PNB GILTS LTD

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ECONOMY & GILT WATCH

PNB GILTS LTD (Subsidiary of Punjab National Bank)

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Q4 FY23 CAD Overview:
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Q4 FY 2022-23 CAD Shrinks to USD 1.3 bn

The Current Account Deficit for Q4 of FY 2022-23, shrank to USD 1.3 bn mainly on account of a narrower merchandise trade deficit and continued buoyancy in services related inflows. The CAD for Q3 FY 2022-23 on the other hand was revised downwards to USD 16.8 bn as against earlier estimate of USD 18.2 bn due to a narrower trade deficit of USD 71.3 bn vis-à-vis USD earlier estimate of USD 72.7 bn. While the Q4 CAD is a positive development, the trend is unlikely to sustain as trade deficit is expected to widen going forward. As per the available monthly trade data, the total trade deficit for April and May aggregated USD 37.6 bn with exports witnessing a sharp sequential slowdown. Nonetheless, a slowdown in imports accompanying the contraction in exports is likely to keep a check on the overall deficit.

Narrower trade deficit & Robust Invisible Earnings

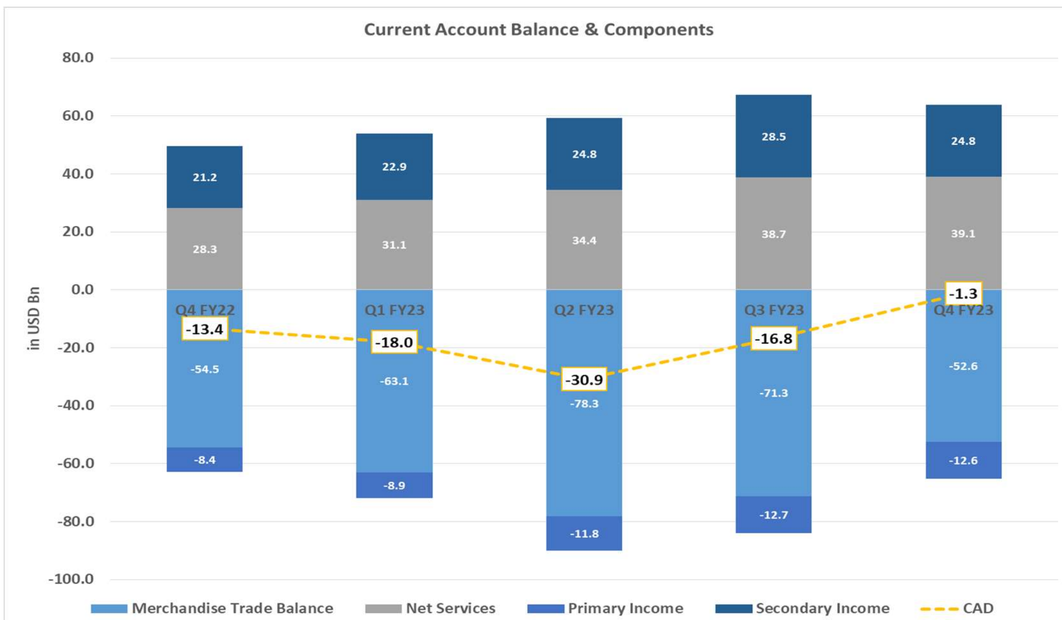
The trade deficit narrowed on both sequential and y-o-y basis during the fourth quarter on sharper y-o-y decline in imports compared to exports. During the quarter, imports contracted by 2.38 per cent on y-o-y basis, while exports contracted by 1.86 per cent, leading to 3.5 per cent reduction in the merchandise trade deficit during Q4. On the other hand, robust earnings from invisibles, i.e. services inflows, primary and secondary income, attributed to the softening of the CAD for the quarter. 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. Earnings from this segment stood higher at USD 34.51 bn in Q4 vis-à-vis USD 33.95 bn in Q3. Total earnings from invisibles stayed elevated at USD 51.3 bn in Q4 FY 2022-23 as against USD 54.5 bn in Q3 FY 2022-23 and USD 41.1 bn in Q4 FY 2021-22.

