1 Nov 2022

Dipanwita Mazumdar
Economist

Bonds Wrap

Global bond market was in a trap trying to untangle growth-inflation dynamics. High frequency indicators in the US and Eurozone reflected slowdown in growth; while inflation worries were aggravated. In the Eurozone inflation again reached a new high. Among the most notable yield movement has been the complete reversal of direction in UK's 10Y yield which fell by 58bps in Oct'22 against 129bps increase seen in Sep'22. This was supported by growing sentiments over fiscal credibility under the newly elected PM. US Fed in its upcoming policy is expected to go for a 75bps hike, yet some slowdown with regard to future pace of rate hike is expected, as impact of frontloading on macro data points are already visible. On the domestic front, India's 10Y yield traded in the range of 7.36-7.51% in Oct'22, though it exhibited less volatility in trading compared to Sep'22. Some degree of buying was supported by risk off sentiment on account of contagion impact of global growth slowdown. Further, MPC members statement hinting that quite a bit of frontloading has already happened, did not allow yields to increase much. Notable development in the current month has been the correction in short end yield. Cut off for the short tenor papers rose at much slower pace in Oct'22 compared to Sep'22. Liquidity remained in deficit for 14 days in Oct'22. Going forward we expect, either neutrality or deficit in liquidity to be the new normal, considering that credit is at a double digit pace and RBI's forex intervention will continue. We expect India's 10Y yield to trade in the range of 7.35-7.50% in the next 30 days.

Growth inflation dynamics a puzzle:

Few of the notable changes that was noticed in global yield movement in Oct'22 compared to Sep'22 was:

- In UK, sovereign 10Y yields fell sharply by 58bps ion Oct'22 against 129bps increase in the previous month. This was led by growing expectation of fiscal consolidation from newly elected PM. Reports suggested that the Chancellor of the Exchequer is planning to fill a fiscal shortfall of US$ 41bn through spending cuts.

- In Germany as well, 10Y yield rose at a softer pace by 3bps in Oct'22 against 57bps increase in Sep'22. This was on account of ECB's hint at the fact that "substantial progress" has already been made on policy front, suggesting that the pace of rate hikes may slow down.

- In US, 10Y yield also rose at a moderate pace by 22bps in Oct'22 against 64bps in Sep'22. This was on account of elevated growth concerns emanating from new home sales (declining for the 8th straight month) and flash PMI print (2-month low).

- Inflation still remained a grave concern. In the US, core inflation quickened to a 40-year high of 6.6% in Sep'22, in China as well, CPI inflation rose to a 29-month high of 2.8% in Sep'22. In the Eurozone, inflation continued to hit record new high for the 12th consecutive month, inching up to 10.7% in Oct'22 from 9.9% in Sep'22. In Tokyo as well, CPI surged to a 33-year high in Oct'22.

- China's 10Y sovereign yield was supported by expectation of more stimulus both from the government and monetary authority.

Table 1. 10Y Yields globally traded mix

Countries	10Y sovereign paper yield, 30-Sep-22	10Y sovereign paper yield, 31-Oct-22	Change in 10Y yield in Sep'22, bps
Bloomberg Barclays EM USD Aggregate Yield to worst	8.16	8.50	34
Indonesia	7.37	7.54	16
India	**7.40**	**7.45**	**5**
Korea	4.08	4.23	15
US	**3.83**	**4.05**	**22**
UK	**4.09**	**3.52**	**-58**
Thailand	3.18	3.19	1
China	**2.75**	**2.65**	**-10**
Germany	**2.11**	**2.14**	**3**
Japan	0.24	0.25	0

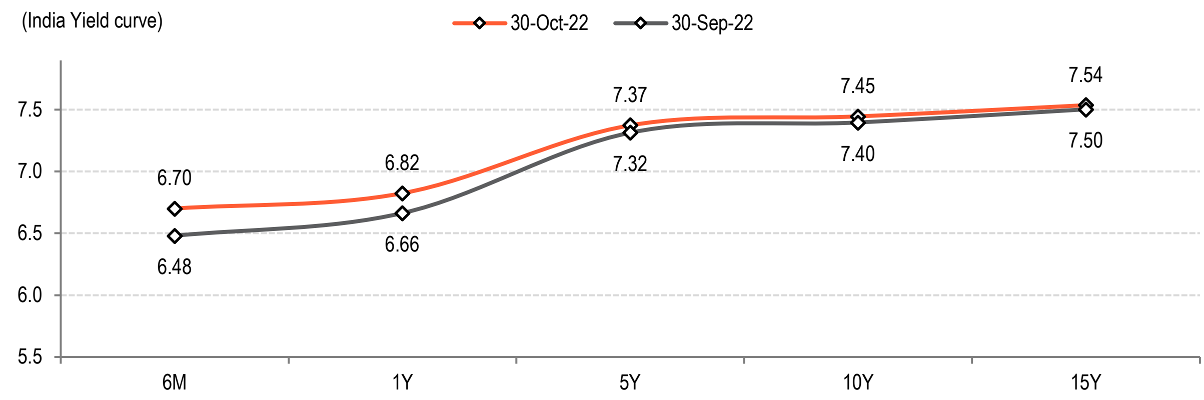
Source: Bloomberg, Bank of Baroda Research

Domestic 10Y yield traded in the wide range of 7.36-7.51% in Oct'22 in the current month against 7.08-7.40% in Sep'22.

