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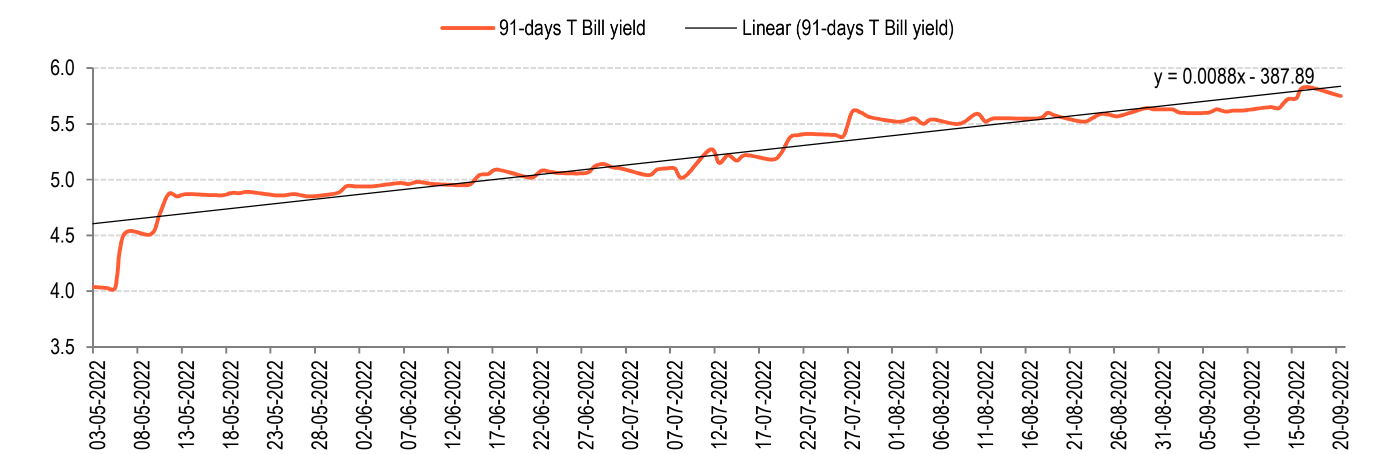
Short term yield spikes

TBill yields are witnessing quite a bit of volatility off late. Even in today's auction, cut off yield have risen sharply (+16bps: 91 days, +24bps: 182-days and +22bps: 364-days paper). In this study, we have analyzed the trend in movement of yields since May, when the RBI started increasing the repo rate and compared the slopes (gradient) of the trend lines of the 10 year bond and 91 days TBill. The trend lines have moved in different directions during this period. The 10Y bond got comfort from lower oil prices, FPI Debt inflow, signaling of inflation having peaked and also news reports of India's inclusion in the global bond index. On the other hand, borrowing cost of short term papers rose sharply as it is more sensitive to repo hike by RBI and also tighter liquidity conditions in the economy.

How have short term rates moved vis-à-vis 10Y GSec?

- TBill rates have started inching up since RBI stepped on to the path of rate hike cycle. With the frontloading of RBI's 140bps rate hike till date, TBill yields have started rising. In comparison to Apr'22 cut off yield, the average cut off yield across all tenor rose by 179bps, while for 10Y Gsec yield the increase is only 31bps. Thus, the borrowing cost for short term papers are increasing at a faster pace compared to longer tenor securities.
- Even the gradient of 91-day TBill curve comes to around 0.0088 which shows that since May'22, when RBI started with the rate hike cycle, the increase in TBill curve is steeper. For 10Y Gsec yield, the gradient comes to -0.0017. Thus, TBill rates seem to be more reflective of the rising rate cycle of RBI.

