10th October 2019

PNB GILTS LTD
(Subsidiary of Punjab National Bank)

ECONOMY & GILT WATCH

RBI Monetary Policy: *As dovish as it could get*

Key Takeaways

In its fourth Bi-Monthly monetary policy statement, as broadly expected, the MPC unanimously voted to reduce the Repo rate for the fourth consecutive time in the current FY by 25 bps to **5.15%.** With this, the cumulative rate cuts during the FY 2019-20 stand at **110 bps** and the underlying monetary stance continues to be accommodative in order to revive growth. The rate cut comes in the backdrop of continued broad based slump in the economy, both domestic as well as global, domestic prices remaining well within the target level as well as key economic and high frequency indicators suggesting still fragile conditions of the economy. ***RBI also takes note of the incomplete monetary transmission and highlights the inconsistency between reduction in policy rate by RBI and lending rates by banks***. RBI has further moderated its view on economic outlook going forward, slashing the GDP growth projection for FY 2019-20 to 6.1% from 6.9% projected earlier. ***What needs to be noted is RBI's continued assertion of maintaining a growth supportive stance even amidst growing certainty of a fiscal slippage in this year.*** Moreover, with the inflation remaining well within the RBI target and with no major upside risks to same, RBI clearly has enough ammunition to support growth going forward. CPI projection for Q2 FY 2019-20 has been however revised slightly upwards to 3.4% as against earlier projection of 3.1% factoring in seasonal uptick in food prices and volatility in the crude oil prices.

Way Ahead

Going forward, RBI shows mild optimism over recent measures taken by the government and its role in stimulating private investment and consumption cycle. ***However, RBI clearly advocates "intensified efforts" to put the economy back into the virtuous growth cycle.*** The onus clearly remains with the government, despite the slew of measures taken till date which will positively impact the supply side factors of the economy. Though the fiscal overhang cripples the government's ability to

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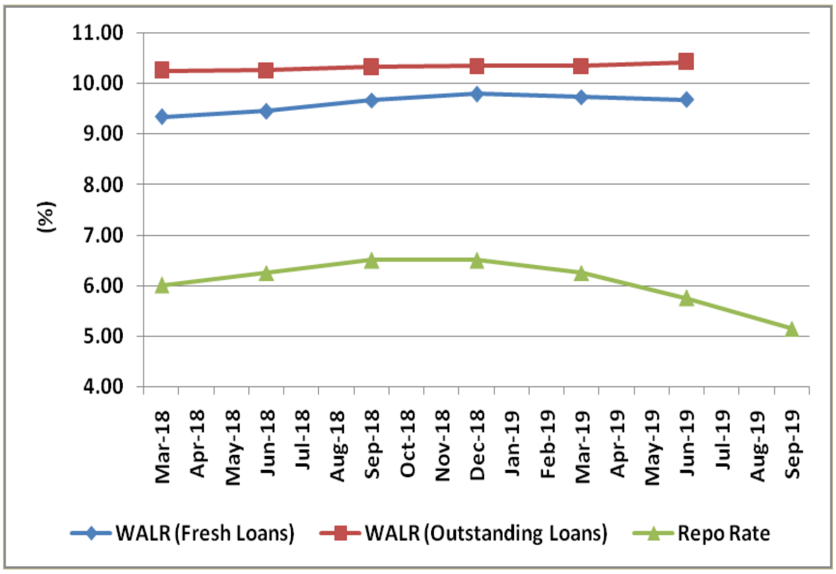
increase expenditure significantly, the worrying trends in the real economy warrant direct fiscal measures to reverse the collapse in demand.



With banks linking their floating rate loans to the repo rate, the extent of monetary transmission may be more pronounced in coming months.

Source: RBI

Liquidity Management Framework: *Review*

RBI released the report of the internal working group on Liquidity Management Framework on 26th Sep 2019. The working group has maintained **status quo** as far as the broad contours of the liquidity framework being followed currently are considered. ***As followed hitherto, the guiding principle of the framework remains keeping the target rate, i.e the interbank rates aligned to the policy rate set by the MPC.*** To achieve this policy objective and to manage the liquidity in the system, RBI will continue to utilise the flexible corridor system of 50 bps spread between the ceiling and the floor rates.

