PGIM
India Mutual Fund

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RBI Policy: The Real Transmission

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Today's MPC meeting was all about the transmission of policy rate cuts as RBI announced the conduct of Long Term Repo Operations. The real action was in the **"Statement on Developmental and Regulatory Policies".** It was easily one of the most innovative and relevant meetings of the MPC for a long period of time. Similar to the ECB, the RBI will provide durable liquidity by way of LTROs of 1yr and 3yr maturity having a cumulative size of INR 1 trillion, starting Feb 15, 2020. The rate will be the Policy repo rate. **This is an effective step towards transmission of rates than the operation "Twist" done earlier by RBI.** In our view, LTRO's will be more effective in not only pulling down the yields on the sovereign curve but will actually lead to a spread compression between the AAA Corporate Curve and the Sovereign Curve, which will lead to a much better monetary transmission.

Going further, RBI has given incentive to banks for giving credit to specific sectors, banks will now be allowed to deduct the equivalent of incremental credit disbursed by them as loans for automobiles, residential housing and MSME's, over and above the outstanding level of credit to these segments as at the end of Jan 31, 2020 from their NDTL for maintenance of CRR. This exemption will be available for incremental credit extended up to Jul 31, 2020.

The Monetary Policy Committee (MPC) kept the benchmark Policy rates on hold as expected. The MPC decision was a unanimous one with all the members voting to hold rates. **The MPC maintained an accommodative stance stating that "The MPC also decided to continue with the accommodative stance as long as it is necessary to revive growth, while ensuring that inflation remains within the target."**

The CPI projection has been revised upwards with the Q4 FY20 inflation projection at 6.5% (revised higher from 4.5% in Dec-19). H1 FY21 inflation is projected to be in 5.0-5.4% range (revised higher from 3.8-4.0% range in Dec-19). Q3 FY21 CPI inflation projection has been given at 3.2%

The GDP growth is projected at 6.00% for FY2021.

The MPC noted that while the Inflation outlook remains highly uncertain, Growth continues to be weak and Output gap remains negative.

The MPC statement also stated that there is policy space available for future action.

Market Outlook:

This Policy has introduced the concept of long dated durable liquidity to the Indian markets and this step will be more effective in transmission of the Policy rates. RBI has been doing stealth easing by keeping banking sector liquidity abundant (in excess of INR 2.5 Trn) and by conducting Operation "Twist" in spite of maintaining status quo on policy rates. The start of LTRO's by RBI is a significant step in the same direction but it is more potent and effective Monetary Tool. This is likely to steepen the curve as there is a clear cut arbitrage now available to the market players in the segments where the LTRO is proposed to be conducted.

We also believe that this will reduce the spreads between the AAA Corporate curve and the Sovereign curve. The entire yield curve should benefit from this step though we expect the Shorter segment of the AAA corporate curve to outperform. We expect one more rate cut of 25 bps by RBI in second half of Calendar year 2020.

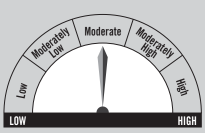
We would advise Investors to stay invested in funds like PGIM India Banking and PSU Debt Fund and PGIM India Premier Bond Fund of short to medium duration. Tactical Investors can also look at the PGIM India Dynamic Bond Fund.

Riskometer

This product is suitable for investors who are seeking*:

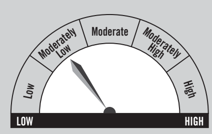
PGIM India Premier Bond Fund
- Income over the medium term
- Investments predominantly in AA+ and above rated corporate bonds including bonds
- Degree of risk – MODERATE

PGIM India 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



Investors understand that their principal will be at moderate risk

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



Investors understand that their principal will be at moderately low risk

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

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