PNB GILTS LTD

Volume 13/2023-24
October 17, 2023

ECONOMY & GILT WATCH

(Subsidiary of Punjab National Bank)

INSIDE THIS ISSUE:

September CPI review
Deeba Hasan
Vice President
deeba.hasan@pnbgilts.com

Lavisha Wadhwani
Associate Vice President
lavisha.wadhwani@pnbgilts.com

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

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

September CPI review: Comfort now, pain in the offing?

After witnessing inflationary shock in the months of July and August with the headline inflation shooting up to 7.44 per cent in July 2023, followed by a mild correction in August 2023 to 6.83 per cent, CPI inflation witnessed sharper than expected moderation in the month of September mainly because of correction in vegetable prices and favourable base effect. Bearing signs of convergence towards RBI's 4 per cent inflation target, the latest CPI print did bring some respite when it overturned to 5.02 per cent in September 2023, against broader expectations of the market at 5.50 per cent. Average CPI for the quarter now stands at 6.43 per cent, much closer to the RBI's estimate of 6.4 per cent. Upside risks to the inflationary trajectory have resurfaced, with the triggering of Israel-Hamas conflict and its larger potential implications, which is likely to keep RBI vigilant going forward.

Monthly inflation trend

September CPI witnessed a m-o-m decline of 1.13 per cent, owing to continued correction in vegetable prices (-15.80 per cent m-o-m), followed by fuel, fruits, oil and housing. On 30th August, the Centre announced a price cut of INR 200 on domestic LPG. The move was successful in pulling down inflationary pressures in the fuel and light category, which recorded a drop of 3.86 per cent in the month.

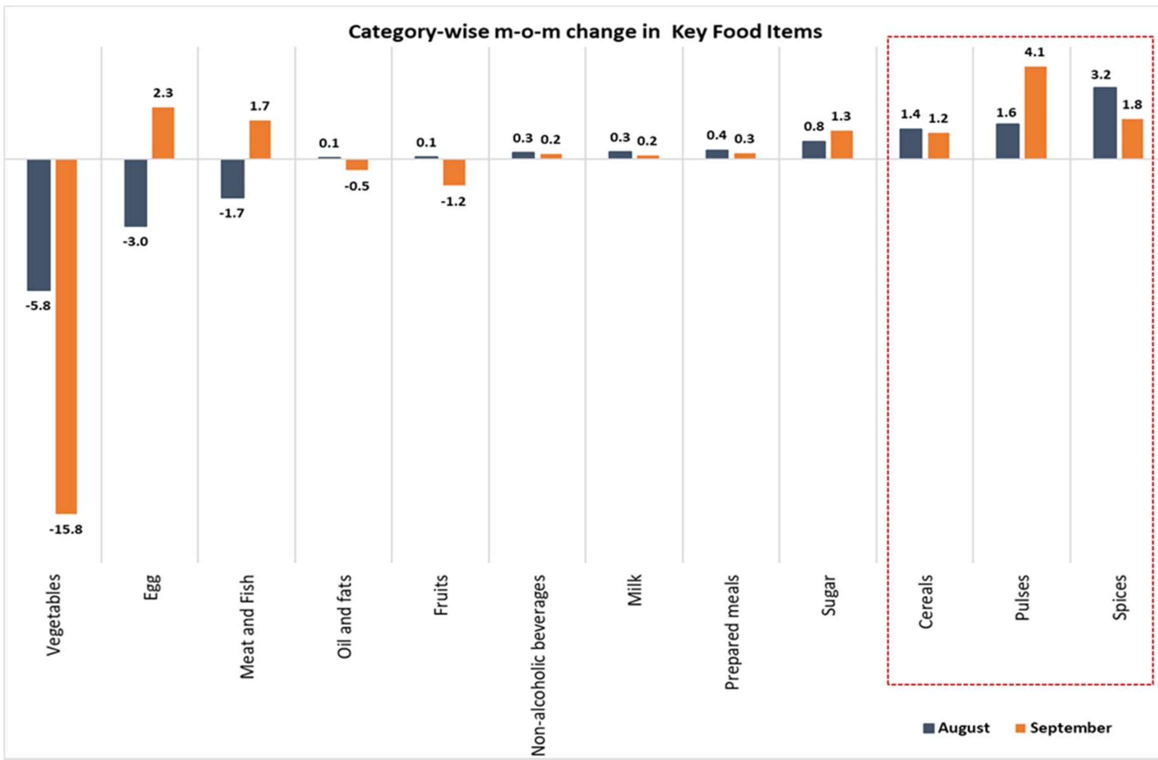
While protein inflation moved upwards on anticipated grounds, the P-C-S trio – Pulses, Cereals and Spices, continued with its rising streak. The prices of cereals and spices seem to have plateaued now, however, pulses are still showing significant signs of price volatility. The extended dry spell in July had caused some severe damage to the Kharif crops. The shortage affected the daily arrivals of pulses in the market and subsequently led to a drop in its processing. Hence, the prices of pulses are seen holding rigidity in the upward price band since past few months.

