Fixed Income Weekly Update

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Indian Bond Yields remain stable:

Indian Bond Yields were stable during the week after an uptick in yields last week. Markets were keenly awaiting the Q2 FY24 GDP data for further guidance and also given the divergence between the estimates of RBI and the analyst community in respect of the GDP forecast for FY24.

The central bank has been consistently saying that India's growth will surprise to the upside while the analyst community was circumspect due to global headwinds and concern on rural growth. The GDP growth for Q2 came in much above consensus expectations at 7.60% while the consensus was 6.80% -7.00%. Industrial growth was higher led by manufacturing and construction compared to services. Agriculture growth was weaker than last quarter.

Government spending was one of the main reasons for stronger growth at 12.4% while gross fixed capital formation came in at a five quarter high of 11%.The growth number underscores the prevailing goldilocks scenario in India. Worldwide growth is becoming a concern and in such scenario India is an outlier with high growth and stable macro's. After the robust growth numbers almost all analysts have upped their growth forecast for FY24.

Now analysts expect FY24 GDP growth to be around 6.70%, which is higher than RBI's forecast of 6.50%. We expect RBI to revise its growth forecast higher in the next weeks MPC meeting. GST collections for the month of October grew by 15% to Rs.1.67 lac crore highlighting the strong domestic demand in the festival season. Given the strong growth numbers bond market yields inched up a bit ignoring the fall in global bond yields as well as crude oil prices.

The benchmark 10yr Bond yield was higher by 2bps ending the week at 7.29% from last weeks closing of 7.27%. The market action was generally lacklustre throughout the week as selling emerged at lower yields. The tightness in interbank liquidity continued leading to elevated money market yields. INR continues to be under pressure touching an all-time low of 83.40 during the week though INR strengthened a bit by the end of the week closing the week at 83.30 slightly better than last week's closing of 83.38. Crude dipped below 79 even as OPEC+ continued with voluntary production cuts.

The Overnight Index Swap curve (OIS) curve moved down in line with the fall in global bond yields. The 5yr OIS was down by 5bps ending the week at 6.53% from 6.58% last week and the 1yr OIS was also down by 4 bps ending the week at 6.88% from last week's closing of 6.92%.

International Markets:

The global bond yields continued on their softening trend with US Fed speakers including chairman Powell by and large sounding dovish and both the bond and the equity markets did well as the narrative of a soft landing gathered momentum. The benchmark US10yr bond yield was down by 27bps on the week ending the week at 4.20% from the last weeks' closing of 4.47%. Preliminary readings showed softening in European Inflation.

Next week will be crucial as we have the US employment data which will be important to see if the trend of softer economic data continues. The US treasury market is pricing in 100 bps rate cuts in 2024. The reserve Bank of New Zealand left rates unchanged but sounded hawkish on inflation concerns. The Dollar Index fell slightly though found support at lower levels ending the week at 103.27 from the last weeks closing of 103.40.

The OPEC+ meeting agreed on a voluntary cut in production of a million barrels a day but the market was not convinced given the lack of cohesion in the group and the uncertain demand outlook in 2024. Brazil, one of the fastest growing oil producers will join OPEC from 2024. Gold continued its upward march and it will be interesting to see if its able to go above its all-time high levels.

Our View

We believe that global monetary tightening has come to a pause though rate cuts by major central banks are still sometime away. RBI will also be on a long pause. Investors can look to increase allocation to Fixed Income as growth is expected to slow down in 2024 with expected rate cuts and fall in yields.

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 Money Market Funds as yields are pretty attractive in the 1yr segment of the curve.