

CANARA ROBECO

Macro Review & Fixed Income Market Outlook - August 2025

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Global Economy Update:

Macro Backdrop:

- The global macroeconomic environment remained fluid in July so far amidst geo-political tensions and tariff policy uncertainties.
- Central banks in many advanced economies (AEs) kept policy rates unchanged, as the last mile of disinflation turned out to be stickier than expected, while also awaiting clarity on the trade tariff front and its implications for inflation.
- **Purchasing Managers' Index (PMI):**
 - **United States:** The S&P Global US Composite PMI rose to 54.6 in July 2025 from 52.9 in June 2025, marking the fastest pace of growth in 2025 and the 30th consecutive month of expansion. The upturn was driven by strong services activity, which grew at the quickest rate since last December 2024.
 - **Eurozone:** The HCOB Eurozone Composite PMI for July 2025 rose to 51.0, up from 50.6 in June 2025, marking the strongest expansion in private sector economic activity in 11 months. The increase was driven by stronger service sector activity (51.2 vs 50.5 in June 2025) and a near stabilization in manufacturing (49.8 vs 49.5 in June 2025).
 - **Japan:** The Japan Composite PMI for July 2025 remained unchanged at 51.5, according to flash data. This marks the fourth consecutive month of private sector growth, holding steady at the strongest pace since February. The growth was driven by a faster rise in services activity, which offset a decline in manufacturing output.
- **Unemployment Trends:**
 - **United States:** The U.S. unemployment rate rose a little to 4.2% in July 2025 (4.1% in June 2025).
 - **Eurozone:** In June 2025, the euro area seasonally adjusted unemployment rate was 6.2%, stable compared with May 2025 and down from 6.4% in June 2024.
- **Monetary Policy:**
 - **European Central Bank (ECB):**
 - Since February, the ECB slashed rates thrice by 25 bps, now at 2.00%, with one more cut likely to 1.75%; signaling forceful action against persistent supply shocks.
 - ECB likely to continue gradual easing, capping ahead of next strategy review in 2030.
 - **U.S. Federal Reserve:**
 - The Federal Reserve held rates at 4.25–4.50% in July 2025, emphasizing a data-dependent approach amid stagnant and sticky inflation and trade-related risks.
 - Fed is expected to begin easing in September–December 2025, targeting a terminal rate near 3.50% by 2026.

Inflation Trends:

Global:

- CPI inflation in major AEs registered an uptick in June 2025, with the US, Euro area and the UK witnessing a pick-up due to increase in goods inflation amidst persistence in services inflation.
- Japan, however, saw some moderation in its inflation.
- Among Emerging Market Economies (EMEs), CPI inflation edged up marginally in Brazil, while it moderated in Russia.
- However, inflation remained elevated and above the target rate in both the countries.
- China moved out of the deflation zone after four months.

Indian Economy Update:

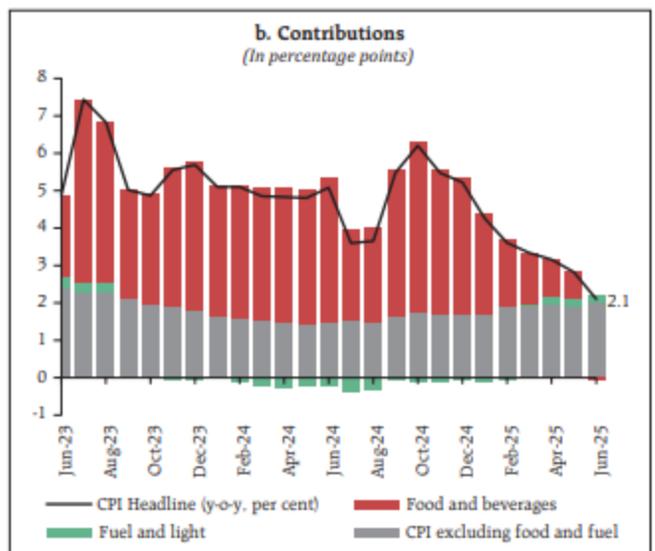
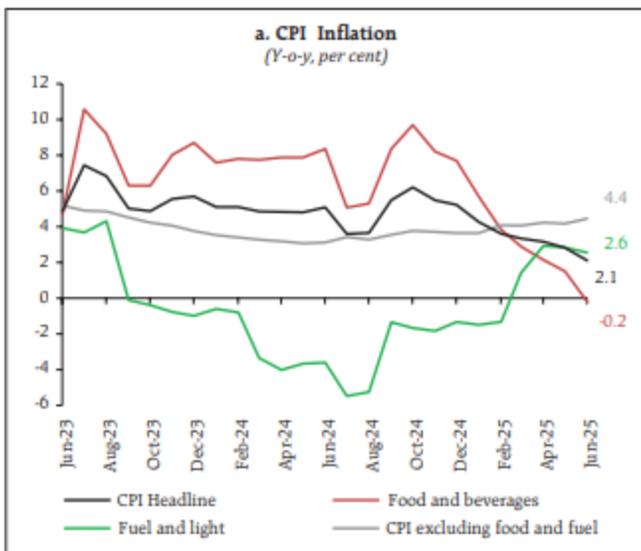
Macro Backdrop:

