India FI Weekly: US yields in see-saw, IGBs remain relatively sticky

17th Aug 2024

Fig-1: 50 bps Fed rate cut probability for Sep'24 has repriced to 25%

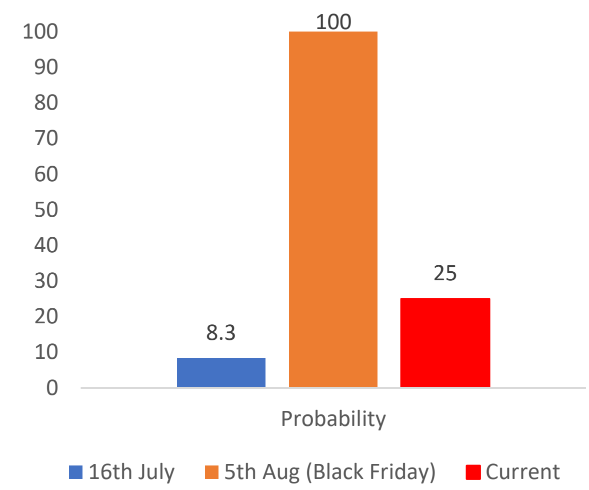
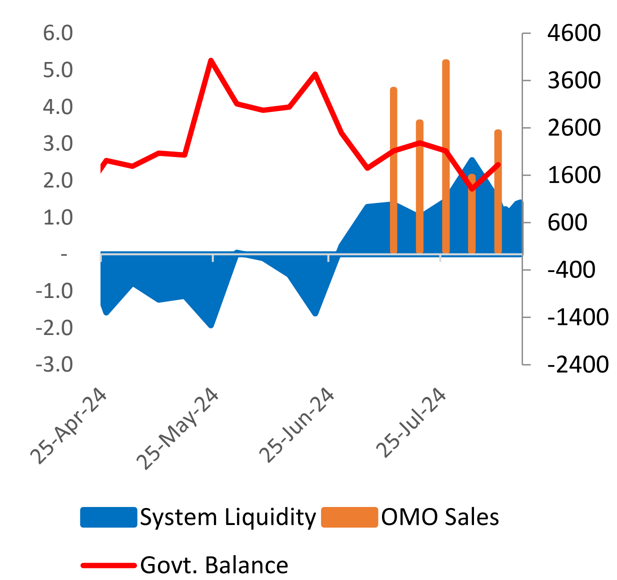


Fig.2: Positive Liquidity coupled with OMOs



By:
Kanika Pasricha
kanika.pasricha@unionbankofindia.bank

Dhiraj Kumar
dhirajkumar@unionbankofindia.bank

Monetary policy has been in focus during the FY 2024-25 with every central bank in the G10 space adopting a "to each his own" policy strategy contingent on their individual domestic macros. US yields witnessed see-saw as 50bps rate cut probabilities in CY24 has repriced from c.100% (on 5th Aug'24) to 25% as of today. In this regard, US 10-year yields after touching a low of 3.66% on 5th Aug'24, bounced sharply to 3.93% during this week. Bank of Japan, hiked rate after 2007, shall be in focus as BoJ Governor shall be called to Parliament on 23rd Aug'24 next week. Domestically, Indian bond market has remained range bound with ample liquidity in the system and news of intervention by Central Bank via OMOs last week kept profits capped. During the week, the 10 year benchmark traded in narrow range (6.86%-6.88%), while Rupee depreciated hitting record lows.

Fed rate cut probability has shifted from "aggressive to gradualist approach"

- Inflationary pressure continues to ease in US as July CPI data came in line with market expectations. The consumer price index rose by 0.2% MoM in July on a seasonally adjusted basis, after declining 0.1% in June. On YoY basis the CPI increased by 2.9% in July after advancing 3% in June as against Est. of 3%. While the CPI still may be above the FED's 2% comfort level, but it is the first reading which came below 3% since March 2021. This reading largely sums it up that the FED might have enough data to take the call to cut interest rates in its September FOMC meeting. Initially after CPI data release, US 10yr yield slipped back to 3.8%.
- Retail sales on MoM basis increased by 1% in July vis-à-vis -0.2% in June, surpassing an estimate of 0.3% uptick. While core retail sales on MoM basis clocked 0.4% in July vis-à-vis 0.5% in June below the estimate of 0.5%. The GDP data are also not showing any signs of weakness. FED Atlanta estimates the US economy will continue to do better in Q3'24, to grow by 2.9% vis-a-vis 2.8% in Q2.
- As retail sales data and Fedspeak on GDP numbers helped abate recession fears for now, US 10 year yield bounced back to 3.93% levels. The market has repriced 50bps rate cut probability from 74% to 25% during the week, while keeping the 25bps rate cut in Sep'24 close to 100%.

WPI moderated, Base effect at play: (WPI on July'24)

- Headline WPI for the month of July'24 moderated to 2.04% vis a-vis 3.40% recorded in June'24. Data prints were largely in-line with our estimates of 2.2%, with mild downward surprise, while consensus estimate was 1.86%. This cooling in YoY inflation levels was primarily led by high base effect. Meanwhile, core inflation i.e. non-food manufactured products WPI inflation, saw an uptick, in line with our estimates.
- Core WPI which is mostly reflective of manufacturing sector inflation, continued on higher trajectory to clock at 1.0% y/y in Jul'24, vis-à-vis 0.8% in Jun'24. However, core WPI reported deceleration on monthly basis due to downward movement in global commodity prices.
- Going forward, while monsoon progress bodes well with 5% cumulative surplus, the uneven distribution (north-west region in 1% deficit while central and south regions flooding at 12% and 21% respectively) is still a cause for concern and needs close watch.

July Trade data provided a negative surprise: (Trade Data July'24)

- Merchandise Trade Deficit widened sharply in Jul'24 to $23.50bn (highest since October 2023) vis-a-vis our estimate of $20.7bn.
- In a sharp negative surprise, non-oil non-gold (NONG) deficit widened to $12.06 bn (last seen in Oct'23) vis-à-vis $8.61 bn a month ago. This was despite downward pressure on commodity prices especially base metals. Sub-segment wise data shows that close to 55% of the MoM widening in NONG deficit was explained by electronics (c.29%), machinery (c.18%) and agri (c.7%).
- Going forward, trends in commodity prices remain key to watch while lump machinery imports may see some correction in the coming months even as electronics demand may stay strong post customs duty cut in Budget.

Liquidity in strong surplus zone, RBI open market operations continues:

- As of 16th Aug, the system liquidity was in surplus, to the tune of Rs.1.40 lakh crore, easing from the peak of Rs.2.86 lakh crore earlier this month on probable USD outflows which also drove Rupee to record lows.
- It is to be highlighted here that RBI has conducted OMO sales worth Rs.2,510 Crore during 05th Aug to 11th Aug 2024 taking the total to Rs. 14,185 Crore. In alignment to RBI's stance of continuing "withdrawal of accommodation", the Central Bank is continuing with its OMOs in G-Sec market, thereby, capping the gains on IGBs.
- While G-secs remain supported despite volatility, Rupee continues to trade at record lows defying weak Dollar trends, The latter is on close watch especially with role of foreign investors on bond markets gaining momentum post JP Morgan global bond index inclusions.

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