

## Macro Review & Fixed Income Market Outlook

### Global Economy Update:

#### Macro Backdrop:

- ✚ The outlook for the global economy remains ambivalent, driven by a dichotomy in macroeconomic conditions across regions.
- ✚ While expectations of a 'Goldilocks' soft landing in the US are strengthening, concerns about slowdowns in China and Europe are rife.
- ✚ The impact of aggressive monetary tightening is spreading, with the services sector joining housing, bank lending and industrial production in a loss of momentum.
- ✚ Global supply chains have been under pressure, which along with rising global commodity prices contributed to multi-decadal high inflation in 2022.
- ✚ The resultant aggressive monetary tightening has dampened the global growth outlook.
- ✚ Tight financial conditions and volatile capital flows are accentuating the impact of global slowdown on the prospects of emerging and developing economies.
- ✚ Headline inflation is now easing unevenly across countries but remains above the target in major economies.
- ✚ The pace of monetary tightening has been scaled down, but policy rates could stay higher for longer in several countries.
- ✚ Even as the grim prospects of hard landing have receded, global growth is likely to remain low by historical standards in the medium-term.
- ✚ Global manufacturing output contracts as demand weakens in September.
- ✚ Manufacturing PMI edges up to 49.1. Output declines in intermediate and investment goods sectors.
- ✚ Global trade activity continues to face significant headwinds.
- ✚ Export orders for manufacturing, as evident from PMIs, remained in contraction in August, in spite of a modest sequential improvement.
- ✚ Export orders for services, however, remained in the expansionary zone, partly offsetting the drag from manufacturing.

### Indian Economic Growth:

#### Macro Backdrop:

- ✚ Amidst such volatile world environment, India stands out as the emerging growth engine for the world.
- ✚ India's real gross domestic product (GDP) recorded a growth of 7.2 per cent in 2022-23, surpassing its pre-pandemic level by 10.1 per cent.
- ✚ Overall, the conditions are favourable for the growth momentum to continue and the capex cycle to gain momentum in 2023-24.
- ✚ Opportunities are now promising and can be utilised to propel the economy to a higher growth trajectory.
- ✚ The challenge of high inflation, however, persists and needs to be effectively addressed.
- ✚ After reaching a low of 4.3 per cent in May 2023, headline inflation has risen to 7.4 per cent in July '23 driven by the surge in tomato and other vegetable prices. It moderated to 6.8% on Aug' 23.
- ✚ The seasonally adjusted S&P Global India Manufacturing Purchasing Managers' Index (PMI) fell to 57.5 in September, down from 58.6 in August.
- ✚ The PMI for services moderated in August from a 13-year high last month due to moderation in new business, although the index remains in the expansionary zone, well above its historical average.

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- ✚ Exports from India declined by 6.9% year-on-year to USD 34.48 billion in August 2023, due to elevated commodity prices and weakening foreign demand.
- ✚ India's goods and services tax (GST) collections reached Rs 1.63 lakh crore in September, a 10% increase compared to the same period last year.

## Inflation:

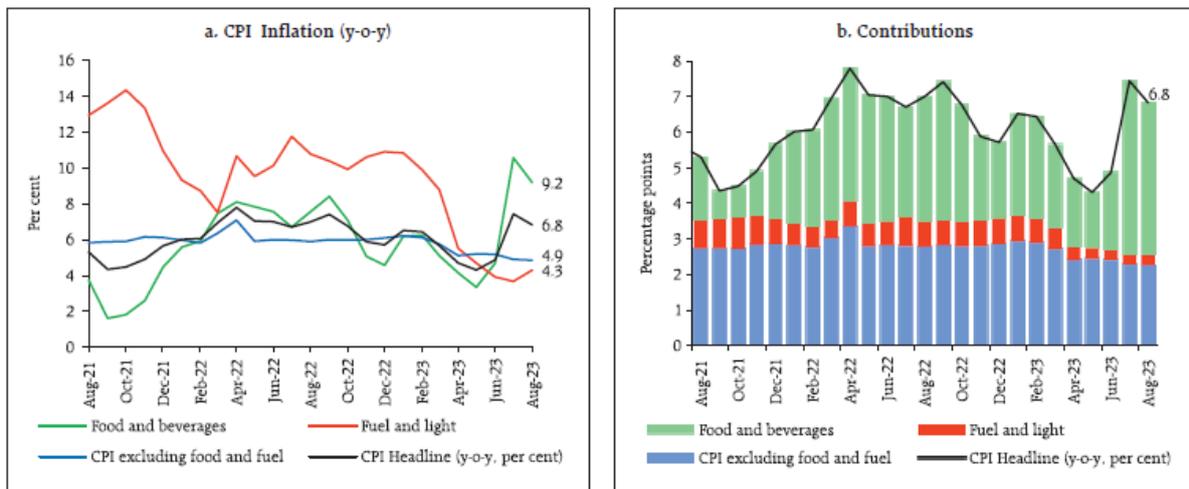
### Global:

- ✚ Headline inflation, which receded from multi-year peaks over the course of last year, recorded a marginal uptick or a slowdown in the pace of its decline in most economies during July-August.
- ✚ As per flash estimates, Euro area inflation remained steady at 5.3 per cent (y-o-y) in August 2023. In the US, CPI inflation increased to 3.7 per cent in August from 3.2 per cent in July. However, Core CPI in US fell to 4.3% from 4.7%, continuing a declining trend.
- ✚ Inflation based on the US personal consumption expenditure (PCE) price index edged up to 3.3 per cent in July from 3.0 per cent in June.
- ✚ CPI inflation eased in the UK, to 6.8 per cent in July 2023, the lowest since February 2022, and in Japan (CPI excluding fresh food) to 3.1 per cent in July (3.3 per cent in June).
- ✚ Core and services inflation continue to rule above headline inflation in major AEs.
- ✚ Among the emerging market economies (EMEs), inflation edged up in Brazil, China, and Russia in August.

