बैंक ऑफ़ बड़ौदा
Bank of Baroda

17 Feb 2025

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Bonds Wrap

Global yields in the first fortnight of Feb'25 reflected some risk off sentiments amid ongoing global protectionism. India's 10Y yield remained rangebound supported by RBI's rhetoric of a softer policy going forward. Increased quantum of OMO purchases, especially redirected towards long end papers will also remain supportive of yields. In the coming days, led by an auction light calendar (only two auctions left for this fiscal), we expect not much momentum in domestic yield. The only bit of wriggling might be on account of some gesticulation of US yields or domestic liquidity. We expect India's 10Y yield to trade in the range of 6.65-6.75% in the current month. Liquidity conditions will continue to get support from RBI's long end repos and OMO auctions.

Global yields traded in a thin range:

- The first fortnight of Feb'25 didn't show much momentum for 10Y yields of major economies. For the US, broadly risk off sentiments came into play before frontloading of full tariffs. Its 10Y yield fell by 9bps cumulatively, in Jan and Feb (till date). The unchanged borrowing calendar for the next quarter also kept US 10Y yields largely capped. On macro front, the signaling remained mixed with hotter than expected CPI and core CPI reading, stickier average hourly earnings data albeit some softening in payroll numbers. This got translated in the 1Yr inflation expectations data which rose to 4.3% against 3.3% earlier. On the other hand, some demand indicators showed a loss of momentum such as retail sales and core retail sales (excl. auto and gas) and softening ISM services print. Fed officials, including Fed Chair vouched for cautious data dependent approach. We expect the timing of the next Fed rate cut is likely to be postponed to H2 as the evolution of tariff and counter tariff measures take shape.
- Yields of UK and Germany also showed softening bias. For the UK, BoE's recent rate cut decision and forward guidance of staggered easing have lent support. The moderation of growth forecast also coincides with some high frequency data being toned down such as services PMI, new car registrations and broadly flat private consumption data (QoQ, 4th Quarter estimate). For Germany, softening CPI print and repeated statements of ECB officials hinting at flexibility towards further easing on account of downside risks to inflation, have contributed towards moderation of yields. The considerable softening of Indonesia's 10Y yield happened on account of its currency volatility amidst the tariff turmoil.
- Only outlier has been Japan where the policy divergence with the US is a known factor amongst market participants. The firming up of real cash earnings along with stickier PPI data has built up hopes of a tighter monetary policy. BoJ official has also acknowledged rising food inflation leading to de-anchoring of inflation expectations, thus implying further tightening.

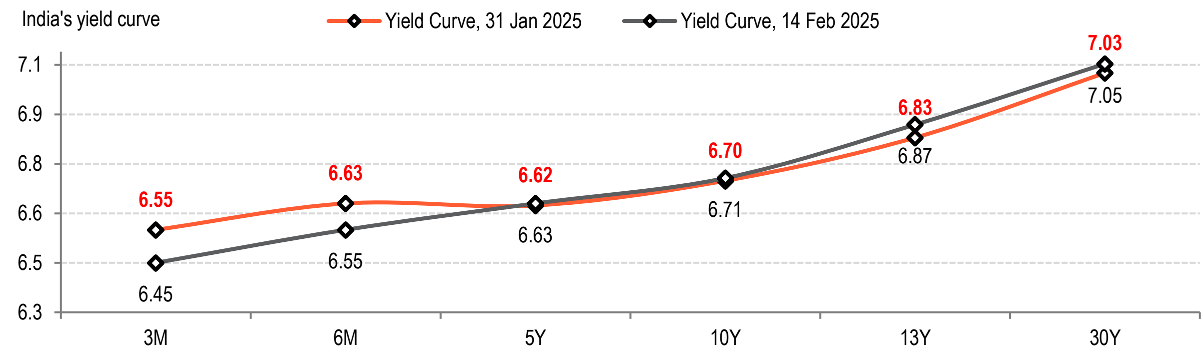
Domestic 10Y yield inched down and traded in the range of 6.66-6.71% in the first fortnight of Feb'25 compared to 6.68-6.85% in Jan'25. There has been much reduced volatility supported by the government's persistent efforts towards fiscal consolidation and providing a long-term vision towards debt management. RBI's liquidity infusion measures also helped in containing long end yields rangebound. However, some announcements on deferment of LCR guidelines did provide slight aberration but were largely contained. A lower-than-expected inflation readings for the past two months also helped in keeping yields largely capped.

Table 1. 10Y Yields movement globally

Countries	10Y sovereign yield, 31 Jan 2025	10Y sovereign yield, 14 Feb 2025	Change in 10Y yield, Jan/Dec, bps	Change in 10Y yield, 14 Feb/31 Jan, bps
Japan	**1.25**	**1.36**	**14**	**12**
Thailand	2.29	2.31	4	2
China	1.63	1.65	-5	2
India	**6.70**	**6.71**	**-6**	**1**
Korea	2.86	2.85	-1	-1
Germany	2.46	2.43	9	-3
UK	4.54	4.50	-3	-4
Singapore	2.91	2.85	6	-6
US	**4.54**	**4.48**	**-3**	**-6**
Indonesia	6.99	6.77	-1	-22

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 considerably to 60bps in the first fortnight of Feb'25 compared to 48bps seen on 31 Jan 2025. This is on account of the tempering down of yields of shorter part of the curve. As we have seen in earlier years of the liquidity deficit situation, shorter part of the curve was more responsive, which is not the case now. Thus, RBI's measures coupled with government's reduced reliance on short term borrowings as highlighted in the Budget have kept short end yields in check. Since tightening liquidity is not impinging on short end yields in this current cycle, some steepness in India's yield curve might be witnessed.

