

# Economy & Gilt Watch

## Monetary Policy: RBI Opts for a Pause

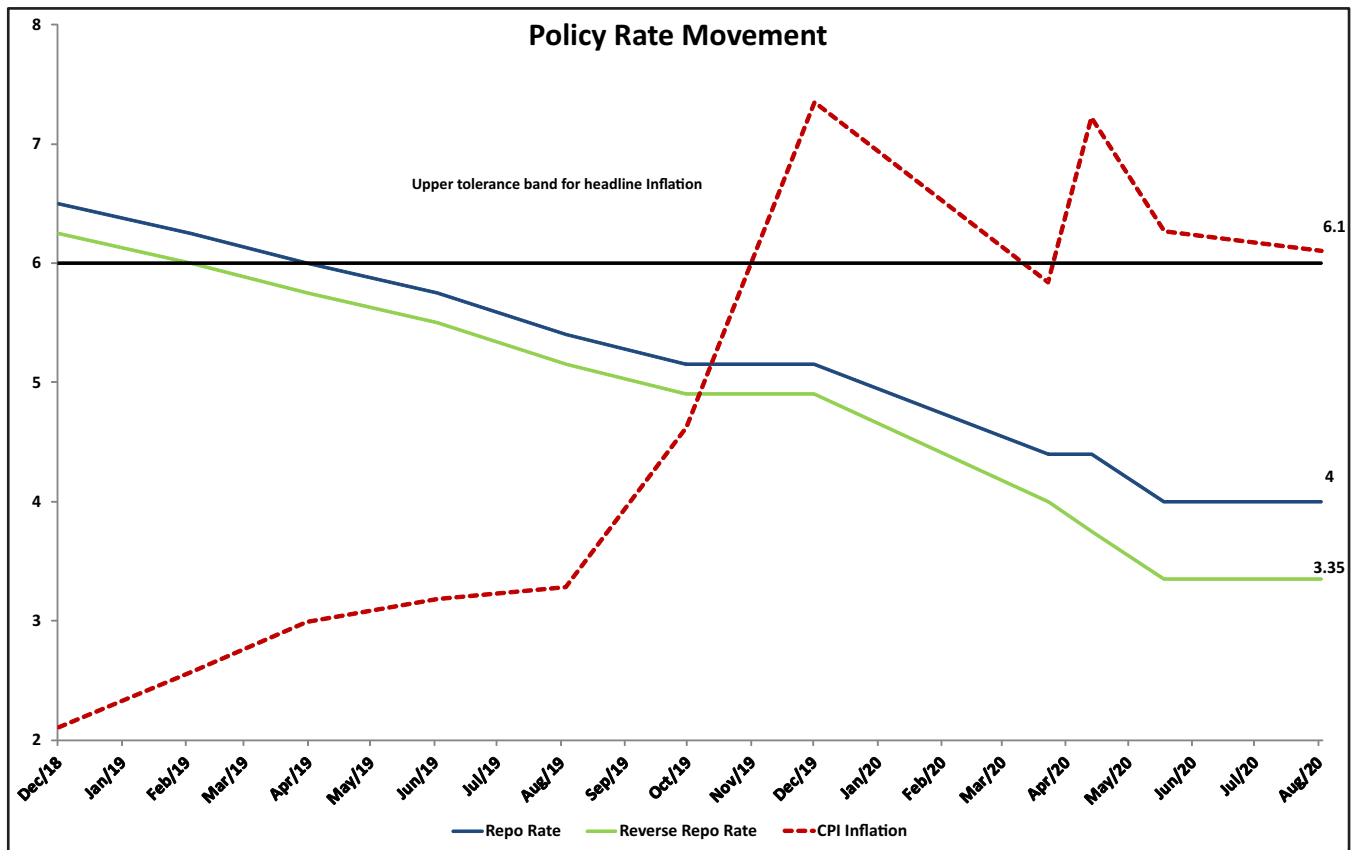
After a relentless cycle of easing since the beginning of 2020 which brought 115 bps reduction in policy rates, RBI halted the easing cycle, maintaining status quo in the third monetary policy meet of FY21 announced on 6th August'20. With this policy meet, the concerns over inflation made a serious comeback, as RBI highlighted the rising risks and uncertainties surrounding the inflation scenario warranting a wait and watch mode at this juncture. RBI's decision is also in contrast with the decisions of some other central banks like Brazil, South Africa and Russia which continued with the easing cycle. While no measures were announced on the monetary front, RBI announced some important credit related measures most important of which is the Resolution Framework for Covid related stress in corporate and personal loans.

## Inflation concerns weigh

While the economic backdrop continues to remain grave, it is the above target inflation number that has likely prompted the unanimous committee decision to hold the rates steady. In its forward guidance, RBI warns about upside risks to both food (particularly protein based) and non-food inflation due to supply side constraints and cost push pressures. Inflation is expected to remain elevated in the second quarter but may witness softening in the second half of the year largely on account of favorable base effect. Citing uncertainties surrounding the inflation outlook, RBI yet again refrained from providing any inflation projections. Clearly, RBI is worried about the outlook of inflation being obscured by multiple factors such as floods in eastern India, lockdown-related disruptions and cost-push pressures in the form of high taxes on petroleum products, hikes in telecom charges, and rising raw material costs. Rising commodity prices further add to the upside risks. Growth concerns continue to be reiterated in the policy with stance maintained at "accommodative" as long as it is necessary to revive growth and mitigate the impact of COVID-19 on the economy. RBI has again not put up any numbers for GDP growth and has only stated that the real GDP growth is expected to be negative for full year FY 2020-21. RBI has highlighted the likely asymmetric recovery in the economy with recovery in rural sector expected to be robust. The risks to growth outlook emanate from a more protracted spread, deviations from the forecast of a normal monsoon, and global financial market volatility.

## INSIDE THE ISSUE

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**New loan recast scheme**

The widely expected restructuring framework for resolution of stressed assets was announced as part of the developmental and regulatory measures. While the RBI has provided a window to enable the lenders to restructure corporate and personal loans, there is significant ring fencing to prevent misuse of this window. The resolution window is available only to Covid related stressed assets and it comes with clearly defined contours and strict implementation timelines. While the broad contours of the resolution plan have been defined by RBI, the finer details such as financial parameters, sector specific benchmark ranges for such parameters, shall be put up by a five member expert committee headed by K.V. Kamath. The restructuring scheme will be a significant breather for banks who will be able to tide over increase in NPAs due to the Covid related stress in their assets, as well as borrowers who can now repay their loans according to the current repayment capacities.

**Is it the end of the rate cut cycle?**

There is a dramatic shift in the policy tone between the May and the latest policy statement. The differentiating factor being the inflation outlook, as it changed from uncertain but benign in the May

policy statement to uncertain with upside risks in the August statement. This has prompted RBI to shift gears and save the limited policy space that is available to be used at an opportune time, given there is “durable” reduction in inflation going forward. The policy rates are already hugging the ground and though the transmission has been significantly high in the bond markets, the transmission to bank lending and deposit rates has been rather slow. The recovery in economic activity is strongly contingent on adequate easing of retail borrowing rates as revival of consumer demand will play a big role in restarting of the economic activity. Though, the risks to inflation cannot be denied, the additional policy space that is left could well have been used at the current juncture rather than later as (a) inflation is expected to moderate in the second half of the year (b) due to the large lags in transmission of policy rates in retail lending rates. Nonetheless, we are seemingly at the end of the rate cut cycle and it would have to be seen how soon the objective of these rate cuts, which is revival of demand, is achieved.

## **Fixed Income Outlook**

### ***Fundamental View***

G-sec yields expectedly moved up in response to the status quo policy announcement by RBI on 6<sup>th</sup> August. Though a portion of the market was anticipating a pause on policy rates, the path of future policy moves has become clouded with the uncertainty surrounding the inflation outlook, which has left the market disappointed. It is clear that RBI would refrain from nudging the rates further unless there is reduction in the headline inflation. Having said that, we expect the yields to drift higher going forward, however the expectation of RBI supporting the markets implicitly through OMOs or OTs shall help prevent any untoward and sharp movements in the market. Market would also keenly watch out for the July inflation print to be release in this week as well as the first quarter GDP number to be release at the end of the month.

## Technical View

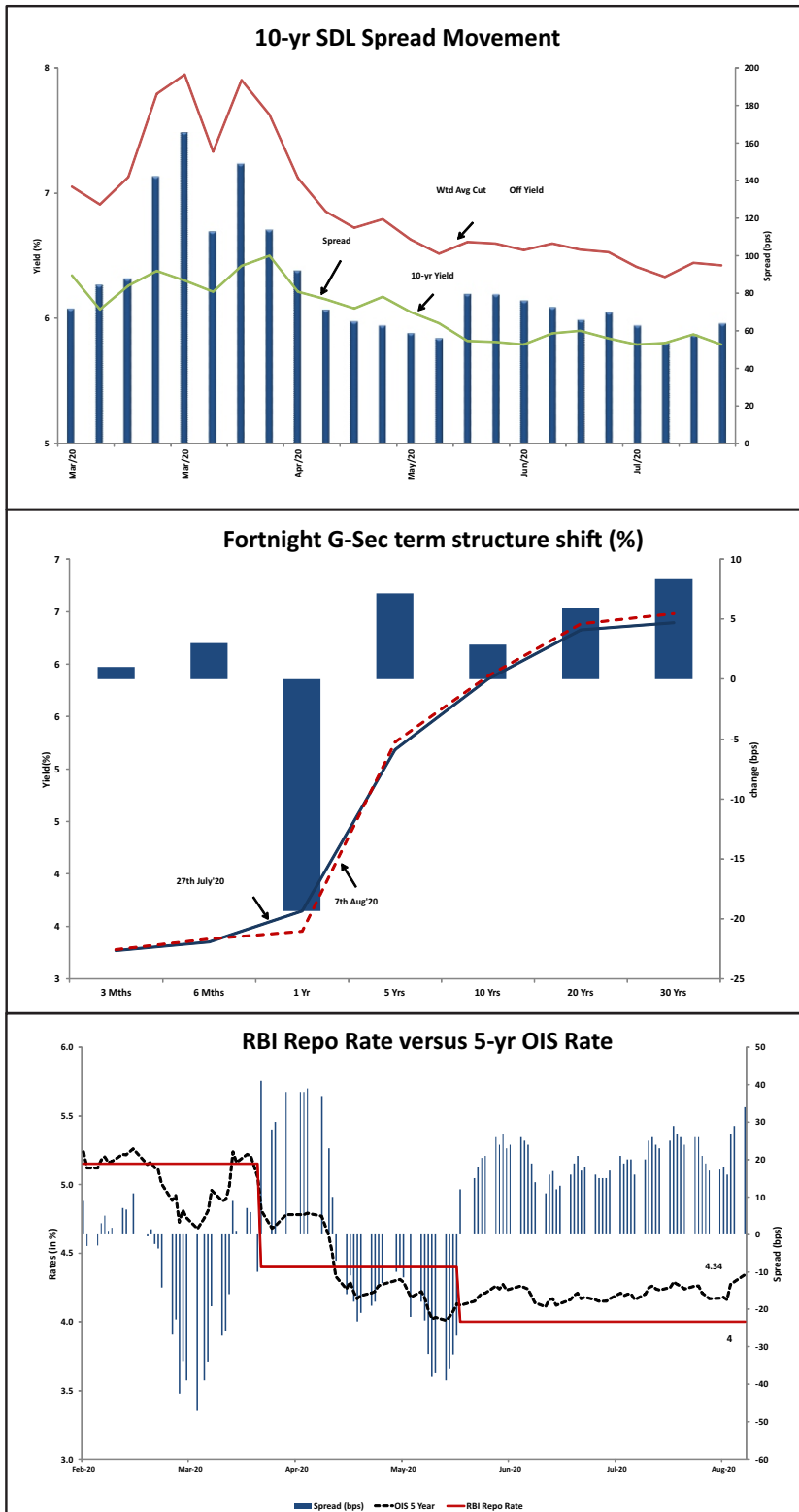
**Analyst1:** 5.79% GOI 2030 yield settled at 5.89% on Friday's session. Last fortnight, benchmark yield headed higher as it settled above upper Bollinger band of 5.87%. Momentum oscillator RSI is placed around 62 level and seems it is eyeing 70 in sort term. Last week post RBI monetary policy, benchmark yield have witnessed a trend-line break out, indicating further surge possible in yields. As discussed in last post, we are witnessing a range shift in the 10-yr yield and any closing above 5.91% may lead to further upside in yield towards 5.96%. From here on, immediate support is placed at 5.87%.



Chart source: TickerPlant

**Analyst 2:** 5.79% GOI 2030 has broken above the important resistance level of 5.88% which opens up a shorting opportunity. The view is to short 5.79 GOI 2030 on a closure above 5.88 % with a take profit at 5.98%. The stop loss stands at 5.83%. Only below 5.83%, one may have to resume long position. 5.88% to 5.83% is a zone with no trading opportunity.

**SPREAD MONITOR**



*Sovereign yields moved up after RBI left key policy rates unchanged in the Bi monthly policy meet. Longer term yields witnessed sharper spike as inflation remained a prominent factor in RBI's status quo policy decision*

*OIS rates moved up substantially post policy outcome as probability of incremental rate cuts going forward remains bleak as RBI expresses concerns over uncertainty surrounding inflation outlook*

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