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Bonds Wrap

Global yields traded in a wide range with no directional convergence between 10Y yield of major economies. For US, we have seen a softening bias in yields. This was further supported by Fed Chair's recent statements hinting at rate cut in Sep'25. CME Fed watch tool is also showing that traders are pricing in a higher probability for the outcome of rate cut in Sep'25. However other Advanced Economies (AEs) showed stickiness in yield amidst growing expectation of a wait and watch policy response in the near term. India's 10Y yield also showed significant firmness in Aug'25, with longer part of the curve exhibiting maximum movement, a phenomenon called bear steepening. This was primarily led by lower expectations of rate cut by RBI amidst growth holding ground. Apart from this, concerns of excess supply of government papers also weighed on sentiments. We expect India's 10Y yield to trade in the range of 6.50-6.60% in the current month. The release of H2 borrowing calendar would only give a clearer picture about the allocation of securities towards different maturity buckets, and hence some respite in yields may be seen. Another point of comfort for yields could be the rising interest rate differential with the US in the wake of Fed again embarking on the rate cut cycle and RBI maintaining status quo momentarily.

India, an outlier of the month:

- Global yields remained divergent in Aug'25. US 10Y yield has fallen sharply as expectations of rate cut by Fed have increased. CME Fed watch tool shows a 90% probability of 25bps rate cut in its 17 Sep 2025. On macro front, indicators showed mixed performance. Core retail sales softened, University of Michigan's inflation expectation index (1 & 5-Yr) remained well anchored. Core PCE (broadly gauged by Fed as a measure of inflation) remained stable. Core durable goods orders picked up, so are new home sales. The Q2 second GDP estimate also showed upward bias led by consumption demand. Thus, not much has been felt on growth and inflation front as of now, due to tariff related uncertainty. This month's key event will be any developments on US Supreme Court ruling over Federal appeals court's which has claimed most of the tariffs imposed by US President as illegal under the 'International Emergency Economic Powers Act (IEEPA)'. Apart from this, US Fed projection of major macro variables will shed light on the pace of policy easing in the future. We expect US 10Y yield to trade with a downward bias in Aug'25.
- In the UK as well, yields exhibited firmness. This may be on account of pickup in retail price index and some sequential buildup of CPI, albeit at a softer pace. Healthy net consumer credit offtake also implied buoyant consumption demand. Thus, despite some softening in public sector net borrowing, 10Y yield in UK inched up. Further, commentaries of Central Bank officials also hinted at a cautious wait and watch approach to test the waters of inflation persistence.
- Among EMs, Singapore, Thailand and Indonesia showed considerable softening supported by increased bets of monetary policy easing to support growth amidst volatile global economic,

financial, and trade landscape. For China, 10Y yield got support amidst extension of tariff truce with the US till 10 Nov 2025.

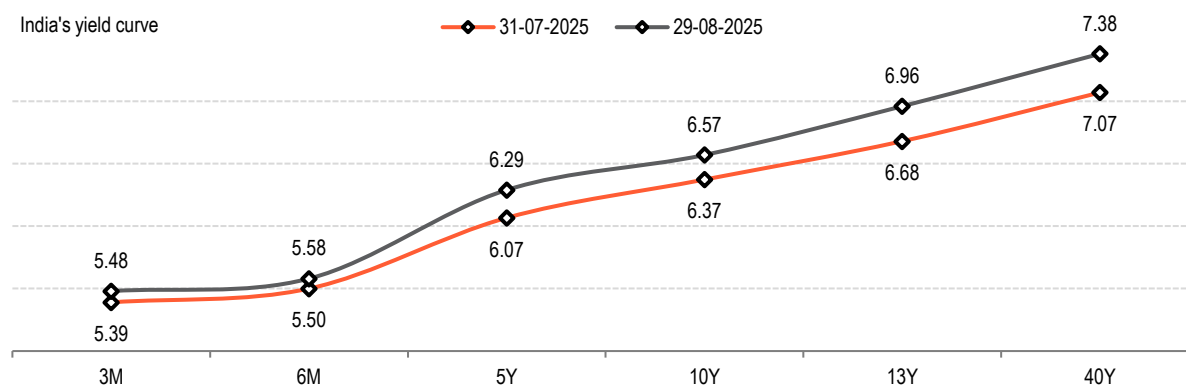
- **Domestic 10Y yield** rose at the sharpest pace compared to its major peers. It traded in the range of 6.32-6.6% in Aug'25 compared to 6.29-6.37% in Jul'25. The monthly volatility rose sharply to 0.72 in Aug'25 compared to 0.20 in Jul'25. Most of the increase happened post RBI policy where traders could sense that most of the frontloading of rates by RBI have already happened and future policy approach would be more on cautious line.

