

February 08, 2023

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Vikas Garg  
Head – Fixed Income



*MPC moderates the policy rate hike to 25 bps with continuation of “withdrawal of accommodation” stance, in line with our expectation. A growth focused FY24 budget coupled with resilient domestic demand conditions require a tight vigil on core inflation. Global factors remain critical for further policy action. Overall, marginally hawkish commentary than the market expectations. Future rate actions will be calibrated and more data dependent as we approach the last leg of the current rate hike cycle. Policy rates are expected to remain higher for longer.*

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## Key decisions/Highlights

Four out of six members of Monetary Policy Committee (MPC) voted to **increase the policy rate by 25 bps at 6.50%.**

The **standing deposit facility (SDF) rate** stands adjusted to **6.25%** and the **marginal standing facility (MSF) rate** and the **Bank Rate** to **6.75%.**

MPC by a majority of four out of six members voted to continue with **“withdrawal of accommodation”** to ensure that inflation remains within the target going forward, while supporting growth.

Consumer Price Index (CPI) inflation projected at **6.5%** (down from 6.7%) in 2022-23 with Q4 at 5.7% (down from 5.9%). CPI inflation for 2023-24 at 5.3% with Q1 is projected at 5.0% (retained), for Q2 at 5.4% (retained), Q3 at 5.4% and Q4 at 5.6%.

Real GDP growth projections for 2023-24 at 6.4% with Q1 is projected at 7.8% (up from 7.1%), Q2 at 6.2% (up from 5.9%), Q3 at 6.0% and Q4 at 5.8%.

MPC **restored the market hours for the Government Securities market** to the pre-pandemic timing of 9 am to 5 pm.

To develop, add depth and liquidity to the government securities market, **lending and borrowing of G-sec has been permitted.**

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## MPC further moderates the rate hike to 25 bps; in line with the market expectations

This MPC was setup against the benign backdrop as US FOMC further moderated the rate hike and domestically also last 2 monthly headline inflation prints came in at sub 6%. While continued pressure on INR with FPI outflows negated it to some extent, market was largely positioned for a moderate 25 bps rate hike (lowest in current rate hike cycle) which is in line with the global Central Banks and MPC didn't surprise on it. The softening of domestic inflation coupled with a prudent fiscal Budget made us believe that MPC would opt for a lower rate hike of 25 bps. Additionally, today's policy announcement was a crucial one as market participants were looking for cues whether this hike will be the fag end of the rate hike cycle with few participants also expecting MPC to change the policy stance to “Neutral” to explicitly convey the same. Even though the quantum of rate hike has moderated, MPC remains focused on bringing inflation within its medium-term target of 4% and has thus retained the stance of withdrawal of accommodation in the current policy review.

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FPI: Foreign Portfolio Investment  
FOMC: Federal Open Market Committee  
Source: Internal, RBI

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## **Inflation commentary remains hawkish; FY24 inflation projection elevated at 5.3%**

Headline CPI has moderated from 7.41% in September'22 to 5.72% in December'22, led by fall in food prices. While MPC acknowledged the decline in inflation and indicated that the worst is behind us, it continued to maintain its caution on inflation highlighting the sticky core inflation and global uncertainties can pose upside risks to the inflation trajectory. RBI has projected quarterly inflation prints above 5% through all the four quarters of FY24 while estimating average inflation at 5.3%. This signals that inflation may take longer to reach closer to the long-term inflation target of 4%. We believe RBI would remain cautious about the inflation trajectory & maintain its vigil on core inflation and would wait for actual data prints to sound comfortable on inflation.

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## **Growth dynamics remains comfortable; FY24 projection at 6.4% much higher than market expectations**

The MPC sounded confident on growth prospects and projected the FY24 growth at 6.4% which was much higher than market expectation of 5.5%-6%. Strong growth prospects have been attributed to robust credit growth, improving capacity utilisation, continued focus of government on infrastructure, rebound in consumption activity and improved business sentiments. Indian economic growth remains resilient, drawing strength from its macroeconomic fundamentals however downside risks to growth outlook may emanate from global headwinds viz. geopolitical tensions, tightening global financial conditions, and slowing demand.

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## **Liquidity remains benign for now; expected to moderate over the medium term with LTROs / TLTROs maturity**

Liquidity has remained in surplus mode with monthly average liquidity surplus for month of January 2023 at ~Rs. 1.4 lakh crore though lower than levels seen in April 2022 (~Rs. 7.4 lakh crore). We expect the liquidity to remain adequate till the year end especially on the back of higher government expenditure and healthy FPI inflows. However, the LTROs (Long Term Repo Operations) and TLTROs (Targeted Long Term Repo Operations) maturity during February to April 2023 (amounting to ~Rs.74,648 crore) is expected to reduce liquidity from the system. MPC remained committed to act on two-sided liquidity operations depending on the evolving liquidity conditions.

