

Bonds Wrap

Global yields continued their downward trajectory. US 10Y yield declined as renewed bets of rate cut by Fed resurfaced. This was attributable to softer PCE price index which came in line with expectations. With the cooling off price pressure, the rate cut is expected by the market to begin as early as Sep'24. ECB on the other hand, has already begun the rate cut cycle and is expected to trim rates further as they deem it reasonable which could bring the borrowing cost lower. On the domestic front, India's 10Y yield inched up. Going forward, it is expected to trade in the range of 6.95%-7.05% in Jun'24, with risk evenly balanced. The inclusion in the global bond yield index and the expectation of fiscally prudent Budget remains a key positive for the government bonds.

Movement in global yields in Jun'24:

- There was significant variation in movement in global yields in Jun'24 within advanced economies. While 10Y yield in Indonesia inched up, yields in US, UK, China and Germany eased.

Table 1. 10Y yield movement globally

Countries	10Y sovereign yield, 31 May 2024	10Y sovereign yield, 28 June 2024	Change in bps (MoM)
Indonesia	6.96	7.07	11
India	7.00	7.01	1.2
Japan	1.06	1.06	-0.7
China	2.31	2.21	-9.6
US	4.55	4.40	-14.9
Germany	2.65	2.50	-15.2
Singapore	3.36	3.20	-16.3
UK	4.35	4.17	-17.5
Korea	3.56	3.26	-30.2

Source: Bloomberg, Bank of Baroda Research

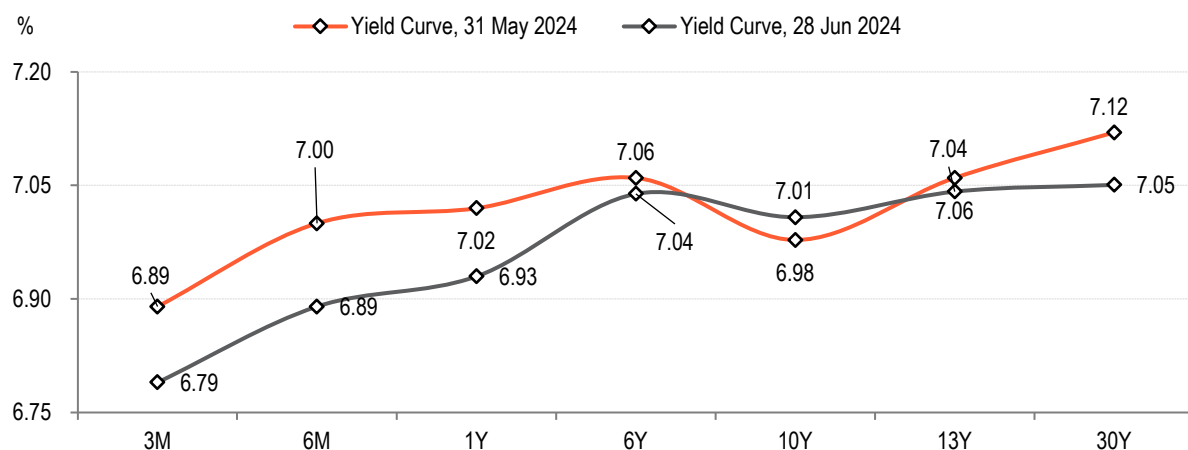
- US 10Y yields ended Jun'24 lower by 15bps. US PCE price index, which is Fed's preferred gauge of tracking inflation, remained steady on a monthly basis, while the core PCE (excluding food and energy) moderated down to 0.1% from 0.3% in Apr'24. The moderation in PCE was attributed to lower prices of both goods (0.4%-biggest fall since Nov'23) and energy prices (2.1%). Additionally, consumer spending inched up by 0.2% (0.1% in Apr'24) while personal income was up by 0.5% from 0.3% in Apr'24. On an annual basis, both headline and core inflation eased to 2.6% (2.7% and 2.8% in Apr'24) in May'24. The cool-off was broadly in line with expectations and raises likelihood of at least one rate cut and as early as Sep'24. Central

Banks' inflation target is 2%. According to the CME FedWatch Tool, the probability of a 25bps rate cut stands at more than 50% for Sep'24.

- In the UK, BoE kept the rates unchanged ahead of the upcoming election. The committee noted the decision to hold rates was 'finely balanced' and stated it was too soon to cut rates. The possibility of next rate cut is delayed and is unlikely before Sep'24 or Nov'24.
- ECB in line with expectations, trimmed rates by 25bps for the first time in over 5-years. The statement reflected a hawkish bias and noted headline inflation since Sep'23 was down by 2.5 percentage points and 'outlook has improved markedly'. ECB has also revised its inflation forecast upwards for CY24 (2.5%) and CY25 (2.2%). It expected the economy to recover supported by higher wages and growing terms of trade.
- Despite hawkish commentary by BoJ, 10Y yields eased. In the minutes, it was highlighted the officials contemplated decision of rate hike in order to counter the risk of inflation overshooting. The possibility of rate hike has now shifted to the next meeting, in Jul'24.

India's 10Y yield inched up by 2bps and traded in the range of 6.90%-7.03% in Jun'24 from 6.97%-7.14% in May'24. The notable inclusion of domestic bond yield in the global bond index is favorable for yield movement in the coming days.

Figure 1: Movement in India's yield curve



Source: Bloomberg, Bank of Baroda Research

The short end part of the curve has shifted downwards. The spread between 3M and 30Y edged up to 26bps in Jun'24 from 23bps in May'24. *The shorter end of the curve (less than 1 year) was supported by RBI's liquidity management operations.*

What auctions in the domestic market reflect?

In Jun'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 (%)	
	May'24	Jun'24
Central Govt.	7.17	7.06
SDL	7.4	7.32
91-day Tbill	6.99	6.80
182-day Tbill	7.04	6.92
364-day Tbill	7.06	6.96

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 moderated to Rs 54,660 lakh crore in Jun'24 from Rs 1.38 lakh crore in May'24. However, it must also be noted that there has been some fall in banking system liquidity surplus (defined as incremental deposit-incremental credit-incremental investment) to Rs. 11,250 crores (as of 14 Jun 2024) compared with Rs. 1.72 lakh crores in May'24. Going forward, with some easing of credit growth, liquidity will get the desired support in the near term.

Outlook on 10Y yield for the next 30days:

- *India's 10Y yield is expected to trade in the range of 6.95-7.05% in the current month.* The focus will shift towards the upcoming Union Budget which holds further cues to the movement of bond yield. A fiscally prudent budget will be positive for the yields. Any announcement pertaining to the curtailing down of government borrowing program will also be monitored closely.
- Following the much anticipated inclusion in the JP Morgan index, FPI inflow is expected to increase and this is likely to push down government bond yields.
- Given the recent movement in US inflation, there is higher likelihood of at least one rate cut this year, which can be as early as Sep'24. Some downward movement on account of this rate cut is expected and this can lend some support to the domestic yields as well. However, given the recently evolving political dynamics, there has been some volatility noted in global yields and this might pose some risk to even domestic yields.

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