PGIM India Mutual Fund

Fixed Income Weekly Update

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Escalating Conflict in Middle East Puts Brakes on The Bond Rally

Indian Markets:

Bonds had a volatile week as a deteriorating geopolitical situation and retracement of US rate cut expectations led to risk aversion and profit booking as yields went up across the curve. The benchmark 10yr bond yield ended the week at 6.83%, up 7bps over the week. Bond yields were higher by 6-7 bps across the curve as brent crude jumped almost 7% following the escalation in the ongoing middle east conflict as concerns grew on the future production and supply of Iranian crude. Rise in US bond yields put further pressure on the domestic bond curve. INR also came under pressure and ended the week at 83.97, depreciating by 27 paise from last week's closing of 83.70 as the dollar index jumped on better than expected economic data in US. INR depreciation came about even as India's forex reserves crossed USD700bn to be the fourth largest in the world.

Monsoons were satisfactory this year with the highest rainfall since 2020 and recording the lowest number of sub divisions (3 out of 36) with deficient rains. Overall, the monsoon is set to be 7-8% higher than the long period average (LPA), thus falling under the above normal category. This marks the sixth year in a row that India has witnessed normal to above normal rainfall in the season. Rains in late September, particularly in UP, augur well for soil moisture for Rabi crops which will be sown from late October onwards. Central India had the highest surplus with 20% higher than normal rainfall.

GST collections rose 6.50% in September to Rs. 1.73 lac cr, the slowest growth over the last three years, suggesting some slowdown. GST revenues for the upcoming festive season will be keenly watched for any signs of a sustained slowdown.

RBI released its audit report on Gold Loan NBFC's in the backdrop of record gold loan growth across banks and NBFCs. Gold Loan sanctions in Q1FY25 grew 26% YOY and 32%, over the march quarter. According to RBI's sectoral data on bank credit for Aug 2024, Gold loans grew nearly 41% on a YOY basis.

FPI inflows into debt accelerated as inflows topped USD 4bn in September with the cumulative YTD CY25 FPI inflows into debt crossing USD 17bn.

Money Market yields came down after the elevated levels seen during the quarter end as liquidity eased in the banking system. December maturity Bank CDs are trading in a range of 7.05%-7.10% and 1yr CD's trading around 7.55%

OIS curve also trended higher following the rise in bond yields both domestically and globally. The 1yr OIS ended the week at 6.46% up by 7bps while the 5yr OIS was higher by 10 bps and ended the week at 6.13%.

The three external members of the MPC were announced ahead of The MPC meeting on 9th October. The three new members are Prof. Ram Singh, Director – Delhi School of Economics, Dr. Nagesh Kumar – Director & Chief Executive – Institute for Studies in Industrial Development and Saugata Bhattacharya – Economist.

In a positive development, FTSE Russell told investors that it had very positive meetings with India's securities regulator on access to the bond market, ahead of its decision on the review to include India's FAR bonds on Oct 8th.

International Markets:

Global and US bond yields inched higher as the US employment data exceeded all expectations and it led to paring of bets on the Fed rates cuts. This shows that the US economy remains resilient and the bond yields gave up most of their gains since august. The benchmark US 10yr bond yield ended the week at 3.97%, higher by 20bps over the week. The bond markets are now pricing in about 50bps rate cut for the remainder of the 2024. Yields may find it difficult to move lower from the current levels, especially the long bond yields, in the absence of a meaningful downturn in the US economy. Inflation data will be crucial for the trajectory of bond yields. All eyes are on China after the big bang monetary easing over the last week and markets are waiting for any further stimulus in the form of fiscal easing. As tens of thousands of dock workers went on an indefinite strike in most of US ports, it led to a shutdown for the first time in 50yrs, threatening significant trade and economic disruption.

Our View

As the US economy shows incredible resilience, bond markets have pared their expectations of rate cuts in US, a similar theme which has been repeating itself over the course of the last many quarters. we expect the Fed to continue with its rate cutting cycle though at a calibrated manner. Indian bonds remain attractive on the back of strong and stable underlying macro-economic variables with 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. The start of the rate cut in US has increased the probability of a December rate cut by the MPC.

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 CY25.

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.