PNB GILTS LTD

Volume 2/2024-25
April 16, 2024

ECONOMY & GILT WATCH

PNB GILTS LTD
(Subsidiary of Punjab National Bank)

INSIDE THIS ISSUE:

Middle East Tensions
Parikshit Payal
Associate Vice President
parikshit.payal@pnbgilts.com

SDL Outlook:
Anshul Arora
Sr. Vice President
a.arora@pnbgilts.com

Technical Outlook:
Ashish Bansal
Vice President
a.bansal@pnbgilts.com

Liquidity
Prabhakar Gautam
Associate Vice President
Prabhakar.gautam@pnbgilts.com

Middle East Tensions

Tensions have consistently been rising in the Middle East following Hamas' attack in early October last year that left more than 1000 people dead. While the conflict was largely confined to the targeted strikes by IDF inside Gaza Strip, the latest escalation with direct involvement of Iran and Israel has the markets on toes.

Last such episode of major geopolitical escalation in 2022 between Russia and Ukraine was marked by a tumultuous year for the broader markets. The world economy just coming out of Covid pandemic was taken by surprise and markets reacted with **positively correlated negative returns** across bonds and equities. Unprecedented volatility in commodities markets led to **inflationary environment** particularly for **import dependent economies** such as India. Particularly concerning is the timing of these developments when **ex-US DM economies** have been struggling while US **growth is diverging** on a consistent basis. For India the recent developments do not augur well in the short to medium term due to following possible outcomes:

1. **Uptick in Inflation:** India imports close to 85% of its crude oil for its energy needs. Also, following restrictions on Russian oil exports, India had negotiated arrangements for cheaper crude oil imports with Russia. With escalating tensions in Middle East the spike in crude prices is likely to lead to a **higher trade deficit** which recently touched **a 11-month Low** in March. Of particular concern can be the **loss of bargaining power** with non-Middle East Suppliers in case the situation deteriorates so much so that production is hit in the region.
2. **Slowdown in Foreign Investments:** FPI investments have been robust, led by JP Morgan Bond inclusion, clocking **net inflows of USD 41 Billion** for the FY24 and reaching a **9 year high**. In case of a major fallout of the Iran-Israel conflict, money managers across the world are likely to become **cautious on EM assets**, particularly equities which accounted for 63% of last year's inflows. In a highly risk off environment, investor rush to **safe haven assets** will hurt the nascent momentum that has been building up in Indian Assets' demand. The subsequent sell off can lead to **spike in Indian bonds yields** as well as a **correction in the equity** market.

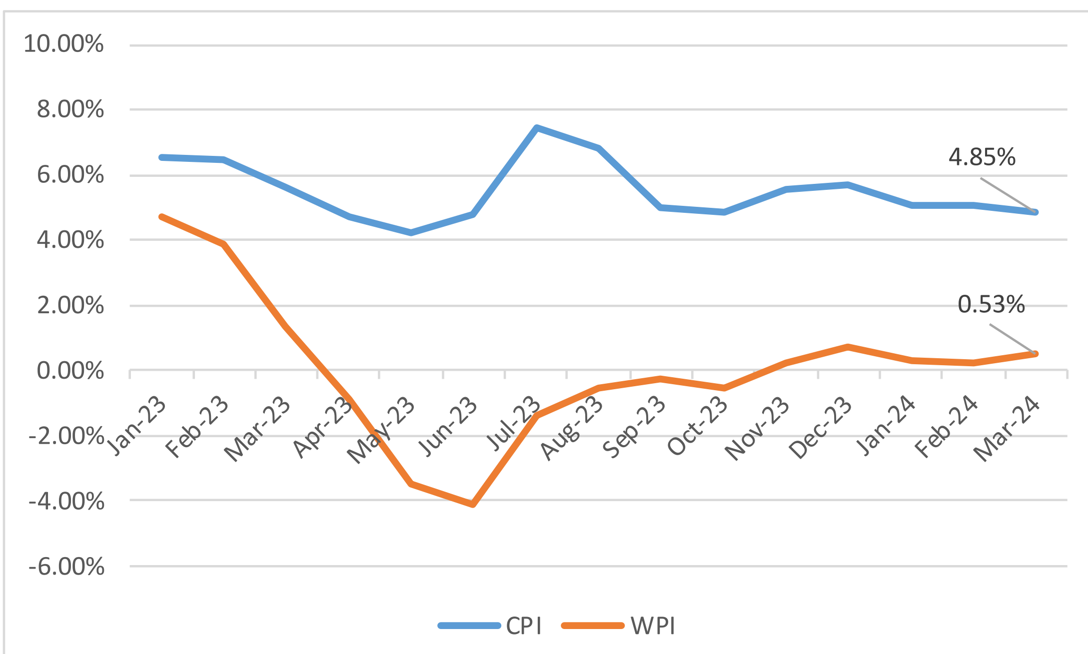
Global markets remain watchful with ongoing geopolitical tensions

3. **Currency Risk**: India's foreign exchange reserves stood at an **all-time high of $648.56 billion** as of April 5. With increasing likelihood of spike in crude oil prices along with escalating Middle East tensions, the foreign exchange reserves are set to fall leading to a possibility of **speculation against Rupee**. This further puts pressure on the fragile foreign **investor risk appetite** for Indian Assets due to aversion to currency depreciation losses, which would then again diminish the currency inflows further.