Fig 1 – 91-days TBill yield movement since May'22

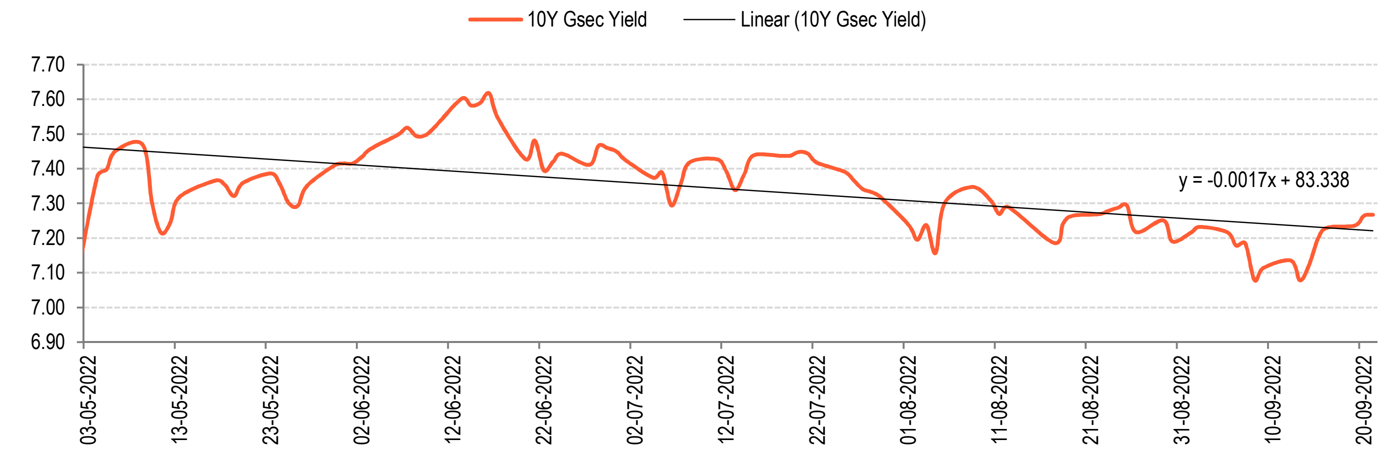


Source: Bloomberg, Bank of Baroda Research

- 10Y GSec yield has exhibited less volatility compared to short term papers. The reason behind has been falling oil prices (17% decline from May'22) and rising debt inflow from FPIs (US$ 255mn since May'22). Apart from this, reports of India's inclusion in the global bond index have also supported market sentiments.

Going forward, if government trims down its H2 Borrowing program, some buying spree might further be noticed in the 10Y paper.

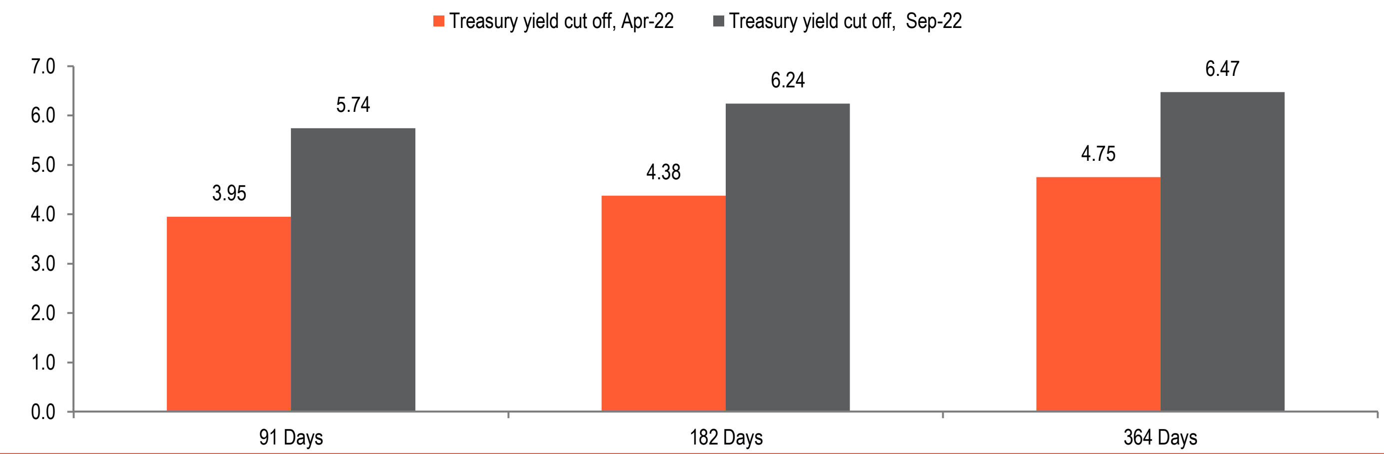
Fig 2 – 10Y Gsec yield movement since May'22



