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PNB GILTS LTD
(Subsidiary of Punjab National Bank)

Economy & Gilt Watch

GOI Delivers on Budget

The Union Budget for FY 2021-22 was unveiled last week in an economic set up fraught with uncertainties and scarring of the COVID crisis. Obviously, expectations were running high, the budget being the first formal policy response to the crisis. The budget has done well on several counts and what really stood out is the directional shift in stance especially with respect to the fiscal deficit. It has marked a turning point, giving up the obsession & fear of fiscal deficit and rather taking it simply as a consequence of additional expenditure over revenue. The fiscal deficit number which earlier has been a nemesis of market bulls, has been taken well in stride by both the government as well as the market. Infact, in the current context of the crisis, a higher fiscal deficit is reflective of higher government spending, which is required for the economy to return to pre COVID levels. Another key aspect of the budget for which it has garnered much lauding is the believable growth and revenue projection, unlike the previous budgets, which suffered from large deviation of projection from actual realized numbers, which has led to slippage in the headline fiscal deficit numbers. Tax revenues have been projected to grow at 14.9% in line with 14.4% nominal GDP growth projected for the year. The 26% y-o-y increase in Capital Expenditure is also a welcome step even though the share of it in overall expenditure continues to remain extremely thin. And the last major step that the Government has taken this year, is reducing the dependence on extra budgetary resources and shifting off balance sheet items to on balance sheet, hence drastically improving the credibility of the fiscal deficit numbers. All these factors put together, make this year's budget one of better intended budgets though implementation will be key for it to have the desired impact on the economy.

