

## ECONOMY &amp; GILT WATCH



(Subsidiary of Punjab National Bank)

## Reading the Poll Outcome

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Results were announced for the Lok Sabha elections on 4<sup>th</sup> June. Market participants were expecting the ruling BJP-led NDA coalition to improve on its previous tally which did not turn out to be true. On election day, with trends coming in there was high volatility in equity markets and bond yields spiking approximately ~10 bps. BJP became the single largest party for the third consecutive term with 240 seats and the NDA coalition sitting comfortably at 290+. With rumours of defections proving wrong, market stabilised and equity markets have posted a sharp recovery to pre-election result levels.

Let us look at the implications of poll results on different markets –

- Bonds** – In the run up to election results the bond market had priced in a repeat or improved performance from the NDA coalition and as a result the yields breached and traded below the important 7.00% levels. However, with BJP falling short of an absolute majority and having to rely on coalition partners, concerns around derailment of fiscal prudence and return of populist schemes put pressure on yields due to a possible increase in Bond supply. With the NDA coalition proving itself to be more cohesive and resilient, the market is now broadly aligned on policy continuity and fiscal discipline to follow. While some of the demands of coalition partners are likely to be accepted by the BJP, they are unlikely to have a significant impact on investor confidence which guides the inflows and the borrowing levels of the government. Hence, bond markets are likely to look past election result and move onto local and global macro factors along with increased FPI activity due to policy continuity.
- Equity** – Benchmark Equity index NIFTY posted the worst crash in 4 years on the results day having scaled all-time highs the day before. Particularly hard hit were the PSU stocks and banking stocks. But with the market sentiment pivoting towards policy continuity despite lower seats, the market has seen a sharp recovery and is back near the all-time high levels. Even though valuations remain on the higher side, global investors remain bullish on India in spite of the slightly weak poll results and look to park money in Indian equities in a secular manner in coming time. Hence, going forward without any global macro shocks, the outlook for Indian equities

#### Reading the Poll Outcome

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*Resumption of pre-election dynamics in Bonds, equities and currency*

remains positive barring profit booking led small corrections along the way.

3. **Currency** – USDINR pair has traded in 83.00-83.55 range in the run-up to election results and post that. Considering the volatility in Equity and Bond markets the moves in currency look tiny with RBI's active intervention. With increasing the FX reserves buffer now an official element of RBI's policy, the pair is going to see muted volatility with positive bias due to FPI inflows going forward and looks set to trade below 83.00 in the later part of the year.

### **RBI MPC:**

The MPC kept the benchmark repo rate unchanged for the eighth consecutive time at 6.5% with a 4:2 vote and stuck to its stance at withdrawal of accommodation. Despite being the first monetary policy after the General Election results, the policy did not throw any surprises and was in line with the markets expectations. Particularly notable was the admission that the RBI is focused on domestic growth-inflation mix and does not draw inspiration from other Central Banks to time the hike and cut decisions. The RBI's continued focus on a data driven approach and the upward revision of 20 bps to Growth forecast suggests that there is no haste in cutting the rates and as and when that happens it is not a certainty that it will be a complete cut cycle. Considering India's robust macro fundamentals, it looks unlikely that the RBI is going to cut rates soon and will provide stability to markets while actively supporting and weeding out any currency risk to support increased FPI participation.

Some of the major announcements of the monetary policy were as follows:

- FY25 GDP growth forecast raised to 7.2%. The quarterly projections are - Q1 at 7.3%; Q2 at 7.2%; Q3 at 7.3% and Q4 at 7.2%.
- CPI inflation estimates for FY25 retained at 4.5%. Detailed inflation forecast: Q1 at 4.9%; Q2 at 3.8%; Q3 at 4.6% and Q4 at 4.5%
- Review of limit of Bulk Deposits for Scheduled Commercial Banks, Small Finance Banks and Local Area Banks
- Rationalisation of Export and Import regulations under Foreign Exchange Management Act

*RBI maintains cautious data driven approach*

## Fixed Income Outlook

### Fundamental View

During the last fortnight, G-Sec yields traded in the range of 7.07% to 6.95% and are stabilising near the crucial 7.00% mark. With the major Election event out of the way and RBI continuing with its stance, yields once again will look towards Global macro events and investor flows. If there are no major policy surprises post the cabinet formation yields are set to continue on their downward trend below the 7.00% mark driven by investor interest. The yields will take further cues from the inflation figures coming in later this week from the USA and India.

