

April 05, 2024



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*On expected lines, status quo on policy rates at 6.5% and stance as “withdrawal of accommodation”. FY25 inflation maintained at 4.5% even though the projection for 3 out of 4 quarters lowered. 2QFY25 expected to see inflation dropping below 4%, almost after 5 years. Despite elevated crude prices & food inflation, several comments like “Goal in sight” & “Elephant has gone to Forest” gives a dovish tilt on inflation. Fundamental factors remain healthy as reflected in FY25 GDP at 7%, manageable CAD and record high Fx reserve. Overall, it doesn’t disrupt the expectations of rate cuts in 2HCY24, in line with global rate cut cycle. Market focus will be back to fiscal demand-supply dynamics which looks extremely favorable with Government’s rapid fiscal consolidation over next 2 years, FPI inflows and particularly light G-Sec borrowing calendar in 1HFY25.*

## Key decisions/Highlights

Five out of six Monetary Policy Committee (MPC) members voted to **keep the policy rate unchanged at 6.50% while 1 member voted to reduce the policy rate by 25 bps.**

The **standing deposit facility (SDF)** rate remains **unchanged at 6.25%** and the **marginal standing facility (MSF)** rate and the **Bank Rate at 6.75%.**

MPC by a majority of five out of six members voted to remain focused on **“withdrawal of accommodation”** to ensure that inflation progressively aligns to the target, while supporting growth.

Consumer Price Index (CPI) inflation projected **for FY25 projected at 4.5% (retained)** with **1QFY25 at 4.9% (down from 5.0%), 2QFY25 at 3.8% (down from 4%), 3QFY25 at 4.6% (retained) and 4QFY25 at 4.5% (down from 4.7%).**

Real GDP growth projections for **2024-25 at 7% (retained)** with **1QFY25 at 7.1% (down from 7.2%), 2QFY25 at 6.9% (up from 6.8%), 3QFY25 at 7% (retained) and 4QFY25 at 7% (up from 6.9%).**

## Status quo on policy rates and stance maintained as “Withdrawal of accommodation” on expected lines; a non-event policy

Many factors have turned positive on both global & domestic front since the last policy announcement in February’2024. Global backdrop has turned more benign as many key Central Banks like US Federal Open Market Committee (FOMC), European Central Bank (ECB) & others have recently reiterated the high likelihood of rate cuts beginning over next few months. Switzerland’s Central Bank has already delivered a rate cut. Bank of Japan (BOJ) has ended the negative interest rate regime thereby addressing the overhang. Domestically also, core inflation has eased to a four year low of 3.4% in February’2024 and recent cuts by Government on LPG, diesel & petrol price is expected to provide 15-20 bps relief in headline inflation. Additionally, the lower-than-expected G-Sec borrowing calendar for 1HFY25 positively surprised the market with 1HFY25 gross borrowing pegged at Rs. 7.5 lakh crore, out of its total gross borrowing target of Rs. 14.13 lakh crore for the fiscal year. India’s external sector indicators have remained resilient; current account deficit for FY24 is expected well below 1%, and Foreign Exchange (Fx) reserves have strengthened to more than USD 645 bn (as on March 29, 2024). However, at the same time, crude prices have escalated again, and food inflation remains elevated.

Given this backdrop, RBI maintained status quo on policy rates and retained the stance as ‘withdrawal of accommodation’ as was widely expected. MPC adopted a dovish policy tone by indicating ‘goal is in sight’ and ‘elephant appears to be returning to forest’ signaling inflation is moderating and is towards the last leg of reaching the targeted 4%.

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## Active liquidity management to continue

Systemic liquidity has improved considerably in February & March owing to increased Government spending. RBI has been using variable rate repos (VRRs) and variable rate reverse repo (VRRR) to actively manage liquidity. These operations have aided in easing the overnight TREPs rate by 20-25 bps to 6.45%, thus reversing the stealth 25 bps rate hike undertaken by RBI in October 2023 through the indication of likelihood of OMO sales to withdraw liquidity. We expect liquidity to ease further in April as Government spending further picks up.

