8th June 2020

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PNB GILTS LTD (Subsidiary of Punjab National Bank)

ECONOMY & GILT WATCH

Q4 GDP Growth at 3.1%, Economic Activity Poised to Hit the Abyss

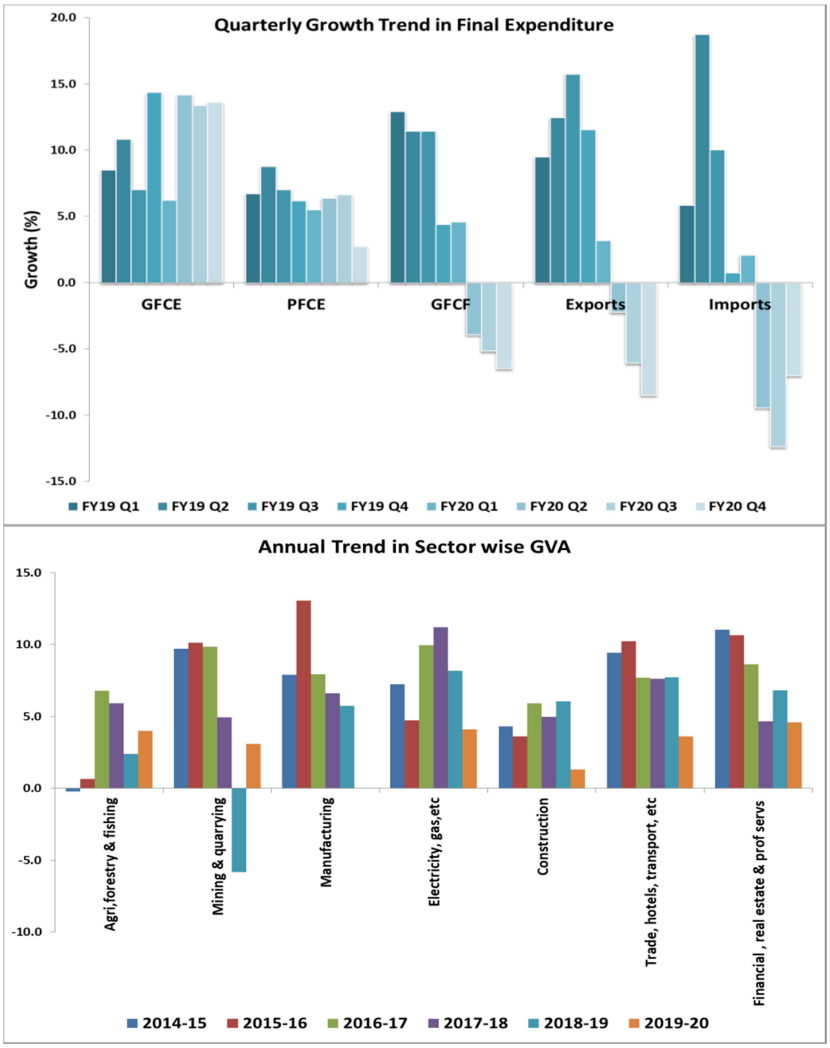
The GDP growth figure for Q4 of FY20 came in better than expectations at 3.1% while for the complete year the provisional GDP growth stands at 11 year low of 4.2% with the worst yet to come, as the Covid induced collapse in the economic activity will only be reflected in the figures for the coming quarters. While the fourth quarter's growth figures were expected to be weak, the previous quarters' GDP print went under downward revision which is a telling indication that the economy was in an extremely fragile state much before the onset of the Covid crisis. The growth numbers for the first three quarters were revised downwards to 5.2% from 5.4% for Q1, 4.4% from 4.8% for Q2 and 4.1% from 4.5% for Q3. The collapse in consumer and investment demand had already weakened substantially and now with demand hitting the wall and very much unlikely to be restored to pre Covid levels in the foreseeable future, the economic activity is expected to plunge into a free fall in Q1 of FY21.

