The Monetary Policy Committee (MPC) decided to keep repo rate unchanged at **5.15%**. The stance of the policy remained “accommodative”. The decision to keep repo rate unchanged and the policy stance “accommodative” was unanimous by the 6 member MPC.

**Key takeaways**

- The path of CPI inflation was revised upwards from 3.5-3.7 % in H2:2019-20 and 3.6% for Q1:2020-21 to **5.1-4.7 % in H2:2019-20 and 4.0-3.8 % in H1:2020-21**

- GDP growth for 2019-20 is revised downwards from 6.1% in the October policy to 5%. H2:2019-20 growth forecast has been revised downwards from 6.6-7.2% to 4.9-5.5%

- The MPC noted that economic activity has weakened further and that the output gap remains negative. Some early signs of recovery in the investment activity has begun. The introduction of external benchmarks will strengthen monetary transmission

- As per the MPC, although there is space for further monetary action, they have decided to take a pause and gain clarity on the incoming inflation data as well as see off the measures taken by Government in the union budget and their impact on growth

**Market impact post MPC Announcement**

Pre Policy, the 10-year benchmark was trading at around 6.46%. Market was already pricing in a 25 bps rate cut and a dovish tone. The unanimous no cut in repo rate came as a surprise and markets sold off. The 10-year ended 15 bps up at 6.61%. The old 10-year also closed 18 bps above the pre-policy levels at 6.82%.

The yield curve bear flattened with the 4-year Gilt ending 22 bps up from pre-policy levels closing at 6.38% and 5-year Gilt closing 16 bps up at 6.32%. Corporate bond across segments closed 12 to 15 bps higher. Yields on 3 month CP/CDs to 1 year CP/CDs also ended higher by 15-20 bps.

**Outlook**

The markets have been negatively surprised and shocked by the MPC decision to hold rates. From our point of view - while the unanimous 6-0 nature of the pause in rate cutting cycle was definitely a surprise, we are broadly in sync with the thought process laid out by the RBI Governor while explaining the rationale behind this temporary pause.

We have been of the view that there is little incremental benefit at this stage to just mechanically cut rates in the desperate hope that growth would pick up, because majority of the issues plaguing growth are to do with various sectoral issues and require focused efforts by the government, including possibly fiscal measures. In this backdrop, to expect rate cuts as the panacea to our problems would have been just deluding ourselves.

With the next couple of inflation prints running over 5%, the MPC is likely to wait and watch out for the dis-inflation in the core CPI as well as the turnaround in food CPI before it commences any further rate cut. The longer end of the yield curve will be determined by Government stance on fiscal and union budget to be presented in 1st week of February. The RBI's downgrading of growth in
Over the past 6-8 months, we have written in detail about the merits of the 10-year AAA space, with a focus on the L&T Triple Ace Bond Fund. We continue to believe that for investors able to take MTM volatility, the 10 year AAA bond strategy is likely to perform well over a 2-3 year period, given the attractive carry. Breakeven analysis suggests that over an investment horizon of 3 years, even if yields move up by more than 125 bps for a 9-10 year AAA bond, the extra carry provided by that segment would still result in a total return which can beat the returns from a 2-3 year AAA bond.

Similarly, we also believe that - going forward - markets will start focusing on the less liquid AAA and AA rated papers of good quality issuers, which offer attractive credit spread over the liquid AAA papers - now in excess of 200 bps, compared to 40-60 bps a year back. For investors looking at products which benefit from the extreme credit risk aversion prevalent currently and the attractive spreads available on the less liquid bonds, the L&T Resurgent India Bond Fund is well positioned with attractive yield and spread pick-up while still having 70% of the assets in the AAA segment, and 30% in the AA segment.

For investors focused more on the shorter end of the yield curve, the good part of yesterday’s post policy sell-off is that accruals in funds such as L&T Ultra Short Bond Term and L&T Short Term Bond Fund will be somewhat better going forward. The risks of another 75-100 bps downward move in yields in these segments is now probably off the table, with the RBI MPC clearly showing their aversion to mindlessly cutting rates in a desperate attempt to support growth.
This product is suitable for investors who are seeking*

L&T 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)
- Generation of reasonable and stable income and liquidity over short term
- Investments predominantly in highly liquid money market instruments, government securities and corporate debt

L&T Short Term Bond Fund
(An open ended short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 1 year to 3 years)
- Generation of regular returns over short term
- Investment in fixed income securities of shorter term maturity.

L&T Triple Ace Bond Fund
(An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds)
- Generation of regular and stable income over medium to long term
- Investment predominantly in AA+ and above rated corporate bonds and money market instruments

L&T Resurgent India Bond Fund
(An open ended medium term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 years to 4 years)
- Generation of income over medium term
- Investment primarily in debt and money market securities

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

Source: RBI Press Release, Internal

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.