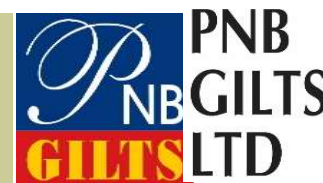


ECONOMY & GILT WATCH



(Subsidiary of Punjab National Bank)

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June Inflation Inches Upwards on High Food Prices

Breaking the four-month's declining streak, India's headline inflation overturned to 4.81 per cent in June 2023. The 25-month low inflation print of May 2023 (revised) at 4.31 per cent anchored expectations of diminishing price pressures, however, the spiking prices of the food basket resulted in higher inflation for the month of June 2023 against the broader expectations at 4.60 per cent.

Food prices, which make up roughly half of the CPI basket, increased by 4.63 per cent y-o-y in June 2023 as opposed to 3.35 per cent in May 2023. On a monthly basis, all the items under Food & Beverages, except oil and fruits, recorded an uptick in prices, led by tomatoes, pulses and cereals. The vegetable prices shot up by 12.17 per cent m-o-m in June 2023, primarily on the back of the much-talked '**Tomato Trouble**'. The prices of this perishable kitchen staple rose more than three times when the rains caused supply disruptions.

The fact that the vegetable prices in June 2023 recorded a yearly disinflation of around a percent contradicts the popular opinion of tomato being the villain in the June inflation narrative. Rather, almost every item of the CPI basket, barring oil and vegetables, registered an elevation over the year. While spices, pulses and cereals registered a double-digit y-o-y growth of 19.2 per cent, 12.7 per cent and 10.5 respectively, oil went south to record a decline of 18.1 per cent.

What lies ahead?

With the revised numbers of May 2023 CPI, the average headline inflation now stands at 4.61 per cent for the first quarter of FY 2023, in line with the Reserve Bank's projection of 4.6 per cent. However, the rising food prices may lead to the inflation surpassing the projected number of 5.2 per cent for the next quarter. The impact of patchy monsoon and flash floods on the farm output will unfold in the upcoming inflation prints, and will be a key monitorable for RBI's monetary policy stance.

Further, it will be interesting to watch the evolution of core inflation with a persistent rise in food inflation, expected to put a strain on the household budgets. With their borrowings linked to the external rate, retail borrowers are the worst affected in this rising rate scenario, which is unfolding with a lag.

