PGIM
India Mutual Fund

Fixed Income Weekly Update

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RBI can change its monetary policy stance to Neutral before starting rate cuts

Indian Markets:

Indian bond markets continued to trade in a range and were stable during the week in the absence of any major triggers. The benchmark 10yr bond ended the week at 7.06, down 2 bps over the week. The rest of the curve was also down by 2 bps over the week.

The talking point of the week was the GDP growth of 8.40% for Q3 (Oct-Dec 2023) which was much higher than street estimates of 6.60%. Gross Value Added (GVA) numbers were more in line with the consensus estimates at 6.50%. This makes it a third consecutive quarter of 8% plus growth after revisions to growth in the first half of the fiscal year (Apr-Sep).

The GDP numbers for FY22 and FY23 were also revised. For FY22, growth was revised higher at 9.7% (prior 9.10%) and for FY23 growth was revised a tad lower to 7% (prior 7.20%). Thus the GDP estimate for FY24 has been revised higher to 7.60% from 7.30% earlier. There are noises that the GDP growth for Q3 is exaggerated but there can be no denying that the underlying growth momentum remains strong.

Apart from the growth numbers, government also released the household consumption expenditure survey which indicated a faster pace of consumer expenditure growth for rural households. The share of food in total spending, continued to decline across rural and urban households. In real terms, the average monthly per capita consumption expenditure grew at a CAGR of 3.1% for rural households and 2.70% for urban households. The data will play a key role in reviewing economic indicators like GDP, CPI and poverty levels. The government is conducting two back to back surveys. This survey was carried out between August 2022 and July 2023 and the next survey is likely to be completed by the second half of the year.

Overnight rates eased further on the back of higher government spending with 3 month and 1yr CD rates coming down further by 5bps during the week on the back of the 10 bps rally last week. Crude was higher ending the week at 83.22, up by 2%.

The Overnight Index Swap curve (OIS) curve flattened a bit with the 1yr OIS higher by 1bps to end the week at 6.74% and the 5yr OIS lower by 4bps over the week at 6.32%.

International Markets:

Global bond yields were range bound as economic data in the US remained robust. The benchmark US 10yr bond yield was down by 7bps over the week, ending the week at 4.18% after touching a high of 4.32% during the week as value buying emerged though given the strength of the US economy and the current stickiness of Inflation, few analyst have started to expect no rate cuts from the US fed against the market pricing of around 75bps rate cuts.

In other global news, The Reserve Bank of New Zealand surprised the market by appearing dovish and less inclined to raise rates further when the market was expecting a hawkish policy with market pricing in a 25% probability of a rate hike in this meeting and a 50% probability of a rate hike in May.

Our View

The global monetary tightening has ended and we are in for a long pause on rates both domestically and internationally. RBI will also be on a long pause given the strong growth momentum 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 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 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 with fall in long end bond yields in anticipation of rate cutting cycle starting later this year.