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ECONOMY & GILT WATCH

(Subsidiary of Punjab National Bank)

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October Inflation review

After peaking in July 2023 to a whopping 7.44 per cent, the headline inflation in October brought some respite by continuing the declining streak of the past three months. The CPI inflation print for October came in broadly around expectations at 4.87 per cent, down from 5.02 per cent in September, with core moderating to 4.28 per cent. Besides a sequential decline in edible oil, a deflation in fuel and a favorable base helped in bringing down the print.

Overall, the inflation in food basket dropped a little to 6.24 per cent y-o-y in October 2023, as against 6.30 per cent in September 2023. The vegetable inflation, which reached to heightened levels in July 2023, witnessed some substantial price corrections in the last two months. The tomato prices have now stabilized and are on the lower side, however now, onion prices have posed concerns with their rising trend amid supply shortage. Consequently, vegetable inflation treaded upwards to around 1 per cent m-o-m elevation. Furthermore, the prices of eggs have picked up a high pace since September 2023, and have been posting sequential price rises. Over-cautiousness amongst producers amid the festive season led to a lagging production of eggs, and now that the demand is up again, this demand-supply gap has pushed the prices upwards. While pulses, cereals and spices continue to post a double-digit annual growth, a 13.73 per cent decline in edible oils has helped in taking some pressure off.

Some comfort in the October inflation also roots from the deflation posted in the fuel and light category for two months straight. At the beginning of October 2023, the subsidy amount on LPG cylinders under Pradhan Mantri Ujjawala Yojana was raised from Rs. 200 to Rs. 300 per cylinder. Further, in the preceding month, the cost of domestic LPG cylinders was decreased by Rs 200 per cylinder. These moves have largely attributed in pulling the headline inflation as well as the sticky core inflation down for the past two months.

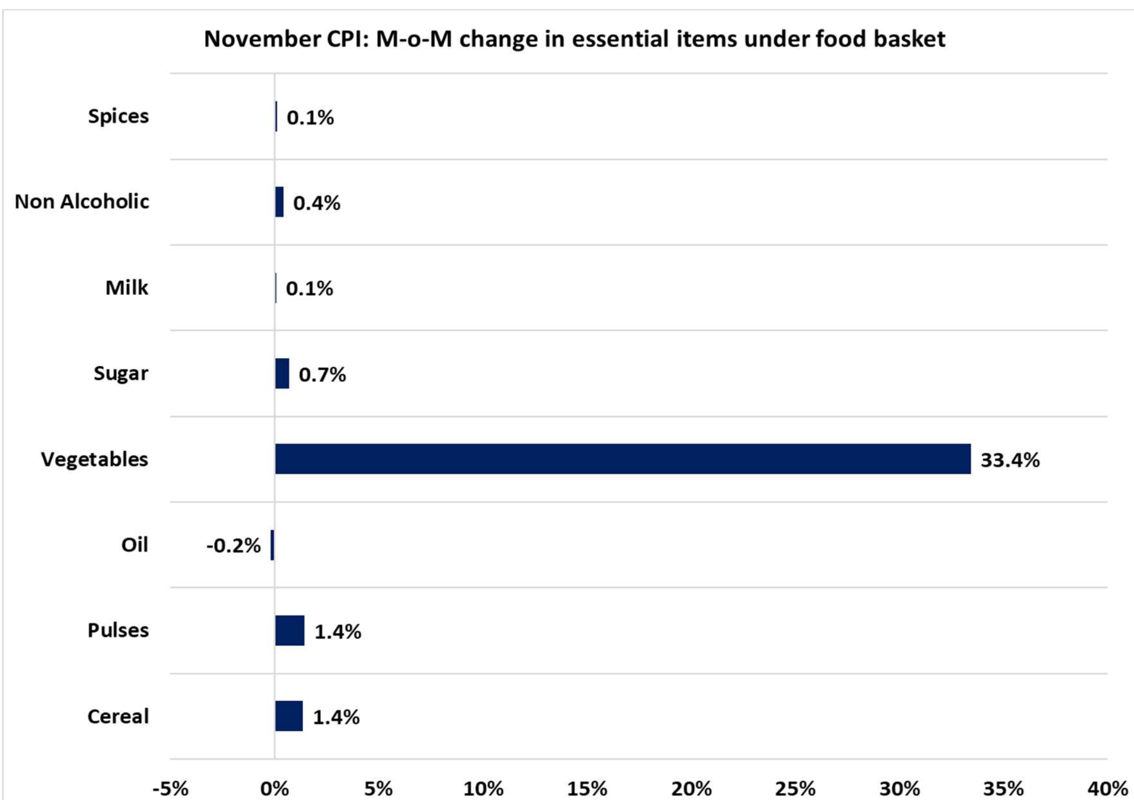
Inflation in the food basket for the current month is expected to witness an upward movement

Is Inflation abating?

