PGIM India Mutual Fund

Fixed Income Weekly Update

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Indian Markets:

Indian Bond yields remained stable during the week after the benchmark 10yr bond yield touched 7.25% last week. There was decent buying interest from investors as the benchmark 10yr bond yield touched 7.25% as value buying emerged. The benchmark 10yr ended the week at 7.20% little changed from the last week's closing levels. Money market rates climbed as banking sector liquidity went into deficit after the outflows related to the Incremental CRR (I-CRR) and GST. The amount borrowed from RBI under the MSF window touched INR 90000cr with the daily net liquidity deficit touching INR 42000cr. The MPC minutes released during the week were on expected lines underlining the cautious approach. The minutes highlighted RBI's focus on liquidity with Deputy Governor Patra highlighting the risk to inflation on account of liquidity overhang. Given the announcement of I-CRR and the focus on liquidity management as reflected in the comments of deputy governor Patra, we believe that RBI will extend I-CRR beyond the review date of September 8. As food inflation took centre stage, government has been proactively announcing steps to help cool inflation like increasing the export duty on onions and announcing a ban on sugar exports for the first time in 7yrs. Thus, we believe that in spite of the elevated food prices, RBI will stay on a long pause with government likely to pitch in with fiscal steps to help cool inflation. Meanwhile growth is looking resilient as the Q2 GDP is expected to come in at 7.80%. EPFO added 17.89 lacs new members in June 2023, the highest since August last year and 9.71% more than May this year.

Brent crude has stabilised after the stellar run over the last month ending the week at USD 84.48 a barrel. INR appreciated in the week ending at 82.65 after touching a life time high of 83.14 as Chinese authorities stabilised the yuan in spite of the dollar index moving above 104. RBI has also intervened in the currency market as FX reserves dipped marginally below USD600bn. The overnight index swap curve (OIS) was little changed in line with the bond curve.

International Markets:

Internal Bond yields have been on an uptrend over the last 3 months as the higher for longer theme gained traction along with the fiscal overhang on the US Bond markets. In this context all eyes were on the Jackson hole symposium of global central bankers with particular interest in the comments of the chairman of the federal reserve. Powell did not deviate from the script and reiterated that Fed can hike more, if required and will maintain restrictive policy till they have confidence that inflation will slide back towards their target of 2%. The Fed's inflation target of 2% has been generating a lot of debate with many eminent economists advocating that the Fed abandon its 2% target and set a higher target in light of the possible structural shift in the outlook on inflation. The comments by chairman Powell reinforced the Fed's commitment on adhering to the 2% target as, in our view, the Fed believes that abandoning the 2% target will erode their credibility and can have far reaching consequences on the economy and the markets. Thus, for now the target of 2% stays and it remains to be seen whether the target is achieved with a soft landing or not. The US 10yr yield retraced from its high of 4.34%, as value buying merged along with possible short covering. Technically, it's a significant level to watch out for as a monthly closing above 4.34% can herald further increase in yields. Indonesia held on to its rates while Iceland hiked. PMI numbers in the developed economies were lower than expected. BOJ reduced its intervention in the bond markets as yields stayed elevated.

Meanwhile.... In Argentina, looting started in many places as inflation rose to 113%, which has aggravated a cost of living crisis. JP Morgan is forecasting inflation of 190% by the end of the year.

Interesting Concept

Boots Theory: "Boots" theory of socio economic unfairness or simply the Boots theory outlines that people in poverty have to buy cheap and subpar products that need to be replaced repeatedly proving more expensive in the long run than more expensive items.

A popular example being that of boots .... Someone who can afford an expensive pair of boots can utilise it for many years, while a poor person who can only afford a cheap pair of boots is likely to have spent much more in totality while replacing the cheap pair of boots more frequently.

It is named after Captain Samuel Vimes "Boots" as featured in Men at Arms

It resonates with our own Indigenous saying "Mehenga le ek baar, Sasta le Baar Baar"

Our View

We believe that global monetary tightening is on its last legs and central banks globally will be on a long pause. RBI will also be on a long pause with government taking fiscal steps to manage inflation. We think that the broad range of the benchmark 10yr bond yield will be between 7.10% to 7.35% over the next one month. Given the recent rise in yields which have pushed back the expectations of rate cuts, yields are entering attractive territory and investors can look to increase allocation to Fixed Income as growth is expected to slow down towards the end of the year.

Investors with medium to long term investment horizon can look at funds having duration of 3-4yrs with predominant sovereign holdings as they offer a better risk reward currently. Investors having an investment horizon of 6-12 months can look at money market funds as yields are attractive in the 1yr segment of the curve.