11th January 2021 Vol: 22/2020-21

PNB GILTS LTD
(Subsidiary of Punjab National Bank)

Economy & Gilt Watch

Make India Budget

It's that time of the year again, and in couple of weeks, the government will roll out with the annual budget, tabling the roadmap for the coming financial year, presenting its projections on revenues, spending and economic growth. The annual exercise is awaited every year with tall expectations, however, this year, there seem to be a sense of exhortation for the budget to take the charge and lead the Indian economy out of distress. The economy is clearly in need of a "never before" like budget, and whether it will truly deliver what it takes to get the economy back up on its feet, will be only known once the budget is announced. This year, the budgeting exercise is made difficult not only because of the dire state of the economy, but also because of the sheer fact that the state of government finances is far more worse, throwing up a huge challenge in terms of accommodating a fiscal impulse within highly restricted fiscal resources. Nonetheless, the bigger challenge lies in overcoming this challenge and coming out with practical and believable solutions and delivering them in their spirit which will be the key in reviving the economy.

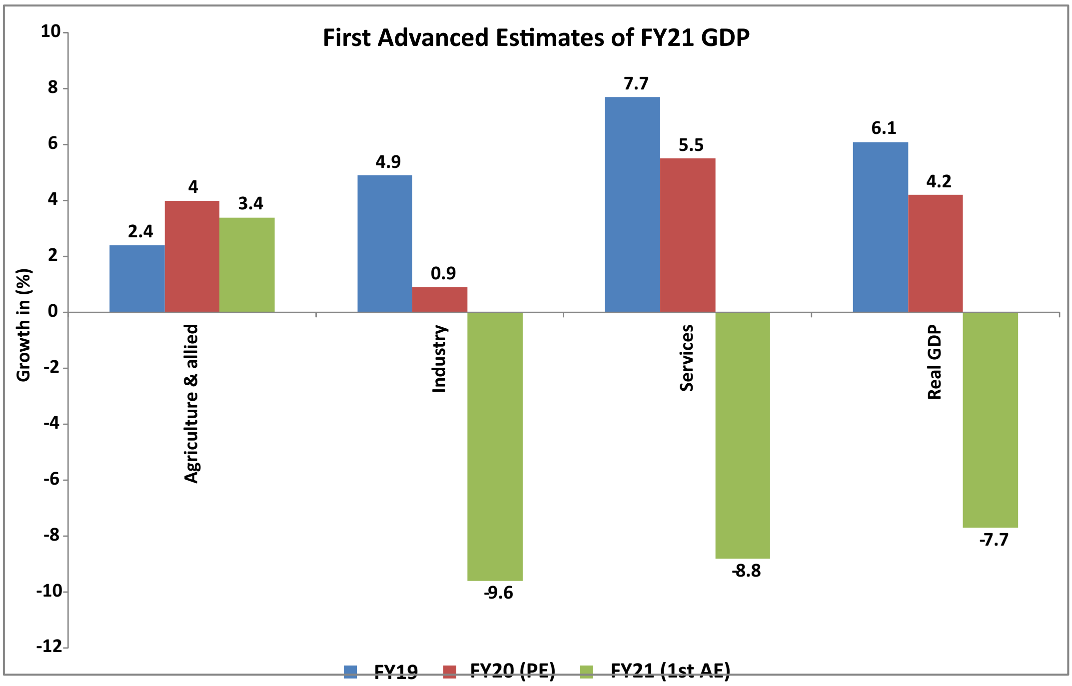
The good and the bad of the economy

As we near the big event, one needs to clearly understand the current state of the economy and the kind of damage that the crisis has imparted to it. Much of the time since the crisis has been spent on firefighting and coming out with immediate solutions to issues such as loss of livelihood, freezing of liquidity, providing forbearance to borrowers, while a large part of the stimulus was directed through the credit channel and not direct government spending. The economy bounced back, much faster than expectations largely on account of playing out of pent up demand, falling infections leading to improvement in mobility, a resilient farming sector, pick up in manufacturing activity and continued monetary policy support. The first advanced estimates (AE) for GDP growth for FY 2020-21 released by NSO,

