HDFC Bank – Research Presentation

April 2024

Risk profile-based asset allocation

Asset Class	Overall View	Asset Allocation		
		Aggressive	Moderate	Conservative
Equity Funds	◆	75%	55%	25%
Debt Funds	▲	20%	40%	70%
Gold	▲	5%	5%	5%

Note:		
	Optimistic	▲
	Cautiously Optimistic	◆
	Cautious	▼

Category-wise view

MF Categories	View
Equity Oriented Funds	
Largecap Funds	▲
Large Cap Index Funds	▲
Multi/Flexicap Funds	▲
Large and Mid Cap Funds	◆
Mid cap	▼
Small cap	◆
ELSS	◆
Value / Contra / Dividend Yield Funds	◆
Focused Funds	◆
Aggressive Hybrid Funds / Dynamic Asset Allocation / Balanced Advantage Funds	▲
Equity Savings Funds	▲
Sector/Thematic Funds	◆
Multi Asset Allocation Funds	▲

MF Categories	View
Debt Oriented Funds	
Short Duration Funds/Medium Duration Funds	▲
Banking & PSU Funds	◆
Corporate Bond Funds	▲
Target Maturity Index Funds	▲
Medium to Long / Long Duration Funds	▲
Dynamic Bond Funds	▲
Gilt Funds	▲
Ultra Short Duration/Low Duration/Money Market Funds	◆
Arbitrage Funds	▲
Liquid/Overnight Funds	◆
Conservative Hybrid Funds	◆
Credit Risk Funds	◆

Equity MF Strategy – April 2024

- The global economic growth estimates has seen upgrades coming through from key multilateral agencies, driven by improved economic outlook in key economies.
- Ample liquidity provided by the US Government's fiscal support, despite the balance sheet tapering by the US Fed, has kept the US economy going. Signs of steadiness are being witnessed in the incoming data on Manufacturing and Services. The consumption and the employment data remains robust and GDP growth is also holding up well. While the US Fed seems to be hinting at peaking of the policy rates, the timing of the rate cuts seem to have been postponed. Going forward, **a very important element that all risk assets will have to pay attention to is how the focus of both the US Fed and the US Government move towards managing liquidity, rates and growth dynamics.**
- Eurozone growth remains weak as most incoming data shows lacklustre performance. However, some early signs of stability being witnessed due to easing of financial conditions, the continuation of which would be important.
- While the GDP growth in China remains below expectations led by the issues in their Real Estate sector, some key data points are showing gradual recovery, such as growth in consumer spending and improved trade balance. The Chinese equity markets have also moved higher on the back of these data points along with the fiscal and monetary support being provided by the Government. With the valuations in the Chinese markets at multi year lows, any positivity that comes about due to the measures taken by the government, may drive global FPI flows in that market.
- With stable economic performance of the US and green shoots being witnessed in China, commodity prices are gradually seeing uptick from their recent lows; while the food price inflation globally is still weakening. The conflict in the Middle East and tight supply by OPEC+ members have driven up crude oil prices. The troubles in the Red Sea is leading to rise in logistics costs for businesses across the world.
- Improved economic data from the US vs its peers and expectation of delay in policy rate cuts by the US Fed has led to uptick in the US dollar index, impacting foreign flows into the equity markets in the emerging economies.
- The overall economic indicators in India continued to remain strong. The GDP growth estimates have been upgraded by major multilateral agencies.
- Many of the key indicators like the strength in the real estate and construction activities bode well for rural economy, which has yet to fire completely. The growth in Two-wheeler sales seems to give an early sign of improvement in the rural demand. The unemployment rate for the rural labour also seems to be declining. Softening core inflation could further help lifting the demand sentiments.
- Urban demand trends have seen improvement. Indicators like personal loan growth, high hotel occupancy rates, and air passenger traffic have been strong. Passenger vehicle sales growth, led by SUV's, too has held strong.
- Corporate and Banking sector balance sheets in India have shown strong improvement, capacity utilisation data too has improved, and this is driving incremental private capex demand. With policies like PLI, preference by global corporations to diversify out of China into economies like India and others, need to create more energy assets and focus on import substitution by Indian government, the capex cycle is expected to last long. The growth in the Gross Fixed Capital Formation remains robust. The current cycle in the equity market seems to be largely driven by the capex upcycle and policy reforms by the Government.
- The RBI has paused its rate hikes and is projecting moderation in inflation going forward. The recent focus of the RBI to keep liquidity on a tight leash in India has helped contain inflation. While this has not had negative implication on growth trajectory so far, but with the economy geared up for high capital spending, eventually the market participants expect improvement in liquidity conditions..
- The Equity markets have moved to near all-time highs on Key indices, led by stable earnings performance and strong Domestic investor participation. The recent correction in the Smallcap segment has led to reduction in the valuations and also taken some steam off the likely froth building in certain segments. Though at an aggregate level the valuations of both Midcap and Smallcaps are still higher than Largecap indices.
- **Q4FY24 results may see the benefit of lower base on the business margins gradually declining and may lead to results which are lower than market expectations in many segments, in absence of revenue growth. The differential between earnings performance may see a gradual narrowing in the number of outperforming stocks in the equity market.**
- Any large earnings cuts and change in consumer spending trends, relative valuations play (within the EM basket), and unfavourable general election results could weigh on the market performance. While, in the long term, improving domestic macro conditions, favourable demographics and higher capex investments could keep driving the Indian corporate earnings higher and support the equity markets.
- **Investment deployment strategy could be at 40% lumpsum and rest 60% to be staggered over the next 5-6 months. Investors can look to focus on categories like Largecap, Flexicap, Multicap, Equity Hybrid and Multi-asset funds. In the Smallcap segment, investors could either use large dips to invest in lumpsum or follow a STP method in absence of a dip. All allocations should be done in line with the risk profile and product suitability of the investor.**

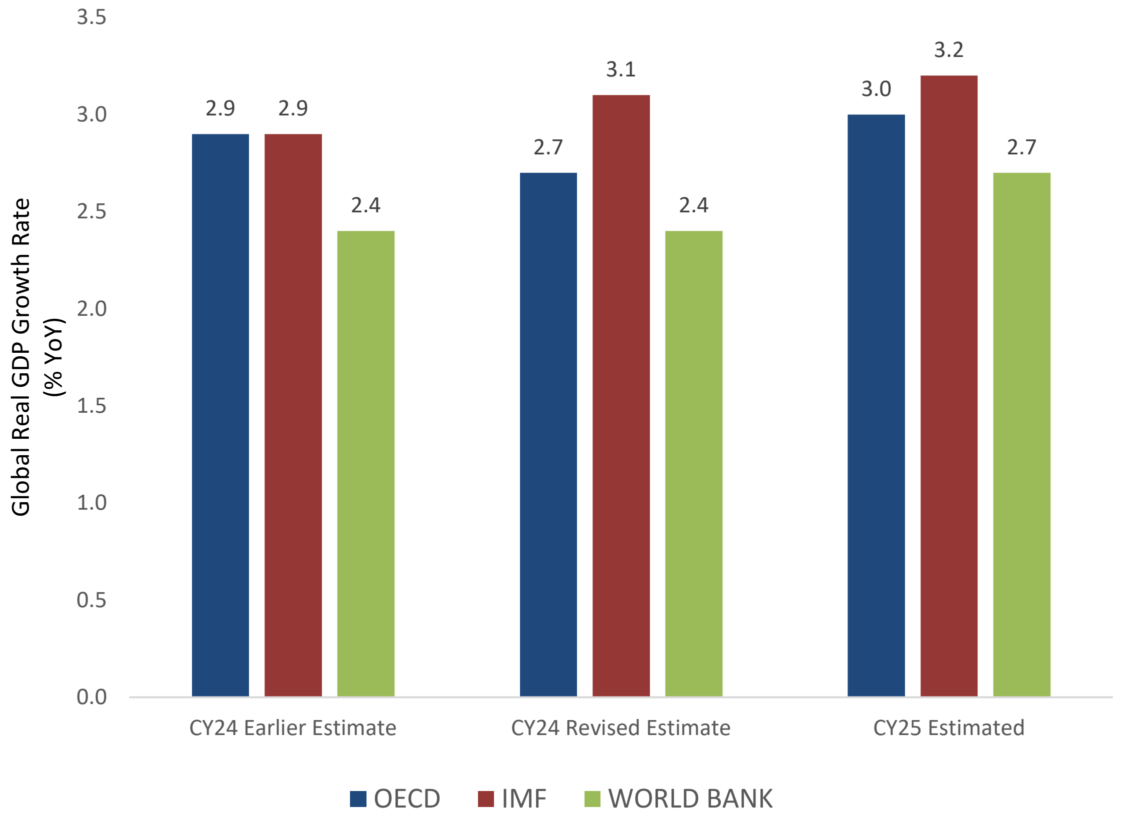
Debt Mutual Fund Strategy

- Corporate Bond Funds, which typically have a higher yield to maturities, look a safe bet at the current juncture.
- Thus, investors can look at Corporate Bond Funds and Short duration funds for a horizon of 15 months and above.
- Investors who are comfortable with volatility and have a longer horizon of 24 months and above can take exposure to Dynamic Bond Funds, Gilt Funds and longer-tenor SDL Index Funds to play the improved fiscal deficit dynamics.
- For lower volatility and a horizon of 3 months and above, investors can consider Arbitrage Funds.
- Whereas for a horizon of up to 3 months, investors can consider Overnight Funds and Liquid Funds.
- Investors can also look at Multi-asset allocation funds for a horizon of 36 months and above.
- Investors should invest in line with their risk profile and product suitability.

Research presentation – Content

While Global growth projections have improved……Due to geopolitical tensions, incremental pressure visible on supply chains

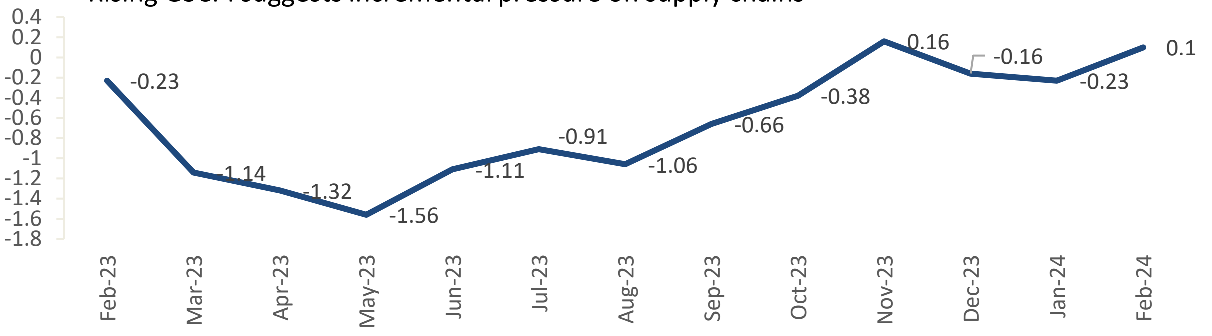
Global GDP growth projections have been pushed up



Source: OECD; IMF; World Bank

Global Supply Chain Pressure Index (GSCPI)

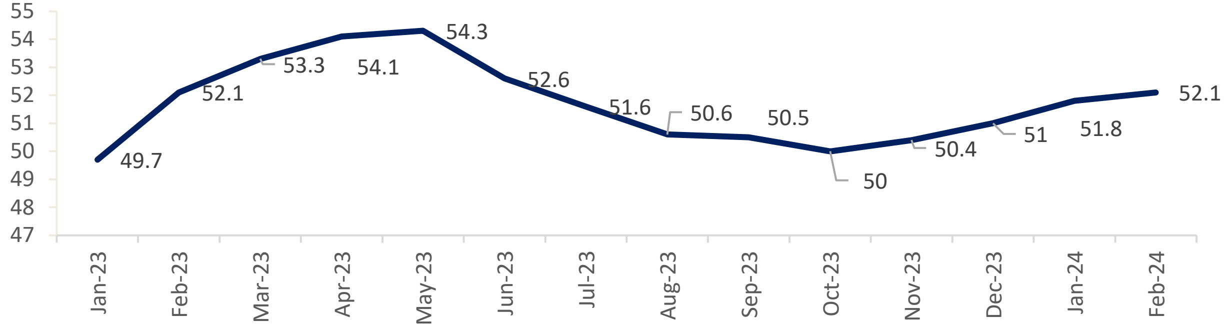
Rising GSCPI suggests incremental pressure on supply chains



Source: Bloomberg

JPMorgan Global Composite PMI

Global composite PMI in expansion zone lead by strong Macro data across key economies

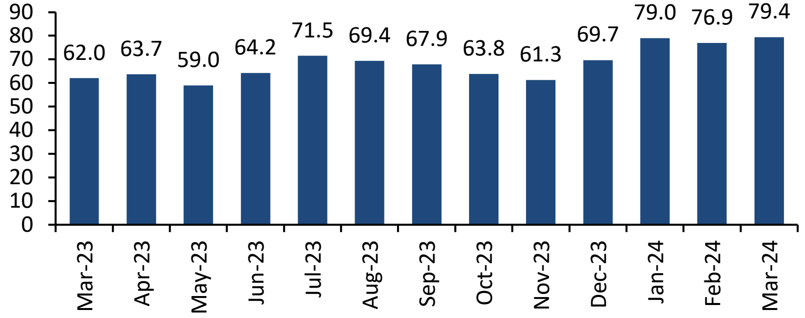


Source: Bloomberg

US economy showing sign of stability

US Consumer Sentiment Index

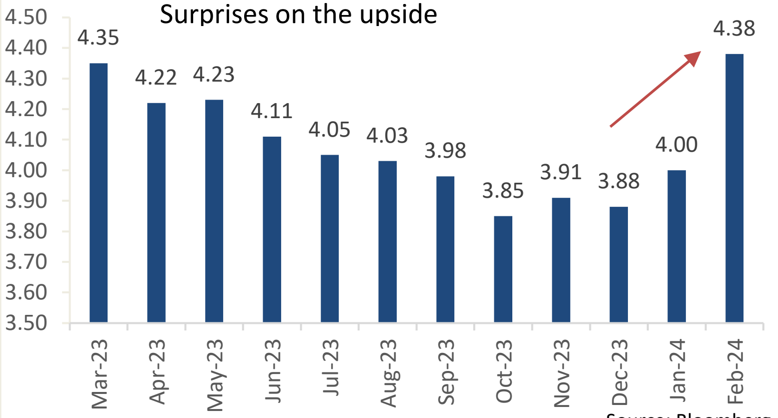
Rising Consumer Sentiment indicative of growing confidence in the US consumers



Source: Bloomberg

US Existing Home Sales (In Million)

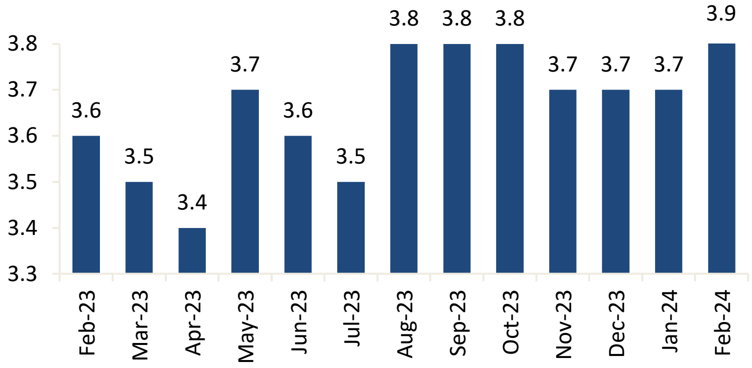
Surprises on the upside



Source: Bloomberg

US Unemployment Rate (%)

Continues to remain low



Source: Bloomberg

US Fed Guidance for three rate cuts

The US Federal Reserve held rates steady but still signalled that 3 rates would most likely happen in CY 2024. The market is factoring in the first rate cut happening in June 2024.

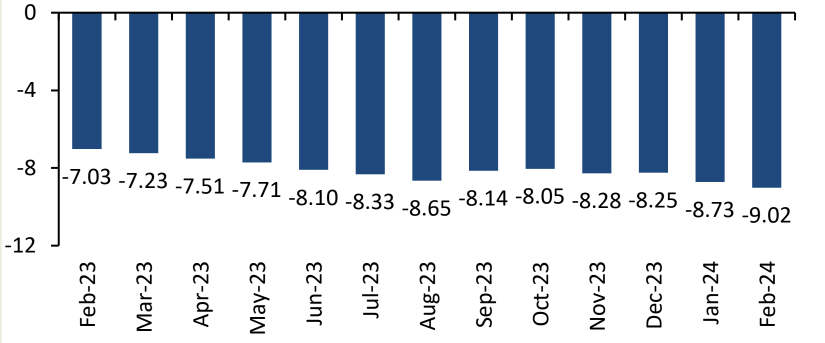
Driven by improved sentiments, US market valuations scale to recent high

Source: Bloomberg

Eurozone – economy continues to struggle, despite easing financial conditions

Eurozone Leading Economic Index YoY (%)

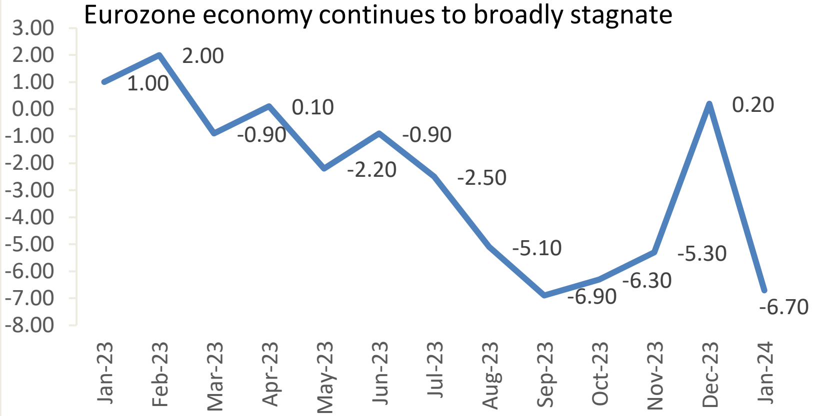
Headwinds to growth continue to persist



Source: Bloomberg

Eurozone Industrial Production - YoY Change (%)

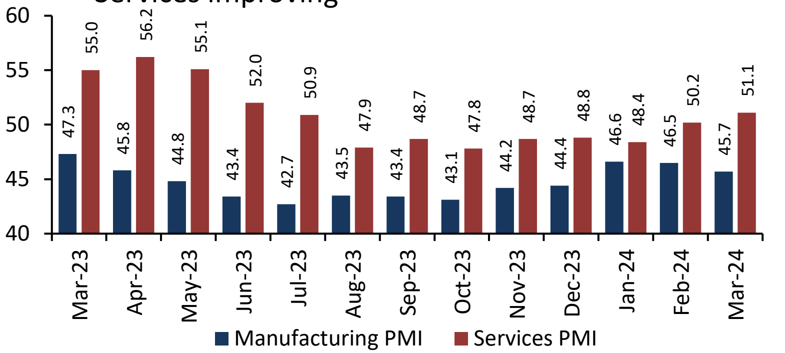
Eurozone economy continues to broadly stagnate



Source: Bloomberg

S&P Global Eurozone PMI

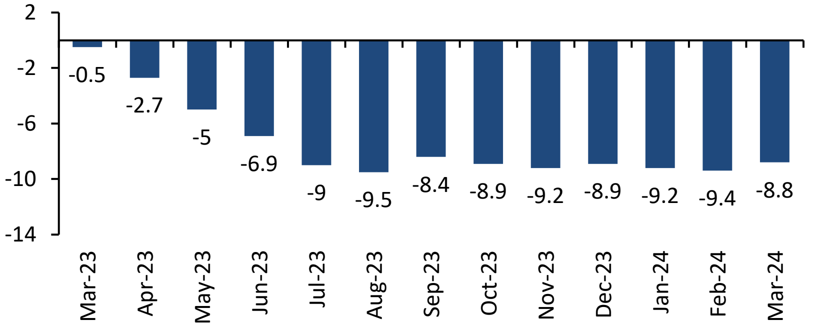
Manufacturing on a declining trajectory, while Services improving



Source: Bloomberg

Eurozone Industrial Confidence Indicator

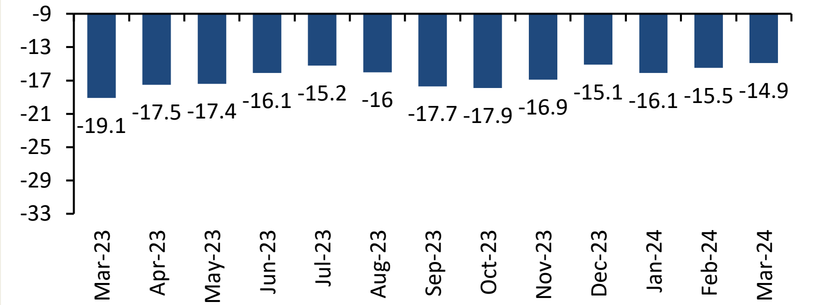
Weakness continues to persist but trend showing turn



Source: Bloomberg

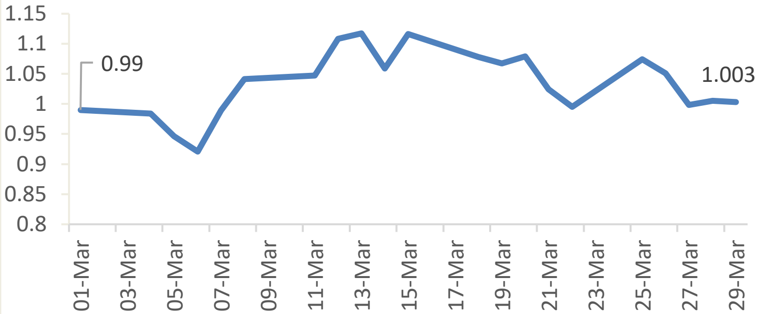
Eurozone Consumer Confidence Indicator

In the negative territory, but improving



Source: Bloomberg

Euro Area Financial Conditions Index has seen improvement



Source: Bloomberg

China – Economic downgrade continues driven by real estate sector…green shoots visible… valuations cheap

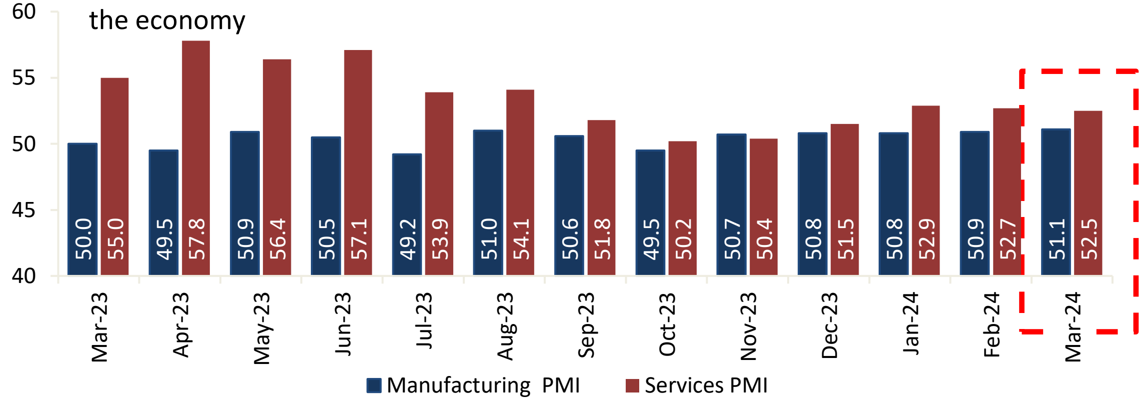
Shanghai Composite Trailing PE Ratio

Valuations have become cheap...