On a purely objective basis 240 LS seats on a standalone basis is a very good figure since the times of coalition governments started in 1990s. The government will be stable and the policies are likely to remain on similar lines. Speaking of subsidies and freebies it is not that in the previous government there were no welfare schemes. To name a few, free distribution of ration, various schemes for women etc. despite that fiscal discipline was maintained. Asset monetization and stake sale in PSUs which are behind schedule will more than cover the increase in spending if any. Hence, from the supply side perspective we do not see major impact on benchmark yields.

While ECB and Bank of Canada have taken the plunge and gone for a rate cut, it is unlikely that the RBI is going to follow suit soon. Also, the decision to cut rates in both the cases were driven by efforts to prevent any cracks in the financial system as the economies have largely remained low rates economies and are not used to current high levels. Going forward the yields are likely to remain range bound with a downward bias below 7.00% and will remain data dependent and how the monsoon evolves which would have an impact on inflation.

### SDL Overview

In last fortnight, CG benchmark 10 Yr traded in the range of 6.94%-7.07%, whereas, the 10Y SGS got dealt in the range of 7.35-7.46 i.e. the benchmark 10Y G-sec yield spread narrowed and traded in the range of 33 - 38 bps. Going forward, with election results out of the way we expect SDL supply as a % of stipulated quantity to increase towards quarter end. We expect the spreads to be slightly on the higher side in the range 37-42 bps.

*Market to remain range bound with flows and data giving direction*

*SDL spreads likely to remain flat to slightly up*

## Technical View

### Technical Synopsis 7.10% GS 2034 Yield:

7.10% G Sec 2034 paper settled at 7.03% on today's session. Passing fortnight benchmark yield traded broadly in the range of 6.94% to 7.06% zone.

Momentum oscillator RSI is placed around 48 level. Making base around 6.94-6.95% zone, we have witnessed minor halt in bonds post decent rally in last one month. We still believe, this rally has further legs till Benchmark is holding below its crucial resistance level of 7.05% which coincide with 30EMA line and also presence of 38.2% retracement level at 7.06% validates the interest of investors at these levels. On higher side any sustainability above 7.06% will indicate trend reversal with confirmation of HH/HL formation taking it towards 7.12%.



Running Chart GOI 10yr Daily. Source: Tickerplant

## Liquidity

The proactive liquidity management by RBI by conducting both VRR and VRRR auctions has kept the WACR range to 6.50% to 6.83% in Q1 2024-25 with average of 6.70%. This has been effected largely by RBI's intervention through VRR in the current financial year, auctions of which have witnessed robust demand. While there has been a decline in WACR, the decline has been accompanied with large volatility in the overnight rates, which is bringing uncertainty to funding operations.

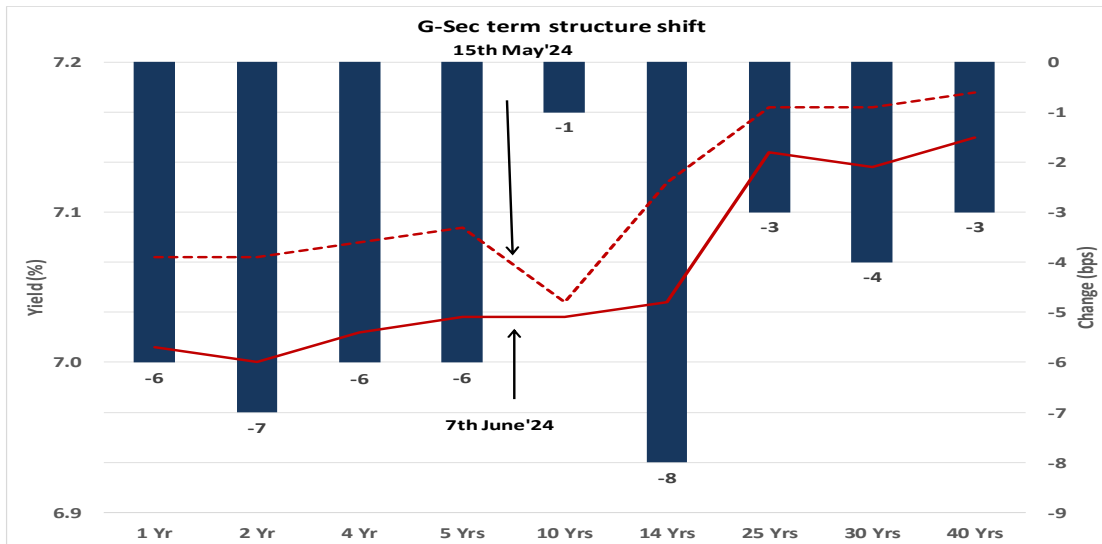
GOI cash balances with RBI stand at approximately Rs. 4.15 lakh crore as on 31 May 2024. The tightness in the money market rates is also largely due to large cash balances of GOI being held with RBI as the government expenditure has hit a slow lane due to election related model code of conduct.

