Market Outlook

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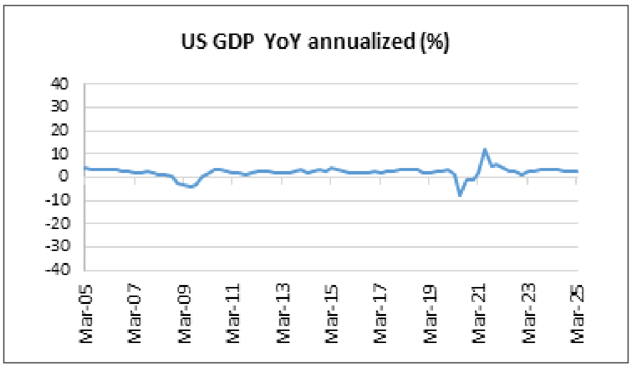
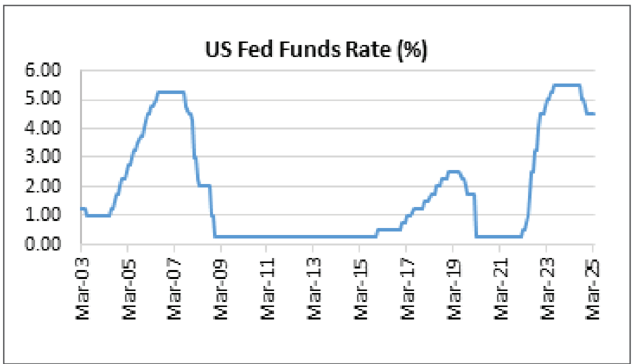
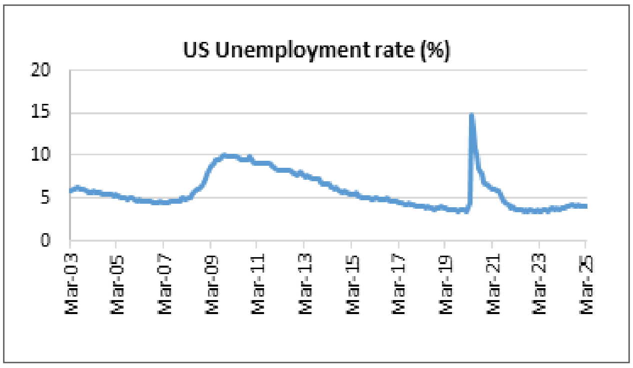
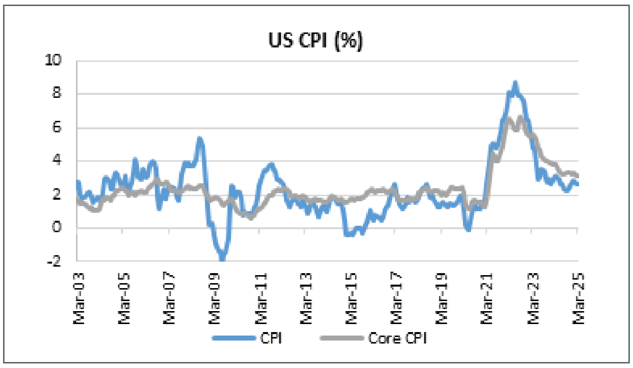


