PGIM
India Mutual Fund

Fixed Income Weekly Update

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Indian Markets:

Bond yields edged higher in the last two days after being stable through the week. The erratic distribution of monsoons and global geopolitical developments sustain the concerns on food Inflation. The rise in global bond yields is also pressurising domestic yields. The benchmark 10yr bond yield was up 7bps on the week largely on back of higher global bond yields led by the surprise tweaking of the Yield curve control (YCC) by the Bank of Japan. Money market yields were largely stable during the week though on the last day of the week the overnight lending rates went higher as higher amount was lend in the 14day Variable rate reverse repo (VRRR). IMF increased the forecast for India's GDP growth for FY24 to 6.10% and expectations increased of India becoming the 3rd largest economy in the world by FY28. Monsoons fully covered the earlier deficit and were at 5% above the long term average as on 25th July though the distribution of monsoons remains skewed and is a cause for concern. According to an HDFC bank report, 1/3 of all India districts have received normal rainfall, 1/3 received excess rainfall and in 1/3 of districts rainfall was in deficit. Overall Kharif sowing was up 1.20% YOY though pulses sowing was down 9.80% YOY. The threat of EL NINO has not fully abated and the monsoons trend needs to be watched in August/September as EL NINO generally impacts the second half of the monsoons.

Government's effort to combat food price inflation is seeing some initial success as prices of non-basmati rice has fallen after the government announced a ban on its exports though it has created some panic abroad with surge in prices of basmati rice as people fear that it can also be banned. Wheat prices remain stable and pulses are also expected to stabilise going ahead as pulses imports are expected to pick to close to 12 lac tonnes up 35% from last year.

NREGA outlay may increase as 58% of the budgeted amount INR 60,000cr has already been utilised in the first quarter of the financial year. There has been a wage increase of 10.4% hike. In FY23, spend on NREGA was INR 90000 cr against the budgeted amount of INR 73000 cr.

India is looking to set up its own International Financing messaging system along the lines of SWIFT, being part of the government's bigger plan to increase the internationalisation of INR. An expert committee of Bankers is looking at options and expected to submit findings by August.

The price of brent crude rose above its 200 day moving average to touch US84 a barrel. In fact both the Bloomberg and Reuters commodities Index is showing an uptrend. INR depreciated on the last day of the week after staying stable throughout the week as DXY (Dollar Index) rebounded above 101 from the low of 99.50 couple of weeks back.

The overnight Index swap curve (OIS) has been rising steadily since the last RBI Meeting in April and is now pricing in RBI rate cuts from H2 of CY24 though it remains inverted. The 1yr OIS is currently trading at 6.86% up 8 bps on the week and the 5yr OIS is trading at 6.48% up 18 bps in the week.

International Markets

Bank of Japan made the most headlines as it tweaked its yield curve control (YCC) policy by increasing the "flexibility" of the range. It kept its policy rate unchanged at -0.10%. The change in the YCC range was a surprise and lead to higher yields across global markets. BOJ stated that it will conduct YCC with greater flexibly de facto increasing the upper threshold of the 10yr bond yield by 50bps to 1%. During the week, we had meetings of the US Fed which raised its policy rate as expected by 25bps and the ECB which also raised rates as expected. The Fed and the ECB were neutral in their guidance while keeping the door open for further hikes depending upon data. Overall economic data in US came in strong with the flash Q2 advance GDP growth estimates coming in at 2.40% against expectations of 1.80%. The residential housing market in US remains strong. PCE deflator came in slightly lower than expected. The benchmark US 10yr Bond yield is higher by 11 bps on the week. European economic data has started to moderate. Chinese economy continues to be sluggish with more stimulus expected by markets. We think that the synchronised global monetary tightening is in its last stages and continue to believe that the aggressive rate hikes done so far will have an impact on growth, given the lagged impact of monetary policy, Slower economic growth is on the anvil by end of CY23.

Meanwhile....

Japan's population declined in all its 47prefectures for the first time in a record drop, while its number of foreign residents hit a new high. Japan's population has fallen for the 14th straight year.

July 2023 will be the hottest month ever recorded according to climate scientists..

What is a Minsky moment

A Minsky moment is a sudden, major collapse of asset values marking the end of the growth phase of a cycle. According to this hypothesis, the rapid instability occurs because long periods of steady prosperity and investment gains encourage a diminished perception of overall market risk. The term was coined by Paul McCulley of PIMCO in 1998 and is named after economist Hyman Minsky.

Our View:

We believe that global monetary tightening is entering its last phase. RBI will be on a long pause in spite of higher Inflation prints expected for the next couple of months on back of higher food prices especially vegetables. This quarter (July-Sept) is quite heavy on net supply and we might see some pressure on the belly of the curve, we think that the broad range of the benchmark 10yr bond yield will remain between 7% to 7.25%. Given the recent rise in yields which have pushed back the expectations of rate cuts, yields are entering attractive territory and it is the right time for investors 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.