For Fortnight Ended

18th October 2019

Vol: 2/2019

PNB GILTS LTD

(Subsidiary of Punjab National Bank)

ECONOMY & GILT WATCH

MPC Minutes: Growth & Monetary transmission key concerns

The minutes of the Monetary Policy Committee meeting held on 5th October were released on 18th October. The members unanimously expressed alarm over the continued slack in demand, both domestic and global, as well as slow & uneven transmission of monetary policy impulses at a time when there are significant downside risks to growth. It is a fact that effects of monetary policy stimulus are felt in a lagged manner and the "frictional" factors in the banking system are further delaying the process in the Indian context. ***The stickiness in the savings rate of small savings scheme further impediments reduction in bank deposit rates, thus hampering the overall transmission process.*** Despite the concerns, the members of the MPC expect the external benchmarking of bank rates to expedite the process of monetary transmission going forward.

With regard to inflation, the members see the current bout of rise in prices as a temporary phenomenon. The delayed withdrawal of monsoon and resultant healthy reservoir capacities across the country bode well for the rabi crops. This augurs well for revival of rural demand which is also the key for reinvigoration of overall domestic demand in the economy. Based on the above grounds, MPC members signaled room for more rate cuts going forward in order to revive economic growth and continue with the on-going accommodative stance. Though all members broadly agreed on the importance of the role of monetary policy in supporting growth, there were some views stressing on the limited extent to which it can deliver the desired outcomes and hence the need for more fiscal push. A small section of the committee hinted on waiting for the combined impact of the earlier steps taken by government and RBI to play out and that further action taken to be dependent on growth inflation dynamics going forward. Nevertheless, the broad consensus of the meeting

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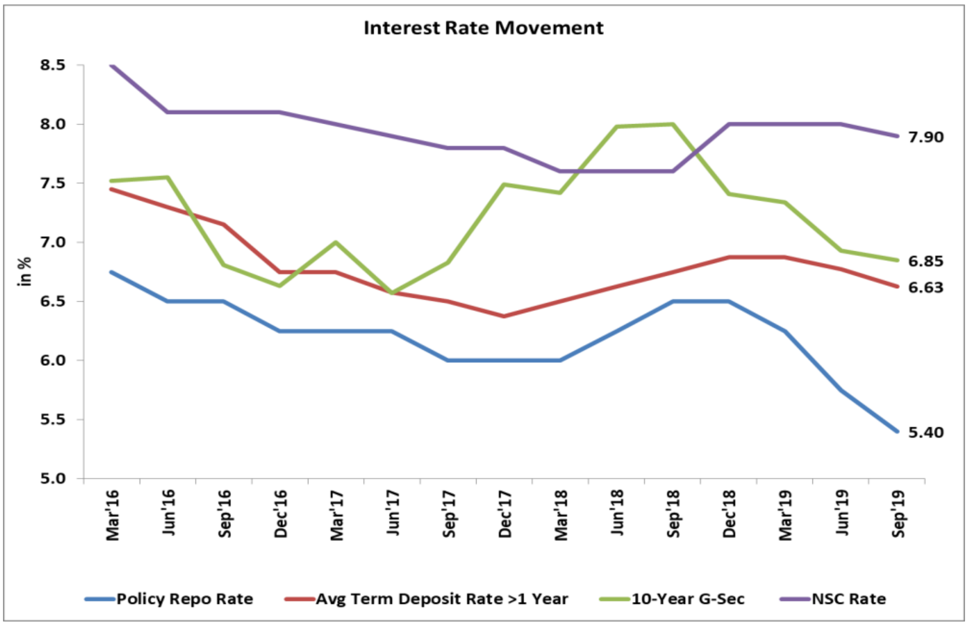
remained in favour of continuing with the steps required to arrest the on-going slowdown while ensuring inflation remains within the target range.



