PNB GILTS LTD

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# ECONOMY & GILT WATCH

PNB GILTS LTD
(Subsidiary of Punjab National Bank)

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## Bond Inflows & Rupee Strength

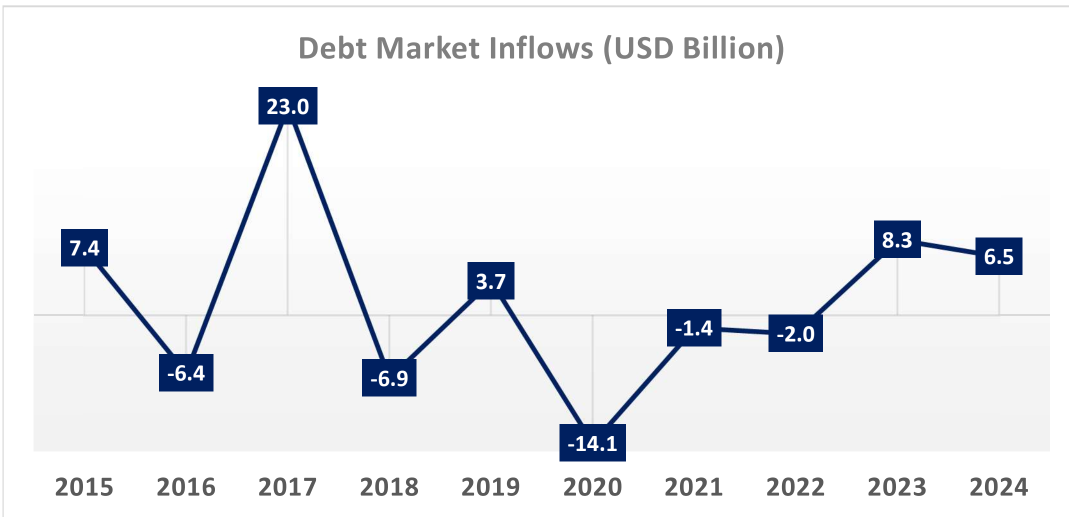
Since India's inclusion in JPM Bond index was confirmed last September, the impact has been evidently visible this year. While there was front running from money managers from the day news broke out, decisively strong inflows have started coming in from this year. This augurs well for Indian markets on multiple fronts as it lends more comfort to investors who have historically considered Indian bond markets as frontier which was visible in low FPI holdings of Indian Bonds. Other major concern for investors was the volatile nature of INR which made redemption a headache for investors looking to lock in attractive yields in EM markets such as India.

India clocked **FPI inflows of $2.3 Billion and $2.7 Billion** for the month of January and February respectively, with January figure breaking the monthly record of trailing 6 months. The momentum is likely to continue with the inclusion in **Bloomberg EM Index**, along with expected **~$2.5 monthly inflows** for JP Morgan Index rebalancing. Along with above investments, active money managers are likely to increase their weight to Indian bonds as and when rate cut cycle also starts in the coming time. India last recorded net FPI outflow in bond markets in March 2023. Consecutive **11 months of FPI inflows** in India's bonds stand as a testament to India's strong macro fundamentals and increasing Investor confidence in Indian assets. The impact of inflows has been evident in the Indian Benchmark yield levels which are now testing the **crucial 7.00%** yield levels starting the year at 7.20% levels.

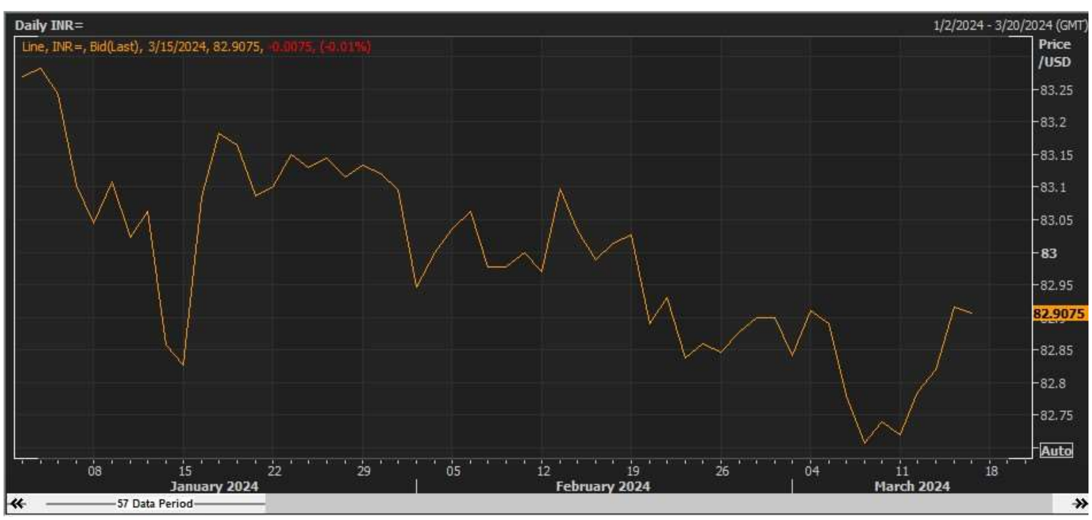
During the same period Rupee's volatility has remained subdued on the back of active intervention by RBI in the currency market. While RBI's actions in the currency markets can be questioned considering active intervention on both buying and selling side. The intentions broadly hinge on the following factors:

