Monthly Debt Market Update

March 03, 2023 I Economics

Global Overview

US

- The US financial market has been influenced by the release of positive macroeconomic data, leading to expectations of higher interest rates for a longer period. Strong retail inflation, personal consumption expenditure, purchasing managers index, and retail sales figures indicate the economy's continued strength. The housing market also showed signs of improvement. Additionally, a strong labour market contributed to the possibility of rate hikes in March, May, and June. In fact, as per the CME's FedWatch tool there is a 25% probability of a 50bps hike at the March FOMC meeting. The Fed funds rate projection for the December 2023 meeting has been repriced to 5.25-5.50%.

- Minutes from the February meeting indicated that some participants favoured a 50bps rate hike and indicated that the financial conditions have eased in recent months. The upcoming March 22 meeting will be influenced by inflation and job reports, with consensus estimates for payrolls in February at 200,000 and a marginally higher unemployment rate of 3.5%. However, high services inflation may keep headline inflation from moderating significantly. Unless there is a significant deviation from these key indicators, US Treasuries may remain under pressure, and the dollar is expected to rise as yields increase.

Europe (ex-UK)

- In Europe, the market was affected by the ECB officials' hawkish comments and mixed data releases, which created uncertainty about the region's outlook. Retail sales and industrial production figures were below expectations, while composite PMI number albeit higher, failed to impress due to the stagnant manufacturing sector. Both investor and consumer confidence remained low. Preliminary estimates of EU GDP showed a slowdown in Q4 to 1.9% YoY from 2.3% in the previous quarter, with improving trade balance being the only positive indicator benefiting from falling energy costs.

- However, major economies such as Germany, France, Spain, and Italy continued to report high headline and core inflation levels, along with healthy consumer confidence and PMI indicators. The ECB policymakers are determined to bring inflation back to the 2% target, leading to expectations of a 50bps rate hike in March and a terminal rate of around 4% by year-end. This suggests that the ECB could continue raising rates through 2023. As the US monetary policy expectations are being repriced, the EUR may experience some downward pressure from current levels.

UK

- In the UK, high-frequency indicators have provided a mixed picture, creating uncertainty about the Bank of England's policy decision at the next meeting. At the February monetary policy meeting, the Committee voted for a second consecutive 50bps rate hike but hinted that smaller hike or even an end to the hiking cycle may be possible in the next meeting. Despite the BOE's signals, the market has been focused on improvement in recent economic data releases such as PMI, consumer confidence, retail sales, and industrial production. With improving economic data and only a slight moderation in inflation, markets are factoring in a terminal rate of 4.5% in the next meeting. However, the tight labour market presents upside risks to inflation, brushing aside the possibility of rate cuts this year. Going ahead, dollar strength and a disadvantageous interest rate differential could continue to put pressure on GBP and UK gilts.

Japan

- The nomination of Kazo Ueda as the incoming Bank of Japan governor was a significant event for Japan's financial markets. Contrary to expectations that Ueda would push for policy normalisation, he sees the current loose monetary policy stance as appropriate. Ueda has stated that inflation would need to rise "significantly" higher to justify an exit from the current policy, which is necessary to boost wages and growth. The increase in inflation to over twice its 2% target in January has been supported by a weaker yen and rising input prices. On the policy front, while there may not be an immediate change in policy when Ueda assumes his position on April 8, there could be some revisions to the yield curve control framework and/or new exit strategies discussed over the course of the year.

