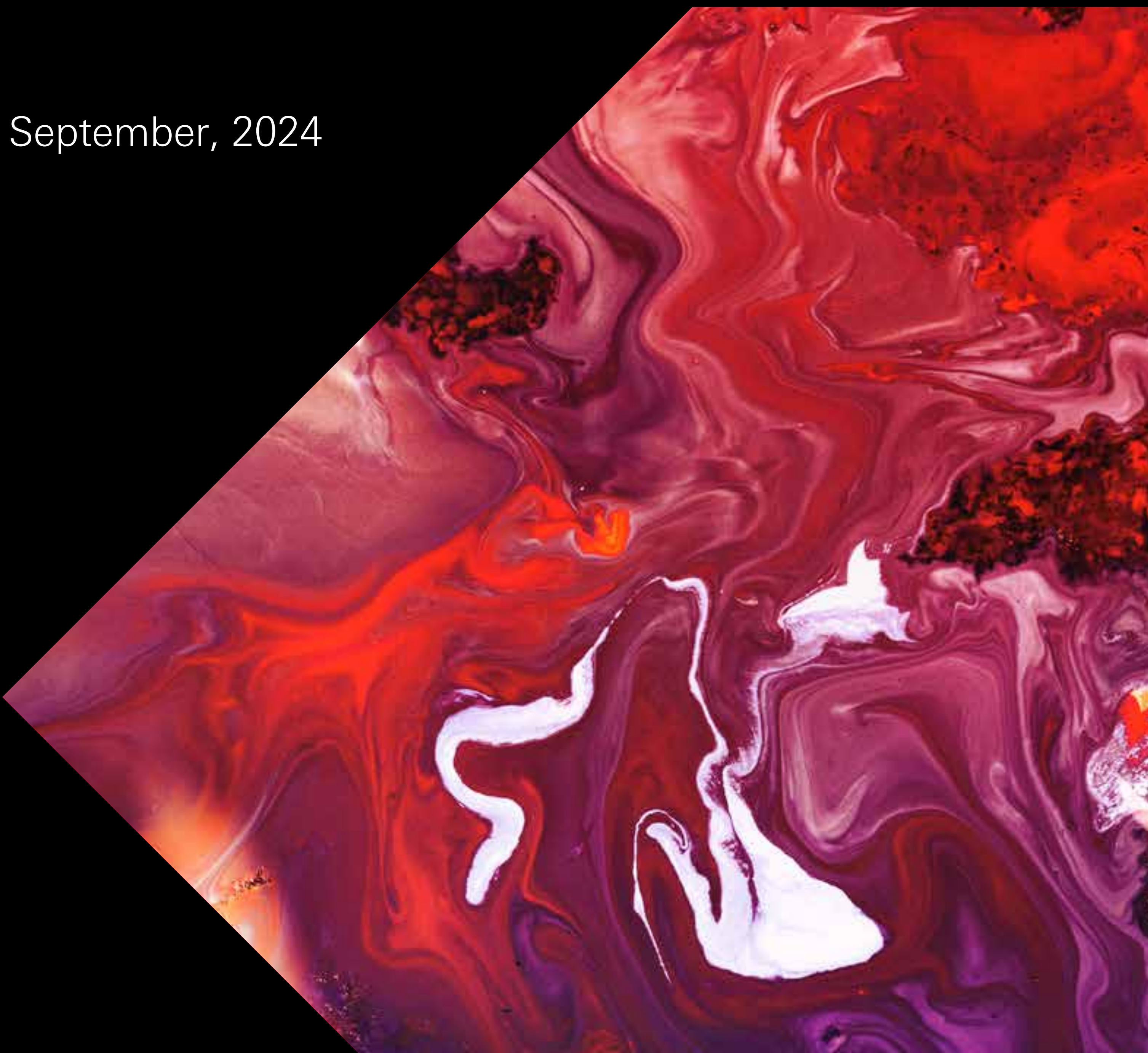
HSBC Mutual Fund

Debt Market Review

September, 2024



HSBC Mutual Fund

Current macroeconomic environment

FOMC kicks off in the power play

The FOMC commenced its rate easing cycle by reducing policy rates by 50 bps on September 18, 2024, instead of broad market expectations of a 25 bps cut. The Dot plot suggests another 50 bps of easing in 2024, 100 bps in 2025 and another 50 bps in 2026, taking the terminal rate to below 3%. The Fed Chair acknowledged that significant progress has been made on easing inflationary pressures and the Fed has greater confidence in inflation moving towards the target of 2%. What possibly could have tilted the FOMC towards 50 bps of easing is the weakening in labour market data. The Dot plot suggests that median expectations of unemployment rate in the US have increased from the June estimates, with unemployment rate expected to remain at 4.4% in 2024 and 2025 and cool down to 4.2% by 2027. While the Fed Chair indicated that the FOMC will remain data dependent and they will not follow any preset course, he also hinted that in the event of unexpected weakening in labour market data or unanticipated fall in inflation, the FOMC will remain alert to act, thereby increasing the possibility of 50 bps cuts in the future as well.