Table 1. 10Y Yields movement globally

Countries	10Y sovereign yield, 31 Jul 2025	10Y sovereign yield, 29 Aug 2025	Change in 10Y yield, Aug/Jul, bps
India	6.37	6.57	19
UK	4.57	4.72	15
China	1.71	1.79	7
Japan	1.56	1.60	5
Germany	2.70	2.72	3
Korea	2.79	2.81	2
US	4.37	4.23	-15
Indonesia	6.57	6.36	-21
Thailand	1.50	1.29	-21
Singapore	2.08	1.82	-26

Source: Bloomberg, Bank of Baroda Research

Table 2: Evolution of India's yield curve



Source: Bloomberg, Bank of Baroda Research

The gap between 3M and 30Y paper heightened to 190bps as on 29 Aug 2025 compared to 168bps as on 31 Jul 2025. Major realignment occurred for 5-Yr and above part of the yield curve which was considerably stable in earlier months. Especially the very long part of the curve 13-Yr and above witnessed steeper increase. Notably, post the reissuance of securities in the 15-Yr and 40-Yr bracket by the government, yields of the respective bucket exhibited stickiness amidst concerns of higher supply.

What do auctions in the domestic market reflect?

In Aug'25, the cut off yield for central government papers hardened. The short-term papers also inched up. For Gsec, major selling was on part of foreign banks.

Table 3. Cost of borrowing

Type of Papers	Avg. Cut off yield, Jul 2025	Avg. Cut off yield, Aug 2025
Central Government Securities	6.54	6.67
SDL	8.68	7.27
Tbills	5.50	5.54
91-day	5.39	5.46
182-day	5.53	5.57
364-day	5.57	5.60

Source: Bank of Baroda Research, Note: Auction dates differ

- Steeper borrowing cost also got reflected in WACR rate which on an average increased to 5.44% in Aug'25 compared to 5.38% seen in May'25.

Liquidity remains comfortably in surplus mode:

- The average system liquidity surplus was stable at Rs 2.8 lakh crore (1.1% of NDTL) in Aug'25 compared to Rs 3.0 lakh crore in Jul'25. The current month would witness further handholding on liquidity front as the first tranche of CRR cut is scheduled on 6 Sep 2025, which would release liquidity of more than Rs 600bn. Further Rs 71,616 crore of securities (including 5.97% GS 2025 (Conv)) are due to be matured in Sep'25. This will further lend support to liquidity.
- The banking liquidity also mirrored system liquidity, albeit showing some correction. The gap between incremental deposits and borrowings net of incremental credit and investment of SCBs was at Rs 4 lakh crore lower than Rs 5.4 lakh crore level seen in Jun'25. This is led by momentum seen in bank credit.

Outlook on 10Y yield for the next 30days:

- India's yield curve is persistently recording steepening bias. In previous episodes the steepening was more of a phenomenon resulting from a sharper pace of increase in short end yields. However, the current steepness is more of a bearish phenomenon witnessed towards very long part of the curve. So, what has resulted in this so-called bear steepening. Most of the increase in yields happened post RBI policy where traders have formed set of expectations that India is way past rate cut cycle and has entered a status quo phase. The Q1 GDP print further validated the same registering a strong print, notwithstanding statistical base and deflator issues.
- More importantly, traders have also assessed from the angle of government's revenue spending which is expected in the wake of impact of higher US tariff on India's major exports.
- Apart from this, weaker demand from banks, especially foreign banks in Aug'25 (Bloomberg data) and concerns of excess supply towards the longer part of the curve have led towards this steepening bias.
- Thus, weighing all these factors, *we expect India's 10Y yield to trade in the range of 6.50-6.69% in the current month.*

Table 5: OIS rates inched up amidst anticipation of status quo by RBI

	As on 31 Jul 2025	As on 29 Aug 2025
OIS Rates		
1M	5.44	5.54
2M	5.43	5.52
9M	5.48	5.49
Corporate Spreads-10Y		
AAA	64	57
AA+	113	103
AA	156	149

Source: Bloomberg, Bank of Baroda Research, Note: data as on the mentioned time point

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