PGIM India Mutual Fund

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MPC Outcome – RBI comes out with heavy artillery

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To address the rising financial and credit market risks and to prevent any financial market disruption caused by the outbreak of the COVID epidemic, the MPC met earlier than scheduled (early April) and agreed to release a barrage of measures.

Reminiscent of the measures announced at the time of the Global Financial Crisis 2008, the current package was comprehensive in ticking all boxes ranging from rates to liquidity and regulatory forbearance, all of which were equally deserving of attention.

Besides, the MPC also took cognizance of the frozen credit markets, addressing them with specific and directed measures. We list each of these key measures detailing their impact on the markets.

1. **Rate Easing**

   In one swoop, RBI slashed the repo rate by 75 bps from 5.15 to 4.40%. To be sure, the rate cut was approved with a 4:2 majority with 2 members voting for a lower 50 bps cut. Importantly, RBI also made an asymmetric cut to the "reverse repo rate" lowering it by 40 bps thus widening the Liquidity Adjustment Facility (LAF) corridor from the existing 50 bps to 65 bps. The MSF (Marginal Standing Facility) rate remains at 25 bps over repo. Given the surfeit of liquidity already in the system which is expected to get complemented by the new measures, the "reverse repo" almost becomes the new operative rate. Thus, the rate cut is more like 90 bps going forward. Besides, given the assurance that the RBI stands ready to act if needed, we expect the Overnight rates (CROMS, TREPS, Call Rates) to remain anchored at or below 4% in the foreseeable future.

2. **Liquidity**

   The system liquidity in the last few months has remained well in surplus mode with daily LAF balances averaging close to INR 2.5 to 3.0 lakh crore. Despite this, the system has witnessed certain wrinkles from time to time caused by temporary dislocations, more so since the first week of March. To add, FPIs have been continuous sellers in the Indian bond markets ever since the start of the crisis. Year till date, FPIs have sold INR 63,000 crore (INR 52,000 crore in March alone) of Indian bonds (c. USD 8.4 bn). Almost 90% of these sales have been in G-Secs. This pressure was partly offset through OMOs of INR 40,000 crore completed by RBI in March.

   To pre-empt liquidity dislocations from causing either solvency or market disruption issues and /or interfere with rate transmission, RBI decided to further unskew the distribution by a massive 100 bps cut in the Cash Reserve Ratio (CRR) rate, bringing it down to 3% (from 4% earlier). This is effective from the fortnight starting March 28th and hence its impact will be felt almost immediately. RBI has repeatedly stated and emphasized the need to use the lever of liquidity to hasten rate transmission in the past and in our view, this takes it forward.

   RBI also permitted banks to tap an additional 1% (raised from 2% to 3%) from the MSF window to the extent of their Statutory Liquidity Ratio (SLR) holdings. This will be able to those banks which have excess SLR holdings.

   The cumulative impact of these measures is expected to fully release almost INR 3.7 lakh crore (c. USD 50 bn), the highest that the Indian financial markets have witnessed till date.

3. **Credit Markets**

   LTROs (Long Term Repo Operations) of INR 1 Lakh crore. To aid rate transmission in an otherwise liquidity clogged pipeline, RBI in the past few months has been experimenting with the practice of supplying low cost term money to banks (given at the repo rate) to be on-lent. However, most banks have been readily exploiting the arbitrage existing between repo and G-sec yields (3 years) to deploy most of this money.

   At a time when credit markets are almost in a state of freeze with bonds up to 3 years of AAA-rated corporates trading at 8.50 % to 9.0%, RBI announced targeted LTROs at the meeting. The measure has now specified the end use restriction for this money (up to INR 1 Lakh crore to be issued) to be deployed equally through the Primary and Secondary markets only into investment grade securities covering Commercial Papers and Corporate Bonds. Additionally, to insulate the banks from any Mark to Market (MTM) volatility on such investments, RBI has allowed them to move these fully into the Held to Maturity (HTM) category. In the last few weeks, money and corporate bond markets have witnessed a surge in yields with short term CPs rising to almost double digits (9-10%), translating to a 400-bps spread over the extant repo rates. Similarly, Corporate bond volumes had collapsed with hardly any buyers in this segment.

4. **Regulatory easing and forbearance**

   This is a critical pillar necessitated by the need to maintain financial stability of the system, specially banks, given the risk of likely uneven repayments especially from borrowers in the informal segment, SME and MSMEs. As an immediate measure, the RBI has permitted a "repayment moratorium" on all "term loans" from borrowers covering retail and institutional for the next 3 months. Interest on working capital loans can also be deferred for the next three months (which is otherwise paid on a monthly basis).

