Global Economy Update:
Macro Backdrop:

The global economy is transfixed in the cross-currents of slowing growth and high inflation, and an uneasy calm prevails in the global financial markets as they await clearer signals from policy authorities on banking regulation and supervision, and contours of deposit insurance.

Global financial markets staged a recovery from late March as fears of contagion from the recent banking turmoil in the US and Europe receded.

Markets, however, remained rangebound in April - May as the focus turned to the pace and magnitude of future rate hikes.

Central banks in the AEs (Advanced Economies) and EMEs (Emerging market economies) have either reduced the magnitude of hikes or paused in their rate hike cycles.

The US FOMC increased its policy rate by 25 basis points on May 3, 2023, and indicated that further actions “will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments”.

The Bank of England and the Reserve Bank of Australia raised their policy rates by 25 bps each in May.

In its April meeting, the Sveriges Riksbank increased its key rates by 50 basis points while the ECB raised the three key rates by 25 bps in May.

Most EME central banks have also pivoted to relatively less aggressive monetary policy actions.

Emerging market economies (EMEs) appear to be positioned ahead of their advanced peers in charting a path of the multiple shocks that characterised the years gone by.

Risks to global growth in 2023 stem from elevated inflation, tighter financial conditions, in the backdrop of the conflict in Ukraine.

Indian Economic Growth:
Macro Backdrop:

In April and May 2023, domestic economic conditions have sustained the quickening of momentum seen in the last quarter of 2022-23.

Headline inflation eased below 5 per cent in April 2023, for the first time since November 2021.

Corporate earnings are beating consensus expectations, with banking and financial sectors posting strong revenue performance, aided by robust credit growth.

In the first quarter of 2023-24, growth is expected to be driven by private consumption, supported by reviving rural demand, and renewed buoyancy in manufacturing on easing of input cost pressures.

During 2022-23, the year gone by for which a clearer picture now emerges, merchandise exports grew by 6.7 per cent, driven by petroleum products, while non-oil exports declined.

Exports of petroleum products were buoyed by the price effect, resulting in a growth of 44.4 per cent in value terms despite a 0.4 per cent fall in volume terms.

Merchandise imports fell to a twenty-month low of US$ 49.9 billion in April 2023, recording a sequential contraction of 16.9 per cent and a y-o-y decline of 14.1 per cent on account of easing commodity prices and a fall in demand for discretionary items such as gems and jewellery.

The index of industrial production (IIP) grew by 5.1 per cent in 2022-23, led by a robust expansion in the production of electricity followed by mining and manufacturing.
As per the use-based classification, the expansion was led by capital goods, infrastructure goods and primary goods while the growth in consumer durables and non-durables remained subdued at 0.5 per cent each.

The goods and services tax (GST) collections (Centre plus States) in May 2023 stood at INR 1.57 lakh crore and recorded a growth rate of 12 per cent y-o-y.

**Inflation:**

**Global:**

- Inflation continued to edge down grudgingly across most economies.
- In April, the headline CPI inflation (y-o-y) in the US eased marginally to 4.9 per cent (the lowest since April 2021) from 5.0 per cent in March.
- Inflation based on the US personal consumption expenditure (PCE) index also eased to 4.2 per cent in March from 5.1 per cent in February.
- In the UK, CPI inflation moderated to 10.1 per cent in March from 10.4 per cent in February.
- Japan’s CPI (all items less fresh food) inflation remained steady at 3.1 per cent in March.
- In the Euro area, inflation edged up marginally to 7.0 per cent in April 2023 from a 13-month low of 6.9 per cent in March.