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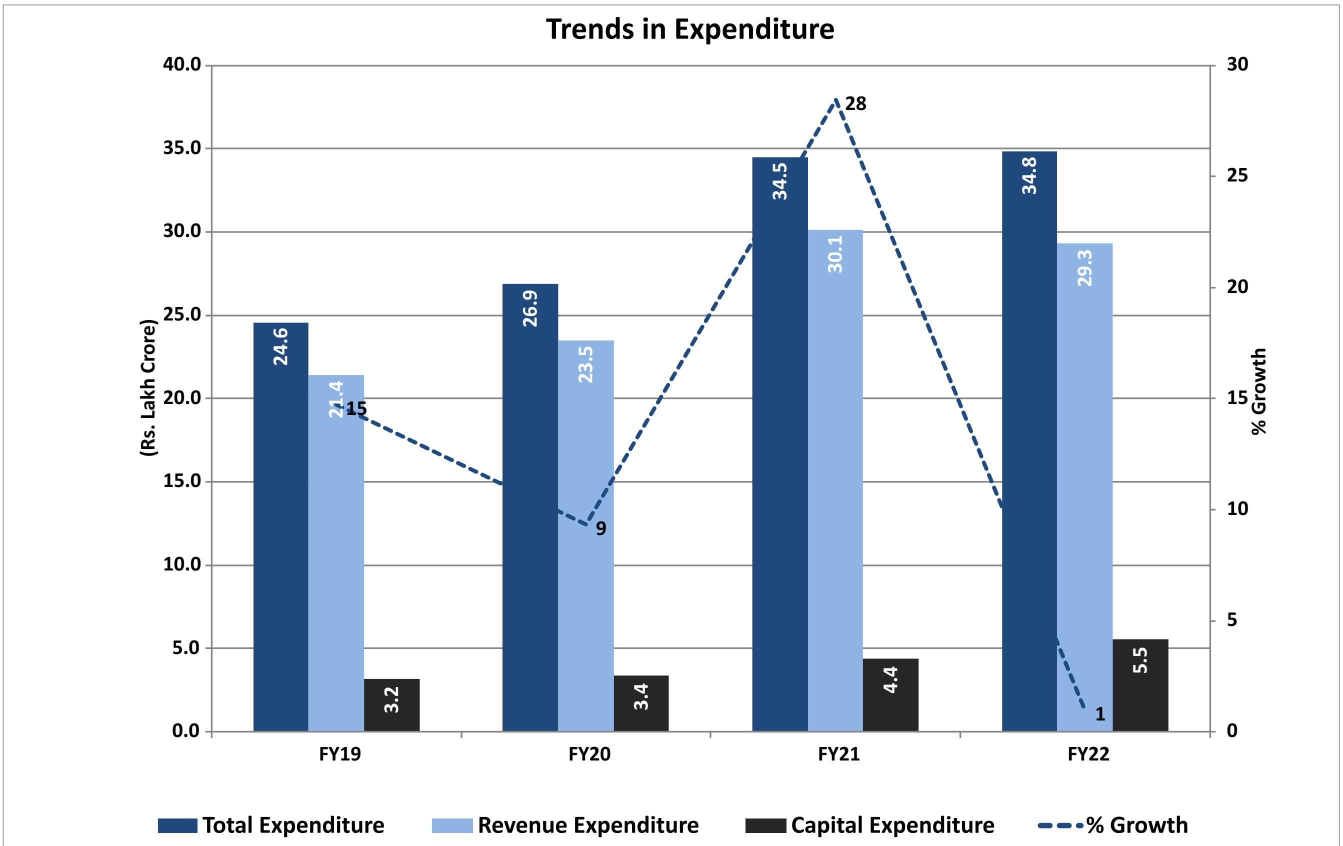
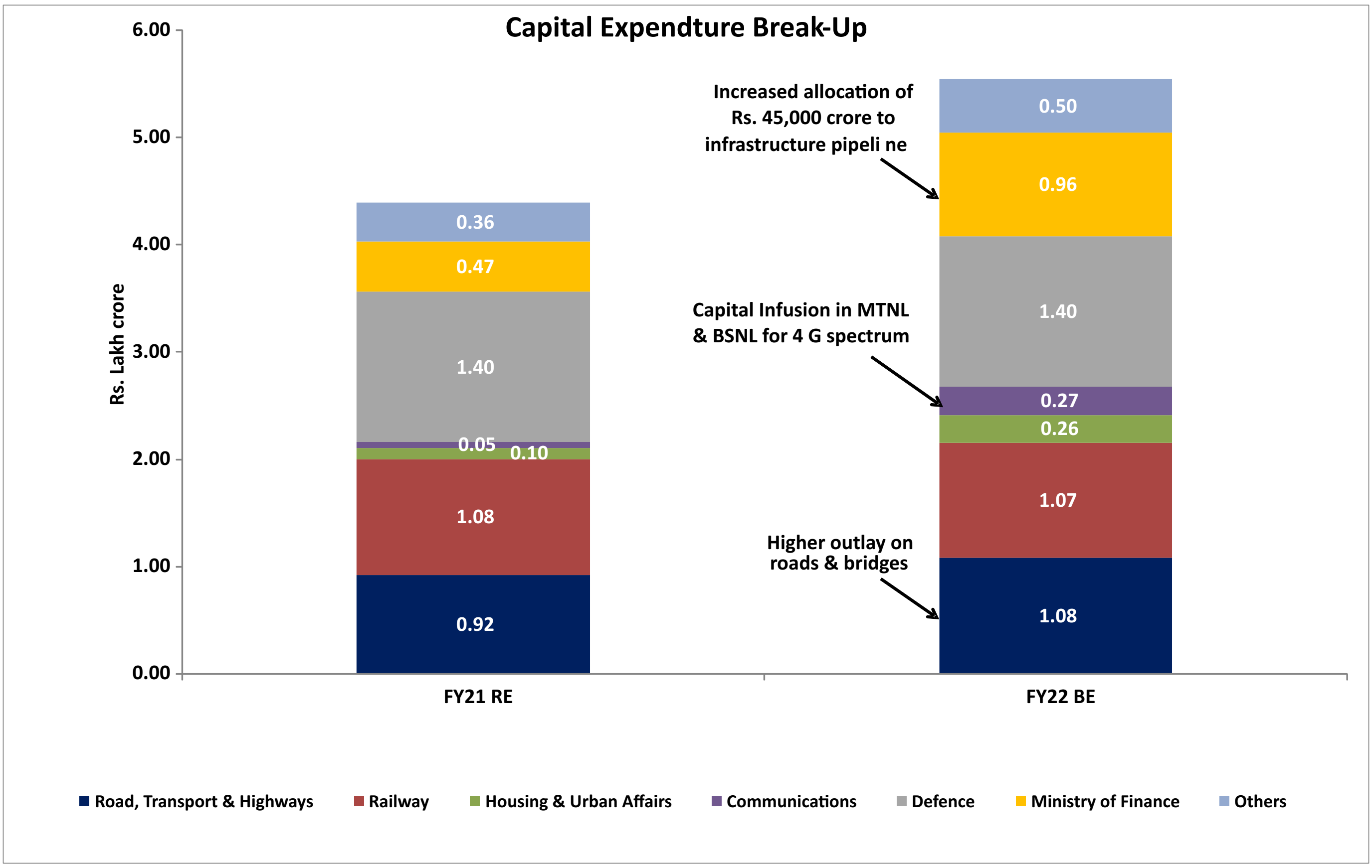


