PNB GILTS LTD

Volume 02/2021-22
19th April 2021

ECONOMY & GILT WATCH

PNB GILTS LTD
(Subsidiary of Punjab National Bank)

INSIDE THIS ISSUE:

A Defiant Pandemic Threatens Normalization

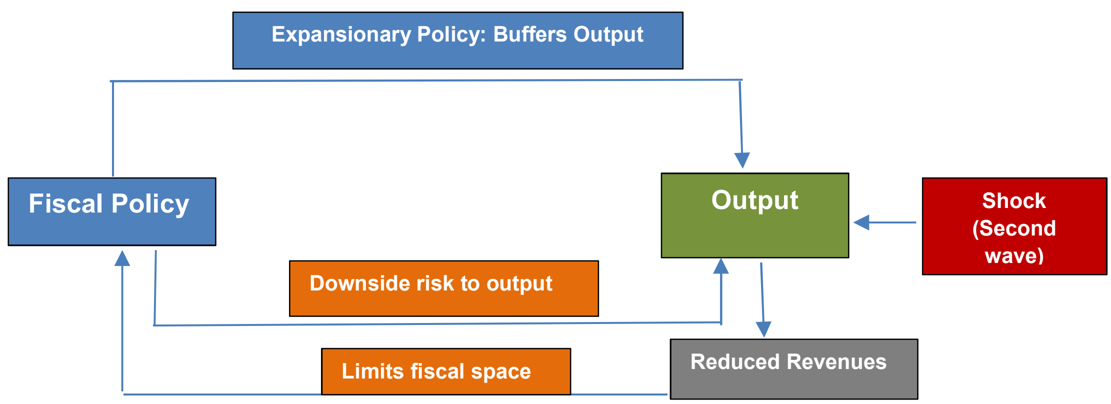
The second wave of the pandemic has swept the country, defiant and stronger than the one we saw exactly a year ago. We are seeing new highs every day in terms of new cases and are swiftly moving towards the peak of ~3 lakh cases a day that US witnessed in January this year. States and Centre have come in firefighting mode yet again, with restrictions on movement and activity being imposed at various levels. Inoculation drive is yet to gather a strong momentum amidst a shortage of vaccination supply, which adds yet another layer of challenge in management of the ongoing crisis. Another key setback is that the second wave is affecting the younger population adversely, which has not yet been vaccinated, thus further compounding the risk that we may not have yet peaked as far as daily number of cases are concerned.

The second wave brings along with it challenges in way of economic recovery, which had been slowly returning back to the track as observed from various high frequency indicators. However, beginning April, the data releases have been mixed with some slowdown in momentum seen in indicators such as rail freight, vehicle registrations, fuel consumption. With localized lockdowns and restriction such as weekend lockdown or night curfew being placed in various states, the normalization of economic activity is bound to face a setback. The fiscal and monetary responses which had remained at the vanguard, buffering the economy last year, remain stretched and largely exhausted as we enter a frightening second wave of the pandemic. A fortnight ago, RBI announced its policy decision to keep rates status quo, while maintaining an accommodative stance sans the time based guidance that it provided till the Feb policy meet (i.e. maintaining an accommodative stance till FY22). Wary of the uptick in inflation and normalization of demand and economic activity, RBI is expected to gradually unwind the easy policy stance that it has maintained for more than a year. However, the exponential rise in infections witnessed in the last fortnight, once again puts the spotlight on the policy makers. The vulnerabilities in the economy remain exposed and the question one can reckon is that whether the role of supportive policy is far from over. And if not, then what are the current dynamics of the fiscal and monetary policy and whether there is enough firepower left to address the macro economic imbalances.

Fiscal Policy: Stretching beyond limits

The fiscal space becomes the first casualty in a scenario of growth not panning out as expected. While growth projections have remained anything but stable over last one year, a sharp deterioration from here could put the fiscal arithmetic in dire state once again. GOI's targeted fiscal deficit of 6.8% for FY 2021-22 is largely contingent on growth resuming the path of normalization, which would provide succor to the tax revenues. A quarter of subdued economic activity, which now looks increasingly plausible, can disturb the fiscal math for the coming year. Moreover, in the previous year, the shortfall in tax revenue was partially offset by successive increase in fuel taxes and increase in market borrowings, the sources that are already heavily stretched. On the other hand, expenditure pressure may once again mount on the government on account of spending towards ramping up of health infrastructure and bolstering the vaccination drive, which is indispensable in repressing the pandemic in a sustained manner. While the fiscal space is clearly squeezed, a larger deviation in growth from the expected path can be highly disruptive and difficult to be managed within the current fiscal constraints.