Source: Bloomberg

China Manufacturing & Services PMI

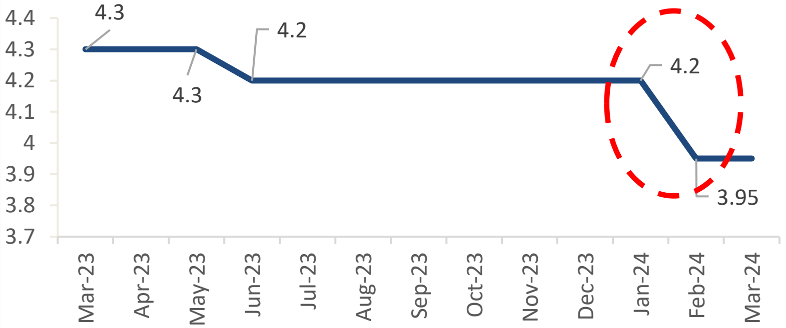
PMI remains in expansionary zone which is a positive sign for the economy



Source: Bloomberg

China Loan Prime Rate - 5 Year (%)

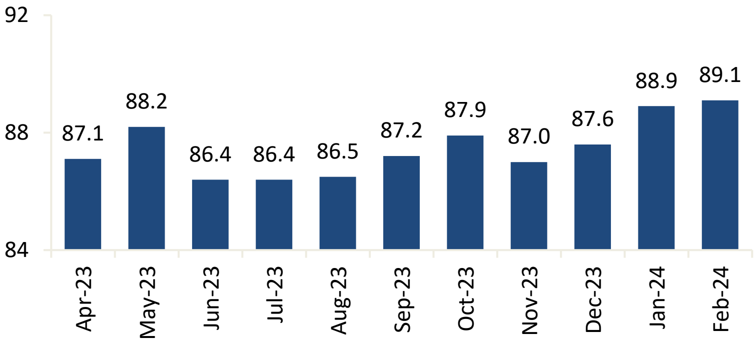
25 bps cut to the five-year LPR is clearly aimed at supporting the housing market



Source: Bloomberg

China Consumer Confidence Index

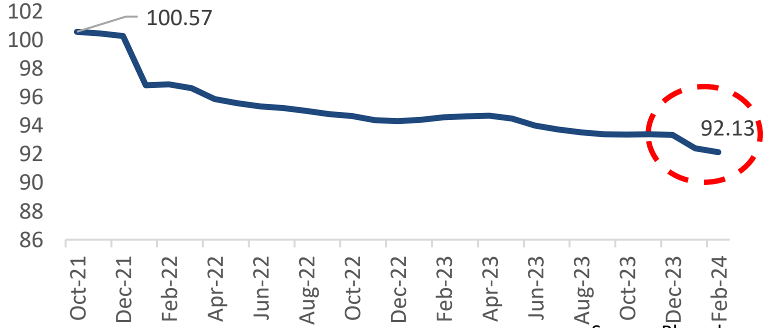
Consumption trends improving



Source: Bloomberg

China Real Estate Climate Indicator

Real Estate sector in China continues to drive weakness in overall economic outlook



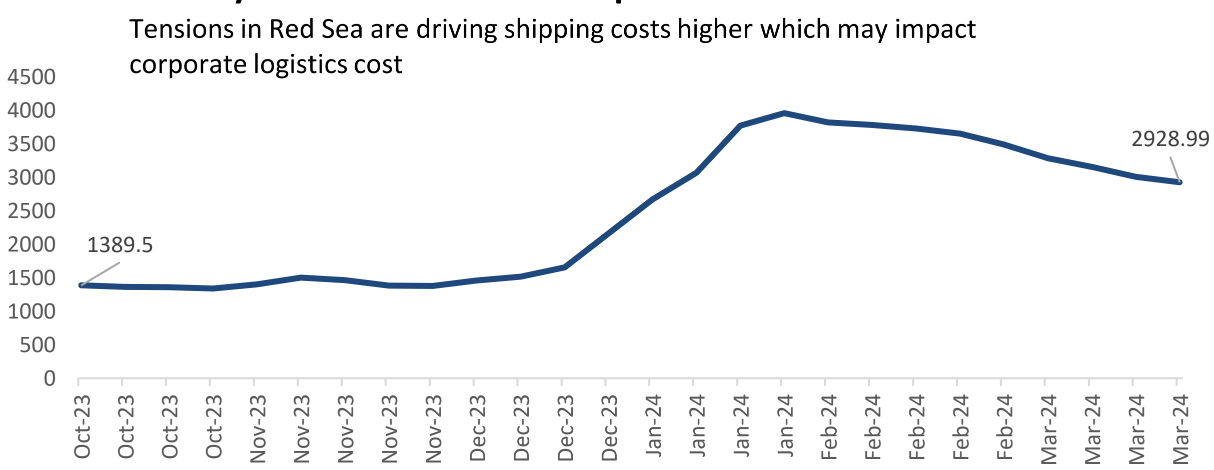
Source: Bloomberg

Commodities: Industrial commodities rise from a low base, Crude jumps, logistics costs rise…. While food prices remain benign… Gold moves to all time highs

Bloomberg Commodity Index

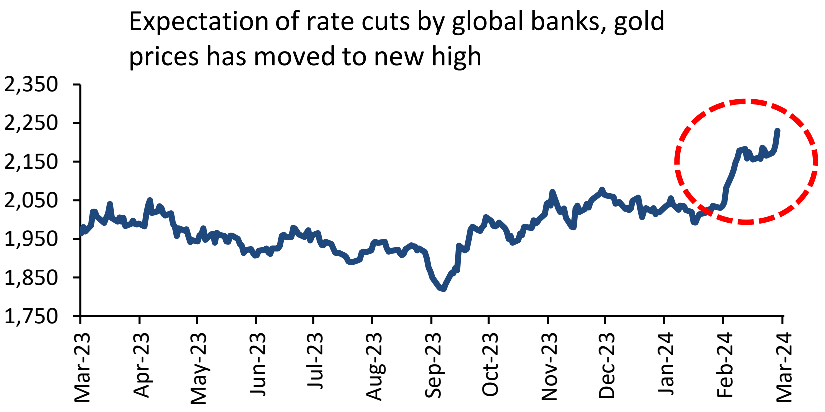
Source: Bloomberg

Drewry World Container Index per 40 Foot Box



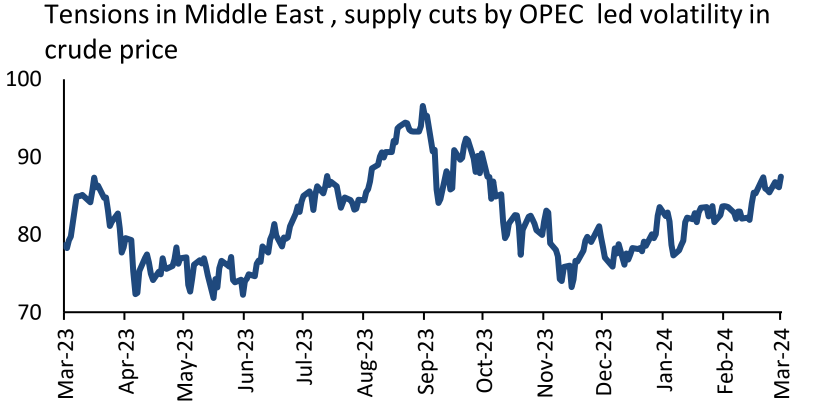
Source: Bloomberg

Gold Price (USD Per Troy Ounce)



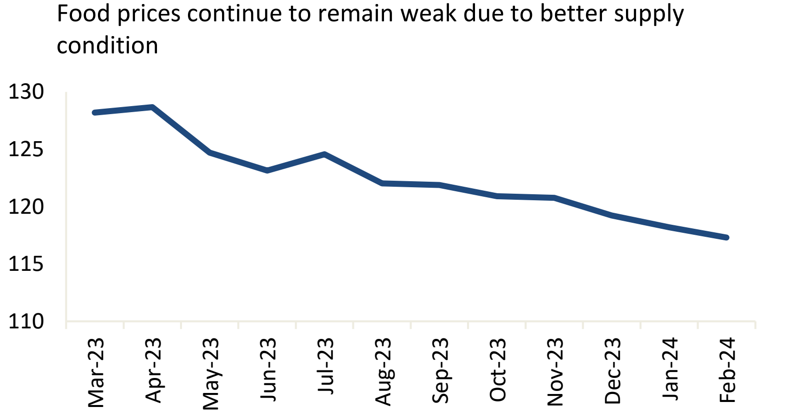
Source: Bloomberg

Brent Crude (USD Per Barrel)



Source: Bloomberg

UN Food & Agriculture World Food Price

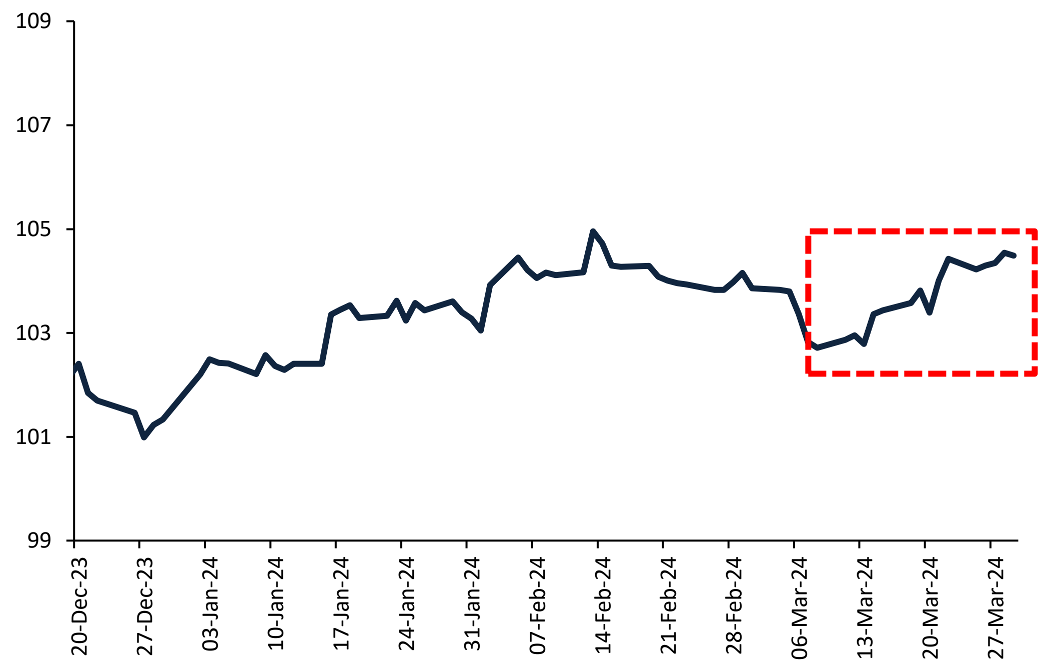


Source: Bloomberg

Uptick in the US dollar index, impacting foreign flows into the emerging economies

US Dollar Index

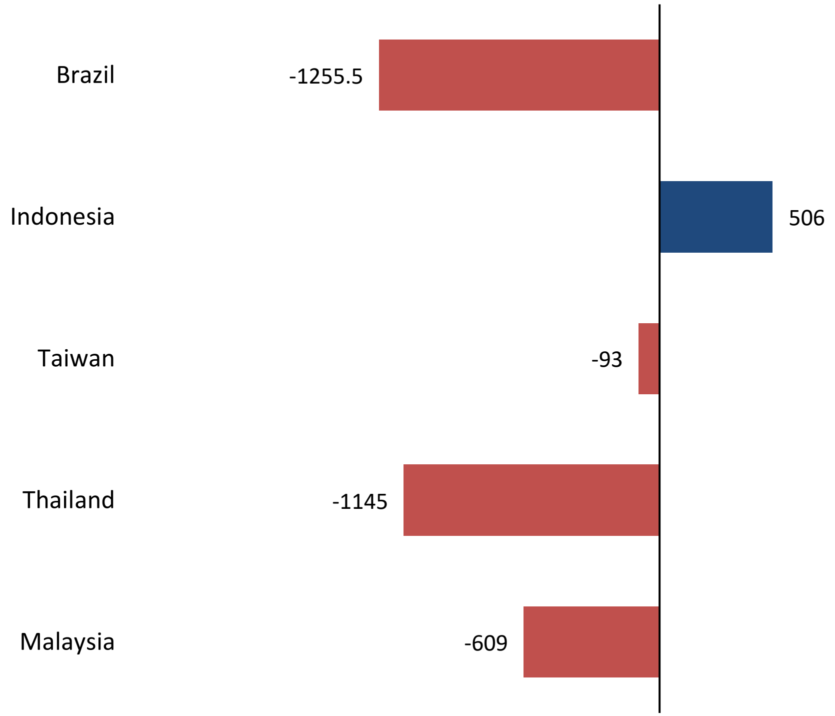
Improved macro data points from US & expectation of pushback of rate cuts has led to jump in dollar index…



Source: Bloomberg

Emerging Markets - Net Flows In March 2024 (USD Million)

…driving outflows from Emerging markets

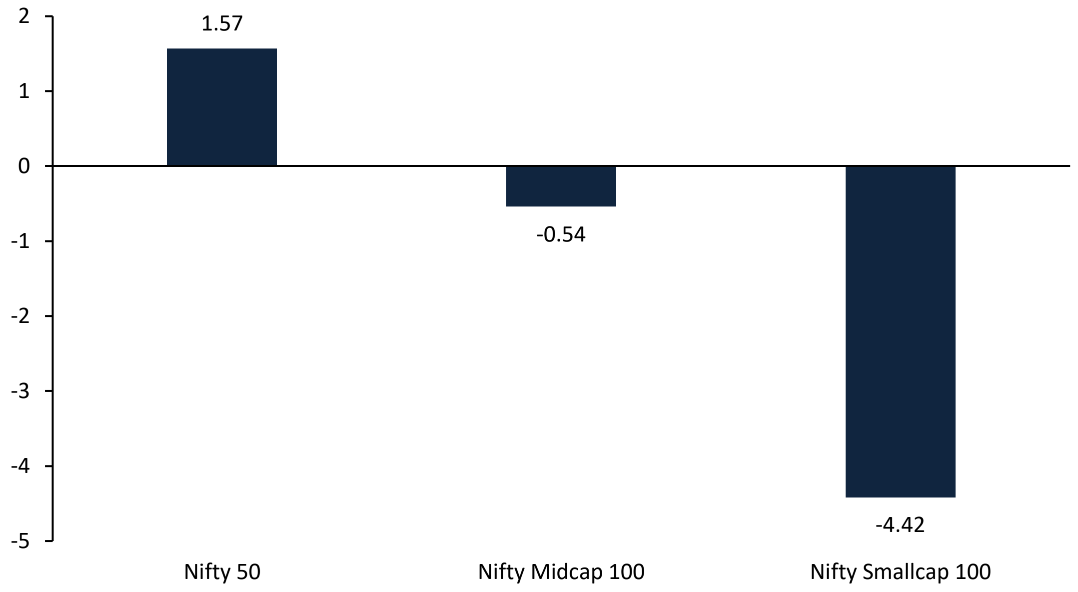


Source: Bloomberg

Indian Equity Markets show mixed picture… Smallcap index corrects on profit booking…. Largecaps outperform due to better valuations

Absolute Return In March 2024 (%)

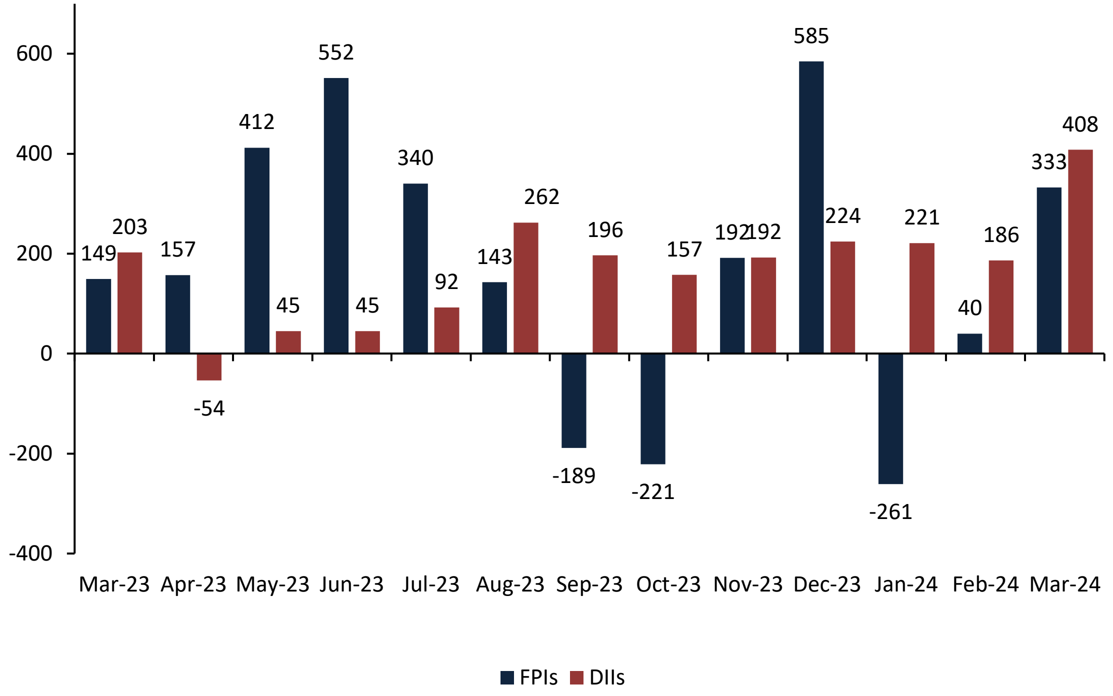
Large caps have outperformed Small caps



Source: Bloomberg

Net Flows In Equities (Rs Bn)

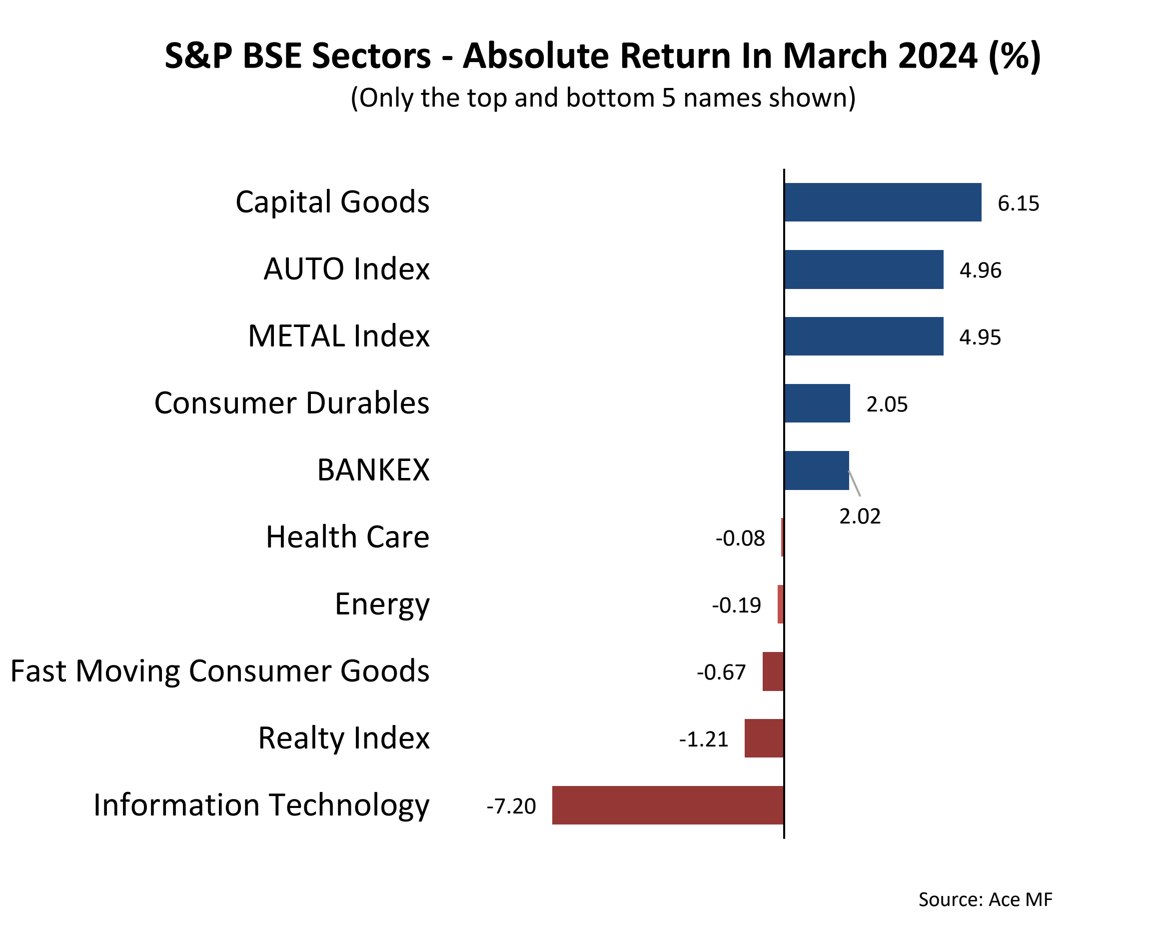
FII and DII both were net buyers in the month of March

