PGIM
India Mutual Fund

Fixed Income Weekly Update

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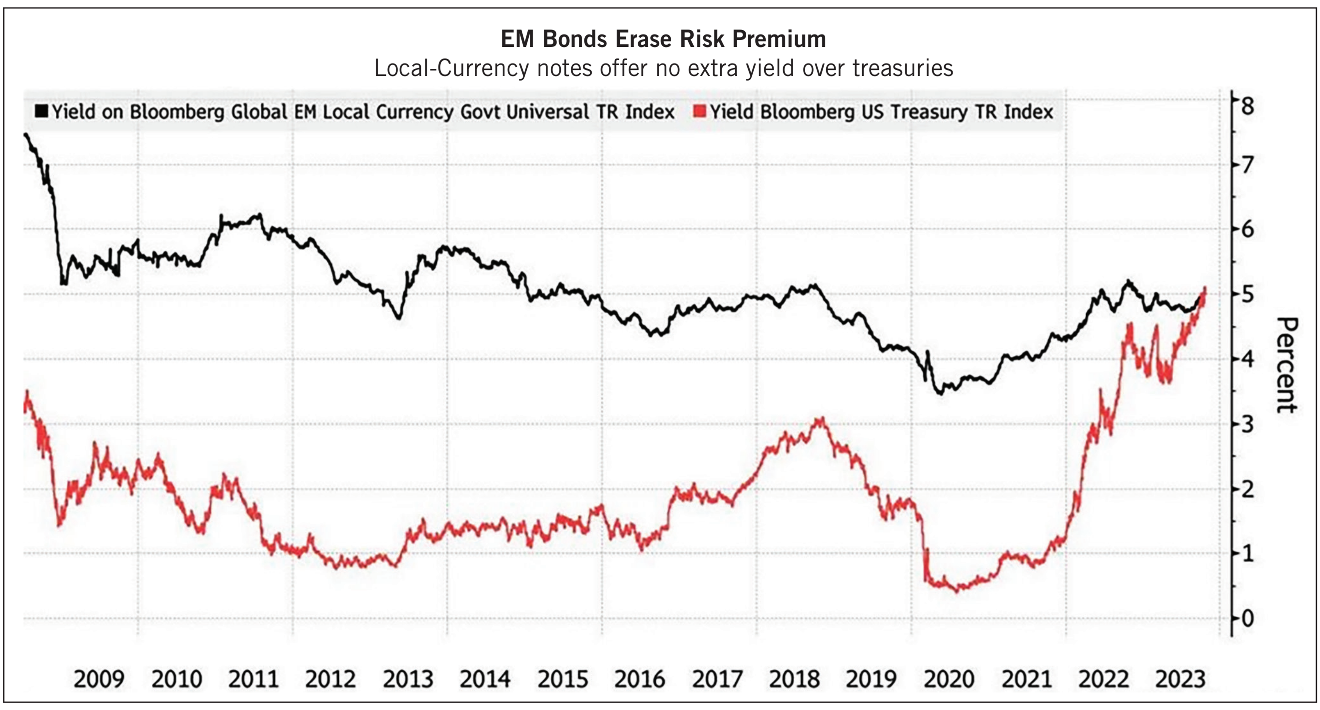
Puneet Pal
Head - Fixed Income

Indian Markets:

Indian Bond yields were stable during the week amidst continuing uncertainty on the geopolitical front. The benchmark 10yr bond yield ended the week at 7.36% flat from last weeks close. The weekly statistical statement of RBI released after market hours on 27th showed OMO sales worth INR 4175 cr last week (16th -20th Oct). Thus it seems it is a matter of time before RBI formally announces the conduct of OMO sales as OMO sales on the NDS OM platform when the banking system liquidity is already tight with overnight lending rates hugging the MSF rate of 6.75% indicates that RBI is giving a yield signal apart from sucking out liquidity. Crude prices remained elevated above 90 during the week ending the week at USD 90.40 slightly lower from last week's closing of 92. INR traded in a narrow range throughout the week depreciating marginally ending the week at 83.25 from the last weeks closing of 83.12. US dollar continued to strengthen ending the week at 106.56 from last week's closing of 106.16. Despite the strength in the US dollar and the elevated global bond yields, Gold continued to go higher on back of escalating conflict in middle east ending the week at 2016 up almost10% from the recent lows just before the middle east conflict erupted.

Emerging market currencies are coming under pressure as interest rate differentials with advanced economies come to historically low levels.



Source: Bloomberg

There is substantial amount of intervention in the FX market by RBI to ward off the pressure on INR due to US dollar strength and this is leading to tightness in banking liquidity. This FX intervention and the expected increase in currency in circulation due to festival seasons and upcoming state election will lead to outflows from banking sector liquidity but this outflow will be matched by the maturity of FX swaps next week (USD 5bn) and the substantial amount of Government securities maturities lof over INR 2 trn lined up over the next two months.

Money market rates stayed elevated anchored to the MSF rate as banking liquidity remained tight on RBI intervention in the FX market.

The overnight Index swap curve (OIS) curve was range bound during the week and was marginally lower tracking slightly lower global bond yields. The 5yr OIS was down by 6bps ending the week at 6.71% down 6bps from the last weeks closing of 6.77% and the 1yr OIS was lower by 3bps ending the week at 6.97% from 7.00% last week.

International Markets:

Global bond yields were relatively stable during the week as value buying emerged in US treasuries along with some high profile traders and managers covering their short positions in US treasuries. The benchmark US 10yr bond yield ended the week 8bps lower even as the PCE inflation in US printed slightly higher than expectations. The strength in the US dollar continues to put pressure on emerging market currencies and after the surprise hike by the Indonesian central bank, the Philippines central bank also hiked rates in an out of the turn meeting. The higher for longer rate theme continues to play but we think that after the relentless rise in US and global bond yields over the last 3-4 months, yields can take a breather and stabilise with some retracement possible over the next couple of months. Global geopolitical scenario is stoking a risk off scenario which can lower US yields along with continuing US Dollar strength putting pressure on emerging market currencies. In this backdrop, emerging market central banks are likely to continue with their tight monetary policy stance. The ECB held rates as widely expected and markets now keenly await the Bank of Japan meeting which can signal an exit from the ultra loose monetary policy as Inflation pressure keep rising in Japan.

Meanwhile Ford Motor co. reached a tentative agreement with the United Auto workers union for a 25% hourly wage increase over the life of the contract which exceeds four years along with cost of living increases with the top wage rate expected to increase by 33% to be over US$40 an hour.

Our View

We believe that global monetary tightening has entered its last phase and global central banks will be on a long pause on rates. 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.