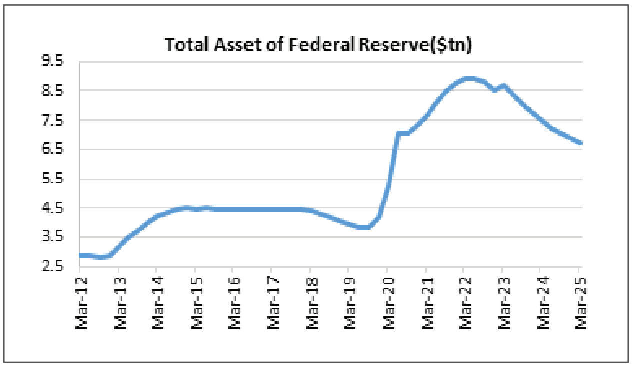


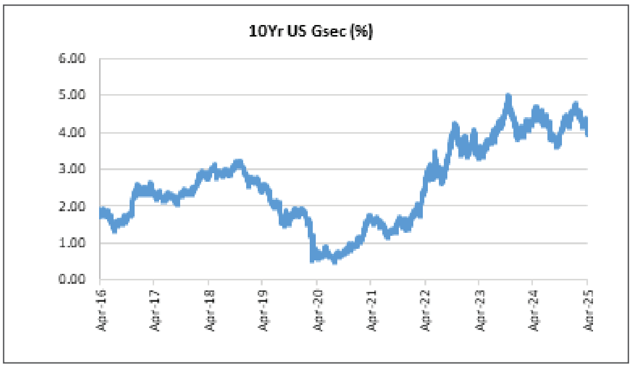


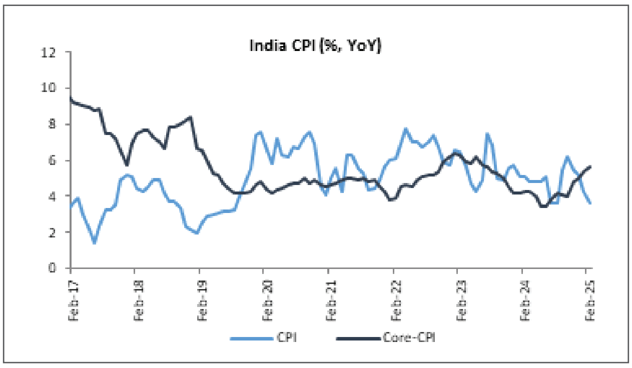


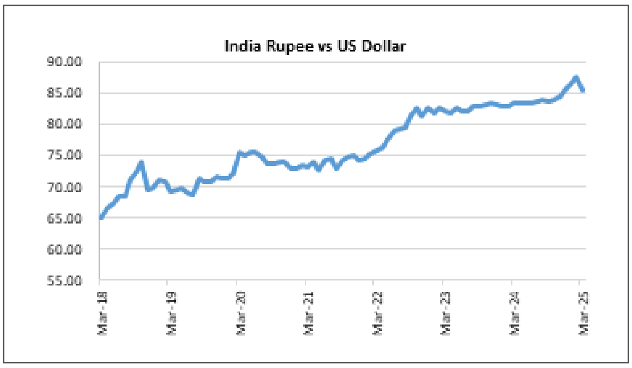
Global Macro Review

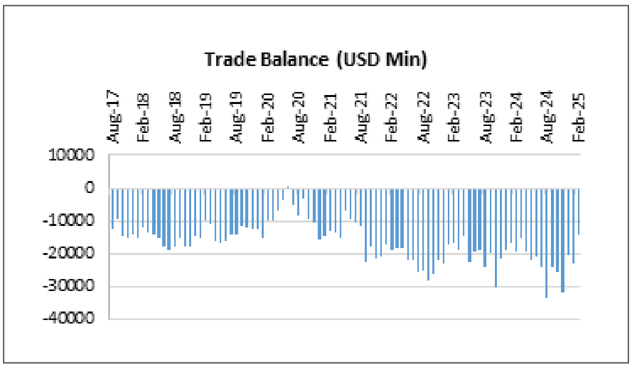
- The US Real GDP increased 2.8% in 2024. The increase in real GDP in 2024 reflected increases in consumer spending, investment, government spending, and exports. US growth has, so far, proven resilient. Donald Trump was elected President in Nov 2024 and took office in January 2025. After the initial euphoria, concerns on the impact of economic measures, notably rising tariffs and related uncertainty, are raising concerns of elevated inflation and recession risks weighing on markets. The Chinese economy is unlikely to be a major contributor to global growth and demand in the coming year. However, the opening up of China has put some downward pressure on prices globally, spurred by robust Chinese exports.
- The Fed, after cutting rates by 100bps in 2024 has paused its rate cutting cycle citing economic uncertainty.
- The US labour market has largely held up, although there are concerns of unemployment rising owing to federal government job cuts. The US unemployment rate has been in the range of 4.0 - 4.2% in recent months. It inched up to 4.2% in Mar'25 from 4.1% in Feb'25.
- US CPI inflation has been sticky and stood at average 2.7% for 2H2025. Core inflation has remained in the range of 3.1-3.3% on account of elevated services inflation (led by house rents) which is gradually moderating. However, there are emerging concerns on the impact of tariffs on inflation and outlook remains unclear on the possible impact on the headline CPI.











