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Macro Review & Fixed Income Market Outlook

Global Economy Update:

Macro Backdrop:

- The global economy has exhibited resilience in the midst of heightened geopolitical uncertainty.
- As inflation continued to ease towards targets in most AEs (Advanced Economies), several central banks have embarked on the path of policy easing.
- Global financial conditions are easing from restrictive levels, with financial markets continuing to front run central banks in their expectations of policy rate reductions.
- The S&P Global US Manufacturing PMI rose to 48.5 in October from 47.3 in September but remained below the 50.0 threshold, indicating continued contraction. This marks the fourth consecutive month of PMI below 50, though conditions deteriorated at the slowest rate since July.
- New orders decreased for the fourth straight month, with uncertainty around the Presidential Election cited as a factor. However, the pace of decline slowed, and production contracted only slightly, marking the weakest decrease in three months.
- Employment in manufacturing fell modestly for the third consecutive month, and purchasing activity dropped at its steepest rate since June 2023 as firms cut inventories amid weaker demand and supply delays.
- The S&P Global US Services PMI edged up slightly to 55.3 in October 2024 from 55.2 in September, surpassing market expectations of 55.
- The HCOB Eurozone Manufacturing PMI rose to 45.9 in October 2024, reaching a five-month high from 45.0 in September and exceeding expectations of 45.3. Despite this improvement, manufacturing output continued to decline for the 19th month, though at a slower pace.
- The HCOB Eurozone Services PMI dropped slightly to 51.2 in October 2024, missing the expected rise to 51.5 and marking the weakest growth in services since February. Employment in services nearly stalled, while input costs rose sharply, prompting firms to increase their prices.

Indian Economic Growth:

Macro Backdrop:

- The outlook for domestic economic activity remains neutral as earnings season have been a bit of disappointment but RBI is confident of India's growth story
- The revival of private consumption is buoyed by receding inflation and pick-up in rural demand is expected to be its mainstay.
- The Government's capex push on infrastructure, upturn in investment activity, improved prospects of agricultural sector, strong corporate and bank balance sheets and improved outlook of global growth and trade are further aiding the growth momentum.
- India's manufacturing sector saw improved performance in October, with the HSBC Manufacturing PMI rising from 56.5 in September to 57.5, driven by accelerated output and new orders, both domestic and international.
- India's services sector expanded for the 39th consecutive month in October 2024, with the Services PMI rising slightly to 57.9. New business inflows drove a surge in employment, reaching the highest growth in 18.5 years, across both full-time and part-time roles. Export sales also improved, while rising capacity pressures led to the fastest backlog growth since May.
- India's total exports during April-September2024 are estimated at USD 393.22 Billion registering a positive growth of 4.86 percent.
- Total imports during April-September 2024 are estimated at USD 448.05 Billion registering a growth of 6.89 percent.
- October GST collection surpasses ₹1.87 lakh crore, with 9% YoY growth driven by higher domestic transactions and imports.

Inflation:

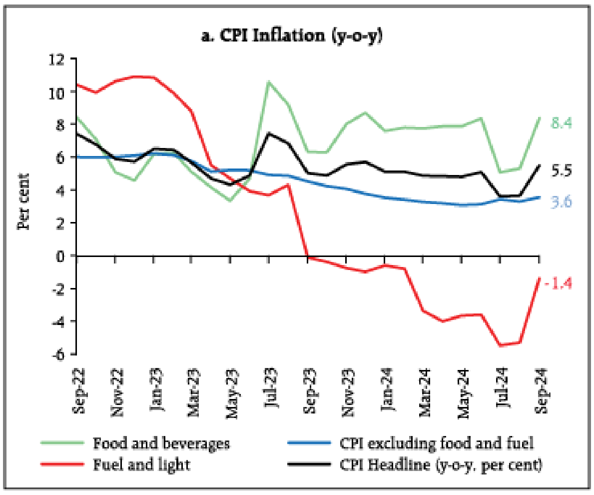
Global:

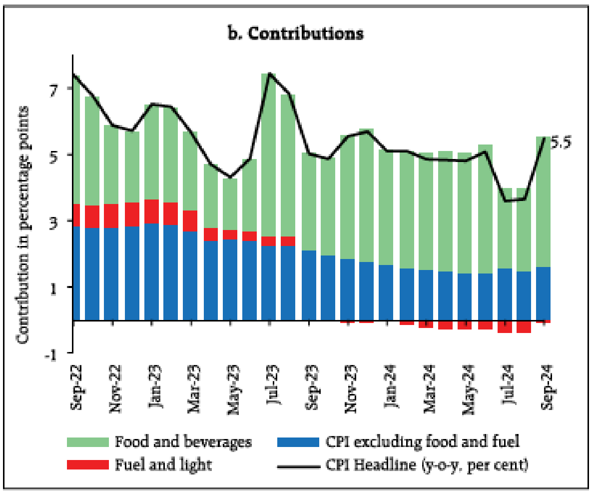
- Inflation continued to moderate across major economies, albeit unevenly.
- In the US, consumer price index (CPI) inflation eased to 2.4 per cent (y-o-y) in September from 2.5 per cent in August.
- Headline inflation in the Euro area and the UK decelerated to 1.8 per cent and 1.7 per cent, respectively, in September.
- Inflation in Japan (CPI excluding fresh food) softened to 2.4 per cent in September.
- Among EMEs, inflation increased in Brazil in September but softened in Russia and China in September.
- Core and services inflation trended downwards in most AEs; however, it remained higher than the headline.
- Among AE central banks, Euro area, South Korea and Iceland cut their policy rates by 25 bps while New Zealand cut its benchmark rate by 50 bps in October.
- Sweden, Switzerland and Czech Republic lowered their benchmark rates by 25 bps each in their September meetings.
- Australia, however, continued to hold its policy rate unchanged in September.

India:

- CPI inflation increased to a nine-month high of 5.5 per cent in September 2024 from 3.7 per cent in August 2024.
- The sharp increase in inflation of 1.75 percentage points came from a positive momentum of 60 bps and an unfavourable base effect of 115 bps which was compounded by a resurgence in food price momentum.
- Food inflation increased y-o-y to 8.4 per cent in September from 5.3 per cent in August, driven up by a positive momentum and an unfavourable base effect.
- Core inflation firmed up to 3.6 per cent in September from 3.3 per cent in August.
- In terms of regional distribution, inflation hardened in both rural and urban areas in September, with rural inflation at 5.9 per cent being higher than urban inflation at 5.0 per cent.
- Majority of the states registered inflation close to 6 per cent.

Trends and Drivers of CPI Inflation:





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

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Bond Yields & Spreads:

- Indian yields trended lower in October 2024 on global cues as US FED cut rates by more than expected 50bps.
- India 10Y benchmark traded lower mimicking lower US rates. The 10Y yield fell to a low of around 6.70% before closing the month at 6.75%.
- Passive flows continue to support markets.
- Post a jumbo rate cut by US FED, markets are pricing in another 50bps of easing in 2024.
- The US FOMC (Federal Open Market Committee) has a median forecast of further 50bps cut in 2024.
- RBI expected to look for further data cues before they meet in December 2024 as they have changed stance in October Monetary Policy (MPC) meet.
- Governor of Reserve Bank of India reiterated commitment to the 4% inflation target on a durable basis and expecting that RBI is within distance for rate cuts
- 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 softened with flattening bias as long-term yields fell on US rate easing.
- Corporate bonds moved in tandem with sovereign with overall yields softening 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 for the rate cuts to start in Indian market.
- The next market movement will largely hinge on the outcome of the U.S. election, as both candidates have significantly different approaches to guiding the country, with substantial policy implications for the rest of the world.
- With markets pricing further rate cuts from US FED in 2024, it is likely that RBI may ease rates in December 2024 policy but will largely hinge on US election outcome.
- FII flows continued to remain strong post inclusion in JP Morgan EM Bond Index since June 2024. Overall CYTD, FIIs have invested over USD 16.75 billion in debt.
- 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.
- Coupled with further rate moves from the US FED, we believe that RBI may 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 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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