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Dipanwita Mazumdar
Economist

Bond Market Round-up: September 2022

Financial tightening continued globally which led to sell-off in the bond market. The sharpest sell-off was seen for UK where expansionary fiscal policy was perceived as a threat to inflation. Fed's projection of 4.6% as the terminal rate for CY23, made investors believe that global rates are bound to rise. On the domestic front as well, RBI frontloaded another 50bps rate hike (total 190bps till date in the current cycle). However, this was much on expected lines, hence India's 10Y yield broadly remained stable, post policy. The main highlight in the domestic bond market in Sep'22, has been the sharper pace of increase in short end yields, whether be it T-bills of all maturity or short tenor government papers. We expect yield curve flattening to continue in the coming days, with short end papers rising at a faster pace than long end papers. This will be on account of liquidity slipping into deficit due to RBI's forex intervention and faster growth in credit.

10Y yield is likely to be broadly stable and is expected to trade in the range of 7.30-7.45% in the current month. Only discomfort might be another above 7% headline CPI print in Sep'22. We expect it to be between 7-7.3%.

Financial conditions tightening continued:

- Global 10Y yields started firming up sharply worldwide. The sell-off spree was the sharpest in the UK market with 10Y yield inching up by 129bps. This was on account of UK's expansionary policies announced at a time when the economy was facing considerable inflationary pressure. Even a bond purchase announcement of US$ 71bn in the next 2 weeks, could hardly comfort yields.

- Sentiments in the bond market also worsened with US materializing a 75bps rate hike in the current policy and indicating a terminal Fed Fund rate projection of 4.6% in CY23. Currently market is pricing in another 75bps rate hike in the next policy of US Fed (CME Fed Watch Tool data). Thus, US 10Y yield rose by 64bps.

- With Germany's inflation touching the highest level in 25-years (10.9%), expectation of 75bps rate hike by ECB crept in. This led its 10Y yield rise by 57bps.

- Even major EMs were not insulated from this financial tightening. Thus, Bloomberg EM bond yield rose by 111bps.

- Sentiments in the domestic market was dampened with reports of delay in India's inclusion in the EM Global Bond Index, on account of procedural issues. Thus, India's 10Y yield rose by 21bps in Sep'22.

Table 1. 10Y Yields globally inched up considerably

Countries	10Y sovereign paper yield, 31-Aug-22	10Y sovereign paper yield, 30-Sep-22	Change in 10Y yield in Sep'22, bps
UK	**2.80**	**4.09**	**129**
Thailand	2.43	3.18	76
US	**3.19**	**3.83**	**64**
Germany	1.54	2.11	57
Korea	3.71	4.08	37
Indonesia	7.13	7.37	25
India	**7.19**	**7.40**	**21**
China	2.64	2.75	11
Japan	0.23	0.24	2

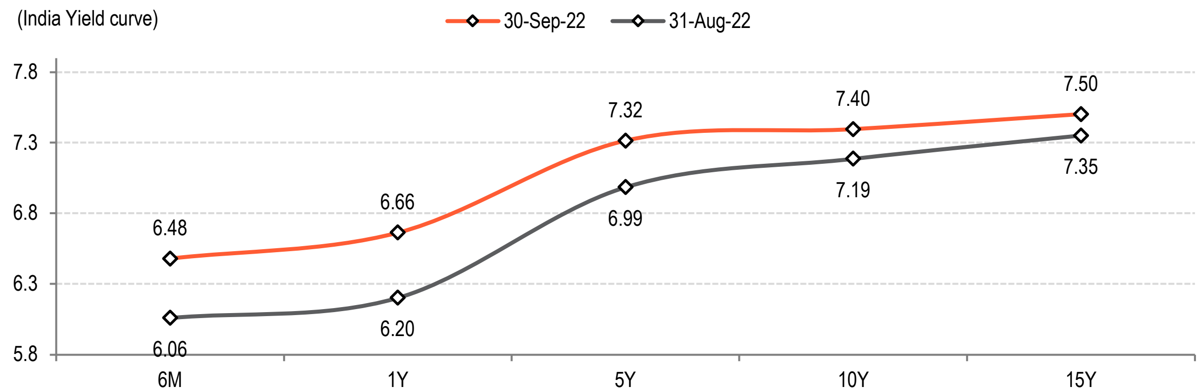
Source: Bloomberg, Bank of Baroda Research

Domestic 10Y yield traded in the wide range of 7.08-7.40% in the current month. The downward swing was on account of 8.8% drop in crude prices in the current month while the upshot was led by spillover impact on account of sell off in the global bond market.

