4 Mar 2025

बैंक ऑफ़ बड़ौदा Bank of Baroda

Jahnavi Prabhakar
Economist

Bonds Wrap

Uncertainty on global economic growth and heightened market volatility amidst lingering geopolitical tensions, tightening financial conditions and escalated concerns around possible impact of tariff war, has kept the global investors on the edge. US 10Y yield moderated given the growing risk of slowing economy and the same has been reflected by weaker consumer sentiment and retail sales print. On the domestic front, given the moderation in inflation and evolving liquidity conditions, India's 10Y yield eased. Extensive efforts by RBI in managing liquidity through VRR auction supported bond yields. Going forward, the 10Y yield is expected to trade in the range of 6.65%-6.75% in Mar'25, with certain upside risk including tightening liquidity conditions amidst tax outflows. On policy rate, we anticipate RBI will wait and watch before taking any action in Apr'25 given the moderation in headline inflation.

Movement in global yields in Feb'25:

- There was significant variation in movement in global yields in Feb'25 across global economies. While 10Y yield in US fell by 33bps, yields in Singapore was down by 18bps and for China and Japan, the bond yields were up by 15 and 13bps respectively.

Table 1. 10Y yield movement globally

Countries	10Y sovereign yield, 31 Jan 2025	10Y sovereign yield, 28 Feb 2025	Change in bps (MoM)
China	1.63	1.78	15
Japan	1.25	1.38	13
India	**6.70**	**6.73**	3
Germany	2.46	2.41	-5
UK	4.54	4.48	-6
Indonesia	6.99	6.91	-8
Korea	2.86	2.70	-16
Singapore	2.91	2.73	-18
US	**4.54**	**4.21**	**-33**

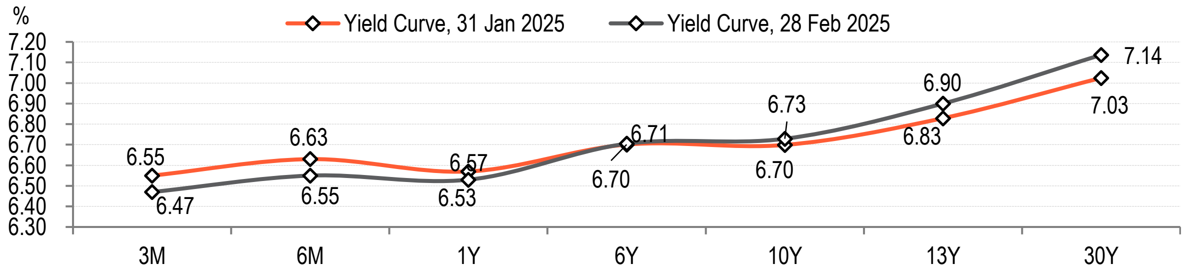
Source: Bloomberg, Bank of Baroda Research

- US 10Y yields ended lower by 33bps in Feb'25. US Fed in its last meeting paused the rate cut cycle and signaled cautious note on the outlook of interest rates given the ongoing concerns around inflation. The same was reiterated in the Fed minutes noting 'committee could hold policy rate at a restrictive level if the economy remained strong and inflation remained elevated'. The Fed has kept the benchmark policy rate at 4.25-4.50% level. Markets have currently priced in a possibility of at least one rate cut in CY25. The members are also closely watching the potential implication of the proposed policy measures by US President Donald Trump as they see such policies carry upside risk for inflation and downside risk in terms of labor market. Recently US PCE, Fed's preferred gauge of inflation moderated in line with expectation to 2.5% in Jan'25 from 2.6% in Dec'24. Core PCE (excl food and energy cost) too eased to 2.6% against an increase of 2.9% in Dec'24. This comes post the higher than expected reading of CPI print with headline inflation climbing towards the 3% mark in Jan'25 (2.9% in Dec'24).

