Bond Yields – Retreats from recent highs

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Bond yields moderated slightly across several major economies in May as investor concerns over runaway inflation ebbed and apprehensions over the pace and strength of economic recovery grew. Although economies across regions continued to pick up with the relaxation of pandemic restrictions, the recovery has shown signs of weakness in some of them amid emerging problems viz. supply chain challenges and increase in raw material costs. This fuelled safe-haven demand for government securities, tempering their yields. Additionally, the asset purchase programme by the central banks has been limiting the rise in yields across economies.

At the same time, vaccination led optimism of economic rebound has improved investor risk appetite and has helped push up yields in recent months.

Although yields came off the highs touched in Mar-Apr'21, it continues to be well above the pre-pandemic levels across economies.

The analysis of the benchmark 10-year benchmark government bond yields of 11 major economies in May'21

- The benchmark sovereign bond yields moderated in seven of the 11 economies from month ago. It nevertheless continued to be at elevated levels.
    - US (1 bp), Canada (2 bps), UK (2 bps), India (7 bps), Japan (1 bp), China (8 bps) and Australia (2 bps) observed a fall in average yields from that in April'21
- The benchmark yields rose on a month-on-month basis in case of Germany (4 bps), France (6 bps) and Brazil (23 bps) while it was unchanged in the case of South Korea.
    - Germany benchmark sovereign yields rose to a twenty-five month high while that of France moved to a two year high in May'21.
- Barring China, government bond yields have witnessed a notable increase since the start of 2021 across all the 11 major economies.
    - Yields have climbed in the range of 5 to 178 bps across economies since January'21 with the average increase being 57 bps.
    - Brazil has witnessed the sharpest increase in yields at 178 bps during January to May'21.
    - The average benchmark yields in the five months to May'21 hardened by 55 bps each for the US and UK, 72 bps in case of Canada, 62 bps for Australia, by 52 bps for France, 37 bps for Germany, 40 bps in S Korea, 10 bps in case of India and by 5 bps for Japan.
    - Yields have decline by 6 bps since January'21 in case of China
- Real, or inflation adjusted, benchmark sovereign bond yields were negative in the US (-2.6%), Canada (-1.9%), UK (-0.7%), Germany (-2.2%), France (-1%) and South Korea (-0.2%) in May.

Chart 1: 10 year Government Bond Yield (Average)

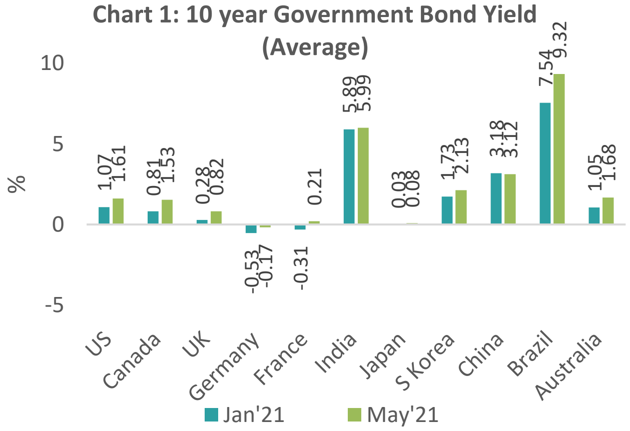

Table 1 : 10 Year Government Bond Yield

	Apr'21	May'21	Range: May'21	Real Yields: May'21
US	1.63	1.61	1.47 - 1.71	-2.6
Canada	1.55	1.53	1.44 - 1.62	-1.9
UK	0.84	0.82	0.88 - 0.93	-0.7
Germany	-0.21	-0.17	(-0.26) - (-0.07)	-2.2
France	0.15	0.21	0.11 - 0.33	-1.0
India	6.06	5.99	5.96 - 6.05	1.7
Japan	0.09	0.08	0.07 -0.09	0.5
S Korea	2.13	2.13	2.09 - 2.20	-0.2
China	3.19	3.12	3.06 - 3.26	2.2
Brazil	9.09	9.32	8.77 - 9.55	2.6
Australia	1.70	1.68	1.58 - 1.77	0.6

Source: CNN, Bloomberg, RBI and CARE Ratings

Factors driving bond yields across key economies in May'21

US: Treasury yields were marked by fluctuations in May. It rose during the first half of the month on concerns over building price pressures. Yields retreated after the Federal Reserves reiterated that it would maintain an accommodative monetary policy stance for an extended period. The likelihood of continued bond purchases by the Federal Reserves outweighed investor expectations of a rise in inflation. Also, the slowing pace of growth of various economic indicators coupled with the emerging economic uncertainties supported demand for risk free Treasuries pushing down their yields. At the same time, the improving risk appetite with expectations of a rebound in demand following the vaccination programme and concerns over high public debt exerted upward pressure on yields.

Euro Zone: Germany and France saw a rise in bond yields on improving economic fundamentals that boosted appetite for riskier asset classes.

Canada: Bond yields followed the movement of US Treasuries and declined marginally. The prospects of the tapering of bond purchases and the rate hike in 2022 however kept the yields at elevated levels.

Brazil: The rise in yields can be attributed to rising inflation that has raised the likelihood of an increase in interest rates amid higher government borrowings.

China: The decline in bond yields here has primarily been on account of the continued foreign inflows into the domestic bond markets. The higher interest rates of Chinese debt securities and the limited nature of pandemic stimulus programmes have been boosting inflows into the debt markets here.

India: The decline in the benchmark bond yields despite the demand -supply mismatch can be attributed to the RBI's bond buying from the secondary markets as a part of its regular open market operation (OMOs) along with the recently launched G-sec acquisition or G-SAP programme. However, concerns over the likelihood of additional market borrowings by the government to tide over the financial strain caused by the second wave of the pandemic and the underlying inflationary concerns with the firming of global commodity prices limited the fall in yields.

Outlook for the benchmark Indian Government Bonds

The additional borrowing of Rs.1.58 lakh crores by the central government to compensate states for the shortfall in GST cess would add to the demand-supply concerns and pressurise bond yields. The RBI is expected to continue with it secondary bond purchases to anchor yields and the latest move of GSAP would be scaled up. We expect the 10- year GSec yields to move in the range of 6.00 % - 6.05% in June'21.

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