India Overview

- In February, the RBI MPC meeting voted 4-2 in favour of a 25bps rate hike, citing concerns over sticky core inflation, leaving the door open for further rate hikes. Probability of future rate hikes further increased after retail inflation numbers spiked to 6.5% in January. The headline number was elevated due to a higher-than-expected surge in prices of cereals, pulses, and protein items, as well as stubbornly high core inflation of 6.3% caused by elevated costs in segments such as housing, healthcare, and personal care.
- Looking ahead, there are some factors that could provide relief from inflationary pressures. A favourable base, healthy wheat, and pulses production (as per the second advanced estimate for 2023), supportive government measures to cool off prices, and the fizzling out of pent-up demand, especially in the service sector, could all contribute to easing inflation. However, there are still some potential upside risks to food inflation, particularly from adverse climate conditions. The IMD has warned of an enhanced probability of heatwaves between March and May in central and north-west India, which are key wheat-producing regions. Additionally, the emergence of El-Nino conditions also poses an upside risk to inflation.
- The Overnight Index Swap (OIS) market has already begun pricing in rate hikes following the last policy meeting, with the 1-year OIS rate inching above 7%. While the 10-year benchmark bond yield rose 7bps to 7.45% in the last one month, the spread between the 10-1-year yield narrowed sharply as liquidity conditions and rate-hike bets pulled yields on the short-end sharply higher. The spread between the 10-1-year yield narrowed sharply, from 44bps at the start of February to 17bps by end February.
- The India-US interest rate differential has been a key factor weighing on the rupee, with the Fed expected to continue hiking rates and the dollar strengthening. As a result, the rupee depreciated over 1% in February, although RBI intervention helped limit the fall.
- From a policy perspective, we believe there is a possibility of another 25bps rate hike in April, given the renewed upsurge in CPI inflation. As core inflation remains stubbornly high and the likelihood of a rate hike increases, upward pressure on yields will continue. We see the 10-year bond yield trading within the 7.4-7.5% range over the next couple of months before easing towards 7.3% in H1 FY24. Further easing of bond yields to the 7-7.2% range could be expected in H2 FY24 as domestic inflation cools, and global tightening of monetary policy comes to a halt.
- Meanwhile, the rupee may remain exposed to volatility in the near term, as we see a further narrowing of the India-US interest rate differential. For H1 FY24, we expect the rupee to see a further downside of 85/$ before retreating towards 81/$ levels in H2 FY24. For the second half of FY24, we anticipate the rupee appreciating on the waning dominance of the dollar and moderation in India's current account deficit.

Financial Market Performance

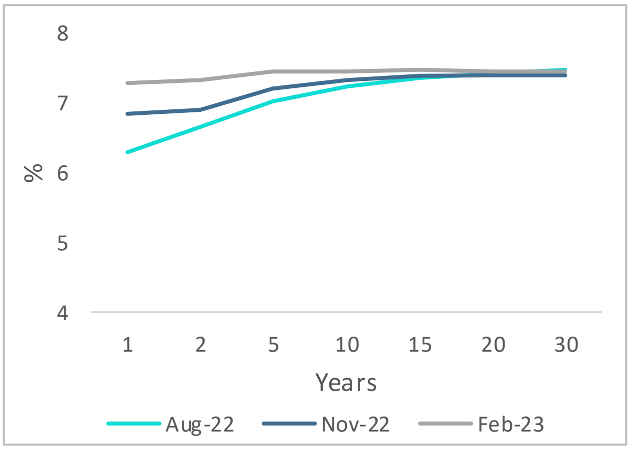
	Close	MOM	YOY
Global indices			
S&P 500	3,981	-2%	-9%
Nasdaq	11,463	-1%	-17%
Dow Jones	33,004	-3%	-3%
Euro Stoxx	7,944	2%	7%
FTSE 100	456	2%	4%
DAX	15,327	1%	6%
CAC40	7,284	3%	9%
Nikkei 225	27,521	1%	4%
Hang Seng	20,445	-6%	-10%
Sensex	58,909	-1%	0%
NIFTY	17,322	-2%	-1%

	Close	MOM	YOY
Treasuries		**(bps)**	**(bps)**
10-yr UST	4.08%	56	227
10-yr Bund	2.76%	46	277
UK 10-yr Gilt	3.89%	48	257
10-yr JGB	0.53%	2	34
India 10-yr G-sec	7.45%	7	69
Currencies			
DXY	105.0	3%	39%
EUR/USD	1.1	-2%	-5%
GBP/USD	1.2	-3%	-11%
USD/JPY*	136.8	5%	18%
USD/CNY*	6.9	2%	0%
USD/INR*	82.6	1%	9%
*(+) indicates weakening and (-) denotes strengthening			
Commodities			
Gold ($/Oz)	1,841	-5%	-3%
Silver ($/Oz)	21	-12%	-18%
Brent ($/bbl)	85	0%	-5%
WTI ($/bbl)	78	-1%	-11%
Aluminium($/mt)	2,367	-7%	-31%
Copper($/mt)	8,896	-2%	-11%