i. **Containing Downward Volatility:** Post the 2022 experience, the intervention playbook hinged around aggressively protecting Rupee depreciation. While the bias remains to contain sudden depreciation, the case for buying at dips hinges on incentivising exporters which are already faced with historically low premia levels. Lower premia however incentivises outflow hedging operations of FPI investors betting on India story in case there are partial redemptions.

ii. **FX Reserves:** Despite 2023 being marked by Dollar strength, RBI has been able to shore up its FX reserves from $560 Billion to $620 Billion levels now. The Central Bank acted proactively and made sure that it used all the avenues not just limited to the conventional spot and forward book deployment. RBI was seen active in futures and NDFs as well. Above actions give further confidence to investors looking to park money in Indian bond markets where holding periods are usually high and look for protection against sudden currency depreciation.

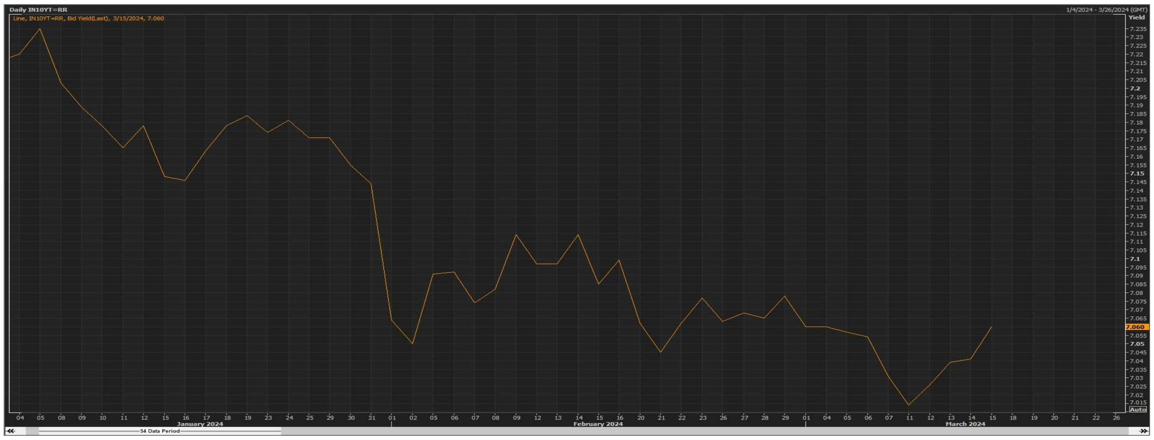



*Downward trending USDINR supported by strong macro fundamentals and a lack of speculative bets against Rupee*