- Amidst a challenging global environment, the Indian economy showed resilience.
 - High-frequency indicators suggest stability in aggregate demand.
 - Growth momentum was buoyant for agriculture and services sector while the growth in industrial sector remained modest.
 - US imposed 25% tariff in Indian imports plus an unspecified penalty for trade ties with Russia. However, tariff dialogue continues between US-India to resolve differences.
 - Higher US tariffs could impact exports and overall growth projections
- **Purchasing Managers' Index (PMI):**
 - The HSBC India Composite PMI decreased to 60.70 points in July 2025 from 61 points in June of 2025.
 - Services activity rose at a slightly slower pace, though still robust by historical standards, while manufacturing output grew the most since April 2024.
 - **Employment Trends:**
 - The overall unemployment rate for persons aged 15 and above remained unchanged at 5.6% in June 2025 compared to May 2025.
 - Rural unemployment declined to 4.9% in June 2025, while urban unemployment increased to 7.1%.

Inflation Trends:

Domestic:

- Headline CPI in India declined to 2.1% in June 2025 (the lowest since February 2019) from 2.8% in May 2025.
- For the first time since February 2019, food group registered a deflation of (-) 0.2 per cent (y-o-y) in June 2025 as against an inflation of 1.5 per cent in May 2025.
- Fuel and light inflation moderated to 2.6 per cent in June 2025 from 2.8 per cent in May 2025.
- Core inflation inched up higher to 4.4 per cent in June 2025 from 4.2 per cent in May 2025.
- In terms of regional distribution, both rural and urban inflation eased further to 1.7 per cent and 2.6 per cent, respectively, in June 2025, with a greater fall witnessed in rural inflation.



Sources: NSO, and RBI staff estimates.

Bond Yields & Spreads:

- Indian yields moved sideways with upward bias as RBI Monetary Policy Committee (RBI MPC) had shifted stance to 'neutral' in June 2025 policy.
- Despite CPI inflation slipping to 2.1% in June 2025, rate markets remained in consolidation mode, as more than 50bps rate cut in June 2025 policy meet, reduces the chances of rate cut in the near term.
- US 10Y yield moved sideways as US FED held rates on sticky inflation and tariff uncertainty.
- Corporate bonds moved in tandem with sovereign with overall yields rising across the curve.
- Short term bonds yields rose more as further rate cuts expectations were dashed.

Outlook:

- US FED remains on hold and is dependent on incoming data on inflation and growth to assess the needs for further rate actions. US rates are likely to remain rangebound with an upward bias.
- The passage of a large expenditure bill is further clouding outlook, as higher borrowings by the US treasury may lead to higher rates.
- After pumping liquidity in early part of 2025, RBI chose to start weekly Variable Rate Reverse Repo (VRRR) auctions to withdraw short term liquidity from the system, endeavoring to bring the overnight rate near the weighted average call rate.
- Withdrawal of liquidity may lead to flattening of curve in the short end as short term rates react more to liquidity changes.
- FII flows were marginally positive in July 2025 as global rates eased.
- We expect RBI to remain on a long pause, if growth remains on track. Any change in momentum in growth trajectory may push RBI to respond, if inflation remains within target of 4%.
- Markets may remain rangebound in near term on RBI neutral stance. Liquidity is ample and RBI is trying to manage excess short term liquidity through VRRR operations. Debt Market sentiments are more likely to be influenced by geo-political tensions, and evolving US tariff situation.

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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