

Bonds Wrap

Growth remained comparatively on better footing for US, Eurozone and India; thus risk on sentiments led firming up of yields of these economies. Global central banks remained cautiously dovish. Softening inflation data, moderation in employment cost index and well anchored inflation expectations in the US, might reflect that policy rate has peaked in the US. A prolonged data dependent pause might be incumbent for major economies including India. However, on domestic front, food induced inflation is worrisome, with supply shocks getting aggravated on account of skewed monsoon and disruption in production. Thus some upside risk to India's 10Y yield cannot be ruled out. We expect it to settle in the range of 7.15-7.25% in the current month. Only comfort would come from favourable liquidity conditions and government's measures to assuage supply side concerns.

Japan's 10Y yield rose at the sharpest pace:

- The most notable jump in 10Y sovereign yield was visible in case of Japan, post the announcement of a tweak in its yield control curve (YCC) policy. The flexibility in allowing its 10-year yields to rise above the 0.5% ceiling to 1.0%, led its 10Y yield on an upswing which previously traded in a stable range.
- In the US, most of the rise in 10Y yield was visible post the release of better than expected Q2 advance estimates of GDP (2.4% against est.: 1.8%, annualized QoQ) and strengthening labour market data. However, some rise in yield was pared post the release of PCE data which dropped to its near 2 year low. Fed officials (Chicago and Minneapolis Fed President) also sounded affirmative on cooling off inflation. Fed President's statement was also cautiously dovish.
- In Germany, 10Y yield firmed up by 10bps following ECB's hint at sufficiently restrictive policy. Further resilient growth in Spain and France also supported the view.
- In UK, 10Y yield have fallen by 8bps in Jul'23 against 21bps increase in Jun'23, on MoM basis. The reversal in trajectory of yields was attributable to softening CPI, PPI and falling consumer confidence data.

Table 1. 10Y Yields movement in Jul'23

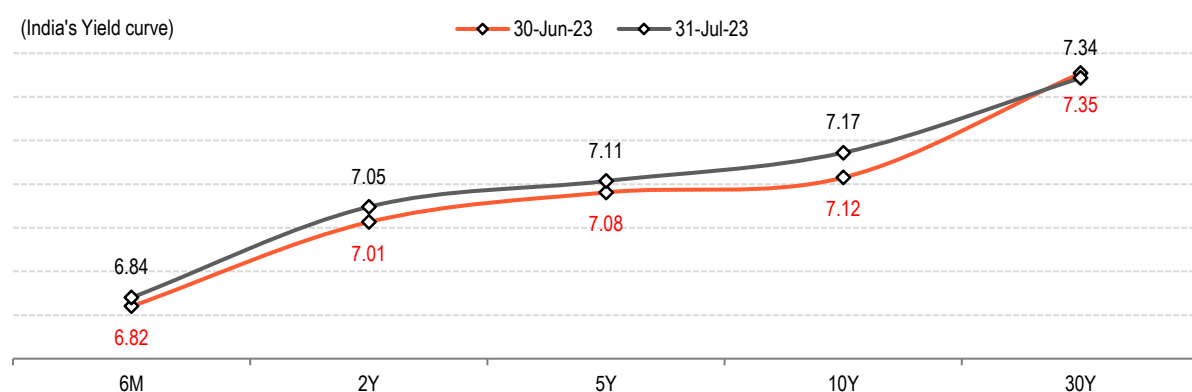
Countries	10Y sovereign yield, 30 Jun 2023	10Y sovereign yield, 31 Jul 2023	Change in 10Y yield in Jul/Jul'23, bps
Japan	0.40	0.61	21
US	3.84	3.96	12
Korea	3.66	3.77	10
Germany	2.39	2.49	10
India	7.12	7.18	6
Thailand	2.56	2.60	4
China	2.64	2.66	2

Countries	10Y sovereign yield, 30 Jun 2023	10Y sovereign yield, 31 Jul 2023	Change in 10Y yield in Jul/Jun'23, bps
Indonesia	6.26	6.25	-1
Singapore	3.06	3.04	-2
UK	4.39	4.31	-8

Source: Bloomberg, Bank of Baroda Research

Domestic 10Y yield rose by 6bps and traded in the range of 7.06-7.18% in Jul'23 compared to 6.98-7.12% in Jun'23. Upside pressure to domestic yield was visible following higher than expected CPI print in Jun'23. Sudden spiraling of vegetables, some components of pulses, cereals and spices, have exacerbated pressure on headline CPI.

Figure 1: Some degree of upward shift in the yield curve was visible



Source: Bloomberg, Bank of Baroda Research

What auctions in the domestic market reflect?

In Jul'23, cut off yields for central government papers' inched up while short end papers got comfort from the underlying liquidity conditions.

Table 2. Cost of borrowing for central government papers rose while short end remained stable

Type of Papers	Cut off yield as on 31 May 2023	Cut off yield as on 30 Jun 2023	Cut off yield as on 31 Jul 2023
Central Government Securities	7.09	7.18	7.24
SDL	7.36	7.41	7.39
Tbills	6.86	6.83	6.82

Source: Bank of Baroda Research, Note: Average cut off yield is taken to arrive at borrowing cost, Auction dates differ

RBI's fine tuning supported liquidity conditions:

- System liquidity deficit rose to Rs 1.6 lakh crore in Jul'23 from Rs 1.3 lakh crore in Jun'23. The evolution of liquidity has been interesting in Jul'23 as well, with RBI conducting shorter variable rate reverse repos (VRRRs) of overnight, 2,3 and 4 days in the first fortnight of the month. While in the latter part of the month 14 day VRRR was conducted.

- Liquidity remained comfortable as in the last two auctions offers received for VRRR remained comfortably higher against the notified amount (For 14 Jul auction: notified amount: Rs 1 lakh; offers received: Rs 59,875, for 28 Jul auction: notified amount: Rs 1 lakh; offers received: Rs 93,761).
- Durable liquidity rose to Rs 3.7 lakh crore as on 31 Jul 2023 compared to Rs 2.8 lakh as on 30 Jun 2023. This was supported by fall in currency in circulation by Rs 0.2 lakh crore in Jul'23. Some comfort on durable liquidity was also provided by accretion in foreign currency assets to the tune of US\$ 9.8bn (21 Jul'23 over 30 Jun'23). Further higher capital spending by the government as is the current trend, will keep liquidity elevated in the near term.

Major Player of the month

As per Bloomberg data, foreign banks, PVBs and MFs have been major sellers of the month. Even PSBs' holdings moderated.

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to remain in the range of 7.15-7.25% in the current month, with risks tilted to the upside.* The CPI print in Jul'23 holds the key where an upward blip is expected. We see headline CPI to settle in the range of 5.5-6% in Jul'23. Our BoB ECI is showing 6.5% increase in food inflation on YoY basis in Jul'23. Crude is also trading at US\$ 85.6/bbl, much higher than previous month's average of US\$ 75/bbl, on account of production cut from OPEC+.
- Only comfort to yields would be provided with more supply side initiatives of the government to cool off domestic food inflation. Market is also awaiting some news on issue of new benchmark security as the current 7.26GS2033 security has reached an outstanding amount of Rs 1.5 lakh crore.

Table 3: OIS rates indicative of a pause by RBI in CY23, corporate spreads moderated

	As on 30 Jun 2023	As on 31 Jul 2023
OIS Rates		
1M	6.63	6.59
2M	6.63	6.63
9M	6.74	6.83
Corporate Spreads 10Y, bps		
AAA	44	37
AA+	76	67
AA	111	102

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

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