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## **Global factors will be monitored closely**

The MPC highlighted that domestic macro-economic indicators are gaining momentum and remain well placed however global headwinds may have a bearing on Indian economy. We believe global factors like global recessionary fears, tightening of policy rates by key Central Banks, relative currency movement, commodities prices in the wake of China opening up, etc. would continue to have an influence on domestic policy direction.

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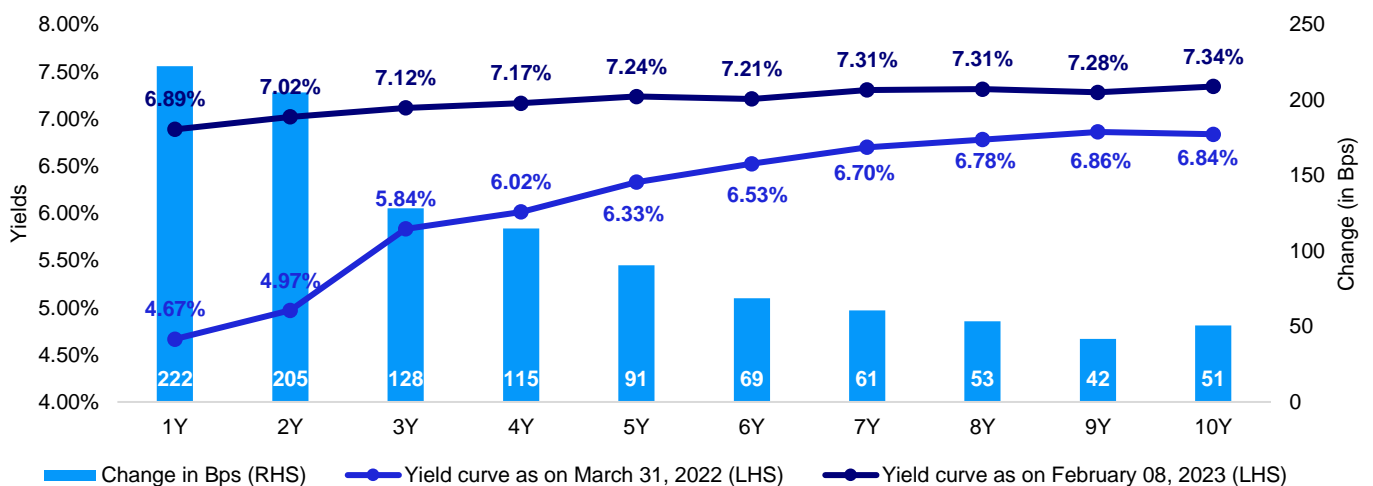
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## Stance maintained as “Withdrawal of accommodation”, indicating some possibility of further rate hike; although closer to an end of current rate hike cycle

MPC has moderated the rate hike to 25 bps but has continued to maintain “withdrawal of accommodation” stance leaving the market guessing for the next policy action. While the debate on peak policy rate is still on, we believe MPC as well as Global Central Banks are towards the final leg of policy rate hike as large cumulative rate hikes are transmitted to the system with a lag and as the inflation is expected to maintain its downward trajectory. MPC’s commentary on inflation concerns and resilient growth has somewhat raised the probability of one more rate hike in the next meeting in April 2023 (from almost nil earlier), but we believe the next policy action would be more data dependent and largely driven by the monetary policy action of other Global Central Banks. Current policy rate of 6.5% with FY24 inflation projections at 5.3% gives a positive real interest rate of ~1.2%, which along with neutral liquidity expected by Q1FY24 (with maturities of LTRO) will be able to anchor domestic inflation expectations. While the markets have largely factored in the peak policy rates as 6.5%, a marginally higher actual peak policy rate of ~6.75% may not be very disruptive for markets as long as it is supported with no further rate hikes thereafter.

Soon after reaching the peak policy rates, debate will pick up on timing of the start of rate cut cycle. We believe that 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.

## G-Sec Yield Curve change since March 2022



Source: Bloomberg

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## Market Movement - Slight disappointment due to marginally hawkish commentary

Segment	Broad movement of yields in bps (as on February 08, 2023)	
	G-Sec	AAA Corporates
3 Months	+5 to 7 bps	+2 to 3 bps
6 Months	+9 to 10 bps	+1 to 2 bps
1 year	+12 to 15 bps	+5 to 7 bps
2 -3 years	+10 bps	+5 to 7 bps
4 - 5 years	+7 bps	+5 to 7 bps
10 years	+3 bps	+3 to 5 bps

Source: Bloomberg

## Rate volatility may moderate compared to earlier; flattened yield curve gives opportunity to investors to benefit from high accrual.

Global Central Banks as well as MPC are steering towards the end of rate hike cycle which will help in limiting any extreme interest rate volatility and that can be well absorbed by already elevated gross yields especially upto 5 year segment. While the longer end may somewhat remain under pressure as the fiscal supply overhang continues for next year as well, we believe Indian fixed income market has come to an inflection point with risk-reward turning favorable for investors.

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 & flattened 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. 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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