Source: Reuters

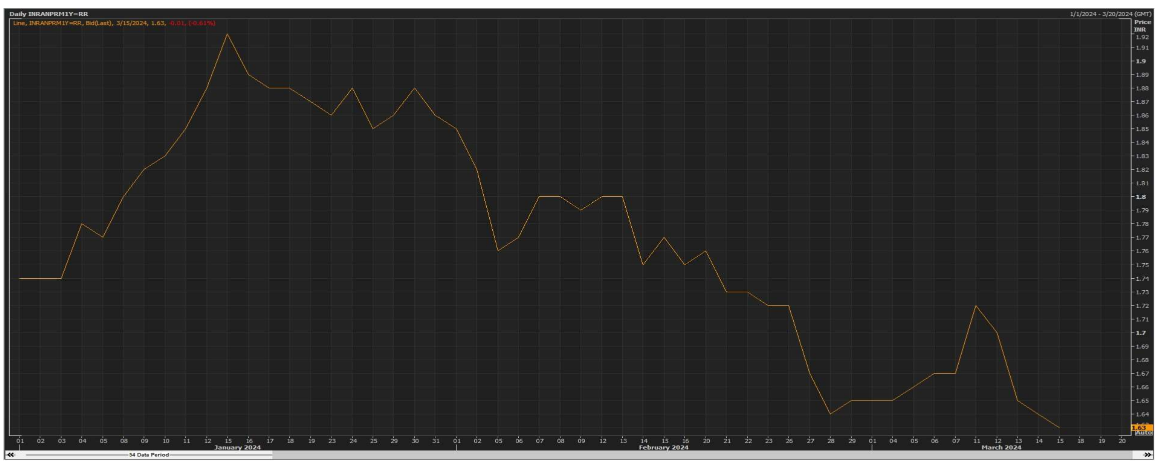
**YTD USDINR**



Source: Reuters

**Benchmark India 10 Year Yield**

*Benchmark yields have been helped by Bond inflows.*



Source: Reuters

**India 1Y Forward Premia Annualised**

*Premia supported by downward trending India Yields*

# Macro Monitor

**February Retail Inflation: Review**

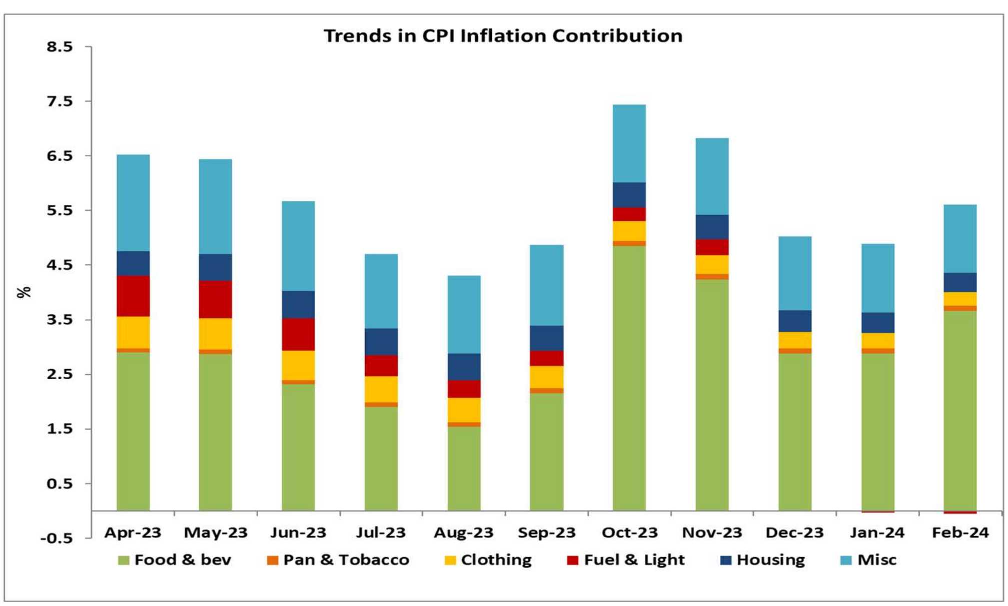
Headline inflation for the month of February 2024 remained largely flat at 5.09 per cent against 5.10 per cent in the preceding month. While food inflation inched upwards, subdued movement was witnessed across other groups. Consequently, the core inflation eased to 3.4 per cent.

*While food inflation inched upwards, subdued movement was witnessed across other groups*

Food prices, which make up roughly half of the CPI basket, increased by 7.76 per cent y-o-y in February 2024 as opposed to 7.58 per cent in January 2024. On a monthly basis, cereals, meat & fish and milk prices recorded an uptick, whereas all other food items witnessed a decline in prices. The prices of spices came down by 1.9 per cent m-o-m in February 2024 as new arrivals from Kharif season hit the market. The egg prices also underwent a drop of 1.2 per cent m-o-m. Vegetable prices were broadly stable.

Further, in addition to the extension of LPG cylinder subsidy under Ujjwala Yojana for the upcoming year, the Centre reduced the LPG cylinder prices by Rs. 100, which would support in pulling down the fuel prices for the coming months.