- The Fed has continued with quantitative tightening, although actual tightening has lagged the Fed's announced target. Moreover, the Fed has announced a reduction in the pace of quantitative tightening (QT) from US$60bn to US$40bn beginning April.
- US yields remain elevated despite rate cuts. It rose from 3.7% in end September, to around 4.8% in Jan'25 before moderating to ~4.2% driven by concerns over an elevated fiscal deficit and tariff driven inflation.
- The ECB has cut rates by ~175bp since June'24 as growth remains weak. Growth projections for 2025 and 2026 have also been cut.
- China's economy grew at 5% in CY 2024 meeting the government's target, driven by stimulus measures, strong exports, and high-tech investment, despite challenges like weak domestic demand and demographic pressures. However, the ongoing tariff war will likely escalate and impact growth and further dampen demand outlook for FY26.

₹ Domestic Macro Review

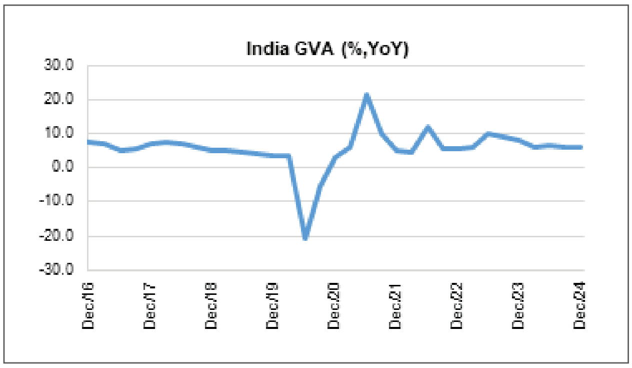
India CPI:

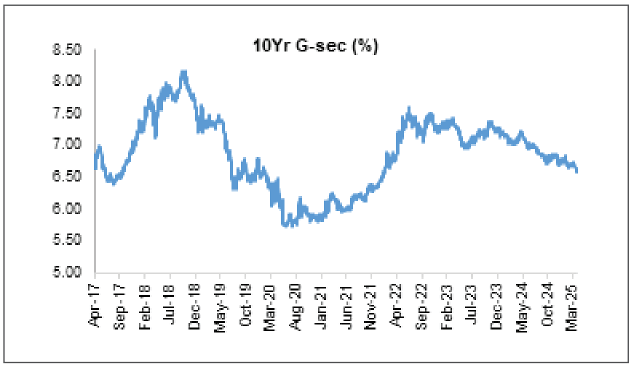
• After peaking at 6.2% in Oct'24, CPI inflation has been on a moderating trend supported by lower food inflation led by a decline in vegetable prices and stood at 3.61% as of Feb'25. Core inflation is bottoming out and stood at 4% in Feb'25 after remaining sub-4% for the whole of FY25. However, it continues to remain benign. Easing inflation has provided RBI room to cut rates.

