Fixed Income Outlook 2024

HSBC Mutual Fund

January 2024

Top-down Macro economic factors

Impact on Bond Markets

Negative		Positive
	Global interest rate environment	Global bond index inclusion
Banking trends - Credit Deposit ratio	Fiscal Policy	Real rates
Systemic Liquidity and OMO sales	Monetary Policy	Current Account Deficit & Balance of Payments
	CPI Inflation trends	G-Sec/SDL Demand Supply dynamics

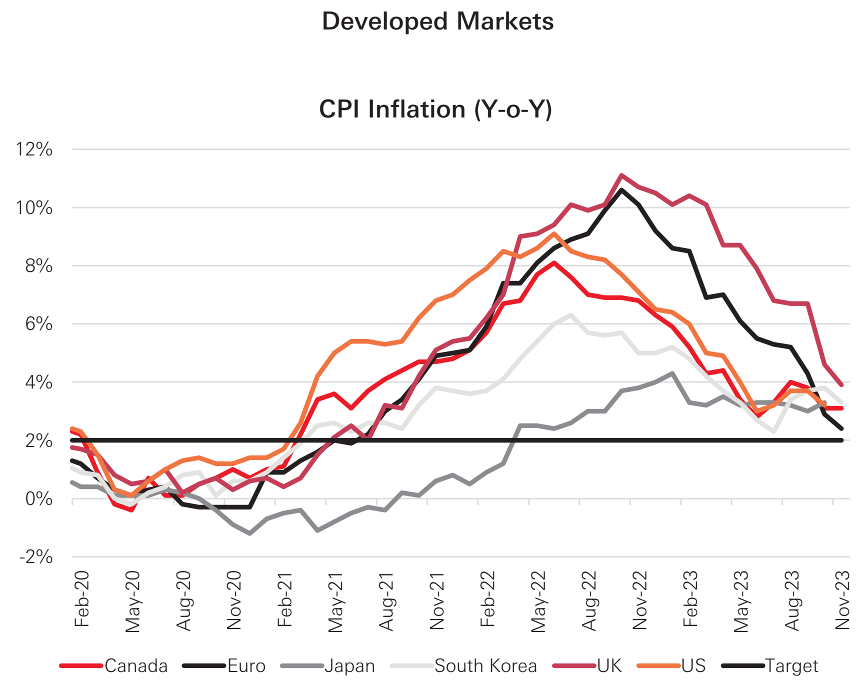
- Global Central banks are at the end of interest rate hiking cycle; Cumulative rate hikes in this cycle: Fed–525 bps, BOE–515 bps, ECB–450 bps, RBI MPC–250 bps
- MPC unanimously kept the Repo Rate unchanged at 6.50%, with current pause to assess the 250 bps hike working through the system
- The recent inflation print came at 5.55% and is likely to remain higher in the next few months due to higher food inflation
- The systemic liquidity has moved to a deficit, negating any immediate need for RBI to do OMOs

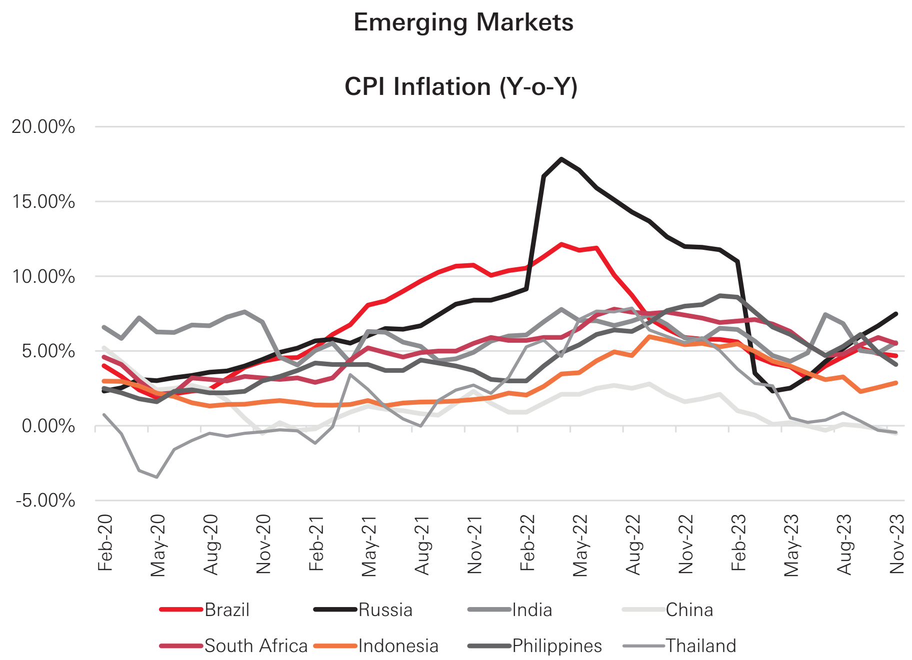
Our top down assessment of various factors indicates a positive duration bias for portfolios

Source – Bloomberg, RBI, Data as on 20 Dec '23,

Past performance may or may not be sustained in the future and is not indicative of future results.

