PNB GILTS LTD

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ECONOMY & GILT WATCH

PNB GILTS LTD
(Subsidiary of Punjab National Bank)

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Union Budget

Finance minister Nirmala Sitharaman announced the Union Budget 2024-25 on 23rd July 2024 in the Parliament. Various announcements regarding new schemes and continuation of others were made across different sectors such as infrastructure, agriculture, MSMEs etc. Broadly speaking, the budget more or less focused on policy continuity without any fundamental surprises. On expected lines, considering the coalition nature of government there was comparatively higher emphasis on the states of Bihar and Andhra Pradesh.

Purely from a markets perspective changes were made to the tax regime on how Long Term and Short Term Capital Gains are taxed. Also, in the real estate sector, effects of indexation have been taken out. Above changes remain in line with government's indicative remarks in public forums around the increasingly high retail participation in derivatives markets which is often considered speculative in nature. Equity markets reacted negatively to the move and the likely impact is to be seen in some time to come if the changed tax regime has potential to start a profit booking led correction in the market.

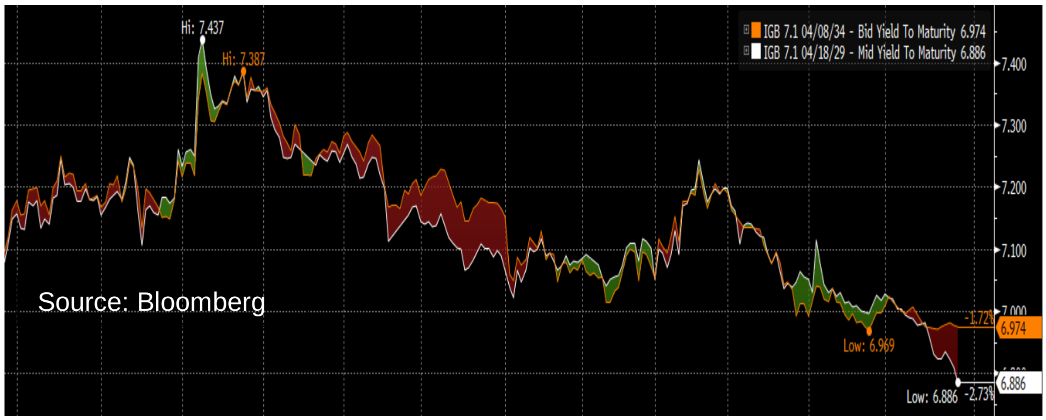
On the bond market front government reassured the market for its commitment towards fiscal consolidation by announcing a fiscal deficit reduction from 5.1% to 4.9% for the current year while laying out roadmap for further reduction to 4.5% in the subsequent FY. Also, the calculations for fiscal conditions seem practical given that the tax forecasts have rather been on the conservative side. If the past trends are to continue and we do not see any major shock, then there is a chance of borrowing cut in last quarter considering above estimate tax collection. RBI surplus dividend of approximately 1.2 Lac Crores makes the fiscal maths easier. While the quantum of borrowing cut at 12,000 Crores is not significant it can be taken as a positive indication from the government that it is committed on the path of fiscal prudence.

While the majority of the cut was announced in T-Bills as such the near end yields are expected to come down with widening short vs long tenor spreads. The RBI is also expected to review its policy and can change its stance as and when the inflation comes down in due course of time. All of these factors along with the continued FPI inflows into Indian Bonds make the case for a rally in the Indian bond markets. While in the near term shocks from political developments in the

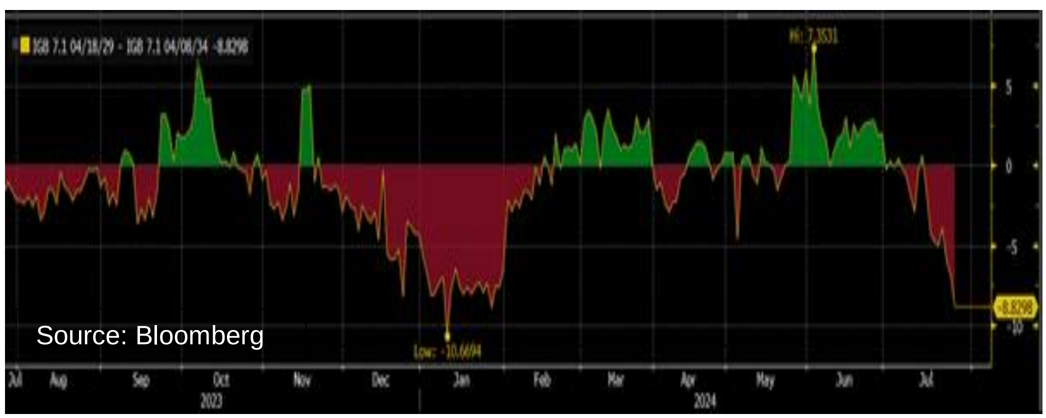
Budget has confirmed policy continuity as a phenomenon

Bull Steeping likely to play out with lower T-Bill supply

United States can hamper the bond rally in Indian markets. Domestic factors such as Monsoon and Equity market related turbulence remain to be seen.



