

Bonds Wrap

US 10Y yield has pared most of its increase in Aug'23 as major growth indicators remained patchy. Fed Chair's speech though remained hawkish, market is anticipating higher probability of a hawkish pause in the Sep'23 policy meet. Domestic 10Y yield remained stable. Some comfort came from slower pace of increase in high frequency data on prices in Aug'23 coupled with government's supply side measures. However, short end part of the curve reacted spontaneously to the underlying liquidity conditions. Mandate of incremental CRR together with monthly GST outgo have resulted in liquidity moving into deficit for the time this fiscal. We expect India's 10Y yield to remain in the range of 7.15-7.25% in the current month. Liquidity would continue to remain under pressure till RBI reviews the position on maintaining incremental CRR by banks. If RBI continues to extend the decision beyond 8th Sep, we might see some sell off in the short part of the curve.

Broadly sell off in global bond market continued in Aug'23:

- US 10Y yield has pared most of the increase seen post release of Fed minutes. Till 17 Aug'23, US 10Y yield have risen by 32bps when compared to 31 Jul'23. However, it ended only 15bps higher for the full month of Aug'23. This was on account of a moderate GDP data in Q2 (2.1%, annualized QoQ against estimate of 2.4%), core PCE data also remained in line with expectations. However, labour market data is giving mixed signals with private payroll and jobless claims showing different picture albeit remaining tighter. The probability of a pause under these conditions have been raised to 89% by market participants which was 80% a week earlier.
- Bond sell off was witnessed in emerging economies with Thailand 10Y yield rising at the sharpest pace by 16bps. This was on account of policy rate being raised to its 9-year high of 2.25%.
- In Germany, deterioration in business conditions, flat growth in Q2 and in line CPI led to its 10Y yield close a tad bit lower. Even moderation in Eurozone core inflation has resurfaced the debate of whether rate hike cycle is nearing its end or not.
- China's 10Y yield fell by 8bps as more stimulus is expected on the back of weakening growth indicators (manufacturing PMI, exports, retail sales).

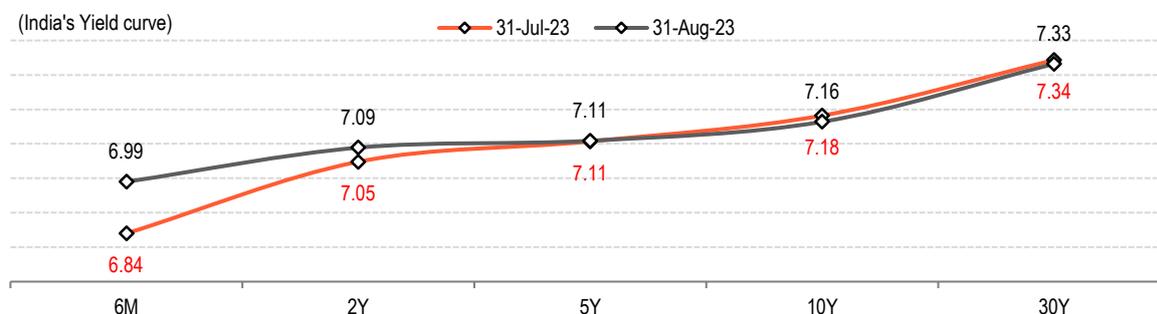
Table 1. 10Y Yields movement in Aug-23 over Jul-23

Countries	10Y sovereign yield, 31 Jul 2023	10Y sovereign yield, 31 Aug 2023	Change in 10Y yield in Aug/Jul'23, bps
Thailand	2.60	2.76	16
US	3.96	4.11	15
Indonesia	6.25	6.38	13
Singapore	3.04	3.13	9
Korea	3.77	3.83	6
UK	4.31	4.36	5
Japan	0.61	0.65	4
India	7.18	7.16	-1*
Germany	2.49	2.47	-3
China	2.66	2.58	-8

Source: Bloomberg, Bank of Baroda Research*Due to rounding off

Domestic 10Y yield inched down a bit by 1bps and traded in the range of 7.15-7.25% in Aug'23, in line with our estimate and compared to 7.06-7.18% in Jul'23. What has come out of this month's evolution of yield curve is that the gap between short and long end curve (6month and 30 Year paper) has reduced. From 50bps as on 31 Jul'23 it has fallen to 34bps as on 31 Aug'23.

Figure 1: Gap between short and long end part of the curve has fallen



Source: Bloomberg, Bank of Baroda Research

What auctions in the domestic market reflect?

In Aug'23, cut off yields for central government papers' remained broadly stable while for short end papers it inched up based on the evolving liquidity conditions.

Table 2. Cost of borrowing for central government papers were stable while short end it inched up

Type of Papers	Cut off yield as on 30 Jun 2023	Cut off yield as on 31 Jul 2023	Cut off yield as on 31 Aug 2023
Central Government Securities	7.18	7.24	7.25
SDL	7.41	7.39	7.43
Tbills	6.83	6.82	6.96

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

Strain on liquidity was visible:

- Average system liquidity surplus was lower at Rs 1.2 lakh crore in Aug'23 compared to Rs 1.6 lakh crore in Jul'23. In fact in three days of the month for the first time this fiscal, system liquidity went into deficit. This reduction in liquidity was visible on account of maintaining incremental CRR and also due to GST outflows.
- Pressure on liquidity will slowly ease with review of RBI's incremental CRR in Sep'23.

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to remain in the range of 7.15-7.25% in the current month.* Some comfort might be provided towards long end of the curve as high frequency price data is showing less than earlier pace of increase. Government's support is playing out well towards the same. Short end would continue to see some volatility till RBI's review of position on holding incremental CRR by banks. If RBI continues to extend the decision beyond 8th Sep, we might see some sell off in the short part of the curve.

Table 3: OIS rates inched up as RBI remained cautious on inflation

	As on 31 Jul 2023	As on 31 Aug 2023
OIS Rates		
1M	6.59	6.73
2M	6.63	6.73
9M	6.83	6.94
Corporate Spreads 10Y, bps		
AAA	37	37
AA+	67	68
AA	102	102

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

Disclaimer

The views expressed in this research note are personal views of the author(s) and do not necessarily reflect the views of Bank of Baroda. Nothing contained in this publication shall constitute or be deemed to constitute an offer to sell/ purchase or as an invitation or solicitation to do so for any securities of any entity. Bank of Baroda and/ or its Affiliates and its subsidiaries make no representation as to the accuracy; completeness or reliability of any information contained herein or otherwise provided and hereby disclaim any liability with regard to the same. Bank of Baroda Group or its officers, employees, personnel, directors may be associated in a commercial or personal capacity or may have a commercial interest including as proprietary traders in or with the securities and/ or companies or issues or matters as contained in this publication and such commercial capacity or interest whether or not differing with or conflicting with this publication, shall not make or render Bank of Baroda Group liable in any manner whatsoever & Bank of Baroda Group or any of its officers, employees, personnel, directors shall not be liable for any loss, damage, liability whatsoever for any direct or indirect loss arising from the use or access of any information that may be displayed in this publication from time to time.

Visit us at www.bankofbaroda.com



For further details about this publication, please contact:

Economics Research Department

Bank of Baroda

+91 22 6698 5143

chief.economist@bankofbaroda.com

dipanwita.mazumdar@bankofbaroda.com