FIRST LIGHT

02 September 2022

RESEARCH

BOB Economics Research | Bonds Wrap

Fortnightly review

SUMMARY

India Economics: Bonds Wrap

Global sovereign 10Y yields have shown steepest increase, post Jackson Hole conference. Fed Chair's speech focusing on reducing inflation and hinting trade off with regard to growth, led yields soaring. CME Fed watch tool data which attached 50% probability for 75bps rate hike in the Sep'22 policy, now is pricing in 75bps rate hike with 72% probability. Even US OIS 1Y rate rose by 14bps post Fed Chair's speech. Not only in the US, even in the Eurozone record high inflation was witnessed in Aug'22, and exerted pressure on Germany's 10Y yield. UK's 10Y yield registered monthly increase of 94bps in Aug'22 which is the sharpest since Sep'86.

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Daily macro indicators

Indicator	30-Aug	31-Aug	Chg (%)
US 10Y yield (%)	3.10	3.19	9bps
India 10Y yield (%)	7.25	7.19	(6bps)
USD/INR	79.97	79.46	0.6
Brent Crude (US$/bbl)	99.3	96.5	(2.8)
Dow	31,791	31,510	(0.9)
Hang Seng	19,949	19,954	0.0
Sensex	57,973	59,537	2.7
India FII (US$ mn)	**26-Aug**	**29-Aug**	**Chg ($ mn)**
FII-D	19.9	(85.4)	(105.3)
FII-E	(14.2)	257.7	271.9

Source: Bank of Baroda Economics Research

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This is despite fears of sharp slowdown in growth as is reflected in PMI of major economies. India and China have shown anomalies. China's 10Y yield closed a tad lower supported by government and central bank's stimulus measures. On the other hand, sharp drop in oil prices and comments from central bank officials about inflation getting anchored, have lend support to domestic yield.

India's 10Y yield closed 10bps lower in the current fortnight. What has been an interesting observation in the current fortnight is volatility at the short end of the curve continue reflecting frontloading of rates. Going forward, we expect India's 10Y yield to trade in the range of 7.20-7.30% in the coming fortnight. Upside risk remain on account of global financial tightening and downside risk emanate from growth slowdown. Liquidity conditions are likely to be tighter and we are looking at 0.6-1% of NDTL, contingent on how RBI's forex intervention would pan out in the wake of pressure on currency.

Signal of aggressive global policy tightening impacted yields:

Sovereign yield for the current fortnight ending 31 Aug 2022, noticed sharp upswing. The sharpest jump in yield happened in the last 5 days since 26 Aug 2022, post Fed Chair's speech. Comments such as 'reducing inflation is likely to require a sustained period of below-trend growth'; reflected some trade off in growth on the back of price stability. Notably CME Fed watch which showed a probability of ~50% a week before the Jackson Hole conference, is now pricing a 75bps rate hike in Sep'22 policy attaching a 72% probability to the outcome.

Elsewhere, inflation still remained a concern. Eurozone inflation rose to its record high of 9.1% in Aug'22. A survey conducted by British Retail Consortium (BRC) and market research firm NielsenIQ showed that UK shop price inflation in Aug'22 rose to its highest since Sep'08. Notably the current 94bps monthly jump in UK 10Y yield is the sharpest increase since Sep'86. Inflation fears also prompted Central Bank of South Korea to raise policy rate by 25bps to 2.5% and even inflation forecast was revised sharply upward to 5.2% for CY22 (highest since CY98).

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HOLD – Expected return from -6% to +15%

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Note: Recommendation structure changed with effect from 21 June 2021

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