PNB GILTS LTD

Volume 8/2024-25
Aug 13, 2024

ECONOMY & GILT WATCH

(Subsidiary of Punjab National Bank)

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Yen Carry Unwind
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Yen Carry Unwind

There has been widespread talk of a US recession with a weaker jobs data coming in from US for the month of July. While the data has been weak such that Sahm's rule was triggered. It was the timing that led to the market rout. Just before the weaker data Print Bank of Japan had hiked its interest rates by 25 basis points and unveiled its plan to reduce its bond purchase program. The reaction was such that USD/JPY plummeted from the 162 high to 142 levels within a few trading sessions.

Behind these massive currency moves along with the dip in Topix and Nikkei index led equity sell off was the unwinding of Yen carry trade. According to some estimates the size of carry trade sits at approximately USD 20 Trillion. The basic premise of the Yen carry trade is borrowing money at a zero or negative interest rates in Yen, convert the borrowed Yen into Dollar and invest in higher yielding asset classes abroad. To make the proposition of Yen carry trade more attractive the returns were amplified with further depreciation of Yen with continuing benchmark rate differential between Japan and elsewhere.

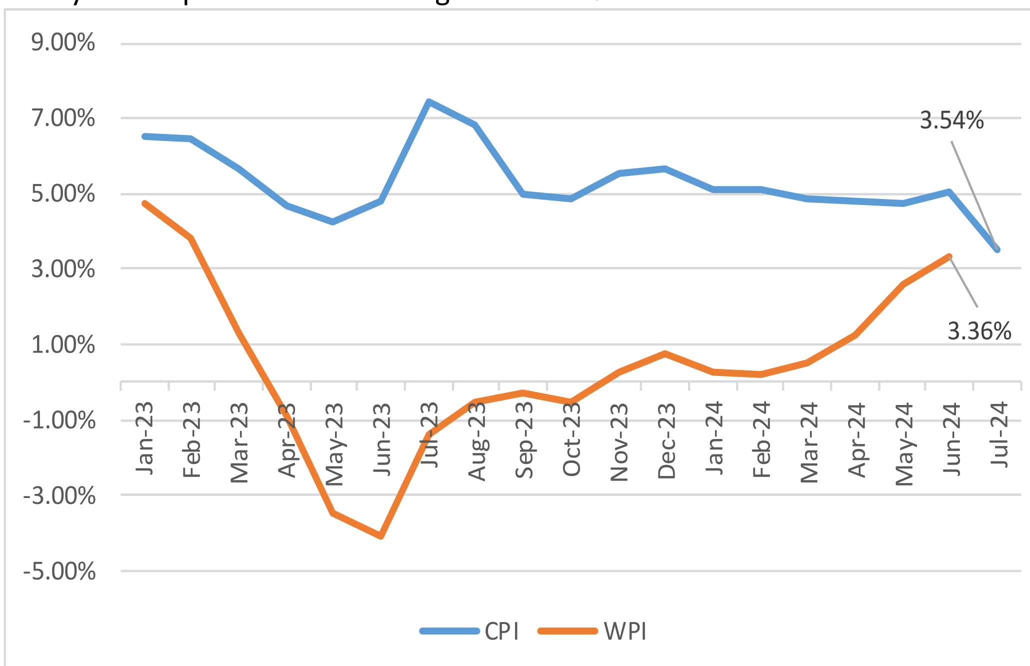
While it is estimated that 50-75 percent of the leveraged positions of the carry trade have been unwound. The concern right now is that with a slowing US economy, in case Fed's hand is forced with higher or unforeseen rate cuts then the second leg of this carry trade unwinding can cause more mayhem in the market. Also, irrespective of the unwinding it appears as if the market has realised that Bank of Japan is in a very difficult spot considering the fact that with a very high debt to GDP ratio further rate hikes will crush the highly leveraged Japanese economy which was finally starting to show some green shoots.

The way things stand right now in global markets a structural, gradual slowdown is the best case scenario rather than a financial contagion. Japanese currency having financed a lot of the boom in asset classes worldwide stands at a tipping point. Too much depreciation can kill the domestic economy while rate differential led appreciation can spell doom for financial markets as well as for an over leveraged Japanese economy. It remains to be seen the follow up moves in the Yen. Also, haphazard or deep cuts by fed will lead to a further unwinding of the Yen Carry Trades and this time longer term asset classes such as debt and real estate might see selloff.