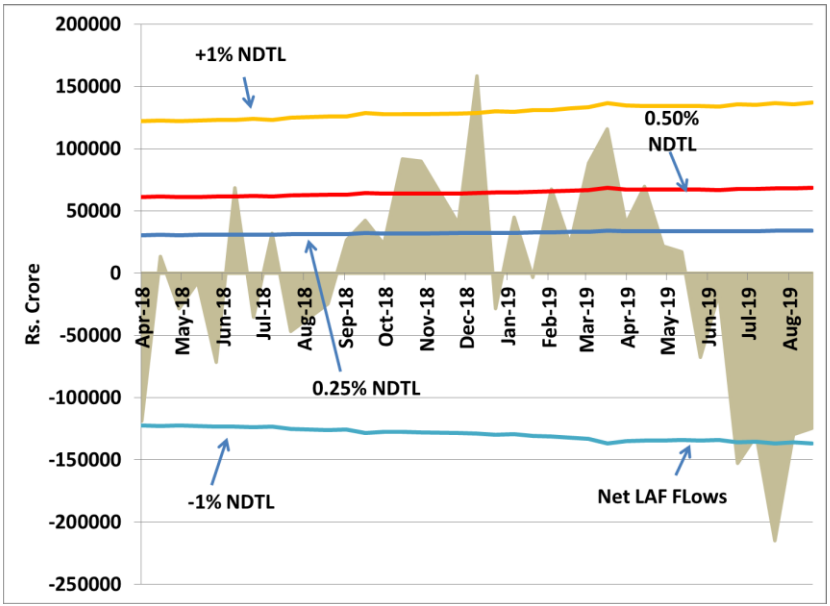
With the overall structure of the framework remaining more or less same, the working group has recommended certain new measures which have implications for the bond and money market. The group has recommended maintaining the system liquidity in a deficit mode to the extent of 0.25%-0.50% of NDTL as against the neutral level. ***This would help achieve the objective of anchoring the interbank rates near the repo rate.*** In times of

Key Measures

- *Maintain liquidity deficit to the extent of 0.25%-0.50% of NDTL*
- *One single overnight variable rate operation to manage daily primary liquidity*
- *Long term variable rate repos to complement OMOs*
- *More transparency on daily liquidity condition*

surplus liquidity RBI proposes to use variable rate operations to keep interbank rates close to the policy rate. **Also in order to minimise uncertainty, the daily primary liquidity management operation would be one single overnight variable rate operation.**

For managing durable liquidity (long term or permanent liquidity) in the system, RBI currently utilises durable liquidity injection operations such as OMOs and Forex buy- sell swaps. ***In addition to this, RBI recommends long term variable rate repos (longer than 14 days to 1 year tenor) as a complementary tool to OMOs when system liquidity is in large deficit.*** This is mildly negative for the bond markets as an alternative tool for managing liquidity deficits would reduce RBIs dependence on OMOs. ***However, term repos expose banks to roll over risks, which mean that OMOs may still be a preferred tool for managing shifts in systemic liquidity.***



By restricting the liquidity deficit in the range of 0.25%-0.50% of NDTL, system may not witness instances of extreme crunch in liquidity. However, RBI has not stated any limits on the surplus side of the liquidity.

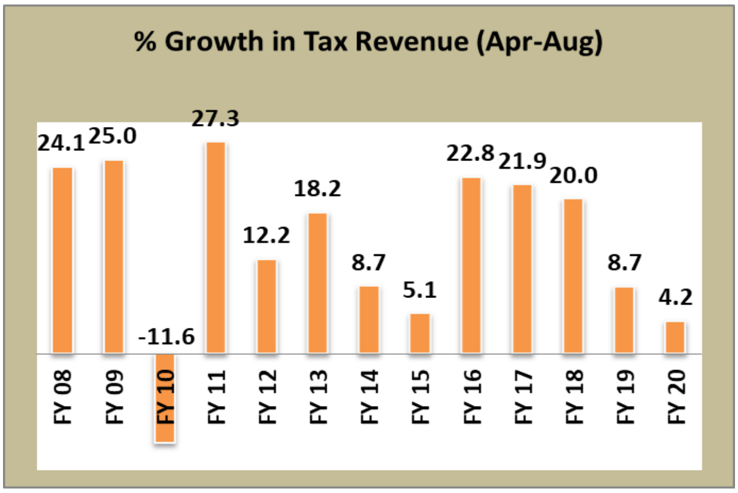
In order to bring greater transparency on daily liquidity conditions and to achieve the objective of reducing information asymmetry between RBI and the market participants, RBI moots for separate information on daily and outstanding LAF operations. ***This would help in efficient operations and better price discovery in the interbank markets.*** Overall, the liquidity framework reiterates earlier principles, with an endeavour to simplify and streamline the current framework (in terms of minimizing the number of operations) while bringing in elements which will help market participants to gauge the money market conditions with greater certainty and efficiency.

