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RBI Policy View

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A Pause not a Pivot

A pause not a pivot, this is how the RBI governor choose to describe the outcome of the MPC meeting today. The MPC today unanimously decided to hold the policy rates while retaining the monetary policy stance at “withdrawal of accommodation” with a 5-1 majority. The MPC revised the inflation forecast for FY24 lower by 10bps to 5.30% and revised higher the growth forecast to 6.50%. The RBI Governor, in his statement, highlighted that the “policy rates have been increased by a cumulative 250 basis points since May 2022, which is still working through the system, there can be no room for letting down the guard on price stability. Taking these factors into account, the MPC decided to keep the policy repo rate unchanged at 6.50% in this meeting, with readiness to act, should the situation so warrant. The MPC will continue to keep a strong vigil on the evolving inflation and growth outlook and will not hesitate to take further action as may be required in its future meetings”. The statement also highlighted the recent turbulence in the banking sector of developed economies which have brought financial stability issues to the forefront.

In our view RBI seems to have taken a nuanced view of the evolving scenario as the developed economies face increasing growth headwinds with the inverted yield curves signalling an imminent growth downturn and steep rate cuts later in the year after the banking crisis in US and Europe. RBI has kept the window open for further rate action by refusing to acknowledge the end of the rate hiking cycle as risks remain on food inflation due to expected EL NINO and continued sticky core inflation though the bar for another rate hike is quite high given that the developed market central banks will likely pause on monetary tightening over the next one quarter. Thus we expect a long pause from RBI.

Market Reaction and Our View:

The market was divided going into the policy with the swaps market pricing in a 50% probability of a pause. Bond yields had also come down in the last couple of days and thus the pause decision had a relatively muted impact on the market with the yield curve steepening as the 5yr Gsec yield came down by 13 bps and the 10yr yield was down by 6bps. Going ahead the market will focus on RBI’s liquidity management and global yield movements. Supply pressure can negate any meaningful downside in yields and we expect the benchmark 10yr bond to trade in a broad range of 7.00% to 7.40% and the steepening bias to continue over the next one quarter. We recommend that 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.