

ECONOMY & GILT WATCH



(Subsidiary of Punjab National Bank)

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Global Bond Index Inclusion: The Indian Bond Party Begins

The Indian bond markets opened today to the pleasant and much awaited news of being finally included in a major bond index, i.e. JP Morgan Government Bond Index-Emerging Markets (GBI-EM), which is expected to have far reaching impact on bond and currency markets. With the inclusion news being announced by JP Morgan, the Indian bond market could finally salvage last year's disappointment and years of waiting. According to the JP Morgan report, "Indian bonds will be included in the GBI-EM Global index suite and all relevant derivative benchmarks, beginning 28th June 2024." The GBI-EM series was launched by JPM in June 2005 and GBI-EM Global Diversified (GBI-EM GD) is one of the most popular amongst the six versions of GBI-EM series due to its diversification weighting scheme and country coverage. India is expected to reach maximum weight of 10 per cent in the GBI-EM GD and 8.7 per cent in the GBI-EM Global Index with 23 Indian Government bonds (designated under the Fully Accessible Route) being eligible to be included in these forms of the index.

With this, the Indian bonds will now be at par with other emerging market bonds such as China and Indonesia, which enjoy a weightage of 10 per cent in the said index. Indian bonds are also expected to enter other JPM indices such as JADE Global Diversified Index, JADE Broad Diversified index, JESG GBI-EM. This has also triggered expectations of announcement of inclusion by other major indices by FTSE Russel and Bloomberg Barclays.

Inclusion Details

The GBI-EM GD, which accounts for nearly USD 213 bn of the USD 236 bn benchmarked to the GBI-EM family of indices, is likely to see a staggered inclusion of the FAR designated Indian government securities over a 10-month period beginning from June 28th 2024 to 31st March 2025, with an increment of 1 per cent every month. This is likely to translate into inflows approximating USD 21 bn over the 10-month period. This is a meaningful inflow (approximating Rs. 1,70,000 crore) and will have favorable implications for the demand and supply dynamics in the Indian debt markets. Another caveat is that only securities with residual maturity of at least 2.5 years and an outstanding notional of USD 1 bn will be assessed for eligibility at the time of inclusion.

GBI Inclusion

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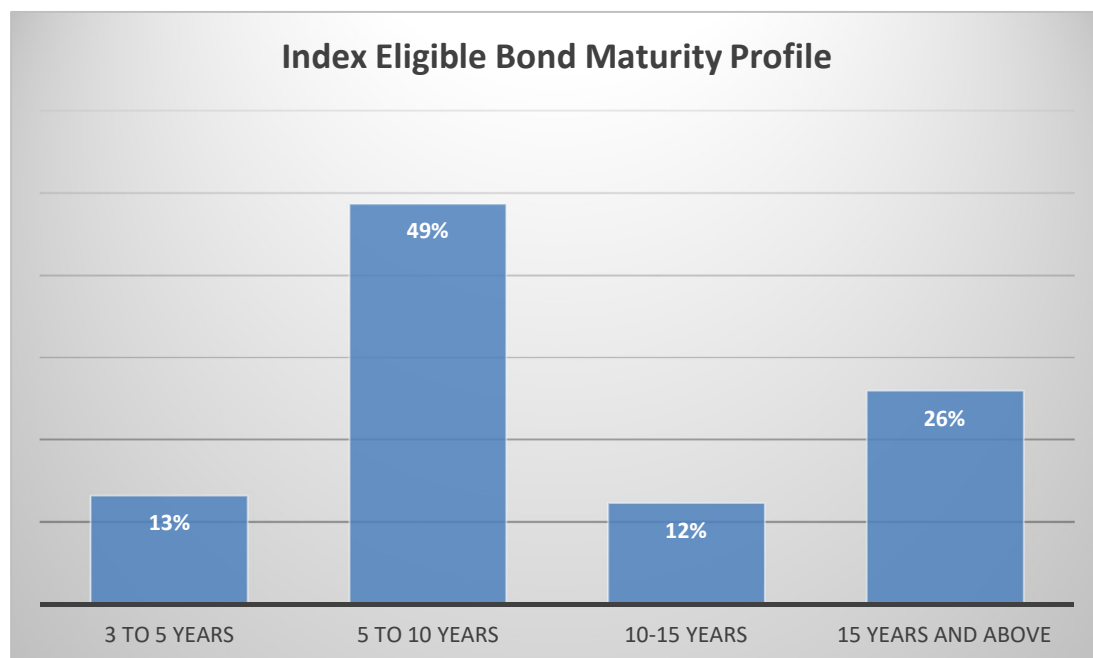
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With short dated securities kept out of the purview of index, benefits may not accrue to the short end of the term structure



What does the inclusion entail?

