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Bonds Wrap

Global yields showed the impact of risk aversion on the backdrop of geopolitical conflict in the Middle East. This kept yields of major AEs such as the US and UK to trade with a softening bias. In the US, weaker macro print, especially cooling labour market conditions, raised hopes of an easier monetary policy in the near term. India's 10Y yield however showed some upward bias albeit more than expected dovish policy by RBI. Some expectation driven pricing might have come into play as OIS rates show most of the frontloading of rates by RBI has already happened. Higher outflow (on account of lower interest rate differential with the US) both through the debt-VRR and FAR route by FPIs has also contributed to some degree of stiffening of India's 10Y yield. The yield curve continued to show steepening bias as very long part of the curve (13 year and above) showed upward momentum. Going forward, we expect some correction. The long run part is expected to be stable as both global (risk off sentiment ahead of 9 Jul tariff deadline) and domestic macros (in terms of lower inflation numbers and favourable liquidity conditions) are supposed to act in favour. On liquidity front, the announcement of VRRR by RBI has hinted at normalisation and resorting back to the 1% NDTL surplus level. The extension of call money market hours is also a welcoming move towards improving its liquidity and volume, thus enabling further realignment of operating target variable to repo. Against all these backdrops, we expect India's 10Y yield to trade with a softening bias in the range of 6.25-6.35% in the current month.

Geopolitics impacted yields:

- Risk averse sentiments weighed by geopolitical conflict in Middle East impacted the direction of global yields in Jun'25. US 10Y yield considerably softened buoyed by weakening high frequency indicators. Core retail sales softened, capacity utilisation moderated, new home sales dropped, the Q1 third estimate also came in lower than anticipated driven by slowdown in services driven spending. Labour market also weakened as 4-week initial claims data remained elevated. Core PCE showed marginal pickup albeit inflation expectations remaining well anchored (U. of Michigan 1 & 5 year inflation expectation index edged down). The yields got support from the Fed median rate projections for CY25 which hints at 50bps rate cut in CY25. Further, Fed Chair, in his recent testimony before the Senate and House reaffirmed that if inflation remains durably aligned to Fed's target, rate cut will happen sooner. On trade related front as well, there have been some positive developments; in response to the US Treasury Department removal of Section 899 "revenge tax", a shared understanding has been proposed that will exclude US companies from some taxes imposed by other countries. Even some optimism was seen on US-China trade dynamics with hint of implementation of the Geneva accord. US Commerce Secretary has further confirmed that efforts are in progress to reach agreements with 10 of its major trading partners before the 9 Jul deadline.
- In the UK, yields got comfort from some moderation in net public sector borrowing data. This was complemented by patchy performance of some macro indicators. Consumer confidence inched down, core retail sales softened and net consumer credit moderated. The recent

commentaries of BoE Governor hint at cautious wait and watch approach as risks may be seen on inflation from a higher minimum wage that was in effect from Apr'25 onwards.

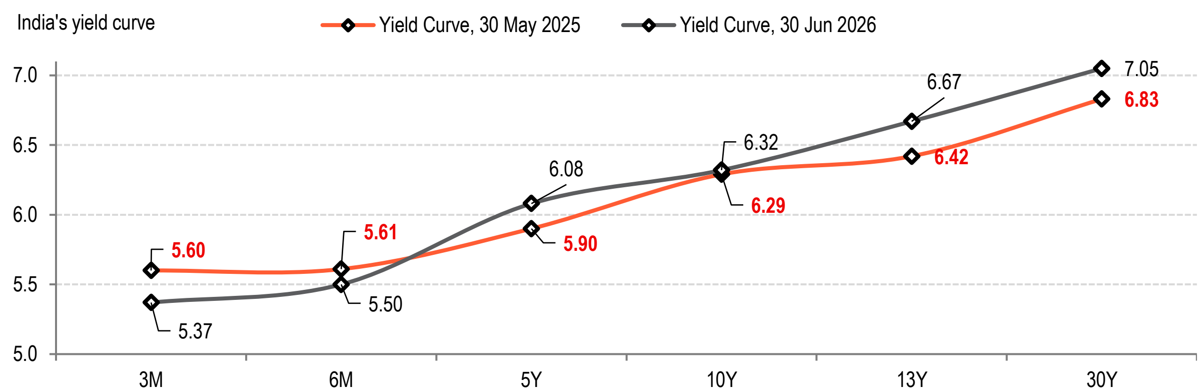
- The 10Y yield of majority of EMs, also showed the dominance of risk off sentiments.
- Among major yields, only Germany's 10Y yield showed some deviation witnessing 11bps increase, as some anticipation prevailed that most of the frontloading of rate cuts by ECB has already happened.
- **Domestic 10Y yield** showed some correction in Jun'25 after three consecutive months of precipitous fall. It traded in the range of 6.25-6.37% in Jun'25 compared to 6.24-6.40% in May'25. The monthly volatility also rose to 0.53 in Jun'25 from 0.43 in May'25. This is despite RBI's sharp pace of rate cut and ample liquidity measures in the current cycle. The change in stance to neutral has built up hopes that on rate front, there might be a data dependent pause. Further, some impact on 10Y yield was on account of the higher outflow in FAR securities at US$ 1.2bn and in debt VRR at US$ 0.7bn in Jun'25.