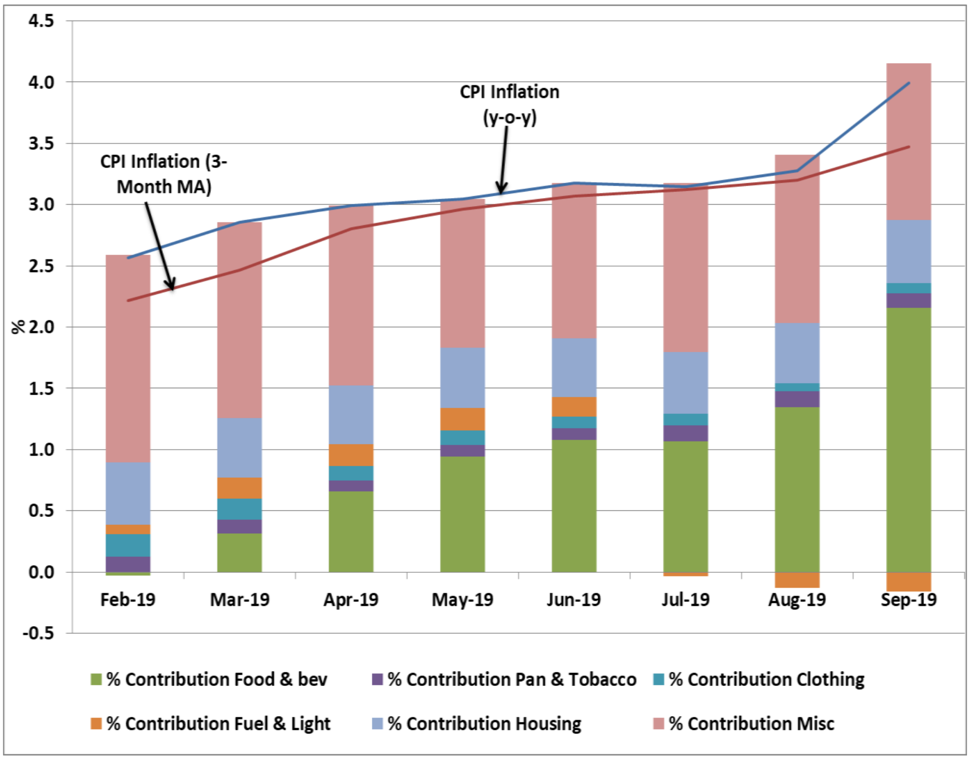
Source: RBI

Stickiness in small savings rate has hampered monetary policy transmission as bank deposit rates continue to stay at elevated levels to maintain competitiveness

Retail inflation nudges up on higher food prices

The CPI inflation rose to a 14 month high of 3.99% in September’19 largely on account of sharp uptick in food prices. The surge in CPI inflation was mostly on expected lines as the country grappled with widespread floods which impacted vegetable supplies. During the month, food and beverages inflation rose to 4.7% as against 2.96% in August’19. On the other hand, inflation in all other categories moderated on a sequential basis, which was mirrored in decline in core inflation to 4.2% in September’19 vis-à-vis 4.3% registered in August’19. Rural sector which has seen subdued price pressures in past one year, posted sharpest rise in y-o-y inflation in September (3.24% in Sep’19 vis-à-vis 2.25% in Aug’19). Contrastingly, WPI inflation recorded a fall to 0.3% as against 1.1% in the previous month.

The surge in CPI seems to be of transitory nature and food prices are expected to normalise as rain induced supply disruptions ease out in coming months. Moreover, abundant water reserves bode well for rabi crops going forward which should keep the overall CPI inflation trajectory under check. However, overall inflation may continue to stay firm in the near term as food prices may take a while before bottoming out with arrival of winter supplies.



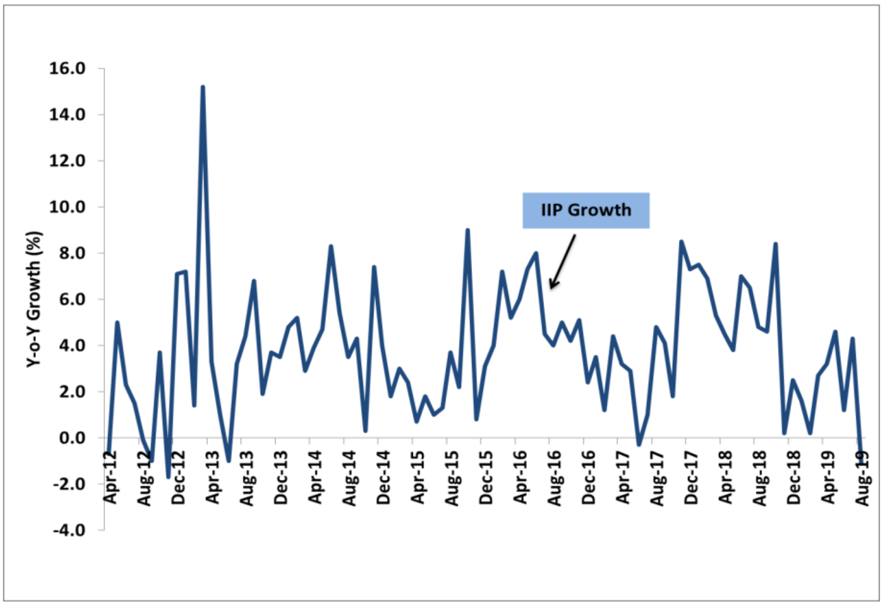
Contribution of Food & Beverages in retail inflation has surged post supply disruptions; while that of fuel & light turned negative on account of disinflation

