PNB GILTS LTD

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ECONOMY & GILT WATCH

PNB GILTS LTD
(Subsidiary of Punjab National Bank)

INSIDE THIS ISSUE:

Q1 FY 2023-24 GDP: Preview; Macro Monitor
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SDL Outlook:
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Q1 FY 2023-24 GDP: Preview

The GDP growth data for Q1 FY 2023-24 to be released at the end of the month, is expected to show that the Indian economy continued to grow at a brisk pace, led by continued recovery in the services and manufacturing sector, with a favourable base accentuating the y-o-y gains in economic activity. To note, the economy had grown by a robust 6.1 per cent in Q4 FY'23, surpassing estimates by a wide margin boosted by strong performance by the agriculture and services sector. RBI pegged the real GDP growth for Q1 FY'24 at 8.0 per cent in the August monetary policy meet. The slowdown in trade activity is likely to be offset by continued pick up in domestic activity and a healthy government capital expenditure. Even though the headline number is expected to be buoyant, the data would have to be combed finely to understand the likely pressure points and the sustainability in the coming quarters. At a broader level, barring the Q1 GDP, the growth is expected to be lower in FY 2023-24 at 6.5 per cent as per RBI's estimate, while some agencies such as IMF and World Bank have pegged FY 2023-24 growth lower at 6.1 per cent and 6.3 per cent respectively.

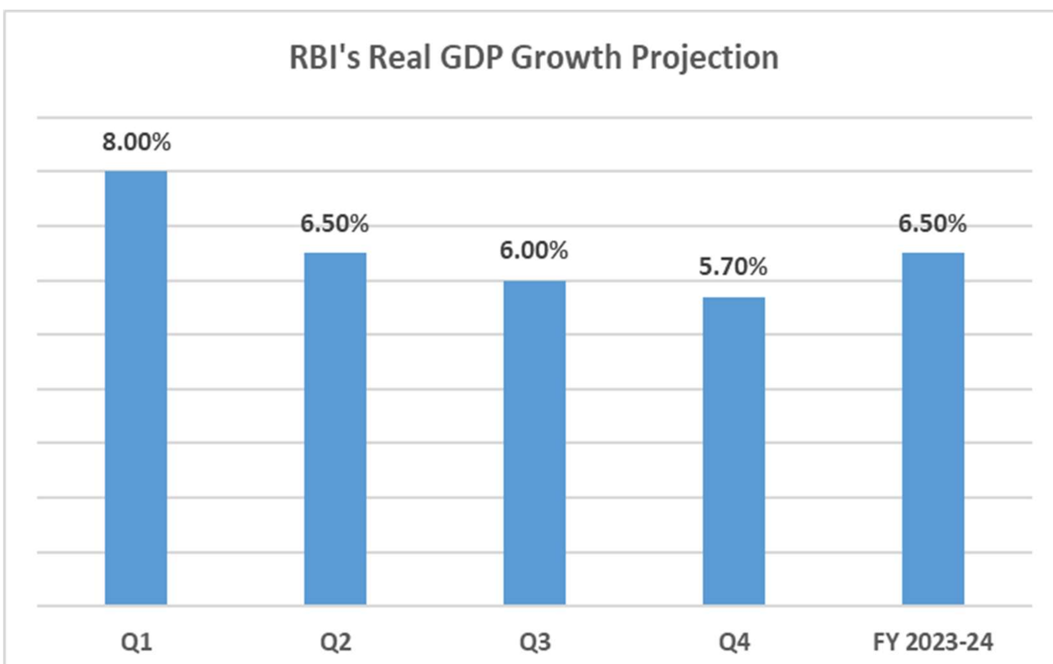
Expected Key Drivers

While the Q4 FY 2023 growth was led by strong show by agriculture and services sector, the first quarter growth is expected to be driven by rebound in manufacturing sector and continued recovery in the services sector. The industrial sector bounced back in the first quarter as indicated by the Index of Industrial Production. The IIP grew by 4.5 per cent during April to June 2023 led by manufacturing and mining sectors. The services sector on the other hand is expected to continue to be a key growth driver, given a broad based sharp pick up in all the segments of the sector. Construction activity is expected to be the front runner, while other segments such as financial services, trade, hotels, transport are also expected to give further fillip to the service sector growth during the quarter. The agriculture sector which was a key growth driver in the previous financial year, is expected to witness some moderation in FY 2023-24, given the vagaries of weather which have impacted the agriculture sector outlook. Nonetheless, agriculture sector growth is expected to continue to provide a positive push to the overall growth in the first quarter. The real GDP growth is also expected to get further push from a sharply lower inflation witnessed in the first quarter of the year.