During the February MPC meet, RBI kept the policy rate constant for the sixth consecutive time, with no change in stance as well, while being watchful of the volatile food prices going forward. Although a high growth rate provides some room for monetary policy easing, RBI indicated to wait firmly till the inflation stabilizes around the 4 per cent target. For inflation to reach the Central Bank's projection of 5 per cent for this quarter, March 2024 inflation has to be sub-5 per cent. Given the above, we do not expect any rate or stance change in MPC's June meeting.



# Fixed Income Outlook

## Fundamental View

G-Sec yields are trending downwards driven by increased investor interest in locking in higher yields before the rate cut cycle begins. The 10 Year Benchmark yield touched a low of 7.01% on 11th March. While the momentum is clearly on the downside for benchmark yields, near term challenges exist with surging US Treasury yields. Consistently strong data from US coupled with a surge in Crude Oil prices is putting pressure on Government Bonds. On the domestic front, India's February CPI figure at 5.09% came in lower than the January and December figure staying well within the 2%-6% target range of RBI. While core inflation kept its declining trend with February figure at 3.3% down from January's figure of 3.6%. Industrial growth remains volatile with January Figure decelerating to 3.8% from 4.2% December figure. Apart from demand-supply dynamics and global macro, developments in the run up to Lok Sabha election can pose risks to the downward trending Indian Bond Yields.

With India's macro fundamentals stable and proactive management of liquidity by RBI, without any external shocks Indian Government Bonds are likely to continue their rally well supported by increased FPI appetite.

*While the momentum is clearly on the downside for benchmark yields, near term challenges exist with surging US Treasury yields.*

## SDL Overview

The spread between yields on the 10-year state bonds and the benchmark 10-year government bond eased and traded in the range of 32-37 bps in the gone fortnight. As, in Q4, States have borrowed a sum of Rs. 2,73,806 crores vs scheduled figure of Rs. 3,56,243 **(~23% less)**. However, as we had shared in our previous view, we expect states to mop up borrowing in the last fortnight of this FY. We hold the same view, States have come up with a humongous auction size of **Rs. 50,206** Crores ***(vs the scheduled figure of Rs.27,810 Crores***) in its penultimate auction of this FY. Another big auction could lead to widening of spreads of 10 Yr SGS vs the the benchmark 10-year G-sec to 37- 42 bps.

# Technical View

*Going forward with downward sloping trend line reflecting presence of strong resistance at 7.10% and hence 10Yr may remain capped around 7.10-11% for coming days*

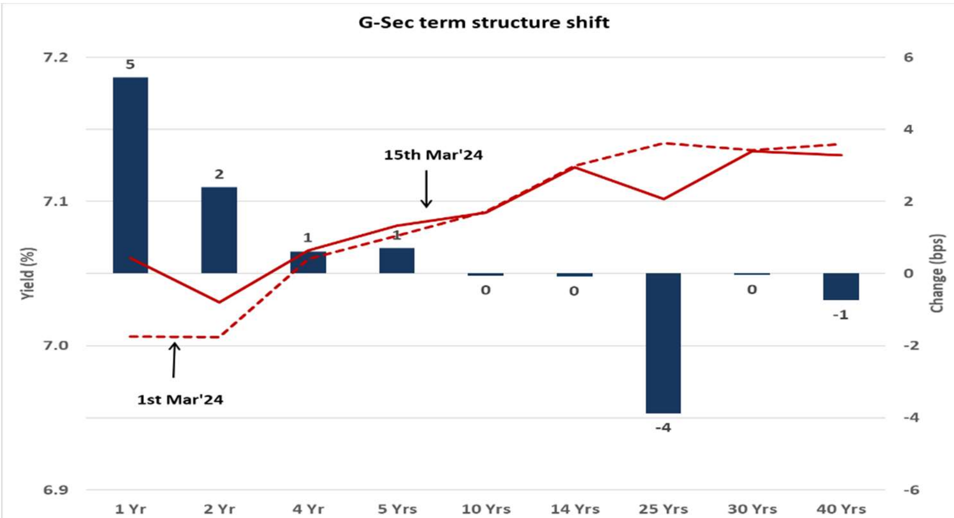
**<u>Technical Synopsis 7.18% GS 2033 Yield:</u>**

7.18% settled at 7.0871% in Today's session. Passing Fortnight, post hitting low of 7.0056% Benchmark inched higher and settled shop at 3 weeks high. Momentum oscillator RSI is currently valued at 54. Also, we have witnessed Divergence between RSI and Yield Wherein Yields making fresh low and RSI is not, indicating of a short term bounce.

