

ECONOMY & GILT WATCH



(Subsidiary of Punjab National Bank)

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US Fed Policy Review

The US Federal monetary policy committee decided to keep policy rates unchanged for a second time in a row at 5.25 per cent – 5.50 per cent, despite strong economic data flow that was witnessed in the run up to the meeting. The policy tone was neither out rightly hawkish nor dovish, despite the firmness of data giving respite to the bond markets. This has put under question the possibility of further hikes and the markets seem to be cautiously optimistic about it now. The key point to note was that the US Fed refrained from giving clear indications of whether they have reached the “sufficiently restrictive” space, keeping options of further hikes open. Nonetheless, despite the mix of hawkish and dovish undertones, the market has taken positive cues from the Fed decision and policy stance, with across the board softening of US treasury yields.

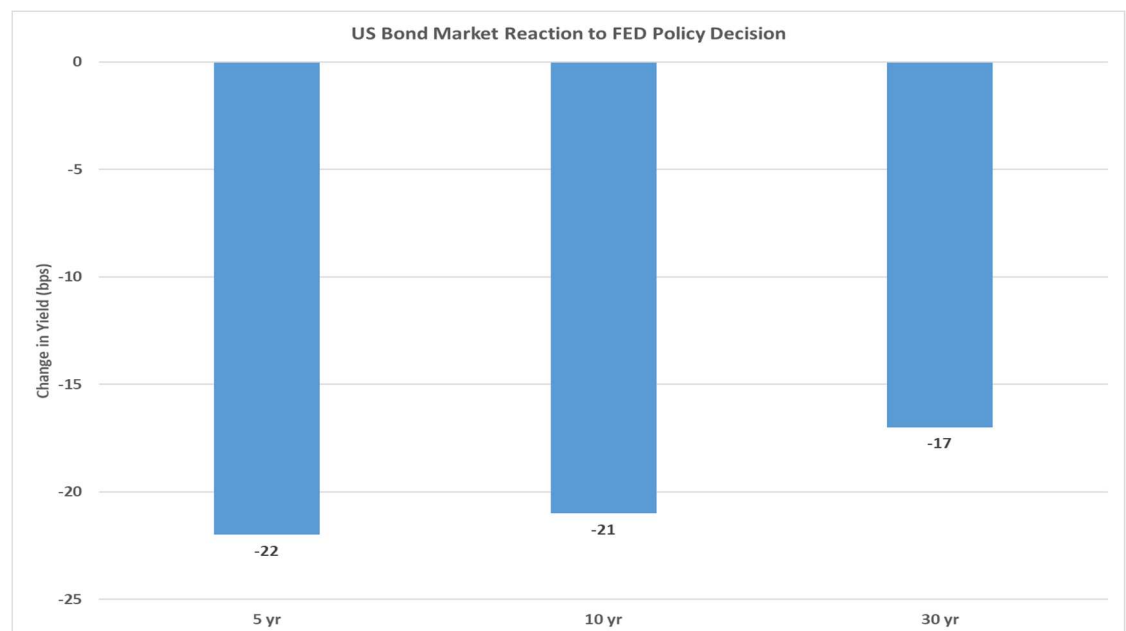
Key Takeaways from Policy Statement

The US Fed continues to acknowledge that tight monetary policy conditions are exerting downward pressure on economic activity and inflation, with full effects yet to be percolated completely. Economic activity gains have been attributed to sharp and continued surge in consumer spending, with housing sector and business fixed investment being weighed down by higher interest rates. Despite the sharp and unanticipated surge in September retail spending, the US Fed did not sound alarmed, implying that it may wait for forthcoming data and gauge things in totality. On labour markets, there is no substantial change in Fed’s assessment of supply demand dynamics and wage growth trend. On inflation, the US Fed sounded quite confident, drawing comfort from the recent softening trend which it termed as “favorable.” However, the central bank was quick to add a caveat to its inflation assessment, stating that a few month’s of favorable inflation data marks only the beginning in building confidence over the sustenance of the inflation trajectory. Nonetheless, the overall assessment of inflation is rather dovish, as US Fed draws comfort from both the recent trend in inflation and longer term inflation expectations, which it stated as remaining anchored. Another dovish takeaway from the Fed’s press conference was the Fed’s Chairman’s comment on the relevance of the September dot plot, which had indicated one more rate hike in the year. According to him, the recent tightening of financial conditions has made the

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September dot plot redundant in the current context. Further in this regard, the US Fed has emphasized on the recent surge in bond yields, which may have a bearing on the monetary policy path. To our understanding, the US Fed may be indicating that higher bond yields may offset requirement of further policy rate hikes as they work through the real sector and help in softening the blazing demand in the economy. Counterintuitively, the US Fed also highlighted that the resilience of the US economy and labour demand and persistence of the same could warrant further tightening of the policy. We feel that this may have been added to counterbalance build-up of rate cut expectations, which could offset the gains that have been witnessed on the inflation front so far.

