2 Mar 2024

Dipanwita Mazumdar
Economist

Bonds Wrap

Sell off in global bond market persisted in Feb'24 as well since markets have already priced in a late start to the rate cut cycle of major central banks. For Fed, odds are in favour of a rate cut from Q2 onwards. For other central banks, it may be an even more delayed response based on the evolution of growth-inflation data. For domestic yields, the undertone is different. India's 10Y yield got support from buoyant demand from FPIs. In Feb'24, there were inflows of US$ 2.7bn in the debt segment. Going forward, resilient domestic macros, fiscal discipline and easing price pressure would put further downward bias on yields.

We expect 10Y yield to remain in the range of 7-7.10% in the current month. Liquidity deficit is likely to persist and remain in the range of 1.0-1.2% of NDTL. Durable liquidity would come under further pressure due to expected increase in currency in circulation in the coming months.

US 10Y inched up considerably:

- US 10Y yield continued to inch up. The undertone of major Fed officials (Atlanta Fed President, Chicago Fed President and Fed Governor) was that policy rate has already peaked but easing warrants a correct balance of macroeconomic mix. The core PCE data closely tracked by Fed in policymaking has remained firm. University of Michigan's inflation expectations have also hinted at stickier inflation both for 1 and 5 year horizon. Other macro data such as ISM manufacturing print, consumer confidence index and new homes data showed some softening. This has pared the increase in yields to some extent. As per CME Fed watch tool the odds of a rate cut is visible only from Q2CY24 onwards. The upcoming Fed Chair's testimony before the Congress and payroll data holds the cue.
- Other central banks such as BoE and ECB closely monitored the growth-inflation dynamics of the region. BoE's Chief Economist was not convinced of easing price pressures and hinted at 'guard against a false sense of security'. Markets are not pricing any move by BoE before Aug'24. Elsewhere, Bundesbank President also cautioned against easing policy too soon. In the Eurozone, despite cooling inflation, core has remained sticky.
- 10Y yield in China was supported by PBOC's surprise move of cutting the 5 year loan prime rate by 25bps. In Thailand, worries about state of the economy has led to a fall in yield, due to risk-off sentiment.

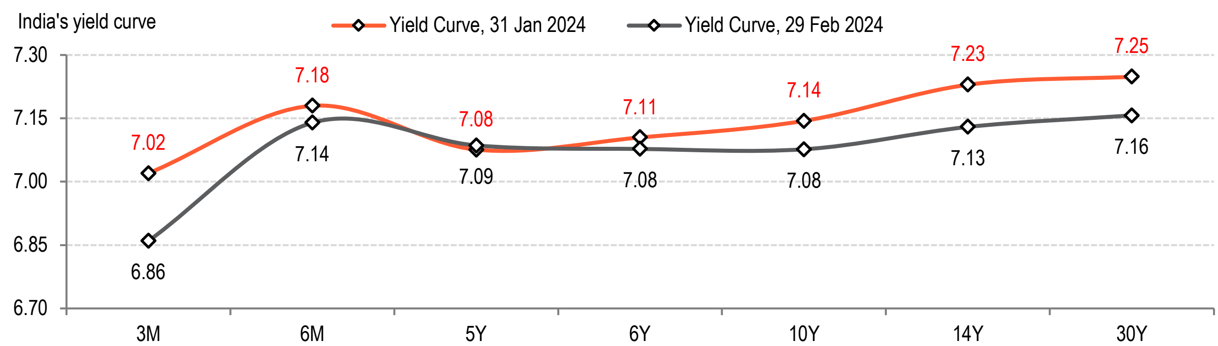
  Domestic 10Y yield fell by 7bps in Feb'24 and by another 2bps in yesterday's trading session, supported by continued buying support from FPIs on account of fairly resilient macro data and growing confidence about fiscal prudence.

Table 1. 10Y Yields movement globally

Countries	10Y sovereign yield, 31 Jan 2024	10Y sovereign yield, 29 Feb 2024	Change in 10Y yield, Feb'24/Jan'24	Change in 10Y yield, 1 Mar 24/Feb'24
US	**3.91**	**4.25**	**34**	**-7**
UK	3.79	4.12	33	-1
Germany	2.17	2.41	25	0
Singapore	2.90	3.09	19	0
Korea	3.35	3.48	14	0
Indonesia	6.58	6.60	2	3
Japan	0.73	0.71	-2	1
India	**7.14**	**7.08**	**-7**	**-2**
China	2.43	2.35	-8	3
Thailand	2.64	2.56	-9	0

Source: Bloomberg, Bank of Baroda Research, Note: Change in bps

Table 2: Evolution of India's yield curve



Source: Bloomberg, Bank of Baroda Research

The longer part of the curve shifted downwards completely. Even for the 3 month paper, considerable moderation in yield was noticed. This has increased the gap between 3 Month and 30Y paper to 30bps as on 29 Feb 2024 from 23bps as on 31 Jan 2024.

What auctions in the domestic market reflect?

In Feb'24, cut off yields inched down across the board, with SDL noticing a sharp drop.

Table 3. Cost of borrowing

Type of Papers	Cut off yield as on 29 Dec 2023	Cut off yield as on 31 Jan 2024	Cut off yield as on 29 Feb 2024
Central Government Securities	7.22	7.19	7.13
SDL	**7.63**	**7.65**	**7.44**
Tbills	7.07	7.13	7.08

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

Pressure on liquidity still remained:

- Average system liquidity deficit moderated to Rs 1.9lakh crore in Feb'24 from Rs 2.1 lakh crore in Jan'24. RBI's fine tuning operations with the frequency of VRR being higher than VRRR kept liquidity range bound. The VRRR auction results with offers received being lower than the notified amount, itself enumerated that liquidity conditions are still tight. Call money rate is also above repo, hovering at 6.67%, currently.
- System liquidity is likely to be in the range of 1.0-1.2% of NDTL. The current gap between incremental credit and deposit in FYTD24 is at Rs 3.2 lakh crore. Thus, medium term pressure on liquidity cannot be discounted.
- Adding to this, durable liquidity also came under pressure moderating to Rs 1.7 lakh crore as on 29 Feb 2024 from Rs 1.8 lakh crore as on 31 Jan 2024. This is attributable to increase in currency in circulation which has picked pace since Jan'24 onwards and likely to go up more in the coming months.
- The second leg settlement date of INR swap is due on 11 Mar 2024. This is expected to add around Rs 40,000 crore of liquidity into the system. Impact of which is likely to be closely monitored.

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to remain in the range of 7.00-7.10% in the current month*. The narrative of domestic yield seems to be bit different from global yields, where delayed rate cut response of major central banks seem to be the dominant factor. On the other hand, downward bias to domestic yield exists from a comforting inflation print. Apart from this, robust demand of FPIs in debt asset class would continue to support yields in the near term. Even a sub 7% number cannot be ruled out.

Table 4: OIS inched up slightly, corporate spreads moderated

	As on 30 Nov 2023	As on 29 Dec 2023	As on 31 Jan 2024	As on 29 Feb 2024
OIS Rates				
1M	6.87	6.79	6.71	6.85
2M	6.87	6.78	6.76	6.78
9M	6.86	6.66	6.63	6.74
Corporate Spreads 10Y, bps				
AAA	41	43	44	39
AA+	70	76	75	74
AA	106	111	113	109

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

Disclaimer

Visit us at www.bankofbaroda.com

For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
chief.economist@bankofbaroda.com