Interestingly, the increase in short term yields was much shaper. For 6 month paper, the increase in yield was 42bps, for 1Y paper it showed an increase of 46bps. However, for long end papers, the increase was considerably at a softer pace (for 10 Year paper, +21bps and 15 Year paper: +15bps).

The spread between 15 Year and 6 months paper went down to 102bps as on 30 Sep 2022 compared to 129bps as on 31 Aug 2022.

Figure 1: Gap between short end and long end yields reducing



Source: Bloomberg, Bank of Baroda Research

What auctions in the domestic market reflect?

Auction results reflected that borrowing cost went up sharply for TBill. For 91 days TBill, it went up by 54bps, for 182-days by 55bps and for 364-days, the increase was 48bps, in the month of Sep'22. On the other hand, for 10Y Gsec yield the cut off rose by only 4bps. For SDL as well, it remained unchanged.

Table 2. Cost of borrowing rising sharply for TBills

Type of Papers	Cut off yield as on 26 Aug 2022	Cut off yield as on 30 Sep 2022
Central Government Securities	7.31	7.35
SDL	7.67	7.67
Tbills	6.01	6.54

Source: Bank of Baroda Research, Note: Implicit yield at cut off taken as on the mentioned date

Liquidity tightening would prevail:

System level liquidity went into deficit for 5days in Sep'22. This was the first time after 28 May 2019 that we are observing a deficit. In Sep'22, on an average, system liquidity was in surplus of Rs 73,433 crore, lower compared to surplus of Rs 1.16 lakh crore seen in Aug'22.

There are indications that liquidity is likely to be in deficit on account RBI's forex intervention and buoyant pick up in credit due to resilient economic activity. Thus, we expect there will days when liquidity will move into deficit. However, it would get comfort from RBI's fine tuning operation. Thus RBI recently switched on to 14-days VRRR as 28-days would lock in liquidity for longer.

Government's cash balance dropped to Rs 2tn as on 5 Sep 2022and is presently higher at Rs 3.9tn as on 29 Sep 2022 against Rs 2.9tn as on 31 Aug 2022. The level is still lower than Rs 5.5 lakh crore level seen on 25 Jul 2022. We believe that with government spending picking up in the second half of FY23, there will be drawdown from this cash balance to finance the spending.

Major players in the fortnight

As per Bloomberg data, maximum buying for government securities in Sep'22 has been from public and private banks.

Outlook on 10Y yield for the next 30days:

- The main factor which is going to impact India's 10Y yield movement in the current month will be the inflation print for Sep'22. High frequency price data still shows considerable pressure for vegetable prices especially tomato prices, meat and fish and milk. Apart from this, economy is also running at full capacity which will also aggravate the demand pull inflation. We expect the headline CPI data to be around 7-7.3%.
- However, much bouts of volatility in the long tenor papers is not expected. On the supply side as well more than 70% of issuance have been reserved for 10Y and above tenor papers. Even post RBI's policy, there have been no major movement in India's 10Y yield as markets have already priced in the rate hike. We expect it to remain in the range of 7.30-7.45% in the current month, with risks remaining on the upside from inflation print.

Table 3: OIS rates have inched up sharply, while there has been no major change in corporate spreads as long end curve exhibited less volatility

	As on 31 Aug 2022	As on 30 Sep 2022
	OIS Rates	
9M	6.19	6.79
1Y	6.32	6.90
	Corporate Spreads-10Y	
AAA	29	27
AA+	64	67
AA	99	94
AA-	139	142
A+	264	267
A	289	292
A-	339	342
BBB+	389	392
BBB-	464	467

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

For further details about this publication, please contact:

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