Source: Bloomberg, Bank of Baroda Research, Note: Growth rate in constant prices

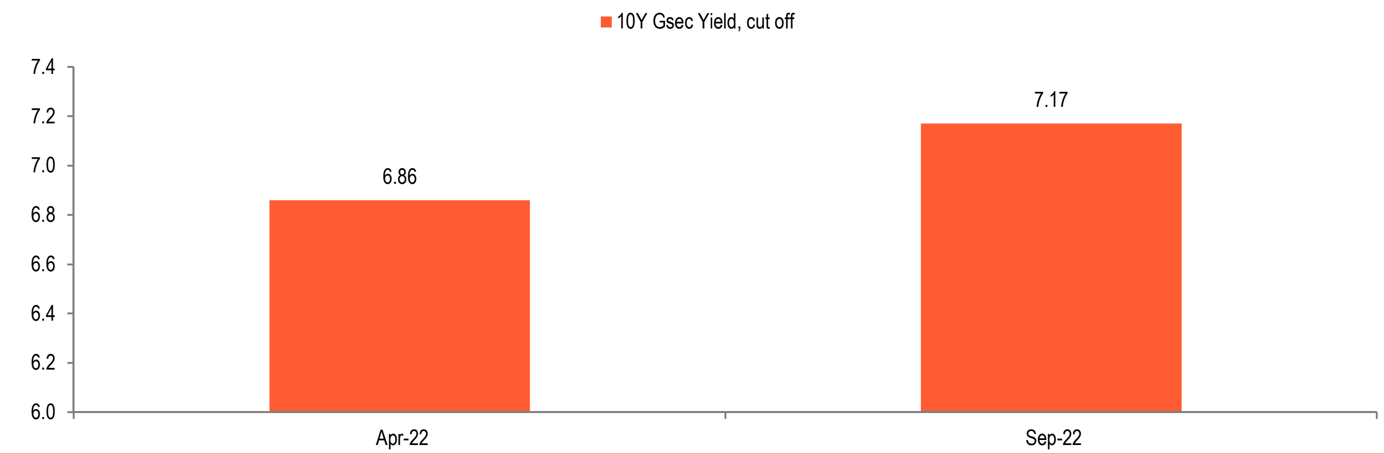
- For 91-days, the cut off yield rose by 179bps, for 18-days, it rose by 186bps and for 364-days, it inched up by 172bps in Sep'22 compared to Apr-22.

Fig 3 – Treasury bill cut off yield has risen sharply: 91 up by 179 bps, 182 by 176 bps and 364 by 172 bps



Source: RBI, Bank of Baroda Research

Fig 4 – While for 10Y sovereign security, the cut off yield rose at a lesser pace of just 31 bps

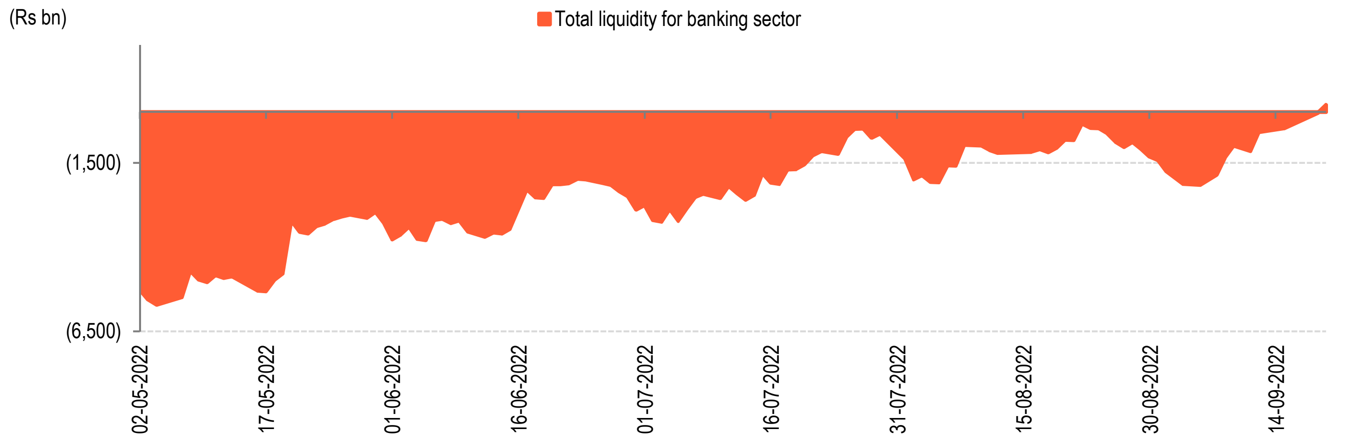


Source: RBI, Bank of Baroda Research

Liquidity in deficit mode:

- After a span of nearly 3 years, liquidity has been back in deficit mode of Rs 21,873 crore as on 20 Sep 2022. In coming months, pressure on liquidity would continue from RBI's forex intervention, capital spending of the government as also pickup in currency demand. With credit growth already running at double digit, it would add further pressure on the liquidity numbers. Short term rates thus would increase at a faster pace as the direct reflection of tighter liquidity and RBI's rate hike would be on these papers. We expect another 50-bps rate hike by RBI in the current cycle with terminal repo of ~5.9-6%.

