PGIM
India Mutual Fund

# Fixed Income Weekly Update

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## Indian Markets:

Indian Bond yields were volatile during the week. Bonds started the week on a weak footing as rising crude oil price and global bond yields dented sentiments and the benchmark 10yr Bond yield touched a high of 7.25% on the first day of the week before value buying crept in. News reports about high probability of Indian Government bonds getting included in one of the global benchmark bond indices led to a decent rally with the 10yr benchmark bond touching a low of 7.13%. Yields were also supported by comments on higher collection in the small savings schemes which augurs well for the fiscal position. The news about bond inclusion is not new and there was high speculation about Index Inclusion at the same time last year also and nothing has changed materially from last year including taxation for FPI's (Govt has declined to tweak tax rules). In any case even assuming the best case scenario of Index inclusion, the actual flows can take up to 6 months to come in and even when they come, it will not change the fundamentals of the market in a significant manner though in the short run, it can lead to a 20-30 bps rally as fast money will try to pre-empt the expected flows. Market scepticism about Index inclusion become evident as yields rose a day after the news reports negating much of the earlier rally as the 10yr bond yield ended the week at 7.20%. Rising crude prices and higher global bond yields impacted sentiments as INR depreciated to the end of the week at 83.19 amidst USD strength. The curve remained flat. August trade deficit widened to USD 24.2bn from USD 20.7bn. Analysts expect the current account deficit to be around 1.50% of GDP in FY24. Monsoon rains remain in deficit at 9% below the long-term average. Out of the 36 subdivisions 10 have received deficit rainfall, 22 have received normal rainfall and 4 have received excess rainfall. Overall sowing remains in line with last year, but pulses and oilseeds sowing is marginally down from last year. Basin and reservoir levels are 11.6% below the long-term average. Government continues its proactive stance on managing food inflation particularly with respect to cereals, pulses, and vegetables. India CPI Inflation came in lower than expected at 6.83% (expected 7.10%), with lower food prices while the core inflation remained subdued below 5%. Food inflation can continue to be volatile though encouragingly core inflation is showing a softer trend sequentially.

Money market rates inched higher as liquidity tightened ahead of advance tax outflows. INR came under pressure on USD strength, weakness in Yuan and higher crude oil prices ending the week at 83.18 depreciating by 20 paise from the last weeks closing of 82.94.

Brent crude continued its upward march posing a threat to all the calculations and assumptions as it ended the week at 94.27 up almost 4% on the week. Dollar Index continued to strengthen ending the week at 105.32.

The overnight index swap curve (OIS) curve steepened marginally as the 5yr OIS inched up by 4bps to 6.76% and the 1yr OIS remained flat at 7.06%.

## International Markets:

Global Bond yields continued to inch higher as ECB unexpectedly hiked rates while not committing to a pause. Economic data continued to signal US economic strength as inflation data came in higher than expected. The benchmark US 10yr ended the week at 4.33% flirting with crucial technical resistance levels of 4.34%-4.35%. The 10yr yield was up 7 bps on the week as higher for longer narrative took hold. US markets are expecting the Fed to pause in next week's FOMC meeting while forecasting a longer wait for rate cuts. Markets expect Fed to sound hawkish while pausing and indicate one more rate hike this year. The Fed's forecast on economy and rates in next week's FOMC meeting will be crucial. The high supply of US treasuries due to the high fiscal deficit is one of the factors keeping yields elevated. Technically, the level of 4.34%-4.35%% is a significant level to watch out for as a monthly closing above 4.35% can herald further increase in yields. China cut the reserve ratio for banks by 25bps after the surprise cut in the policy rate in august in an effort to stabilise the economy by injecting more liquidity. Markets expect further cuts in both the policy rate and RRR.

## Our View

We believe that global monetary tightening is on its last legs and central banks globally will be on a long pause. 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 7.10% to 7.25% till the end of the month. Given 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.