CANARA ROBECO

Macro Review & Fixed Income Market Outlook - March 2025

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Global Economy Update:

Macro Backdrop:

- The global economy continues to grow at a steady but moderate pace, with divergent outlook across countries amid rapidly evolving political and technological landscapes.
- Financial markets remain on edge on the slowing pace of disinflation and the potential impact of tariffs.
- Emerging market economies (EMEs) are witnessing selling pressures from foreign portfolio investors (FPIs) and currency depreciation engendered by a strong US dollar.

- **Purchasing Managers' Index (PMI):**
  - **United States:** The S&P Global US Manufacturing PMI rose to 52.7 in February 2025, up from 51.2 in January, indicating an expansion in manufacturing activity.
  - **Eurozone:** The eurozone's manufacturing downturn showed signs of easing in February, with the PMI rising to 47.6 from 46.6 in January. Although still below the 50 mark, this indicates a slower rate of contraction.
  - **China:** China's manufacturing activity is expected to contract for the second consecutive month in February, with the official PMI forecasted at 49.9, below the 50-point mark that separates growth from contraction.
- **Trade and Export-Import Dynamics:**
  - **United States:** President Donald Trump's administration has imposed new tariffs on imports from Mexico, Canada, and Europe, with additional tariffs on Chinese goods effective March 4, 2025. These measures have raised concerns over escalating trade tensions and their potential impact on global economic stability.
  - **Canada:** In response to U.S. tariffs, Canada has threatened retaliatory measures, signaling potential escalation in trade tensions.
- **Monetary Policy:**
  - **European Central Bank (ECB):** The ECB decided to cut its deposit rate to 2.50% on March 6, 2025, aiming to spur growth amid a sluggish eurozone economy and escalating trade tensions.
  - **U.S. Federal Reserve:** The Federal Reserve maintained its policy stance during its January 2025 meeting, citing persistent, albeit moderating, inflationary pressures and steady labor market conditions.

Inflation Trends:

Global:

- In the US, CPI inflation increased to 3.0 per cent (y-o-y) in January from 2.9 per cent in December.
- Headline inflation in the Euro area accelerated to 2.5 per cent in January from 2.4 per cent in December.
- Inflation in Japan (CPI excluding fresh food) increased to 3.0 per cent in December, while in the UK it inched lower by 10 bps to 2.5 per cent.
- Among EMEs, CPI inflation in China rose to a five-month high of 0.5 per cent in January; Russia and South Africa also witnessed an increase in inflation in December while in Brazil, it declined to 4.6 per cent in January.
- Core inflation remained steady in the Euro area in January 2025 but edged up marginally in the US.
- Services inflation decreased in both the US and the Euro area but remains elevated.

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Indian Economy Update:

Macro Backdrop:

- In India, high frequency indicators point towards a sequential pick-up in momentum of economic activity during H2:2024-25, which is likely to sustain moving forward.
- The Union Budget 2025-26 prudently balances fiscal consolidation and growth objectives by continued focus on capex alongside measures to boost household incomes and consumption. Retail inflation moderated to a five-month low in January of 4.3%, mainly due to a sharp decline in vegetable prices.

- **Monetary Policy:**
  - The Reserve Bank of India (RBI) cut policy rate by 25bps in Feb Monetary policy meet (MPC), though keeping stance at neutral.
  - The IMF retained its classification of India's exchange rate as "stabilized" through 2024, while awaiting more data on recent currency depreciation trends.
- **Purchasing Managers' Index (PMI):**
  - The HSBC India Manufacturing PMI declined to 56.3 in February 2025 from 57.7 in January, marking the slowest expansion since December 2023.
  - This dip was attributed to weaker growth in output and sales, alongside a slowdown in input purchasing to a 14-month low.
- **Trade and Export-Import Dynamics:**
  - **Trade Balance:** The trade deficit widened due to increased imports of crude oil and electronics. However, exports of software services, textiles, and pharmaceuticals remained resilient, contributing positively to the trade balance.
  - **Production Linked Incentive (PLI) Schemes:** The government's PLI schemes have started yielding positive outcomes, enhancing export competitiveness in sectors like electronics and renewable energy components.
- **Labor Markets and Employment:**
  - **Employment Trends:** The labor market witnessed steady improvement.
  - Urban employment rates improved with the expansion of tech and service industries, while rural employment benefited from higher agricultural output and government rural employment schemes.

Inflation Trends:

Domestic:

- Headline CPI in India declined to a five-month low of 4.3 per cent in January 2025 from 5.2 per cent in December 2024.
- Food inflation decelerated to 5.7 per cent in January from 7.7 per cent (y-o-y) in December.
- Core inflation increased to 3.7 per cent in January 2025 from 3.6 per cent in December.
- Among the subgroups, inflation edged up in housing, household goods and services, transport and communication, and personal care and effects subgroups; it remained steady in clothing and footwear, and health; and moderated in pan, tobacco and intoxicants, recreation and amusement, and education.
- In terms of regional distribution, rural and urban inflation was at 4.6 per cent and 3.9 per cent, respectively, in January 2025.

Bond Yields & Spreads:

- Indian yields trended higher in February despite rate cut, as markets were disappointed on status quo on stance at "neutral".
- Wide ranging and disruptive tariffs are affecting global markets as uncertainty remains high.
- US 10Y yield trended lower to around 4.2%, as ongoing tariff war is expected to lead to slower global growth.
- The Indian 10Y yield was marginally higher at 6.73% end February.
- Debt FII flows turned positive in CY2025, as Union Budget remained focus on fiscal consolidation and RBI cut rates. RBI Open market operations (OMO) purchase may have further added to positive sentiment.
- US FED policy remained status quo as Trump administration's policies may likely have inflationary impact.
- Liquidity measures like OMO purchase, longer duration USD/INR buy swaps and long term VRR (variable rate repo) auctions were undertaken by RBI to increase durable liquidity in the system.
- Corporate bonds moved in tandem with sovereign with overall yields marginally rising across the curve.

Outlook:

- US FED rate cut expectations turned sour as inflation remains sticky and growth resilient. Though US FED cut rate by 100bps in 2024, it remained on hold in January 2025. Further rate action is contingent on inflation easing on sustainable basis.
- US yield are likely to benefit from tariff war, as growth may get impacted in US.
- Liquidity has eased to a certain degree however RBI may need to do conduct more liquidity enhancing measures like OMO purchases to have sustainable level of durable liquidity
- FII flows have improved in February and remain positive, despite FII equity seeing substantial outflows.
- 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 and other indices, as the demand for Government Securities (G-Sec) is likely to drive yields downward.
- We expect RBI to reduce rates again in April policy, as growth is moderating, and inflation is likely trending towards 4%. Further, the ongoing tariff disruptions may lead to slower global growth in near term.
- We are structurally long on India as growth inflation dynamics are still favorable for yields to tick down as RBI may have to resort to few more rate cut as growth slows.
- We anticipate that over the next few months, 10-year yields may trade in 6.60 – 6.80% range.

Source: RBI, MOSPI, PIB, CMIE, NSDL, S&P Global, Ministry of Commerce and Industry, Reuters, Bloomberg, Internal Research. Note: Data updated as available in the beginning of the month.

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