A Balanced Approach

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The MPC today delivered a 25 bps rate cut while maintaining a Neutral Stance. MPC voted 4-2 (Ghate & Viral voted for no cut) in favour of the rate cut while the Neutral Stance was retained with a 5-1 vote. Dholakia voted for a change in the stance to Accommodative. CRR was kept unchanged.

Though the rate cut was in line with the market Expectations, the unchanged "Neutral "stance was disappointing as the market was expecting a change in stance to accommodative which did not come about. A small segment of the market was also expecting a 50bps rate cut.

The MPC lowered its forecast both for Inflation and GDP Growth while sounding cautious on the Fiscal situation.

On Inflation RBI lowered its forecast to 2.9 -3.00% in H1 2019-20 and 3.5-3.8% in H2 2019-20. It is 30bps lower than the earlier forecast. This is presuming normal monsoons with risks evenly balanced.

On GDP growth the forecast for FY20 has been lowered by 20bps to 7.2% from 7.4% earlier.

The MPC also noted that the Output Gap remains Negative and the domestic economy faces headwinds, especially on the global front.

Overall the MPC Statement mentioned Global growth concerns and that the monetary policy stance of the US Fed and other advanced economy central banks has turned dovish. It also noted the slowdown in major emerging market economies. It also noted that Inflation in advanced economies and key emerging markets continued to remain low.

On the Development and the Regulatory front, some of the important measures announced were:

1. An additional 2% FALLCR within the Mandatory SLR requirement, thus increasing it from 13% to 15% in a phased manner. This measure will further lead to convergence of LCR with SLR.
2. Setting up of a committee to assess the state of Housing Finance securitisation markets and propose steps to further develop these markets.
3. Setting up of the task force to propose measures for developing a secondary market for Corporate loans in India.

Market Outlook:

The market backdrop in the run up to the policy was positive with market participants expecting a change in stance apart from the Rate Cut. A small minority were also expecting 50bps rate cut. From this perspective the markets were a little disappointed that the stance of the monetary policy has not been changed and as such the market reaction has been negative with the benchmark 10yr bond yield rising by 6-7 bps post the Policy announcement.

Going ahead we continue to expect another 25 bps rate cut in the June review and expect the yield on the Benchmark 10yr Bond to range between 7.20-7.50%. We expect the curve to steepen further and the Spreads securities (AAA Corporate Bonds / State Loans) to outperform the Sovereign curve.

With the fiscal concerns weighing on the market, Liquidity management by RBI will be an important factor for the markets and in this context the evolving global monetary Policy stance will play an important role. What kind of Liquidity injection tools RBI will use will have a bearing on the market yields and the shape of the yield curve.

We would advise Investors to stay invested at the shorter end of the Curve as we believe that RBI will have to inject further liquidity into the markets for the effective transmission of the rate cuts which will be supportive of the shorter end of the curve and for Spread assets like AAA bonds and SDL's.