### India:

- ✚ CPI inflation moderated to 6.8 per cent in August 2023 from 7.4 per cent in July.
- ✚ Food inflation (y-o-y) fell to 9.2 per cent in August from 10.6 per cent in July as the negative momentum was reinforced by a favourable base effect.
- ✚ In terms of sub-groups, inflation in vegetables softened sharply, though it remained elevated.
- ✚ Inflation moderated in cereals, milk, pulses, and prepared meals, while it edged up in spices, fruits, eggs, meat, and fish.
- ✚ Edible oils continued to record deflation, albeit at a lower rate. Inflation in the fuel and light group increased to 4.3 per cent in August from 3.7 per cent in July.
- ✚ Electricity prices recorded double-digit inflation (13.5 per cent y-o-y).
- ✚ While inflation in LPG prices softened in line with a sequential decline in prices, kerosene prices recorded a lower rate of deflation.
- ✚ Higher oil prices could impact short term inflation trajectory and impact growth.
- ✚ Government could mitigate higher pump prices by reducing excise duties, if required.
- ✚ In terms of regional distribution, rural inflation at 7.02 per cent was higher than urban inflation at 6.59 per cent in August 2023.
- ✚ Majority of the States registered inflation in the range of 6-8 per cent. Arunachal Pradesh, Goa, and Delhi experienced inflation of less than 4 per cent.

## Trends and Drivers of CPI Inflation:



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

## Bond Yields & Spreads:

- Global central banks continue to remain extremely data dependent as inflation remains higher than their respective goals, punctuated by slowdown in inflation moderation.
- US FED held rates in September policy but indicated one more rate hike may be possible. Further, it moderated its pace of rate easing in 2024.
- US 10Y yields grinded higher as growth continues to remain robust with soft-landing narrative taking hold, as well larger supplies of treasuries hitting markets.
- Higher US yields has led to commensurate rise in global yields as negative US bond sentiments battered global currencies on US dollar strength.
- US 10Y climbed to 4.57% by Sep end, rising almost 47 bps from end August.
- With global rates firming up on good growth data and hawkish central banks, 10Y G-Sec yield went to around 7.21% in September (new 10Y). This was only a marginal increase from 7.18% from end August, considering sharp rise in US yields. Sentiment remained positive in September on back of news of imminent inclusion in JP Morgan Bond Index.
- Indian Bonds were included in JP Morgan Emerging Bond index in a big fillip for bond markets. The inclusion is likely to start from June 24 and will end in March 25. India is likely to have a weightage of 10% in the index. This is likely to draw in USD 20-22 billion of flows in FY25.
- Inclusion in JP Morgan is likely to prompt other index providers like Bloomberg to add Indian bonds to their indices as well.
- Medium to long term corporate spreads remained on lower side in absence of any material increase in supply.

## Outlook:

### Global:

- The global economy continues to confound central bankers, as growth sustains despite sharp rise in rates in last 15 months. Recession fears have receded, and markets are forecasting a “soft landing” scenario as a high probability.
- Inflation seems to have peaked in major countries, though reasons to cheer may still be far away, as the momentum of drop in inflation has slowed down, belying market expectations of a quick “pivot” in policy rates.

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- ✚ With core inflation rates remaining sticky, Central banks are failing to provide forward guidance and remain highly data dependent.
- ✚ US FOMC seems to be at the end of rate hike cycle but continues to indicate probability of rate moves on incoming data.
- ✚ Rate markets rose sharply in September on hawkish FED with expectations of rate easing in immediate future receding.
- ✚ With rate markets adjusting to “higher rates for longer” scenario, markets will continue to be moved by incoming data.

## India:

- ✚ In India, macro situation remains resilient.
- ✚ Recent increase in oil prices could impact inflation, however government is unlikely to increase pump prices of petrol or diesel ahead of elections.
- ✚ There is room available to cut excise duties, if required
- ✚ While monsoons have been below normal, the spikes in vegetables have tapered. Crop output is expected to be normal, though certain items like cereals and pulses continue to show inflationary trends.
- ✚ GOI has taken several steps to manage primary inflation. This should continue to bring down inflation in the near term. Fresh arrival of kharif crop in September should have salutary impact on inflation.
- ✚ Core inflation remains under control, which will likely dissuade RBI MPC from any rate hike action.
- ✚ With RBI projecting inflation to be 5.4% for FY2024, it remains above their 4% medium term policy target. Coupled with strong growth numbers, there is no pressure on the RBI to ease any time soon.
- ✚ This may keep RBI on hold for much longer as it sees the impact of higher food prices on overall inflation trajectory.
- ✚ The second half borrowing calendar announced in Sep end was in line with budgeted amount of Rs.6.55 lac crore with no increase.
- ✚ Markets are likely to remain volatile as the narrative of “rates higher for longer” takes hold.
- ✚ Markets are likely to be driven by global rate cues i.e., US yield movements and oil prices.
- ✚ Local conditions remain favorable to bonds considering falling inflation as well inclusion in JP Morgan Index.
- ✚ The government borrowing remains within budgeted amount keeping fiscal under check.
- ✚ In the near term, 10Y yield may move in a range of 7.15%-7.25%.

Source: RBI, MOSPI, CMIE, FIMMDA, NSDL, Bloomberg, Internal Fund Manager Views.

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