

Bonds Wrap

Global yields got comfort from expectation of easing financial conditions in the coming year. CME Fed watch tool is pricing in a rate cut by Fed from Mar'24 onwards. Fed Chair's comments remained balanced. Yield of other AEs also followed US. Even yields in major EMs noticed a sharp correction in Nov'23. Inflation is showing signs of moderation in major economies on the back of stable energy prices. However indicators of growth remained blurry. Thus going forward, global yields will be guided by movement of US 10Y yield, where correction on the downside would persist in Dec'23 as well.

India's 10Y yield fell at a slowest pace compared to its major peers. The moderation in yield was arrested by tighter liquidity conditions. In the coming days as well, pressure on liquidity is going to persist as incremental credit and deposit gap in financial year till date is ~ Rs 3.4 lakh crore. Thus, RBI did not conduct any OMO sale in the secondary market in Nov'23. We expect India's 10Y yield to remain in the range of 7.25-7.35% this month. CPI data print for this month and RBI's articulation would be closely monitored.

Global yields on a downswing led by US:

- Risk appetite for sovereign securities increased in Nov'23. This was driven by anticipation of easing financial conditions, especially in the US. Softer labour market data of the region, likely impact of past period higher rates in the housing sector, pullback by consumers on spending as well as softer core PCE data, provided some comfort that Federal fund rates have already peaked. Fed Chair's recent speech was also more balanced, while a litany of other Fed officials did not refrain from hinting that if moderation in inflation is persistent, then easing may be on the cards. CME Fed watch tool has evolved interestingly, it is now pricing even a 50bps rate cut in Mar'24 meeting of Fed, with 8.3% probability attached to it, while 55.1% probability is attached for a 25bps rate cut. Thus the fair play of growth inflation dynamics, led US 10Y yield closed 60bps lower in Nov'23 over Oct'23. Even yesterday's close was 13bps lower.
- Other AEs also followed suit. Germany's 10Y yield moderated following softer growth and inflation data, which raised anticipation that ECB may also walk on similar lines of Fed. Thus, Germany's 10Y yield fell by 36bps in Nov'23 and further by 9bps in yesterday's close.
- 10Y Yields of other EMs such as Thailand and Indonesia also showed sharp correction in Nov'23, which moderated following respective central bank's hinting of a relatively comforting inflation amidst mixed performance of some growth indicators.
- Going forward, the tone of central bankers will be cautious. A few softer inflation prints in the coming days in the wake of stable energy prices and muted demand conditions, will call for some degree of monetary stimulus especially in H2 of next year, where growth would require some hand holding.

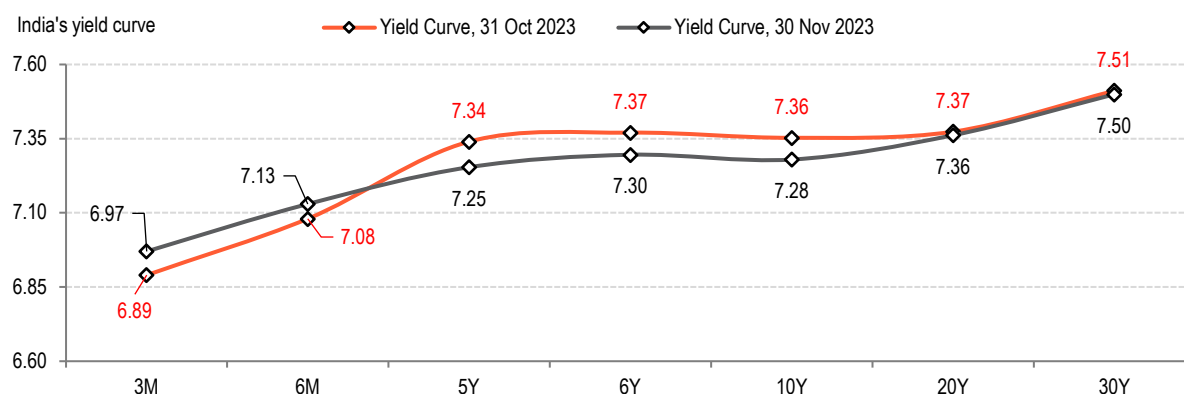
Table 1. 10Y Yields movement globally

	10Y sovereign yield, 31 Oct 2023	10Y sovereign yield, 30 Nov 2023	10Y sovereign yield, 1 Dec 2023	Change in 10Y yield, Nov-23/Oct-23
China	2.69	2.69	2.68	-1
India	7.36	7.28	7.29	-8
Thailand	3.21	2.95	2.95	-26
Japan	0.95	0.67	0.70	-28
UK	4.51	4.18	4.14	-34
Germany	2.81	2.45	2.36	-36
Singapore	3.37	2.95	2.97	-42
Indonesia	7.11	6.63	6.62	-48
US	4.93	4.33	4.20	-60
Korea	4.34	3.70	3.70	-64

Source: Bloomberg, Bank of Baroda Research

Domestic 10Y yield moderated by 8bps and traded in the range of 7.22-7.36 in Nov'23 against 7.22-7.38% in Oct'23. Stickiness in food inflation, resilient growth indicators and tighter liquidity conditions, have arrested further fall in yields.

Table 2: Movement of India's yield curve



Source: Bloomberg, Bank of Baroda Research

Short end part of the curve remained sticky due to tighter liquidity conditions, while 5-10Y part of the curve moderated. The spread between 3M and 30Y part of the curve moderated to 53bps in Nov'23 from 62bps in Oct'23.

What auctions in the domestic market reflect?

In Nov'23, cut off yields moderated for the 10Y paper, while for short end papers it remained sticky. Yesterday's auction results showed the cut off yield for the 10Y paper (7.18GS2033) was 7bps higher. Thus some pressure cannot be ruled out entirely this month.

Table 3. Cost of borrowing

Type of Papers	Cut off yield as on 29 Sep 2023	Cut off yield as on 31 Oct 2023	Cut off yield as on 30 Nov 2023
Central Government Securities	7.34	7.44	7.38
SDL	7.47	7.72	7.73
Tbills	7.01	7.08	7.09

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

Pressure on liquidity continued:

- Average system liquidity deficit rose to Rs 61,434 crore from Rs 52,034 crore in Oct'23. Liquidity deficit actually crossed Rs 1 lakh crore towards the latter part of the month. This is on account of GST outgo. Bank's reluctance to park funds in the reverse repo window was visible this month, as well.
- Going forward, government securities of Rs 78,834 crore is due to mature. This will ease liquidity to some extent. We do not expect any OMO sale calendar this month, as in the secondary market as well, RBI broadly did not perform any OMO sales operation in Nov'23. The gap between incremental credit and incremental deposit in this financial year is considerably higher at Rs 3.4 lakh crore. Thus, pressure on liquidity would broadly reign in.

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to remain in the range of 7.25-7.35% in the current month.* On the downside, moderation will be in line with US 10Y yield movement. However, considerable upside pressure remains from surprise shock in vegetable prices, which might disrupt the inflation trajectory going forward. In Nov'23, onion price shock is expected to keep food inflation elevated. RBI's tone will also be closely watched. Liquidity pressure might not dissipate soon as credit growth is maintaining a buoyant pace. Advance tax payment's December installment will also add pressure on liquidity.

Table 4: Corporate spreads inched up

	As on 31 Oct 2023	As on 30 Nov 2023
OIS Rates		
1M	6.81	6.87
2M	6.80	6.87
9M	6.91	6.86
Corporate Spreads 10Y, bps		
AAA	32	41
AA+	64	70
AA	97	106

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

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