13th July 2020

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PNB GILTS LTD (Subsidiary of Punjab National Bank)

# ECONOMY & GILT WATCH

## *Agriculture Sector: A Silver Lining or a Mirage?*

**INSIDE THE ISSUE**

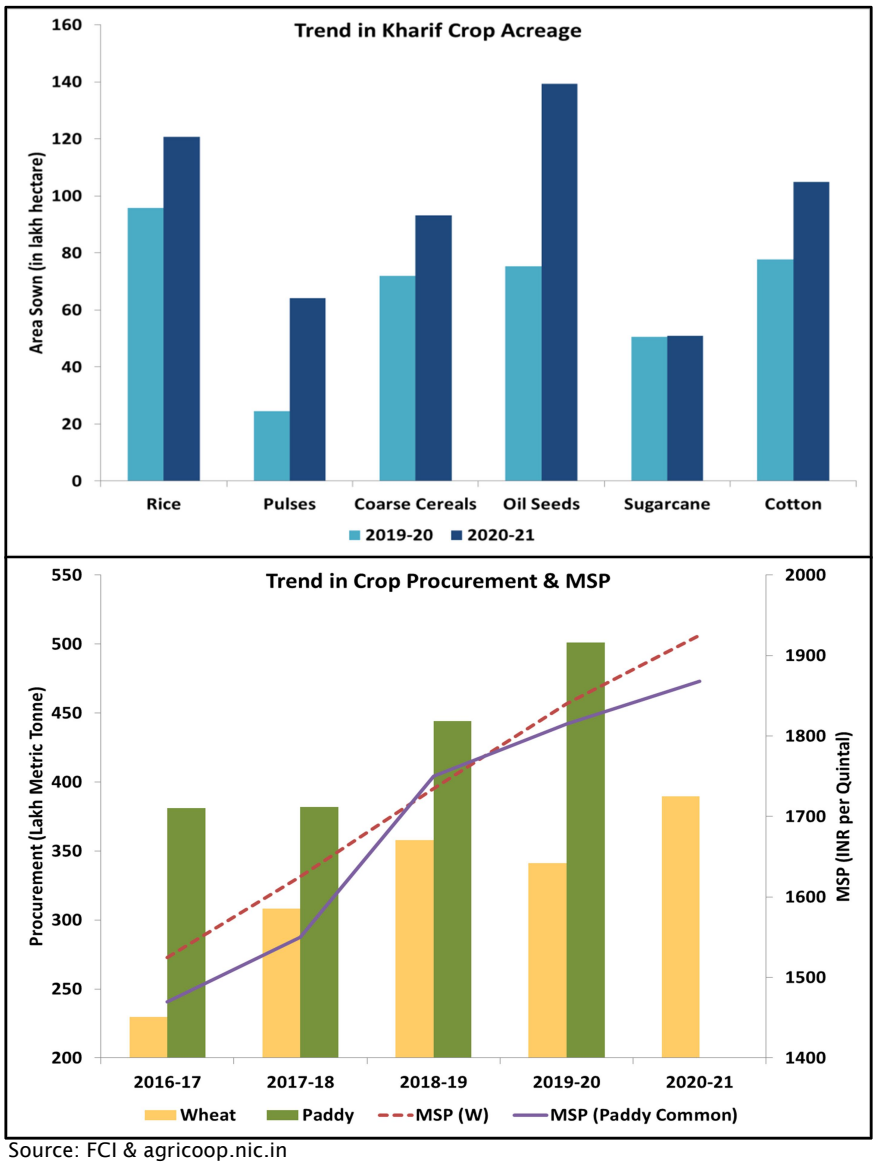


The Indian economy has forayed into the second quarter, with hopes that it possibly troughed in the first. Lead economic indicators including IIP, rail freight traffic, retail fuel consumption etc. witnessed moderate narrowing of year on year contraction rates. However, the same cannot be construed as signs of revival as uncertainty continues to loom large with infections climbing sharply and marking new daily highs with every passing day. And even though the phased unlocking is underway, economic activity continues to remain subdued and far below the pre Covid times. Trade related activity also continues to remain under stress and the same was reflected in the narrowing of the trade deficit on account of sharp contraction in imports, indicating dampened domestic demand.

### Ray of Hope

Amidst the gloom and doom, the revival in the agriculture sector and better prospects of the rural economy compared to its urban counterpart, has provided a dash of hope. While the agriculture sector has been under chronic distress for decades, the 4% growth in gross value added for FY20 came as a pleasant surprise. The prospects of the agriculture sector seem to have brightened, largely on account of bumper harvest benefiting from bountiful monsoons. The same has been reflected in the rising trend seen in the acreage especially in wheat, rice, cereals and pluses. Another important factor is the increase in MSPs for food grains and record procurement by the government to meet the additional food grain requirements which has resulted in higher realization for farmers. Additionally, the rural sector has also received a boost from front loading of direct cash transfer scheme *PM KISAN* and increase in *MGNREGA* allocation by Rs. 40,000 crore in the wake of the Covid crisis. While the rural sector has

received government support at a time when monsoons have been favorable for the farming community, the same inducing a positive impact on the rural income cannot be considered as a foregone conclusion. It must be noted that an increase in agriculture output does not necessarily translate into an increase in rural income. The income is after all dependent on the input cost for the farmer and the demand for the agriculture produce. The input costs for the agriculture sector have witnessed a rise with increase in prices of diesel, electricity and fertilizers. On the other hand the demand is contingent on the overall demand in the economy which has been depressed due to decline in spending on both discretionary (to a larger extent) and non-discretionary goods amidst the ongoing crisis.




Source: FCI & agricoop.nic.in

Kharif Crop Acreage as on 10th July 2020

*Agriculture has been able to buck the slowdown trend as pivotal factors such as rainfall, procurement demand and MSPs bear a favourable impact on the sector.*

## More Still Needs to be Done

While the government has been working with increased focus in order to provide a stimulus to the rural economy, more needs to be done in terms of additional direct government spending besides ensuring remunerative prices for the farming community. The slew of agri related reform measures announced by the government as part of its stimulus package cover important aspects of the sector such as market reforms, investment in agriculture infrastructure (for minimizing agri wastage), changes in the essential commodities act and dismantling of the mandi system which will bring in the much needed competiveness in the sector. However, these measures will take time to yield the desired outcomes as the agriculture sector undergoes various reforms. In the meanwhile, it is important that the government continues to lay emphasis on the rural sector and keep up the momentum through short term measures as well. Though the allocations to the employment scheme MGNREGA have been increased substantially over the original budget allocations, the same may fall short of meeting the increased demand for work with influx of migrants returning to their homes. The scheme can do the much needed heavy lifting by providing work to the unemployed rural population which can give a boost to the rural spending as the rural population consumes most of what it earns. It is imperative that the true potential of our hinterlands be realized through implementation and furthering of reforms, for the sector to become the growth driver of the Indian economy and also a global agricultural powerhouse.

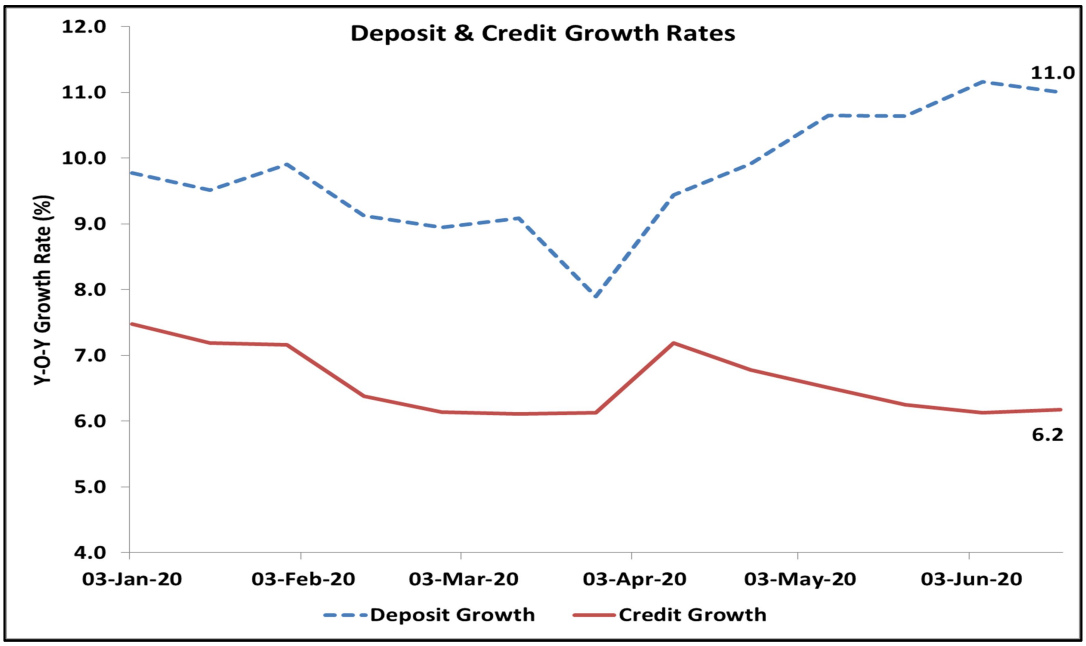
# *Key Economic Data Prints*

## Contraction in IIP Narrows in May

The index of industrial activity continued to contract albeit at a slower rate as the economy undergoes unlocking in a phased manner. In the month of May, the IIP contracted by 35% as against 56% in April. Sector based figures showed narrowing of contraction in year on year growth figure over the previous month. Manufacturing output saw a contraction of 39.3% in May compared to a contraction of 67.1% in April, while mining contracted by 21% in May, compared to a contraction of 26.9% in April. Electricity generation contracted the least by 15.4% compared to a contraction of 22.9% in April. As per use based classification, the contraction rates narrowed in all the categories with consumer durables and capital goods witnessing maximum contraction of 68.4% and 64.3% respectively indicating continued slump in consumer and investment demand.

## Gap between Deposit & Credit Growth Continues to Widen

The credit growth on the other hand continues to remain muted while deposit mobilisation continues to exceed the credit off take in the economy. In the fortnight ended 19th June, deposits grew by 11% while credit growth grew by 6.2% y-o-y. The heightened uncertainty has also resulted in sharp increase in growth in currency in circulation (CiC) with the same growing by 9% during the current financial year till 3rd July'20 as against 2% growth witnessed in the corresponding period of last year as people are directing funds towards bank deposits or are hoarding cash to meet covid related exigencies.




## Fixed Income Outlook

### *Fundamental View*

The G-sec market ended the previous fortnight on a positive note as sentiments continue to remain largely anchored due to bond positive factors such as excess liquidity, demand for safe haven assets, well behaved rupee and the implicit RBI support. RBI has so far refrained from announcing any calendar for buybacks which has defied strong expectations of the market players. The steepening bias in the yield curve is expected to continue as excess liquidity and fiscal deficit concerns will continue to be the main drivers. In absence of any outright support from the central bank, we expect the markets to trade in a range bound manner with the new 10 yr yield likely to move between 5.72% and 5.82% in the coming fortnight.

## *Technical View*

**Analyst1:** 5.79% GOI 2030 yield settled at 5.76% in previous session. Last fortnight, benchmark yield headed lower and touched the crucial support level of 5.75%. A doji candle formation was witnessed on Friday's close, indicating close contest between bulls and bears near the lower Bollinger band area.

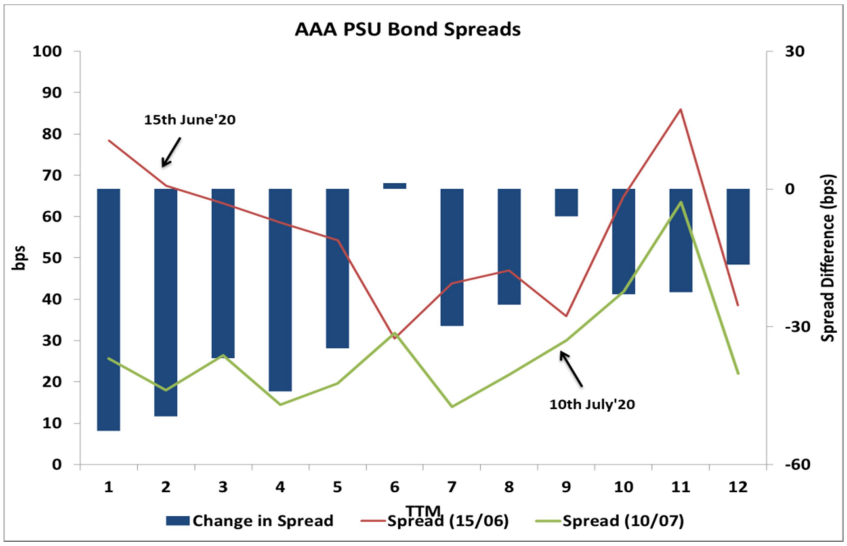
Momentum oscillator RSI is placed around 40 level. From here on, any sustainability above 5.78/5.79% may trigger a surge towards 5.85% i.e. 20 SMA level. Having said that, our view still remains sideways to weak for coming days and any sustainability below 5.74% could attract further downside towards 5.65% in the benchmark.

Chart source: TickerPlant

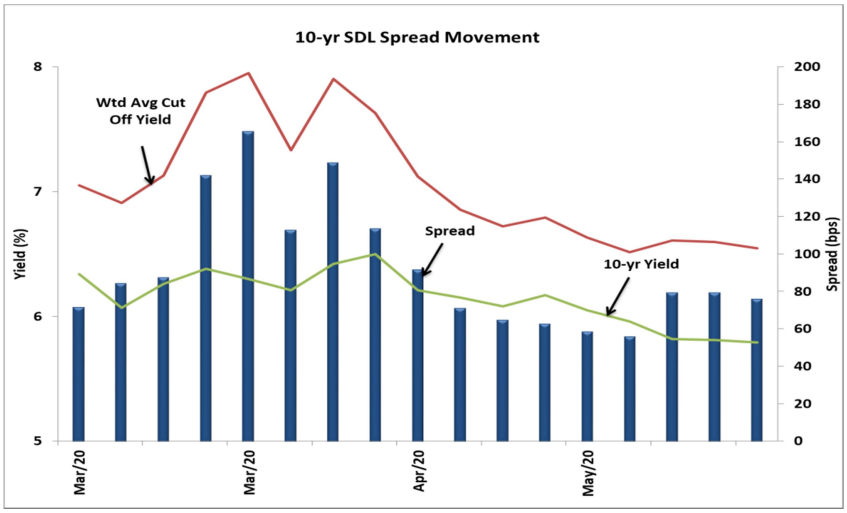
**Analyst 2:** In the price band of Rs. 101 - 99.04, 5.79% GOI 2030 has broken above the 61.8% upside Fibonacci retracement at 100.24. Hence, the view is to stay long with a stop-loss at Rs. 99.86 and a take profit at Rs. 100.58. Long positions to be exited once the price breaks below the stop-loss of 99.86.

# 13th July 2020

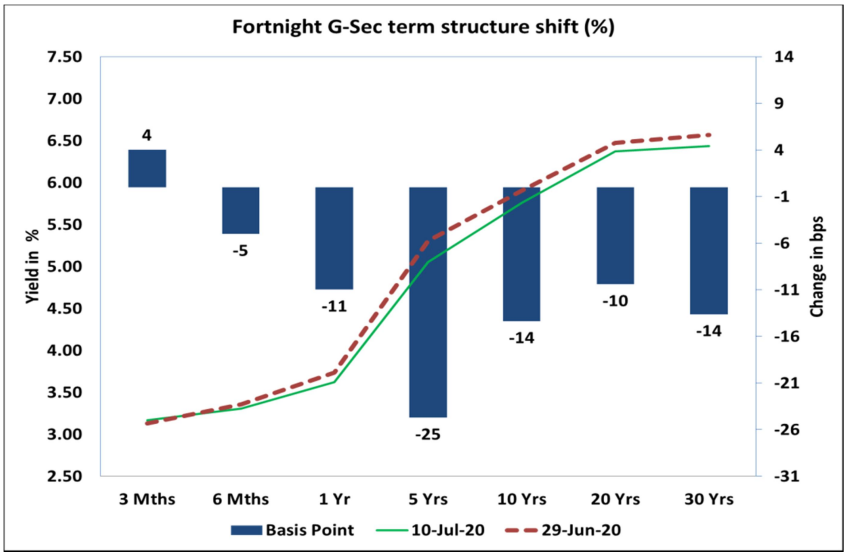
## SPREAD MONITOR




*PSU bond spreads have plunged sharply as liquidity overhang in the system continues to induce demand for high rated non SLR papers*




*In the G-sec segment, the steepening bias is expected to continue on account of excess liquidity and fiscal deficit concerns. SDL spreads are trading stable as sentiments remain anchored in the bond market*



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