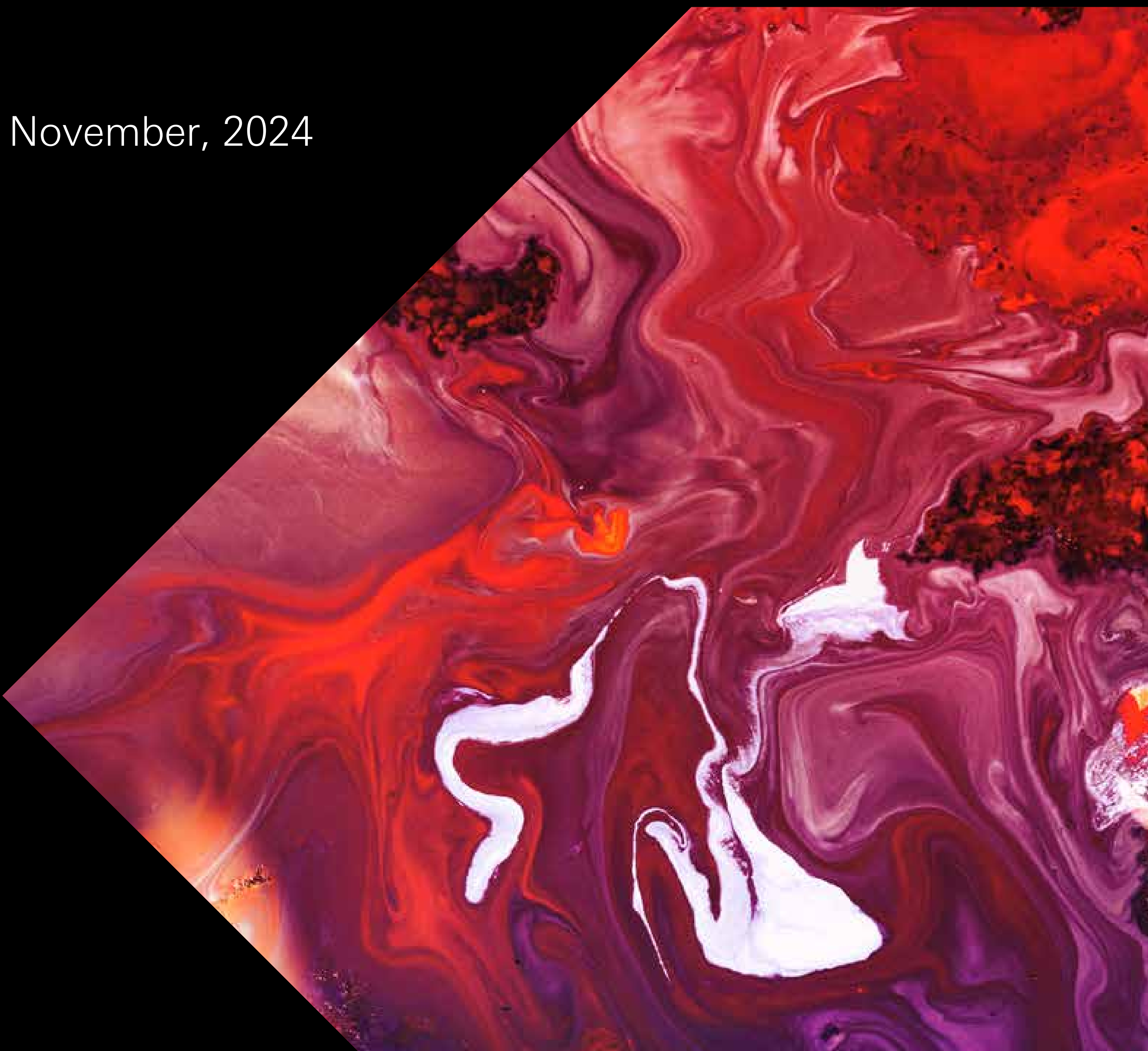
HSBC Mutual Fund

Debt Market Review

November, 2024



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FOMC continued to ease amidst return of the Red wave

The key event during the month was the outcome of the US elections, which resulted in the return of the Red wave with the Republicans sweeping the election mandate. All asset classes responded to the election results, with USD strengthening accompanied with a weakening bias across all EM currencies. Risk assets in the US rallied while US Treasury yields saw a sell-off as fears of tax cuts and fiscal expansionary policies put pressure on bond yields.