Apart from global risks, risks to growth may emanate from domestic factors too

Risks to Sustainability

For sure, the headline numbers are expected to be strong, however, the question of sustainability of the growth momentum cannot be ruled out due to a host of reasons. Firstly, the outlook of agriculture sector has come under strain as the phenomenon of El-Nino is seen to be emerging as a bigger risk than previously expected. The phenomenon has already affected rainfall in the month of August and going ahead, the September rainfall is crucial for key rabi crop, i.e. wheat. Already, the agriculture sector has borne the brunt of erratic rainfall in the key monsoon month of July, any further weather related disturbances are expected to put agriculture sector growth under strain. Secondly, private consumption has lost momentum in the previous quarters, with the share in overall GDP retracing to 55 per cent in Q4 FY’23. Even though Q1 saw sharply lower inflation, which may have pulled up private consumption expenditure in the first quarter, the recent pickup in food price inflation is likely to dent purchasing power and discretionary spending. Hence any pick up in private consumption in the first quarter, needs to be seen with a sense of caution. So even as India remains a relatively brighter spot in the global economic milieu, challenges are expected to persist and the path of growth may not be devoid of roadblocks.

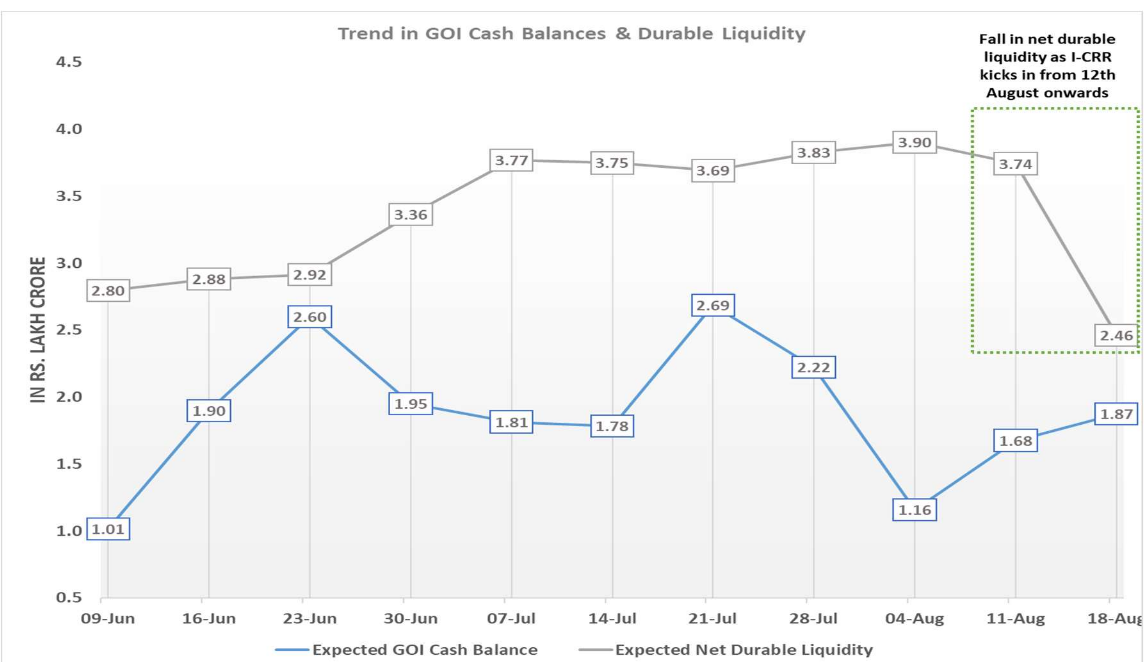


Macro Monitor

Durable Liquidity Tightens as I-CRR Flushes Out Liquidity

The net durable liquidity tightened in the previous fortnight as the Incremental CRR (I-CRR) kicked in from 12th August onwards, lowering the net durable liquidity by ~ Rs. 1.1 lakh crore in week ended 18th August from 11th August's level of Rs. 3.6 lakh crore. The impact of the same was felt on the level of money market rates, with call money rate firming up to an average of 6.74 per cent in the previous fortnight, as against 6.41 per cent in the fortnight ending 11th August'23. The I-CRR, which was announced by RBI in the August policy meet is being perceived as a stealth-tightening move and in the current context of inflation surge witnessed in the month of July, is expected to keep inflation expectations anchored. With the I-CRR move flushing out a significant quantity of liquidity from the system, fears of repo rate hike will also remain contained despite inflation expected to remain at elevated levels in the month of August also. RBI will review the I-CRR on 8th September and a decision to extend the I-CRR may have an adverse impact on the banking liquidity and keep money market rates under pressure, given that the middle of the month of September will witness advance tax outflows. Additionally, the beginning of the festive season will be another factor which will see the banking liquidity getting further squeezed. Broadly, in anticipation of these events, we will see money market rates rather firm in the coming weeks.

