PNB GILTS LTD
(Subsidiary of Punjab National Bank)

14th December 2020 Vol: 20/2020-21

Economy & Gilt Watch

INSIDE THE ISSUE

MPC Meet: Staying the Course

The key highlight of the previous fortnight was the announcement of fourth monetary policy for the current financial year. RBI maintained status quo on both rates as well as stance, refuting expectations of a hawkish stance amidst unabated inflationary pressures that the economy is facing currently. On the contrary, RBI continued to weigh clearly in favour of supporting growth, reiterating its commitment of maintaining an accommodative stance during the current financial year and into the next financial year. By retaining its stance, RBI has chosen to refrain from giving any knee jerk reaction to the current bout of inflation and fears of superfluous liquidity further aggravating the price pressures at a time when recovery is in extremely nascent stages. Nonetheless, RBI does acknowledge that price pressures are severe, though supply side constraints and cost push pressures are again highlighted as the main reasons driving the current bout of inflation in the economy.

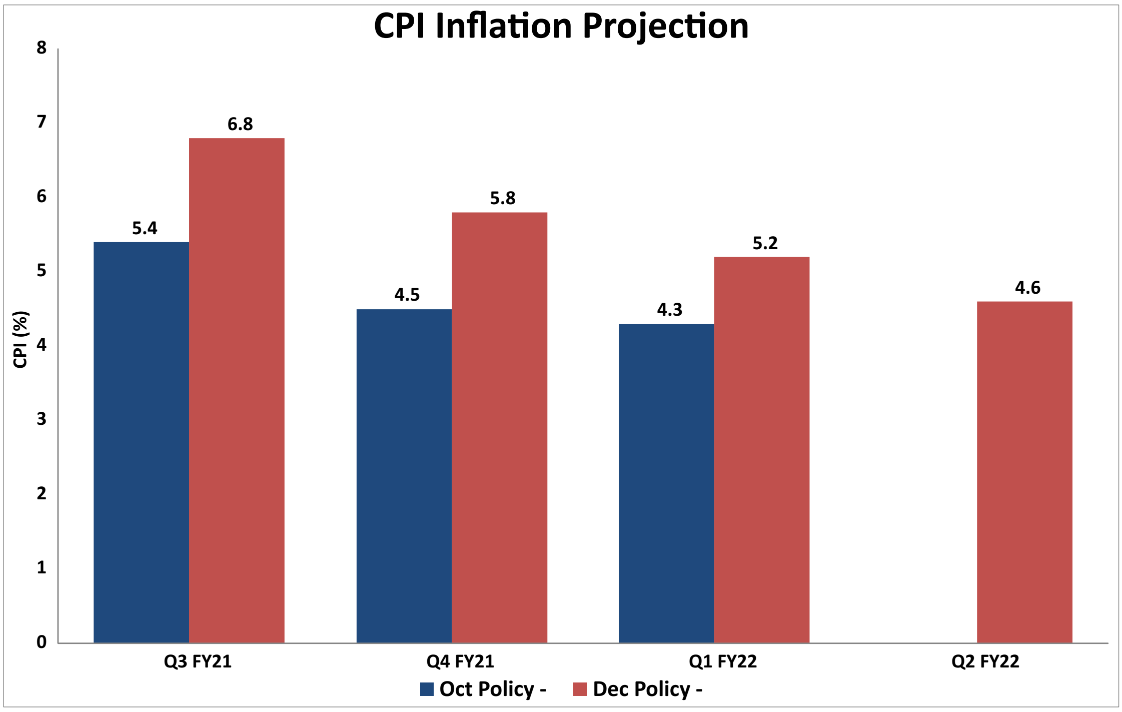
The members of the newly formed committee unanimously voted for a status quo on policy rates as well as maintaining the stance as accommodative. The repo and the reverse repo rate stay unchanged at 4% & 3.35% respectively.