The FOMC in its November meeting eased policy rates by 25 bps to 4.50%-4.75%. The Fed Chair indicated that with inflation moving towards the target of 2.0% and general easing in labour market conditions, the risk to achieving the dual mandate remained broadly in balance. The Fed will continue to remain data dependent in determining the future course of rate actions. Meanwhile, the BOE also eased policy rates for a second time this year by 25 bps to 4.75%. Recent inflation prints in the US (PCE), Eurozone and UK remained above the target at 2.3%. US Treasury yields remained volatile during the month, moving to a high of 4.45% before closing the month at 4.17%. Crude prices remained broadly range bound, trading in the USD 71-76/bbl band.

RBI takes guard as FPIs turn sellers and liquidity tightens

Post the US elections outcome, emerging market currencies witnessed a depreciating bias driven by a strong dollar. FPI outflows continued in both equity and debt. While India remained better placed than most other emerging market economies, Rupee still had to bear the brunt moving from 84.10 to 84.50 during the month, with RBI having to strongly intervene in the FX markets to keep volatility in currency to a low. FX reserves fell sharply during the month to USD 657 bn, due to RBI intervention. From a peak of USD 705 bn witnessed in end Sep 2024, FX reserves have fallen by USD 48 bn over the last couple of months. The fallout of RBI's intervention in the currency market was a steep reduction in liquidity. The month started with liquidity being in surplus of around INR 2.5 trn. However, by mid of the month the surplus reduced sharply due to increase in CIC and reduction in FX reserves. Post the indirect tax outflows, liquidity moved into deficit which resulted in overnight rates moving to the higher end of the interest rate corridor. The month end spending by GOI bought some respite and liquidity moved back into surplus marginally. Going ahead, liquidity might remain neutral to tight unless RBI intervenes to bring liquidity back to positive.

Domestic macro-economic factors and data points

- Inflation for Oct 2024 surprised on the upside with headline CPI printing at a 14 month high of 6.21%, driven by a sequential pick up in food inflation on account of higher vegetable and edible oil prices. Core CPI also inched higher to 3.7%. With the last two prints now being above market consensus, FY2025 inflation would most likely remain higher than RBI estimates of 4.5%
- IIP for Sep 2024 remained weak at 3.1%, with industrial growth number for YTD FY2025 at 4.0%
- Trade deficit widened to USD 27.14 bn (from USD 20.78 last month) due to higher oil and gold imports
- Government's fiscal deficit for the period Apr-Oct 2024 widened to INR 7.5 trn (46.5% of full year target) as the Government released an advance instalment of tax devolution to the States in Oct 2024. Revenue remained supported by strong personal income tax growth, while corporate taxes remained weak. On the expenditure side, revenue expenditure kept pace with budget targets while capex continued to remain a drag
- GST collections continued to remain strong at INR 1.82 trn

GDP data spins a googly…

India's GDP data for Q2 FY2025 came in as a negative surprise printing at 5.4%, significantly lower than market and RBI estimates. GVA growth also came in much lower than market consensus at 5.6%. Nominal GDP for the quarter also remained tepid at 8.0%. Private investment growth and private consumption continue to remain a laggard. Industry growth remained weak at 3.6%, with mining sector seeing a contraction and manufacturing sector seeing a slump in growth to 2.2%, while services sector growth has held up. Although Government spending has picked up pace (evident from the low Government cash balance) and rural demand is expected to pick up, there is a significant catch up required to be even close to the full year growth estimates and markets are now expecting the full year growth number to massively undershoot RBI estimates.

Which leaves RBI between a rock and a hard place.

RBI finds itself in a precarious situation before the upcoming MPC meeting. On one hand, inflation has remained above expectations for the last two months and in all likelihood MPC will have to increase their full year inflation estimates, and on the other hand the recent GDP print has been a shocker, with no market participants expecting such a fall in growth. Although, the Government will continue to push on expenditure and provide the required stimulus, but at this stage only fiscal measures might not be enough to revive growth. RBI will have to do their bit in easing policy rates to ensure no further damage happens on the growth front. In between all of this, RBI also needs to be extremely mindful of the weakening currency bias, which has resulted in tightening of liquidity (which doesn't tie up with the MPC's neutral stance) and a corresponding fall in FX reserves.

