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Bonds Wrap

Moderation in US 10Y yield occurred because of risk alignment surrounding political developments in the region which has resulted in higher demand for sovereign debt assets. The same got reflected in yields of other major AEs (UK, Germany). The narrative of global yields hinges on the President-elect's policy discourse. Till now, the environment calls for a moderate pace of easing by Fed, going ahead. India's 10Y yield witnessed majority softening following release of Q2GDP data which surprised on the downside. In the last trading session itself, India's 10Y yield has inched down by 9bps. The trajectory of domestic yield rests on whether moderation in growth is a one-off event or not. However, we expect a downward bias to domestic yield remains from correction in FPI flows in Nov'24 due to favourable interest rate differential with the US. Apart from this, expectation reins in terms of measures from RBI to maintain adequate durable liquidity. Any development on the same would also support yields in the near term. We expect India's 10Y yield to trade in the range of 6.70-6.85% in Dec'24 and will also hinge on MPC call on repo rate and direction provided through the articulation.

US 10Y yield guided movement of major global yields:

- The direction of US 10Y yield drove the narrative of major global yields. Risk off sentiment amidst ongoing uncertainty surrounding US President elect's future policy led to some frontloading of sovereign assets. The tariff threat on China, Mexico and Canada again resurfaced in the current week. Host of macro data in the US pointed to resilience of US economy. This ranged from retail sales, personal spending, core PCE and consumer confidence. FOMC minutes also highlighted that the pace of disinflation has softened and risks to core inflation persists from financial services and seasonal factors thus calling for a gradual approach to rates. We believe the terminal Fed rate might be higher in 2025 than previously priced in and future rate decisions will be more nuanced based on the evolution of growth-inflation dynamics under the new political administration. CME Fed watch tool has also pared down the probabilities of a lower terminal rate in 2025. Thus, hinting at less than expected monetary easing amidst stronger dollar and political uncertainty.
- Taking cues from a sharp rise in US 10Y yield, other Advanced Economies (AEs) also followed suit to maintain its yield differential. Germany and UK's 10Y yield has risen sharply. For Germany, yields softened albeit firming up of Euro area inflation as moderation in growth outweighed the same. ECB policy makers have also telegraphed further cuts as evident in their recent speeches accounting for rising downside risks to growth. In the UK as well, moderation in high frequency macro indicators such as retail sales, consumer credit, Q3 preliminary estimate of GDP all signaled some loss of growth momentum which was reflected in the direction of yields. BoE warned against excessive debt deluge against rising public borrowing, thus yields are likely to be capped in the long run.
- For China, liquidity infusion by PBOC and some anticipation of cut in reserve requirement ratio have kept yields lower. A stickier inflation data and expectation of faster pace of normalization for BoJ to maintain appropriate yield differential with US, has resulted in firming up of its 10Y

yield. The BoJ Governor also acknowledged that inflation and growth are in line with central bank's projections, thus hinting at some accommodation in policy rates.