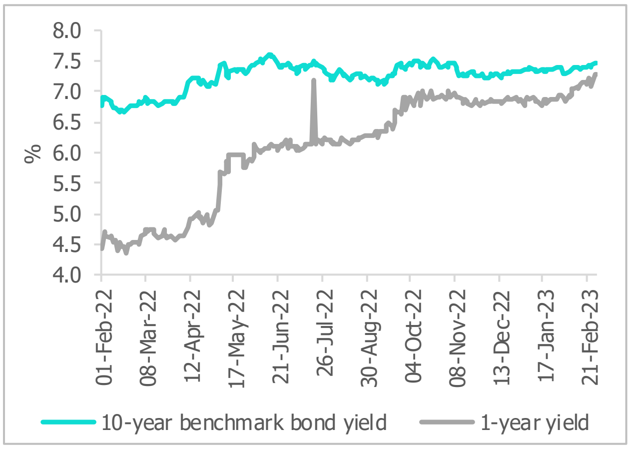
Source: CEIC, WSJ (Closing values are as on March 02)

Indian Debt Market Chartbook

Yield Curve Flattens

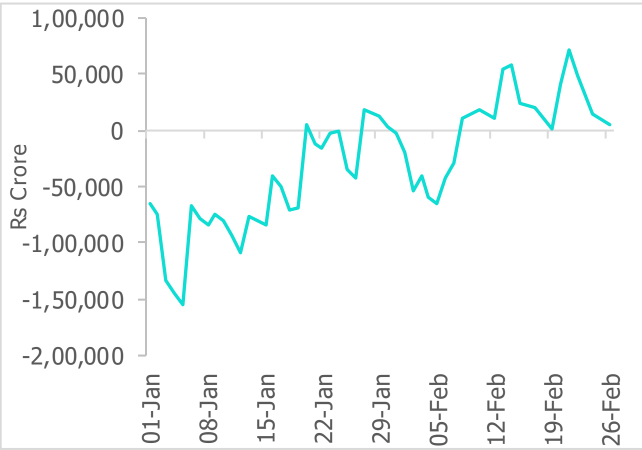


G-sec Spreads Narrow Sharply



The yield curve flattened further in February on account of a sharper rise in short-tenor bond yields. The rise was driven by tightening of banking system liquidity. This saw the spread between the 10-1-year yield narrow as much as 17bps, its lowest since 2018. Repricing of rate hikes, quarterly advance tax outflows and redemption of long-term repo operations could result in a temporary inversion of the yield curve going ahead. Redemptions worth Rs 18,018 crore and Rs 61,131 crore are due in March and April, respectively.

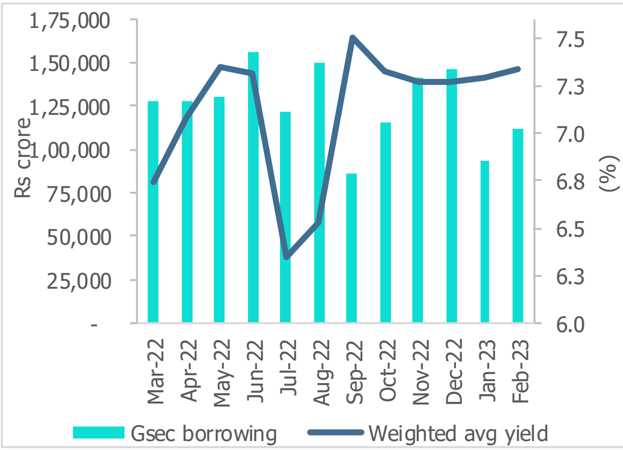
Banking System Liquidity Tightens



(+ indicates deficit/- denotes surplus)