INSIDE THE ISSUE

"Let's make sure that there is certainty during uncertain times in our economy"
George W Bush

peg the nominal growth at -7.7% while the real GDP growth is estimated at -4.2%. In terms of expenditure, for FY 2020-21, Gross Fixed Capital Formation (GFCF) and Private Final Consumption Expenditure (PFCE) are estimated to contract by 14.5% and 9.5% respectively. The support to the economy is estimated to come from a 5.8% growth in Government Final Consumption Expenditure (GFCE) and positive net exports. In terms of sector performance, the 7.2% contraction in GVA in FY 2020-21 AE, is driven by the sharp contraction in industry (-9.6%) and services (-8.8%), with agriculture and allied activities remaining the sole sector posting a positive growth of 3.4%. The full year's estimates are certainly far better than what was earlier feared, however it is important that not much comfort should be drawn from these numbers. The economy has suffered deep scars from the crisis, which cannot be left untreated. Household and business incomes have suffered permanent damage during the COVID havoc. The job market which saw some recovery in the last few months, is again battling with rising unemployment and job losses. Persistent demand for job insurance scheme MNREGA, only indicates that job opportunities remain curtailed in the current environment. On the external side too, a deeper contraction in imports compared to exports has been indicative of a poor investment and domestic demand. The normalization of economic activity seems far from over as a broad based economic recovery still remains a little away from sight. Hence, the role of the budget becomes paramount under such fragile economic environment and the very basis of economic revival greatly hinges on to it.



What we look forward to

While great minds are currently at work, deliberating over a befitting fiscal policy response to the economic distress, we feel that what the economy needs at the current juncture is a very conventional policy response. The two broad objectives of the budget should be to revive the consumption and investment cycle, which has remained choked for an elongated period of time and reducing the inequities in the system, which have been aggravated by the COVID crisis. The household and business confidence stands on shaky grounds and it is pertinent that these two mainstays of economic growth be given utmost importance in the budget. The choked consumption and investment demand cycle needs urgent revival and it can be ensured only through large public spending program. A large public spending program shall ensue two advantages, one is creation of public goods and second is creation of jobs which is pivotal in spurring demand and hence private investment demand. While the policy response seems straight forward one, effecting it would require ingenuity as resources are disproportionate to spending requirements. The ballooning fiscal deficit and slowing growth have led to sharp deterioration of the debt dynamics of the country. The general government debt to GDP ratio currently stands at ~90% and optically it looks difficult to stretch the debt burden further. However, at this crucial juncture, where almost Rs. 9 lakh crore are estimated to be shaved off from the nominal GDP in FY 2020-21, further plunge in economic activity can be detrimental for the debt dynamics of the economy. Under such circumstances, it is essential that the government switches its stance from being a cautious spender to a rescuer in the next year's budget.

Macro Monitor

Government spending rises in November

The latest data release on the state of government finances showed that the government accelerated its spending, with capital expenditure and revenue expenditure rising to 58.52% and 63.31% of the budgeted target for the fiscal. On the revenue front, revenue receipts rose to Rs. 8.13 lakh crore, standing at 40.2% of the target set for the ongoing fiscal in the April-November, while non-debt capital receipts remained at a paltry 8% of the annual target of over Rs. 2.25 lakh crore (which includes disinvestment target of Rs. 2.1 lakh crore). The fiscal deficit reached 135% of the annual target as revenues continue to sharply lag the projections. The fiscal deficit is likely to be the worst ever and expected to be in the range of 7% to 8% of GDP for FY 2020-21, as contraction in growth led to a sharp fall in revenues.

