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Macro Review & Fixed Income Market Outlook

Global Economy Update:

Macro Backdrop:

- The global economic outlook is beset by geopolitical tensions, unsettled financial conditions, and plateauing inflation in major economies.
- Consumer sentiments dipped in the US and the UK but improved in the euro area where employment expectations remained broadly stable.
- Financial conditions stayed tight across geographies as central banks modulated expectations of early policy easing.
- The global composite PMI increased to 52.1 in February 2024 - its highest reading since June 2023 from 51.8 in January. All six sub-sectors covered by the survey − business services; consumer goods and services; financial services; intermediate goods; and investment goods − recorded output increases simultaneously for the first time since May 2023.
- The services PMI rose to a seven-month high of 52.4 in February, driven by faster rate of growth in business activity.
- The manufacturing PMI at 50.3 returned to expansionary zone in February driven by new orders, output, and stocks of purchases, after a prolonged contraction for 18 months.
- The composite PMI for export orders rose to 49.6 in February 2024, propelled by its manufacturing component reaching a 19-month high of 49.4.
- Meanwhile, the services export orders index moderated marginally to 50.4 in expansionary territory.

Indian Economic Growth:

Macro Backdrop:

- The Indian economy recorded robust growth amidst external headwinds in the form of supply chain disruptions.
- Economic activity gained momentum in February 2024 after witnessing a slight moderation in January and GDP growth for Q4:2023-24 is nowcast at 7.2 per cent.
- During Q3:2023-24, real GDP growth accelerated to 8.4 per cent from 8.1 per cent in the preceding quarter and 4.3 per cent in Q3:2022-23.
- Led by a revival in rural consumption, private consumption growth inched up to 3.5 per cent during Q3:2023- 24.
- GFCF continued to register double digit growth (10.6 per cent), which was mirrored in its proximate indicators of steel consumption and capital goods production.
- Export growth remained subdued amidst weak global demand conditions.
- With import growth surpassing that of exports, the external sector dragged aggregate demand down by 1.2 percentage points in Q3:2023-24.
- India's goods and services tax (GST) collections stood at Rs 1.78 lakh crore during March 2024, records 11.5% Year-on-Year growth.

Inflation:

Global:

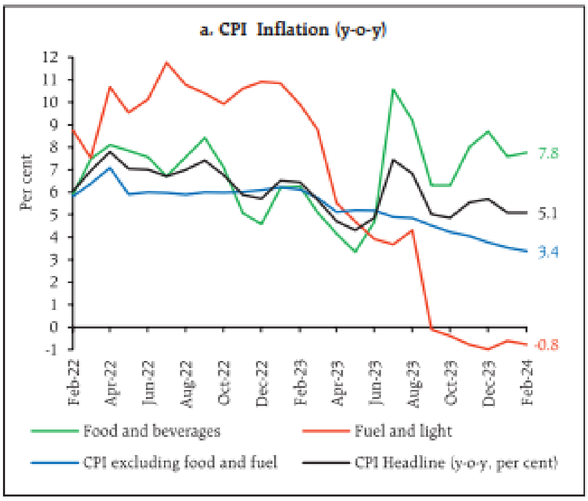
- Headline inflation continued its gradual moderation in major AEs, inching closer to targets in many countries.
- In the US, however, CPI inflation increased to 3.2 per cent in February 2024 from 3.1 per cent in January primarily due to increase in services inflation across motor insurance and health.