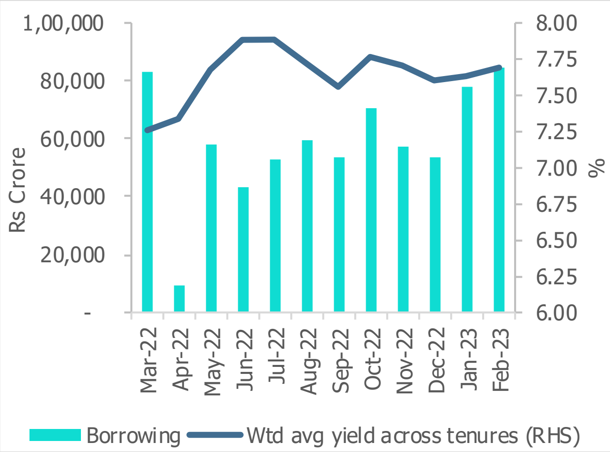
The banking system saw an average monthly deficit of around Rs 4,000 crore in the month. This compares to an average monthly surplus of Rs 54,000 crore in January.

G-sec Borrowing and Weighted Average Yields

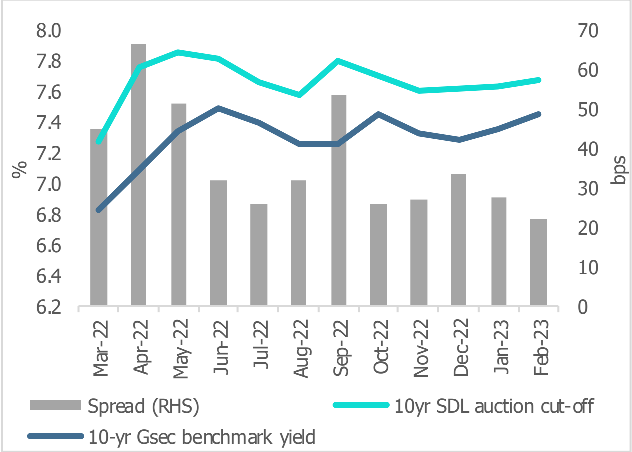


In February, G-sec borrowing and weighted average yields at auction rose over the previous month. RBI's devolvement of the new-10year paper at the February 17 weekly auction also indicated the central bank's discomfort with high yields sought by investors.

SDL Borrowing and Weighted Average Yields



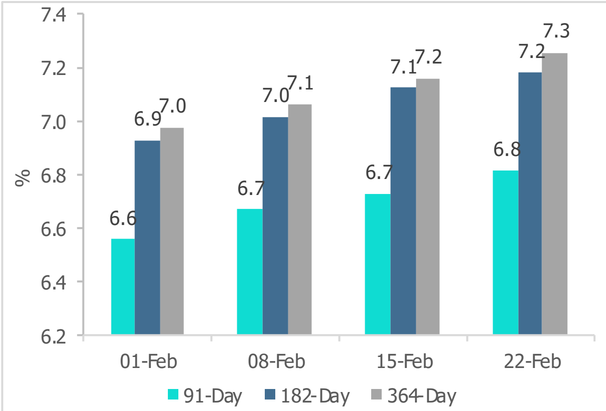
10-year SDL-G-sec Spread Narrows



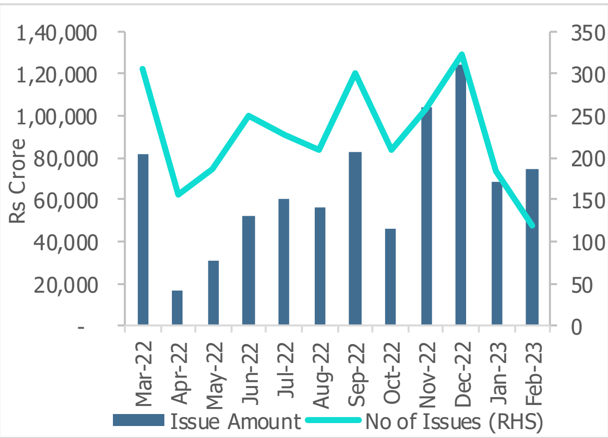
In line with past trends where SDL borrowing picks pace in the final quarter, borrowings rose for the second straight month in February, although remaining 8% lower than indicated in the calendar.

