For Fortnight Ended
4th November 2019
Vol: 3/2019

PNB GILTS LTD
(Subsidiary of Punjab National Bank)

ECONOMY & GILT WATCH

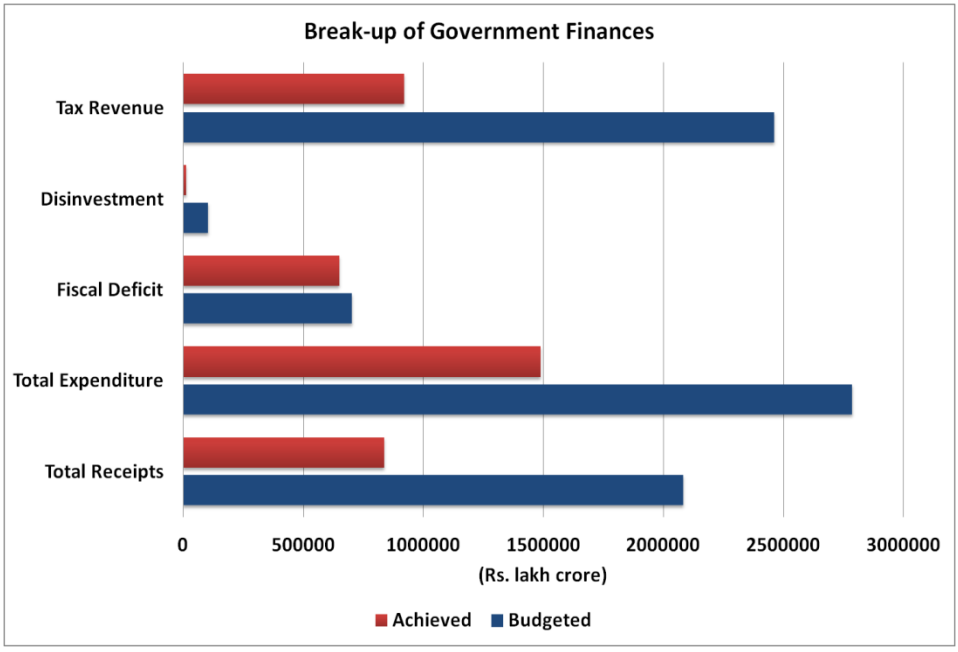
INSIDE THE ISSUE

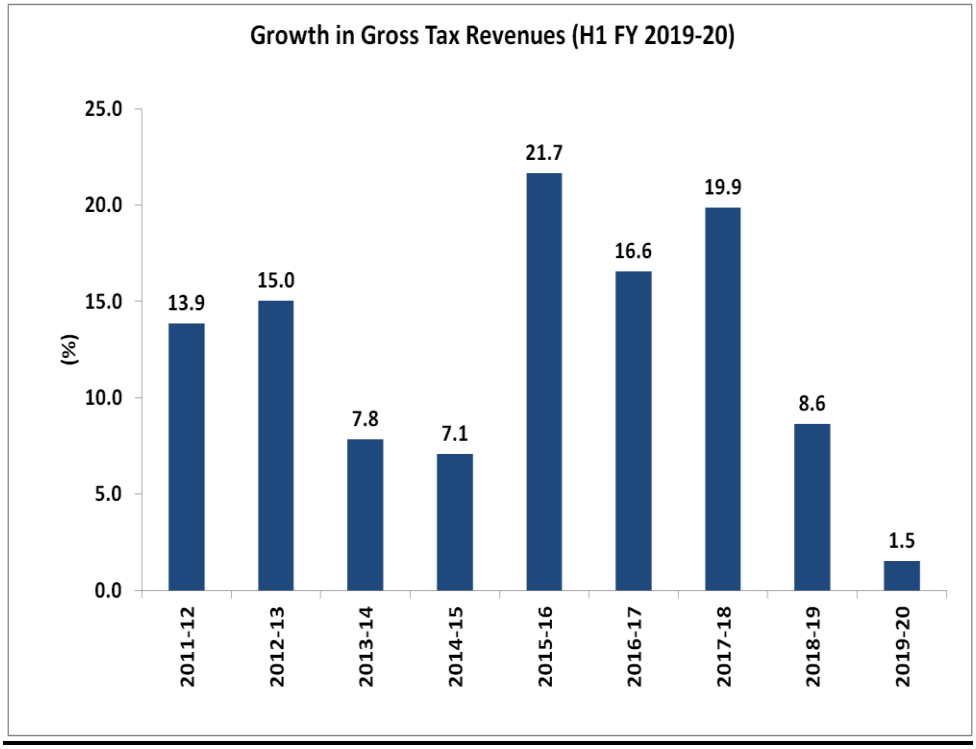
Fiscal Deficit at 93% of Budget Estimate, Tax revenues continue to play spoil sport