Worst drag on IIP in more than five years

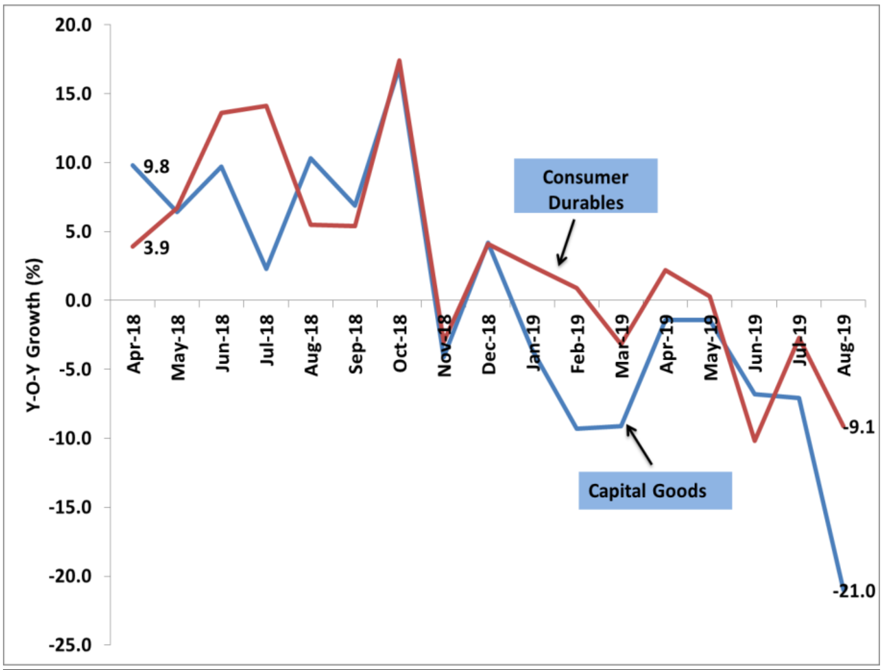
IIP data released for the month of August highlighted some sobering facts as performance deteriorated across the board. The industrial production contracted by 1.1% in August, which comes in line with the contraction of core industries growth by -0.5% in the same period. Sector wise, manufacturing & electricity sectors posted negative growth of -1.2% & -0.9% respectively, while mining growth barely managed to stay in the positive territory at 0.1% y-o-y. Manufacturing which carries the heaviest weight in the IIP basket, recorded its worst performance in almost 5 years, contracting by 1.2% in the period under review. The trend is especially worrying as 15 out of 23 subgroups under manufacturing registered contraction over previous year's levels, with as many as 5 sub-groups registering double digit negative growth in output.

As per use based classification, IIP growth was largely weighed down by negative growth posted by capital goods sector (-21% y-o-y), consumer durables (-9.1% y-o-y), construction goods (-4.5% y-o-y). The performance of other sub groups, viz, primary goods, intermediate goods and consumer durable goods which had shown resilience, also reflected weakening trend.

Going forward, though hopes are pinned on the current festive season, the same is unlikely to result in meaningful turnaround in the ongoing anemic IIP trend. High frequency indicators such as sales of vehicles still continue to reflect slackness in demand while continued contraction in exports in the face of slowing global economy also have a negative bearing on manufacturing outlook. Any meaningful turnaround in IIP will be contingent on revival of rural demand, which is still reeling under the impact of stagnant income growth.



