PGIM
India Mutual Fund

Fixed Income Weekly Update

9th September - 13th September 2024

Puneet Pal
Head - Fixed Income

Global monetary easing to pick up pace

Indian Markets:

The bond rally continued unabated in the first half of September as Indian bond markets rallied on the back of the optimism in the global bond markets fuelled with expectations of the start of the rate cutting cycle in US even as ECB did another rate cut.

Yields came down across the curve by 7 bps. Fall in brent oil prices along with the continued weakness in metal prices provided the necessary tailwind to Indian bonds as the entire yield curve shifted lower. CPI inflation came in a tad higher than expected at 3.65%, on higher than expected food prices even as “core inflation” remained steady at 3.40%. On a sequential basis, the headline Index grew 0.1% largely due to fall in food prices. FX reserves have risen to a new high of USD 689 bn as on Sep 6. On a YTD basis, FX reserves have risen by USD 65bn. Import cover was 11.6 months as of July 2024 compared to 10.6 months as of July 2023. External debt decreased to 18.70% of GDP as of Mar 2024 compared to 19% as of Mar 2023.

FPI inflows into debt remain strong with USD 1.76bn of inflows in the first fortnight of September after averaging more than USD 2 bn over the last couple of months after the formal inclusion of Indian FAR securities in the JP Morgan EM Index. On the monsoon front, heavy rains in central India drove an increase in rainfall surplus with distribution trends positive except for a negative skew in some states. The reservoir levels are strong and this augurs well for rabi crops.

The benchmark 10yr bond yield ended the week at 6.79%, down 7 bps since the start of the month. The entire yield curve is down by 6-7 bps over the last fortnight.

The OIS curve also trended lower with the 1yr OIS ending the week at 6.38%, down 11bps while the 5yr OIS ended the week at 5.94%,down 14bps. INR ended the week at 83.90, little changed from the start of the month.

International Markets

Global bond yields led by the US bond yields trended lower on the back of optimism of monetary easing. The stage is set for monetary easing to begin in US from next week. The benchmark 10yr US bond yield ended the week 20 bps lower at 3.65%, though the US Inflation is proving to be sticky. ECB reduced rates as expected.

Bond markets are keenly looking forward to next week's FOMC meeting as it remains divided between a 25 or 50bps rate cut. Employment data in US was in line with expectations.

Our View:

The US Fed is all set to start cutting policy rates from next week onwards and in the backdrop of global monetary easing, Indian bonds remain attractive on the back of strong and stable underlying macro-economic factors and favourable demand supply dynamics at play. The scope for rate cuts in India is on account of high real positive rates and the need to encourage private investment and there is a fair probability of rate cuts beginning from CY25 onwards.

Bond yields tend to move in advance of rate action and investors can look to increase allocation to Fixed Income at every uptick in yields. We expect long bond yields to continue to drift lower over the next couple of quarters .We expect the benchmark 10yr bond yield to go towards 6.50% by Q4 of FY25.

Investors with medium to long term investment horizon can look at Dynamic Bond Funds having duration of 6-7yrs with predominant sovereign holdings as they offer a better risk- reward currently. Investors having an investment horizon of 6-12 months can consider Money Market Funds as yields are attractive in the 1yr segment of the curve also.