91-day T-bill Borrowing and Yields

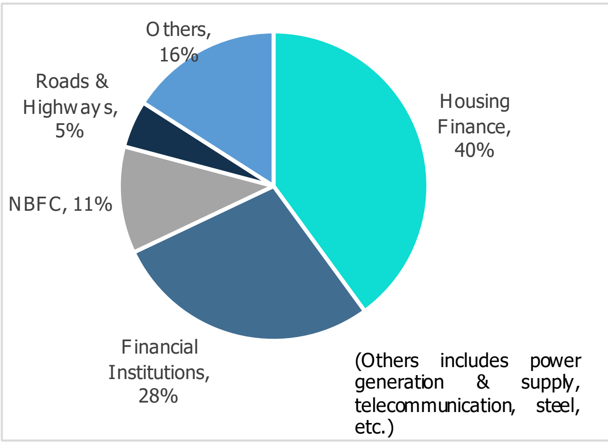
T-bill Yields Rise on Liquidity Squeeze



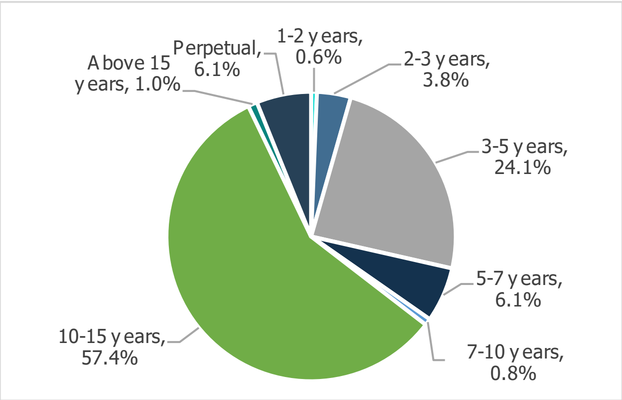
Corporate Bonds Issuances Dip in Feb



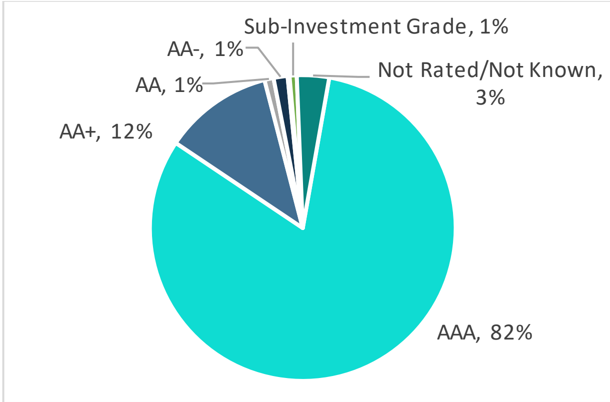
Industry-wise Corporate Bond Issuance (Feb)