India's fiscal deficit concerns continue to loom large as tax revenues fail to show signs of improvement in a slowing economy. The gross tax revenue collections sharply trail the budgeted estimates (BE) for the year, growing by just 1.5% y-o-y in H1 FY20 as against 18.3% growth projected for the whole year. Under the tax revenue head, both direct as well as indirect tax receipts show a disquieting trend, requiring the revenues in H2 to stretch substantially in order to cover the huge shortfall for the whole year. In H1 of FY20, the corporate and income tax mop up stand at 33% and 37% respectively of the budgeted estimate for the whole year. GST collections have also remained subdued with H1 FY20 y-o-y growth at 4.9%. Non tax revenue which received a booster from RBI windfall, are largely in line with the BE for the current fiscal. On the other hand, government has been able to garner just about 17% of the budgeted capital receipts. A major portion of the budgeted capital receipts are in form of disinvestment receipts, the target for which has been set at a steep Rs. 1,05,000 crore for the entire fiscal. Against this, the actual disinvestment receipts in H1 stand at Rs. 12,358 crore.

On the expenditure front, after a rather slow start in Q1, both capital and revenue expenditure picked up significantly in Q2, with 53% of the total expenditure target being achieved in H1 of FY20. This is a positive for the economy as government expenditure in times of sagging private investment will feed into growth. The impact of corporate tax rate cut, muted GST collections and bleak economic growth outlook makes fiscal slippage almost unavoidable in the current scenario. The extent of the slippage will depend primarily on the realizations through disinvestments and how tax revenues catch up in the second half of the year. In the coming months, government is planning to offload stake in BPCL, HPCL, Shipping Corporation, NEEPCO, THDC, CONCOR according to reports. Though in the previous financial year,

government was able to achieve the disinvestment target of Rs. 80,000 crore, this year's disinvestment inflows will be extremely critical in bridging the fiscal gap as government faces significant pressure on its finances owing to tax reforms. With stock market touching new highs and renewal of foreign investors' interest, it may be an opportune time for privatization of government assets, sans which, the government would struggle to stabilize its finances.





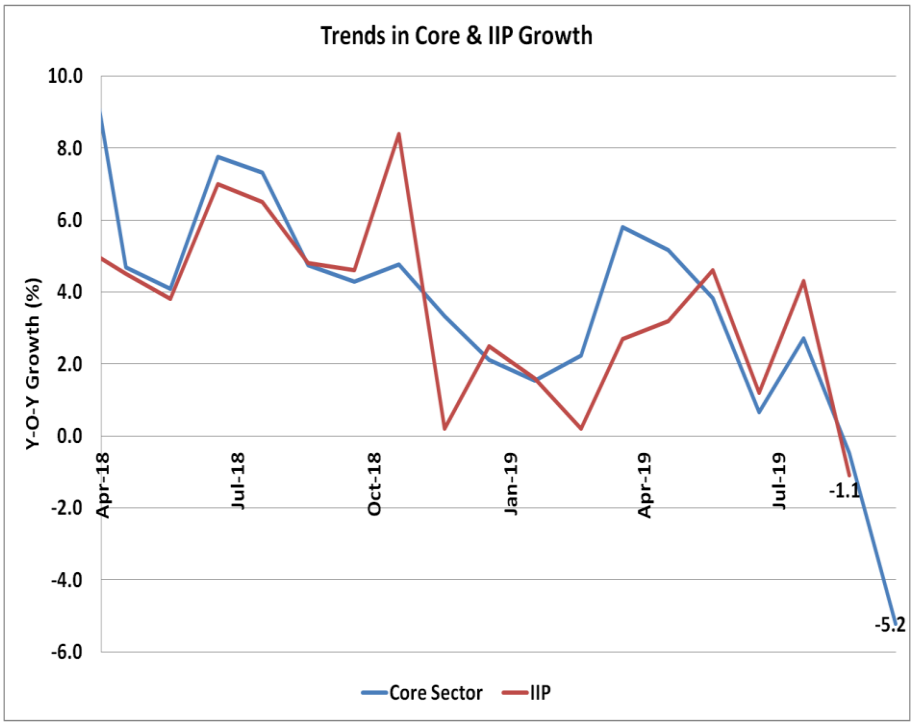
With flagging tax collections expected to create a significant dent in government revenues, trend in other sources of finance will play a critical role in bridging of the fiscal gap. Nonetheless a slippage in fiscal deficit looks almost inevitable but is also a requisite for the revival of the economy.

Source: CGA

Core industries growth plummets to 14 year low

Hopes of turnaround in economic activity were dashed as core sector contracted to a 14 year low in the month of September. Of the eight sectors, Core sector saw across the board contraction in the month of September, as the eight sectors contracted by 5.2% on account of sharp deceleration in seven out of eight key sectors. ***Demand contraction has clearly impacted the production chain in the economy, while an extended and heavy monsoons further aggravated decline in output of the key industries, especially that of coal and cement.*** Coal was the worst performer, with index plunging by 20.5% as against contraction of 8.6% in August. Fertilizer is the sole sector which registered growth of 5.4% over the previous year. The dismal core performance is expected to be reflected in the upcoming IIP data to be released in the next fortnight. The outlook for pick up in investment activity remains bleak. As per the recent Industrial Outlook Survey (IOS) conducted by RBI, net response for increase in production was negative for quarter ended September 2019 and positive but low for the December 2019 quarter. Net response indicates the percentage of respondents who assess the current quarter's production to increase over the percentage of respondents who expect it to decrease.

Adding to the gloom was the unemployment data released by CMIE for the month of October. India's unemployment rate in October rose to 8.5%, the highest since August 2016, and sharply up from 7.2% in September. The manufacturing PMI data for October came in at a two year low of 50.6 as against 51.4 in September, while the sub index of business confidence was also at a two year low. Expectations of festive season induced turnaround in economic activity seem rather implausible as the successive data releases clearly point towards a deeply entrenched and a prolonged weakness in the economy.



From Bad to Worse: Core industries suffer a double whammy of prolonged monsoons and weak demand. The dismal core performance is expected to be reflected in the upcoming IIP data to be released in the next fortnight

Global developments: It's a risk on

An upbeat US unemployment data following Fed's signal to hold interest rate cuts in the FOMC meet held on 30th October, sparked a rally in global equities and commodities market. The Federal Reserve reiterated that the domestic economy marked by strong labour market is on a solid footing. Wages have been rising, particularly for lower-paying jobs and labour participation is expanding. Household spending has been rising at a strong pace and consumption oriented sectors are doing well. Fed flagged subdued investments & exports emanating from trade uncertainties as key risks to growth. However, Fed has clearly signaled that going forward it intends to base future rate decisions on actual economic condition. ***While this does not imply that Fed would resume with rate hike cycle anytime soon as that would prove counter-productive, the stance is clearly expected to remain accommodative in line with other global central banks for an extended period of time.*** Additionally, with US and China also expected to reach the much anticipated trade deal, the outlook for emerging market assets looks positive. During the fortnight, US 10-year yield fell by 9 bps to close at 1.70%. Brent oil also shot up sharply towards the end of the fortnight to close above USD 61 a barrel mark. The Dollar Index, which tracks the dollar against a basket of developed market currencies, closed the fortnight at 97.05 falling from fortnightly high of 97.60.

Fixed Income Outlook

Fundamental Point

The last fortnight saw bond yields trading in a tight range, with yields cooling off towards the end in reaction to poor core industries data, which led to resurgence of growth concerns. Going forward, growth concerns are expected to dominate sentiments as we move closer to the GDP data release due for the second quarter of the fiscal. With the latest announcement of long term repos for Rs. 50,000 crore by RBI to mop up excess liquidity from the system may induce some knee jerk reaction in the bond market. However, RBI reiterated that it intends to maintain "durable liquidity" in the system as and when deemed necessary, which might provide some comfort to the market. On the flip side, improved risk appetite in global markets and firming up of US treasury yields may cap sharp gains the domestic bond markets. The new 10 year yield is likely to trade in the range of 6.37%-6.52% with a downward bias. The old 10-year paper, 7.26% GS 2029 is expected to trade with a spread of 18 to 22 bps over the new 10-year paper.

Technical Point

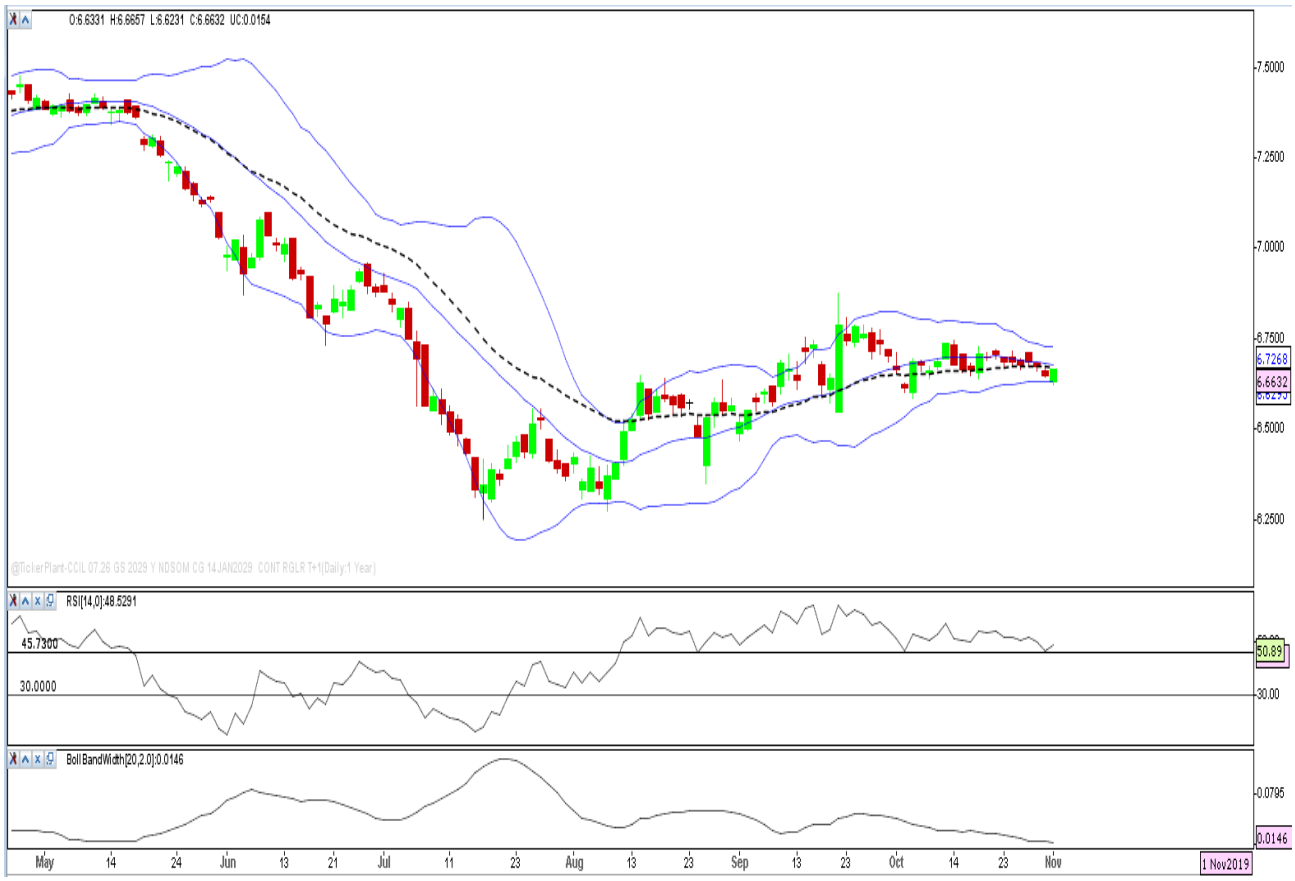


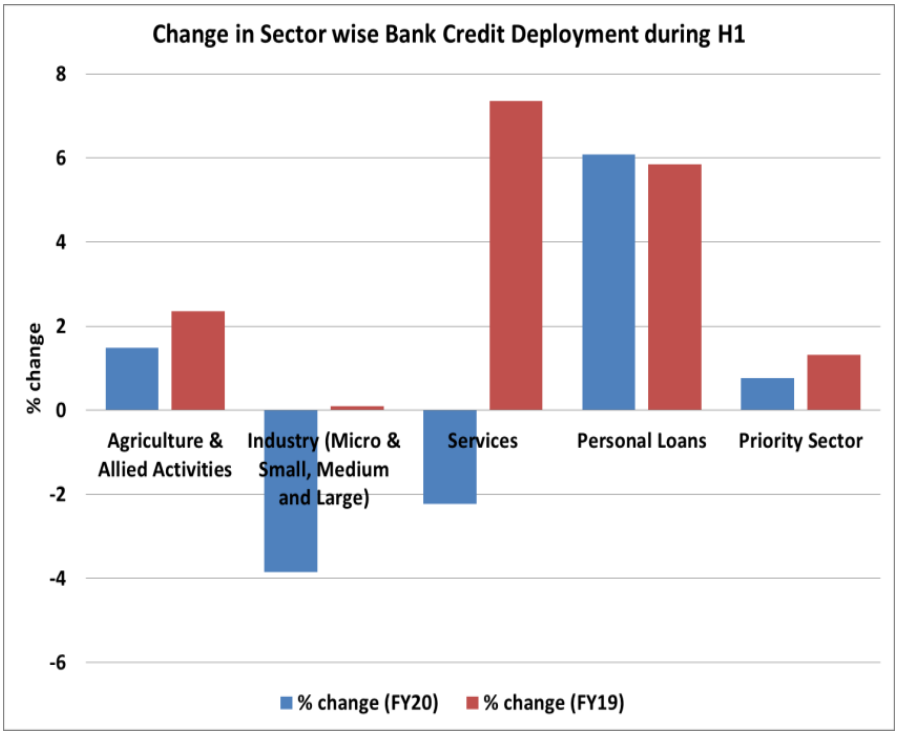
Chart source: www.investing.com

7.26% GS 2029

7.26% GS 2029 yield settled at 6.66% on Friday's session. In last fortnight, 10 yr yield traded range bound between 6.72%-6.62% zone. In last session decent surge was witnessed from 6.62%, which also coincided with lower band of Bollinger, indicating decent support near 6.62% zone. Momentum indicator RSI is placed at 48 and has good supports around 45 zone. Currently, Bollinger band width is around 2019 lows, indicating narrowing of range. Immediate resistance is placed around 6.72%-6.73% levels. We reiterate our view that 10 yr may trade range bound between 6.62%-6.73%. However, sustenance outside this range may trigger a rapid move in that direction.

DATA CHECK

Key Events: Upcoming Fortnight		
Date	**India**	**US**
5-Nov		Exports, Imports and Trade Balance (Sep)
6-Nov	M3 Money Supply	
12-Nov	CPI and IIP (Oct)	
13-Nov		CPI (Oct)
		Federal Budget Balance (Oct)
14-Nov	WPI (Oct)	PPI (Oct)
14-Nov		IIP (Oct)



Source: RBI

During H1 of FY20, bank credit to industries and services sector contracted considerably. While personal loan disbursals remained robust mainly on account of housing loans & credit card outstanding. Consumer durables and vehicle loans exhibited weakness reflecting the feeble consumer demand in the economy.

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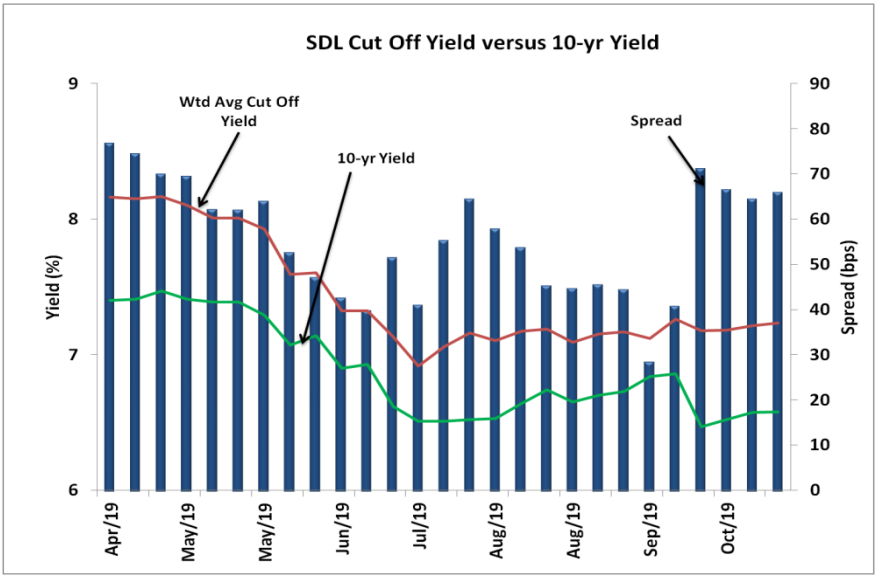
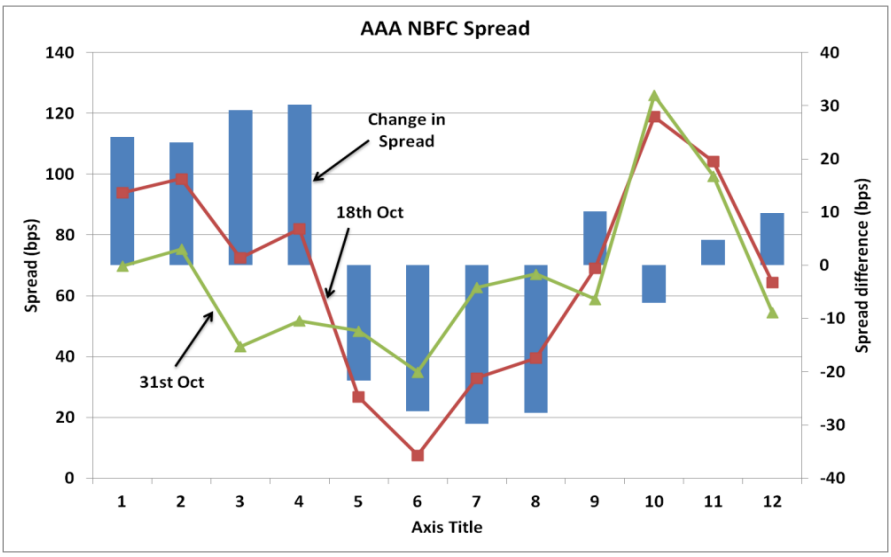
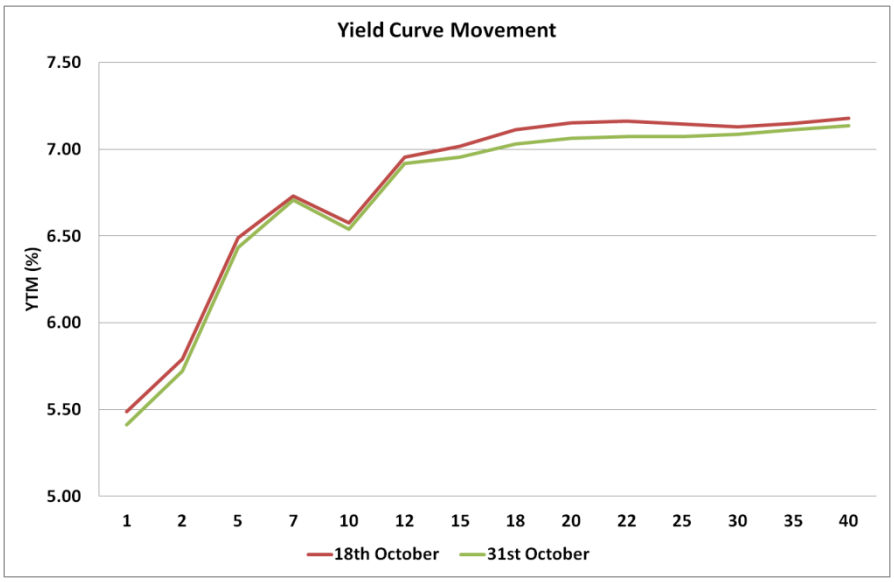
SPREAD MONITOR



As expected SDL spreads continue to stay at elevated levels. With tax revenues slowing at an alarming pace & UDAY bonds proving to be additional burden, states may cut back on Capex for respite.



Bond yield curve witnessed flattening during the fortnight as short term spreads eased while medium term spreads rose



Yield curve may witness an upward shift at the short end, as excess transient liquidity built up in the system will be mopped up via the scheduled long term repos (Rs. 50,000 cr) and CMB auction (Rs. 25,000 cr)

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