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*Unexpected rate pause by MPC indicates lesser uncertainty on global monetary policy rate actions. However, war against domestic inflation not yet over as reflected in continued “withdrawal of accommodation” stance. Overall, a dovish pause than the market expectations. This pause has raised the bar higher for any more rate hikes, if required to tame the inflation. As of now, we are in for a long pause as inflation remains higher than the target.*

## Key decisions/Highlights

Monetary Policy Committee (MPC) member 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 continue with **“withdrawal of accommodation”** to ensure that inflation progressively aligns with the target, while supporting growth.

Consumer Price Index (CPI) inflation projected at **5.2%** (down from 5.3%) **in 2023-24 with Q1 projected at 5.1% (up from 5.0%), Q2 at 5.4% (retained), Q3 at 5.4% (retained) and Q4 at 5.2% (down from 5.6%).**

Real GDP growth projections for **2023-24 at 6.5% (up from 6.4%) with Q1 is projected at 7.8% (retained), Q2 at 6.2% (retained), Q3 at 6.1% (up from 6.0%) and Q4 at 5.9% (up from 5.8%).**

## MPC surprises the market with a pause on policy rates; responding to recent changes in global backdrop

Global economy has been witnessing upheaval since the last Monetary Policy announcement in February 2023. The collapse of some of the US regional banks and Credit Suisse raised concerns regarding global financial stability. In response to these challenges, major central banks - US FOMC, European Central Bank (ECB) and Bank of England decided to reduce the pace of rate hikes though continued to tighten monetary policy to combat stubbornly high inflation. Taking cues from global central banks and to evaluate the cumulative impact of rates hikes (repo rate increased by cumulative 250 bps since May 2022) on domestic inflation trajectory, MPC decided to maintain status on interest rates in this policy review. Further, India's external sector indicators have improved significantly; current account deficit (CAD) and trade deficit have moderated sharply, INR has been stable despite global headwinds, and Fx reserves have strengthened to more than US \$600 billion (including forward book)<sup>1</sup>. This has given room to RBI to push the pause button on interest rates. Today's announcement of keeping the rates unchanged came as a surprise as inflation remain elevated (last two months' inflation prints recorded above 6%) and well above the central bank's medium-term target.

## Inflation commentary moderated with risks evenly balanced now; FY24 CPI projections lowered by 10 bps to 5.20%

RBI seemed lesser hawkish in inflation commentary and acknowledged that inflation trajectory is likely to soften in 2023-24. The food prices outlook is supported by expectations of record rabi harvest whereas outlook for crude prices remain uncertain. The recent cut in crude oil production by OPEC+, unseasonal rains, global financial market volatility, lagged pass-through of input costs may pose an upside risk to inflation trajectory. By retaining the “withdrawal of accommodation” stance and readiness to act if situation warranted, RBI has indicated that it remains focused on aligning inflation with the target. We believe RBI would remain watchful of inflation prints going ahead and maintain its vigil on core inflation.

Fx: Forex reserves

FOMC: Federal Open Market Committee

<sup>1</sup>Source: RBI

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## **Growth dynamics remains resilient; FY24 GDP projection increased by 10 bps to 6.5%**

India's economic activity continues to remain stable and resilient. The strong growth momentum can be attributed to various factors such as expanding IIP and PMI, strong passenger vehicle sales figures, double digit credit growth, improving capacity utilization, continued focus of government on infrastructure, and revival in corporate investments. The economic growth draws strength from its macroeconomic fundamentals however downside risks to growth outlook may emanate from global headwinds viz. geopolitical tensions, tightening global financial conditions, and global financial market volatility.

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## **Liquidity remains benign for now; RBI stands ready to intervene**

Liquidity remained well managed last month as RBI conducted both VRR as well as VRRR auctions to smoothen the system liquidity excess and deficits amidst volatility arising out of scheduled tax outflows and government expenditure. As overnight liquidity (SDF) crossed INR 3 lakh crore for consecutive days, RBI announced 15-day VRRR auction of INR 2 lakh crore for next fortnight. Banks parked INR 1.24 lakh crore, which should catapult overnight rates from lows of 6.25% seen over last few days closer to repo rate level of 6.50%. RBI has been proactive in liquidity management, and we expect RBI to maintain adequate liquidity level going forward.

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## **Stance maintained as “Withdrawal of accommodation”, indicating some possibility of further rate hike; however the bar has been raised higher for further rate hikes**

MPC has kept the rates unchanged but has continued to maintain “withdrawal of accommodation” stance leaving the room open for further rate hikes. We believe that further rate hikes, if any, would be dependent on inflation trajectory and would be undertaken only if inflation comes under pressure. As RBI has decided to pause even when the current inflation is trending at 6%+, we expect the bar for any further rate hikes is much higher now as the inflation for FY24 is expected to remain within the upper threshold. Further, we expect RBI to adopt a data dependent approach like global Central Banks viz. US FOMC and ECB and will keep an eye on incoming global and domestic macro-economic data.

