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Bonds Wrap

Upward rally in US 10Y steered other global yields. Resilience in US growth indicators coupled with stickiness in earnings report guided its movement of yield. The spillover was felt in yields across major AEs. In UK, concerns of a fiscal slippage added to further pressure in its yield. Going ahead, volatility in financial market would persist in the run up to the US elections. Thus, rewinding of positions would continue to exert pressure on global yields till traders are pacified by actual outcome. On domestic front, India's 10Y yield also moved in tandem with other global yields. Geopolitical conflict, rising yield differential with the US and muted corporate results continued to be weighed down on FPI flows. System liquidity remained comfortable. However, some pressure cannot be discounted as credit growth is maintaining its momentum. We expect India's 10Y yield to trade in the range of 6.8-6.9% in the current month, with risks tilted to the upside.

US 10Y yield guided movement of major global yields:

- US 10Y yield exhibited sharp upswing in Oct'24 and the momentum persists (10bps jump on the first day of Nov'24). Factors which drove yield higher were buoyant consumption demand as per Q3 advance estimates, stickier earnings data, higher input cost, upbeat consumer confidence, better services PMI data and pickup in home sales, which pointed towards resilience of US economy. IMF in its recent World Economic Outlook has also revised its growth forecast of the region by 20 and 30bps respectively for CY24 and CY25. Thus, the above macro drop support accommodative policy and not taking the risk of excessively loose monetary conditions. Fed November policy is also coinciding with US Presidential elections where opinion polls suggest a tight run between two Presidential candidates. US 10Y yield is expected to exhibit upward bias on account of squaring off in the run up to the elections. CME Fed watch tool is pricing in a 25bps rate cut by Fed both in Nov and Dec'24 policy meet. However, the terminal Fed fund rate is contingent on election outcome. A Republican party victory might hint at exceptionalism policy which might restrict the current discourse to easier financial conditions, while a Democratic Party win might signal policy continuity.
- Taking cues from a sharp rise in US 10Y yield, other Advanced Economies (AEs) also followed suit to maintain its yield differential. UK's 10Y yield has risen sharply. However, most of its rally in part was attributable from a loser fiscal policy and likely increase of slippage. Post Budget itself, UK's 10Y yield has risen by 13bps. BoE's policy is also scheduled in the current week where 25bps rate cut is expected as some macro data such as house prices, PMI data, consumer confidence and shop price index show some underlying softening. Thus, going forward, some rally in UK's 10Y yield might be capped.
- Germany's 10Y yield was supported by some revival in its Q3 preliminary growth estimate, rebound in retail sales and some momentum in CPI data. Eurozone's latest inflation reading of 2% in Oct'24 from 1.7% in Sep'24 has already led to paring down of expectations of outsize cut in CY24. Thus, some upward rally in yields cannot be ruled out. A 25bps rate cut by ECB is priced in for Dec'24.

- China's 10Y yield got comfort from stimulus measures to prop up growth. Going forward, with more measures in place, the divergence in yield from the US would continue. The National People's Congress Standing Committee is scheduled to meet. Market estimates suggest frontloading of another US$ 1.04tn extra debt to finance the spending. Higher debt supply might result in correction of its 10Y yield.

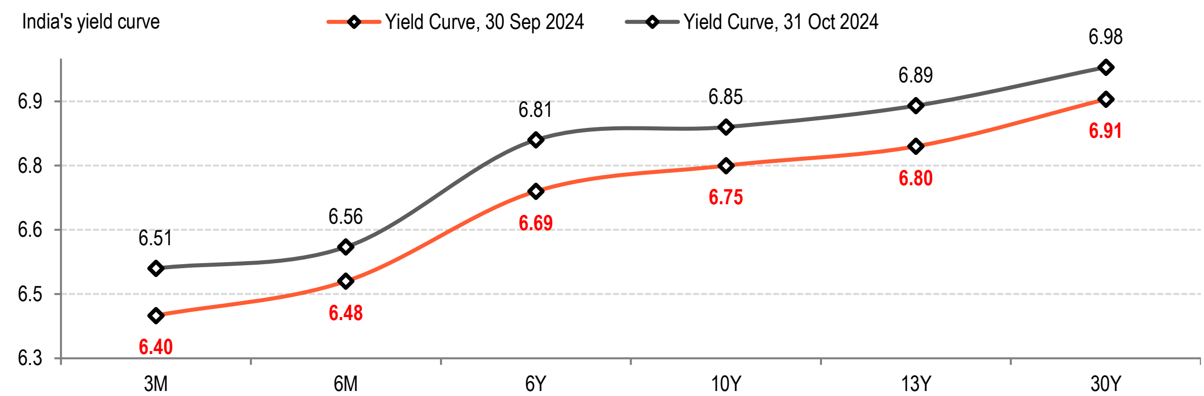
  Domestic 10Y yield maintained its upward momentum in line with US 10Y yield. It traded in the range of 6.73-6.87% in Oct'24, exhibiting less volatility compared to last month. Much of the increase in yield was also attributable to sell off by FPI especially in the debt segment. Volatility in global financial market weighed on the same.