Yearly inflation trend

Despite various interventions, inflation in these three essential categories registered a double-digit y-o-y growth, led by spices. Thanks to the drastic fall in prices of edible oil that aided in containing the inflation print for September 2023. Oil and fats registered a deflation of 14.04 per cent y-o-y, on the back of steps taken by the Government and a decline in the global prices of major edible

While protein inflation moved upwards on anticipated grounds, Pulses, Cereals and Spices continued their rising streak for yet another month

oils such as crude soyabean oil, crude sunflower oil and refined palm oil in the last one year. Core inflation continues to provide much needed relief dropping to 4.5 per cent in September as against 4.8 per cent in the previous month. This is the lowest level of core inflation print since April 2020 and is likely to keep rate hike expectations at bay at the current juncture. A high base of the corresponding month of the previous year also contributed towards the softening of the core inflation during the month.



What lies ahead?

Core inflation for September 2023 is recorded at 4.5 per cent, down from 4.9 per cent in the previous month. However, going ahead, with onset of the festive season, as the demand of goods will be on the rise, core inflation might struggle to maintain its resilience at the current level. Within the food basket, prices of pulses are still seen rising as per the latest data available for the month October, along with milk and sugar.

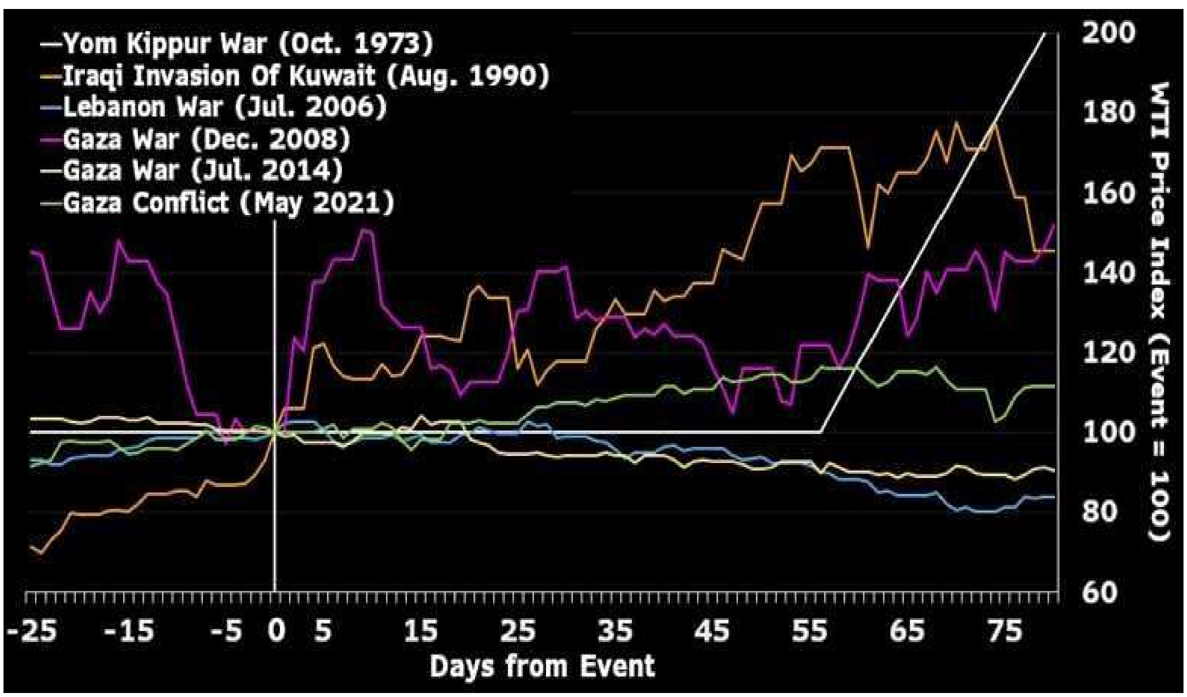
Beside this, the economy is also exposed to upside risks from the geo-political conditions and the on-going war between Israel and Hamas. If the conditions were to exacerbate further, it may have an adverse impact on crude oil prices and emerging economies exchange rate, which is likely to keep RBI vigilant of upside risks to the inflation trajectory.

