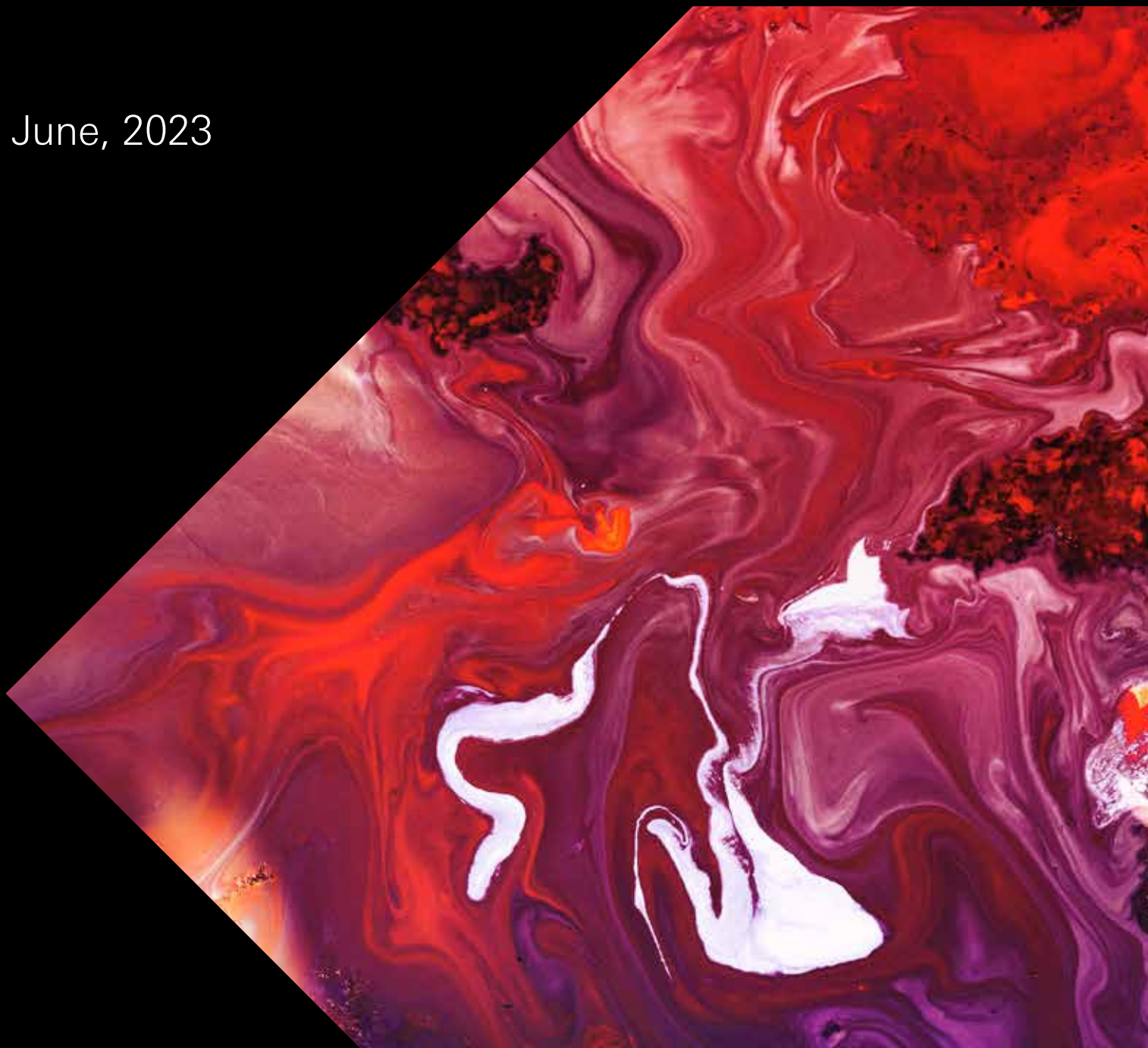


Debt Market Review

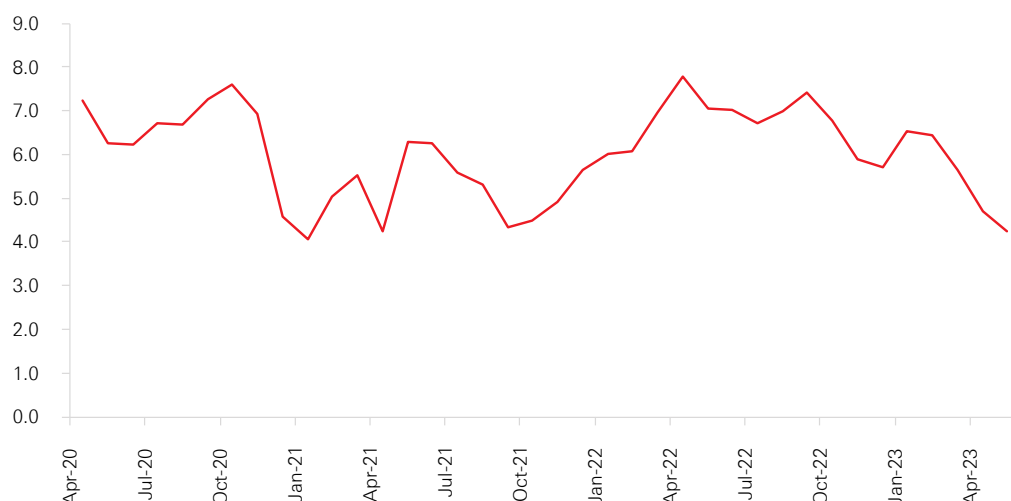
June, 2023



The Federal Open Market Committee (FOMC) delivered a hawkish pause in the June meeting. The Central Bank raised the dot plot by 50 bps for 2023, while hinting the July policy meeting being a 'live one'. Growth and inflation forecasts were revised higher while unemployment rate forecasts were revised lower. The FOMC Chair clarified that although recent inflation prints show moderation, inflation was still far off from the target. In a surprise move, the Bank of England (BoE) raised policy rates by 50 bps (against broad market expectations of 25 bps hike). This was the 13th consecutive rate hike conducted by the BoE. The European Central Bank (ECB) also raised policy rates by 25 bps on inflation concerns, taking their policy rate to the highest level in the last 22 years.