On Growth & Inflation

Factoring in the recent exuberance in economic activity, RBI acknowledged that the recovery is gaining ground as exhibited by various high frequency indicators. However, despite the optimism, RBI throws in a word of caution about the shallow nature of recovery and the outlook still remaining clouded by a host of factors such as spurt in regional COVID cases, slackness in private investment activity and subdued demand for contact intensive sectors. Nevertheless, RBI has revised the GDP projections upwards as it counts on the resilience of the rural sector, positive impulses in the urban sector and the growth supportive fiscal measures to lead to gradual improvement in overall health of the economy. For the full FY 2020-21, RBI revised its GDP projection at (-)7.5% as against (-)9.5% projected in the October policy meet. The uncertainty as spelled out by RBI, justifies its stance of maintaining an accommodative stance, setting aside concerns on inflation staying at elevated levels and not panning out as earlier expected.

GDP Projections (in %)					
	FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22
Oct Policy	-9.8	-5.6	0.5	20.6	-
Dec Policy	-7.5	0.1	0.7	21.9	6.5

Inflation as per RBI is largely a result of supply side constraints and cost push measures, which means that the regulator does not see demand factors yet playing in. However, RBI has highlighted that inflation is expected to remain stubborn and has revised its inflation projection for Q3 FY21 to 6.8% and 5.8% in Q4 FY21. One notable admission by RBI is that though core inflation is currently being driven largely by cost push pressures, it could firm up with normalization in economic activity and the resultant pickup in demand.



Developmental & Regulatory Measures

1. **Liquidity Measures:** The policy announcement was supplemented by a host of developmental & regulatory measures which are quite expansive. Under liquidity measures, RBI has opened the call & notice money market platform to RRBs to participate as both lenders and borrowers, besides providing them with access to LAF and MSF facility. The move will help deepen the money markets further, while providing flexibility to RRBs in managing their funds with greater efficiency. Another key measure that has been announced is extension of the on tap TLTRO scheme to the 26 stressed sectors identified by the Kamath committee. The funds can not only be deployed in corporate bonds, commercial papers and NCDs issued by entities of the specific sectors, but also be used to sanction loans and advances.

2. **Financial markets:** With regard to deepening of financial markets, RBI reviewed the existing guidelines on CDS (for deepening of corporate bond markets), OTC derivatives (efficiency & high standards of governance & conduct by market makers in OTC derivative segment) & money market directions and has issued draft guidelines on the same.

3. **Regulation & Supervision:** The key announcement under this segment was on dividend distribution by SCBs and cooperative banks. According to the guidelines, banks shall not be making dividend pay outs for FY 2019-20. Further, RBI has also proposed to formulate dividend distribution guidelines for NBFCs citing interlinkages of the NBFC sector with the rest of the financial system. Besides, RBI also proposes to include large UCBs and NBFCs under the ambit of Risk Based Internal Audit (for an independent risk focused internal audit system), which is currently applicable to banks.

4. **External Trade Facilitation:** With a view to further provide a push to exports, RBI announced measures which would help ease trade related procedures.

