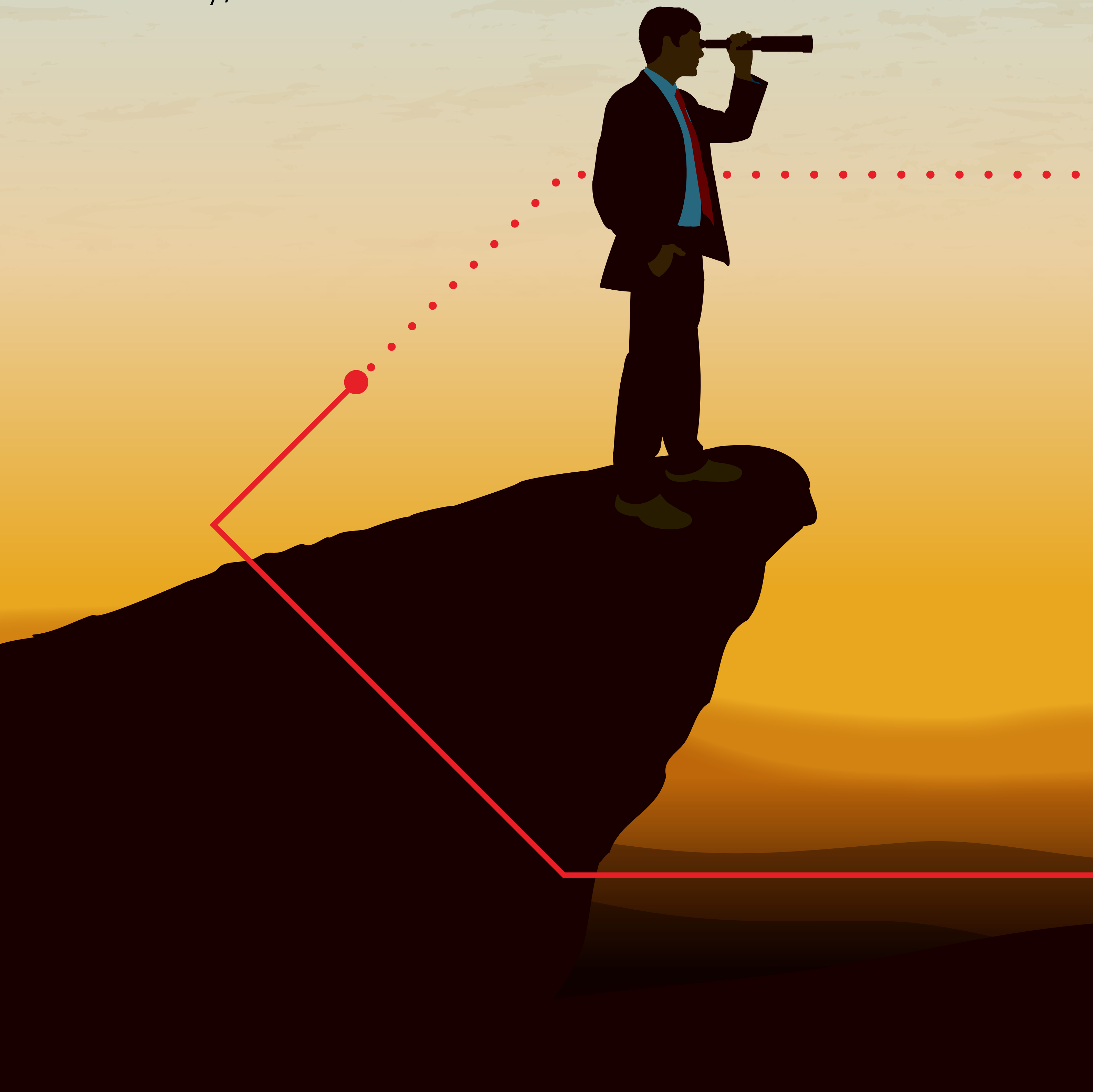
HSBC Mutual Fund

India bonds

Calm amidst the Chaos

7 January, 2025



Year 2024 by all accounts has been a tough one, especially for global macro analysts and traders. Through all this volatility, India's CY24 scorecard shines out compared to the performance of most EMs, with equity markets up YTD by ~13%, INR weaker by just ~1.9% and amongst the top 5 EM performers, 10-year bond yields down ~45 bps and FX reserves still up a net USD ~35 bn.

