Insights- Monetary Policy Review

December 8, 2021

Vikas Garg
Head – Fixed Income

“Overall, the policy continues to focus on durable and broad-based growth recovery coupled with the effective liquidity management. With uncertainties arising from the surge in Covid-19 infections in many parts of the world and emergence of Omicron variant, MPC chose to support growth and maintain accommodative stance. As inflation remains within MPC’s medium-term target, we believe the direction is – repo rate lower for longer, coupled with a gradual policy normalization in a non-disruptive way through further liquidity recalibration and narrowing of policy rate corridor most likely by early next year.

Key decisions/Highlights

All MPC members unanimously voted to maintain status quo on policy rates. **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) members voted **5:1 to continue with the accommodative policy stance as long as necessary to revive and 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.

The **Consumer Price Index (CPI)** based inflation is expected to peak in Q4:2021-22 and soften thereafter. CPI **for FY22 maintained at 5.3%**; while for Q3 it is revised upwards to 5.1% (4.5% earlier); and 5.7% in Q4 (5.8% earlier) with risks broadly balanced. CPI inflation for Q1 FY23 is projected at 5% (earlier 5.2%) and for Q2 FY23 is projected at 5%.

Real Gross Domestic Product (GDP) growth projection retained at 9.5% for FY22 consisting of 6.6% in Q3 (earlier 6.8%) and 6.0% in Q4 (earlier 6.1%). Real GDP growth for Q1 FY23 is projected at 17.2% (no change) and for Q2 FY23 is projected at 7.8%.

Liquidity management operations to continue in order to support economic recovery and bring in financial stability

The **14-day variable rate reverse repo (VRRR)** auction would be the main **liquidity management operation,** RBI has been rebalancing the liquidity surplus by shifting it out of the **fixed rate overnight reverse repo** window into the **VRRR auctions** of longer maturity.

The **14-day VRRR** auctions would be conducted on a **fortnightly basis and the auction amount has been raised** – Rs. 6.5 lakh crores on December 17 and Rs. 7.5 lakh crores on December 31. From January 2022 onwards liquidity absorption will be undertaken through the auction route.

The RBI **may consider complementing the 14-day VRRR auctions with longer term VRRR auctions** in a similar calibrated manner depending upon the evolving liquidity conditions.

Flexibility to conduct fine-tuning liquidity operations of varying amounts as and when required.

To **undertake Operation Twists (OT) and regular open market operations (OMOs)** as may be required for **effective monetary transmission and anchoring of interest rate expectations.**

Banks allowed to **prepay the outstanding amount** of funds availed under the **Targeted Long-Term Repo Operations (TLTRO 1.0 and 2.0)**

Dovish policy with focus on stimulating growth

The policy was set amidst a mixed set of macro indicators in global as well as domestic context. The global financial markets are witnessing heightened uncertainty due to the emergence of Omicron variant, the persistent supply chain disruptions and uptick in commodity prices. On domestic front, the reduction in new Covid-19 cases and rise in pace of vaccination had improved sentiments and economy was gradually set on path of recovery. However, the emergence of new variant coupled with the high energy and commodity prices had increased uncertainty with regards to the growth-inflation dynamics.

As was widely expected, MPC decided to continue with its growth supportive stance by keeping policy rates unchanged and maintaining accommodative stance, for the consecutive ninth policy review. It was expected that RBI may narrow the corridor between repo rate and the reverse repo rates. We believe the announcement of the same was deferred due to heightened uncertainties. We believe RBI would start normalizing the policy corridor in a phased manner from February policy onwards depending on the evolving macro-economic conditions. The deferment of the narrowing of the corridor gave the policy a dovish tone.

Focus on effective liquidity management. Liquidity withdrawal to be continued in a calibrated and gradual manner

The RBI's intent to manage liquidity in a manner which is supportive of economic recovery and strengthens macro-economic & financial stability is reassuring and confirms to continuation of monetary policy support.

