PNB GILTS LTD

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ECONOMY & GILT WATCH

PNB GILTS LTD (Subsidiary of Punjab National Bank)

INSIDE THIS ISSUE:

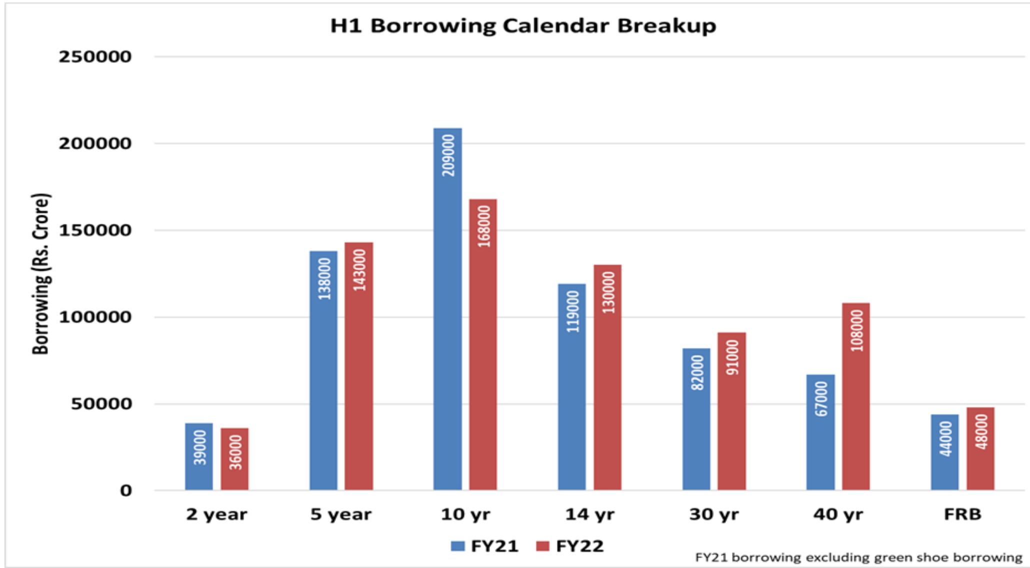
H1 G-sec Borrowing Calendar Update

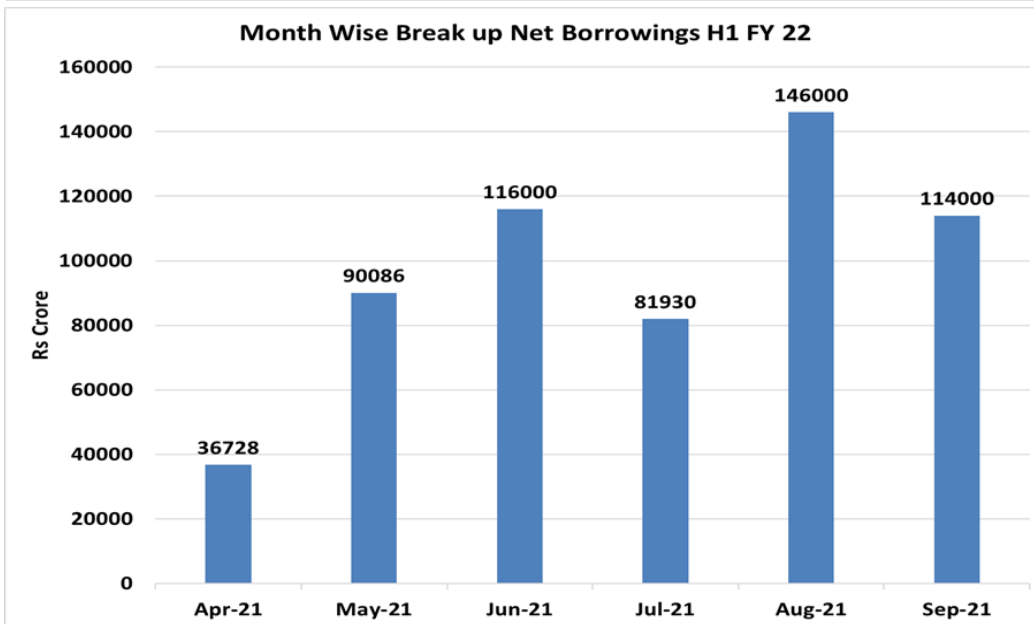
The borrowing calendar for government securities issuances for the first half of new financial year 2021-22 was released by RBI. In FY 2021-22, GOI aims to borrow Rs. 12.05 trillion out of which Rs. 7.24 trillion shall be borrowed in the first half of the year as against Rs. 7.66 trillion borrowed in H1 FY21 (including Rs. 0.68 trillion through green shoe option). Weekly auction size varies from Rs. 26,000 crore to Rs. 32,000 crore and the calendar is front loaded with 60% borrowing planned in H1 FY22 as compared to 56% in H1 FY21. However, net supply is lower after taking into account redemptions. Net supply in H1 FY22 stands at Rs. 5.85 trillion vis-à-vis Rs. 6.28 trillion in H1 FY21. The heavy supply slated for the first half is expected to keep bond market under pressure, unless the same is offset with regular OMO auctions by RBI.