On the Capital account front, the picture is not as rosy. The net financial flows eased during the quarter, to USD 6.5 bn, sharply down from USD 28.93 bn in Q3 FY 2022-23. The decline in financial flows is mainly attributable to portfolio investment outflows (USD (1.7) bn in Q4 as against USD 4.61 bn in Q3) and heavy outflows in the banking capital segment (outflows of USD 7.7 bn in Q4 as against inflow of USD 12.01 bn in Q3 FY 2022-23). The increased outflows in these segments were partly offset by healthy direct investment and other investment inflows.

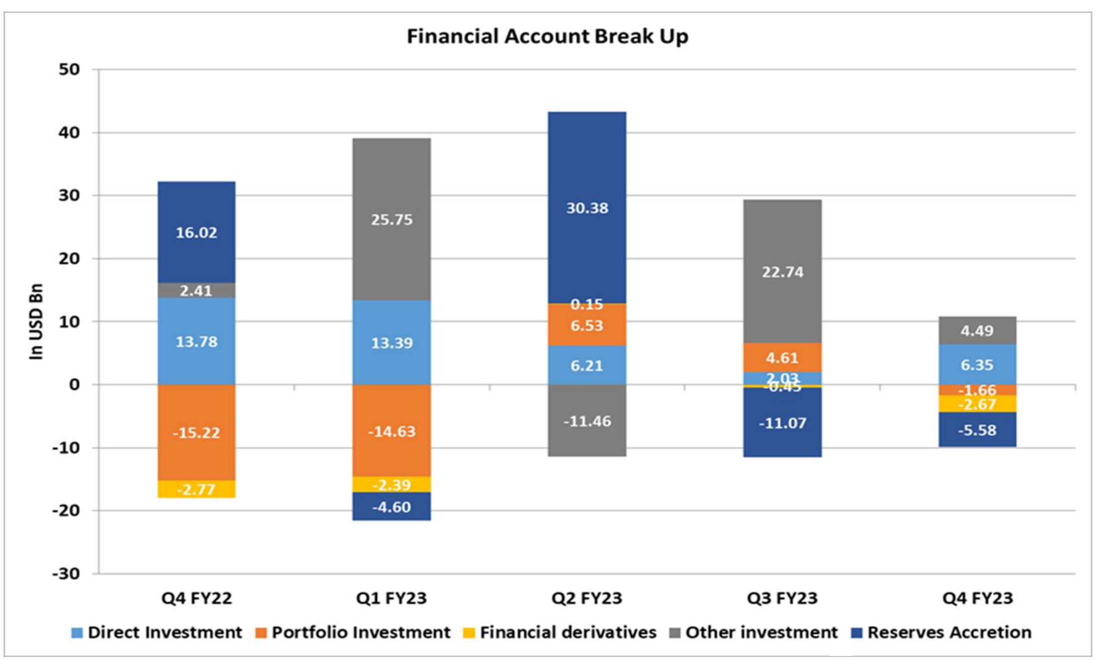
Due to softening of financial flows, the accretion to forex reserves also eased to USD 5.58 bn in Q4 as against USD 11.07 bn in Q3 despite the sharp reduction in the CAD over the previous quarter.

For the full year, FY 2022-23, the CAD settled at USD 66.98 bn (2 per cent of GDP) as against USD 38.69 bn in FY 2021-22 (1.2 per cent of GDP). With financial flows at USD 58.99 bn, the year witnessed reserve drawdown aggregating USD 9.14 bn as against an accretion of USD 47.51 bn in FY 2021-22.