Deteriorating Trends

The growth trends in both expenditure and sector wise estimates of GDP reflect a stark deterioration in key drivers of the Indian GDP. Looking at the expenditure side break-up of GDP, the quarterly trend in key GDP growth driver i.e. private final consumption expenditure (PFCE) is seen plunging to a five year low of 2.7% in Q4 as against five year average of 7%. Similarly, the economy saw Gross Fixed Capital Formation (GFCF), exports and imports registering negative growth for three successive quarters which reflect extremely poor investment sentiment both in domestic and global markets. In order to offset the sharp decline in private activity, the government expenditure continued to grow at 10% plus rate.

Sector wise annual trends show that manufacturing and construction sectors fared poorly during the year posting growth of 0.03% and 1.3% respectively during the year, while agriculture and mining activity (4% and 3.1% respectively) threw a positive surprise registering higher growth rates compared to previous year, partly making up for the sharp decline in growth in other sectors.

INSIDE THE ISSUE



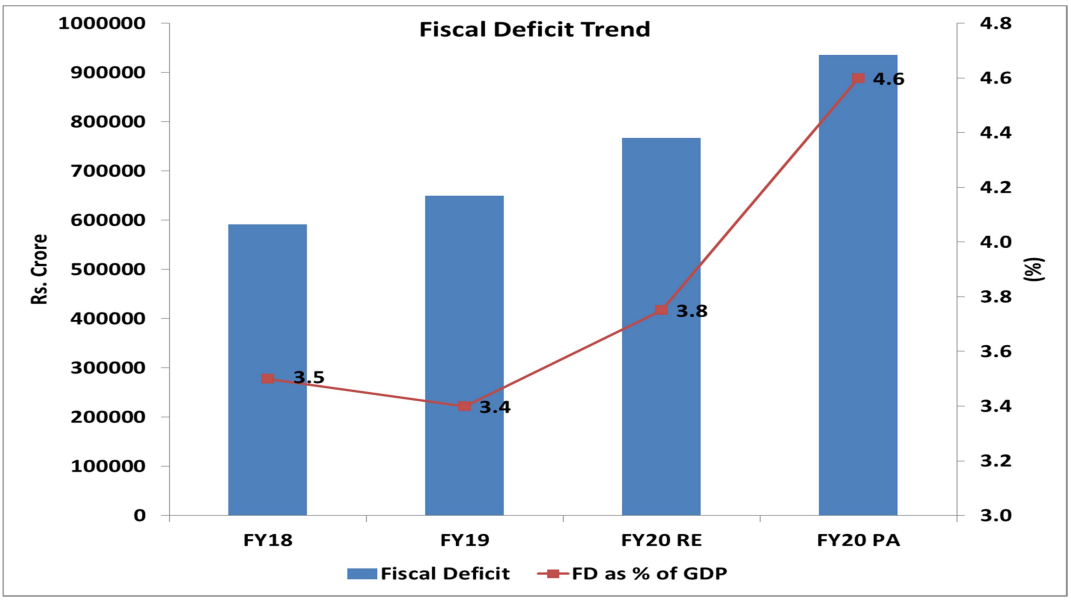
Contraction in Capital formation, Exports and slowing Private Consumption was partly offset by sustained double digit growth in Government Expenditure.

Sector wise trends indicate that growth in industry and services fared much below the average growth, while a rebound in agricultural output was registered in Q4.

Bottom-line

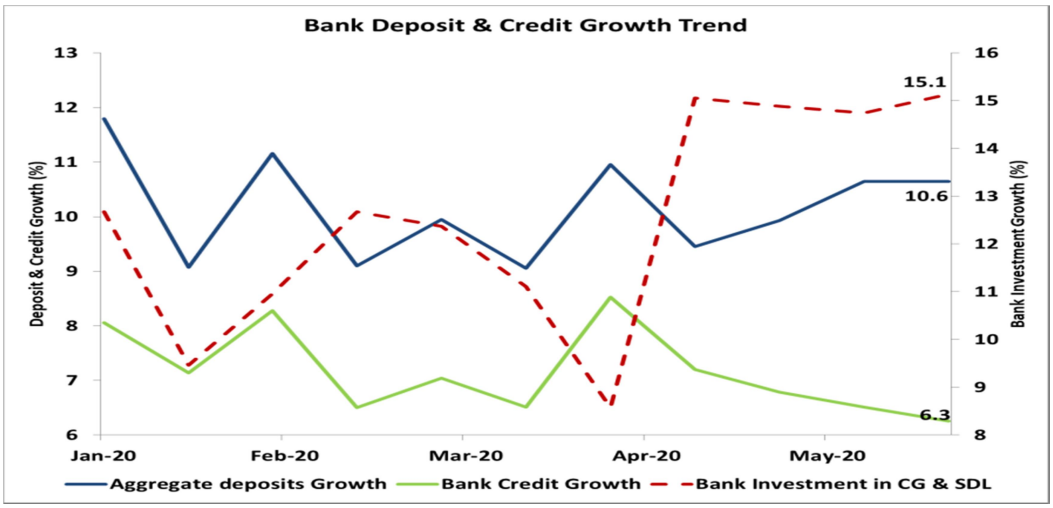
The GDP numbers released last Friday are dire, however what is even more worrying is that the numbers are still not truly reflective of the actual state of the economy that probably prevailed in the last quarter of the year. The release of the data comes with this caveat and the GDP print is likely to undergo major revision as the actual flow of data gets incorporated in the provisional numbers. Thus the actual GDP may be a fry cry from the released numbers which will have severe implications for the Fiscal Deficit (FD) situation. Already, the FD calculations for FY 2019-20 have been upended with the FD settling at a seven year high of 4.6% of GDP as against the RE of 3.8% as per the budget FY21. The risk of further widening of the FD for FY20 is imminent with the GDP likely to undergo downward revision from the current estimates. The government has provided a modest boost through spending in the wake of the ongoing crisis, but government finances situation still remains highly fluid in current situation, which makes it difficult to make any credible projection for fiscal deficit for FY21. Nonetheless, as is seen from the growth print for FY20, it is the government expenditure which had largely cushioned the overall growth in FY20. The economy clearly needs this

support going forward too and relying solely on the investment and demand cycle to kick-start through credit related schemes at a time when risk aversion is high, may be wishing for too much.



Credit Growth Weakens Further, Deposit Growth Remains Steady

The impact of lockdown measures is seen to be manifesting in the credit off-take as per the RBI data released on 5th June'20. In the fortnight ended 22nd May bank credit grew 6.5% y-o-y, as against 12.7% growth in the corresponding fortnight of previous year. The credit growth has seen a sequential decline from the beginning of the new financial year with y-o-y growth declining by 220 bps from March end growth of 8.5%. On the other hand deposit growth continues to remain steady with y-o-y growth at 10.6%. With decline in credit off-take, growth in banks' investment in Government securities has jumped sharply with the beginning of the new financial year with y-o-y growth at 15 per cent.



Fixed Income Outlook

Fundamental View

During the last fortnight, yields traded in a tight range with the 10-yr yield hovering in a narrow band of 5.95% & 6.09% and ending the fortnight at 6.02%. Yields have so far remained anchored in anticipation of RBI's support to the government borrowing program. The Monetary Policy minutes clearly indicate that RBI is extremely downbeat as far as economic growth is concerned and is expected to continue playing a proactive role in revival of the economy. In the coming fortnight, we expect yields to continue trading in a range bound manner with the 10-yr yield likely to move in the band of 5.95% to 6.05%. Any outbreak from this range is strongly contingent on RBI's action as bond markets keenly await for a trigger to move out of the ongoing lull.

Technical View

Analyst1: 6.45% GS 2029 yield settled at 6.02% in previous session. Last fortnight, benchmark yield headed higher as it sustained above hammer candlestick pattern. Momentum oscillator RSI is making higher lows despite lower low, lower high formation in yield, which indicates further rise in yields possible once it sustains above crucial resistance level of 6.09% on EOD chart. Having said that, till yield is trading below 6.09% it may trade range bound between 5.95% to 6.09% zone for coming days with downward bias and any sustainability below 5.95% could attract further downside towards 5.85% in it.

Chart source: TickerPlant

Analyst 2: The market has been largely range-bound and 6.45% GS 2029 is currently hovering around 6%. Even during the rating downgrade, the paper has failed to breach 6.09% on the higher side. The 61.8% retracement of the wave from 6.28% to 5.85% comes at 6.12%.Hence the view is to stay long with the ultimate stop loss at 6.12% and a take profit at 5.75%.

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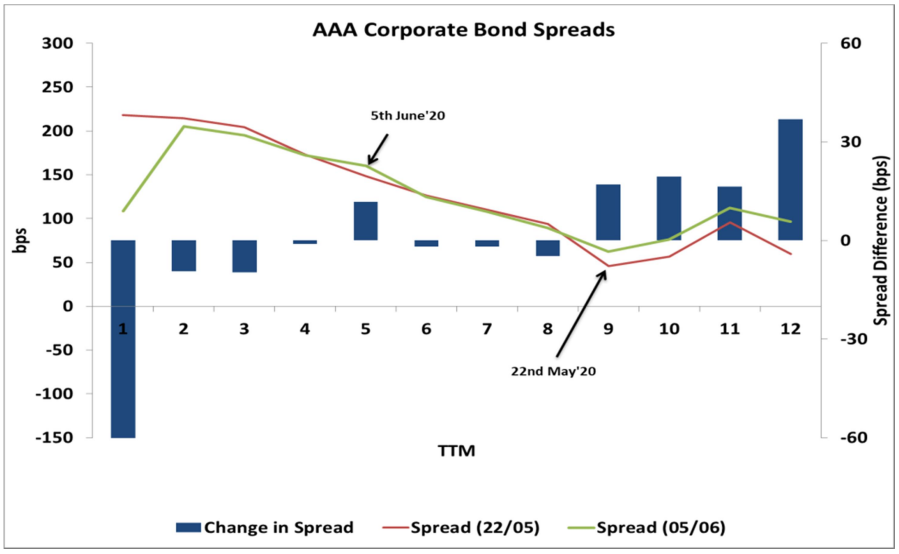
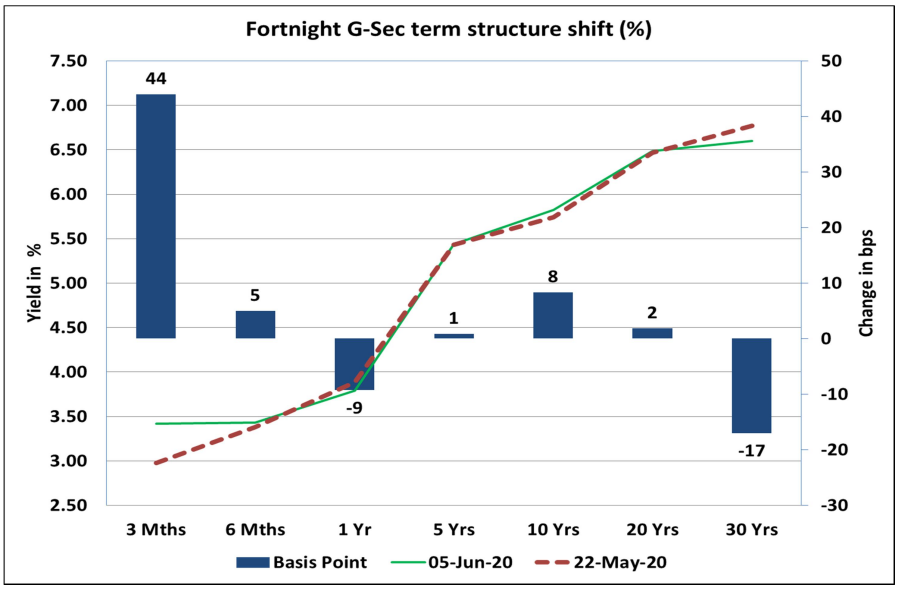
SPREAD MONITOR



Short term corporate bond spreads are at steep levels as the business activity faces severe hurdles and cash flow concerns.



The yield curve continues to display a steepening bias amidst concerns of rising fiscal deficit.

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