PGIM
India Mutual Fund

Fixed Income Weekly Update

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Puneet Pal
Head - Fixed Income

Indian Markets:

Bond Yields were steady this week as crude oil sold off towards a more than three month low even as the middle east conflict raged on. Stable global bond yields and lower crude helped Indian Bond yields as the benchmark 10yr bond ended the week at 7.30% almost flat from last week's closing of 7.31% but the real surprise of the week was INR. INR closed at its lifetime low against the US dollar at 83.34 after touching an intra-week high of 83.50. Though the week over week movement in INR is minor but the all-time low weekly closing is significant given the fall in crude and the continuous intervention in the market by RBI. Within the emerging market and Asian currencies also INR is a relative underperformer since the start of this month. The dollar index which had weakened post the Fed meeting at the start of the month strengthened toward 106 again after some hawkish comments by Fed Chairman Powell. Government announced the extension of the PMGKAY scheme for next 5yrs under which the government supplies 5kg of food grain free of cost to eligible families. Though the immediate fiscal cost is likely to be met by higher revenues as net direct tax collections rose 21.8% from last year crossing 58% of the budgeted target, which presents a healthy revenue picture for the government but nonetheless this kind of announcement can give rise to competitive populism ahead of elections. Banking system liquidity remained tight through the week on lack of government spending and FX intervention by RBI as overnight rates tracked the MSF rate of 6.75%. We estimate that the government cash balance is running close to INR3.5trn which is leading to the current liquidity tightness. After a gap of eight months India's goods export rose for the first time in October. This is based on preliminary data and base impact is there, it still shows that demand is not as weak as thought of earlier. Another interesting news which came this week was that patents filed by Indian applicants grew by 31.6% in 2022 according to World Intellectual property organisations thereby extending an unbeaten 11 yr run of growth unmatched by any other country among the top 10 patent filers.

The overnight Index swap curve (OIS) curve was stable during the week in line with bond yields domestically and globally. The 5yr OIS was down by 3bps ending the week at 6.55% and the 1yr OIS was lower by 1bps ending the week at 6.88%.

International Markets:

The global bond markets were stable while showing a downward bias in yields most of the week before some hawkish comments by the Fed chairman and a weak 30yr auction led bonds to give up some of their gains. The benchmark US 10yr Bond ended the week at 4.65% up 8 bps on the week The US Fed is, in our view, done with rate hikes and is going to be on a long pause. The lower issuances of longer tenure US bonds as announced by the US treasury last week has led to a downward tick in yields but it may not change the long term challenge of funding a higher fiscal deficit over the coming years, which gives support to the higher for longer narrative. Rating agency MOODY's changed its credit outlook on US to "negative" from stable The dollar index strengthened after falling almost 1.50% from its peak. It ended the week at 105.68. Next weeks Inflation number is expected at 3.30% and will be crucial in determining whether the recent soft economic and jobs data is being accompanied by softer inflation also. The university of Michigan Inflation expectations rose to a 12yr high.

The Reserve Bank of Australia hiked rates as expected while increasing its Inflation forecast.

Meanwhile 2023 is on course to be the warmest year ever recorded .....

Our View

We believe that global monetary tightening has come to a pause though rate cuts are still sometime away. RBI will also be on a long pause with government taking fiscal steps to manage Inflation. We think that the broad range of the benchmark 10yr bond yield will be between 7.20% to 7.45% over the next couple of months. Given the recent rise in yields which has pushed back the expectations of rate cuts, yields have entered attractive territory and investors can look to increase allocation to Fixed Income as growth is expected to slow down towards the end of the year.

Investors with medium to long term investment horizon can look at funds having duration of 3-4yrs with predominant sovereign holdings as they offer a better risk reward currently. Investors having an Investment horizon of 6-12 months can look at the money market funds as yields are pretty attractive in the 1yr segment of the curve.