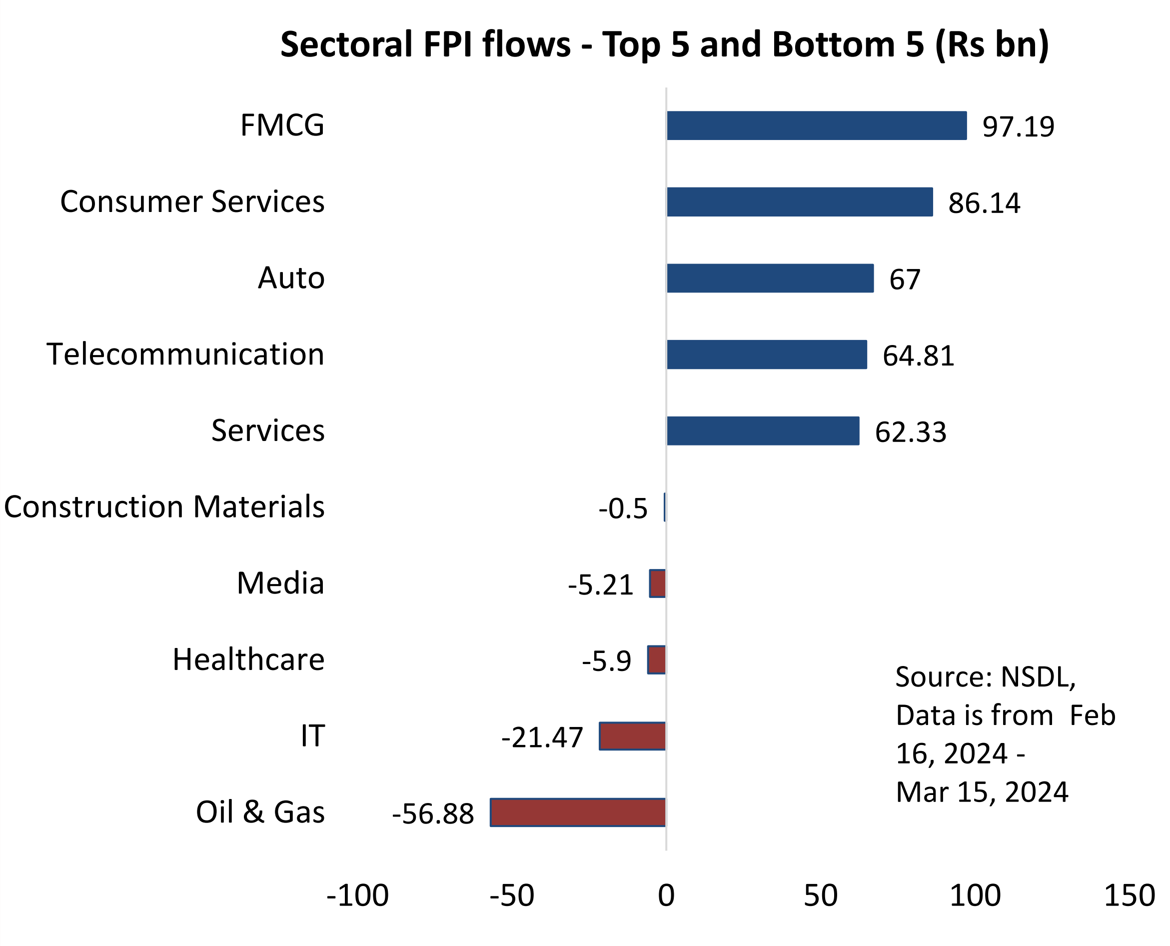


*For 2024, FPI and DII data is up to 28th and 27th March, 2024, respectively

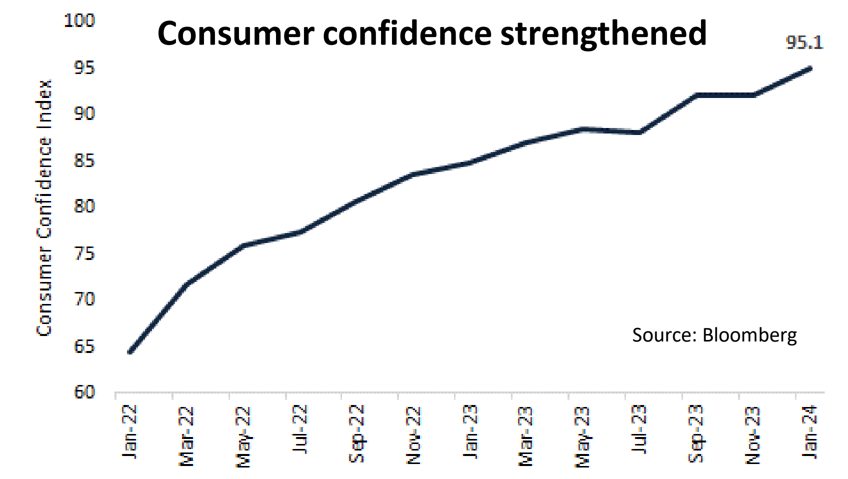
Source: SEBI, CDSL

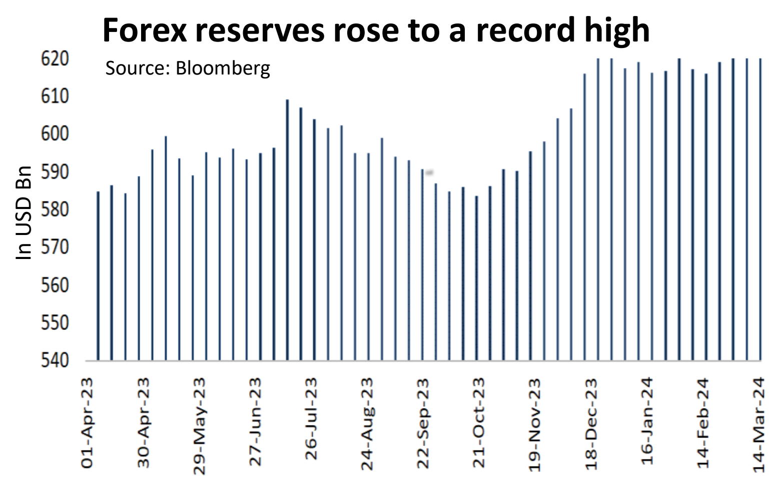
Sectoral performance and FPI flows in March 2024

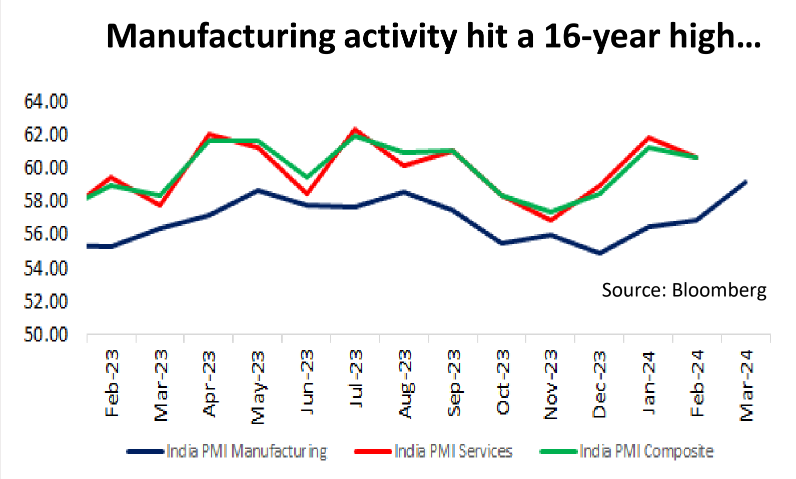


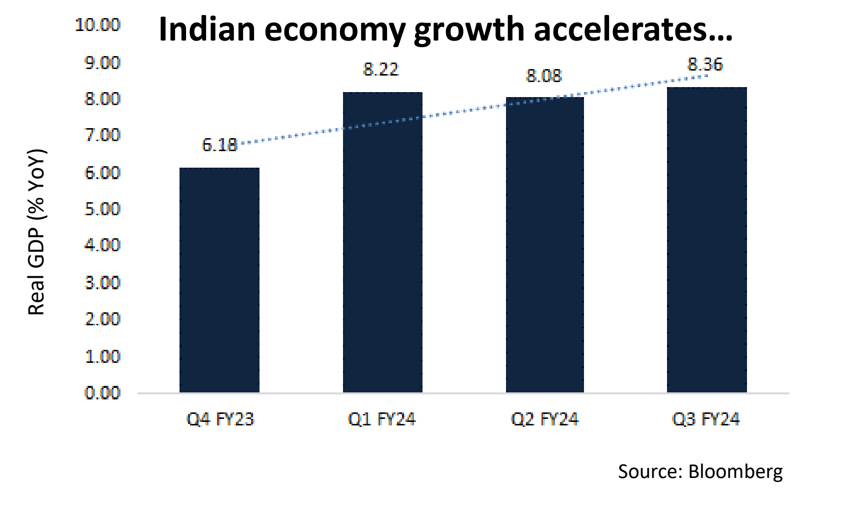


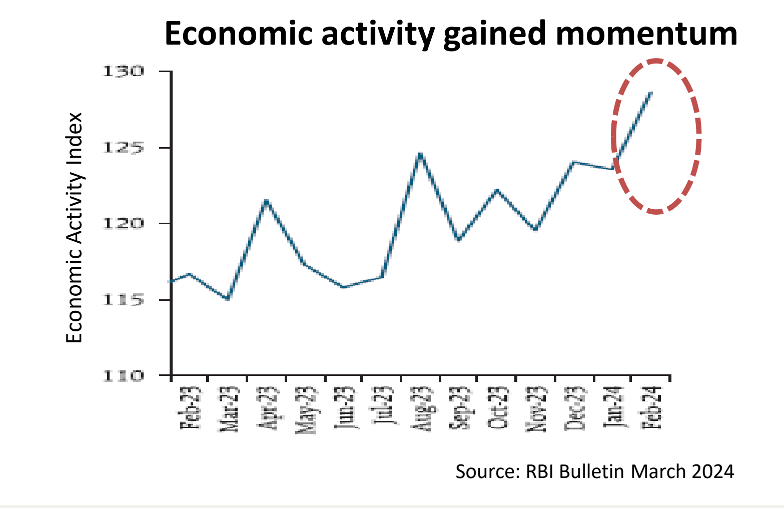
India - Economic momentum remains robust

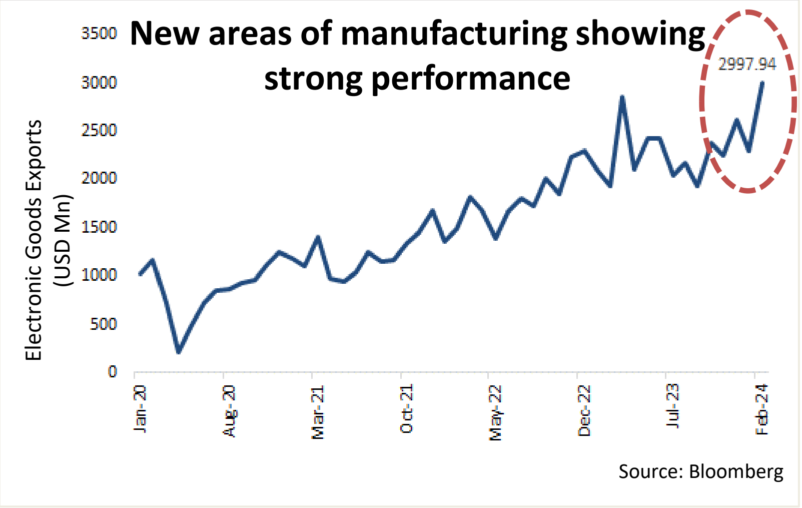






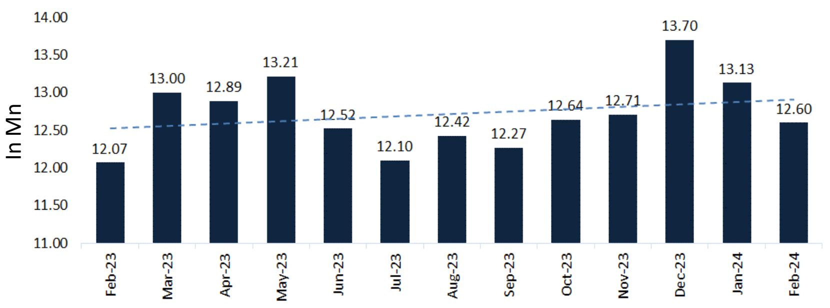






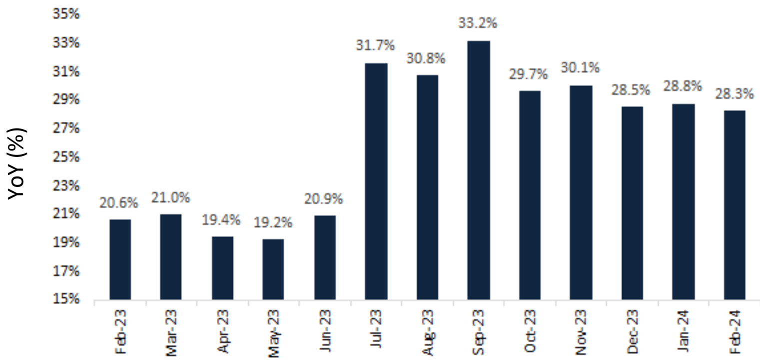
Urban consumption holding strong…

Domestic Air Passenger Traffic remains robust…



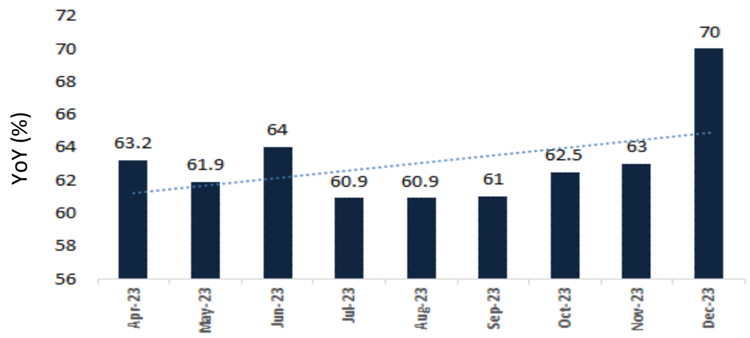
Source: DGCA

Personal loan growth continues…



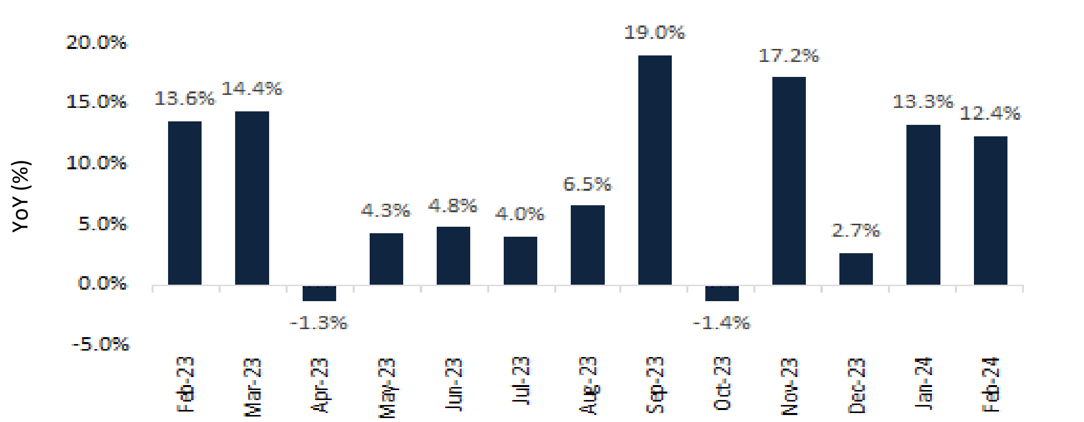
Source: Bloomberg

Hotel occupancy rate at record high



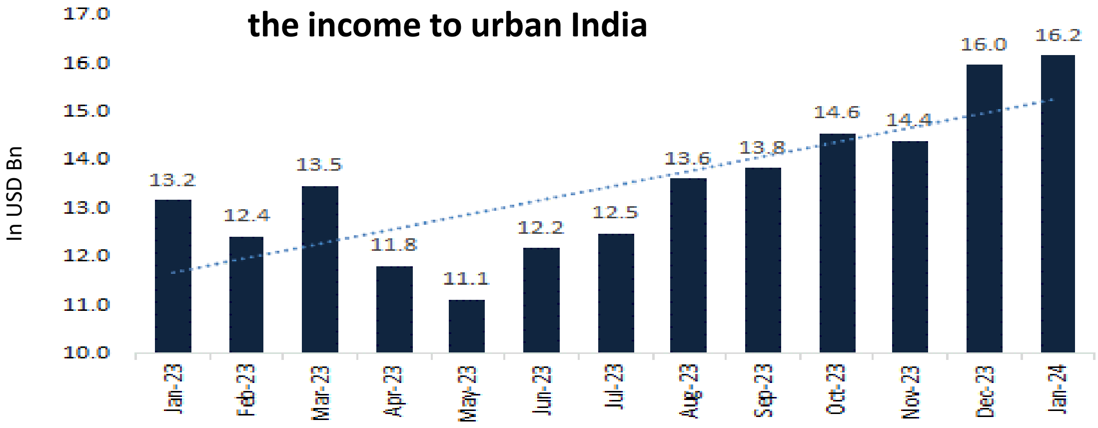
Source: RBI Bulletin March 2024

Passenger Vehicle (PV) registration growth continues…



Source: Bloomberg

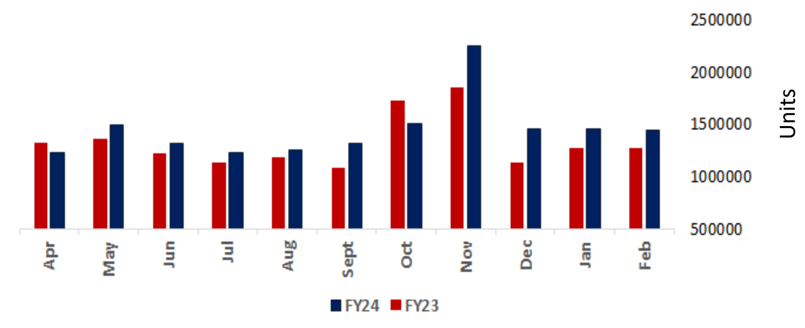
Net services export continues to grow adding to the income to urban India



Source: Bloomberg

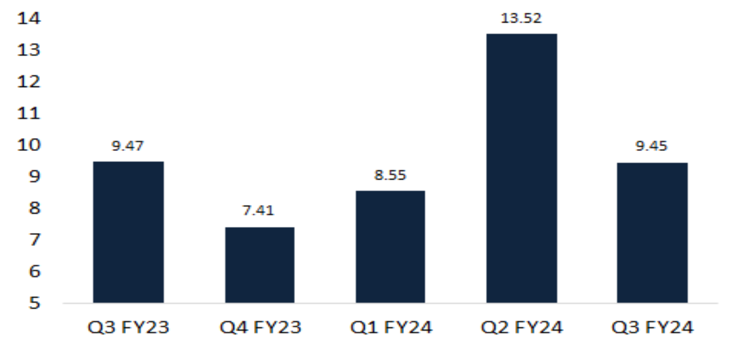
Rural India : Showing Green shoots

Two-Wheeler sales continues to show momentum



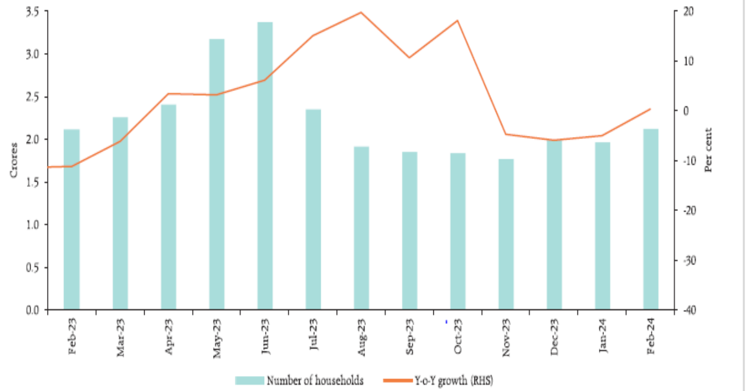
Source: Bloomberg

As construction activity remains strong, demand for rural labours has increased (% YoY)



Source: Bloomberg

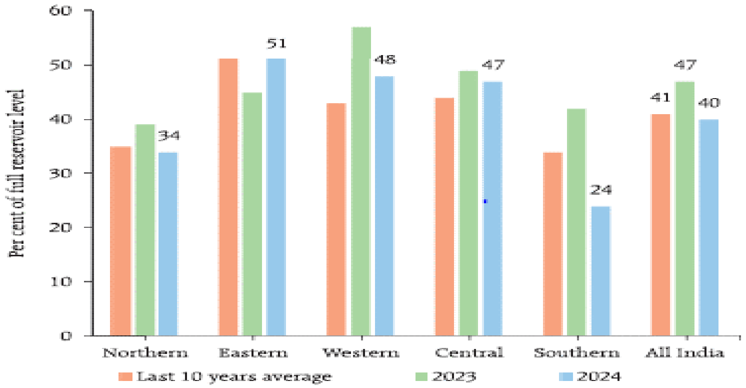
Keeping demand for MGNREGA under check….