The ECB also eased policy rates by cutting their deposit rates by 25 bps while BOJ and BOE kept rates unchanged. The BOE will keep an eye on the upcoming inflation prints and make a full assessment of the market developments in the November policy. Meanwhile China has announced a slew of monetary and fiscal measures to address the weakness in economic activity in the country. Inflation prints in major economies continue on an easing trajectory with the recent CPI prints in the US, UK and Eurozone at 2.5%, 2.2% and 1.8% respectively, along with the recent US PCE print at 2.2%. Crude prices remained benign, trading in the USD 70-77/bbl band during the month.

With risks of global slowdown having escalated and with the Fed commencing its rate easing cycle by 50 bps, we continue to believe that the RBI is unlikely to remain immune from rate actions by global Central Banks, thereby implying that the possibility of rate easing by 75-100 bps in India has meaningfully increased.

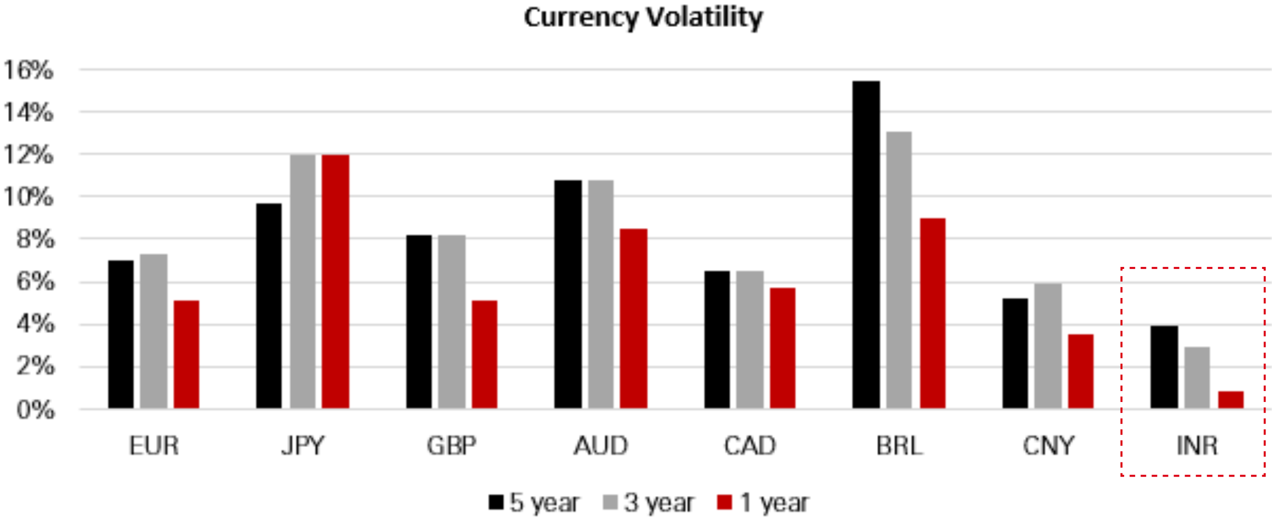
Impact of geo-political tensions in the Middle East

