

ECONOMY & GILT WATCH



(Subsidiary of Punjab National Bank)

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Geopolitical Risk Premium

The recent Israel Iran war had the markets on edge for close to two weeks. The evolution of war precipitated in wild swings and volatility in the markets. While previously such military escalations were associated with a sell-off and re-alignment of capital across the global. This time around, however, the situation was different:

1. **US Asset Rush:** Previous such incidents were always associated with a rush for US assets. This was visibly not the case during the current conflict. Erstwhile security of US Dollar and Treasuries was absent in the backdrop of fiscal and policy concerns arising out of the United States. Instead, investors have been chasing alternatives such as BTC, Gold for some time along with staying put in their exposures in non-USD FX.
2. **Indian Markets' Resilience:** Throughout the conflict Indian markets across equity and bonds showed remarkable resilience. This was due to a couple of factors such as more higher currency reserves, a proactive RBI, stable inflation outlook and diversified oil sourcing especially Russian crude. The bond market, which a better gauge of, volatility during such skirmishes held up pretty well largely due to fiscal prudence of the government policies and a tumultuous RBI policy which had shaken out any bullish long positions already.
3. **Impact on Oil Markets:** Previously, a similar conflict in Russia in 2022 upended oil markets with Brent and natural gas spiking along with the complete spectrum of energy products. This time around, the impact was subdued due to better pricing in of the conflict as it had been simmering since 2023 October. Importantly the deciding factor was a waning demand for fossil fuels and an American political alignment with oil drilling. The absence of rush to buy Dollar settled Energy products also explains lack-lustre USD moves.

Geopolitical Risk Premium:

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*Safe Haven
status of US
assets is being
challenged*

*RBI is expected
to remain data
driven while
keeping
liquidity surplus*

Fine tuning of liquidity and NOT withdrawal of liquidity:

RBI's latest decision to absorb liquidity through VRRR is with an intent to align the overnight rates to the Repo rate. Currently, the call money rate is trading in the lower band of the policy corridor near the SDF rate of 5.25%. With this move, the central bank is signalling that its actions are in line with the recent change in policy stance to 'neutral'. The decision to conduct VRRR should not be read as withdrawal of liquidity but fine-tuning of liquidity. Markets would take cues from the incremental policy actions on these lines in the near term for a decisive reaction.

Post the RBI VRRR the interbank liquidity is expected to remain in comfortable surplus (to ensure transmission of rates to the broader economy) as already reinforced by the Governor in his recent Business standard interview as Monetary transmission generally takes two to three quarters to gain traction.

Rates Market Response would be of unwinding of steepeners at the front end of the curve, while going ahead tracking further actions of RBI on VRRR/Overnight liquidity.

In the recent RBI, interaction with Business Standard the Governor indicated his intent of keeping system liquidity in surplus during the easing cycle and mentioned that it is not unusual for the weighted average call rate (WACR) to be at the lower end of the corridor during those times. The Governor also mentioned that choosing the right operating target of monetary policy (WACR or otherwise) is the main issue being considered by the RBI's internal liquidity committee. The governor also emphasized that fine-tuning operations, whether through the VRRR or the VRR, do not affect durable liquidity. The RBI remains committed to maintain sufficient durable liquidity in the banking system.

Fixed Income Outlook

Fundamental View

Indian bonds are expected to trade in range taking cues from concurrent developments be it on the domestic front or global front. The 10 Year paper is likely to trade in a narrow range in yield terms. Liquidity management from RBI has to be keenly watched for inter-tenure flows and positioning. Things look bright on the growth-inflation dynamic front but unease in Global Bond Markets pose serious challenges going forward. Next market moving event is going to the evolution of trade deals deadline that the US has set for 9th of July.

On the global front, weak commodities prices continue to support the inflation at home and the deficit figure. Weakening of dollar has lifted sentiment for INR with RBI having replenished its reserves having faced a 10 percent drawdown. Going forward, both bonds and currency are likely to face sharp volatility due to looming US Fiscal weakness and Tariff threats. In case there are substantive tariffs or cracks in bond markets elsewhere, Rupee is likely to come under pressure due to outflows considering almost peak NIFTY levels and neutral RBI stance.

