CANARA ROBECO

Macro Review & Fixed Income Market Outlook

Global Economy Update:

Macro Backdrop:

- The global growth outlook is rendered uncertain in an environment of cooling labour markets, ongoing geopolitical tensions and decline in commodity prices.
- The S&P Global Flash US Composite PMI edged lower to 54.4 in September 2024 from 54.6 in August but beat market forecasts of 54.3.
- Business activity growth in the US private sector remained strong, indicating that the economy will continue to expand in the third quarter.
- The services sector continued to grow strongly, albeit at a slightly slower pace (55.4 vs 55.7), while the manufacturing decline deepened (47 vs 47.9).
- Meanwhile, order book growth has slowed and company expectations for the coming year have fallen to a near two-year low, reflecting increased uncertainty ahead of the Presidential Election.
- As a result, companies held back on recruiting, allowing employment to shrink for the second consecutive month at the highest rate since March, while input costs rose the most in a year.
- The HCOB Eurozone Manufacturing PMI was revised slightly higher to 45 in September 2024 from a preliminary of 44.8 and compared to 45.8 in the previous two months.
- There were big divergences across countries, with Spain having the strongest-performing manufacturing in September while Germany recorded its most pronounced worsening of factory conditions for 12 months.
- Looking ahead, manufacturers remained slightly optimistic on balance.
- Globally, growing expectations of monetary policy easing by major central banks, however, continue to instil confidence about a soft landing.
- The European Central Bank (ECB) implemented its second rate cut of the year, followed by a 50 basis points (bps) cut by the United States (US) Federal Reserve, while the Bank of England and Bank of Japan diverged, maintaining status quo.

Indian Economic Growth:

Macro Backdrop:

- September data showed a slight decline in manufacturing growth in India.
- Factory production and sales growth rates fell for the third month in a row, reaching their lowest levels since the beginning of the year but still above their long-term averages.
- Notably, overseas orders increased at the slowest rate in a year and a half.
- Despite the loss of growth momentum, net employment and purchases increased, and company confidence remained consistent with the long-run average.
- On the price front, there were moderate increases in input costs and selling charges.
- HSBC India Manufacturing Purchasing Managers' Index fell from 57.5 in August to 56.5 in September 2024.
- Household consumption is poised to grow faster in Q2 as headline inflation eases, with a revival of rural demand already taking hold.
- The demand for fast moving consumer goods (FMCG) is also accelerating as companies target older customers with healthy lifestyle products in response to rising longevity and affluence and younger ones with premiumisation.
- Yet another consumption booster is the ramping up of hiring by e-commerce majors ahead of the festival season, not just in the metros but in tier 2 and 3 cities as well.
- Logistics hiring is also rising to support increased transportation, warehousing and delivery activities.

- According to Team Lease Services, about 62 per cent of companies across telecom, internet service providers and allied industries intend to expand their workforce in this year.
- India's current account deficit (CAD) widened marginally to US$ 9.7 billion (1.1% of GDP) in Q1 FY25 from US$ 8.9 billion (1.0% of GDP) in Q1 FY24 and against a surplus of US$ 4.6 billion (0.5% of GDP) in Q4 FY24.

Inflation:

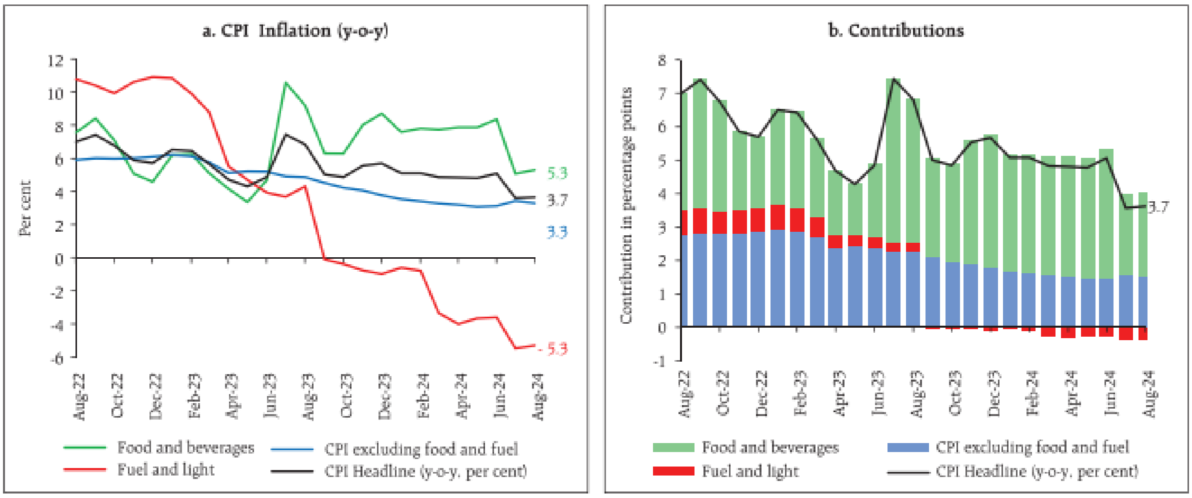
Global:

- Inflation declined across major economies, although at a slow and uneven pace.
- In the US, CPI inflation moderated to 2.5 per cent (y-o-y) in August from 2.9 per cent in July.
- US headline personal consumption expenditure (PCE) inflation, however, remained steady at 2.5 per cent in July.
- As per flash estimates, Euro area inflation decelerated to 2.2 per cent in August from 2.6 per cent in July.
- Headline inflation in the UK remained steady at 2.2 per cent in August while inflation in Japan (CPI excluding fresh food) edged up to 2.8 per cent.
- Among Emerging Market Economies (EMEs), inflation increased in China, softened in Brazil and South Africa, and remained steady in Russia in August.
- Core and services inflation trended downwards in major Advanced Economies (AEs) although it remained higher than the headline.

India:

- CPI inflation edged up to 3.7 per cent in August 2024 from 3.6 per cent in July 2024.
- The marginal increase in inflation came entirely from an unfavourable base effect of around 5 bps while the index remained unchanged at the previous month's level (zero momentum).
- Food inflation (y-o-y) firmed to 5.3 per cent in August from 5.1 per cent in July as a negative momentum of 30 bps was more than offset by an unfavourable base effect of 52 bps.
- Core inflation moderated to 3.3 per cent in August from 3.4 per cent in July.
- Inflation increased in case of transport and communication, education, recreation and amusement, and household goods and services while it remained steady for sub-groups such as clothing and footwear, housing, and health.
- Personal care and effects, and pan, tobacco and intoxicants recorded a moderation.
- In terms of regional distribution, rural inflation at 4.2 per cent was higher than urban inflation at 3.1 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 lower in September 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 75bps of easing in 2024.
- The US FOMC (Federal Open Market Committee) has a median forecast of further 50bps cut in 2024.
- RBI expected to remain in status quo mode in the October Monetary Policy (MPC) meet. Governor of Reserve Bank of India reiterated commitment to the 4% inflation target on a durable basis.
- 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 for RBI action in October MPC.
- A large than expected rate cut by US FED may push RBI to take some rate easing steps and / or change stance to “neutral”.
- With markets pricing further rate cuts from US FED in 2024, it is likely that RBI may ease rates in December 2024 policy.
- 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 change to neutral stance and deliver first rate easing by Dec 24.
- We may expect 25 bps rate cut from RBI in FY2025.
- 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, Bloomberg, Internal Research.

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

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