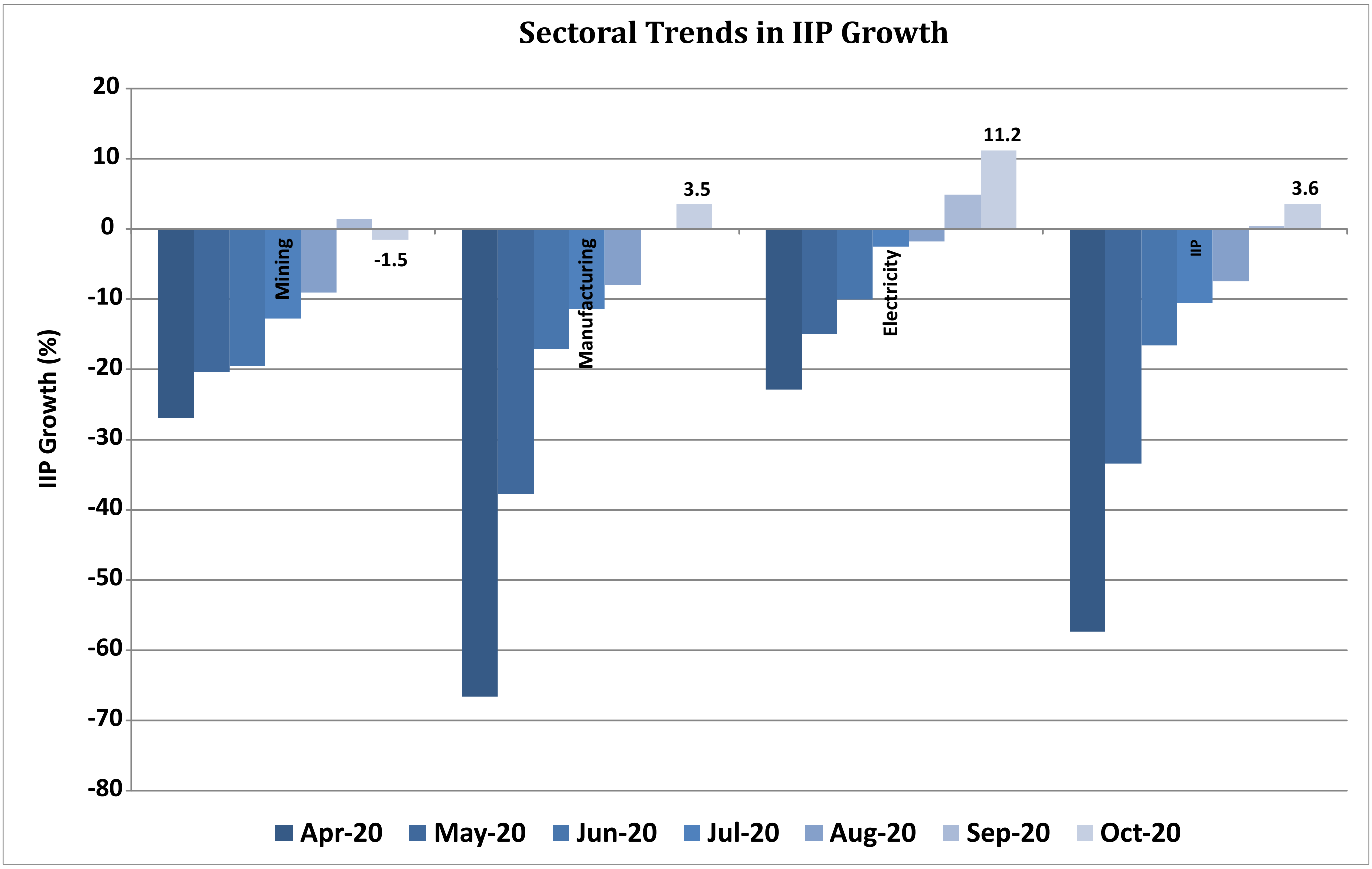
Bottom line: The 4th Policy statement confirms earlier expectations that the space for further rate cuts is completely squeezed out, as inflation continues to remain out of RBI's target zone. However, the policy does quite a balancing act, in anchoring the sentiments of the bond market by clearly indicating its intent for supporting growth, confirming that rates shall remain lower for longer. Not only this, RBI has squashed fears of reversal in its stance on liquidity by emphasizing that ample liquidity shall be maintained and that various instruments such as OMO purchases, OTs will be used appropriately.

