Monetary and Liquidity Measures:

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) at its meeting decided to:

- Reduce the policy repo rate under the liquidity adjustment facility (LAF) by 35 basis points (bps) from 5.75% to 5.40% with immediate effect.
- Consequently, the reverse repo rate under the LAF stands revised to 5.15%, and the marginal standing facility (MSF) rate and the Bank Rate to 5.65%.
- The MPC also decided to maintain the accommodative stance of monetary policy.

These decisions are in consonance with the objective of achieving the medium-term target for Consumer Price Index (CPI) inflation of 4% within a band of +/- 2%, while supporting growth.

The RBI also released Statement on Developmental and Regulatory Policies which included measures on Banking Regulation, Financial Inclusion and Credit flow to NBFCs, amongst others.

MPC’s Outlook:

In line with market expectations, the RBI reduced the Repo rate yet again in the fourth consecutive monetary policy since February 2019. However, the Repo rate cut of 35 bps came in as a bonus, as the market participants were largely expecting 25 bps cut in the Repo rate. Four members of the MPC voted for a Repo rate cut of 35 bps and two members voted for a cut of 25 bps. While reducing the Repo rate, the RBI’s policy stated, “Addressing growth concerns by boosting aggregate demand, especially private investment, assumes the highest priority at this juncture while remaining consistent with the inflation mandate.” Though the inflation projection for Q2FY20 was retained at 3.1%, that for H2FY20 was increased very marginally to 3.5%-3.7% from 3.4%-3.7% projected in June 2019 monetary policy. The inflation projection for Q1FY21 was kept below the 4% mark at 3.6%. While giving its projections on inflation, the RBI stated that the inflation trajectory would be influenced by factors like: possibility of sustained uptick in food inflation due to price pressures in vegetables and pulses, and possibility of uneven distribution of monsoon exerting pressure on food items (while recent catch up in rainfall may mitigate this risk); volatility in crude oil prices due to geo-political tensions in the Middle-East; soft outlook on core inflation; and lastly moderation in households’ one year ahead inflation expectations.

On domestic growth, the RBI revised the FY20 GDP growth projections downward to 6.9% (5.8%-6.6% for H1FY20 and 7.3%-7.5% for H2FY20) from 7% (6.4%-6.7% for H1FY20 and 7.2%-7.5% for H2FY20 projected in June 2019. GDP growth for Q1FY21 is projected at 7.4%. While revising the growth projections, the RBI stated that the risks are now ‘somewhat tilted to the downside’, instead of ‘risks evenly balanced’ mentioned in the June 2019 monetary policy. More importantly, the RBI acknowledged that economic activity continues to remain weak and that there are downside risks in the form of global slowdown and escalating trade tensions. The RBI also stated that benign inflation outlook, provides headroom for policy action to close the negative output gap.

Impact on the Bond Market and outlook:

The monetary policy seemed quite dovish, not only because the RBI chose to cut the repo rate by more than 25 bps, but also because the governor spoke about the RBI’s liquidity stance. On liquidity, the RBI governor said that the RBI will use the liquidity tools available with it to ensure that the day-to-day and durable liquidity needs of the system are met. This gives a lot of comfort on the liquidity front. Additionally, in this monetary policy, given the RBI’s projections on inflation, the RBI seems very comfortable on the inflation trajectory despite some risks. Also, the policy clearly shows that the RBI’s priority at this juncture is supporting growth, given that it has also announced measures to enhance credit flow to various segments of the economy. The monetary policy also ticked the box as far as maintaining financial stability is concerned. While the RBI believes, that previous rate cuts
are being transmitted gradually, and that transmission is likely to improve going forward, it stated that benign inflation outlook provides headroom for policy action to close the negative output gap. This gives ample reason to expect further monetary easing by the RBI going forward. When one looks outside India, wherein major economies of the world are also grappling with economic growth slowdown and their central banks now beginning to start monetary easing, expectations of more monetary easing are strengthened further. The 10 year benchmark G-sec yield declined very briefly today, after the announcement of the rate cut, however profit booking and possibly lack of clarity on the overseas sovereign bond issue led the yield to close higher than its previous close. Yield on the 10 year benchmark 7.26% 2029 G-sec closed at 6.37% compared to its previous close of 6.34%. Overall, the bond yields may continue to decline across the yield curve, given the expectations of further monetary easing, as well as positive liquidity stance of the RBI.

Investments in Medium Duration Funds can be considered with a horizon of 15 months and above. Investments into Short Duration Funds can be considered with an investment horizon of 12 months and above. Investors, who are comfortable with intermittent volatility, can also look at strategies that have allocation to the longer end of the yield curve, through Dynamic Bond Funds. Investors looking to invest with a horizon of up to 3 months can consider Liquid Funds, while Ultra Short Duration Funds and Arbitrage can be considered for a horizon of 3 months and above.

Equity Market outlook:
The RBI acknowledged that the economic activity has weakened further and that global slowdown and escalating trade tensions also pose risks to domestic economic growth. The RBI also stated that the aggregate demand and investment activity remain sluggish. Thus, the RBI revised the domestic economic growth projections downward to 6.9% for FY20 (5.8%-6.6% for HF1Y20 and 7.3%-7.5% for H2FY20) from 7% (6.4%-6.7% for HF1Y20 and 7.2%-7.5% for H2FY20) in June 2019. GDP growth for Q1FY21 is projected at 7.4%.

Key macro-economic data like declining GDP growth, IIP and exports along with weak auto sales are showing weakness. With the outcome of today's monetary policy, going ahead once the liquidity availability improves along with the improvement in buyer sentiments, the consumption demand may start to revive and thereby overall economy as well. However, it will be important to see how the consumption demand is picking up as any delay in revival of domestic consumption demand can be a risk to economic growth.

Given the expectation of further weakening in global economic outlook, most of the central banks worldwide continue to maintain their dovish stance with many even planning to provide further stimulus to enhance the growth either in the form of rate cut or increased spending. The government’s focus on giving a strong fillip to the rural economy and create more jobs is likely to drive the growth in the capital formation and improve demand conditions in the economy. From here on the Indian equity markets are likely to move on the back of improved corporate earnings and upcoming macro-economic data points. We remain positive on the Indian equity markets over the medium term and continue with our investment strategy to 50% lumpsum and rest 50% to be staggered over the next 3-4 months. From mutual fund investment perspective, focus should be on Large cap Funds and Multicap funds for Lumpsum investments, while SIP could be considered for Midcap and Smallcap funds with an investment horizon for 2-3 years.

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HDFC Bank House, 1st Floor, C.S. No. 6 \ 242, Senapati Bapat Marg, Lower Parel, Mumbai 400 013. Phone: (91)-22-66521000, ext 1311, Fax: (91)-22-24900983 \ 24900858