AXIS BANK

RBI MONETARY POLICY

APRIL 2019

HIGHLIGHTS

RBI cuts rates again in benign inflation, softer growth environment, neutral stance held

RBI's First Bi-monthly Monetary Policy Review: 2019-20
RBI cuts its benchmark repo rate by 25 bps to 6.00% (4-2 votes), but maintains its stance at neutral (5-1 votes). Further easing bias visible, but transmission will likelier be priority in the near term

Policy Actions
Repo, reverse repo, MSF & bank rate cut by 25 bps, CRR held constant at 4%.
Policy stance held at neutral

GROWTH-INFLATION DYNAMICS

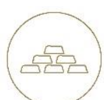
RBI revised inflation projections further downwards to 2.9%-3.0% for H1FY20 (from 3.2%-3.4% in Feb policy), and 3.5%-3.8% for H2FY20 from the 3.9% for Q3FY20 in February. Driving the downward revisions were lower than projected prints for headline inflation, signs of stabilisation in core inflation and further softening in inflation expectations at both households and industry.

Risks to inflation were seen as broadly balanced, with risks to food inflation from El-Nino and a possible rebound in vegetable prices in summer months, from the fall in firewood and chips prices proving unsustainable and also from fiscal stress. Balancing these were the effects of weaker growth. Global factors, including oil prices, trade uncertainty, and growth were seen as risks on both sides.

FY20 growth projection was lowered to 7.2% from the earlier 7.4%, in line with the slowdown seen in high frequency indicators and anecdotes. Risks were seen as evenly balanced, with weaker capex and global growth balanced by resilient private consumption (strong consumer confidence), public spending in rural areas, still-high business confidence and higher overall flows to the financial sector

LIQUIDITY AND EXTERNAL SECTOR

Liquidity conditions are now firmly in deficit mode, despite heavy OMO purchases through FY19 and the maiden FX swap carried out at end of March. Deficient conditions will likely remain even if swaps and OMOs continue, given seasonal currency note demand. These conditions have prevented the transmission of softer CP and bond yields into bank lending rates.



The external sector currently looks favourable, with global growth worries placing central banks on pause, and stronger sentiment driving risk on and carry flows back into emerging markets. Chatter of a US/China trade deal in final stages have also helped, and growth worries are now lessening slightly. The environment remains uncertain however and continues to be watched.

POLICY STANCE AND GUIDANCE

The MPC maintained its stance of neutral, signaling that the latest move was not the start of a fresh easing cycle. Guidance remained of data dependence, though transmission of rate cuts so far will likely be the focus in the near term, rather than further easing. In the year ahead however, we retain an easing bias.

MUTUAL FUND RECOMMENDATIONS

IMPACT ON THE MUTUAL FUND INDUSTRY:

Liquid Funds:

These schemes will continue to generate returns above the repo rate due to their portfolio composition i.e. being invested at the shorter end of the money market segment. Liquid funds have low average maturity as they concentrate more on high quality papers including 1 month CDs, or CDs with residual maturity of 2 months. These funds may be considered for parking short term (up to 3 months) surplus money.

Ultra Short Term / Low Duration / Money Market Funds (Maturity Up to 1 Year):

These schemes predominantly invest in below 1 year maturity paper. The strategy adopted by these schemes is to hold the paper till maturity and capitalize on the running yield. Hence, returns in this category will continue to remain relatively attractive over liquid funds depending on the positioning of the fund.

Short Term Income Funds:

Schemes in this category are predominantly invested in Corporate Bonds, CPs and CDs while a few of them also have some exposure to G-Secs. We continue to remain bullish on the shorter end of the curve. Investors may consider these funds with a time horizon of 12 to 18 months and gain from current accruals and capital appreciation in the event of yields coming off.

Medium Duration & Credit Risk Funds: Schemes in this category from the Axis Select list are predominantly invested in Corporate Bonds. Given today's elevated yield levels compared to the past 9-12 months, investors may consider these funds that hold good quality credit papers (issued by well known corporate houses with strong corporate governance) as one can potentially benefit from accrual returns and the prospect of steady capital appreciation of the assets over a 3 year+ period.

MUTUAL FUND RECOMMENDATIONS

Long Term Income Funds / Gilt Funds / Dynamic Bond Funds: In last policy, the RBI spoke of focusing on growth apart from inflation. Post policy, intermittent data received have pointed to lower growth and softer inflation. Barring oil prices, which have risen on OPEC production cuts, there are growing signs of slower global growth resulting in lower global bond yields. In addition, the US Fed signaling that there won't be any more rate hikes in 2019 (on the backdrop of an impending US recession) may also have an impact on Indian bond yields. Furthermore, the current government's strong response to the border situation with Pakistan appears to have boosted the popularity of the ruling party which has also led to some traction on FIIs' inflows in the debt markets. Having said this, we will have to wait and watch on the developments of the upcoming general election where voting will take place in seven phases between April 11 and May 19 and results will be out on May 23.The spreads between 3 year corporate bonds and the 10-Yr benchmark paper has increased over the past few quarters on the backdrop of NBFC defaults, tighter liquidity and rally in g-sec yields. Though, spreads on corporate bonds continue to remain elevated in select pockets, implying that quality assets at the front end of the curve have become relatively more attractive at the current juncture. Shorter duration funds (short term, ultra short term, etc.) as well as funds which have the flexibility to play accrual in their portfolios (i.e. Medium Duration funds and Corporate Bond funds) assuming a 3 year+ investment horizon continue to offer superior risk adjusted returns compared to their longer end counterparts. Having said this, one should consider aspects such as exit load, capital gains tax and asset allocation amongst others while evaluating their investment options.

Conservative Hybrid Funds-CHF *(Erstwhile: Monthly Income Plans (MIPs)*: With between 10% to 25% allocation to equity, returns of CHFs are largely determined by the vagaries of the equity markets as against the debt markets. These funds are therefore suitable for investors who have a reasonably long time horizon and are comfortable with taking exposure to equities.

OUTLOOK

IMPACT ON THE MUTUAL FUND INDUSTRY:

The MPC continued to indicate that it was moving to support growth, specifically private sector capex, given recent softness and the benign inflation environment ahead. Risks are posed by the upcoming general election, with the choice of policies of the new government likely to bear on policy going forward. The state of the monsoon will also help gauge food inflation better, and will feed into the decision making process.

We remain constructive **on the shorter end of the yield curve; short term duration funds, Banking & PSU Debt Funds, Low Duration Funds and Ultra Short Duration Funds can be considered by investors with an investment horizon commensurate with the maturity profile of the schemes. Medium duration funds and Corporate Bond funds forming a part of the Axis Select list can be considered by investors with minimum investment horizon of 24 to 36+ months** to benefit from accruals and ensuing capital appreciation in the event of yields heading lower.

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