Dipanwita Mazumdar
Economist

Current cycle favoring corporate bond yields

The current easing cycle has been conducive for corporate bond market. There has been considerable softening across yields of major rated paper, with higher rated paper showing a steep fall in yields. Interestingly, transmission has occurred in lower rated papers too. This speaks highly of the increasing depth of the corporate bond market under the evolving financial landscape. This was further reinforced by liquidity inducing measures adopted by the RBI which supported lower yields. Measures such as giving market clear signaling about the quantum of liquidity surplus to float around 1% of NDTL, announcing OMO calendar, have also led to better pricing and transmission of rate cuts to parallel market segments.

Ceteris Paribus, a one-on-one comparison of yields under the current environment, reflects that for higher rated corporates, resorting to corporate bonds is cheaper compared to bank loans. For papers A and below, bank credit may be the preferred mode of finance. However, there are limitations to this analysis:

1) It is a yield-based comparison, reflective of premium/discount,

2) MCLR of similar tenor loans are not available, hence benchmarking could get skewed.

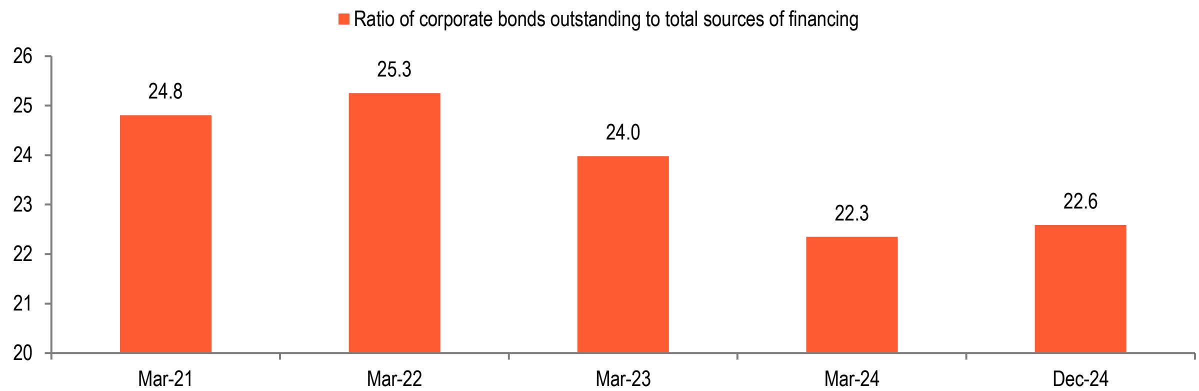
Therefore, the results should be interpreted with care.

Banks versus Corporate bonds:

Bank versus bond finance is always a contentious issue when depth of corporate bond market is increasing with evolving regulation in place focusing on increasing participation, enhancing transparency and lessening compliance burdens. The complementarity of both sources of financing is essential to fuel the ambitious target of US$ 30tn economy by 2047. FY25 saw a remarkable improvement in terms of corporate bond issuances. This was supported by improving financial metrics of corporates and better debt servicing ability as reflected in their interest coverage ratio which has remained comfortably above historical standards. Most importantly, regulatory developments in place such as reduction in face value, removal of HTM cap and launching of centralized database portal, amongst others, have put corporate bond market an accessible source of finance for a wide set of investors.

Fig 1. Shows some degree of substitutability between two major modes of financing-Bank and bond finance. In terms of quantum, Bank credit is not comparable with absolute number at Rs 182 lakh crore (Food + non-food, for the last fortnight of Mar'25); while corporate bond outstanding is available with a lag of 1 quarter and Dec'24 number is at Rs 51.6 lakh crore. In majority of the years since FY21, bank credit growth has far outpaced corporate bond market growth. However, FY25, has been a year of normalization for bank credit on account of elevated base and regulatory interventions. Hence, we might expect some pick up in the ratio of corporate bonds outstanding to total sources of finance. In Dec'24, the ratio is slightly higher. The Mar'25 data would give a better picture. Thus, what can be inferred is that with the evolving financial landscape, the corporate bond market is developing and becoming a popular source of financing in consonance with Bank credit while the latter still occupy the major chunk of the pie.

Figure 1: Financing through corporate bond market



Source: SEBI, RBI, Bank of Baroda Research, Note: For total sources of finance the sum of bank credit outstanding and corporate bond outstanding has been taken, for simplicity

Transmission across different monetary policy cycles

In the current juncture, a yield-based comparison is necessary since CY25 marked the beginning of easing cycle of RBI. The current cycle of RBI's easing began in Feb'25 and till now 50bps of rate cut has been frontloaded. Hence, it is important to look at how borrowing costs have evolved and transmission fared in different markets. India has mostly experienced easing cycles in the past. There has been considerable pass-through in yields of different rated papers. Of course, Here for simplicity and focusing on the depth of the corporate bond market, we have concentrated over past three cycles of RBI spanning from Feb-19 (a year before pandemic) till date.

