CANARA ROBECO

Macro Review & Fixed Income Market Outlook

Global Economy Update:

Macro Backdrop:

- Despite strong monetary tightening, the expansion of geopolitical tensions, and increased economic uncertainty, the global economy remained impressively robust in recent past.
- The U.S. economy is only slightly slowing over the halfway point of the first quarter, and job and wage growth remain healthy despite the many layoff announcements made by firms in the first two months of the year.
- However, initial findings imply that buyers are limiting their large-ticket purchases. Business spending has been constant over the last three months, owing to the temporary and modest industrial slowdown.
- The European Central Bank maintained its interest rates at historically high levels during its March meeting, as policymakers balanced concerns over a looming recession with persistently elevated underlying inflationary pressures.
- The ECB has also revised its growth projection for 2024 downward to 0.6%, anticipating continued subdued economic activity in the near future.
- Japan's GDP grew by 0.1% qoq in Q4 of 2023, compared with flash data of a 0.1% fall and a 0.8% contraction in Q3. The economy narrowly escaped a recession as markets expected a 0.3% rise, helped by a strong upward revision of capital expenditure.
- The yield on China's 10-year government bond led to a fresh record low, after the PBOC Governor hinted about more easing policies. The Governor also noted that the central bank will push for financing costs to trend lower.
- The Bank of Canada held its target for the overnight rate at 5% during its March meeting and pledged to continue normalizing the Bank's balance sheet, as policymakers remained concerned about risks to the outlook for inflation. The bank stated that it will persist in its policy of quantitative tightening until it observes further and sustained easing in core inflation.
- Saudi Arabia's GDP shrank by 4.3% year-on-year in the fourth quarter of 2023, compared to preliminary figures of a 3.7% drop, following a revised 3.2% contraction in the previous three-month period. It was the 2nd consecutive quarter of contraction, mainly due to declines in oil activities.
- However, Emerging market economies (EMEs) have demonstrated resilience, in contrast to earlier instances of volatility where they were negatively impacted.
- The improved macroeconomic fundamentals and buffers of the EMEs in recent years provided cushion against global shocks of the last four years.
- The pandemic has accelerated the dissemination of technology in industry and services. This has increased productivity in numerous EMEs, offsetting the negative impact on output caused by variables such as monetary tightening.
- The international economy is at an inflection point. There are still many challenges to face, but there are also many new opportunities. The global economy is anticipated to develop faster than predicted in 2024, with risks remaining balanced.
- To ensure that everyone benefits from international collaboration, the principles of comparative advantage and resource endowment must be correctly considered.

Indian Economic Growth:

Macro Backdrop:

- The Indian economy continues to sustain the momentum achieved in the first half of 2023-24, going by high frequency indicators. Expectations of a fresh round of capex by the corporate sector is likely to fuel the next leg of growth.
- The Indian economy expanded 8.4% year-on-year in Q4 2023, the strongest growth since Q2 2022, compared to an upwardly revised 8.1% in Q3.
- The Interim Union Budget for 2024-25 adopted a balanced approach towards ensuring inclusive growth and sustainable development through fiscal consolidation as well as continued thrust on capital expenditure.
- During 2023-24 revised estimates (RE), capital expenditure of the Union government recorded an increase of 28.4 per cent (y-o-y) while revenue expenditure growth remained contained at 2.5 per cent.

- The Reserve Bank of India held its benchmark policy repo at 6.5% for the sixth consecutive meeting in February 2024, as widely expected, as inflation remains above medium-term target of 4%
- RBI Governor reaffirmed its commitment to bring down inflation to 4% in a timely and sustainable manner. Additionally, the central bank projected economic growth for the fiscal year 2025 at 7%.
- The HSBC India Manufacturing PMI was revised higher to 56.9 in February 2024 from 56.7 in the preliminary reading, following a final 56.5 in January. Both output and new orders expanded at the quickest rate since September, helped by marketing efforts to boost demand.
- The HSBC India Services PMI was revised lower to 60.6 in February 2024 from 62.0 in the preliminary estimates and after January's six-month high of 61.8. Australia, Asia, Europe, the Americas, and the UAE were among the sources of gains.
- Annual retail inflation in India eased in January 2024. The slowdown is mostly due to an ease in food inflation and favourable base effects from last year.
- Unemployment Rate in India decreased to 6.78 percent in January from 8.65 percent in December 2023.
- Despite falling commodity prices and the Red Sea crisis, India achieved positive merchandise exports in January. Exports rose 3.2% year-on-year and imports went up at a slightly slower 3%.
- Out of 30 major commodities, 18 commodities accounting for 72.3 per cent of the export basket registered expansion on a y-o-y basis
- Government revenues in India increased by 13.9% year-on-year to INR 22.52 trillion in April-January 2023-24. While Fiscal expenditure in India increased by 5.9% year-on-year to INR 33.55 trillion in April-January 2023-24.
- To sustain the momentum of economic growth, the capex thrust especially on roads and railways has been continued. The capital spending of states grew by 35.8 per cent (y-o-y), reflecting the continued thrust by the Union government.
- Reserve Money (RM) growth decelerated to 5.8 per cent in February 2024 from 11.2 per cent a year ago 8.8 per cent adjusted for the first-round impact of change in Cash Reserve Ratio (CRR)
- While liquidity conditions tightened in the second half of January 2024 following the build-up of government cash balance, they eased for a brief period in the beginning of February with an increase in government spending.