Weakness in IIP turned broad based, with the three sectors performing poorly in August. Any meaningful turnaround in IIP will be contingent on revival of rural demand, which has a strong linkage with IIP growth.



***In a free fall**: Capital goods plunged for eighth consecutive month, reflecting continued weakness in investment activity. Consumer durables performance continues to stay depressed ahead of the festive season.*

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Fixed Income Outlook

Fundamental Point

The last fortnight saw fixed income market lying in the balance with lower core CPI and stable global commodity prices proving to be the positives while high headline CPI due to sharp uptick in food prices, higher global yields due to positive news flow from U.S.-China trade deal and noise about fiscal slippage from Government quarters being the negatives. The recently announced MPC minutes clearly show that the members are more concerned about the growth trajectory going forward and willing to be more tolerant when it comes to transient spike in upcoming CPI prints. This along with some explicit clarity on likely fiscal slippage and its source of funding should lead to yield curve remaining well behaved in the coming weeks. Specifically, new 10 year should continue to trade in the range of 6.45%-6.55%. Going forward, in addition to domestic factors, market would keenly await the outcome of the FOMC decision. Geo political events related to Brexit, Syria-Turkey conflict and re-emergence of tension between India and Pakistan will also weigh on market sentiments.

Technical Point

Chart source: www.investing.com

7.26% GS 2029 yield settled at 6.69% on Friday's session. Yield is trading in upward channel pattern, with major support placed around 6.64% level. Adding to it, on daily chart lower channel trend line also coincides with 30 EMA level (blue line), indicating 6.64%-6.65% to act as a crucial support zone for short term. On higher side immediate resistance zone is placed at 6.74% level. Momentum indicator RSI is currently placed at 53 levels. Going forward, till yield is sustaining above 6.64% level, resumption of downtrend seems difficult and it may consolidate between 6.64%-6.74% zone. Further strength can't be ruled out above 6.74%.

DATA CHECK

Key Events: Upcoming Fortnight		
Date	**India**	**US**
24-Oct	State Assembly Election Results (Maharashtra & Haryana)	Manufacturing & Services PMI
30-Oct		GDP (Q-o-Q) (Q3)
		FOMC Decision
31-Oct	Fiscal Deficit (Sep)	
	Core Industries Growth (Sep)	
01-Nov	Manufacturing PMI	Unemployment Rate (Oct)

GOVERNMENT SECURITIES						
INFLOWS				**OUTFLOWS**		
Date	**Security**	**Coupon Receipts**	**Redemption**	**Date**	**Security**	**Scheduled auction amount**
22-Oct	10.70% GS 2020	321		28th Oct-1st Nov	5-9 years	4000
26-Oct	7.72% GS 2055	3860			10-14 years	6000
3-Nov	7.80% GS 2020	2804			15-24 years	2000
					25 years & above	4000
Total Inflows		**6985**	**0**			**16,000**