To be sure, this is not a “waiving off” of repayments, but only a deferment. Hence, non-repayment will not lead to an asset quality deterioration for banks and exert pressure on an otherwise capital starved banking system. To clarify, this easing is only for term loans and not for any capital market instrument. Hence non-repayment / delay on CP / NCDs and other market instruments will attract the usual rating actions. Also, the introduction of the last segment of counter-cyclical capital conservation buffer aggregating 62.5 bps under Basel III which was to kick in from April 1 has been deferred until Sept 30th.

Credit

What has not happened at this stage is RBI acting as a direct buyer of the last resort in Corporate Bonds (akin to what has been instituted by the Fed, which is buying both Corp bonds and agency MBS and other credit instruments). RBI has preferred to act through banks. Since RBI has maintained that it will look at the evolving situation, a step to have an SPV in place to buy troubled Corporate securities as a proxy to the Fed actions could be an alternative if things deteriorate.

Rate Outlook

Given the massive liquidity easing we expect the yield curve to steepen further. The long end should witness pressures going ahead from having to bear the burden of excess supply to meet growing fiscal gaps amidst falling tax revenues from weaker future GDP prints plus the cost of economic dole outs.

We expect the wall of liquidity to act as an anchor to short term rates. The 3 to 5 Year segment of the AAA corporate curve remains an attractive play. The longer end of the curve is likely to be slightly volatile as India’s fiscal situation remains under stress. We do expect further rate cut to the extent of 50bps in Q3 of CY20 as growth will remain anemic post the disturbance caused by COVID19.

Product Suitability

Investors with short term parking requirements such as Corporate Treasuries and retail investors (for their emergency funds) should look at the high quality PGIM India Overnight Fund and PGIM India Insta Cash Fund.

Investors with a holding tenor of more than 15 days should actively look at PGIM India Ultra Short-Term Fund and those with beyond a month can consider the PGIM India Money Market Fund.

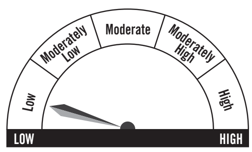
We would like to highlight the PGIM India Banking & PSU Debt Fund and PGIM India Premier Bond Fund as the products for risk averse and conservative investors with a three-year holding period as these products in our view hold out the best risk reward given our rate view.

Connect with us on: www.pgimindiamf.com 1800 2667 446

PGIM India Overnight Fund (An open ended debt scheme investing in overnight securities)

This product is suitable for investors who are seeking*

- Income over a short term investment horizon
- Investment in debt and money market instruments having maturity of upto 1 business day
- Degree of risk – LOW

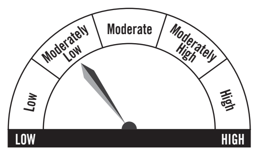


Investors understand that their principal will be at low risk

PGIM India Banking and PSU Debt Fund (An open ended debt scheme predominantly investing in Debt instruments of banks, Public Sector Undertakings, Public Financial Institutions and Municipal Bonds)

This product is suitable for investors who are seeking*

- Income over the short term
- Investment in debt instruments issued by Banks and Public Sector Undertakings, Public Financial institutions and Municipal Bonds
- Degree of risk – MODERATELY LOW

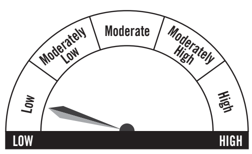


Investors understand that their principal will be at moderately low risk

PGIM India Insta Cash Fund (An Open Ended Liquid Scheme)

This product is suitable for investors who are seeking*

- Liquidity and generate income in the short term
- Investment in debt and money market securities with maturity upto 91 days only
- Degree of risk – LOW

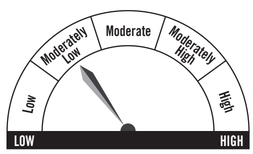


Investors understand that their principal will be at low risk

PGIM India Money Market Fund (An open ended debt scheme investing in money market instruments)

This product is suitable for investors who are seeking*

- Regular income for short term
- Investments in Money Market instruments
- Degree of risk – MODERATELY LOW

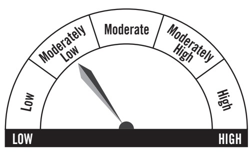


Investors understand that their principal will be at moderately low risk

PGIM India Ultra Short Term Fund (An open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 months to 6 months)

This product is suitable for investors who are seeking*

- Income over the short term
- Investment in short term debt and money market instruments
- Degree of risk – MODERATELY LOW

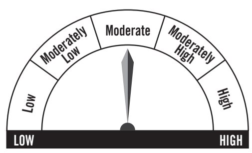


Investors understand that their principal will be at moderately low risk

PGIM India Premier Bond Fund (An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds)

This product is suitable for investors who are seeking*

- Income over the medium term
- Investments predominantly in AA+ and above rated corporate bonds including bonds
- Degree of risk – MODERATE



Investors understand that their principal will be at moderate risk

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