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Vikas Garg  
Head – Fixed Income



*MPC turns less hawkish and adopts a balanced approach. Pauses on policy rates for 5<sup>th</sup> consecutive time and retains the stance as “withdrawal of accommodation” as expected. FY24 Inflation projection unchanged at 5.4% despite higher food prices and much stronger GDP growth. Not much overhang of G-Sec OMO sales for now as systematic liquidity already in deficit and significant reduction achieved in RBI’s balance sheet. Risk-reward remains favorable for debt market with no rate hike expectations.*

## Key decisions/Highlights

Monetary Policy Committee (MPC) members unanimously decided to **keep the policy rate unchanged at 6.50%**.

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 at **5.4% (retained) in 2023-24 with Q3 at 5.6% (retained), Q4 at 5.2% (retained), Q1FY25 at 5.2% (retained), Q2FY25 at 4% and Q3FY25 at 4.7%**.

Real GDP growth projections for **2023-24 at 7% (up from 6.5%) with Q3 at 6.5% (up from 6%), Q4 at 6% (up from 5.7%), Q1FY25 at 6.7% (marginally up from 6.6%), Q2FY25 at 6.5% and Q3FY25 at 6.4%**

RBI has allowed reversal of liquidity facilities under both SDF and MSF even during weekends and holidays with effect from December 30, 2023 to facilitate better fund management by banks.

## Status quo on policy rates, stance maintained as “Withdrawal of accommodation”; on expected lines

Since the last MPC in October 2023 when RBI spooked the market by the indication of OMO sales, many factors have turned benign. On global front, US FOMC has likely peaked on policy rates as incoming data on inflation & more specifically jobs market have shown sign of moderation. Same is reflected in US treasury yields which have rallied by ~70-80 bps from the recent peak. Brent crude prices have softened to US \$75-80 per barrel from US \$90-95 per barrel in October, despite the production cut by OPEC+. India’s headline inflation as well as core inflation for last 2 months have come down more than market expectations. India’s systematic liquidity has turned deficit since last policy and overnight TREPs has been consistently at the upper end of policy rate corridor at 6.75%. While FDI inflow has moderated, FPI’s inflow has picked up well over last 2 months and Fx reserves have also surged by ~USD 10 billion since the last MPC alleviating pressures on INR to some extent.

Against the backdrop of these factors, market had expected a pause on policy rates and MPC didn’t surprise on that. MPC retained the policy stance as “Withdrawal of accommodation” as the near-term inflation concerns, especially on elevated food prices which again came as no surprise to market. While MPC maintained a very balanced & a nimble approach on forward policy actions keeping in mind inflation-growth dynamics, overall, it was a lesser hawkish statement than our expectations as the Governor underplayed the likelihood of OMO sales for now.

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## **G-Sec OMO sales overhang reduced for now; active liquidity management to continue**

In the last policy announcement, MPC has announced OMO sales for liquidity management which had spooked the market and had led to a sell-off. We had expected that MPC will not be as vocal about the use of OMO Sales as systemic liquidity has already turned deficit. Further, huge G-Sec maturities lined up in the month of December'23 & January'24 (~INR 1.38 trillion) are expected to be largely compensated by increase in currency in circulation (~INR 1.5 trillion). We believe the overhang of G-sec OMO sales is now reduced as systematic liquidity is expected to remain in deficit in December with advance tax outflow and as indicated by the Governor, significant reduction achieved in RBI's balance sheet (from 28.6% GDP in 2020-21 to 21.6% in current financial year up to December 1, 2023). For Q4FY24, government spending before the general elections and overall FPI inflows could drive the likelihood of OMO sales. In the interim, we believe RBI would actively manage liquidity through various policy tools like variable rate repo (VRR) and variable rate reverse repo (VRRR) to keep the systematic liquidity on tighter side.

## **Major boost on growth dynamics; FY24 GDP revised upwards to 7%**

India's growth momentum remains strong with Q2FY24 GDP growth coming at robust 7.6% against 7.8% in Q1FY24. The better-than-expected growth numbers, strong domestic demand, improving rural growth, expanding manufacturing purchasing managers' index (PMI), buoyant service sector, robust investment activity and increased infrastructure spends has bolstered MPC's confidence of India's growth prospects and which is reflected in the upward revision of 50 bps for FY24 to 7% from 6.5%. However, the geopolitical turmoil, global economic slowdown, and volatile global financial markets may pose downside risks to growth outlook and warrants monitoring.