Source: RBI Bulletin March 2024

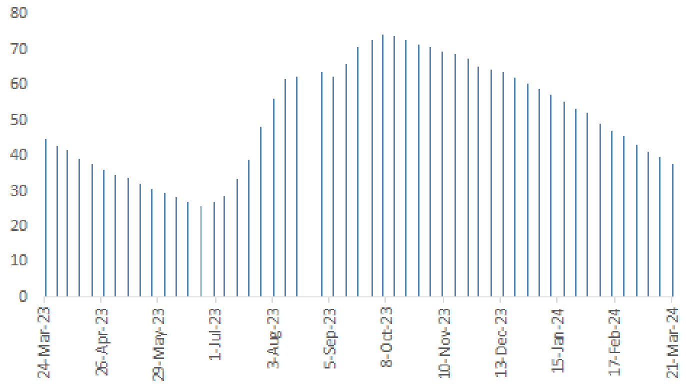
Low reservoir levels pose challenge for agriculture growth, which has been seeing steady decline

Region wise reservoir levels



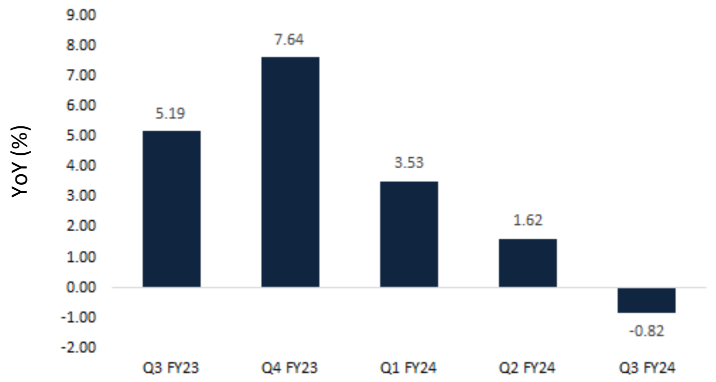
Source: RBI Bulletin March 2024

Total 133 reservoirs - % of current live storage



Source: Cogencis

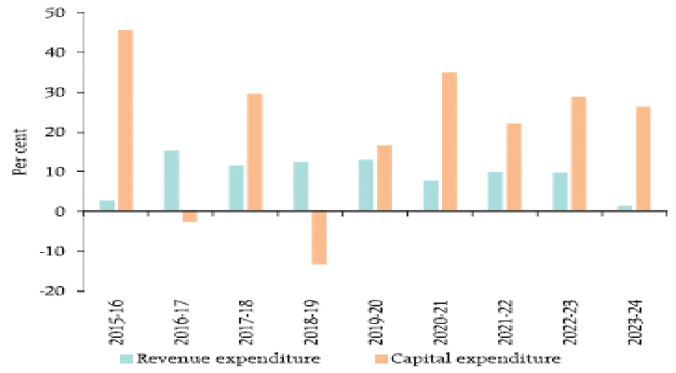
Agriculture, forestry and fishing segment of India's GVA has been underperforming



Source: Bloomberg

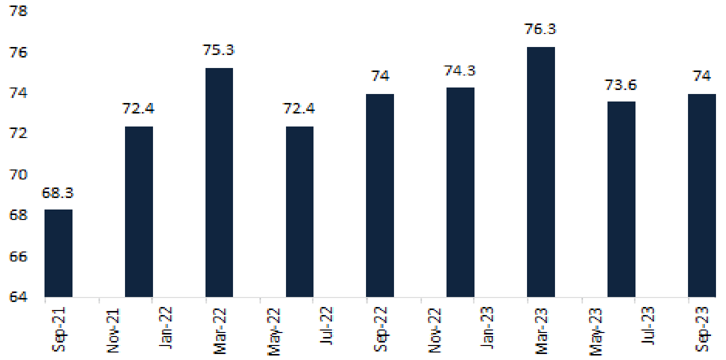
Capex remains key driver for India’s growth…. Conditions ripe for Private sector capex to improve

Capital spending recorded increase while revenue expenditure growth remained contained

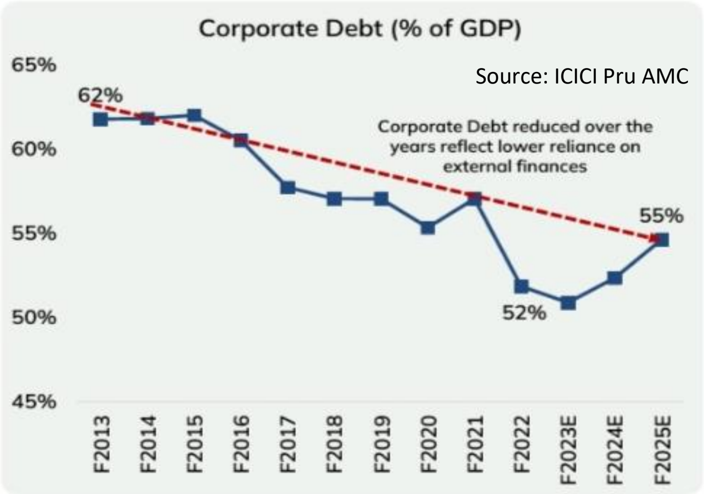


Source: RBI Bulletin March 2024

Capacity utilisation in the manufacturing sector remains robust (in %)

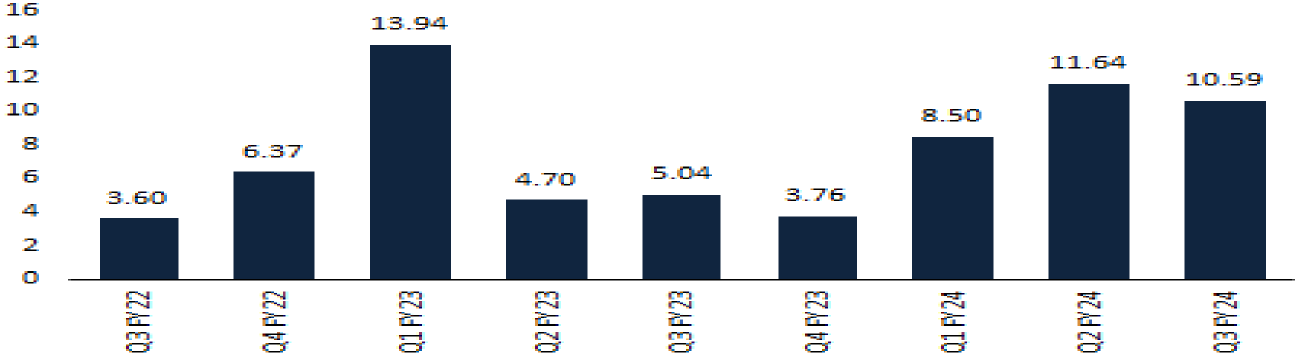


Source: Bloomberg

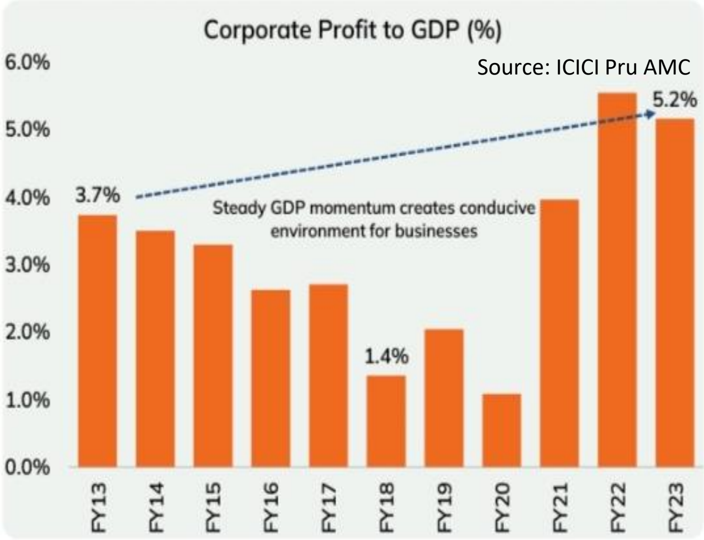


Gross Fixed Capital Formation - YoY Change (%)

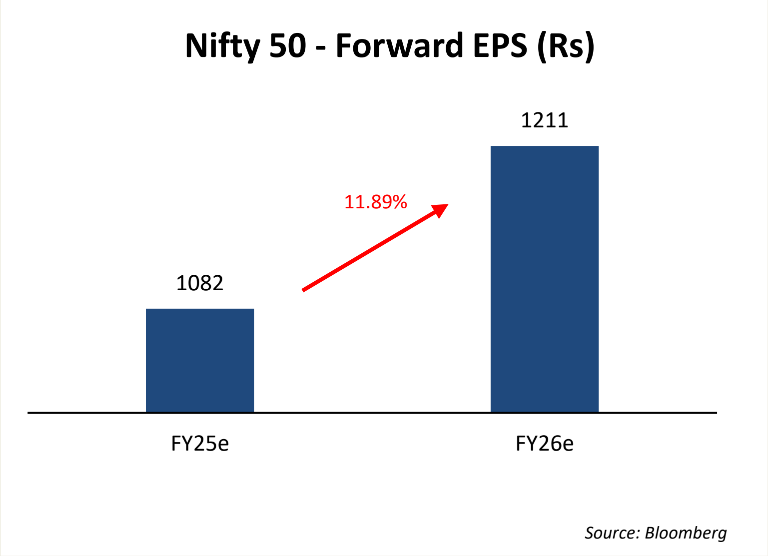
In strong momentum… key driver of economic growth

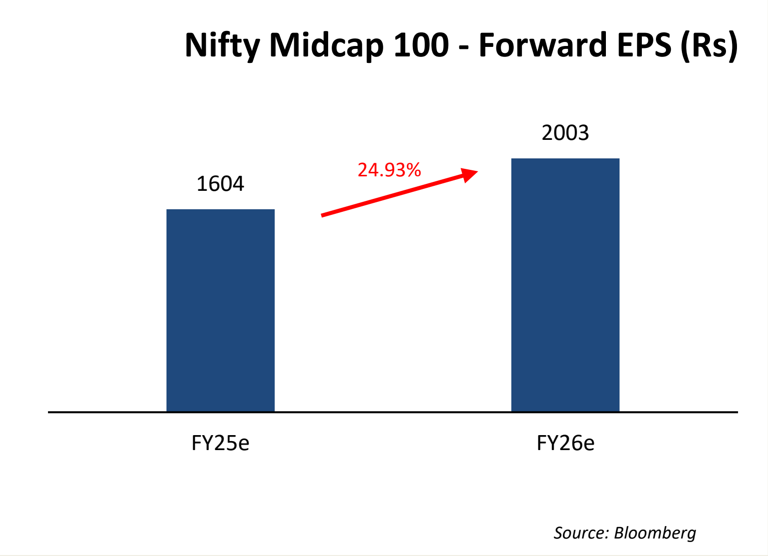


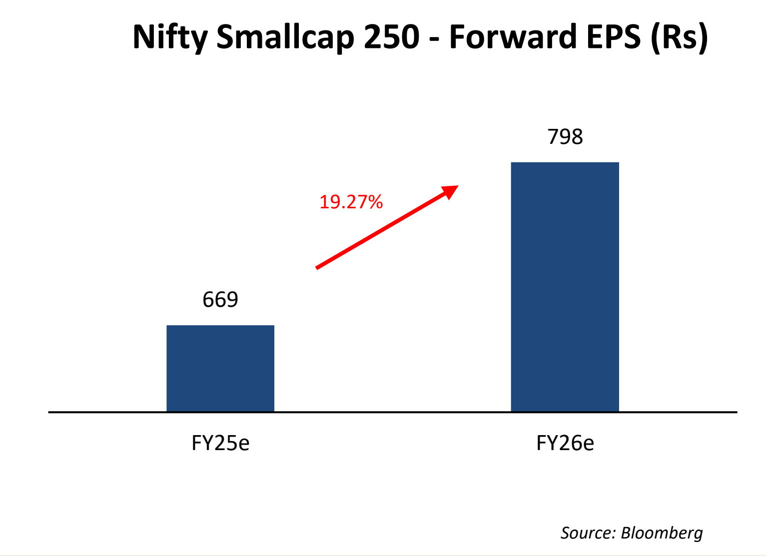
Source: Bloomberg

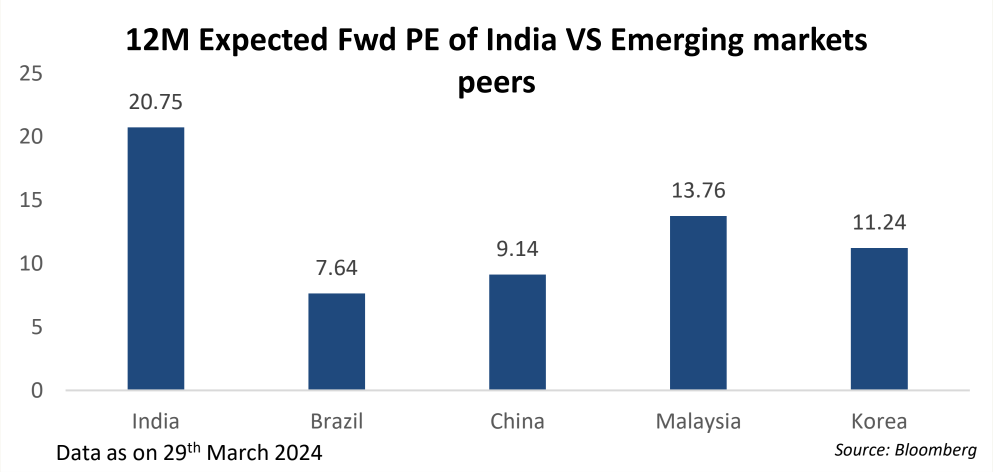


India valuations – Despite Mid & Small Cap correcting from recent highs, their valuation continues to remain higher than the Large Cap









Correction in Small/Mid cap index valuation premium have come off

12M expected Fwd P/E (x) Comparison By Market Cap

Index	FY25 (Est)	FY26 (Est)
Nifty 50	20.75	18.55
Nifty Midcap 100	30.29	24.24
Nifty Smallcap 250	22.30	18.69

Source: Bloomberg

Data as on 28th March,2024

12M expected Fwd P/E (x) Comparison By Market Cap

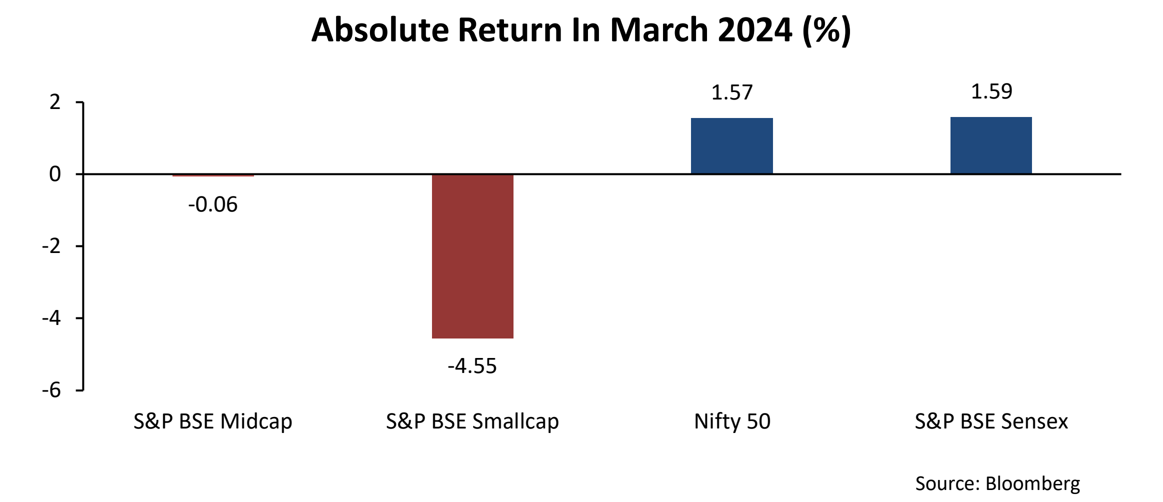
Index	FY24 (Est)	FY25 (Est)
Nifty 50	23.40	20.92
Nifty Midcap 100	36.78	27.12
Nifty Smallcap 250	28.19	24.79

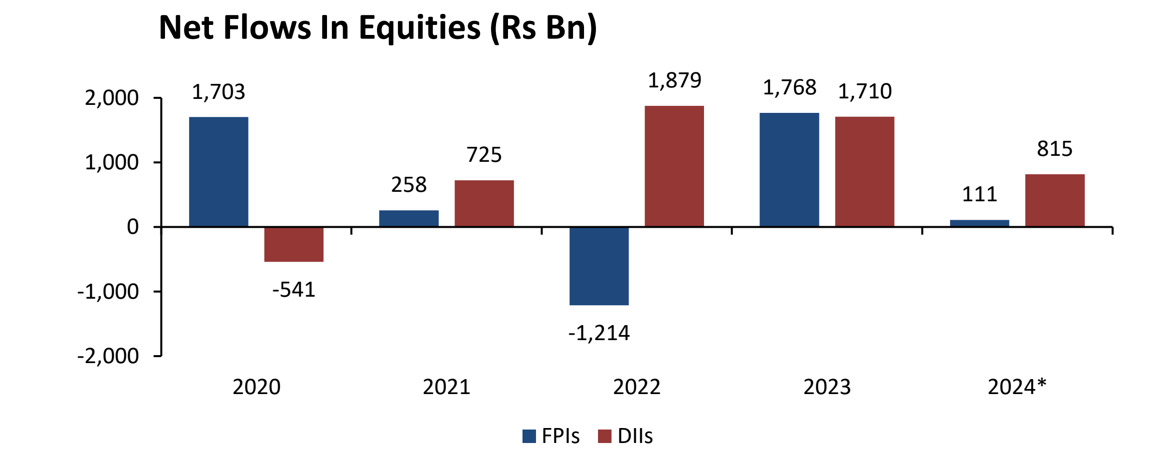
Source: Bloomberg

Data as on 28th Feb,2024

Market Roundup – March 2024

- Indian equities ended the month on a mixed note. Large cap-oriented S&P BSE Sensex and Nifty 50 ended higher to the tune of 1.6% month-on-month (MoM).
- While the S&P BSE Midcap & S&P BSE Small cap indices ended lower by 0.1%, & 4.6% (MoM) respectively.
- In terms of BSE sectoral indices, Capital Goods was the top performer. In contrast, IT, Realty and FMCG underperformed the most.
- Indian equities ended the month on mixed note as heavy sell-off was witnessed across the segments, especially in the mid-cap and small-cap segments, before the release of the stress test result on Mid-cap & Small-cap schemes on March 15, 2024. However, sentiments were boosted following the robust preliminary domestic business activity data i.e. PMI of March 2024 that expanded at the fastest rate in eight months. Robust direct tax collection number also aided to boost the sentiment.





*For 2024, FPI and DII data is up to 28th and 27th March, 2024, respectively

Source: SEBI, CDSL

Sectoral outlook by fund managers – Part 1

Sector	Particulars
Financials	**View –Neutral to Positive** • Valuations in most of the Banks are reasonable, especially the Largecap Private sector banks. • NIM concerns have resurfaced as the cost of funds have risen due to tight liquidity scenario and with policy rates likely to be cut, further pressure to NIM possible. • Credit cost (provisioning) are holding up, Unsecured loans are under scrutiny by the RBI. • Most fund managers are cutting underweights/ Equal weight in the sector. Pvt sector banks gradually being given preference due to lower valuations.
IT	**View – Negative to Neutral** • Q4FY24 results expected to be weak. Large global bellwethers have suggested caution for growth going forward. • Order book growth holding up, margins need to sustain, execution cycle seem to be pushed back by customers. • Stocks are expected to consolidate going forward as valuations have run up. • Funds are taking tactical positions, but mostly running underweight.
Pharma	**View – Overweight** • Reasonable valuations, domestic demand holding up well. • US is seeing abatement of price erosion in the generic space and some shortage of drugs has built up, which should be positive for Indian pharma stocks. • Decline in the raw material prices to drive margins and earnings. • Fund Managers expect the sector to outperform on the back of improved earnings given lower base and relative under ownership.
Auto	**View – Overweight** • Passenger vehicle demand to sustain, but on a high base the volume growth likely at low single digits. • 2-Wheeler stocks are seeing renewed traction and driving alpha. Once the base is high, the volume growth can taper. • SUV oriented companies expected to still hold on to earnings growth, as improved product mix in the sales would help drive earnings. • Initial signs of weakness seen globally in the EV theme. Indian policymakers still supportive of this segment. • Commercial vehicle sales getting sluggish, fund managers underweight. • Auto ancillaries gaining due to China+1, Europe+1, PLI and EV initiatives.

Sectoral outlook by fund managers – Part 2

Sector	Particulars
Construction & real estate	**View – Positive** • Favourable demand scenario for housing in terms of volume growth. • Government's focus on infrastructure and investment cycle. • Real estate stocks are also finding space in the Fund Portfolios, as growth in the sector quite strong. **Approach followed by most AMCs -** Prefer investing in this space through proxy sectors such as housing finance companies, cement, steel, pipes, and building materials, among others. Though some are gradually building exposure into direct Real Estate stocks.
Consumption	**View – consumer services -Positive, consumer durables and FMCG- negative** • Staples – Low volume growth, pricing power weak, Valuations high. Funds generally underweight. • Hotels/Travel – Valuations rich, funds holding on to their overweight. Earnings visibility is strong. • Consumer Durables – Funds are looking to bottom fish, as they expect turnaround of demand. • Retail and Quick Service Restaurant: Retail demand expected to improve, while QSR's near term performance expected to be weak, finding favour in portfolios due to expectations of change in consumer behaviour in long term. **Long-term positives** • Rising per capita income. • Premiumization across categories.
Capital goods, industrials, utilities	**View – Neutral** • Capex cycle uptick implies that domestic capital goods are gaining traction. • Export prospects appear promising, albeit on a bottom-up basis. • Order books are robust, and earnings remain stable. • New ideas also emerging and some old themes getting churned. • Power, Automation, Electronics continues to be the dominant theme for capex. • **Valuations are steep, while earnings momentum holding up. Funds with high exposure not keen on raising further weights, trimming/churning at margin.**
Metals	**View – Neutral to positive** • With outlook of Chinese economy improving, US economy continuing to see growth, metal stocks are finding favour with the Fund managers. Fund manager have reduced their underweight positions and are gradually getting upbeat on the sector.