Markets are now pricing in some possibility of a Dec rate cut and higher probability of a Feb rate cut. While base case might still remain of 50 bps of easing, but if growth continues to lag and food inflation retraces majority of its up move over the next few months, RBI might be pushed to ease rates by a total of 75-100 bps. On liquidity front, RBI might look to use CRR and/or OMO purchase as a tool to infuse liquidity. To create a positive impetus through OMO might require a large amount of IGBs to be purchased by RBI in a short period of time, which makes CRR possibly a more effective tool to infuse liquidity in a shorter span of time. Easing of CRR by 50 bps will roughly add INR 1.1 trn to liquidity.

What this means is that rate cuts might get frontloaded and liquidity injection will be top priority on RBI's agenda. We continue to maintain a positive duration bias across the funds with duration at the higher end of the prescribed band for most of the funds. We recommend investors to stay invested and add duration to their portfolios wherever possible subject to their risk return frameworks.

Fund Strategies

- Although some volatility might unfold in G-Sec rates over the next few months, we believe the longer end of the curve is likely to remain supported as end investor demand might remain strong. Hence, we believe that any further corrections, can be looked at as an opportunity to cautiously add duration. **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
- With liquidity expected to remain comfortable and expectations of rate cuts getting priced in going forward, we believe the corporate bond spread compressions story is there to be captured
- **HSBC Banking and PSU Debt Fund** is predominantly invested in assets maturing in the 1.5 year segment, it provides an investment opportunity for investors looking at a short-to-medium term investment horizon
- **HSBC Short Duration Fund** and **HSBC Corporate Bond Fund** are predominantly positioned in the 2-6 year part of the curve and may be considered for investment with a medium-term horizon and slightly higher appetite for interest rate risk. Both these funds are appropriately positioned to benefit from these developments

Abbreviations:

FOMC: Federal Open Market Committee
ECB: European Central Bank
BOJ: Bank of Japan
BOE: Bank of England
GDP: Gross Domestic Product
GVA: Gross Value Added
MPC: Monetary Policy Committee
OMO: Open Market Operations
CRR: Cash Reserve Ratio
G-Sec: Government Securities
FPI: Foreign Portfolio Investment
IGB: Indian Government Bond
CPI: Consumer Price Index
PCE: Personal Consumption Expenditure
CIC: Currency in Circulation

Scheme name	Potential Risk Class
HSBC Corporate Bond Fund **HSBC Gilt Fund** **HSBC Banking & PSU Debt Fund**	see table below

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	Potential Risk Class
HSBC Short Duration Fund	see table below

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

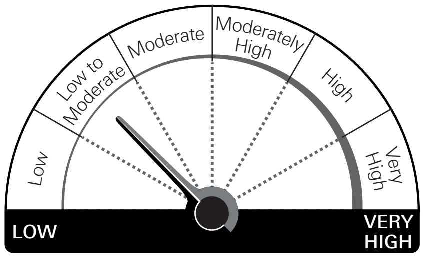
This product is suitable for investors who are seeking#

***Riskometer of the Scheme**

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.

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. 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.

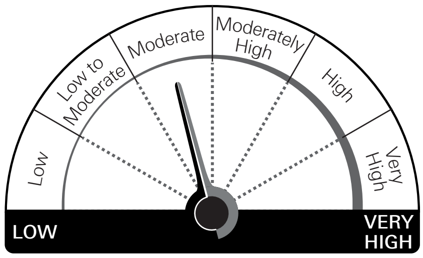
HSBC Corporate Bond Fund (An open-ended debt scheme predominantly investing in AA+ and above rated corporate bonds. A relatively high interest rate risk and relatively low credit risk.)

- 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.

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 November, 2024.

Source: Bloomberg & HSBC MF Research estimates as on 30 November, 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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Mutual Fund investments are subject to market risks, read all scheme related documents carefully. CL2154