PNB GILTS LTD

Volume 04/2021-22
17th May 2021

ECONOMY & GILT WATCH

PNB GILTS LTD
(Subsidiary of Punjab National Bank)

INSIDE THIS ISSUE:

RBI's Second Wave Measures

RBI in an unscheduled announcement came out with a new set of emergency measures to combat the impact of the ongoing second wave of the pandemic. Given the severity of the pandemic this time, its impact on economic activity cannot be undermined, though, the disruptions are far lesser compared to last year in absence of a clampdown. Nonetheless, the pressure for a full-fledged lockdown are continuing to mount which, if announced may be extremely detrimental for the economy, which was yet to recover fully. The main highlights of the fresh set of measures are:

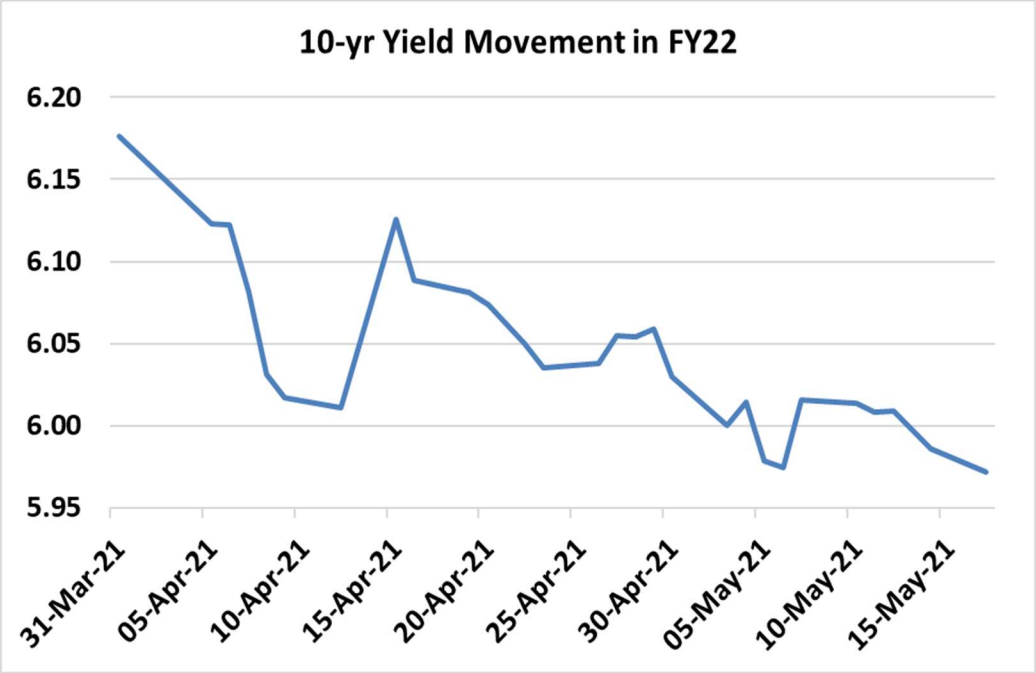
1. **GSAP**: Within the Rs. 1 lakh crore of GSAP 1.0 operation, RBI shall be conducting Rs. 35,000 crore of OMO on 20th May 2021. The intent has been made very clear, that is to keep G-sec yields soft in order to ensure softness in corporate bond yields and other borrowing rates in the economy subdued. RBI has already conducted Rs. 25,000 crore of OMO in first tranche of GSAP on 15th April 2021.

2. **Term liquidity towards health care infrastructure**: RBI has come out with a targeted and innovative term lending scheme to provide support to the crippled health infrastructure. Under this scheme, banks can access on tap liquidity window of Rs. 50,000 crore at the repo rate and direct funds towards health services (including vaccine manufacturers, importers/suppliers of vaccine & oxygen, COVID related drugs etc). In order to incentivise bank for prompt extension of credit, RBI allows banks to park funds equivalent to the amount of credit extended under the **COVID loan book** under the reverse repo window at **Reverse repo plus 40 bps i.e. at 3.75%**. The scheme holds till 31st March 2022.

