

Bonds Wrap

The reiteration of hawkish tone by central banks in US, Eurozone and UK have led to sell off in the bond market. The OIS curve (EUR-1Y: 3.7% at GBP-1Y: 5.4%) also point that peak in policy rate is not yet over. Even India's 10Y yield rose in consonance with global yields. The domestic yield curve noticed one striking change. The yield on 6month paper moderated while for longer end curve it continued to inch up. Similar thing is noticed in the borrowing cost of these papers. The short end curve was supported to an extent by RBI's pause on interest rates. Liquidity got comfort from RBI's fine tuning operation despite advance tax payments and maturity of debt security of Rs 0.13 lakh crore. We expect India's 10Y yield to trade in the range of 7.05-7.15% in Jul'23. It is expected to trade sideways with upside risk from global yields and downside risk from a comforting inflation print.

Global yields in UK and US inched up:

- In the US, macro data continued to paint mixed picture. While housing sales, retail data and labour market conditions continued to build case for some degree of strengthening of the economy. On the other hand, manufacturing activity and inflation expectations data painted a grim picture. Fed Chair hinted at two more rate hike this year. CME Fed watch tool is pricing in an 87.4% probability for 25bps rate hike in the upcoming policy.
- In UK, higher than expected sequential momentum in CPI, improvement in consumer confidence and business sentiments have led its central bank to raise policy rate by 50bps against expectation of 25bps. In the central bank officials' meeting last week, the rhetoric was faster pace of tightening than earlier anticipated.
- On the other hand, BoJ remained steadfast in its policy stance, which supported its yield. In China softening of all major macro prints such as retail sales, industrial production, fixed assets and home prices, pointed towards weaker demand conditions. China's beige book data suggested more stimulus to lift the economy from the current conditions. This led its 10Y yield to moderate in Jun'23.

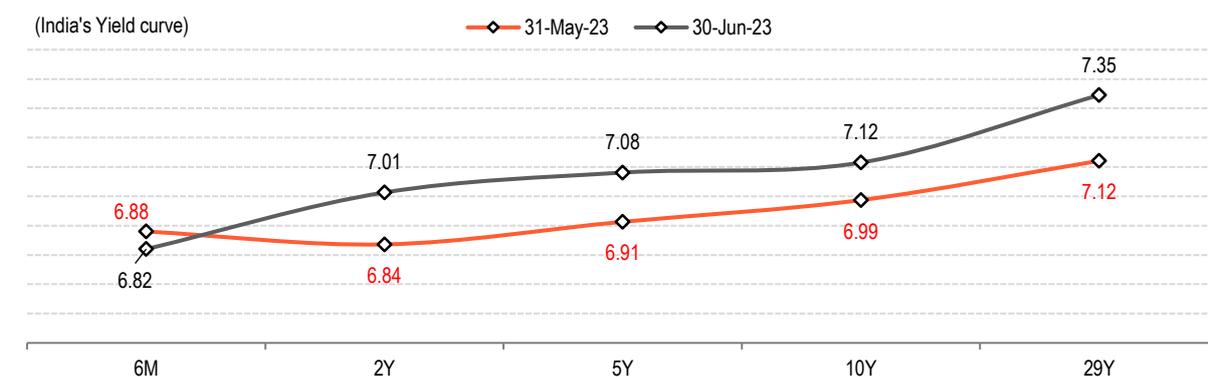
Table 1. 10Y Yields globally traded mixed in Jun'23 over May'23

Countries	10Y sovereign yield, 31 May 2023	10Y sovereign yield, 30 Jun 2023	Change in 10Y yield in Jun/May'23, bps
UK	4.18	4.39	21
US	3.64	3.84	19
Korea	3.52	3.66	14
India	6.99	7.12	13
Germany	2.28	2.39	11
Thailand	2.49	2.56	7
Japan	0.44	0.40	-4
China	2.71	2.64	-7
Indonesia	6.37	6.26	-11

Source: Bloomberg, Bank of Baroda Research

Domestic 10Y yield rose by 13bps and traded in the range of 6.98-7.12% in Jun'23 from 6.96-7.09% in May'23. Upside pressure to domestic yield was visible in consonance with rise in US 10Y yield. *Notably, a striking thing was visible in India's yield curve after many months. The yield on short end papers showed moderation, while long end continued to pick pace. The more sensitive shorter part of the curve was impacted by softening of domestic inflation and pause in policy rate by RBI.*

Figure 1: Yields on longer tenor paper inched up



Source: Bloomberg, Bank of Baroda Research

What auctions in the domestic market reflect?

In Jun'23, cut off yields for central government papers' inched up while short end papers showed some moderation. Notably, the bid to cover ratio of 7.26% GS 2033 security has fallen considerably to 1.9 as on 30 Jun 2023 compared to 2.1 seen in the previous auction.

Table 2. Cost of borrowing for central government papers rose while form shorty end inched down

Type of Papers	Cut off yield as on 28 Apr 2023	Cut off yield as on 31 May 2023	Cut off yield as on 30 Jun 2023
Central Government Securities	7.20	7.09	7.18
SDL	7.40	7.36	7.41
Tbills	6.93	6.86	6.83

Source: Bank of Baroda Research, Note: Average cut off yield is taken to arrive at borrowing cost, Auction dates differ

RBI's fine tuning supported liquidity conditions:

- System liquidity deficit averaged to Rs 1.3 lakh crore compared to Rs 72,590 crore in May'23. The evolution of liquidity has been interesting in Jun'23, with RBI conducting shorter reverse repo of 2 and 4 days in the first fortnight of the month.
- On 19th Jun, the 4 day variable rate repo witnessed offers of Rs 75,695crore against the notified amount of Rs 75,000crore due to higher demand for liquidity. Apart from this Rs 0.13 lakh crore of debt securities matured, which has put some strain on liquidity.
- Durable liquidity rose to Rs 2.8 lakh as on 30 Jun'23 crore from Rs 89,697 crore as on 31 May 2023. Post the notification on withdrawal of 2000 rupee notes, currency in circulation has fallen by Rs 1.1 lakh crore. Some comfort on this front was also provided by accretion in foreign currency assets to the tune of US\$ 4.5bn (23 Jun'23 over 26 May'23).

Major Player of the month

As per Bloomberg data, buying has been supported by PSBs and private banks, while foreign banks and MFs witnessed sell off.

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to remain in the range of 7.05-7.15% in the current month.* Domestic yield may trade sideways. Downward bias might emanate from a comforting headline CPI in Jun'23, on account of a favourable base. We expect headline CPI to be in the range of 4-4.3%. While a tighter labour market data in the US, will continue to push global yields and in that case domestic yield would also swing in that direction.

Table 3: OIS rates inching up, corporate spreads for lower rated papers fell marginally

	As on 31 May 2023	As on 30 Jun 2023
OIS Rates		
1M	6.51	6.63
2M	6.54	6.63
9M	6.58	6.74
Corporate Spreads 10Y, bps		
AAA	42	44
AA+	80	76
AA	113	111

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

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