The index inclusion entails boost in demand for government debt as well as an improvement in outlook for the domestic currency with expectations of greater inflows in the local debt. The index inclusion will lead to creation of an additional demand side in the ensuing financial year, and the inclusion eligibility will be subjected to periodic reviews. With short dated securities kept out of the purview of index, benefits may not accrue to the short end of the term structure. With 5 to 10-year maturity securities accounting for almost 50 per cent of the outstanding currently designated under the FAR and index eligible and taking into account the fact GBI EM GD's current duration is approximately ~5, the 5 to 10-year bucket is likely to see greater inflows on account of the index inclusion.

On a macro level, the inflows will be beneficial from fiscal and current account deficit perspective. The cost of funding for the government and the private sector is also likely to ease as a consequence. However, there are concerns over index inclusion leading to greater volatility in the flows in the debt market subject to the development in the size of the AUM benchmarked to these indices, which may be an additional area of concern for the central bank. Nonetheless, the event is certainly a positive for the market and augurs well for the broader economy in the long run, opening door to further diversification of investor base with more indices likely to follow suite. The Indian bond market reacted positively to the news of the index inclusion, however, it shed the gains later on as higher US treasury yields (US 10-year yield at 4.50%) and crude oil prices, offset the positive sentiments.

Macro Monitor

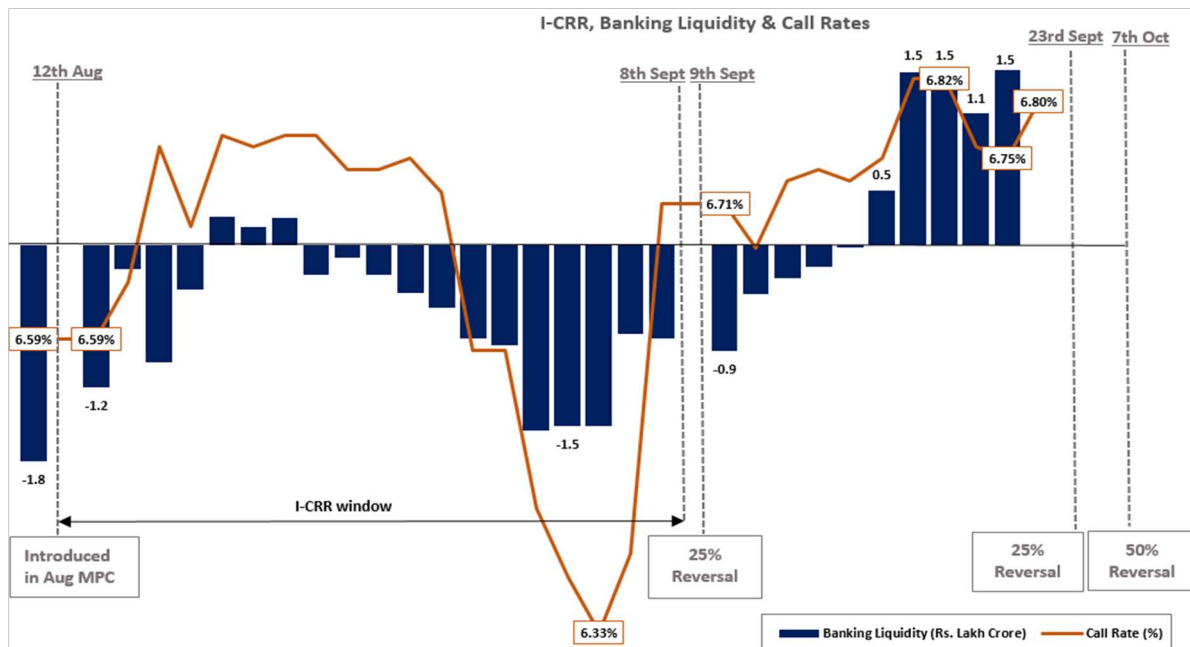
Liquidity deficit widens to a 4-year-high

The banking liquidity deficit hit a 4 year high of Rs. 1.47 lakh crore on September 22nd, with the MSF touching Rs. 1.97 lakh crore. The liquidity deficit can be attributed to – tax outflows in the form of advance taxes and GST collection, and a significant part of banks’ funds parked with RBI under I-CRR. The net advance tax collection (till September 15th) recorded 23% higher y-o-y at Rs. 8.63 lakh crore for FY2023. RBI’s intervention in the FX market to salvage the rupee from depreciation pressures, could be another likely source of liquidity tightening. To add to all this, RBI’s WSS data showed that RBI sold bonds worth Rs. 2885 crore during the week ended 22nd Sep’23, thus mopping off liquidity aggregating to this extent.