(Rs. crore)

Particulars	2019-20 Budgeted	2019-20 Provisional Actuals	2020-21 Budgeted	2020-21 Till Nov	Achieved %till date FY 2020-21
Revenue Receipts	1962761	1682107	2020926	812710	40.21%
Tax Revenue (net)	1649582	1355886	1635909	688430	42.08%
Non-Tax Revenue	313179	326221	385017	124280	32.28%
Non Debt Capital Receipts	119828	68620	224967	18141	8.06%
TOTAL RECEIPTS	**2082589**	**1750727**	**2245893**	**830851**	**36.99%**
Revenue Expenditure	**2448264**	**2349618**	**2630145**	**1665200**	**63.31%**
Capital Expenditure	**338085**	**336744**	**412085**	**241158**	**58.52%**
Total Expenditure	**2786349**	**2686362**	**3042230**	**1906358**	**62.66%**
Fiscal Deficit	**703760**	**935635**	**796337**	**1075507**	**135.1%**

Fixed Income Outlook

Fundamental View

In the previous edition, our base assumption was that the upper end of the predicted range could be in danger if US treasury yields and crude oil break their highs, however, the Indian bond yields came off by almost 10 bps on back of buying by mutual funds and on expectation of a sharply lower CPI inflation for the month of December. The headline inflation for the month of December is expected to be sub 5%, however the positive momentum induced by the same would be tempered by sharp surge in US treasury yields and crude oil prices coupled with the fact that RBI announced reverse repo auction of Rs. 2 trillion to take out the excess liquidity from the system, as part of the gradual unwinding of the liquidity measures taken so far for supporting the economy. The plan to restore normal liquidity management operations come with an assurance of availability of ample liquidity in the system, which indicate RBIs intent of normalizing the liquidity in the system in the most non-disruptive manner. Nevertheless, it does give a reason for the bond yields to stay range bound with the 10-yr yield within the 5.85% to 5.95% band. Broadly, given the macro environment and the fact that the budget announcement is nearing, it would be advisable to refrain from placing large bets as the likelihood of the bond yields breaking the upper band of the range looks increasingly likely. Caveat Emptor!

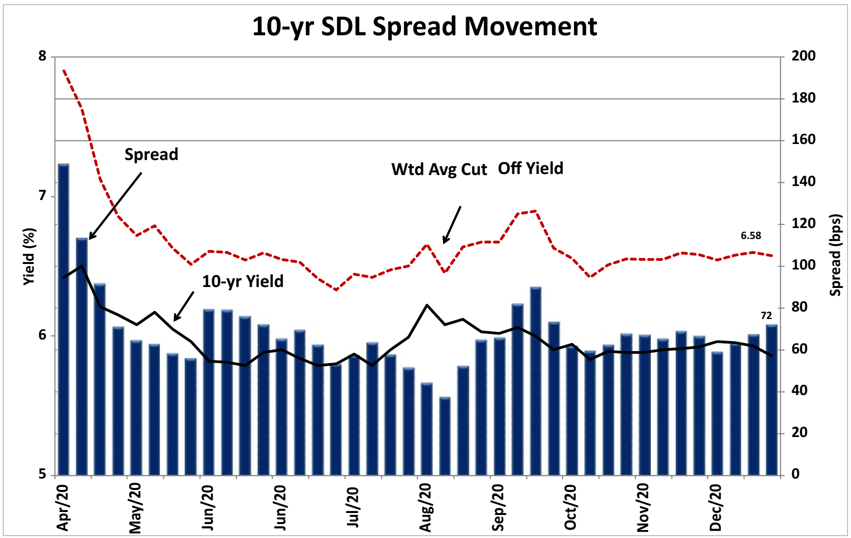
Technical View

Analyst 1: 5.77% GSec 2030 yield settled at 5.89% on Friday's session. Last fortnight, benchmark yield traded with downward bias and touched level of 5.84% on the lower side.