While the October print is comforting, the November price trend (till date) paints a grim picture. Concerns hover around the sharp hike in vegetable inflation, mainly driven by the key vegetables, wherein, onion prices nearly doubled in the month and tomato prices have also firmed up. Weak output of Kharif crops and a delayed sowing of Rabi crops further pose upside inflationary pressures on the pulses and cereals category. Consequently, inflation in the food basket for the current month is expected to witness an upward movement.

In the view of the ICC World Cup 2023, the economy has witnessed a sharp demand uptick in the travel and hospitality sector, with surge in airline fares and hotel rentals during the tournament. This, along with the prevailing festive demand, could cast a shadow on the inflation trajectory for the month of November.

Furthermore, currently, the financial markets are undergoing broad repricing which can pose an upside risk to the overall inflation outlook.



Source: Ministry of Consumer Affairs

Inflation Trajectory: Q3 FY2024

Vegetables usually observe a typical deflation during the months of November and December every year. However, the moderation may get offset in case the key vegetables continue with the upward streak. Since, any more pleasant surprises from the fuel category are not expected as yet, food inflation could pose an upward bias to the inflation print for the next two months.

Moreover, now, the base effect will turn unfavourable in the coming two months. And despite keeping the index value constant as that of October 2023, ceteris paribus, an unfavourable base will push the inflation prints for the next two months higher. Unless any significant price downtrends are witnessed, the inflation trajectory for the third quarter is seen to be poised with upside price pressures.

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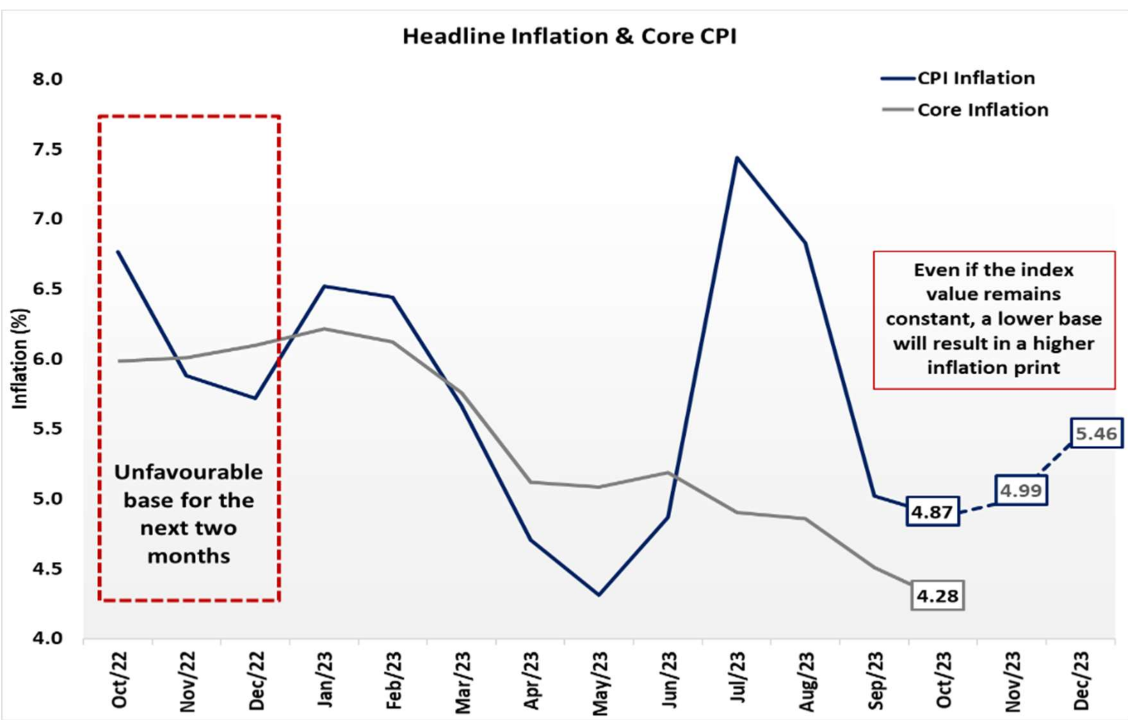