More Details

While the issuance size is higher, the borrowing is spread more evenly if we compare it with the H1 calendar of FY21. Longer end of the curve shall see heavier supplies in H1 of the new fiscal, while the 10 yr segment will witness lower supply as compared to the last year. On the other hand, at the short end of the curve (2 to 5 year bucket), supply remains more or less at similar levels as last year. The year will also see slightly higher issuances of FRB, slated at Rs. 0.48 trillion vis-à-vis Rs. 0.44 trillion in H1 FY21. In terms of net supply, April and May will see lowest supply on account of heavy redemptions of Rs. 1.05 trillion in these two months. The supply is likely to have a steepening impact on the yield curve with relatively heavier supplies concentrated at the longer end of the curve. However, the outright steepening impact of the borrowing calendar may be tempered by RBI's special OMO auctions in which it sells short end papers and buys medium to long dated papers. RBI has been clearly reiterating its objective of a conducting the GOI borrowing program smoothly, while stating that tools like OMO shall be continued to be used to ensure that yields don't surge sharply.

The borrowing calendar is likely to have a steepening impact on the yield curve with higher proportion of borrowing planned at the long end of the curve



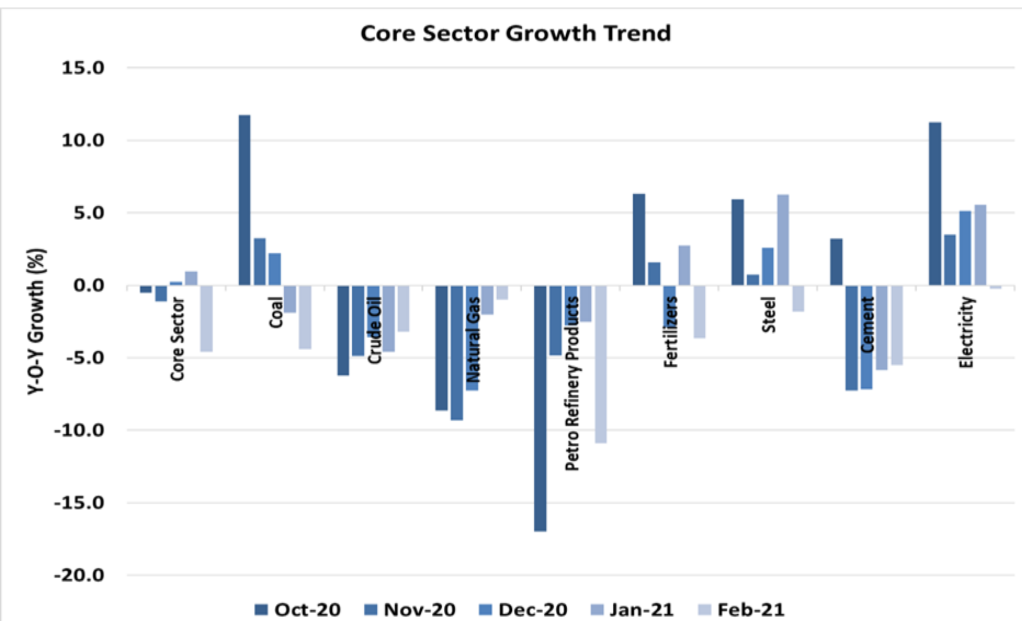


Inflation target band retained at 2% to 6%

Another key development with regard to bond markets is that Government has decided to keep 4% as the inflation target with a 2% band. This is a good development and any tinkering in this 2%-6% would have been an error of judgement. These numbers should have longer-term sanctity and should not be tinkered with to suit the intermittent requirements. RBI and Government can always to choose to look through these numbers in the interim with an explanation, if the situation so demands but tinkering with the stated objective should not be done by changing the goalpost as that would have deeper ramifications on inflation expectations.