- In the first cycle starting January 2019 till May 2022, the RBI had lowered the repo rate by 225 bps. The 1 year and 3 year bonds reacted the most with the former registering a decline of more than 225 bps for AAA, AA+ and AA- paper. The response was weaker for 5 and 10 year paper. Interestingly, the decline in yields for corporate paper was sharper than for GSecs of equivalent tenure.
- The second phase was the time when the repo rate was hiked post the Ukraine war which was for the period May 2022 till Jan 2025. The repo rate was up by 250 bps to 6.5%. During this phase, bond yields for all the four rated paper increased for 1 and 3 year paper but fell for the 10-year paper. AA- paper in the 5 year bucket also witnessed a decline in yield.
- In the third phase which has just begun where the repo rate has been lowered by 50 bps so far, all bond yields have gone down. It was highest for 1 year bond where yields have declined by 80-90 bps. In case of 10-years, it was more modest as the decline was of the order of 20-50 bps

In general it has been observed that yields on AAA rated bonds tend to respond better to rate actions of the RBI.

Table 1: Pass through of policy rate cut to different yields across different rated corporate papers

Cycle	Change in repo	Monetary Policy Cycle	Change in corporate bond yields, bps			
			AAA	AA+	AA	AA-
Feb-19 till May-22	225bps	**Easing**				
1Y			-301	-299	-287	-210
3Y			-205	-203	-197	-117
5Y			-170	-170	-160	-69
10Y			-129	-137	-111	-30
May-22 till Feb-25	250bps	**Expansion**				
1Y			146	154	148	90
3Y			44	35	51	-13
5Y			16	5	19	-46
10Y			-35	-42	-38	-64
Feb-25 till date	50bps	**Easing**				
1Y			-92	-84	-81	-91
3Y			-70	-60	-67	-80
5Y			-57	-54	-59	-72
10Y			-25	-19	-25	-52

Source: Bloomberg, Bank of Baroda Research, Note: For corporate yield, data till 29 May 2025 is taken

Game of yields

The table below compares the cost of borrowing between banks and corporate bond market. For banks, the limitation is that only 1-year MCLR is available and hence it has been taken as the benchmark as most lending rates are pegged to it. Furthermore, a distinction has been made between Public Sector Banks (PSBs) and Private Sector Banks (PVBs), for the purpose of better comparison. Notably, MCLR of PVBs across all months have been higher. Juxtaposing this data with the corresponding yields of corporate bonds of different ratings for different tenors, we can infer that in case the MCLR is lower than the corresponding yield on the corporate bond, the borrower would prefer the lower cost bank borrowing and vice versa. Here it is important to mention that, in terms of comparison with market rate, for 1 Year corporate yield, we have juxtaposed it with 364-days TBill as it is the widely traded paper of corresponding maturity. The 1Y GSec yield has been kept out due to limited availability of information. For remaining tenor papers, however, GSec yield of corresponding maturity is available.

Based on this, we can make the following observations:

- Corporate bond yields across major tenors have fallen sharply in the current easing cycle of RBI. This has been in line with corresponding major circulated papers. For example, just like the precipitous fall in 364-days TBill rates, major high rated papers have fallen along with front loading of reduction in policy repo rate and improvement in system liquidity conditions.

- One important observation here is that companies with credit rating of "A+ and above" generally have lower rates than bank rates. This holds majorly true for PSBs and in some cases for PVBs. Hence, these corporates would benefit from borrowings in the corporate bond market as bank borrowings are expensive, ceteris paribus.
- In case of companies with credit-rating of "A and below", bank credit can be the preferred choice, purely from the context of cost analysis.
- This situation of rates where yields of better rated corporate bonds have come down significantly in consonance with policy repo rate, has opened more opportunities for further issuance in the corporate bond market. Notwithstanding, this is purely from the angle of differential rates.

The yield-based comparisons for other tenor papers are given in the Appendix, where results are broadly similar with better rated companies able to raise finance at a lower rate in the corporate bond market than borrowing through bank.

Table 2: Comparison of corporate bond yields with bank lending rates

1 Year											
CY25	**AAA**	**AA+**	**AA**	**AA-**	**A+**	**A**	**A-**	**364-days Tbill**	**MCLR*, PSBs**	**MCLR*, PVBs**	**Avg. System Liquidity, Rs lakh crore**
Jan	7.72	8.10	8.33	8.60	9.05	9.82	10.60	6.65	9.05	10.00	(2.0)
Feb	7.73	8.10	8.35	8.48	8.93	9.71	10.48	6.54	9.08	10.00	(1.7)
Mar	7.71	8.08	8.36	8.44	8.89	9.67	10.44	6.51	9.08	10.00	(1.2)
Apr	7.00	7.40	7.76	7.95	8.40	9.18	9.95	6.03	9.08	10.00	1.4
May	6.80	7.25	7.52	7.69	8.14	8.91	9.69	5.83	9.08	10.00	1.7

