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Macro Review & Fixed Income Market Outlook

Global Economy Update:

Macro Backdrop:

- ✚ The global activity is moderating amidst momentum of a halting decline in inflation, flattening of consumer confidence, and some easing of labour market conditions.
- ✚ Despite moderate easing, financial conditions remain tight, especially in housing and credit markets.
- ✚ In its Economic Outlook of May 2024, the OECD projected global growth at 3.1 per cent in 2024 (same as in 2023), before edging up to 3.2 per cent in 2025 on the support from stronger real income growth and lower policy interest rates.
- ✚ These projections place global growth lower than the pre-pandemic average (2013-2019) of 3.4 per cent.
- ✚ The outlook is levelling across economies, with Europe and most low-income economies gaining pace recently, while the US economy is moderating and many large EMEs are poised for a stronger performance.
- ✚ The global supply chain pressures index (GSCPI) recorded an uptick in May 2024 after declining for two consecutive months.
- ✚ Geopolitical tensions eased marginally, although the geopolitical risk indicator remained significantly higher than its level recorded a year ago.
- ✚ The J.P.Morgan Global Composite PMI[®] Output Index rose for the seventh successive month to post 53.7 in May, up from 52.4 in April and its highest level since May 2023.
- ✚ The rate of global economic growth hit a 12-month high in May, as new work intakes strengthened.
- ✚ The upturns in business activity and new orders also showed improved breadth, with all six of the sub-sectors covered by the survey registering expansions in both.
- ✚ The J.P.Morgan Global Services PMI Business Activity Index rose to a 12-month high of 54.1 in May. Input price and output charge inflation were both unchanged compared to April.

Indian Economic Growth:

Macro Backdrop:

- ✚ India is projected to remain the fastest growing major economy.
- ✚ The Indian economy has demonstrated marked resilience in the face of geopolitical headwinds imparting supply chain pressures.
- ✚ While revising India's GDP growth upwards by close to 2 percentage points for 2023-24, the IMF's April 2024 World Economic Outlook (WEO) alludes to the robustness of growth expected in 2024 and 2025 which is projected to remain strong at 6.8 per cent in 2024 (FY25) and 6.5 per cent in 2025 (FY26), reflecting continuing strength in domestic demand and a rising working-age population.
- ✚ The OECD's May 2024 Economic Outlook points to strong momentum in India in recent monthly indicators and expects strong investment and improving business confidence in India to sustain real GDP growth.
- ✚ Growth in the Indian manufacturing sector recovered some of the ground lost in May, with the headline PMI posting nearly five points above its long-run average, as per the HSBC Purchasing managers' Index (PMI) data.
- ✚ The India PMI increased from 57.5 in May to 58.3 in June, thus indicating a sharper improvement in business conditions.
- ✚ Although this marked the slowest monthly manufacturing growth in the last three years, it remained above the long-run average of 53.4.
- ✚ While the overall outlook for the manufacturing sector remains positive, the future output index receded to a three-month low, albeit it remains above the historical average.
- ✚ The final HSBC India Services Purchasing Managers' Index, compiled by S&P Global, fell to 60.4 in May from April's 60.8, contrary to a preliminary reading predicting a rise to 61.4.

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- ✚ Despite the slowdown, the index remained above the 50 mark, indicating growth, for the 34th consecutive month.
- ✚ New export orders surged at a record pace, with broad-based demand from across the globe.
- ✚ India's total exports (Merchandise and Services combined) in May 2024 is estimated to be USD 68.29 Billion, exhibiting a positive growth of 10.25 per cent over May 2023.
- ✚ Major drivers of merchandise exports growth in May 2024 include Petroleum Products, Engineering Goods, Electronic Goods, Drugs & Pharmaceuticals, RMG of all Textiles and Plastic & Linoleum.
- ✚ Petroleum products exports increase by 15.75% from USD 5.85 Billion in May 2023 to USD 6.78 Billion in May 2024
- ✚ Engineering Goods exports increase by 7.39% from USD 9.3 Billion in May 2023 to USD 9.99 Billion in May 2024.
- ✚ Electronic goods exports increase by 22.97% from USD 2.41 Billion in May 2023 to USD 2.97 Billion in May 2024.
- ✚ Drugs and pharmaceuticals exports increase by 10.45% from USD 2.08 Billion in May 2023 to USD 2.30 Billion in May 2024.
- ✚ RMG of all Textiles exports increase by 9.84% from USD 1.24 Billion in May 2023 to USD 1.36 Billion in May 2024.
- ✚ Plastic & Linoleum exports increase by 16.6% from USD 0.65 Billion in May 2023 to USD 0.76 Billion in May 2024.
- ✚ Total imports (Merchandise and Services combined) in May 2024 is estimated to be USD 73.367 Billion, exhibiting a positive growth of 7.95 per cent over May 2023.
- ✚ Gross GST revenue collection in June 2024 stands at ₹1.74 lakh crore; Records 8% y-o-y growth.