SDL Overview

SDL borrowing calendar has come in at almost market expectations. Going forward risk environment globally can drive the spread which have spiked recently. Spreads are likely to remain elevated considering many bullish positions have not been exited and transferred from trading books to HTM books.

*Yields to remain
stuck here*

*SDL spreads
can widen*

Technical View

Technical Synopsis 6.79% GS 2034 Yield

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6.79% G Sec 2034 paper settled at 6.35% at closing bell on Friday. As discussed in last Newsletter 6.79% paper may consolidate in range of 6.32% to 6.40% in coming days and the same was witnessed in passing Fortnight.

Momentum Oscillator RSI is hovering around 50 zone. Going forward, with Bollinger bandwidth around 3month low, is hinting towards expansion of range in coming Fortnight, However, for that either side range break and sustainability is necessary for the confirmation. To conclude, resumption of uptrend (in yields) to continue if sustains above 6.40%-6.41% zone and on lower side major respite of 6 to 8 basis possible for Bond traders if 10yr sustains below 6.32% on closing basis.



1D chart: 10 yr Source: Tickerplant

Liquidity

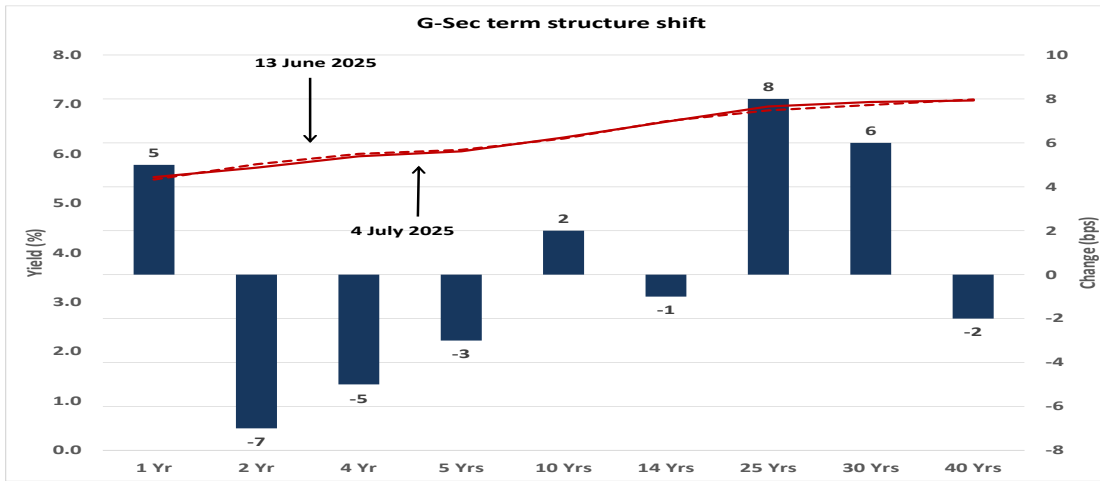
On a review of the current and evolving liquidity conditions, the central bank decided to conduct Variable Rate Reverse Repo (VRRR) auction to the tune of INR 1Tn on 04 Jul 2025, with a tenor of 7 days, total amount offered by market was INR 1.70 Tn out of which INR 1 Tn was accepted at WAR of 5.44%.

RBI's latest decision to start VRRR is to absorb liquidity worth INR 1Tn through VRRR is with an intent to align the overnight rates to the Repo rate. Currently, the call money rate is trading in the lower band of the policy corridor near the SDF rate of 5.25%. The decision to conduct VRRR should not be read as withdrawal of liquidity but fine-tuning of liquidity.