Going forward, money market rates are expected to remain volatile on account influx of liquidity due to pick up in government spending and withdrawal of liquidity due to advance tax outflows and GST.

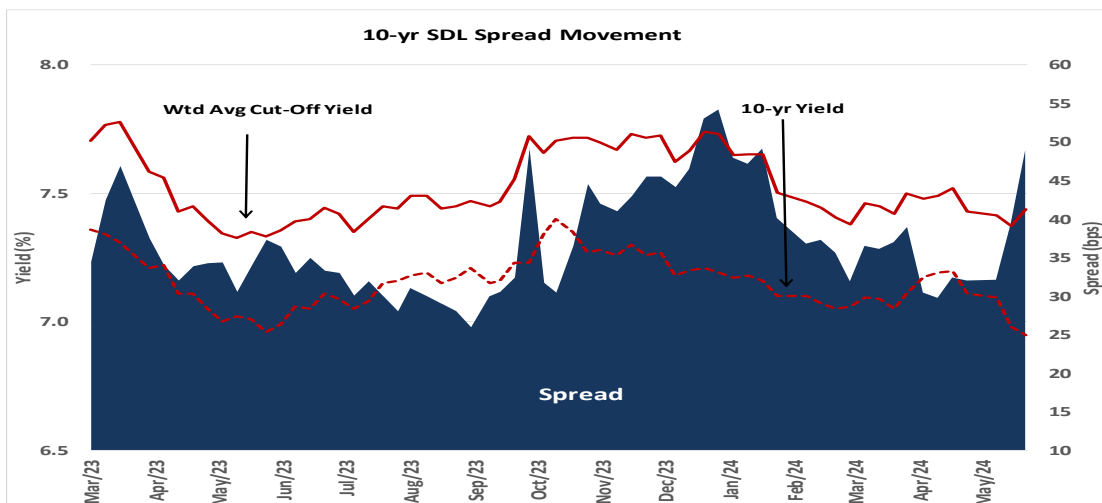
*We still believe, this rally has further legs till Benchmark is holding below its crucial resistance level of 7.05% which coincide with 30EMA line and validates the interest of investors at these levels.*

*Money market rates are expected remain volatile with pickup in government spending*

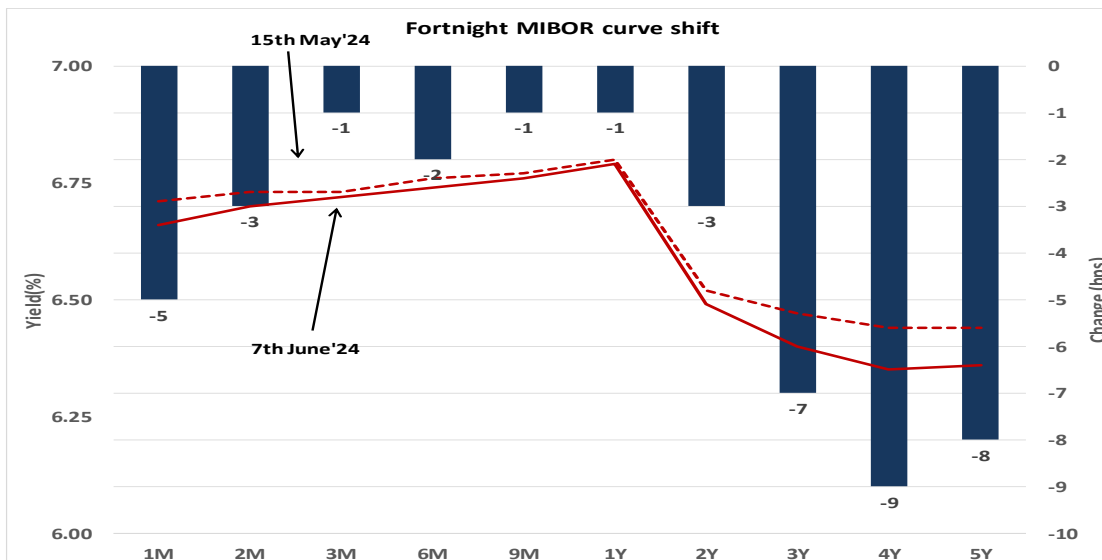
# Spread Monitor



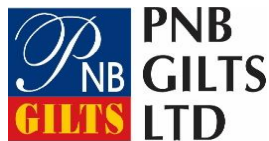
*G-Sec yields trended downwards*



*SDL Spreads have inched up*



*OIS trended downwards along with bond yields and USTs*



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