Inflation:

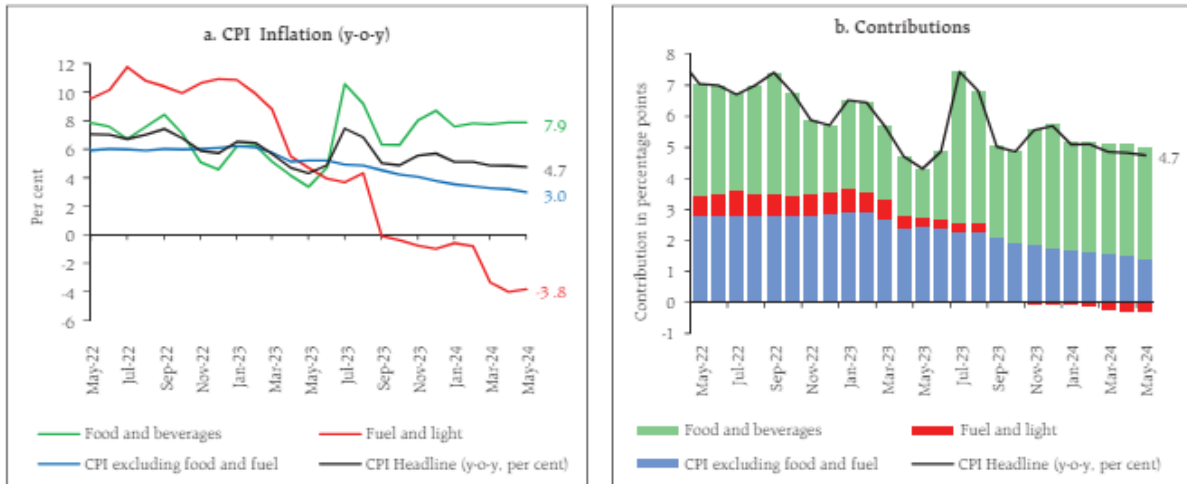
Global:

- ✚ Headline inflation is gradually easing, driven by sustained softening of its core component, although the path of disinflation is interrupted by volatile and elevated food prices.
- ✚ In the US, consumer price index (CPI) inflation moderated to 3.3 per cent in May from 3.4 per cent in April, while the headline personal consumption expenditure (PCE) inflation remained unchanged at 2.7 per cent in April.
- ✚ As per flash estimates, euro area inflation edged up to 2.6 per cent in May from 2.4 per cent in April.
- ✚ Among EMEs, Brazil experienced an increase in inflation in May, while it remained steady in China.
- ✚ Core and services inflation remained higher than headline inflation across major AEs.

India:

- ✚ CPI inflation softened to 4.7 per cent in May 2024 4.8 per cent in April as a positive momentum of 48 bps was more than offset by a favourable base effect of 56 bps.
- ✚ Food inflation (y-o-y) remained unchanged at 7.9 per cent in May.
- ✚ Fuel and light deflation narrowed to (-)3.8 per cent in May from (-)4.0 per cent in April, mainly due to an increase in inflation in kerosene prices under the public distribution system (PDS). Electricity prices remained elevated in double digits while LPG prices continued to record double digit deflation.
- ✚ Core inflation eased further to 3.0 per cent in May from 3.2 per cent in April, the lowest in the current CPI (2012=100) series.
- ✚ Inflation in pan, tobacco and intoxicants remained unchanged while that in personal care and effects recorded a marginal increase.
- ✚ In terms of regional distribution, rural inflation stood at 5.3 per cent, higher than urban inflation (4.2 per cent) in May 2024.
- ✚ Majority of the states experienced inflation less than 6 per cent.

Trends and Drivers of CPI Inflation:



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

Bond Yields & Spreads:

- US Yields trended lower in June 24 on softer inflation data. It marginally rose at end of month on election fear.
- Indian yields mirrored US yields as well as on FII flows on back of inclusion in J.P.Morgan EM Bond Index from June 24 onwards.
- India 10Y benchmark traded in range of 6.95-7.05%
- Markets are pricing in likely two rate moves by US FED in 2024.
- ECB delivered the first rate cut, deviating from US FED move. BoE also remained in pause mode
- RBI remained in status quo mode in the June Monetary Policy (MPC) meet, though the number of dissents rose to 2 from 1 (from previous policy).
- RBI may reduce rates in 2HFY2025, but is likely to follow US FED cut cycle
- Liquidity moved both ways with RBI dynamically managed liquidity mismatches through variable repo rate (VRR) auctions and variable reverse repo rate (VRRR) auctions.
- Bond yield curve remained flat with longer term yields softening on demand from investors.
- Corporate bond spreads remain rangebound in absence of any rate cut expectations in near term.

Outlook:

- Market recovered smartly post general elections as strong coalition government calmed markets on any fiscal disruptions in near term
- The fiscal deficit is likely to remain around 5.0% as indicated in the vote-on-account budget.
- Extra RBI dividend of more than Rs. 1 lakh crore should support any extra government outlays.
- Market dynamics are likely to be influenced by global factors as RBI is likely to remain in pause mode.
- Markets will look towards the formation of government and full year budget, likely in July, for further domestic cues.
- With the US rate easing cycle likely in 2024, the question remains only on timing of rate cuts.
- FII flows have been strong ahead of Index inclusion with FII debt inflows of USD 9.47bn (Jan-Jun24).
- The influx of foreign funds is anticipated to be liquidity-positive, further contributing to the positive sentiment surrounding bonds.
- 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, as the demand for Government Securities (G-Sec) is likely to drive yields downward.

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- ✚ Coupled with anticipated rate moves from the US FED, RBI may change to neutral stance in next few policies.
- ✚ We may expect about 25bps rate cut from RBI in FY2025.
- ✚ We anticipate that over the next few months, 10-year yields may trade in 6.90-7.10% range.

Source: RBI, MOSPI, PIB, CMIE, FIMMDA, NSDL, IMF, J.P.Morgan, ECI, S&P Global, Bloomberg, Internal Research.

Note: Data updated as available in the beginning of the month.

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