Sharp fall in Inflation across economies





Softening of inflation leading to an abrupt reversal of the tightening policy so far

Source – Bloomberg, Data as on 20 Dec '23,

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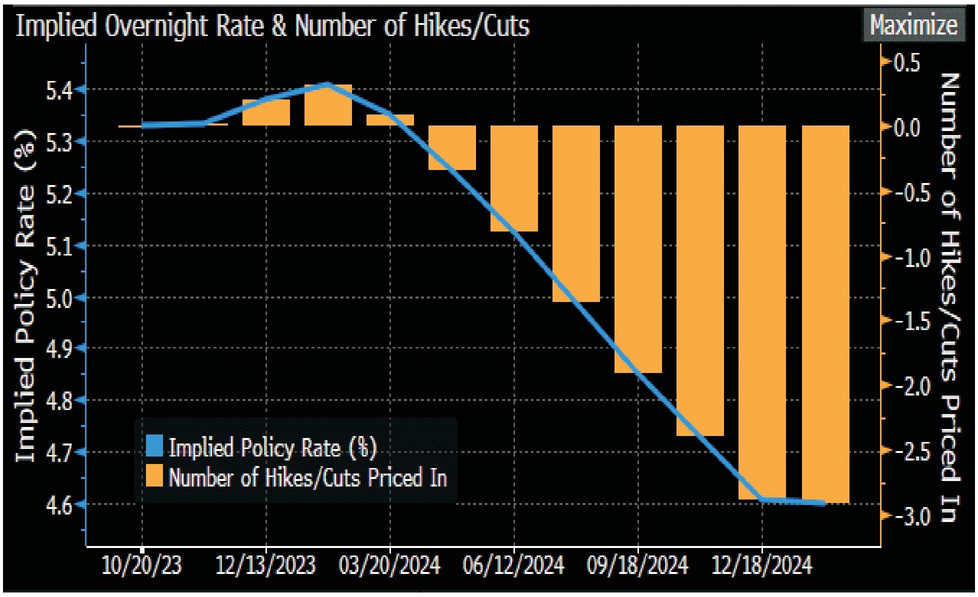
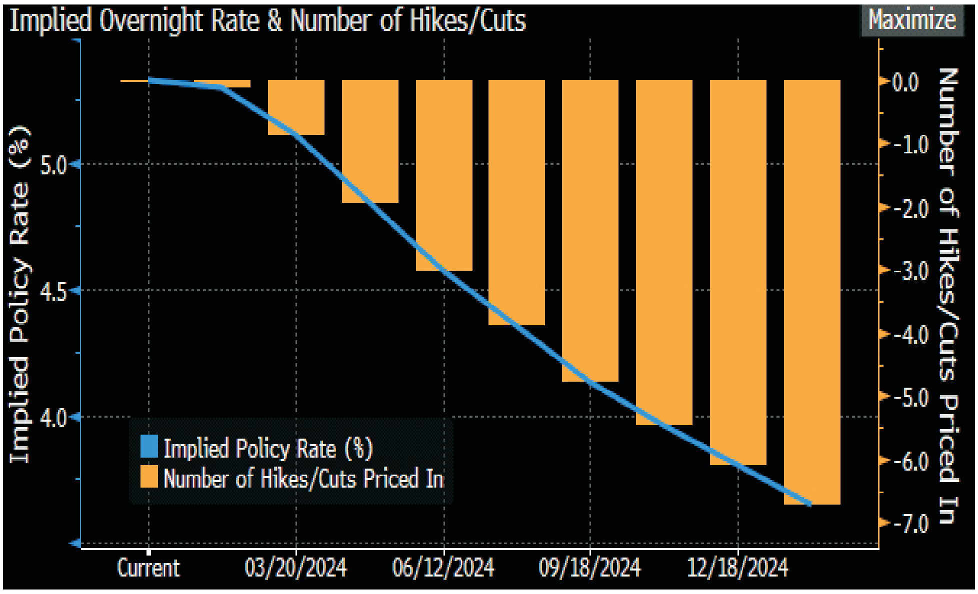
Fed Funds Rate: Implied Policy Rate

US Fed implied policy rate on 20th Oct 2023



US Fed implied policy rate on 20th Dec 2023



- Markets are now pricing in 6-7 rate cuts in 2024, while the Dot plot suggest 3 rate cuts in 2024
- US Treasury yields have seen a sharp fall since Dec 2023 FOMC meeting

Sharp rate cut expectations getting built in over the last couple of months; no rate hikes priced in currently

