1 Jan 2024

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Bonds Wrap

Global yields continued their downward trajectory. Expectations of easing financial conditions increased post Fed policy and recent inflation readings of major economies, which gave relief to central banks. Thus, we are entering 2024 with the narrative of a softer interest rate regime in the near term. India's 10Y yield also felt the reverberation of the same. In Dec'23 it fell by 11bps and in CY23, it inched down by 15bps. Going ahead, we do not expect much volatility in India's 10Y yield, as we have seen buying support broadly reigned in amidst resilient macros. We expect India's 10Y yield to remain in the range of 7.19-7.25% in the current month. The short end part of India's yield curve would continue to exhibit volatility based on the evolving liquidity conditions which we feel will normalize in the range of 0.5-0.6% of NDTL in the coming months (currently at ~0.9% of NDTL).

Global yields on a downswing led by US:

- Global yields continued its downward descend. Demand for sovereign securities increased amidst expectation of easing financial conditions starting from the US itself. The Fed dot plot showed FOMC members expecting rate cuts of 75bps in CY24. Reports suggested that swap traders are pricing in steeper pace of easing with expectation of 150bps cut. In terms of major macros as well, there is indication that labour market is witnessing some degree of softness in the US. Even Core PCE a closely tracked indicator by Fed for inflation is showing moderation for the past two quarters. Other high frequency indicators are giving mixed signals, for which Fed might be cautious. *However, CY24 holds the undertone of some relaxation in the restrictive policy approach and the reverberations will be felt across major central banks, sooner or later.*
- In the Eurozone as well, survey results and measures of inflation showed some comfort. However, the ECB seems to be cautious for some time before it is convinced that inflation expectations will be closely anchored. Recently, ECB Chief Economist also hinted towards the same.
- The sharper than expected fall in CPI print in UK in Nov'23 might allow BoE to soften its hawkish rhetoric a bit. However, the evolution of wage data, details of the Spring Budget are close watchable.
- BoJ on the other hand signaled some swimming against the current tide and exiting the ultra-dovish approach. However, recent minutes showed that members are divided over the same and yet to be convinced of the pace of wage growth, which is still on the higher side.
- China's 10Y yield will continue to gain support from PBOC's liquidity infusion which is expected to continue at its current pace.

