PGIM India Mutual Fund

RBI Policy View

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Puneet Pal
Head - Fixed Income

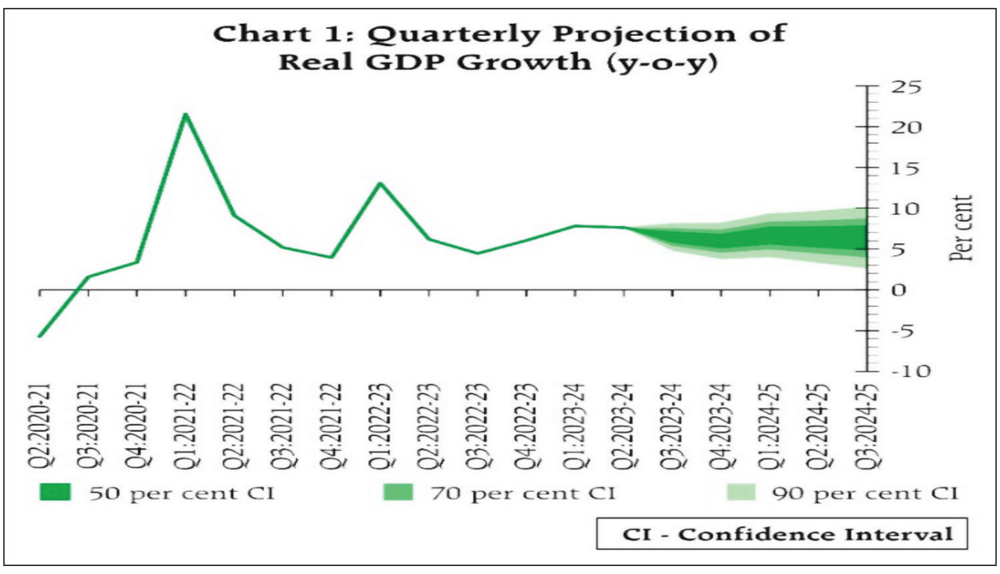
A Longish Pause…

The MPC policy today was on expected lines and devoid of any major surprises. As expected, status quo was maintained on policy rates as well as on the monetary policy stance. The decision on policy rates was a unanimous decision while the monetary policy stance of "Withdrawal of accommodation" was retained with a 5-1 majority as Prof. Varma, consistent with his earlier views, expressed reservation on the stance.

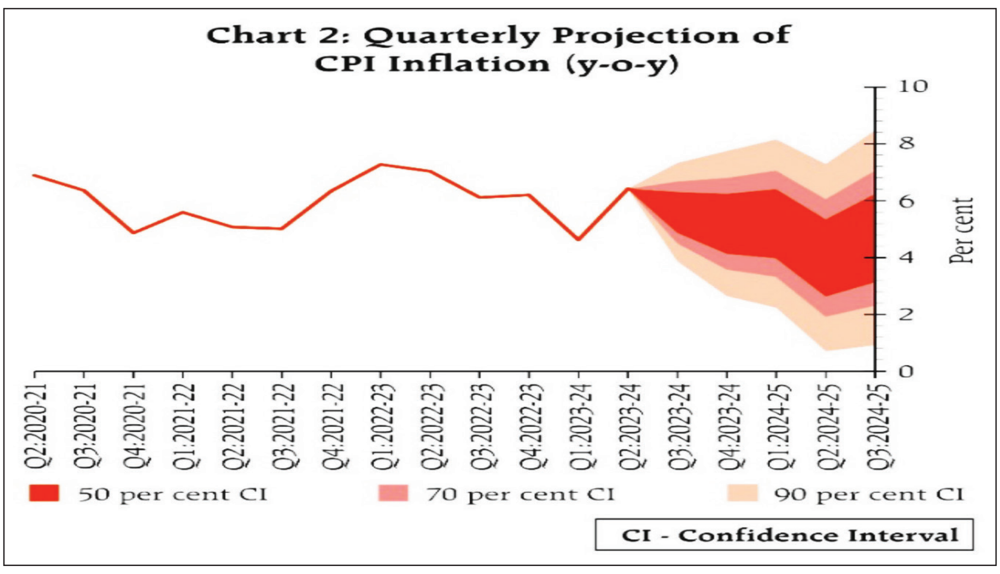
Taking into account the robust growth momentum and the recently released Q2 GDP growth numbers, RBI increased its FY24 GDP growth forecast to 7.00% from 6.50% earlier while retaining its Inflation projection at 5.40%. The MPC statement acknowledged the broad based moderation in core Inflation while also stressing on the uncertainty associated with Food Inflation and the need to contain any generalisation of food price Inflation.