Slowdown Woes Continue

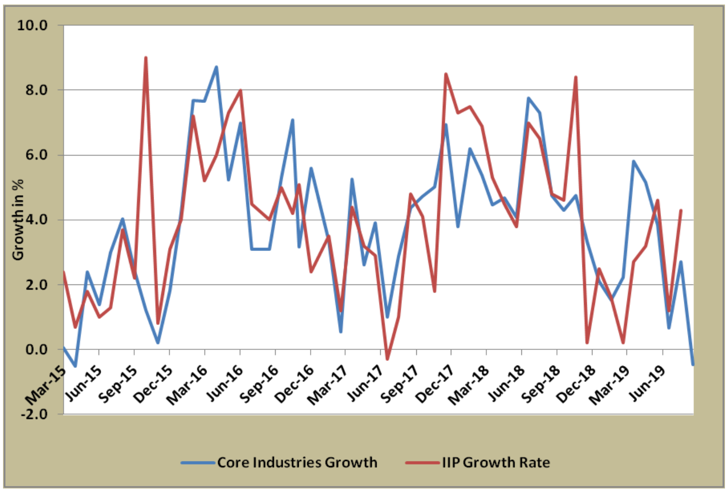
A spate of key data releases in the last fortnight continues to portend across the board weakness in the economic activity. To begin with, core industries, the bellwether of industrial activity, registered weakest growth in more than four years. Four out of eight industries registered sharp contraction on annual basis, while the sequential trend was also quite discomforting. On y-o-y basis, the core industries group contracted by 0.5% as against 4.7%

growth registered a year ago. Within the core industries, coal production saw the steepest decline of 8.6% over the previous year. Other sectors registering negative y-o-y growth are crude oil (-5.5%), natural gas (-3.9%), cement (-4.9%) and electricity (-3%). The latest core data print also dashes hopes of revival in IIP growth after the latter saw an uptick in the month of July.

The data release on fiscal deficit for the month of August 2019 reinforced concerns over the drag in tax collections. On gross basis, only 27% of the gross tax revenue target has been achieved in this fiscal till August'19 as against 30% achieved in the same period of FY19. It's a pressing concern that this year's gross tax revenue target has been set at an ambitious level of Rs. 24.6 lakh crore over previous year's revised estimate figure of Rs. 22.5 lakh crore, while the provisional actual collection for FY19 was much lower at Rs. 20.8 lakh crore. Additionally, the government will bear a hefty loss of Rs. 1.45 lakh crore owing to the recent reduction in corporate tax rates. ***Though there are significant downside risks to the buoyant tax revenue estimates emanating from expected revenue loss arising due to tax sops and growth slowdown, hopes are pinned on non-tax revenue generation and the upcoming festive season to cushion the fiscal calculations.*** The GST collections also remained muted in the month of September at Rs. 91,916 crore marking fresh lows in 19 months.



Tax collections have contracted sharply during the period Apr-Aug of FY19. Q3 is expected to fare better as the festive season kicks in. A favorable base effect will also see the numbers coming tad higher in the coming quarter.



