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Bonds Wrap

The global yields largely softened in Sep'24. US 10Y yield eased after Fed unveiled the rate cuts and signaled the possibility of additional cuts this year and this will be followed in CY25. Moderation in the recent PCE data adding to the Fed's conviction of abating price pressure, with inflation inching closer to the target mark. Incoming US jobs data will add further clarity to Fed's guidance on rate outlook. On the domestic front, given the moderation in inflation and favorable liquidity conditions, India's 10Y yield eased. Going forward, the 10Y yield is expected to trade in the range of 6.68%-6.75% in Oct'24, with risk evenly balanced. On policy rate, we anticipate RBI will wait and watch before taking any action in Dec'24 given the moderation in headline inflation.

Movement in global yields in Sep'24:

- There was significant variation in movement in global yields in Sep'24 across global economies. While 10Y yield in Indonesia fell by 18bps, yields in US was down by 13bps and for China, the bond yields were up by 3bps respectively.

Table 1. 10Y yield movement globally

Countries	10Y sovereign yield, 30 Aug 2024	10Y sovereign yield, 30 Sep 2024	Change in bps (MoM)
China	2.18	2.21	3
UK	4.02	4.00	-1
Japan	0.90	0.86	-4
Singapore	2.69	2.60	-9
Korea	3.09	2.99	-10
India	**6.86**	**6.75**	**-11**
US	**3.90**	**3.78**	**-12**
Germany	2.30	2.12	-18
Indonesia	6.63	6.45	-18

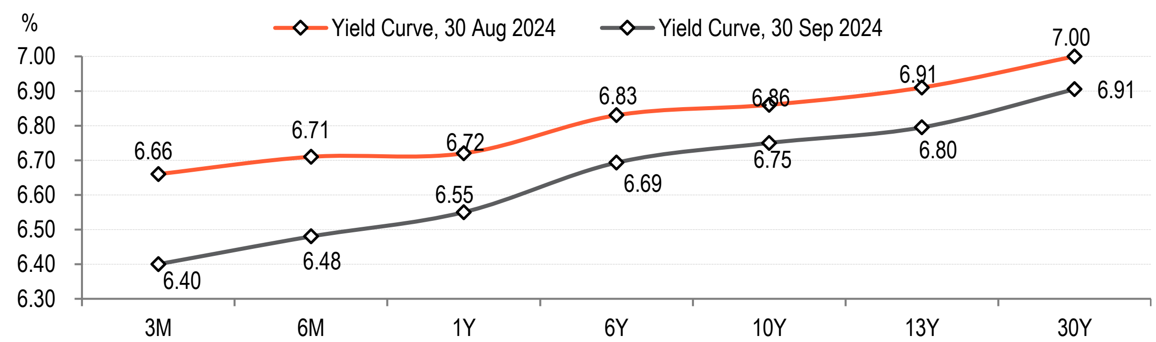
Source: Bloomberg, Bank of Baroda Research

- US 10Y yields ended lower by 12bps in Sep'24. US Fed began with the aggressive rate cut as it announced the 50bps cut and the beginning of the easing cycle after a span of 4-years. With this the benchmark policy rate were lowered down to 4.75-5%. Fed Chair referred to it as 'recalibration' given the moderation in inflation as it is moving closer to the target mark and noted the economy continues to signal resilience. According to the Fed dot plot, FOMC members have projected the fed funds rate to be lowered down by a total of 100bps this year (including the Sep'24 cut), by 100bps in CY25 and by 50bps in CY26. Thereby a sum of 250bps reduction in rate, of this 50bps has already been cut in Sep'24. The committee has also revised its economic projections with GDP growth now expected at 2% for CY24 (from 2.1% in Jun'24) and unemployment projection revised upwards to 4.4% (earlier 4%). On inflation, the projections for both headline and core has been revised downwards to 2.3% and 2.6% respectively. US PCE, Fed's preferred gauge of inflation moderated down to 2.2% (lower than anticipated) from 2.5% in Jul'24. Even the core PCE (excl food and energy prices) cooled off to 2.7% from 2.6% in Jul'24. US Fed chair recently in his speech noted that they will evaluate the incoming data and will take a decision on rates from meeting-to-meeting basis. Moreover, they noted the move towards neutral stance will happen over time as they were not on 'pre-set course'. Markets have priced in 65% chance of a 25bps rate cut in Nov'24 with the likelihood of another rate cut in Dec'24.