Source – Bloomberg, Data as on 20 Dec '23,

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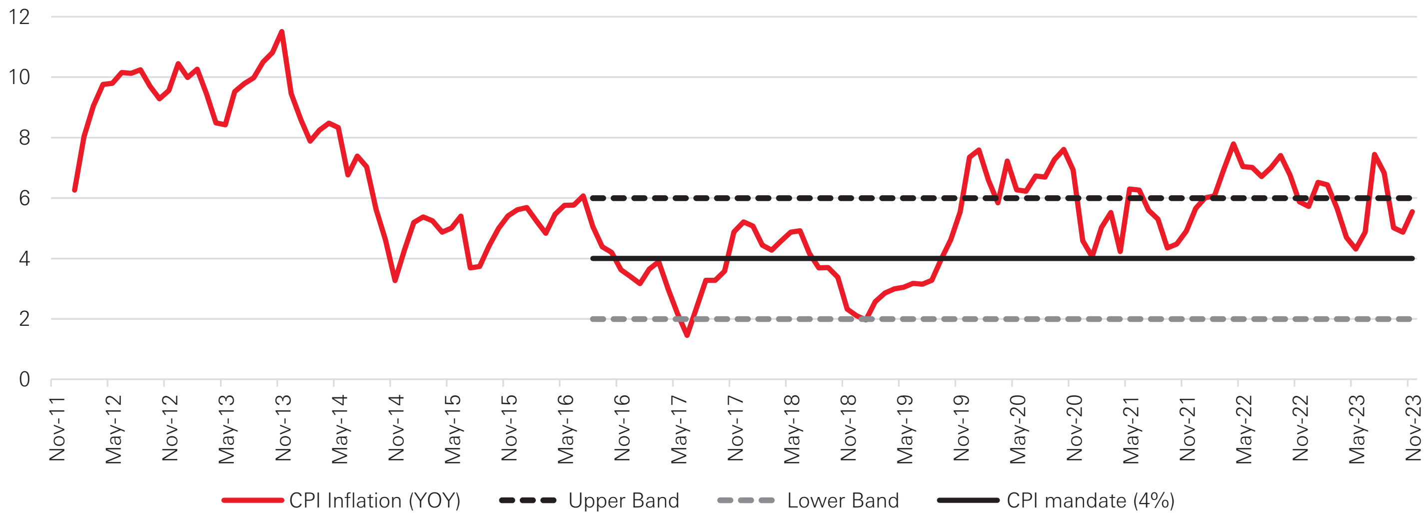
MPC continues to focus on inflation targeting

Inflation trajectory vs Targeted mandate



- The recent inflation print came below market expectations, however, pressure on food prices continue to remain a key monitorable
- Core inflation eased to 4.1% and has remained below 5% over the last few months, allowing MPC to look through the interim spike in headline inflation
- MPC reiterated in the recent policy the need to align inflation to the 4% target on a durable basis

Since 2016, Inflation in India has been broadly tamed despite various global and domestic price shocks

Source – Bloomberg, RBI MPC Data as on 20 Dec '23,

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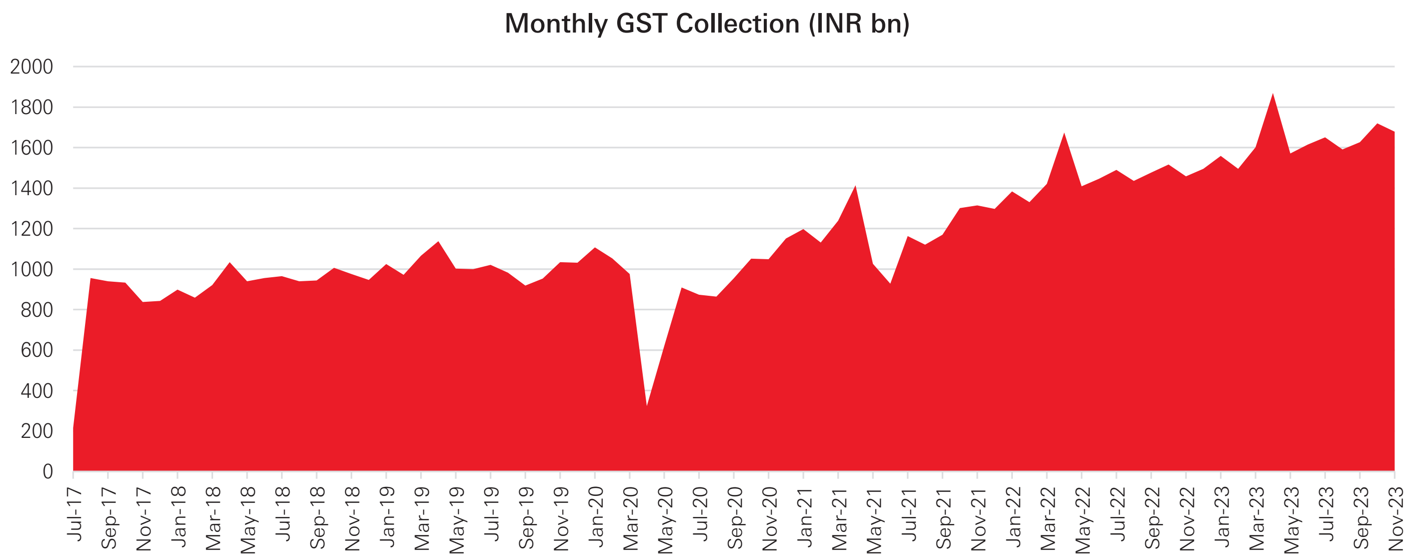
GST implementation leading to unlocking of revenues



GST collections have steadily improved since inception in 2017

Healthy tax collections has allowed Govt. to meet any additional spending without incremental borrowing