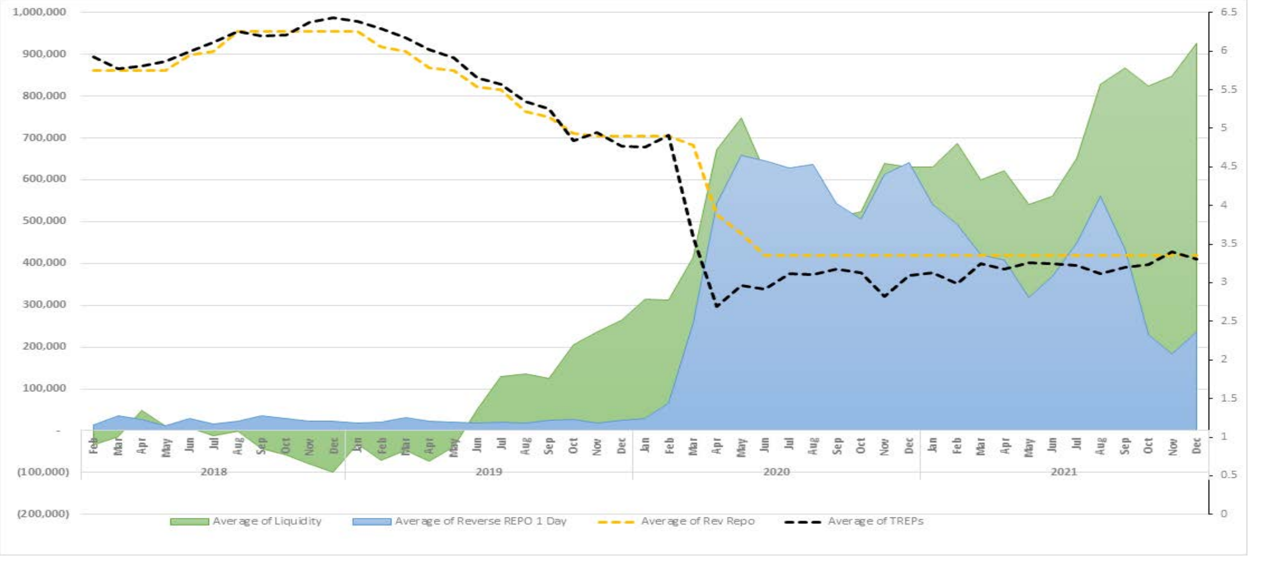
According to RBI, the rebalancing of liquidity has proceeded in a timely and non-disruptive manner as planned. It is also fulfilling its objective of strengthening the Reserve Bank's control over the liquidity overhang which, in turn, reinforces the ability of the Reserve Bank to normalize liquidity conditions when warranted.

As expected, MPC has decided to undertake more liquidity re-calibration measures through higher quantum of 14-day VRRR for more effective risk pricing especially at the short end. It will conduct the 14-day variable rate reverse repo (VRRR) auctions on a fortnightly basis – Rs. 6.5 lakh crores on December 17 and Rs. 7.5 lakh crores on December 31. The RBI Governor also mentioned that from January 2022 onwards liquidity absorption will be undertaken through the auction route, the frequency and quantum of the same would be watched out for.

Additionally, the 14-days VRRR auctions will continue to be complemented by longer term VRRRs of varying amounts for fine-tuning liquidity operations as and when required.

Further, for effective transmission of monetary policy and supporting the rates at the longer end of yield curve, RBI may conduct OTs and OMOs as and when required.

Monthly Systemic Liquidity & Liquidity under 1-day fixed rate Reverse Repo



Source: Bloomberg.

As clearly reflected in the above chart, Rs. 2-2.5 lakh crores of liquidity under 1 day Fixed Reverse Repo will still be much higher than the pre-Covid times.

Growth projections retained however downside risks emanate

The expanding vaccination coverage, slump in fresh COVID-19 cases and rapid normalization of mobility has helped recovery in domestic economic activity. The consumption demand has been improving, with pent-up demand getting reinforced by the festive season. In this backdrop, RBI retained its growth projection for FY22 at 9.5%. However, volatile commodity prices, persisting global supply disruptions, new mutations of the virus and financial market volatility may impart downside risks to the growth outlook.

Inflation expected to peak in Q4 2021-22 and soften thereafter

The RBI has retained FY22 inflation forecast at 5.3% while revising the projection for Q3FY22 upwards by 60 basis points to 5.1%. Going ahead the inflation prints are likely to be somewhat higher as positive base effect wanes. The sticky core inflation since June 2020 remains a cause of concern and as demand strengthens the input cost pressures could rapidly be transmitted to retail inflation.

Market reaction post policy announcement

Segment	Broad movement of yields today in bps	
	G-Sec	AAA Corporates
3 Months	-5	-5
6 Months	-2	-5
1 year	No Change	-5
2 -3 years	-6	-5 to -7
4 - 5 years	-6	-4 to -5
10 years	-5	-5

Source: Bloomberg.

