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Non-event policy as MPC maintained status quo on policy rates & stance as “withdrawal of accommodation”. More MPC split appears with 4:2 vote, indicating moving closer to rate cut. Growth – inflation dynamics remains favorable as GDP for FY25 upped to 7.2% with average inflation maintained at 4.5%. Strength on external stability & importance of domestic factors for MPC emphasized again. No mention on surprise outcome of General elections & robust commentary on growth indicates RBI’s comfort on continuation of Government policies. Active liquidity management to continue. Overall, a very balanced policy. Banking liquidity is expected to turn surplus in June/July with Government spending post elections and FPIs inflows in debt segment. Market focus will be now on new Government’s fiscal policies. For now, we expect positive sentiment to continue for debt market driven by favorable demand-supply dynamics.

Key decisions/Highlights

Four out of six Monetary Policy Committee (MPC) members voted to **keep the policy rate unchanged at 6.50% while 2 members 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 four out of six members voted to remain focused on **“withdrawal of accommodation”** to ensure that inflation progressively aligns to the target, while supporting growth. Two members voted for change of stance to neutral.

Consumer Price Index (CPI) **inflation projections retained across period. FY25 projected at 4.5% with 1QFY25 at 4.9%, 2QFY25 at 3.8%, 3QFY25 at 4.6% and 4QFY25 at 4.5%.**

Real GDP growth projections for **2024-25 at 7.2% (up from 7%) with 1QFY25 at 7.3% (up from 7.1%), 2QFY25 at 7.2% (up from 6.9%), 3QFY25 at 7.3% (up from 7%) and 4QFY25 at 7.2% (up from 7%).**

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

Global economic backdrop has turned positive since the last policy announcement in April. Bank of Canada and European Central Bank kicked off its rate cutting cycle with both banks delivering a 25 bps cut in policy rates. US jobs market data has started to show the signs of cooling off. Inflation across economies is slowly progressing towards target range. Domestic factors remained benign with higher-than-expected GDP growth for FY24. Core inflation and fuel inflation has continued to decline which has helped soften the headline CPI inflation however persisting food inflation remains a concern.

Given this backdrop, RBI maintained status quo on policy rates and retained the stance as ‘withdrawal of accommodation’ as was widely expected. The four- to-two vote split suggests divergence in policy view and indicates reaffirmation to our view of benign rate cycle going ahead.

Robust growth outlook with projection revised upwards to 7.2% in FY25

India’s growth momentum continues to remain buoyant with FY24 registering a growth of 8.2% and Q4FY24 GDP growing by 7.8%. The robust performance was driven by continued strong investment demand, expanding manufacturing and services activity. Private consumption is expected to revive on back of normal monsoon, strengthening rural demand and strong urban consumption. Further, growth is expected to gain traction on back of expanding manufacturing & service purchasing managers’ index (PMI), strengthening global trade and external demand, robust investment activity, improved business sentiments, healthy corporate balance sheets, continued focus on capital expenditure by Government. The healthy growth momentum gives room to RBI to remain resolute on its commitment of anchoring inflation.

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Inflation projections retained at 4.5%

Headline inflation has come down significantly but remains above the 4% target. Core inflation has softened for 11th consecutive month and has come down to 3.2% in April. Fuel inflation has also been treading lower on back of LPG price cut. Food inflation, on the other hand, has remained high given the uptick in vegetable, cereal and pulses price. Prospects of normal monsoon bodes well for food production and may help in bringing food inflation down. Further, geo-political tensions and any further uptick in food prices, pose an upside risk to inflation trajectory. RBI has not let down its guard on inflation and is expected to maintain a close vigil on the inflation till it aligns to the 4% of target.

Active liquidity management to continue

System liquidity had turned into deficit about Rs. 1.22 lakh crore during April 20 - May 31, 2024. This was mainly due to build-up of Government cash balances due to restrictions in Government spending with model code of conduct in place. RBI recently announced a record dividend of Rs. 2.11 lakh crore to the Government which has further increased the Government cash balance. We believe that now the Government spending will pick up as the elections have got over. Additionally, Indian G-sec are getting included in global debt indices from June 2024, which will fetch ~USD 25-30 Bn inflows in FY25 and help improve the system liquidity further. Owing to these factors, we expect banking liquidity to turn in surplus in June/July. We believe RBI will actively manage liquidity through options like longer dated Variable Reverse Repo Rate (VRRR) auctions, Forex (Fx) swaps etc.

Strength on external stability & importance of domestic factors for MPC emphasized again; we retain our stance on possibility of rate cut in 2H CY24

India's external sector indicators have remained resilient with lower trade deficit, robust service exports, expectation of moderate current account deficit for FY24 and record Foreign Exchange (Fx) reserves US\$ 651.5 Bn as on May 31, 2024. Further, the recent upgrade by S&P Global Ratings in India's rating outlook to 'positive' from 'stable' while reaffirming BBB- rating indicates confidence in policy stability and growth momentum. However, the geopolitical tensions pose risk to the outlook.

Governor explicitly addressed that while they keep a track on monetary policy announcements in advance economies, domestic policy outcomes are driven by domestic growth-inflation dynamics. With moderating domestic inflation and healthy GDP, we continue to expect India to start the rate cut cycle towards the last quarter of CY24. We believe MPC is also expected to precede the rate cuts with stance change from "withdrawal of accommodation" to "Neutral" and maintain better systemic liquidity conditions.

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Market Movement

Segment	Broad movement of yields in bps (as on June 07, 2024)	
	G-Sec	AAA Corporates
3 months	0 bps	0 bps
6 months	0 bps	0 bps
1 year	0 bps	0 bps
2 -3 years	-1 bps	-1 bps to -2 bps
4 - 5 years	-1 bps	-1 bps to -2 bps
10 years	0 bps	0 bps
14 years	0 bps	NA
30 years	0 bps	NA

Source: Bloomberg

Favourable demand supply dynamics to drive debt market

Post a very balanced monetary policy announcement, markets will shift its focus to upcoming Union Budget announcement by new Government and fiscal policies. While we expect the Government to maintain its budgeted fiscal deficit of 5.1% in FY25, more critical will be to watch out for the fiscal consolidation in FY26 and onwards. We will keep a close watch on evolving political landscape and keep reassessing our interest rate views, any aggressive populist measure announcement by the Central Government may result in fiscal slippage.

Given the current domestic macro backdrop and robust demand-supply dynamics, we maintain our constructive outlook on duration. We 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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