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Macro Review & Fixed Income Market Outlook

Global Economy Update:

Macro Backdrop:

- Global growth appears to have lost pace from the third quarter of 2023, after having quickened in the first half of the year relative to the preceding six months.
- Headline indicators suggest that labour market tightness in advanced economies (AEs) is easing, with weak wage growth adjusted for inflation dampening consumer spending and confidence.
- In this group of countries, manufacturing activity is either stagnating or contracting and services are moderating from a robust expansion.
- Europe’s biggest economies ended the third quarter in contraction, according to purchasing managers’ indices (PMIs).
- Tightening financial conditions in response to monetary actions to address still elevated inflation, persisting geopolitical tensions and growing geoeconomic fragmentation render the outlook fragile.
- Headline inflation has been gradually easing across the world, however, in most countries, it remains elevated in relation to targets.
- Core inflation is moderating but at a tardy pace and services inflation is sticky.
- These concerns are reflected in 'higher for longer' monetary policy settings. In some countries, however, the monetary policy tightening cycle is complete or nearing it or even in accommodation in response to weakening economic activity.
- Market expectations relating to the global economic outlook are fluctuating widely and sensitive to every incoming information, imparting high volatility.
- Credit growth in major economies is decelerating in response to monetary tightening.
- After strong gains in the first half of 2023, global equity markets retreated in Q3 (July-September).
- The US dollar depreciated to a 15-month low in mid- July but has recovered subsequently on better-than-expected US economic data.
- Food prices are volatile on supply concerns arising from the breakdown of the Black Sea deal on Ukrainian grain movements and the El Niño weather phenomenon.
- The S&P Global US Manufacturing PMI was confirmed at 50.0 in October 2023, marking a slight improvement from 49.8 in September and indicating a stabilization in the health of the manufacturing sector.
- The International Monetary Fund (IMF), in its October 2023 update of the World Economic Outlook (WEO), kept the global growth forecast unchanged at 3.0 per cent in 2023, same as in its July 2023 update.
- Growth in 2024 is, however, projected to moderate to 2.9 per cent (downward revision by 10 basis points from the July 2023 update) as a stronger-than-expected momentum in the US is likely to be more than offset by a weaker-than-expected growth in the euro area and China.

Indian Economic Growth:

Macro Backdrop:

- The Indian economy is forging ahead in a challenging global environment, drawing strength from its underlying macroeconomic fundamentals and buffers.
- Domestic economic activity is being supported by robust agricultural performance, sustained buoyancy in contact-intensive services, the boost to investment from the government’s thrust on capital expenditure, above trend capacity utilisation in manufacturing, double digit credit growth, and healthier corporate and bank balance sheets.

- The World Bank's latest India Development Update (IDU) reflects India's resilience to global spillovers, even as pandemic-induced pent-up demand wanes.
- Supply chain pressures in India remain below historical average levels.
- Consumer Confidence has improved with upticks in most of the macroeconomic conditions.
- Overall credit ratio of ICRA assigned ratings was 2.0 in Apr-Aug 2023, indicating improved credit quality of India Inc.
- Rating upgrades were strong in the Hotels, Auto components, Financials and transport and infrastructure sectors.
- The S&P Global India Manufacturing PMI unexpectedly dropped to 55.5 in October 2023 from 57.5.
- It was the 28th straight month of increase in factory activity but the softest pace since February, as output rose the least in 8 months, new order growth hit its lowest level in a year, and foreign sales expanded at the softest pace in 4 months.
- The PMI for services drops to 58.4 in October '23 from 61.0 in September '23.
- India's overall exports in September 2023 estimated at USD 63.84 Billion.
- Merchandise exports at USD 34.47 Billion in September 2023.
- Trade Deficit projected to improve by 47% during April-September 2023 at USD 39.91 Billion.
- Merchandise trade deficit also improves from USD 140.83 Billion during April-September 2022 to USD 115.58 Billion in April-September 2023.
- In October, the unemployment rate in India reached its highest level in over two years due to a rise in joblessness in rural areas.
- India's goods and services tax (GST) collections reached Rs 1.72 lakh crore in October, the second highest ever, next only to April 2023, records increase of 13% as compared to the same period last year.

Inflation:

Global:

