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Dipanwita Mazumdar
Economist

Bonds Wrap

Sell off in global bond market was seen in Jan'24 and Feb'24 (till 2nd Feb). It was led by US and the undertone of Fed. Globally, central banks are expected to embark on the easing cycle but the timing might be pushed back as underlying macro picture gives a confusing signal in terms of growth-inflation dynamics. Domestic yields got support from Union Budget. Lower than expected gross borrowing numbers, fiscal prudence; supported yields. Post Budget, it has fallen by 9bps. We expect it to trade in the range of 7-7.10% in the current month. Downward bias persists from a favorable inflation print.

Liquidity deficit is likely to persist and remain in the range of 1.0-1.2% of NDTL. This is primarily on account of higher pace of increase in credit than deposits. Going forward, RBI may come up with some measures to improve durable liquidity which has shown moderation.

Volatility in US 10Y yield persist:

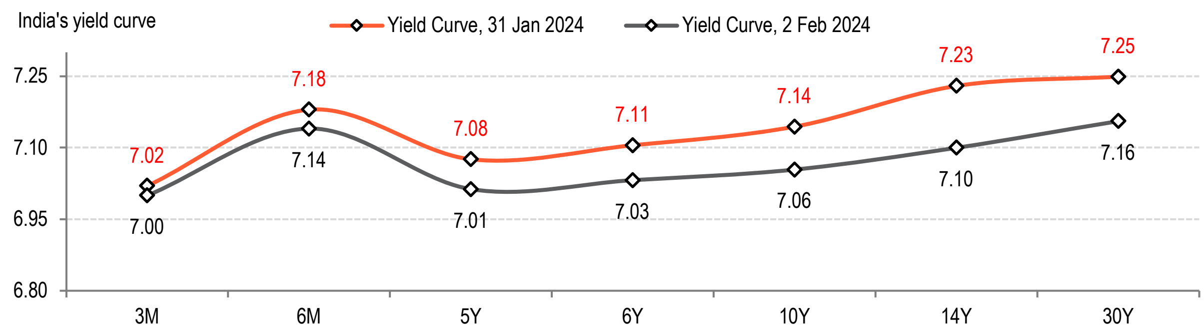
- Global yields led by US continued to exhibit volatility. US 10Y yield after falling by 45bps in Nov'23 on MoM basis again reversed its trend in Dec and Jan. It rose by 3bps in Jan'24 and by another 11bps in Feb'24 (till 2nd Feb'24). When the Fed policy meeting for Jan'24 was ongoing, the 10Y yield fell by 15bps alone (30 Dec'23 to 1 Jan'24). However, the fall in yields was erased entirely in the last trading session tracking the US non-farm payroll numbers, which has risen at a robust pace of 353K (est.: 185K) in Jan'24. Even the Dec'23 number has been revised upward to 333k from 216k earlier. Average hourly earnings on MoM basis has risen by 0.6% against estimation of 0.3%. Even inflation expectation in the US as tracked by University of Michigan has remained firm both for 1 Year and 5 Year ahead. CME Fed watch tool data now attaches a 38% probability for a 25bps rate cut in Mar'24, pruned down from 46.2%, a week earlier and 64.7%, a month earlier. Recent remarks by Fed Governor Michelle Bowman also highlights that it is too early to embark on the easing cycle.
- Other global yields also felt the reverberation of the same. ECB hinted at a cautionary data dependent approach in the near term. Thus, Germany's 10Y yield rose by 14bps in Jan'24, on MoM basis and by another 8bps in Feb'24. UK's 10Y yield has risen at a much sharper pace by 26bps in Jan'24 and by 12bps in Feb'24, led by stickier inflation data and slightly improving macros in terms of consumer credit and consumer confidence. BoE on the other hand, effectively ruled out further rate hikes.
- The undertone of major central banks globally has been preparing to put the foot on the pedal of rate cut but not pressing it too hard, keeping an eye on the growth-inflation mix.
- China's 10Y yield was supported by liquidity injection and rate cut by PBOC.
- **Domestic 10Y yield** moderated by 3bps in Jan'24 and by another 9bps in Feb'24. Much of the decline in yields was a post Budget phenomenon. Lower than expected gross borrowing numbers, lower repayment numbers on account of recovery from GST compensation fund and fiscal prudence, all seem to be favourable for yields.

