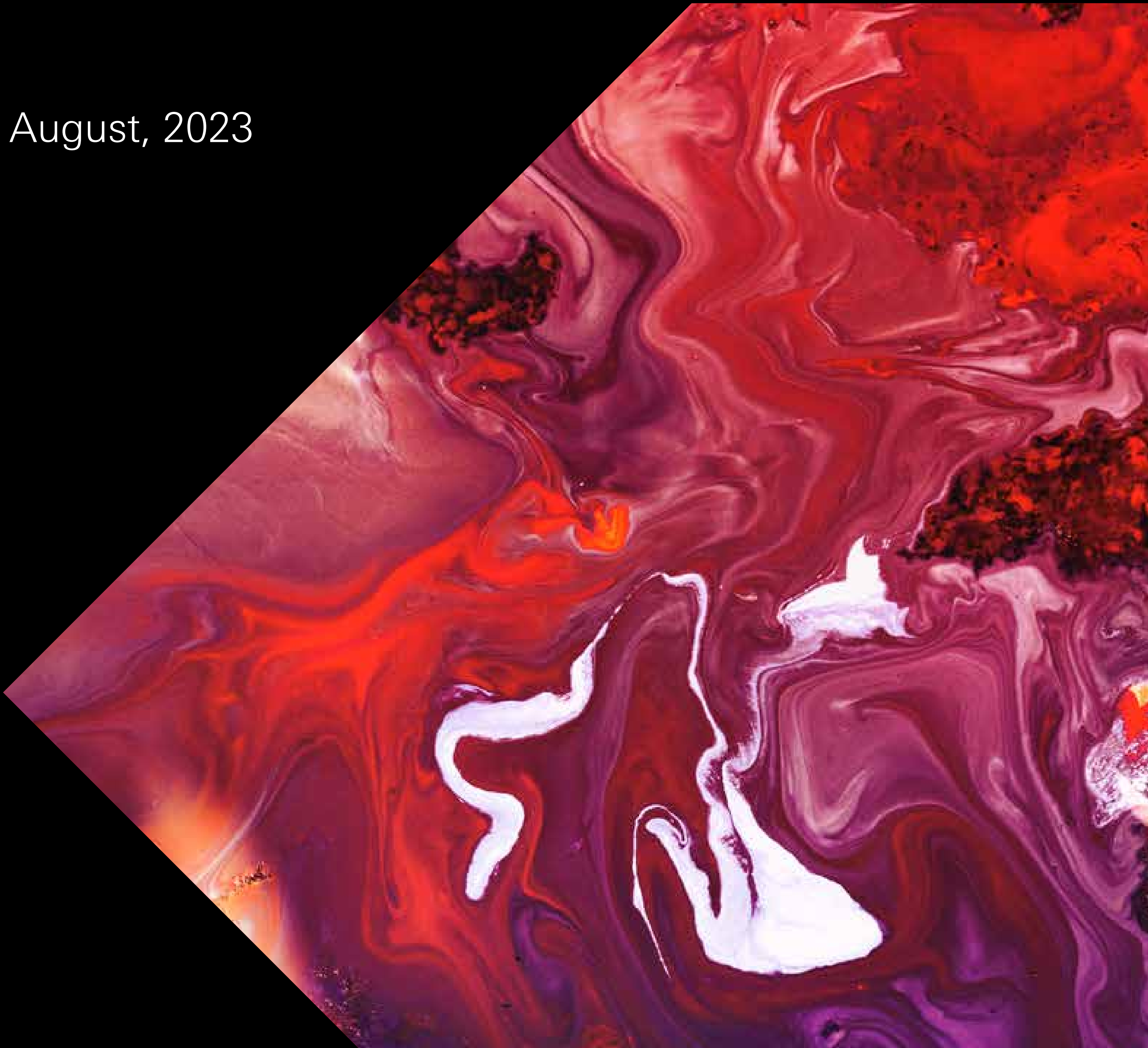
HSBC Mutual Fund

Debt Market Review

August, 2023



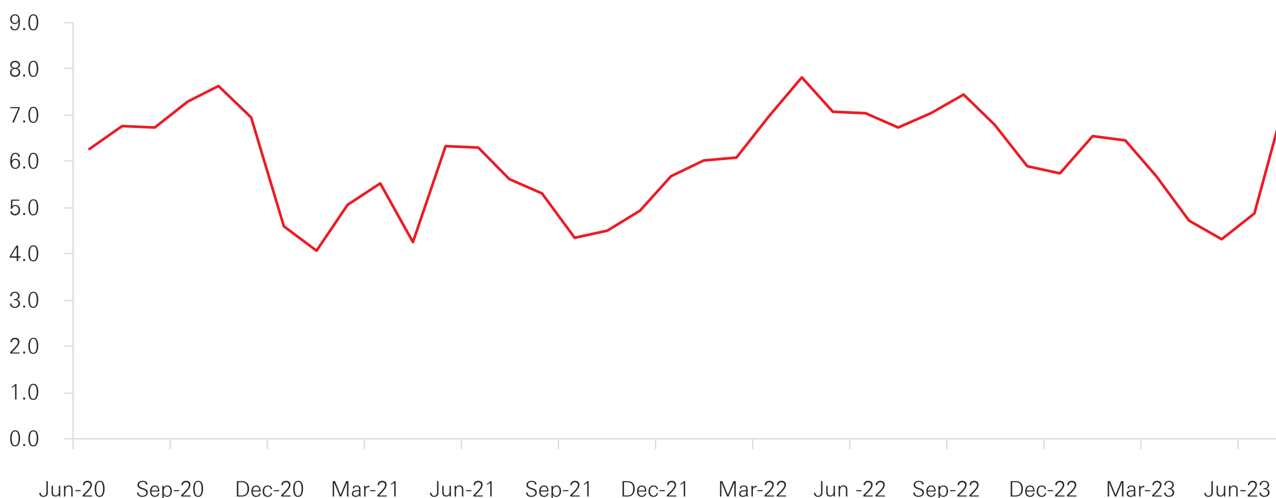
In early August, we saw a surprise downgrade of USA sovereign rating to AA+ from AAA by Fitch. With this downgrade, the USA is now rated AAA by Moody's only. FOMC minutes for the July Fed meeting indicated that Federal Reserve would remain data dependent going forward in terms of rate actions. On the inflation side, US CPI inched up to 3.2% in July vs 3.0% in June, which was largely on expected lines. With rate cut expectations in the US being pushed back and markets pricing in a higher for longer narrative, US Treasury (UST) yields inched up during the month and reached a peak of ~4.34% vs 3.96% in end July before reverting to 4.11% in end August. The UST curve remains inverted with 2-year vs 10-year spread currently at ~70 bps vs ~90 bps in end July. Crude prices traded above the USD 80/bbl mark and inched up further to USD ~88/bbl in early September.

Domestically, the key event in the month of August was the RBI monetary policy committee (MPC) meeting where status quo on rates was maintained. The MPC reiterated "withdrawal of accommodation" stance with a majority of 5:1. The RBI also introduced a temporary "incremental CRR" of 10% on Net Demand and Time Liabilities (NDTL) garnered from 19th May 2023 till 28th July 2023. The same will be reviewed by RBI on 8th September 2023.

Macro-Economic Developments

- On the domestic macro front, inflation rose sharply in July driven by an extremely sharp spike in vegetable (tomato) prices, leading to CPI inflation moving to 7.44% in July vs 4.81% in June. The sharp increase in vegetable prices resulted in food inflation moving to 11.5%. Core inflation on the other hand remained subdued and inched lower to 4.9%. While vegetable prices have reverted lower towards the end of August, risks to food inflation, including from likes of pulses and cereals, could emerge from uneven temporal and distribution of the monsoon, with the month of August seeing deficit rains in several geographies.

CPI Inflation (%)