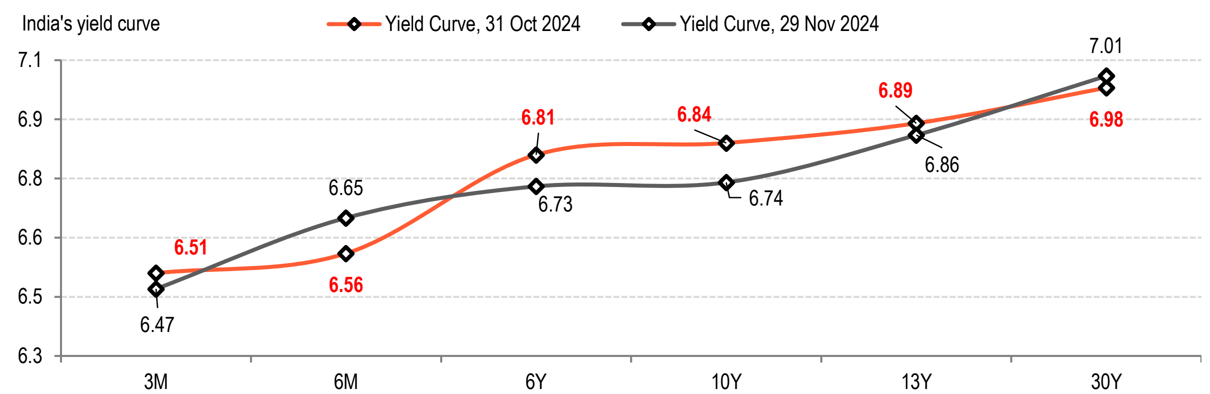
Domestic 10Y yield inched down and traded in the range of 6.74-6.87% in Nov'24, broadly in the same range as last month. Most of the decline is attributable to the last trading session where it fell sharply by 9bps. This is led by weaker than expected GDP print in Q2FY25. Other than that, India's 10Y yield got support from a higher FPI inflows under debt-VRR at US$ 0.4bn in Nov'24 and debt-general limit at US$ 0.1bn.

Table 1. 10Y Yields movement globally

Countries	10Y sovereign yield, 31 Oct 2024	10Y sovereign yield, 29 Nov 2024	Change in 10Y yield, Nov/Oct, bps
Japan	0.95	1.05	10
Indonesia	6.79	6.87	8
Singapore	2.81	2.75	-6
India	**6.85**	**6.74**	**-11**
US	**4.28**	**4.17**	**-12**
Thailand	2.41	2.29	-12
China	2.15	2.03	-12
UK	4.45	4.24	-20
Germany	2.39	2.09	-30
Korea	3.10	2.76	-34

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 rose to 54bps in Nov'24 compared to 47bps seen in Oct'24. Major realignment occurred for the 6-10Y part of the curve which moderated significantly, while short end yield remained sticky monitoring underlying domestic liquidity conditions.

What auctions in the domestic market reflect?

In Nov'24, cut off yields firmed up across the board with considerable rise seen for central government securities.

Table 3. Cost of borrowing

Type of Papers	Avg. Cut off yield, Oct 2024	Avg. Cut off yield, Nov 2024
Central Government Securities	6.85	6.95
SDL	7.10	7.12
Tbills	6.54	6.58

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

Liquidity might witness some pressure:

- Average system liquidity went into surplus of Rs 1.4 lakh crore in Nov'24 from Rs 1.5 lakh crore seen in Oct'24. Some seasonal pressure on liquidity was visible towards the end of the month of Nov when it went into deficit. Going forward, the narrative of liquidity is likely to be tighter. This is on account of the strain on durable liquidity. Further, pressure on INR driven by a stickier dollar, usual pickup in currency in circulation in H2, advance tax payment installment in Dec and moderation in government spending (still trailing behind last year); all signal some loss of momentum in liquidity in the near term.
- From the bank's perspective as well, Incremental deposits and Borrowings net of Incremental Credit and Investment has moderated to Rs 2.1 lakh crore as of latest fortnight of Nov'24 from Rs 2.4 lakh crore in Oct'24.

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to remain in the range of 6.70-6.85% in the current month, with risks tilted to the downside*. The credit policy will provide further clues. Some resumption in FPI flows is expected in Nov'24 on account of favorable interest rate differential with the US. Some vigilance towards volatile food inflation is anticipated which will prompt RBI to stay put. A softer Q2GDP print has led investors pricing in some early response from RBI mainly through fine balancing of system liquidity especially durable liquidity.
- The future direction on yields will be contingent on whether softening growth is a one-off event. We believe H2 will see rebound in growth, which will also keep yields rangebound.

Table 4: OIS rates were a bit higher while corporate spreads softened across the board

	As on 31 Oct 2024	As on 29 Nov 2024
OIS Rates		
1M	6.58	6.65
2M	6.60	6.63
9M	6.56	6.54
Corporate Spreads 10Y, bps		
AAA	36	28
AA+	78	70
AA	122	115

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

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