



Status quo on rates and continued dovish stance

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Policy outcome

The Monetary Policy Committee (MPC) at its meeting held today, voted unanimously (6-0) to maintain status quo on key policy rates. The policy retained a dovish tone spelling continuity on all counts. The MPC voted for an “accommodative stance” stretching into next financial year as well to help revive growth. While silent on rate easing, RBI cautioned by referencing high and sticky CPI inflation which was constraining monetary policy.

RBI's outlook on key variables

RBI clearly acknowledged surplus system liquidity and very easy monetary conditions in the money and bond markets. While silent on forex inflows and their sterilization, RBI reiterated follow through of OMOs to maintain yield control and rate transmission. RBI showed no concern as yet on any likely spill-over effects of this liquidity either to capital markets or interfering with risk pricing by banks. Clearly prioritizing growth for now, RBI refrained from any measures to drain out some of this liquidity. Overnight rates which are almost 30 bps lower than the reverse repo, are hence likely to remain anchored to those levels.

While continuing to ‘look-through’ high inflation for now, RBI had a word of caution, noting the sticky prints and sustained rise to over 7.5%. While refraining from sounding hawkish on inflation, RBI expressed how the high CPI was ‘constraining’ monetary policy space. This should be interpreted as very remote chances of a policy rate cut until CPI falls to levels close to / below 6% in a sustained fashion. The MPC raised their CPI forecast by almost 100 bps for Q3 (to 6.8%), Q4 (to 5.8%) and also H1-FY 21 (4.6%-5.2%).

Notably, inflation on metals and commodities globally is picking up again. Many metals such as copper, aluminium and steel are at multi year highs. Oil has stabilized in the mid 40s, with demand data turning out quite strong. As such raw material inflation may prevent the core from falling materially even as food inflation could soften a bit from better output – both on grains and perishables.

On growth, RBI sounded positively surprised taking on board improvement in high frequency indicators such as double digit growth in passenger vehicle and motor cycle sales, railway freight traffic and electricity consumption. RBI lowered the full contraction (GDP) for FY 2021 to 7.5% from 9.5% (as put out at the last policy).

View on bond yields and recommended products

Markets welcomed today's actions particularly the non-action on draining out the liquidity surplus for now. Benchmark bonds rallied marginally post the policy. Across the curve there is a mild buying bias though not a strong rally.

The strong economic rebound combined with high and sticky inflation practically eliminates monetary room for a cut. By upping the inflation forecast, RBI has signaled to the market that it is cognizant of these risks though it stopped short of sounding hawkish. Pending borrowing program for this fiscal and expected normalization as the vaccine becomes a reality, means that the odds favouring outperformance at the long end is steadily declining.

RBI's yield control measures through targeted Open Market Operations (OMOs) will prevent any sharp upswing in long end yields for now. As the borrowing program comes to an end over the next few months and economy rebounds, RBI could signal its first steps at a pull-back through liquidity normalization. This could happen in myriad ways such as compressing the rate corridor (which has widened to 65 bps from 25 bps pre Covid), part suction of liquidity and / or through lower bond purchases.

We are yet to see meaningful offsets on revenue mobilization though GST monthly collections are showing some green shoots. Asset sales (disinvestment) still remain slow. Corporate tax collections are yet to pick up meaningfully as well.

Given these factors, risk reward at the long end is hence diminishing a little. While overall risks appear balanced as of now, easy local and global liquidity and ultra soft interest rates may spur demand faster than expected. Hence upside risks are gradually emerging in our view.

We hence prefer to remain positioned in short and mid segment products with a 2-5 year duration, as these should witness lower volatility besides generating some ‘carry’.

We recommend the PGIM India Banking & PSU Debt Fund alongwith PGIM India Premier Bond Fund as suitable investment options for investors seeking moderate duration exposure and a preference for high quality (AAA) portfolio in the 2-5 year segment.

Long end remains tactical. PGIM India Dynamic Bond Fund and PGIM India Gilt Fund are recommended for investors with a slightly higher appetite for volatility to capture such opportunities.

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Riskometer

This product is suitable for investors who are seeking*:

PGIM India Premier Bond Fund

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



PGIM India Banking and PSU Debt Fund

- 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

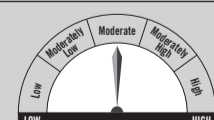


PGIM India Dynamic Bond Fund

- Regular income for short term
- To generate returns through active management of a portfolio of debt and money market instruments
- Degree of risk – MODERATE

PGIM India Gilt Fund

- Income over the medium term
- Investments only in Central/State securities of various maturities
- Degree of risk – MODERATE



*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

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