PGIM
India Mutual Fund

Fixed Income Weekly Update

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We expect the benchmark 10yr bond yield to go towards 6.50% by Q4 of FY25

Indian Markets:

The Indian bond yield curve has flattened further during the course of this month with the longer end of the curve outperforming the shorter end of the curve. The benchmark 10yr bond yield has remined flat during the course of this month whereas the yields at the longer end of the curve have come down by 9-10 bps.

There is strong investor demand from Insurance and PFs at the longer end of the curve as the benchmark 10yr bond faces a key technical resistance at 6.95%. Apart from the favourable demand supply dynamics playing out in the bond markets, the impending inclusion of Indian government bonds in the JP Morgan Emerging Market Bond Index is also positive sentiment wise.

Despite news reports of potential extra spending by the government and tax cuts, bond markets are not perturbed as the markets are expecting the government to stick to the 5.10% fiscal deficit as outlined in the interim Budget.

The MPC meeting minutes released yesterday showed that committee members from RBI remained concerned about food inflation with the RBI governor highlighting the risks of a likely Rabi production shortfall in some pulses and vegetables and the recent upward revision in milk prices which warrants close monitoring while noting that though the CPI Inflation has moderated, it was moderating at a very slow pace.

Few external members of the committee - Dr. Ashima Goyal and Prof. Varma, who had voted for a rate cut, were concerned about the impact on growth by keeping the real rates above the neutral rate for an extended period of time. Meanwhile, RBI continued to sound cautious on growth in lending as the RBI governor, in an address, cautioned banks to be wary of risks while pursuing growth opportunities. Perhaps this caution is justified by the growth seen in unsecured loans. According to a report by Assocham and ICRA on NBFCs, the unsecured loan by NBFCs have grown by a CAGR of 32% during FY2017-24 double the rate of growth seen in secured loans like vehicle, home and gold loans.

Despite the strong performance of the bond and equity markets, INR depreciated and ended the week at 83.54 after having touched an all-time low against the US dollar at 83.67 even as FPI inflows into debt during the month remained positive at USD1.27bn and on a CYTD basis have crossed USD 7bn. There was general weakness in Asian FX and INR weakness was a reflection of the weakness in Asian peer currencies. The 10yr bond yield ended the week at 6.97%. Money Market yields were stable even as banking system liquidity tightened following the advance tax and GST outflows. The 3 month bank CD yields are trading at around 7.10%.

The Overnight Index Swap curve (OIS) was little changed with 1yr OIS ending the week at 6.78% and the 5yr OIS ended the week at 6.36%.

International Markets:

US yields were also little changed during the week as the benchmark 10yr bond yield ended the week at 4.25%, down by 20 bps during the month following some soft economic data. After the hawkish rate cut by the ECB, BOE kept rate on hold.

Yen continued its weakening trend, marching towards 160 even as Japanese officials reiterated their stance to curb any outsized moves in the currency. Yen ended the week at 159.80 following DXY strength which ended the week at 105.80. Yen has depreciated by 11% against the US dollar this year.

As the US Fed holds rates and other global central banks start to cut, the Dollar Index will likely remain strong.

Our View

We expect Indian bond yield curve to remain flat amidst favourable demand supply dynamics. The scope for rate cuts in India is on account of high real positive rates and the need to encourage private investment and there is a fair probability of rate cuts in second half of FY25 though any rate cuts in India will follow rate cuts in advanced economies and will not precede them.

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 FY25.

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 look at Money Market Funds as yields are also attractive in the 1yr segment of the curve.

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