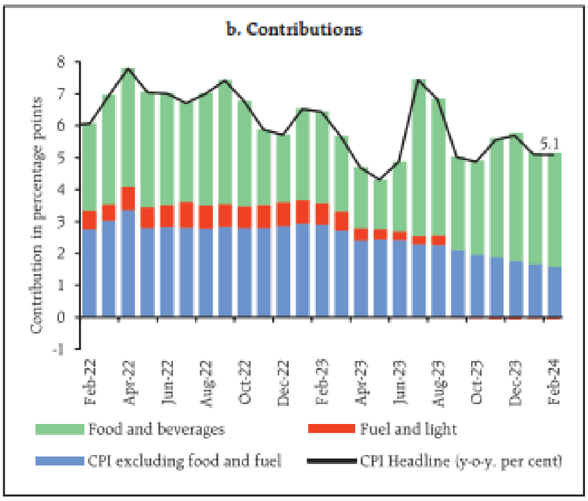
- As per flash estimates, euro area inflation moderated to 2.6 per cent in February, down from 2.8 per cent in January.
- In the UK, CPI inflation moderated to 3.4 per cent in February 2024, down from 4.0 per cent in January while Japan's inflation (CPI excluding fresh food) accelerated to 2.8 per cent in February 2024, climbing from 2.2 per cent in January 2024.
- Among EMEs, inflation edged up in South Africa in January and in Russia in February while inflation in Brazil remained steady for the second consecutive month in February.
- In China, however, inflation increased to 0.7 per cent in February - its highest level in 11 months – from a deflation of 0.8 per cent in January due to robust spending during the lunar new year holiday.
- Core and services inflation moderated across major AEs but remained higher than headline inflation.

India:

- CPI inflation remained unchanged at 5.1 per cent in February 2024 as a positive momentum of around 15 bps was fully offset by favourable base effects.
- Food inflation (y-o-y) edged up to 7.8 per cent in February from 7.6 per cent in January.
- In terms of sub-groups, higher inflation was recorded in meat and fish, eggs, vegetables, and sugar while cereals, milk, fruits, pulses, spices, non-alcoholic beverages, and prepared meals registered a moderation in inflation.
- Core inflation continued to ease down to 3.4 per cent in February from 3.5 per cent in January - its lowest level in four years. The moderation was across all sub-groups.
- In terms of regional distribution, inflation remained steady in rural areas at 5.3 per cent in February while in urban areas, it softened by 10 basis points to 4.8 per cent.
- Majority of the states registered inflation in the range of 4-6 per cent.

Trends and Drivers of CPI Inflation:





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

Bond Yields & Spreads:

- Indian Yield curve remained rangebound in March 2024, moving both ways on absence of any new data and largely following global cues.
- In the absence of government supply, markets remained subdued.
- Yields trended lower ahead of US FOMC but retreated later in month on strong US data.

- US FOMC officials are pushing back on timing of first rate cut as well extent of easing in light of sticky inflation and strong economic data.
- RBI unveiled the 1HFY2025 borrowing calendar. Presenting lower borrowing of 53% in Apr-Sep 2024. Lower than expected borrowing numbers supported bond market sentiments.
- As expected, RBI MPC remains in pause mode as (1) US FED rate cut gets delayed (2) Growth remains robust whilst inflation could remain a concern in light of volatile food prices.
- Liquidity remained comfortable in March 24, despite advance tax outflows, as RBI dynamically managed liquidity mismatches through variable repo rate auctions (VRR).
- Bond yield curve remained flat with longer term yields softening on demand from investors.
- Corporate bond spreads remain elevated in absence of any rate cut expectations in near term.

Outlook:

- Market dynamics are likely to be influenced by RBI MPC as well as global factors.
- With the US rate easing cycle likely in 2024, the question remains only on timing of rate cuts.
- The RBI MPC decided to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns to the target, while supporting growth.
- The Policy outcome was as per expectations as no sharp rate cuts were expected from RBI MPC, as inflation continues to remain above target of 4% and growth remains robust.
- FII flows have been strong ahead of Index inclusion with USD 7.14 bio in 1QCY2024.
- Liquidity has improved in the recent past probably on account of Government spending. RBI had further injected short term liquidity via VRR (variable rate repo auctions).
- 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.
- Fiscal consolidation in the interim Budget is likely to provide further positive impetus to bond markets.
- Coupled with anticipated rate moves from the US FED, RBI may change to neutral stance in next few policies.
- We may expect about 50bps rate cut from RBI in FY2025.
- We anticipate that over the next few months, 10-year yields may gradually fall below 7%.

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

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