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1. Global Economic Outlook

Global economic activity

Global economic activity remained resilient amidst the persistence of inflation at elevated levels, turmoil in the banking system in some advanced economies (AEs), tight financial conditions and lingering geopolitical hostilities.
Recent financial stability concerns had triggered risk aversion, flights to safety and heightened financial market volatility. Sovereign bond yields fell steeply in March on safe haven demand, reversing the sharp increase in February over aggressive monetary stances and communication. Equity markets have also declined, and the US dollar has pared its gains. Weakening external demand, spill overs from the banking crisis in some AEs, volatile capital flows and debt distress in certain vulnerable economies weigh on growth prospects.

Meanwhile, the International Monetary Fund expects global economic growth to dip below 3% in 2023 and to remain at around 3% for the next five years. Strong monetary and fiscal policy actions to respond to the COVID-19 pandemic and Russia's invasion of Ukraine had prevented a much worse outcome in recent years, but growth prospects remained weak given persistently high inflation. Bank failures in Switzerland and the United States which exposed financial vulnerabilities, have also increased the downside risks for the global economy.

Solid US jobs data keeps Fed on track for rate hike in May

A historically low U.S. unemployment rate and rising wages will likely keep the Federal Reserve on track to raise interest rates by another quarter of a percentage point next month, as risks of a financial crisis ease while concern about inflation remains high. U.S. job growth is slowing, something Fed policymakers have anticipated as they raised borrowing costs. But the economy still added 2,36,000 jobs in March and has averaged gains of 3,45,000 per month during the first quarter, well above the level the central bank sees as consistent with its 2% inflation goal.

2. Domestic Economy Outlook

RBI pauses Rate hike in a surprise move

In a move that was not widely anticipated, the Monetary Policy Committee (MPC) of RBI kept policy repo rate unchanged at 6.5%. The decision marks a pause in the continuous hike in repo rate that commenced in May 2022. Since then, the MPC has hiked policy rate by 250 basis points (bps) in 6 successive rounds of MPC meetings, of which the first one was an off-cycle hike. The MPC continued with its focus on 'withdrawal of accommodation' in order to bring down inflation within the upper band of 6%.
The tone of the policy was rather hawkish as the RBI highlighted inflationary risks and said it would not refrain from taking further action if required –thereby, becoming "data dependent" and keeping the "door open for future hikes". RBI also emphasised that this "pause" in rate hike cycle should not be seen "pivot". However, for all practical purposes, macro conditions would have to change significantly from current levels to trigger further rate hikes by the RBI. Analysts expect no more rate hikes by the RBI going forward and see an "extended pause" as the most likely scenario.

Upward revision in growth to 6.5% (FY24)

The RBI's MPC made an upward revision in the gross domestic product (GDP) growth forecast for the current fiscal year to 6.5% from the earlier 6.4% is optimistic in the backdrop of slowing private consumption and continued global uncertainties.

The MPC's growth outlook was based on factors including robust rabi production that has improved prospects for the rural economy, steady growth in contact-intensive services as well as the government's focus on capital expenditure. RBI's surveys also pointed out that businesses and consumers are optimistic about the outlook.

The upward revision in the growth forecast by the RBI comes just days after the World Bank and the Asian Development Bank lowered their GDP estimates for the fiscal to less than 6.5%. While the World Bank has pegged the economy to grow at 6.3% this fiscal, the ADB expects it to grow by a notch higher at 6.4%. Most agencies expect GDP to grow at a more subdued 6% or so in the current fiscal after 7% growth in FY23.

Consumer confidence remains on recovery path

RBI', s bi-monthly consumer confidence survey (CCS) vey showed confidence continues to recover from the historic low recorded in mid-2021, although it remained in the pessimistic zone. Households' overall outlook for the year ahead remained in positive terrain despite marginally lower optimism. The current situation index rose by 2.2 points to 87 from 84.8 on account of improved perception on general economic situation, employment, and household income. The latest round of the survey was conducted during 2-11 March 2023, covering 6,075 respondents.

