PGIM
India Mutual Fund

Fixed Income Weekly Update

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Benchmark 10yr bond yield may go towards 6.50% by Q3/Q4 of FY25

Indian Markets:

Global cues continued to be the dominant theme for Indian bonds as yields remained under pressure though value buying was seen at higher yields. The benchmark 10yr bond yield ended the week at 7.19%, down 4 bps over the week after having touched 7.23% intra week before value buying emerged.

Given the relative sharp surge in yields this month, we expect yields to stabilise going into next month. Inter Bank liquidity tightened after the GST outflows and given the fact that government spending may not pick up till the formation of the government after the elections, which means that while the government borrowings continue, the government spending will be low, resulting in higher government surplus and tighter banking liquidity. Tightness in liquidity has pushed up short term money market rates by almost 15/20 bps this week with June maturity CD's trading around 7.10% from 6.90% earlier. Though bond yields have risen, the underlying macroeconomic fundamentals remain strong with headline and core inflation remaining benign.

INR ended the week at 83.35 appreciating marginally by 12 paise over the week even as Brent crude remined elevated ending the week at USD 89.50 up 1.6% from last week.

FPI flows into bond market this month remain negative at over USD 1bn though on a CYTD basis debt inflows remain positive at over USD 7bn.

The Overnight Index Swap (OIS) curve yields came off from their highs with 1yr OIS ending the week at 6.89%, down by 2bps over the week and the 5yr OIS ended the week at 6.59%, down by 4 bps. OIS curve has reacted the most to the rise in global bond yields and after a substantial sell off during the course of this month, we may see some consolidation going ahead. Currently, the 1yr OIS is not pricing in any rate cuts over the course of the year.

International Markets:

Global bond yields stayed elevated with the benchmark US 10yr bond yield rising by 5 bps during the week. It briefly went above 4.70% during the week after the US GDP data which showed higher inflation and lower growth compared to expectations. US Bond markets have substantially repriced their expectations of rate cuts from the Fed and are currently split between 1 and 2 rates by the end of the year. BOJ meeting has no surprises with BOJ standing par on rates after the increase in the last meeting and Yen trading at a 34yr low vis a vis USD. DXY came off from its highs of last week, ending the week at 105.77 down marginally from last week's closing of 106.15.

Our View

The recent flare up in US inflation and the consequent rise in US bond yields has put pressure on global bond yields including Indian bond yields with FPI outflows from Indian bonds happening for the first time in the last 7 months and INR also coming under some pressure in spite of strong underlying fundamentals. We continue to believe that the global monetary tightening cycle has effectively ended and the bar of further rate hikes in US remains pretty high despite the hawkish posturing by some FOMC members and strong economic data along with sticky inflation.

The Indian OIS curve is now not expecting any rate cuts in India and the yield curve remains flat. We continue to think that scope for rate cuts in India is on account of high real positive rates and the need to encourage private investment and that 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.

Positive demand/supply dynamics will continue to favour bonds with the inclusion in the JP Morgan EM bond Index kick starting from end June.

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 stabilise over the next few months after a sharp uptick this month and to drift lower over the course of the next one year. We expect the benchmark 10yr bond yield to go towards 6.50% by Q3/Q4 of FY25.

Investors with medium to long term investment horizon can consider 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 consider 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 this year.

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