31 Aug, 2024

Jahnavi Prabhakar
Economist

Bonds Wrap

Most of global yields eased in Aug'24. US 10Y yield softened further hinting rate cuts are incoming. US Fed minutes and Fed Chair Powell had signaled the same in the recent commentary amidst the moderation in inflation, reflected with the recent PCE data which is inching closer to the target mark along with signs of weakness in labor market. The only uncertainty lies over the quantum of rate cuts, it could vary between 25-50bps with the market pricing increased likelihood of at least 3-cuts this year, followed by more cuts in CY25. On the domestic front, India's 10Y yield too softened and we expect further moderation given the possibility of further dip in inflation in the coming months as well as favorable liquidity conditions. Higher FPI-inflows in debt segment with the bond index inclusion also bodes well for the bond market. Going forward, the 10Y yield is expected to trade in the range of 6.8%-6.9% in Sep'24, with risk evenly balanced.

Movement in global yields in Aug'24:

- There was significant variation in movement in global yields in Aug'24 across global economies. While 10Y yield in Japan fell by 16bps, yields in US was down by 13bps and for UK and China, the bond yields were up by 4.5bps and 3bps respectively.

Table 1. 10Y yield movement globally

Countries	10Y sovereign yield, 31 July 2024	10Y sovereign yield, 30 Aug 2024	Change in bps (MoM)
UK	3.97	4.02	4.5
China	2.15	2.18	2.8
Korea	3.06	3.09	2.8
Germany	2.30	2.30	-0.1
India	6.93	6.86	-6.6
US	4.03	3.90	-12.66
Japan	1.06	0.90	-16.2
Singapore	2.87	2.69	-18.2
Indonesia	6.90	6.63	-26.7

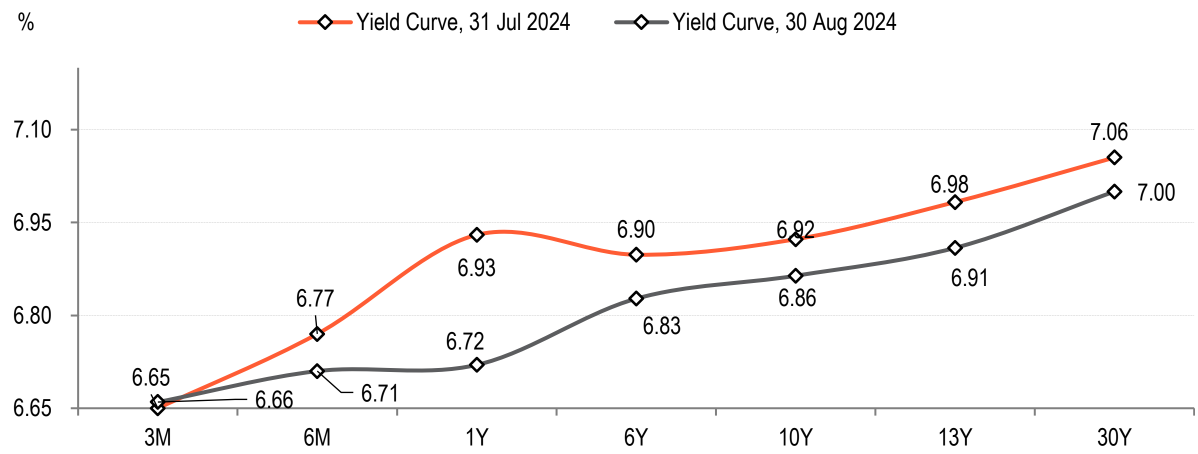
Source: Bloomberg, Bank of Baroda Research

- US 10Y yields ended lower by 13bps in Aug'24. The recently released Fed minutes signaled the rate cuts are very much back on the table given 'vast majority' of officials were willing to reduce rates in the next meet given the data 'comes in as expected'. This was further reaffirmed by the Fed Chair comments in the Jackson Hole speech as he noted 'time has come' to move towards policy easing which has been imminent for some time. He stated the inflation risks have lowered and it is inching closer to the Central bank target. Furthermore, he stated that Fed will remain data dependent with the focus also moving towards supporting the labor market as risks to inflation have lowered. Recently, US GDP data for Q2CY24 was revised upwards to 3% (from 2.8%) compared with 1.4% growth in Q1 led by robust consumer spending which accounts for 2/3rd of the economy. Additionally, weekly jobless claims dropped down to 231k for week ending 24 Aug and have retreated back from 11-month high claims noted in Jul'24. US PCE remained unchanged at 2.5% in Jul'24 and was below market expectation of 2.5%. Core PCE excluding volatile items such as food and energy prices, came in at 2.6% in Jul'24 again lower than the forecast (2.7%). Markets have priced in 70% chance of a 25bps rate cut in Sep'24 and there seems more appetite for additional rate cuts by the end of the year and also in the next year.

- Inflation in EU eased down to 2.2% in Aug'24 from 2.6% in Jul'24 and opening room for a rate cut by ECB as inflation inches nearer towards the bank's target level. This is the lowest inflation level in over 3-years and is attributed to the sharp drop in energy prices. Core inflation also moderated marginally by 2.8% (lowest since Apr'24) from 2.9% in Jul'24.
- In a policy divergence from other Central Bank, BoJ's Governor in one of his statements noted that there could still be possibility of more rate hike if the economy aligns with the projections. This was further reinforced by the commentary of Deputy Governor with another rate hike on the table if the 'outlook of economic activity and prices will be realized'.

India's 10Y yield eased by 8bps and traded in the range of 6.85-6.91% in Jul'24 from 6.91-7.12% in Jul'24. In Aug'24, 10Y yield touched the 6.85% mark, lowest in over 2-years given the favorable supply-demand dynamics.

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 narrowed down to 34bps in Aug'24 from 40bps in Jul'24, given the long-end part of the curve has moderated.

What auctions in the domestic market reflect?

In Aug'24, cut off yields for the 10Y paper of both state and Centre moderated suggesting strong demand conditions. Even the cut-off yield for short term paper eased.

Table 2. Cost of borrowing

Type of Papers	Cut off yield (%)	
	Jun'24	Jul'24
Central Govt.	6.96	6.95
SDL	7.32	7.23
91-day Tbill	6.67	6.63
182-day Tbill	6.79	6.72
364-day Tbill	6.80	6.72

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 Aug'24 turned out to be 1,52,104 crore Rs from Rs 1,02,718 crore in Jul'24. Notably, the banking system liquidity surplus (defined as incremental deposit-incremental credit-incremental investment) has risen to Rs. 1.4 lakh crore (as of 9 Aug 2024) compared with Rs. 90,462 in Jul'24.

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to trade in the range of 6.8-6.9% in Sep'24*. Tracking global yields, India's 10Y yield is expected to soften supported by falling inflation print and is likely to cool-off further given normal monsoon condition which will be favorable for food prices.
- The 10Y yield curve has been supported by RBI's liquidity management strategy through VRRR.
- RBI could begin rate action earliest by Dec'24 as there will be more clarity on any underlying information. Higher inflows through the JP Morgan index will be positive for the Bond market. FPI holding in the FAR securities have improved. However, given the escalation in geopolitical movement, global crude and commodity prices needs to be closely monitored.

For further details about this publication, please contact:
Economics Research Department
Bank of Baroda
+91 22 6698 5143
chief.economist@bankofbaroda.com
jahnavi@bankofbaroda.com