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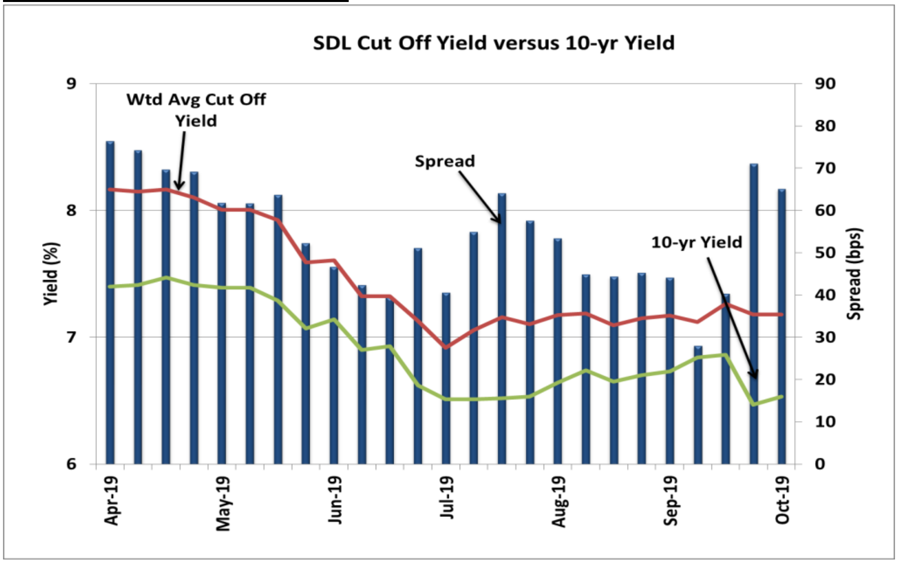
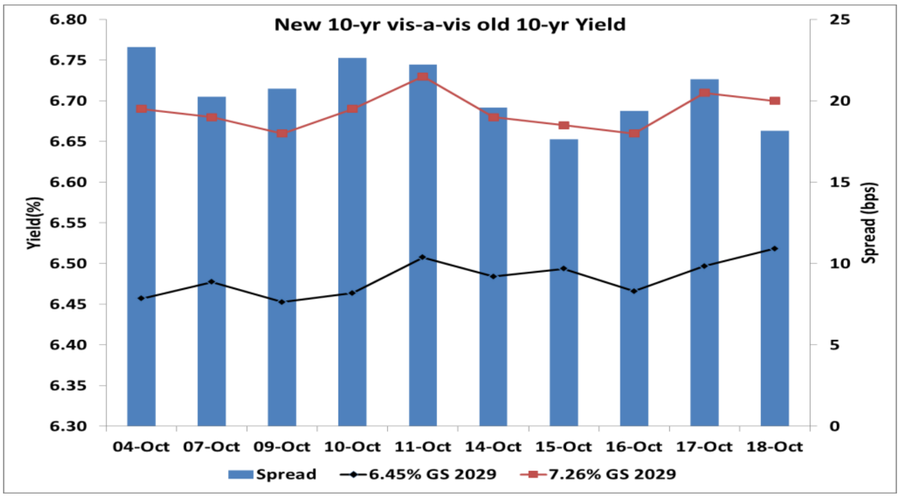
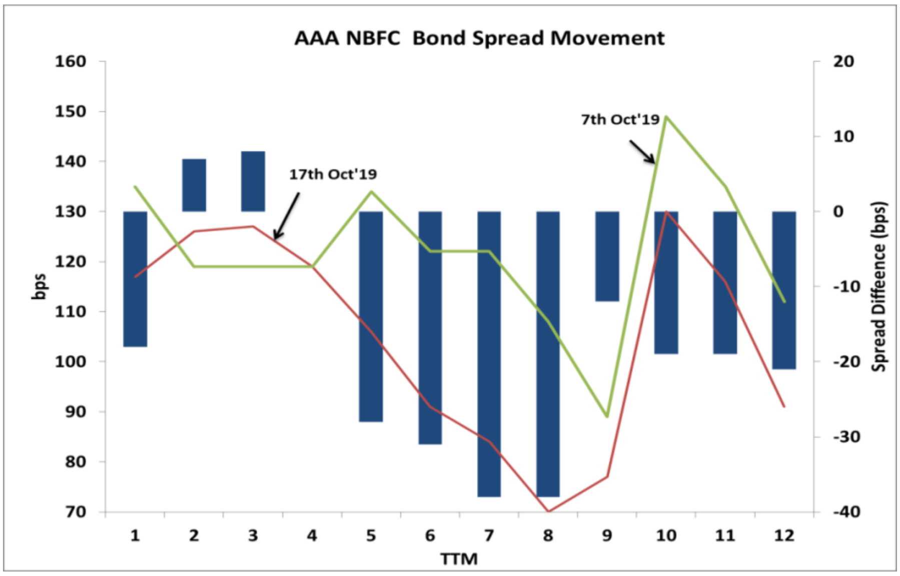
SPREAD MONITOR



SDL spreads have increased as cut offs align with the new 10-yr benchmark. With deterioration of state finances and expectation of continuous supplies, the spreads are expected to remain at elevated levels.



The spread between the new 10-yr, 6.45% GS 2029 and the old 10-yr 7.26% GS 2029 has stayed in the range of 18-23 bps. The new 10-yr yield may inch higher on account of conversion auction for Rs. 20,000 crore in the coming week.



Spreads on NBFC bonds saw correction in the previous fortnight, while short and long end spreads remain at more or less same levels. In coming fortnight, the short end spreads may ease & the curve is likely to flatten out.

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