- Inflation in Euro zone moderated to 2.4% in Feb'25 from 2.5% in Jan'25 and tad higher than expectation (2.3%) with unprocessed food prices remaining elevated at 3.1%. Core CPI also eased down to 2.6% (from 2.7%) in Jan'25. Furthermore, services inflation eased to 3.7% against 3.9% in Dec'24. Against this backdrop, a dovish stance by ECB is expected in its upcoming meeting scheduled later this week. The rates could be lowered down by 25bps (6th cut since the easing cycle began) with growing bets of further easing expected in the coming months given the inflation has remained stagnant and growth has turned anemic.
- Headline inflation in Japan climbed up to 4% in Jan'25 much higher than anticipated and against a 3.6% increase in Dec'24. Core CPI, excluding fresh food surged to 3.2% (19-month high) in Jan'25 against a 3% increase in Dec'24. Additionally, the core-core inflation (excl food and fuel) also inched up to 2.5% (2.4% in Dec'24) in Jan'25. The headline inflation continues to remain above the BoJ's target mark of 2% and has resulted in hawkish commentary by BoJ officials. Against this, there is growing expectation of further tightening by BoJ with 2 rate hike in June and Dec'25, followed by 2-more hikes by Jun'26.
- Bank of England with a majority of 7 members voted to lower benchmark rates by 25bps to 4.5%. This was the first rate cut of the year (3rd cut in the last 6-months) and the BoE Governor noted there is likelihood of more cuts in the coming year. It has revised the growth projection downwards for CY25 from 1.5% to 0.75%. Inflation in UK accelerated to a 10-month high to 3% in Jan'25 against a 2.5% increase in Dec'24. Services inflation was up by 5% in Jan'25 against an increase of 4.4% in Dec'24 and core inflation rising to 3.7% (3.2% in Dec'24).
- Recently PBOC, kept the benchmark rate steady at 3.1% for 1-year LPR and 3.6% for 5-year LPR. There has also been a status quo for the 7-day benchmark rate at 1.5% with the Central Bank trying to protect the currency amidst the downward pressure given the ongoing threats of tariff war.

India's 10Y yield eased by 3bps and traded in the range of 6.47-7.13% in Feb'25 from 6.55-7.03% in Jan'25. Given the evolving supply-demand dynamics, the 10Y yield touched the 6.73% mark in Feb'25.

Figure 1: Movement in India's yield curve



Source: Bloomberg, Bank of Baroda Research

The long end part of the curve has edged up. The spread between 3M and 30Y has widened to 67bps in Feb'25 from 48bps in Jan'25, given the long-end part of the curve has risen.

What auctions in the domestic market reflect?

In Feb'25, the cut off yields for the 10Y paper of both state and Centre inched up. On the other hand, the T-bills moderated.

Table 2. Cost of borrowing

Type of Papers	Cut off yield (%)	
	Jan'25	Feb'25
Central Govt.	6.82	6.93
SDL	7.10	7.19
91-day Tbill	6.56	6.45
182-day Tbill	6.67	6.60
364-day Tbill	6.63	6.54

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 deficit in Feb'25 turned out to be lower at Rs 1,66,854 from Rs 2,03,564 crore in Jan'25. Notably, the banking system liquidity (defined as incremental deposit-incremental credit-incremental investment) has fallen to Rs. 7.5 lakh crore (as of 7 Feb 2025) compared with a dip of Rs. 8.3 lakh crore in Jan'25.
- In order to address the persistent liquidity deficit in the system, RBI conducted the second swap auction of US$ 10bn for a period of 3-years and received bids of over US$ 16.2bn. Thereby, signaling strong demand conditions. This is expected to add over Rs 87000cr to the banking system liquidity.

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to trade in the range of 6.65-6.75% in Mar'25*. The 10Y yield is expected to remain range bound as it continues to track global yields along with any Central Bank action. We do not expect any rate action by RBI in the upcoming policy meet in Apr'25.
- The 10Y yield curve has been supported by the ongoing RBI's liquidity management strategy through VRR.
- We expect newer announcement of OMOs based on evolving liquidity conditions.
- The headwinds to these projections emerge from the ongoing threats of tariff wars, percolating and impacting even the external sector. Additionally, there might be some liquidity pressure even in Mar'25 given the advance tax outflow. However, overall 10Y yield will remain range bound.

Visit us at www.bankofbaroda.com

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