PGIM
India Mutual Fund

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Fixed Income Weekly Update

17th July - 21st July 2023

Indian Markets:

Bond yields remained largely stable in a week dominated by vagaries of nature with respect to the monsoons in India and heat wave across Europe. Lack of any major fresh triggers kept the bond market range bound ahead of a slew of major central bank policy meetings scheduled to be held next week. Bond markets in India took cues from yield movements in the developed market space and moved largely in tandem in this week. Money market yields were rangebound even as GST outflows led to some upward moment in overnight rates. Crude oil remained strong ending the week at USD81. INR appreciated to end the week just below 82 even as DXY strengthened higher above 100 from the YTD lows seen last week as US economic data continued to come in steady. BRICS nations are crystallising their plans for creating a new international currency for trading and financial transaction and this currency will be “Gold backed” though this has been in news over the last couple of months, we still think it is going to take a lot more time to find a practical working alternative to the US dollar, Domestic bond markets will likely follow the trajectory of global yields for the next couple of weeks.

International Markets:

Global Bond yields were rangebound even as the much-anticipated UK inflation data came in lower than expected, which provided some sort of relief to the markets. Both the headline CPI and core inflation came in lower than expected. US bond markets are pencilling in a 25 bps hike in policy rate in the next week’s Fed meeting ECB and BOJ also have their meetings lined up. The focus will be on the Fed’s guidance and outlook as markets remain uncertain on the second hike as its factors in less than 50% probability of the second hike. Russia suspends the black sea grain deal which can potentially jeopardise the export of grain and other food items from Ukraine. This can reignite food inflation which, to some extent, had already been under pressure. The theme of soft landing continues to be the dominant theme giving support to risk assets. Chinese economy continues to be sluggish with more stimulus expected by markets. BOJ meeting is significant as it remains last of the major central banks to continue to be dovish. We continue to believe that with the aggressive rate hikes done so far and the lagged impact of monetary policy, monetary tightening globally is in the last phase and slower economic growth is on the anvil by end of CY23.

Concept of Shrinkflation and Skimpflation

We are quite familiar with the concept of Shrinkflation and Skimpflation, which means businesses reduce the quantity of a product or the quality of a product while retaining prices to support the idea of stable inflation. This is especially true as it leads to reduced quantity and quality of goods consumed thus lowering the quality of life and the full impact of these changes has to be understood in qualitative terms and government statistics are unable to capture such subtleties. This invariably comes across as an experience to consumers.

Our View

RBI is set to be on a long pause with the US Fed also expected to be on pause after the rate hike next week. This quarter (July-Sept) is quite heavy on net supply and we might see some pressure on the belly of the curve, we think that the broad range of the benchmark 10yr bond yield will remain between 7% to 7.25%. We think that it is the right time for investors to increase allocation to Fixed Income as monetary tightening enters its last phase globally and growth is expected to slow down towards the end of the year.

Investors with medium to long term investment horizon can consider 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 consider money market funds as yields are attractive in the 1yr segment of the curve.