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Macro Review & Fixed Income Market Outlook

Global Economy Update:

Macro Backdrop:

- ✚ Global growth remains resilient, with easing inflationary pressures and tight employment conditions in spite of geopolitical and extreme weather event risks.
- ✚ The International Monetary Fund (IMF) in its latest world economic outlook (WEO April 2024), raised global growth forecast for 2024 to 3.2 per cent, 10 bps higher than its January 2024 Update and expected the global economy to grow at the same pace in 2025.
- ✚ For AEs, the growth forecast has been revised up for 2024 by 20 bps to 1.7 per cent due to a significant upward revision in the US growth forecast while for Emerging Market and Developing Economies (EMDEs), the forecast has been revised up by 10 bps to 4.2 per cent.
- ✚ Global headline inflation is expected to fall from an annual average of 6.8 per cent in 2023 to 5.9 per cent in 2024 and further to 4.5 per cent in 2025 (both revised up by 0.1 percentage points from previous projections), with AEs returning to their inflation targets sooner than EMDEs.
- ✚ The global composite purchasing managers index (PMI) recorded a sequential uptick in March 2024, supported by continued expansion in both services and manufacturing activity.
- ✚ The services PMI rose to an eight-month high in March, driven by new businesses and gains in exports.
- ✚ The global manufacturing PMI accelerated to its highest reading since July 2022 as new orders, output and employment expanded.

Indian Economic Growth:

Macro Backdrop:

- ✚ The Indian economy continued to exhibit resilience amidst external headwinds which led to the build-up of supply chain pressures.
- ✚ Consumer confidence strengthened across parameters set out in the RBI's latest survey of households.
- ✚ Enterprise surveys indicate that business assessment and expectations remain in positive terrain, with optimism on production, capacity utilisation (CU), order books, employment, and overall business conditions.
- ✚ According to the economic activity index (EAI), economic activity remained resilient in Q4:2023-24, although available data indicate some moderation in March vis-à-vis the previous month on a seasonally adjusted basis.
- ✚ As per the data from the Centre for Monitoring of Indian Economy (CMIE), the all-India unemployment rate (UR) fell to 7.6 per cent in March, declining across both urban and rural regions.
- ✚ The labour force participation rate (LFPR) and employment rate (ER) fell marginally vis-à-vis the previous month.
- ✚ The headline PMI for the manufacturing sector reached to 58.8 in April 2024, backed by rising demands.
- ✚ The PMI for services rose to 60.8 in April 2024, driven by solid expansion in new business and employment.
- ✚ India's goods and services tax (GST) collections hit a record high in April 2024 at ₹2.10 lakh crore.
- ✚ This represents a significant 12.4% year-on-year growth, driven by a strong increase in domestic transactions (up 13.4%) and imports (up 8.3%).
- ✚ After accounting for refunds, the net GST revenue for April 2024 stands at ₹1.92 lakh crore, reflecting an impressive 15.5% growth compared to the same period last year.

Inflation:

Global:

- ✚ Headline inflation receded significantly from levels recorded a year ago in most economies, although it remained above targets.
- ✚ In the US, CPI inflation rose to 3.5 per cent in March from 3.2 per cent in February, while the headline personal consumption expenditure (PCE) inflation increased to 2.5 per cent in February.

