

Bonds Wrap

Global yields witnessed quite a bit off sell off both in Sep'23 and in Oct'23 (till 3 Oct 2023). This was led by sharp increase in US 10Y yield which rose to its level seen last in 2007. Tighter labour market conditions, uncertainty over the trajectory of inflation and mixed signaling on demand front, all contributed towards expectation of a tightening policy response from Fed. India's 10Y yield has still been immune to that increase compared to its major peers. The positive news from inclusion in the JP Morgan Bond Index and stable demand from PSBs and Mutual fund have arrested its increase.

Going forward we expect however some pressure on India's yield to persist. It is expected to trade in the range of 7.15-7.25% in the current month. The upward bias exists as there is fair degree of correlation between the movement of India and US 10Y yield. Liquidity is also expected to be in deficit in the current month in the range of 0.1-0.3% of NDTL. RBI's tools will lend support.

Selling rout visible in global yields:

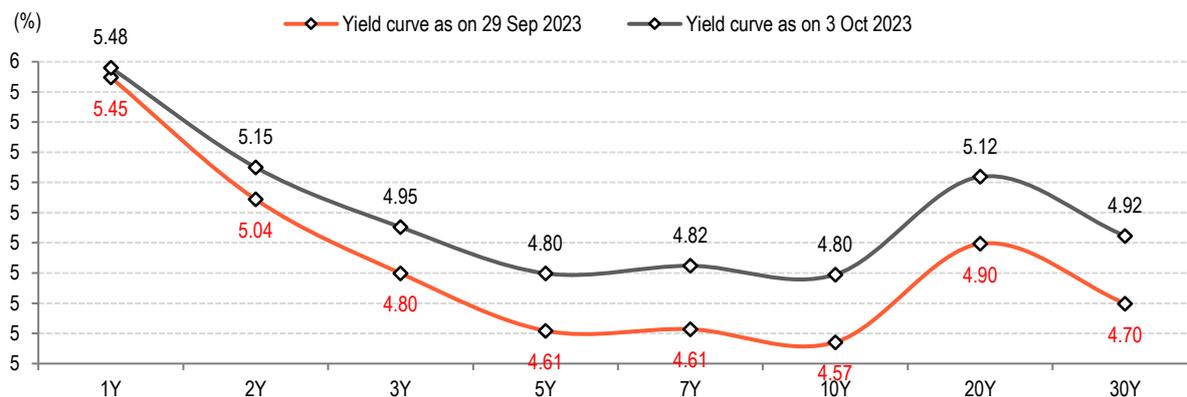
- Anticipation of tighter monetary policy with US Fed leading the pack, followed by volatility in oil prices (on an average 8.8% increase in Sep-23 compared to Aug-23) and a sharper rise in dollar led to selling spree in global bond market. In Sep-23, US 10Y yield rose by 46bps compared to last close of Aug-23. As per CME Fed watch data, the likelihood of a rise in Fed fund rate rose to 28.1% from previous week's level of 16.4%. Fed officials such as Michelle Bowman, Loretta Mestar and Raphael Bostic also reiterated for a tighter policy.
- The recent PCE deflator, stable personal income, sticky inflation expectations as well as a tighter employment index all pointed towards a restrictive monetary policy on part of Fed. As of 3 Oct 2023, the entire US yield curve has shifted up considerably with significant increase in yield being visible in the 5-30Year part of the curve.

Table 1. 10Y Yields movement globally

Countries	10Y sovereign yield, 31 Aug 2023	10Y sovereign yield, 29 Sep 2023	10Y sovereign yield, 3 Oct 2023	Change in 10Y yield, Sep-23/Aug-23	Change in 10Y yield, Oct-23/Sep-23
Indonesia	6.38	6.91	7.02	54	11
US	4.11	4.57	4.80	46	22
Thailand	2.76	3.14	-	38	-
Germany	2.47	2.84	2.97	37	13
Singapore	3.13	3.39	3.38	26	0
Korea	3.83	4.01	-	19	-
Japan	0.65	0.77	0.77	11	0
China	2.58	2.68	-	10	-
UK	4.36	4.44	4.60	8	16
India	7.16	7.22	7.23	5	2