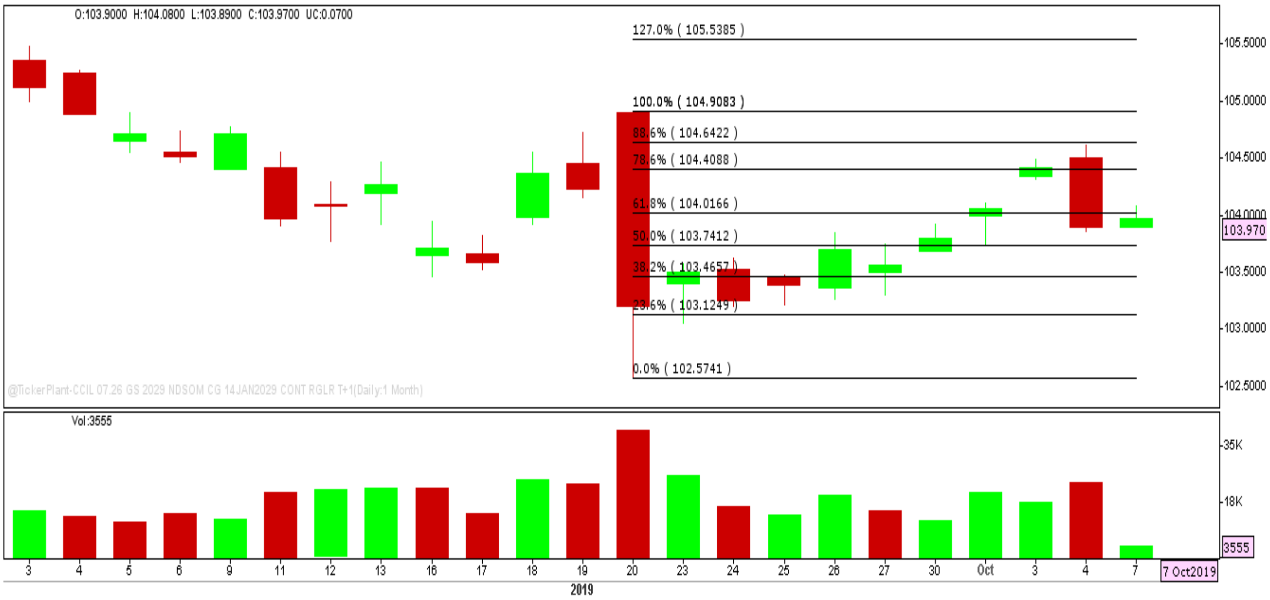
Anemic trend in core industries data continues as annual growth slumps to new lows in four years in Aug' 19. Five out of eight industries post negative annual growth.

Technical Point

7.26% GOI 2029

The pre-policy closure above 104.02 in 7.26 GOI 2029 has opened up the upside for further rally till 105.40- 105.54(Fibonacci resistance - 127%). The post-policy correction in this paper may extend till 103.36 (Fibonacci support - 61.8%). Hence, the price band in 7.26% GOI 2029 is expected to be in the range of 103.36-105.40.

Any closing below 103.36 will lead to a downtrend as compared to the current range bound price action. Hence, the price action of this paper around 103.36 is of paramount importance.