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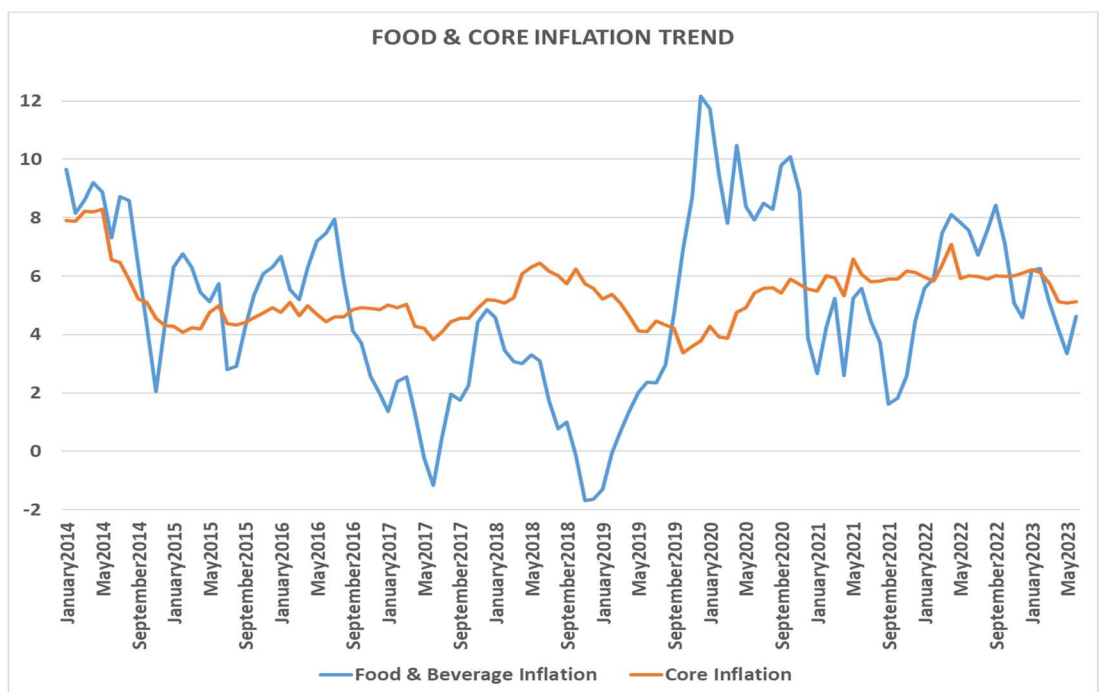
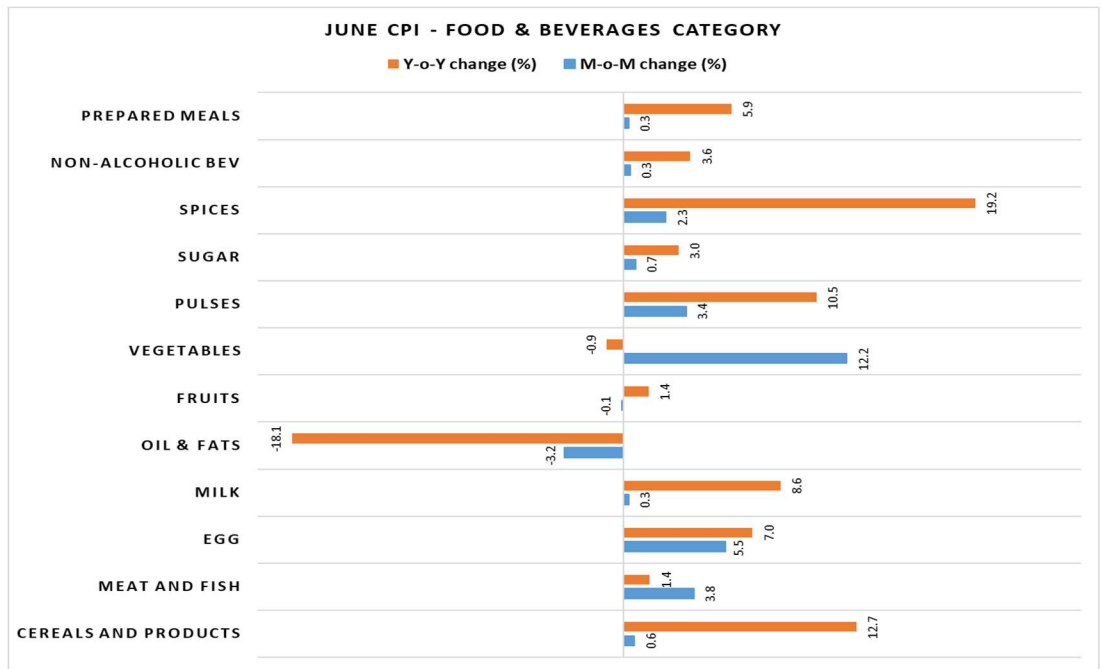
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The average headline inflation now stands at 4.61 per cent for the first quarter of FY 2023, in line with the Reserve Bank's projection of 4.6 per cent.

With high food inflation, the core inflation may remain subdued going forward, with fuel prices extending a supporting hand.

Consequently, one may expect a contained discretionary spending and the core inflation to remain range bound going forward, with fuel prices extending a supporting hand. However, upside risks in the form of tightened cotton and textile prices may persists, given the recent cyclone occurrence in the key producer state. Given the above, the trajectory of inflation remains fraught with various risks, and we expect RBI to continue to maintain a cautious stance in the upcoming monetary policy.