3. **TLTRO for small finance banks:** TLTRO scheme of Rs. 10,000 crore extended to small finance banks for on lending to MFIs of asset size upto Rs. 500 crore.

2. **Flexibility in OD facility to States:** In order to provide flexibility to States in managing their finances amidst the ongoing pandemic, the maximum number of days of OD in a quarter is being increased from 36 to 50 days and the number of consecutive days of OD from 14 to 21 days. This facility is available till 30th September 2021.
3. **Resolution framework 2.0:** Onetime restructuring for individuals & MSME borrowers with aggregate exposure of upto Rs. 25 crore (till 30th September 2021). Only for those borrowers who did not avail restructuring earlier and who have been classified as standard as on 31st March 2021. Moratorium period under restricting 1.0 can now be extended upto 2 years.

Continuous RBI intervention through OMOs, auction cancellation, devolvement etc. has softened the 10-yr yield to below 6% mark despite adverse macro factors such as high inflation, surging commodity prices and firm global yields



Comments on Economic situation

1. RBI expects demand conditions to be affected only moderately helped by adaption in post pandemic era. Agriculture sector expected to be the flagbearer with positive impact on demand, supplies at both domestic and trade level, with healthy output to have soothing impact on inflation. Inflation is not expected to deviate from what was projected in the April meet.

2. RBI concludes by emphasising that it will remain in “battle ready” mode to ensure orderliness in financial markets and ”proactive throughout the year” to deal with the evolving conditions.

The fact that RBI has been prompt about the above set of measures indicate that the economy faces much uncertainty and that RBI is back in its “battle ready” mode to take measures required to alleviate the impact of the pandemic on the economy. The fact that the pandemic is ravaging in the hinterland of the nation, does not augur well for the rural economy and demand, which had been the only saving grace in last year. Though, various rating agencies have cut their GDP forecast for FY22, with the virus being more virulent and widespread this time, the actual set back to the economy will be far too difficult to anticipate.

Macro Monitor

WPI inflation surges to 10.49% in April, CPI inflation softens on favorable base

Wholesale inflation continued to post yet another sharp uptick, rising 10.49% y-o-y largely led by across the board rise in prices of fuel & power, manufactured products and food prices during the month. A low base of the previous year also contributed to the sharp rise in WPI inflation. During April, fuel inflation shot up by 21%, more than double of March's already high inflation of 10.2%. Prices of manufactured products, which have a combined weight of 65% in the index, rose by a sharp 9.01% percent, up from March's 7.3%. Food articles inflation also contributed towards the larger than expected uptick in WPI Inflation as it rose by 4.92% as against 3.84% in the previous month.

The decline in CPI inflation is largely transitory as the favorable base effect wears off, while rising commodity prices and supply disruptions pose risk to the overall inflation situation

Retail inflation on the other hand, eased to a three month low of 4.29% from 5.5% in March 2021, largely on account of a high base of the previous year (CPI inflation in April 2020 at 7.20%) as supply disruptions led to sharp escalation in domestic food inflation. On back of a high base, food inflation softened in April’21 to 2.66% as against 5.24% in March’21. On the other hand, the fuel and light inflation surged to 7.91% in April’21 as against 4.43% in March’21 mainly due to the low base of previous year. Global lockdowns in the first wave of the pandemic had led to a crash in crude oil prices to below USD 30 a barrel in April’20. After remaining largely sticky, core inflation also softened to a 10-month low of 5.41% on back of favorable base and easing of inflation in miscellaneous items.

The downtick in inflation looks largely transient as the recent surge in global commodity prices and supply disruptions may exert upward pressure on prices. Wearing away of the favorable base effect will also exert upward pressure on headline inflation going forward. On positive side, normal monsoon may be an alleviating factor for food inflation.