5Y and 10Y movement



5Y*10Y Spread

Fixed Income Outlook

Fundamental View

Benchmark yields have been trading in a tight range for some time now. With all major events out of the way, the markets will look to global markets developments going forward.

Market likely to trade sideways with bullish bias

The budget was more or less on expected lines as far as bond markets developments are concerned. One possibility that may materialise as a fallout of the budget is that Equities finally see a correction and in the event of a sideways or correcting equities markets flows further strength in the Indian Bonds which can decisively help break the 6.90 hurdle and open gates for 6.75-80 levels.

SDL Overview

Last fortnight, CG benchmark 10 Yr traded in the range of 6.926% -7.018%, whereas, the 10Y SGS got dealt in the range of 7.30-7.38 i.e. the sdl spreads vis-a-vis their CG counterpart remained in the range of 35 - 40 bps. In Q2, States are continuing the trend, they followed in Q1, of coming up with smaller issuances than the notified calendar amount. So far, they had borrowed a sum of 38,883 Crores vs the notified figure of 53,390 Crores (72.83% lower). We expect states to continue this trend in the next fortnight as well on the back of higher devolutions from Centre than the budgeted amount. Hence, we expect the spreads between SG & CG to compress and stay in the band of 30-36 bps..

SDL spreads likely to compress

Technical View

Technical Synopsis 7.10% GS 2034 Yield:

7.10% G Sec 2034 paper settled at 6.9634% on 24th July session. Passing fortnight benchmark yield broadly traded in the range of 6.93% to 7.00% zone. Momentum oscillator RSI is placed around 39 level. As discussed in last Newsletter softening is here to stay till we are holding below 7.02% level and the same was witnessed in last Fortnight. Going Forward, with Descending Triangle pattern (continuation pattern) in making we may see further strength in the bond prices once 6.95% is sustained on closing basis. Till then we may trade in narrow range of 6.95% to 7.00%. We reiterate, with Bollinger width trading near 2024 lows infers either side sharp and volatile move possible in coming weeks. On higher side any sustainability above 7.00% may trigger surge towards 7.06% and on lower side any sustainability below 6.95%may trigger further softening towards 6.90-6.83% levels.

With Bollinger band width trading near year's low, sharp moves below likely

Running chart Daily: 10yr. Source: Tickerplant

Liquidity

Monthly Liquidity Scenario: There was surplus liquidity in the system, which led to lower money market rates. The Weighted Average Call Rate (WACR) for the month stood at 6.53%.

RBI's Actions: To absorb this surplus liquidity, the RBI has announced 16 Variable Rate Reverse Repo (VRRR) operations so far this month.

Future Liquidity Outlook:

Redemption Inflow of GSEC: There is an expected inflow due to the redemption of Government Securities (GSEC), which will increase system liquidity by Rs 61,000 crores(approx.).

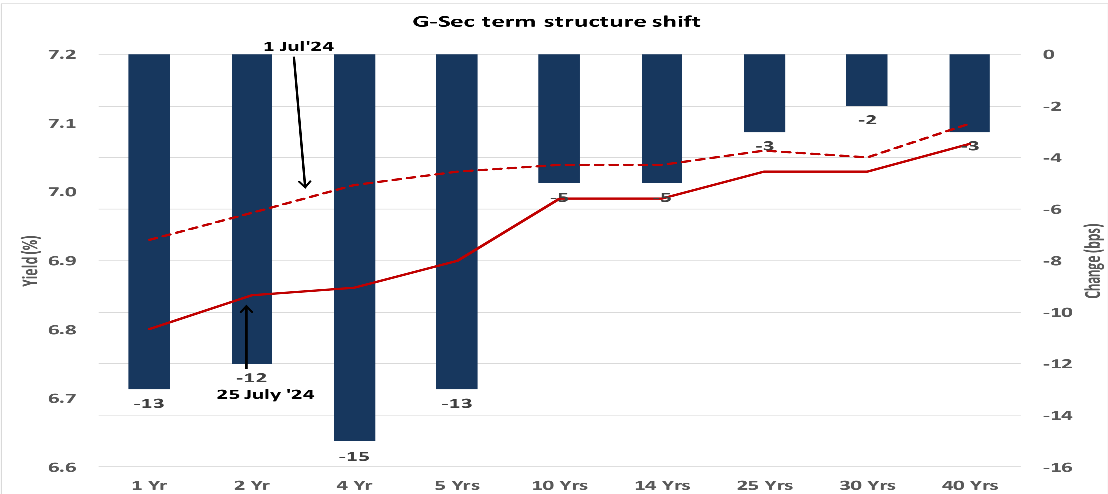
Liquidity is expected to increase

Government Cash Balances: Additionally, reduction in government cash balances due to salary and other expenditure (as has been the case for past few months) would increase system liquidity.

