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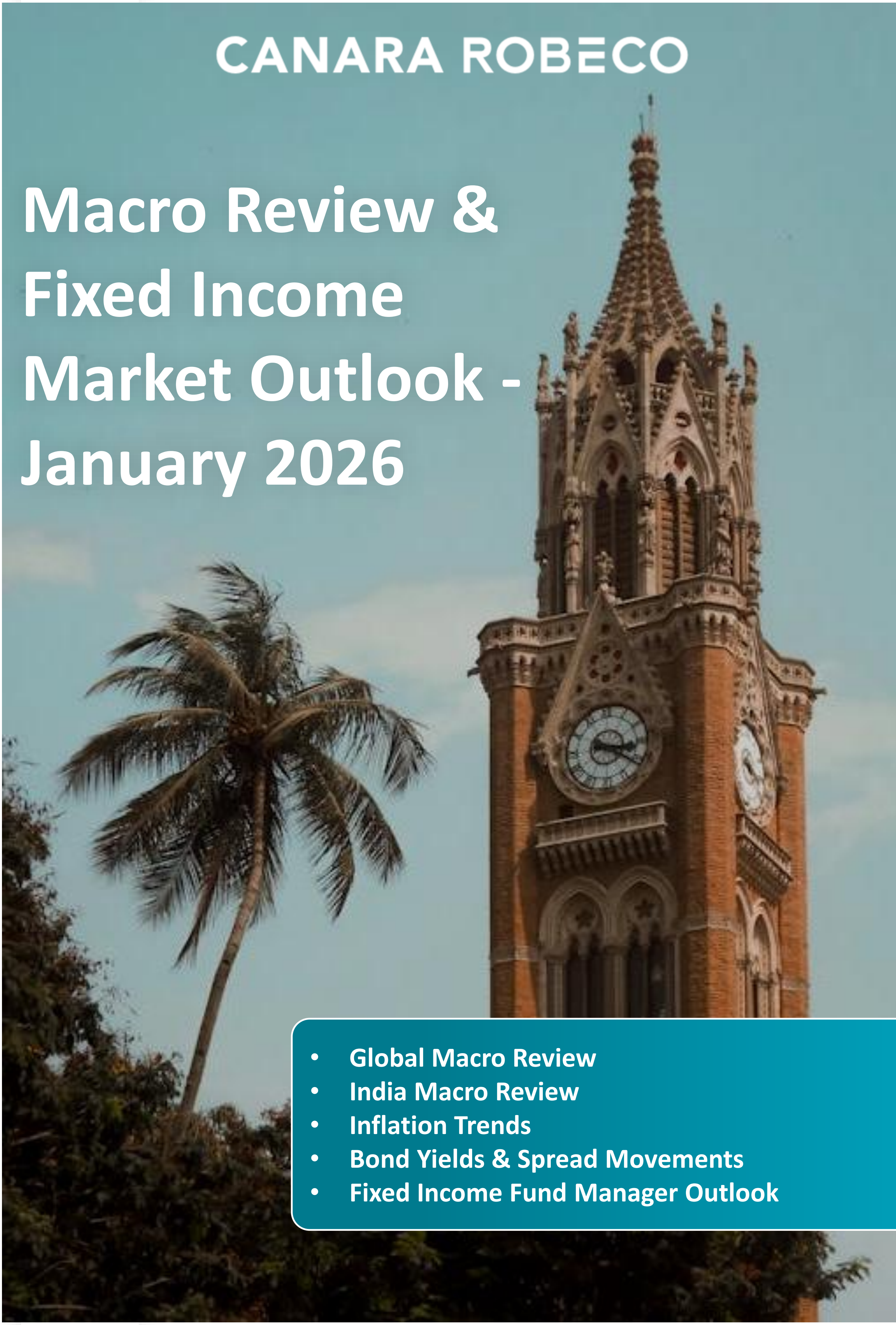

Macro Review & Fixed Income Market Outlook - January 2026

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

Global Economy Update:

Macro Backdrop:

- The global economy closed 2025 with moderate but uneven growth.
- Overall activity remained resilient despite elevated geopolitical risks and trade disruptions, supported by services demand and relatively stable financial conditions.
- Entering 2026, the global economy is positioned for continued expansion but at a slower and more fragile pace, with downside risks dominating the outlook.

Purchasing Managers' Index (PMI):

United States:

- The S&P Global US Manufacturing PMI was confirmed at 51.8 in December 2025, down from 52.2 in November, marking the weakest expansion in the current five-month growth phase.