Fixed Income Outlook

Fundamental View

Bond markets continue with status quo with RBI doing every bit to keep a cap on yield, latest action being cancellation of the 10-yr paper auction. Its been a little more than a month in the new FY and RBI has used its ammunition of various kinds such as full devolvements, cancellations, special OMOs and latest being GSAP to push the yields towards the 6% mark. Till when the central bank can do it, when overall macro conditions, particularly global macros are no longer benign (except for the severity of the pandemic) is the moot question.

Global commodity prices of ferrous, non ferrous, energy and agriculture commodities are spiraling to recent highs, some even at decade high levels, which puts inflation forecast of various central banks at the risk of going kaput. US recently saw an inflation scare with CPI inflation at a 13 year high of 4.2% for the month of April, intensifying the inflation debate.

While global macro developments remain adverse to bond markets, domestic macro conditions are in an extremely fragile state, with the pandemic just beginning to show signs of peaking even as mortality continues to soar. The pandemic has also gripped the rural areas which puts the rural demand at risk and should be a cause of worry, given that it is the rural economy which largely cushioned the loss in demand during the first wave in the previous year. Under such circumstances, RBI is expected to continue keeping the bond markets assuaged and bond yields largely under control. The 10-yr yield is expected to be range bound within 5.95% to 6.02% in the coming fortnight.

Technical View

5.85% G Sec 2030 Yield settled at 5.99% on Friday's session. Last fortnight, Benchmark yield traded range bound broadly between 6.04%-5.96% zone.

Post witnessing a breakout in first week of Feb'21, since then Benchmark yield is trading in broader range of 5.96% to 6.26%. Momentum oscillator RSI is currently placed around 38 zone. We continue to believe, till yield is sustaining above major support level of 5.96%-5.95%, which also coincide with lower Bollinger band level, yield may trade range bound between 5.95% to 6.04% for coming fortnight. However, any sustainability and closing below 5.95% will trigger Neckline breach of Head and Shoulder pattern (Technical reversal pattern), which could open the gates for 5.87%-5.85% level. On higher side 6.04% will act as crucial resistance zone.

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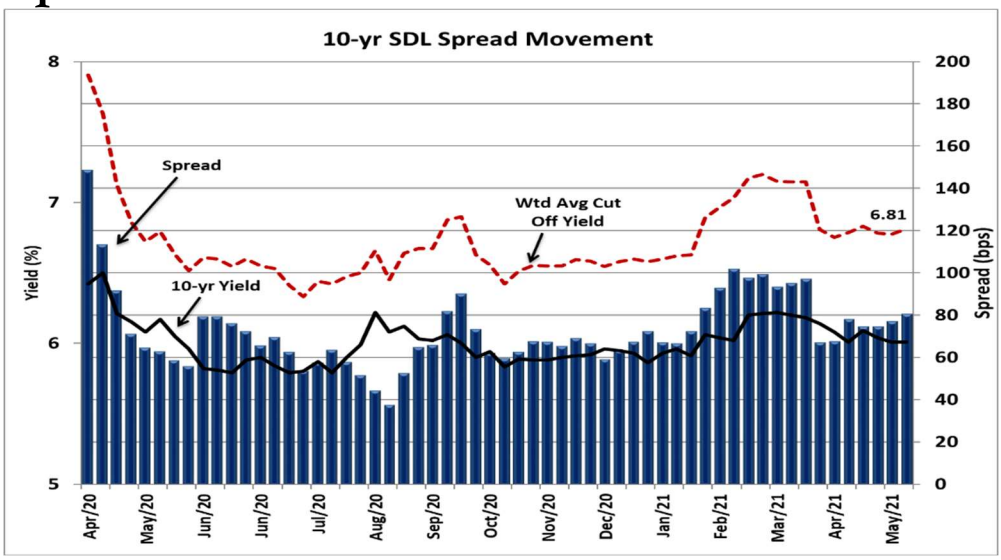
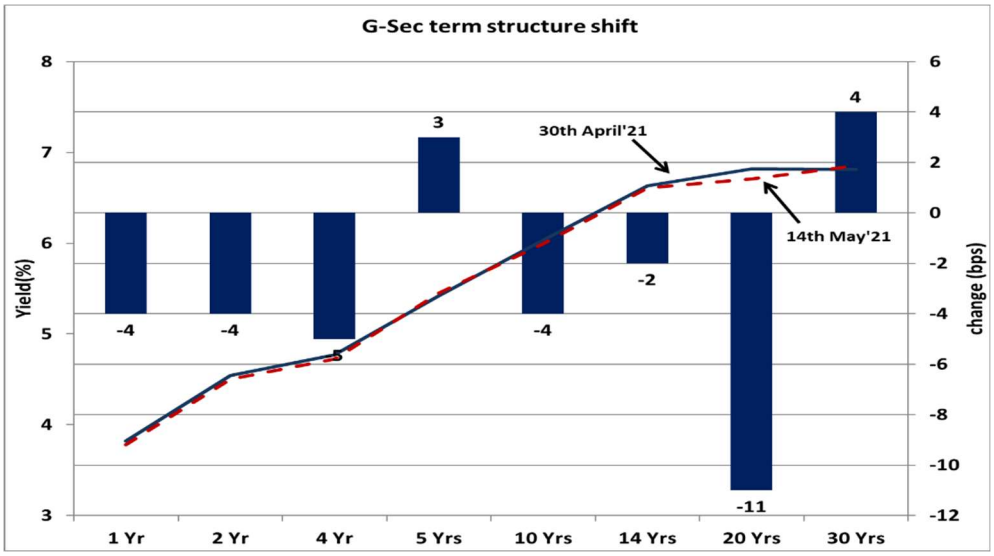
Source: Tickerplant

