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Bonds Wrap

Global yields showed some stiffening in May'25 led by elevated debt concerns in the US which partly weighed down risk off sentiments. For India, however, the softening of yields continued across all part of the curve. The significant moderation was visible in the very short end part which is more susceptible to evolution of system liquidity. Thus, it resulted in a steeper yield curve, which is likely to persist. RBI's orderly management has ensured system liquidity to be in a comfortable surplus of ~0.7% of NDTL in May'25. The elevated system liquidity also got mirrored in banking liquidity where the gap between incremental deposits and borrowing net of incremental credit and investment went up. Going forward, we expect some pressure on account of the usual seasonal buildup of government cash balance. However, RBI's transfer of bountiful dividend coupled with continued fine tuning of daily liquidity will lend support. We expect more OMO announcements in the coming days to maintain the 1% of NDTL surplus level. Thus, RBI's upcoming policy will set the undertone of yields. Any reduction in policy rate more than the expected 25bps might lead India's 10Y yield to trade further downward. We expect it to trade in the range of 6.15-6.27% in the current month, with risks tilted to the downside.

Elevated debt concerns in the US impacted yields:

- Among major global yields, the US 10Y yield has risen the most. This is on account of downgrade of US sovereign credit rating by one notch on account of the expanding fiscal deficit and burgeoning debt burden. Apart from this, the ruling of US Court against the President's tariff policies which have been deemed to be illegal, have lend support to its yield. However, after the current stay order secured by the US President and elevated concerns of fresh tariff on steel and aluminum at 50% from earlier rate of 25%, some rebalancing of portfolio towards safer sovereign asset class might be witnessed. The US Treasury secretary also spoke of US-China talks as being "bit of stalled". There have been reports of fresh round of restrictions from the US catering to sale of chip design software and some engine jet parts to China. Thus, the odds are in favour of some softening of US 10Y yield in the near term. Majority of the high frequency data in the US ranging from core retail sales, core PCE, GDP Q1 second estimate, labour market and trade data, all signal some loss of momentum. The commentaries of Fed officials also indicate that any deflection from the base case tariff of 10% might be double whammy in terms of growth and inflation. Thus, risk-off sentiment is likely to dominate and signal some moderation in the US 10Y yield in the current month.
- In the UK as well, higher public sector net borrowing data was reflected in its higher yield. Even some of the macro indicators such as retail sales, Q1 provisional estimate of GDP and CPI data showed some resilience. Hence its 10Y yield showed stickiness. Even the BoE Governor spoke of being cautious about any hump in inflation.
- Among EMs, Thailand showed considerable softening supported by Bank of Thailand's easing of policy rate by 25bps in its latest meeting. The policy further highlighted the downside risks to growth emanating from changes in the global economic, financial, and trade landscape.

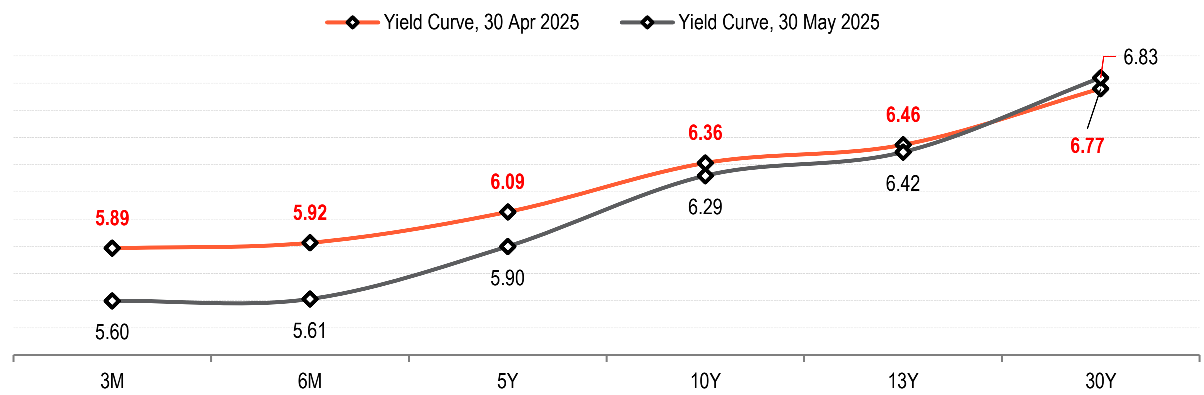
- **Domestic 10Y yield** showed moderation and traded in the range of 6.24-6.40% in May'25 compared to 6.32-6.50% in Apr'25. The monthly volatility also fell to 0.43 in May'25 compared to 0.55 in Apr'25. Most of the decline is supported by favourable domestic liquidity conditions. The softening inflation print of Apr'25 along with expectation of above normal monsoon has all remained conducive for India's 10Y yield.

