PGIM
India Mutual Fund

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A dovish and pro-growth policy, reiterating support to liquidity and yields

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The MPC meeting through an unanimous vote (6-0) decided to keep all key policy rates unchanged. With a view to reviving growth and sustaining it on a durable basis, the MPC decided to retain an accommodative policy stance while keeping liquidity in surplus mode. There was no mention or any indication in the policy of a likely exit date from loose monetary conditions for now.

In subsequent clarifications, the MPC also stated that it was “premature” to discuss liquidity normalization at the current stage and there were no plans to alter the policy stance either.

The policy undertone remained dovish referencing the serious human tragedy and economic destruction left behind by the pandemic. To alleviate the pain, RBI further announced sector specific measures with INR 150 bn on tap liquidity for the hospitality sector at repo rate for a tenor upto 3 years. Besides additional allocation of INR 160 bn has been earmarked for SIDBI under the Special liquidity funding line over and above the INR 150 bn announced in April.

On regulatory forbearance, RBI enhanced the scope of loan restructuring from INR 25 cr (announced in May) to INR 50 cr per account.

G-SAP program widened

In wake of the success of G-SAP 1.0, RBI announced G-SAP 2.0 for the 2nd quarter (July to Sept) raising the aggregate quantum by 20% to INR 1.2 trillion. The program is supportive of RBI’s narrative of anchoring benchmark yields to help in stabilizing the cost of capital for all stake holders.

Scope of the last auction under G-SAP 1.0 aggregating INR 400 bn to be held in June has been widened to include SDLs (of INR 100 bn), which is supportive for this segment.

The combination of the GSAP, which is pre-announced and on-going Open Market Operations (OMOs), which is more ad-hoc should help RBI exercise stronger “yield curve control” in the ensuing quarters.

For the next few quarters, we expect long end yields to remain range bound within a 5.90-6.25% band. Very short end yields are unlikely to rise sharply given that the reverse repo has not been moved and neither are there any actions around compressing the repo-reverse repo corridor for now.

Inflation forecast raised– FY 2022

Notably on inflation, RBI pegged its forecast at 5.1% for the full year FY 22. This was a marginal raise by 10 bps (0.1%) over the 5.0% forecast issued at the April meeting. Forecasts for each of the next 3 quarters in the fiscal have been raised by 10-20 bps.

RBI acknowledged downside risks to growth especially in the rural areas from the heightened spread of infections in the 2nd wave. Given this, RBI lowered the growth forecast for FY 2022 by 100 bps to 9.5%.

Despite an inflation forecast at the mid-point of the band, RBI did not sound perturbed, clearly outlining growth as a priority needing focused attention.

Recommendation

RBI in its policy statement drew reference to the success of the unconventional tools that have been deployed over the course of last year to manage yields and the record govt borrowing. RBI stated that it hoped that the market would respond appropriately to the G-SAP 2.0 announcement through an orderly yield behavior.

Over time, RBI has been getting more explicit in its guidance in capping benchmark yields at competitive levels. Post meeting, RBI clarified that it was looking at the entire yield curve and not only the benchmark.

With inflation forecast at 5.1% for FY 22 (raised by 10 bps at the meeting) and 1 year T bills at 3.70%, there already exists a negative real rate to the extent of 140 bps. It will be important to ascertain the point at which RBI deems it necessary to issue a market guidance to withdraw from the ultra-loose monetary conditions, since this will have implications for the front end of the curve and lead to some yield flattening.

Given that the benchmark 10 Y yields are anchored close to 6.0% (on the benchmark), there appears a limited case for yields to decline structurally. RBI has displayed an ability to cap yields successfully in the face of a record borrowing in fiscal 2021, which will be put to test again in FY 22. We expect tactical opportunities to play the long end yields. For most, the short and mid segments of the curve would be preferred operating zones.

Post today’s policy, we continue to prefer the Short / mid products such as the Corporate bond (PGIM India Premier Bond Fund) and PGIM India Banking & PSU Debt Fund together with the PGIM India Dynamic Bond Fund (for investors with ability to handle some yield volatility).

For investors with a shorter and less than 1 year horizon, we recommend the PGIM India Ultra Short Term Fund and PGIM India Low Duration Fund.

Riskometer

This product is suitable for investors who are seeking*:

PGIM India Low Duration Fund (An open ended low duration debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 6 months to 12 months)
- Income over the short term
- Investment in low duration debt and money market instruments
- Degree of risk – LOW TO MODERATE

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

PGIM India Premier Bond Fund (An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds)
- 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 (An open ended dynamic debt scheme investing across duration)
- 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 (An open ended debt scheme predominantly investing in Debt instruments of banks, Public Sector Undertakings, Public Financial Institutions and Municipal Bonds)
- 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 – MODERATE

Investors understand that their principal will be at moderate risk

PGIM India Ultra Short Term Fund (An open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 months to 6 months)
- Income over the short term
- Investment in short term debt and money market instruments
- Degree of risk – LOW TO MODERATE

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.