AXIS MUTUAL FUND

FIXED INCOME OUTLOOK

AUGUST 2024

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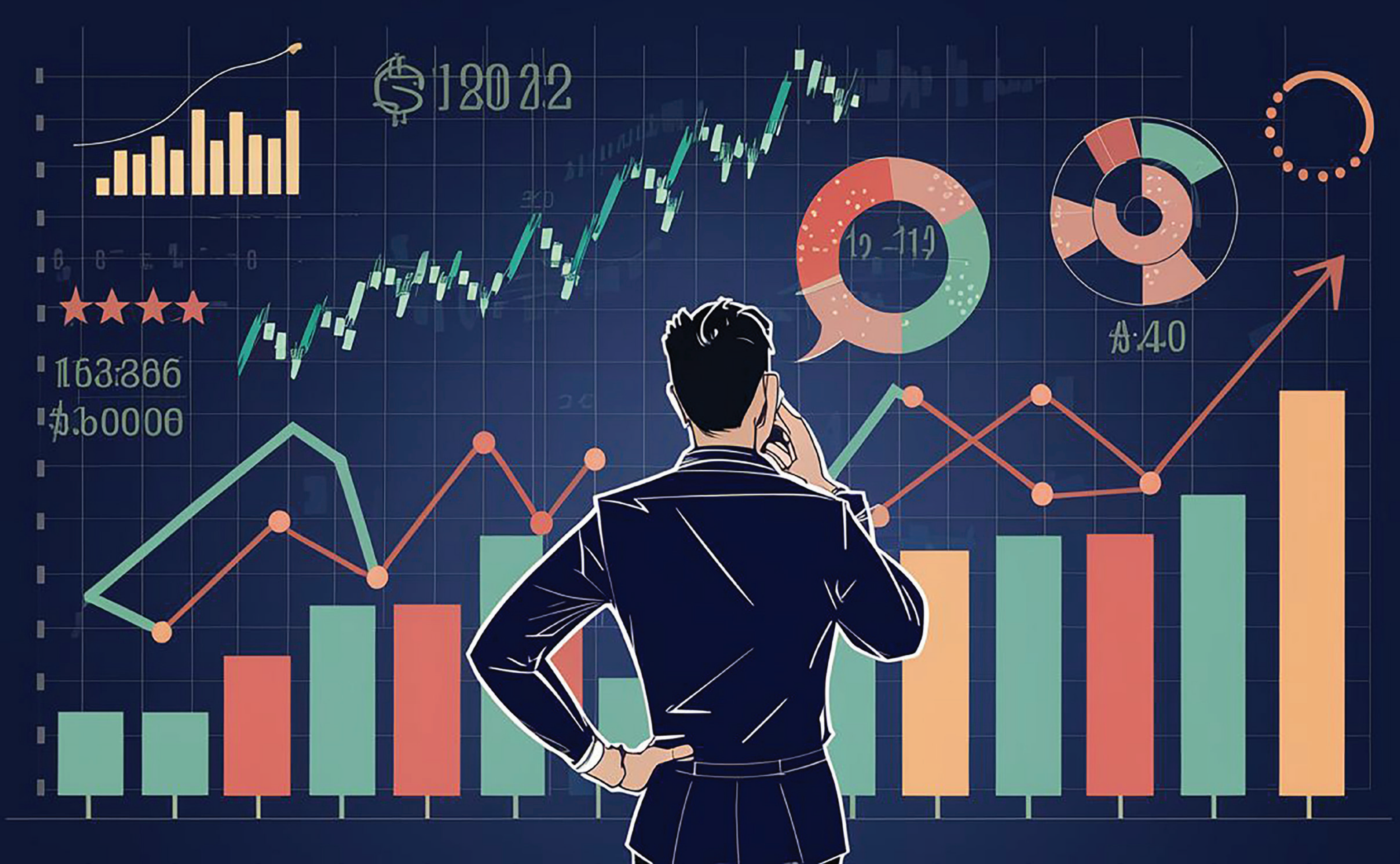

SUMMARY OF MACRO EVENTS IN JULY 2024

The month of July was positive for bond markets.

