

DEBT OUTLOOK

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Global economic momentum remains resilient and markets are fairly benign, despite the tightest global monetary policy since the Global Financial Crisis, multiple geopolitical tensions and uncertainties related to elections in important economies. The April Purchasing Managers' Index (PMI) came in at its highest since June 2023. The International Monetary Fund (IMF) has also marginally revised its 2024 growth forecast to 3.2%, with the biggest increase of 0.6 points coming in US growth, which is now forecasted at 2.7% for 2024 compared to 2.1% in January alone. The scale of the upward revision in US growth reflects the surprisingly resilient US growth data in Q1. Resilient global growth and a re-acceleration in inflation in the US in Q1 have led markets to reprice the number of Fed rate cuts needed this year.

Globally, while headline inflation is much lower than last year and goods inflation has remained low, services inflation is turning out to be much stickier, forcing central banks to focus on labour cost dynamics to provide guidance on where service price inflation is heading. While the US employee cost index moved up in Q1, recent data points from the labour market suggest that labour demand-supply is coming towards balance, which will reduce the tail risks from inflation and the Fed trajectory. While US inflation readings in Q1 have been high, we believe that inflation will cool off from the strong Q1 pace in the US as residual seasonality effects reverse and catch-up for past increases is almost complete in important categories like shelter and car insurance.

Growth in Europe has also rebounded this year, while inflation has fallen significantly, resulting in a strong possibility of rate cuts by the European Central Bank (ECB) beginning as early as June. In China, despite the decent Q1 numbers, uncertainties remain high and the recent credit numbers were quite disappointing. However, exports continue to remain robust. Export prices are falling, supporting lower inflation elsewhere.

Indian Macro and Markets: India's high frequency data continues to show strong growth momentum. Indian PMIs (both services and manufacturing) are running near series highs, with manufacturing PMIs strongest among Asian peers, auto sales turning better, and The Index of Industrial Production (IIP) growth resilient. Bank credit growth, cement output, steel output, and electricity production all suggest a decent growth momentum.

However, growth is still K-shaped in nature, especially if we look into consumption patterns, the housing market, tax collection numbers and commentary from consumer-facing companies. The challenge for the new government will be to broaden the recovery. We believe that the K-shaped nature is due to the residual scarring of Covid pandemic disruption on the informal sector, certain government policies to keep inflation low in the face of poor rainfall; as the growth momentum sustains, the recovery will get more broad-based.

The market consensus of FY25 growth has moved from 6.2% at the start of the year to 6.7% now. IMF has revised up India's growth forecast to 6.8% from 6.5% earlier. The Global growth forecast for 2024 has also been revised marginally upward to 3.2% and US growth has been revised notably up to 2.7% from 2.1% earlier. A better global backdrop will be a tailwind for Indian growth as well. The RBI also remains bullish on Indian growth at 7% which we think is achievable if the global backdrop and monsoon remain favourable. The India Meteorological Department (IMD) has forecasted the monsoon to be 106% of normal for this year, which is welcome news for the economy, both from a growth and inflation point of view.

Inflation data for April declined marginally and came in at the lowest in 11 months at 4.83%, with core inflation declining to another record low at 3.23%. Our preferred measure of core inflation also declined further to 3%. Food inflation remained high, but seasonal month-on-month momentum in food inflation was low. With the sticky core inflation making new lows every month, we expect food inflation to correct and move towards core inflation if the weather remains favourable. Given that the upside risks coming from food inflation were cited by RBI as an important factor they are watching, inflation moving lower as per their expectation and upside risks not playing out will open up space for monetary easing.

Government spending in the economy has remained muted (both at the centre and states) owing to the election, resulting in the build-up of cash balance of the Central government (resulting in tight banking liquidity) and lower state government

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borrowing. The RBI has announced the buy-back of government securities to ease the tight liquidity (deficit averaging INR 1.4tn), which we think will persist till government spending picks up post-elections. State budgets for FY25 suggest budgeted state fiscal deficit declining marginally to 3.2% of GDP in FY25 from 3.5% of GDP in FY24, which will further support the demand-supply dynamics for gilt bonds.

Most market participants and media remain fixated on the ongoing 7-phase General Election amidst some nervousness built up in markets with discussion on supposed voter apathy and lower voter turnout. We see the voting percentage as only marginally lower than last time, plus a strong heat wave was underway in earlier phases of the election. We also note that voting percentage has increased in later phases and widespread thunderstorm activity has also reduced temperature, which may be contributing to better turnout in later phases. So, we would not like to read too much on the marginally lower voting percentage and do not think it will alter the final result.

Portfolio positioning: There are multiple things which are positive for Indian bonds currently: Healthy fiscal health, lower supply, receding inflation, stable INR and upcoming inclusion to global/EM bond indices. The key risks that we are closely watching are largely global in nature: the impact of geopolitical risks on oil prices and US inflation turning out to be sticky. On liquidity, we believe, from June 2024 onwards, liquidity will be eased durably and provide relief to short-term rates as well. We remain constructive on Indian bonds and have kept our duration and G-Sec allocation on the higher side. We believe that investors should continue to add duration to their portfolios and take benefit of any intermittent sell-off through short-term funds (Aditya Birla Sun Life Short Term Fund, Aditya Birla Sun Life Corporate Bond Fund, and Aditya Birla Sun Life Banking & PSU Fund). Investors who are looking to dial in more aggressive duration in their portfolio are recommended to invest in our Aditya Birla Sun Life Long Duration Fund or Aditya Birla Sun Life Government Securities Fund or Aditya Birla Sun Life CRISIL IBX Gilt April 2033 Index Fund (10-year GILT Debt Index Fund). Ultra short-term investors should look to invest in money market, ultra-short duration funds & low duration funds incrementally to reduce reinvestment risk over Overnight Fund.

Source: CEIC, Bloomberg, RBI

For Product Labelling of Aditya Birla Sun Life Short Term Fund, Aditya Birla Sun Life Corporate Bond Fund, Aditya Birla Sun Life Banking & PSU Fund, Aditya Birla Sun Life Long Duration Fund, Aditya Birla Sun Life Government Securities Fund and Aditya Birla Sun Life CRISIL IBX Gilt April 2033 Index Fund, please Click Here

Our Recommendations

Approach	Fund	Investment horizon
Very Short Duration	Aditya Birla Sun Life Liquid Fund	7 days -1 month
Very Short to Short Duration	Aditya Birla Sun Life Savings Fund	1 month -6 months
Short Duration	Aditya Birla Sun Life Low Duration Fund	6-12 months
Accrual Strategy with High Quality Credit	Aditya Birla Sun Life Corporate Bond Fund	1-3 years
Active Management	Aditya Birla Sun Life Dynamic Bond Fund	Above 3 years
Accrual Strategy with High Yielding Credit	Aditya Birla Sun Life Medium Term Plan	Above 3 years

None of the aforesaid recommendations are based on any assumptions. These are purely for reference and the investor are requested to consult their financial advisors before investing.

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