Macro Monitor

Macro-economic data remained somewhat mixed in the backdrop of sharp surge in COVID cases, which has once again raised concerns over the path of economic recovery. Core sector recorded a sharp contraction of 4.6% in February 2021, with all the 8 sectors posting negative growth. The decline was largely led by sharp contraction in the refinery products and cement and coal production. Refinery production contracted declined sharply to a 4-month low of 10.9% in February compared with a decline of 2.6% in January 2021. After showing positive growth in January (6.2%), Steel segment also posted negative growth of 1.8% in February which indicates that investment demand is still not out of woods. The weak core sector data shall be reflected in the upcoming IIP data for the month of February, which is likely to be in the negative territory too. However, going forward, a favourable base effect emanating from last year's steep fall in the industrial activity may support the forthcoming numbers.



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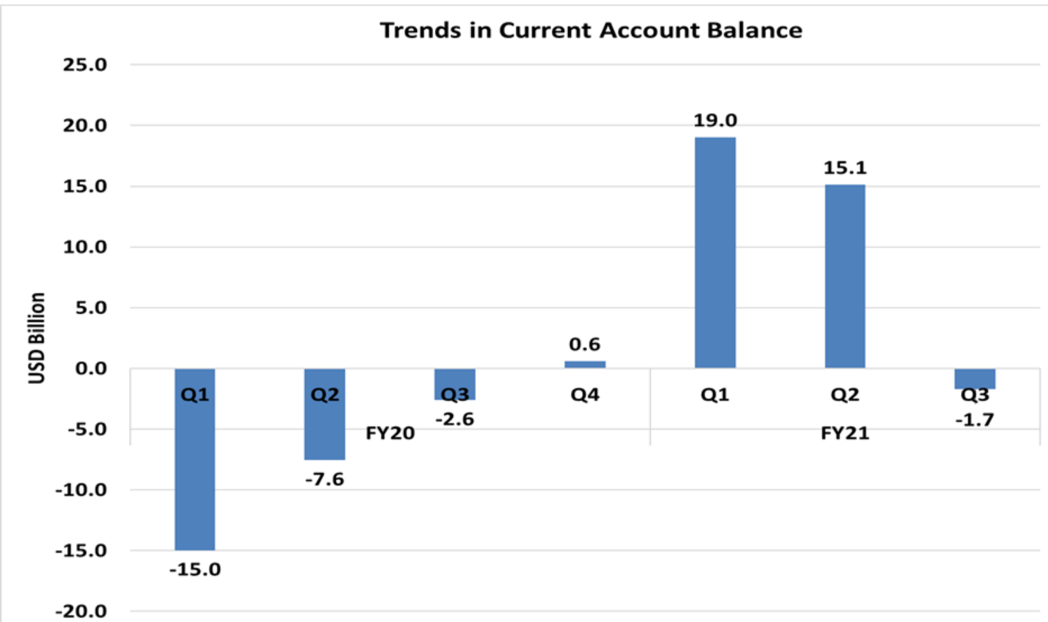
India Returns to Current Account Balance Deficit

After remaining in surplus for three quarters, India's current account balance recorded a deficit of US$ 1.7 billion (0.2% of GDP) in Q3 FY 21 after a surplus of US$ 15.1 billion (2.4% of GDP) in Q2 FY 21 and US$ 19.0 billion (3.7 per cent of GDP) in Q1 FY21. Trade deficit rose to US$ 34.5 billion during Q3 as against US$ 14.8 billion in Q2 FY21 as economic activity normalized during the festive season leading to increase in import demand during the quarter.

