



August, 2019

The Monetary Policy Committee (MPC) reduced repo rate by **35 bps** from **5.75% to 5.40%**. The stance of the policy remained unchanged at 'accommodative'. Four members of the MPC voted to cut rates by 35 bps, whereas two members voted to cut rates by 25 bps.

Our key takeaways

- The path of CPI inflation remains unchanged from that given in the June policy. CPI is projected at 3.1% for Q2 2019-2020, 3.5-3.7% for H2 2019-2020 and 3.6% for Q1 2020-2021
- GDP growth for 2019-20 is revised downwards from 7% in the June policy to 6.9% – in the range of 5.8-6.6 per cent for H1:2019-20 and 7.3-7.5% for H2 – with downside risks. GDP growth for Q1 2020-2021 is projected at 7.4%
- The MPC noted that inflation will stay in the targeted range over the next 1 year. The MPC also noted that domestic activity continues to remain weak, along with added concerns of global slowdown and escalating trade tensions. Private consumption as well as investment activity remains sluggish. The benign inflation outlook provides room to cut rates in order to close the output gap
- On the regulatory side, RBI has reduced the risk weight for consumer credit which includes personal loans but excludes credit card receivables from 125% to 100% which is a positive for consumer lending by the banks
- In order to further enhance credit flow to NBFCs; banks' exposure to a single NBFC is increased from 15% of its Tier 1 capital of the banks to 20% of the banks' Tier 1 Capital
- RBI has allowed bank lending to NBFCs (other than MFIs) for on-lending to Agriculture up to ₹10.0 lakhs; Micro and Small Enterprises up to ₹20.0 lakh and housing up to ₹20.0 lakh per borrower to be classified as priority sector lending

Market impact and outlook post RBI MPC

Pre Policy, the 10-year benchmark was trading at around 6.32-6.34%. The market was already pricing in a 25 bps rate cut and a dovish tone which is what the MPC delivered. **Post policy, the curve steepened with the 5-year Gilt closing at 6.15%, down 7 bps, whereas 10-year Gilt closed at 6.37%, up 3 bps.** The spread between the 5-year and the 10-year Gilt is now 22 bps. **The spread between the 10-year and 15-year Gilt has also widened considerably and stands at 35 bps.**

We believe we are nearing the end of the rate - cutting cycle, with the terminal rate likely to be in the range 5-5.25%. While there is a risk that a further dramatic collapse in the global backdrop could lead RBI to take further extraordinary measures, in the current context – globally and domestically – we believe RBI has already done its bit in terms of the series of rate cuts since early this year and most importantly, the surplus liquidity provided to the system. The rest of the growth revival measures need to come from the side of Government of India.



Investment strategy & fund recommendations

From a longer end G-Sec perspective, ***we believe we are nearing the lower end of the band with 10 year G-Sec yields likely to bottom in the 6.00-6.25% zone.*** G-Sec supply is still an issue, especially, given the need for fiscal support for the economy, increasing likelihood of shortfall in revenues, and importantly lack of OMO support from the RBI on the backdrop of positive flush liquidity in the system. There remains confusion over whether the USD sovereign bond will go through this year, and if not – that will bring back that much more supply to our local bond market.

However, ***where we remain very positive is with regard to the AAA corporate bond curve and spread over G-Sec.*** With liquidity likely to remain positive over the coming year atleast, and bank deposit rates likely to move sharply lower, ***we expect the short to medium part of the curve to move lower significantly from current levels.***

We would continue to encourage investors to look at products such as the ***L&T Banking & PSU Fund (a passive 3.5-year roll down strategy) and the L&T Short Term Bond Fund which invests predominantly in the 2-5 year part of the AAA corporate bond curve.*** These funds have a yield pickup over G-Sec of upwards of 100-120 bps, which we believe can fall towards the 50-60 bps range or potentially even lower, given the chase for the limited supply of high quality AAA assets in this space.

The L&T Triple Ace Bond Fund, which invests in the 2028-29 maturity segment, with investments in the highest credit quality AAA corporate bonds is also a good carry product, especially in comparison to tax free bonds. While the underlying government bond yields are somewhat lower than the longer term fair value, ***we are still positive in our outlook for the spread of AAA corporate bonds over G-Sec,*** which currently continues to be in excess of ~100 bps, versus the long term average of 50-55bps. We expect that this spread will compress over the coming quarters, thereby allowing corporate bonds to outperform underlying G-Sec s.

For investors looking at products which benefit from some of the credit risk aversion prevalent currently and the attractive spreads available on the less liquid bonds, the ***L&T Resurgent India Bond Fund is ideally positioned with attractive yield and spread pick-up while still having more than 70% of the assets in the AAA segment.***

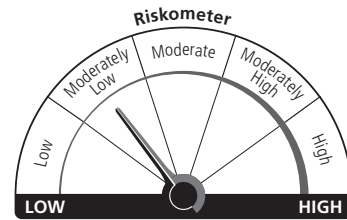


This product is suitable for investors who are seeking*

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 in fixed income securities of shorter term maturity.



Investors understand that their principal will be at moderately low risk

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 Banking and PSU Debt Fund

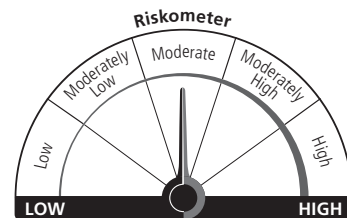
(An open ended debt scheme primarily investing in debt instruments of banks, public sector undertakings, public financial institutions and municipal bonds)

- Generation of reasonable returns and liquidity over short term
- Investment predominantly in securities issued by Banks, Public Sector Undertakings and Public Financial Institutions and municipal corporations in India

L&T Resurgent India Bond Fund (Formerly known as L&T Resurgent India Corporate 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 understand that their principal will be at moderate risk

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