- ECB lowered the interest rates for the second time this year by an additional 25bps, bringing the rates down to 3.5-3.75%. Inflation in Germany eased down more than expected to 1.8% in Sep'24 from 2% in Aug'24. The Eurozone inflation reading in Sep'24 is expected to be much lower than the target level of 2%. The lowering of the price pressure have bolstered a case of another rate cut in Oct'24 in order to provide support to the ailing economy (evident from various data points including disappointing economic sentiment).
- Bank of England maintained status quo on policy rates with a vote of 8-1 with a cautious tone as the Governor noted the rate cut will be a gradual approach amidst cooling of inflation. Headline inflation in UK has remained steady at 2.2% in Aug'24 same as Jul'24.
- BoJ kept the benchmark rate steady at 0.25% in Sep'24 in line with expectation. The Governor noted they will spend more time before taking a decision on hiking rates again given the uncertainty in global economic outlook.
- In an effort to revive the ailing economy, the authorities in China announced fiscal stimulus measures which included lowering down of rates and injecting liquidity back in to the system. The 7-day reverse repo rate have been lowered down by 20bps to 1.5%. It was also stated the reserve requirement ratio (RRR) will be cut by 50bps in the near term and this provide a liquidity boost of 1tn yuan.

India's 10Y yield eased by 8bps and traded in the range of 6.72-6.88% in Sep'24 from 6.85-6.91% in Aug'24. Given the favorable supply-demand dynamics, the 10Y yield touched the 6.72% mark lowest level in more 2-years in Sep'24 (lowest since Feb'22) post the announcement of the borrowing calendar for H2FY25.

Figure 1: Movement in India's yield curve



Source: Bloomberg, Bank of Baroda Research

The long end part of the curve has softened. The spread between 3M and 30Y has widened to 51bps from 34bps in Aug'24, given the long-end part of the curve has moderated.

What auctions in the domestic market reflect?

In Sep'24, on the back of strong demand conditions, the cut off yields for the 10Y paper of both state and Centre moderated.

Table 2. Cost of borrowing

Type of Papers	Cut off yield (%)	
	Aug'24	Sep'24
Central Govt.	6.95	6.78
SDL	7.23	7.11
91-day Tbill	6.63	6.65
182-day Tbill	6.72	6.72
364-day Tbill	6.72	6.70

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

Liquidity situation:

- Average system liquidity surplus in Sep'24 turned out to be Rs 1,00,916 from Rs 1,50,897 crore in Aug'24. Notably, the banking system liquidity surplus (defined as incremental deposit-incremental credit-incremental investment) has risen to Rs. 1.3 lakh crore (as of 6 Sep 2024) compared with Rs. 34,120 in Aug'24.

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to trade in the range of 6.68-6.75% in Oct'24*. The 10Y yield is expected to soften as it continues to track global yields along with any Central Bank action. It will be further supported by lower inflation print amidst normal monsoon with a possible rate action by RBI only expected in Dec'24. Furthermore, the influx of FPI flows also bodes well for 10Y yield.
- The government announced the borrowing calendar for H2FY25 which was in line with expectations. The yield curve is expected to steepen given the lower supply in short term.
- The 10Y yield curve has been supported by RBI's liquidity management strategy through VRRR.
- The headwinds to these projections emerge from the ongoing geopolitical tensions in the Middle East, movement of commodity prices especially crude.

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