

ECONOMY & GILT WATCH

RBI's Bazooka Moment

In a surprise move, RBI which had been sitting taut on policy rates, unleashed its arsenal of monetary and non-monetary tools to combat the stress in the economy due to Covid19 crisis which has dug its heels in the country. Earlier, the government had announced a host of relief measures to support the vulnerable section through direct cash transfers and food security measures. Following suit and without much delay, RBI announced a host of relief measures on 27th March, a week earlier than the scheduled policy announcement day. It was indeed a 'whatever it takes' moment for RBI as it delivered big on all accounts, i.e., rates, liquidity and regulatory. On the rates front, RBI went for an asymmetrical rate cut, slashing the Repo Rate by 75 bps and the Reverse Repo rate by 90 bps. The policy portends the economy to be in a highly precarious position with any economic recovery highly contingent on the state of the pandemic going forward. So much so RBI has even refrained from providing any estimates on growth and inflation given the unprecedented nature of the crisis.

Tackling the crisis: Conventional & unconventional way

With RBI unleashing a slew of measures to combat the crisis, the central bank has joined the league of other central banks which have been working on a war footing to contain the impact on economic activity and financial system. The rate cut of 75 bps has taken the policy rate to historic low of 4.40% while a 90 bps cut in the reverse repo rate has led to a wider interest rate corridor (65 bps vis-à-vis 50 bps previously), which will result in the reverse repo rate becoming the effective lending rate given the copious level of liquidity prevailing in the banking system.

On the liquidity front, different measures taken (CRR cut of 100 bps for a year, MSF increase to 3% from 2% of SLR till June 2020 and Targeted LTROs for Rs. 1 lakh crore) will inject massive liquidity of Rs. 3.74 lakh crore in the system. While the CRR cut will infuse primary liquidity in the system of about Rs. 1.37 lakh crore, banks can avail funds via the MSF window for an additional Rs. 1.37 lakh crore. The targeted LTROs is an unconventional tool that the central bank has deployed to give a much needed boost to the corporate bond market which has seen a sharp sell-off and consequent surge in liquidity premia. While the end use

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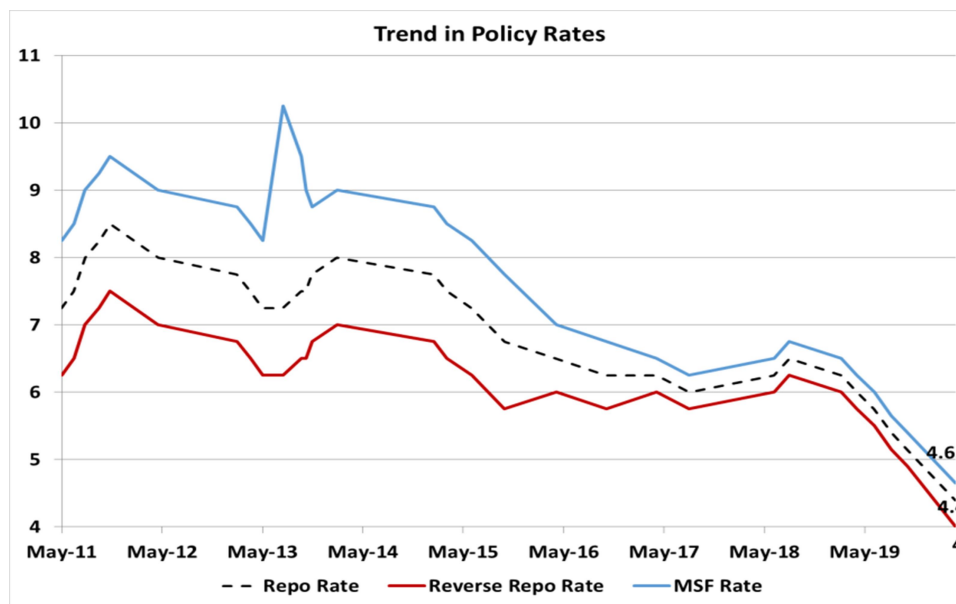
- *Repo Rate reduced by 75 bps to 4.40%*
- *Reverse Repo Rate by 90 bps to 4%*
- *Liquidity shot of Rs. 3.74 lakh crore*

➤ **Fixed Income Fundamental View**

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of the original LTROs was unspecified, the new version of LTROs will entail the funds being deployed in investment grade corporate bonds, commercial paper and non-convertible debentures (50% each in primary & secondary market). Further, classification of investment made under this facility into HTM category is likely to spur good interest from banks.



The interest rate corridor has been widened to 65 bps to disincentivize banks from parking funds at the reverse repo window

The regulatory forbearance with respect to both banks as well as borrowers (both individuals & businesses) is expected to give temporary but much needed respite. The forbearance is on multiple accounts, ranging from extending the moratorium on payment of installments of term loans, a three-month deferment of interest on working capital facilities, easing of working capital norms and deferment of NSFR norm implementation as well as last tranche of capital conservation buffer by 6 months period. Also, in order to ease operational difficulties, RBI has eased the daily CRR requirement of banks from 90% to 80%.

Policy efficacy amidst looming uncertainties

RBI has showed both intent as well as way in dealing with the current crisis. The forward guidance of the central bank is also heavily dovish as it emphasizes to deal with this unprecedented situation using both conventional & unconventional ways while acknowledging that the shock to the economy could be severe and needs strong fiscal and monetary measures to deal with the same. RBI has done everything it could do on the liquidity and interest rate front, however the bigger challenge lies in transmission of these measures in the economy amidst a scenario where risk aversion is likely to rise and needs to be broken. The availability of funds at lower costs cannot simply revive the capex cycle as

we see the economy staring at large scale disruption in supply of labour owing to mass exodus in various cities. To aggravate the problem, the economy will likely see dampened demand for an extend period of time with layoffs and shutting down of businesses triggering another wave of vicious cycle of weak investment and demand in the economy. RBI and the government face an uphill task of reviving the economy as the current situation has all the makings of a full blown recession.

Fixed Income Outlook

Fundamental View

The domestic bond markets, which had been witnessing thinning of volume and rising spreads, heaved a sigh of relief, after RBI joined the rate cut and monetary stimulus bandwagon on Friday. While the G-sec yields fell by 8-10 bps in response to the surprise policy move, the corporate bond segment saw huge moves of around 100 bps as the targeted LTRO gave much needed life to the limping corporate bond market. However despite the rate cut and an extremely dovish forward guidance given by RBI, all is not rosy for the bond markets. Going forward, market move will hinge upon announcement of auction calendar tomorrow amidst concerns of funding of the fiscal relief measures announced by the government. Any kind of implicit or explicit indication by RBI regarding future purchases in secondary market or even private placement of GOI issuance will be a huge positive for bonds. Market's expectations of bond buying program are huge and in absence of such a program the G-sec yields are likely to take a severe beating. Whether RBI will oblige or not and follow other central banks will be a key driver of the bond yields as we enter the new financial year.

Technical View

6.45% GS 2029 yield settled at 6.14% in previous session. Last fortnight, benchmark yield traded volatile between 6.00%-6.44% range. On Friday, post RBI announcement of reduction in repo rate, yield touched lows of 6% however, smart recovery was seen thereafter as it settled around the opening level.

Momentum indicator RSI is hovering around 40 zone. Bollinger's upper band is placed at 6.43% and lower band is placed at 6.08% zone. Current candle stick pattern indicates, this pull back may continue further till 6.23%/6.25% zone. Having said that, we still maintain a view of downward bias in 10-yr yield, with major resistance placed at **6.25%**(20 SMA zone) and **6.42%**(previous breakdown level). On lower side **6%** (double bottom) will act as crucial support zone, as twice in this month markets have seen smart surge from this level.

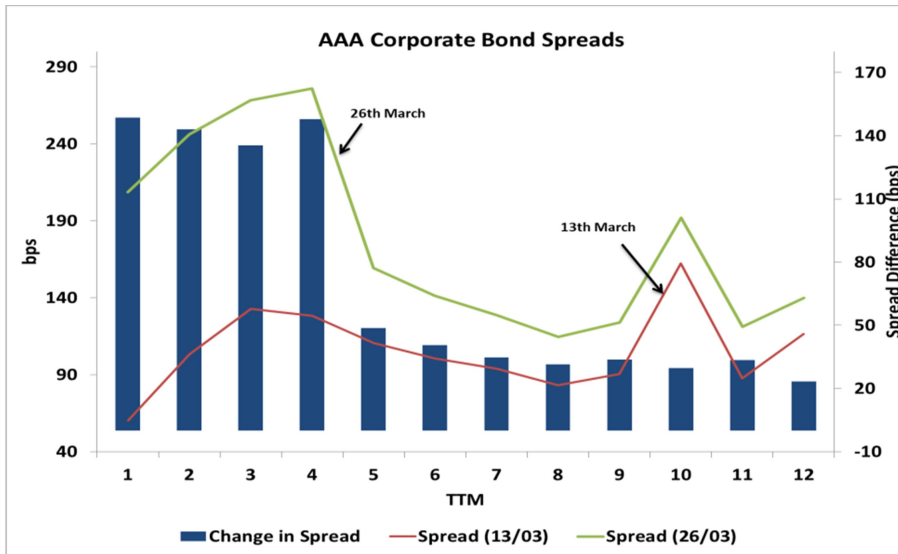
30th March 2020

Chart source: Investing.com

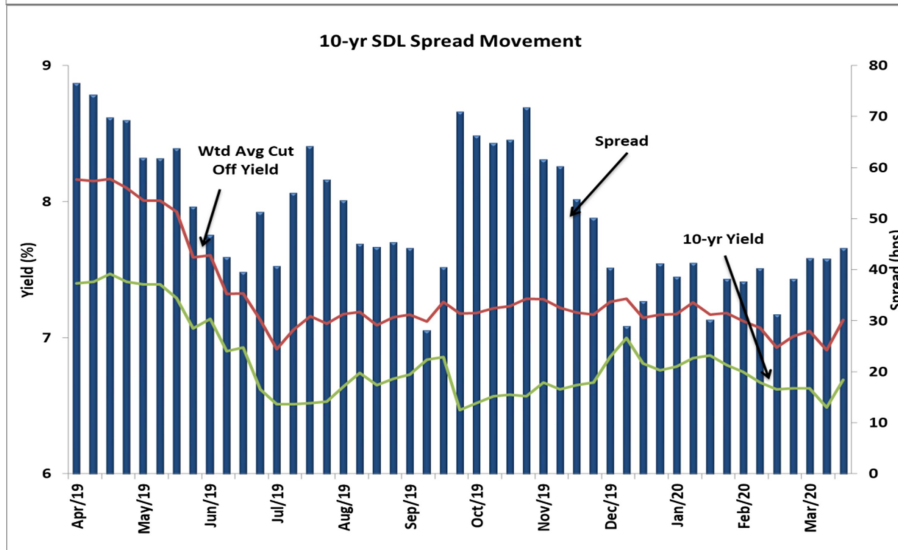


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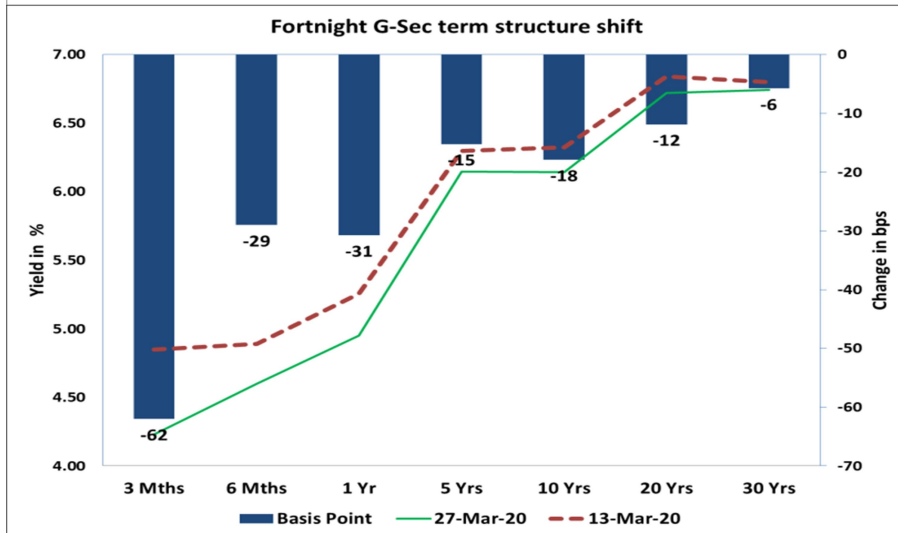
SPREAD MONITOR



Announcement of TLTROs has calmed down the corporate bond markets which came under severe stress in the past fortnight

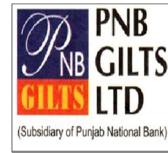


The outlook for SDLs remains negative amidst concerns of heavy borrowing schedule for the upcoming year which may push spreads higher from current levels



The short end of the curve has reacted sharply to the massive liquidity injection announced by RBI

30th March 2020



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