Another reason for the deficit recorded during the third quarter is rise in net outgo on account of investment income, which increased to USD$ 10.1 billion from USD$ 7.4 billion a year ago. Another indicator of improvement in global economic activity is improvement in net services exports and remittances during the quarter under review. Net services exports were up 7.9% y-o-y in Q3 FY21, mainly driven by the IT sector. The capital account surplus stood at US$ 33.5 billion in Q3 FY21 vis-a-vis US$ 15.4 billion in Q2 FY21 as portfolio flows swelled. On the other hand, FDI moderated to US$ 17 billion in Q3 FY21 from US$ 24.6 billion in the previous quarter, though it continues to remain significantly higher compared to previous year (US$ 9.7 billion in Q3 FY20).



Better domestic demand conditions push current account balance into deficit in Q3 FY21

Fixed Income Outlook

Fundamental View

So the Generic 10 year Indian Government Bond yield closed the Financial Year at a level almost from where it started the last FY, unchanged! That too in a year which saw steep cuts in policy rates, highest ever surplus liquidity and highest ever government borrowings. An interesting happenstance. To the uninitiated, this would mean as if the there was no action in the bond markets. On the contrary, it was a year full of action for the bond market. What next?

The calendar for H1 borrowings has been announced and it contains no surprises per se. Market players were expecting a front-loading of borrowings, so no surprises there. A cursory look at the issuance schedule tells us that the issuance is heavy in 10-14 segment and the longer duration too. Thus, the yield curve will see a steepening bias throughout the year, punctuated by some tactical flattening due to sales in short end due to special OMOs/OTs conducted by RBI. Needless to say, that the RBI's guidance and stance shall be keenly awaited in the upcoming policy meet due 7th April 2021. We do not expect RBI to change its stance at a time when the economy sits on the edge once again as a sense of déjà vu strikes amidst exploding COVID infections. Having maintained status quo on rates since August 2020, will RBI take the plunge and preemptively announce a rate cut is a question that definitely cannot be ignored.

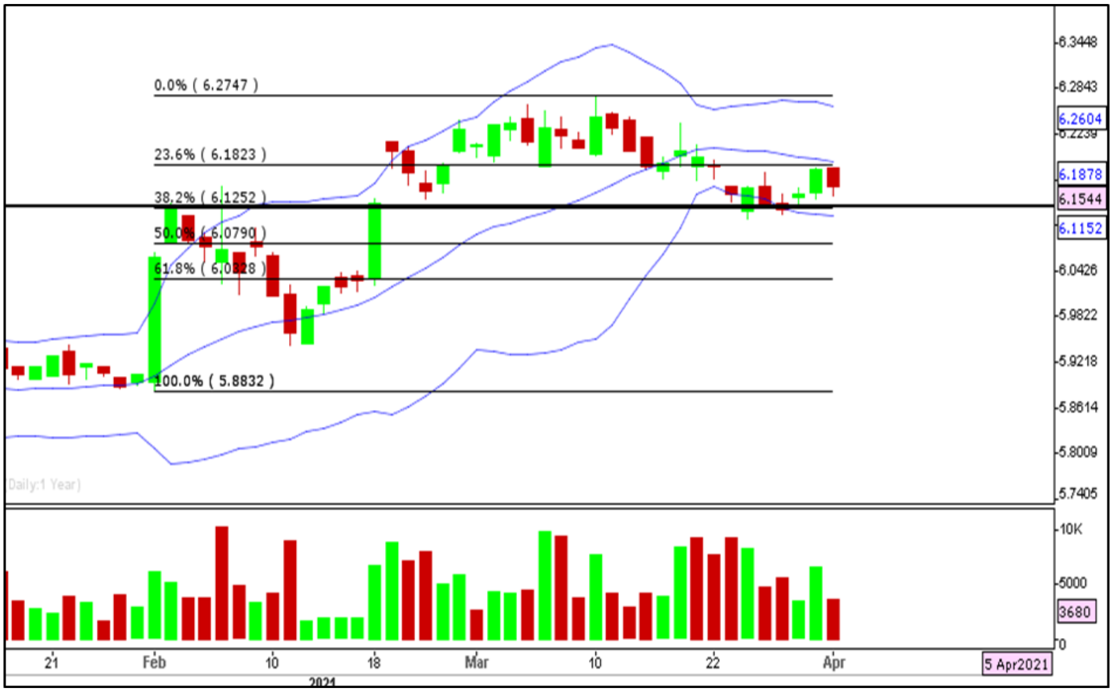
The yield curve will see a steepening bias throughout the year, punctuated by some tactical flattening due to sales in short end due to special OMOs/OTs conducted by RBI