Source: Bloomberg, Bank of Baroda Research

Figure 1: US Yield curve has shifted upwards entirely in Oct-23



Source: Bloomberg, Bank of Baroda Research

Domestic 10Y yield inched up by 5bps and traded in the range of 7.13-7.25% in Sep'23. Broadly buying support remained compared to other emerging peers. Lower than expected CPI print in Aug'23, easing price pressure from Government's supply side measure, supported yields. Adding to that was the positive news of India's inclusion in the JP Morgan Bond Index. Thus, broadly India's 10Y sovereign yield did not exhibit much volatility; the slight movement was in tune with global yields.

Table 2: Evolution of India's yield curve

Dates	Yield Curve, 31 Aug 2023	Yield Curve, 21 Sep 2023	Yield Curve, 22 Sep 2023	Yield Curve, 29 Sep 2023
3M	6.77	6.79	6.86	6.80
6M	6.99	7.03	7.06	7.03
5Y	7.11	7.15	7.11	7.23
6Y	-	7.17	7.15	7.24
7Y	-	7.16	7.12	7.25
10Y	7.16	7.16	7.18	7.22
20Y	7.20	7.23	7.22	7.28
30Y	7.33	7.32	7.13	7.41

Source: Bloomberg, Bank of Baroda Research, Yield exhibiting much movement have been highlighted in red, Dates 21 Sep and 22 Sep have been chosen to see the impact of yields post announcement of India's inclusion in the JP Morgan Bond Index

It is interesting to see the movement of India's yield curve. Here 5-7year part of the curve has seen major shift in yields between 21 Sep and 22 Sep during the episode of announcement of India's inclusion in the JP Morgan Bond Index. This is because securities in the bucket of 5-10 years have the maximum share in terms of outstanding amount. However, soon after the announcement, there have been considerable correction.

What auctions in the domestic market reflect?

In Sep'23, cut off yields for central government papers' rose the most by 9bps whereas for TBill and SDL by 5bps and 4bps respectively, amidst tighter domestic liquidity conditions.

Table 3. Cost of borrowing inched up

Type of Papers	Cut off yield as on 31 Jul 2023	Cut off yield as on 31 Aug 2023	Cut off yield as on 29 Sep 2023
Central Government Securities	7.24	7.25	7.34
SDL	7.39	7.43	7.47
Tbills	6.82	6.96	7.01

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 deficit was at Rs 17,799 crore in Sep'23 compared to Rs 1.19 lakh crore surplus observed in Aug'23. Currently liquidity is in deficit of Rs 40,336 crore. In the coming months, pressure on liquidity would come from higher pace of accretion in currency in circulation due to festive demand. Apart from this, RBI's Fx intervention on the back of a strengthening dollar to support INR will also impact the liquidity conditions. Apart from this, Rs 1.43 lakh crore of securities are due for redemption in Nov'23, this will also put pressure on liquidity going forward.
- RBI may comfort in terms of OMO purchase going forward or higher tenor VRR. We expect liquidity to remain in deficit in the current month as well in the range of 0.1-0.3% of NDTL.

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.* Upside pressure emanates from increase in US 10Y yield. Currently the gap between India and US 10Y yield is 241bps, whereas historical average gap between the two has been around 442bps, so there is a possibility that there might be some catch up of Indian 10Y yield in response to faster pace of increase in US 10Y yield. The correlation between Indian and US 10Y yield since Apr'23 has also been high at 0.47, so some upside pressure on India's 10Y yield as a result cannot be ruled out entirely.

Table 4: OIS rates inched up

	As on 31 Aug 2023	As on 29 Sep 2023	As on 3 Oct 2023
OIS Rates			
1M	6.73	6.83	6.83
2M	6.73	6.83	6.85
9M	6.94	7.05	7.07
Corporate Spreads 10Y, bps			
AAA	37	35	33
AA+	68	67	67
AA	102	98	100

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

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