PGIM India Mutual Fund

Puneet Pal
Head - Fixed Income

Fixed Income Weekly Update

4th March - 7th March 2024

The yield curve has flattened and can continue to stay flat

Indian Markets:

Indian bond markets traded with a bullish undertone even in the face of continued strong economic data underscored by the favourable demand supply dynamics in the bond markets.

The week started with strong PMI numbers even as the composite PMI number came in at 60.60, a tad lower than last month.

Indian FAR bonds were included in the Bloomberg EM local currency government Index with a start date of January 31, 2025. The weight of the Indian FAR bonds will be 10% and will reach their full weightage exposure by November 2025. The initial news flash had come earlier in January and the flows are not expected to be significant since the inclusion, for now, is limited to EM local currency government index though this is definitely a positive and a step closer to inclusion in the bigger Bloomberg Global aggregate Index. The flows expected from this inclusion are around USD 3-4bn but as mentioned earlier this inclusion can be a catalyst for inclusion into the larger global aggregate index later. Since the announcement of the inclusion of Indian sovereign FAR bonds the JP Morgan EM index, FPI inflows of USD 10bn have come in.

The benchmark 10yr bond ended the week at 7.03%, down by 3 bps over the week even as the RBI governor said that growth can surprise on the upside maybe even coming in at 8%, higher than the previous estimates.

Money Market rates eased on the back of higher government spending with 3 month CD rates trading at 7.65% and 1yr CD rates at 7.70-7.75%.

Overnight rates also eased on higher interbank liquidity. Crude came down by 1.40%, ending the week at 82.08.

The Overnight Index Swap curve (OIS) curve came down and flattened with the 1yr OIS ending the week at 6.71% lower by 3bps and the 5yr OIS ended the week lower by 4bps at 6.28% flat.

International Markets:

Global bond yields edged lower during the week led by US bonds as the US Fed chairman reiterated comments regarding the scope for rate cuts later in the year while acknowledging the strong growth.

The benchmark US 10yr treasury yield came down by 18bps during the week, closing the week at 4.07%. US growth indicators continue to be strong and all eyes will be on the US CPI next week. The US employment report was a tad weaker than expected with the unemployment rate edging higher to 3.90% and average hourly earnings also coming in lower at 0.1% against expectations of 0.3% though the monthly non-farm payrolls were higher than expectations at 275K against expectations of 200K.

The FOMC meeting later this week will provide further insights into the Fed's take on stronger US economic data. There is rising speculation on the end of the negative rate policy of the BOJ as Japanese wage gains accelerated to the fastest clip since June amidst the annual wage negotiations with unions. The biggest Japanese bank MUFG expects change in BOJ's policy later in the month. Any change in BOJ's policy will have implications across asset classes.

Our View

The global monetary tightening cycle has ended and we are in for a long pause on rates both domestically and internationally. 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" before the commencement of rate cuts. The yield curve has flattened and can continue to stay flat given the positive demand/supply dynamics and rate cut prospects going into FY25.

Bond yields tend to move in advance of rate action and investors can look to increase allocation to fixed income as we expect long bond yields to keep drifting lower and expect the benchmark 10yr bond yield to go lower towards 6.50% by Q2/Q3 CY24.

Investors with medium to long term investment horizon can consider funds having duration of 5-6yrs with predominant sovereign holdings as they offer better risk-reward currently. Investors having an investment horizon of 6-12 months can consider 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.