PGIM
India Mutual Fund

Fixed Income Weekly Update

22nd January - 25th January 2024

Puneet Pal
Head - Fixed Income

We expect the benchmark 10yr bond yields to continue to fall

Indian Markets:

Bond yields were stable and remained flat last week on lack of fresh triggers ahead of the Union Budget on 1st Feb next week. The 10yr bond yield ended flat at 7.18%. Yields at the longer end of the curve came down outperforming the entire curve as SDL issuance has been lower than the SDL auction calendar.

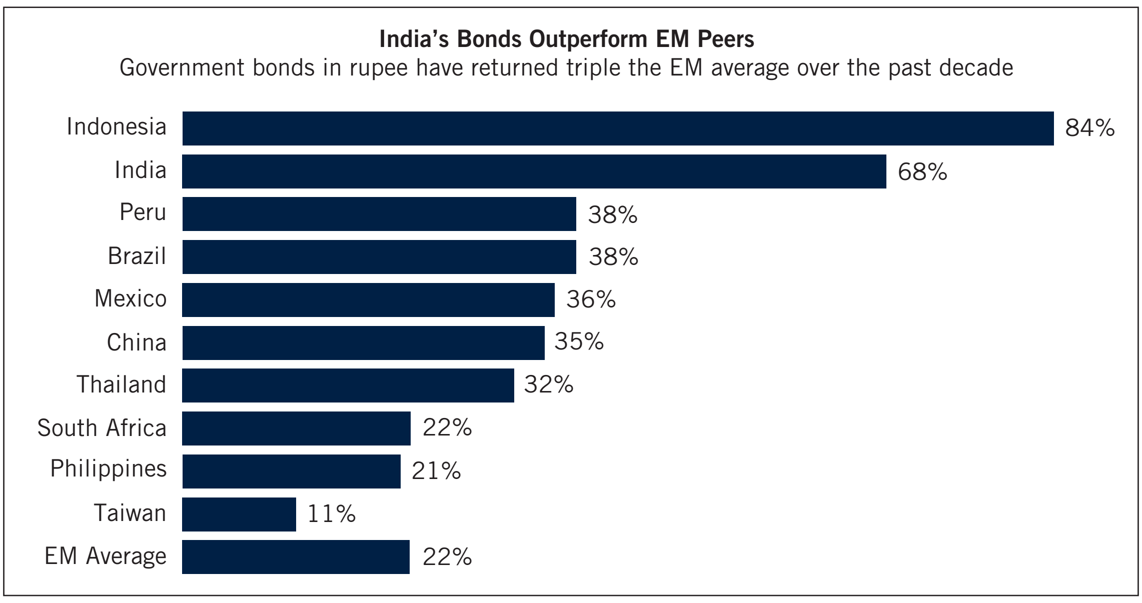
This has led to spread compression at the longer end of the curve. The next trigger for the bond market will come in the form of the Union Budget next week and the market is expecting fiscal deficit to come in at 5.3% in line with the fiscal consolidation roadmap. The gross borrowing are expected to be tad lower than last year around Rs.15 lakh crore.

Beyond the Budget next week, markets will be keenly awaiting the MPC policy, where markets are building in a high probability of a change in the monetary policy stance to “Neutral” given the decelerating trend in “Core” inflation. Money Market yields continued to inch higher as banking system liquidity remined tight despite RBI announcing VRR (variable rate repo auctions) as government continued to run surplus of more than Rs.3 lakh crore.

The Rupee was also flat during the week ending at 83.12 from 83.07 last week though volatility in the equity market continues. Crude oil rose by 6% during the week as a fuel tanker was hit by a missile near Yemen underscoring the geopolitical risk to crude supplies.

The Overnight Index Swap (OIS) curve came down with the 5yr OIS ending the week at 6.18% down 6 bps on the week and the 1yr OIS was down by 4 bps to 6.60%.

Meanwhile Indian Bonds have outperformed their emerging market peers ......



Source: Bloomberg

International Markets:

Global bond yields were flat week-on-week as markets await clues from the FOMC meeting on 31st January. US economic data continued to come in strong with higher than expected PMI’s. The PCE data was in line with market expectations, rising at the slowest pace in nearly three years. Even as economic data continues to be strong, inflation is slowing and markets expect the Fed to start cutting rates from march as it attempts to achieve soft landing though the aggressive market pricing of bigger and/or faster rate cuts given the continued resilience of the US economy looks optimistic.

The benchmark 10yr bond yield was flat ending the week at 4.14%, higher by 2bps over the week. The Dollar Index continued its upward trajectory ending the week at 103.43 from last week’s closing of 103.29. Next week’s FOMC meeting will be important with respect to future expectations regarding the trajectory of the US rate cycle which will influence the global monetary cycle.

Our View

The global monetary tightening cycle has ended and we think we are in for a long pause. RBI will also be on a long pause and though we expect rate cuts only in Q3 of CY2024, RBI can change its monetary policy stance to “Neutral” in the Feb/April MPC policy meeting as core inflation is on a falling trend and is below 4%. Bond yields tend to move in advance of rate action and thus we believe that with the rate cutting cycle on the horizon investors can look to increase allocation to Fixed Income.

Investors with medium to long term investment horizon can consider 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. Dynamic Bond Funds and Gilt Funds are also likely to do well with fall in long end bond yields in anticipation of rate cutting cycle starting later this year. We expect the benchmark 10yr bond yields to continue to fall and come down below 7% over the next couple of quarters.