What do auctions in the domestic market reflect?

In Feb'25, cut-off yields firmed up for central government papers on account of increased demand. For SDL, it remained rangebound and for TBills, it softened across the board.

Table 3. Cost of borrowing

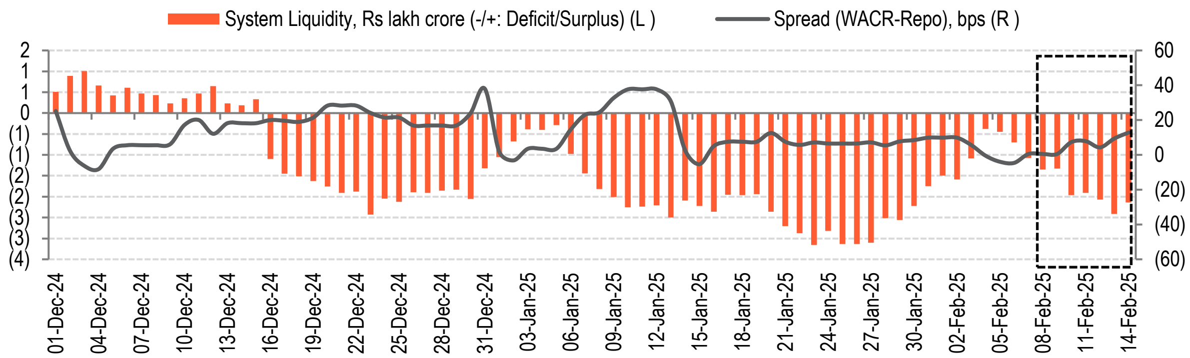
Type of Papers	Avg. Cut off yield, Dec'24	Avg. Cut off yield, Jan'25	Avg. Cut off yield, Feb'25
Central Government Securities	6.9	6.88	6.95
SDL	7.11	7.14	7.13
Tbills			
91 days	6.47	6.59	6.46
182 days	6.62	6.70	6.58
364 days	6.61	6.68	6.55

Source: Bank of Baroda Research, Note: Average cut off yield of auctions for the month have been accounted for

Liquidity might witness some pressure:

- Average system liquidity went into a deficit of Rs 1.4 lakh crore in the first fortnight of Feb'25 compared to an average deficit of Rs 2 lakh crore seen in Jan'25. The liquidity infusion measures of RBI have remained supportive. In addition to the Rs 1.5 lakh crore liquidity measures announced by RBI to correct durable liquidity, another Rs 95,000 crore liquidity infusion through 49-day VRR and ramp up of OMO purchase have been undertaken. As per Bloomberg data, in the secondary market RBI has already purchased Rs 58,835 crore of OMOs in Jan'25 compared to just Rs 20 crore in Dec'24. These figures are indicative of a leg up approach by RBI to contain system level liquidity to a comfortable range so that it remains conducive for credit conditions.
- The recent results of repo auctions also revealed considerable demand for funds. The Bids received were ~ 1.75 times (averaged for both 56-days and 49-days auctions) higher than the notified amount. The tighter liquidity also led to a considerable divergence of call money rate from the targeted repo as seen in the month of Feb'25 (Fig 2, where spread widened).

Fig 2: Evolution of system liquidity and spread between Call money rate and Repo



Source: Bloomberg, Bank of Baroda Research

- Going forward, the liquidity conditions would remain tight as the seasonal month end outflows would take place. The year end Mar phenomenon also sees the usual pickup in credit demand which will act as a leakage. Hence the gap between incremental deposits and borrowings net of incremental credit and investments would widen. The slower pace of deposit accretion is likely to continue under a softer monetary policy regime which will act negatively towards widening the gap between the two. Currently the gap is Rs (–)1.4 lakh crore for the fortnight ending 24 Jan 2025 which was +Rs 1.5 lakh crore as on 20 Sep 2024, when liquidity was comfortable. CIC leakage is also happening at a faster pace at Rs 1.2 lakh crore in FYTD25 against Rs 0.8 lakh crore in the same period of the previous year. The narrative on INR also hints at gyrations in domestic liquidity as ongoing developments on tariff front signals a stronger dollar. We expect liquidity to remain in deficit of ~ 0.6-0.9% of NDTL, with risks titled to the upside.

Outlook on 10Y yield in the current month:

- *India's 10Y yield is expected to remain in the range of 6.65-6.75% in the current month, with risks tilted to the downside*. Risk off sentiments is at play for the global economy which will largely restrain domestic yields. Domestic macros such as enhanced pace of OMOs by RBI will also keep yields in check especially for long end papers as these are the ones put up mostly for the auction. Apart from this, debt flows, especially through the FAR route (net flows of US$ 947mn in Jan'25 and US$ 1bn in Feb-till date) have been conducive which remains supportive of a lower domestic yield in the near term.

Table 4: OIS rates softened indicative of monetary easing going ahead, low rated papers showed stickiness

	As on 31 Dec 2024	As on 31 Jan 2025	As on 14 Feb 2025
OIS Rates			
1M	6.68	6.49	6.42
2M	6.66	6.58	6.5
9M	6.53	6.34	6.31
Corporate Spreads 10Y, bps			
AAA	34	30	36
AA+	79	71	78
AA	130	113	121

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

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