

Bonds Wrap

Global bond yields traded mixed in Apr'23 influenced by varied macros. In the US, while labour market and consumption demand remained buoyant, burgeoning budget deficit and contraction in manufacturing activity posed concerns. However, market is pricing in a 25bps rate hike by Fed in the coming policy with expectations of prolonged pause post that as the OIS papers reflect the same. This comforted US sovereign 10Y yield to some extent in Apr'23. On the other hand, 10Y yields in UK and Germany inched up as the rhetoric of inflation posed concerns. India's 10Y yield have exhibited quite a bit of downswing in Apr'23, falling by 19bps. This was post RBI's surprise move of a pause, defying market expectations of another 25bps hike. Further a lower than expected inflation reading in consonance with favourable oil price and improved appetite for sovereign securities, supported yields in the domestic market. Interestingly, yields across all tenor fell in Apr'23; even the short end curve exhibiting quite a bit of correction, which was not observed in the past two months. Thus the entire yield curve of India shifted downward. Liquidity remained in surplus to the tune of Rs 1.6 lakh crore, supported by RBI's fine tuning through SDF. We expect India's 10Y yield to trade with a downward bias in the range of 7.10-7.15% in May'23. Comfort would come from softening of CPI data in Apr'23, as major high frequency domestic price data are reflecting the same.

Global yields gave mixed signals in Apr'23:

- Both risk on and risk off sentiments conveyed by varied macro data points globally led sovereign 10Y yields in major economies to trade differently. While in major economies such as US, China and India, 10Y yields moderated; on the other hand for UK, Japan and Germany, it inched up.
- In the US, while personal consumption demand and labour market conditions remained buoyant, burgeoning budget deficit, elevated core PCE and contraction in manufacturing activity posed concerns about state of the economy and inflation. CME Fed watch tool is attaching a 95.1% probability for a 25bps rate hike in the coming policy. However, post that money market is pricing in a pause and the 1 Year ahead OIS paper is signaling a rate cut from Fed. US 10Y yield fell by 5bps in Apr'23 compared to Mar'23. In China, softening CPI and PPI print despite some breather in economic activity raised expectations of more monetary stimulus, thus its 10Y yield fell by 8bps.
- On the other hand, in UK 10Y yield firmed up by 23bps supported by firming up of inflation numbers and also robust macro data such as consumer confidence, retail sales and flash services PMI reading. BoE Deputy Governor Dave Ramsden highlighted inflation as key risk. In Japan 10Y yield firmed up by 4bps as its monetary policy statement included the term "broad-perspective review of monetary policy", under its new Governor, which has sparked a bit of anticipation regarding its recourse of ultra-low rates. In Germany as well, 10Y yield inched up by 2bps as elevated inflation in the region pose risks to the outlook on rates. ECB's Chief

Economist Philip Lane hinted a rate hike in the coming policy. Market is pricing in a 25bps rate hike in the coming policy.

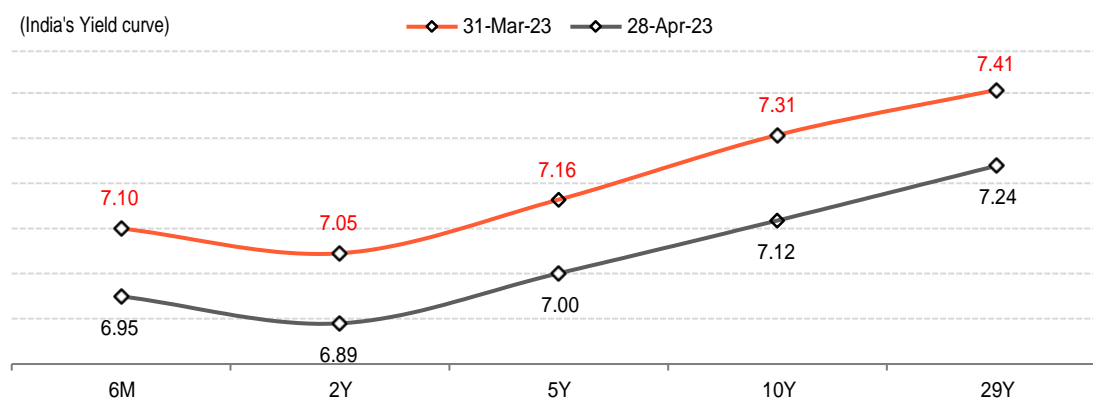
Table 1. 10Y Yields globally traded mixed in Apr'23 over Mar'23

Countries	10Y sovereign yield, 31 Mar 2023	10Y sovereign yield, 28 Apr 2023	Change in 10Y yield in Apr/Mar'23, bps
Bloomberg Barclays EM USD Aggregate Yield to worst	7.36	7.32	-4
India	7.31	7.12	-19
Indonesia	6.79	6.53	-26
UK	3.49	3.72	23
US	3.47	3.42	-5
Korea	3.36	3.37	1
China	2.86	2.78	-8
Thailand	2.43	2.53	10
Germany	2.29	2.31	2
Japan	0.35	0.39	4

