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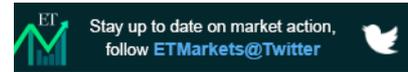
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# Expect Rajan to wait for monsoon outcome before cutting rates: Shobhit Mehrotra, HDFC Asset Management

By ET Now | 3 Jun, 2016, 03.02PM IST

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*It is very important that the monsoon plays out well, says Shobhit Mehrotra, Senior Fund Manager & Head of Credit, HDFC Asset Management. In a chat with ET Now, Mythili Bhusnurmath and Mehrotra share their understanding of the Indian economy. Edited excerpts:*



**ET Now: I think, it is all going to be about what the RBI does in lieu of all that is happening globally because their review meeting is before the Fed meet. So is it almost pre-empting what the Fed would do?**

**Mythili Bhusnurmath:** Well, yes, it is always a complex picture. It is complex domestically and if you add the external environment, it gets even more complicated. So the governor's task in India is never easy, particularly in a globalised environment and in such an uncertain environment, because post the global financial crisis, many of the basic fundamental principles of economics, at least macroeconomics, have broken down.

So it is going to be very difficult for the governor. By and large, the consensus is that he will opt to maintain status quo particularly since we do not know which way the Fed will act. There have been different kinds of voices speaking from the US Fed. So one really does not know whether the Fed will finally take the bull by the horns and raise rates now or whether it will do it in the July meeting or later still. At the moment, it makes sense for the RBI governor to maintain status quo because we will have to wait and see what the Fed does.

We also have the big issue of the FCNR redemptions coming up in September. So any hasty action to cut rates now if the Fed were to hike rates would not be very advisable. So the broad consensus at the moment is that the Reserve Bank of India will opt to hold its horses because if you look at the economy also, there does not seem to be much of a case.

Of course, the case for cutting rates and thereby triggering investment and growth was always a little suspect because interest rates as we have seen is not the only factor that guides investment decisions. By and large, I think we will have to wait and see, of course, because the governor can always pull a rabbit out of hat but by and large the broad consensus and I would tend to go along with that is that there is no case at the moment for the RBI to do any rate action.

At best, we might see something in terms of the guidance, in terms of RBI's own reading, what kind of preparation it has for the FCNR (B) redemptions but beyond that as far as interest rate is concerned, I would not expect anything at all.

**ET Now: Is that the view on the street - given local and global factors, status quo on rates?**

**Shobhit Mehrotra :** Yes, that is the view. Most market players expect RBI to stay on hold, to be on wait and watch mode, to wait for to see the outcome of monsoon, to get past the Brexit on 23rd June and also the FOMC. RBI has all these events which they would want to wait and see what the outcome is and only thereafter maybe perhaps in August go ahead with a rate cut.

**Mythili Bhusnurmath:** As far as banks are concerned, it is very evident that RBI's rate action impacts banks' depositors, lending rates, everything almost immediately, of course, accepting that transition is not as efficient as it should be. But as far as mutual funds are concerned, is it a more an indirect effect? If the banks cut rates, would some regional investors go into mutual funds? How are mutual funds really impacted by anything that the RBI does?

**Shobhit Mehrotra :** Mutual fund investors on all long term products stand to gain. Investors in our short-term bond funds, income funds, gilt funds, if they have invested money before the rate cut, would stand to benefit because bond prices should rally if you get a rate cut.

Other than that, only the liquid fund investors would see their returns decline, because liquid funds are predominately invested in overnight rate linked assets. If the repo rates go down from six half to six quarter, the overnight lending happens around those rates and even the money market yields like on commercial papers or certificate, CDs, start moving lower.

Apart from the liquid funds, wherein the returns start heading lower, the other fund categories stand to benefit. So if investors have a view that RBI is likely to cut, if they invest before that, they all stand to benefit.

**Mythili Bhusnurmath :** If, as you said, they all stand to benefit in the case of debt funds, particularly longer term debt funds and given the

tax advantages that mutual funds enjoy vis-a-vis bank deposits, why is it that the subset of mutual fund investors so much smaller than that of bank depositors? Is there some lack of awareness of the "advantages" that mutual funds enjoy? Is not that they tend to be less easy to actually transact in? What is it that mutual funds see and what are they doing about it?

**Shobhit Mehrotra:** Actually, it is more about the volatility of the returns. The NAV volatility is one which really scares away a lot of investors. Other than that, I think investors have come in in big numbers. Over the last few years, the size of the industry has grown and has a huge scope to grow even further.

But it is the mindset of investors to look for fixed rate kind of return products such as [fixed deposits](#) which really is not encouraging them to come into mutual funds because the mutual fund NAV is changed on a daily basis.

The returns fluctuate and that acts as a deterrent for investors, because they start worrying when the NAVs fall.

If they have two-three-year investment horizon and they do not worry on the day to day fluctuations, then mutual fund is a very attractive investment product which retail investors should consider.

**Mythili Bhusnurmath:** Having talked about the Indian mutual fund industry, what is your sense of what Janet Yellen is going to be saying in her speech?

**Shobhit Mehrotra :** We do not expect too much of a change in the June statement. I think the event of Brexit being round the corner will put the US Fed on hold in the June policy.

I think that event has to be behind only then perhaps the Fed would be in a position to move which even the market expects that the probability of a hike in July is upwards of 50% so the chances of the June policy not changing the tone or tenor of the statement is very, very high.

**Mythili Bhusnurmath :** So even if there is no change in the tone and tenor and the Fed chairman seems to suggest that there is not going to be any action in June, will the governor opt to wait or will he take sufficient comfort and do something because his policy review is the very next day after her speech? Will he still prefer to wait and see what the Fed actually does or will the speech give him sufficient confidence about what the action is likely to be and will he go ahead with whatever he wishes to do?

**Shobhit Mehrotra :** I think RBI would give more importance to local factors. I think monsoon is far more important for us than what the US Fed does. So I expect the governor to stay on hold or wait to see the outcome of monsoon and by August if the monsoon progression is good enough, then perhaps he will have far more room to act on bringing down rates.

Hopefully, the progress and special distribution of monsoon by then should be clear and he should be in a position to act.

**Mythili Bhusnurmath:** The monsoon has a big impact really on [food](#) inflation and we have already seen that that government has announced fairly modest increases in the MSP, the minimum support prices. How do you expect them to play out together?

**Shobhit Mehrotra :** I think food inflation or food prices remaining under check is quite important. We have had two successive years of drought, the reservoir levels are extremely low. It is very important that we get the monsoon, get the rains and get our reservoir storage levels up.

I think post that, you could expect rural wages, the sentiment could change, rural incomes can be slightly better and then the rural demand kicks in.

So I think in the order of priority, it is very important that the monsoon plays out well and that helps, or at least allows food prices to remain under check. If not fall, at least they will remain under check and will not rise. So that to me is far more important.

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