Source – Bloomberg, Income Tax Website, Data as on 20 Dec '23,

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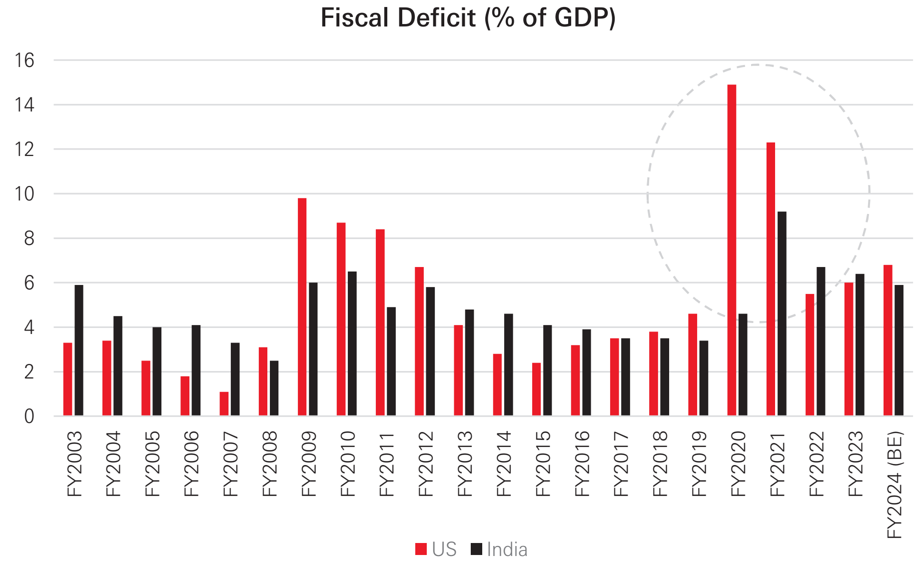
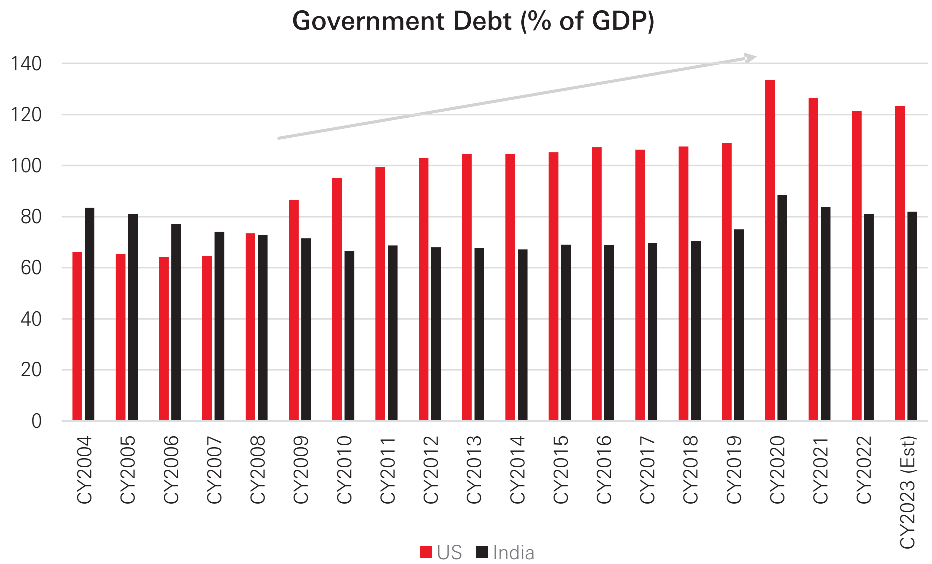
Fiscal restraint in India vs fiscal profligacy in the developed world





- During the period post Global Financial Crisis and during Covid, Fiscal Deficit in India was lower than that in the US
- During Covid, Government deficit was raised above 9% and then brought down gradually to 6%. The target is to reach 4.5% by FY 2026
- While Government Debt to GDP data in the US had been increasing over the years, the figures for India have been moderate