Geo-political tensions in the Middle East have increased recently which pose a risk to Crude prices. Such events typically trigger a risk-off sentiment and a flight to safety, resulting in weakening in emerging market currencies and possible FPI outflows. While further escalation in the Middle East will remain a key monitorable going forward, India is better placed compared to most other emerging market economies to tackle this situation based on the following factors:

- Rupee continues to remain among the least volatile currencies, with RBI being pro-active to address any sharp movement in currency on either side
- Crude prices have been softening over the last few months with visible slowness in economic activity globally. While sharp rise in Crude prices cannot be ruled out due to geo-political risks and remains a key risk, the inherent trajectory of Crude prices based on the macro factors remains one of weakening. The baseline assumption in RBI's domestic inflation projections have been built considering average Crude price at USD 85/bbl (as per Monetary Policy Report, April 2024), hence there is still some cushion before it starts impacting inflation meaningfully
- RBI has continued to build-up on FX reserves (USD 692 bn, as of September 20, 2024) which allows RBI to intervene to keep Rupee stable and provide comfort to markets in case of any Dollar outflows
- Index related FPI inflows continue to track a run rate of USD 2-3 bn every month given the 1% incremental index weight to be added through IGB purchases
- G-Sec supply-demand dynamics continue to remain favourable. The AUM growth of EPFO, insurance companies and pension funds remain strong, resulting in demand for longer maturity G-Sec. Also, the proposed changes in the LCR norms for Banks may create further demand for short to mid maturity G-Sec

India may continue to be a favoured destination for FPIs

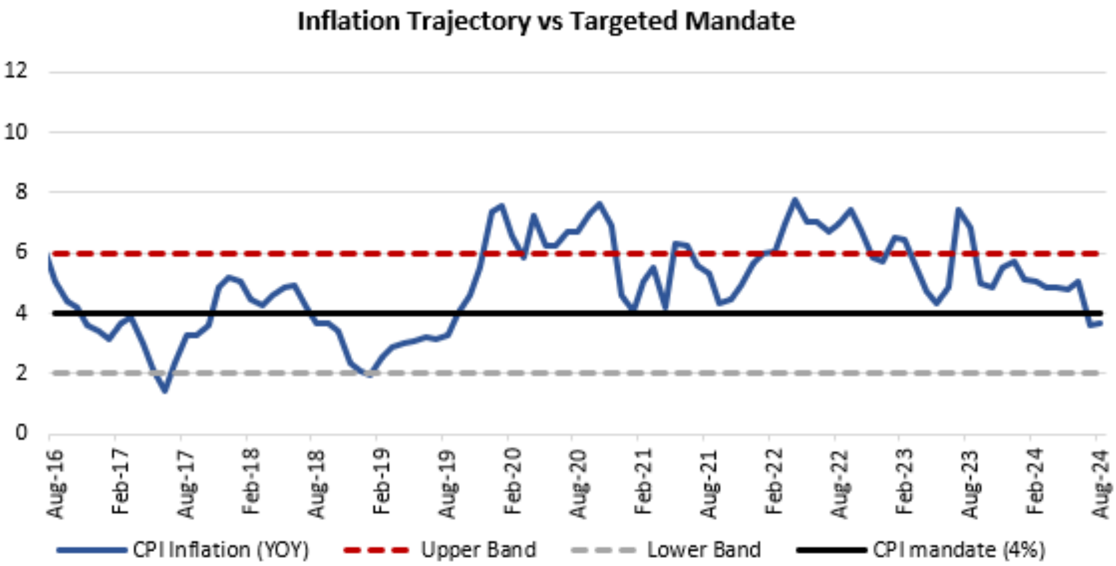
JP Morgan GBI-EM index inclusion continues to keep FPI demand for IGBs at a steady USD 2-3 bn per month, with total FPI buying since the index announcement in September 2023 at ~USD 18 bn so far and another ~USD 15 bn of index flows projected to come over the next 6 months. India's bond and currency markets continue to exhibit relatively low volatility versus other asset classes and peers.