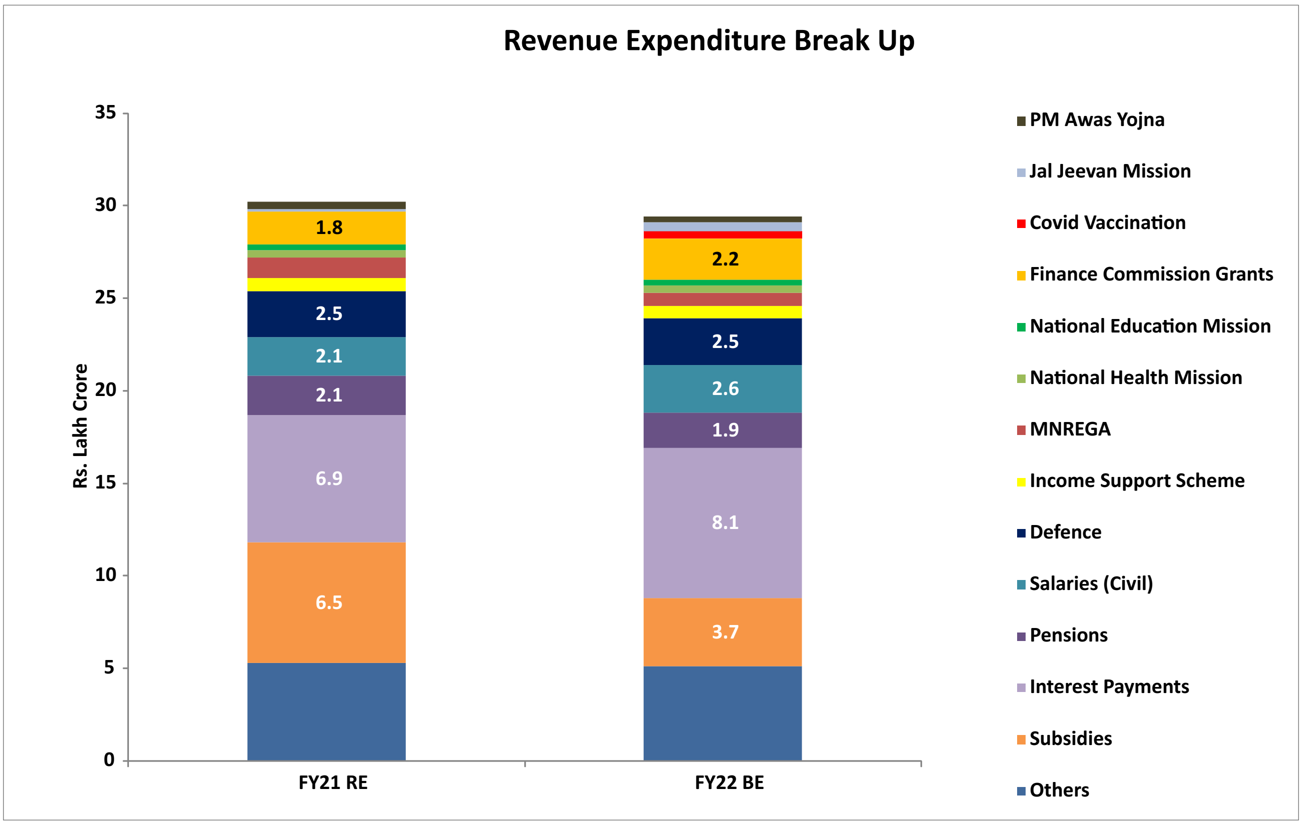
Dissecting the Budget Numbers

Expenditure Side

The total expenditure that the GOI plans to incur in the next FY is almost at the same level as estimated for the current FY. In FY 2021-22, the total expenditure is at Rs. 34.83 lakh crore vis-à-vis Rs. 34.50 lakh crore for FY 2020-21, with revenue expenditure (Rev-Ex) estimated to undergo a mild contraction of 2.72% in the next year, while capital expenditure (Cap-ex) to see a 26% rise over the current year. The quality of expenditure is expected to improve in the coming FY with greater thrust on Cap-ex. For FY22, capital expenditure is budgeted at Rs. 5.5 lakh crore vis-à-vis RE of Rs. 4.4 lakh crore for FY21, i.e an increase of Rs.1.1 lakh crore. GOI plans to give infrastructure sector a push by increased allocations to the Roads & Bridges ministry as well as by setting up a Development Financial Institution (DFI), with greater outlays for infrastructure sector with an initial capital of Rs. 20,000 crore. The actual thrust towards Cap-ex is however lower than what is being presented as ~Rs. 20,000 crore out of the Cap-ex kitty shall go towards capital infusion in MTNL BSNL.



