

**CANARA ROBECO**

# **Macro Review & Fixed Income Market Outlook - May 2025**

- **Global Macro Review**
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- **Inflation Trends**
- **Bond Yields & Spread Movements**
- **Fixed Income Fund Manager Outlook**

# Global Economy Update:

## Macro Backdrop:

- Escalation of trade and tariff tensions and the resultant financial market volatility have raised concerns regarding the weakening of global growth in the near term.
- The Bank of Japan (BOJ) maintained its short-term interest rate at 0.5% but downgraded its economic growth forecasts due to the negative impact of U.S. tariffs and weakening exports.
- **Purchasing Managers' Index (PMI):**
  - **United States:** The S&P Global US Manufacturing PMI for April 2025 was revised down to 50.2, unchanged from March but below the preliminary estimate of 50.7.
  - **Eurozone:** The HCOB Eurozone Manufacturing PMI inched higher to 49 in April 2025 from 48.6 in the previous month, reflecting the softest pace of contraction in factory activity in over two years, and revised higher from the preliminary estimate of 48.7.
  - **China:** The Caixin China General Manufacturing PMI declined to 50.4 in April 2025, down from March's four-month high of 51.2.
- **Unemployment Trends:**
  - **United States:** The U.S. unemployment rate held steady at 4.2% in April 2025, matching the March figure and aligning with market expectations.
  - **Eurozone:** Euro zone inflation unchanged at 2.2% in April, leaving path open for further ECB interest rate cuts.
- **Monetary Policy:**
  - **European Central Bank (ECB):**
    - On April 17, 2025, the European Central Bank (ECB) reduced its key interest rates by 25 basis points, lowering the deposit facility rate from 2.50% to 2.25%.
    - This marked the ECB's seventh rate cut since June 2024, aiming to support the eurozone economy amid escalating global trade tensions and subdued inflation.
    - Looking ahead, markets anticipate additional rate cuts in 2025, with the next ECB policy meeting scheduled for June 5.
  - **U.S. Federal Reserve:**
    - The Federal Reserve held rates steady in March, emphasizing the need for more data before any easing.
    - The next scheduled FOMC meeting is set for May 6–7, 2025.
    - Market participants widely expect the Fed to keep interest rates unchanged during this meeting, despite recent economic indicators showing a 0.3% contraction in Q1 GDP and inflation cooling to 2.6% in March.

## Inflation Trends:

### Global:

- Headline inflation continued to remain moderate in most major economies, although spillover of tariffs to final consumer prices has emerged as a major upside risk.
- In the US, CPI inflation softened to 2.4 per cent (y-o-y) in March from 2.8 per cent in February.
- Headline inflation in the Euro area moderated to 2.2 per cent in March from 2.3 per cent in February.
- Inflation in the UK and Japan also softened by 20 bps and 30 bps to 2.8 per cent and 3.7 per cent, respectively, in February.
- Among EMEs, CPI inflation in Brazil and Russia rose in March, while that in South Africa remained stable. China, on the other hand, remained in deflation, with CPI registering a decline of 0.1 per cent (y-o-y) in March.

# Indian Economy Update:

## Macro Backdrop:

- The Indian economy continues to remain resilient on strong domestic growth impulses and sound macro-fundamentals despite strong global headwinds emanating from trade tensions.
- Consumers and businesses remain optimistic regarding the economic outlook.

### Purchasing Managers' Index (PMI):

- The HSBC India Manufacturing PMI edged up to 58.2 in April 2025 from 58.1 in March, slightly below the flash estimate of 58.4, marking the strongest sector improvement in ten months.
- In April 2025, India's Services Purchasing Managers' Index (PMI) rose to 59.1, up from 58.5 in March, marking the highest reading in four months and indicating a robust expansion in the services sector.

