PGIM
India Mutual Fund

# Fixed Income Weekly Update

12th August - 16th August 2024

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## We expect the benchmark 10yr bond yield to go towards 6.50% by Q4 of FY25

### Indian Markets:

Indian bond markets remained stable with a positive bias. The positivity was underlined by lower headline CPI Inflation which came in at 3.54%. This inflation print was aided by base effect which offset the higher momentum in food prices and higher telecom tariff. The increase in telecom tariff led to an increase in “core inflation” to 3.35%, from 3.15% last month though prices remained stable across other categories, underscoring stable underlying inflation.

Given this CPI number, in all likelihood, will undershoot RBI’s forecast for Q3. RBI had forecasted CPI Inflation to average 4.4% for Q3 but the actual average inflation for Q3 is now likely to be around 4%. Overall for FY25, against RBI projection of 4.5%, actual inflation can come in lower by 10 to 20 bps.

Yields in the first fortnight of the month are lower by 5-7 bps across the curve.

Monsoons remain surplus at 5%, though the spatial distribution remains uneven as monsoons in east and north east regions remain in deficit. Rainfall by distribution of districts remains skewed with significant deficits in states of Punjab, Haryana, Bihar and West Bengal. Sowing remains satisfactory.

Trade deficit came in at $23.5bn higher than USD 21bn in June. Imports remained steady while exports were lower. Despite the higher trade deficit, the current account deficit is expected to remain stable at around 1% of GDP in FY25.

FPI inflows into debt remain stable with more than $1bn coming in till August 16. Cumulatively, the CYTD 2024 inflows have been to the extent of $12 bn.

The OIS curve continued to come down with the 1yr OIS ending the week at 6.53% while the 5yr OIS ended the week at 6.11%. The OIS curve has outperformed the gilt curve this month with the 1yr OIS lower by 14 bps while the 5yr OIS is lower by 11 bps.

INR remained weak despite the weakness in Dollar Index. INR ended the week at 83.95 depreciating by 23 paise over the course of this month.

Money Market yields remained stable.

### International Markets:

The international bond markets exhibited some volatility as expectations gyrated on the quantum of rate cuts by the US Fed. The US inflation data was in line with expectations though the retails sales numbers were strong leading to renewed optimism on the prospects of a soft landing.

The benchmark 10yr US bond yield ended the week at 3.88%, lower by 15 bps this month. Reserve Bank of New Zealand cuts rates in a surprise move. Japanese officials played down sharp rate hikes amidst market volatility due to the unwinding of the Yen carry trade. US Bond markets are pencilling in rate cuts from the Fed starting from September onwards though expectation keep on changing in respect to the quantum of rate cuts.

The geopolitical situation remains fluid, especially in the Middle East, which is a tail risk for the markets.

## Our View

We remain constructive on Indian bonds with 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 with RBI likely to draw comfort from the start of the monetary easing cycle in advanced economies.

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 look at the money market funds as yields are pretty attractive in the 1yr segment of the curve also.