Govt focus on Fiscal consolidation, leading to better relative debt metrics

Source – Bloomberg, Data as on 20 Dec '23,

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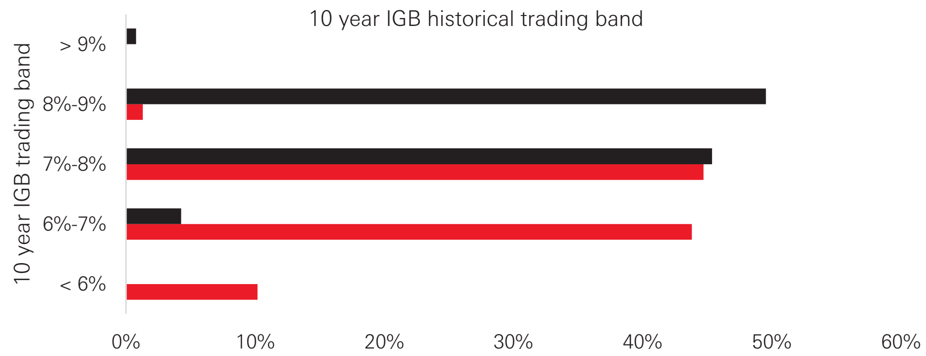
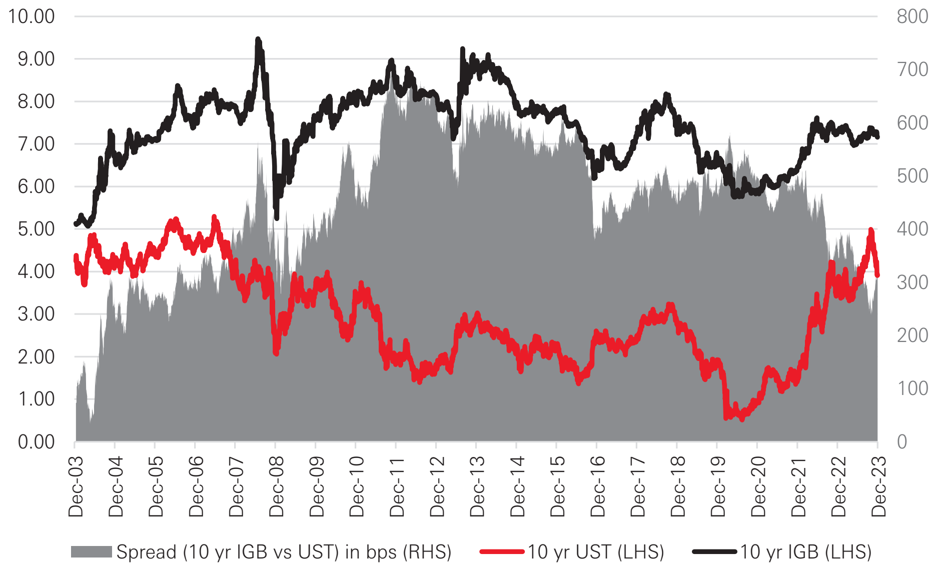
Post 2016/17 – Bond markets have rewarded the strong macro framework



	< 6%	6%-7%	7%-8%	8%-9%	> 9%
2010-2016	0%	4%	45%	50%	1%
2017-2023	10%	44%	45%	1%	0%

■ 2010-2016 ■ 2017-2023



- Since 2017, 10 year G-Sec has broadly traded in the 6%-8% band, while between the period 2010 to 2016, the trading band was 7%-9%
- Spreads between IGBs and USTs have historically been above 300 bps
- Spreads have narrowed lately due to a sharp rise in US Treasury yields, IGBs have remained stable broadly during this period

Policy credibility leading to interest rates trending lower, with fewer spikes

Source – Bloomberg, Data as on 20 Dec '23,

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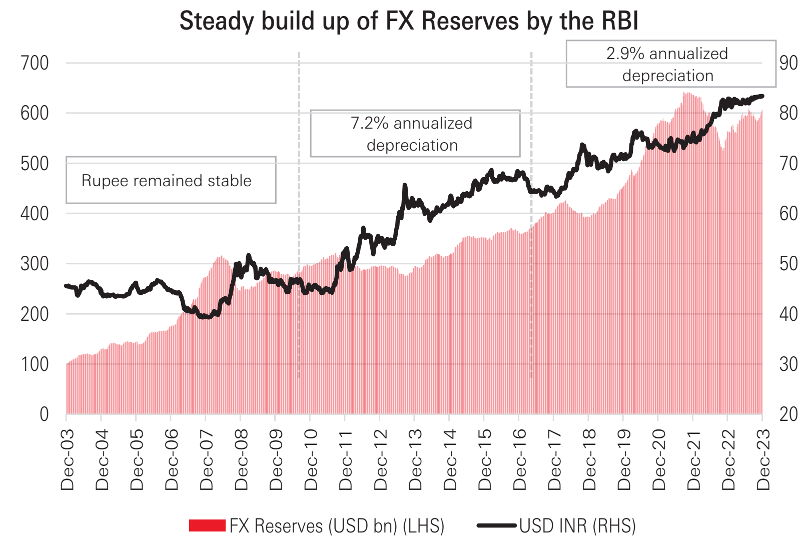
Rupee trajectory going forward



Parameters	2011-2013 *	FY 2024
10 year IGB yield (%)	9.24	7.19
USD INR	68.85	83.17
Fiscal Deficit (% of GDP) **	5.8	5.9
Current Account Deficit (% of GDP) **	5.1	1.7
Import Cover (months)	6.71	10.82
Inflation (% y-o-y)	11.51	5.55
FX Reserves (USD bn)	274.81	615.97

* Weakest data point during the period of 2011-2013 has been considered for comparison

** Fiscal deficit and CAD are FY24 forecasts

- Rupee weakened through the period of 2011 to 2016 due to weaker domestic macro factors and global events
- With increased focus on fiscal prudence, inflation target mandate and FX reserve build up since 2016-2017, Rupee has been more resilient to global shocks
- Going forward, we expect strong fundamentals to continue, with Rupee remaining stable and witnessing low depreciation

India's robust macro economic backdrop suggests the Rupee should do better than the 2017-23 period and could possibly even show the stability witnessed during 2003-10 phase