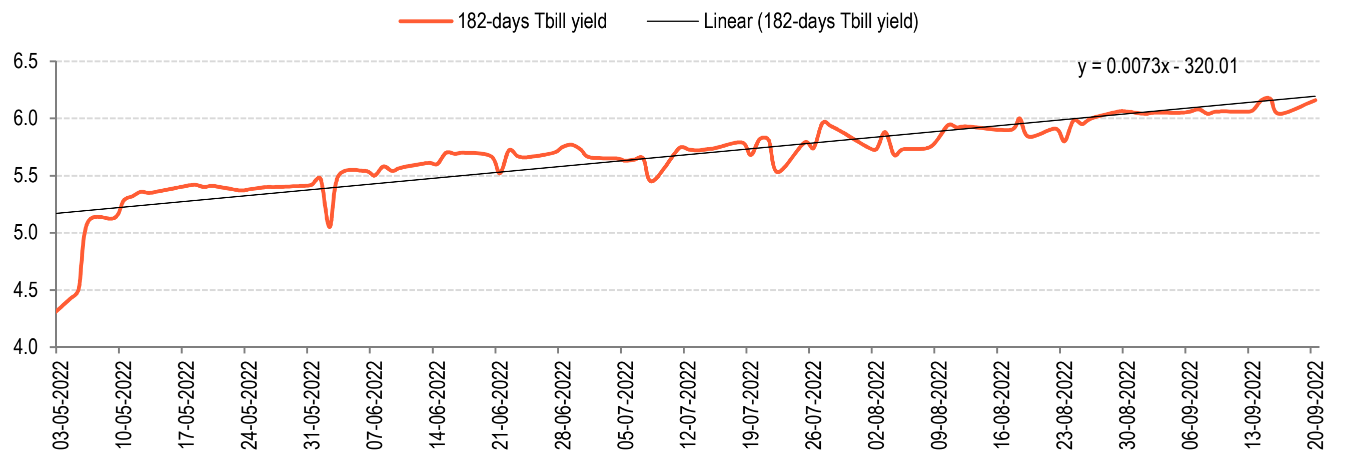
Fig 5 – Liquidity back in deficit last seen since 28 May 2019



Source: CEIC, RBI, Bank of Baroda Research

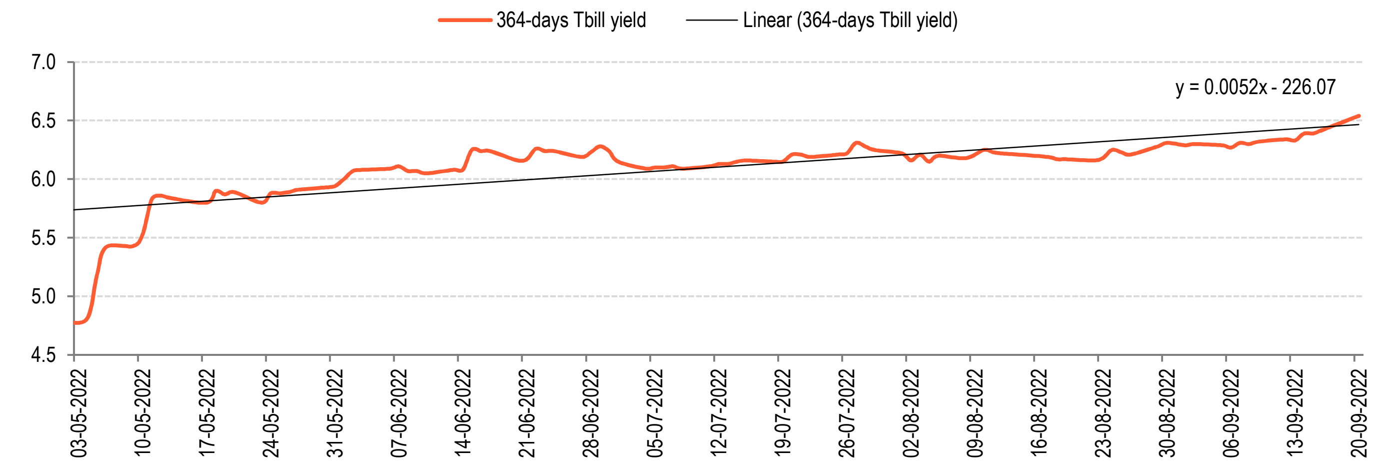
Appendix:

Fig 6 – 182-days TBill yield movement since May'22



Source: Bloomberg, Bank of Baroda Research

Fig 7 – 364-days TBill yield movement since May'22



Source: Bloomberg, Bank of Baroda Research

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