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Macro Review & Fixed Income Market Outlook - January 2025

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Global Economy Update:

Macro Backdrop:

- The year 2024 presented a mixed bag of economic trends and challenges as nations navigated a landscape marked by post-pandemic recovery, geopolitical uncertainties, and evolving trade dynamics.
- **GDP Growth:**
  - Global GDP growth remained moderate in 2024, with advanced economies witnessing subdued expansion due to tighter monetary policies.
  - The U.S. economy grew strongly by around 2.6% 9MCY2024, driven by resilient consumer spending, while the Eurozone faced near-stagnation, struggling with high energy costs and declining industrial output.
  - Emerging markets like India and Southeast Asian nations remained bright spots, achieving robust growth rates exceeding 5%, bolstered by domestic demand and government-led infrastructure investments.
  - December data showed a slight uptick in growth momentum as holiday season spending provided a boost in major economies.
- **Purchasing Managers' Index (PMI):**
  - The PMI for manufacturing and services painted a divergent picture.
  - Global manufacturing PMI hovered around the contraction zone (below 50) for most of the year, reflecting weak demand and inventory adjustments.
  - In contrast, the services sector exhibited resilience, with PMIs consistently above 50, fueled by strong post-pandemic consumer activity, particularly in travel and hospitality.
  - December PMIs showed signs of stabilization in manufacturing, with services continuing their robust performance.
- **Trade and Export-Import Dynamics:**
  - Global trade faced headwinds due to lingering geopolitical tensions and a slowdown in major economies.
  - Export growth from China remained sluggish, weighed down by declining global demand and supply chain diversification efforts by Western nations.
  - Meanwhile, countries like Vietnam and India gained prominence as alternative manufacturing hubs.
  - Import demand from advanced economies weakened, affecting global trade balances.
  - December trade data showed modest improvements, with a pre-holiday surge in shipments stabilizing trade flows.
- **Labor Markets and Employment:**
  - Labor markets in advanced economies remained tight, with unemployment rates near historic lows.
  - However, wage growth showed signs of deceleration, aligning with central banks' efforts to control inflation.
  - Emerging markets continued to generate employment opportunities, particularly in technology and manufacturing sectors, though informal employment remained a significant concern.
  - December hiring trends in retail and logistics reflected seasonal increases, though long-term structural issues persisted.

Inflation Trends:

Global:

- Central banks, including the Federal Reserve and ECB, maintained a cautious stance, balancing between curbing inflation and supporting economic growth.
- In the US, consumer price index (CPI) inflation increased to 2.7% (y-o-y) in Nov from 2.6% in October.
- Headline inflation edged up in the Euro area to 2.2% in Nov from 2.0% in Oct.
- In the UK, it edged up to 2.6% in Nov from 2.3% in Oct.
- Inflation in Japan (CPI excluding fresh food) increased to 2.9.
- Emerging markets faced varying inflationary pressures, with food and energy prices being major contributors.

Indian Economy Update:

Macro Backdrop:

- The Indian economy demonstrated resilience and adaptability in 2024, amid a volatile global landscape.
- **GDP Growth:**
  - India's GDP grew by an estimated 6.6% in 9MCY2024, driven by strong consumption, rising investments, and increased government expenditure on infrastructure.
  - The December quarter recorded a slight acceleration, with sectors such as manufacturing, construction, and services performing well.
  - The agriculture sector remained stable, supported by favorable monsoon conditions earlier in the year.
- **Purchasing Managers' Index (PMI):**
  - India's PMI consistently remained in expansionary territory throughout the year.
  - Manufacturing PMI averaged around 55, reflecting robust factory activity supported by strong export orders and domestic demand.
  - The services sector saw even stronger growth, with the December HSBC India Services PMI hitting 60.8 as per preliminary estimates, signaling continued expansion in IT, finance, and hospitality.
- **Trade and Export-Import Dynamics:**
  - India's trade balance remained under pressure in 2024, with a widening deficit due to high imports of crude oil and electronics.
  - However, exports of software services, textiles, and pharmaceuticals showed resilience.
  - India's fiscal deficit for the period from Apr to Nov of FY25 stood at Rs. 8.47 lakh crore or 52.5% of the Budget Estimates (BE) of the current fiscal.
  - India's fiscal deficit was at 50.7% of the BE in the corresponding period of the previous fiscal year.
  - Total expenditure stood at Rs. 27.4 lakh crore or 56.9% of the BE as compared to 58.9% of the BE in the corresponding period of the previous fiscal year.
  - December's trade data revealed a marginal improvement, with holiday season demand boosting exports, particularly to Western markets.
  - The government's Production Linked Incentive (PLI) schemes also began to show results, enhancing export competitiveness in electronics and renewable energy components.
- **Labor Markets and Employment:**
  - The labor market witnessed steady improvement in 2024.
  - Urban employment rates improved with the expansion of tech and service industries, while rural employment benefited from higher agricultural output and government rural employment schemes.
  - The December hiring season in sectors like retail and logistics contributed to temporary job creation, though concerns over underemployment in informal sectors persisted.

Inflation Trends:

Domestic:

- The Inflation in India moderated to an average of 4.92% in 11MCY2024, within the Reserve Bank of India's target band of 2-6%.
- After spiking mid-year due to food price volatility, particularly in tomatoes and other perishables, inflation cooled in the last quarter.
- Headline Inflation fell to 5.5 per cent in November 2024 from 6.2 per cent in October 2024.
- Food inflation declined to 8.2 per cent in November from 9.7 per cent in October.
- Core inflation eased to 3.7 per cent in November 2024 from 3.8 per cent in October.
- In terms of regional distribution, inflation moderated in both rural and urban areas in November, with rural inflation at 6.0 per cent being higher than urban inflation at 4.8 per cent.
- Majority of states experienced inflation between 4 to 6 per cent.

Bond Yields & Spreads:

- Indian yields trended in December, post policy, as rate cut expectations did not materialize.
- 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 6.79% at year end.
- Debt FII flows turned negative, further denting sentiments.
- US FED cut rates further by 25bps in December, but future rate cuts are likely to be data driven.
- RBI monetary policy committee (MPC) did not ease repo rate, as higher inflation kept MPC members cautious.
- RBI MPC cut CRR by 50bps as durable liquidity fell to near deficit.
- Change of guard at RBI, with Mr. Sanjay Malhotra replacing Mr. Shaktikanta Das on term completion.
- 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 expectations turned sour as inflation remains sticky and growth resilient. Though US FED cut rate by 100bps in 2024, further rate action is contingent on inflation easing on sustainable basis.
- US yields have further risen to 4.50%-4.60% denting global bond sentiment.
- Liquidity remains tight, and after CRR (Cash Reserve Ratio) cut , there is hopes of 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 Emerging Markets 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.
- We believe that RBI may likely deliver first rate easing in Feb policy as government has shown commitment to fiscal prudence and inflation would have likely fallen further.
- Recent movement in USDINR (touching high of INR 85.8125/US$) may impinge on policy decision making, though growth considerations may play a larger role.
- We are structurally long on India as growth inflation dynamics are still favorable 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, Reuters, Bloomberg, Internal Research. Note: Data updated as available in the beginning of the month.

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