Escalating Geo Political Risks and Oil Prices

The geo political milieu has worsened with the triggering of the Israel-Hamas conflict, which introduces a fresh dose of uncertainty in the oil and energy markets. Though the reaction in crude oil prices remains contained as of now, there is a potential for large upswing in the crude oil prices if the conflict intensifies further, involving larger stakes. Going by historical precedence, while the Lebanon war of 2006 and Gaza war of 2014, did not impact crude oil prices much, there was significant impact felt in other instances of war especially that of the Gaza war of 2008. As the global economy is still recovering from the shock of Russo Ukraine war, another wide scale geopolitical conflict at this juncture could have serious implications on the global inflation and growth trajectory through higher energy costs and other supply disruptions. The oil market is already poised for a serious supply demand imbalance in the October to December quarter, with demand expected to exceed supply by almost 3 mn barrels a day. Given the developments, global central banks are expected to stay on the edge and unlikely to let the guard down until we see clear signs of de-escalation of the conflict, which looks unlikely as of now.

The freshly triggered Middle East conflict poses upside risks to oil prices

Oil Price Reaction to Middle East Conflict



Source: Bloomberg

Fixed Income Outlook

Fundamental View

The bond index inclusion induced rally in the bond market faltered as quickly as it set in, with RBI's stance on liquidity souring sentiments significantly. The 10-yr yield surged to 7-month high to touch 7.43 per cent on 9th October. RBI in the October policy meet clarified that it will remain vigilant on the liquidity front and use OMO sales as a tool to draw out liquidity from the system. Fears of OMO sales is hence keeping the market on the edge, with market eyeing liquidity status closely on a daily basis in anticipation of OMO sale auctions. Going forward, in absence of major domestic cues, the G-sec market is likely to be driven by global developments. Amongst key economic data to be released in the US is retail sales data, to be released today, which may add to the evidence of slowing demand in the US economy. The minutes of the October MPC meet to be released on 20th October will also be watched for the language and tilt of the MPC members. Broadly, amidst largely bearish set of factors and continued tightness in liquidity, yields are expected to trade with an upward bias in the coming fortnight.

In absence of major domestic cues, the G-sec market is likely to be driven by global developments

SDL Overview

During the last fortnight, 10 Yr. State Loans traded in the broad range of 7.38%-7.72%, whereas the 10 Yr. CG benchmark, remained in the range of 7.12%-7.40%. In aggregate, State governments have raised Rs. 3,90,100 Cr in this fiscal so far, which is ~20.04% lower vis-a'-vis an indicated figure of Rs. 4,68,260 Cr. However, the amount raised so far this fiscal (FY-24) is 28% more than what they had raised in the same period last fiscal (FY-23) at Rs 3,90,100 Cr, up from Rs 3,04,700 Cr in the year-ago period. Meanwhile, the yield spread between the 10-year SGSs and the benchmark 10-year government bond has widened (30-35 bps) this fortnight by almost 5-7 basis points, compared with the previous fortnight (25-30 bps).

The RBI has announced Q3FY24 indicative SGS borrowings on 28th September at Rs 2,37,623 Cr which is lower than the market expectations of (Rs 2,60,000- 2,80,000 Cr). Despite this, last week auction saw a steep increase in the cut-offs across tenors leading to the weighted average cost interest rate payable soaring to the highest so far this fiscal at 7.68 %, 12 basis points (bps) more than the previous peak (7.56%) at the last auction.

Technical View

Benchmark may witness correction between 7.30% to 7.35% range, followed by next leg of up move taking Benchmark towards 7.54%

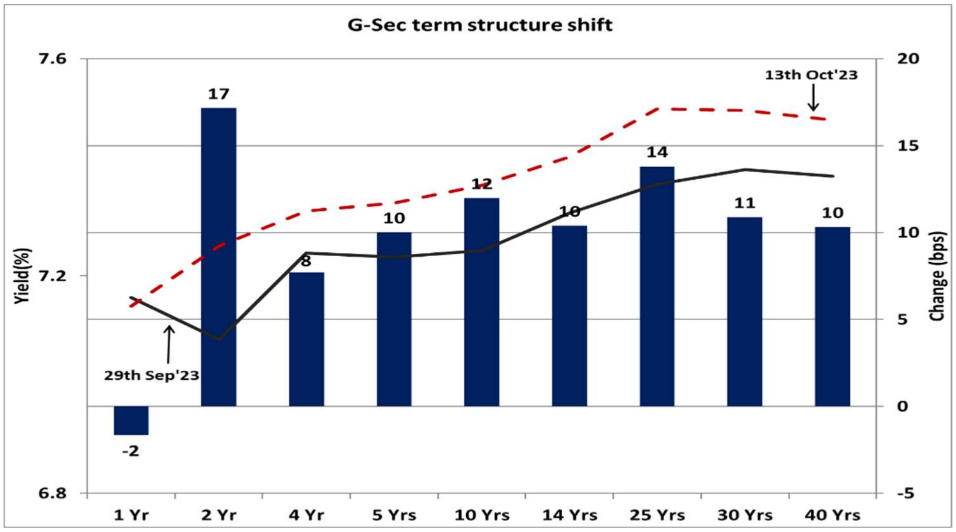
Technical Synopsis 7.18% GS 2033 Yield:

7.18% 2033 Yield settled at 7.3355% in Today's session. Last fortnight benchmark yield traded northwards and settled above 7.30% level.

