The Monetary Policy Committee (MPC) as widely expected reduced repo rate by 25 bps from 6.25% to 6% while keeping the policy stance as “neutral”. 4 members voted in favor of a cut whereas the other 2 member voted for a status quo. The stance of the policy remained unchanged at “neutral”. 5 members voted for no change in stance whereas Dr. Ravindra Dholakia voted for an accommodative stance.

**Our key takeaways**

- The path of CPI inflation is revised downwards to 2.4% in Q4:2018-19, 2.9-3.0% in H1:2019-20 and 3.5-3.8% in H2:2019-20, with risks balanced on both sides.
- GDP growth for 2019-20 is also projected a bit downwards at 7.2% in the range of 6.8-7.1% in H1:2019-20 and 7.3-7.4% in H2 with risks evenly balanced.
- The MPC highlighted several risks to the inflation outlook. Although the short term food prices will stay lower in the near term, early signs of El-Nino effects and summer season can see upward pressure on vegetable prices. Although the fuel group showed softening in the recent prints, there is uncertainty in the sustainability of this drop. Crude price outlook remains uncertain.
- Core inflation has remained elevated through the year, but growth concerns can arrest the spike in the year ahead. Financial markets remain volatile reflecting in part global growth and trade uncertainty, which may have an influence on the inflation outlook and fiscal situation at the general government level requires careful monitoring.
- The rate cut is against the backdrop that output gap remains negative and there is a need to strengthen domestic growth impulse by spurring private investment.
- RBI has decided to increase the FALLCR by 2% of NDTL in a phased manner 0.50% increase every quarter for the year.

**Market impact and outlook post RBI MPC**

Pre Policy, the 10-year benchmark was trading at 7.22% with certain market participants expecting a change in stance from ‘neutral’ to ‘accommodative’. There was a small section which was expecting a 50 bps rate cut as well but the consensus was towards a 25 bps rate cut along with a change to accommodative stance aided by some liquidity measures. Therefore, just a 25 bps rate cut with a neutral stance came as a disappointment to the markets.

Post policy, gilt sold 12-13 bps with the 10 year benchmark trading at 7.34%. 5 year G-Sec closed 18 bps higher from the intraday low in yields. Corporate bond yields in the 10 year segment was up by 10-15 bps tracking 10 year G-Sec whereas in the 3-5 year corporate bond segment, the yields moved up by 10-15 bps.

While there is possibility of another 25-50 bps rate cut in this cycle, the timing and the quantum will depend on how much growth falls from the RBI projections and how the incoming data on inflation tracks the RBI projections. Our view is that there will be a pause in the June policy as the RBI will take a closer look on the inflation trajectory with incoming data, fiscal policy of the new government, internals of growth data, focusing on transmission of the back to back cuts by banks and continue to provide liquidity to the market to aid transmission.
**Investment Strategy**

With the 25 bps rate cut and RBI providing sufficient liquidity through OMO purchases, FX swaps and term repos, short end rates have come down significantly in the first week of April from 7.8%-8.3% in the 1 year -3 year segment to 7%-7.50%. Still the **1-3 year AAA corporate bond segment offers good carry over** the repo rate and funds such as the **L&T Ultra Short Term Fund, L&T Money Market 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 in the 80-120 bps range versus the historical average of 50-60bps. The **L&T Triple Ace Bond Fund is well positioned in this segment**.

Finally, while credit risk funds have witnessed turbulent times, given the IL&FS as well as NBFC / HFC scare and recently the loan against shares triggers, none of our funds have any kind of exposure to IL&FS and its SPVs and we have zero exposure to any kind of loan against shares. We believe that spreads offered by such funds are actually very attractive compared to the past. It is in times of such risk aversion, that issuers are forced to pay higher rates, which compensate adequately for their underlying credit risks. **Well managed funds, with a majority of exposures in the AA segment, offer a good risk –return tradeoff.**

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**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 Money Market Fund**
(An Open ended debt scheme investing in money market instruments.)
- Generation of regular income over short to medium term
- Investment money market instruments

**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.**