Source: Bloomberg, RBI, Bank of Baroda Research, Note: Yields have been averaged for all months, * 1 Yr MCLR is taken, For May'25, data is available till 26 May 2025, Shaded areas are yields less than 1 Yr MCLR of PSBs, For MCLR in May'25, data of Apr'25 has been juxtaposed due to unavailability of information, Negative means deficit liquidity and positive figure stands for surplus liquidity

Conclusion

- Across different monetary policy cycles, there has been subsequent pass-through to corporate bond yields throughout tenors. However, the 1-3Y part of the curve is more responsive to changes.
- In the current easing cycle, even the yield of lower rated papers has gone down considerably. This phenomenon has not been observed in past monetary policy cycles of RBI. This speaks of the widening depth of the corporate bond market.
- Among major various securities, the major pass through of policy rate has happened for the highest rated AAA paper.
- Ceteris Paribus, comparing the yields of different rated papers with corresponding MCLR of banks, reflects that in the current cycle, yields of higher rated papers are lucrative for borrowing compared to MCLR rates of banks.
- For companies, with credit-rating of "A and below", bank credit can be the preferred choice.

- However, studies and anecdotal evidence in the past have shown that the pass-through of policy rates to bank rates happen with a lag. For loans pegged against EBLR, it happens at a faster pace. So, for MCLR we can expect some moderation in line with policy rates in the coming months and then some degree of reversal of the current situation might be visible. Thus, we may witness some shifting of higher rated corporates towards bank lending, based on yield differential.

Appendix:

Table 1: Comparison of corporate bond yields with bank lending rates for 3 Y paper

3 Year										
CY25	AAA	AA+	AA	AA-	A+	A	A-	Gsec	MCLR*, PSBs	MCLR*, PVBs
Jan	7.55	7.82	8.21	8.48	8.93	9.71	10.48	6.68	9.05	10.00
Feb	7.49	7.80	8.18	8.41	8.86	9.63	10.41	6.59	9.08	10.00
Mar	7.48	7.81	8.16	8.34	8.79	9.56	10.34	6.53	9.08	10.00
Apr	7.08	7.41	7.75	7.93	8.38	9.15	9.93	6.14	9.08	10.00
May	6.85	7.22	7.54	7.68	8.13	8.90	9.68	5.93	9.08	10.00

Source: Bloomberg, RBI, Bank of Baroda Research, Note: Yields have been averaged for all months, * 1 Yr MCLR is taken, For May'25, data is available till 26 May 2025, Shaded areas are yields less than 1 Yr MCLR of PSBs, For MCLR in May'25, For MCLR in May'25, data of Apr'25 has been juxtaposed due to unavailability of information

Table 2: Comparison of corporate bond yields with bank lending rates for 5 Y paper

5 Year										
CY25	AAA	AA+	AA	AA-	A+	A	A-	Gsec	MCLR*, PSBs	MCLR*, PVBs
Jan	7.44	7.78	8.20	8.40	8.85	9.63	10.40	6.69	9.05	10.00
Feb	7.44	7.78	8.19	8.34	8.79	9.57	10.34	6.63	9.08	10.00
Mar	7.43	7.78	8.17	8.29	8.74	9.51	10.29	6.57	9.08	10.00
Apr	7.06	7.40	7.78	7.90	8.35	9.13	9.90	6.19	9.08	10.00
May	6.87	7.25	7.61	7.68	8.13	8.90	9.68	6.01	9.08	10.00

Source: Bloomberg, RBI, Bank of Baroda Research, Note: Yields have been averaged for all months, * 1 Yr MCLR is taken, For May'25, data is available till 26 May 2025, Shaded areas are yields less than 1 Yr MCLR of PSBs, For MCLR in May'25, For MCLR in May'25, data of Apr'25 has been juxtaposed due to unavailability of information

Table 3: Comparison of corporate bond yields with bank lending rates for 10Y paper

10 Year										
CY25	AAA	AA+	AA	AA-	A+	A	A-	Gsec	MCLR*, PSBs	MCLR*, PVBs
Jan	7.25	7.60	7.99	8.51	8.96	9.73	10.51	6.75	9.05	10.00
Feb	7.30	7.61	8.01	8.46	8.91	9.69	10.46	6.70	9.08	10.00
Mar	7.35	7.68	8.08	8.45	8.90	9.67	10.45	6.67	9.08	10.00
Apr	7.09	7.43	7.84	8.18	8.63	9.41	10.18	6.40	9.08	10.00
May	6.99	7.41	7.74	7.99	8.44	9.22	9.99	6.31	9.08	10.00

Source: Bloomberg, RBI, Bank of Baroda Research, Note: Yields have been averaged for all months, * 1 Yr MCLR is taken, For May'25, data is available till 26 May 2025, Shaded areas are yields less than 1 Yr MCLR of PSBs, For MCLR in May'25, For MCLR in May'25, data of Apr'25 has been juxtaposed due to unavailability of information

Disclaimer

Visit us at www.bankofbaroda.com

For further details about this publication, please contact:

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