PNB GILTS LTD

Volume 08/2021-22
12th July 2021

ECONOMY & GILT WATCH

PNB GILTS LTD
(Subsidiary of Punjab National Bank)

INSIDE THIS ISSUE:

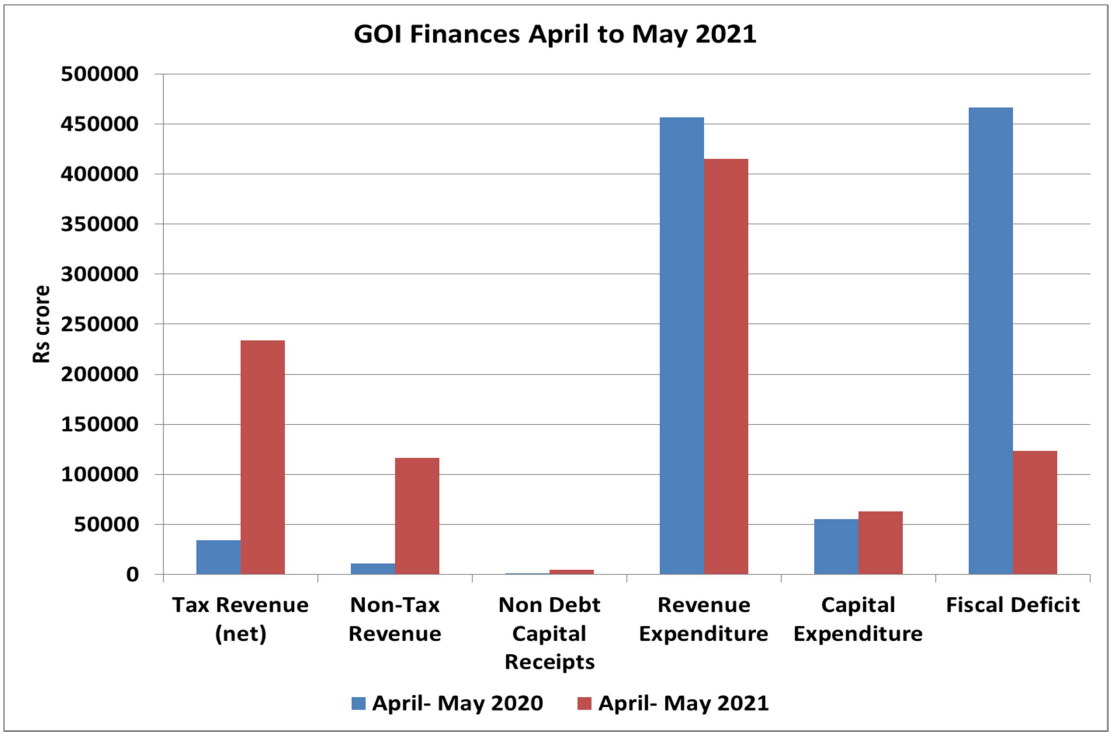
Fiscal Deficit at 8.2% of Annual Target

India's Fiscal Deficit for FY 2021-22 stood at 8.2% of the annual target during the period April to May on back of healthy tax revenues and dividend payment by RBI. In absolute terms the deficit stood at Rs. 1,23,174 crore during April to May 2021 vis-à-vis Rs. 4,66,343 crore during corresponding period of FY 2020-21. Net tax revenues stood at 15% of the budgeted target on account of robust GST collections in months of April and May. On the other hand, non-tax revenue was ~48% of the annual target as RBI transferred Rs. 99,122 crore in the government's kitty. On the other hand, expenditure remained largely controlled on account of lower subsidy related payments. Revenue expenditure stood at Rs. 4,15,000 crore which is 14.2% of the budgeted amount. Capital expenditure stood at Rs. 62,961 crore which is 11.4% of the annual budget. For Fy 2021-22, GOI has set a fiscal deficit target of 6.8% of the GDP, while for FY 2020-21, the ratio stood at 9.3%.

While the outlook on tax revenue collections is positive, with GOI expected to meet the year's target, the disinvestment target of Rs. 1,75,000 crore is very ambitious and non-realization of the target may weigh on the state of government finances. Till date, GOI has been able to raise only Rs. 3,995 crore via disinvestment. On the spending front, GOI has been a rather cautious spender and even with the latest set of reforms announced the impact on government finances is likely to be limited. The additional stimulus announced is in the form of Rs 1.5 lakh crore of additional credit for small businesses, more funds for the healthcare sector, loans to tourism agencies and guides, and waiver of visa fees as part of a credit-led package to support the pandemic-hit economy. However, with bank credit growing at a sluggish pace due to weak demand and increased risk aversion amongst lenders, the hopes of economic revival through such credit based stimulus measures appear rather bleak. Banks' balance sheet is expected to come under further duress as COVID related stress starts to get reflected. RBI expects banks' bad-loan ratio to rise to 9.8% by the end of this financial year from 7.48% a year ago.