Tenor-wise Corporate Bonds - % Share in Feb

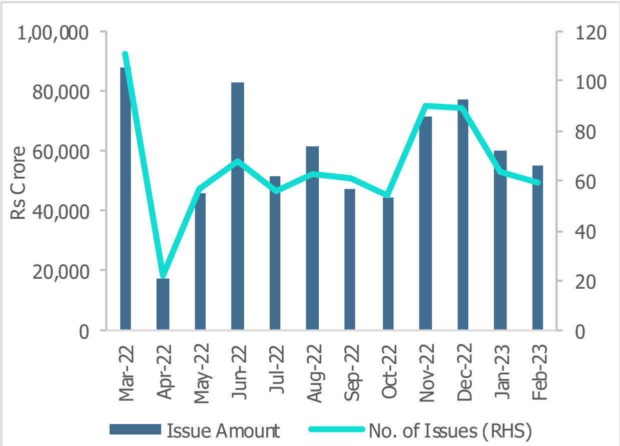


Corporate Bond Issuance by Rating – Feb

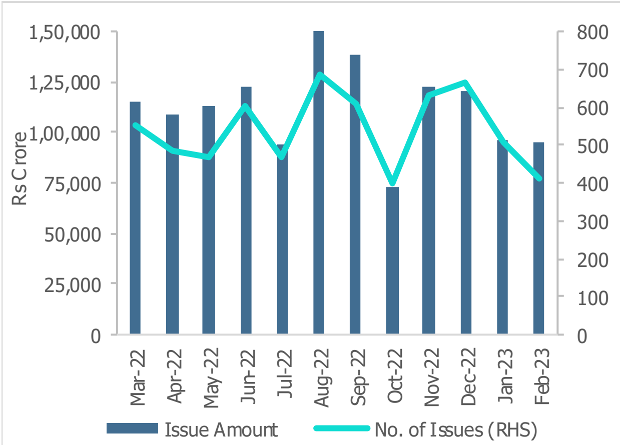


(Sub-Investment Grade includes bonds rated A, A-, BBB+,BBB,BB-,B+ and B-)

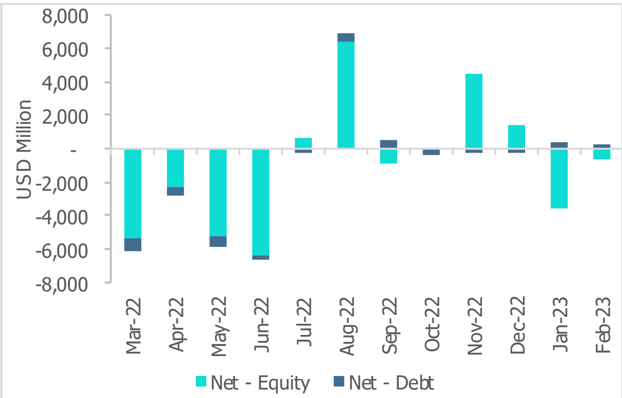
CD Issuances Decline in Feb



CP Issuance Pace Remains Low



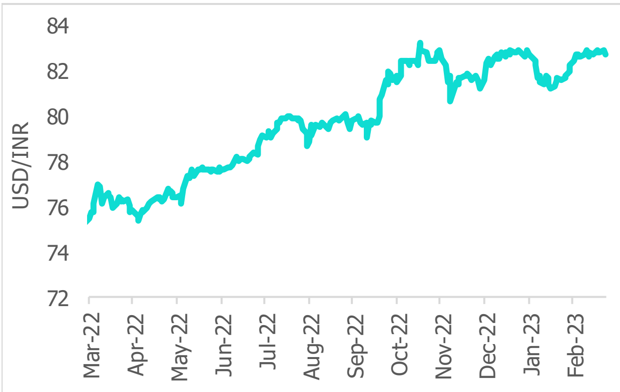
Net FPI Flows in Debt and Equity (USD million)



(Does not include debt-VRR and hybrid segment)

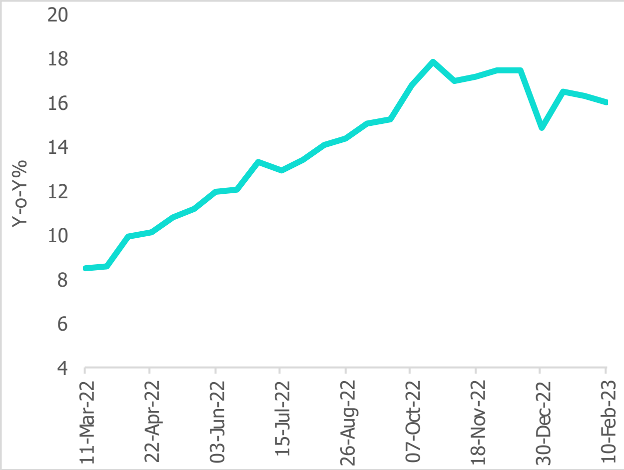
FPIs stood as net sellers of $501 million in February on account of large outflows from the equity markets. This compares to $3,233 million of outflows in January. Debt markets, however, witnessed inflows worth $302 million in February.