Table 1. 10Y Yields movement globally

Countries	10Y sovereign yield, 30 Apr 2025	10Y sovereign yield, 30 May 2025	Change in 10Y yield, Apr/Mar, bps
US	**4.16**	**4.40**	**24**
UK	4.44	4.65	21
Korea	2.57	2.77	20
Japan	1.32	1.50	18
China	1.63	1.71	8
Germany	2.44	2.50	6
Singapore	2.47	2.43	-4
Indonesia	6.88	6.84	-4
India	**6.36**	**6.29**	**-7**
Thailand	1.88	1.78	-10

Source: Bloomberg, Bank of Baroda Research

Table 2: Evolution of India's yield curve



Source: Bloomberg, Bank of Baroda Research

The gap between 3M and 30Y paper heightened to 128bps as on 30 May 2025 compared to 88bps as on 30 Apr 2025. Major realignment occurred for a very short part of the yield curve (3-6 months paper). The transmission of liquidity measures taken by the RBI in the recent past has finally shown its impact, especially in short term rates which are more susceptible to such changes, as seen historically. Thus, we are seeing a steeper yield curve. This is likely to continue with RBI's frontloading of more rate cuts.

What do auctions in the domestic market reflect?

In May'25, the cut off yield softened across the board indicating buoyant demand. The major shift was noticed for short-term papers. For Gsec, major holdings came from PSB.

Table 3. Cost of borrowing

Type of Papers	Avg. Cut off yield, Apr 2025	Avg. Cut off yield, May 2025
Central Government Securities	6.57	6.43
SDL	6.76	6.73
Tbills	6.00	5.72
91-day	5.90	5.76
182-day	6.06	5.76
364-day	6.05	5.63

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

Liquidity remains comfortably in surplus mode:

- The average system liquidity rose to a surplus of Rs 1.7 lakh crore (0.7% of NDTL) compared to Rs 1.4 lakh crore in Apr'25. So, what guided liquidity movement in May'25. RBI's measures continued at full pace with continuation of daily VRR coupled with durable liquidity infusion through OMOs. In fact, the announcement of OMO calendar for May'25 beforehand has contributed significantly to the orderly evolution of liquidity.
- The elevated system level liquidity surplus was also reflected in banking liquidity. The gap between incremental deposits and borrowings net of incremental credit and investment of SCBs went up to Rs 3.2 lakh crore as normalisation in credit continued. However, with activity gaining ground and Kharif sowing kicking in from Jun onwards, this gap would tend to reduce with pickup in credit demand and some moderation in deposit rates with pass through of rate cuts.
- The comfortable liquidity conditions also got reflected in WACR rate which were far lower at 5.83% in May'25 compared to 5.95% on a daily average basis in Apr'25.

Table 4. Liquidity measures by RBI in Apr and May'25

Liquidity injection (Rs crore)	Notified amount, Apr'25	Notified amount, May'25
VRRs	**10,75,000**	**5,25,000**
Less than equal to 14 days	9,00,000	5,25,000
above 14 days	1,75,000	0
OMOs		
Outright Purchase	1,20,000	1,19,203

Source: Bank of Baroda Research

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to soften and likely to trade in the range of 6.15-6.27% in the current month, with risks tilted to the downside*. The south-bound journey of yield will continue to reign in with gradual build up in volume of the new benchmark security. Apart from this, even risk-off led sentiments from a global perspective will keep a lid on yield. For the US, the narrative on yield points towards some softening since majority of its high frequency data has seen weakening. The tariff driven uncertainty is also likely to result in some safe-haven demand for sovereign securities.

- On domestic front, two factors will broadly guide India's 10Y yield this month 1) RBI policy where we expect another 25bps rate cut in the next policy. OIS rates have already inched down hinting at sharper cuts. Any further softer guidance on liquidity will put further downward pressure on yields across all spectrums of India's curve. 2) The moderation in inflation is also expected in May'25, as we have seen vegetable prices declining. The expectation of above normal monsoon also bodes well for the overall outlook.
- Further government moves such as buyback of securities of Rs 25,000 crore, have also been supportive of yields. In Jun'25, we have one maturity of Rs 79,718 crore security. The usual seasonal buildup of government cash balances will happen on account of GST outflows and 1st installment of advance tax payment. However, fine balancing of RBI on liquidity front will provide cushion.

Table 5: OIS rates inched down in anticipation of monetary easing by RBI

	As on 28 Mar 2025	As on 30 May2025
	OIS Rates	
1M	5.90	5.70
2M	5.87	5.67
9M	5.66	5.60
AAA	49	67
AA+	90	112
AA	137	157

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

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