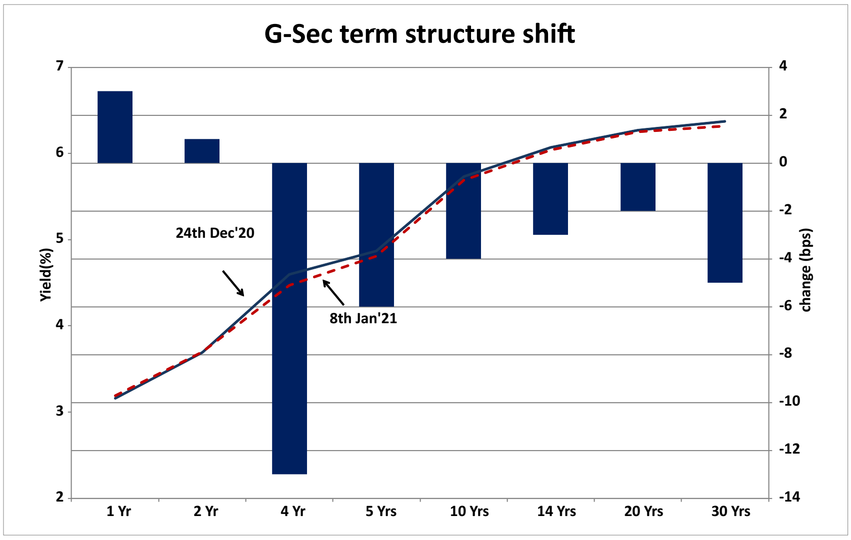
Passing week, Benchmark closed below crucial support zone of 5.89% level and touched lows of 5.84%. However, a gap up on Wednesday's session post a Doji candle below the Lower band indicated Benchmark to renter in a range with 5.85% to act as a crucial support level going forward. Momentum indicator RSI also made a double bottom at 30-32 zone giving strength to the above rationale. We are witnessing a range expansion in Benchmark paper from 5.89%/5.96% to 5.85%/5.96% zone and it may trade in above mentioned range for coming fortnight.

Analyst 2: 5.77% GS 2030 has indeed reversed from the lower end of our range 5.85% and it is currently hovering around 5.90% level. The view is to buy 5.77 GS 2030 again at current level with a closing stop loss of 5.93% and stay long with an immediate take profit of 5.85%.

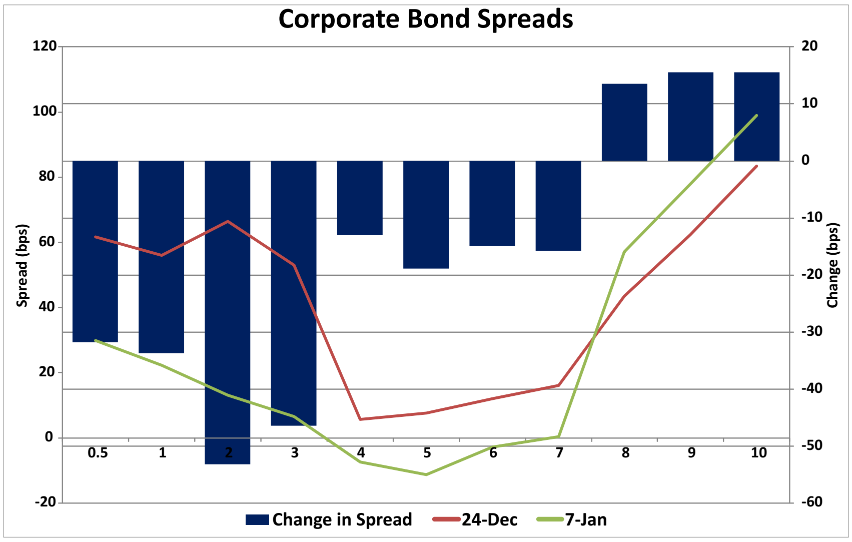
SPREAD MONITOR



10-yr SDL spreads widened on account of heavy state borrowings schedule for the fourth quarter



The announcement of 14-day reverse repo auction for Rs. 2 trillion shall exert upward pressure on short term yields, leading to bear flattening of the curve



Corporate bond spreads narrowed during the fortnight at the short end of the curve

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