Market reaction post policy announcement (continued)

Some market participants were expecting the narrowing of corridor between repo rate and reverse repo rate. No announcement of the same in the policy led to softening of yields at the shorter end and the longer end of the yield curve. The shorter end of the curve (2 to 3 years segment) softened by 5 to 7 bps while the longer end of the curve softened by 4-5 bps.

Our expectation- Repo Rate lower for longer coupled with a gradual policy normalization

We believe that the emergence of new variant of the virus has led to deferment of the normalizing of the policy rate corridor. The RBI will continue to prioritize growth by keeping repo rates lower for longer while continuing with the accommodative stance. However, the policy normalization is already underway through a gradual liquidity withdrawal which may be followed by restoring of the policy rate corridor back to 25 bps (as before the pandemic) by early next year and would be undertaken in phased manner depending on the evolving macro-economic conditions.

RBI is expected to be growth supportive and would use all the possible tools to revive the growth. Governor's statement that RBI would continue to manage liquidity in a manner that is conducive to entrenching the recovery and fostering macroeconomic and financial stability indicates that RBI is likely to maintain ample liquidity in the system.

We feel that at this juncture RBI has given precedence to growth and draws comfort from medium-term inflation prognosis as inflation projection has been anchored at 5% for H1 2022:23.

Fund Positioning

We feel that upto 6 months segment of the yield curve provides opportunity to risk-averse investors amid expectations of gradual normalization of policy rates with a possibility of reverse repo rate hike in beginning next calendar year or so. Our funds like **Invesco India Ultra Short Term Fund, Invesco India Money Market Fund and Invesco India Treasury Advantage Fund are apt for such risk-averse investors looking for short term investment horizon.**

For investors looking at the core allocation of their portfolio, the 2-5 years segment of the yield curve remains attractively placed from carry perspective given the current steepness of the curve. Additionally, benign liquidity conditions and favorable demand- supply dynamics also augers well for this segment. Our funds such as, **Invesco India Corporate Bond Fund, Invesco India Short Term Fund, and Invesco India Medium Duration Fund largely positioned in 2-5 years space could provide attractive investment opportunity amid RBI's continued accommodative policy and liquidity stance.**

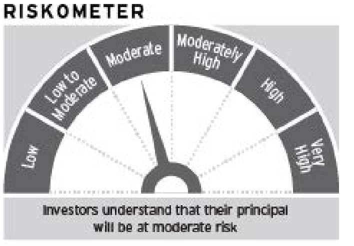
Further, long term rates remain anchored on the back of no negative surprises in the policy review and as RBI remains focused on orderly evolution of yield curve. In such a scenario, **investors with long term horizon and ability to absorb short term volatility may consider Invesco India Banking & PSU Debt Fund which is positioned at longer-end of the curve** and finds merit on the back of conviction that RBI will manage the yield curve and may support the long-term yields through the tools like regular Open Market Purchase Operations/ Operation Twist and secondary market intervention.

While the credit environment is expected to improve over the medium term, we believe credit dispersion will continue as of now, with very high-quality credits benefitting from RBI's benign liquidity policy but the lower quality credits (below AA) to be avoided for the time being. At the same time, very selective AA+/ AA credits backed by strong internal credit assessment can also be considered.

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. A relatively high interest rate risk and relatively low credit risk.)

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

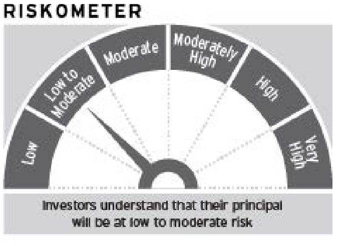
***Investors should consult their financial advisers if in doubt about whether the product is suitable for them.**



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. A moderate interest rate risk and relatively low credit risk.)

Suitable for investors who are seeking*:
- Income over short to medium term
- Investments in short term debt and money market instruments

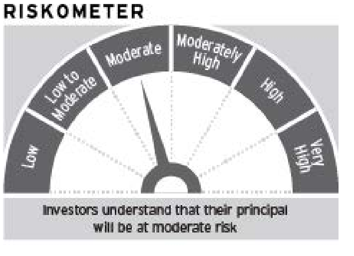
***Investors should consult their financial advisers if in doubt about whether the product is suitable for them.**



Invesco India Corporate Bond Fund
(An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds. A relatively high interest rate risk and relatively low credit risk.)