Table 1. 10Y Yields movement globally

Countries	10Y sovereign yield, 30 May 2025	10Y sovereign yield, 30 Jun 2025	Change in 10Y yield, Jun/May, bps
Germany	2.50	2.61	11
India	**6.29**	**6.32**	**4**
Korea	2.77	2.81	4
China	1.71	1.65	-6
Japan	1.50	1.43	-7
UK	4.65	4.49	-16
US	**4.40**	**4.23**	**-17**
Thailand	1.78	1.60	-18
Indonesia	6.84	6.63	-21
Singapore	2.43	2.19	-24

Source: Bloomberg, Bank of Baroda Research

Fig 1: Evolution of India's yield curve



Source: Bloomberg, Bank of Baroda Research

The steepening bias of the yield curve remained with the gap between 3M and 30Y paper rising to 168 bps compared to 123bps as on 30 May 2025. Major realignment occurred for the very long end of the curve (13Y and above) which went up significantly. The shorter part of the curve continued with its downward correction, supported by favourable liquidity measures of RBI. Going forward, we expect some moderation in the steepness of the curve as long end part of the curve is likely to be broadly stable.

What do auctions in the domestic market reflect?

In Jun'25, the cut off yields for short tenor papers softened considerably, indicating buoyant demand. However, for central and state government securities, the cut off yield was higher. For Gsec, major selling was witnessed in the case of PSBs and Mutual funds.

Table 2. Cost of borrowing

Type of Papers	Avg. Cut off yield, Apr 2025	Avg. Cut off yield, May 2025	Avg. Cut off yield, Jun 2025
Central Government Securities	6.57	6.34	6.52
State Government Securities	6.76	6.73	6.85
Tbills	6.04	5.77	5.49
91-day	6.02	5.76	5.43
182-day	6.06	5.76	5.51
364-day	6.05	5.78	5.54

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

Liquidity remains within RBI's 1% NDTL surplus level:

- The average system liquidity rose to a surplus of Rs 2.7 lakh crore in Jun'25 (1% of NDTL) compared to Rs 1.7 lakh crore (0.7% of NDTL) in May'25. RBI's measures continued at full pace with the announcement of phased reduction of CRR which is likely to add ~Rs 2.5 lakh crore of liquidity to the system in H2. Apart from this, pick up in pace of government spending has also been supportive of system liquidity. Despite Jun'25 being the month of advance tax collection, there has not been much built up in government cash balance partly reflective of the fact that government spending is picking pace.
- Banking liquidity also remained comfortably placed in line with system liquidity. The gap between incremental deposits and borrowings net of incremental credit and investment of SCBs showed some normalisation at Rs 3.5 lakh crore as on 13 Jun 2025 compared to Rs 5.2 lakh crore as on 30 May 2025. This is led by gathering momentum of credit demand in Q1FY26. Going forward, we expect further moderation in the gap as H2 generally coincides with pick-up in credit demand, seen historically.
- The comfortable liquidity conditions also got reflected in WACR rate which was far lower at 5.38% (average in Jun'25) compared to 5.83% in May'25.

Table 3. Liquidity measures by RBI

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

Source: RBI, CEIC, Bloomberg, Bank of Baroda Research

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to have a softening bias and likely to trade in the range of 6.25-6.35% in the current month*. The current degree of correction is on account of some expectation driven pricing of traders led by anticipation that most of the frontloading of rate cut by RBI has already happened. However, the current MPC minutes have been dovish hinting at further space being available if we look in terms of neutral interest rates.
- The inflation factor will also be supportive of lower rates. High frequency price data of Jun'25 also suggests a lower inflation print. Further, the narrative of global yields will also be weighed down by risk aversion sentiments as the 9 Jul tariff deadline is nearing. The Fed rate is also expected to come down as the underlying growth indicators show moderation.
- Thus, balancing and counterbalancing domestic macros and global factors, we expect India's 10Y yield to show not much aberration, with risks tilted to the downside.

Table 4: OIS rates inched down, and corporate spreads also softened

	As on 30 May 2025	As on 30 Jun 2025
OIS Rates		
1M	5.70	5.43
2M	5.67	5.44
9M	5.60	5.51
Corporate spreads		
AAA	67	61
AA+	112	109
AA	157	152

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

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