PNB GILTS LTD

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ECONOMY & GILT WATCH

PNB GILTS LTD
(Subsidiary of Punjab National Bank)

INSIDE THIS ISSUE:

19th OPEC Plus Meet

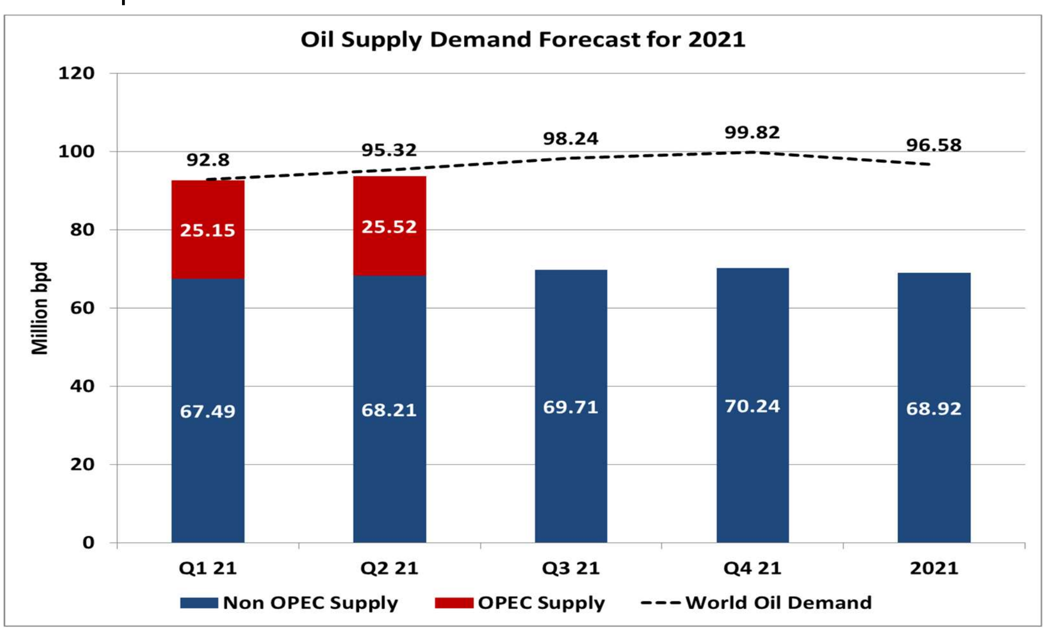
The 19th OPEC & non OPEC ministerial meet concluded on 18th July putting an end to the stale mate between key members Saudi Arabia and UAE, which pushed oil prices to multiyear high in early July. In the midst of faltered global demand, the cartel, OPEC plus (which includes OPEC and its allied group of major oil producers led by Russia) had slashed its output heavily by 9.7 million barrels per day (bpd) in the previous year. And now with demand back on its feet, the cartel has pushed its plans which calls for continuing production increases into 2022 until all the cuts made in 2020 are fully restored. The market has already seen an increase in supplies of more than 2 million bpd in May and June. And on 18th July 2021, OPEC plus reached a deal to further increase oil output by 0.40 mn barrels per day (bpd) each month beginning from August to December 2021. In total, including previous increases, the cartel will have boosted output by about 4 million b/d by the end of July. In its press release, OPEC Plus referred to "the ongoing strengthening of market fundamentals, with oil demand showing clear signs of continued improvement."

The agreement was reached after a stiff standoff between the Kingdom of Saudi Arabia and UAE with the latter desiring for a higher output ceiling from which its share of curtailment would be calculated. While this is the apparent reason, there are some political reasons also being attached behind UAE displaying assertiveness in OPEC affairs. Nonetheless, with the deal being finally salvaged, oil prices cooled off significantly, dropping by more than 5% in a single day on 19th July as news of additional supply was complemented with concerns over fast spreading Delta variant across Asia and Europe. The latest developments have once again pushed the oil markets into a turbulent zone, arresting the bull run that began in May this year. While the additional supply is certainly good news from India's perspective, as fears of oil marching upwards towards higher levels and the consequent pressure on retail prices will now be allayed at least in the short term, a longer term respite though remains uncertain.

While the demand outlook is fraught with uncertainties emanating from likely resurgence of newer variants of the virus, it is the squeeze in supply that is giving much of the confidence to the oil bulls.

Demand and Supply Dynamics

While the surging Delta variant has once again clouded the demand outlook making the task of projection of future trajectory of oil prices rather tricky, the demand and supply dynamics remain tilted in favour of price rise, given that the Delta variant does not cause much disruption. OPEC expects demand to outweigh supply in the current and the next year, expecting it to increase by 3.3 million bpd to average 99.9 million bpd in 2022 (back to pre-pandemic levels). The cartel expects demand this year to increase by 6.0 million bpd to average 96.6 million bpd as against 90.6 million bpd in year 2020. While the demand outlook is fraught with uncertainties emanating from likely resurgence of newer variants of the virus, it is the squeeze in supply that is giving much of the confidence to the oil bulls. The opening up of OPEC supply has been slow. OPEC crude production averaged 25.1 million bpd in Q1 2021, about 0.2 million bpd lower than demand for OPEC crude. In the Q2 2021, OPEC crude production averaged 25.5 mb/d, again implying a supply deficit of 1.6 million bpd. Supply from Non OPEC producers is also expected to remain subdued in the current year and is only expected to pick up meaningfully in the next year. According to the OPEC monthly oil market report, Non-OPEC liquids supply growth in 2021 is expected to grow by 0.81 million bpd to average 63.76 million bpd. On the other hand, in year 2022, Non-OPEC liquids production is expected to pick up pace and rise by 2.1 million bpd to average 65.85 million bpd.