Source: Bloomberg data as on Sep 30, 2024; HSBC MF research

Domestic macro-economic factors and data points

- Inflation prints have softened over the last couple of readings partly due to cooling-off in vegetable prices and due to a favourable base effect. A normal monsoon along with higher kharif acreage for certain food items augers well for food inflation outlook, however, some pick up in vegetable prices has been seen recently, which will remain a monitorable. Broad market expectations are for headline inflation for Q2 FY2025 to undershoot RBI's estimates. Core inflation continues to remain benign in spite of rise in telecom tariffs
- CAD for Q1 FY2025 came in at USD 9.7 bn (1.1% of GDP) due to widening of merchandise trade deficit. CAD for FY2025 is estimated to be around 1%
- GST collections continue to remain strong at INR 1.73 trn while PMI numbers also remain robust
- India's external debt remained broadly steady at USD 682.3 bn (as of Jun 2024), with external debt to GDP at 18.8%



Source: Bloomberg data as on Sep 30, 2024; HSBC MF research

HSBC Mutual Fund

Borrowing calendar in line with broad market expectations

RBI announced the G-Sec borrowing calendar for H2 FY2025. Gross borrowing for H2 FY2025 was announced at INR 6.61 trn (in line with the budgeted gross borrowing number for FY2025). While a section of the market was disappointed as they were expecting a cut in the second half borrowing due to improved tax collections, any reduction in borrowing should not be ruled out. GOI can still reduce borrowing towards the end of the financial year after having more clarity on tax collections and evolving market conditions over the next few months. Gross borrowing through SDL and T-Bill for Q3 FY2025 were announce at INR 3.2 trn and INR 2.47 trn, respectively.

Liquidity may continue to remain comfortable

Liquidity remained positive for most of the month of September. Post GST outflow, liquidity had turned marginally negative but reversed due to Government spending. The net durable liquidity stood at INR 4.3 trn (as of Sep 06, 2024). We believe accelerated Government spending will continue over the next few months keeping liquidity buoyant. Additionally, there is G-Sec maturity of around INR 1.5 trn in Nov 2024, which will absorb any reduction in system liquidity due to drag because of seasonal CIC impact.

Market movement

During the month, T-Bill rates fell by around 10-15 bps, while CD levels eased by 3-10 bps. OIS levels also moved lower by 5-10 bps. G-Sec yields closed lower by 8-13 bps across the curve. Short end corporate bonds were lower by only 5 bps, while the 3-10 year segment moved lower by 10-15 bps.

Present Market Outlook

While Government bond yields have rallied by about 25-30 bps over past few months, we believe there is further space for yields to still move lower and resultantly, we maintain our positive outlook on interest rates and a long duration bias across our portfolios. While swap markets are pricing in about 75 bps of rate cuts, the underlying G-Sec curve is still not pricing any significant rate easing. As and when the underlying curve starts pricing in policy easing, it may create room for yields to fall further.

Given the recent developments with the Fed easing rates by 50 bps, inflation expectations aligning with the target, expectations of weakening in labour market data along with risks of slowdown, we believe the RBI may be mindful of these developments and is unlikely to remain immune from US Fed actions, implying that possibility of rate easing by 75-100 bps has meaningfully increased.