The fiscal policy can be a restraining factor as external shocks reduce economic output, thereby limiting the extent of fiscal space, which puts output at further risk



Monetary Policy: Little powder left dry

RBI is treading a very fine balance between staying accommodative and indicating a calibrated exit from ultra-loose monetary policy without causing disruptions in the market. Though RBI decided to keep policy rates unchanged, it announced a G-sec buying program (GSAP) of Rs.1 lakh crore to be conducted in Q1 to cushion the huge spate of supply. Having burned much of the ammunition (both conventional & unconventional) in FY21, extending an easy monetary policy into the new financial year will be faced with multiple challenges. The global economy is expected to rebound led by advanced economies, which may lead to a reversal of easy policy first in these economies. The tapering can be extremely disruptive for emerging economies especially India, making the conduct of monetary policy more difficult.

The inflationary pressures are also likely to stay elevated as asset prices rise, aggravating the inflation dynamics amidst a depreciating domestic currency. Hence, cost-push pressures may continue to remain persistent. However, inflation expectations may be moderated due to yet another setback to the domestic demand and a continued gap in output. Needless to say that both fiscal and monetary policy framework may continue to face renewed challenges even as the space to maneuver remains extremely limited.

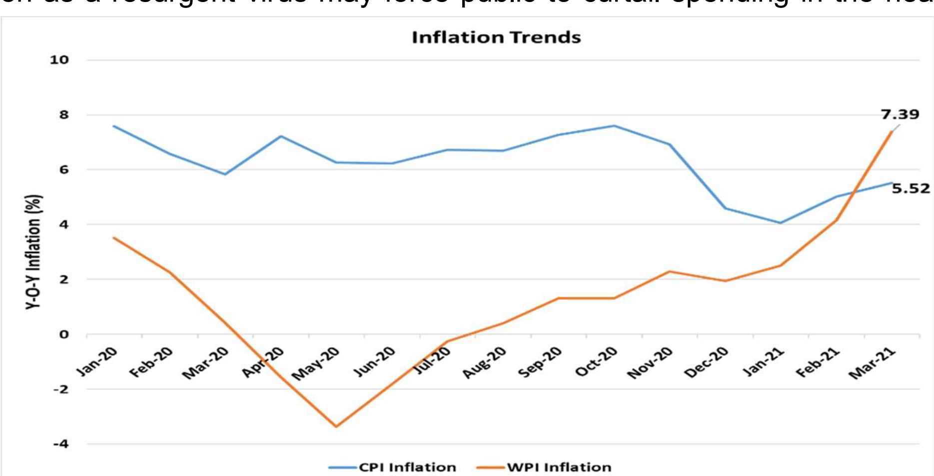
Macro Monitor

WPI surges to 7.4% in March

The wholesale price inflation for the month of March came in higher than expectations at 7.4%, marking a high in the WPI series as against 4.2% in February. The surge in the whole sale prices comes on back of rise in input prices and was largely broad based in nature, with uptick witnessed in categories such as non food manufactured products, primary food articles, minerals, primary non - food articles , manufactured food products, and fuel and power. The sharp rise in WPI inflation is also attributed to the adverse base effect of the previous year.

Higher input prices and commodity prices push WPI inflation past the retail inflation. CPI inflation also remains elevated due to higher core inflation and rise in some of the items in the food basket

The rise in WPI inflation does not augur well for the retail inflation as higher wholesale prices feed into retail prices. CPI inflation climbed to 5.52% in the month of March as fuel and transportation costs increased apart from some categories within the food basket. Core inflation also increased to more than two year high of 6% because of rise in commodity prices and higher demand in the economy. The outlook for inflation remains mixed as the recent surge in COVID infections and the resultant lockdowns may once again lead to temporary disruption in supply, however, demand may also suffer yet another bout of subjugation as a resurgent virus may force public to curtail spending in the near term.