Source: Bloomberg, Bank of Baroda Research

Domestic 10Y yield traded in the range of 7.10-7.31% in Apr'23 compared to 7.29-7.43% in Mar'23. Downside pressure to yield was visible post RBI's decision to hold rates against market expectation of a 25bps rate hike. In fact, the minutes reflected that future decision will be a wait and watch mode evaluating the past impact of transmission. The lower than expected headline CPI data and also sharp fall in wholesale inflation also provided additional comfort to yields. *Thus, in contrast to previous few months considerable flattening of the yield curve, this month noticed a drop in yields of all tenor papers.*

Figure 1: Yields fell across all tenor papers



Source: Bloomberg, Bank of Baroda Research

What auctions in the domestic market reflect?

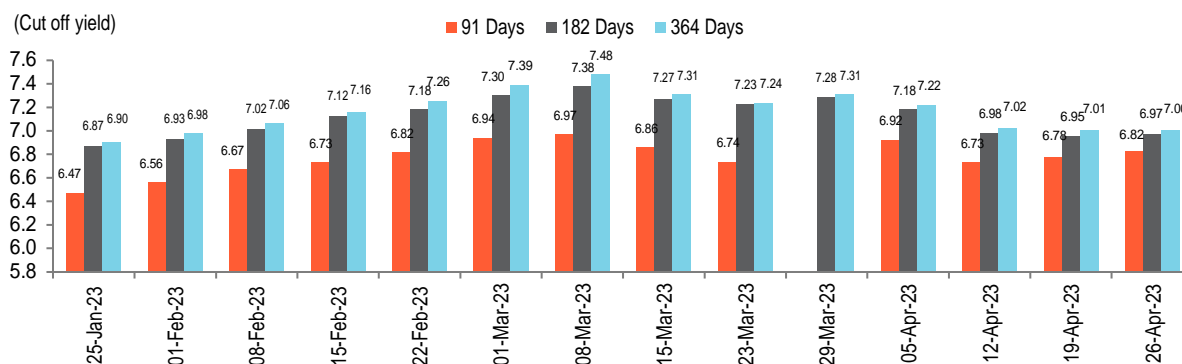
In Apr'23, cut off yields for short term papers have fallen sharply as expectation of no further rate hike from RBI was directly reflected in the moderation of yields of these papers.

Table 2. Cost of borrowing for Tbills rose sharply

Type of Papers	Cut off yield as on 28 Feb 2023	Cut off yield as on 31 Mar 2023	Cut off yield as on 28 Apr 2023
Central Government Securities	7.41	-	7.20
SDL	7.69	7.71	7.40
Tbills	7.08	7.29	6.93

Source: Bank of Baroda Research, Note: Average cut off yield is taken to arrive at borrowing cost, Auction dates differ, The cut off yield for central government securities is as of Feb'23, hence Mar'23 is left black as no auction is scheduled

Figure 2: Cut off yield for T-bills have fallen sharply



Source: RBI, Bank of Baroda Research, Note in the 29 Mar 2023 auction the YTM of 91-day TBill is not available

Liquidity conditions remained tighter:

- System liquidity surplus averaged to Rs 1.6 lakh crore compared to deficit of Rs 1,300 crore in Mar'23, supported by RBI's fine tuning through SDF. RBI conducted VRRR of notified amount of Rs 2.5 lakh crore but the demand response was muted with less than 50% offers received. This was because liquidity was already under pressure due to maturity of Rs 61,131 crore of TLTROs and LTROs.
- Durable liquidity has moderated sharply to Rs 79,885 crore as on 27 Apr 2023 compared to Rs 1 lakh crore as on 31 Mar 2023, as currency accretion is happening at a faster pace. Some comfort on this front was provided by accretion in foreign currency assets to the tune of US\$ 4.8bn in Apr'23.

Major players in the month

As per Bloomberg data, buying has been supported by foreign and private banks as well as PDs.

Outlook on 10Y yield for the next 30days:

- India's 10Y yield is expected to remain in the range of 7.10-7.15% in the current month. Downward bias exists as major high frequency indicators of domestic price data are showing

comfort on inflationary front. Even short end papers are likely to see further correction. A *phenomenon of entire shift of the yield curve rather than only change in the slope may continue to persist even in the coming month.*

Table 3: OIS rates have inched down reflecting easier policy space, corporate spreads remained broadly stable

	As on 31 Mar 2023	As on 28 Apr 2023
OIS Rates		
1M	6.69	6.58
2M	6.71	6.59
9M	6.82	6.62
Corporate Spreads 10Y, bps		
AAA	38	38
AA+	71	75
AA	108	110

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

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