![Graph of inflation in Advanced Economies and Emerging Market Economies](image)

Source: Bloomberg and OECD

**India:**

- CPI inflation moderated sharply to 4.7 per cent in April 2023 from 5.7 per cent in March.
- The decline in inflation was broad-based across food, fuel, and core (excluding food and fuel) groups, which was also reflected in their falling contribution to overall inflation.
- The fall in headline inflation was on account of the combined impact of monetary policy tightening, supply augmenting measures and a favourable base effect.
- CPI food inflation (y-o-y) moderated sharply to 4.2 per cent in April 2023 from 5.1 per cent in March on account of a large favourable base effect of around 145 bps, which was more than offset by a positive price momentum of around 55 bps.
Trends and Drivers of CPI Inflation:

**Bond Yields & Spreads:**

- US FED hiked rates by 25bps in May 23 FOMC (Federal Open Market Committee), following a similar hike in Mar/Feb ‘23, despite banking sector stress, indicating that inflation remains top priority. However, the FOMC has indicated that they would likely pause, though continue to watch inflation trajectory. No rate cuts are envisaged by the FOMC in 2023.
- ECB hiked by 25bps in May, with the Bank of England (BoE) hiking by 25bps in May as well.
- In a surprise move, RBI paused in the first policy of FY2024, keeping rates steady at 6.50%. Markets now expect RBI to remain in pause mode for a rest of 2023.
- US 10Y rose in May as the brinkmanship over US Debt ceiling rattled markets. With few of FED speakers advocating more rate hikes, market pricing of an early “pivot” has receded, pushing rates higher.
- India rates continue to ease post RBI April policy surprise as well as sharp drop in inflation. 10Y Gsec yield dropped below the crucial level of 7% and touched a low of 6.94%.
- Overall yield curve dropped lower with flattening bias as long-term rates dropped more on back of RBI’s pause. Short term rate drop was limited as expectations of rate easing is still well in the future.
- Medium to long term corporate spreads remained on lower side in absence of any material increase in supply.

**Outlook:**

**Global:**

- Global economy is likely to be marked by slower growth, moderating but elevated inflation, peaking policy rates, and continuing geo-political risks.
- While growth is slowing, labor market in the US remains strong, keeping US FED on its toes.
- Receding risks from US bank failures and the speed at which these were addressed has brought confidence back into markets.
- 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.
US FOMC has indicated a pause in the rate hike cycle while other central banks like ECB and BoE may still have more work to do.

While rate hikes in major countries seem to have ended, rates may have to remain higher for longer to bring down inflation to mandated levels in the absence of any sharp fall in growth rates.

With the banking crisis addressed and debt ceiling issue behind us, markets will likely be driven by incoming data as policy makers are becoming more data dependent.

Overall rate markets should benefit from softer growth prints, slowing inflation and end of rate hikes in a number of economies.

India:

In India, macro situation remains resilient.

GDP growth for FY2023 surprised on upside, printing 7.2% (against 7% estimates), with a blowout 4QFY23 growth at 6.1% (against projection of 5.1%). Growth trend may continue into FY2024, though it is likely to slow down to 6%-6.5% in FY2024.

Inflation downtrend has started, with 1Q FY2024 inflation likely printing well below 5%.

RBI MPC surprised markets by pausing rate hikes, citing global financial stability concerns and the need to assess the impact of cumulative tightening already delivered in last 1 year.

We now expect RBI MPC to go for a longish pause and watch the evolving inflation dynamics. RBI MPC may change the stance of policy to “neutral” as inflation is coming down as expected.

With RBI projecting inflation to be 5.2% 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.

The global rate scenario has turned benign as growth slows in advanced economies and large central banks either indicating a pause or nearing end of hike cycles.

Markets have rallied post policy, with the curve flattening as longer-term rates drop faster than short term rates.

10Y GSEC rates has fallen below 7%, and the downside may remain limited in absence of any rate easing expectations in the near term.

Markets are likely to consolidate from here. Market movements may depend on global cues, supply-demand of local bonds in the market, oil price movements and inflation trajectory. 10Y G-SEC may trade in 6.90-7.10% range.

Source: RBI, MOSPI, CMIE, FIMMDA, NSDL, Bloomberg.

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