Table 1. 10Y Yields movement globally

Countries	10Y sovereign yield, 30 Sep 2024	10Y sovereign yield, 31 Oct 2024	Change in 10Y yield, Oct/Sep, bps
US	**3.78**	**4.28**	**50**
UK	4.00	4.45	44
Indonesia	6.45	6.79	34
Germany	2.12	2.39	27
Singapore	2.60	2.81	21
Korea	2.99	3.10	10
India	**6.75**	**6.85**	**10**
Japan	0.86	0.95	9
China	**2.21**	**2.15**	**-6**
Thailand	2.47	2.41	-6

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

Table 2: Evolution of India's yield curve



Source: Bloomberg, Bank of Baroda Research

There was an upward uniform shift of the entire yield curve. The gap between 3M and 30Y paper is also largely contained at 47bps compared to 51bps seen in Sep'24. The impact of global financial market volatility in the wake of global political dynamics will be felt uniformly across all part of the curve with likely no major change in slope rather in curvature.

What auctions in the domestic market reflect?

In Oct’24, cut off yields softened for SDL and Tbills as demand remained buoyant.

Table 3. Cost of borrowing

Type of Papers	Avg. Cut off yield, Sep 2024	Avg. Cut off yield, Oct 2024
Central Government Securities	6.85	6.85
SDL	7.16	7.10
Tbills	6.69	6.54

Source: Bank of Baroda Research, Note: Auction dates differ

Liquidity to be in a comfortable range:

- Average system liquidity went into surplus of Rs 1.5 lakh crore in Oct’24 from Rs 1 lakh crore surplus seen in Sep’24. The frequency of VRRR was more compared to only one VRR conducted in Oct’24. However, demand for funds remained firm as in the VRR auction the amount of bids received was far higher at Rs 48,700 crore against notified amount of RS 25,000 crore.
- Durable liquidity also showed slight moderation. Depreciating currency and intervention by RBI to keep INR rangebound is resulting in the same. Government cash balance has also seen some temperance as spending is expected to pick up. Till now, government spending is trailing behind last year. So, the second half remains crucial for meeting of capex and other spending targets. We expect domestic liquidity to face some strain as global financial conditions support a stronger dollar which will continue to weigh on domestic currency and indeed strain durable liquidity. From banks perspective as well, Incremental deposits and Borrowings net of Incremental Credit and Investment has risen to Rs 2.4 lakh crore, currently, compared to 1.5 lakh crore in the last fortnight of Sep’24. Thus, some tightness in liquidity going ahead, cannot be discounted, as credit demand is still reigning in.

Outlook on 10Y yield for the next 30days:

- *India’s 10Y yield is expected to remain in the range of 6.8-6.9% in the current month*. FPI flows are likely to be volatile. In Oct’24, FPI debt under general limit witnessed outflows amounting to US$ 524mn and FAR securities inflow softened to US$ 81mn from US$ 1.7bn inflow seen in Sep’24. Thus, higher interest rate differential with the US will continue to result in aberration of FPI flows. In fact, somber corporate results in Q3 coupled with some moderation in couple of domestic growth indicators will also result in some sentiment driven sell off. Thus, upside pressure on domestic yields remains.

Table 4: OIS rates reflect no rate cut by RBI this year; corporate spreads softened

	As on 30 Sep 2024	As on 31 Oct 2024
OIS Rates		
1M	6.61	6.58
2M	6.6	6.60
9M	6.44	6.56
Corporate Spreads 10Y, bps		
AAA	41	36
AA+	88	78
AA	130	122

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

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