Source – Bloomberg, Data as on 20 Dec '23,

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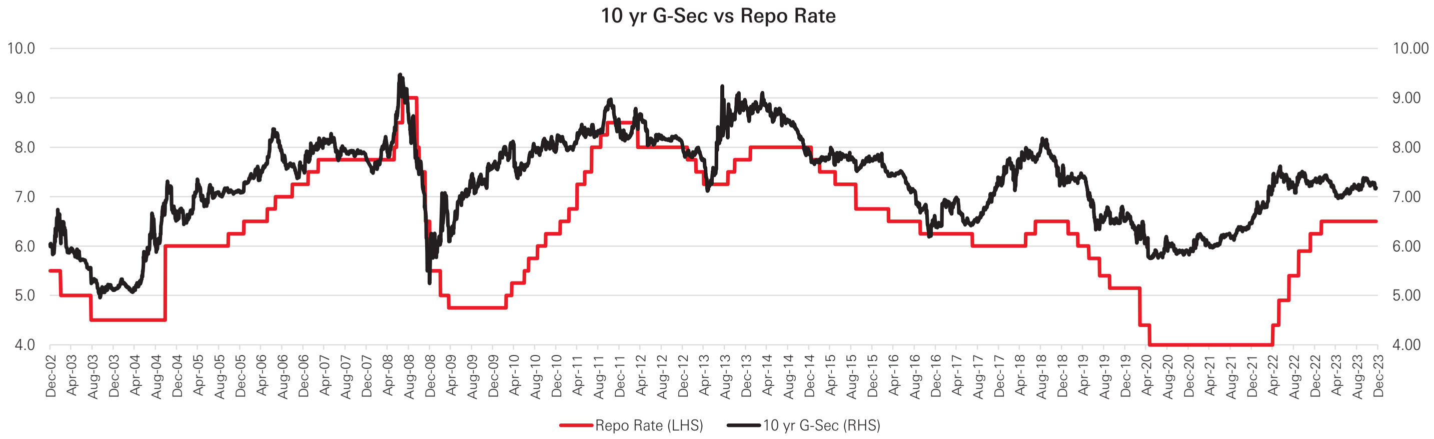
In India, Policy rates have peaked with easing bias likely over the coming year



- 2008-2009 : Yields started moving lower in July 2008 ahead of the first rate cut in October 2008
- 2011-2013 : Yields started moving lower from November 2011 ahead of the first rate cut in April 2012
- 2014-2017 : Yields started moving lower from April 2014 ahead of the first rate cut in Jan 2015
- 2018-2020 : Yields started moving lower from Sept 2018 ahead of the first rate cut in Feb 2019

One of the few markets offering 65-75 bps positive spread over policy rate

Source – Bloomberg, Data as on 20 Dec '23,

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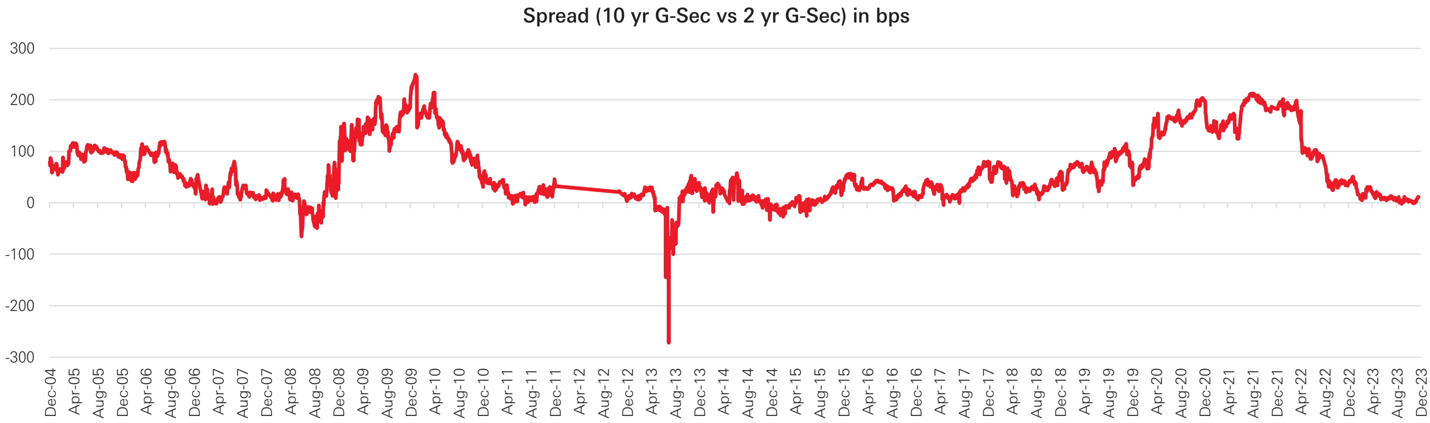
Term premium movement over the years



- 2008-2009 : 2 X 10 curve inversions have provided good entry opportunities in longer dated G-Sec
- 2011-2013 : 2 X 10 spreads below 15 bps have proved to be good entry points.
- 2014-2017 : 2 X10 spreads remained negative and lower in 2014 and 2015 providing decent opportunities to enter and capture the rally
- 2017-2020 : while 2017 was false signal because of wrong interpretation from Demonetization
- 2018 provided signals of lower spreads to enter
- 2023: 2 X 10 spreads have remained low for most of 2023

Yield curve has flattened, but not inverted

Source – Bloomberg, Data as on 20 Dec '23,
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What are markets pricing in?