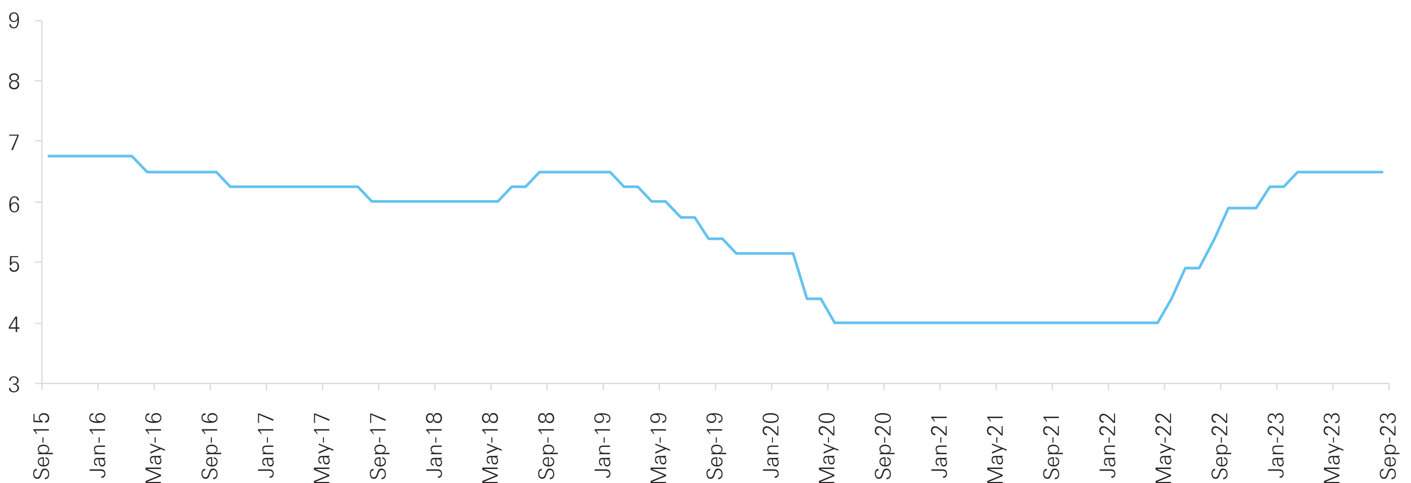


- On the growth front, GDP growth for Q1 FY2024 came in at 7.8% vs 6.1% in the previous quarter. GVA growth was also similar at 7.8%. Nominal GDP growth slowed down to 8.0% vs 10.4% in the previous quarter.
- Other data points including August manufacturing PMI at 58.6, June IIP at 3.7%, July core sector growth at 8% continue to point to reasonable growth momentum in the economy.
- GST collections were at INR 1.59 Lakh Crs, up ~11% (YoY).
- Liquidity in the month tightened post the introduction of the I-CRR and dropped into deficit during the middle of the month. However, towards the end of the month, liquidity eased back on government spending.

MARKET MOVEMENTS

- The new 10-year benchmark was auctioned during the month and closed the month at 7.14%, while the 5-year G-Sec remained broadly unchanged.
- Corporate bond yields inched higher by 2-6 bps across various points on the curve.
- OIS rates moved higher across the curve with the 1-year OIS moving up by 10 bps and the 2-5 year OIS moving up by 4 bps.
- 6–12-month T-Bill rates moved up by around 15 bps while the CD rates were in the 7.20%-7.50% (higher by up to 5 bps during the month).

Repo Rate (%)



Outlook

Global bond yields have moved higher in the past month with the narrative once again moving towards higher for longer on the US rates front. Growth and employment indicators in the US continue to indicate an economy far from recession. This has re-ignited fears that inflation may remain stubbornly above the Fed's target of 2% and higher for longer policy rates may be required by the Fed over the coming 3-4 quarters before the fight against inflation can be declared as over.

Indian bond markets have so far been less volatile relative to global bond markets. With oil prices inching up as well and food inflation showing signs of remaining elevated, the correlation between the two has started increasing. As a result, rates could remain volatile, with global narratives shifting from one side to the other. In this backdrop, our bond markets could see some correction in yields. We believe, such a move would provide an opportunity to add duration and provide a good entry point into longer duration bond funds.

From a medium term perspective, despite some volatility in bond yields over the coming few months both globally and in India, we continue to believe we are at the peak of the rate hiking cycle. In our view, the risk–reward has turned in favor of careful deployment into certain areas which offer the best risk adjusted returns.

Outlook (contd.)

Based on the above outlook above, we believe the below mentioned strategies make investment sense:

- If yields do move higher over the coming few months, investors can look at bond funds in the 2- 5-year maturity segment. **Corporate Bond Funds** and **Banking & PSU Debt Funds** are positioned in these segments.
- For investors willing to take some risk – with volatility being high and markets likely to swing from one narrative to the other during the course of the next few months, we believe **Dynamically Managed Duration and Gilt Funds** may provide opportunities to add alpha through duration changes to take advantage of these movements.
- And for the next level of alpha seeking investors, adding an element of measured credit risk to these strategies (through products such as **Medium Duration Fund**), may become a rewarding proposition.

Source: Bloomberg, HSBC Mutual Fund

Disclaimer: This document has been prepared by HSBC Asset Management (India) Private Limited (HSBC) for information purposes only and should not be construed as i) an offer or recommendation to buy or sell securities, commodities, currencies or other investments referred to herein; or ii) an offer to sell or a solicitation or an offer for purchase of any of the funds of HSBC Mutual Fund; or iii) an investment research or investment advice. It does not have regard to specific investment objectives, financial situation and the particular needs of any specific person who may receive this document. Investors should seek personal and independent advice regarding the appropriateness of investing in any of the funds, securities, other investment or investment strategies that may have been discussed or referred herein and should understand that the views regarding future prospects may or may not be realized. In no event shall HSBC Mutual Fund/HSBC Asset management (India) Private Limited and / or its affiliates or any of their directors, trustees, officers and employees be liable for any direct, indirect, special, incidental or consequential damages arising out of the use of information / opinion herein. This document is intended only for those who access it from within India and approved for distribution in Indian jurisdiction only. Distribution of this document to anyone (including investors, prospective investors or distributors) who are located outside India or foreign nationals residing in India, is strictly prohibited. Neither this document nor the units of HSBC Mutual Fund have been registered under Securities law/Regulations in any foreign jurisdiction. The distribution of this document in certain jurisdictions may be unlawful or restricted or totally prohibited and accordingly, persons who come into possession of this document are required to inform themselves about, and to observe, any such restrictions. If any person chooses to access this document from a jurisdiction other than India, then such person do so at his/her own risk and HSBC and its group companies will not be liable for any breach of local law or regulation that such person commits as a result of doing so.

© Copyright. HSBC Asset Management (India) Private Limited 2023, ALL RIGHTS RESERVED.

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

GST - 27AABCH0007N1ZS | Email: investor.line@mutualfunds.hsbc.co.in | Website: www.assetmanagement.hsbc.co.in

Mutual Fund investments are subject to market risks, read all scheme related documents carefully. CL577