Inflation:

Global:

- Headline inflation remained above the target in major economies, despite moderation during 2023.
- In the US, CPI inflation moderated to 3.1 per cent in January 2024 from 3.4 per cent in December 2023.
- As per flash estimates, Euro area inflation moderated to 2.8 per cent in January 2024 from 2.9 per cent in December 2023.
- In the UK, CPI inflation remained steady at 4.0 per cent in January 2024.
- Japan's inflation (CPI excluding fresh food) moderated to 2.3 per cent in December.
- Among EMEs, inflation moderated in South Africa in December 2023 and Brazil in January 2024.
- China recorded deflation of 0.8 per cent in January 2024
- Core and services inflation fell across major AEs but remained higher than headline inflation.

India:

- CPI inflation moderated to 5.1 per cent in January 2024 from 5.7 per cent in December 2023.
- The 60-bps softening in inflation came from a negative momentum of around 10 bps further supported by a favourable base effect of around 50 bps.
- Food inflation (y-o-y) fell to 7.6 per cent in January 2024 from 8.7 per cent in December 2023.
- The fuel and light group continued to record deflation at (-) 0.6 per cent in January 2024, as against (-) 1.0 per cent in December 2023.
- The moderation was mostly broad-based and across various sub-groups such as pan, tobacco and intoxicants, clothing and footwear, housing, household goods and services,
- inflation softened across both rural and urban areas in January 2024, with rural inflation at 5.3 per cent and urban inflation at 4.9 per cent.

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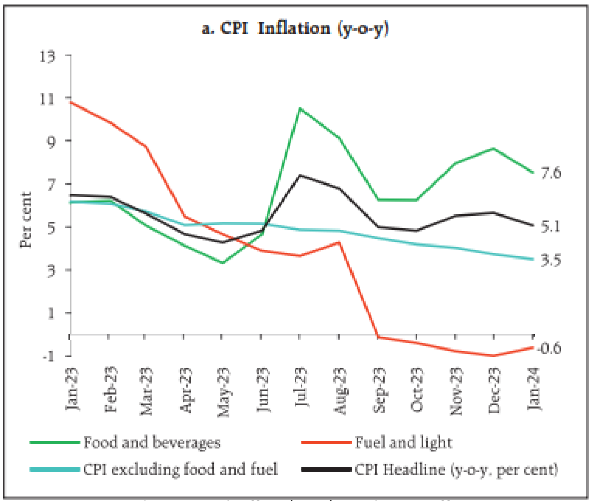
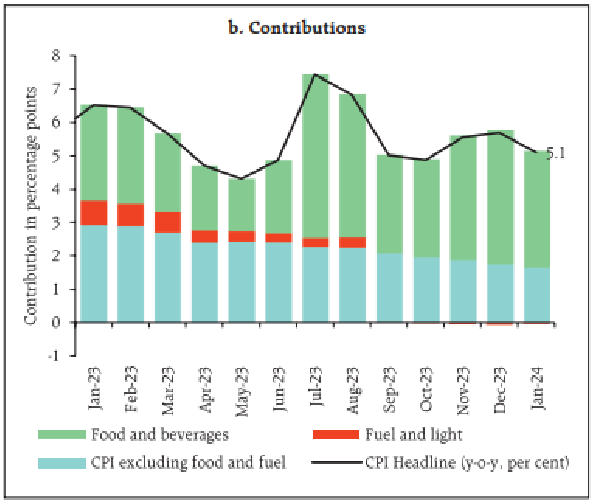
Trends and Drivers of CPI Inflation:





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

Bond Yields & Spreads:

- Indian Yield curve has continued to remain in a narrow range during Feb 24
- Apart from volatility in short term rates, to be expected on rate hikes and tightening liquidity conditions through the year, longer term rates traded in a narrow range on the back of strong local demand in government bonds and moderating inflation conditions.
- RBI MPC remaining in pause mode in FY24 further added to positive sentiment in bonds.
- India's 10Y yield had fallen to 7.02% in early Feb 2024 on back of the Union Budget 2024-25 (where fiscal deficit is expected to reduce to 5.1% of GDP in FY2025), but thereafter traded in a narrow range of 7.05%-7.10% tracking global cues.

Outlook:

- Market dynamics are likely to be influenced by short-term factors such as oil prices, U.S. yields, and a positive bond sentiment emanating from anticipated US FED rate cuts.
- In the short term, the impact on markets is expected to be more sentimental, given that additional flows are anticipated only in FY25 as JP Morgan Index inclusion is likely to start in June 24.
- FII flows have picked up in the last few months, as active positions get built up leading to the event.
- The influx of foreign funds is anticipated to be liquidity-positive, further contributing to the positive sentiment surrounding bonds.
- Looking ahead to the medium and long term, the effect on bonds is expected to be positive due to inclusion in JP Morgan Bond Index, as the demand for Government Securities (G-Sec) is likely to drive yields downward.
- Inflation is likely to trend lower in 1QFY25.
- Coupled with anticipated rate moves from the US FED, RBI may change to neutral stance in 1QFY25.
- However, no sharp rate cuts are expected from RBI MPC, as inflation continues to remain above target of 4% and growth remains robust.
- We may expect about 50bps rate cut from RBI in FY2025.
- We anticipate that in the coming months, 10-year yields may gradually decrease to 7%.
- Any exuberance in Indian debt markets may be tempered by RBI's continuing hawkish stance and tight liquidity conditions.

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

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