India Inflation:

CPI continued with the downtrend while IIP improved

India's retail Inflation eased further to a **10-month low** for the month of March and stood at **4.85%** on an annual basis and slightly **below market expectation**. The inflation is in the target band of 4%-6% of RBI but still above the 4% target figure. The recent developments in Middle East along with potentially hotter summer however can lead to a slight spike going forward. Inflation in the volatile food basket segment also eased slightly from February's figure of **8.66% to 8.52%.** WPI while increased slightly from the February figure of **0.20% to 0.53%.** Meanwhile the Index of Industrial Production (IIP) touched a **4-month high** of **5.7%** in February along with **upward revision** in January's figure to 4.2%.



Fixed Income Outlook

Fundamental View

During the last fortnight, G-Sec yields have trended upwards from 7.07% levels to now inching towards 7.20% territory. There has been a cool off in the investor demand for Bond inflows for active investors apart from Passive Bond inclusion flows. The uptick in Crude Oil prices along with consistently strong data from US has left little room for the rate cuts that the market was pricing in and as a result the yields have ticked higher.

The market will remain sensitive to global cues and to some extent to weakness in USDINR beyond 83.50

Going forward, major concern will be around how the situation in Middle East evolves along with voter sentiment in the Lok Sabha election's first phase which kicks off on 19th April. It remains to be seen if the inflows into bond markets can provide much needed support to the yields. With USDINR at a crucial level of 83.50 against a DXY surge it remains to be seen how currency risk plays out which can have a spill over impact on bond yields as well. In absence of major domestic cues apart from General Election, the market will look to developments outside to look for direction in the near term with 7.20% being a crucial level.

SDL Overview

The first fortnight of FY24 saw the 10Y SGS vs benchmark 10Y G-sec yield spread compressing and getting traded in the range of 30-35 bps, owing to smaller actual issuance calendar by states vis-à-vis their notified calendar. Stated had borrowed a sum of Rs. 24,500 Crores vs their scheduled figure of Rs. 53,740 Crores (45.6% lower). We expect states to come up with bigger issuances in coming fortnight & coupled with overall negative sentiment of market, we expect the 10Y SGS vs benchmark 10Y G-sec yield spread to elevate from current levels and trade in the range of 35-40 bps during the coming fortnight.

Higher state government borrowings are likely to keep CG-SG spreads elevated

Technical View

Technical Synopsis 7.18% GS 2033 Yield:

7.18% 2033 settled at 7.1779% on Monday's session. Passing Fortnight Benchmark yield broadly traded in range of 7.09%-7.19% and settled near three months high of 7.18%.

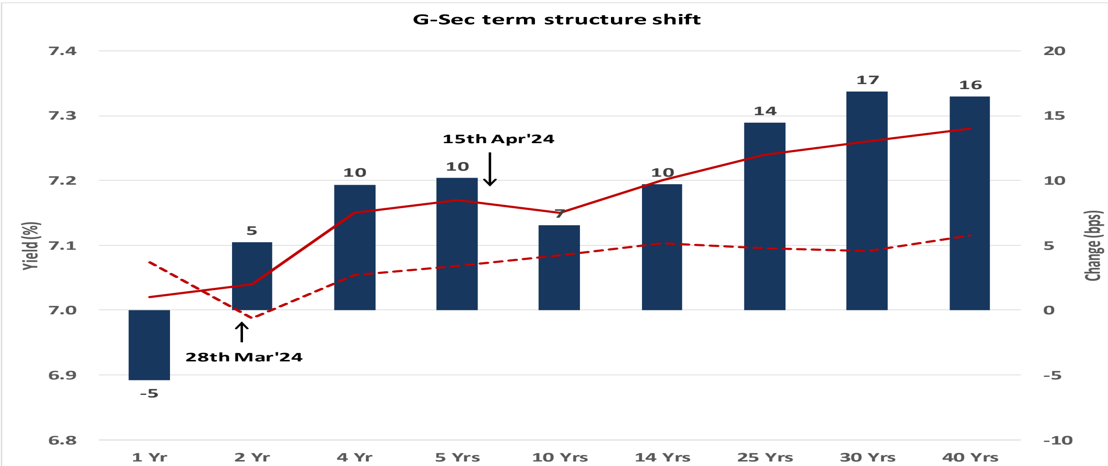
Momentum oscillator RSI is currently valued at 63. As discussed in last newsletter, any sustenance above 7.11% may trigger surge towards 7.19% level and the same was witnessed in last week. We have seen a Trend line breakout, coinciding with Higher High Higher Low formation indicating further hardening possible till trading above 7.16% level. Going forward with short term trend now favoring hardening of yields, we may see Benchmark drifting North with immediate targets of 7.24%/7.25% on higher side and immediate support now placed at 7.16% on any decline.