Nonetheless, RBI's inflation projections still remain above 5% across all quarters while estimating average inflation at 5.2% in FY24. This signals that inflation may take longer to reach closer to the long-term inflation target of 4%. Given this backdrop, we believe RBI has moved to an extended pause and India will see the policy rates remaining **“Higher for Longer”** as domestic growth-inflation dynamics may not provide any room for rate cuts in 2023 even if the Global Central Banks were to start their rate cuts in 2023 to address their country specific growth concerns.

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IIP: Index of Industrial Production  
PMI: Purchasing managers' indices  
VRR: Variable rate repo  
VRRR: Variable rate reverse repo

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## Market Movement - Sharp downward movement in yields with steepening bias

Segment	Broad movement of yields in bps (as on April 06, 2023)	
	G-Sec	AAA Corporates
3 Months	-15 bps	-15 bps
6 Months	-15 bps	-15 bps
1 year	-15 bps	-7 to -10 bps
2 -3 years	-15 bps	-7 to -13 bps
4 - 5 years	-13 bps	-7 to -10 bps
10 years	-7 bps	-5 to -7 bps
14 years	-3 bps	NA

Source: Bloomberg

The current policy announcement was positive for the market, and we saw yields rallying across segments with the upto 5-year segment reacting more positively which rallied by ~12 to 15 bps. The yield curve has steepened over last few weeks as reflected in 5x10 yr g-sec, which had turned inverted for a brief time in Feb 2023 end, to ~19 bps as of now.

## Fiscal supply overhang may continue in FY24

RBI announced H1FY24 borrowing calendar of INR 8.88 trillion which is 57.6% of its budgeted borrowing of Rs. 15.41 trillion slated for FY24. There is increase in both Gross/Net supply as well as the duration in H1FY24 as compared to H1FY23. Share of longest maturity bonds (30 and 40 Year) has been increased from 26.98% in H1FY23 to 33.67% this fiscal. Following table shows the maturity comparison for H1FY24 with H1FY23.

Gross Issuance (Rs. Trillion)					
Tenor	Apr-Sep'23	% of Total	Apr-Sep'22	% of Total	Net Change (Rs. Trillion)
FRB	0	0	0.52	6.15%	-0.52
Up to 5 Yr	0.56	6.31%	0.52	6.15%	0.04
5 Yr	1.04	11.71%	1.17	13.85%	-0.13
7 Yr	0.91	10.25%	0.91	10.77%	0.00
10 Yr	1.82	20.50%	1.69	20.00%	0.13
14 Yr	1.56	17.57%	1.36	16.09%	0.20
30/40 Yr	2.99	33.67%	2.28	26.98%	0.71
<b>Total</b>	<b>8.88</b>	<b>100%</b>	<b>8.45</b>	<b>100%</b>	<b>0.43</b>

Source - RBI

With increased supply in 10Yr, 14Yr and long dated bonds, we expect the curve to steepen as the seasonal demand of long Investors (Insurances and PFs) is usually low in first half and as the short end upto 5 years is protected as RBI reaches to the peak of policy rates.

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State Governments have borrowed a lower INR 7.58 trillion in FY23 against indicative calendar of Rs. 9.95 trillion supported by higher tax revenues and lower capital expenditure by State Governments. States have indicated to borrow ~ Rs 2 trillion in Q1FY24. With growth slowing down, states may see lower tax revenues causing them to stick to their borrowing plan.

While the supply is expected to be higher both in G-sec as well as SDL (State Development Loans) in FY24, incremental demand from banks may remain relatively lower as credit offtake remains robust. Additionally, demand from Insurance and Mutual Funds could be somewhat lower owing to recent taxation changes introduced in Budget 2023-2024. Hence, we see combined duration supply from central and state governments affirming our view of steeper yield curve

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### **As MPC reaches closer to the peak rates investors can benefit from opportunities across the curve; curve may further steepen going forward**

As MPC reaches closer to the peak rates, investors can look at various points of rate curve to meet their asset allocation requirements. Having said that, for the active investors, we find risk-reward to be more favorable for upto 5-year space as of now as we believe that the rate curve may further steepen going forward on account of supply side overhang in the longer end and as the rate cut cycles gets delayed on sticky inflation concerns.

Our fund positioning will be guided by evolving market dynamics as well as individual fund's mandates. At the current juncture, we feel that policy rates are expected to remain "*Higher for Longer*" given the current growth-inflation dynamics. Thus, we believe investors should look at the fixed income investments more constructively and benefit from the elevated yield curve to maintain high accrual without even taking excessive market risk. Risk averse investors may look at the 6 months to 1 year segment of the yield curve amidst expectations of liquidity re-calibration & as the peak policy rate is established. Given the steepness of the curve, investors may look at the 2 to 5 years segment as their core allocation, as this part of the yield curve remains well placed from carry perspective. To us, it is a sweet spot on the yield curve –as it provides opportunity to capture prevailing high yields while getting less impacted by the volatility at the longer end. Credit environment remains healthy, however current narrow spreads of AA / AA+ over AAA bonds do not provide favorable risk adjusted reward opportunities and accordingly high credit quality-oriented debt funds should be a preferred choice as of now.

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