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Dovish accommodative policy stance, first time calendar on G-sec purchase and ample liquidity helps to alleviate market concerns and thus the volatility. Focus on yield curve management to ensure orderly evolution. Inflation and global backdrop of rate trajectory remain key monitorable for us.

Insights- Monetary Policy Review

April 7, 2021

Key decisions/Highlights

Policy **Repo rate remains unchanged at 4%** and Reverse repo rate at 3.35%.

No change in other policy rates; Marginal Standing Facility (MSF) rate and Bank rate stands unchanged at 4.25%.

Monetary Policy Committee (MPC) to **continue with accommodative stance as long as necessary**, to sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward.

All MPC members **unanimously voted in favor of maintaining status quo** on rates with accommodative stance as long as necessary to sustain growth on durable basis.

The projection for Consumer Price Index (CPI) inflation has been revised downwards to 5.0% in Q4 2020-21 from earlier 5.2% while CPI inflation range for Q1 and Q2 2021-22 is projected at 5.2% , 4.4% in Q3 2021-22(earlier 4.3%) and 5.1% in Q4, with risks broadly balanced.

Real Gross Domestic Product (GDP) growth retained at 10.5% in 2021-22 consisting of 26.2% in Q1, 8.3% in Q2, 5.4% in Q3 and 6.2% in Q4.

The RBI remains **committed to ensure availability of ample system liquidity** i.e. a level of liquidity that would keep the system in surplus even after meeting the requirements of all financial market segments and the productive sectors of the economy in consonance with the accommodative stance of the MPC.

Targeted Long-Term Repo Operations (TLTRO) on Tap Scheme extended by a period of six months till September 30, 2021.

To extend fresh support of Rs. 50,000 crores to all India financial institutions for new lending in 2021.

To extend the Priority Sector Lending (PSL) classification for lending by banks to NBFCs for 'on-lending' to the above sectors for six months, i.e. up to September 30, 2021.

To conduct **secondary market G-sec acquisition programme or G-SAP 1.0**. Under the programme, the RBI will commit upfront to a specific amount of open market purchases of government securities with a view to enable a stable and orderly evolution of the yield curve amidst comfortable liquidity conditions. For Q1 2021-22 it has announced a G-SAP of Rs.1 lakh crores.

Overall a dovish policy with clear focus on yield management

What was largely expected to be a non-eventful and a routine monetary policy, rather came out to be much more than that with RBI clearly indicating its readiness to use all kind of conventional / un-conventional tools to support the rate sentiments during current disruption caused by Covid-19 situation and remain vigilant to curb the market volatility. The focus of the policy is clearly on the yield management and to ensure the orderly evolution of the yield curve by addressing the market concerns.

The RBI policy was more dovish than our expectations with RBI recognizing the risks associated with the resurgence of Covid-19 cases and the pivotal role it may continue to play to support economic growth through various measures including its accommodative policy stance and commitment to keep systemic liquidity in surplus. In our view, the fears of pre-mature withdrawal of RBI's supportive measures either through upward rate revision or liquidity management have been addressed to an extent over the first half of FY22.

We see policy response as continuation to RBI's stance of supporting durable economic recovery given uncertainty created by sharp resurgence in Covid-19 cases while ensuring that inflation remains within its stipulated target. While, we had not expected any big announcement in the policy, dovish tone of the policy with a market supportive and accommodative stance provided a respite to the jittery market. The bond market since quite some time has been reeling under volatility amid concerns of large fiscal deficit given expansionary budget, inflationary pressures, fears of further liquidity normalization by RBI and lack of clarity on open market operations (OMOs).

Broadly, the policy review addressed these concerns and its guidance on direction of interest rates, policy stance and reassurance of maintaining ample liquidity reaffirmed our views and portfolio actions. Whilst accommodative policy stance is data dependent and based on the prospects of sustained economic recovery, we feel that pandemic led disruption will lead MPC to maintain its stance in near term. This is the fifth policy review in a row when MPC maintained status quo on interest rates while retaining its accommodative stance.

