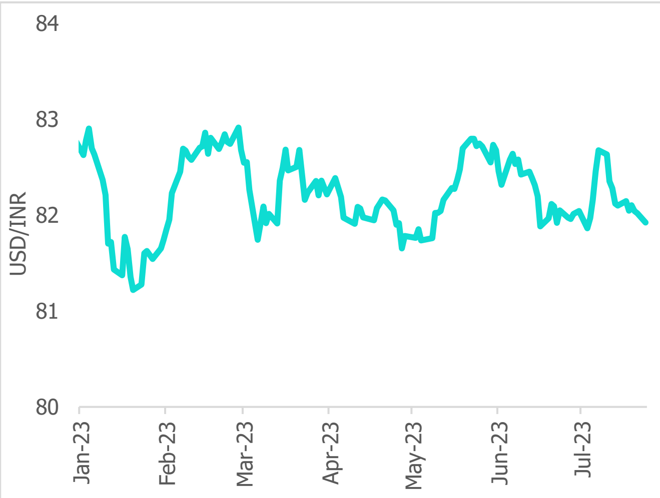
FPI Inflows Climb For 5th Month in July



(Data for July up to July 28)

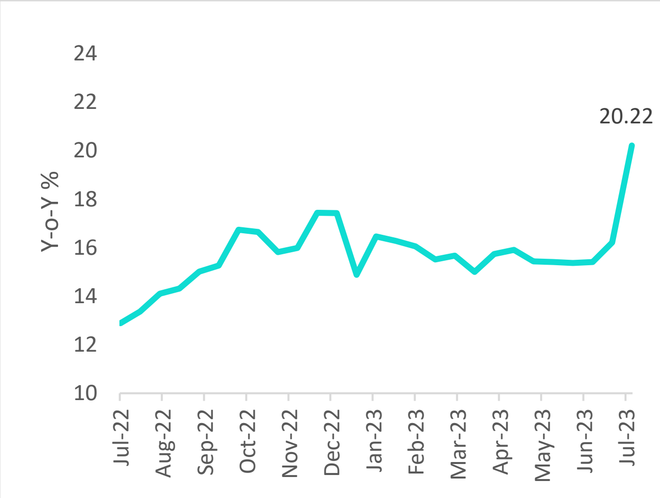
Net FPI inflows rose for the fifth straight month to USD 5.6 billion in July. Positive real rates, despite the recent uptick in inflation, and improved growth prospects are likely to sustain overseas investment flows.

INR Appreciates on Overseas Flows, Weak Dollar



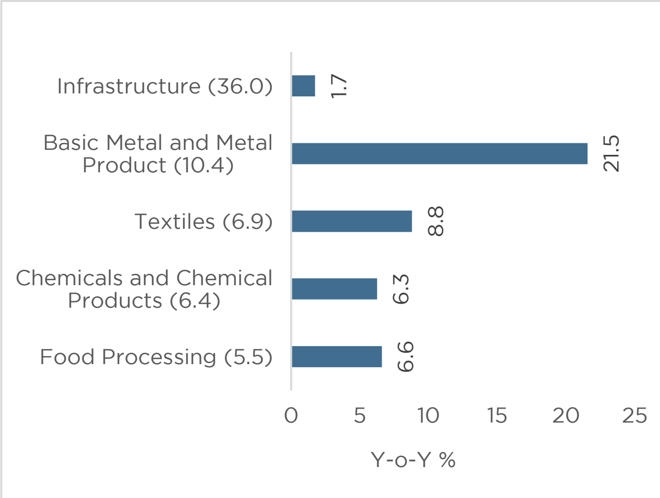
Rupee appreciated nearly 1% over the last month amidst waning dollar strength and healthy FPI inflows. Two-way FX intervention by RBI has however ensured that the USD/INR pair remains restricted to the 81-83 range.

Bank Credit Growth Improves



(Data for July 2023 as of the fortnight ending July 14)

Bank Credit Growth by Industry – Top 5



(Data as on June 30, 2023; Top 5 in terms of share in total industry credit; Figures in bracket represent % share in total industry credit)

Bank credit rose 20% y-o-y in July (fortnight ending July 14), compared to 14% a year ago. Credit to industry registered a growth of 8.1% y-o-y in June 2023 as compared with 9.5% in June 2022. Meanwhile, credit to services sector grew 26.7% in June, from 12.8% a year ago. Personal loans expanded by 20.9% in June 2023, higher than 18.1% a year ago, mainly driven by housing and vehicle loans.

Among major industries, credit growth accelerated for basic metal and metal product (21.5% growth) and textiles (8.8% growth), as compared to the corresponding month of the previous year.

Weekly Average AAA Corporate Bond Spread Over Comparable G-Sec (bps)

Maturity Buckets	Week ended June 30, 2023	Week ended July 21, 2023
<= 1 year	43	32
>1 year -<= 2 years	74	76
>2 year -<= 3 years	75	20
>3 year -<= 5 years	56	59
>5 year -<= 7 years	52	64
> 7 years	53	52

Source: Data for this report is sourced from RBI, CCIL, CEIC, CMIE, Refinitiv and Prime Database.

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