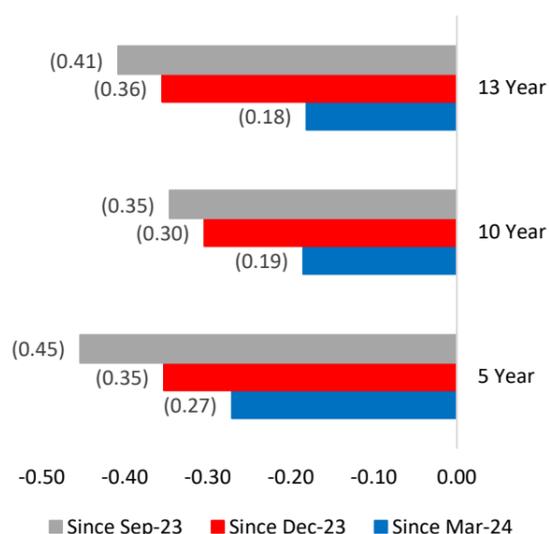


Fig.1: The Benchmark yields of 5Year, 10Year and 13Year have shown softening since Bond Index Inclusion announcement



Source: Bloomberg, UBI Research

On the macro front, the Non-Farm payroll in the US rose by 142K in Aug-24 against expectations of 165K. The Jul-24 NFP reading was revised lower to 89K from 114K. Currently, the CME FEDWatch tool shows 67% probability of 25 bps rate cut in September meeting while that for 50bps at 33%. During the week, US 10 year yield touched a low of 3.65% post NFP data and rebounded back to the 3.77% mark with the 10Y-2Y spread becoming positive. Indian benchmark 10 year yields have remained in the range of 6.84%-6.88% awaiting major triggers and continued flows in debt segment due to JP Morgan Index inclusion.

**US macro data and Fedspeak affirming start of Fed rate cut cycle in September**

- As per the Non-farm Payrolls (NFP) data released on 07<sup>th</sup> Sept-24, the number of jobs opening rose by 142K in Aug-24 against the expectations of 165K. The Jul-24 NFP data was revised lower to 89K from 114K. The Unemployment Rate edged lower to 4.2% in Aug-24 from 4.3% earlier.
- Post NFP data, the US10 year touched a low of 3.65% and rebounded to 3.77% (Presently trading at 3.62%). Currently, the market is factoring the certainty of 25bps in Sep-24 policy, the probability of 50bps reduction in September FOMC meeting is at 33%, according to CME FedWatch tool.
- Dollar index currently trading at 101.57 has touched a low of 100.52 last week making a comeback as US10 year rebounded.

**Fed rate cut this month: 25 or 50bps? Is the economy slipping into a recession?**

- FOMC have decided to cut rates typically when the US was already or heading into recession. The US macro-economic data suggests softening growth, the probability of recession according to Bloomberg economists stands at only 30%.
- Inverted yield curve (Negative difference between 10 year and 2 year yields) has typically been preceded by the recession. Rate cuts do happen when the spread (10 year and 2 year yield spread) is nearer to zero which is the present scenario.
- Combining the above, the market dynamics become complicated as the yield curve gets steeper with 10Y & 2Y spread getting close to zero and low probability of US going into recession. The baseline view of the market is soft landing for the US and global economy, while the risks are skewed towards hard landing and market price action may quickly take on that as US 10 Year restrained itself from falling further post soft labor market data.

**RBI Governor asserted that the growth-inflation balance has improved**

- The RBI Governor in his speech at FIBAC 2024 emphasizes that the “Indian growth story remains intact” with IMF pushing India’s GDP forecast upwards to 7% and World Bank upgrading India’s growth forecast to 7% for 2024-25. Relatively, RBI has projected the same even higher at 7.2%.
- As per his speech, Investment which accounts for 35% of GDP which grew at 7.5% and Private consumption which accounts for 56% of GDP, grew at 7.4% against 4% in the second half of previous year, thus, confirms revival in rural demand. It is evident that India is on a sustained growth path with two main drivers of growth (consumption and investment) are growing in tandem.
- Further, the Governor highlighted that it is the headline inflation that matters, as people understand food inflation which carries 46% weight in headline inflation.

**Monetary Policy Committee pivot ahead amid easing global rates yet divide on timing**

- There is a divide within domestic market / investors and economists on the timing of the start of the rate cut cycle by the RBI led MPC. There are 3 scenarios being discussed currently:
  - rate cut as soon as October 2024 with a deep 100bps rate cut cycle, on sharp cooling seen in food inflation and the urgent need for stimulating demand in the economy;
  - rate cut cycle starting Dec’24 / Feb’25 with a shallow 50bps rate cut cycle expected as growth is holding up relatively well and the MPC’s commitment towards sustainability of headline inflation to the 4% target also limits policy space and
  - our view of a possibility of no rate cuts in this fiscal, with climate shocks keeping food price pressures elevated and growth resilience providing policy space to delay rate cuts. The latter is also likely to let the RBI focus on financial stability given the upward pressure on C-D ratio is not in consonance with the “withdrawal of accommodation” policy stance. We acknowledge that an aggressive rate cut cycle by the US Fed (vis-à-vis a gradualist approach expected) and / or a sharper than expected cooling in food inflation poses risks to our view.
- It is important to note that the Indian G-Sec benchmark yields (5Y, 10Y and 13Y) have already shown a downward shift post the announcement (Sept-23) of inclusion in JPM Bond Index by 35-45 bps till Aug-24 (Fig. 1).
- Even if we do not see any rate cuts in near term, we continue to remain positive on long duration bonds based on favorable demand supply dynamics. The FPI flows in debt segment is consistently positive during FY25.
- The system liquidity is consistently hovering in positive zone which has gone upto Rs.2.5 lakh crore as of 05<sup>th</sup> Sept’24 and presently at Rs.1.08 lakh crore as of 10<sup>th</sup> Sep’24. This reduction may be attributed to GST and advance tax payouts due this month.
- Going forward, we will watch out for new incoming members of MPC, CPI data of US & India and Fed Meeting outcome & guidance which is due on 18<sup>th</sup> Sep’24.

By:  
Kanika Pasricha  
[kanika.pasricha@unionbankofindia.bank](mailto:kanika.pasricha@unionbankofindia.bank)

Dhiraj Kumar  
[dhirajkumar@unionbankofindia.bank](mailto:dhirajkumar@unionbankofindia.bank)

**Banking Research Team**

Kanika Pasricha Chief Economic Advisor	kanika.pasricha@unionbankofindia.bank
Suneesh K	suneeshk@unionbankofindia.bank
R Gunaseelan	gunaseelan@unionbankofindia.bank
Nidhi Arora	nidhiarora@unionbankofindia.bank
Rajesh Ranjan	rajeshranjan@unionbankofindia.bank
Jovana Luke George	jovana.george@unionbankofindia.bank
Amit Srivastava	asrivastava@unionbankofindia.bank
Rohit Yarmal	rohitdigambar@unionbankofindia.bank
S. Jaya Laxmi	s.jayalakshmi@unionbankofindia.bank
Dhiraj Kumar	dhirajkumar@unionbankofindia.bank
Akash Deb	akash510@unionbankofindia.bank
Shreyas Bidarkar	shreyas.bidarkar@unionbankofindia.bank

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