PGIM India Mutual Fund

Fixed Income Weekly Update

1st July - 5th July 2024

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There is a fair probability of rate cuts in second half of FY25

Indian Markets:

The rally at the longer end of the curve took a breather last week on back of profit booking. The curve steepened marginally as yields at the shorter end of the curve were down by 3-4 bps while yields at the longer end of the curve were up by 2 bps. The benchmark 10yr bond yield was down 1bps ending the week at 6.99%. Overall yields traded in a narrow range and remained stable.

FPI inflows into debt continued with USD 755 mn coming in the first week of July after the formal inclusion of Indian Bonds in the JP morgan GB-EM Index. Monsoons did not had a great start as rainfall till July 5th was 1.80% below the long term average. Out of the 36 sub-divisions, till date, eight have received deficient rainfall, 19 have received normal rainfall, and nine have received excess rainfall. Basin wise reservoir levels remain deficient though it improved over last week. Among major river basins, Ganga (north and east), Narmada (central and west), and Tapi (central and west) were surplus. Indus (north India), Godavari (west and south), Mahanadi (central and east), Cauvery (south), Krishna (west and south), and West flowing southern rivers were deficient. Overall basins and reservoirs levels were around 10% below long-term average for week-ending July 4.

Monsoons remain critical for Food Inflation, which RBI is worried about, and its progress will be a key monitorable for the economy in general and bond markets in particular. Retail prices have increased for vegetables and pulses while declining for cereals and oilseeds. Rate of growth in GST slowed to single digit for the first time in 3yrs, growing by 7.70% in June to Rs. 1.74 lac cr.

The composite PMI remained strong at 60.9 same as of last month indicating the continuation of the growth momentum. Heat wave in June drove up the consumption of power by 9% on the back of higher demand from both households and commercial establishments.

On the credit side, credit card outstanding and gold loans remained the outliers with a yearly growth rate of 26.2% and 29.7%, respectively compared to the overall credit growth of 16.1% for the banking sector as of May 2024. This increase in credit card outstanding and gold loans comes at a time RBI is expressing concerns on the growth of unsecured credit. This has come out in the monthly report on sectoral credit released by RBI.

Another interesting data point which was released in the week pertained to the money spent abroad by Indians, where the increase in forex spend by Indians outpaced the growth in remittance of foreign exchange into India. Money spend abroad has grown 29x over the last decade to touch USD 31.7bn in FY24 from USD 1.1bn in FY14. The rate of growth of outward remittance has outstripped the rate of growth of inward remittance growing at a CAGR of 40% much more than inward remittance growth rate of 5.50%, though on an absolute basis India continues to be the highest receiver of foreign remittances in the world.

The OIS curve came down a bit in line with global yields with the 1yr OIS ending the week 4bps lower at 6.78% while the 5yr OIS was down 2bps ending the week at 6.42%. INR was steady and remained range bound ending the week at 83.49 even as brent crude hit its highest level since April ending the week at 86.86

Money Market yields came down as banking system liquidity eased after traditional liquidity tightness associated with quarter ends with the September maturity Bank CD yields trading around 7.05% from 7.15% last week.

International Markets:

US yields were lower following a spate of relatively weak economic data which culminated in the monthly employment data on the last day of the week where the unemployment rate inched higher to 4.1% against expectations of 4%. The US benchmark 10yr bond yield ended the week at 4.28%, down 12bps on the week though the market remains divided on the quantum of the Fed rate hike for this year. DXY weakened in line with weaker economic data, ending the week at 104.88 from last week's closing of 105.80.

Our View

We expect Indian bond yield curve to remain flat amidst favourable demand supply dynamics though a lacklustre start of the monsoons can put some short term pressure on yields. 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 the start of the rate cutting cycle 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 few 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 attractive in the 1yr segment of the curve also.