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Amidst challenging global monetary policy backdrop, RBI stays with a 3<sup>rd</sup> consecutive rate hike of 50 bps and keeps a tight vigil on domestic inflation. Continuation with “withdrawal of accommodation” signals more rate hikes to come. External factors holding well as of now but needs to be monitored closely. Re-assurance on ample systemic liquidity provides relief to the shorter segment. Overall, in line with market expectations as of now but we expect market volatility to remain high with fast evolving global backdrop.

#### Key decisions/Highlights

Monetary Policy Committee (MPC) decided by a majority of five members out of six to **increase the policy rate by 50 bps at 5.90%**.

The **standing deposit facility (SDF) rate** stands adjusted to **5.65%** and the **marginal standing facility (MSF) rate** and the **Bank Rate** to **6.15%**.

MPC with 5 – 1 vote remain **focused on withdrawal of accommodation** to ensure that inflation remains within the target going forward, while supporting growth.

On back of elevated imported pressures, surging food prices and assumption of average crude oil price (Indian basket) of US\$ 100 per barrel, Consumer Price Index (CPI) inflation projection is retained at **6.7% in 2022-23 with Q2 at 7.1% (retained); Q3 at 6.5% (up from 6.4%); and Q4 at 5.8% (retained), with risks broadly balanced. CPI inflation for Q1:2023-24 is projected at 5.0% (retained).**

Real GDP growth projections for **2022-23 at 7% (down from 7.2%), with Q2 at 6.3% (up from 6.2%); Q3 at 4.6% (up from 4.1%); and Q4 at 4.6% (up from 4.0%), with risks broadly balanced. Real GDP growth for Q1:2023-24 is projected at 7.2% (up from 6.7%).**

In view of the moderation in surplus liquidity, RBI decided to merge the 28-day VRRR with the fortnightly 14-day main auction. Consequently, **from now on, only 14-day VRRR (Variable rate reverse repo) auctions will be conducted.**

#### MPC maintains its tight vigil on inflation; hikes repo rate by 50 bps

Post the last policy announcement in August, market participants were expecting a rate hike of 35 bps in September MPC meeting. However, the global backdrop changed a lot post the announcement with significant hardening seen in global interest rates and sharp deterioration seen in the currency market. Owing to which the market participants had already realigned the rate hike expectation to 50 bps going into the policy.

The policy announcement was on expected lines with RBI deciding to be in sync with the global central banks and hiking the policy rate to 5.90% while maintaining hawkish commentary on domestic inflation. The global adverse conditions and RBI's stance to remain focused on withdrawal of accommodation indicates that there is further room for policy rate hikes. The governor signaled that future rate actions would be calibrated to incoming data and suggested that they will be watchful of evolving global environment.

Source: Internal, RBI

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## **FY23 inflation projections retained at 6.7%; risks of surging food prices and global uncertainties persists**

The inflation print has breached RBI's upper tolerance band of 6% for eight consecutive months now. Despite some softening in global commodity prices, RBI has continued to sound cautious on elevated inflationary pressures led by global uncertainties, recent surge in food prices & possible demand-pull factors and has retained its inflation projection at 6.7% for FY23. The committee cited that elevated imported inflation amplified by appreciation of US dollar, uncertain crude oil prices and domestic food prices may put upward pressure on inflation trajectory. Given the volatile global environment, we expect MPC to be watchful of how the global environment pans out and the sustainability of fall in commodity price before revising the inflation forecast downwards. We feel that the geopolitical developments, commodity prices and global financial market developments would play a key role in the inflation trajectory in coming months. On domestic front, food prices and demand side factors may also play out on inflation.

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## **Growth projection moderated marginally to 7% from 7.20% for FY23**

RBI maintained that Indian economy remains resilient despite turbulence in global environment and concerns emanating from global growth slowdown & hawkish stance of various central banks. The acceleration of credit growth to 16.2% y-o-y as on September 09, 2022 and improvement in capacity utilization in manufacturing sector to 74.3% in Q1FY23 (highest level in three years) should help economic growth. However, headwinds from extended geopolitical tensions and tightening global financial conditions can pose downside risks to growth.

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## **RBI reassures to maintain adequate liquidity is a welcome move**

The liquidity surplus had moderated to Rs. 2.3 lakh crore during August-September 2022 (up to September 28) from Rs. 3.8 lakh crore during June-July. The moderation in liquidity was mainly on back of GST and advance tax payments coupled with forex outflows & RBI's active intervention in foreign exchange market. Market participants were keenly looking for some guidance on liquidity front as the banking system's liquidity had recently slipped into deficit after being in surplus mode. RBI has sounded comfortable on systemic liquidity going into October as government spend picks up which provides relief to the interest rates on short tenor segment. RBI has also decided to merge 28 day VRRR with 14 day VRRR in order to better manage the liquidity given the high volatility on liquidity front.

## H2FY23 G-Sec borrowing calendar announced; in line with market expectations

Government of India has announced a calendar for H2FY23 where it has decided to borrow Rs. 5.92 lakh crore. The borrowing numbers are on the expected lines. For the FY23, government has reduced its borrowing amount from Rs. 14.31 trillion as projected in budget to Rs. 14.21 trillion.