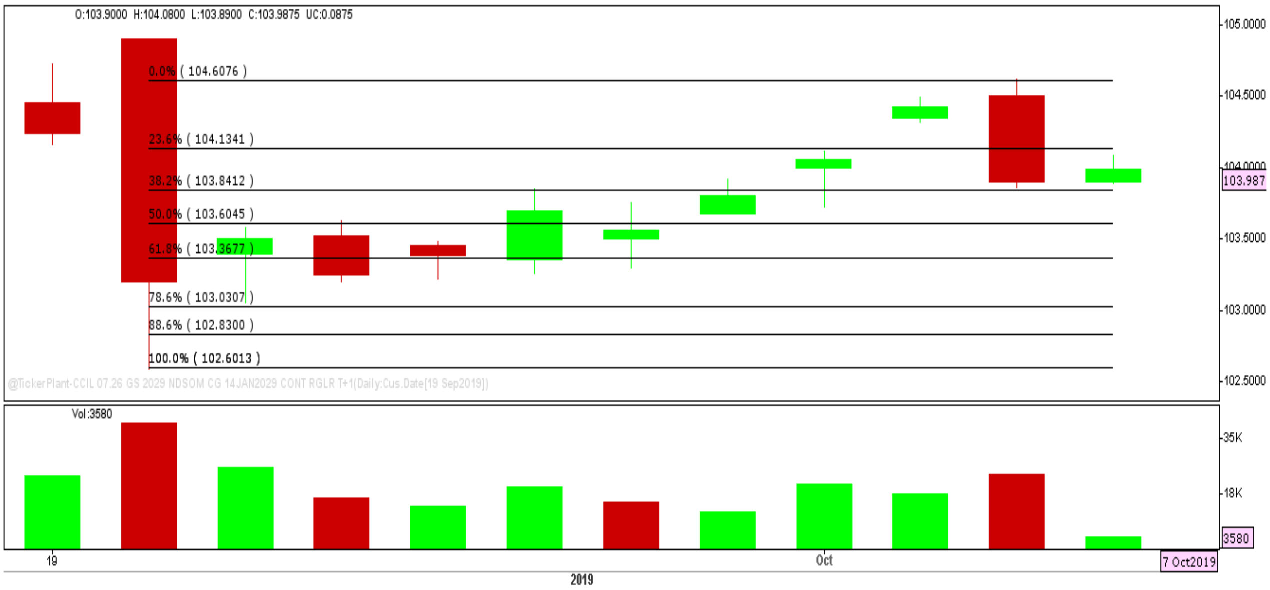


Chart source: www.investing.com

Fixed Income: Outlook

Bond market remained largely volatile in the previous fortnight on account of fiscal stimulus measures and announcement of borrowing calendar for H2. Markets witnessed a relief rally after the G-sec borrowing schedule remained unchanged from budgeted figures and RBI slashed the Repo Rate by 25 bps in its fourth bi monthly review of MPC. The short end of the curve is likely to benefit from reduction in the policy rate, continuation of benign liquidity conditions and lower supply in short dated securities. However, the yield curve may witness steepening in the coming fortnight due to continued ambiguity on the fiscal front and in anticipation of more stimulus measures for revival of demand in the economy. Market would also take cues from the CPI data for the month of September. CPI is expected to inch up on account of seasonal uptick in food prices, however core CPI is expected to remain at subdued levels. The new 10 year paper was also issued in the last fortnight at 6.45%. In the coming fortnight, the 10-year yield may trade in the range of 6.37% to 6.52% with an upward bias.

DATA CHECK

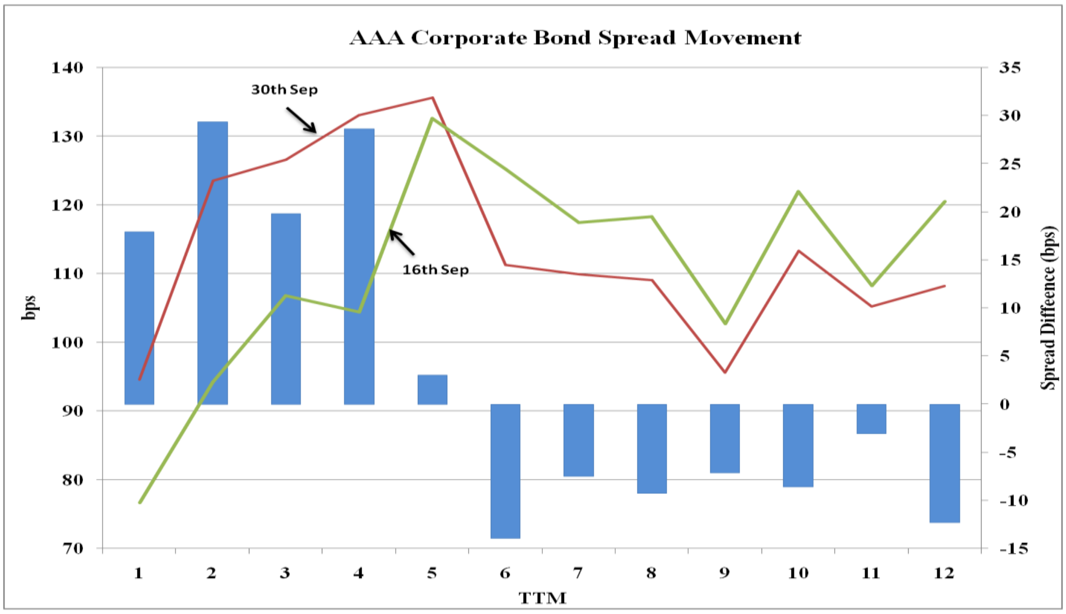
(Rs. Crore)

