Nippon india Mutual Fund

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Fixed Income

Market Outlook

May 2024

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Fixed Income Market Update and Outlook

Market Update

Global Financial market repricing & Extended long pause in policy rates

April 2024 witnessed sharp repricing of assets across the global financial markets. Recent rhetoric of global central bankers, stronger than expected growth data and grudging acceptance by market participants of slower and delayed start in the rate cut cycle resulted in ***volatility in global fixed income and currency markets*** during April'24. Further, the sharp rise in geo-political tensions and growing uncertainty added uncertainty risk premium to the already volatile markets.

India

Monetary Policy:

In Apr'24 policy, RBI maintained the status quo on policy rate and stance. While RBI expect economic growth to be robust and inflation to edge down in FY25, it highlighted the upside risk to inflation from food inflation, climate shock, rising geo-political risks and crude prices.

Inflation:

In Mar'24, CPI inflation eased to 4.85%y/y (Feb 2024: 5.09% y/y, Last year same period: 5.66%y/y), driven down primarily by favourable base effect and broad-based muted sequential momentum. Excluding vegetables, headline inflation eased further to 3.53%y/y (Previous month: 3.73%y/y; Mar 2023: 6.58%y/y). Core inflation continued to edge down to record low 3.25%y/y (Feb 2024: 3.37%y/y; Last year same period: 5.78%y/y). Average headline CPI inflation in FY24 eased to 5.4%y/y from 6.7%y/y in FY23 and was in line with RBI's projections. Core inflation eased sharply to 4.3%y/y in FY24 (FY23: 6.1%y/y).

External Sector:

Mar’24 Trade deficit moderated to US$15.6 bn (Feb 2024: US$18.7 bn; Mar 2023: US$18.7 bn; & lower than monthly average FY24: ~US$20bn) - aided by seasonality in exports and decline in sequential pick up in imports. After the robust growth in FY22 & FY23, export as well as imports declined in FY24 on easing commodity prices (including crude oil) and contraction of global trade in CY2023. Although net services exports declined in March, overall net services grew robustly at 14%y/y despite the adverse base effect (FY23: 33%y/y).

After the robust inflows in Feb-Mar 2024, FPI flows contracted by ~US$2 bn in Apr’24 on global cues. Sharp rise in UST, strong dollar led to outflows from emerging markets (including India). That said, CY2024 saw overall robust inflows in first four months to the tune of US$7.4 bn, driven primarily by debt inflows (US$5.4 bn).

On back of strong dollar, average Rupee continued to depreciate, albeit marginally against US dollar in April 2024 and stood at 83.41during the month (Mar 2024: 83).

Liquidity:

Core liquidity (system liquidity + Government balances) declined from 2.4 trn at Mar’24 end to ~1.5 trn by Apr’24 end, driven by cash leakage due to seasonally high cash demand, RBI’s actions (intervention and forex swap maturities), and higher CRR provisioning requirement. System liquidity was marginally positive at average Rs. 10,500 cr in April (Jan 2024: avg -ve Rs. 2.1 trn; Feb 2024: avg -ve 1.9 trn; Mar 2024: avg -ve Rs. 0.43 trn) on back of seasonally robust government spending.

Yield Levels & Spreads:

While Indian fixed income market yields rose in Apr'24 reflecting the global trends, the rise in Indian G-sec (IGB) yield was relatively limited. Since March end, the G-sec yield curve has moved in range of 15-20 bps, while impact on corporate bond was relatively muted (in range of 10-14 bps across curve). This vis-à-vis global trends of 20-40 bps since global asset price repricing during the month.

In Apr 2024, 10-year G-sec yield moved in the range of 7.10-7.23% during the month. 10 yr G-sec closed the month lower at 7.20% (March 2024: 7.05%; February 2024: 7.08%; January 2024:7.14%). Average 10-year term premia improved to ~13 bps during the month (Mar 2024: flattish).

Taking cues from G-sec, 10-year SDL yields moved up (range of 7.40-7.51%) to close the month higher at 7.47% (March 2024: 7.38%). April SDL primary issuances was high at Rs.51,200 cr (Apr 2023: Rs. 22,300 cr). The average spread between 10 yr SDL over G-sec eased to 29 bps during the month (March 2024: 34 bps).

Like SDLs, AAA bonds moved up a bit during the month with 10 yr AAA PSU moving in the band of 7.44%-7.559% (Previous month: 7.44%-7.55%). It closed the month lower at 7.56% (Mar 2024: 7.44%).

Global

Monetary Policy:

Better than expected economic data, relatively tight labour market, high crude prices pickup in sequential momentum of headline inflation and sticky core services and expansionary fiscal policy have resulted in postponement of start of rate cut cycle and cutting down of market expectations of overall cut. US Fed Reserve Chairman Powell, in his early May'24 Fed meeting, has clearly indicated that monetary easing might take longer than initially indicated. Amongst the advance economies, only European Central Banks (ECB) has indicated that they might start policy easing from Jun'24 onwards.

Inflation:

US inflation rose to 3.5%y/y in March 2024 (Feb 2024: 3.2%y/y; Jan 2024: 3.1%y/y). Sequential growth in headline was higher at 40 bps driven by food, fuel and core services. Global food prices continued to remain in disinflation for sixteen consecutive months, (with IMF's FAO food index down to negative 7.3%y/y in Mar 2024 vis-à-vis -ve 20%y/y one year prior). Oil prices have increased sharply since the start of calendar year 2024, with April brent prices hovering on average ~ US$89.9/barrel (Jan 2024: US$80/barrel, Feb 2024: US$83.5/barrel; Mar 2024: US$85.41/barrel), on supply concerns (Red Sea issue, middle east war, geo-political risk escalation, OPEC plus extending the supply cuts).

Financial Markets:

During Apr'24, US treasury yields rose sharply during the month driven by strong non-farm data, sticky monthly inflation print, oil movement, US Fed policy makers comments and rising geo-political concerns. US 10 Yr Treasury bond (UST) yield moved in the range of 4.31-4.70% and closed the month lower 4.69% (March 2024: 4.20%). Dollar Index appreciated by 1.54% in Apr (March 2024: +ve 0.54%; CY2024 YTD: +ve 4.8%) on rising global uncertainty.

Market View

- While Inflation has been trending downwards in recent months and is expected to ease further in FY25, the strong domestic growth, high oil prices, global geo-political uncertainty and postponement of rate cut cycle by major global central bankers have put RBI on hold.
- Going forward, the RBI rate cut cycle size and timing will be influenced by evolving domestic inflation outlook along with global policymakers' actions timeline. We believe RBI to cut the rates in 2H (Aug/Oct) of calendar year.
- In Apr 2024, the Developing Markets (DMs) space led by the US has seen very high volatility across the rates and currency markets, which may continue in the near term. However, the INR has relatively performed better across Emerging Markets, which may lead to sustainability and better rationale.
- Notwithstanding recent volatility and some uptick in yields, there is enough reason to stay constructive in Indian rates and use these corrections to add allocation and incremental duration in portfolios

Common Source:
RBI, ECB, CSO, FAO, CEIC, NSO, JP Morgan, US Federal Reserve, US Treasury department, Commerce Ministry of India, NIMF Internal Research.

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