With credit growth remaining feeble, the onus of reviving growth continues to remain on the government and RBI. The cuts on excise duties on fuel are still highly awaited, which may soften the inflation blow and provide RBI some more time to keep its policy accommodative. Soaring inflation has pushed RBI between a rock and a hard place as economic recovery is still in nascent stages which warrant policy to remain accommodative.

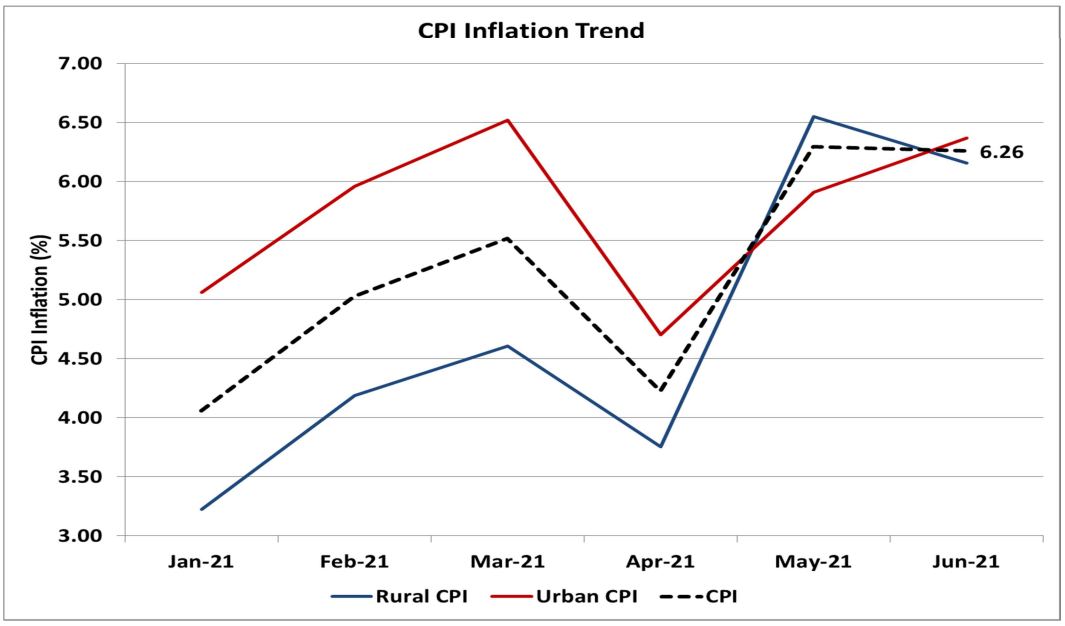
GOI finances look far better compared to the previous year as tax collections remain robust and expenditure curtailed.



Macro Monitor

CPI Inflation Falls Sharply to 6.26% in June

CPI inflation eased sharply in the month of June to 6.26% much against market expectations which feared a June print of as high as 6.70%. The decline is indeed surprising after high headline & core inflation numbers that we saw for the month of May, which stoked fears, that inflation is becoming entrenched in the economy, despite being supply side. The core inflation number stands at 6.05% sharply down from 6.57% in the previous month. The sharp sequential uptick that was witnessed in the month of May (over April) mellowed down substantially in June (over May), which led to the overall softening of the inflation number. Category wise, food inflation witnessed an increase over the previous month, with y-o-y food & beverage inflation rising to 5.58% in June as against 5.24% in May. The rise in food products was broad based with inflation in eggs, oil, milk, pulses rising further in the month of June from May levels. Fuel & light inflation on the other hand continued to rise in the month of June, witnessing a y-o-y rise of 12.68% up from 11.86% in May. Miscellaneous items inflation was also little higher at 7.28% as against 7.25% in the previous month. Inflation in Pan & Tobacco category fell sharply to 3.98% as against 10.03% in the previous month largely on account of high base effect, while that in housing category, it eased to 3.75% from 3.86%. The easing of inflation is certainly a big respite and will allay the fears that had built up significantly.



