PGIM India Mutual Fund

Fixed Income Weekly Update

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Global monetary easing to pick up pace

Indian Markets:

Indian bond markets remained stable and rangebound in the absence of any major triggers even as the new Unified Pension Scheme (UPS) was announced over last weekend which can have a potential negative impact on both the central and the state's fiscal deficit. While the newly announced Unified Pension Scheme (UPS) is not a revert to the old pension scheme, it can have fiscal consequences. The new pension scheme is expected to benefit around 2.3mn central government employees and if the states adopt it then the beneficiaries can go up to 9mn. The estimates of the impact on the fiscal currently differs with the government estimating the impact to be Rs.62.50bn while some other estimates are talking about an impact of around Rs.400-450bn which can result in a fiscal impact of 15bps (Macquarie Report). The fear is that the state's fiscal deficit can also be adversely impacted which is already running above the threshold levels of 3%.

Poll bound Maharashtra has become the first state to adopt UPS. In spite of this marginal negative announcement, long bonds remained stable with traders looking forward to the month end GDP data for Q1 FY25 which was released on the last working day of the month after market closing. The GDP numbers came in line with expectations at 6.70% (exp. 6.80%) but the GVA numbers surprised on the upside and came in at 6.8% which was higher than expectations of 6.40%. Though GDP numbers generally do not sway bond markets much as they are backward looking, nonetheless, this time given the expectations of monetary easing going ahead, the Q1 FY25 numbers were important and in this context, the analyst community is expecting FY25 GDP to be lower than RBI's estimate at 7.20%.Even the CEA has estimated India's GDP growth for FY25 to range between 6.50% to 7%. Given the current growth momentum and the inflation trend, RBI may reduce both its inflation and growth forecast for FY25 going ahead though given the current and expected growth numbers and RBI's endeavour to reduce the credit growth in the economy, we continue to believe that RBI will stay put on rates till the end of this calendar year and monetary easing will start only in 2025.

Rainfall picked up with the cumulative rainfall at 7% above the long term average. Monsoons remained excess in central and southern India, normal in northern India and deficit in east and north east India. Out of the 36 sub divisions,till date, 5 have received deficient rainfall, 19 have received normal rainfall and 12 have received excess rainfall. Total kharif acreage is 1.90% higher than same period compared to last year.

Basin wise reservoir levels improved with 12% above long term average levels.

Overall, in the month of August, yields came down by 6-7 bps across the curve as expectations of monetary easing in the US firmed up along with other developed markets helping bond market. The benchmark 10yr bond yield ended the week and the month at 7.86% while the longer end bond yields were up by 2bps on the week.

FPI inflows into debt remained stable with USD 2.14bn coming in the month of August. Cumulatively, the CYTD 2024 FPI inflows into debt have been USD 13.08 bn so far.

The OIS curve steepened with the 1yr OIS ending the week at 6.48% down 5bps while the 5yr OIS was flat and ended the week at 6.08%. INR ended the week at 83.87 little changed from last week's closing of 83.90. Brent also ended the week almost flat at 79 with the November contract at 77, showing continues weakness.

International Markets:

US bond yields were higher by 10bps as US economy continued to show strength. The benchmark 10yr US bond yield ended the week 10 bps higher at 3.90%. The US GDP numbers surprised on the upside which continued to underline the current solid growth momentum of the US economy. US GDP growth got revised higher to 3% vs 2.8% consensus. Personal consumption also got revised higher to 2.9% vs 2.3% with sizeable upward revisions to goods and services, though inflation printed in line with forecasts, markets are keenly looking forward to next week's employment data which is crucial given that the Fed is basing its case for rate cuts on the slowdown in the employment. Germany's inflation printed lower than expected and overall eurozone's inflation was in line with expectations which further buttresses the view of ECB rate cuts. It will carefully watch the impact of the unstable financial markets on the inflation outlook.

Chinese central bank did its version of operation twist wherein they bought short tenure bonds and sold long duration bonds in their bid to stop the fall in longer end bond yields.

Our View

The US Fed is all set to start cutting policy rates from September onwards and in the backdrop of global monetary easing, Indian bonds remain attractive on back of strong and stable underlying macro-economic factors and favourable demand supply dynamics at play. 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 beginning from CY25 onwards.

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