PGIM
India Mutual Fund

Fixed Income Weekly Update

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Puneet Pal
Head - Fixed Income

Indian Markets:

Finally Indian government bonds got included in the JP Morgan Bond Index. Indian markets had started anticipating such a move since the start of the month and speculation had grown in the last couple of weeks after news reports started circulating regarding the inclusion. Indian FAR securities will be included in the JP Morgan GBI-EM Global diversified Index from June 28 2024 with a weight of 10% staggered over 10 months. Expectations of flows range between USD25 -30 bn which can diversify Indian bond holdings and at the same time put more responsibility on Indian policymakers in terms of ensuring macroeconomic stability. BOP surplus should improve though RBI will most likely ensure that volatility due to these flows on INR and bonds remain muted. Near term we expect the benchmark 10yr bond yields to remain rangebound between 7% to 7.25% with a flattening bias. The inclusion in the JP Morgan Index can lead to an inclusion in other such indices like the FTSE Russel and the Bloomberg Barclays indices which can trigger further flows going ahead. Given the fact that currently the banking system is having excess SLR holdings and RBI also holds bonds in its balance sheet, we do not expect a structurally downward shift in yields in the near term as the demand will be matched by corresponding supply as the inflows will likely be matched by banks reducing their SLR holdings and selling of bonds by RBI. In the long run this will definitively be positive for bonds and INR, provided the macro-economic variables remain supportive. The 10yr benchmark bond touched an intra-day low of 7.12% following the news of inclusion before ending the week mostly flat at 7.19% from last week's closing of 7.20% as traders booked profits on their positions made in anticipation of the event. Elevated crude prices and higher global bond yields continued to play on sentiments. INR appreciated to the end of the week at 82.94 after the news of index inclusion even as dollar index strengthened to 105.58. The curve remained flat.

Monsoon rains improved as the deficit reduced to 6% from 9% last week of the long term average. Out of the 36 subdivisions 9 have received deficit rainfall, 23 have received normal rainfall and 4 have received excess rainfall. Overall sowing remains in line with last year but pulses sowing is down 4.6% from last year and oilseeds sowing is 1.6% down from last year. Basin and reservoir levels are 7.7% below the long term average.

Money market rates inched higher as liquidity tightened due to GST and advance tax outflows. Interbank liquidity deficit touched a 4yr high of INR1.97 trn.

Brent crude ended the week marginally lower at 93.27 from 94.27 last week. Dollar Index continued to strengthen ending the week at 105.58.

The overnight Index swap curve (OIS) curve flattened marginally as the 5yr OIS ended the week lower by 1bps to 6.75% and the 1yr OIS inched higher by couple of basis to 7.08%.

International Markets:

The higher for longer theme dominated the narrative in the global bond markets as yields continued to inch higher. The FOMC stayed pat on rates as was expected but reduced its forecast of rate cuts in 2024 and 2025. BOE also left rates unchanged as inflation came in lower than expected. US yield curve steepened after the Fed policy as markets recalibrated their expectations of rate cuts next year and are now pricing in rate cuts to begin from September 2024 relative to the earlier expectations of rate cuts starting from May 2024. US economic data continues to come in strong though growth in Europe is slowing rapidly. The benchmark US 10yr yield ended the week at 4.43% up 10bps from the previous weeks closing of 4.33% going past the technical resistance levels of 4.34%. 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.

Our View

We believe that global monetary tightening has entered its last phase with key central banks like the Fed and BOE pausing on rate hikes. 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 7.00% to 7.25% over the next couple of months. Given the inclusion of Indian government securities in the JP Morgan EM Index and the recent rise in yields which has 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 the money market funds as yields are attractive in the 1yr segment of the curve.