The maturity-wise distribution of the H2FY23 borrowing as compared to H1FY23 and H2FY22 is as follows:

Tenor	H2FY23	H1FY23	H2FY22
2 year	6.25%	6.15%	3.98%
5 year	12.15%	13.85%	11.93%
7 year	10.42%	10.77%	0.00%
10 year	20.83%	20.00%	28.43%
14 year	19.10%	15.38%	17.89%
Long Bonds (30 & 40 year)	31.25%	27.69%	29.03%
FRB	0.00%	6.15%	8.75%
Grand Total	100.00%	100.00%	100.00%

Separately, State Governments have indicated to borrow Rs. 2.53 trillion in Q3FY23. States have undershot their calendar borrowing in H1FY23 where they borrowed Rs 2.76 trillion against the calendar of Rs. 4.02 trillion. (Source: RBI)

## Currency movement needs to be watched closely

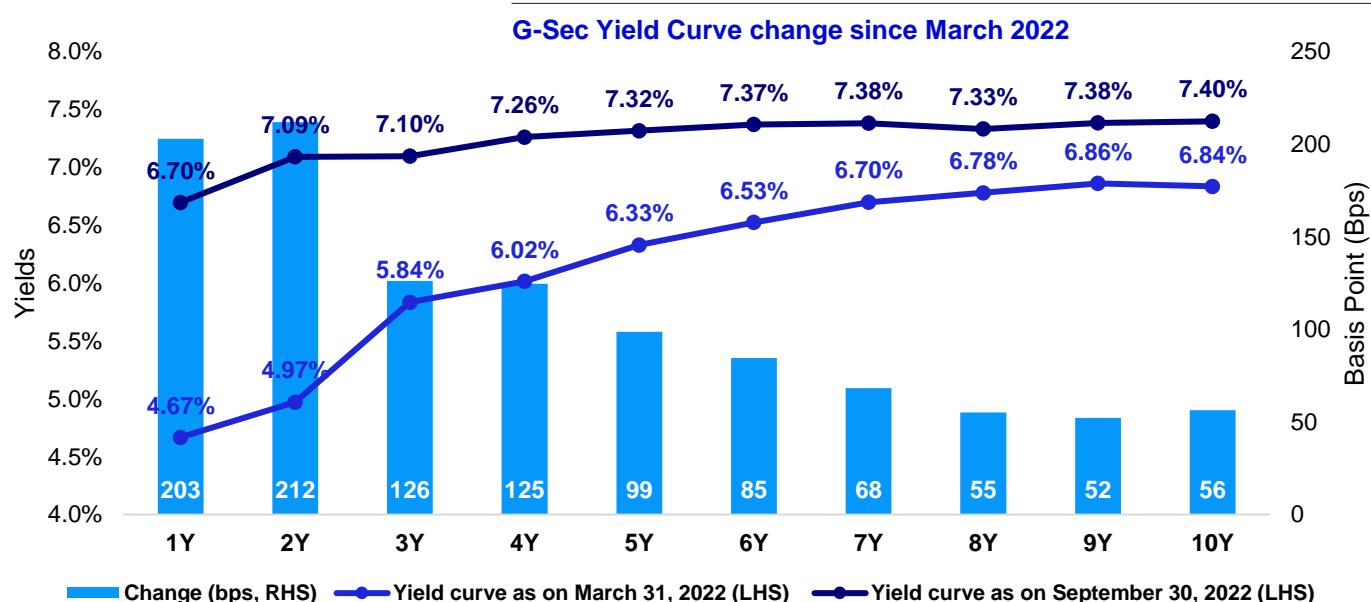
Besides the inflationary pressures, another key monitorable to keep a watch on is the currency movement. US dollar has appreciated significantly owing to aggressive rate hike expectation which has caused a lot of turmoil in currency markets globally. INR has also depreciated in line with other Emerging market currencies even as RBI has actively intervened to smoothen the volatility. The governor highlighted that major reason for decline in forex reserves was due to valuation changes due to appreciating US dollar. However, other external indicators such as external debt to GDP ratio, net international investment position to GDP ratio, ratio of short-term debt to reserves and debt service ratio provides comfort on external front.

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**Rate volatility may remain high; significantly flattened yield curve gives opportunity to investors to cut down on risk without compromising on accrual**

With the current policy action, we believe that further rate hikes will be a function of not only the domestic inflation trajectory but also the global backdrop especially the currency market. We expect another MPC policy in December also to be colored by the global backdrop and accordingly we see a 35 to 50 bps rate hike in next policy.

Going forward, we expect uncertainty on domestic inflation to remain high led by various factors like food prices, demand-pull & global situation. Given the current inflation trajectory and the global monetary policy tightening cycle, we expect MPC to continue with more rate hikes and reach a terminal policy repo rate closer to 6.25%/ 6.50% by early 2023.



Source: Bloomberg

## Market Movement

Segment	Broad movement of yields in bps (as on September 30, 2022)	
	G-Sec	AAA Corporates
3 Months	-5 to -7bps	-15 bps
6 Months	-5 bps	-7 bps
1 year	0 bps	-5 bps
2 -3 years	0 to -3 bps	0 to -3 bps
4 - 5 years	+1 bps	0 bps
10 years	+6 bps	0 bps

Source: Bloomberg

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## Fund positioning

With challenging global backdrop as many Central Banks tightens the monetary policies to tame inflationary pressures, huge fiscal supply and RBI's expected rate hikes, we expect domestic interest rates to remain volatile with an upward bias.

With the expectation of future rate hikes, our fund positioning will be guided by evolving market dynamics as well individual fund's mandates. We believe investors should invest in funds which are positioned at the shorter end of the curve as the longer end may remain volatile as the global backdrop further becomes negative with relatively tighter monetary policies for tackling inflation and continued high domestic fiscal supply. Against this backdrop, the 1 to 4 years segment provides prudent risk-reward proposition as the curve has already flattened out significantly.

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