In RBI, We Trust

A large part of the credit should go to RBI which has manned our gates in a credible, clairvoyant and decisive manner. This is best underscored by RBI's series of actions in the financial sector, where pre-emptive stern actions have probably helped deliver a soft landing of the personal and microfinance credit boom, before it potentially spiraled into another financial sector crisis as we have often seen in the past.

The reason we are starting our 2025 outlook with an ode to the RBI for its prudent management of CY24, is that given the kind of uncertainties and issues that the world is facing now, we need as much and more of RBI's steady hand, of course in tandem with the government policy makers, to ensure that India continues to carry the mantle of being a "beacon of stability" in an otherwise tumultuous world. And for that - In RBI, We Trust. With ex-Governor Shaktikanta Das' term having ended after a memorable 6-year period, Shri Sanjay Malhotra (erstwhile Revenue Secretary) now takes charge of the institution with the responsibility of ensuring this trust not only continues, but also grows stronger.

Starting CY25 with a positive outlook

Our macro scorecard for CY25 reflects a positive rate bias for the Indian bond markets as depicted below:

Impact on Bond Market

Food Inflation trends	Global interest rate environment	Domestic growth slowdown
	Monetary policy	Global bond index inclusion
	Balance of Payments & Current Account Deficit	Fiscal policy & G-Sec Demand Supply
	Systemic Liquidity	Core CPI Inflation trends
	Banking trends - Credit Deposit ratio	
	Real rates	

Over the past few months, the bands of uncertainty have widened around some factors suggesting that navigating the bond markets in 2025 may be a bit more challenging than in 2024.

Let's take a deeper dive into 3 factors where there is visibility and more certainty of the path ahead

- **Fiscal policy and G-Sec demand-supply:** Both these factors continue to be strong tailwinds into 2025, similar to 2024. Strong domestic demand along with continued FPI inflows, and potential OMO purchases by RBI will keep Government securities well bid and market technicals positive.
- **Index and strategic FPI flows:** India bond markets are now in the process of inclusion into all 3 relevant EM bond indices viz. JP Morgan GBI-EM, Bloomberg EM LC index and FTSE-EM Government Bond Index. Total index flows should total USD 35-40 bn by March 2026.
- **External balances:** India's Current Account deficit has been steady, hovering around the ~1% mark for the past few years and we expect the same to continue into FY26 as well. Capital flows by their very nature are and will remain fickle. However, given the steady trickle of bond inflows, recent RBI tweaks with regards to FCNR deposit inflows and a still strong macro story, we believe Balance of Payments should still remain comfortable.

Moving onto the 3 factors where visibility has become clouded and may need to be watched closely.

- **Global interest rate and FX environment:** Given the lack of clarity on Trump 2.0 policies and their impact, US monetary policy backdrop is likely to be more uncertain in 2025. We prefer to start with a neutral stance on its impact on India bond yields. Consensus view on FX seems to be USD strength and EM weakness. The wildcard of course is any potential CNY depreciation / devaluation as a counter to Trump tariffs, which could lead to severe ripples across EM currencies. Clearly currency movements and related central bank actions will be critical for rates assessments as well.

