



RBI Policy: View from the Fixed Income Desk

Kumaresh Ramakrishnan
CIO – Fixed Income

RBI cuts key rates by 25 bps, slashes GDP target for FY 20 and retains a dovish stance

In line with market expectations, RBI today cut the key repo rates by 25 bps, being the 5th time in a row. Together with today's cut of 25 bps, the overall easing since February stands at 135 bps.

The Policy Statement also slashed GDP growth targets for the current financial year by 80 bps from 6.9% earlier to 6.1%. The sharp cut was based on continued softness in demand conditions, weak consumption and a below average investment climate. RBI also referred to the widening of the output gap as a result of weak demand which is further depressing fresh capital investment into new capacities. RBI's growth outlook as stated in the Monetary Policy report was rather downbeat, signaling some more near term downside risks.

Given the weak demand and growth conditions, RBI referred to its almost unchanged outlook on CPI which has also remained mostly benign in the last year. There has been some uptick of late in the headline prints which have been driven more by some reversal in food inflation stemming from price changes caused by supply disruptions triggered by the monsoon. Overall the Monetary Policy Committee retained the one year forward Consumer Price Index (CPI) target at 3.6%, which is well below the medium term target of 4%.

Since CPI remains well anchored and below 4%, RBI has shifted priority of monetary policy to address growth needs. Given this context, the Policy was rather forceful in stating that there existed adequate monetary space even after today 25 bps cut. Today's policy statement stated this in no uncertain terms and reiterated that the 'accommodative stance', would continue for "as long as was necessary to revive growth".

Besides, the Policy also reassured the market on system liquidity, stating that adequate liquidity would be provided to both aid and hasten monetary transmission. Easy liquidity conditions which could in part be supported by Open Market Operations (OMOs) also take away some of the bond market worries of absorption of any excess G sec supply in the second half.

The assurance of adequate monetary space in its armory, continued accommodative stance and adequate market liquidity favour both the front end (1-2 years) and short term (2 to 5 years) bond yields. We expect market yields to settle down over the next few days but retain a bullish bias going forward.

The very short end (upto 1 year) will experience low yields going forward while the long yield could face bouts of uncertainty as we move into Q4 of the financial year. Today's rate action and RBI's assurance to do more if needed is very reassuring for the bond markets and should help the entire bouquet of short term funds (2-5 years) benefit going forward. This segment in our view is the sweet spot for investors and should form the core of their fixed income portfolio allocation.

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