Suitable for investors who are seeking*:
- Income over medium to long term
- Investments in AA+ and above rated corporate bonds

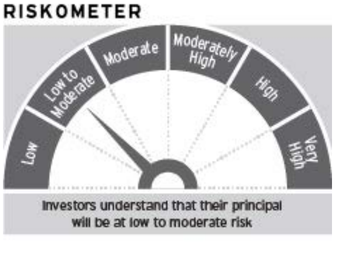
***Investors should consult their financial advisers if in doubt about whether the product is suitable for them.**



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. A relatively low interest rate risk and relatively low credit risk.)

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.**

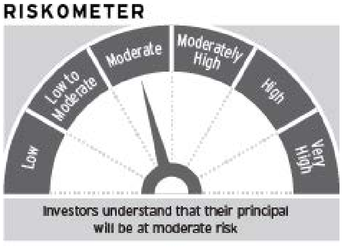


^Please refer to the heading 'C. Asset Allocation Pattern' under Section 'II. Information about the Scheme' of Scheme Information Document where the concept of Macaulay duration has been explained.
Note - Macaulay duration of a bond is the number of years taken to recover the initial investment of a 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.

Invesco India Medium Duration Fund
(An open ended medium term debt scheme investing in instruments such that the Macaulay duration^ of the portfolio is between 3 years and 4 years. A relatively high interest rate risk and moderate credit risk.)

Suitable for investors who are seeking*:
- Income over medium term
- Investments predominantly in debt and money market instruments with portfolio Macaulay Duration of 3 – 4 years

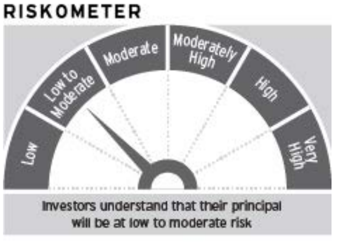
***Investors should consult their financial advisers if in doubt about whether the product is suitable for them.**



Invesco India Ultra Short Term Fund
(An open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration^ of the portfolio is between 3 months to 6 months. A relatively low interest rate risk and moderate credit risk.)

Suitable for investors who are seeking*:
- Income over short term
- Investments in a portfolio of short term money market and debt instruments

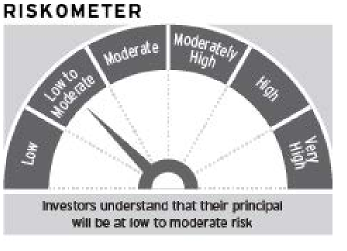
***Investors should consult their financial advisers if in doubt about whether the product is suitable for them.**



Invesco India Money Market Fund
(An open ended debt scheme investing in money market instruments. A relatively low interest rate risk and relatively low credit risk.)

Suitable for investors who are seeking*:
- Income over short term
- Investment in money market instruments

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



^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.

Potential Risk Class Matrix

Scheme Name

Invesco India Treasury Advantage Fund

Invesco India Money Market Fund

Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)	A-I		
Moderate (Class II)			
Relatively High (Class III)			

Scheme Name

Invesco India Short Term Fund

Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)	A-II		
Relatively High (Class III)			

Scheme Name

Invesco India Banking & PSU Debt Fund

Invesco India Corporate Bond Fund

Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)	A-III		

Scheme Name

Invesco India Ultra Short Term Fund

Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)		B-I	
Moderate (Class II)			
Relatively High (Class III)			

Scheme Name

Invesco India Medium Duration Fund

Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)		B-III	

Disclaimer:

This document 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. All figures and data included in this document are as on date and are subject to change without notice. The statements contained herein may include statements of future expectations and other forward looking statements that are based on prevailing market conditions / various other factors and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. The data used in this document is obtained by Invesco Asset Management (India) Private Limited (IAMI) from the sources which it considers reliable. While utmost care has been exercised while preparing this document, IAMI does not warrant the completeness or accuracy of the information and disclaims all liabilities, losses and damages arising out of the use of this information. The content of this document is intended solely for the use of the addressee. If you are not the addressee or the person responsible for delivering it to the addressee, any disclosure, copying, distribution or any action taken or omitted to be taken in reliance on it is prohibited and may be unlawful. The readers should exercise due caution and/or seek appropriate professional advice before making any decision or entering into any financial obligation based on information, statement or opinion which is expressed herein.

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