Rupee Weakness Continues in Feb

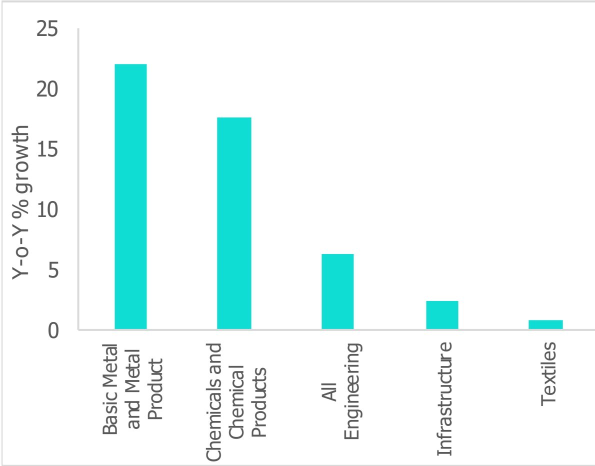


Rupee depreciated over 1% in February on sharp narrowing of the India-US interest rate differential. The spread between the 10-year India-US benchmark bond narrowed to as low as 344 bps in February.

Bank Credit Growth Drops Marginally in Feb



Bank Credit Growth by Industry – Top 5



(Data as on Feb 10, 2023)

10-Year Corporate Bond Spreads Over G-sec (percentage points)

	Aug-22			Feb-23		
	PSU, FIs & Banks	**NBFC**	**Corporates**	**PSU, FIs & Banks**	**NBFC**	**Corporates**
AAA	0.21	0.51	0.33	0.16	0.40	0.41
AA+	0.65	0.95	0.73	0.59	0.96	0.78
AA	0.95	1.25	1.10	0.98	1.26	1.14
AA-	1.40	1.70	1.50	1.41	1.66	1.56
A+	2.15	3.45	2.75	2.16	3.41	2.81
A	2.40	3.70	3.00	2.41	3.66	3.06
A-	2.65	3.95	3.50	2.66	3.91	3.31
BBB+	3.15	4.45	4.00	3.16	4.41	4.06
BBB	3.40	4.70	4.25	3.41	4.66	4.31
BBB-	3.90	5.20	4.75	3.91	5.16	4.81

Source: Data for this report is sourced from CEIC, CMIE, WSJ, RBI, FIMMDA, PRIME DATABASE

Contact

Rajani Sinha	Chief Economist	rajani.sinha@careedge.in	+91 - 22 - 6754 3525
Sonali Vahadane	Senior Economist	sonali.vahadane@careedge.in	+91 - 22 - 6754 3459
Mradul Mishra	Media Relations	mradul.mishra@careedge.in	+91 - 22 - 6754 3596

CARE Ratings Limited

Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022

Phone : +91 - 22 - 6754 3456 | CIN: L67190MH1993PLC071691

Connect :

Locations: Ahmedabad | Andheri-Mumbai | Bengaluru | Chennai | Coimbatore | Hyderabad | Kolkata | New Delhi | Pune

About:

CareEdge is a knowledge-based analytical group that aims to provide superior insights based on technology, data analytics and detailed research. CARE Ratings Ltd, the parent company in the group, is one of the leading credit rating agencies in India. Established in 1993, it has a credible track record of rating companies across multiple sectors and has played a pivotal role in developing the corporate debt market in India. The wholly-owned subsidiaries of CARE Ratings are (I) CARE Advisory, Research & Training Ltd, which offers customised advisory services, credible business research and analytical services (II) CARE Risk Solutions Private Ltd, which provides risk management solutions.

Disclaimer: