5st October 2020 Vol: 15/2020-21

PNB GILTS LTD
(Subsidiary of Punjab National Bank)

Economy & Gilt Watch

H2 Govt. Borrowings: No upside shocks

Sticking with the revised borrowing target of Rs. 12 trillion for FY21, the government announced that it would borrow Rs. 4.34 trillion in the second half of the year through dated government securities. The government seemingly has chosen to adhere to fiscal rectitude as of now, though it is unlikely that additional borrowings will not be resorted to going forward, given the dire outlook of government finances. The borrowings through treasury bills as well as state government borrowings for the third quarter of the year came in lower than what was anticipated. In Q3 of FY21, government plans to raise Rs. 2.08 trillion through treasury bills, which is almost half of Rs. 4.55 trillion raised in Q2. On the other hand, states plan to raise Rs. 2.02 trillion in Q3 of FY21. The WMA limit for central government stands reduced to Rs. 1.25 trillion for H2 FY21 from Rs. 2 trillion in H1 FY21.

Trends in revenue & expenses

While the government has stuck to the borrowing plan, the trends in revenue tell a different story altogether. The net tax revenue are trailing the budgeted numbers significantly, having achieved only 17.39% in five months till August'20. On the other hand, disinvestment has failed to take off till now as against a tall target of Rs. 2 trillion for the year. Expenditure items are mostly on track with respect to the yearly budget, with revenue expenditure at 42.32% of the year's target. On the other hand capital expenditure has been bit slow, with 32.63% of the budgeted target being achieved till August'20. The fiscal deficit for April-August 2020 stood at a staggering 109.3% of budget estimate as against 78.7% of budget estimate in the same period of last year. As far as financing of the fiscal deficit is concerned, while the pressure on market borrowings indeed remains significant, the trends in external sources of finance and through small savings scheme look positive. External financing stands nearly 10 times of the year's target at Rs. 40,072 crore. Government aims to finance almost 30% of the deficit through the NSSF and with the interest rates remaining unchanged for Q3 (and widening gap between small savings rate and bank deposit rates), the small savings scheme may continue to see healthy flows. In the first five months of FY20, inflows in small savings & deposits and PPF stood at a healthy Rs. 94,933 crore as against Rs. 87,622 crore in

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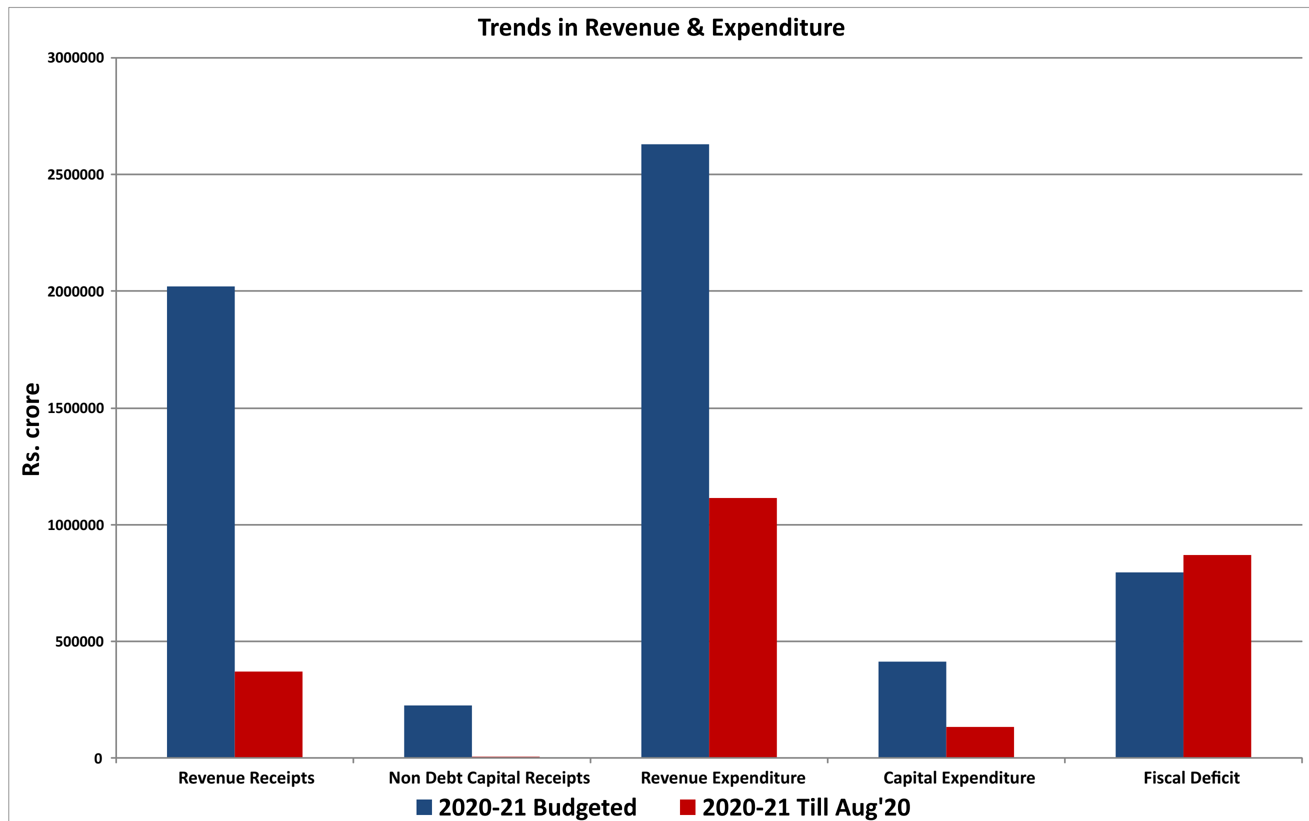
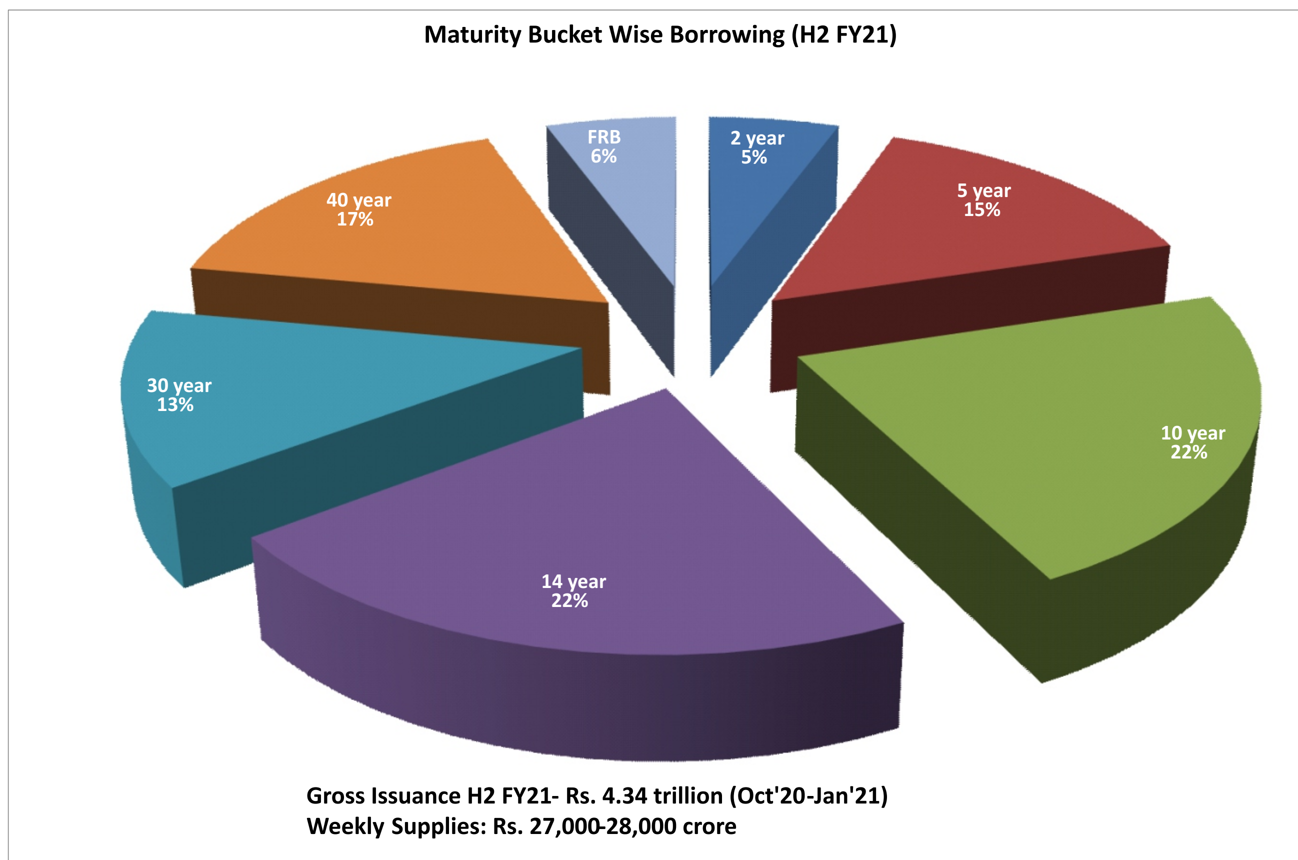
corresponding period of FY20. Nevertheless, the fiscal health of the government continues to hang in thin balance barring a few bright spots and it seems that the government is buying time to seek more clarity on the revenue trajectory and expenditure requirements.



Borrowing calendar details

The borrowing for the year has been retained at Rs. 12 trillion. The additional borrowings of Rs. 68,000 crore (via green shoe option) in H1 have been adjusted, resulting in a borrowing target of Rs. 4.34 trillion for H2 FY21. The weekly supplies stand slightly lower at Rs. 27,000-28,000 crore (Oct-Jan'21) compared to Rs. 30,000 crore in H1. Borrowing is majorly concentrated in the 10-14 year bucket with almost 45% to be raised in this maturity bucket. Also, reliance on longer dated securities is higher in H2 with almost 30% to be borrowed in the 30-40 year bucket. Meanwhile, FRB issuances are lower with bi weekly supply of Rs. 3,000 crore in H2 as against Rs. 4,000 crore in H1.



Respite for bond market?

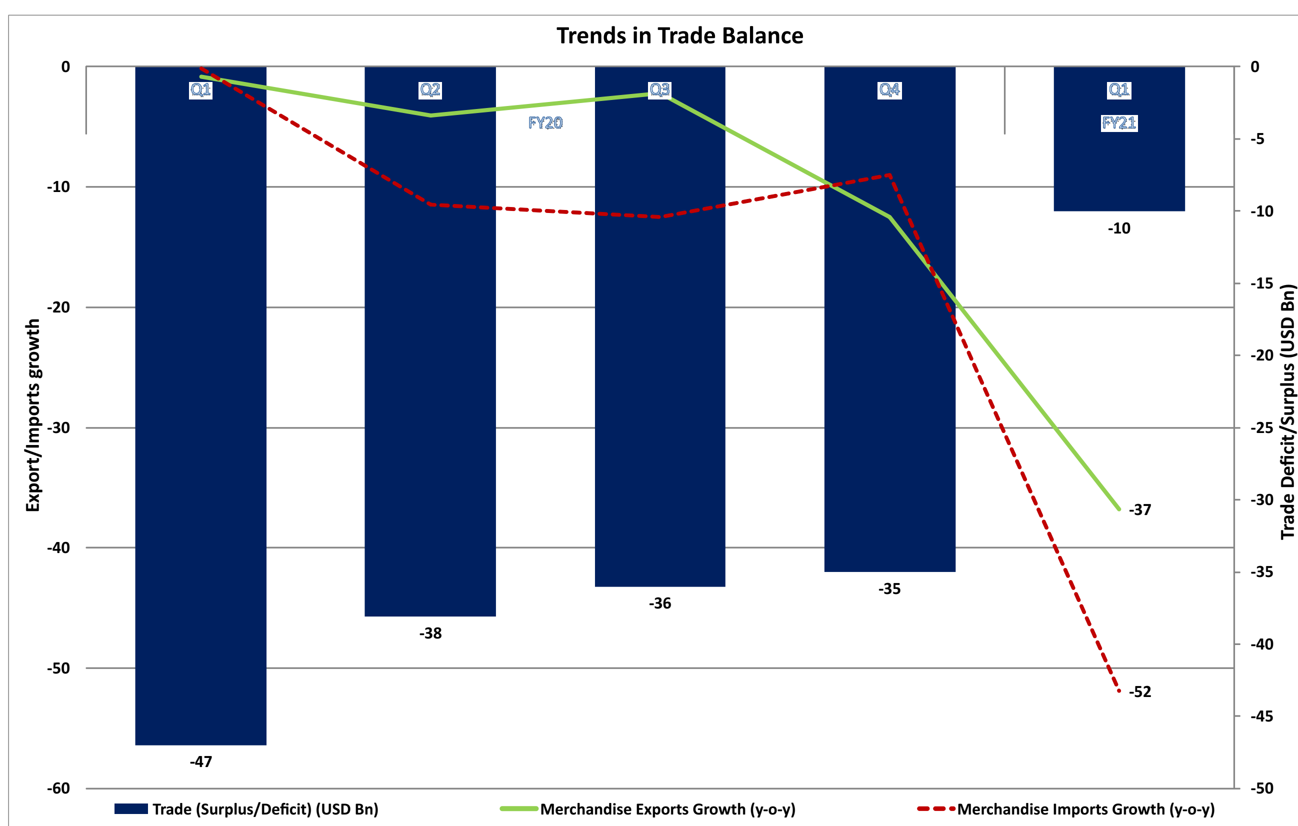
The unchanged borrowing program for FY21 has given a moment of respite to the bond markets and yields slipped by 3-4 bps in reaction to the calendar announcement. However, the market continues to remain concerned about the overall fiscal health of the government and despite RBI's continued assurances and hand holding, yields have not eased much. Lower borrowings through T-bills and with the planned borrowing schedule ending in Jan'21, the G-sec market may remain perturbed about more supplies hitting the market in the last two months of the financial year. State borrowing number for the third quarter also stands lower than anticipated at Rs. 2.02 trillion, which means remainder of the supply to be concentrated in the last quarter of the year. Amidst the expected glut in supply, market is unlikely to be solaced by the borrowing calendar and RBI would have to continue lending implicit and explicit support to avoid any sharp rise in yields.

Macro Monitor

Current Account surplus widens further in Q1

India's current account balance (CAB) registered record surplus, widening to a staggering USD 19.8 bn in Q1 FY21 as against USD 0.6 bn in Q4 FY20 and a CAB deficit of USD 15 bn in Q1 FY20. As a percentage

of GDP, the CAB stands at 3.9% in Q1 FY21 rising from 0.1% in the previous quarter. The trade deficit shrank to USD 10 bn as imports fell more sharply compared to exports. During the quarter, exports contracted by 37% y-o-y, while imports plunged by 52% reflecting a sharp deterioration in domestic demand. Services trade surplus on the other hand continued to hold up, rising marginally to USD 20.5 bn in Q1 FY21 as against USD 20.08 bn a year ago. Private transfer receipts, mainly remittances, fell 8.7% in Q1 from a year ago as the ongoing pandemic takes a toll on livelihoods and incomes. The capital account saw significant slowing of net FPI and FDI flows. Net FDI recorded outflow of USD 0.4 bn in Q1 FY21 vis-a-vis an inflow of USD 14 bn a year ago. On the other hand net portfolio investment was at USD 0.6 bn compared to USD 4.8 bn a year ago.



Fixed Income Outlook

Fundamental View

After remaining slightly apprehensive over the borrowing calendar, bond markets settled down at the end of the fortnight, witnessing moderate easing of yields after government restricted the borrowing size as per the schedule to Rs. 12 trillion. Market shall now eye the announcement of the MPC which was supposed to be conducted on 1st October but was deferred due to delay in appointment of three external members of the committee. The delay in announcement of Monetary Policy has induced some uncertainty and market may continue to remain cautious. Also, with the US Presidential elections

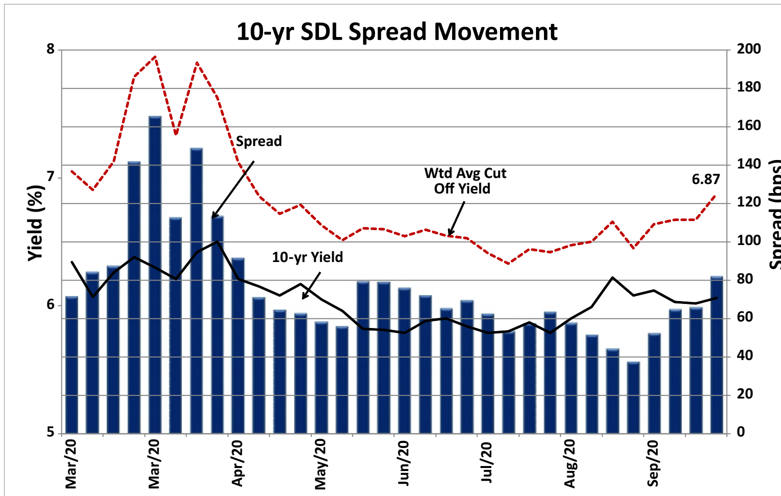
approaching, volatility in global markets shall remain high. And amidst such political uncertainty, strengthening of the USD shall not augur well for emerging markets. In the coming fortnight, we expect the 10-yr yield to trade in the range of 5.95% to 6.10%.

Technical View

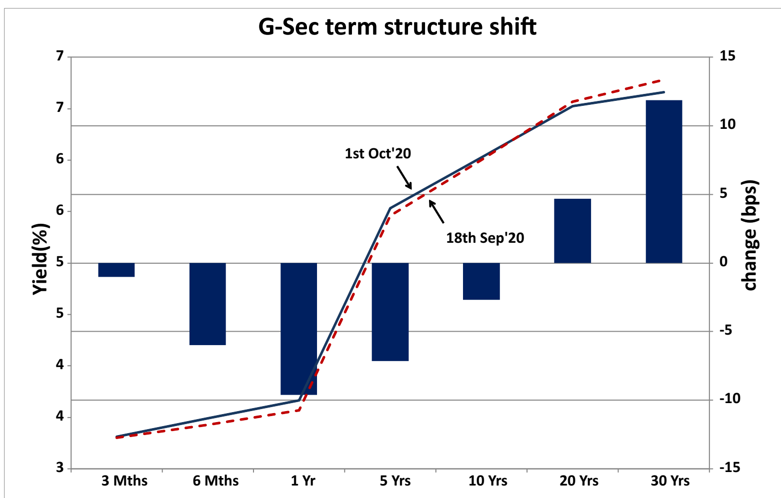
Analyst 1: 5.77% GOI 2030 yield settled at 5.99% on Friday's session. Last fortnight benchmark yield traded range bound, broadly in range of 5.97% to 6.07%. Momentum oscillator RSI is placed around 50 zone and short term moving average i.e. 30EMA is place around current levels of 5.99%. On Friday, Benchmark yield opened with gap down and touched crucial support zone of 5.96%/ 5.97% zone, which coincides with lower Bollinger Band zone and witnessed a recovery as the day progressed. Going forward, till 10yr is sustaining above 5.97% level we may see yield trading range bound between 5.97% to 6.10% zone. Any closing below 5.97% may trigger fresh move towards 5.88% zone.

Analyst 2: In line with our stop loss level, 5.77% GOI 2030 has touched 6.075% for a brief period but the paper managed to quickly rebound and managed to close well below 6.075%. The same paper managed to close below 6% last week. Hence, the view to stay long continues with a take profit of 5.87% and closing stop loss of 6.075%.

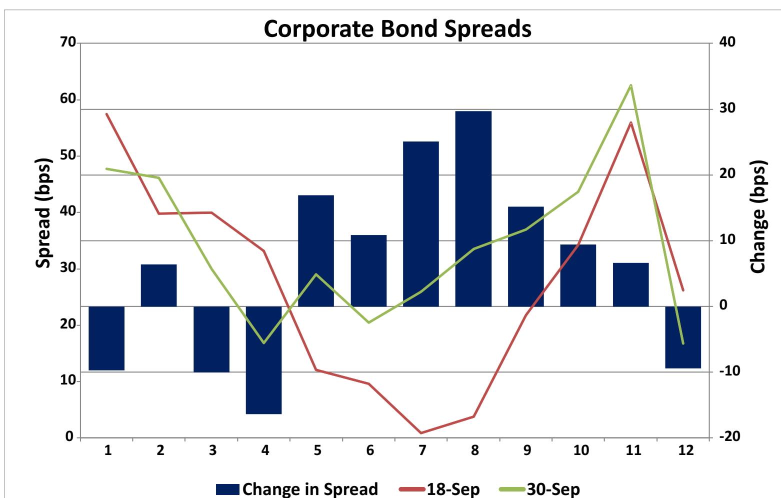
SPREAD MONITOR



SDL spreads witnessed an uptick on continued concerns over state finances. Spreads may remain upward bound as the market is not taking much comfort from the borrowing calendar for Q3 FY21



G-sec curve is expected to steepen as supply in H2 is concentrated in the medium and long dated papers



Corporate bond spreads widened during the previous fortnight amidst steady supply

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