PGIM India Mutual Fund

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Fixed Income Weekly Update

30th October - 3rd November 2023

Indian Markets:

Indian Bond yields retraced lower from their last week highs tracking global bond yields which trended lower as the US Fed paused while indicating that they may be at the end of the rate hiking cycle given the tightening in financial conditions due to the rise in long term bond yields. Indian Bond markets also got support from the fall in crude prices even as hostilities raged on in the middle east. GST collection came in at 1.70 lac cr, the second highest collection ever highlighting robust growth momentum as well as improved efficiency in collections though both the manufacturing and the services PMI's came in below last month's numbers. The RBI governor, in one of his comments, also mentioned that India's growth is likely to surprise on the upside. The benchmark 10yr bond yield ended the week at 7.32% 4 bps lower than last week's closing of 7.36%. Banking system liquidity remained tight through the week though it's expected to ease next week on back of higher government spending. The expectations of tighter liquidity conditions prevailing led to higher money market rates with CD yields in the 1yr segment inching higher. There is high likelihood of an OMO sale announcement by RBI next week as Liquidity eases. Crude prices softened to below 87 even as hostilities continued in the middle east. With efforts underway to contain the fallout of the conflict. INR was stable and traded in a very narrow range throughout the week closing at 83.29.

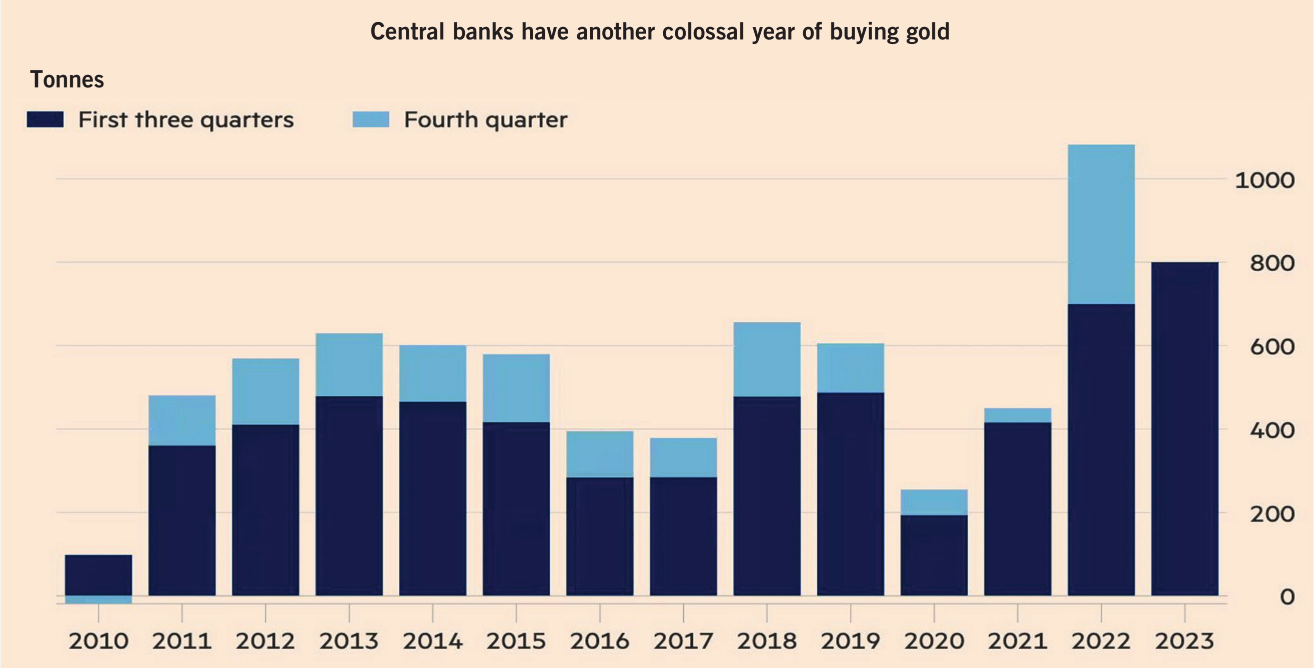
RBI continues to intervene in the FX markets even as INR closes the week towards near a record low. According to a news report, in a meeting with select bankers, RBI was given the feedback that volumes in the Bond markets have dwindled ever since the announcement of OMO sales by RBI. We expect OMO sales to be conducted by RBI in this month amidst increase in government spending on back of the substantial amount of Government securities maturities of over INR 2 trn lined up over the next two months.

The overnight Index swap curve (OIS) curve came down during the week in line with the fall in global bond yields. The 5yr OIS was down by 12bps ending the week at 6.58% and the 1yr OIS was lower by 8bps ending the week at 6.89%.

International Markets:

The global bond markets saw lot of action led by the US Bond market as yields fell almost 25ps during the week. The US Fed paused as was widely expected and hinted that the Fed may be done with rate hikes. This Fed action and the lower issuances of longer tenure US bonds as announced by the US treasury led to a sharp fall in US bond yields especially at the longer end of the curve. The US employment numbers also moderated and the unemployment rate came in at 3.90%, higher than market expectations of 3.80%. The monthly hourly earnings also came in lower than market expectations and the PMI's were broadly in line with expectations. The benchmark US 10yr bond yield fell to a low of 4.51% before ending the week at 4.57% compared to lasts weeks closing of 4.83%. The dollar index fell almost 1.50% to close the week at 105.02 from 106.58 last week. We believe that US yields can take a breather here and stabilise after rising relentlessly over the last 3 months The Bank of England held rate steady as was expected. The Bank of Japan kept its rates unchanged and tweaked its yield curve control by ending daily fixed rate bond buying which can allow the benchmark 10yr bond yield to drift higher than 1% though it continues to emphasise than BOJ will continue to conduct large scale bond buying. Yen went past 150 after the BoJ's policy with market reading it as dovish.

Meanwhile Gold is looking to glitter as it held steady near 2000 with central banks buying continuing unabated in a bid to diversify FX Reserves. Central Banks buying of Gold has been humongous and is one of the reasons why Gold continues to do well in spite of higher global bond yields.



Purchases reported to the IMF
Source: Metals Focus, Refinitiv GFMS, World Gold Council

Our View

We believe that global monetary tightening has come to a pause though rate cuts are still sometime away. 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 7.45% 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 pretty attractive in the 1yr segment of the curve.