Weak Economic data in US economy, positive demand supply for bonds in India, China surprise rate cut, weak Oil and commodities prices and finally Fiscal consolidation in budget led to yields trending lower.

Banking liquidity as highlighted last month turned surplus and overnight funding rate eased from 6.65-6.7% to 6.4-6.45%.

Macro data for India especially CPI came at 5.08% v/s expectation of 4.8%, a tad higher than expectations on account of food and vegetable prices but we didn’t see any rise in yields as core inflation continued to behave well @3.1% and expectation of July CPI print is 3.3% -3.4% due to base effects.

Because of huge increase in Banking liquidity due to RBI dividend and FPI flows over last 2 months, RBI did some small amount of OMO sales ~ INR 7.5K Crore to neutralize some of surplus liquidity, impact of the same on yields was insignificant

IMPACT ON THE MARKETS

India 10-year bond yields rally by more than 10 bps over the month and US 10-year yields are down by more than 35 bps

With ease in Banking liquidity yields in short term/money market curve too saw a rally of 10-25 bps.

In August, all eyes would be on RBI policy where we believe that RBI would stay put on monetary policy rates.

Due to weak macro data US yields have started pricing in more than 125 bps rate cuts in next 12 months starting from September 2024 but Indian bond markets are not pricing in any cuts till Mar 2025.

Weak CPI data and weak US data along with positive demand supply dynamics for bonds would lead yields to slowly trend lower to 6.75%.

STRATEGY FOR THE PORTFOLIOS AND OUTLOOK FOR MARKETS

1. Strong Growth/ high frequency indicators and monsoon uncertainty will keep RBI cautious, and we don't expect RBI to be in any hurry to cut rates.

2. US bond markets will continue to trade in a range of 3.9%-4.4% as Fed starts to cut rate from September, high US fiscal deficits will not allow massive rally in US yields.

3. Our core view continues to remain constructive on rates due to positive demand supply dynamics especially for India IGB's, lower CPI and stable external sector outlook.

4. We expect 50 bps of rate cut in this cycle in next 9-12 months.

5. In anticipation of continued FPI flows in Govt bonds due to JP Morgan inclusion and tweaking of LCR guidelines our portfolio allocation has tilted towards a higher Gsec and 1-3 year corporate bonds.

RISKS TO VIEW

Market positioning is heavy (both traders and investors), which means everyone is positioned for rally in bonds. Any surprises from RBI policy especially on OMO sales or MSS announcements can lead to volatility and rise in yields by 10-20 bps.

WHAT CAN INVESTORS DO?

- Investors should continue to hold duration across their portfolios.
- Investors would need to be patient for further rally as further rates easing in India would be delayed to H2 of FY 25.
- With expectations of lower Q2 CPI, favorable demand supply dynamics for bonds and continued flows from FPI we continue to advise Short to Medium term funds with tactical allocation too gilt funds to our clients.

DISCLAIMER

Data as on 31th July, 2024
Source: RBI, Bloomberg, Axis MF Research

Past performance may or may not be sustained in the future.
Investors are requested to consult their financial, tax and other advisors before taking any investment decision(s).

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Budget continued on its path of fiscal consolidation and policy continuity, from bond market perspective there was no significant deviation from Interim budget both in terms of spending and borrowing numbers, hence the price reaction post the budget on yields was very muted.

RBI also released a consultation paper tweaking Bank LCR requirements which if implemented would lead to additional demand for Liquid assets (especially G-Sec) of INR 2 trillion from next financial year.

Month ended with Fed status quo policy which has guided the markets with September rate cut and would be data dependent.

With, INR at all-time high, highest reserves, strong FPI flows to tune of USD7 Billion for the month (both debt and equity) and weaker commodity prices we don't expect any major depreciation in INR.