

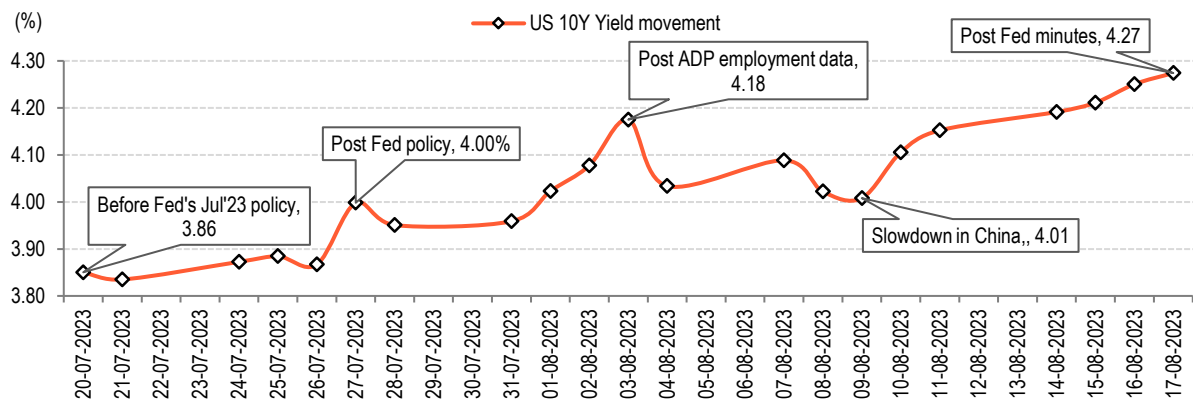
## **Why Bond yields are inching up?**

*US 10Y yield has risen considerably post the last Fed policy meeting (26 Jul). Though the 25bps rate hike was priced in by the market, what contributed to the bull run of yield has been the strong macro data in the US especially demand driven components. FOMC member's reiteration of an uncomfortably higher and above target inflation and relatively stable growth indicators have further resulted in sell off in the bond market. The last close has been the highest since 8 Nov 2007, amidst expectation that another rate hike by Fed is on the cards. The ripple effect has been felt in case of other AEs such as UK and Germany's 10Y yield. China's 10Y yield on the other hand showed moderation amidst mired growth conditions. On the domestic front, India's 10Y yield have gained considerable momentum post upside surprise in the CPI data. Though sharp volatility towards the long end part of the curve would not be visible, it shouldn't also shy off to touch the 7.3% mark in this month. Short end yields however might witness fair degree of pressure due to RBI's surprise move of imposing incremental CRR on NDTL.*

### **Quite an upsurge in US 10Y yield:**

- Since 26 Jul 2023, US 10Y yield has risen from 3.87% to 4.27%, which translates to a sharp 41bps jump. Most of the increase in yield was concentrated in the first fortnight of Aug'23, (23bps increase). Few of the macro data prints such as 1) ADP employment data (324K increase against estimated 190k increase). 2) Buoyant factory order (2.3%, MoM SA increase matching estimates). 3) Average hourly earnings increasing by 0.4% on MoM basis against estimate of 0.3%, posing inflationary concerns. 4) In fact both CPI and PPI data also maintained its same MoM pace in Jul'23. 4) Advance retail sales data also rose more than expected by 0.7% against estimates of 0.4% for Jul'23, on MoM basis. 5) Housing starts, capacity utilization all pointed towards recovery.
- Adding to these were the comments from FOMC participants. Statement such as “further evidence would be required for them to be confident that inflation was clearly on a path toward the Committee's 2 percent objective”, buoyant consumer spending on the back of tighter labour market conditions clearly gave hawkish signals to market. Even members have stressed upside risks to inflation might occur due to supply side disruptions and near term risks to lower commodity prices.
- *All in all, the minutes could be read out as a restrictive one where focus was on bringing down inflation to the 2% level. Post the release of the minutes, US 10Y yield rose by 4bps.*