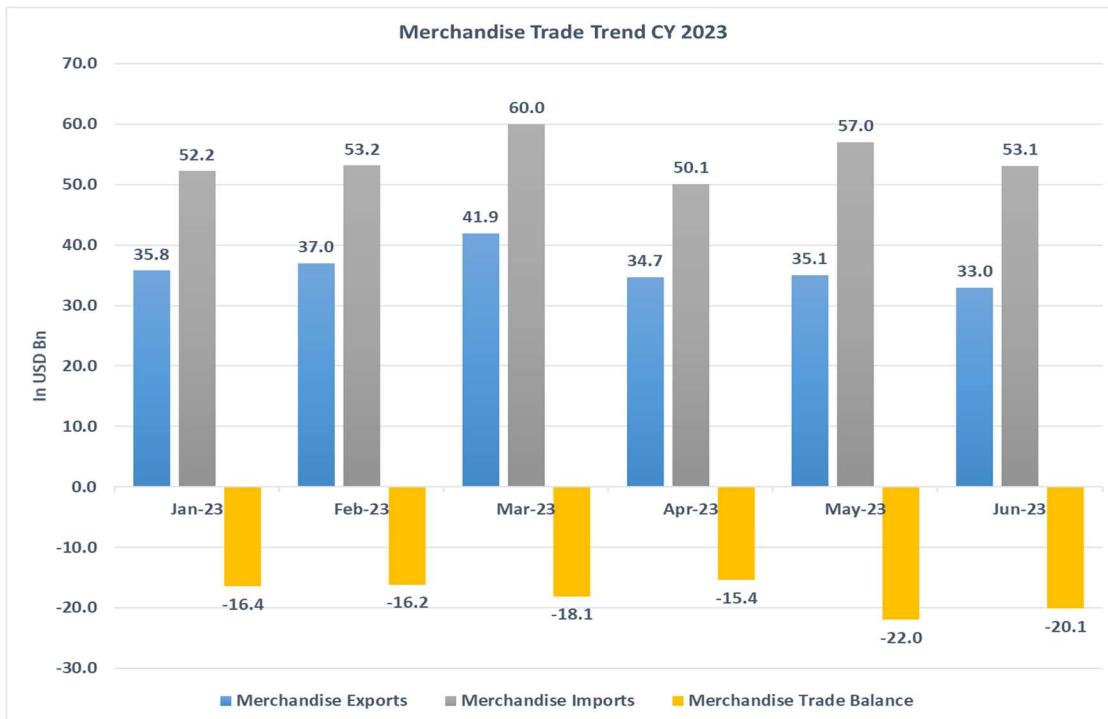


Macro Monitor

Q1 FY 2023-24 trade deficit widens to USD 22.5 bn

The merchandise trade data released for the month of June, showed that exports and imports witnessed both sequential and y-o-y deceleration. The trade deficit narrowing mildly to USD 20.1 bn as compared with USD 22 bn in May 2023 as imports contracted more than exports during the month over May. During June, merchandise exports contracted by 22 per cent (y-o-y) to stand at USD 33 bn while imports contracted by 17.5 per cent (y-o-y) to stand at USD 53.1 bn. The sharp y-o-y deceleration in exports and imports can be majorly contributed to the drastic decline in commodity prices over last one year. However, growing global headwinds have also a role to play in the slowing trade momentum and cannot be looked over. For the whole quarter (Q1 FY 2024), the merchandise trade deficit has widened to USD 57.5 bn as against USD 50.7 bn for Q4 FY 2023. The services exports, which were a major contributor towards the lowering of CAD in Q4 FY 2023, also softened during the quarter. In Q4 FY 2023, service trade inflows registered both sequential and y-o-y rise, surging to touch an all-time high of USD 39.1 bn boosted by strong performance in telecom, communication and information segment. However, in Q1 FY 2024, net services exports slipped a little to USD 35 bn in Q1 FY 2024. Consequently, the overall trade deficit for Q1 FY 2024, is expected to widen to USD 22.5 bn as against USD 11.7 bn in Q1 FY 2023.

A larger goods trade deficit and slowing of services exports, are expected to lead to widening the overall trade deficit for Q1 FY2024



Trade Internals

Of the top 10 export contributing items, 7 witnessed decline on y-o-y basis during Q1 FY 2024. Petroleum products exports softened by ~33 per cent chiefly due to sharp decline in crude oil prices. Petroleum products were followed by Gems and jewellery, which continues to face weak global demand. Contraction in export of cotton yarn, ready-made garments (RMG) is reflective of slowing global demand in the segment. Electronic goods, drugs & pharma and rice on the other hand witnessed positive growth during the quarter. Amongst imports, key import items such as petroleum products, coal & coke, organic & inorganic chemicals etc. witnessed sharp contraction on y-o-y basis, again mainly owing to fall in prices of commodities. Overall, weaker Q1 trade data is a consequence of both cooling commodity prices as well slowing global as well as domestic demand on account of tighter monetary policy.