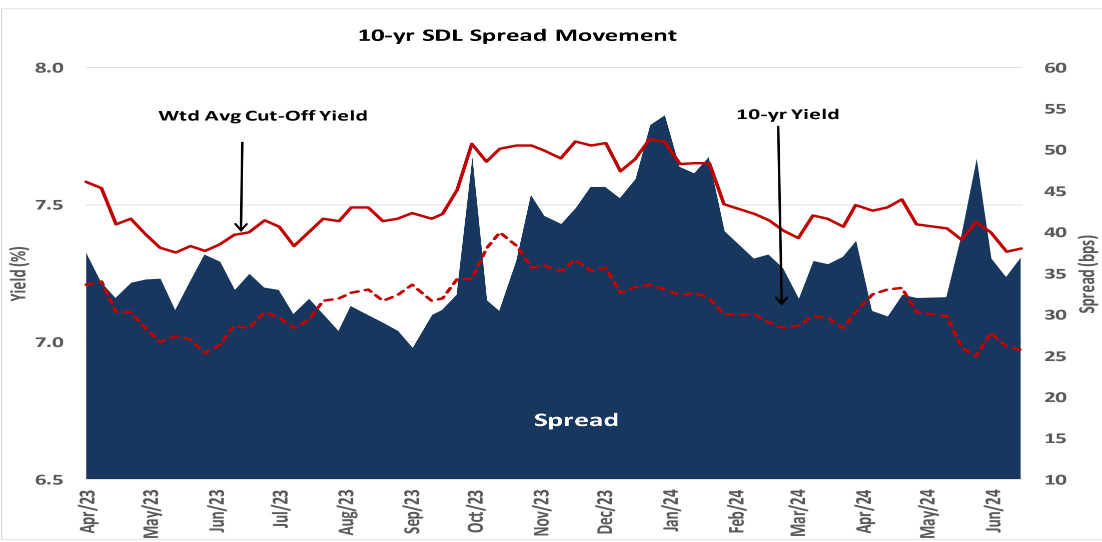
RBI's Pro-active Role: The RBI Governor mentioned in the last Monetary Policy Committee (MPC) meeting that the RBI would proactively manage liquidity. This indicates that the RBI will take further actions to maintain liquidity levels as needed.

The current surplus liquidity has led to lower money market rates with WACR remaining anchored around policy repo rate. G-Sec redemptions and drawdown in government cash balances would lead to lower WACR however, it is expected that RBI would keep on undertaking VRRR auctions to suck out excess liquidity.

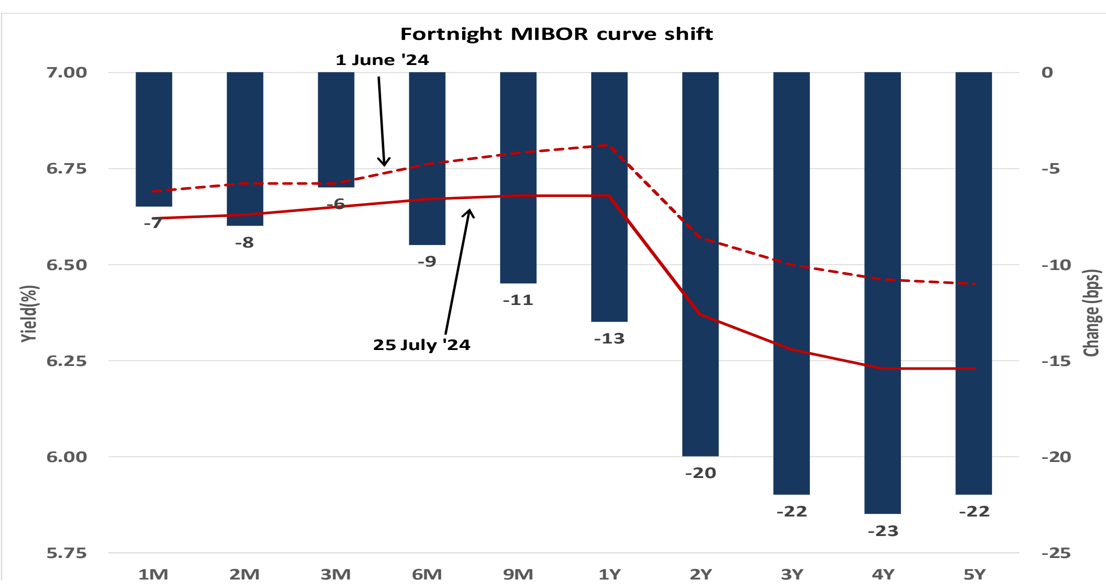
Spread Monitor



G-Sec yields have come down



SDL Spreads have remained flat



OIS has outperformed G-Sec

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