PGIM
India Mutual Fund

Fixed Income Weekly Update

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Indian bonds remain attractive on the back of stable underlying macro-economic variables

Indian Markets:

Bonds were steady amidst a fluid geopolitical situation in the Middle East as traders looked to book profits. The benchmark 10yr Bond yield ended the week at 6.79%, unchanged from last week's closing even as brent crude came down by almost 7% during the week. The bond market continues to trade cautiously as hopes of an immediate rate cut by RBI are fading. The cautious stance by bond traders was vindicated at the end of the week when the RBI governor, in an interview on the last day of the week, said that a rate cut at this stage would be premature and risky.

The RBI governor sounded optimistic on growth while emphasising on the resilience of the Indian economy. The RBI governor also pushed back on the suggestion that RBI may be behind the curve in cutting rates by stating that the market expectations were aligned with the stance of the central bank and the growth inflation dynamics were well balanced.

CPI inflation rose to a nine month high at 5.49% on the back of rise in food prices particularly in vegetables, edible oils and pulses. This was higher than the market expectations of 5.10%. WPI inflation came in marginally lower than expectations at 1.84%. Trade deficit narrowed to USD 20.80 bn in September from USD 29.70 bn in August with decline in non-oil imports led by normalisation of gold imports. Services trade surplus remained steady at US 14.3 bn. Analysts continue to expect the Current Account Deficit in FY25 to be in the vicinity of 1%. In other interesting data released by government, the number of taxpayers in India rose by 82% to 10.40 cr in last 9yrs between FY15 to FY24. Total direct tax collections in FY24 were at INR 19.6 lac cr, up 182% from nearly INR 7 lac cr in FY15. For the second consecutive year, personal income tax collections were higher than corporate tax collections.

Government approved MSP hikes for the Rabi crops. On an average, the MSP for winter crops rose 4.90% YOY compared to 4.80% in the previous season. Barley had the highest increase of 7%. The increase in MSP is in line with last year's trend and is unlikely to add to food inflation pressures. Reservoir levels are also higher than the average of the last 10yrs which is likely to benefit rabi crops.

Amidst concerns on private credit, RBI banned four NBFCs from incremental sanction and disbursal of loans. This action reiterates RBI's focus on maintaining macro-economic stability.

INR remained under pressure as FPI outflows from equity market continued though RBI intervention ensured that it ended the week unchanged from last week's closing of 84.07. FPI outflows from equities have topped USD 9 bn so far this month. FPI flows into debt this month have remained flat.

Money Market yields also came under some pressure as 3 month CD yields rose by 3-4 bps during the week even as Interbank liquidity remained easy.

OIS curve inched higher with the 1yr OIS ending the week at 6.50%, up by 7bps while the 5yr OIS was higher by 2 bps and ended the week at 6.19%. The 5yr OIS has risen by 25bps since it touched a low of 5.94% on 13th September, in line with the movement in US bond yields.

International Markets:

US bond yields were little changed during the week even as the incremental economic data continues to be strong. The benchmark 10yr bond yield ended the week at 4.08%. The US bond markets are factoring in a Fed Fund rate between 3.25% to 3.50% over the next one year. ECB cut rates and gave a dovish outlook which led to European yields moving lower. Meanwhile, the prices of new homes in China were down 5.08% YOY. The new home prices in China are down for the 15th consecutive month underlying the continuing distress in the housing sector.

Our View

As the US economy continues to be resilient, bond markets have pared their expectations of rate cuts in US, a similar theme which has been repeating itself over the course of the last many quarters. We expect the Fed to continue with its rate cutting cycle though in a slow and gradual manner. Indian bonds remain attractive on the back of strong and stable underlying macro-economic variables with favourable demand supply dynamics at play. The scope for rate cuts in India is on account of high real positive rates and the need to encourage private investment. The start of the rate cut in US has increased the probability of rate cuts in India in the near future.

Bond yields tend to move in advance of rate action and investors can look to increase allocation to Fixed Income at every uptick in yields. We expect long bond yields to continue to drift lower over the next couple of quarters.We expect the benchmark 10yr bond yield to go towards 6.50% by Q4 of CY25.

Investors with medium to long term investment horizon can look at Dynamic Bond Funds having duration of 6-7yrs with predominant sovereign holdings as they offer a 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 also.