Inadvertently, the cat is out of the bag on the cut in small savings rates. The market will discount a steep cut in small savings rate (in line with the withdrawn circular) at the start itself. However once this news and the impact thereof is absorbed, the yields could start inching upwards. The supply is indeed very heavy on the top of a heavy supply last year. RBI will be using its firepower to the full extent and judiciously through OMOs/OTs/secondary market purchases to see that the government borrowings are completed in non-disruptive manner. Nonetheless, the direction of the yields would be upwards only. Investors need to be patient buyers and should wait for higher levels, if they can. Catching a falling knife generally results in a cut in fingers. We would advise not to chase the prices on short term rallies and rather sell on rallies and then wait on the sidelines for higher levels. The 10 year yield could gradually inch up towards 6.35% in current quarter. Till then, patience is the buzzword.

Technical View

Analyst 1: 5.85% G Sec 2030 yield settled at 6.18% on Friday's session. Last fortnight, benchmark yield traded range bound broadly between 6.12%-6.18% zone.

Post witnessing a breakout in first week of Feb'21, Benchmark yield is making Higher high, Higher low formation, indicating upward bias. However, due to divergence between RSI and yield we have witnessed a pullback towards 6.12%. We continue to believe, till yield is sustaining above major support level of 6.11%-6.12%, which coincide with lower Bollinger band level and also 38.2% retracement level (swing low 5.88%- swing high 6.27%) as indicating in chart, yield may trade range bound between 6.11% to 6.20% zone. On higher side any sustainability above 6.20% will trigger the resumption of northward trend in yields with immediate target of 6.27% and 6.35%.

