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PNB GILTS LTD
(Subsidiary of Punjab National Bank)

Economy & Gilt Watch

INSIDE THE ISSUE

An Unforgettable Year

As we draw close to the end of the year, we cannot help but wonder and reminisce about the year which was relentless, painful and unforgiving but at the same time shook the entire humanity out of inertia, opened new avenues and taught us that there are no fixed play books when it comes to dealing with life or economy. The crisis has not altered our vision, but infact has changed the very lens through which we look at all aspects of life. The health crisis which spread like wildfire has proved to be enduring and a long drawn battle, defying hopes and expectations of it getting subdued with time. Nonetheless, all efforts remained directed towards minimizing the damage that the crisis caused to people, their health and well-being, incomes and sustainability. The start of the new year brings with it hope that difficult times are behind us. Though, the hope is shaded with some caution as the long haul may well extend into the next year. Nevertheless, there is realization that the new normal is here to stay, which may keep efforts and preparedness amongst various stakeholders concerted to handle untoward developments in coming times.

A cheery RBI

The financial markets which were rattled at the onset of the crisis, have not looked back as policy makers stay committed in preserving economic and financial market stability, for a longer period of time. The ongoing ebullience and confidence in the financial markets is very much in sync with the optimism that seems to be building up. Equity markets have sky rocketed and commodities are gearing for a bull market on expectations of strong rebound in economic activity and earnings. Back home, a similar sentiment is being echoed by RBI, which in its latest edition of economic activity assessment in the monthly bulletin, sounds extremely sanguine and positive about the state of the economy. Despite the headwinds, RBI expects the economy to be on a “faster growth trajectory” and that the recovery is likely to be stronger than what was earlier envisaged. The central bank draws confidence from the fact that India has not been subjected to a second wave of the pandemic and the current environment of supportive macroeconomic policies is helping in faster recovery of the economy. RBI goes at length to make us believe that the glass is half full, by highlighting that demand is expanding, employment conditions are improving and supply side dynamics are gradually restoring back to pre covid conditions led by agriculture and manufacturing. There is indeed immense optimism that recovery is very much underway and also an emphasis that the government is providing the fiscal push in a methodical way, with focus of the stimuli shifting from consumption expenditure to investment expenditure in form of Aatma Nirbhar packages 2 & 3. Inflation is clearly highlighted as a concern, but one that needs efficient and effective supply side management and measures to contain the cost push pressures which are currently driving the price pressures. Clearly, RBI seems to opine the view that inflation is merely a supply side phenomenon and with demand expected to remain muted, a more tolerant view on headline inflation seems to be in the offing, as the central bank remains committed to the task of reviving growth in the economy.

But is the picture as rosy?

There are enough reasons to believe that the stage is set for economic recovery. The development on vaccine front will give a boost to the global economy as the uncertainty comes to an end. However, challenges still confront us in the relentless fight against the pandemic. Concerns over probable adverse reactions could lead to fear amongst the public which may hamper the general acceptance of the vaccine. The new found mutated strains of the virus have further created concerns and it only raises the ambiguities with regard to the future. The path to normalization of economic activity still faces umpteen and unforeseen challenges. And hence, the role of policy makers will continue to be of utmost importance in the coming year as well. In the Indian context, RBI has unambiguously communicated its commitment of reviving growth by maintaining an accommodative stance that goes well into the coming financial year. Yes, the economy will climb back and post positive growth numbers, but a more pertinent issue is that of reversing the loss in potential output, which would require continued calibration of fiscal and monetary policies towards achieving the same.