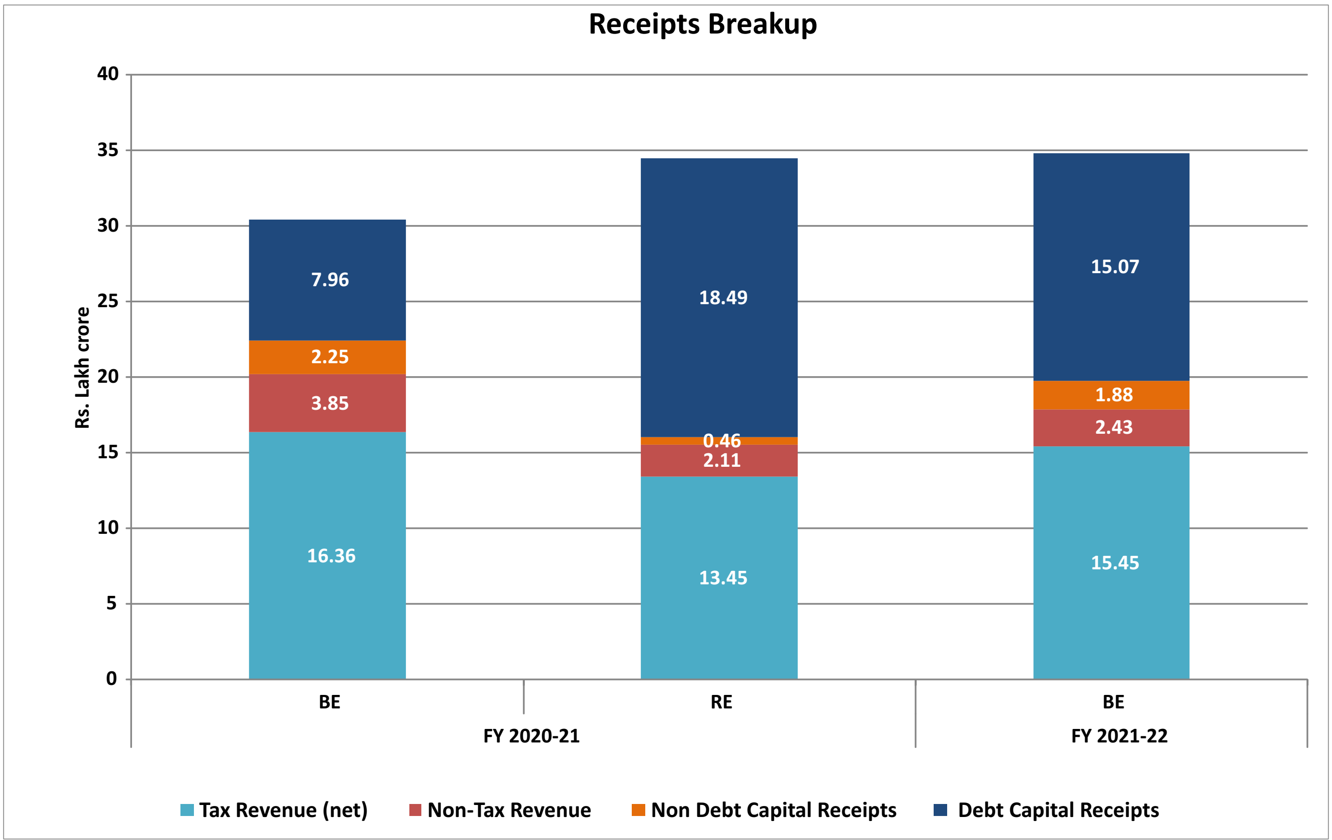
On the revenue expenditure front, after seeing a sharp rise of ~15% in FY21 (RE over BE) on account of stimulus and support measures, GOI intends to curtail the revenue expenditure projecting a contraction of 2.7% in the next FY. Subsidies (food, fertilizer & fuel) for FY22 have been axed by a sharp 43% to Rs. 3.7 lakh crore from Rs. 6.5 lakh crore in FY21. On the other hand, out go on account of interest payments is substantially higher, seeing a rise of ~17% to Rs. 8.1 lakh crore from Rs. 6.9 lakh crore in FY21. The health sector which continues to remain under duress and the importance of which has increased multi fold in recent times, does not see any substantial increase in allocations. Infact the allocations are lower than the revised estimates for FY21 (at Rs. 82,000 crore). In FY22, the expenditure towards health is projected at Rs. 75,000 crore, which includes an outgo of Rs. 35,000 crore towards COVID vaccination program