In-fact what RBI didn't address in the last monetary policy on the ask of market participants on Open Market Purchase Operations to absorb record G-Sec supply in FY22, RBI this time acted upon it by announcing the First of its kind Rs. 1 lakh crores of G-Sec Acquisition Programme (G-SAP 1.0) in 1QFY22. This will help in addressing the volatility in long end of the curve, although we need to get more clarity if it is in addition to the regular Open Market Purchase Operations (OMOs) for FY22, which was expected to be of higher or at least similar quantum as that in FY21 (Rs 3.13 lakh crores in FY21), as earlier indicated by the Governor.

Continues to maintain accommodative policy stance; changed from time-based approach to state-based approach

RBI Continues to maintain the accommodative policy stance and changed from time-based to state-based guidance. In our view it was a logical move as the FY22 has already started and also given the uncertainties surrounding the economical recovery amidst the resurgence of Covid-19 & inflation trajectory.

GDP estimates retained despite uncertain outlook

Even as recent upsurge in Covid-19 cases has triggered uncertainty, we had not expected any downward revision in FY22 GDP projections with policy statement retaining GDP projections at 10.5% for FY22. However, we remain cognizant of pandemic led disruption and any slip-up on growth can have further repercussion on fiscal management.

Inflation is a critical thing to watch out for

Inflation targeting continues to be a key parameter of policy framework. With no significant increase in inflation projections in policy review, it is expected to support the MPC's accommodative policy stance. However, we remain watchful of inflation trajectory. On inflation, we were of view that RBI may look to revise the 4QFY21 average inflation downwards by 20-25 bps towards 5%, which coincided with policy estimates. At the same time, we are cognizant of rising commodity prices, which may exert upward pressure on 1HFY22 inflation. For good part of FY22, MPC estimates inflation to remain above 5%. Inflationary risks can emanate from supply side disruption and rise in international crude oil prices and poses risks to policy stance. For good part of FY22, MPC estimates inflation to remain above 5%, which in our view, can see upward pressure. We believe, RBI is cognizant of the risk factors on inflation and will embark upon a gradual exit from loose monetary policy depending upon the sustainability of the growth recovery.

MPC remains committed to ensure ample liquidity

Fundamentally, there is no change in liquidity stance and is expected to remain benign and in surplus. The MPC has reiterated its commitment to ensure ample system liquidity in consonance with its accommodative stance. In-fact, RBI's G-SAP 1.0 of Rs 1 lakh crores and another Rs 50,000 crores of credit line to Financial Institutions will add to the durable liquidity during the year. In our view, RBI's decision to conduct variable rate reverse repo (VRRR) auctions of longer maturity (amount and tenor to be decided on 9 Apr 2021) is in line of liquidity management framework and should not be seen as liquidity tightening. We expect RBI to conduct 1-3 months VRRR which may be done in addition to the current 14 days VRRR. In our view, it should be seen alongside the G-SAP which will infuse domestic liquidity and VRRR will manage the impact of surplus liquidity at the short end. While the aforesaid VRRR auctions may lead to realignment of short-term rates specifically the very short-term rates to an extent over next few days, overall, ample liquidity will ensure the support. Besides, with credit growth remaining low, we feel that it may provide options to banks for better liquidity management through VRRR.

Market reaction post policy announcement

Segment	Broad movement of yields today in bps	
	G-Sec	AAA Corporates
3 Months	+3/5	+7/10
6 Months	+5	+3/5
1 year	+5	+5/10
2 -3 years	+6/7	+3/5
4 - 5 years	Flat	-6
10 years	-4/5	-9

Data source: Bloomberg.

Fund Positioning

The policy stance to maintain ample liquidity augers well for short end of the yield curve, while the long end also gets supported by the active yield management by RBI through the G-SAP 1.0.