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With an uptick in current perception, the sentiments on employment are nearing the levels seen around mid-2019; consumers are also optimistic about the employment outlook as more than half of the respondents expect employment scenario to improve over the next one year. Household spending was buoyant on the back of higher essential and non-essential spending; more than a third of the households expect a rise in non-essential outlay over the next year.

3. Inflation Outlook

March inflation to remain sticky

Inflation is expected to be close to 6.2% in March compared to 6.44% in February. The marginal fall in retail inflation is likely to come from the food group. Specifically, the cereals & products group is likely to witness a fall in inflation in March 2023. The Food Corporation of India (FCI), through the six auctions, cumulatively sold 3.38 million tonnes of wheat which has brought prices down very dramatically in March. Thus, inflation in wheat is expected to fall from 25.37% in February to 7% in March.

Meanwhile, the RBI revised down FY24 inflation estimate by 10 bps to 5.2%. On a quarterly basis, the central bank revised down Q4FY24 estimate to 5.2% from 5.6% and left estimates for Q2 and Q3 unchanged. As per the RBI, normal monsoon and robust Kharif production are likely to check food inflation. The central bank also emphasised that easing cost conditions could slow the pace of output price increase in manufacturing and services sector.

However, significant upside threats to inflation persist. The sudden cut in crude oil production by the Organisation of Petroleum Exporting Countries (OPEC) and by 1.16 million barrels per day from May to December 2023 portends a serious threat to global inflation.

On the domestic front, milk prices are also likely to remain firm. Extreme climatic conditions such as unseasonal rains in March 2023, high temperatures expected in April 2023 and the heightened possibility of El-Nino adversely affecting the upcoming southwest monsoon present significant upside threats to inflation.

4. Interest Rate Outlook

Rupee eyes gains amidst RBI rate hike pause

The RBI surprised markets last Thursday by holding rates steady but kept the door open for more hikes if needed. This could have been rupee negative, but the relief on India's current account front from improving trade deficit and the expectations of a softer U.S. Federal Reserve make us think the rupee's prospects remain strong.

Bond yields may dip in data-heavy week

The Indian rupee is likely to continue its positive run and bond yields are expected to ease in the upcoming data-packed week that also includes the release of crucial U.S. inflation figures. For the coming week, Investors will be awaiting March inflation figures for U.S. and India due on Wednesday (12 April), with the former being closely scrutinised to see if it would add to recent views that the Fed may be near the end of its rate hiking cycle. The minutes of the U.S. central bank's March meeting, in which it hiked rates by 25 bps but also sounded dovish, will be released on Wednesday (12 April) as well. During the week 03-10 April 2023, the 10-year bond yield fell by 10 basis points (7.31 to 7.21). A similar significant decline was witnessed cross all tenures.

Stable long term Yield outlook

Indian government bond yields, especially at the shorter end of the curve, are expected to dip further this week, as sentiment remains bullish after the RBI's surprise. If the central bank's projections holdup and there are no surprises, the pause in rate hike is expected to be an extended one. The market has started building expectation that we are at the end of the cycle and yields across the board could adjust themselves to the terminal policy rate. Going forward, tightening could continue in the form of normalising liquidity conditions which would imply that the yield curve could remain flat for some time and further transmission of past rate hikes could mean some more increase in money market rates. The 10-year bond yield dropped by 6 bps post the policy announcement to 7.21%.

Weekly Benchmark Bond Yield Movement (%)

Date	03 April	04 April	05 April	06 April	07 April
USA 10 years	3.41	3.35	3.30	3.30	3.41
India 10 years	7.31	--	7.27	7.21	--
India 5 years	7.20	--	7.15	7.02	--
India 3 months	6.93	--	6.92	6.83	--

Source: CMIE, worldgovernmentbonds.com

We see some rise towards a 7.18-7.30% range in the coming weeks as the oil price risk remains, and the government's weekly bond supply could put pressure on yields.