Macro Monitor

IIP Grows 3.6% in October

Industrial activity expanded for second consecutive month, registering a growth of 3.6% in the month of October, while growth for the month of September was revised upwards to 0.5% from provisional estimate of 0.2%. The pick-up is largely attributed to a favourable base (IIP contracted 6.6% in Oct'19), even though, manufacturing activity expanded for the first time in this financial year, thus contributing to the uptick in the overall IIP number. In October, manufacturing sector grew by 3.5%, in line with inventory restocking ahead of the festive month. The sustainability of the spurt in manufacturing activity remains uncertain as both festive and pent up demands have exhausted. Electricity production also continued to remain buoyant, registering a y-o-y rise of 11.2% in October as against 4.9% in September. Mining on the other hand, posted a contraction of 1.5%, after witnessing positive growth of 1.4% in the month of September.

Use based segments saw all segments posting positive growth apart from primary goods segment, which contracted by 3.3%. Trends in consumer durables and non-durables growth were encouraging as they grew by 17.6% and 7.5% respectively, largely benefitting from festive demand. Infrastructure segment also saw growth picking up (7.8% in October vis-à-vis 2.5% in September).



WPI Inflation Rises to 1.55% in November

Wholesale inflation seems to catching up, registering a year on year rise of 1.55% in November as against 1.48% in October. While food articles saw softening of prices in November, manufactured items witnessed hardening of prices. Food inflation in November witnessed y-o-y rise of 3.94%, against 6.37% in the previous month. Manufactured products saw a rise of 2.97% in November (2.12% in October), while non-food articles inflation stood significantly higher at 8.43% vis-à-vis 2.85% in October. Fuel and power basket eased to (-) 9.87% in November.

Fixed Income Outlook

Fundamental View

Directionally, the scope for yields to drift downwards in a substantial manner seems very limited and only a further severe growth crisis would warrant such a drastic downward move in yields. The Indian macros are currently not in a very comfortable spot with growth inflation dynamics turning adverse and much out of comfort zone for the policy makers. And despite RBI Governor's continued reassurances on keeping rates low and liquidity ample in the system, may not be enough to convince market participants to go overboard with bond buying. On the other hand, the risk of run-away rise in yields also seems to be low, and bond yields may trade in a range bound manner with old 10-yr expected to trade broadly in the range of 5.85% to 6% during the month.

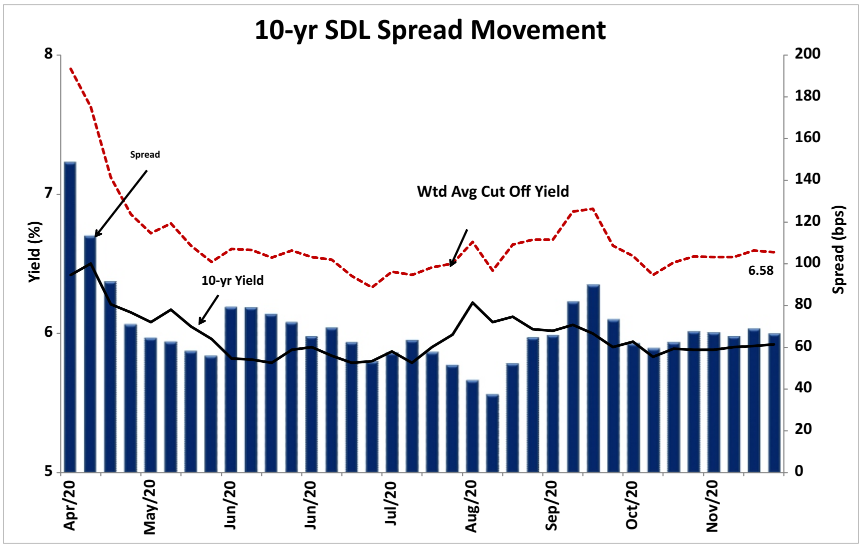
Technical View

Analyst 1: 5.77% G Sec 2030 Yield settled at 5.96% on Friday's session. Last fortnight, benchmark Yield traded range bound broadly in range of 5.88% to 5.96%.