Fixed Income Outlook

Fundamental View

What a fortnight it was! It began with a bond positive monetary policy announcement which included RBI bazooka in the form of GSAP. This was bold enough move to take yields lower than our expected floor of 6.10%, touching 5.98% levels swiftly. However, the 10-yr yield moved back from such low levels back to 6.18% as quickly after the first round of GSAP was over, and ended the fortnight at 6.09% when RBI cancelled the auction of the 10-yr paper. Once again all the action was seen in liquid points of 5, 10 & 15 yr papers and other points on the yield curve were by watchers mostly. It was an interesting tussle between bond vigilantes and RBI and its too early to name the winner. In the short run, RBI can easily pulverize the bears and set the market direction while in the longer run its not easy to override the overall market forces. RBI through its actions has given clear indications that it is not comfortable with 10-yr yield much higher than the 6% levels.

As we said above that in the short run RBI can set the market direction, it would be futile to fight the big bull. Again we would reiterate that it would be difficult for markets to stay below 6% for sustained period of time, unless we see total lockdown type of situation as experience a year ago. Though the pandemic is crossing last year's worst peak and is continuing to spread very fast, the economic impact of the same will be limited as compared to the last year. In the coming fortnight also, we expect RBI to use force to keep yields down while bond bears will want to see higher levels. We recommend that sometimes staying at the sidelines is not a bad strategy and rather wait for extreme levels (6.25% to 6.30%) on the upside and 5.98% to 6.03% on the lower side to initiate positions on the buy side and sell side respectively.

Technical View

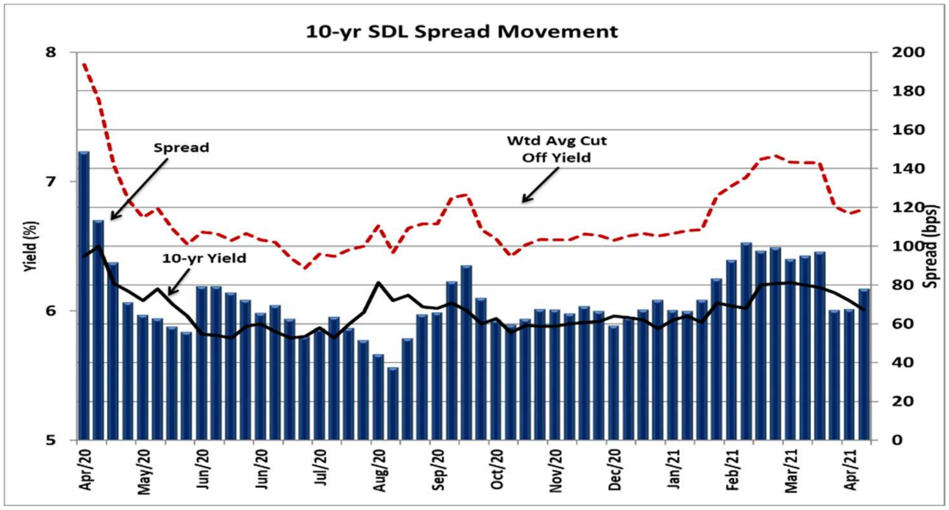
Analyst 1: 5.85% G Sec 2030 yield settled at 6.09% on Friday's session. Last fortnight benchmark Yield headed south, towards previous breakout zone of 5.96% and witnessed a bounce back thereafter. Momentum oscillator RSI, witnessed a bounce after touching lows of 32. Last Monday, post an inside candle, resumption of uptrend was seen in Benchmark yield. Current chart structure indicates widening of range with crucial supports placed at 5.96% and on higher side crucial resistance placed around 6.18% zone. Going forward either side break will decide the further course of action for yields, till then for coming fortnight benchmark may trade in above mentioned range of 5.96% to 6.18%.

