PGIM India Mutual Fund

Fixed Income Weekly Update

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Indian Markets:

Indian Bond yields stayed elevated during the week as crude and global bond yields continued their uptrend. The benchmark 10yr bond yield ended the week at 7.36% up 4 bps from last week. The RBI Governor reiterated that rates will stay high as of now as uncertainties persist and RBI was committed to bringing inflation down towards the 4% inflation target. Crude prices hardened further as hostilities continued in the middle east with brent up 1.50% over the week ending the week at 92.16 though INR appreciated marginally by 14 paise ending the week at 83.12 from 83.26 last week.

Some segments of the market are still expecting that RBI will not do open market sales (OMO) of bonds as announced in the policy on 6th Oct as liquidity remains tight. There is substantial amount of intervention in the FX market by RBI to ward off the pressure on INR due to US dollar strength and this is leading to tightness in banking liquidity. This FX intervention and the expected increase in currency in circulation due to festival seasons and upcoming state election will lead to outflows from banking sector liquidity but this outflow is more than matched by the maturity of FX swaps next week (USD 5bn) and the substantial amount of Government securities, of over INR 2 trn, which are getting matured over the next couple of months. We continue to believe that the announcement of OMO's by RBI was meant to be a yield signal.

Money market rates stayed elevated anchored to the MSF rate as banking liquidity remained tight on suspected RBI intervention in the FX market.

The Dollar Index pared some its gains to end the week at 106.16 down 0.50% from last week's closing of 106.67

The overnight Index swap curve (OIS) moved up in line with bond yields. The 5yr OIS was up 12 bps on the week at 6.77% from the last weeks closing of 6.65% and the 1yr OIS was higher by 5bps ending the week at 7.00% from 6.95% last week.

International Markets:

The higher for longer rate theme has taken a firm grip on the global bond markets and US bond yields continue to touch multi year highs as economic data continued to come in strong with US retail sales coming in higher than expectations. The benchmark US 10yr yield ended the week at 4.91% up 30 bps on the week from the last week's closing level of 4.61%. The contradiction of a loose fiscal policy and tighter monetary policy in US is not lost on the markets and the yields at the longer end of the US treasury curve are reflecting concerns of a looser fiscal policy as the higher supply of US treasuries keeps yields elevated. Indonesia unexpectedly hiked rates with the central bank terming the hike as a pre-emptive rate hike given the weakness in the currency. This surprise hike brings forth the challenging environment faced by emerging market central banks wherein the emerging economies are having much better macro-economic variables as compared to advanced economies but given the US dollar strength and narrowing interest rate differential with advanced economies, emerging economies are forced to keep a tight monetary policy stance to preserve macroeconomic stability.

Meanwhile Japan 's largest labour union demanded higher pay increases for next year asking for at least 5% raise in wages.

Our View

We believe that global monetary tightening has entered its last phase and global central banks are on a long pause on rates. 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 7.20% to 7.60% over the next couple of months. Given the recent rise in yields which has pushed back the expectations of rate cuts, yields have entered 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 the money market funds as yields are attractive in the 1yr segment of the curve.