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Bonds Wrap

Global bond yields broadly went into a downswing in Nov'22, a situation not seen in the past few months. US 10Y yield fell by 44bps, 14bps of which was attributed to the overnight fall, post Fed Chair's dovish speech. Markets are now anticipating a slower pace of rate hike by Fed. CME Fed watch tool is now pricing in a 50bps rate hike with 82% probability attached to the outcome which was around 45% as on 31 Oct 2022. IY US swap rates which are indicative of terminal rate is trading above 4.8%. Other global yields are also likely to feel the contagion of falling US 10Y yield. Most central banks' policy decisions are also scheduled this month and slight easing in the rate cycle is expected. In the Eurozone, some economies provided comfort with regard to moderation in flash CPI data.

On the domestic front, 10Y yield traded in the range of 7.26-7.48% in Nov'22 with higher volatility compared to last month. The trajectory was on the downside comforted by ~10% decline in international crude oil prices. Even some moderation in inflation data in Oct'22 raised hopes of a smaller pace of rate hike by RBI. Considerable flattening of India's yield curve was also noticed as short end yields remained inflexible while yield on long end papers fell. Another notable thing noticed in the current month is that, banks have been heavy sellers of government securities especially PSBs. This might be because of the rising wedge between credit and deposit growth, which has raised their demand for funds.

In the current month, we expect India's 10Y yield is expected to remain in the range of 7.2-7.4%. Key watchable will be the RBI policy where we expect a 25-35bps hike in repo rate. Even a slightly lower CPI print (our expectation of ~6-6.2%) will also put downside pressure on yields.

Global yields on a downswing:

- In Nov'22, global yields broadly fell compared to Oct'22. There was a sharp fall in US 10Y yield of 44bps, with 14bps of it happening overnight post Fed Chair's speech which had a thorough dovish bias. Statements such as 'moderate the pace of our rate increases' was a clear signaling that steeper rate hike cycle is way past. The rationale behind was soft landing of the economy and materialization of previous rate hikes. Recent ADP private payroll numbers in the US also indicated that some degree of softening of the tighter labour market conditions has already taken place. The 1Y US swap rate, which can be reflective of the terminal fund rate, is currently trading at 4.8% against 4.9% seen in the first week of Nov'22.
- Softening flash CPI print in Germany, Spain, France and Netherlands in the Eurozone also comforted yields in the region raising expectation of a softer rate cycle by ECB as well. UK's 10Y yield was supported by the fiscal credibility expressed in the recently announced Mini Budget. Further lower than expected borrowing in Oct'22 of £ 13.55bn (est.: £ 22bn) also comforted yields.

- Only China's 10Y sovereign yield showed a sharp uptick, as investors were cautious monitoring the Covid zero policies of the region.

Table 1. 10Y Yields globally traded mix

Countries	10Y sovereign paper yield, 30-Nov-22	10Y sovereign paper yield, 31-Oct-22	Change in 10Y yield in Nov'22, bps
Bloomberg Barclays EM USD Aggregate Yield to worst	7.59	8.50	-91
Indonesia	6.94	7.54	-60
Korea	3.68	4.23	-55
Thailand	2.72	3.19	-47
US	**3.61**	**4.05**	**-44**
UK	3.16	3.52	-36
Germany	1.93	2.14	-21
India	**7.28**	**7.45**	**-17**
Japan	0.25	0.25	1
China	2.92	2.65	27

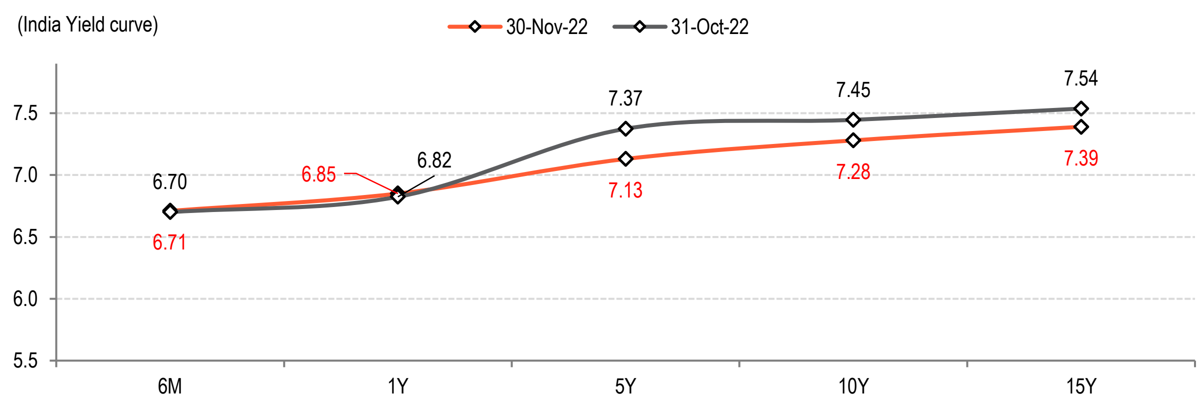
Source: Bloomberg, Bank of Baroda Research

Domestic 10Y yield traded in the range of 7.26-7.48% in Nov'22 against 7.36-7.51% range seen in Oct'22.

The volatility was higher in the current month (standard deviation at 0.07 in Nov'22 against standard deviation of 0.03 in Oct'22). However, there was a clear downward bias in the trajectory supported by ~10% month on month decline in international crude prices. Even moderation in CPI print in Oct'22 also provided comfort and raised the expectation of a smaller pace of rate hike by RBI.

