PGIM
India Mutual Fund

Fixed Income Weekly Update

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We expect Indian bond yield curve to remain flat amidst favourable demand supply dynamics

Indian Markets:

Bond markets remained stable during the week on lack of any major triggers. The 2-5yr segment of the curve outperformed the rest of the curve as yields in the 2-5yr segment were down 2-4 bps while yields remained flat in other segments of the curve. The benchmark 10yr Bond yield remained stable, ending the week at 6.99%.

Monsoons improved in some regions though the cumulative rainfall remains 2.8% below long term average. Cumulatively, rainfall was normal in south, north-west, east and north east India and was below in central India. Out of the 36 sub divisions, till date, 11 have received deficit rainfall, 18 have received normal rainfall and seven have received excess rainfall.

The trend in sowing is good and as of July 8th, total kharif acreage was 14.1% higher than the same period last year which bodes well for food inflation going ahead. Basin wise reservoir levels remained deficient and overall basins and reservoirs levels were around 11% below long term average for week ending July 11th. CPI Inflation rose to a 4 month high coming in higher than expected at 5.10% led by higher food prices especially vegetables. Headline CPI (ex-vegetables) rose 3.50% YOY from 3.40% in May. "Core" Inflation remained stable at 3.10%.

The RBI Governor, in an interview, indicated that there was no rush to cut rates and the growth momentum remains pretty strong. We have also been sharing the view that we do not expect any immediate rate cuts though given the positive real rates and the start of the rate cutting cycle in advanced economies will eventually lead to rate cuts by RBI in CY2025. Meanwhile, the wedge between deposit and credit growth continues as bank credit rose 14% while deposits grew at 11% on a YOY basis even as both deposits and credit lagged last year's growth.

The RBI deputy Governor Dr Michael Patra expressed optimism that the Indian economy can become the second largest economy in the world by 2031 and the largest economy by 2060 rising on the back of a stable investment rate, macroeconomic and financial stability, favourable demographics and other growth multipliers.

FPI inflows into debt continued at a steady pace exceeding USD1bn (till 12th July) bringing the cumulative inflows into debt at USD 9.28 bn in CY2024.

The OIS curve came down in line with global yields with the 1yr OIS ending the week 4bps lower at 6.74% while the 5yr OIS was down 6bps ending the week at 6.36%. INR was steady and remained range bound ending the week at 83.54 even as brent crude remained elevated at 85.00.

Money Market yields came down a tad by 3-4 bps as liquidity in the banking system increased on the back of higher government spending and FX inflows with the September maturity Bank CD yields trading around 7.00%.

International Markets:

US yields were lower during the week as Inflation came in lower than expected and markets started discounting 50 bps rate cut by the end of CY24. The lower inflation follows a spate of relatively weak economic data in the US and the benchmark 10yr bond yield ended the week at 4.18%, down 10bps on the week. DXY weakened in line with weaker economic data, ending the week at 104.09 down from last week's closing of 104.88. Japanese authorities intervened in the currency market post the release of US inflation numbers and the Yen retraced from its lows ending the week at 157.83.

Our View

We expect Indian bond yield curve to remain flat amidst favourable demand supply dynamics though the progress of monsoons will be the key factor to access the trajectory of Food inflation and subsequently RBI's stance on the monetary policy. The scope for rate cuts in India is on account of high real positive rates and the need to encourage private investment and there is a fair probability of rate cuts in the second half of FY25, though any rate cuts in India will follow the start of the rate cutting cycle in advanced economies and will not precede them.

Bond yields tend to move in advance of rate action and investors can look to increase allocation to Fixed Income at every uptick in yields. We expect long bond yields to continue to drift lower over the next couple of quarters. We expect the benchmark 10yr bond yield to go towards 6.50% by Q4 of FY25.

Investors with medium to long term investment horizon can look at Dynamic Bond Funds having duration of 6-7yrs 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 too.

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