Both export and import basket exhibited broad based weakening during Q1, with most of the items in contractionary mode on y-o-y basis

Export Items	% Share in overall export basket	Q1 FY 2023-23 (y-o-y growth)
Engineering Goods	26	-7.5
Petroleum Products	17	-33.3
Gems & Jewellery	7	-26.4
Electronic Goods	7	47.1
Drugs & Pharmaceuticals	6	5.1
Organic & Inorganic Chemicals	6	-19.4
RMG of all Textiles	4	-17.7
Rice	3	3.6
Cotton Yarn/Fabs./made-ups,Handloom	3	-12.8
Plastic & Linoleum	2	-17.9
Others	19	-2.8

Import Items	% Share in overall import basket	Q1 FY 2023-23 (y-o-y growth)
Petroleum, Crude & products	27	-18.5
Electronic goods	12	6.3
Machinery, electrical & non- electrical	7	12.1
Coal, Coke & Briquettes, etc.	7	-32.5
Gold	6	-7.5
Organic & Inorganic Chemicals	5	-27.7
Pearls, precious & Semi-preciousstones	4	-25.0
Artificial resins, plastic materials	3	-14.2
Non-ferrous metals	3	5.1
Transport equipment	3	-6.4
Others	21	-9.5

Fixed Income Outlook

Fundamental View

The flavor of the underlying theme and trading in the Indian bond market continues to remain dynamic. First week of the fortnight saw the yields shoot up on the back of US yields breaching the higher range of 3.80 per cent to 3.85 per cent, while the second week saw the yields coming down on the back of sharp slide in US yields due to their soft CPI. The 10-year yield touched a high of 7.18 per cent in the first week of the fortnight and a low of 7.07 per cent in the second week. Bereft of the overseas trading cues, domestic yields have all the ingredients of inching higher. The supply side continues to remain heavy, weighing on the demand. Additionally, the CPI also seems to have bottomed out for now. The reversal of favourable base effect and strong sequential momentum will ensure that the CPI edges back up from here on in the second quarter. Besides, the troublesome development on the vegetable inflation along with extremely uneven spread of monsoons this year is giving a scare on food inflation once again. The coming fortnight, will see US Fed deliver its policy verdict on 26th July and it is expected to deliver a final 25 bps hike, despite the softer than expected US CPI print for the month of June. Markets will keenly watch out for forward guidance on rate trajectory and a soft guidance is largely anticipated by the market as demand is progressively seen cooling off. Under such circumstances, the domestic yields are likely to draw cues from US bond markets in absence of fresh domestic cues.

SDL Overview

During the last fortnight, 10-year State Loans traded in the broad range of 7.39%-7.47%, whereas the 10-year CG benchmark, remained in the range of 7.06%-7.18%. In aggregate State government have raised Rs. 1,78,450 crore in this fiscal, so far which is 18% lower vis-a'-vis an indicated figure of 2,10,750 Cr. The spread between the 10-year State Government Securities (SGS) and Government Security (G-Sec) of corresponding maturity rose mildly to 33 bps in this fortnight as compared to 30 bps in the previous fortnight.

The spread between long end SGS vs CG have compressed to 10 bps from 40+ bps at the starting of financial year FY24 illustrating strong demand for longer tenure state government securities (SGS) from specific investors, such as Insurance Companies & Pension Funds. This week, the scheduled auction amount of state government securities (SGSs) is Rs. 12,430 crore against the notified amount of Rs. 16,830 crore. Historically, states borrow less in the starting months of the quarter. Sighting low supply, we expect the spread between 10-year SGS and CG to trade in the range of 30-33 bps in the next fortnight as well.

During the last fortnight, 10 Yr State Loans traded in the broad range of 7.39%-7.47 %

Technical View

Technical Synopsis 7.26% GS 2033 Yield:

After previous week's twin attempt to break above 7.18%, 7.26% GS 2033 saw a quick recovery towards 7.06%, purely driven by the significant drop in US yields.

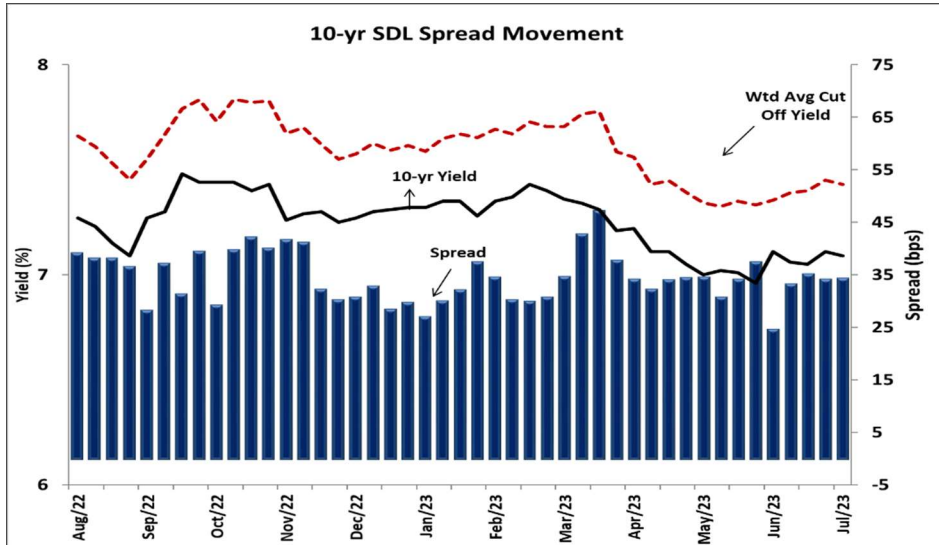
Going forward, as the relative strength index is already hovering above 50, the bullish momentum should broadly fade out around 7.04% levels. Hence, the 10-year trading range for the upcoming week has broadly shifted up to 7.04%-7.13% band.

