

CANARA ROBECO

Macro Review & Fixed Income Market Outlook - September 2025

- **Global Macro Review**
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- **Inflation Trends**
- **Bond Yields & Spread Movements**
- **Fixed Income Fund Manager Outlook**

Global Economy Update:

Macro Backdrop:

- In August 2025, the global economy expanded moderately but unevenly, with the IMF revising its 2025 and 2026 growth forecasts slightly upward to 3.0% and 3.1%, respectively.
- Strong service sector activity and robust emerging market demand supported growth, but advanced economies like the Eurozone faced weak manufacturing and slower exports.
- Downside risks persisted, driven by increased trade tariffs, sticky goods inflation, and ongoing geopolitical tensions.
- **Purchasing Managers' Index (PMI):**
 - **United States:** The S&P Global US Composite PMI rose to 55.4 in August 2025, an eight-month high, indicating robust private sector growth driven by a strong rebound in manufacturing activity, which hit a 39-month peak. Services activity also remained in solid expansion, though it dipped slightly from the previous month. Overall, the PMI signaled the fastest pace of expansion seen so far in the year.
 - **Eurozone:** The HCOB (Hamburg Commercial Bank) Eurozone Manufacturing PMI rose to an over-three-year high of 50.7 in August 2025 from 49.8 in July 2025, surpassing the 50.0 threshold that separates growth from contraction.
- **Unemployment Trends:**
 - **United States:** Labor markets showed initial signs of strain. In the U.S., job creation slowed in July and August, with the unemployment rate rising to 4.2%. This has raised concerns about the durability of household demand and growth momentum.
 - **Eurozone:** In the Eurozone, unemployment remained steady at 6.2% in July 2025, but weak forward-looking indicators in the manufacturing sector suggested vulnerability to global trade disruptions.
- **Trade:**
 - The United States implemented a broad tariff package effective August 7, 2025, which raised the average effective tariff rate to about 16%.
 - Country-specific levies reached as high as 30%-50% on certain imports.
 - Global merchandise trade remained stagnant, while services trade expanded by around 5% year-on-year in Q1 2025, driven by strong demand in Asia.

▪ **Monetary Policy:**

European Central Bank (ECB):

- Since February 2025, the ECB slashed rates thrice by 25 bps, now at 2.00%, with one more cut likely to 1.75%; signaling forceful action against persistent supply shocks.
- ECB is likely to continue gradual easing, capping ahead of next strategy review in 2030.

U.S. Federal Reserve:

- The Federal Reserve held rates at 4.25-4.50% in July 2025, emphasizing a data-dependent approach amid stagnant and sticky inflation and trade-related risks.
- Fed is expected to begin easing in September-December 2025, targeting a terminal rate near 3.50% by 2026.

Other central banks, such as the **Bank of England** and **Bank of Japan**, maintained a cautious stance.

Inflation Trends:

Global:

- CPI inflation in the US remained steady at 2.7 per cent in July, though core inflation reached a six-month high of 3.1 per cent.
- In the Euro area, headline inflation held steady at 2.0 per cent marking the second consecutive month that inflation has aligned with the European Central Bank's official target.
- Inflation in the UK rose to its highest level since January 2024, while Japan's inflation dropped to an eight-month low.

Indian Economy Update:

Macro Backdrop:

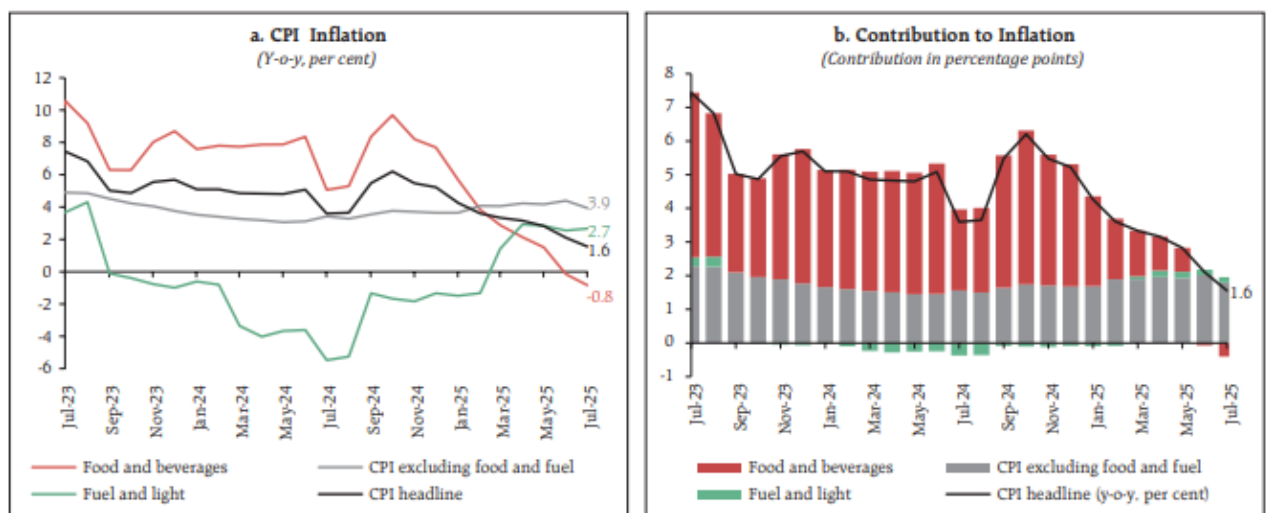
- Amidst a challenging global environment, Gross Domestic Product (GDP) of the Indian economy at constant (2011-12) prices witnessed a growth of 7.8% YoY in the first quarter of FY26, supported by strong domestic consumption and investment.
- Purchasing Managers' Index (PMI):**
 - The HSBC India Composite PMI for August 2025 was 65.2, a significant surge from 61.1 in July 2025, marking the fastest growth in the private sector since survey data began in December 2005. This strong expansion was driven by record growth in the services sector and robust performance in manufacturing.
- Trade and Tariffs:**
 - The United States imposed additional tariffs on Indian exports effective August 7, 2025.
 - These included an across-the-board 25% duty, with certain categories such as textiles, gems and jewellery, footwear, furniture, seafood (particularly shrimp), and chemicals now facing duties as high as 50%. Industry experts estimate that the tariff shock could reduce India's FY26 GDP growth by 0.3-0.8 %, if sustained.
 - Exporters are already reporting order cancellations and renegotiations.
- Unemployment Trends:**
 - According to CMIE (Centre for Monitoring Indian Economy) data, India's unemployment rate declined to 6.8% in July 2025, the lowest in nearly three years. This improvement was driven by rural employment gains linked to the agricultural season and strong hiring in the services sector.

Inflation Trends:

Domestic:

- Headline CPI in India was at 1.6% in July 2025 (the lowest since February 2019) from 2.1% in June 2025.
- Food inflation dipped to its lowest level in 78 months driven by a deflation in vegetables, pulses, spices, and meat and fish sub-groups.
- Fuel and light inflation inched up in July with inflation remaining elevated for LPG while moderating for electricity.
- Core inflation eased to 3.9 per cent in July 2025 from 4.4 per cent in June 2025.
- The decline in inflation was mostly driven by transport and communication and education sub-groups, while inflation in health and personal care and effects inched up.
- Clothing and footwear recorded a marginally lower inflation, while that in pan, tobacco and intoxicants, household goods and services, and housing remained unchanged.

Trends and Drivers of Inflation:



Sources: NSO; and RBI staff estimates.

Bond Yields & Spreads:

- Indian yields rose in August on double shock of US tariffs and announcement of GST rate reductions by the Prime Minister (which may lead to fiscal slippage).
- Despite CPI inflation slipping to 1.6% in July 2025, RBI MPC (Monetary Policy Committee) chose to maintain status quo in August 2025 meet while maintaining a neutral stance.
- US rates trended lower on expectations of US FED cutting policy rates in September 2025, after data revisions showed weakness in labor market.
- Corporate bonds moved in tandem with sovereign with overall yields rising across the curve.
- Short term bonds yields rose more as rate cut probability is very low.

Outlook:

- US FED may reduce rates by 25bps in the upcoming September 2025 policy meet. This may lead to further fall in US rates.
- The fiscal deficit of the US continues to remain a concern, while chaotic trade policy keeps the markets guessing on the potential outcomes and impact on US economy.
- After pumping liquidity in early part of 2025, RBI chose to start weekly Variable Rate Reverse Repo (VRRR) auctions to withdraw short term liquidity from the system, endeavoring to bring the overnight rate near the weighted average call rate.
- Withdrawal of liquidity may lead to flattening of curve in the short end as short term rates react more to liquidity changes.
- FII flows were positive in July 2025 as higher India bond yields attracted investors.
- We expect RBI to remain on a long pause, if growth remains on track. Any change in momentum in growth trajectory may push RBI to respond, if inflation remains within target of 4%.
- Market participants are awaiting any news on slippage in fiscal deficit due to GST cuts. In case, government borrowings do not change, markets may recover from current levels.
- Liquidity is ample and RBI is trying to manage excess short term liquidity through VRRR operations. Debt Market sentiments are more likely to be influenced by any news on fiscal slippage, geo-political tensions, and evolving US tariff situation.

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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