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Dipanwita Mazumdar
Economist

Bonds Wrap

US 10Y yield exhibited quite a bit of volatility. While sharp sell-off was witnessed in Oct'23, it got reversed in the last trading session. Fed policy remained on expected lines with Fed Chair acknowledging a slightly resilient economy and a tighter labour market backdrop. However, money market is pricing in end of the rate hike cycle, which in turn supported yields. Apart from US, 10Y yield in Japan noticed some change post BoJ's twitch in its YCC program by scrapping its reference to daily bond purchasing at a fixed level of 1%.

India's 10Y yield exhibited a slight discomfort from RBI's surprise announcement of OMO sales in its policy document. Apart from this, volatility in crude prices and rise in US yield also retained pressure on domestic yields. Liquidity conditions continued to remain tighter with current deficit at around 0.24% of NDTL. RBI is already conducting OMO sales in the secondary market to some degree. Going forward, this may continue to rule out any additional pressure on yields from a formal calendar announcement.

We expect India's 10Y yield to trade in the range of 7.30-7.40% in the current month with risks tilted to the upside. We need to observe how indicators like growth in credit, deposits as well as inflation progress during the month.

US 10Y yield exhibited considerable volatility:

- Selling spree was visible with US 10Y yield rising at a sharp pace by 36bps in Oct'23 against Sep'23. This was buoyed by fairly resilient macros of the region. Q3 advance estimate of GDP grew at its highest pace in two years. Apart from this, retail sales, new home sales, composite PMI print all aggravated the sell-off in the US bond market. However, post the recent Fed policy, US 10Y yield exhibited quite a sharp downswing with 20bps fall in a single trading session. Though policy decision was on expected lines with Fed Chair's rhetoric of being data dependent; yet money market is pricing in nearing of the rate hike cycle. Apart from this, report of US Treasury's plans to slow the pace of increases in long term debt sales also triggered fall in US 10Y yield.
- 10Y yield in other EMs such as Korea was supported by stickier inflation (both PPI and CPI) and fairly buoyant GDP print. In Indonesia, its central bank's surprise move of a 25bps hike in policy rate to stabilize its currency has led to hardening of its yield.
- Japan's 10Y yield neared towards the 1% mark post piecemeal tweak in the YCC program by BoJ. In Germany, 10Y yield moderated as growth conditions softened and inflation showed some respite in the Eurozone.

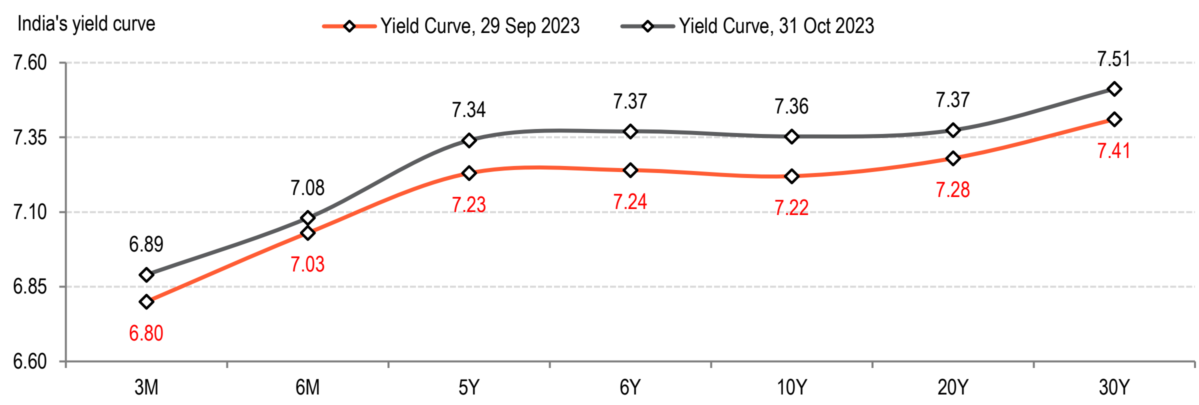
Table 1. 10Y Yields movement globally

	10Y sovereign yield, 29 Sep 2023	10Y sovereign yield, 31 Oct 2023	Change in 10Y yield, Sep-23/Aug-23	Change in 10Y yield, Oct-23/Sep-23
US	**4.57**	**4.93**	**46**	**36**
Korea	4.01	4.34	19	32
Indonesia	6.91	7.11	54	19
Japan	0.77	0.95	11	18
India	**7.22**	**7.36**	**5**	**14**
UK	4.44	4.51	8	7
Thailand	3.14	3.21	38	7
China	2.68	2.69	10	1
Singapore	3.39	3.37	26	-2
Germany	2.84	2.81	37	-3

Source: Bloomberg, Bank of Baroda Research

Domestic 10Y yield inched up by 14bps and traded in the range of 7.22-7.38% in Oct'23 from 7.13-7.25% in Sep'23. Apart from global factors, the major driver towards this increase has been RBI's surprise mention of OMO sales in the policy document.

Table 2: Evolution of India's yield curve



Source: Bloomberg, Bank of Baroda Research

India's yield curve shifted entirely, with 5-10Year part of the curve witnessing major change.

What auctions in the domestic market reflect?

In Oct'23, cut off yields rose across the board. It rose at the sharpest pace for State Government papers, mirroring movement in Gsec yields.

Table 3. Cost of borrowing inched up

Type of Papers	Cut off yield as on 31 Aug 2023	Cut off yield as on 29 Sep 2023	Cut off yield as on 31 Oct 2023
Central Government Securities	7.25	7.34	7.44
SDL	7.43	7.47	7.72
Tbills	6.96	7.01	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 continued:

- Average system liquidity deficit rose to Rs 52,034 crore in Oct'23 from Rs 17,799 crore in Sep'23. Bank's reluctance to park funds in the V3R window was visible in this month as well. Incremental Credit deposit gap is around Rs 1 lakh crore. This has exerted pressure on liquidity. Apart from this, run down of forex reserves of US$ 3.4bn in Oct'23 has also exerted pressure on liquidity.
- Going forward, government securities of Rs 1.43 lakh crore are due to be mature. RBI has already been conducting some quantum of OMO sales in the secondary market. As per Bloomberg data, the RBI has done Rs 6,630 crore OMO sale in the secondary market to support liquidity mismatches. This sort of intervention would persist. A formal announcement calendar might be postponed towards the end of Nov or Dec'23 depending on the evolution of underlying liquidity conditions. We expect liquidity to remain in deficit in the current month as well in the range of 0.2-0.5% of NDTL.

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to remain in the range of 7.30-7.40% in the current month*. Upside pressure emanates and 10Y yield might not shy off from the 7.5% mark if any surprise higher quantum of OMO sales calendar is brought out by RBI. Global factors will be in play in paring a steep increase in yields on account of the risk off sentiment for choice of assets. Comfort will also be provided by a softening CPI print in Oct'23, which is expected to crawl towards the targeted 4% level sooner.

Table 4: OIS rates still pricing in another 25bps rate hike by RBI

	As on 29 Sep 2023	As on 31 Oct 2023
OIS Rates		
1M	6.82	6.81
2M	6.83	6.8
9M	7.05	6.91
Corporate Spreads 10Y, bps		
AAA	35	32
AA+	67	64
AA	98	97

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

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For further details about this publication, please contact:

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