Overall, the US Fed policy has been perceived as dovish, with Fed drawing comfort from positive inflation data over the previous few months



Bottom line

The US Fed now seems to be in position to bring the rate hike cycle to its culmination, though the dilemma between keeping status quo and the need to hike rates further was also emphasised upon in the press conference. The language of the policy and the conference was largely dovish, with some hawkish caveats drawn in between so as to maintain the balance. What stood out was the fact that the US Fed remains open about the fact that it remains unclear if overall financial conditions were yet restrictive enough, which implies that the market will continue to face uncertainty. Going forward key economic data to be released beginning from Non-Farm payrolls (NFP), CPI and Retails sales for the month of October, will give direction to the US bond markets and rate expectations. Another key risk to US yields arises from BoJ's relinquishing of the yield curve control, which it has subtly hinted at in its last policy meet, by stating that the 1% cap on 10-yr yield will now be a "reference."

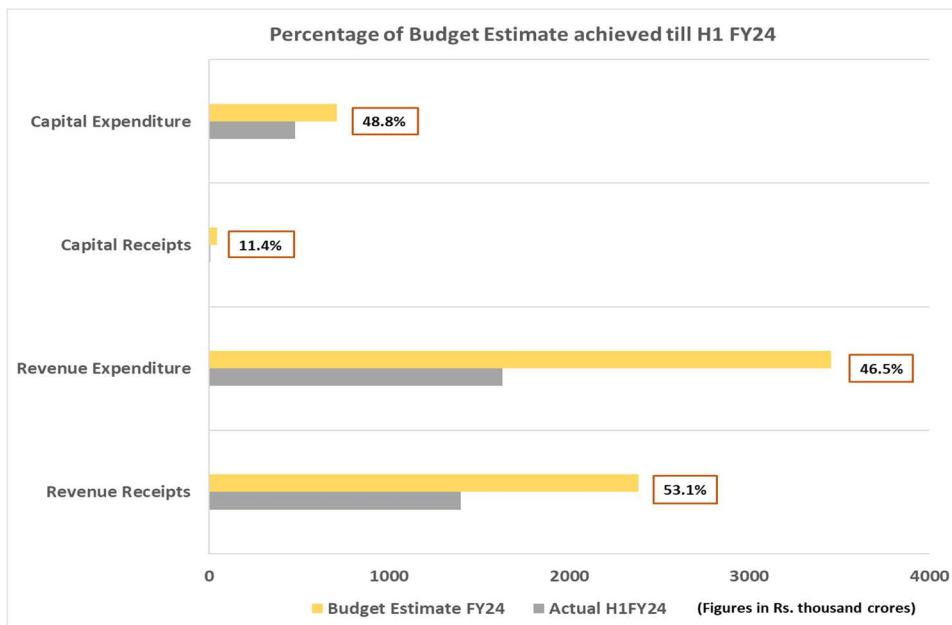
Macro Monitor

Government Finance Position: H1 FY 2023-24

Fiscal deficit of the Centre has neared to 40 per cent of the annual estimate at the end of the first half of fiscal, as compared to 37 per cent during H1FY23. The deficit widened to Rs. 7.02 lakh crore for H1FY24, as against Rs. 6.2 lakh crore in the same period previous year, partly on the back of a higher capital expenditure to the tune of 4.8 lakh crore. Gross tax revenues grew by 16.3 per cent y-o-y to Rs. 16.2 lakh crore, wherein, direct taxes recorded a healthy growth of 25.4 per cent y-o-y in comparison to the muted growth of 6 per cent y-o-y for indirect taxes. Despite a double-digit y-o-y growth in CGST, customs duty, GST and service tax collection, a negative and lagging growth under excise duty led to the slowdown in the pace of indirect tax collection.

