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Macro Review & Fixed Income Market Outlook

Global Economy Update:

Macro Backdrop:

- The flash PMI (Purchasing Managers' Index) data from S&P Global signalled a strengthening of growth for the world's major developed economies in August, with improving trends seen across the board.
- However, the expansion was skewed towards services as manufacturing contracted at a steepening pace.
- Flash PMI data for August brought some encouraging news on developed world economic growth midway through the third quarter.
- A sustained robust expansion was seen in the US, with growth also accelerating to solid rates in both the UK and Japan.
- Even the struggling eurozone reported an improved rate of growth, albeit still lagging.
- Although, US growth slowed slightly compared to the prior three months, it was still stronger than the majority of the rates seen in the prior two years.
- UK growth, meanwhile, accelerated to the second-fastest seen over the past 15 months, and Japan's rate of expansion hit a 15-month high.
- While modest in comparison, eurozone growth was the best seen for three months.

Indian Economic Growth:

Macro Backdrop:

- The Indian economy remained resilient despite headwinds from supply chain pressures due to the rise in global freight and container costs, and semiconductor shortages.
- Government data showed that Gross Domestic Product (GDP) of the Indian economy at constant (2011-12) prices witnessed a growth of 6.7% YoY in the first quarter of FY25. In the Apr-Jun quarter of last year, the GDP growth rate was 8.2%.
- According to the Ministry of Commerce & Industry, the combined Index of Eight Core Industries increased by 6.1% YoY in July 2024 as compared to 8.5% in July 2023.
- The Indian manufacturing sector continued to expand in August, although the pace of expansion moderated slightly.
- The seasonally adjusted HSBC India Manufacturing Purchasing Managers' Index stood at 57.5 in August, below July's reading of 58.1 but above its long-run average of 54.0, signalling a substantial improvement in operating conditions.
- Foreign direct investment inflows surged by 26.4% to reach $22.4 billion from April to June 2024, showing strong growth as global cross-border investments increase.
- Government data showed that India's fiscal deficit for the period from Apr to Jul of FY25 stood at Rs. 2.77 lakh crore or 17.2% of Budget Estimates (BE) of the current fiscal.
- India's fiscal deficit was at 33.9% of the BE in the corresponding period of the previous fiscal year.
- Total expenditure stood at Rs. 13 lakh crore or 27.0% of the BE as compared to 30.7% of the BE in the corresponding period of the previous fiscal year.
- Gross GST revenue collection in August 2024 stands at ₹1.75 lakh crore; Records 10% y-o-y growth.

Inflation:

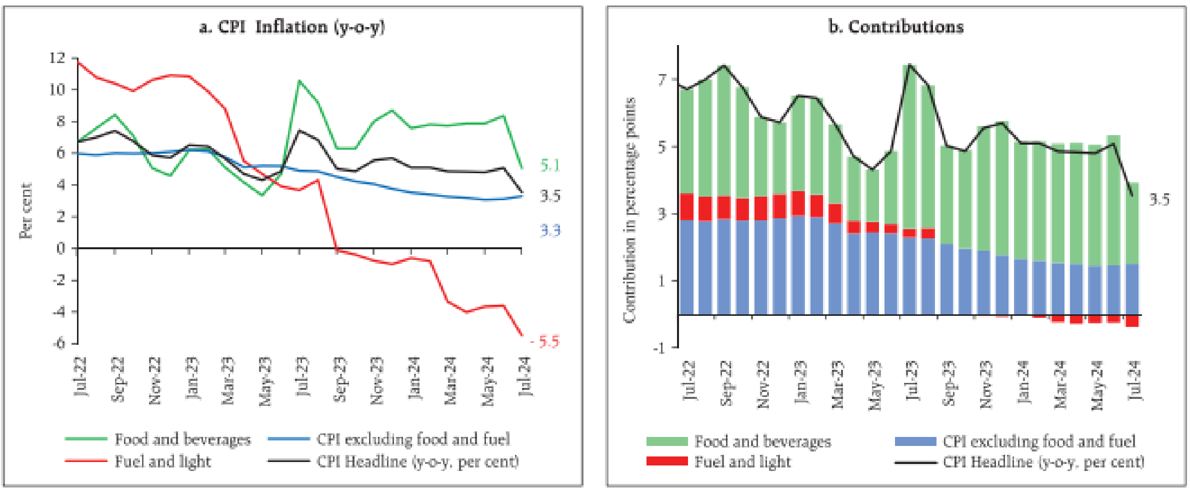
Global:

- Headline inflation continued to recede across major economies, although services inflation remained high.
- In the US, CPI inflation moderated to 2.9 per cent (y-o-y) in July 2024 from 3.0 per cent in June 2024.
- As per flash estimates, euro area inflation edged up to 2.6 per cent in July 2024 from 2.5 per cent in June 2024.
- In the UK, headline inflation rose to 2.2 per cent in July 2024.
- Among EMEs (Emerging Market Economies), inflation increased in China, Brazil and Russia while it softened in South Africa.
- Core and services inflation trended downwards in AEs (Advanced Economies) although they remained higher than the headline in most of them.

India:

- CPI inflation moderated sharply to 3.5 per cent in July 2024 from 5.1 per cent in June 2024.
- The 154 bps fall in inflation in July 2024 was on account of a favourable base effect of 2.9 per cent which more than offset a positive momentum of 1.4 per cent.
- Food inflation (y-o-y) declined to 5.1 per cent in July from 8.4 per cent in June, driven by a favourable base effect of 5.7 per cent which more than offset a strong momentum.
- In terms of regional distribution, inflation eased in both rural and urban areas in July, with rural inflation at 4.1 per cent being higher than urban inflation at 3.0 per cent.
- All the states registered inflation less than 6 per cent in July 2024.

Trends and Drivers of CPI Inflation:



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

Bond Yields & Spreads:

- Indian yields trended lower in August 2024 on global cues as expectations of US FED rate cut increased post weaker US labor data.
- India 10Y benchmark traded lower mimicking lower US rates. The 10Y yield fell to around 6.87% in August 2024.
- Passive flows continue to support markets.

- Markets are pricing the first US FED move in September 2024, post a dovish FOMC on 31st July 2024.
- The US FED Chair further indicated that easing was on the table in the annual central banks' meeting.
- Markets are pricing in around 75 bps rate cut in 2024.
- RBI expected to remain in status quo mode in the August 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 remains rangebound in absence of any action from RBI.
- Corporate bonds moved in tandem with sovereign with overall yields softening across the curve.

Outlook:

- The fiscal consolidation efforts have supported markets and yields have been softening.
- Market dynamics are likely to be influenced by global factors as RBI is likely to remain in pause mode.
- The Bank of England (BoE) started its easing cycle, by reducing its key policy rate by 25bps. ECB had already cut rates in early July 2024.
- With US FED indicating likely rate easing in September, markets are pricing in more rate cuts in 2024 and yields have dropped from highs seen in Apr-May 2024.
- FII flows continued to remain strong post inclusion in JP Morgan EM Bond Index since June 2024. Overall CYTD, FIIs have invested over USD 13 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 anticipated rate moves from the US FED, we believe that RBI may change to neutral stance in next few policies.
- 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 6.80 – 6.95% range.

Source: RBI, MOSPI, PIB, CMIE, NSDL, S&P Global, Bloomberg, Internal Research.

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