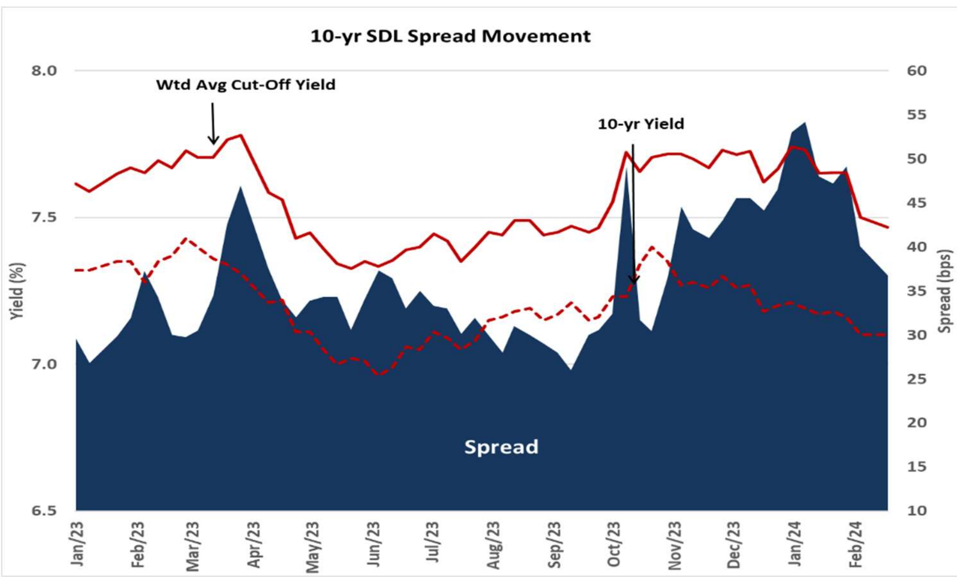
Going forward with downward sloping trend line reflecting presence of strong resistance at 7.10%(as visible in chart) which also coincide with upper Bollinger Band making strong case for crucial rest zone and hence 10Yr may remain capped around 7.10-11% for coming days. On lower side 7.02%(lower Bollinger band) to act as an immediate support zone on lower side.


Running Chart GOI 10yr Daily. Source: Tickerplant

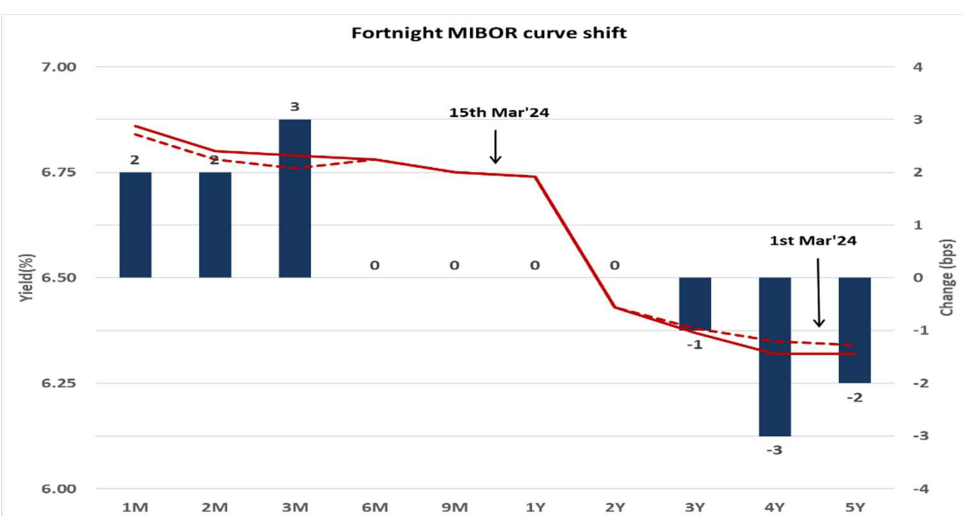
# Spread Monitor




*During the last fortnight, post hitting low of 7.01% Benchmark G-sec yield inched higher and settled at 3 weeks' high*




*The spread between yields on the 10-year state bonds and the benchmark 10-year government bond eased in the gone fortnight.*




*OIS rates traded largely flat in the previous fortnight*

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