Source: OPEC Monthly Oil Market Report

Closing Remarks

While the broader and supply dynamics point towards robust demand and tighter inventories exerting largely upward pressure on oil prices, few factors do pose significant risk to the presumed trajectory. Recent concerns emanate from the loss in momentum in Chinese economic growth and activity. China's Q2 GDP declined to 7.9% (y-o-y), which was below expectations of 8% growth. On the other hand, growth in retail sales also eased to 12.1% y-o-y in June from 12.4% in May. The recent government crackdown on misuse of import quotas by state owned companies in China is also expected have an adverse impact on Chinese oil demand. Given these factors, the oil market is expected to face volatility and expectations of a supply deficit shall remain tempered with risks to demand arising from pandemic resurgence and likely weakening of Chinese demand.

Macro Monitor

Non Food Credit Growth Improves to 6.16%

Bank credit growth saw an improvement in fortnight ended 2nd July 2021 with y-o-y growth rising to 6.10% as against 5.82% in fortnight ended 18th June 2021. Non-food credit offtake was even better, registering a rise of 6.16% as against 5.89% in the previous fortnight. Deposit growth on the other hand declined marginally to 9.8% during the fortnight as against 10.3% y-o-y growth in the previous fortnight. Nonetheless, deposits continue to sharply outpace credit offtake, despite government's push to allay pandemic related economic stress through credit based stimulus measures. Banks have continued to park liquidity well above Rs. 6 lakh crore with RBI under the reverse repo window for most part of FY 2021-22.

Fixed Income Outlook

Fundamental View

We expect a range bound movement in domestic bond market in the current fortnight with some volatility built around the day of monetary policy

What a change a fortnight can bring! Two fortnight ago, the global markets were highlighted with concerns over inflation across the globe and resultant bearish voices for the bond markets globally. The last fortnight witnessed tempering of these bearish sentiments. The threat of rising COVID wave across East Asia and parts of Europe along with some soothing voices from Fed and ECB saw the yields coming down sharply, particularly in the developed markets. However, this was not as pronounced in Indian bond markets where the 10 year and above segment didn't resonate with drop in US yields. On the domestic front, the CPI inflation may have peaked out for the year and upside surprises may not occur on this count. Now that the RBI has once again entered the fray of managing the yields after remaining away for few weeks, as shown by devolvement of a large portion of the 10-year bond on Friday, markets are largely expected to remain anchored.

The next fortnight witnesses two main events:- US Fed meet and RBI MPC meeting. As of now we don't expect any change in policy rates or even the tone and tenor of statement. On the basis of this assumption, we expect a range bound movement in domestic bond market in the current fortnight with some volatility built around the day of policy. The range for 10 year bond is expected to be in 6.10-6.20% range. As it inches towards 6.20%, we expect RBI to be more actively involved through devolvement, cancellations and OTs/OMOs. The risk to the markets may arise from any unexpected outcome from either the Fed Meeting (indications of an early lift off/taper) or RBI MPC meeting (showing concern on high inflation).

Technical View

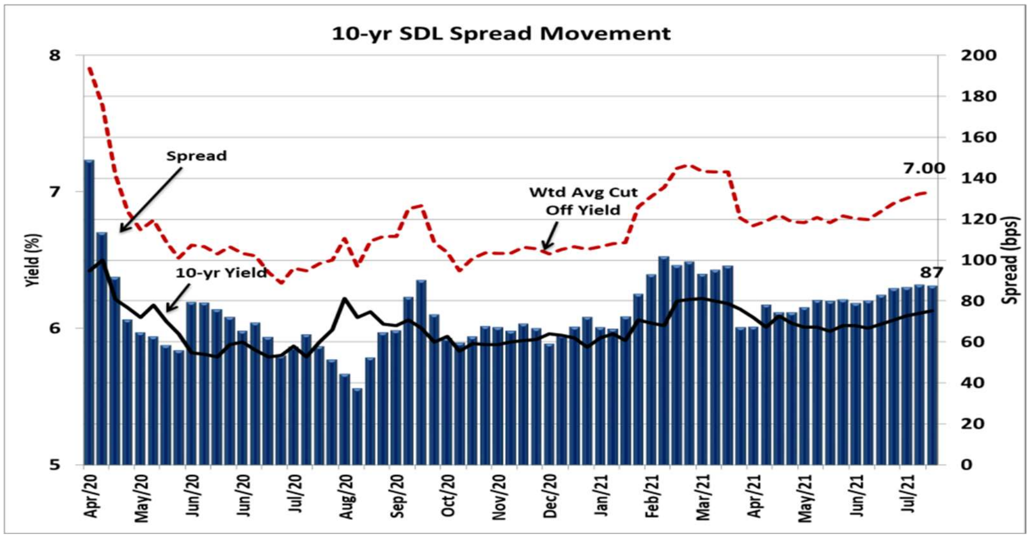
5.63% G-Sec 2026 yield settled at 5.73% on Friday's session. Markets witnessed decent volatility in last couple of weeks, with 5year paper touched high of 5.89%. However, short covering seen on Wednesday and Thursday led it to close at 5.7311% level.