Money market rates may continue to remain under pressure as liquidity situation is not expected to see a quick reprieve



Fixed Income Outlook

Fundamental View

G-sec yields continued to firm up in the previous fortnight with the 10-yr yield rising to as high as 7.26 per cent. Market sentiments were dented by an unexpectedly high inflation print for the month of July and also higher US treasury yields. The MPC minutes released in the previous fortnight, confirmed RBI's readiness to take action in case of inflation persistence, even though some members felt that the current bout of inflation will cease soon, with normalisation of supplies. Another key event was US Fed Chairman's speech at Jackson Hole Symposium, wherein the door for further rate hikes was continued to be left open. The coming fortnight will see key data releases, with Indian Q1 GDP data to be released on 31st Aug'23. US will also release its Q2 GDP data apart from key jobs data, i.e. NFP and unemployment rate for the month of August in the coming fortnight, which will be key movers for US treasury yields. Overall, we expect yields to trade with a firming and flattening bias as liquidity squeeze and data releases may keep sentiments cautious.

Markets will be driven by key economic data releases from India and US in the coming fortnight

SDL Overview

During last fortnight, 10 Yr State Loans traded in the broad range of 7.431%-7.50%, whereas the 10 Yr CG benchmark, remained in the range of 7.172%-7.258%. The state governments, continue to borrow much lower than the scheduled borrowing amount while demand for long tenure paper has remain robust. In aggregate, State governments have raised Rs. 2,43,830 Cr in this fiscal, so far which is ~21.82% lower vis-a'-vis an indicated figure of Rs. 2,97,030 Cr. The spread between the 10-year State Government Securities (SGS) and Government Security (G-Sec) of corresponding maturity narrowed to 25-30 bps.

Sighting low supply, on account of high capex loan released by the central government to states we expect the spread between 10-year SGS and CG to remain in the range of 25-30 bps in the next fortnight as well.

Technical View

Technical Synopsis 7.26% GS 2033 Yield:

7.26% G Sec 2033 Yield settled at 7.18% on Monday's session. Passing Fortnight Benchmark traded broadly in range of 7.25% to 7.16% zone and settled subdued. Momentum Oscillator RSI is showing divergence to Yields Indicating mild softening possible till 7.14% zone. However, with 38.2% retracement level of recent Swing Low/High placed around 7.14% coinciding with previous Gap, Bulls will need full throttle action to stay below it, else bounce back towards 7.21% to 7.28% cannot be ruled out.

Going forward, with Benchmark moving in a rising channel pattern (as shown in chart), 7.28% is expected to act as crucial resistance on higher side and on lower side any sustainability below 7.14% will open gate for 7.05%/7.00% levels.