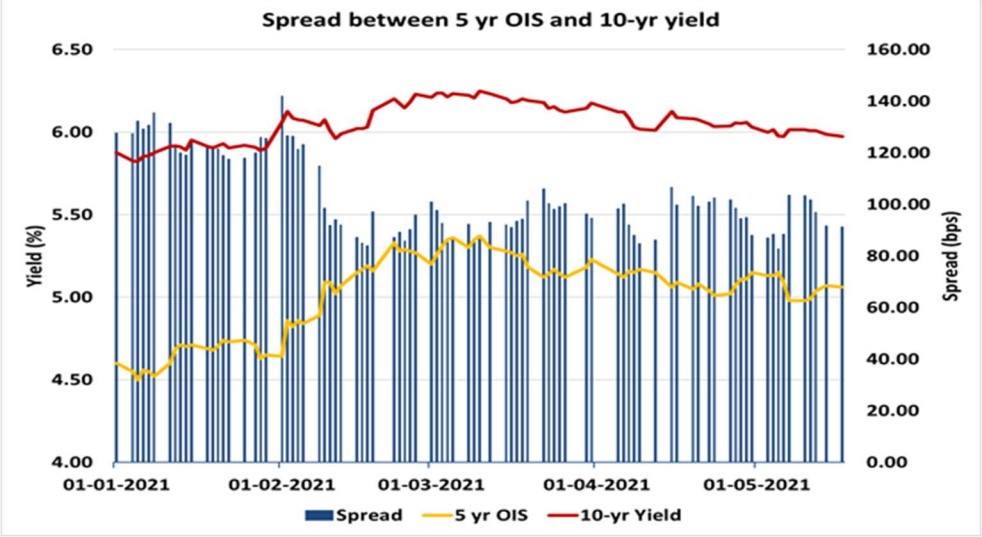
Spread Monitor



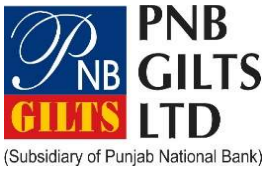
SDL spreads have started to inch upwards as auction supply rise. The outlook for SDL spreads remains bearish as restricted economic activity and vaccination costs may hurt finances



10 year yield eases below 6% mark as RBI continues to manage the yields through OMOs & auction management



5-yr OIS & 10-yr yield spread has eased below 100 bps



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