Present Fund Strategies

- **HSBC Short Duration Fund** and **HSBC Corporate Bond Fund** may be considered for investment with a medium-term horizon and slightly higher appetite for interest rate risk. These funds are primarily invested in the 2-6 year part of the curve. Liquidity easing and pricing of rate cuts along with implementation of revised LCR norms could result in (a) softening of yields in this segment, (b) steepening of the yield curve and (c) compression in spreads of Corporate bonds. Both these funds are appropriately positioned and may benefit from these developments.
- **HSBC Banking and PSU Debt Fund** is predominantly invested in assets maturing in the 1.5-2 year segment. With liquidity easing through this quarter and expectations of rate cuts getting priced in, the fund may benefit from market expectations of softening in short end yields along with compression in spreads of Corporate bonds.

- **HSBC Gilt Fund** is primarily invested in the 10 years and 10+ years part of the curve. The duration of the fund is actively managed. With index inflows continuing in IGBs and steady growth of long only investor segment, the demand supply dynamics remain favorable. Hence, **HSBC Gilt Fund** is positioned with an aim to provide an opportunity to generate alpha over medium to long term for investors looking to play the duration theme.

Abbreviations:

FOMC: Federal Open Market Committee
ECB: European Central Bank
BOE: Bank of England
BOJ: Bank of Japan
GDP: Gross Domestic Product
G-Sec: Government Securities
AUM: Assets Under Management
EPFO: Employees' Provident Fund Organisation
LCR: Liquidity Coverage Ratio
HQLA: High Quality Liquid Assets
FPI: Foreign Portfolio Investment
IGB: Indian Government Bond
CPI: Consumer Price Index
CIC: Currency in Circulation

Scheme name

HSBC Corporate Bond Fund

HSBC Gilt Fund

HSBC Banking & PSU Debt Fund

Potential Risk Class

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.

Scheme name

HSBC Short Duration Fund

Potential Risk Class

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

Product Labels

Scheme name and Type of scheme | ***Riskometer of the Scheme**

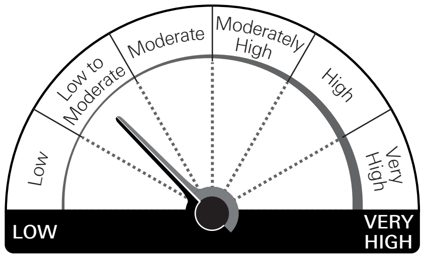
This product is suitable for investors who are seeking#

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 risk.)

- Generation of reasonable returns and liquidity over short term
- Investment predominantly in securities issued by Banks, Public Sector Undertakings and Public Financial Institutions and municipal corporations in India

(Benchmark: NIFTY Banking & PSU Debt Index A- II)

Riskometer



Investors understand that their principal will be at Low to Moderate risk

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 (please refer to page no.16 of SID for details on Macaulay's Duration). A Moderate interest rate risk and Relatively Low credit risk.)

- Generation of regular returns over short term
- Investment in fixed income securities of shorter-term maturity.

(Benchmark: NIFTY Short Duration Debt Index A-II)

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
- Investment predominantly in AA+ and above rated corporate bonds and money market instruments

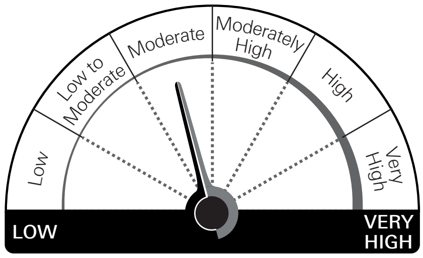
(Benchmark: NIFTY Corporate Bond Index A-II)

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
- Investment in Government Securities

(Benchmark: NIFTY All Duration G-Sec Index)

Riskometer



Investors understand that their principal will be at Moderate risk

***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 30 September 2024.

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.

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

HSBC Mutual Fund, 9-11th Floor, NESCO - IT Park Bldg. 3, Nesco Complex, Western Express Highway, Goregaon East, Mumbai 400063. Maharashtra.

GST - 27AABCH0007N1ZS | Website: www.assetmanagement.hsbc.co.in

Mutual Fund investments are subject to market risks, read all scheme related documents carefully. CL1951