Monthly Sectoral Movement

Absolute Monthly Return By Sector (%)

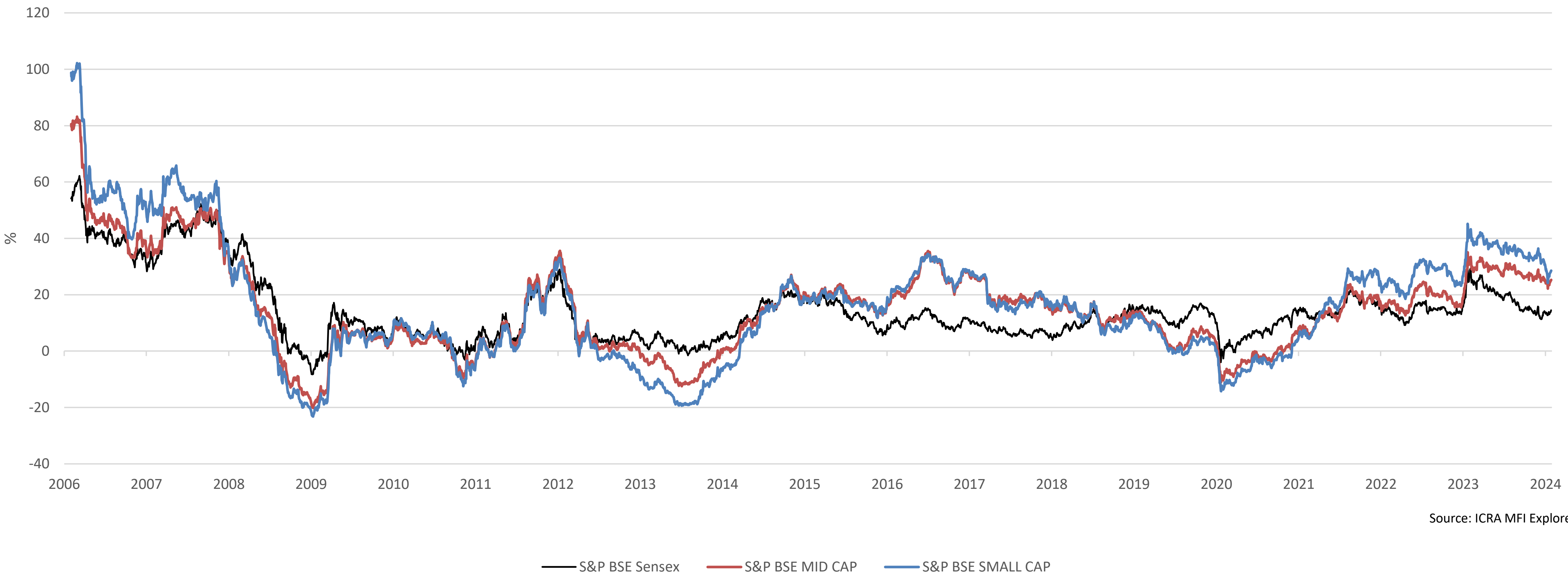
Index	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24
S&P BSE 500	**0.33**	**7.08**	**3.51**	**3.86**	**3.80**	**-0.81**	**2.04**	**-2.93**	**6.75**	**8.01**	**1.90**	**1.93**	**0.84**
Auto	-3.35	10.29	7.94	6.76	3.14	-1.40	3.65	-1.25	10.08	5.43	4.18	8.12	4.96
Bankex	0.93	9.18	2.11	0.12	1.85	-4.01	0.35	-3.44	3.47	8.12	-4.38	1.92	2.02
Basic Material	2.54	7.83	1.70	2.39	3.19	1.06	1.70	-3.70	7.25	11.39	0.33	-0.42	1.06
Capital Goods	1.50	9.71	1.31	9.79	8.15	2.66	6.20	-4.07	8.88	11.31	1.88	-1.21	6.15
Consumer Discretionary	-1.74	9.25	7.18	5.94	4.46	2.10	2.40	-1.38	9.36	5.91	2.35	4.89	1.69
Consumer Durables	0.45	2.91	6.47	5.67	-0.25	4.24	3.18	-2.32	7.42	6.11	0.70	0.00	2.05
Energy	1.95	7.19	-0.07	-0.24	6.89	-4.38	3.20	-2.17	9.17	11.06	12.18	6.18	-0.19
FMCG	2.01	6.81	5.89	2.47	1.58	-2.75	0.97	-0.86	3.58	6.84	-2.81	-2.33	-0.67
Finance	-0.08	9.05	2.13	1.97	3.16	-2.64	1.08	-3.09	4.82	6.92	-2.40	0.47	1.35
Healthcare	1.31	6.33	2.81	9.71	7.45	0.57	2.45	-4.30	10.92	3.87	7.18	5.94	-0.08
IT	-3.15	-0.13	6.70	2.16	1.34	4.13	2.62	-3.13	6.77	8.38	3.74	3.38	-7.20
Infra	4.24	6.06	0.89	4.51	10.73	1.64	8.45	-3.38	10.40	14.88	18.15	1.23	0.48
Metal	1.04	7.21	-2.94	3.99	7.88	-1.64	7.45	-4.17	8.74	11.35	-0.85	1.15	4.95
Oil & Gas	2.77	6.39	-1.64	0.27	6.67	-5.03	1.23	-4.17	12.51	12.02	12.57	6.86	-0.07
Power	9.39	5.37	2.01	4.33	9.20	-0.63	5.96	-4.90	11.16	18.24	8.57	4.33	1.70
Realty	-1.60	19.64	7.67	9.35	9.01	-1.50	5.21	3.70	19.99	9.37	9.37	9.16	-1.21
Telecom	-3.65	8.44	4.12	9.08	5.61	3.20	10.55	-5.69	7.21	6.15	6.94	1.44	1.81
Utilities	10.02	6.22	-0.59	5.02	10.36	-0.64	7.20	-3.98	11.85	20.00	9.71	3.61	0.25

The abovementioned sectoral indices pertain to the S&P BSE universe

Colour scales assigned vertically

Source: Ace MF, HDFC Bank Research

Annexure: 3 year rolling CAGR return of Large, Mid and Smallcap Indices



Source: ICRA MFI Explorer

Key concerns for Indian equities

- Results of the Indian General Elections
- Low growth in consumer demand
- Expectation of weakening margin profile for corporates
- Delay in rate cuts by Global Central Banks
- Upward pressure on food inflation (El Nino, export restrictions by some nations)
- Rising commodity prices, especially Crude Oil
- Rising tensions in Middle East
- Movement of global liquidity
- The impact of Dollar Index and US Bond Yields on FPI flows in emerging markets

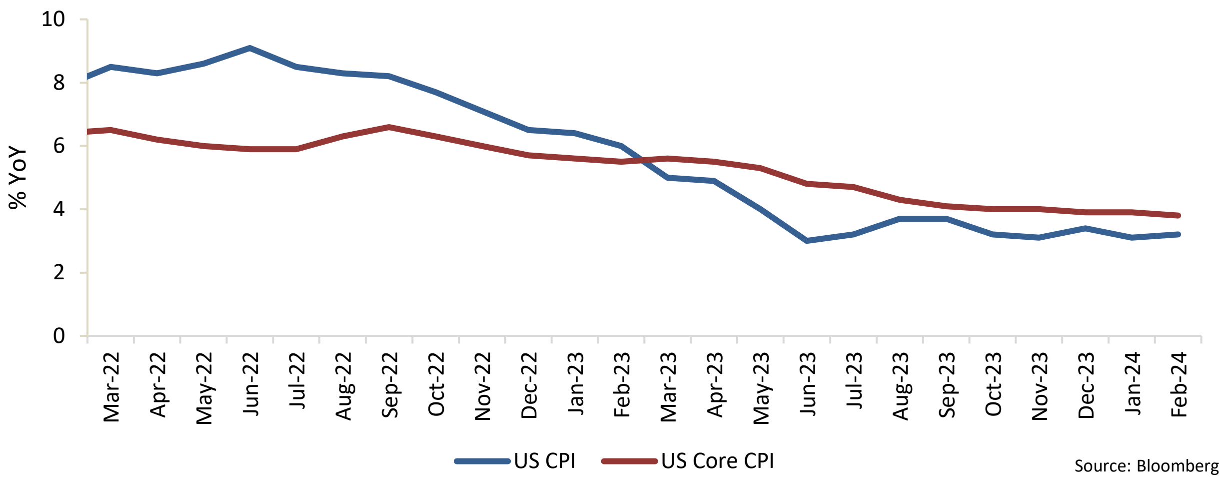
Fixed Income Market

Fixed Income Outlook

- The RBI is keeping the banking system liquidity tight in order to keep the call money rates around or above the repo rates. The RBI has remained nimble in liquidity management and has used tools like VRRR or VRR to manage liquidity. As we move forward, with the inclusion of G-secs in JPMorgan's Government Bond Index-Emerging Markets, liquidity will likely improve unless the RBI decides to sterilize the inflows.
- While retail inflation came off marginally and was higher than market expectations primarily because of elevated vegetable and cereal prices, core inflation decelerated to its lowest levels. The uptick in crude oil prices due to supply cuts and improvement in demand may add to upward pressure on inflation. Nonetheless, the downward revision in the RBI's inflation forecast by 20 bps for the current and the upcoming quarters suggests inflation is likely to ease in the coming months. The favourable base effect will also likely reduce the pressure over inflation print.
- The trade deficit widened in February as imports outstripped exports though both improved sequentially. Most sectors witnessed a growth in merchandise exports, but the rise in imports can be primarily attributed to a surge in gold imports.
- India's Current Account Deficit (CAD) narrowed to 1.2% of GDP in Q3 FY24 due to higher services exports. The resilient services exports, mainly due to increased exports from Global Capability Centres (GCC), provide a cushion against the wider merchandise trade deficit. The trend of services exports is likely to continue and further compress the CAD in Q4 FY24, indicating a potential strengthening of India's external sector.
- India seems to be in a Goldilocks scenario as the economy remains stable and core inflation shows signs of cooling down. However, elevated headline inflation may hold off the RBI from cutting rates at the earliest. Additionally, the rate cuts are likely to be shallow. The market participants believe the MPC may change its stance to 'neutral' before proceeding with the rate cuts, but the timing of a change in stance remains uncertain. The RBI is also likely to take cues from the monetary policies of the major global central banks.
- The narrowing of fiscal deficit remains positive for the bond market as this would lead to lesser market borrowing by the government, thus limiting the supply of bonds and pulling the yields down.
- In the US, the Fed decided to keep the policy rate unchanged, but its forecast suggested three rate cuts this year, which aligned with market expectations. The Fed Chairman Powell has again highlighted that the policymakers will take a data-dependent approach to rate cuts. Even though the current rate cycle has peaked, there is uncertainty regarding the timing and quantum of rate cuts. The Fed will likely balance the risks of keeping interest rates high, which may hamper economic activity, and cutting interest rates before inflation is controlled.
- In a surprise pivot, the Bank of Japan (BoJ) finally ended the regime of negative interest rates after eight years and hiked to 0-0.1%. The surprise pivot may not impact the bond market in the near term. However, over the medium to long term, if Japan raises rates rapidly, this may lead to the unwinding of the carry trade, thus pushing US Treasury yields higher.
- Domestically, strong demand for high quality duration securities suggests limited scope for further yield dips without rate cuts. Hence, yields are expected to move in a range with a declining bias, and fund managers who can play with volatility are likely to generate substantial alpha. The yields at the longer end have been weighed down due to lower-than-expected fiscal deficit estimates for FY25 and advance buying by the FPIs and other market participants ahead of the inclusion of Indian G-secs into the JPMorgan Bond Index. However, the yields at the short end of the curve continue to be determined by the availability of liquidity, which at the current juncture remains under pressure, ensuring a flat yield curve. Recently, we have seen higher demand for SDLs, which can affect the SDL spreads in the near term. Any rise in the SDL spreads can provide an opportunity to buy into long-dated SDL Index Funds.
- Corporate Bond Funds continue to look like a safe bet at the current juncture for investors looking to invest in shorter-tenure funds. Hence, investors can look at Corporate Bond Funds and Short duration funds for a horizon of 15 months and above.
- Investors who are comfortable with volatility and have a longer horizon of 24 months and above can take exposure to Dynamic Bond Funds, Gilt Funds, and longer-tenor SDL Index Funds to play the improved fiscal deficit dynamics.
- For a horizon of 3 months and above, investors can consider Arbitrage Funds. Whereas for a horizon of up to 3 months, investors can consider Overnight Funds and Liquid Funds.
- Investors can also look at Multi-asset allocation funds for a horizon of 36 months and above. Investors should invest in line with their risk profile and product suitability.

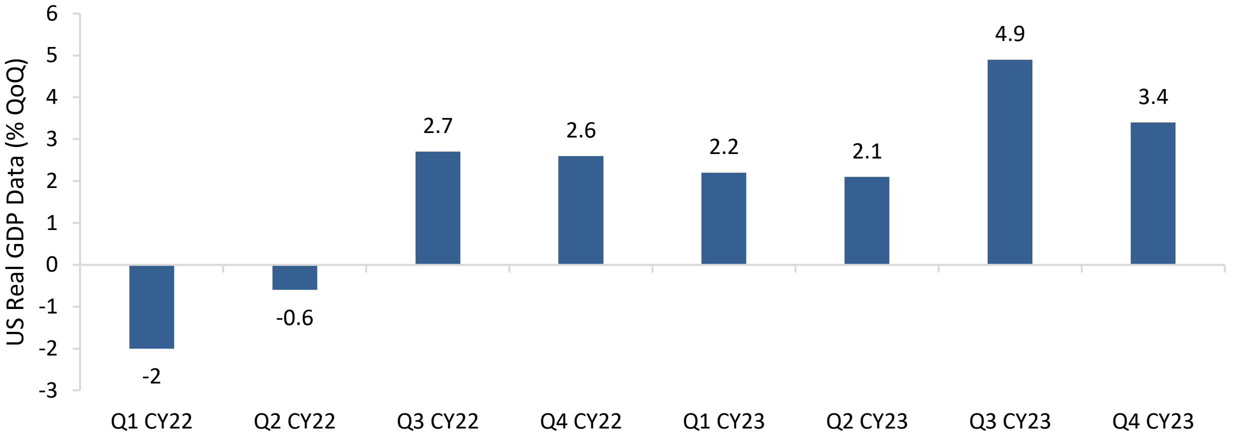
Higher than expected inflation and strong economic momentum keep US yields elevated…

US inflation continues to remain sticky



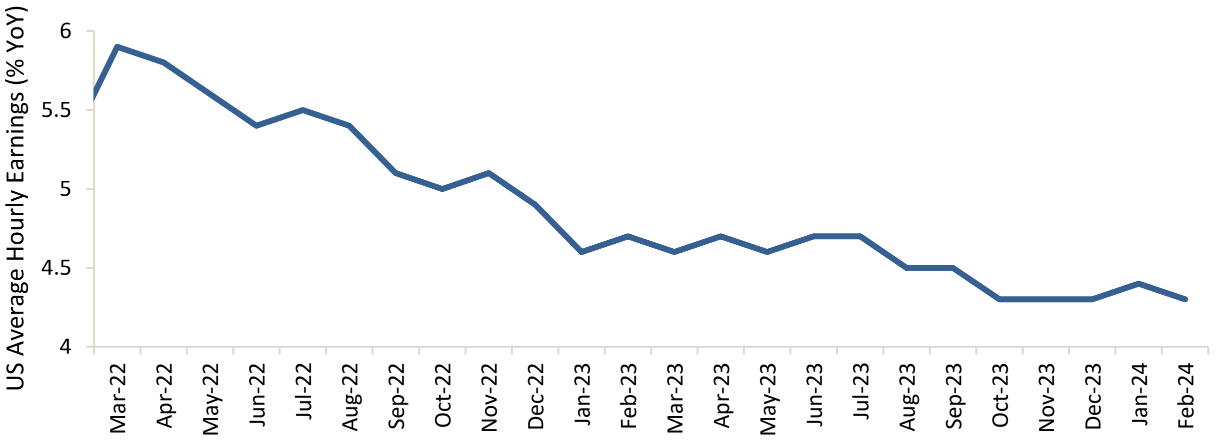
Source: Bloomberg

US economy grew faster than previous estimates



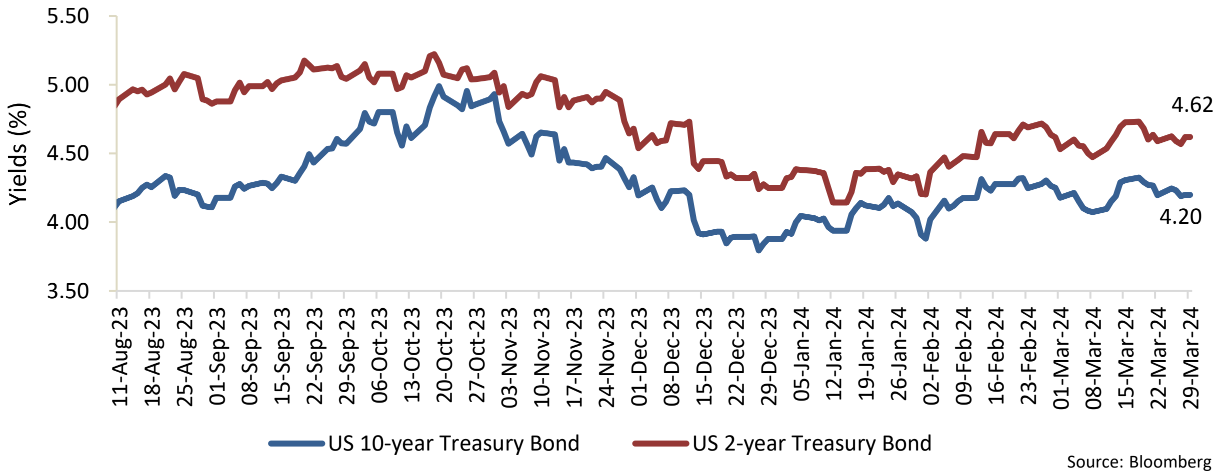
Source: Bloomberg

Wage growth showing signs of deceleration



Source: Bloomberg

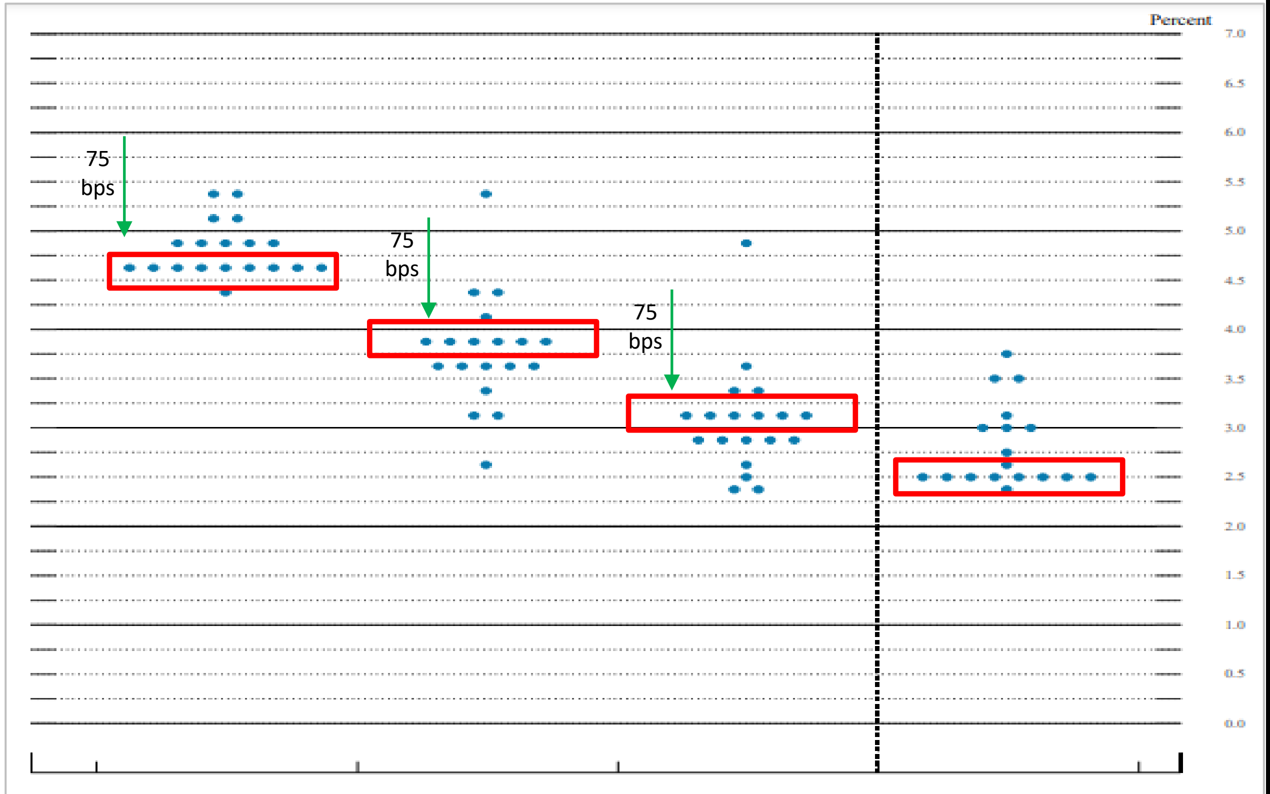
Strong macro data pushed the US yields higher