Eurozone:

- The HCOB (Hamburg Commercial Bank) Eurozone Manufacturing PMI fell to 48.8 in December 2025, below both the preliminary estimate of 49.2 and November's final reading of 49.6, marking the fastest pace of contraction since March 2025.

Trade & Tariffs:

- Trade developments were a defining feature of 2025. The year saw the re-emergence of protectionist trade policies, led by higher U.S. tariffs across a wide range of imports. These measures resulted in:
  - Higher effective trade costs
  - Disruptions to established supply chains
  - Front-loading of imports earlier in the year, followed by softer trade volumes in H2 2025
- By year-end, tariff pass-through into goods prices became more visible as pre-tariff inventories were exhausted. For 2026, trade policy uncertainty remains elevated, with ongoing legal, political and bilateral negotiations likely to influence global trade flows and investment decisions.

Global Monetary Policy:

- Monetary policy pivoted decisively in late 2025.
- The U.S. Federal Reserve initiated an easing cycle in Q4 2025, marking the end of the restrictive phase.
- Other major central banks adopted cautious and data-dependent stances, balancing slowing growth against lingering goods-price pressures from tariffs.
- Inflation closed 2025 on a declining trajectory globally, though progress was uneven across regions.
- At the start of 2026, monetary policy globally is less restrictive than a year ago, but central banks remain cautious given uncertainty around trade-driven inflation and financial stability.

Global Inflation Trends:

- Headline inflation presented contrasting pictures across economies.
- Inflation eased but remained at elevated levels in AEs (Advanced Economies) amidst persistent services inflation.
- In the Euro area, headline inflation increased further in November driven by services costs, while inflation in the US eased.
- Inflation in the UK fell to a six-month low led by food and beverages.
- Japan’s inflation also edged lower on low food inflation.
- Among major EMDEs (Emerging Market and Developing Economies), inflation picked up in China to a 21-month high driven by a rebound in food prices even as core inflation remained steady.
- In contrast, a lower food inflation led to easing of inflationary pressures in Brazil and in Russia, where headline inflation moderated to its lowest level since September 2023.
- Inflation in South Africa eased due to moderation in transport costs.

Indian Economy Update:

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Macro Backdrop:

- India ended 2025 as one of the fastest-growing major economies. Real GDP growth for FY25/FY26 trajectory remained well above global averages, supported by strong domestic demand, public capex and resilient services activity.
- Growth momentum was sustained despite global headwinds, reflecting India's relatively low dependence on external demand compared to peers.
- Entering 2026, India's macro fundamentals remain structurally strong, though external risks have risen.

Purchasing Managers' Index (PMI):

- The HSBC India Manufacturing PMI fell to 55.0 in December 2025, revised lower from initial estimates of 55.7, down from 56.6 in November. This marks the weakest improvement in two years, as factory output expanded at the slowest pace since October 2022, alongside softer growth in new orders.

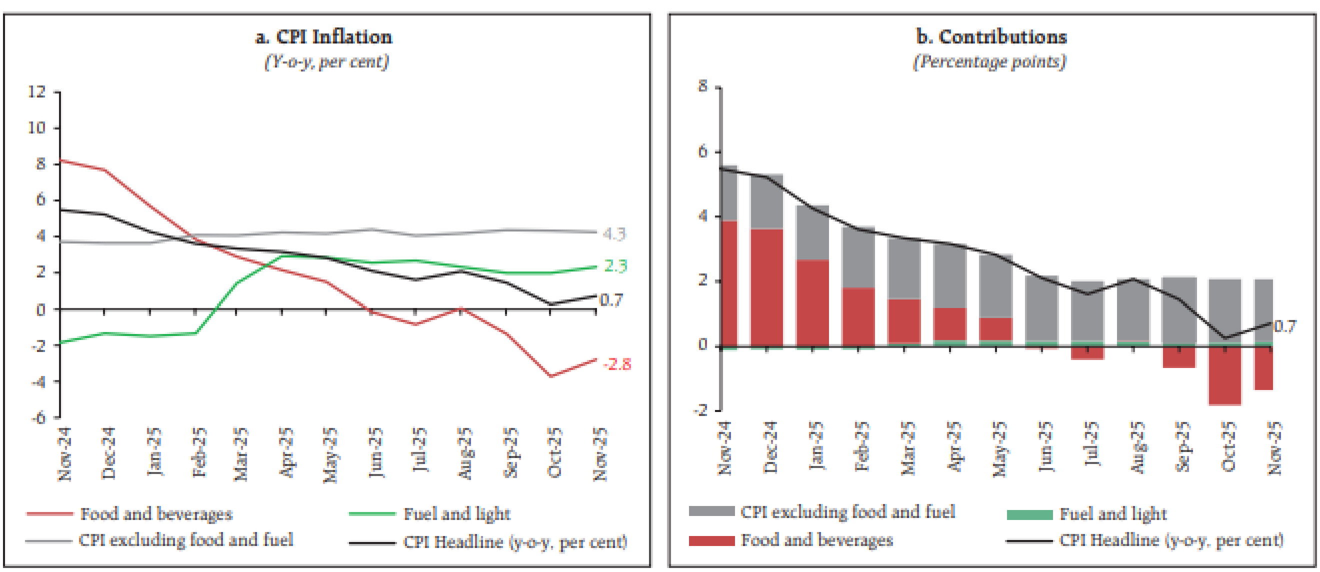
Trade and Tariffs:

- Global trade disruptions and higher U.S. tariffs weighed on select export-oriented sectors during H2 2025.
- Labor-intensive segments such as textiles, gems & jewelry, chemicals and select manufacturing exports experienced pricing pressure and softer order inflows.
- India continued to pursue export diversification and bilateral trade engagement to mitigate these challenges.
- In 2026, the external sector remains a key vulnerability, particularly if global protectionism intensifies.

Domestic Inflation Trends:

- Headline CPI inflation edged up in November to 0.7 per cent, driven by a lower rate of deflation in food prices, after reaching an all-time low of 0.3 per cent in October.
- Fuel and light inflation picked up to 2.3 per cent in November from 2.0 per cent in October.
- Core (i.e., CPI excluding food and fuel) inflation remained stable at 4.3 per cent in November, the same as in October.
- Inflation moderated within clothing and footwear, health, recreation and amusement, education and household goods and services subgroups while inflation in pan, tobacco and intoxicants, and personal care and effects subgroups increased.
- Excluding precious metals, core inflation was at 2.4 per cent.

Trends and Drivers of Inflation:



Sources: National Statistical Office (NSO); and RBI staff calculations.

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Bond Yields & Spreads:

- US FED (Federal Reserve) cut rates by 25bps in December 2025 policy meet, but overall tone remained cautious as inflation remains sticky and growth indicators resilient.
- US 10Y yields trended lower to around 4% before FED meeting, but traded between 4.10%-4.20%, post meeting, as markets remained lacklustre on year end holiday season.
- Indian 10Y yields remained volatile even as RBI cut rates by 25bps, on lower inflation, and announced OMO (Open Market Operations) purchase of Rs 1 trillion, trading in 6.50%-6.70% range.
- INR depreciated sharply in December 2025, crossing key level of INR 90/US$, likely on higher trade deficit and delay in completion of US India trade deal, and continuing FII (Foreign Institutional Investors) outflows.
- Corporate bonds moved in tandem with sovereign yields remaining range bound during December 2025.

Outlook:

- US FED cut rates, but forward easing remains under cloud on uncertainty on inflation concerns.
- Further, US FED cuts are expected, but markets remain cautious on sticky inflation and geo-politics.
- Though RBI MPC cut rates in December policy, further rate cuts are likely dependent on evolving inflation outlook.
- However, markets are now seeing end of rate easing in near term, and hence rates remain volatile with upward bias.
- FII flows turned negative in December 2025 likely on INR weakness and local supply pressure from state issuances.
- Despite RBI announcing large OMO purchases as well liquidity through USD/INR swaps, markets are wary on increased supply of state government securities, with demand side also weaking from banks on increased credit demand.
- Liquidity remains good as RBI provided funds through direct purchase of G-Secs (OMOs), as well as daily Liquidity Adjustment Facility (LAF) operations.
- There is expectation of inclusion of India government bonds in Bloomberg Global Bond Index, for which news is expected to by mid-January. If India is included, it may lead to passive FII flows of about USD 20-30 billion. This may lead to some recovery in market yields and improve sentiment.
- Market sentiment is likely to remain negative in near term on geo-politics, lack of clarity on US trade deal, weakness in INR. Next trigger is likely to be the Union budget, which is about a month away. 10Y Yield may trade in range of 6.55%-6.70% in near term.

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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