CANARA ROBECO

Macro Review & Fixed Income Market Outlook

Global Economy Update:

Macro Backdrop:

- Intensifying geopolitical strife has flung a pall of uncertainty around the global economy as it slows in the final quarter of 2023, albeit with considerable cross-country variations.
- Europe appears to be on the edge of recession, China is stalling. The US has emerged as a key driver of global growth although its outlook is more uncertain now than before as it swings from hard landing to soft landing to no landing.
- Several parts of Asia remain bright spots but in Latin America, activity is losing steam.
- Globally, manufacturing is languishing while services sector activity appears to have reached the end of its post-pandemic expansion.
- Labour markets are exhibiting signs of weakening and consumer, and business confidence is dented by the recent deep sense of insecurity as wars rage.
- International trade is weighed down by the strong US dollar and the post-pandemic rebalancing of consumption.
- The slowdown in international trade is encompassing a broad swathe of countries and a wide array of goods, specifically manufactures such as iron and steel, office and telecom equipment, textiles, and clothing.
- Although trade in services has remained resilient so far, the growth of global trade in goods and services in 2023 is going to be significantly below world output and lower than its average growth during the last decade.
- The November PMI surveys saw the global manufacturing sector move closer to stabilisation.
- Although the downturn in output extended to six consecutive months, the rate of contraction was negligible and the weakest during that sequence.
- Business optimism also ticked higher, as companies' outlooks brightened despite the current continued market uncertainty and cost-caution.
- The JP Morgan Global Manufacturing PMI rose to a six-month high of 49.3 in November, up from 48.8 in October, but remaining below the neutral 50.0 mark for the fifteenth month in a row.
- Although all five of the PMI components continued to signal a deterioration in overall operating conditions, four (new orders, output, stocks of purchases and employment) signalled lesser rates of decline than in the prior survey month.
- November data indicated that the downturn in world manufacturing production was mainly centred on the intermediate goods sector, where output contracted for the sixth month in a row (albeit at a slower pace).
- In contrast, consumer, and investment goods producers both saw increases.

Indian Economic Growth:

Macro Backdrop:

- India is poised to maintain its growth momentum as strong macroeconomic fundamentals impart resilience in the face of global headwinds.
- India has become the new engine of global growth with its young demography, improving physical and digital infrastructure and above all, an enabling policy environment.
- The innate resilience of the Indian economy could be attributed to its well diversified economic structure.
- Although India has made rapid strides in external openness through trade and financial channels and gained competitiveness, its core dependence for growth continues to be its domestic demand which also provides a cushion against external shocks.

- Among the constituents of aggregate demand, private consumption accounts for over half of GDP (around 57.0 per cent average share during 2011-12 to 2022-23), followed by fixed investment and government consumption.
- During the post-pandemic recovery, private consumption contributed an average of 66.0 per cent to GDP growth during 2021-22 and 2022-23.
- At the same time, structural reforms related to banking, digitalisation, taxation, manufacturing, etc., have laid the foundation for a strong and sustainable growth over the medium and long term.
- India's Q2FY24 GDP came in at 7.6% YoY.
- Nominal GDP growth rose 9.1% YoY in Q2FY24 from 8.0% YoY in Q1FY24 with the GDP deflator increasing to 1.4% YoY in Q2 vs 0.2% in Q1FY24.
- The Indian manufacturing industry continued to perform well in November.
- After slowing in October, growth of output gathered pace as strengthening client demand and more favourable input supply boosted production volumes.
- Picking up from October's eight-month low of 55.5 to 56.0 in November, the seasonally adjusted S&P Global India Manufacturing Purchasing Managers' Index TM (PMI) indicated a stronger improvement in operating conditions.
- The reading was below the average for the second fiscal quarter (57.9) but outpaced the series trend.
- The trend for new export business showed signs of resilience, despite weakening in November.
- New export orders rose for the twentieth month in a row and solidly, albeit at the slowest rate since June.
- On the upside, companies signalled higher intakes of new business from Africa, Asia, Europe, and the US.
- Manufacturing employment in India increased for the eighth successive month heading towards the end of the 2023 calendar year.
- New work in the pipeline and a healthy demand environment spurred recruitment, anecdotal evidence showed. Growth ticked higher but was moderate overall.
- India's goods and services tax (GST) collections was at Rs 1.68 lakh crore in November '23, records highest growth rate of 15% Y-o-Y.