### Employment Trends:

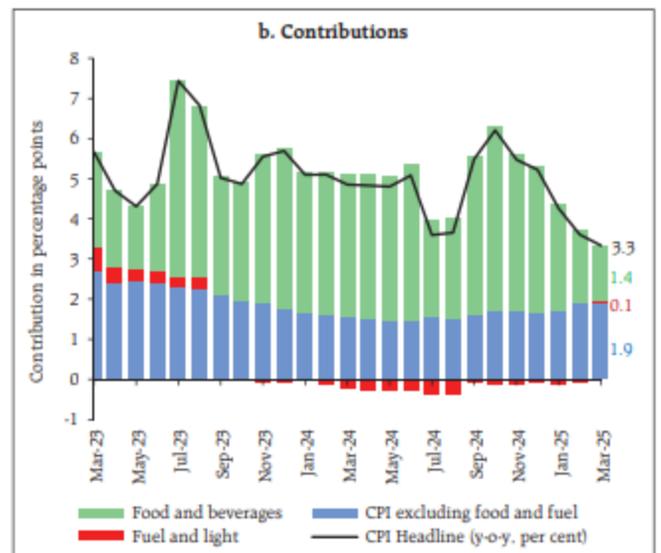
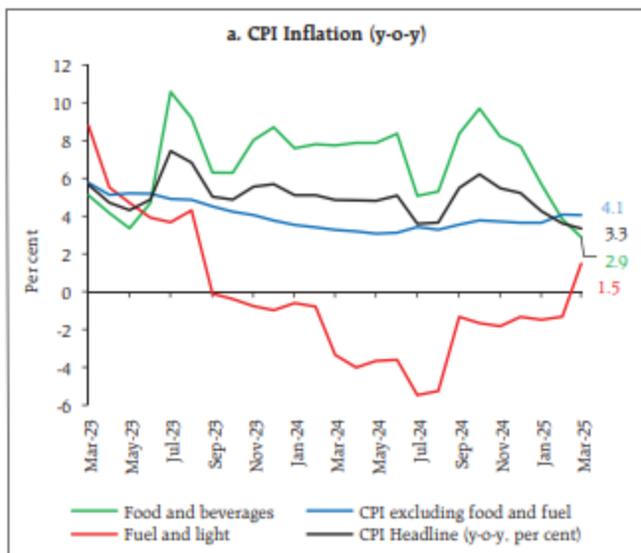
- **Urban:** Urban employment remains strong, led by expansion in IT and financial services.
- **Rural:** Rural employment benefited from higher agricultural output and government employment programs.

## Inflation Trends:

### Domestic:

- Headline CPI in India declined to 3.3 per cent in March 2025 from 3.6 per cent in February, marking the fourth consecutive monthly decline and the lowest reading since August 2019.
- Annual inflation in food group decelerated sharply to 2.9 per cent in March from 3.8 per cent in February.
- Core CPI inflation remained steady at 4.1 per cent in March 2025, although contrarian trends were witnessed within the sub-groups.
- Inflation increased in pan, tobacco and intoxicants, housing, health, transport and communication and education, while it moderated in clothing and footwear, recreation and amusement, personal care and effects and household goods and services.
- In terms of regional distribution, rural and urban inflation eased to 3.25 per cent and 3.43 per cent, respectively.

## Trends and Drivers of Inflation:



## Bond Yields & Spreads:

- Indian yields dropped lower in April as RBI MPC (monetary policy committee) cut rates by 25bps and shifted stance to “accommodative”. Overall, the policy was dovish as RBI MPC shifted focus to growth as inflation fell below 4%.
- RBI stance change further was clarified by the Governor that RBI would likely keep liquidity surplus to the extent of 1% of NDTL.
- RBI has already conducted around 2.45 Lac crore of OMO (Open Market Operations) purchase in Feb/Mar 2025. In April, RBI conducted OMO purchase of Rs. 80,000cr whilst announcing further purchases of Rs.1.25 lac crore for May 25, pointing to RBI’s single focus to increase system liquidity.
- US 10Y yield remained largely range bound as tariff wars kept market participants on sidelines.
- India 10Y slipped sharply on policy actions, dropping to a low of 6.316% in April, before ending April marginally higher at 6.35%
- US FED policy remained status quo with the FED maintaining a wait and watch attitude on likely US tariff impact on inflation.
- Corporate bonds moved in tandem with sovereign with overall yields falling across the curve. Short term bonds dropped more on excess liquidity.

## Outlook:

- US FED rate cut expectations have gone up on recession fears in wake of tariff wars, though rate cuts may get delayed with no clarity on tariff situation.
- Liquidity has eased considerably keeping the overnight rate near the standing deposit facility (SDF) rate. RBI continues to add liquidity through OMO purchases, showing intent to keep liquidity in surplus to enable transmission of rate cuts to ultimate borrowers.
- FII flows turned negative in April on tariff uncertainty as well as India-Pakistan tensions.
- 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 and other indices, as the demand for Government Securities (G-Sec) is likely to drive yields downward.
- RBI is likely to continue to inject liquidity through OMO purchases, further aiding downward movement in market yields.
- We expect RBI to reduce rates again in June policy as lower inflation creates room to support growth. Further, the ongoing tariff disruptions may lead to slower global growth in near term.
- We are structurally long on India as growth inflation dynamics are still favorable for yields to tick down as RBI may have to resort to further rate cut as growth slows and inflation remains near medium term target of 4%.

Source: RBI, MOSPI, PIB, CMIE, NSDL, S&P Global, Ministry of Commerce and Industry, Reuters, Bloomberg, Internal Research. Note: Data updated as available in the beginning of the month.

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