Cash Bond (G-Sec) Markets

Tenor (years)	1	2	3	4	5
G-Sec Yield Curve	7.02%	7.03%	7.08%	7.11%	7.08%
G-Sec Forward Curve	7.04%	7.16%	7.19%	6.99%	

Swap Markets

Tenor (years)	1	2	3	4	5
OIS Yield Curve	6.64%	6.30%	6.25%	6.21%	6.21%
OIS Forward Curve	5.96%	6.15%	6.09%	6.21%	

- The G-Sec yield curve is broadly flattish up to the 5 year segment
- G-Sec levels are not pricing in any rate cuts over the next one year
- Swap levels are pricing in around 50 bps of rate cuts over the next one year along with easing in liquidity

Cash bond markets not pricing in any rate cuts, swap levels pricing in 50 bps easing over the next one year

Source – Bloomberg, Data as on 20 Dec '23,

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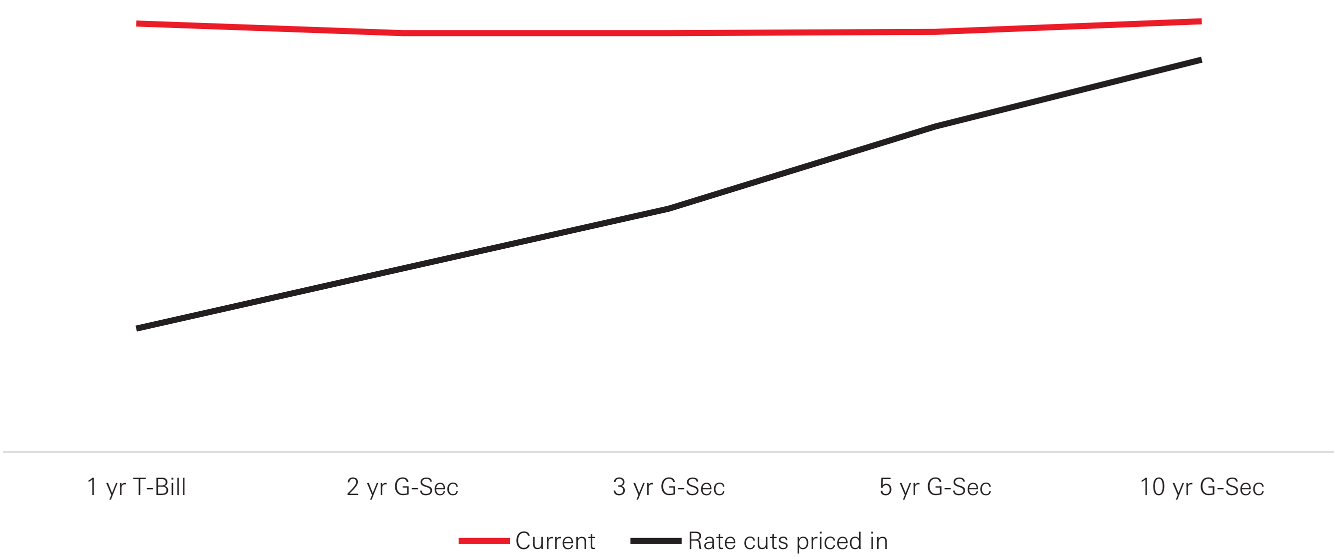
Representative G-Sec securities in the specific maturity bucket considered, interpolated levels taken where exact maturity not available

Forward Curve rates are illustrative only and for general information

Yield curve likely to steepen

Yield Curve



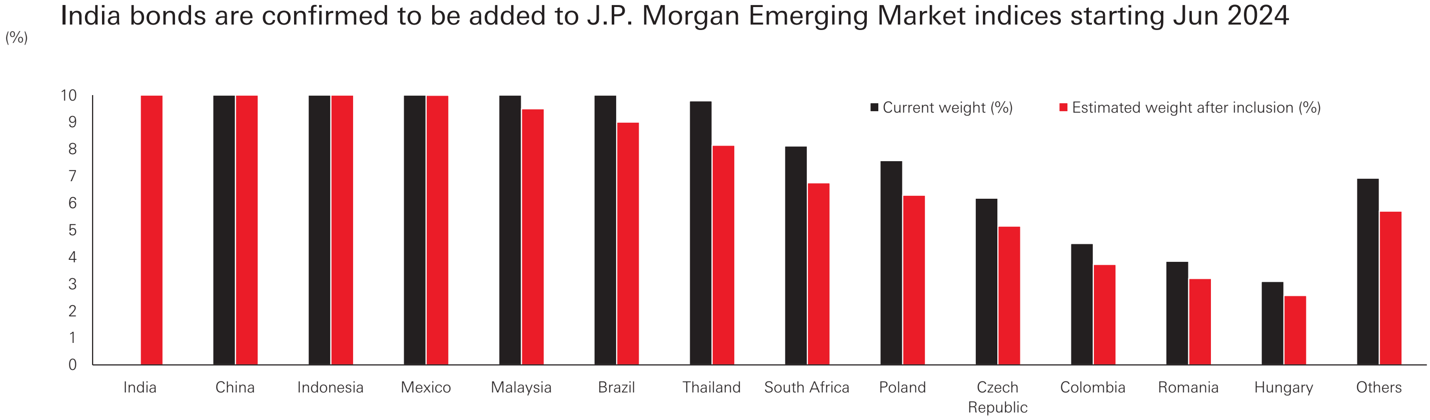
- The Yield curve has flattened over the last 1-2 years as RBI has withdrawn excess liquidity from the system along with increasing policy rates
- With rate cuts getting priced in over the course of the year, the yield curve is likely to steepen

Yield curve likely to steepen with rate cuts getting priced in

Source: NDS, Portfolio Valuation. HSBC MF estimates, Data as on 30 November 2023, Note :
Please refer to Scheme Information Document for more details on Asset Allocation of the scheme.