Source: Tickerplant

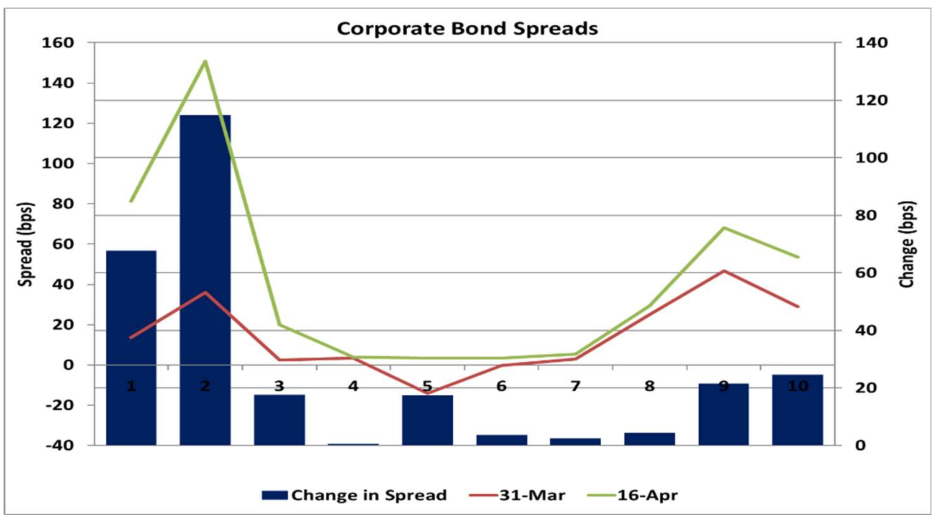
Current chart structure indicates widening of range with crucial supports placed at 5.96% and on higher side crucial resistance placed around 6.18% zone.

Analyst 2: 5.85 GS 2030 after touching a high of 6.15% , has swiftly reversed post auction results and has managed to close around 6.09%.Hence , at this juncture , we shall enter long , with a closing stop loss of 6.15% and take profit of 6%.

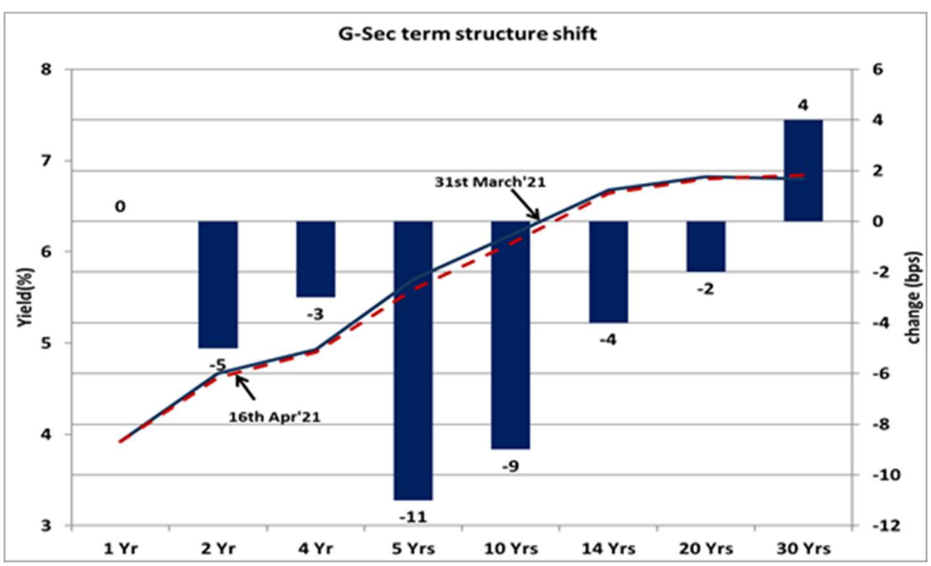
Spread Monitor



SDL spreads are expected to stay around current levels as scheduled supply remains subdued



Corporate bond spreads widened during the fortnight at the shorter end of the curve



Announcement of the G-sec buying program pulled down yields on liquid points on the term structure

PNB GILTS LTD.
5, Sansad Marg
New Delhi
110001

Phone 011-23325759
For Fixed Income retail queries: 011-23321568
E Mail:
marketing@pnbgilts.com
For other queries:
research@pnbgilts.com

We're on the Web!

www.pnbgilts.com

PNB Gilts Ltd, a renowned and preferred name in the Indian debt market was one of the first entities to be granted the Primary Dealership License by the Reserve Bank of India. The company is also a subsidiary of one of the largest Indian commercial banks, Punjab National Bank. Company has played a pivotal role in strengthening of the domestic fixed income markets and is a dominant player, marking its presence with significantly high market share in the overall trading turnover.

Disclaimer