HSBC Mutual Fund

A Joyful March for bonds

March, 2025

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The globe reeled under fears and pressures of tariffs by the US administration. The sentiments and business confidence were fragile. The implications on the real economy are yet to be seen. The outlook especially for global growth is turning grim. In the wake of tariffs on China, Mexico, Canada and on sectors such as automobiles, steel and aluminum kept markets nervous about reciprocal tariffs that the US administration warned of.

The tariff risks for US are expected to result in slower growth and higher prices, a stagflationary situation. The US FOMC SEP projections too indicated of the US moving into that situation as growth was lowered, inflation and unemployment rate were revised higher. The 'dot-plot' showed that median of members expect 50 bps cut in 2025 and 50 bps cut in 2026. However, there were more members calling for the FOMC to do less in terms of rate cuts for 2025 than was communicated in the previous meeting.

Euro zone was in highlight following the Germany elections as well as the pressure on the Euro area to spend more on defence sector, which resulted in hardening of bond yields, in particular the German Bund yields as it proposed fiscal measures to support growth.

In Asia, China was in focus given that the Government increased its commitment towards supporting the economy via fiscal stimulus – with focus on boosting consumption by increasing wages, housing/property sector. While initial economic indicators suggested that Chinese economy was on path to recovery, the recent tariffs imposed on China by the US has further complicated the outlook and increased expectations of increased stimulus by their government.

Amid all the global nervousness, India rejoiced in the festivities and the return of foreign investors. With the RBI stemming the currency swings, while taking active steps to inject liquidity along with increased prospects of a deeper rate cut cycle along and a potential change in stance to accommodative at the April 9, 2025 policy all positively impacted the yield curve across debt assets. The additional demand by the RBI, via OMO Purchases and higher FPI debt inflows to the tune of USD 3.7 bn in March vs 1.4 bn in February shifted the yield curve lower and ended the financial year on a positive note for the bond markets. This was further buttressed by the light borrowing calendar for 1HFY26 and lower T-bill borrowing in Q1FY26.

The system liquidity closed in a surplus after more than 3 months, aided by government spending, and liquidity operations by the RBI (OMO purchase and FX swap) helping tide through the advance tax period without distorting the overnight rates.

Macro - economic indicators

The domestic macro indicators paint a mixed mixture picture. The lead indicators data available till February are showing signs of economic activity losing steam with auto sales, personal loans trending weaker, YoY; and on the supply side, indicators PMI manufacturing and Services, Cargo traffic, domestic steel and cement production saw activity accelerate in Feb/Mar. On the prices front, the retail price pressures moderated to a 7-month low of 3.61% YoY compared with 4.26% YoY in January, led by food inflation at 3.7% YoY (6.0% in January). A seasonal correction in vegetables prices as well as subdued demand conditions kept headline under check. The recent uptrend in gold prices to all-time highs was reflected in consumer inflation too, which led to a spike in core inflation (inflation which excludes food and fuel components). The core CPI inflation picked-up to 4.0% YoY vs 3.7% in January.

India FX Reserves kitty increased to US$658.8 bn for March 21 from the recent CY25 lows of US$ 624 bn seen on January 17. At these levels of total FX Reserves, India is comfortably covering nearly 11-months of its imports. India's trade deficit narrowed sharply to US$ 14 bn in February due to a slump in imports. India's goods exports fell by 10.9% YoY and India's net services exports rose by 41% YoY. Imports on the other hand fell to a 22-month low, falling by 16% YoY due to a contraction in oil imports (-30% YoY), gold imports (-63% YoY) and non-oil non-gold imports (-2.9% YoY). Although lagged, the recent data on India's balance of payments, evinced that the pressure on currency in Oct-Dec 2024 was due to capital account outflows amounting to US$ 27bn even as the current account deficit was subdued at US$ 11bn or 1.1% of GDP.

The exchange rate movements have stabilized following the RBI's FX Swaps to the tune of US$ 25bn in JFM quarter and US$ 10bn it conducted in Mar as well as the resumption of capital inflows and recent dollar weakness.

Our Take:

The tariff fears and the uncertainties around its implementation has upended global growth outlook and market sentiments. Rising gold prices, recent fall in Japanese bond yields and a sharp fall in crude oil prices all are reflecting the prevailing global risk-off mood. For now, India's macros remain fairly resilient; even as India is not isolated from the tariffs effects, India still remains fairly insulated owing to domestic consumption and government infrastructure spending.

Key factors	Market environment in Nov 2024	Yield impact	Market environment in Mar 2025	Yield impact
Global Markets	New US Presidential regime, risks of tariffs Rally in risk assets, sell off in US Treasuries Dollar strengthening → EM currency weakness	↑	Risks of Low Growth, High Inflation in US Softening in US Treasury yields Dollar weakness → aiding EM currencies	↓
Inflation	Sharp rise in vegetable prices → CPI above 6%	↑	Correction in veggie prices → CPI below 4%	↓
Growth	Q2 FY2025 GDP growth sharply lower at 5.4%	↓	Pick up in Q3 GDP print to 6.2% (risks of undershooting full year estimates)	↔
Currency	Sharp FPI outflows in Equity & Debt Rupee weakening → RBI intervention in FX market Steady fall in FX reserves	↑	Equity outflows ease, Debt Inflows continue Rupee rebounds amid Dollar easing, RBI steps FX reserves rising	↓
Liquidity	RBI FX intervention → Liquidity turns negative	↑	RBI injects liquidity which is 'here-to-stay' Liquidity to turn positive in April	↓
RBI measures	Massive FX intervention in spot and NDF market to stem Rupee depreciation	↑	FX Buy Sell Swap OMO purchase Long tenor VRRs	↓
Rate cut expectation	**Shallow rate cut cycle (~50 bps)**		**Deeper rate cuts (75-100 bps)**	

Source - Bloomberg data as on Mar 21, 2025. **Past performance may or may not be sustained in the future and is not indicative of future results.**

Note: Views provided above are based on information available in public domain at this moment and subject to change. Investors should not consider the same as investment advice. Please consult your financial advisor for any investment decision.

RBI's aggressive steps to inject liquidity into the system have reinstated the animal spirits for bond investors who are pricing in a deeper rate cut cycle by the RBI-MPC, with a focus on growth with inflation finally cooling off. Given this backdrop, we continue to maintain a positive duration bias across the funds. We recommend investors to stay invested and add duration to their portfolios wherever possible subject to their risk return frameworks.

Abbreviations:

OMO: Open Market Operations
GDP: Gross Domestic Product
CPI: Consumer Price Index
MPC: Monetary Policy Committee
RBI: Reserve Bank of India
FII: Foreign Institutional Investors
EM: Emerging Markets

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