Fixed Income Outlook

Fundamental View

Domestic bond markets had a good run in the previous fortnight, and we saw the 10-yr yield soften from 7.30 per cent plus to a low of 7.19 per cent on last Friday. Supporting factors that came into play included a sharp rally in the US bond markets, as October CPI came in below expectations, an in line domestic CPI print and subdued crude oil prices. The fervour however got subdued somewhat as markets begin a new fortnight which will see some key releases beginning with the US Fed minutes to be released tomorrow. The Fed minutes will be watched closely for deeper clues on whether the Fed members gauge the rates to be 'sufficiently restrictive' or not. Even though the October policy had a dovish tilt, the Fed may remain tied up in timing the beginning of rate easing cycle, given that the target rate for inflation is still a good distance to go. Another key event to watch out for is the Q2 GDP data to be released at the end of the month. The Q2 GDP is expected to come in higher than RBI's estimate of 6.5 per cent. The latest regulatory development which saw RBI tighten credit norms, by increasing credit risk weights for banks and NBFCs, is likely to have a positive bearing on demand side dynamics in the bond markets in the medium to long term as banking funds may trickle back again into the G-sec market. Though cues remain broadly positive for the G-sec markets currently, domestic price trends for the month of November need to be tracked closely for likely build up in negative surprises going ahead.

The Fed minutes will be watched closely for deeper clues on whether the Fed members gauge the rates to be 'sufficiently restrictive' or not.

SDL Outlook

During the last fortnight, 10 Yr. State Loans traded in the broad range of 7.58%- 7.74%, whereas the 10 Yr. CG benchmark, remained in the range of 7.19%-7.32%. So far, in the Q3, the amount raised by state governments has been **22% higher** than the indicative amount (Rs. 1,30,889 Cr vs Scheduled figure of Rs. 1,07,242 and this has led to the widening of the spread between the 10-year SGSs and the benchmark 10-year government bond to **(35 - 40 bps)** over the last two weeks. We expect, the trend of States continuing to come up with heavier issue size than the scheduled calendar amount and with investors demand also appearing to be less buoyant than has been the case in 1st half of this Fiscal year. We expect the spread between 10 Yr SGS and CG to widen further and trade in the range of ***40 - 45 bps*** in the next fortnight and the spread of Long End SGS over their CG counterparts to remain in the band of ***20 -25 bps*.**

From here on with 61.8% retracement placed at 7.19%, we may see pause to current softening.

Technical View

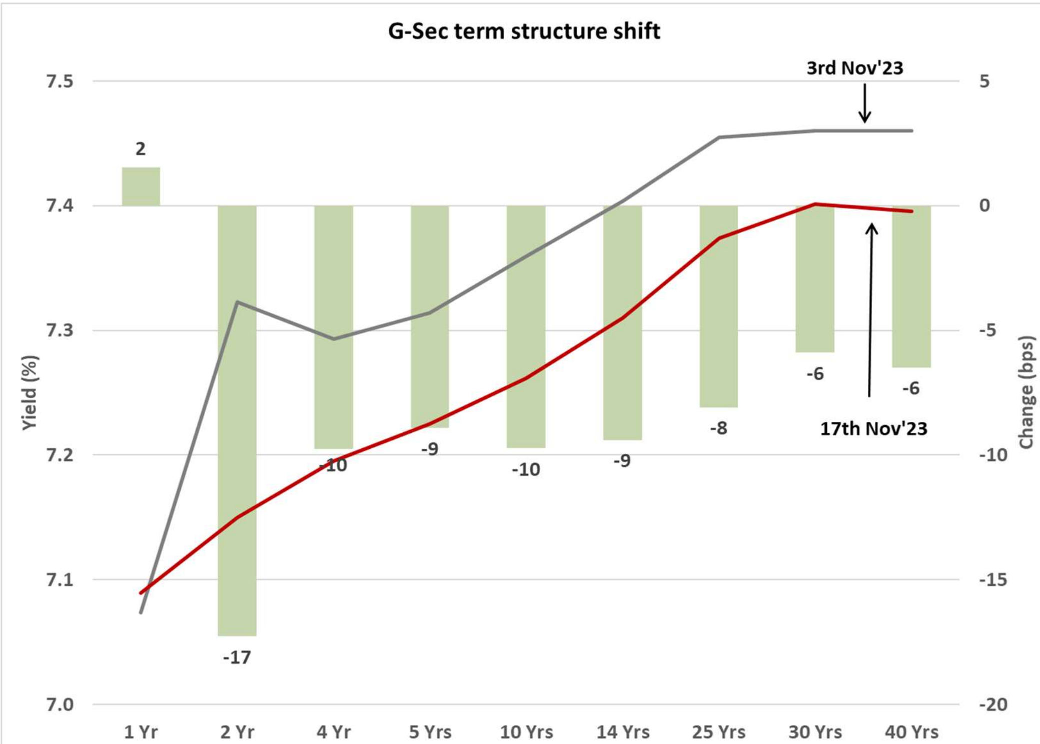
<u>Technical Synopsis 7.18% GS 2033 Yield:</u>