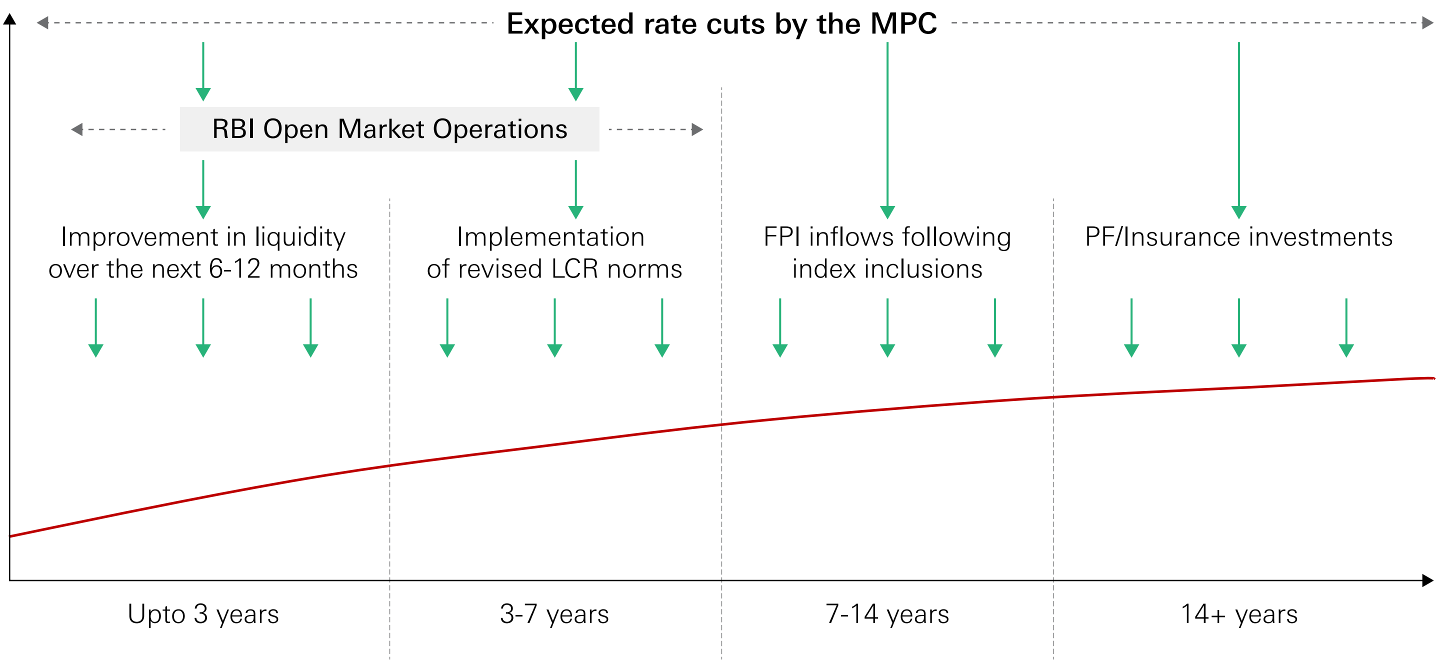
If consensus view of USD strength does indeed turn out to be the way forward for 2025, we would expect INR weakness of 1-3% over CY25, still outperforming majority of EM currencies.

- **Systemic liquidity:** Recent FPI selling frenzy has forced liquidity back into deficit, on back of RBI interventions to maintain INR stability, forcing RBI to cut CRR in its December policy. We expect RBI to continue with further measures in this direction viz. aggressive VRR injections, FX swaps as well as potential Open Market Operations (OMO) to buy Government securities and inject liquidity into the system.
- **Growth inflation imbalance:** This brings us to the final and most relevant point. Growth outlook has suddenly dampened after the Q2 print of 5.4%, while inflation risks remain elevated on the back of unrelenting food price shocks. We expect the balance to get better over next few months as inflation retraces back to sub 5% levels, which would free up RBI's ability to respond better to downside growth risks.

And this is what underpins our positive outlook for bond markets, as we expect the MPC to be able to cut rates by 50bps over the February and April policies. Through all the uncertainty, we still think space would exist for a further cut by June 2025, taking policy repo rate to 5.75% and overnight rates towards 5.5%. However, we remain mindful of the risk that global developments may not leave the RBI space to move that last mile.

To sum up, despite the various uncertainties and imponderables heading into 2025, we remain positive on our outlook on Indian bond markets and expect interest rates to move lower, **supporting our long duration bias across portfolios,** with the intent to remain nimble in our strategies as the year progresses.

Factors impacting the yield curve: The chart shows the impact we expect on different parts of the yield curve based on key factors and help investors arrive at an appropriate risk return profile of their portfolios



Investment themes

- While rates are expected to move lower across the maturity spectrum, the yield curve is likely to steepen significantly, as short end yields move lower on back of positive liquidity and rate cuts. Hence our positive view on 3-4 year AAA corporate bonds, which can benefit from this curve steepening, rate cuts and spread compression. **HSBC Corporate Bond Fund, and HSBC Short Duration Fund** are well positioned to benefit from this.
- Given favorable demand supply dynamics in the government bond market, along with GoI's focus on fiscal consolidation and strong macro fundamentals, we remain positive on our outlook for the longer end of Government securities curve. **HSBC Gilt Fund** is primarily invested in the 10 years and 10+ years part of the curve, and is adequately positioned to provide an opportunity to generate alpha over medium to long term for investors looking to play the duration theme
- Finally, corporate treasuries should continue to farm out their stable liquidity surpluses, to benefit from the upcoming rate cuts and liquidity easing, in our view. **HSBC Banking & PSU Debt Fund, HSBC Money Market Fund, HSBC Ultra Short Duration Fund and HSBC Low Duration Fund** provide an investment opportunity for investors looking at a short-to-medium term investment horizon.