CPI continued with the downtrend

India Inflation:

India's retail Inflation eased further to a **59-month low** for the month of July and stood at **3.54%** on an annual basis. Though this comes on the back of a high base effect it is to be noted that inflation has fallen **below the 4% figure** for the first time. Both urban and rural inflation have edged lower for the month of July. Food inflation which constitutes the major chunk of inflation readings slipped to **5.42%** in July as compared to the June figure of **9.36%**



RBI MPC:

While the MPC remained on expected line with no surprises, there was certainly an acknowledgement of changing data trends that may guide future policy actions. Following were the major takeaways from RBI MPC:

- Repo Rate maintained at 6.5% for the ninth time
- The stance remains unchanged while giving room for caution
- GDP forecast for FY25 kept same at 7.2% growth
- Retail Inflation forecast also maintained at 4.5% for FY25
- Concerns were noted on outsourcing of technology in financial services such as during the recent Microsoft outage
- The RBI has proposed to create a public repository of digital lending apps to help prevent unauthorised lenders.

Fixed Income Outlook

Fundamental View

The last fortnight has been quite eventful for global markets. Indian markets on the contrary have more or less remained unfazed by the drastic moves in currencies, equities and bond yields elsewhere. The risk off frenzy triggered by weak data and massive Yen Carry trade unwinding helped UST break the previous low of 3.78% only to bounce back sharply. This provided the much needed impetus to the Indian Benchmark yields to decisively break 6.90.

Market to remain range bound and driven by global events

Going forward, benchmark yields are likely to follow global market events but the size of the moves are likely to remain slow. Going forward benchmark yields are expected to remain range bound around the 6.90 handle with a bullish bias due to growing global risk off sentiment.

SDL Overview

Last fortnight, CG benchmark 10 Yr traded in the range of 6.84% -6.97%, whereas, the 10Y SGS got dealt in the range of 7.19-7.34 i.e. the sdl spreads vis-a-vis their CG counterpart remained in the range of 35 - 40 bps. In Q2, so far States are continuing the trend, they followed in Q1, of coming up with smaller issuances than the notified calendar amount. So far, they had borrowed a sum of 1,07,533 Crores vs the notified figure of 1,15,430 Crores (6.8% lower). In the last fortnight they are sticking with the calendar and we expect with bigger Auction sizes to follow from states in the second half of this quarter, our sense is that, the spreads between SG & CG to widen from here and remain in the band of 37-45 bps.

SDL spreads likely to widen from here on

Technical View

Technical Synopsis 7.10% GS 2034 Yield:

7.10% G Sec 2034 paper settled at 6.8786% on today's session. Passing fortnight benchmark breached support zone (6.94%-6.95%) of Descending triangle and touched low of 6.84%. As discussed in passing Newsletter softening is here to stay, with 6.90%-6.83% to act as an immediate target in short term. Going Forward, we may witness pause to the current LL/LH formation in yields with 6.89% and 6.93%(30EMA with 23.6% retracement level) to act as an immediate resistance points on any pull back and on lower side we may gradually move towards 6.84% and 6.80% in coming Fortnight.

Running Chart GOI 10yr Daily. Source: Tickerplant

Market looks range bound with bullish bias and a resistance at 6.90

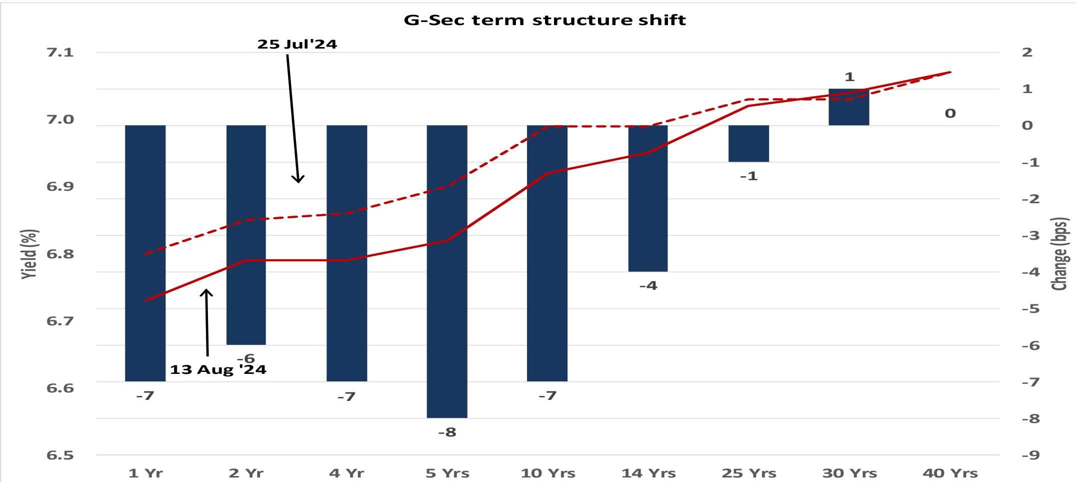
Liquidity

The banking system has been experiencing a liquidity surplus for second consecutive month. In order to manage this surplus liquidity, and to ensure that liquidity remains within desirable levels, the RBI has conducted 10 VRRR operations under the Liquidity Adjustment Facility so far in August 2024. This frequency indicates the RBI's active role in fine-tuning liquidity conditions.