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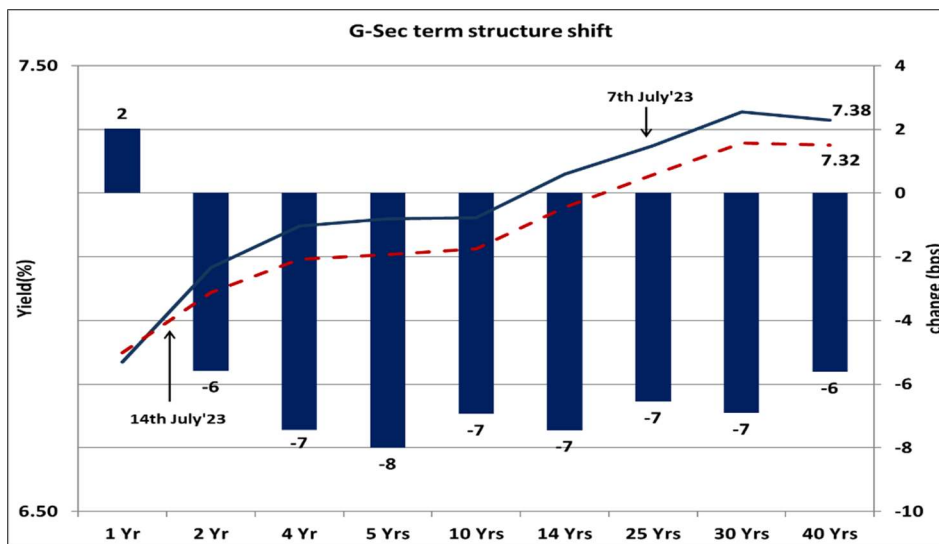


Source: Bloomberg

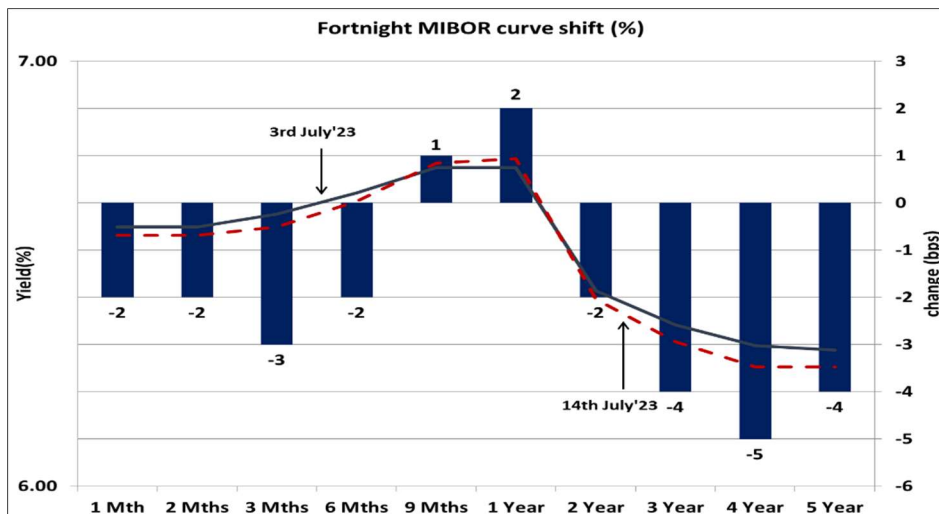
Spread Monitor



The spread between long end SGS vs CG have compressed to 10 bps illustrating strong demand for longer tenure state government securities



First week of the fortnight saw the yields shoot up on the back of US yields breaching its higher range while the second week saw the yields coming down on the back of sharp slide in US yields due to their soft CPI.



OIS rates eased in the previous fortnight tracking sliding US treasury yields



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