The Monetary Policy Committee (MPC) today reduced repo rate by 25 bps from 6.00% to 5.75%. The stance of the policy was also changed from “neutral” to “accommodative”. The vote was unanimous for both the rate cut of 25 bps and stance change to accommodative.

Our key takeaways

- The path of CPI inflation is revised marginally upwards to 3.0-3.1% in H1:2019-20 and marginally downwards to 3.4-3.7% in H2:2019-20, from the last policy with risks balanced on both sides
- GDP growth for 2019-20 is revised downwards from 7.2% in the April policy to 7.0% – in the range of 6.4-6.7% for H1:2019-20 and 7.2-7.5% for H2 – with risks evenly balanced
- The MPC highlighted several risks to the inflation outlook. The risks to inflation trajectory emanate from uncertainties relating to the monsoon, unseasonal spikes in vegetable prices, international fuel prices and their pass-through to domestic prices, geo-political tensions, financial market volatility and the fiscal scenario
- The MPC noted that growth impulses have weakened significantly and there has been a further widening of the output gap compared to the April 2019 policy. There has been a sharp slowdown in investment activity along with a continuing moderation in private consumption growth
- The headline inflation trajectory has been below the target mandated to the MPC
- Thus the MPC cut rates along with changing stance to accommodative to address growth concerns by supporting efforts to boost aggregate demand and reinvigorate private investment activity
- The RBI has constituted an internal working group to review comprehensively the existing liquidity management framework
- The RBI has proposed to rationalize existing regulations covering different money market products to improve the transparency and safety of money markets

Market impact and outlook post RBI MPC

Pre policy, the 10-year benchmark was trading at around 7.00% with most market participants expecting a 25bps rate cut. However, the market was divided on the stance change; in fact the majority of the market was expecting a ‘neutral’ stance. So the 25 bps rate cut along with an accommodative stance came as a positive surprise. Further, that the decision was a unanimous 6-0 vote also triggered rally in the bond markets with 10 gilts trading around 6.90%. 5 year gilts also traded better from 6.85% to 6.75%. Yields on corporate bonds in the 5 year and 10 year were also lower by 5-10 bps.

With an accommodative stance, there can either be a rate cut or a status quo in the next policy. With this rate cut of 25 bps, the MPC since December 2018 has cut repo rate by 75 bps from 6.50% to 5.75% and changed the stance from ‘calibrated tightening’ to ‘neutral’ to ‘accommodative’. We think that the next policy will be guided by more clarity on inflation trajectory especially with the factors like food prices movements, June and July rainfall across the country, crude price movement, some certainty on trade issues between US and China and core inflation prints. The RBI would focus on transmission or the cumulative 75 bps rate cuts and also debate on the space where the MPC has to lower rates in order to maintain 4% headline CPI. 5.75% on the repo rate is the lowest repo rate since the formation of the MPC.
**Investment Strategy**

The 1-3 year AAA corporate bond curve (PSU) ahead of the policy has already priced in a 25 bps rate cut and had rallied to 7%-7.30%. With repo rate at 5.75%, the **1-3 year AAA corporate bond segment still offers good carry over the repo rate** and funds such as the **L&T Ultra Short Term Fund and L&T Short Term Bond Fund** are **high credit quality funds positioned to benefit from this carry**, while keeping interest rate risks relatively low.

At the longer end of the curve, despite a positive fundamental outlook for interest rates, near term technical factors such as demand supply mismatch may keep longer end yields volatile and elevated. The corporate bond curve is very steep with the difference in yields between 10 year and 5 year paper of the same issuer is at 60 bps. Hence, **from a medium term perspective, we believe the longer end of the AAA corporate bond curve is an attractive investment opportunity, with spreads over G-Secs in the 80-120 bps range versus the historical average of 50-60 bps**. The **L&T Triple Ace Bond Fund** is well positioned in this segment.

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**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** (Formerly known as L&T Short Term Opportunities 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 primarily in securities issued by Banks, Public Sector Undertakings and Public Financial Institutions in India

**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

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*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._