Running Chart GOI 10yr Daily. Source: Ticker plant

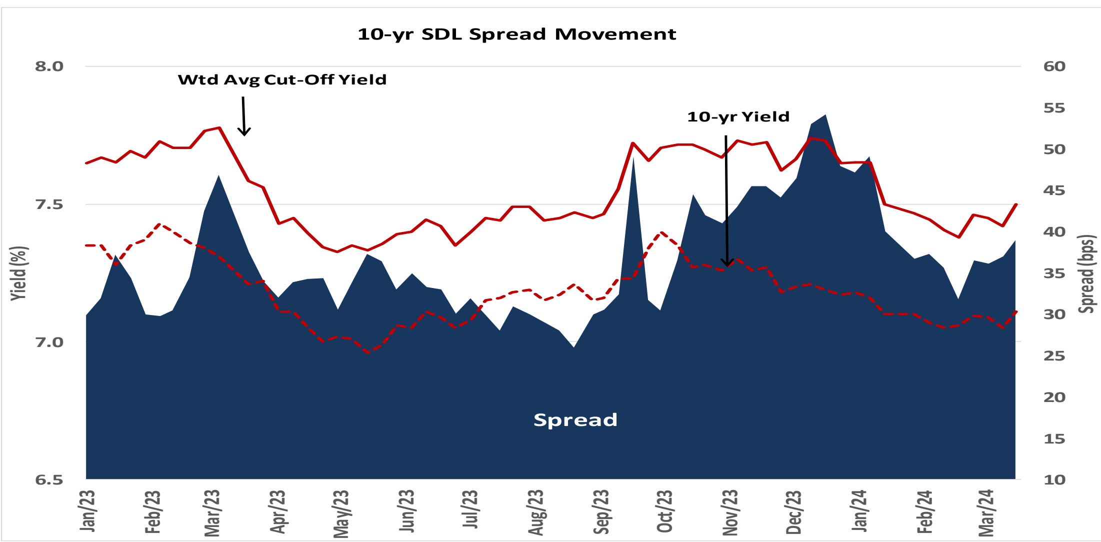
Liquidity

The System liquidity was in Surplus in the past weeks due to which money market rates were on the lower side as most banks were on the lending side, to absorb surplus liquidity RBI announced VRRR for 02 days for Rs. 50,000 crores. Going forward the liquidity condition might tighten on account of GST outflow. However, we may see pro-active participation by RBI in liquidity management as stated in the last MPC meeting by RBI Governor.

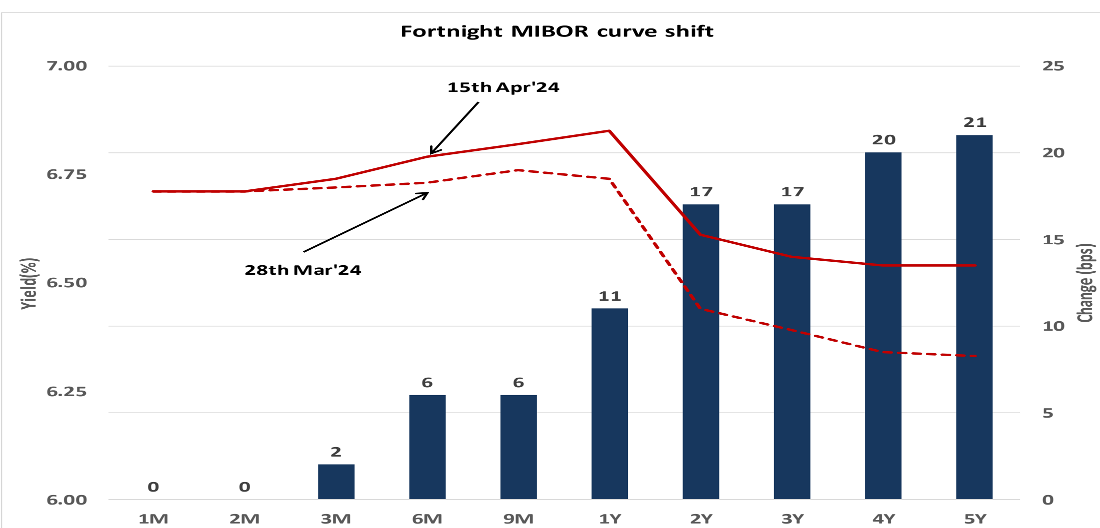
Spread Monitor



G-Sec yields trended upwards due to global developments



SDL Spreads remained flat



Rate cuts being priced out led to surge in OIS

(Subsidiary of Punjab National Bank)

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

Follow us on LinkedIn

https://in.linkedin.com/company/pnb-gilts

& our twitter handle

@pnbgiltsltd

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