In the last fiscal, the Centre proposed the target for fiscal deficit at 6.4 per cent of GDP, however, the actual fiscal deficit for the year was recorded lower at 6.3 per cent. Consequently, the ministry proposed a more ambitious target of 5.9 per cent of GDP for FY24. Even though, it may look feasible to attain the target, but it is not free from some obvious risks. The tax revenues are healthy, but not as much as the previous year. On the non-tax revenue front, receipts from disinvestment are lagging behind with mere 16 per cent target achievement for the year. Nonetheless, a higher-than-budgeted dividend surplus transfer of Rs. 0.87 lakh crore (against the budget of Rs. 0.48 lakh crore) may take some pressure off. Further, 2024 being an election year can come with some big spill-overs in the Rev-ex segment. Surprises in the subsidy bill can also be expected. The second half would be testing for the economy, given the upside risks from the prevailing geo-political conditions, beginning of the state elections from November onwards and the demand constraints on the domestic level.

Fiscal deficit widened to Rs. 7.02 lakh crore for H1FY24, as against Rs. 6.2 lakh crore in H1FY23, partly on the back of a higher capital expenditure



Fixed Income Outlook

Fundamental View

The domestic debt markets after trading in a range bound manner beginning the current fortnight, taking cues from US yields that retreated post US Fed policy verdict. Prior to this fears of OMO sales announcement by RBI had kept the market on the tenterhooks, keeping the 10-yr yield near 7.35 per cent mark for most part of October. Going forward, market will continue to be driven by movement in US bond yields, and closely track spate of key US economic data to be released in the coming fortnight. Banking liquidity condition will be another key determinant, with GOI cash balances currently holding high, north of Rs. 4 trillion and expected to come back into the banking system via government spending. An increase in banking level liquidity, which may happen through regular government spending, redemption of government securities, will bring OMO sales expectations to the fore. Broadly, we do not expect neither sharp easing nor firming up of yields from the current levels. Any positive development on Bloomberg bond index inclusion, the decision of which is impending, will add to the positive sentiments.

G-sec market is expected to be driven by global factors and domestic liquidity conditions

SDL Overview

During the last fortnight, 10 Yr. State Loans traded in the broad range of 7.591%-7.776%, whereas the 10 Yr. CG benchmark, remained in the range of 7.331%-7.392%. In aggregate, State governments have raised Rs. 4,50,537 Cr in this fiscal, so far which is ~13.68% lower vis-a'-vis an indicated figure of Rs. 5,12,150 Cr. Borrowings by states in Q1 and Q2 remained below the indicative calendar. However, so far in the October-December quarter, the amount raised by state governments has been higher than the indicative amount 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. The borrowing cost of states has risen to the highest level so far in this fiscal, following large supply of paper in the current quarter.

We expect, the yield spread between 10 Yr. SGS and CG to widen further and trade in the range of (38 - 42 bps) in the next fortnight and borrowing cost of states likely to remain high considering higher borrowing amounts and the rise in yields on bonds.

Technical View

Technical Synopsis 7.18% GS 2033 Yield:

7.18% G-Sec 2033 Yield settled at 7.3245% in Today's session. Passing fortnight benchmark yield traded range bound between 7.31% to 7.39% zone.

Momentum Oscillator RSI is trading around 52. With today's move post a breakaway gap from rising trend line opens door for 7.29%. However, sustaining below 7.29% will be crucial for any meaningful softening, till then we may trade in broader range of 7.29% to 7.39%. Also, with Bullish Flag pattern in making, sustenance above 7.39% will confirm the pattern, taking Benchmark towards 7.49%-7.50% zone, on lower side 7.29% to act as an immediate support level for the coming fortnight.