**Fig 1. Charting US 10Y yield since Jul'23 policy**

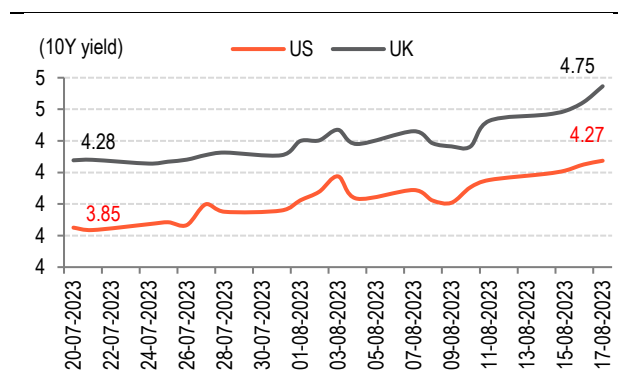


Source: Bloomberg, Bank of Baroda Research

**How yields of other countries have moved in the administered period?**

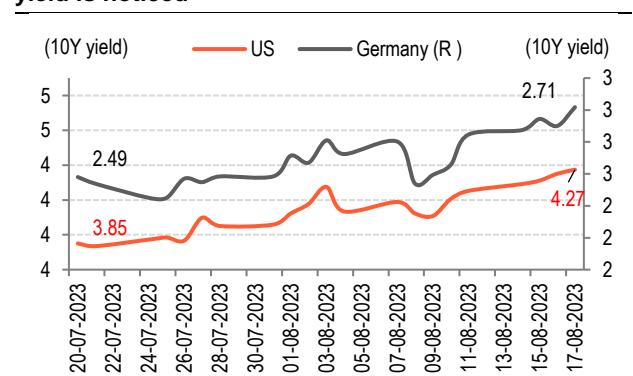
- Amongst major economies, **UK's 10Y yield rose at a sharper pace in the administered period** (i.e, since Jul 26 to take into account the after effect of Fed policy). It has risen by 47bps. This was supported by better preliminary GDP print of Q2CY23 at 0.2% against estimate of 0% supported by buoyant consumption demand at 0.7%. Apart from this, faster pace of increase in average weekly earnings at 8.2% (3month average, YoY) compared to estimate of 7.4% also raised prospects that more rate hike is on the cards.
- **Japan's 10Y yield** picked pace in the period when BoJ allowed its 10Y yield to trade in the range of +/- 50bps from its target. It has risen by 19bps.
- **China's 10Y yield** has moderated as property woes and slowing macro data prints such as manufacturing PMI, exports, imports, retail sales all pointed towards considerable degree of softening. Further real estate sector of the region again faced crisis with regard to payment of dues and filing for bankruptcy which added to further anguish. Expectation of more stimulus from the government and PBOC in terms of easing liquidity conditions has supported its 10Y yield. It fell by 8bps in the administered time period.

**Figure 2: 10Y Yield in UK rose at a sharper pace**



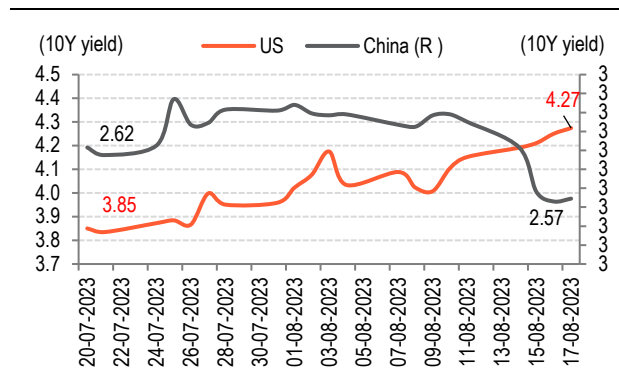
Source: Bloomberg, Bank of Baroda Research

**Figure 3: Considerable increase in Germany's 10Y yield is noticed**



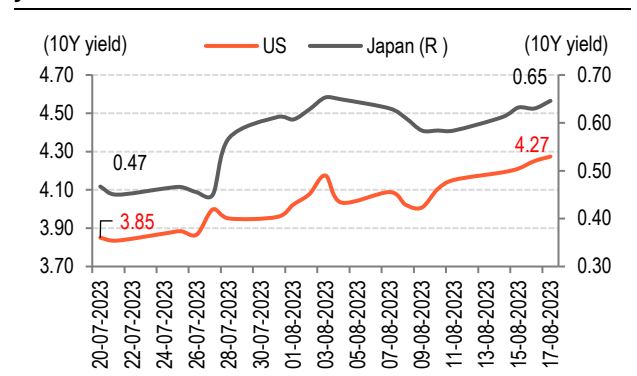
Source: Bloomberg, Bank of Baroda Research

**Figure 4: China's 10Y yield showed moderation**



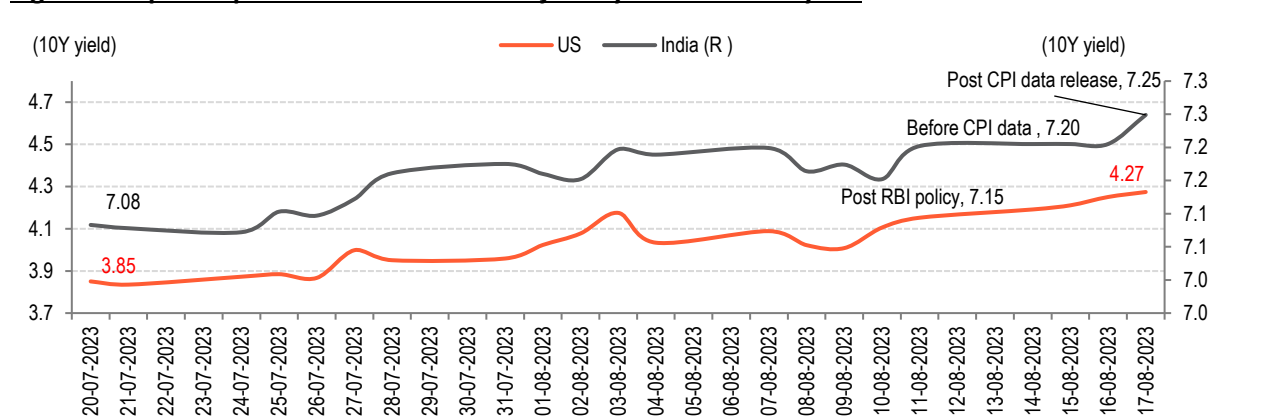
Source: Bloomberg, Bank of Baroda Research

**Figure 5: BoJ's move led to inching up of Japan's 10Y yield**



Source: Bloomberg, Bank of Baroda Research

**Figure 6: Upward pressure visible in the trajectory of India's 10Y yield**



Source: Bloomberg, Bank of Baroda Research

**Movement of India's 10Y yield Vis a Vis US:**

India's 10Y yield has risen by 15bps in the administered period. Currently the 10Y yield differential between India and US is at 312bps. Historically, the difference between the two is on an average at ~400bps, so there is a possibility that the difference might tend towards the mean reverting level. In that case India's 10Y yield has to rise at a faster pace compared to US 10Y yield. However, considering the current fundamentals this seems unlikely unless inflation even continues to surprise on the upside throughout Q2, which might prompt RBI to have a hawk eyed view on rates.

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