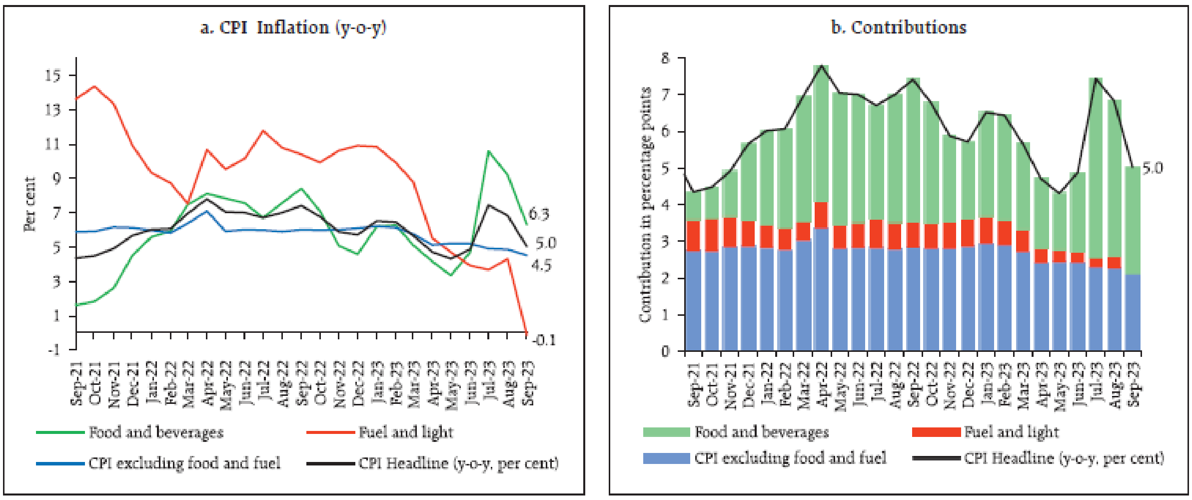
- Consumer price inflation is easing, reflecting softening energy and food prices, improving supply chains and tighter monetary policy. It is, however, ruling well above targets, especially in AEs.
- According to the IMF's WEO July 2023 update, global inflation is projected to moderate from an annual average of 8.7 per cent in 2022 to 6.8 per cent in 2023 and further to 5.2 per cent in 2024 but would remain above the pre-pandemic (2017-19) level of 3.5 per cent.
- In the US, headline CPI inflation decelerated from 5.0 per cent (y-o-y) in March 2023 to 3.0 per cent in June but then hardened to 3.7 per cent in August.
- In the Euro area, CPI inflation eased by 260 bps to 4.3 per cent in September 2023 from 6.9 per cent in March.
- In the UK, CPI inflation eased to 6.7 per cent in August 2023 from 10.1 per cent in March 2023 while core inflation at 6.2 per cent in August was unchanged from its level in March.
- In Japan, CPI inflation (all items less fresh food) was 3.1 per cent in August 2023, the same level as in March, though core inflation (inflation excluding fresh food and energy) edged up to 4.3 per cent in August from 3.8 per cent in March 2023.
- Amongst major EMEs, CPI inflation in Brazil moderated during March-June 2023 but then edged up to 4.6 per cent in August 2023.
- In Russia, it rose to 5.2 per cent in August 2023 from 3.5 per cent in March, partly due to currency depreciation.
- In South Africa, CPI inflation softened to 4.8 per cent in August 2023 from 7.1 per cent in March.

- In China, headline inflation remained subdued during 2023 – it moderated from 0.7 per cent in March 2023 to 0.1 per cent in August (with a temporary descent into deflation of 0.3 per cent in July), reflecting weak demand.
- Core inflation across EMEs has generally remained stickier than headline inflation.

India:

- CPI inflation moderated to 5.0 per cent in September 2023 from 6.8 per cent in August 2023.
- Food prices recorded a m-o-m decline of around 180 bps while fuel prices fell around 390 bps m-o-m.
- The index of core prices (i.e., CPI excluding food and fuel) remained unchanged.
- Food inflation (y-o-y) fell to 6.3 per cent in September from 9.2 per cent in August.
- The fuel and light group recorded deflation of (-) 0.1 per cent in September as against an inflation of 4.3 per cent in August.
- In terms of regional distribution, rural inflation at 5.3 per cent was higher than urban inflation (4.7 per cent).
- Majority of the states registered inflation in the range of 4-6 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 the end of rate hike cycle though rate cuts are still not on radar.
- US FED held rates in November policy and hinted to end of rate hikes though keeping options for one more hike, depending on incoming data.
- US 10Y yields climbed higher, briefly crossing 5%, before retreating. With soft landing narrative taking hold, expectations of rate cuts are reduced in near term. Large supplies of treasuries hitting markets is further putting pressure on yield.
- Higher US yields has led to commensurate rise in global yields as negative US bond sentiments battered global currencies on US dollar strength.
- With global rates firming up on good growth data and hawkish central banks, 10Y G-Sec yield went to around 7.40% in October (new 10Y). Sentiment was soured further by RBI indicating need for OMO Sales to soak up liquidity.
- Post exclusion 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 remained on lower side in absence of any material increase in supply.

Outlook:

Global:

- The global economy continues to vex central bankers, as growth sustains despite sharply higher rates in the last 18 months. The sharp rate hikes have still not had the desired impact, as consumer spending remains strong, and inflation still remains high. Recession fears have receded, and markets are forecasting a "soft landing" scenario as a high probability.
- Inflation seems to have peaked in major countries, though reasons to cheer may still be far away, as the momentum of drop in inflation has slowed down, belying market expectations of a quick "pivot" in policy rates.
- With core inflation rates remaining sticky, Central banks are failing to provide forward guidance and remain highly data dependent.
- US FOMC seems to be at the end of rate hike cycle but narrative of "higher for longer rates" remains main theme for most central bankers as they wait for inflation to drop to targeted levels.
- Rate markets rose sharply in October on hawkish FED with expectations of rate easing in immediate future receding.
- Market yields have retreated 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 dissuading RBI MPC from any rate hike action.
- Inflation is moderating but RBI is wary of the impact of global geo-politics on price pressures.
- 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 may keep RBI on hold for much longer as it sees the impact of higher food prices on overall inflation trajectory.
- The announcement of possible OMO sales by the RBI has led to market yields to trend higher. However, demand in market remains good.
- Markets are likely to remain volatile as the narrative of "rates higher for longer" takes hold.
- 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 inclusion in JP Morgan Index.
- 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 7.25%-7.45%.

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

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