Table 1. 10Y Yields movement globally

	10Y sovereign yield, 31 Jan 2024	10Y sovereign yield, Feb 2024*	Change in 10Y yield, Jan'24/Dec'23	Change in 10Y yield, Feb'24*/Jan'24
UK	3.79	3.92	26	12
US	**3.91**	**4.02**	**3**	**11**
Germany	2.17	2.24	14	8
Thailand	2.64	2.64	-3	0
China	2.43	2.43	-13	-1
Singapore	2.90	2.86	21	-4
Korea	3.35	3.29	17	-6
Indonesia	6.58	6.52	10	-6
Japan	0.73	0.67	12	-6
India	**7.14**	**7.06**	**-3**	**-9**

Source: Bloomberg, Bank of Baroda Research, Note: till 2nd Feb 2024

Table 2: Evolution of India's yield curve



Source: Bloomberg, Bank of Baroda Research

Short end part of the curve remained sticky as tighter liquidity conditions continued to put strain on the same. Long end part got buying support. The spread between 3M and 30Y part of the curve has fallen to 16bps in Feb'24 from 23bps in Jan'24. Thus the tendency of moving towards a flatter curve would continue in the coming months as well.

What auctions in the domestic market reflect?

In Jan'24, cut off yields moderated for the 10Y paper of Centre supported by buoyant demand from MFs and foreign banks. However, tighter system liquidity impacted cut off yields of short tenor papers, which generally is more responsive to such conditions.

Table 3. Cost of borrowing

Type of Papers	Cut off yield as on 30 Nov 2023	Cut off yield as on 29 Dec 2023	Cut off yield as on 31 Jan 2024
Central Government Securities	**7.38**	**7.22**	**7.19**
SDL	7.73	7.63	7.65
Tbills	7.09	7.07	7.13

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 2.1 lakh crore in Jan'24 and currently at Rs 2.2 lakh crore and compared to Rs 1.1 lakh crore deficit in Dec'23. The evolution of liquidity dynamics has been interesting. Government cash balance has risen to Rs 4.1 lakh crore in Jan'24 compared to Rs 3.8 lakh crore in Dec'23.
- RBI's fine tuning operations continued with conduct of VRR of different tenors. It continued to receive bids which was 1.2-2.9 times the notified amount. The spread between call and repo is currently at 24bps.
- Going forward, upcoming RBI policy is expected to give some guidance on liquidity. Currently the gap between incremental credit and deposit in FYTD24 stands at Rs 3.6 lakh crore. Thus near term pressure on liquidity cannot be ruled out unless RBI comes up with some measures to improve durable liquidity of the system. System liquidity is likely to be in the range of 1.0-1.2% of NDTL.

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 downside pressure emanate from supportive crude price, fiscal prudence and lower supply of papers in the coming fiscal.
- A lot is contingent on the direction of global yields where rate cut by Fed in Mar'24 is doused to some extent. This is driving the recent selling rally in global yields. However, long part of India's yield curve is unlikely to be much affected of this narrative and downward bias for domestic yields persist. Even inflation is likely to be supportive of yields. Jan'24 high frequency data of prices have shown moderation. This coupled with favorable base are likely to put downward pressure on inflation, which in turn will keep yields in check.

Table 4: OIS inched down, corporate spreads broadly stable

	As on 30 Nov 2023	As on 29 Dec 2023	As on 31 Jan 2024	As on 2 Feb 2024
		OIS Rates		
1M	6.87	6.79	6.71	6.69
2M	6.87	6.78	6.76	6.72
9M	6.86	6.66	6.63	6.6
		Corporate Spreads 10Y, bps		
AAA	41	43	44	44
AA+	70	76	75	77
AA	106	111	113	113

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