The deficit in liquidity has been putting upward pressures on the overnight interbank rates. The call rates have been moved higher in the range of 6.75 per cent – 6.90 per cent, breaching the upper limit of the current LAF corridor of 6.75 per cent.

Going forward, with onset of the festive season and an increase in withdrawals, the banking liquidity is expected to be in a neutral to deficit side. However, some sigh of relief can be anticipated from the second phase of unwinding of funds under ICRR, which is due on September 23rd as well as from the month-ending government spending, which would restore the reserves of the banks.

The liquidity deficit was witnessed on the back of tax outflows and funds blocked under ICRR



*w.r.t Banking Liquidity, positive indicates deficit and negative indicates surplus

Fixed Income Outlook

Fundamental View

The bond markets ended the fortnight on a positive note, despite a sharp rise in US treasury yields and crude oil prices simmering near USD 95 a barrel, thanks to the long awaited announcement of Indian bond index inclusion by JP Morgan. While the announcement augurs well for the G-sec market, the anticipated inflow on a standalone basis is not large enough to bring about a sharp decline in yields. We believe that once the initial euphoria settles, yields may consolidate as domestic and global factors which are largely adverse at the current juncture, are expected to weigh on the market. On the domestic front, the index inclusion is a structurally positive move, positive from funding of fiscal deficit and the current account gap. The supply demand dynamics are expected to turn favourable with addition of a new set of investor base, which is expected to target the 5 to 10 yr maturity bucket as the index inclusion kicks in from June 2024. However, the bond yields may not witness large moves and yields may continue to remain more attuned to fundamental factors, i.e. inflation and growth dynamics and monetary policy stance and avoid any irrational exuberance.

SDL Overview

During the last fortnight, 10 Yr. State Loans traded in the broad range of 7.40 per cent - 7.47 per cent, whereas the 10 Yr. Central Government bond benchmark, remained in the range of 7.09 per cent - 7.22 per cent. The state governments, continued to borrow much lower than the scheduled borrowing amount while demand for long tenure paper has remained robust. In aggregate, State governments have raised Rs. 3,02,753 Cr in this fiscal, so far which is ~24.48 per cent lower vis-a'-vis an indicated figure of Rs. 3,76,880 Cr. Meanwhile, the yield spread between the 10-year SGSs and the benchmark 10-year government bond stood at 25-30 bps points, same as the previous fortnight.

According to us, states' indicative borrowing calendars for Q3-FY 24 are estimated at Rs 2,60,000-2,80,000 Cr as bond raising by state governments are generally higher in later part of a fiscal year. The inclusion of Indian bonds in JPMorgan's emerging-market index is expected to attract foreign investments, and Central Government securities will likely outperform State Government securities in coming fortnights. Hence, the yield spread between 10 Yr. State Government securities and Central Government securities could widen and trade in the range of 35 - 40 bps and spread of long end State Government bond over their Central Government Counterpart to remain the same in current band of 10-15 bps.

Though, the bond index inclusion expands the investor base, the markets are likely to stay attuned to fundamental realities and avoid irrational exuberance

Technical View

Technical Synopsis 7.26% GS 2033 Yield:

7.26% G Sec 2033 Yield settled at 7.19% on Friday's session. Passing week Benchmark witnessed volatile moves on both the sides, broadly ranging between 7.25% to 7.09%.