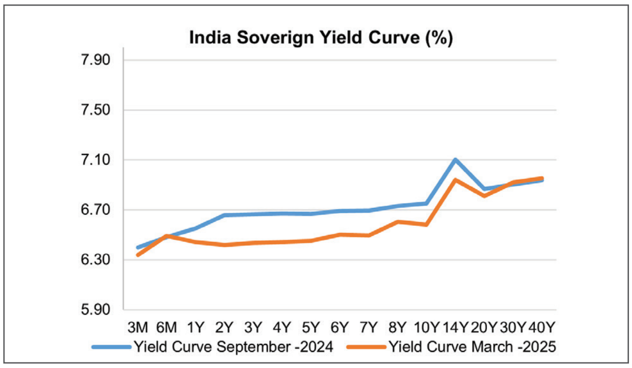
INR & India Trade Deficit:

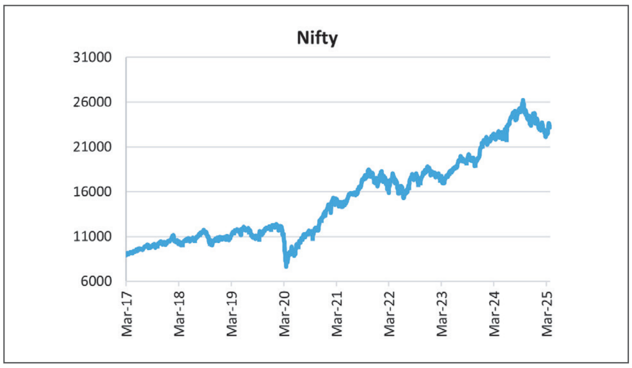
• The INR came under depreciation pressure in 2HFY25, particularly in 4QFY25 led by FPI outflows and a stronger dollar. The INR depreciated by over 4% in 2HFY25, but March saw a smart recovery limiting the extent of depreciation to ~2%. The RBI initially defended the INR through FX sales which in turn sucked out INR liquidity, but then allowed the INR to gradually depreciate.

• The trade deficit averaged US$23bn in 2HFY25 vs. US$23.3bn in 1HFY25 as gold imports remained elevated. Export growth has largely been weaker than imports. The trade deficit spiked to US$31.8bn in Nov'24 led by a jump in gold imports, but the deficit has since moderated to US$14bn in Feb'25 with moderation in gold impors. The services surplus









continues to remain strong and has seen a pickup to US$17.5bn in 2HFY25 from US$13.7bn in 1HFY25. The current account deficit in FY25 is likely to be benign at under 1% of GDP. The CAD for 9MFY25 stood at 1.3% of GDP.

India GDP:

• India's GDP growth plunged to 5.6% in 2QFY25 before recovering to 6.2% in 3QFY25. The NSO has pegged GDP growth at 6.5% in FY25 which implies GDP growth of well over 7% in 4QFY25 which seems highly optimistic. While GDP growth has bottomed out, consumption is still sluggish and government capex is patchy, while private capex recovery remains muted. Tax cuts announced in Budget 2025 may provide some boost to growth even as risks from uncertainty around tariffs remain an overhang.

Domestic Markets

Bond Market:

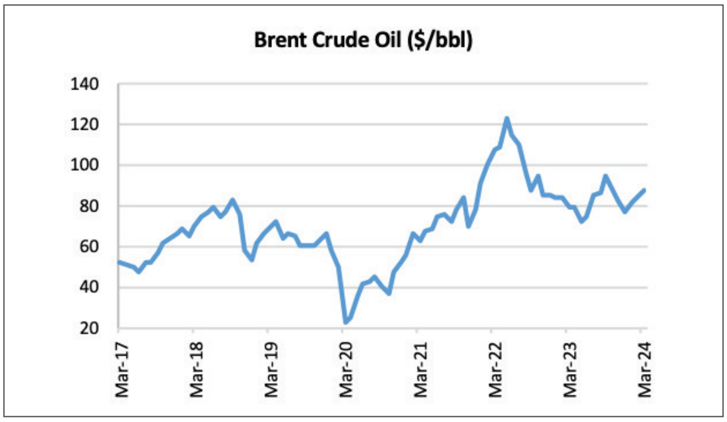
• Bond yields moderated in 2HFY25 supported by the US Fed's first rate cut in Sep, RBI's change in stance to neutral, strong FII participation in India GSec market, moderating inflation, fiscal consolidation and a slew of liquidity boosting measures by RBI - beginning with a CRR cut in Dec'24 followed by OMOs, FX swaps and daily and long term VRRs. The RBI also began its rate cutting cycle in Feb'25 with a 25bps rate cut. The 10-year has moderated from ~6.75% in Sep'24 to ~ 6.50% currently.