US inflation print for May 2023 edged lower to 4.0% (vs 4.9% in Apr 2023). Core CPI also came marginally lower at 5.3%. Inflation in UK and Eurozone continued to remain high with the recent CPI prints at 8.7% and 5.5%, respectively. The UST curve continued to invert further with the 2-year / 10-year spread at ~105 bps as of June end compared to ~75 bps in May end. The UST 10-year inched higher during the month closing at 3.84% vs 3.65% as of May end. Brent crude prices have remained stable through the month, trading around USD 75/bbl.

CPI Inflation (%)



Macro-Economic Developments

- ◆ May CPI inflation moderated to 4.25% (vs 4.7% in Apr 2023), driven by lower food inflation. Core inflation also edged lower to 5.0% (5.2% in Apr 2023). WPI contracted further on a Y-o-Y basis, with the May print at -3.48%. This is the lowest WPI print since November 2015. IIP for Apr 2023 came in higher than expectations at 4.2% (vs 1.7% in Mar 2023), led by an uptick in manufacturing and mining.
- ◆ The State Development Loans (SDL) borrowing calendar for Q2 FY2024 was released with a gross borrowing number of INR 2.37 Lakh Crs.
- ◆ The gross borrowing through T-Bills in Q2 FY2024 is expected to be INR 3.12 Lakh Crs with weekly auctions to the tune of INR 24,000 Crs.
- ◆ Trade Deficit for May 2023 widened to USD 22.1 bn as against a lower deficit number of USD 15.2 bn in Apr 2023.
- ◆ Goods exports is likely to remain weak, given weaker global demand, however robust services exports and lower Crude prices bode well for the external sector and the Rupee.
- ◆ Current Account Deficit (CAD) for FY2023 was reported at USD 67 bn (2.0% of GDP), while CAD for Q4 FY2023 narrowed to 0.2% of GDP.

- ◆ For FY2023, Balance of Payments registered a deficit of USD 9 bn, against a surplus in FY2022.
- ◆ PMI numbers continued to remain robust, with the June Manufacturing PMI number at 57.8, while bank credit also remained resilient, registering a growth of 15.6%.
- ◆ GST collections for June 2023 reported a y-o-y uptick of 12% to INR 1.61 Lakh Crs.
- ◆ RBI had announced the withdrawal of INR 2000 denomination notes from circulation in May 2023. The notes could be exchanged with notes of lower denominations till 30th September or could be deposited with banks. As per latest RBI estimates, 76% of the total INR 2000 notes in circulation (worth INR 2.72 Lakh Crs) have been returned to banks, of which around 87% has been in the form of deposits and 13% has been exchanged into other denomination notes. RBI has used VRRR auctions as the preferred tool to manage the liquidity created through the deposit of these notes.

MARKET MOVEMENTS

In terms of market movements, 10-year G-Sec moved up by 13 bps during the month to 7.12%, while the 2-year to 5-year G-Sec curve also moved up by 12-17 bps. Corporate bonds across the curve rose by 10-15 bps. OIS curve saw an even sharper move, with the 5-year OIS moving higher by 28 bps. Money market rates benefited from improved liquidity conditions, moving lower by 2-5 bps during the month.

Outlook

The MPC decided in the previous policy to assess the impact of past actions and keep an eye on how policy actions shape up in other economies. Globally, Central Banks have either continued to raise rates or maintained a hawkish pause, hinting that inflation still remains way above the target levels. A strong external sector, relatively benign inflation and robust growth momentum (especially compared to rest of the world) gives enough space to the RBI to wait and take calibrated measures in the future if needed.

Markets have seen some correction in rates over the last month, with some uncertainty developing over future rate actions in advanced economies. This has increased volatility domestically as well, with yields across most segments rising. We view the current sell-off as an opportunity to gradually add duration across some of our actively managed strategies. At the same time, we are mindful of the evolving hawkish monetary policy landscape, especially on the global front. The next few months could see further shakeout of rates in developed markets, as bond markets come to grips with inflation being stickier than initially thought.

In such a market environment, it is difficult to predict exactly when the markets turn and often such turnarounds tend to be sharp and dramatic. Hence, while yields may move higher over the very near term, our medium-term expectations on rates remain positive with a 1-2 year investment horizon, as bond markets are likely to benefit from a likely rate cutting cycle in 2024 and a gradually more accommodative RBI stance.

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

- ◆ With 6-9-month CD space now yielding close to 7.10%-7.30%, this makes a compelling case for investors to get into investment products like **Money Market Fund** and **Ultra Short Duration Fund** which invest predominantly in the 6-9-month space.

Outlook (contd.)

- ◆ 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** can provide more 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**), can become a rewarding proposition.

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