Revenue Side

The revenues for FY22 have been projected to increase by 23% to Rs. 19.76 lakh crore as against RE of Rs. 16.01 lakh crore in FY21. The revenue projections at Rs. 19.76 lakh crore are however much lower than budgeted estimates for FY21 (Rs. 22.46 lakh crore). The net tax revenues are projected to rise by 14.9% which is in line with the nominal GDP growth projection of 14.4% for the coming fiscal. Non tax revenue for FY22 is pegged at Rs. 2.43 lakh crore, while, non debt capital receipts are projected at Rs. 1.88 lakh crore which includes disinvestment target of Rs. 1.75 lakh crore.

To plug the fiscal deficit, GOI intends to borrow a massive Rs. 12.06 lakh crore through dated securities & Rs. 50,000 crore through T-bills. Reliance on small saving fund continues to remain significant (Rs. 3.92 lakh crore for FY22 vis-à-vis Rs. 4.81 lakh crore in FY21), while external debt is projected to remain sharply lower in FY22 at Rs. 1514 crore as against Rs. 54,522 crore in FY21.



Fiscal Deficit & Glide Path

Government targets a Fiscal Deficit to GDP ratio of 9.5% in FY21 and 6.8% in FY22 and expects it to ease to 4.5% by FY26. GOI presents a conservative picture as far as fiscal deficit is concerned, which may open up some space for positive surprises. The Revenue Deficit to GDP is also projected to shrink to 5.1% as against 7.5% as per RE FY21.

Baton back with RBI

After delivering a much needed counter cyclical budget, the GOI has yet again passed the baton back to RBI, which now faces the colossal task of managing the GOI borrowings. In the post budget policy, RBI left the key policy rates unchanged, however, it announced restoration of the CRR cut in two phases (by 50 bps each) to be raised back to 4% by 22nd May'21. The increase in CRR is expected to drain off liquidity to the tune of Rs. 1.5 lakh crore. At the same time, RBI has also emphasized that the phasing out of CRR cut would open up space for liquidity injection via other tools. Another announcement that is in favour of the bond markets is extension of the dispensation of the enhanced HTM limit of 22% by another two years upto March 2023 for securities acquired till March 2022. RBI also decided to provide direct online access of government securities market to retail investors. On inflation, RBI revised it CPI forecast for Q4 from 5.8% to 5.2%, and expects core inflation to remain at elevated levels. From bond market prespective, RBI support to the borrowing program remains crucial as was the case in the current financial year. However, buoyant revenue in the next fiscal and better than expected growth may be potential upsides, which may give some respite to the bond markets.

