CANARA ROBECO

Macro Review & Fixed Income Market Outlook

Global Economy Update:

Macro Backdrop:

- Global economic activity appears to be strengthening across advanced economies (AEs) and emerging market economies (EMEs) and global trade in goods and services is gathering momentum.
- The International Monetary Fund (IMF), in its latest World Economic Outlook (WEO) update released on July 16, 2024, maintained the global growth forecast for 2024 at 3.2 per cent (same as its April 2024 projection) and revised the growth forecast up by 10 bps to 3.3 per cent for 2025.
- Monetary policy divergence is setting the tone for global economic developments.
- According to the World Bank, economic surprise indices suggest that activity is exceeding expectations on the upside for AEs and by a greater margin among EMEs.
- Sentiment indicators also indicate that economic conditions and expectations remain solid.
- In terms of purchasing managers' indices, EMEs continued to outperform AEs for a second straight year, with India ahead of the rest on the back of robust growth expectations.
- Labour markets are easing from historically tight conditions and wage growth is slowing.
- Global trade is gathering momentum across goods and services, fuelled by positive trade dynamics in the US and strong export performance in Asia.
- The global composite purchasing managers index (PMI) posted an expansion for the eighth consecutive month albeit with a sequential moderation to 52.9 in June from 53.7 in May.
- Rates of expansion eased month-on-month (m-o-m) for both manufacturing production and service sector business activity.
- The global manufacturing PMI softened to 50.9 in June from May's two-and-a-half year high while the services PMI slowed to 53.1 in June from 54.0 in May.
- Despite the sequential moderation, growth is becoming broad-based, with all 25 subsectors covered by the PMI recording an expansion (as evident in the Index value of above 50) in June 2024 for the first time since July 2021.

Indian Economic Growth:

Macro Backdrop:

- The Indian economy sustained a strong growth momentum, despite geopolitical headwinds and some build-up of supply chain pressures.
- The improvement in the outlook for agriculture and the revival of rural spending have turned out to be the bright spots in the evolution of demand conditions.
- Domestic demand conditions have remained robust during Q1:2024-25 as evinced by movements in high frequency indicators.
- Automobile sales recorded a growth of 18.2 per cent (y-o-y) in June 2024, led by two-and-three wheelers followed by passenger vehicles, even as growth for entry level vehicles continued to remain weak.
- With improving farm sentiments, domestic tractor sales reached an eight-month high in June 2024, with total volumes surpassing the one-lakh mark.
- The HSBC final India Manufacturing Purchasing Managers Index came in at 58.1 in July after clocking 58.3 in June, 57.5 in May, and 58.8 in April.
- Merchandise exports register positive growth of 2.55% at USD 35.20 Billion in June 2024 as compared to USD 34.32 Billion in June 2023.
- Cumulative value of exports during April-June 2024 stands at USD 109.96 Billion as compared to USD 103.89 Billion during April-June 2023, registering a positive growth of 5.84%.

- Merchandise exports during June 2024 were USD 35.20 Billion as compared to USD 34.32 Billion in June 2023.
- Merchandise imports during June 2024 were USD 56.18 Billion as compared to USD 53.51 Billion in June 2023.
- Gross GST revenue collection in July 2024 stands at ₹1.82 lakh crore; Records 10.3% y-o-y growth.

Inflation:

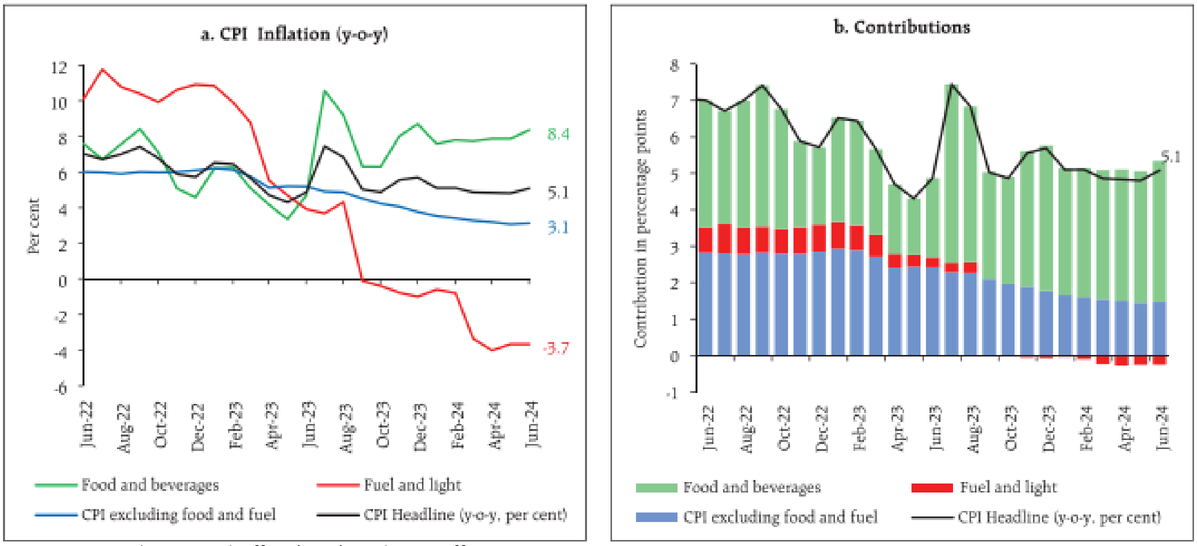
Global:

- Headline inflation continued its gradual descent in most of the economies.
- In the US, CPI inflation moderated to 3.0 per cent (y-o-y) in June from 3.3 per cent in May, and the index recorded a m-o-m decline for the first time since May 2020 on the back of declining gas and automobile prices.
- As per flash estimates, euro area inflation edged lower to 2.5 per cent in June from 2.6 per cent a month ago, despite sticky core and services inflation.
- Among EMEs, inflation increased in Brazil and Russia while it softened in China in June.
- Core and services inflation have been trending down in advanced economies although they remain higher than the headline in most of them.

India:

- CPI inflation edged up to 5.1 per cent in June 2024 from 4.8 per cent in May.
- The 28 bps increase in inflation came from a positive momentum of 133 bps, which more than offset a favourable base effect of 106 bps.
- The m-o-m increase in overall CPI was on account of positive momentum of 269 bps in food, 6 bps in fuel and 12 bps in core group (i.e., excluding food and fuel).
- Food inflation (y-o-y) firmed up to 8.4 per cent in June from 7.9 per cent in May as the positive price momentum more than offset a favourable base effect.
- In terms of the regional distribution, rural inflation stood at 5.7 per cent in June 2024, higher than urban inflation at 4.4 per cent.
- Majority of the states registered inflation less than 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 July 24 on global cues as well as on passive flows from June 24 on back of inclusion in JP Morgan EM Bond Index.
- India 10Y benchmark traded lower on positive sentiments post Union Budget, which lowered the budgeted fiscal deficit to 4.9% of GDP for FY2024-25. The 10Y yield fell to around 6.91%.
- Markets are pricing first US FED move in September 2024, post a dovish FOMC on 31st July 2024.
- Markets are pricing in one more rate cut in 2024 from US FED.
- RBI expected to remain in status quo mode in the upcoming August Monetary Policy (MPC) meet, though market will keenly watch for change of stance, if any.
- 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 steepened as rate cut from US FED lead to rally in short term bonds. Long term bonds rally was muted, leading to curve steepening.
- Corporate bond moved in tandem with sovereign with overall yields softening across the curve.

Outlook:

- The government surprised in the Union Budget 2024-25 (in July 2024, post the general elections) by reducing the fiscal deficit to 4.9% of GDP (from 5.1% announced in interim budget 2024-25), though the government borrowing number was only marginally lower.
- However, the budget continued with the fiscal consolidation efforts, which enthused markets and overall yields softened post Budget.
- 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.
- 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 from June 24. Overall, CYTD FIIs have invested over USD 11 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, 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 6.85 - 7.00% range.

Source: RBI, MOSPI, PIB, CMIE, FIMMDA, NSDL, IMF, J.P.Morgan, ECI, S&P Global, Bloomberg, Internal Research.

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

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