Inflation:

Global:

- A very gradual disinflation is underway even though headline inflation is still above the target in most economies.
- In the US, the headline personal consumption expenditure (PCE) inflation remained steady for the third consecutive month at 3.4 per cent (y-o-y) in September, with core PCE inflation moderating marginally to 3.7 per cent.
- CPI inflation in the US moderated to 3.2 per cent (y-o-y) in October from 3.7 per cent in September.
- Euro area inflation fell back to 2.9 per cent (y-o-y) in October from 4.3 per cent in September, reaching its lowest level since July 2021.
- CPI inflation in the UK moderated to 4.6 per cent in October from 6.7 per cent in September, while Japan's inflation (CPI excluding fresh food) moderated to 2.8 per cent in September from 3.1 per cent in August.
- Among emerging market economies (EMEs), inflation edged up further to an eight-month high in Russia in October while China recorded a deflation of 0.2 per cent in October reflecting weak demand and oversupply.
- Core and services inflation have eased in recent months, although they remain much above the headline in most AEs.

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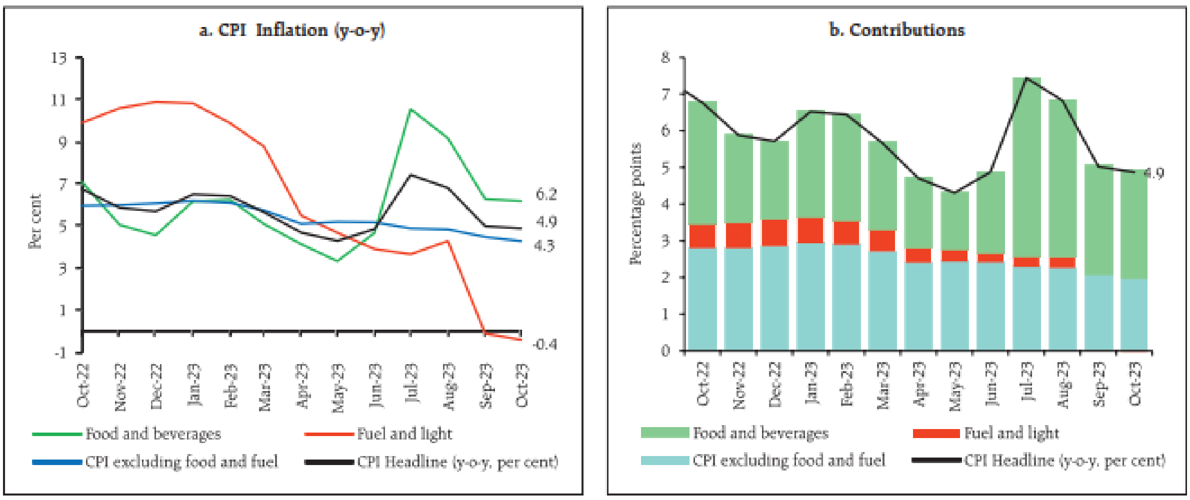
India:

- CPI inflation moderated to 4.9 per cent in October 2023 from 5.0 per cent in September.
- Food inflation (y-o-y) dipped to 6.2 per cent in October from 6.3 per cent in September. Edible oils remained in deflation.
- Deflation in the fuel and light group deepened to (-) 0.4 per cent in October from (-) 0.1 per cent in September, mainly driven by softening of y-o-y growth in prices of electricity and other cooking fuel.
- Deflation in LPG and kerosene prices continued in October.
- Core inflation moderated to 4.3 per cent in October from 4.5 per cent in September.
- While inflation in clothing and footwear, housing, household goods and services, transportation and communication, education and personal care and effects moderated, it remained steady in pan, tobacco and intoxicants, health, recreation, and amusement.
- In terms of regional distribution, rural inflation at 5.12 per cent was higher than urban inflation at 4.62 per cent in October 2023.
- Majority of the states registered inflation in the range of 4-6 per cent. Haryana, Odisha, and Rajasthan experienced inflation between 6 to 8 per cent.