GOI Finances (Snapshot)

Particulars	FY 2020-21		FY 2021-22
	Budgeted	Revised Estimate	Budgeted
Revenue Receipts (1)	2020926	1555153	1788424
Tax Revenue (net)	1635909	1344501	1545396
Non-Tax Revenue	385017	210652	243028
Non Debt Capital Receipts (2)	224967	46497	188000
TOTAL RECEIPTS (1+2)=A	***2245893***	***1601650***	***1976424***
Revenue Expenditure (3)	**2630145**	3011142	2929000
Capital Expenditure (4)	**412085**	439163	554236
Total Expenditure (3+4)=B	***3042230***	***3450305***	***3483236***
Fiscal Deficit (B-A)	***796337***	***1848655***	***1506812***
Revenue Deficit	***609219***	***1455989***	***1140576***
Nominal GDP	**22489420**	**19481975**	**22287379**
Nominal GDP Growth	**11%**	**-4.2%**	**14.4%**
FD as % of GDP	***3.5%***	***9.5%***	***6.8%***
RD as % of GDP	***2.7%***	***7.5%***	***5.1%***

Fixed Income Outlook

Fundamental View

As discussed earlier, the probability of breach of upper end of the trading range was increasing by each passing day and it ultimately broke decisively on the budget day. The massive borrowing number of over Rs. 12 lakh crore for the coming fiscal was way more than what the market expected and what the market can potentially absorb. It is unlikely that such a huge and continuous supply of government bonds can be absorbed by domestic bonds sans a big support

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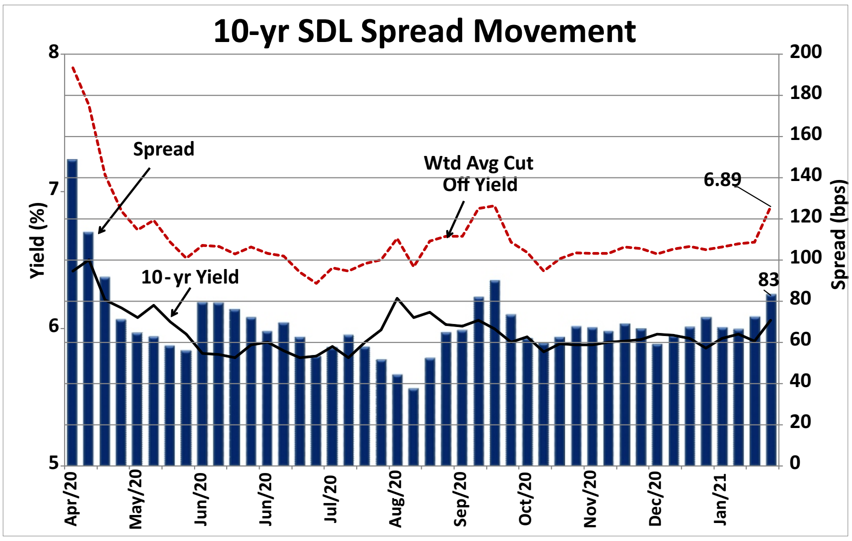
from the RBI and investors like FIIs. With the ongoing successful vaccination program, sustainable growth in the economy seems to be well on cards and seems getting entrenched gradually with sustained global economic growth. Despite RBI's assurance in the MPC meet regarding continued support to government borrowing and adequate liquidity, it would be a herculean task to keep the 10-yr yield below 6% on sustained basis. However, we feel that due to low funding cost (the policy rates are not expected to go up anytime soon) resulting into higher carry income and RBI's continued support in the form of OMOs and OTs, the likelihood of yields flying over the top are not high. In the coming month, we expect the 10 yr yield to trade in the range of 6.00% to 6.20%, with an upward bias.