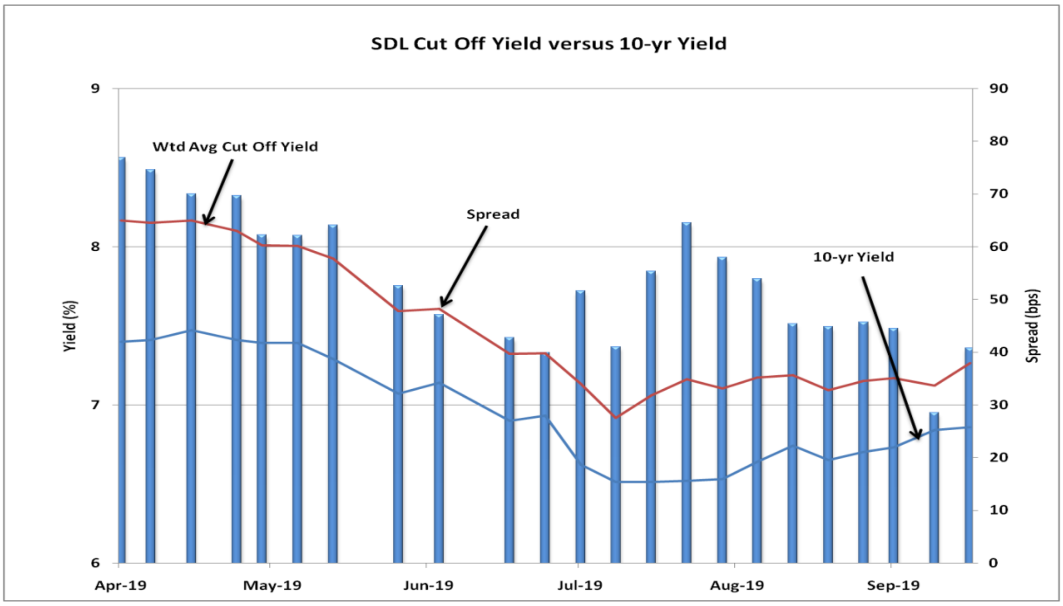
Particulars	As on 13th Sep 2019	Fortnightly Variation	Variation over LRF of March	YOY % growth
Aggregate Deposits	1,27,228	-574	1,491	10.0
Bank Credit	97,012	210	-706	10.3
Non - food Credit	96,364	187	-937	10.1
Banks Investment in G-Sec	36,053	242	2,242	3.3
Broad Money M3	1,56,485	-286	2,176	10.1
Reserve Money 27/09	27,882	-24	177	12.0
Forex Reserves 27/09 (USD bn)	434	4.6	21	8.26
Credit - Deposit Ratio	76.25			
Incremental C-D ratio	-47.34			
MSF Rate (04/10)	5.4			
LAF Repo Rate (%) (04/10)	5.15			
LAF Reverse Repo Rate (%) (04/10)	4.9			
Wtd Avg Call Rate (04/10)	5.19			
Cash Reserve Ratio (%)	4			

GOVERNMENT SECURITIES						
INFLOWS				**OUTFLOWS**		
Date	**Security**	**Coupon Receipts**	**Redemption**	**Date**	**Security**	**Scheduled auction amount**
8-Oct	7.27% GS 2026	1381			5-9 years	4000
		1213			10-14 years	6000
9-Oct	6.65% GS 2020				15-24 years	2000
9-Oct	6.30% GS 2023	410		7th - 11th Oct	25 years & above	4000
10-Oct	7.06% GS 2046	3530			1-4 years	2000
11-Oct	7.80% GS 2021	2632			5-9 years	2000
16-Oct	7.37% GS 2023	1474		14th-18th Oct	10-14 years	7000
					15-24 years	1000
					25 years & above	4000
Total Inflows		**10639**	**0**			**32,000**

Key Events: Upcoming Fortnight		
Date	India	US
08 October 2019		Producer Price Index
09 October 2019	M3 money supply	FOMC Minutes
		Crude Oil Inventories
10 October 2019		Core CPI
		Initial Jobless Claims
11 October 2019	IIP (Aug'19)	
14 October 2019	CPI (Sep'19)	
16 October 2019		Retail sales
17 October 2019		Industrial Production
		Capacity Utilization
18 October 2019	RBI MPC Minutes	

SPREAD MONITOR





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