The last quarter of the year witnessed sharp decline in merchandise trade deficit and buoyant invisible receipts



Despite shrinkage in CAD, steep decline in financial flows, weigh in foreign reserve accretion during Q4



Macro Monitor

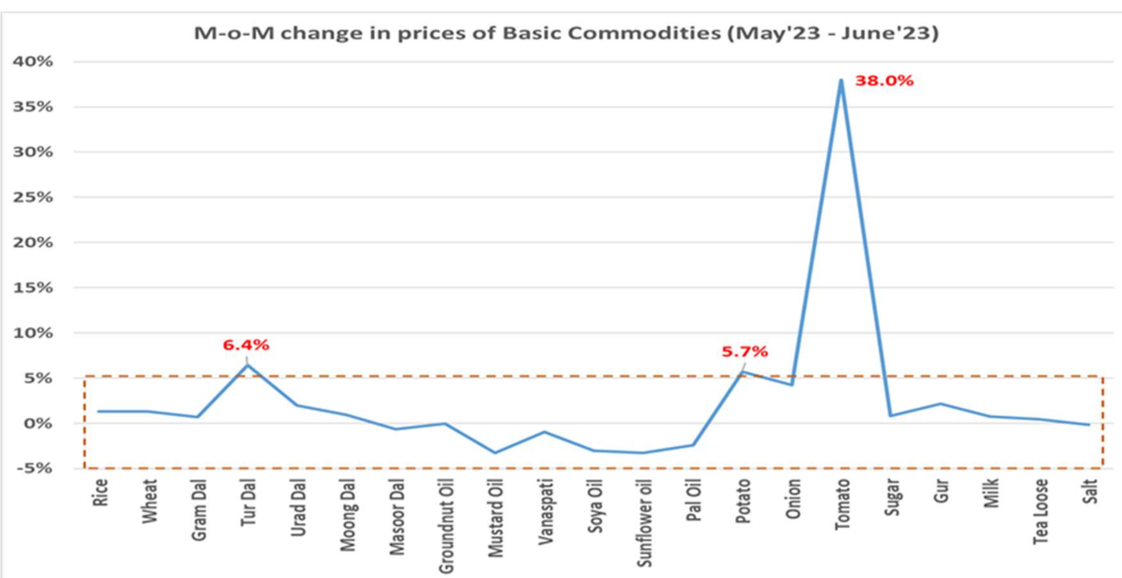
CPI preview: Headline inflation expected to rise as food inflation makes a return

On the back of higher food prices, some firming is expected from the June 2023 headline inflation print. Even though the preceding month witnessed major price elevations against the lower retail inflation for May 2023 at 4.25 per cent, we expect the June headline inflation to be at a sub-5 per cent level as base effect continues to remain favourable.

The food basket is expected to witness some firming, primarily due to a jump in the prices of vegetables, spices, pulses, and cereals. Making to the top of news headlines were the skyrocketing prices of tomatoes towards the second half of the month. This kitchen staple rose more than three times when the rains caused supply disruptions in almost every state. The kitchen budget got further strained when other key vegetables, including ginger and chillies, and cumin in spices also climbed on the bandwagon of price elevation during the month. In pulses segment, tur dal prices treaded upwards owing to the supply shortage. Despite certain price drops in food items such as oil, fruits, and egg; the retail inflation for the month of June 2023 is expected to climb up. Under the miscellaneous category, the yellow metal registered some price downtrend due to weak overseas cues and anticipation of further rate hikes by the Fed. Further, the waning demand pulled down the cotton prices at the beginning of the month.

Given the above mentioned developments, we expect the June 2023 CPI y-o-y inflation in the range of ~4.50 to 4.60 per cent. Despite the inflationary pressures and unexpected monsoon pattern, we expect the MPC to sustain its rate pause decision at least in the upcoming policy meeting.

We expect the June 2023 headline inflation to rise to ~4.50 to 4.60 per cent



Source: Min. of Consumer Affairs

Fixed Income Outlook

Fundamental View

Bond markets witnessed a sell-off in the previous fortnight and in line with our expectations, the 10-yr yield moved up towards the upper band of the expected trading range of 6.90 per cent to 7.15 per cent. Though the rise in yields was largely expected, the up move was rather quick and caught the market participants unaware. Sharp rise in US treasury yields remained the primary reason for the sell off in the market in absence of any domestic triggers. The coming fortnight will see key economic data releases in both US and India. Key US labour market data is slated to be released towards the end of the current week (on 6th and 7th July 2023). Global bond markets will remain on the watch as the labour market data comes in the run up to the 26th July US Fed meet. On the domestic front, CPI inflation data to be released on 12th July will also be watched closely and upside surprise in the same is expected to turn sentiments sour. We expect the markets to remain cautious with the floor of the 10-yr yield trading band shifting up to 7.00 per cent to 7.04 per cent and the upper end of the trading band at 7.20 per cent.

