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Largely a non-event policy as MPC maintained status quo on policy rates & stance as “withdrawal of accommodation”. FY25 inflation guidance at 4.5% reflects continued moderation even as global factors & food inflation remains uncertain. Robust growth expectation at 7% in FY25. No meaningful announcement to immediately ease deficit systemic liquidity. External factors remain healthy with FPI / ECB inflow & adequate Fx reserve. Overall, it doesn’t disrupt expectation of rate cuts in H2CY2024 in line with global rate cut cycle, as also the first split appears with 5:1 vote on policy rate. It re-affirms our view that market focus will remain on demand-supply dynamics, which is looking extremely favorable for longer tenor G-sec, especially after the Government’s aggressive fiscal consolidation.

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 at **5.4% (retained) in 2023-24 with Q4 at 5.0% (down from 5.2%).** CPI for FY25 projected at **4.5%** with **Q1FY25 at 5.0% (down from 5.2%), Q2FY25 at 4% (retained), Q3FY25 at 4.6% (down from 4.7%) and Q4FY25 at 4.7%.**

Real GDP growth projections for **2024-25 at 7% with Q1FY25 at 7.2% (up from 6.7%), Q2FY25 at 6.8% (up from 6.5%), Q3FY25 at 7% (up from 6.4%) and Q4FY25 at 6.9%.**

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

Today’s MPC was setup against the backdrop of many factors turning favourable as compared to the December 2023 policy. Most critically, FOMC delivered a pivotal policy in December 2023 with dovish guidance and an acknowledgement of easing inflation, rebalancing of jobs market and slowing down of growth. On domestic front, inflation surprised positively as Q3FY24 inflation came in at 5.37% against the RBI projection of 5.6% and core inflation falling below 4% in December 2023. Central Government exceeded all expectations on fiscal consolidation by targeting 5.1% fiscal deficit for FY25 and committing to reach below 4.5% by FY26. At the same time, global volatility remained high with geo-political risks & supply side disruptions, along with the uncertainty on domestic food prices. Given the evolving scenario, MPC maintained status quo on policy rates & stance as “withdrawal of accommodation” and maintained caution. While some part of market participants was disappointed as they were hoping for stance change & some relief on liquidity conditions, largely the policy turned out to be a non-event and in line of our expectations.

RBI – Reserve Bank of India; FOMC - Federal Open Market Committee; FPI – Foreign Portfolio Investment; ECB – External Commercial Borrowings; Fx- Forex

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No significant announcement on liquidity easing measures

Systemic liquidity has been in a deficit mode since September 2023 which has kept the overnight TREPs rate elevated at ~6.70% - 6.75% and not at RBI Policy Repo rate at 6.5%. During January 2024, RBI conducted various short term liquidity infusion through VRRs in order to make sure overnight rates doesn't cross upper rate corridor of 6.75%. As the liquidity is expected to tighten further towards March 2024, market participants were hoping for some measures to immediately ease the liquidity deficit. RBI, however maintained its approach of using short term liquidity tools (VRR and VRRR) to address frictional liquidity deficit and reiterated that the liquidity should improve gradually as Government spending picks up. RBI has announced a lesser quantum of VRR of Rs 1.75 lakh crore for February 09, 2024 against the maturity of Rs 2.5 lakh crore. We believe liquidity to remain tight till March 2024 keeping the pressure high on short term rates, before easing April 2024 onwards on the back of Government spending.

Robust growth expectation at 7% in FY25

India's growth outlook remains buoyant with the momentum witnessed in FY24 expected to continue in FY25. MPC growth projection of 7% for FY25 draws strength from strong manufacturing PMI, buoyant service sector, 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 turmoil and volatile global financial markets may pose downside risks to growth outlook and warrants monitoring.

FY25 inflation projection at 4.5% indicates softening trajectory

The CPI inflation for month of December 2023 had come lower than market expectations even as it rose to 5.69% on back of elevated food inflation led by higher vegetable prices despite fuel inflation coming down. Core inflation had surprised even more as it slipped below 4% with broad based moderation.

Food inflation outlook though continues to remain uncertain but has been helped by various supply side measures taken by the Government. Besides, core inflation continues to moderate on the back of softening of commodity prices and transmission of past monetary policy action. Considering these factors MPC projected inflation for FY25 at 4.5% with the risks evenly balanced. MPC is likely to maintain a close vigil on incoming data to prevent against any spillovers to underlying inflation trends while focusing on aligning inflation to 4% CPI target range. We expect headline inflation to moderate to ~4.50%-4.75% range in FY25.

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India remains resilient to external factors

While the key Central Banks are expected to begin the rate cut cycle in CY2024, the path towards the rate cycle is expected to be volatile given the wide difference between market expectations and Central Bank's current guidance. Global rates are expected to adjust depending upon the incoming data prints which have been mixed so far. In addition, any meaningful escalation in geo-political risks or supply side disruption can pose risk to the inflation trajectory and hence delay the rate cut cycle. So far India has largely remained insulated from global headwinds given the sound external factors like manageable current account deficit, healthy service export surplus, higher FPI / ECB / remittances, surging FX reserves, stable INR and surplus Balance of Payments. Strong external factors are expected to provide cushion to absorb global spillovers to an extent.

We see a possibility of rate cut in H2CY2024 in line with global rate cut cycle

Global rate cut cycle is expected to start in 2024 as Central Banks gain more confidence on inflation moderation. Given this backdrop and moderating domestic inflation, RBI is also expected to start the rate cut cycle in H2CY2024. Current policy rate at 6.5% leaves the positive real policy rates at an elevated ~175 – 200 bps, giving room to MPC to cut down the policy rates by ~50-75 bps over time.

Further, this policy showed first signs of divergence in policy rate stance with one member voting for a rate cut. This provides reaffirmation to our view of benign rate cycle going ahead. 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.

Market Movement

Segment	Broad movement of yields in bps (as on February 08, 2024)	
	G-Sec	AAA Corporates
3 months	0 to +1 bps	+4 bps to +5 bps
6 months	0 to +1 bps	0 to +1 bps
1 year	0 to +1 bps	+3 bps to +4 bps
2 -3 years	+1 bps	+2 bps to +3 bps
4 - 5 years	+2 bps	+2 bps to +3 bps
10 years	+1 bps	0 to +1 bps
14 years	0 bps	NA
30 years	+1 bps	NA

Source: Bloomberg

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

Overall, **risk-reward remains favourable** at current juncture with benign fundamental & elevated yields across the yield curve. **Permitting risk appetite, it is a prudent time to go long on duration** with increased allocation 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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