Trends and Drivers of CPI Inflation:



Sources: National Statistical Office (NSO); and RBI staff estimates.

Bond Yields & Spreads:

- Global central banks are likely at end of rate hike cycle.
- US FED held rates in last 2 policy meet, and latest media reports seem to indicate that FED members think that enough has been done to manage inflation.
- US 10Y yields climbed higher, briefly crossing 5%, before retreating. However, with softer economic and inflation data and dovish FED speak, markets yield dropped and closed at 4.33% in end November 23.
- Lower US yields led to a weaker dollar and engendered an all asset rally.
- India 10Y G-SEC softened on global rate rally, however the rally was tempered as liquidity remains tight and there is no expectation of RBI changing rate stance in near term.
- Post inclusion in JP Morgan Bond EM Index, market is expecting inclusion in Bloomberg Bond Index as well. This is likely to be positive for medium to long term bond market sentiments.
- Medium to long term corporate spreads widened a bit as liquidity remained tight and increase in supply of corporate papers.

Outlook:

Global:

- With “goldilocks” scenario of soft-landing taking hold, markets have been celebrating. Inflation has come down in recent readings, while growth in the US remains robust.
- Inflation seems to have peaked in major countries, and markets have started in pricing rate cuts by mid of 2024 in advanced economies.
- However, Central banks are likely to remain vigilant and base their actions on incoming data.
- Rate markets fell sharply in November on soft economic data and dovish FED, with expectations of rate easing becoming stronger in the near term.
- Market yields have reversed sharply from highs. However, with the end of calendar year near, markets may remain in a consolidation phase.

India:

- Oil prices have retreated from highs, providing comfort to markets.
- Spikes in vegetable prices have tapered off. Crop output is expected to be normal, though certain items like cereals and pulses continue to show inflationary trends. The government is taking necessary steps to calm prices in volatile items like onions.
- Core inflation remains under control, which will likely be dissuading RBI MPC from any rate hike action in the December ‘23 MPC (monetary policy committee) meeting.
- Inflation is moderating but RBI is wary of the impact of global geo-politics on price pressures as well as local food price volatility.
- Strong growth trends will likely keep core price pressures alive.
- With RBI projecting inflation to be 5.4% for FY2024, it remains above their 4% medium term policy target. Coupled with strong growth numbers, there is no pressure on the RBI to ease any time soon.
- This will likely keep RBI to maintain hawkish monetary policy with tight liquidity to ensure reduction of inflation to 4% in the medium-term.
- The announcement of possible OMO (Open Market Operations) sales by the RBI in October policy has led to higher market yields. With liquidity remaining tight, RBI did not undertake any OMO sales.
- RBI may indicate in upcoming policy that OMO sales may not be required as the overnight rate has been near the MSF (Marginal Standing Facility) rate in past few months.
- Markets are likely to be driven by global rate cues i.e., US yield movements and oil prices.
- Local conditions remain favorable to bonds considering falling inflation as well as inclusion in JP Morgan Index.
- Inclusion in the JP Morgan EM Bond Index will likely lead to inflows of around USD 20-25 billion in FY25. Active FII flows have already started in the past few months.
- The government borrowing remains within budgeted amount keeping fiscal under check.
- In the near term, we believe that 10Y yield may move in a range of 7.15%-7.30%.

Source: RBI, MOSPI, PIB, CMIE, FIMMDA, NSDL, Bloomberg, Internal Research.

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