Fixed Income Outlook

Fundamental View

This is how typically the markets behave - prolonged periods of lull leading to a false sense of stability amongst the market people and then the sudden jolt to wake everyone up to the power of markets. During the fortnight the yields saw a 15-20 bps rise intra-week, though closing only 3-6 bps higher over the previous fortnight. The jolt came from the choice of securities made by RBI for the first auction of GSAP 2.0. Against the majority belief that liquid papers will be included in the GSAP, RBI thought otherwise and chose illiquid securities. Thus, the traders were left high and dry holding positions in liquid 5 year and 14 year points, on the back of expectation of being 'bailed out' by RBI. Non-inclusion of these securities led to severe price erosion in the markets as the traders rushed to offload these securities in the market.

The million dollar question now is that whether RBI has decided to take a break from "actively managing the yields". Some hint can be taken from non-inclusion of any liquid paper in GSAP and letting the market forces decide the coupon on new 10 year benchmark

However, two things came to the rescue of a very nervous Indian bond market: i) a sharp risk off activity in the global markets leading to a sharp drop of almost 25 bps in USTs and a 4 dollar drop in Crude Oil prices from the top. This happened due to rise in cases of COVID cases (delta variant) in Eastern Asia as well as parts of Europe and Africa. This led to apprehensions about a much feared third wave of pandemic globally. ii) interview of RBI Governor wherein he categorically allayed the fears of an early lift off of rates by RBI citing growth concerns. These two events coming back to back in quick succession helped markets recover much of the lost ground. Another major development was the issue of new 10 year bond and surprisingly RBI cleared the issue at market determined rate of 6.10%.

The million dollar question now is that whether RBI has decided to take a break from "actively managing the yields". Some hint can be taken from non-inclusion of any liquid paper in GSAP and letting the market forces decide the coupon on new 10 year benchmark. We expect that central bank will let the market reset to new levels gradually and their actions last fortnight were a reflection of this strategy. They may again start active management at somewhat higher level of yield. For the next fortnight, we expect the 5 year paper to trade in a broad range of 5.69% to 5.82%. We shall be taking 5 year yield as the representative of the broader market till the new 10 year paper (6.10% GOI 2031) becomes liquid enough to represent the broader market.

Technical View

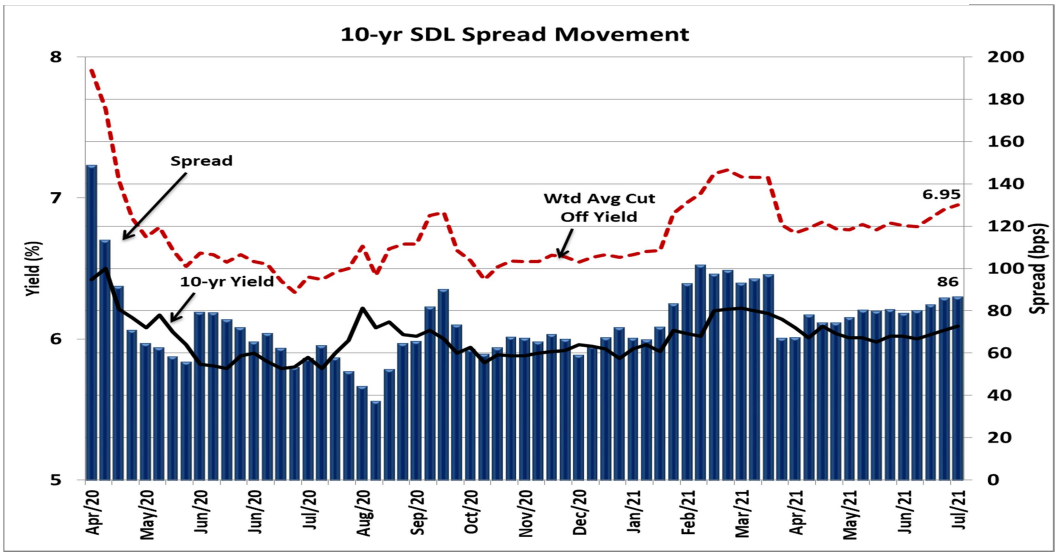
5.63% G Sec 2026 yield settled at 5.73% on Friday's session. Markets witnessed decent volatility in last couple of weeks, with 5 year paper touching high of 5.89%. However, short covering seen on Wednesday and Thursday led it to close at 5.73% level.

Post witnessing a breakout on 15th June, 5 year paper is making Higher High, Higher Low formation indicating strengthening of yields. On Friday it took support from 20 SMA level and closed higher. Current chart pattern indicates 5.68%/5.70% to act as a crucial support on the downside and till is sustaining above this level we may see further upside in it. On higher side it may try to fill the gap made on Thursday session i.e. 5.80%.