7.18% G Sec 2033 Yield settled at 7.27% in Today's session. Passing fortnight benchmark yield traded range bound between 7.33% to 7.19% zone. Momentum Oscillator RSI is trading around 43. Post breakaway gap witnessed on 2nd November Benchmark headed southwards and touched low of 7.19%. From here on with 61.8% retracement placed at 7.19%, we may see pause to current softening. Also it coincides with Lower Bollinger band level of 7.20% giving weightage to the support zone. On higher side we may see bounce back till 20SMA level of 7.30%.

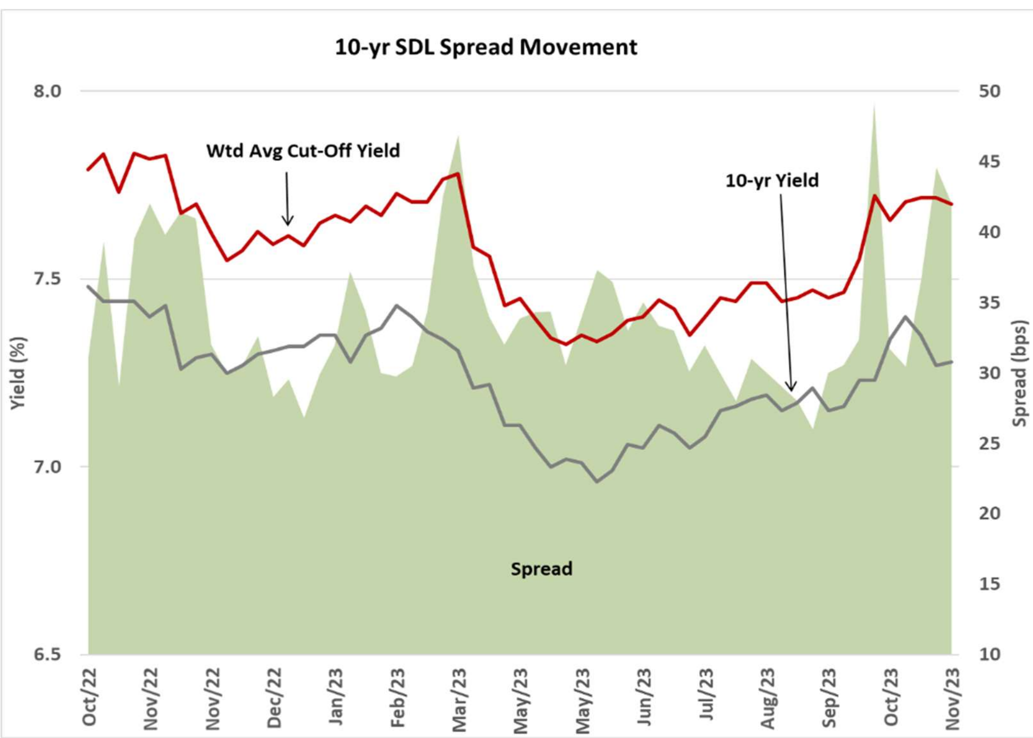
Running Chart GOI 10yr Daily.