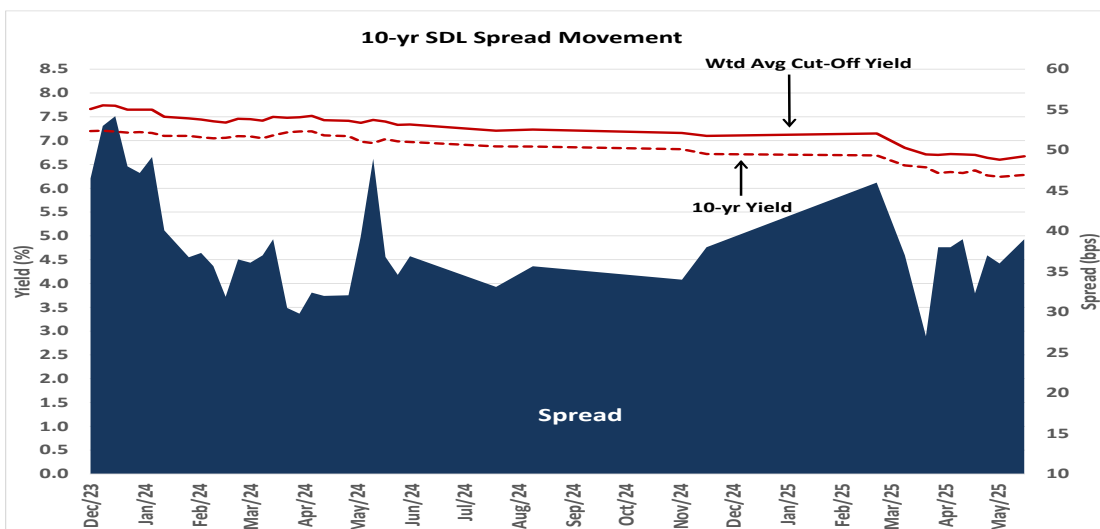
Bearish bias persists

Liquidity remains abundant

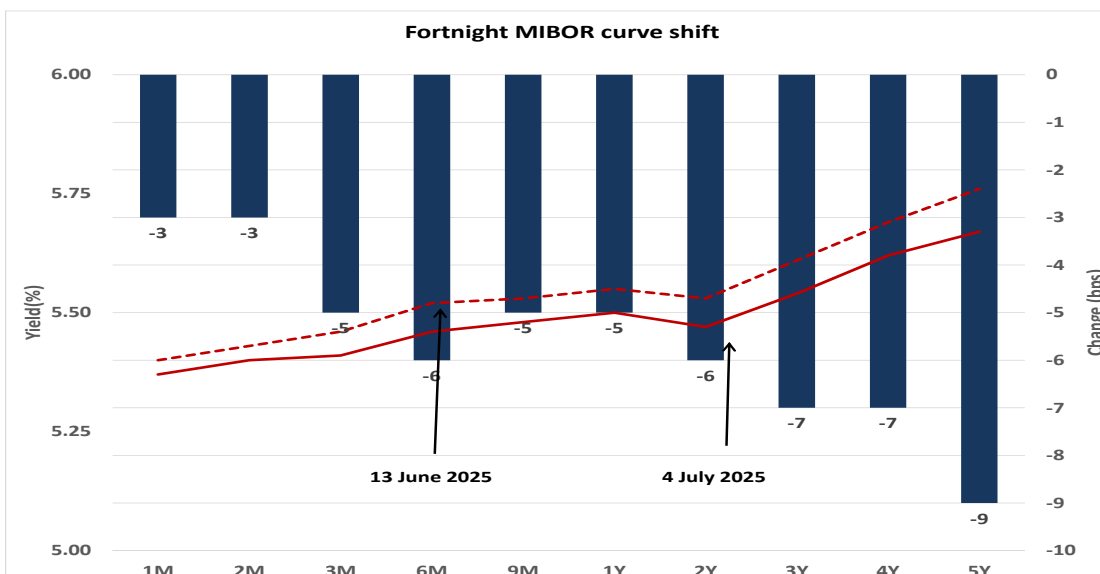
Spread Monitor



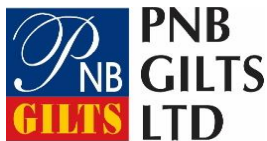
Curve remains unchanged



SDL Spreads to remain high



OIS rates down



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