Any upside surprise in CPI inflation for June is likely to dent market sentiments further

SDL Overview

During the last fortnight, 10 Yr State Loans traded in the broad range of 7.31%-7.43%, whereas the 10 Yr CG benchmark, remained in the range of 7.03%-7.12%. In the first quarter of FY 2023-24, the state governments borrowed SGSs of over ~84% of their scheduled borrowing (Rs.1,68,050 cr vis-a- vis a scheduled figure of Rs. 1,99,250 cr). Last week, State government securities calendar for Q2 Fy-24 (July-Sep) came in line with the market expectation (Rs. 2.37 lacs cr vs. market expectation of Rs. 2.40 lacs cr).

During the last fortnight, 10 Yr State Loans traded in the broad range of 7.31%-7.43 %

The spread between long end SGS vs CG have narrowed to 15bps from 40+ bps at the starting of financial year FY24 illustrating robust investors demand in longer dated state government securities (SGS). We expect the spread to remain in the similar range in the second quarter as well. We also expect the states to continue the trend of borrowing lower than the indicated amount in the beginning of on account of higher tax devolution from Centre. The spread between 10-year State Government Securities (SGS) and Government Security (G-Sec) of corresponding maturity narrowed to 30 bps, from 33-35 bps in the current fortnight. We expect the spread between 10 yr SGS and CG to widen and trade in the range of 30-35 bps in the next fortnight considering increase in supply as state governments have aggressively accelerated their bond issuance in the weekly SGS auctions.

Going forward, sustainability above high of Inside candle on Monthly chart (i.e 7.12% level) may trigger further surge in 10yr.

Technical View

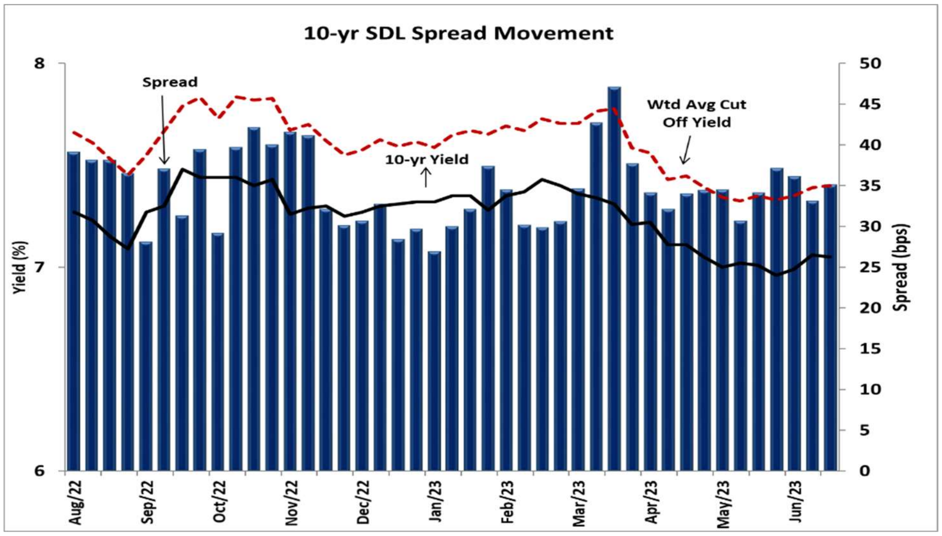
Technical Synopsis 7.26% GS 2033 Yield:

7.26% G Sec 2033 paper settled at 7.1192% on Monday's session. Passing Fortnight Benchmark has witnessed a breakout above 7.06% confirming Higher High Higher low formation on EOD chart.