Hope & Resilience

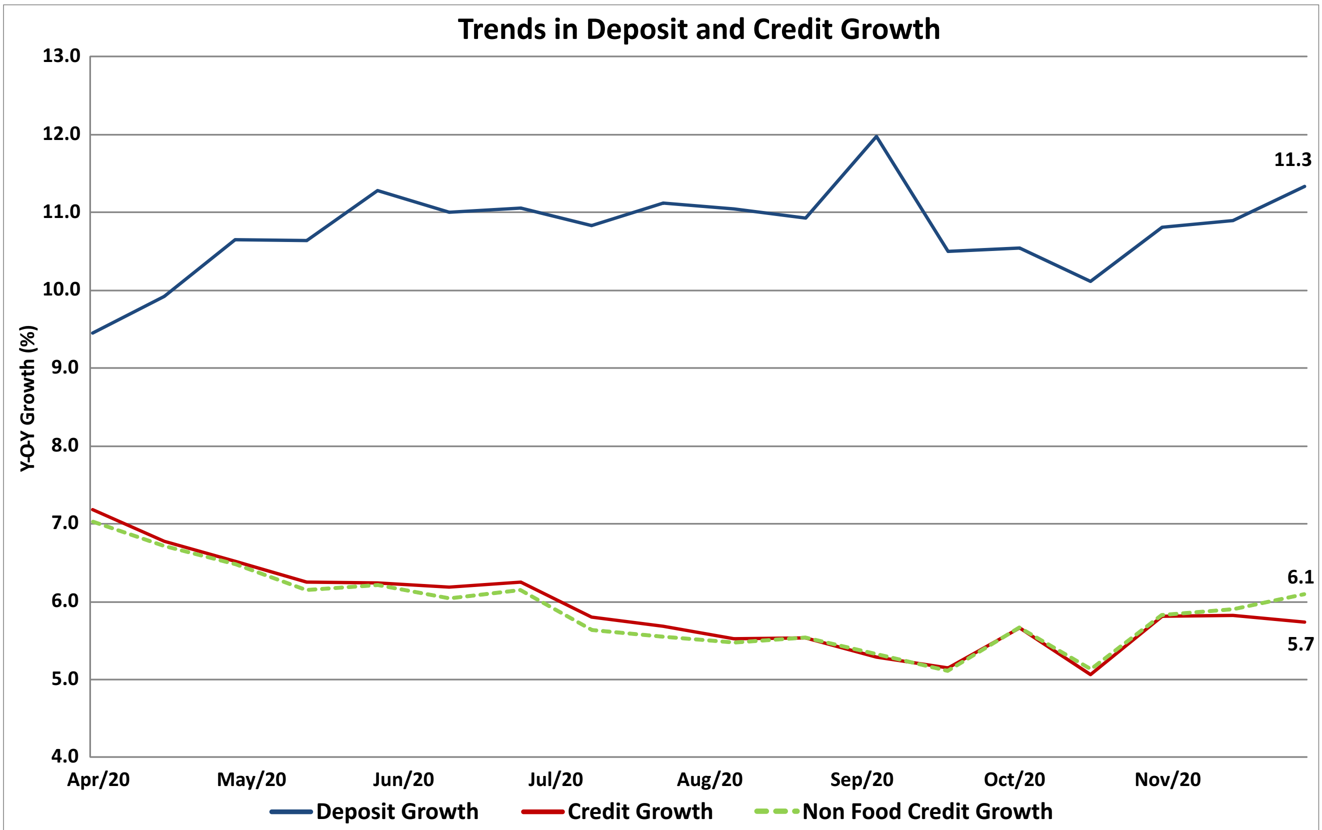
The year that passed was unlike any for most of us, and a common thread that tied the entire humanity during this daunting year was hope and resilience. As we move on to the next year, probably leaving the worst behind us, the challenges will stand tall and so the hope that these challenges will be met with utmost grit, resilience and innovation. We wish all our readers a happy New Year!

Macro Monitor

Credit Growth Slows to 5.7%, Divergence with deposit growth widens

Bank credit growth continues to remain subdued, with y-o-y growth at 5.7% in fortnight ended 4th Dec'20, while deposit growth continued to post double digit growth, with y-o-y growth at 11.3%. The gap between credit and deposit growth continue to widen as credit growth continues to lag despite easy interest rates and conducive liquidity in the banking system. The credit-deposit ratio stood at 71.99 in the fortnight ended 4th Dec'20 vis-à-vis 75.80 in the corresponding fortnight of the previous fiscal year.

In latest study by RBI, the central bank has attributed deteriorating asset quality as one of the contributors of poor credit growth post 2013. While it lists out that the credit decline was accentuated by a slowdown in GDP, slowdown in deposit, and surge in investment growth, the primary reason is the surge in bad loans, which restricts the lending capacity of the banks. RBI also highlighted that in the absence of a sharp cut in the policy repo rate, the slowdown in credit growth would have been far more severe.



Fixed Income Outlook

Fundamental View

During the last fortnight, the 10-yr yield, moved up, closer to the upper end of the trading range twice, but found support both the times. And as expected, RBI jumped in for defending the crucial resistance level on the 10-yr yield. Partial cancellation of the 10-yr bond auction on Friday, followed by announcement of Rs. 10,000 crore of Operation Twist (OT) again gave some breather to the market and the range is expected to stay intact for some more time. Since RBI has shown clear intent on every such occasion, we can hope that they put more ammunition to use to defend this level. The risk to the above view is the recent surge in US treasury yields and crude oil prices. Rise in crude oil price is especially worrisome as it has a direct impact on India's fiscal (through oil subsidies) and current account deficit (through oil import bill) and inflation. Though the outlook on CAD is stable as imports remain generally subdued due to weak demand, a close watch on movement of crude oil prices is warranted as it can play spoilsport and push yields above the defined range. Until then we expect the yield on old 10-yr paper to revolve in the range of 5.85% to 5.98% as discussed in earlier editions.

