PGIM
India Mutual Fund

Fixed Income Weekly Update

16th September - 20th September 2024

Puneet Pal
Head - Fixed Income

Global Monetary Easing Picking up Pace

Indian Markets:

Bonds continued to be well supported with the start of the US rate cutting cycle and market sentiments remained upbeat. The US rate cutting cycle started with the Fed cutting rates by 50 bps. As the markets had priced in the start of the Fed rate cutting cycle, yields were little changed as there was profit booking. Initially, after the Fed rate cut, yields fell by up to 6 bps before profit booking took place and yields ended the week 2-3 bps below last week's closing. Relatively speaking, INR had its best week in a long time on expectations of increased FPI inflows following the Fed rate cut.

Trade deficit widened in August to USD29.7 bn from USD23.6 bn in July. High gold imports contributed to the elevated trade deficit. Gold imports rose to USD10.1 bn compared to the July gold imports of USD 3.1bn. Monsoons were steady and till Sept 18 had already crossed the normal levels for the whole year with an overall surplus of 7.40%. Overall, spatial, and temporal trends remain favourable while reservoir storage levels are above 10yr average which augurs well for Rabi crops. WPI inflation slowed to 1.31% compared to 2.04% in July. Lower commodity prices are supporting lower WPI. Core inflation weakened to 0.70% from 1.20% in July. Going ahead, we expect WPI to increase with a less favourable base and on flat domestic inflation components as compared to lower imported inflation. The RBI State of the Economy Report highlighted that the worst of food inflation that drove up headline inflation may be behind us as there are signs that the vegetable price shocks are easing. Freight rates have surged nearly 70% YoY across Indian ports reflecting global shipment disruptions, sustained demand, and capacity constraints. This increase comes after a gap of two years and can potentially add to the burden of corporates.

FPI inflows into debt remain strong with USD 2.33bn of inflows in the first twenty days of September after averaging more than USD 2 bn over the last couple of months and taking the total FPI inflows into debt above USD 15bn in this calendar year.

The benchmark 10yr bond yield ended the week at 6.76%, down 3 bps over the week. The entire yield curve is trading below 7%. Money Market yields remained stable but elevated with 3-month Bank CDs trading in a range of 7.25%-7.30% as liquidity tightened after advance tax and GST outflows though the average banking system liquidity has improved in this quarter compared to the previous two quarters in this calendar year and the weighted average overnight rate is also lower.

There was profit booking across the OIS curve after a strong rally over the last fortnight. The OIS curve was up by 2 bps across with the 1yr OIS ending the week at 6.40%, up by 2bps while the 5yr OIS was also up by 2 bps and ended the week at 6.00%. INR ended the week at 83.58, a major beneficiary after the Fed rate cut.

International Markets:

The US Fed started its rate cutting cycle with a big bang cut of 50bps even though the Fed did not see a recession. Global bond markets were pricing in the start of the rate cutting cycle by the Fed but were divided between 25-50 bps of rate cut for the September FOMC meeting and after the rate cut, yields went northwards with a steepening bias. As the Fed itself said that they are not expecting a recession and so far, the US economic data is also holding up, yields may find it difficult to move lower from the current levels, especially the long bond yields, in the absence of a meaningful downturn in the US economy. Bank of England stayed put on rates. The benchmark 10yr US bond yield ended the week 10 bps higher at 3.74%. The FOMC dot plot indicated that the terminal Fed funds rate lay in the vicinity of 3%.

Our View

As the Fed started its long-awaited rate cutting cycle, Emerging Market bonds will be in focus once again amidst expectations of increased FPI flows. As the markets had already priced in Fed rate cuts, yields remained rangebound after the rate cut. 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 and after the bigger than expected rate cut in US, probability has increased of a December rate cut by the MPC.

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 consider 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.