PGIM India Mutual Fund

June 08, 2022

RBI remains on course for further rate hike

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The Monetary Policy Committee (MPC) Policy today was broadly on expected lines as the policy repo rate was increased by 50bps. The Standing Deposit Facility (SDF) and Marginal Standing Facility (MSF) rates will now be 50bps higher, at 4.65% and 5.15% respectively.

The decision to raise policy rates was unanimous. The “accommodative” stance was dropped and was replaced with **“The MPC also decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth”.**

Thus the focus of MPC is now on withdrawal of accommodation. The growth projection for FY23 was retained at 7.2% while the inflation forecast was changed to 6.70%, higher than what the market was expecting. Market was expecting inflation forecast to be at 6.50%. RBI has assumed crude oil at $105 while making this forecast.

In its statement the RBI Governor has emphasised the supply side led nature of the current high inflation while at the same time reiterating that RBI has started a gradual and orderly withdrawal of extraordinary accommodation instituted during the pandemic.

Market Reaction:

Bond yields reacted positively to the policy as the hike was broadly factored in the markets. Some sections of the market were of the view that there can be an increase in CRR and /or rate hike of more than 50 bps. Thus, post policy there was a small relief rally across the curve with a steepening bias. The market had been a bit jittery in the run up to the policy and in the absence of any negative surprise, the yields were down by 7-10 bps at the short end of the curve and 2-4 bps at the longer end.

Our View:

The current inflation surge is a world-wide phenomenon led by higher asset and commodity prices. Central Banks across the world are removing the monetary accommodation which was provided in the aftermath of the pandemic. Thus, RBI’s conduct of the monetary policy will depend a lot on how things pan out globally, apart from the domestic scenario of growth / inflation dynamics. The swaps market is currently pricing in a 1 year forward rate of 7.20% (1year rate, 1year hence) and also that the RBI will be frontloading the rate hikes. While our view is that RBI will indeed front load the rate hikes, the 1year forward expectation of rates (current swap market pricing) may be on the higher side.

Hence, we would expect another 50bps increase in the August MPC meeting, the terminal repo rate might be in the vicinity of 6.50%. Thus we would look to tactically increase portfolio duration in our short duration actively managed products and **we would recommend that investors should increase their Investments in short duration products while selectively looking at dynamic bond funds as per their risk appetite.**

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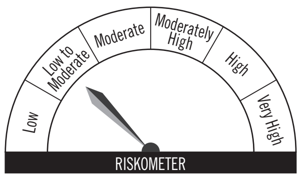

Investors understand that their principal will be at low to moderate risk

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