In conclusion, the coming year is bound to be eventful and exciting from an investment perspective, with a fine line between being "nimble footed" and "holding the line". In such an uncertain backdrop, India is fortunate to have a strong macro-economic fortress and more importantly, a resolute RBI at the gates, to raise the guard as and when required. As we head into 2025, for India bond and currency investors, that is probably the biggest reassurance of calm amidst the chaos. We believe, Indian bond markets are well-armed to navigate through the challenges posed by 2025.

Abbreviations:

MPC: Monetary Policy Committee
OMO: Open Market Operations
G-Sec: Government Securities
FPI: Foreign Portfolio Investment

Scheme name — **Potential Risk Class**

HSBC Corporate Bond Fund
HSBC Gilt Fund
HSBC Banking & PSU Debt Fund

Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)	A-III		

A relatively high interest rate risk and relatively low credit risk.

HSBC Short Duration Fund

Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)	A-II		
Relatively High (Class III)			

A Moderate interest rate risk and relatively Low Credit Risk

HSBC Money Market Fund
HSBC Ultra Short Duration Fund
HSBC Low Duration Fund

Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)		B-I	
Moderate (Class II)			
Relatively High (Class III)			

A relatively low interest rate risk and relatively moderate credit risk.

HSBC Mutual Fund

Product Labels

Scheme name and Type of scheme

This product is suitable for investors who are seeking*

HSBC Banking and PSU Debt Fund (An open-ended debt scheme primarily investing in debt instruments of banks, public sector undertakings, public financial institutions and municipal bonds. A relatively high interest rate risk and relatively low credit.)

- Generation of reasonable returns and liquidity over short term.
- The portfolio will primarily be invested in debt and money market instruments consisting predominantly of securities issued by entities such as Banks, Public Sector undertakings, Public Financial Institutions (PFIs) and Municipal Bonds.

HSBC Money Market Fund (An open-ended debt scheme investing in money market instruments. A relatively low interest rate risk and moderate credit risk.)

- Generation of regular income over short to medium term
- The scheme aims to generate regular income through investment in a portfolio comprising substantially of money market instruments.

HSBC Ultra Short Duration Fund (An Open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 months to 6 months. A relatively low interest rate risk and moderate credit risk.)

- Income over short term with low volatility.
- The Scheme will Invest predominantly in debt and money market instruments such that the Macaulay duration of the Portfolio is between 3 months to 6 months.

HSBC Low Duration Fund (An open ended low duration debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 6 months to 12 months. A relatively low interest rate risk and moderate credit risk.)

- Liquidity over short term
- The Scheme will Invest predominantly in debt and money market instruments such that the Macaulay duration of the Portfolio is between 6 months to 12 months.

HSBC Short Duration Fund (An open-ended short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 1 year to 3 years. A moderate interest rate risk and moderate credit risk.)

- Generation of regular returns over short term
- The Scheme will Invest predominantly in debt and money market instruments such that the Macaulay duration of the portfolio is between 1 year to 3 years.

HSBC Corporate Bond Fund (An open-ended debt scheme predominantly investing in AA+ and above rated corporate bonds. A relatively high interest rate risk and relatively low credit risk.)

- Generation of regular and stable income over medium to long term
- The Scheme will invest predominantly in corporate debt securities rated AA+ and above

HSBC Gilt Fund (An open-ended debt scheme investing in government securities across maturity. A relatively high interest rate risk and relatively low credit risk.)

- Generation of returns over medium to long term
- The Scheme as per the asset allocation pattern has to invest a minimum of 80% in Government Securities and Treasury bills.

***Investors should consult their financial advisers if in doubt about whether the product is suitable for them.**

Please refer notice cum addendum available on website of HSBC Mutual Fund for updates on riskometer/product labeling of the scheme.
Riskometer is as on 31 December, 2024.

Source: Bloomberg & HSBC MF Research estimates as on December 31, 2024 or as latest available.

Note: Views provided above are based on information in public domain and subject to change. Investors are requested to consult their financial advisor for any investment decisions.

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