Notably, the spread between 15 Year and 6 months paper went down sharply to 68bps in Nov'22 against 84bps in Oct'22. So there is considerable flattening happening at the yield curve due to fall in yield of long term papers while short term papers still remains inflexible.

Figure 1: Gap between short end and long end yields continue to fall



Source: Bloomberg, Bank of Baroda Research

What auctions in the domestic market for the current fortnight reflect?

Auction results reflected that borrowing cost (measured by Cut-off price / Yield) for short term papers inched down slightly, which was an anomaly compared to the previous few month's upshot. On the other hand, the borrowing cost for 10Y papers and SDL fell sharply.

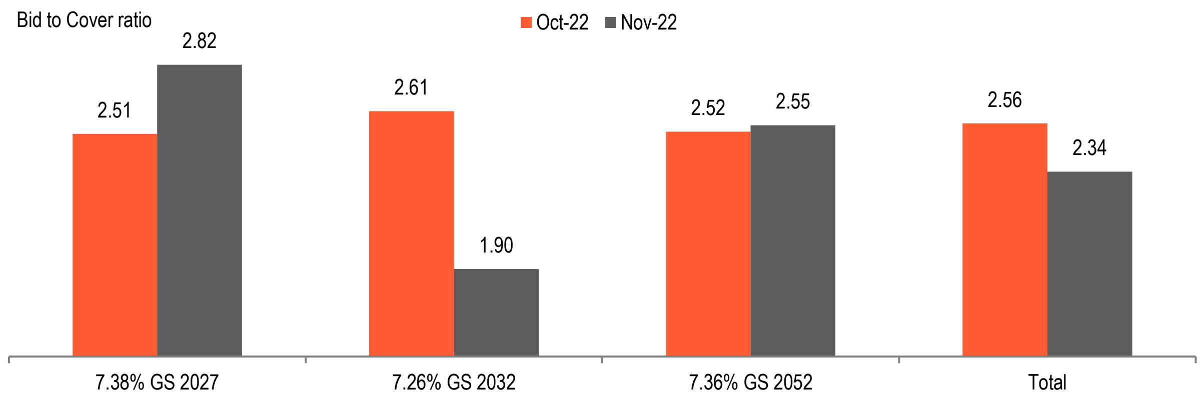
Table 2. Cost of borrowing for TBills moderated

Type of Papers	Cut off yield as on 30 Nov 2022	Cut off yield as on 21 Oct 2022
Central Government Securities	7.26	7.54
SDL	7.60	7.82
Tbills	6.66	6.68

Source: Bank of Baroda Research, Note: Implicit yield at cut off taken as on the mentioned date, Auction dates differ for SDL and TBills

Another notable thing in the current month has been that the bid to cover ratio of 10Y paper has fallen sharply while for short term paper it still remained higher.

Figure 2: Bid to cover ratio across securities



Source: RBI, Bank of Baroda Research

Liquidity tightening would prevail:

On an average, system liquidity was in surplus of Rs 48,100 crore in Nov'22 higher compared to surplus of Rs 6,900 crore seen in Oct'22.

Interestingly, durable liquidity have also risen to Rs 2.7 lakh crore against Rs 2.6lakh crore seen in the first week of Nov'22. This is on account of RBI's limited intervention in the forex market (US$ 13bn accretion in foreign currency assets) due to valuation gains in terms of falling US treasury yields and falling DXY (5% fall on month on month basis). Government cash balance broadly remained in line with last month between Rs 2.5-3.9lakh crore

Going forward, liquidity would get comfort from the maturity of Rs 56,968 crore security on 19 Dec 2022. Even a reverse repo of Rs 52,065crore is due to be mature tomorrow. However, slight deficit would continue to persist.

Major players in the fortnight

As per Bloomberg data, maximum buying for government securities in Nov'22 has been from foreign banks. On the other hand, PSBs and private banks were on a selling spree.

A reason for this may be on account of wider wedge between credit and deposit growth (~9% wedge). Thus banks are reducing their holdings in securities to meet rising credit demand. As per our calculation for the fortnight ending 4 Nov 2022 (the latest data available to us), SCBs excess investment in SLR securities have thoroughly come down to Rs 17lakh crore which was Rs 18lakh crore in Sep'22.

Outlook on 10Y yield for the next 30days:

- Major central bank policy decisions (Fed, ECB, BoE) are scheduled this month. For Fed, market is pricing in a 50bps hike. For ECB, there is a divide between 50-75bps hike. Further any discomfort with regard to the developments on inflation front, will prompt central banks' to be more hawkish. So that is an upside risk to yields.
- However, domestic yield is likely to get some comfort from softening CPI print in Nov'22, on the back of favourable base. We expect it to be ~6-6.2%. Also RBI's tone will be closely watched, whether it will be more cautious towards inflation or growth.
- India's 10Y yield is expected to remain in the range of 7.2-7.4% in the current month.

Table 3: OIS rates have edged down, while corporate spreads at long end have risen slightly

	As on 30 Nov 2022	As on 31 Oct 2022
	OIS Rates	
9M	6.64	6.92
1Y	6.42	6.94
	Corporate Spreads-10Y	
AAA	31	29
AA+	71	69
AA	108	107
AA-	148	141
A+	273	266
A	298	291
A-	323	316
BBB+	398	391
BBB-	473	466

Source: Bloomberg, Bank of Baroda Research, Note: data as on the mentioned time point

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