Source: Bloomberg

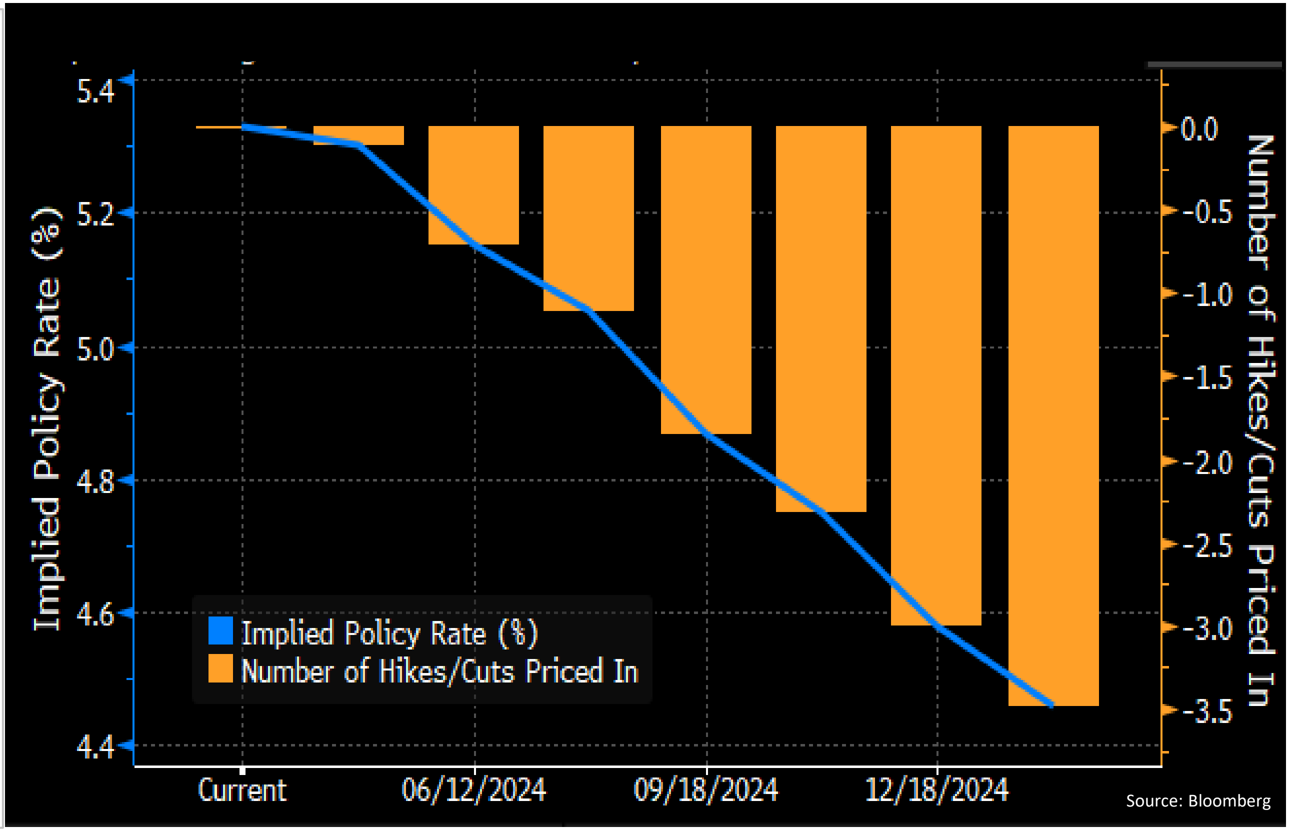
….Yet Fed guides for rate cuts

Fed's dot plot suggests 75 bps of rate cut in CY24



Source: Fed

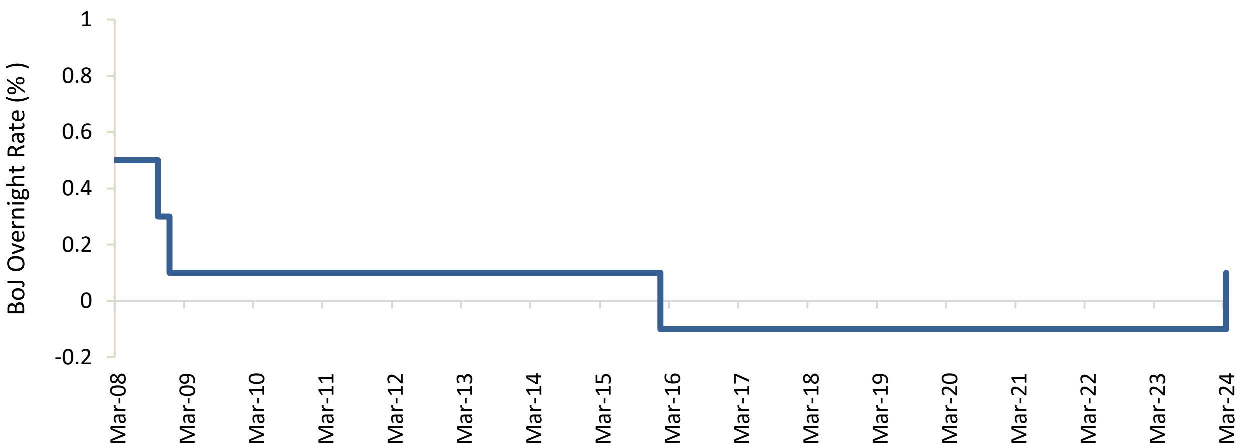
Rate cuts in the US are likely to commence from June 2024



Source: Bloomberg

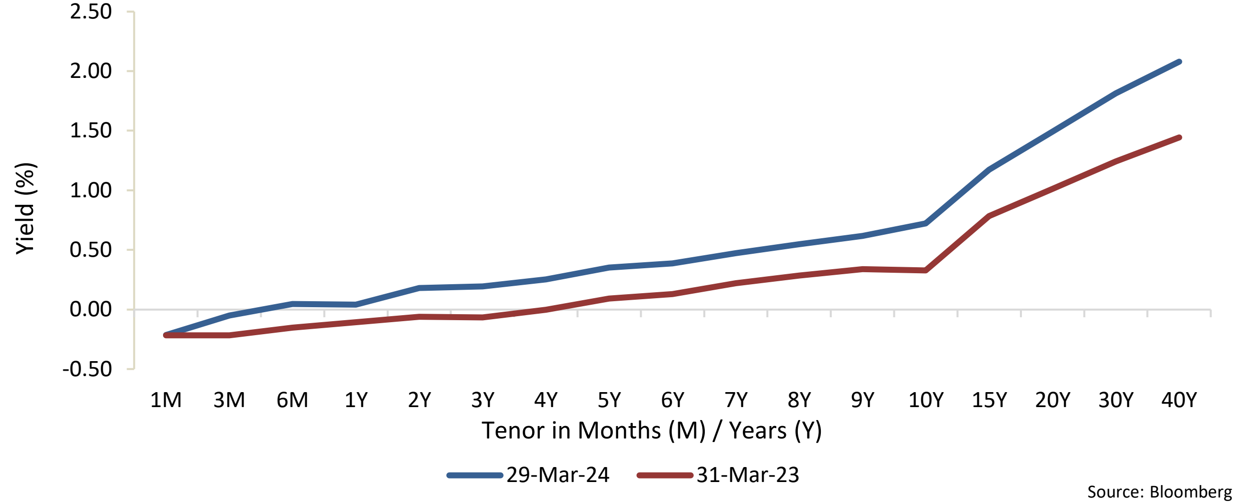
BoJ pivots in a surprise move and hikes rates, pushing Japan's yield curve higher

BoJ ends 8 years of negative interest rates



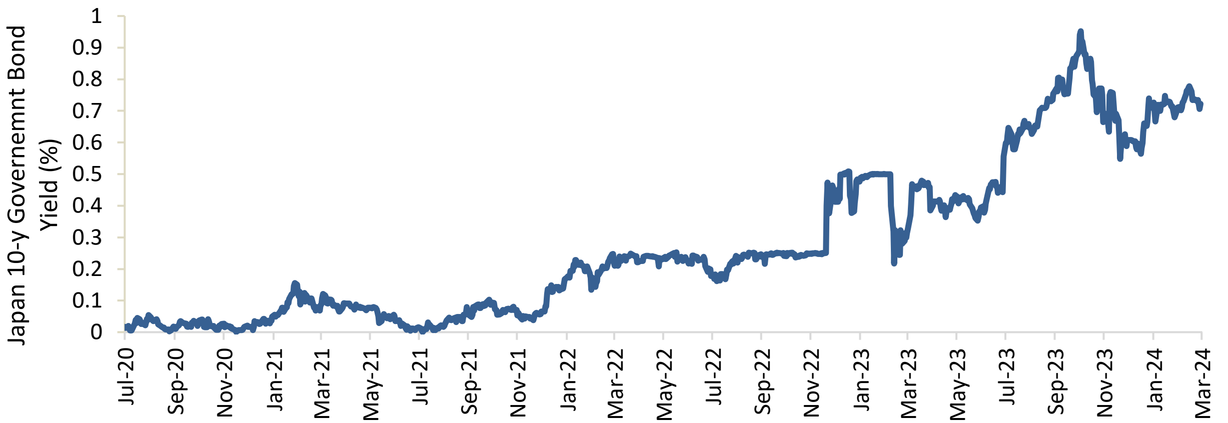
Source: Bloomberg

Japan's sovereign curve witnessed an upward shift



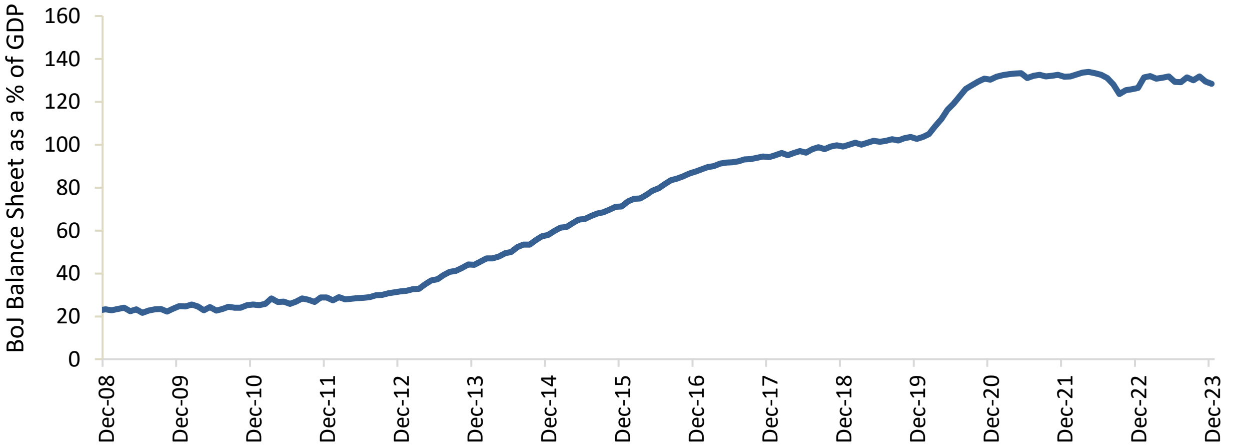
Source: Bloomberg

Yields moved up as Japan unwinds monetary easing measures



Source: Bloomberg

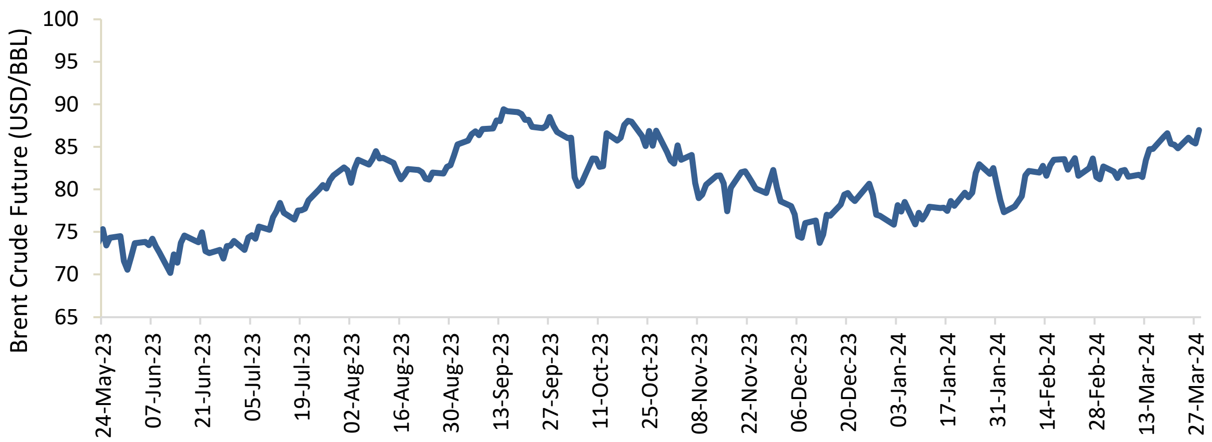
BoJ's balance sheet expansion started to slow down



Source: Bloomberg

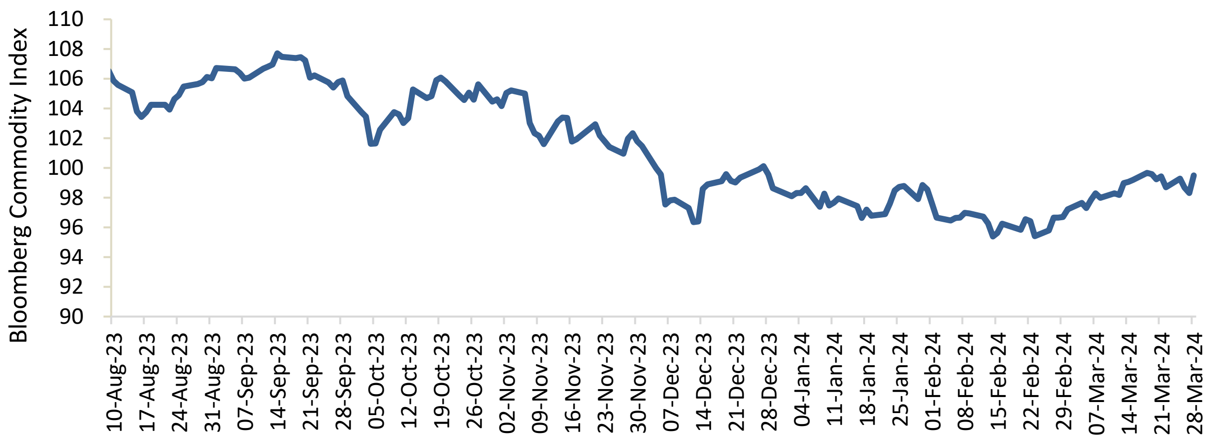
Benign food prices may control incremental inflationary pulses from commodities

Crude oil prices witnessed an uptick



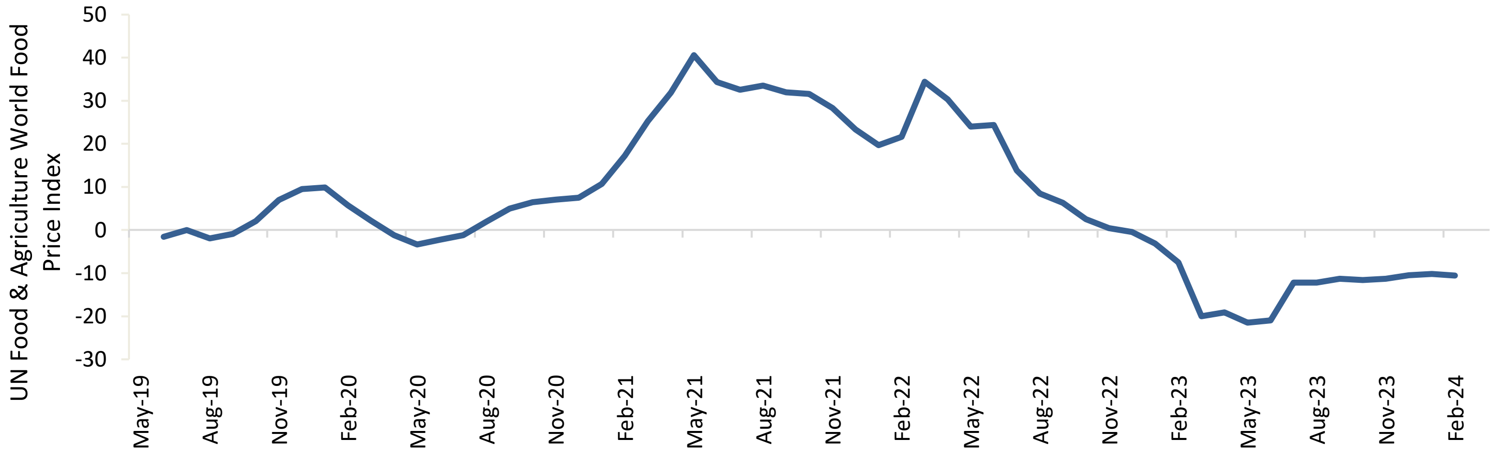
Source: Bloomberg

Strong economic momentum pulling commodities prices higher



Source: Bloomberg

Benign food prices keeping inflation under check



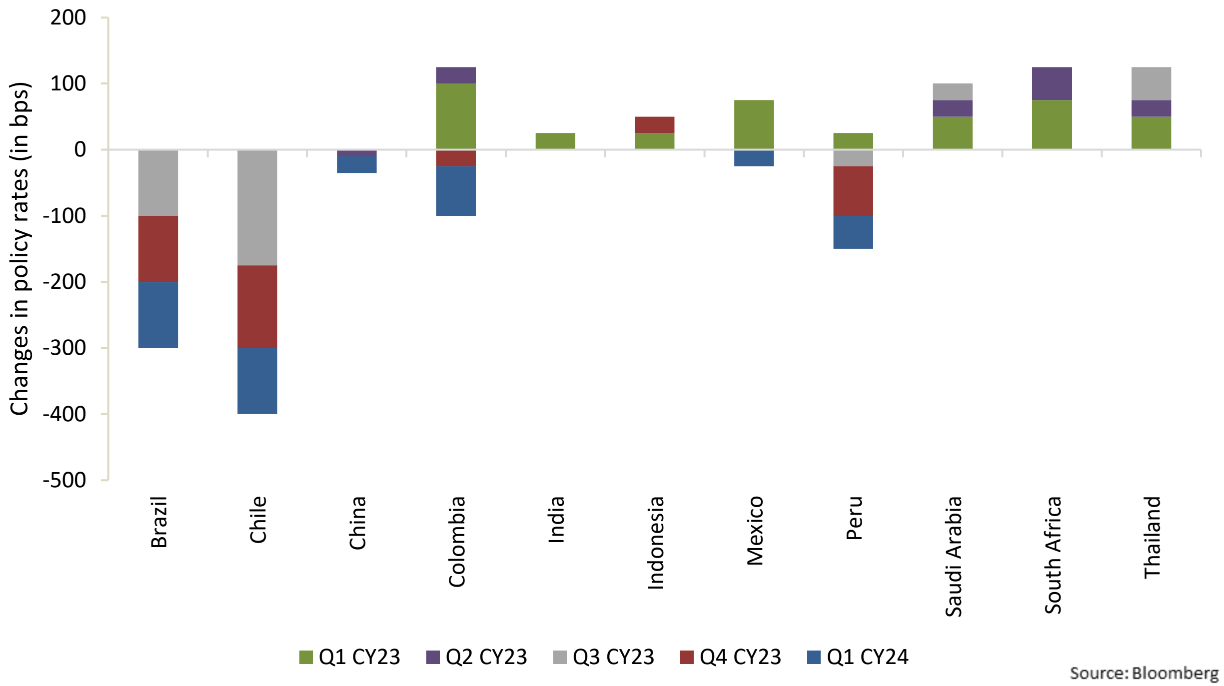
Source: Bloomberg

Rate cuts cycle started – EMs lead and DMs follow

While the rate cycle has peaked in major DMs, central banks remain cautious

Source: Bloomberg

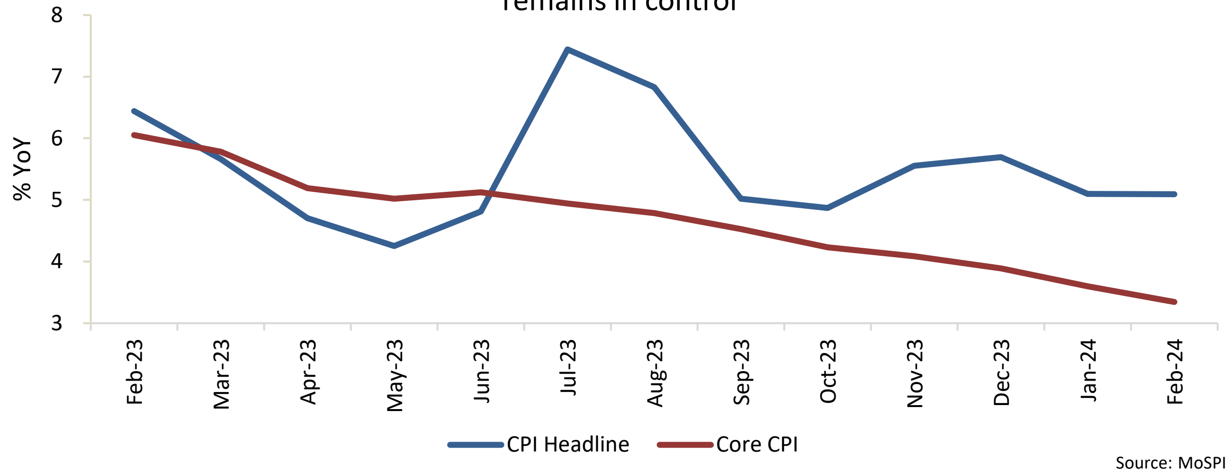
Central banks of EMs seem to be turning



Source: Bloomberg

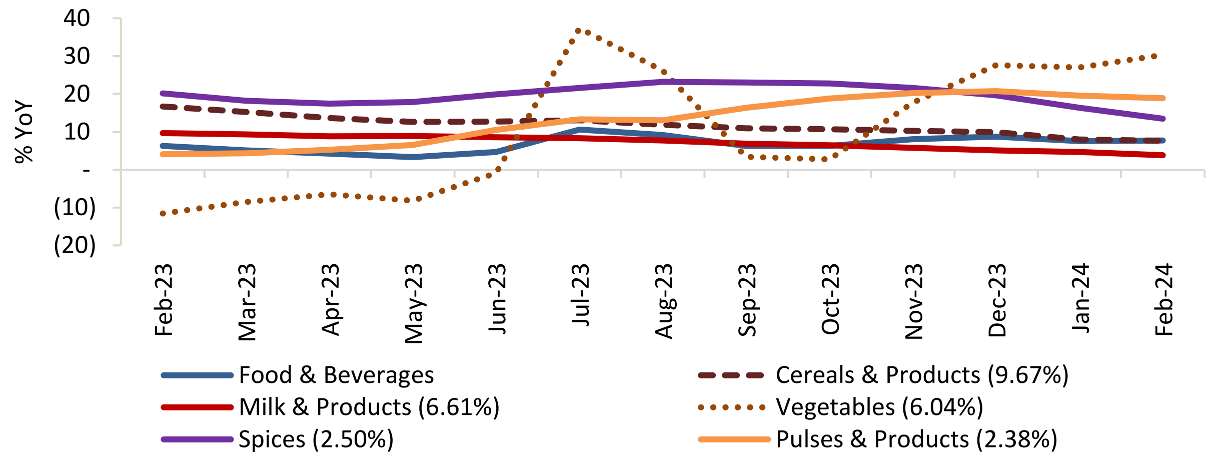
Indian inflation moving in line with expectations, core inflation falls sharply