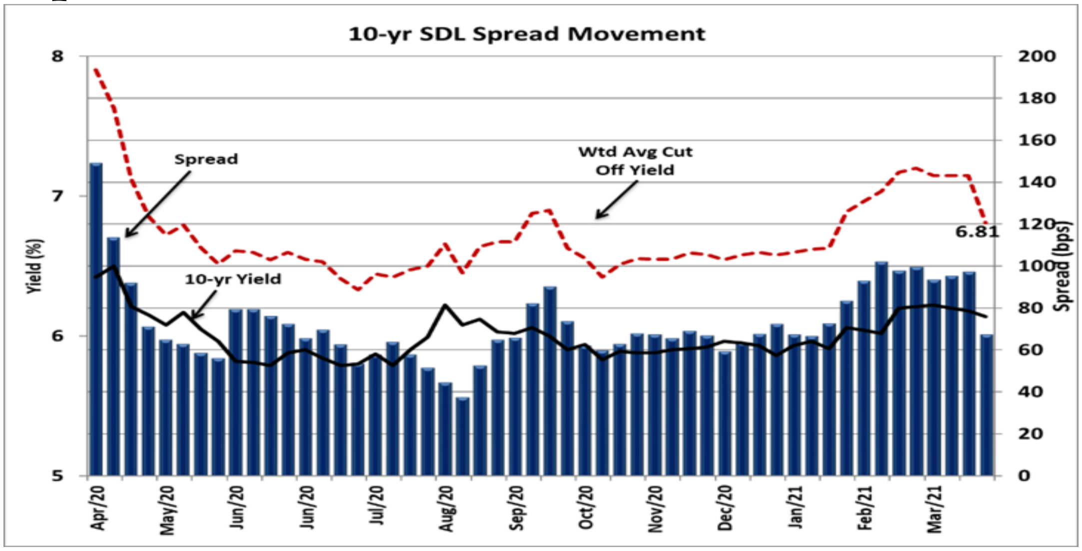


Source: Tickerplant

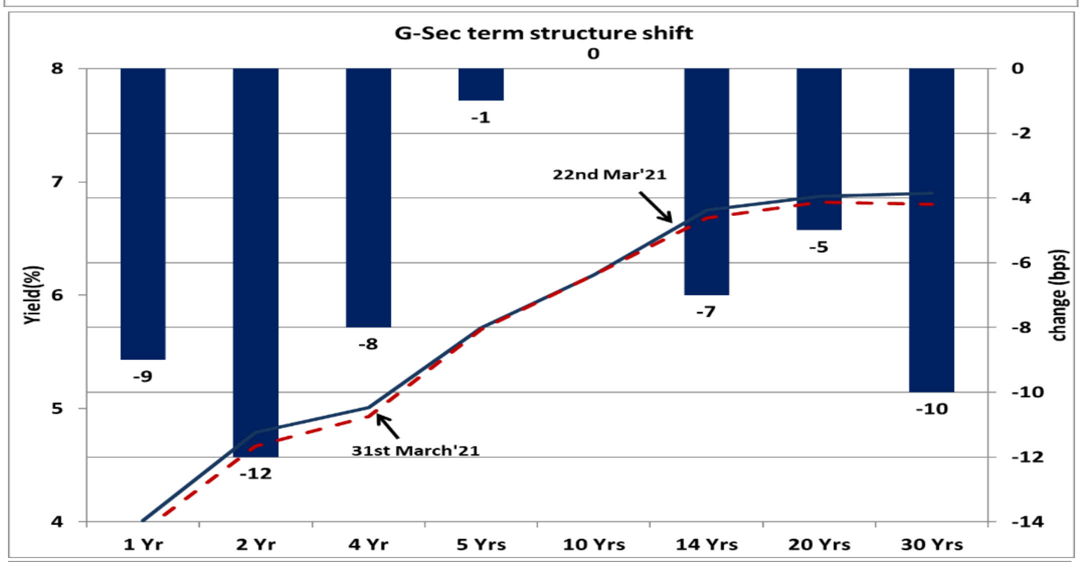
Any sustainability above 6.20% will trigger the resumption of northward trend in yields with immediate target of 6.27% and 6.35%.

Analyst 2: 10 yr yield is currently around 6.1750%. The market is expected to hover in the range of 6.08% to 6.33%. The view is to initiate short (at 6.08%) / long (at 6.33%) positions only at the extreme levels of this range. At current level, one may stay out of the market.

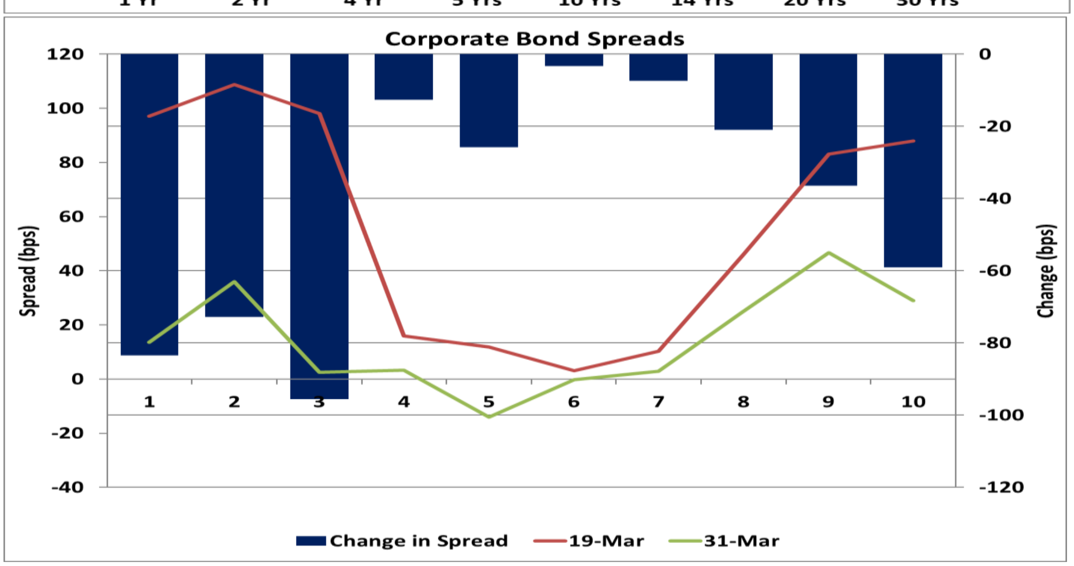
Spread Monitor



SDL spreads eased sharply in the previous auction and further decline in SDL yields seem limited from here on ahead of FY22 supplies



Short end of the curve may see favourable moves amidst lower supply compared to other maturity segment



Corporate Bond spreads eased during the fortnight as underlying sentiments remained positive

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