PGIM India Mutual Fund

RBI Policy View

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Steady and Cautious…

The MPC policy today was on expected lines. Status quo was maintained on policy rates and the monetary policy stance. Just like the last MPC meeting the decision on policy rates and the monetary policy stance was not a unanimous one with Prof. Varma voting for a rate cut along with the change in monetary policy stance to "Neutral". The undertone of the policy was cautious though the RBI Governor, in his statement, acknowledged the fall in Inflation by referring to Inflation as the elephant which has gone for a walk and appears to be returning to the forest. The fall in "core "Inflation was also acknowledged. After acknowledging the significant fall in Inflation, the governor's statement reiterated that Inflation was still above 4% target and that the fall in Inflation should be on durable basis.

RBI retained both its Inflation and Growth forecast for FY25 at 4.50% and 7.00% respectively. The MPC statement mentioned the strong growth momentum in the economy by highlighting the second advance estimates of the real GDP for FY24 which had come in at 7.60% and the manufacturing and the services PMI at multiyear highs. RBI's survey consumer confidence one year ahead also reached a new high. On the global economy both the RBI governor's and the MPC statement highlighted the resilient nature of the current growth cycle along with the stickiness of services Inflation in the advanced economies. Just like the last time, the RBI governor, in his statement, again highlighted the elevated level of public debt in advanced economies which is raising concerns on macroeconomic stability in such countries while in India's case the fiscal consolidation path and improved growth prospects can lead to the general government debt coming down gradually. The governor's statement quoted IMF, which projects India's general government debt to come down to 80.50% of GDP by 2028 from 88.50% of GDP during the pandemic year 2020. In contrast IMF expects the gross public debt to GDP ratio of advanced economies to increase to 116.3% in 2028 from 112.30% in 2022 thus highlighting India's relatively strong economic fundamentals which, in a way, has led to lower volatility of INR. RBI mentioned that India's strong underlying economic fundamentals and the continued strong growth momentum, provides the space to remain focus on Inflation and to ensure its descent to the target of 4% on a durable basis. Thus we read that today's policy had a cautious tone which emphasis macro stability amidst global economic and geopolitical uncertainty.

Market Reaction

In the run up to the policy, Bond yields had gone up in response to higher US and global Bond yields as well as on higher crude oil prices. The benchmark 10yr bond yield went up by 3 bps today ending the day at 7.12%.

Our View: Rate cuts in Q3 CY2024

In our view, this policy stuck a cautious tone while acknowledging the gains in lower Inflation. In our view, RBI will await incremental data on food prices and the evolving cues on growth over the next couple of quarters before taking a call on policy rates.

We continue to believe that rate cuts in India will start from Q3 CY2024 onwards. Bond yields tend to react in advance of the start of a rate cutting cycle and given the favourable demand/supply dynamics in the bond markets we believe it is the right time for investors to start increasing their allocation to fixed Income especially at the longer end of the curve as we expect the curve to remain flat.

Investors with medium to long term investment horizon can look at funds having duration of 6-7yrs with predominant sovereign holdings as they offer a better risk reward currently. Investors having an Investment horizon of 6-12 months can look at the money market funds as yields are pretty attractive in the 1yr segment of the curve. We expect the benchmark 10yr Bond yield to gradually drift lower towards 6.50% by Q3 CY2024.