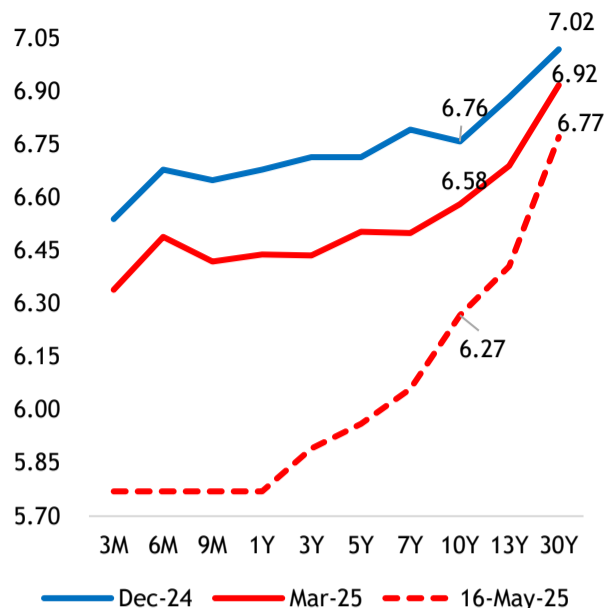
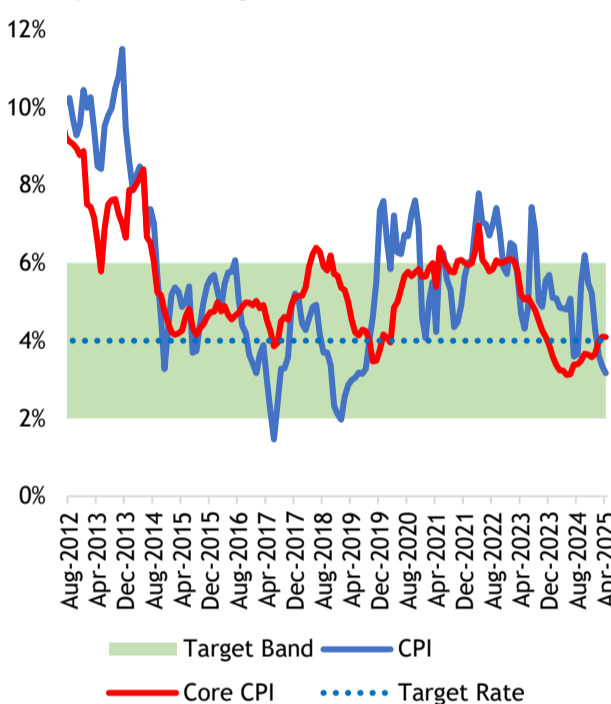


Fig.1: Surplus system liquidity and rate cut expectations keeping yield curve below 1 year flat



Source: Bloomberg, UBI Research

Fig.2: Inflation dynamics stay subdued unless food inflation resurge:



Source: CEIC, UBI Research

During the week ending May 16, 2025, Indian fixed income markets displayed stability, buoyed by dovish signals from the Reserve Bank of India (RBI), benign inflation numbers and a supportive liquidity environment. Globally, market sentiment was shaped by ongoing concerns over US as CPI subsides, Trump calling for rate cut while Powell being cautious on inflation predictability and Moody's downgrading sovereign credit rating from AAA to Aa1.

US CPI benign, Jerome Powell's latest comments and Moody's downgrade:

- US CPI fell to 2.3% in April, the lowest since February 2021, and just under the market forecast of 2.4%. Month-over-month, the CPI saw a 0.2% increase, bouncing back from a 0.1% decrease in March, although it did not meet the predicted 0.3% growth. Core inflation stayed stable at 2.8% year-over-year, achieving a four-year low.
- US Federal Reserve Chair Jerome Powell warned that Long-term interest rates are now notably higher, driven mainly by increased real rates rather than shifts in inflation expectations, while estimates of the longer run neutral policy rate have also risen. He expressed concern that inflation might become more unpredictable in the future because of more frequent supply shocks, making it more challenging for central banks to achieve price stability.
- The CME FedWatch tool indicates that the probability of an interest rate reduction by the Federal Reserve during the June meeting stands at a mere 8.3%. Looking further ahead, the decision on July 30 presents a 36.8% likelihood of rates being decreased from their current levels.
- Moody's has downgraded the U.S. sovereign credit rating from AAA to Aa1, citing a sustained rise in debt and interest payment ratios. The agency also noted that growing borrowing needs are likely to place further strain on the US fiscal outlook.