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## Growth outlook remains buoyant at 7% in FY25

India's growth momentum continues to remain strong on back of strong demand and improving global environment. The growth outlook draws strength from expanding manufacturing & service purchasing managers' index (PMI), strengthening rural demand, strong urban consumption, improving employment conditions, robust investment activity, improved business sentiments, healthy corporate balance sheets, continued focus on capital expenditure by government, improving global trade and external demand. However, the geopolitical tensions and rising Red Sea disruptions may pose downside risks to growth outlook and warrants monitoring.

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## FY25 inflation maintained at 4.5% even though the projection for 3 out of 4 quarters lowered

Headline inflation has come down significantly but continues to remain above the 4% target. Core inflation continued to moderate and fell to the multi-year low level of 3.4% in February. Fuel inflation has been treading lower and is expected to ease further owing to the recent LPG price cut. However, recent uptick in crude oil prices and uncertain food prices may pose upward risk to inflation trajectory. Despite this, RBI lowered the inflation projections for 1Q, 2Q and 4Q of FY25 with 2QFY25 inflation seen to be dropping below 4%, almost after 5 years. While acknowledging that inflation is on a declining trajectory and the goal is in sight, Governor highlighted the importance of maintaining close vigil during the last mile of disinflation to ensure inflation aligns to the 4% target.

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## We see a possibility of rate cut in 2HCY24 in line with global rate cut cycle

Global Central Banks are expected to begin the rate cut cycle in CY24 as they gain more confidence on inflation moderation. However, geo-political risks or supply side disruption can pose risk to the inflation trajectory and hence delay the rate cut cycle. India, so far, has largely remained insulated from global headwinds given the sound external factors like manageable current account deficit, healthy exports, higher foreign portfolio investment (FPI) flows, surging Fx reserves and stable INR. Strong external factors are expected to provide cushion to absorb global spillovers to an extent.

With moderating domestic inflation and healthy GDP, we continue to expect India to follow its global peers and start the rate cut cycle in 2HCY24. We believe MPC is also expected to precede the rate cuts with stance change from "withdrawal of accommodation" to "Neutral" and maintain relatively better systemic liquidity conditions.

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## Market Movement

Post the MPC announcement, G-sec yields hardened marginally by 1-3 bps across the curve. However, it was more of a reversal of gains over last 2 days which were observed as some market participants hoped for an outright chance of policy stance change to "Neutral". Today also marked the beginning of FY25 G-Sec borrowing calendar with the auction of Rs. 38,000 crore – biggest quantum of scheduled weekly auction for 1HFY25. Entire amount was easily absorbed by the market and in fact the new 10-year G-Sec benchmark cut-off yield came at 7.10% and later it closed at 7.09% by the end of day. It clearly reflects healthy demand from the investors.

Segment	Broad movement of yields in bps (as on April 05, 2024)	
	G-Sec	AAA Corporates
3 months	0 bps to -3 bps	-3 bps to -2 bps
6 months	0 bps to -2 bps	-3 bps to -1 bps
1 year	0 bps to -1 bps	-3 bps to -5 bps
2 -3 years	0 bps to +1 bps	0 bps to +1 bps
4 - 5 years	+1 bps	0 bps to +1 bps
10 years	+3 bps^	0 bps to +1 bps
14 years	+2 bps	NA
30 years	+2 bps	NA

Source: Bloomberg

^Pertains to old G-sec benchmark i.e. 7.18% G-Sec 2033

## Risk-reward is favourable for debt markets; time to go long on Duration

Even as the domestic rate cut cycle is some time away, current domestic market sentiment is already positive, with favourable fiscal demand–supply dynamics on the back of rapid fiscal consolidation, inclusion in the JP Morgan global debt index, and a very light G-Sec borrowing calendar in 1HFY25. We remain constructive on duration and believe investors can look at increasing allocation, depending on the risk appetite, toward funds like Gilt fund, Medium duration fund, Corporate bond fund, Banking & PSU fund etc. Markets, being forward looking will react much in advance to the expected policy stance change followed by rate cut cycle thereby upfronting the returns through spread compression over policy repo rate. Active fund management is critical as uncertainties may emanate from domestic inflation, fiscal supply and global backdrop which may influence various yield curve segments differently.

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