Indian Government Bonds inclusion in Global Bond Indices

India bonds are confirmed to be added to J.P. Morgan Emerging Market indices starting Jun 2024



- The inclusion of Indian Govt. bonds (IGB) in the JPM- EMBI index will create demand of ~ USD 25 bn over FY 2025
- **Inclusion in other global bond indices like the Bloomberg Global Aggregate Index remains likely, with possible inflows of another USD 20-25bn**

Index flows could result in USD 45-50 bn inflows into India bonds over the next few years

Source – Bloomberg, Data as on 20 Dec '23,

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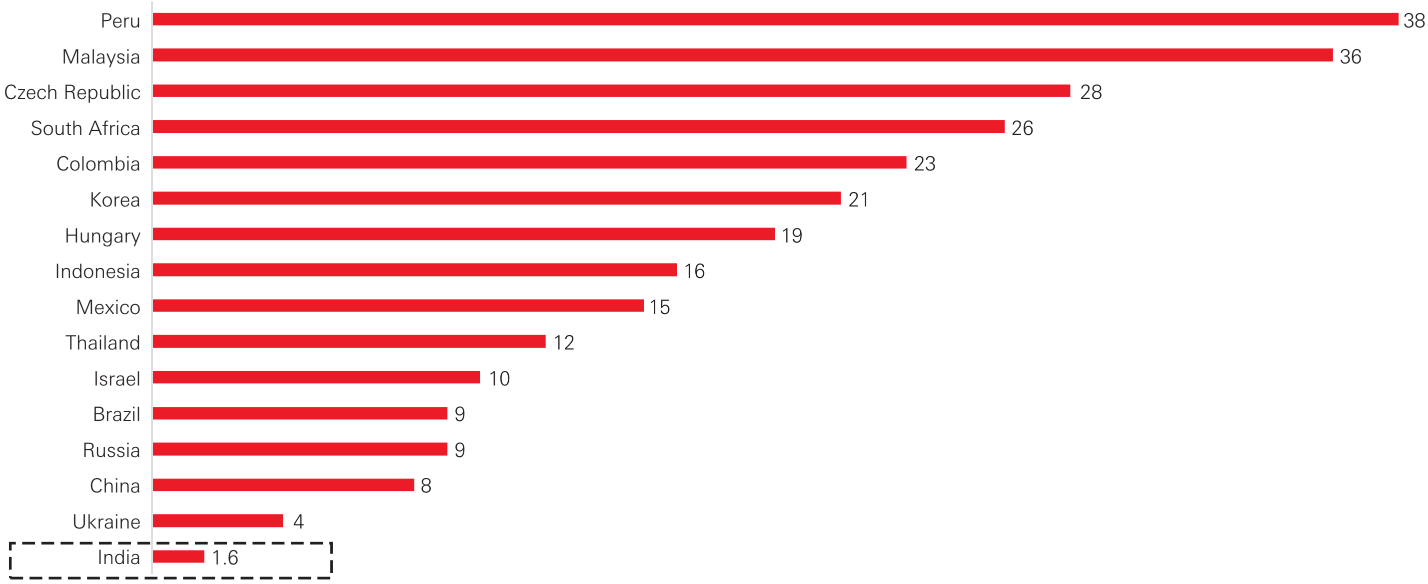
Ownership of FPIs in Indian Government Debt among the least

FPI ownership in EM domestic bond markets (%)



FPI ownership of Indian Government Debt at 1.6% is among the lowest in EMs

Even with incremental flows of USD 50 bn, total FPI ownership of Indian Govt. debt will be ~ 5%

Source – RBI Bulletin, Data for India as on 30 Sep '23, Bank of America Research, Data for other countries as on 17 Aug'23

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2024 Interest rate outlook

Global interest rates have peaked; any growth or financial stability concerns can see yields fall further

CPI is likely to track RBI expectations (5.4% for FY 2024) and gradually move to 4.5% in FY 2025

Fiscal deficit is on consolidation track with FY 2024 @ 5.9% of GDP and FY 2025 likely at 5.4% of GDP

CAD is likely to be below 2% for FY 2024/2025, with BoP surplus adding to RBI reserves

Inclusion of IGBs in global indices to result in USD 25-50 bn of inflows

RBI is likely to shift to an easing bias in Q2/Q3 FY 2025 with two rate cuts by March 2025

Unlike OIS, cash bonds are not pricing in any rate cuts

We believe there is value in adding Duration to portfolios, with an investment horizon of 1.5 to 2 years

Source – Bloomberg, RBI, CPI - CPI (Consumer Price Index), CAD (Current Account Deficit) Data as on 30 November 2023,
Views are personal and based on information available in the public domain at this present for outlook.
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