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Macro Review & Fixed Income Market Outlook

Global Economy Update:

Macro Backdrop:

- The global economy remains resilient despite ongoing geopolitical uncertainty, albeit with a diverging growth outlook across geographies.
- Monetary policy normalisation is driving policy action in AEs (Advanced Economies) even though the pace of disinflation remains uneven in many countries.
- Recent high frequency indicators suggest that global economic activity moderated a little during the fourth quarter of 2024 so far within a broadly unchanged outlook.
- Purchasing managers' indices (PMIs) of manufacturing activity contracted in several advanced economies, while services remained on a firmer footing.
- The S&P Global US Manufacturing PMI remained below the 50.0 no-change mark in November, but at 49.7 pointed to only a marginal worsening in the health of the sector during the month.
- The reading was up from 48.5 in October and the highest in the current five-month sequence of deteriorating business conditions.
- The S&P Global US Services PMI rose to 57 in November 2024 from 55 in the previous month, well above market expectations of 55.2, to mark the sharpest expansion in the US services sector activity since March of 2022.
- Among emerging market economies (EMEs), PMIs are emitting mixed signals.
- For Asia, growth has gained strength relative to expectations, with a tech-driven uptick in exports.
- Despite this robust performance, the IMF assesses that risks to the Asian outlook have increased, mainly due to the weaker external environment and adverse demographics.
- Inflation has continued to decline and is projected to reach targets by 2025 in many jurisdictions.
- Headline inflation in EMEs has been broadly steady or retreating in Asia, but it remains above target in Latin America as services price increases have been persistently stronger than their pre-pandemic averages.

Indian Economic Growth:

Macro Backdrop:

- India GDP growth slowed sharply to 5.4% in Q2FY2025 (8.1% in Q2FY2024) vs 6.7% in Q1FY2025.
- Slowdown in manufacturing and mining led to lower growth. Private consumption slowed down. Government expenditure yet to pick up.
- The Q3FY2025 GDP number may also be lower due to high base effect (8.6% in Q3FY2024).
- The medium-term outlook remains cautiously bullish as the innate strength of the macro-fundamentals reasserts itself.
- In November, India recorded a manufacturing PMI of 56.5, down marginally compared to 57.5 in October 2024 but still firmly in expansionary zone.
- Strong broad-based international demand, as shown by a four-month high in new export orders, drove the Indian manufacturing sector's ongoing expansion.
- At the same time, output growth is slowing due to rising prices.
- In November, input prices for a wide range of intermediate commodities, including chemicals, cotton, leather, and rubber, climbed, while output prices reached an eleven-year high as rising input, labour, and transportation costs were passed on to consumers.
- The outlook for India's exports is brightening. Underneath the subdued growth profile of the past few months, India has been gaining share in global trade of key manufacturing items.
- India currently holds 13 per cent or a sixth of the global market share in petroleum products, attesting to rising refining capabilities and ability to meet international standards.
- It is the largest exporter of precious and semi-precious stones, the third largest exporter of insecticides, the eighth largest in rubber pneumatic tyres, and ninth in semiconductors.

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- In the first half of 2024-25, Apple exported close to US $6 billion of India-made iPhones, while automobile exports expanded by 14.3 per cent, led by passenger vehicles and two-wheelers.
- Export restrictions on several items have been lifted. Efforts are being intensified to expand the number of geographical indication (GI) products to scale up overall exports and secure premium pricing in global markets.
- GST collection for November rises by 8.5% to ₹1.82 trillion.

Inflation:

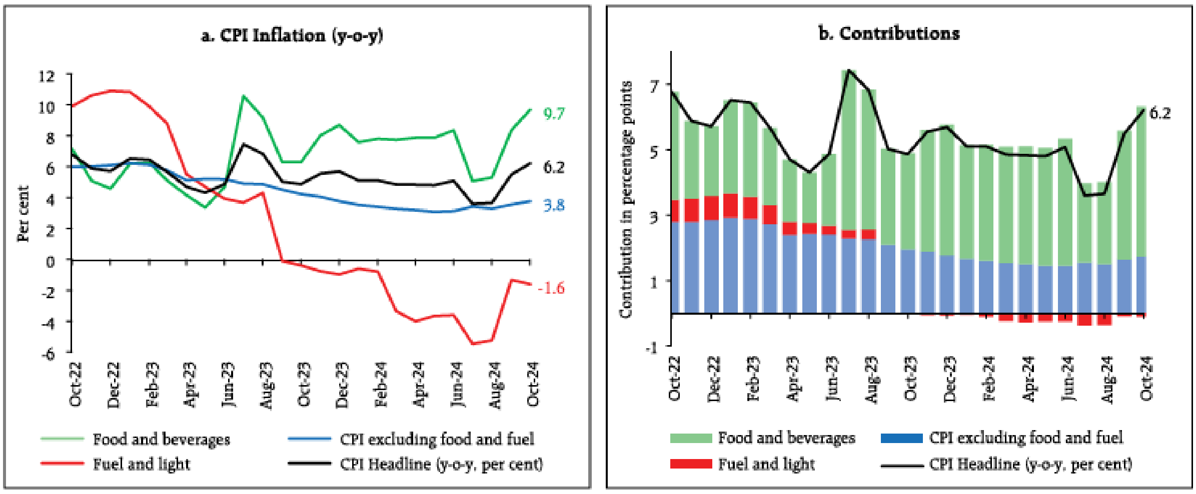
Global:

- Headline inflation continued to decelerate across major economies, albeit unevenly, even though services inflation continues to remain elevated, especially in AEs.
- In the US, CPI inflation increased to 2.6 per cent year-on-year (y-o-y) in October 2024 from 2.4 per cent in September.
- Inflation in terms of the personal consumption expenditure (PCE) deflator softened to 2.1 per cent in September from 2.3 per cent in August.
- Headline inflation in the Euro area edged up to 2.0 per cent in October from 1.7 per cent in September.
- Among EMEs, inflation increased in Brazil and Russia but softened in China in October.
- Core and services inflation remained higher than the headline in most AEs.

India:

- Headline inflation increased to 6.2 per cent in October 2024 from 5.5 per cent in September 2024.
- The increase in inflation of around 70 basis points (bps) came from a positive momentum of around 135 bps, which was partially offset by a favourable base effect of 65 bps.
- CPI food and CPI core (i.e., CPI excluding food and fuel) groups recorded m-o-m increases of 2.2 per cent and 0.6 per cent, respectively, while the CPI fuel index remained unchanged.
- Food inflation increased y-o-y to 9.7 per cent in October from 8.4 per cent in September.
- In terms of sub-groups, vegetables and edible oils recorded significant increases, both on m-o-m and y-o-y basis.
- Core inflation increased to 3.8 per cent in October from 3.6 per cent in September.
- In terms of regional distribution, inflation hardened in both rural and urban areas in October, with rural inflation at 6.7 per cent being higher than urban inflation at 5.6 per cent.
- Majority of the states registered inflation below 6 per cent.

Trends and Drivers of CPI Inflation:



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

Bond Yields & Spreads:

- Indian yields trended higher in initial part of November mirroring global rate trend.
- With Trump winning US Presidential election, there are concerns on higher fiscal which could lead to higher rates.
- The 10Y yield rose to a high of 6.87%, before closing the month at 6.74%, on surprise drop in India GDP data.
- Debt FII flows turned negative, further denting sentiments.
- US FED cut rates further by 25bps and there is even a chance of rate cut in December as well.
- Governor of Reserve Bank of India reiterated commitment to the 4% inflation target on a durable basis but recent drop in growth numbers may nudge the RBI monetary policy committee (MPC) to look closely at the growth-inflation tradeoff.
- Liquidity moved both ways with RBI dynamically managed liquidity mismatches through variable repo rate (VRR) auctions and variable reverse repo rate (VRRR) auctions.
- Corporate bonds moved in tandem with sovereign with overall yields marginally rising across the curve.

Outlook:

- US FED rate cut has turned market sentiments positive as participants look forward to RBI action as they have changed stance to neutral in October MPC. The change in stance would pave way for the rate cuts to start in Indian market.
- With the sharp drop in GDP growth in Q2FY2025, RBI may look at some easing measures.
- Liquidity has further tightened, and there are hopes of CRR (Cash Reserve Ratio) cut / OMO (Open Market Operations) purchases to bring in durable liquidity.
- FII flows have reduced but are likely to restart in 2025 as index flows resume with addition of Indian G-Secs to Bloomberg EM Bond index.
- 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.
- Coupled with further rate moves from the US FED, we believe that RBI may likely deliver first rate easing by Dec 24 or at least start the narrative of cut in Feb policy.
- We are structurally long on India as growth inflation dynamics are still favourable for yields to tick down as RBI would look for further cues.
- We anticipate that over the next few months, 10-year yields may trade in 6.60 – 6.85% range.

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

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