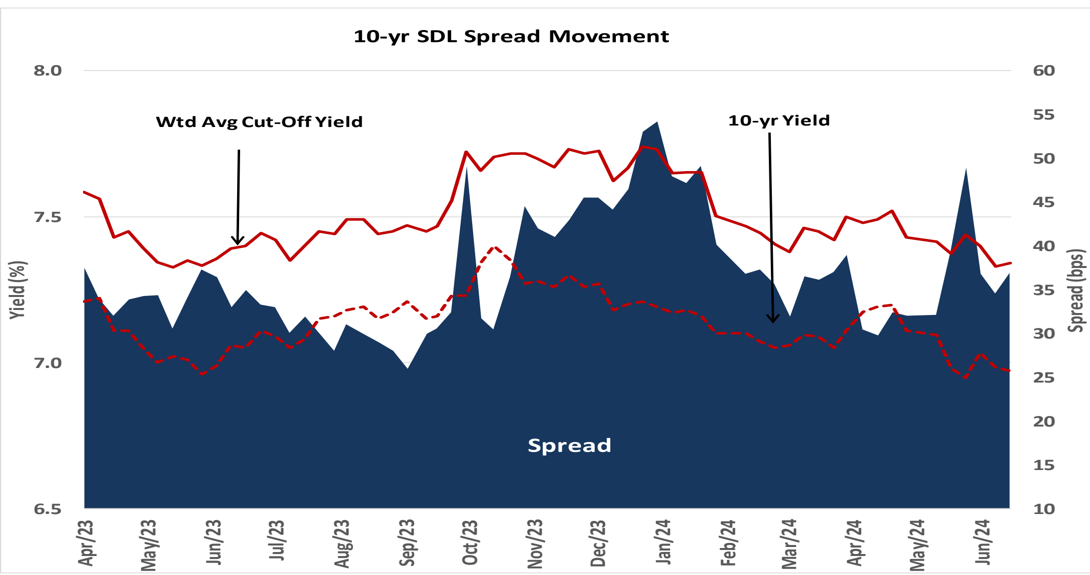
RBI expected to remain proactive in liquidity management

In the forthcoming fortnight, the surplus liquidity could reduce because of monthly GST outflows

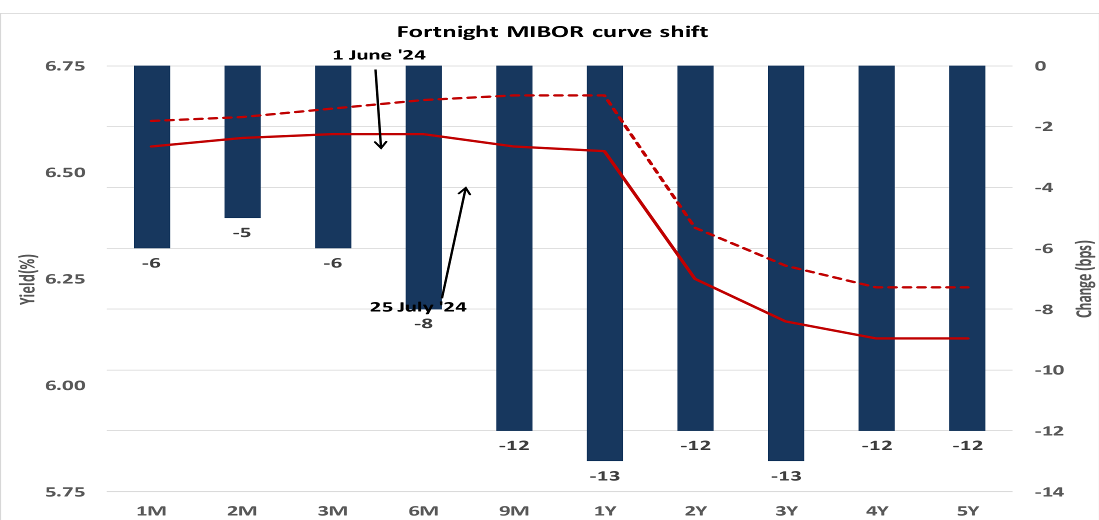
Spread Monitor



G-Sec yields trended downwards tracking global events



SDL Spreads remained flattish



OIS trended downwards along with USTs

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