DSP CONVERSE

TOPICAL CONVERSE: OCT RBI MPC

INTRO:

*"The current macroeconomic conditions and the outlook has **opened up policy space for further supporting growth**" – Gov Malhotra*

WE ADD DURATION

There were no surprises (for us). Anyway, the bar for rate cut was very high (our pre policy DSP CONNECT), because of rupee depreciation. We expected the Governor to sound more dovish, and he was.

Finally, after months, we are ready to add duration. **We will add duration.** We saw the change in tone in policy to add duration when the market sold off, and will selectively add to this utilizing any uptick in yields tactically and selectively.

Why add duration? And why only in tactical upticks?

WHY ADD DURATION?

As we have been saying in the notes (in post FOMC note and DSP TOPICAL CONVERSE in Sept) - it is not the central bank action but the central bank guidance that drives markets. Governor's statement "*opened up policy space for further supporting growth*" is that guidance.

And it is a thankful pivot from the June policy pivot of "*monetary policy has done all it could*".

WHY IN UPTICKS?

Because demand supply is still negative in Gsecs. The LCR regulations still mean that banks demand for Gsecs will continue to remain muted for next few weeks. Until then it is unlikely for yields to fall sharply (even though we remain positioned for it). We still maintain our position that yields will be substantially lower by Dec.

Since there is a floor for yields, we want to ensure that the bond purchases happen at an attractive rate.

MONEY MARKETS: EXPECT FURTHER FLATTENING

As rate cut expectations keep building we expect the curve to keep flattening. The short end of money markets would trade in a range as it gets swayed by liquidity and flows, but longer end of the money market should witness RBI expectations built-in. We have, and will continue to prefer longer maturity papers wherever possible.

WHAT GIVES US MORE CONFIDENCE?

Gov Malhotra displayed a sense of unease at such high yields (even stating that the yields could be 25bp lower). This is in stark contrast to earlier MPC, when RBI believed that repo rate was its only concern, and market traded instruments were a concern for market. Remember, in last Q&A when queried on spreads of long bonds, RBI replied that they do not bother about market yields. However, last week only they reduced the supply of long bonds to arrest the slide.

While it is not unknown for RBI to nurse the market (quite evident during Gov Das' tenure) – but the RBI backing (or sense?) gives margin of safety to long positions.

OUTRO:

*"As India strives towards achieving Viksit Bharat... it would need the **coordinated support of fiscal, monetary**, regulatory and other public policies to attain its goal." – Gov Malhotra*