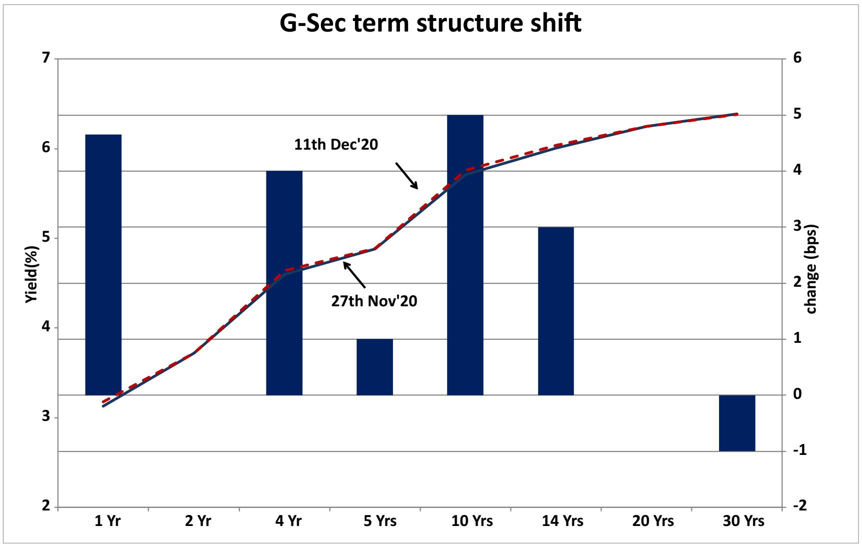
Momentum oscillator RSI is placed at 59 zone. Benchmark yield settled at higher Bollinger band indicating further upside possible if it sustains above 5.96% in coming days. We are witnessing a range shift in Benchmark paper from 5.85%/5.92% to 5.89%/6.02% zone. On lower side 5.89% will act as a crucial support zone on any dip in yields.

Analyst 2: In line with our expectations, 5.79% GS 2030 has indeed touched 5.97% today and have quickly reverted to 5.95%.With this reversal, we may look to go long, at current market levels, with a closing stop loss of 5.97% and a take profit of 5.85%.

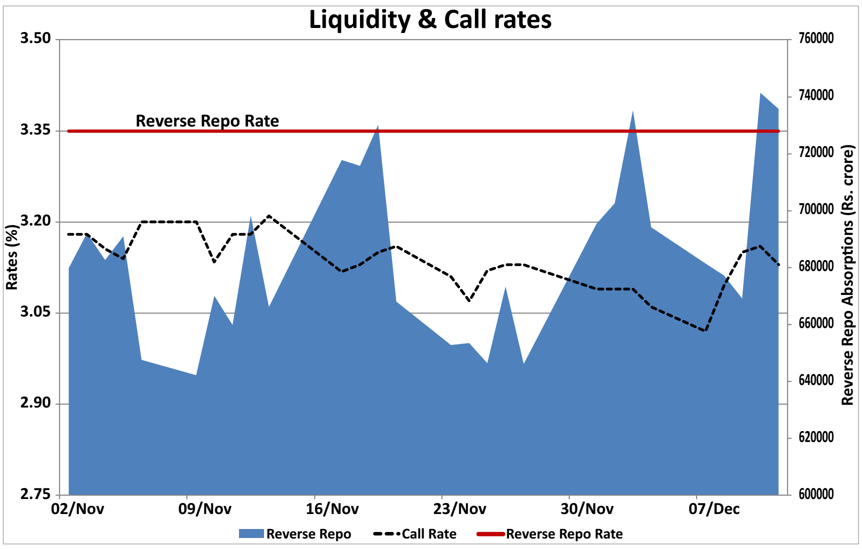
SPREAD MONITOR



Expectations of heavy supplies keep SDL spreads steady



Demand for short end papers continues to remain strong on RBI reassurance on maintaining ample systemic liquidity



Call Rates remain subdued as liquidity in the system surges past 7 lakh crore

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