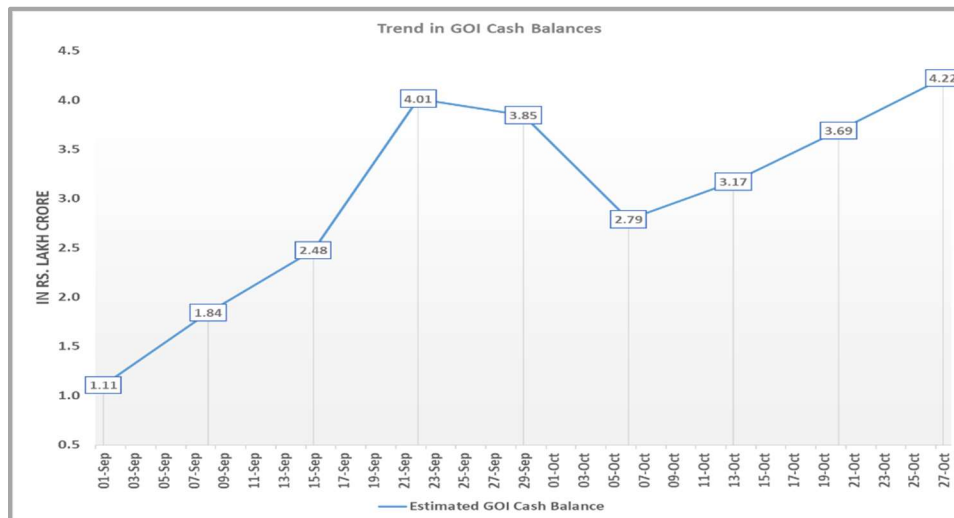
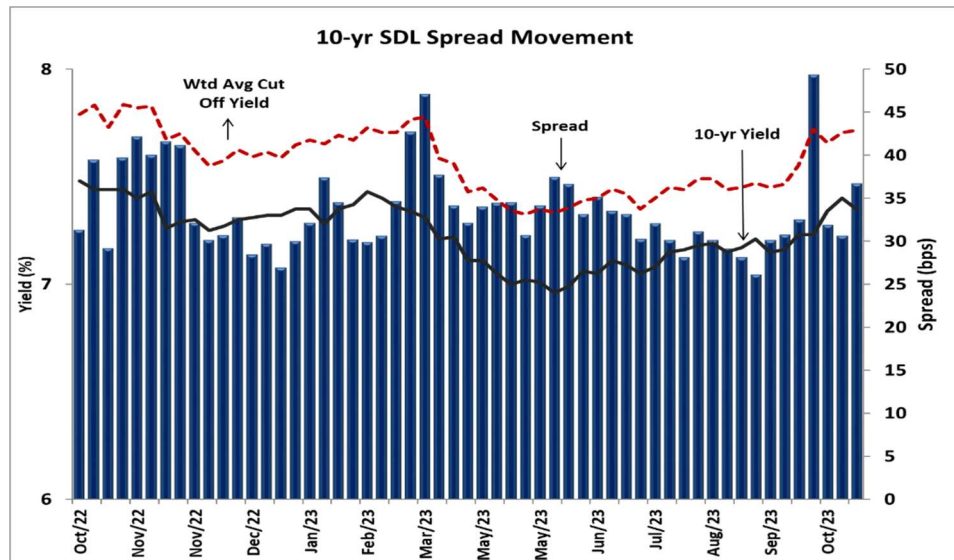
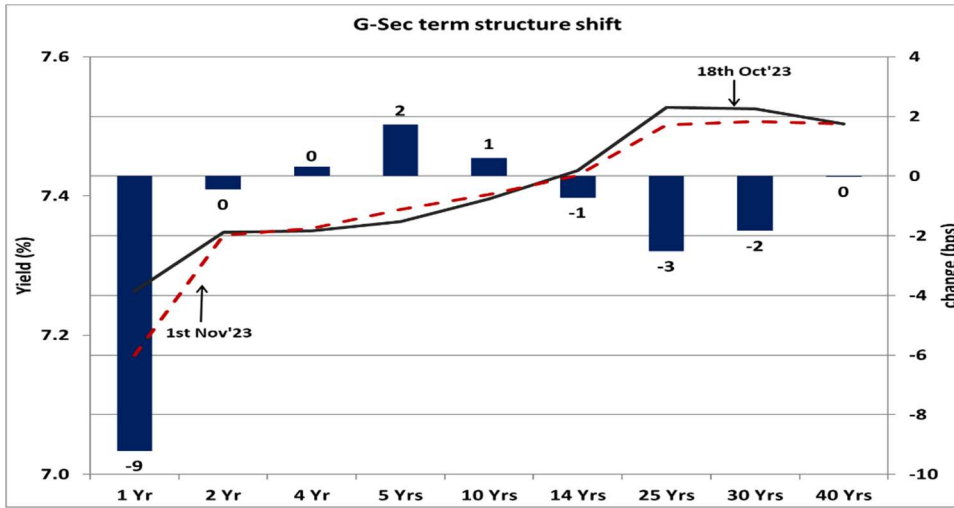
With Bullish Flag pattern in making, sustenance above 7.39% will confirm the pattern, taking Benchmark towards 7.49%-7.50%



Running Chart GOI 10yr Daily.

Source: Tickerplant

Spread Monitor



G-sec yields remained largely range bound in the previous fortnight in absence of strong cues

We expect, the yield spread between 10 Yr. SGS and CG to widen further and trade in the range of (38 - 42 bps) in the next fortnight

GOI cash balances with RBI likely peaked at ~Rs 4 trillion as on 27th Oct'23



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