The RBI governor, in his statement, mentioned that global economy remains fragile and the fact that easing Inflation in advanced economies has led to softening in global sovereign yields which are factoring the end of the rate hiking cycle.

The Governor's statement mentioned the gains made in stabilising Inflation through both monetary and fiscal policy and also the fact that growth remains resilient and robust which has surprised everyone on the upside. On liquidity, the governor's statement drew attention to the fact that after injecting liquidity in the aftermath of COVID-19, RBI has reduced the size of its balance sheet. RBI's balance sheet size has reduced from 28.60% of GDP in 2020-21 to 21.60% of GDP currently (Dec 1st 2023). The governor's statement also mentioned the risk of overtightening and did not explicitly mentioned about OMO sales going ahead.



Source: RBI



Source: RBI

Market Reaction

In the run up to the policy, bond market yields at the longer end had come done in line with the fall in crude oil prices and lower global bond yields over the last one month though the downward move in yields was muted as compared to the massive fall in global yields. Persistent tight liquidity had also negated the need for OMO sales, which RBI governor acknowledged in its statement today.

The market positioning was neutral/slightly positive going into the policy and the market was hoping that unlike the previous policies where the RBI tone was hawkish and there was some or the other negative announcement (I-CRR/OMO sales etc), this policy may not have any major announcements /measures and in the backdrop of falling commodity prices and global yields, RBI may refrain from any hawkish announcement.

Though this expectation proved to be correct as far as the policy was concerned, RBI, in the post policy press conference said that their current stance cannot be construed as neutral and that OMO sales were very much on the table and part of their toolkit for liquidity management. The fact that liquidity has eased of late and the fear that any further liquidity easing due to government spending may still lead to OMO sales led to profit booking and the benchmark 10yr bond yield ended the day 3 bps higher.

Our View: A long Pause

In our view, this policy has a dovish undertone. The RBI governor and the MPC statement acknowledged the moderation in core Inflation as past monetary policy action works through the system. The governor's statement mentioned about the risks of overtightening and unlike the previous policy today's statement did not mention OMO sales explicitly in terms of policy measure though in the post policy press conference RBI governor said that OMO option can be used, if required and the status quo on rates should not be construed as a neutral stance.

We believe the current macroeconomic backdrop has turned decidedly positive and the global monetary tightening cycle, which began in a synchronous manner globally last year, has taken a pause. Crude prices have fallen and global bond yields have retracted sharply from their highs over the course of the last one month. Given the fact that India's growth is pretty robust with Inflation also under control, RBI is likely to be on long pause. RBI will continue to focus on liquidity management and macroeconomic stability. FPI flows in debt market have registered a 6yr high after the inclusion of Indian sovereign bonds in the JP Morgan emerging market Index (GBI-EM). We expect these flows to continue, helping bond yields drift lower.

We continue to believe that rate cuts in India will start only after the rate cutting cycle has begun in the advanced economies which we expect from Q2/Q3 2024 onwards. Bond yields tend to react in advance of the start of a rate cutting cycle and thus we believe it is the right time for investors to start increasing their allocation to Fixed Income especially at the longer end of the curve.

Investors with medium to long term investment horizon can look at funds having duration of 3-4yrs with predominant sovereign holdings as they offer a better risk reward currently. Investors having an Investment horizon of 6-12 months can look at the money market funds as yields are pretty attractive in the 1yr segment of the curve. We expect the benchmark 10yr Bond yield to trade in a range bound manner between 7.10% to 7.35% over the next couple of months.