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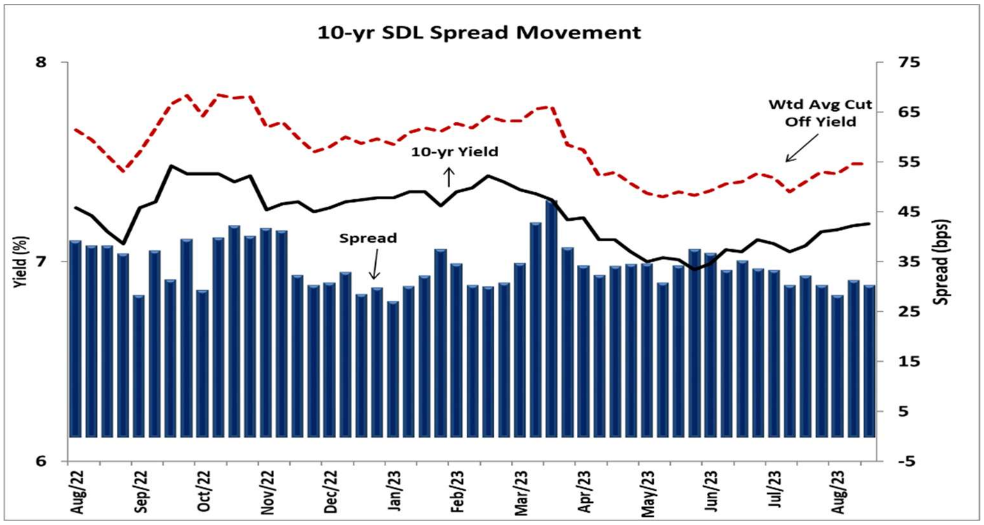
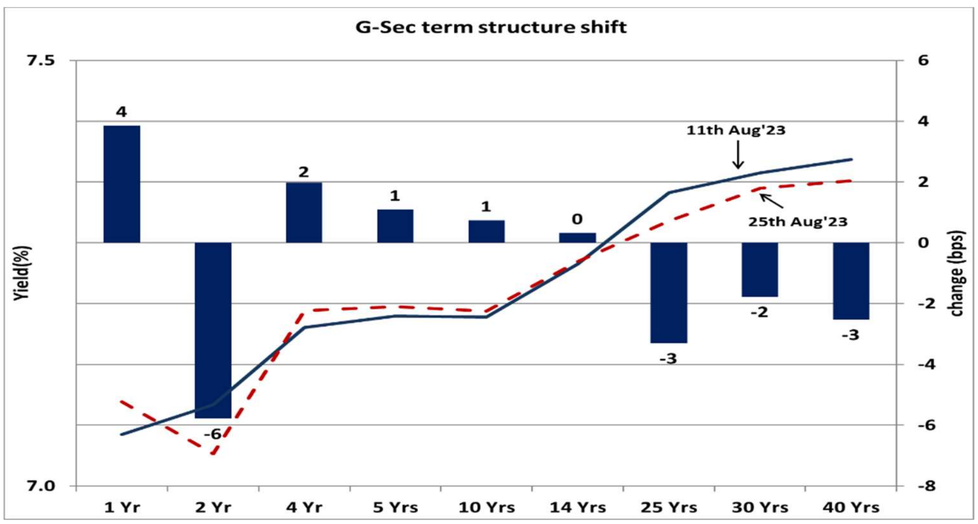
Running Chart GOI 10yr Daily. Source: Tickerplant

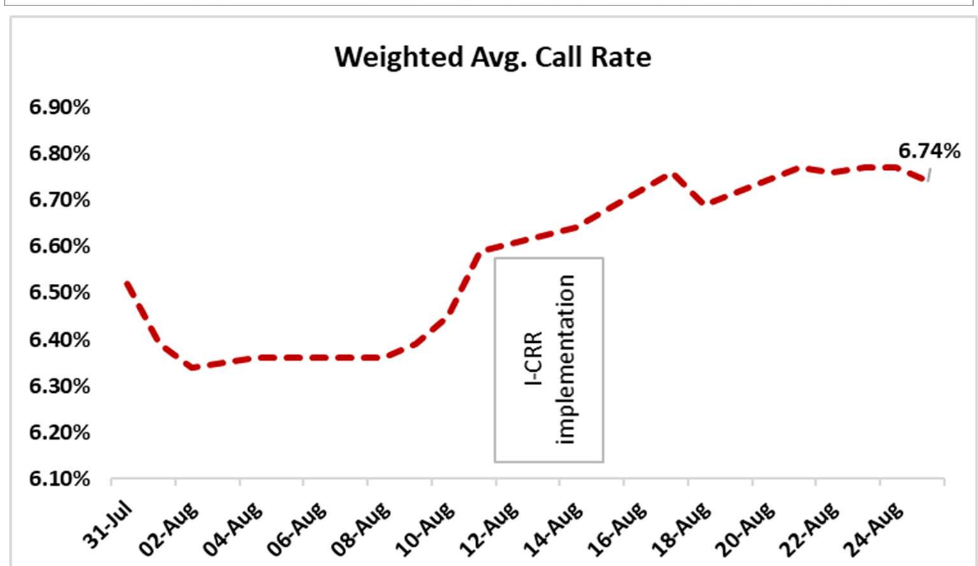
Spread Monitor



Subdued supplies are expected to keep 10-yr SGS and CG spreads in the range of 25- 30 bps



G-sec term structure is expected to trade with a flattening bias in the coming weeks



Call money rates saw substantial firming up on I-CRR outflows

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