India CPI and WPI data released - rate cuts calling

- India's retail inflation eased further in April 2025, with the CPI dropping to 3.16% YoY, the lowest level since July 2019. This was driven by a significant decline in food inflation, which came in at 1.78% YoY, the lowest since October 2021, reflecting easing prices in vegetables, cereals, and pulses. This cooling in inflation is expected to provide the RBI with more room to adopt an accommodative stance, potentially leading to further rate cuts in the coming months.
- Core inflation remained stable remaining flat at 4.09% in Apr'25 from 4.10% in Mar'25; even as gold prices continued to rise during the month.
- The WPI for April 2025 stood at 0.85% YoY, the lowest since March 2024. The reduction in food inflation to 4.66% YoY (from 5.94% in March) was a key driver of the overall decline. However, manufactured products inflation remained elevated at 3.07% YoY, signalling persistent cost pressures in this segment. Despite these pressures, the moderation in food inflation is expected to keep overall inflation in check.

Consideration on Liquidity Management framework

- The banking system remained in surplus for most of the week averaging Rs.2.04 lakh crore. The WACR averaged 5.69%, below the repo rate, signaling excess fund in the system.
- As of 02nd May'25, the total advances of banking system grew by 9.9% while deposits grew by 10.0%, thus, closing the wedge between them. The gap in credit and deposit growth has gone -ve of 6bps from +ve of 13 bps in previous fortnight. This is reflective of efforts by banks to bolster deposit mobilization amid tighter liquidity conditions.
- Meanwhile the 10-year benchmark yields moved to a high of 6.3449% before moving to a low of 6.2525% due to anticipated RBI dividend of approx.Rs.2.5-3.0 lakh crore and easing inflation (CPI) numbers providing room for further rate cuts as real rates expands. RBI has reviewed its economic capital framework (ECF) in the previous week and as per media reports sought government's approval to expand the range of contingent risk buffer (CRB), which may impact the dividend payout.
- Market is looking forward to RBI dividend amount to be announced on 23rd May'25, expecting surplus liquidity sky rocketing above Rs.6.0 lakh crore, phasing out the probability to any more OMOs as they are already front loaded. Notably, RBI has called a meeting on liquidity management framework this week. The liquidity management framework has traditionally centered around the 14-day repo/reverse repo, with shorter-tenor operations acting as supplementary tools. The consistent omission of 14-day operations in recent fortnights indicates a gradual shift from this approach. Given the meeting's proximity to the June MPC, it may serve as an opportunity to signal or outline key elements of a revised liquidity management framework.

Table 1: Market Snapshot

Instrument	Yield (May 16)	Weekly Change	Commentary
10 Year G-Sec (6.79% 2034)	6.26%	-6 bps	Lower due to anticipated RBI dividend & further room for rate cuts on easing CPI
1 Year T-Bill	5.77%	-12 bps	Lower cut-off signals strong demand amid surplus liquidity
WACR (avg.)	5.69%	-15 bps	Dipped below to repo on multiple days, reflecting surplus liquidity
US 10 year Yield	4.44%	+06 bps	Inflation cooling modestly but Fed Stance remains cautious
Credit Growth (%)	9.9%	-34 bps	Credit Deposit wedge closed first time since Mid-December
Deposit Growth (%)	10.0%	-15 bps	
Credit Deposit Wedge (bps)	(6)	+19 bps	

Source: RBI, CCIL, UBI Research

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