PGIM
India Mutual Fund

Fixed Income Weekly Update

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Dynamic Bond Funds and Gilt Funds are likely to do well with fall in long end bond yields

Indian Markets:

The last week of FY24 saw decent action in the Indian bond markets as record high SDL issuance at the beginning of the week pressurised the yields at the longer end of the curve but a lower than expected borrowing calendar for H1 of FY25 led to lower yields on the last day of the month. The gross central government borrowings as detailed in the indicative calendar for the first half of FY25 came in at INR 7.5 trn, which is 53% of the total gross borrowings for FY25. This was lower than market expectations. The market was expecting H1 borrowing being at 58% of the total gross borrowings. In terms of percentage borrowing for first half, this is the lowest since FY19.

The supply in the 10yr segment is the highest at 25.60% of the total H1 FY25 supply. The supply in the 30-50yr segment is at 37.30% of total H1 supply. The indicative calendar for gross SDL borrowing for Q1 FY25 came in at INR 2.54 trn, slightly higher than expectations.

Given the lower than expected H1 supply and the inclusion of FAR bonds in the JP GBI-EM Index, the demand supply scenario is favourable. FTSE held off adding India to its Emerging Market Bond Index this time while continuing with the “watchlist “status. FTSE cited documentary requirements for FPI registration, inflexible length of the settlement cycle and the tax clearance process as some of the reasons for not upgrading India to the Index.

A RBI circular on taking exposure to currency derivates (effective April 5) may significantly impact the volumes in the onshore currency derivates market. The interpretation of the circular is being taken as only hedgers of currency risk capable of establishing underlying exposure can participate while others may not be able to.

INR ended the week and the month at 83.40 slightly better than the all-time low closing of 83.43 last week. This is even as India’s FX reserves rose to an all-time high.

The benchmark 10yr Bond yield ended the week 3 bps lower at 7.06%. Money Market yields came under pressure as liquidity remained tight after advance tax and GST outflows. 1yr CDs were trading between 7.55%-7.65% and 3 month CD yields were trading between 7.50%-7.60%.

Brent stayed elevated and ended the week higher at 87.48 up 2.40% from last week’s closing of 85.43. The Overnight Index Swap (OIS) curve yields came off marginally in line with Gsec yields with the 1yr OIS ending the week at 6.75% lower by 2bps and the 5yr OIS ended the week lower by 5bps at 6.34% compared to last weeks closing.

International Markets:

Global bond yields were stable during the week after a spate of central bank meetings in the week prior. Fed speakers reiterated that there was no rush to cut rates early even as the Fed’s preferred gauge on Inflation, the PCE data, came in line with market expectations.

Policy makers in Japan had to verbally intervene after the Yen declined to the lowest versus the US dollar since 1990. The benchmark US 10yr treasury yield remained flat over the week, closing the week at 4.20%. US growth indicators continue to be strong and certain segments of the market remain sceptical to the projection of rate cuts by the US Fed. Gold continued to rise closing at a record high of USD 2229.87 even as the dollar continued to be strong with DXY closing the week at 104.49.

Meanwhile…

Chocolates can taste bitter as cocoa became more expensive than copper topping USD 9000 a ton for the first time ever as a supply crunch griped the market. Cocoa futures are up more than 50% in a month and have already more than doubled this year. Poor harvests and crop disease in west Africa are the chief reasons behind the supply crunch.

Our View

The global monetary tightening cycle has effectively ended and the developed market central banks are sounding dovish even as growth holds up leading to a scenario of a soft landing.

Indian growth is holding up pretty strong but with core inflation at multiyear lows gives RBI room to cut rates later this year. 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 Q2/Q3 CY24.

Investors with medium to long term investment horizon can look at 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.