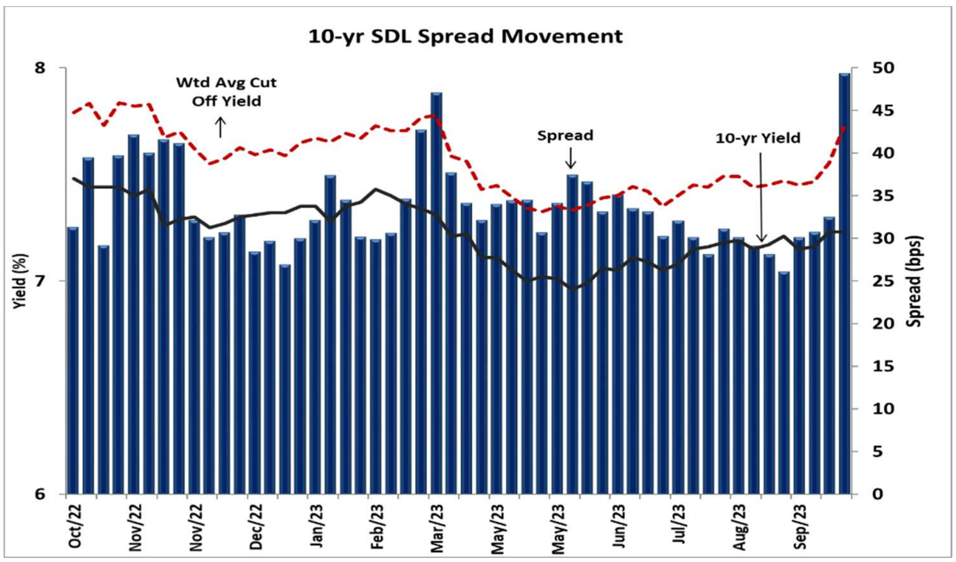
Momentum Oscillator RSI is trading around 63. Passing fortnight benchmark witnessed breakout above 7.26% and touched high of 7.3952%. Currently, we are witnessing formation of Bullish Pennant on EOD chart indicating further surge possible if it sustains above 7.35%. Going forward, we may see some days of time wise correction between 7.30% to 7.35% range, followed by next leg of up move taking Benchmark towards 7.54%(0.19 pole height), on lower side 7.29%-7.30% to act as crucial supports to watch out for.

Running Chart GOI 10yr Daily. Source: Tickerplant

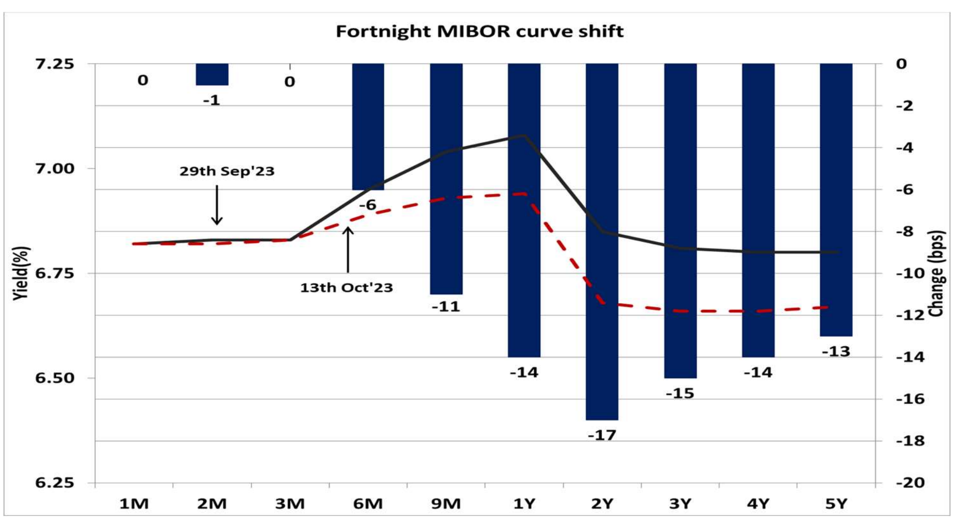
Spread Monitor



Bond yields rise across the curve during the fortnight as upside risks to crude oil prices resurface



Going forward, the yield spread between 10 Yr. SGS and CG to widen and trade in the range of 35 - 40 bps



Overnight indexed swap rates declined tracking fall in US Treasury yields

PNB GILTS LTD
(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