While the last leg of headline inflation remains tricky, the core inflation remains in control



Source: MoSPI

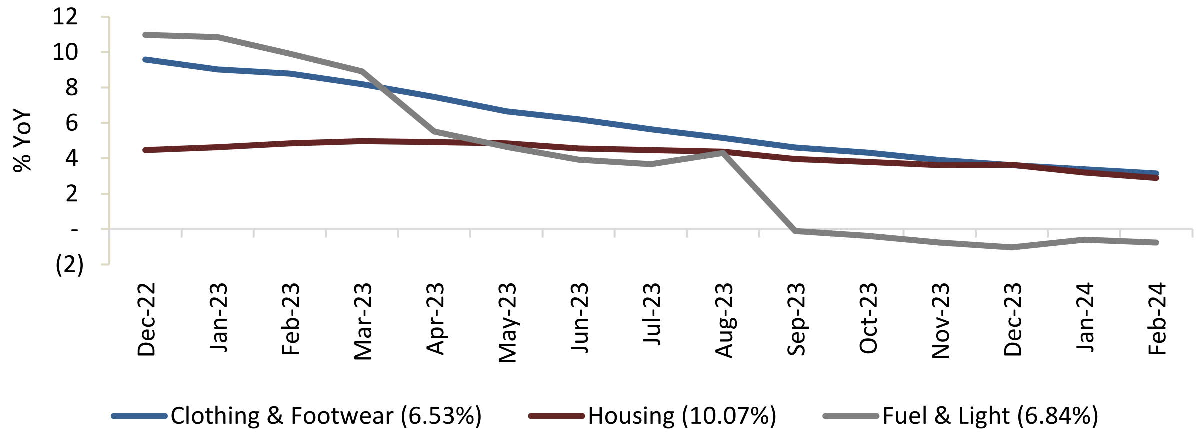
Cereals and vegetable prices keeping food inflation higher…



Note: Data in parenthesis denotes weight of category in CPI basket

Source: MoSPI

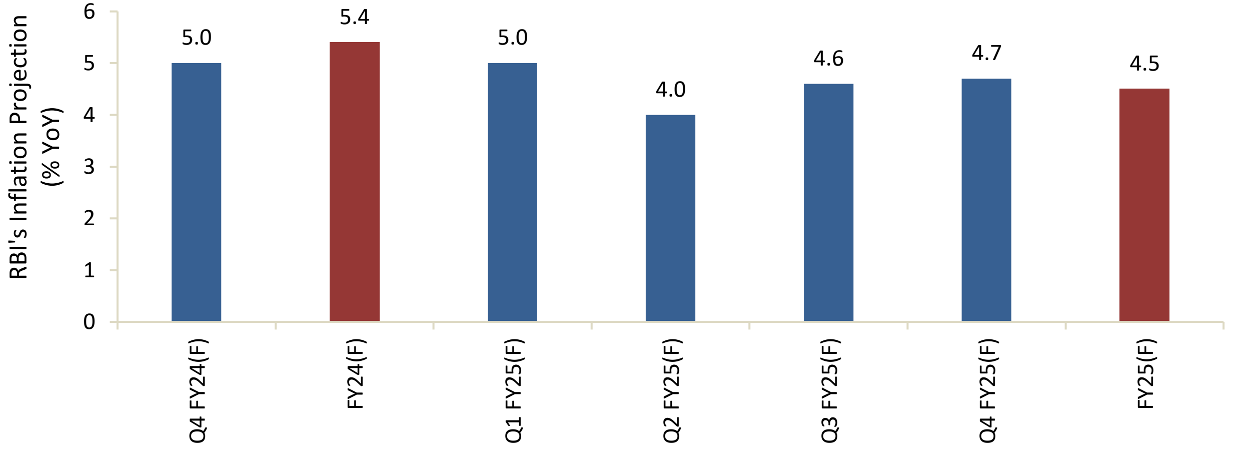
…Other components of inflation providing respite to inflation



Note: Data in parenthesis denotes weight of category in CPI basket

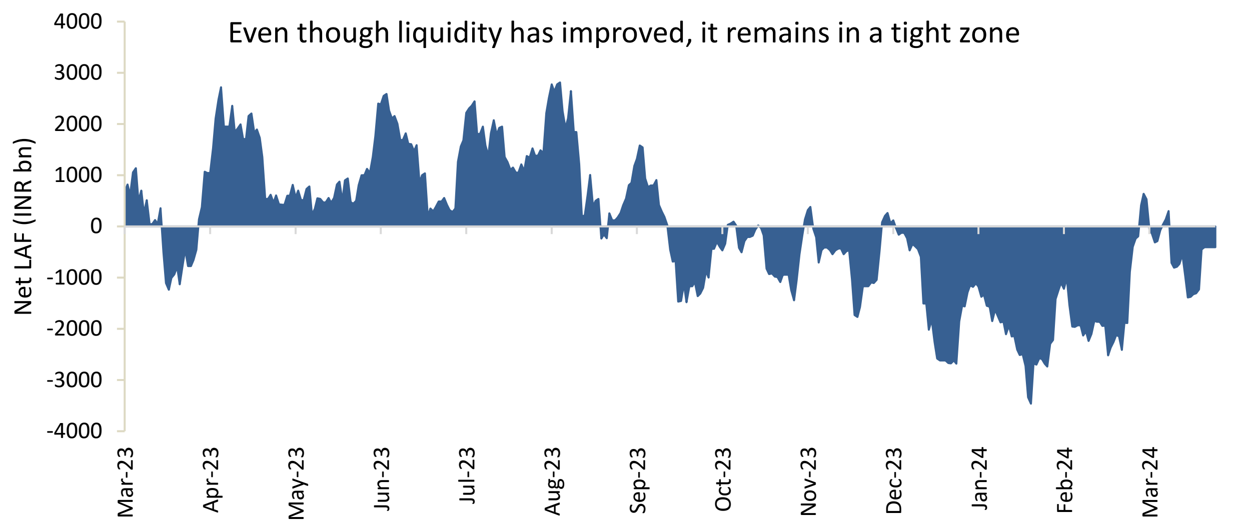
Source: MoSPI

RBI's decelerating inflation forecast remains above the 4% target

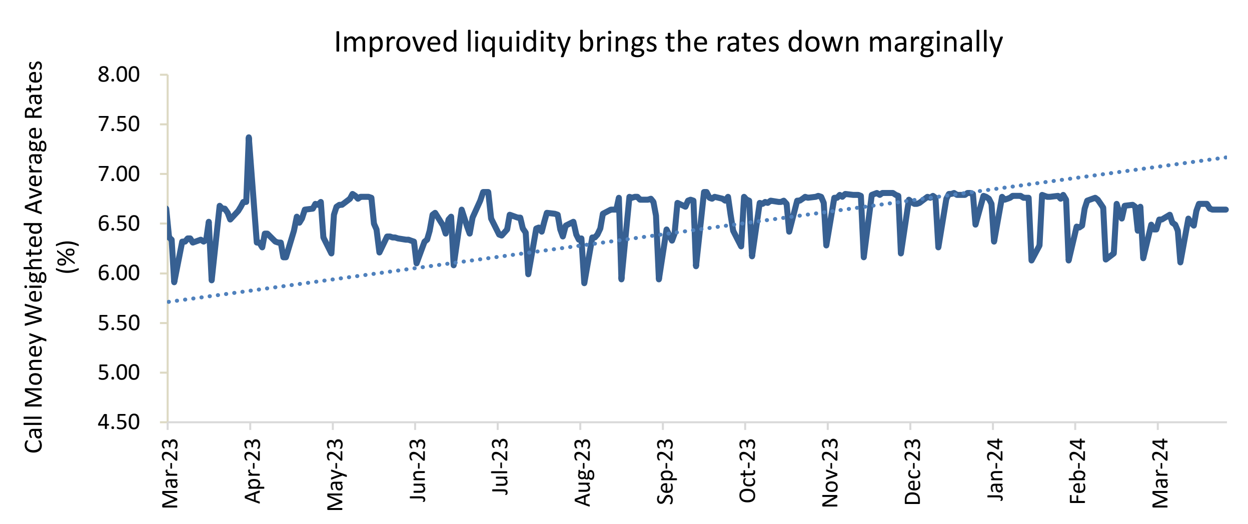


Source: RBI

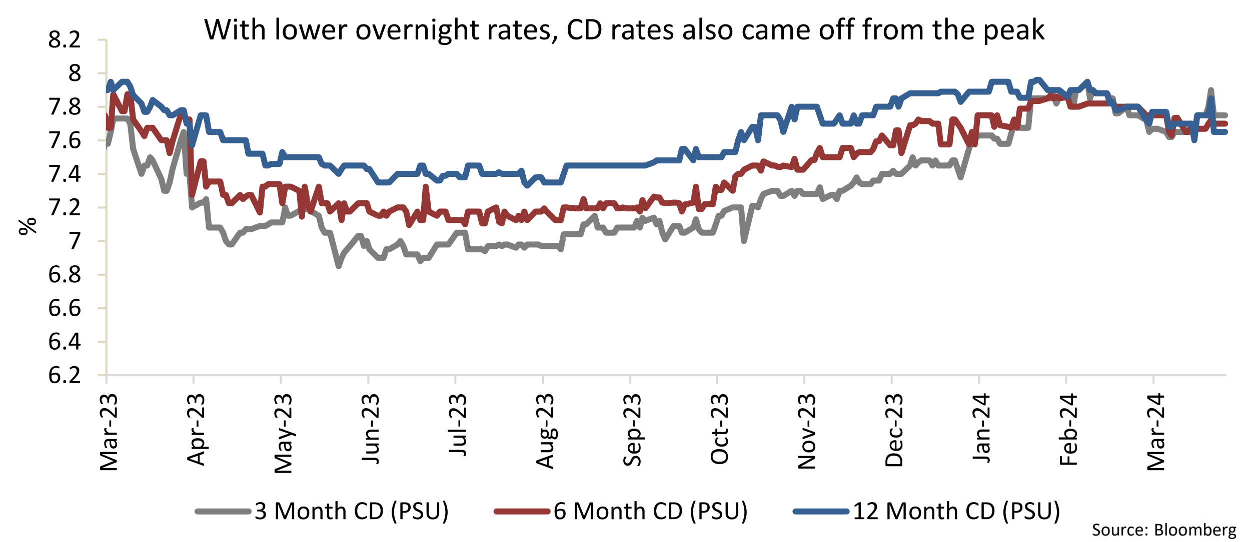
Liquidity continues to remain tight as the RBI ensures call rate remains at or above the repo rate



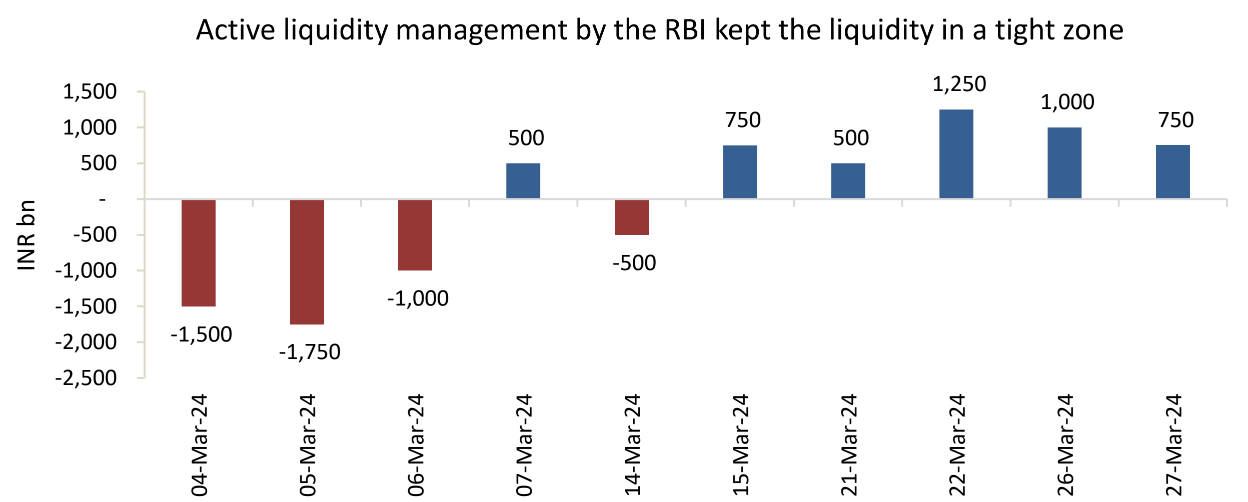
Source: Bloomberg



Source: Bloomberg



Source: Bloomberg

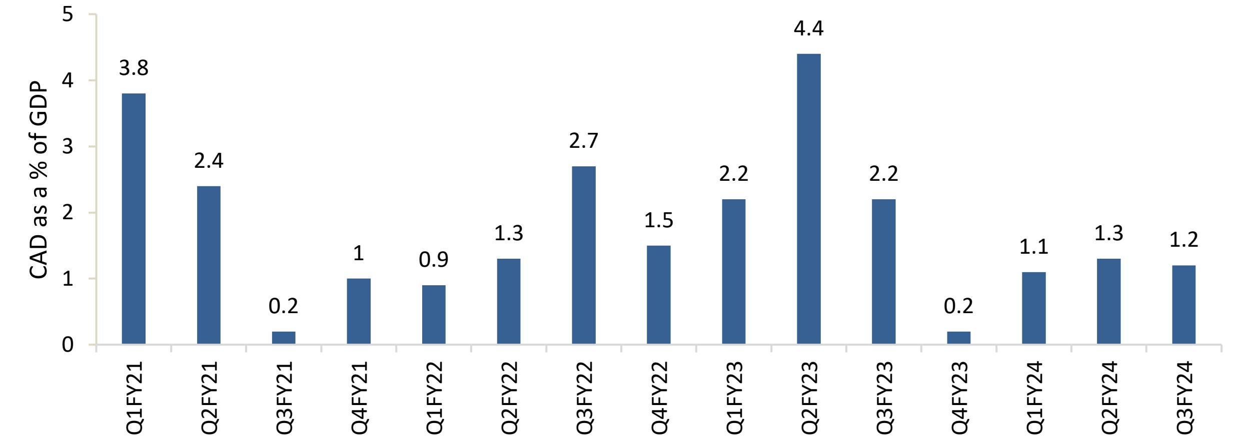


Note: VRR is denoted by positive value and VRRR is denoted by negative value

Source: RBI

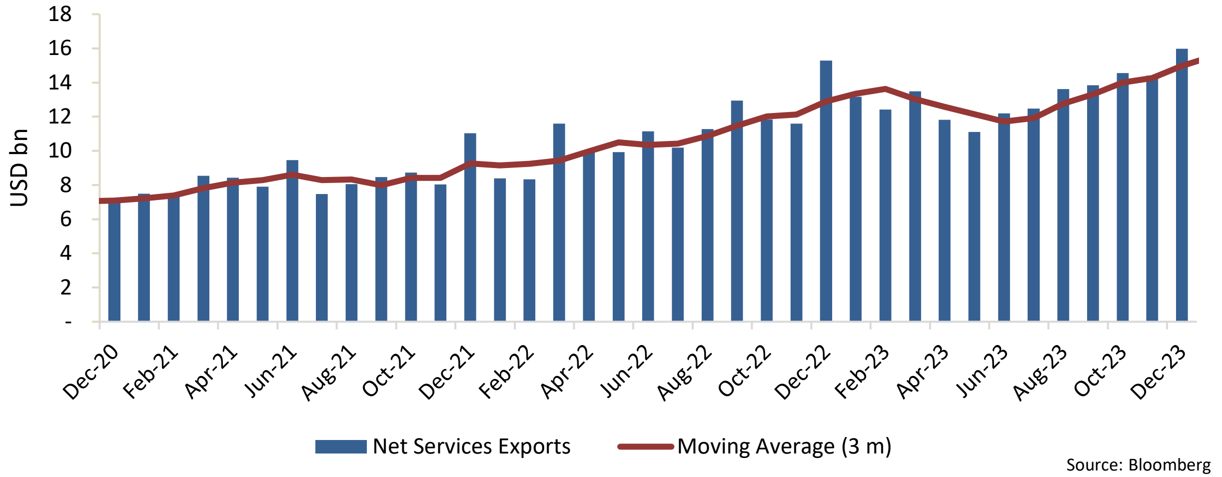
External Sector remains strong supported by services exports and FPI flows