Momentum oscillator RSI is trading around 65 level and may head towards overbought zone in coming days. Going forward, sustainability above high of Inside candle on Monthly chart (i.e 7.12% level) may trigger further surge in 10yr. Also, Marbozu candle on Daily chart indicates further hardening possible if 7.12% is breached convincingly. On lower side immediate support is placed at 7.06% and on higher side 7.18% is the next target which traders should keep a close eye on.

Running Chart GOI 10yr Daily. Source: Tickerplant

Spread Monitor



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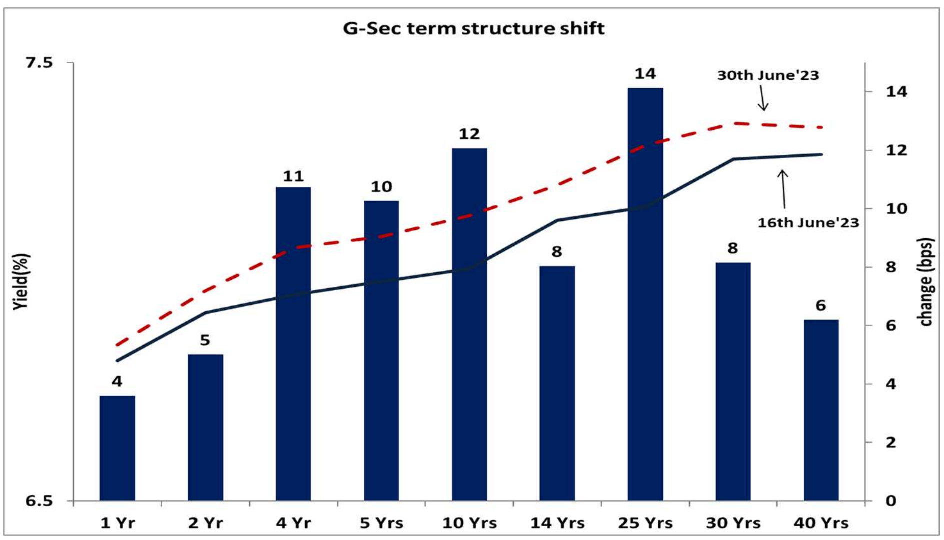
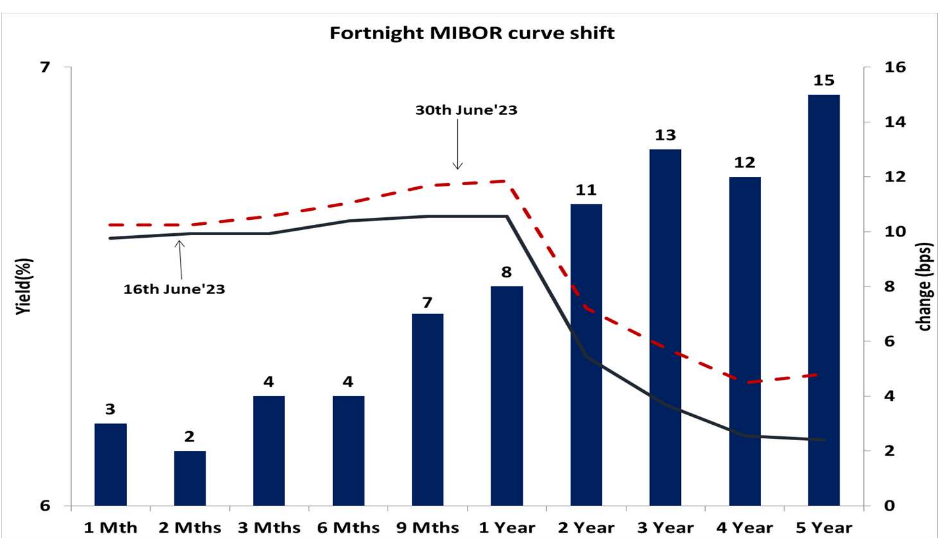


G-sec term structure witnessed steepening during the previous fortnight



OIS rates firmed in the previous fortnight tracking higher US treasury yields

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