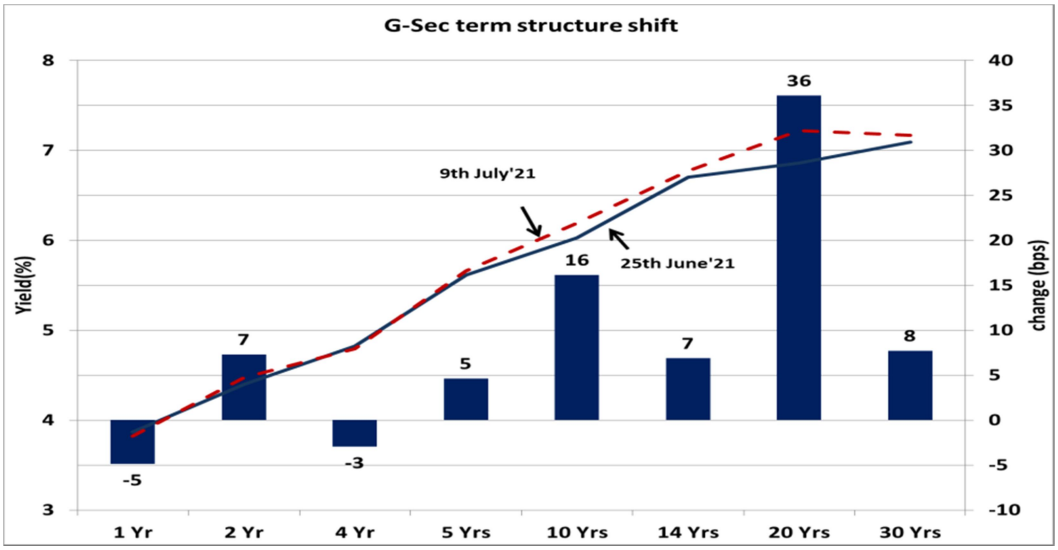
Source: Tickerplant

Spread Monitor

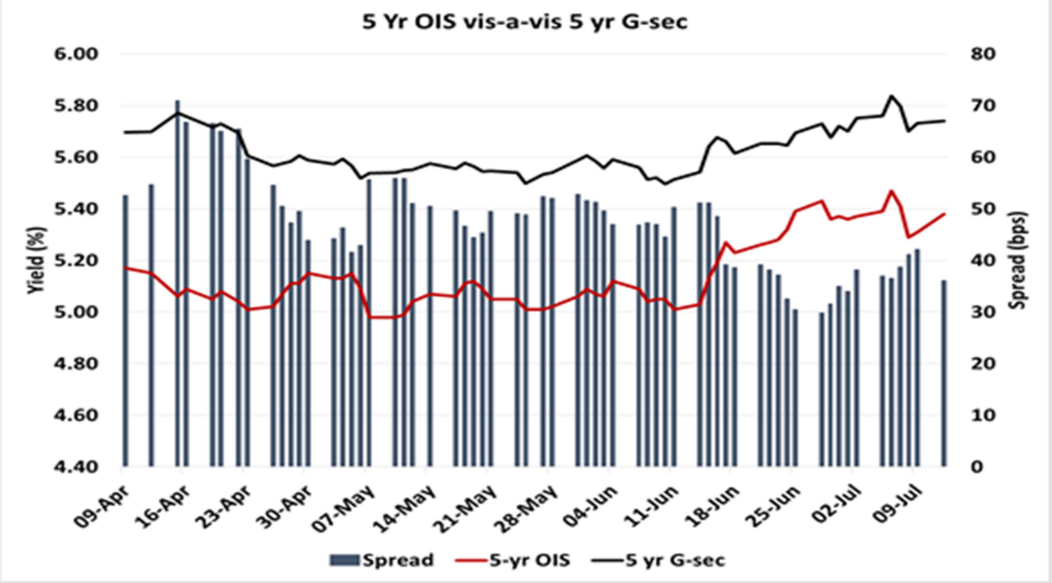
While the 10-yr SDL spreads are expected to remain largely near current levels, the longer end of the SDL curve may witness further steepening as the underlying long end yields come under upward pressure

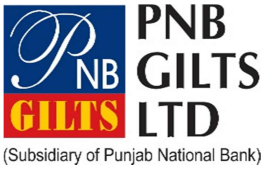


Bond markets witnessed a sell off and are expected to remain jittery ahead of the release of the headline inflation print



OIS yields cooled off in the previous fortnight tracking a sharp fall in the US treasury yields





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