PGIM India Mutual Fund

Puneet Pal
Head - Fixed Income

Fixed Income Weekly Update

9th October - 13th October 2023

Indian Markets:

The bond sell off induced by the hawkish than expected RBI policy on 6th abated a bit as inflation came in lower than expected. CPI inflation came in 5.02% below consensus expectations of 5.40% led by broad based deceleration of food prices. Food and core inflation both came down with core inflation coming in at 4.50%, which is a 43 month low. Given the base impact, inflation can come in likely below 5% next month. The lower headline and core inflation numbers provided a cheer to the bond markets. The benchmark 10yr bond which closed at 7.35% last week and went to a high of 7.38% during the week before closing the week at 7.32% helped by lower inflation as value buying started. The violence in middle east led to a crude price spike as brent ended the week at 90.89 up more than 7% from the last weeks closing of 84.58. INR was stable during the week despite the rise in crude prices and the strength in dollar index, as RBI was active in the FX market. The curve steepened marginally with shorter end outperforming.

Some segments of the market are expecting that RBI will not do open market sales (OMO) of bonds as announced in the policy on 6th as liquidity will remain tight on account of expected increase in currency leakage (CIC) and RBI will not need to use OMO's. Either way, we continue to believe that the announcement of OMO's by RBI was meant to be a yield signal as there are other tools available to RBI for managing liquidity.

Money market rates stayed elevated anchored to the MSF rate as banking liquidity remained tight on suspected RBI intervention. Dollar Index continued to strengthen ending the week at 106.65 up from last week's closing of 106.10

The overnight Index swap (OIS) curve came down due to lower inflation and aided by lower US yields. The 5yr OIS ended the week lower by 22bps at 6.65% and the 1yr OIS was lower by 9bps ending the week at 6.95%.

International Markets:

The higher for longer rate theme continued to dominate the narrative in the global bond markets even as yields retraced a bit from the highs touched earlier in the month. US PPI inflation came in higher than expected while CPI inflation came in line with expectations. The US yield curve has continued its steepening trend as the US bond market recalibrates its expectations of rate cuts next year amid the higher for longer theme and are now pricing in rate cuts to begin form September 2024 relative to the earlier expectations of rate cuts starting from May 2024. US economic data continues to come in strong with jobs data last week coming in better than expected. Growth in Europe is moderating rapidly. The benchmark US 10yr yield ended the week at 4.61% down almost 20bps from the previous weeks closing of 4.80% helped somewhat by the ongoing crisis in middle east. The contradiction of a loose fiscal policy and tighter monetary policy in US is not lost on the markets and the yields at the longer end of the US treasury curve are reflecting concerns of a looser fiscal policy as the higher supply of US treasuries keeps yields elevated.

Our View

We believe that global monetary tightening has entered its last phase with key central banks like the Fed and BOE pausing on rate hikes. 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 7.60% 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.