Current account deficit continues to shrink



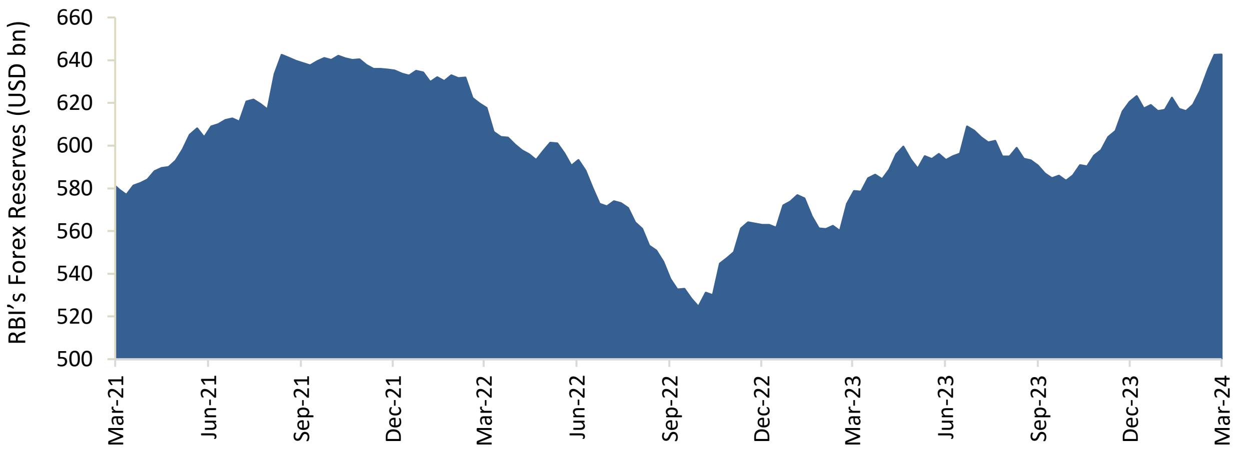
Source: Cogencis

Services exports providing support to CAD



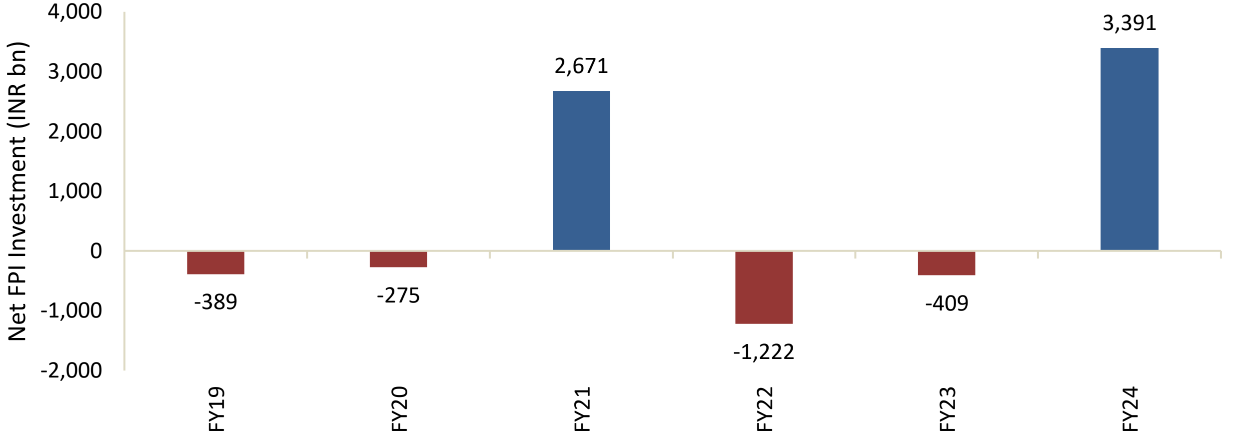
Source: Bloomberg

Forex reserves at an all time high



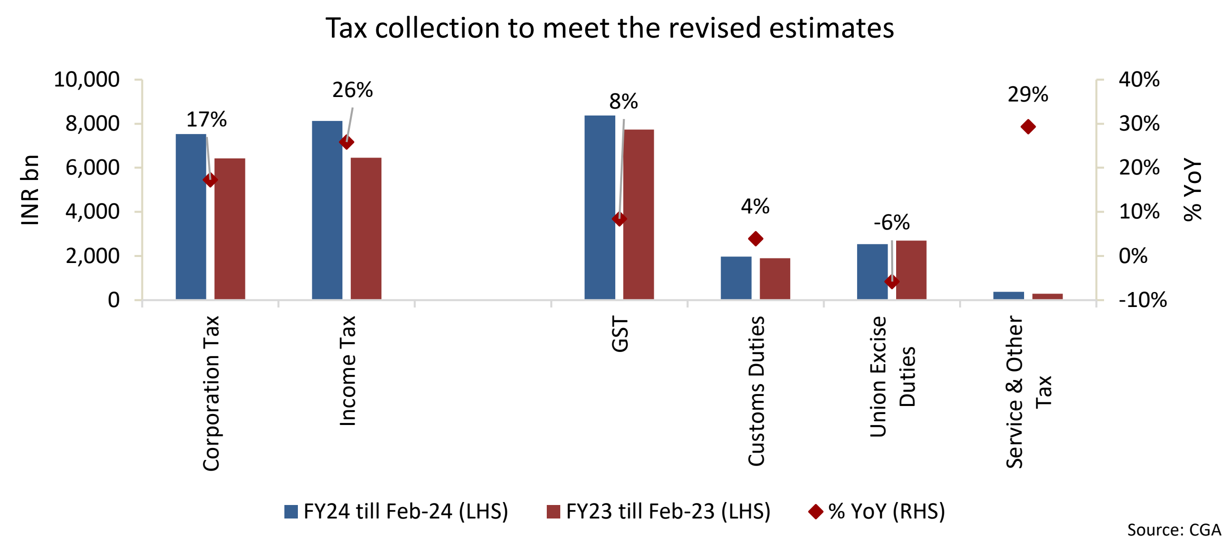
Source: Cogencis

FPIs turn steady buyers in India

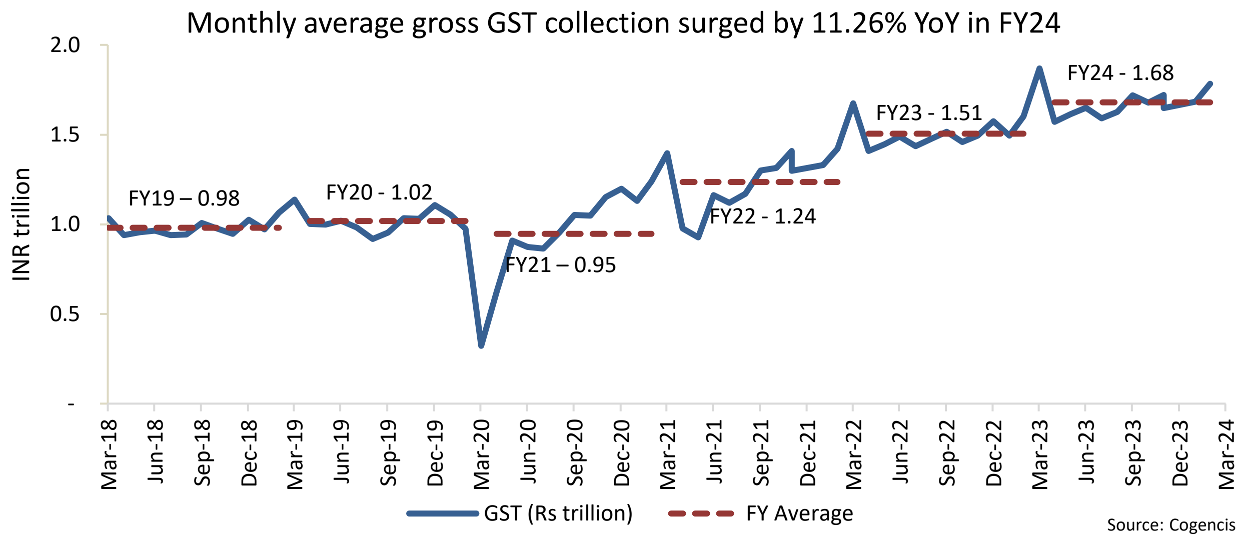


Source: NSDL

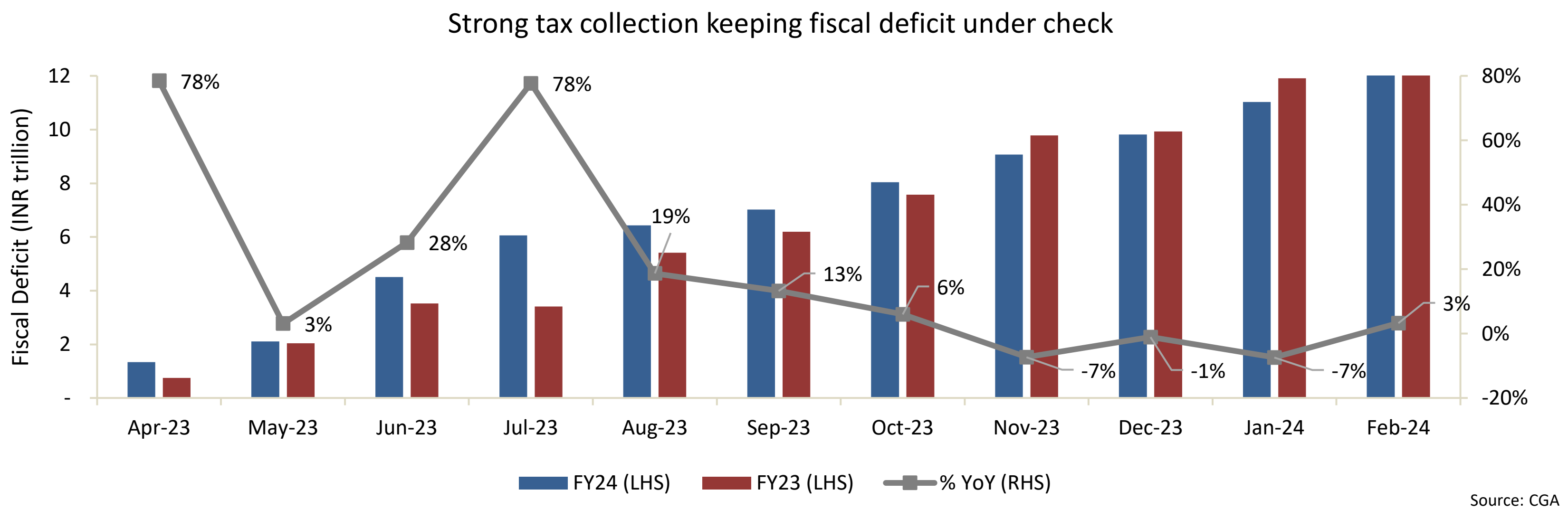
Tax collection remains strong… supporting fiscal conditions



Source: CGA



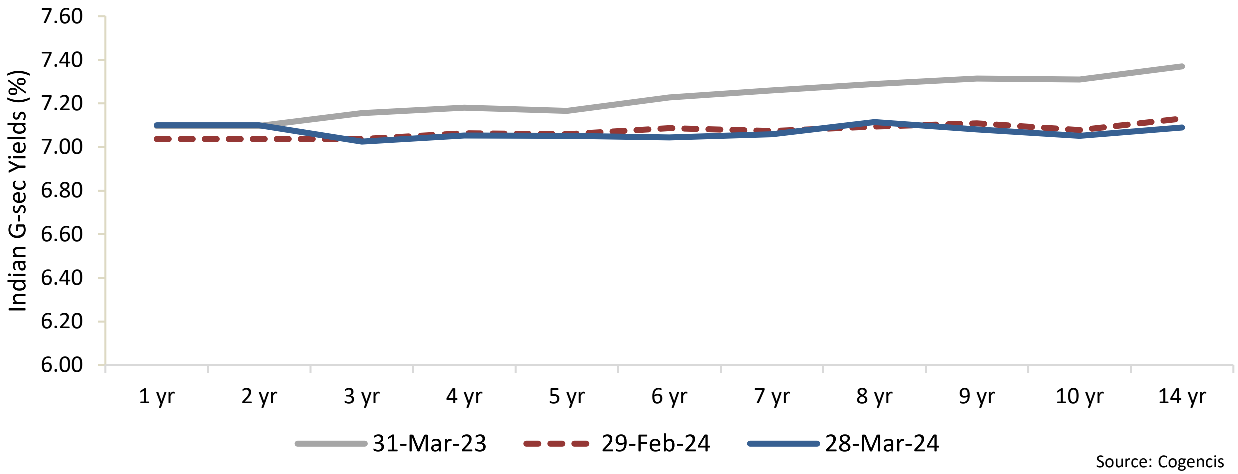
Source: Cogencis



Source: CGA

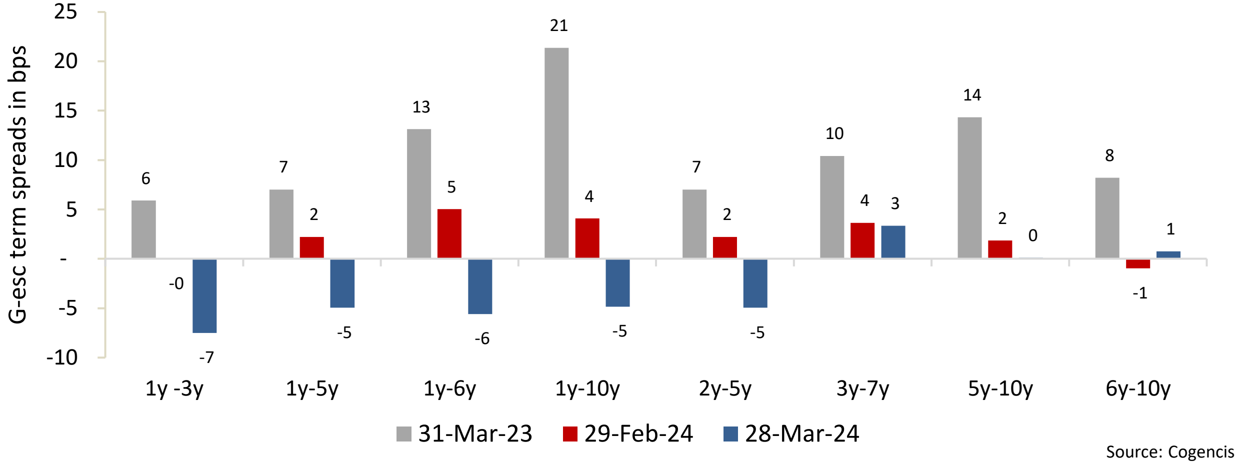
Improved demand-supply conditions drive the G-Sec curve lower… Term spreads compresses sharply

Due to the strong demand, the yield curve witnessed a downward shift



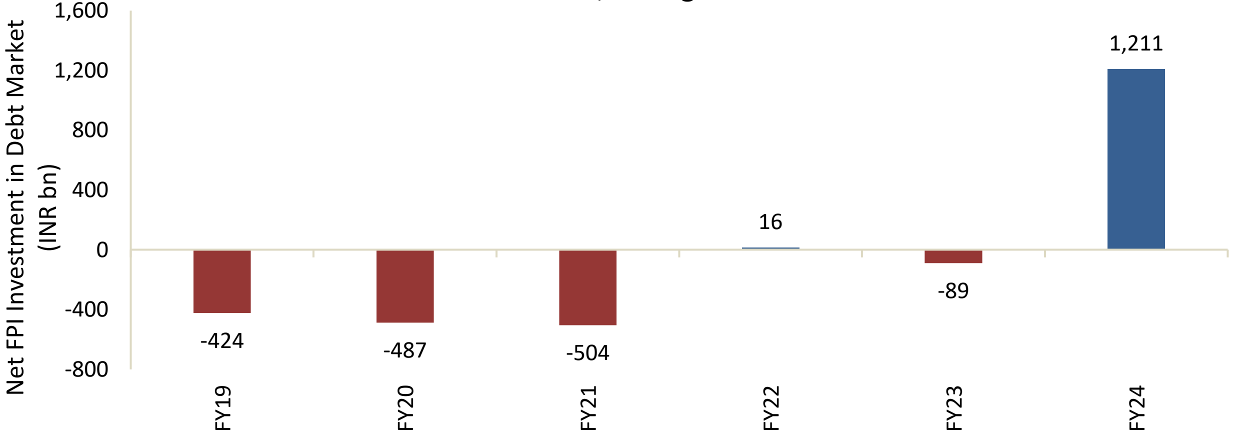
Source: Cogencis

G-sec term spreads remain compressed, keeping the curve relatively flat



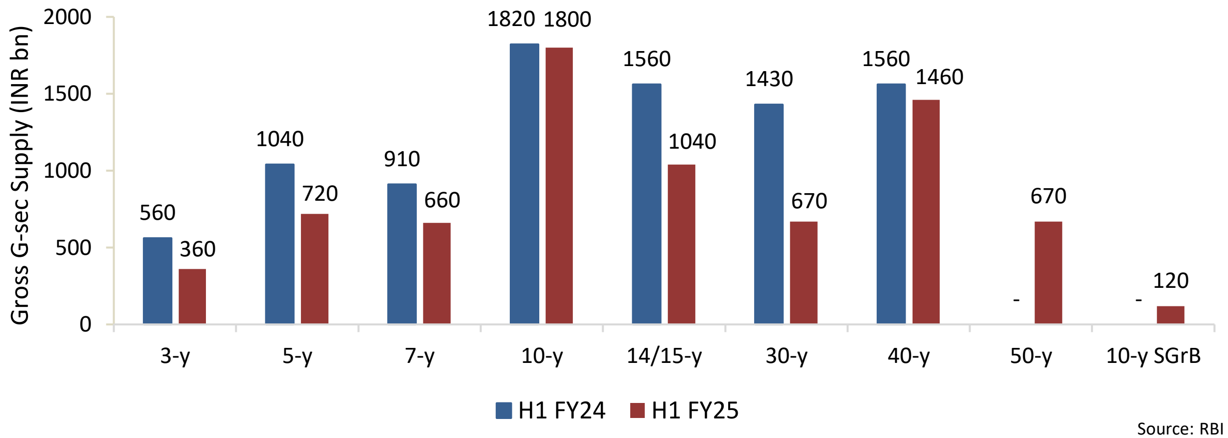
Source: Cogencis

Ahead of index inclusion, strong demand witnessed from FPIs



Source: NSDL

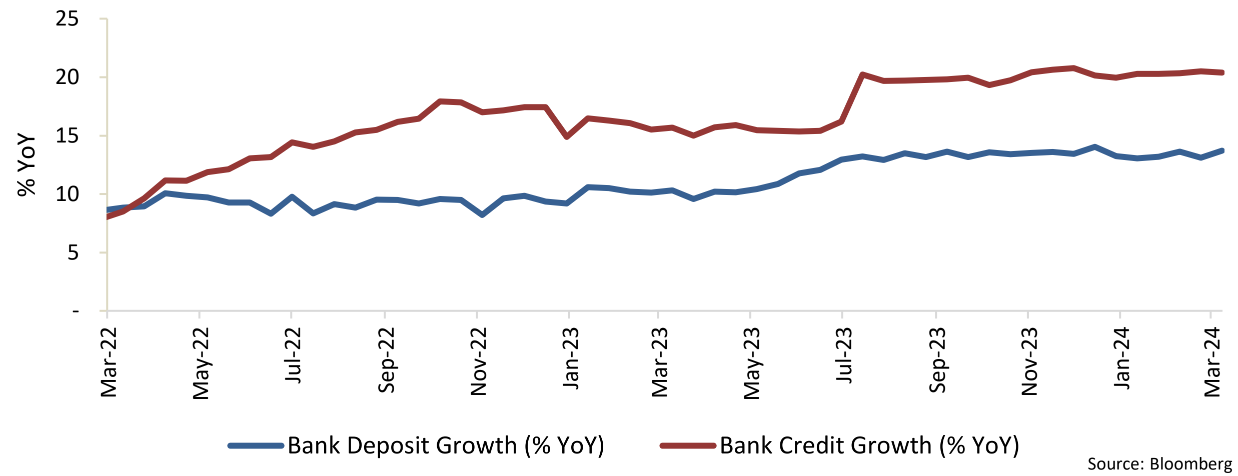
Lower G-sec supply in H1 FY25 as compared to H1 FY24 to further weigh down on yields



Source: RBI

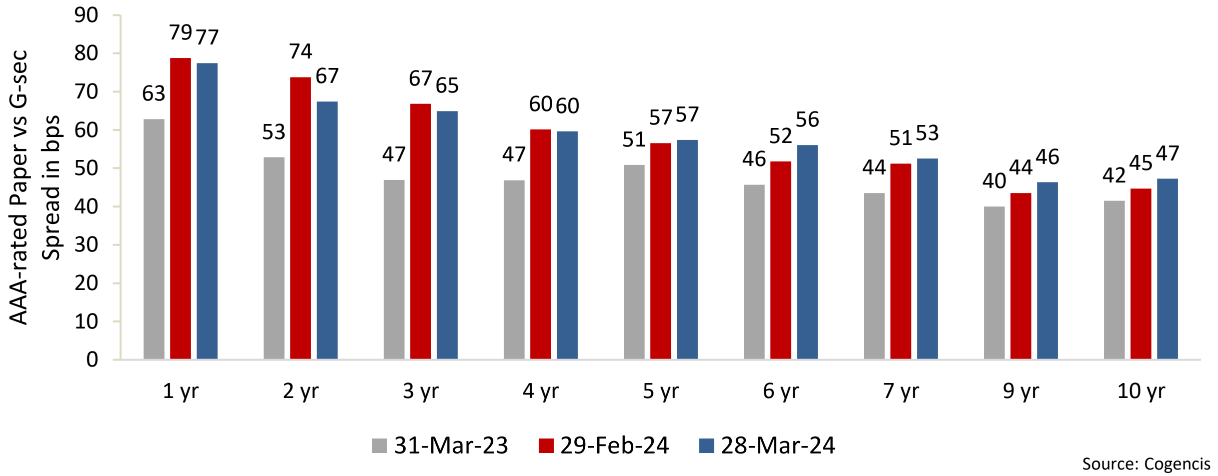
Corporate bond spreads remain relatively elevated

Credit growth continues to outpace deposit growth



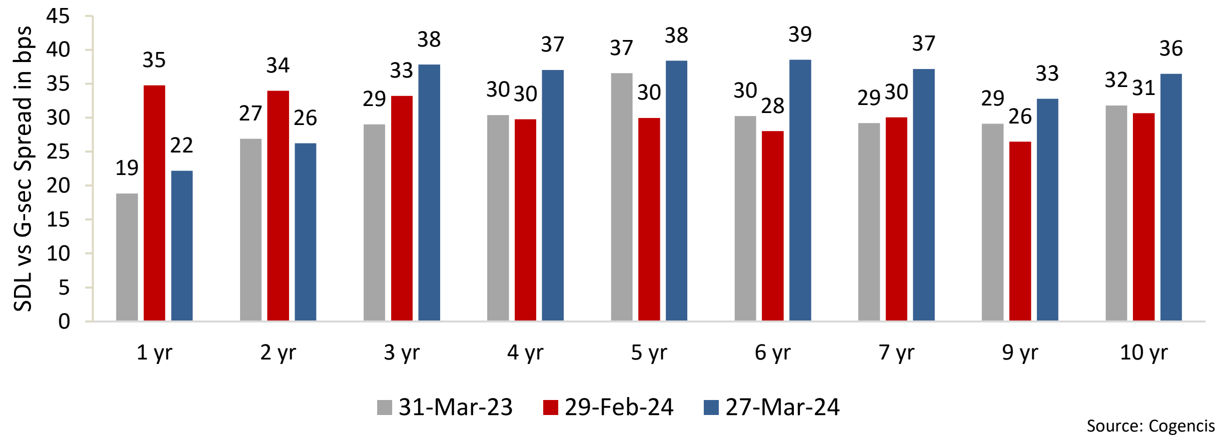
Source: Bloomberg

Spreads of corporate papers vs G-secs remain elevated



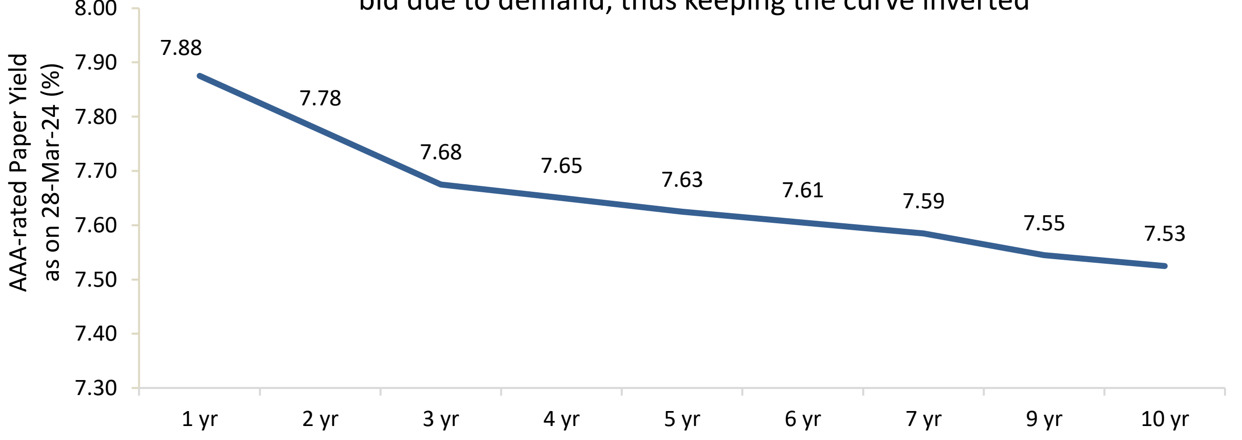
Source: Cogencis

Due to the jump in SDL's supply in March, the spreads of SDL vs G-secs have risen



Source: Cogencis

While tight liquidity keeps the short end elevated, the long end remains well bid due to demand, thus keeping the curve inverted



Source: Cogencis

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