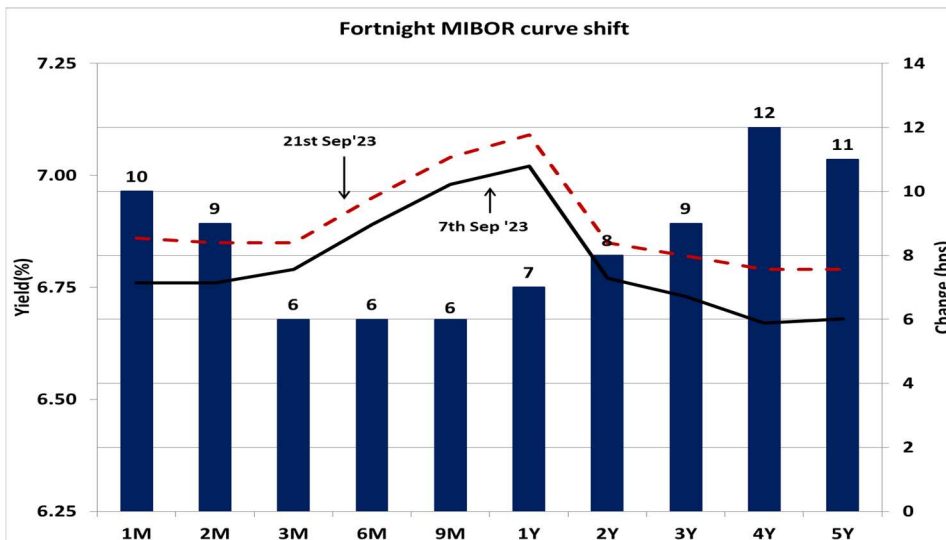
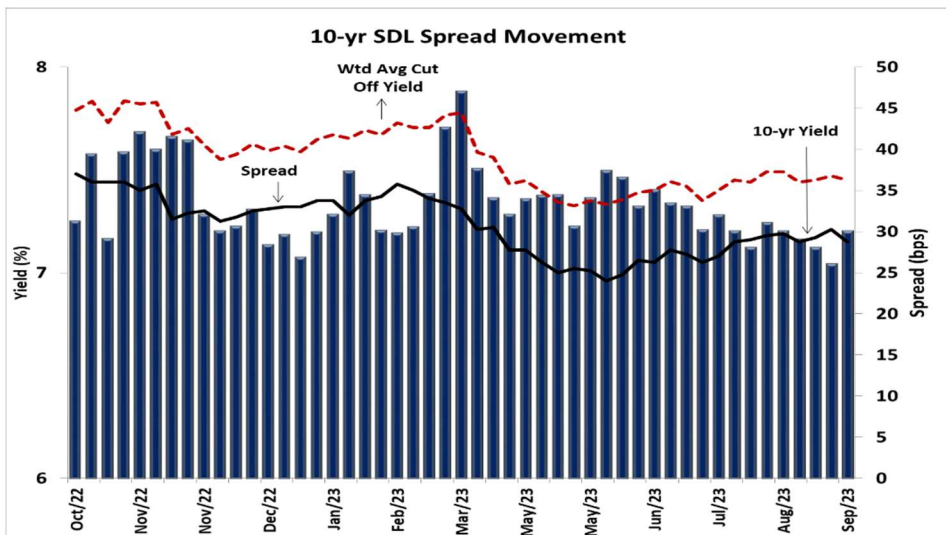
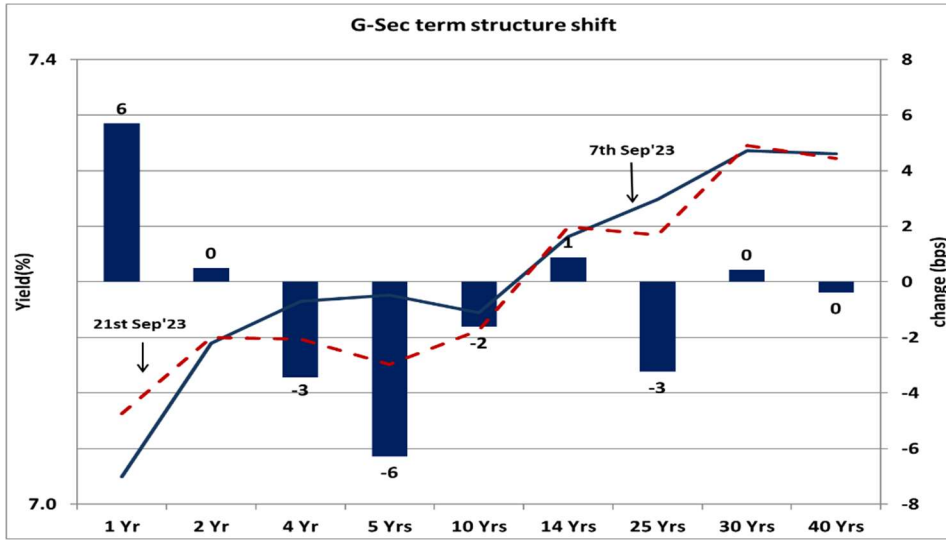
Momentum Oscillator RSI is placed at 50 level. On weekly chart (as shown in attached chart) we have witnessed a Long legged Doji followed by a Dragon Fly Doji indicating indecision between the market participants at current level and this consolidation may continue before the new breakout is formed. Going forward, Benchmark may continue its volatile moves on both the sides with immediate resistance now placed around 7.25-7.26% level and on lower side any sustainability below 7.08% will open gate for 7.02%/6.96% levels.

Going forward, Benchmark may continue its volatile moves on both the sides



Running Chart GOI 10yr Daily. Source: Tickerplant

Spread Monitor



Bond yields softened riding on the news of JP Morgan GBI-EM bond index inclusion

Going forward, State Government securities and Central Government securities could widen and trade in the range of 35 - 40 bps

Overnight indexed swap rates rose higher as traders paid fixed rates tracking rise in US Treasury yields



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