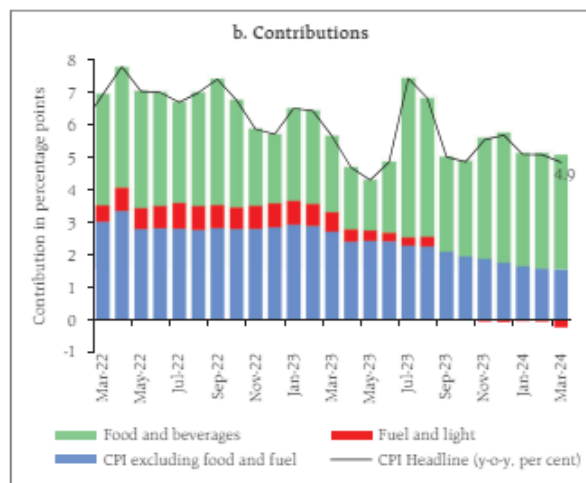
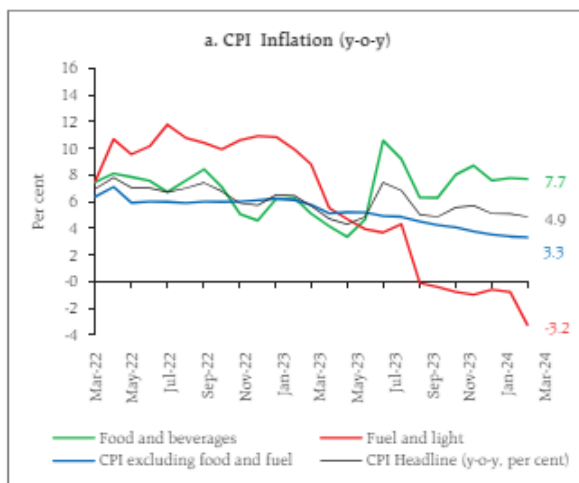
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- ✚ Euro area inflation moderated to 2.4 per cent in March from 2.6 per cent in February.
- ✚ In the UK, CPI inflation softened to 3.2 per cent in March. Japan's inflation (CPI excluding fresh food) eased to 2.6 per cent in March from 2.8 per cent in February.
- ✚ Among EMEs, inflation moderated in Brazil, China, and South Africa in March. Inflation in Russia remained steady for the second consecutive month in March.
- ✚ Core and services inflation also moderated across major AEs but remained higher than headline inflation.

India:

- ✚ CPI inflation moderated to 4.85 per cent in March 2024 from 5.09 per cent in February 2024.
- ✚ In terms of index levels, food, and core (excluding food and fuel) groups registered a m-o-m increase of around 0.2 per cent each which was offset by a m-o-m decline in fuel prices by (-) 2.6 per cent.
- ✚ Food inflation moderated to 7.7 per cent in March 2024 from 7.8 per cent in February as a positive price momentum of 16 bps was more than offset by a favourable base effect of 23 bps.
- ✚ Core inflation eased further to 3.3 per cent in March from 3.4 per cent in February, the lowest in the current CPI (2012=100) series.
- ✚ The moderation was broad-based, with inflation softening across various sub-groups barring personal care and effects, and recreation and amusement.
- ✚ In terms of regional distribution, while CPI-rural inflation increased by around 10 bps to 5.4 per cent in March, CPI-urban inflation moderated by 64 bps to 4.1 per cent.
- ✚ Most of the states continued to record inflation in the range of 4-6 per cent.

Trends and Drivers of CPI Inflation:



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

Bond Yields & Spreads:

- ✚ Indian yield curve trended higher in April 2024 as strong US data negated the expectations of near term cuts.
- ✚ Borrowings for the new fiscal further added to pressure on yields
- ✚ US FOMC officials are pushing back on timing of first rate cut as well extent of easing in light of sticky inflation and strong economic data.
- ✚ As expected, RBI MPC remains in pause mode as (1) US FED rate cut gets delayed (2) Growth remains robust whilst inflation could remain a concern in light of volatile food prices.
- ✚ Liquidity remained even in April 2024 moving between surplus and deficit with RBI doing variable repo auctions (VRR) and variable reverse repo auctions (VRRR) to manage frictional liquidity.
- ✚ Bond yield curve remained flat with longer term yields softening on demand from investors.
- ✚ Corporate bond spreads remain elevated in absence of any rate cut expectations in near term.

Outlook:

- ✚ Market dynamics are largely likely to be influenced by US FED rate decisions.
- ✚ Recent data on US CPI inflation showing stickiness has spooked markets.
- ✚ The extent of US rate cut expectations have reduced for 2024.
- ✚ No rate easing is expected from RBI in the near term as US FED is seen delaying rate cuts.
- ✚ FII flows have been strong ahead of Index inclusion with USD 6.08 bio in CYTD2024.
- ✚ 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.
- ✚ Fiscal consolidation in the interim Budget is likely to provide further positive impetus to bond markets.
- ✚ 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 gradually fall below 7%.

Source: RBI, MOSPI, PIB, CMIE, FIMMDA, NSDL, Bloomberg, Internal Research.

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