We feel that 1-4 years segment of the yield curve continues to provide attractive opportunity from risk-reward perspective. Additionally, favorable demand-supply dynamics also augers well for this segment.

Our funds such as Invesco India Treasury Advantage Fund, Invesco India Corporate Bond Fund, and Invesco India Short Term Fund largely positioned in 1-4 years space are in a sweet spot amid RBI's continued stance on ample liquidity.

Now, with clarity emerging on OMOs and scheduled calendar, we expect volatility at longer end to reduce. We feel that current yields at longer-end provide good entry point to the investors looking for long term allocation given the steepness of yield curve. Some allocation at the longer end also finds merit on the back of conviction that RBI will manage the yield curve and may support the long-term yields.

Investors with long term horizon and ability to absorb short term volatility may consider Invesco India Banking & PSU Debt Fund which is positioned at longer-end of the curve.

Besides, we believe credit dispersion will continue, with very high-quality credits benefitting from RBI's benign liquidity policy but the lower quality credits continuing to be avoided for the time being. All the above funds have maintained highest asset quality and as of now are deployed in 100% AAA rated assets (on long term rating basis).

Disclaimer- The above fund positioning is based on current views and is subject to change from time to time. The information alone is not sufficient and shouldn't be used for the development or implementation of an investment strategy. It should not be construed as investment advice to any party.

Invesco India Banking & PSU Debt Fund

(An open-ended debt scheme predominantly investing in Debt instruments of banks, Public Sector Undertakings, Public Financial Institutions and Municipal Bonds)

Suitable for investors who are seeking*:

- Returns over short to medium term
- Investments primarily in debt & money market instruments issued by Banks, PFIs, PSUs and Municipal Bonds

*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

RISKOMETER



Invesco India Short Term Fund

(An open ended short term debt scheme investing in instruments such that the Macaulay duration[^] of the portfolio is between 1 year to 3 years)

Suitable for investors who are seeking*:

- Income over short to medium term
- Investments in short term debt and money market instruments

*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

RISKOMETER



Invesco India Corporate Bond Fund

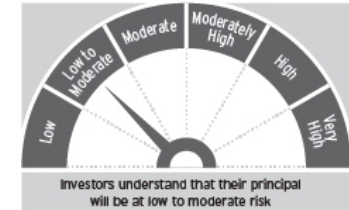
(An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds)

Suitable for investors who are seeking*:

- Income over medium to long term
- Investments in AA+ and above rated corporate bonds

*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

RISKOMETER



Invesco India Treasury Advantage Fund

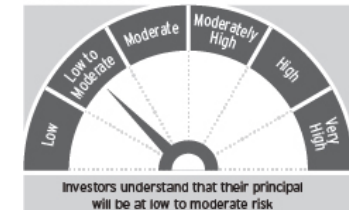
(An open ended low duration debt scheme investing in instruments such that the Macaulay duration[^] of the portfolio is between 6 months to 12 months)

Suitable for investors who are seeking*:

- Income over short term
- Investment in debt and money market instruments

*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

RISKOMETER



[^]Please refer to the heading 'C. Asset Allocation Pattern' under Section 'II. Information about the Scheme' of Scheme Information Document where the concept of Macaulay duration has been explained.

Note - Macaulay duration of a bond is the number of years taken to recover the initial investment of a bond. It is calculated as the weighted average number of years to receive the cash flow wherein the present value of respective cash flows is multiplied with the time to that respective cash flows. The total of such values is divided by the price of the security to arrive at the duration.

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Disclosure of Risk-o-Meter:

Risk-o-meter disclosed in the product label of the Scheme is based on the Scheme portfolio as on March 31, 2021. The AMC will evaluate the Risk-o-Meter on a monthly basis and shall disclose the same along with the portfolio disclosure. Any change in the risk-o-meter will be communicated by way of Notice-cum-Addendum and by way of an Email /SMS to the Unit holders of the Scheme.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.