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## Fixed Income Weekly Update

20th May - 24th May 2024

### 10yr bond yield may go towards 6.50% by Q4 of FY25

#### Indian Markets:

Indian bond markets got a booster dose this week with RBI declaring a whopping double the expected dividend of Rs. 2.11 lakh crore which nobody was expecting. Bond market was expecting RBI dividend to be in the vicinity of Rs. 1 lakh crore.

This provides a great deal of flexibility to the central government on the fiscal side and the government can choose between a faster pace of fiscal consolidation or higher spending or lower taxes. This positive surprise has enthused all the markets with lower bond yields, INR appreciating and the stock markets hitting new highs, though one has to keep in mind that this may not result in sustainable fiscal consolidation.

RBI also increased the Contingency Risk Buffer (CRB) to 6.50% from 6%. We are not yet sure about the source of the higher dividend and this bumper dividend may have resulted from FX sales or revaluation gains or higher income from its holding of foreign securities. Bonds caught a bid after the announcement of the higher dividend and the 10 yr benchmark bond yield ended the week at 7.05%, down by 4 bps with the new 10yr bond yield ending the week a tad below 7%.

The buyback of short maturity G-secs failed again as bids of Rs.5,266 crore were accepted, though the amount accepted was higher than last week's buyback. The maximum impact of the higher dividend was seen at the longer end of the curve with bond markets feeling optimistic about a cut in government borrowing when the full Budget is presented in July.

Yields at the shorter end of the curve also came down as a result of lower borrowing in T-bills as announced last week to reduce the government surplus which may go up to Rs 6 lakh crore after the transfer of the RBI dividend. The 3 month T-bill yield has come down to 6.85% from 6.99% earlier and 3 month bank CD yields have also come down by 10-15 bps.

INR continued the appreciating trend and ended the week at 83.10 appreciating 23 paise over the week as Brent crude remained stable at 82. FPI flows into bond market accelerated and stand at USD 241 Mn (excluding VRR) and the CYTD inflows into debt stand at USD 5.66 bn.

The Overnight Index Swap curve (OIS) was little changed with 1yr OIS ending the week at 6.80%, down by 1 bps over the week and the 5yr OIS ended the week flat at 6.41%.

#### International Markets:

US yields retraced a bit on continuing strong economic data with the benchmark US 10yr bond yield ending the week 5 bps higher at 4.47%, DXY was a tad higher at 104.72 from 104.44. Bond markets in US are currently factoring in only one rate cut by the end of CY2024.

In all likelihood, the ECB and the BOE will start cutting rates before the US Fed as US continues to have sticky Inflation along with stronger economic growth.

#### Meanwhile....

The rise in gold and silver prices has led to a 40-50% rise in Kancheepuram silk saris since last October, hitting the Rs.10,000 crore silk sari Industry in Kancheepuram hard.

#### Our View

As core inflation hits an all-time low of 3.20% and the fiscal leeway available to the government with the higher than expected, RBI bond yields will continue to drift lower with the favourable demand supply dynamics providing the necessary tailwind.

We continue to believe that the global monetary tightening cycle has effectively ended and the bar of further rate hikes in US remains high despite the continuous hawkish posturing by some FOMC members. 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 6-7 yrs 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.