Benchmark yield jumps near 3-year high as RBI revises inflation forecast, hints policy normalisation

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The 10-year benchmark bond jumped to a three-year high after the Reserve Bank of India (RBI) in its monetary policy review revised upwards the inflation forecast and signalled the normalisation of its 'ultra accommodative' policy. With inflation dynamics taking the center stage, the market has built in higher rates from June or August. A downward revision of GDP estimates, introduction of the Standing Deposit Facility (SDF) and concerns over the government's large borrowing programme in the current fiscal also pushed up yields. The 10-year benchmark 6.54%-2032 bond yield ended almost 21 basis points up at 7.1190%, which is a 34-month high, a level last seen on May 30, 2019.

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The RBI kept the repo rate unchanged and normalised the policy corridor to pre-pandemic levels at 50 bps and announced SDF in place of a fixed-rate reverse repo. The SDF is a window through which banks can park money overnight with the central bank without being provided with collateral in return. "The reverse repo will no longer be used for liquidity management purposes and will be used at the discretion of RBI," Gaura Sen Gupta, economist at IDFC First Bank, said in a report.

Higher market borrowing by the government is also impacting yields, but the RBI governor assured the market that it would conclude the borrowing programme without any disruption. “RBI will use various instruments from time to time for successful completion of the government borrowing,” governor Shaktikanta Das said in the post-policy press conference.

The central bank revised the inflation forecast upwards to 5.7% in FY23 from 4.5% and revised the GDP forecast to 7.2%, given the broad-based nature of price increases and uncertainty around the evolving geopolitical situation. The downward revision of growth is due to weaker external demand, tightening of global financial conditions and persistent supply-side disruptions due to ratcheting up of geopolitical tensions.

Market participants expect bond yields to rise as much as 30-35 bps in coming days considering the heavy borrowing, but support is expected in form of open market operations or Operation Twists. “We expect bonds yields to move between 7.25% and 7.50% by June,” Mahendra Kumar Jajoo, CIO – fixed income, Mirae Asset Investment Managers (India), said.

Traders believe that after the normalisation of the policy corridor, the central bank may hike the rate in the next policy considering the geopolitical situations. The RBI is currently remaining cautious about inflation and other geopolitical factors. “I would think a first repo rate hike should happen in the June policy and 50 basis points hike over the year,” Jajoo said.