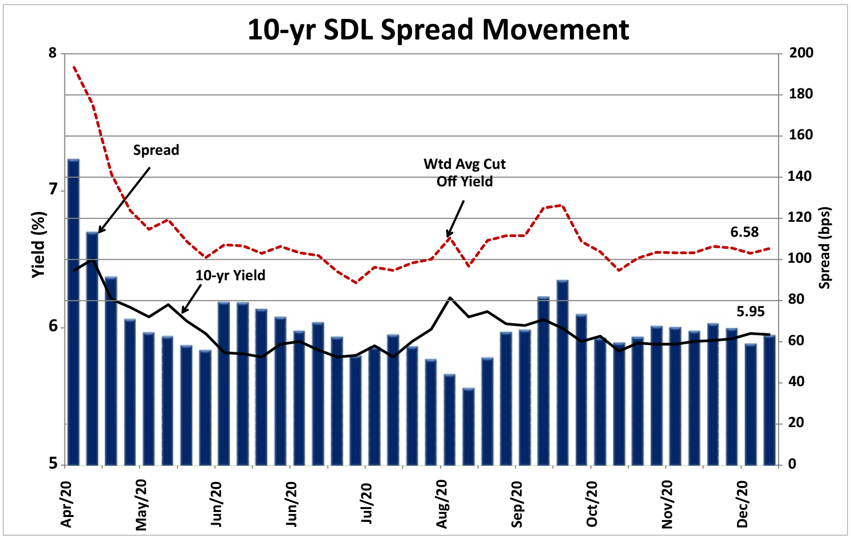
Technical View

Analyst 1: 5.77% GSec 2030 Yield settled at 5.93% on Friday's session. Last fortnight, benchmark yield traded range bound broadly in range of 5.91% to 5.97%.

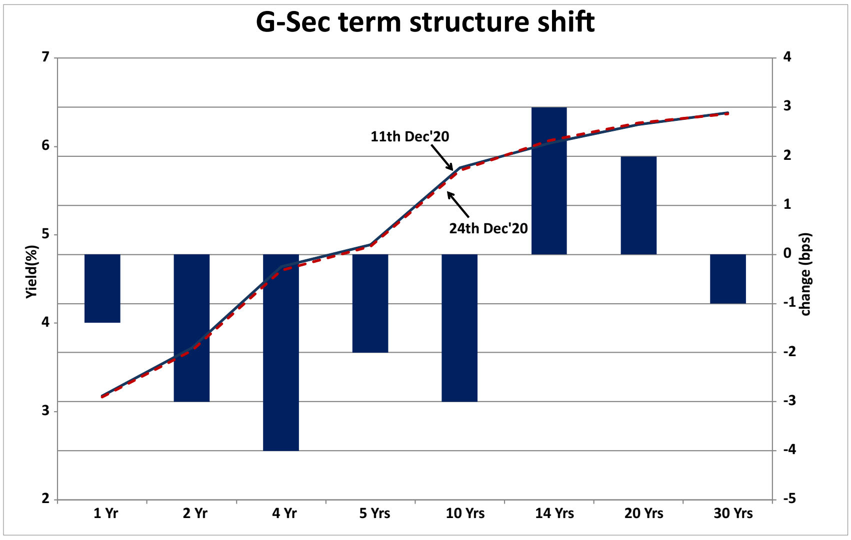
Momentum oscillator RSI is placed at 50 zone. As, discussed in last newsletter that sustenance and closing above 5.96% is crucial for further upside towards 6.02% level, till then it may trade in a range. The same was witnessed in last fortnight, wherein despite various attempts yield was unable to close above the resistance level. On the lower side 5.89% will act as a crucial support zone. We reiterate that, any closing above 5.96% may lead yield to touch 6.02% level, till then benchmark may continue to trade sideways in the range of 5.89% to 5.96% zone.

Analyst 2: In line with our view, 5.77% GS 2030 has taken yield resistance at 5.97% and currently the paper is trading around 5.92%. The view is to stay long with a closing stop loss of 5.97% and an immediate take profit of 5.86%.

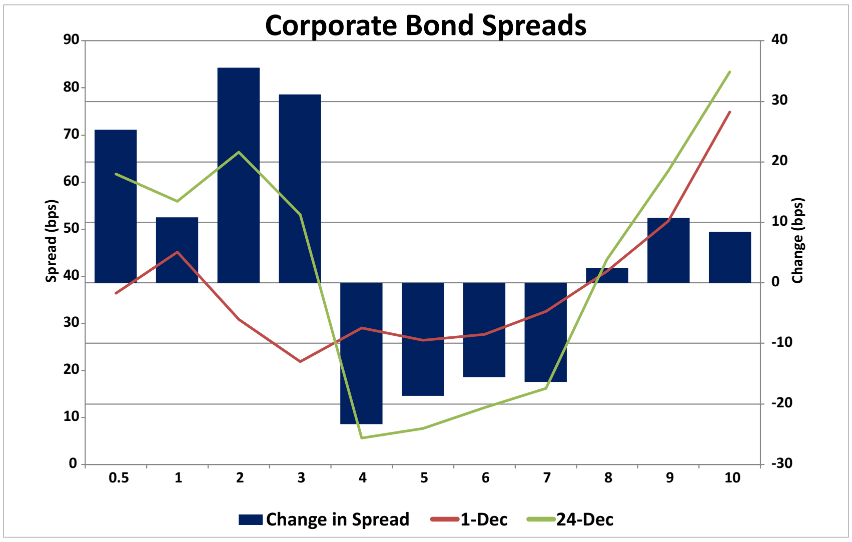
SPREAD MONITOR



10-yr SDL spreads stay steady during the fortnight, further movement in spread would be strongly contingent on supply for Q4



Term structure remained largely unchanged in the previous fortnight



Low yields at the short end of the sovereign curve make corporate bond spreads appear wide in the segment

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