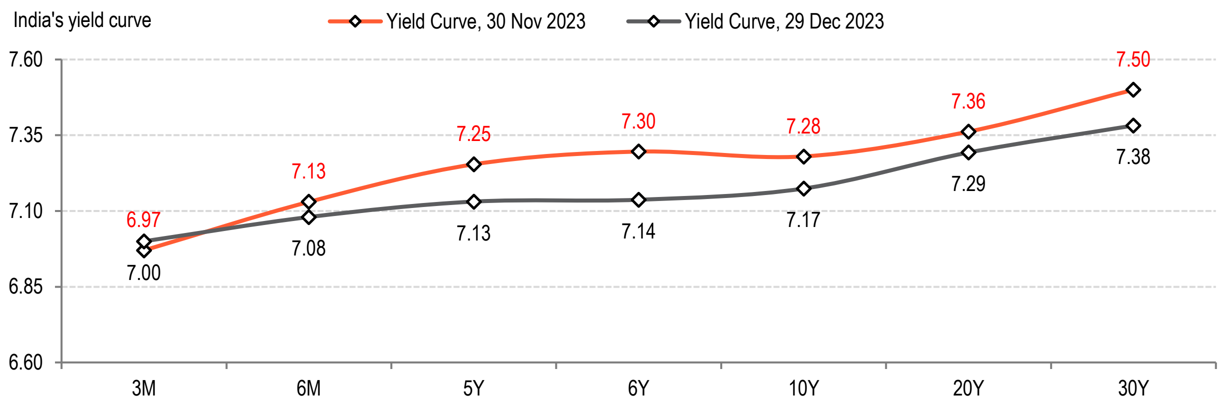
Table 1. 10Y Yields movement globally

	10Y sovereign yield, 30 Nov 2023	10Y sovereign yield, 29 Dec 2023	Change in 10Y yield, Dec-23/Nov-23	Change in 10Y yield, Dec-23/Dec-22
Japan	0.61	0.67	-6	19
India	**7.17**	**7.28**	**-11**	**-15**
China	2.56	2.69	-13	-28
Indonesia	6.48	6.63	-15	-46
Singapore	2.69	2.95	-26	-39
Thailand	2.68	2.95	-28	4
Germany	2.02	2.45	-42	-55
US	**3.88**	**4.33**	**-45**	**0**
Korea	3.18	3.70	-52	-56
UK	3.54	4.18	-64	-14

Source: Bloomberg, Bank of Baroda Research

Domestic 10Y yield moderated by 11bps and traded in the range of 7.16-7.29% in Dec'23 from 7.22-7.36% seen in Nov'23. This month's trajectory was guided by global cues of a softer interest rate environment in the coming days.

Table 2: Evolution of India's yield curve



Source: Bloomberg, Bank of Baroda Research

Short end part of the curve remained sticky due to tighter liquidity conditions, while long end part of the curve shifted downwards. The spread between 3M and 30Y part of the curve moderated to 38bps in Dec'23 from 53bps In Nov'23. Notably, the spread was 119bps in Dec'22. So the curve has flattened considerably in CY23.

What auctions in the domestic market reflect?

In Dec'23, cut off yields moderated sharply for the 10Y paper of both Centre and States, reflecting stronger demand conditions while for short end papers, it remained fairly sticky. If we compare Dec'23 cut off data with Dec'22, one thing clearly evolves is that cut off yields of short end papers have inched up sharply, while demand for long end papers remained stable.

Table 3. Cost of borrowing

Type of Papers	Cut off yield as on 30 Dec 2022	Cut off yield as on 30 Nov 2023	Cut off yield as on 29 Dec 2023
Central Government Securities	**7.30**	**7.38**	**7.22**
SDL	7.63	7.73	7.63
Tbills	6.65	7.09	7.07

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

Pressure on liquidity continued:

- Average system liquidity deficit rose to Rs 1.1 lakh crore from Rs 61,434 crore in Nov'23. Liquidity deficit aggravated towards the latter part of the month due to month end GST outgo as well as Dec installments of advance tax payment. The spread between WACR and Repo also rose to 30bps. The short term yields have also remained under pressure. To ease the situation, RBI conducted surprise VRR of 2 and 7 days tenor, where bids received were more than doubled the notified amount, reflecting higher demand for funds.
- Going forward, financial year ending government spending would provide some comfort. Towards the end of Jan'23, government securities of Rs 59,533 crore is due to be matured. This will ease liquidity pressure to some extent. We do not expect any OMO sale calendar this month, as in the secondary market as well, RBI broadly did not perform any OMO sales operation in Dec'23. The gap between incremental credit and incremental deposit in this financial year is considerably higher at Rs 3.8 lakh crore. Thus, pressure on liquidity would broadly reign in.

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to remain in the range of 7.19-7.25% in the current month*. The downside pressure would emanate from the narrative of global yields, where buying support would persist. The upcoming non-farm payroll of the US would provide more evidence towards the same. But overall in a calendar light month, we do not expect much volatility in India's 10Y yield movement. All eyes will be on the gross borrowing numbers from the Union Budget where we do not expect much pressure on market borrowing amidst fiscal consolidation. Overall in the coming year, we expect some softness in India's yield unless inflation plays quite a spoilt sport, which seems unlikely as vegetable prices have already started correcting in Dec'23, international crude prices are also stable and government's supply side promptness remains.

Table 4: OIS inched down corporate spreads broadly stable

	As on 30 Dec 2022	As on 30 Nov 2023	As on 29 Dec 2023
OIS Rates			
1M	6.32	6.87	6.79
2M	6.42	6.87	6.78
9M	6.71	6.86	6.66
Corporate Spreads 10Y, bps			
AAA	30	41	43
AA+	70	70	76
AA	107	106	111

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

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