Source: Tickerplant

In Graphs

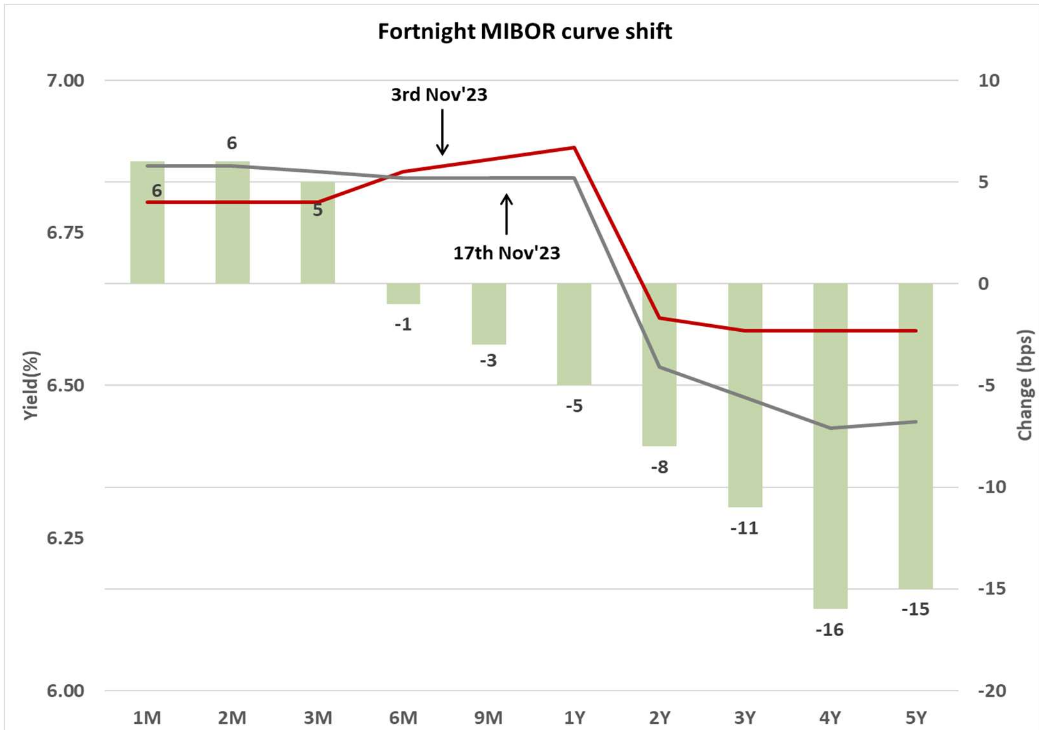


G-sec yields softened on the back of a sharp rally in the US bond market

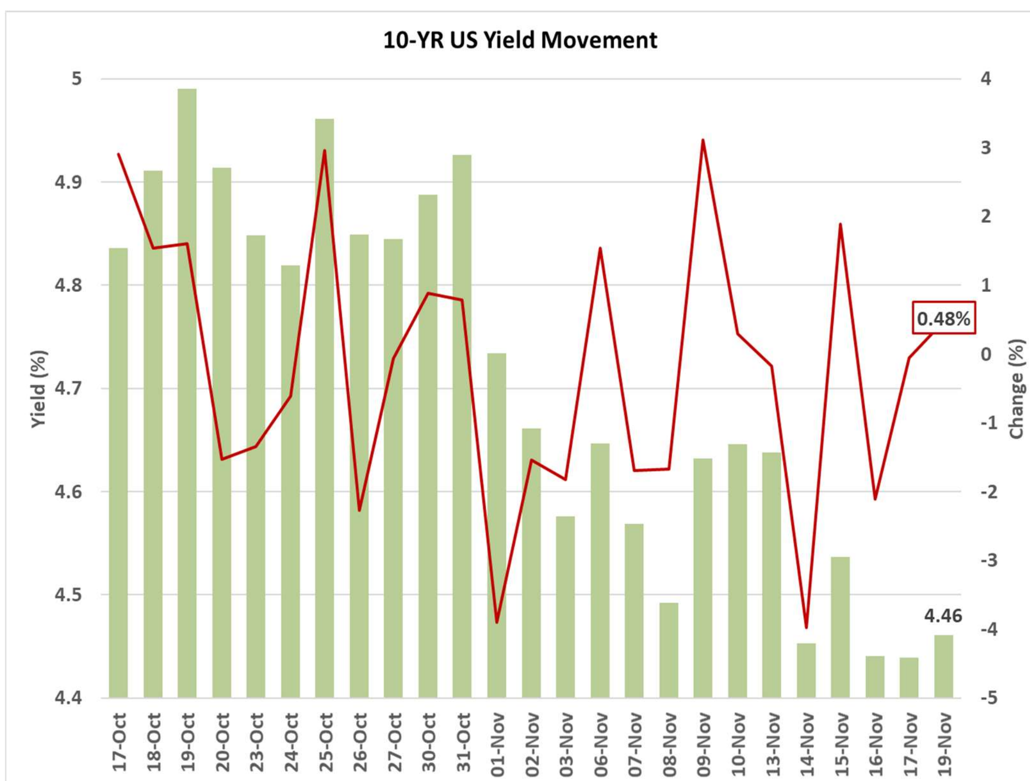


The spread between 10 Yr SGS and CG is expected to widen further and trade in the range of 40 - 45 bps

Overnight indexed swap rates declined tracking fall in US Treasury yields



US bond markets witnessed a sharp rally as October CPI came in below expectations



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