PGIM
India Mutual Fund

Fixed Income Weekly Update

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Puneet Pal
Head - Fixed Income

Indian Markets:

Bond Yields came down with a flattening bias this week as crude oil and global bond yields came off sharply in response to lower inflation. The benchmark 10yr bond yield came down by 10bps ending the week at 7.21%. The trigger for the bond rally was more than 4% fall in crude oil prices and a sharp fall in global bond yields as markets firmed expectations of a pause in the global monetary tightening cycle and ramped up their expectations of rate cuts for next year. CPI came in line with expectations and core inflation came in at 4.30% continuing with its downward trend. The continuous tightness in interbank liquidity has negated any immediate need for RBI OMO sales, which has provided comfort to the market and led to the flattening of the yield curve. The fact that oil has come off sharply even as the conflict in middle east is ongoing, is also positive for the bond markets over all as it signals that the demand is weakening. The surprise continues to be INR as it closed the week just a shade better at 83.27 against the last weeks closing of 83.34, which was an all-time low against the US dollar. Perhaps the record high trade deficit of USD31.5bn in October has a role to play even as both exports and imports accelerated. On a YOY basis exports rose by 6.20%, showing highest growth since December last year while imports rose by 12.30%, a 13th month high growth. Gold imports rose by 95.4% yoy. Most likely this is a one off number as 70% of the uptick in imports is due to higher oil, gold & silver imports. Banking system liquidity remained tight through the week on lack of government spending. We expect Banking system liquidity to remain tight as currency in circulation is likely to pick up pace going ahead.

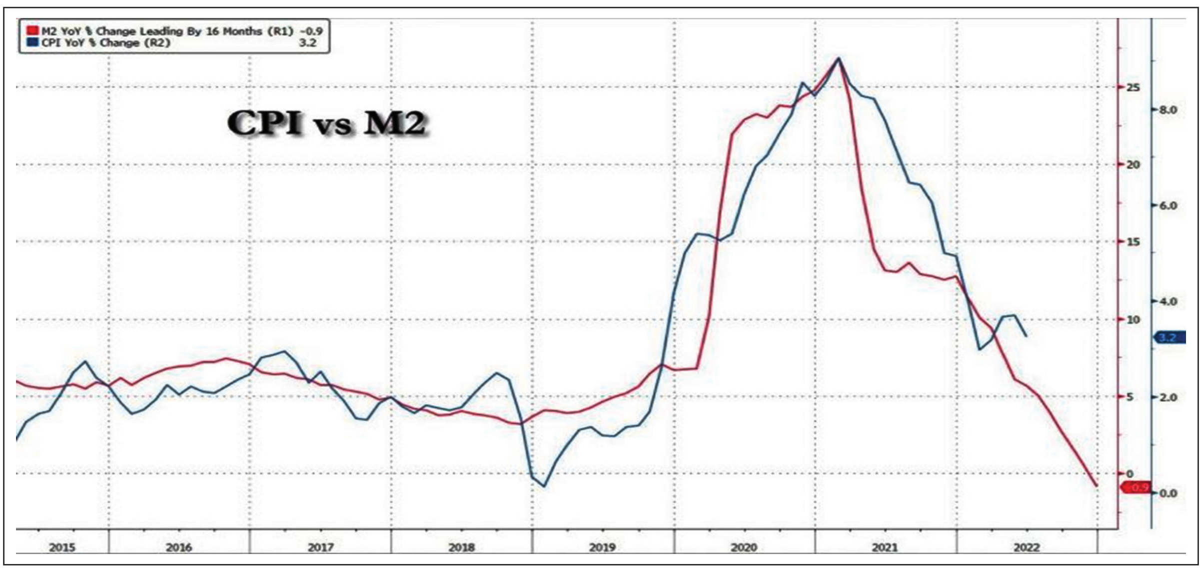
RBI followed up on its caution on unsecured lending, personal loans and credit card outstanding by increasing the risk weight on consumer credit, credit card receivables and loans to NBFC's while exempting home, auto and educational loans. To put things in perspective personal loans have increased by 25% yoy and credit card outstandings have increased 30% yoy.

The overnight Index swap curve (OIS) curve came down during the week. The 5yr OIS was down by 10bps ending the week at 6.45% and the 1yr OIS was lower by 4bps ending the week at 6.84%, following the flattening trend as seen in the bond market.

International Markets:

The global bond markets continued with their downward trend from last week as inflation came in weaker than expected in US and UK while in Europe it was in line with expectations. The rally in bonds started after the Fed meeting at the start of the month with the markets firming up their expectations of a rate pause and with the soft employment data along with weaker inflation, US treasury market is pricing in rate cuts from June 2024 onwards. The benchmark US 10yr Bond ended the week at 4.45% down 20bps on the week. Global central banks are done with rate hikes though rate cuts are still some time away. The dollar index weakened to 103.90, down 1.68% from last week's closing. US treasury maturities for 2024 are being pegged at USD 8trn, which presents a huge challenge though a major portion is in treasury bills. This refinancing along with the next years fiscal deficit of US which is likely to be in the vicinity of USD 2 trn, not only presents a challenge to US policy makers but also means that dollar liquidity will be moving back to US.

Meanwhile US M2 growth has been decelerating and US inflation is also trending lower, it will be interesting to see if this trend continues with rates at multi year highs along with the Fed QT.



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. We think that the broad range of the benchmark 10yr bond yield will be between 7.15% to 7.35% 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 attractive in the 1yr segment of the curve.