The volatility was much less in the current month (standard deviation at 0.007 in Oct'22 against standard deviation of 0.1 in Sep'22). Sentiments in the domestic market improved as H2 borrowing calendar was slightly lower than expected. Further, contagion impact of global growth slowdown also led increased demand for sovereign yields due to risk off sentiment. Apart from this, MPC members hinting at the fact that quite a bit of frontloading has already happened and more rate hike might be detrimental to growth, also impacted domestic yield.

Notably, the spread between 15 Year and 6 months paper went down to 84bps in Oct'22 from 102bps as on 30 Sep 2022.

Figure 1: Gap between short end and long end yields reducing



Source: Bloomberg, Bank of Baroda Research

What auctions in the domestic market for the current fortnight reflect?

Auction results reflected that borrowing cost (measured by Cut-off price / Yield) for short term papers showed some respite in Oct'22 compared to Sep'22. It rose by only 14bps in Oct'22 against 53bps increase seen in Sep'22. For 91 days TBill, it went up by 22bps in Oct'22 against 54bps in Sep'22, for 182-days by 8bps against 55bps in Sep'22 and for 364-days the increase was 12bps against 48bps in Sep'22.

Borrowing cost for central government and state government securities on the other hand inched up. For centre it rose by 19bps in Oct'22 against 4bps increase in Sep'22. For States, it went up by 26bps against no change in Sep'22

Table 2. Cost of borrowing for TBills moderated

Type of Papers	Cut off yield as on 30 Sep 2022	Cut off yield as on 28 Oct 2022
Central Government Securities	7.35	7.54
SDL	7.56	7.82
Tbills	6.54	6.68

Source: Bank of Baroda Research, Note: Implicit yield at cut off taken as on the mentioned date

Liquidity tightening would prevail:

System level liquidity went into deficit for 14days in Oct'22. In Oct'22, on an average, system liquidity was in surplus of only Rs 7,100 crore far lower compared to surplus of Rs 82,200 crore seen in Sep'22.

Interestingly, durable liquidity is also sinking and is at Rs 3.08 lakh crore as on 31 Oct 2022 compared to Rs 3.69 lakh crore in Sep'22 and Rs 4.17 lakh crore as on 31 Aug 2022.

Going forward, we expect liquidity to be in slight deficit mode. This is on account of 1) RBI's forex intervention (US$ 7.7bn of foreign currency assets itself sold in Oct'22) 2) currency demand gaining pace (Rs 8.3 lakh crore accretion in FYTD23 and matching the level seen last year), 3) Credit growing at 17.9% and deposit at 9.6%, amounting to credit deposit gap of 8.3%, which is going to drain out liquidity in the near term. In the coming days, we might see shorter tenor VRRR such as 3, 4 and 7 days coming up, as liquidity deficit might aggravate in the coming months.

Major players in the fortnight

As per Bloomberg data, maximum buying for government securities in Oct'22 has been from others components which includes PDs. Other than that, buying has also been from mutual funds and PSBs. While foreign and private banks were in a selling spree.

Outlook on 10Y yield for the next 30days:

- The main factor which is going to impact India's 10Y yield movement in the current month will be the RBI's off cycle policy meeting. Though no rate call is expected as it is a meeting under Section 45ZN where report is required to submit for failure to meet inflation target. However, some volatility in yields might be observed.
- Fed's meeting is also scheduled. Market will be looking for any pivot from inflation to growth which might provide some temporary comfort to yields.
- Inflation for some items such as cereals, vegetables and milk are still pain points, however in Oct'22, the CPI print is likely to comfort from base effect. We expect a print of ~6.5-6.8%
- India's 10Y yield is expected to remain in the range of 7.35-7.50% in the current month.

Table 3: OIS rates have inched up, while corporate spreads at long end curve exhibited less volatility (except for A-papers)

	As on 30 Sep 2022	As on 31 Oct 2022
OIS Rates		
9M	6.79	6.92
1Y	6.90	7.00
Corporate Spreads-10Y		
AAA	27	29
AA+	67	69
AA	94	107
AA-	142	141
A+	267	266
A	292	291
A-	342	316
BBB+	392	391
BBB-	467	466

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

Visit us at www.bankofbaroda.com

For further details about this publication, please contact:

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