PGIM
India Mutual Fund

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RBI Policy View

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Done but not Dusted

The MPC hiked the policy rates by 25 bps while retaining the monetary policy stance at "withdrawal of accommodation" with a 4-2 majority. The hike in the policy rate was as per market expectations though certain sections of the market, including us, were expecting change in stance to "Neutral."

The policy tone was slightly hawkish as it expressed concern on "Sticky Core Inflation" and the fact that RBI reiterated that FY24 inflation will remain above the 4% inflation target. The governor's statement mentioned that the real rates are now positive though it trails pre-pandemic levels and liquidity remains in surplus. Thus, the overall monetary conditions remain accommodative. RBI projected GDP growth at 6.40% for FY24 and CPI Inflation at 5.30% for FY24.

Market Reaction:

The Bond markets were slightly disappointed with no change in stance and yields were higher by 4-8 bps post policy with a flattish bias. Indian Bond markets have been trading in a narrow range over the last 3 months as markets started to anticipate the end of the rate hiking cycle.

Our View:

In our view, apart from the domestic inflation trajectory, RBI actions will continue to be influenced by the actions of Global Central banks especially the US Fed. Inflation has started to moderate both domestically and globally but at the same time global and domestic growth has been holding up better than expectations. INR has underperformed of late in spite of US dollar weakness and given our twin deficits (Fiscal and Current Account), we need to maintain interest rate differentials with developed economies especially with US, which has been coming down since last year.

RBI has, since May 2022, effectively hiked the operational rate by 315 bps (from reverse repo of 3.35% to 6.50% repo rate) and thus we think RBI may not need to hike further as with the current operating monetary framework the MSF rate (marginal standing facility) at 6.75% can become the operational rate if liquidity turns negative. Thus, bond markets will also be keenly watching the evolution of RBI's management of domestic liquidity. We expect the 10yr Benchmark Bond yields to trade in a range of 7.20% to 7.50% till March end.

We think this is the right time for investors to start building their Fixed Income Investment portfolio. We recommend investors should increase their investments in Short Duration category (4-6 years) with predominant sovereign holdings while selectively looking at Dynamic Bond Funds as per their risk appetite."