PGIM
India Mutual Fund

Fixed Income Weekly Update

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The yield curve has flattened and can continue to stay flat

Indian Markets:

Indian Bond markets were pretty stable and traded in a range with a bullish undertone during the week in the absence of any major triggers. The benchmark 10yr bond ended the week at 7.08 down by 2 bps on the week.

MPC minutes released during the week highlighted that growth remains resilient and the need to stay vigilant on inflation as it stays above the target of 4% with food inflation volatility posing risks while at the same time acknowledging that inflation is decelerating with the moderating trend of "core" inflation providing comfort. Some members highlighted that potential growth might have improved while some members highlighted the high real rate of interest which might impact growth prospects.

In another piece of interesting news, World Bank and other global institutions have issued USD 1.4 bn offshore rupee denominated bonds in this calendar year which is almost half of almost USD 3.30 bn issued in all of 2023. There is strong demand for rupee debt after the news of the inclusion of Indian sovereign bonds in the JP Morgan Emerging Market Bond Index from June 2024 onwards. These offshore bonds have a maturity ranging from 4yrs to 10yrs and are denominated in INR but settled in US dollars.

RBI disagreed with IMF's assertion that if historical risks materialise then Indian general government debt can exceed 100% of GDP in medium term and hence further fiscal tightening is needed. Indian general government debt can be reduced to 73.40% of GDP by 2030-31 which is nearly 5% below IMF's projections for the same period, wrote Indian central bank officials led by deputy governor Michael Patra in a paper as part of the RBI monthly bulletin.

Overnight rates eased on the back of higher government spending with 3 month and 1yr CD rates coming down by 10 bps during the week. Crude came down by 2% ending the week at 81.60

The Overnight Index Swap Curve (OIS) curve flattened a bit with the 1yr OIS higher by 2bps at 6.73% and the 5yr OIS flat at 6.36%.

International Markets:

Global bond yields were range bound with the US benchmark treasury yield down by 3bps on the week, closing the week at 4.25% after touching a higher of 4.34%. US growth continues to be strong while inflation surprised to the upside last week.

FOMC minutes were on expected lines with members mostly united about not hurrying through rate cuts and focussing on the unwinding of the Fed balance sheet.

The People's Bank of China (PBOC) cut the 5yr LPR rate with Chinese economy challenges continue as China FDI flows slumped to the lowest in 30yrs. US yields have retraced over the last couple of months scaling back expectations of faster and deeper rate cuts and the bond markets expectations are currently more aligned with the Fed's forecast. Incremental US economic data will be crucial in terms of determining the trajectory of the rate cutting cycle.

Our View

The global monetary tightening cycle has ended and we are in for a long pause on rates both domestically and internationally. RBI will also be on a long pause and though we expect rate cuts only in Q3 of CY2024, RBI can change its monetary policy stance to "Neutral" before the commencement of rate cuts. The yield curve has flattened and can continue to stay flat given the positive demand/supply dynamics and rate cut prospects going into FY25.

Bond yields tend to move in advance of rate action and investors can look to increase allocation to Fixed Income as we expect long bond yields to keep drifting lower and expect the benchmark 10yr bond yield to go lower towards 6.50% by Q2/Q3 CY24.

Investors with medium to long term investment horizon can consider funds having duration of 5-6yrs 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 attractive in the 1yr segment of the curve. Dynamic Bond Funds and Gilt Funds are also likely to do well with fall in long end bond yields in anticipation of rate cutting cycle starting later this year.