• The 10-year AAA spread inched up slightly in 2HFY25 due higher supply in the last quarter and the tight liquidity, as also the increased supply in SDL, leading to widening of spread from ~35bp to ~45bps, marginally above the long term average.

Equity Market:

• Indian equity markets came under significant pressure in 2HFY25 on the back of FPI selling even as DII flows held up. Tepid earnings growth and earnings growth also contributed to the sell-off in Indian equities.

• Broader markets underperformed; while Nifty 50 was down by 8.8% in 2HFY25, Nifty Midcap 100 was down by 14.1%. Banks saw relative outperformance despite moderation in credit growth as asset quality risks remained contained except in sub-segments such as Micro-finance. Bank Nifty was down by 2.7%.



Other domestic facing sectors such as Auto, real estate, energy and even FMCG etc witnessed sharp corrections. Of late, sectors such as IT and Pharma have come under pressure on concerns over slowing US growth and tariffs.

Future Outlook

• Risks to global growth are intensifying due to unexpected tariff action and limited progress in trade negotiations. Escalation in tariff war has increased the chances of global recession and higher inflation. Central banks worldwide are likely to adopt accommodative policies if the slowdown intensifies.

• The median in the Fed's 'Summary of Economic Projections' continues to project 50bps of rate cuts in 2025. Growth projections for 2025 have been revised lower, while inflation projections have been revised up. GDP growth for 2025 is projected at 1.7% (2.1% in December) while growth for 2026 is seen at 1.8% (2% earlier) and for 2027 at 1.8% (1.9% earlier). PCE inflation in 2025 is seen at 2.7% (2.5% earlier) while PCE inflation in 2026 is seen at 2.2% (2.1% earlier). Core PCE inflation in 2025 is seen at 2.8% (2.5% earlier) while it remains unchanged from previous forecasts for 2026 and 2027.

• The US yield curve has remained elevated despite rate cuts, and volatility has recently increased due to continued escalation on tariff front with concerns lingering around US growth, inflation and fiscal implication. Rising risks of a US recession and the uncertainty around tariffs has also led to a sharp correction in US equities. While the uncertainty is inevitable, the US consumer (70% of the economy) remains in relatively good shape which provides some respite. Any significant moderation in growth is likely to be met with rate cuts and liquidity support from Fed.

• The Indian economy and equity market are better-placed vs most other markets with sound macro-fundamentals, but a cyclical moderation in growth cannot be denied. While domestic flows continue to remain strong, India is not immune to global corrections. Nonetheless, the medium-term outlook for Indian equities remains quite robust.

• CPI inflation is expected to remain benign at 4.0% in FY26 according to RBI. The key risk to inflation, however, is the heat waves across key farming regions which could potentially alter the otherwise benign inflation trajectory.

• Recent data suggests that growth may be bottoming out, although unlikely to see material improvement. The moderating inflation along with weak domestic demand should pave the way for further rate cuts at a time of rising global uncertainty. Cumulative rate cuts of 100-125bps are likely in this cycle out of which 50bp cut has already been delivered. The change in stance in the recent policy along with surplus liquidity, should lead yields lower, along with some moderation in global yields.

• There are some green shoots on the rural recovery front even as urban growth is moderating. A good Rabi crop and favorable monsoons should further improve the outlook for the rural sector. Income tax cuts announced in the budget should also provide impetus for urban mass market consumption.

• Ongoing tariff war and heightened geo-political risk remain the key risks to growth and rates outlook for FY26.

Sar utha ke jiyo!