Technical View

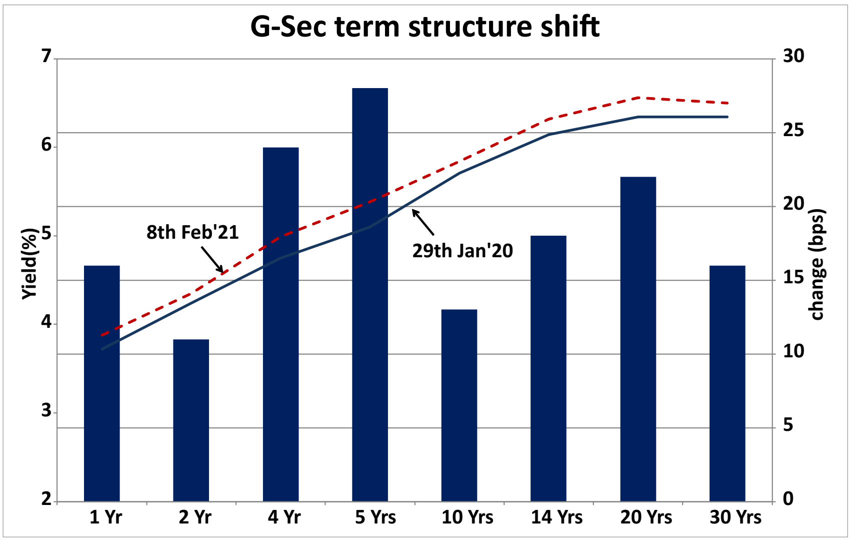
Analyst 1: Despite multiple attempts for upside breakout , 6.15%- 6.17% yield level remains protected in 5.77% GS 2030. At the moment, 5.77% GS 2030 remains range bound between 6.17% to 6.02%. Hence, any yield movement above 6.10% shall be treated as a buying opportunity, with a closing stop loss of 6.17% and a take profit of 6.02%.

Analyst 2: 5.77% G Sec 2030 Yield settled at 6.12% on Friday's session. As discussed in last newsletter, sustenance above 5.99% may led to surge in yield and the same was witnessed in the passing fortnight. After recent breakout, the broader trend has shifted from rang bound to slightly bullish in term of yields. Momentum indicator RSI is placed around 67 zone indicating zone shift in case of momentum too. Current chart structure indicates till yield is sustaining above previous breakout level of 6.05% it may trade higher with immediate target of 6.20%. On higher side minor resistance is placed around 6.15%.

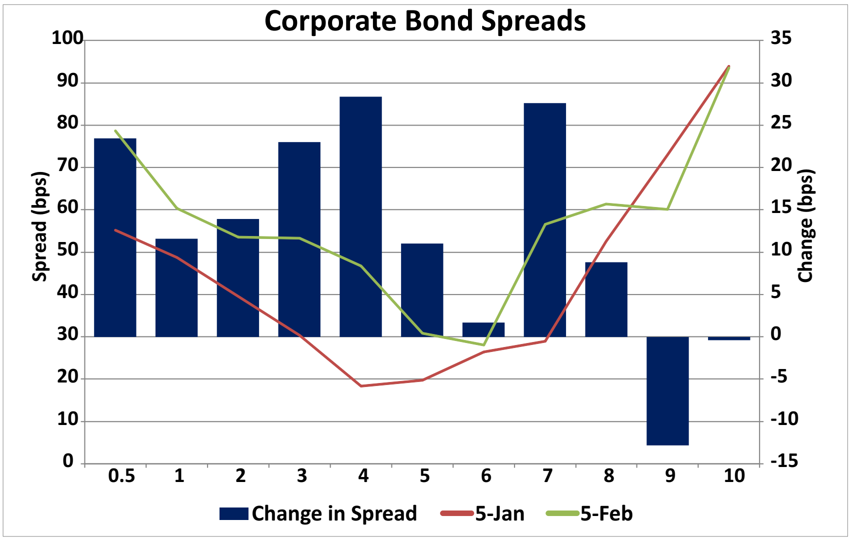
SPREAD MONITOR



SDL spreads are expected to widen as market appetite remains weak amidst heavy supplies scheduled for the coming year



G-sec term structure witnessed an across the curve upward shift as sentiments turn sour on high GOI borrowings for FY22



Corporate bond spreads are expected to face upward pressure on expectation of large govt. borrowing crowding out private borrowings

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