## **Balanced approach on inflation; FY24 inflation projection maintained at 5.4%**

The CPI inflation for month of October eased to a four-month low of 4.87% from recent peak of 7.44% in July and 5.02% in September on back of sharp correction in vegetable prices. The core inflation has also moderated to 4.25% and has been steadily trending down. The past policy actions coupled with supply side interventions by the government have helped ease inflation over time. However, the unseasonal rains might disrupt the harvesting cycle and add to the price pressures on the food inflation over the next 2 months. Despite the concerns on food inflation and strong GDP growth, MPC maintained the inflation projections at 5.4%. If the food prices continue with the upward trajectory, we might see some intervention from the government in form of some fiscal measures to contain the inflation. Further, the recent contraction in crude oil prices is positive for inflation and would give room to Central government to cut down the pump prices which would help arresting the overall inflation. Having said that, the 4% CPI target range might take a while and we expect MPC to maintain a close vigil on incoming data to prevent against any spillovers to underlying inflation trends. The healthy growth momentum gives room to RBI to remain resolute on its commitment of anchoring inflation to 4% target.

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**Overall a less hawkish policy with a balanced approach amidst global / domestic volatility**

Global economy continues to be clouded by uncertainties and is showing signs of slowdown. Major central banks have kept rates on hold while refraining forward guidance given the prevailing uncertainties. Recently the global factors have turned favourable with markets seeing a sharp rally in long term US bond yields. India as of now is in a sweet spot with robust growth, moderating inflation trajectory, contained fiscal deficit and renewed FPI inflows both in equity as well debt segment. While MPC has maintained its tight vigil on domestic inflation trajectory amidst volatile global factors and food prices, it was marginally a lesser hawkish policy as there was no urgency shown on the use of OMO sales to withdraw systematic liquidity. Further, the inflation projections were retained for FY24 despite the concern on food inflation putting upward pressure and robust economic growth. MPC has indeed delivered a very balanced monetary policy with a preparedness to act if required to achieve its dual mandate on inflation & growth. **We believe that with elevated rates there is lesser likelihood of any further monetary tightening.**

**Market Movement**

Segment	Broad movement of yields in bps (as on December 08, 2023)	
	G-Sec	AAA Corporates
3 Months	+1 bps	+2 bps
6 Months	0 bps	0 bps
1 year	0 bps	0 bps
2 -3 years	+3 bps	0 bps
4 - 5 years	+3 bps	0 bps
10 years	+3 bps	0 bps
14 years	+2 bps	0 bps

Source: Bloomberg

Even as the policy came out to be in line with market expectations on rates & stance and relatively lesser hawkish on OMO sales, market saw a 2-3 bps correction across the yield curve. This can be ascribed to the technical factors like pre-policy rally in rates over last couple of days, heavy position of market participants going into policy and big size G-Sec auction of Rs. 39,000 crore.

**Risk-reward is favourable for debt markets and investors can explore opportunities across the curve**

We believe policy rates have peaked out and we do not see further tightening. Additionally, the interest rate differential with US – 10 yr G-Sec, during last MPC the spread was ~250 bps which has now widened to ~310 bps as Indian rates have not reacted much to global rates rally. FPI inflows have picked up well in November & December after seeing outflows in previous two consecutive months. Indian G-Sec will get demand support from FPIs with inclusion in JP Morgan global debt index from June 2024 onwards. Domestically, India is well-placed and is exhibiting higher resilience compared to other Emerging Market peers. India's Fx reserves have also surged again alleviating pressures on INR to some extent. Further, the recent softening of crude oil prices has further strengthened our external conditions.

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At the current juncture of elevated yields, the risk-reward is favourable for debt markets. We believe investors should look at fixed income constructively and take position across the yield curve based on the investors' asset allocation requirement. Our fund positioning will be guided by evolving market dynamics as well as individual fund's mandates. There might be near term volatility led by evolving factors, but it is expected to be range bound and should be ignored. In such a scenario, active fund management is critical as uncertainties may emanate from domestic inflation and global backdrop which may influence various yield curve segments differently. Investors may look at the 2 to 5 years segment as their core allocation as it provides opportunity to capture prevailing high yields while getting less impacted by the volatility at the longer end. Credit environment remains healthy and selective AA / AA+ rated exposure can be explored at fair credit spreads.

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