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%.

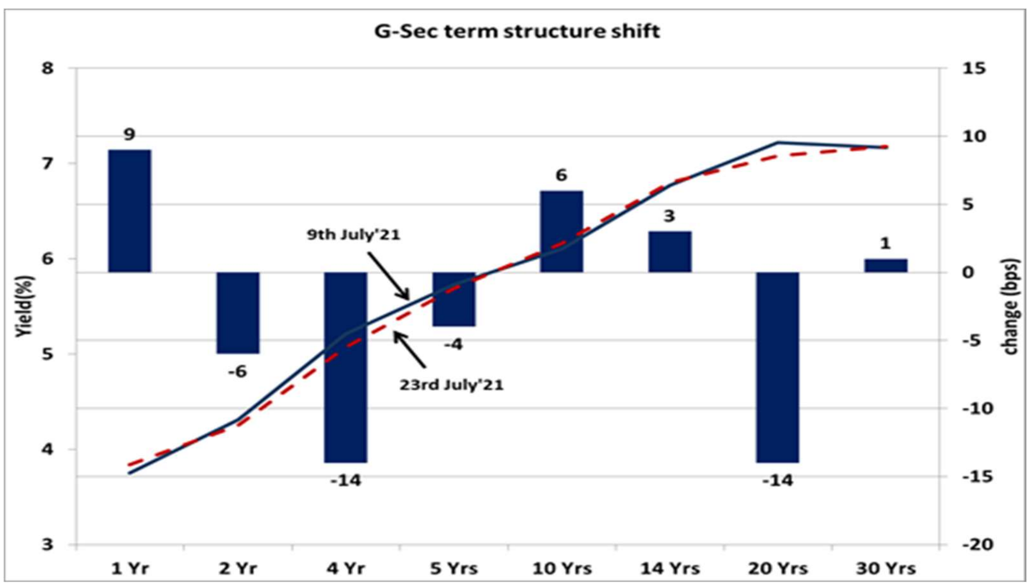
Source: Tickerplant

Spread Monitor

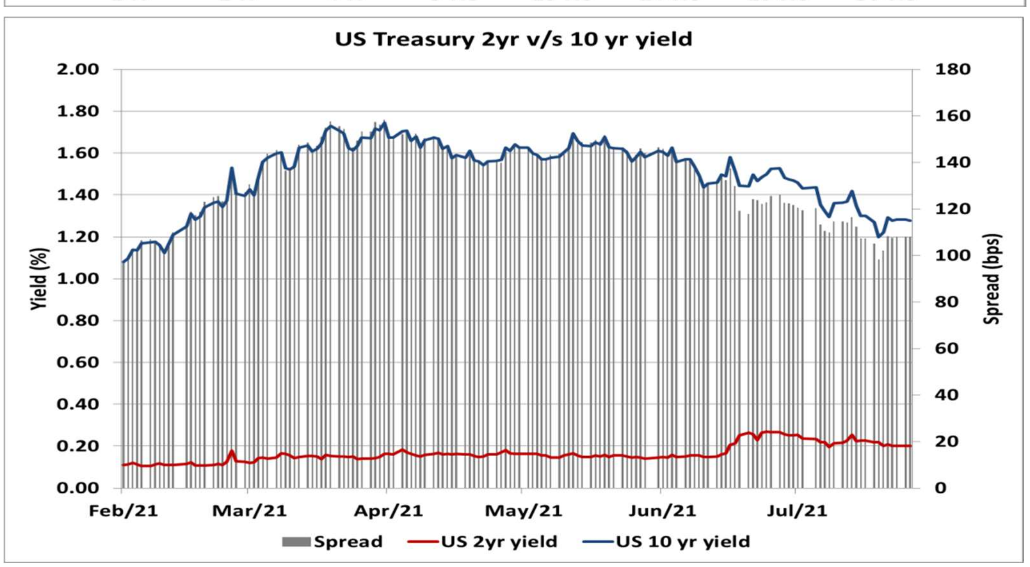
SDL spreads are expected to remain range bound in the coming fortnight on continuous primary market supplies



The short end of the curve is expected to remain favoured amidst large surplus liquidity in the system



The US yield curve has flattened with the 10-yr yield reaching its lowest levels seen since February.



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