Insights- Monetary Policy Review

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“Extremely dovish policy with no change in policy rates and MPC’s stance. Priority was clearly given to domestic growth-inflation dynamics, unswayed by global market conditions. MPC took comfort from evolving inflation trajectory which appears different from the developed nations. With RBI Governor explicitly highlighting a ‘Calibrated and Well-telegraphed’ approach on policy actions, we expect MPC to maintain **“Repo rate Lower for Longer”** in order to provide necessary support to revive & sustain growth on durable basis, while keeping a close watch on the inflation trajectory.

Key decisions/Highlights

All Monetary Policy Committee (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%.

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 projections for **2021-22 is retained at 5.3% with Q4FY22 at 5.7**%. On the assumption of normal monsoon in 2022, **CPI is projected at 4.5% for FY23,** with Q1FY23 at 4.9%; Q2FY23 at 5.0%; Q3FY23 at 4.0%; and Q4FY23 at 4.2% with risks broadly balanced

Real Gross Domestic Product (GDP) growth for FY23 is projected at 7.8% with Q1FY23 at 17.2% (no change), Q2FY23 at 7% (down from earlier 7.8%.), Q3FY23 at 4.3% and Q4FY23 at 4.5%.

The **rebalancing of liquidity** would be on a **dynamic basis** while maintaining adequate liquidity in support of its accommodative stance.

With the progressive **return of normalcy,** RBI decided to **restore the liquidity management framework** to make it more **flexible and agile**

The **variable rate reverse repo (VRRR)** operations of **varying tenors** will be **conducted as and when warranted** by the evolving liquidity and financial conditions within the Cash Reserve Ratio (CRR) maintenance cycle.

Variable rate repos (VRRs) and variable rate reverse repos (VRRRs) of **14-day tenor will operate as the main liquidity management tool** based on liquidity conditions and will be conducted to coincide with the CRR maintenance cycle.

These main operations will be supported by fine-tuning operations to tide over any unanticipated liquidity changes during the reserve maintenance period. **Auctions of longer maturity will also be conducted as warranted.**

With effect from March 1, 2022, the **Fixed Rate Reverse Repo and the MSF operations** will be **available only during 17:30-23:59 hours on all days** and not during 09:00-23:59 hours, as instituted from March 30, 2020 to deal with the pandemic situation.

Enhanced the limit for investments under Voluntary Retention Route (VRR) by Rs. 1 lakh crores to Rs. 2.5 lakh crores with effect from April 1, 2022. This will provide access to additional sources of capital for the domestic debt market including G-secs.

Final **guidelines on Credit Default Swaps (CDS) to be rolled-out** and will facilitate the development of a credit derivatives market and deepen the corporate bond market in India.

Market got it wrong for the 2nd consecutive time; RBI maintains status-quo on all policy rates

A lot had happened since the last MPC review in December in terms of a sharp change in global interest rate outlook with many key Central Banks hinting / moving towards tighter policies, substantially higher commodity prices, Foreign Portfolio Investments (FPIs) inflows under pressure, domestic growth lesser impacted by Omicron and finally – a much higher-than-expected borrowing program for FY23 announced in the union budget which made the consensus view that this time RBI (as also expected last time) will go in to narrow the policy rate corridor by hiking atleast 20 bps in reverse repo. However, RBI belied the market expectations and maintained the rates with 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.

RBI Governor during the press conference addressed the market concerns if RBI is falling behind the curve by reassuring that the policy actions are very much in sync with the evolving situation on the domestic growth-inflation dynamics.

MPC re-iterated the need of continued and coordinated fiscal & monetary policy to support the economic recovery

The biggest risk according to us was that if RBI was to make a change or even mildly hint at the much-anticipated transition from the non-conventional approach adopted so far to support the growth to a more conventional inflation controlling approach and let the government do the heavy lifting to support the growth. This risk had magnified multifold over last few weeks with a sharp change in global monetary policies and more specifically after the budget which carried on with growth agenda with higher than expected fiscal push in FY23. MPC, however decided to play along with the government to support the growth.

RBI surprised the market by not tweaking the rates and maintaining accommodative stance. On growth front, though RBI retained its growth projections for FY22, subsequent growth projections for H2FY23 appeared tepid. The governor highlighted that volatile commodity prices, persisting global supply disruptions, new mutations of the virus and financial market volatility may impart downside risks to the growth outlook. This also suggested that they are not in a rush to shift their focus on rate normalization as of now.

Every country on its own as of now when it comes to the withdrawal of monetary support

As we had highlighted in our Fixed Income outlook few weeks back **"the countries are at different point of normalcy curve and may require the various policy actions which best suits them, instead of moving in a synchronised way with other Central Banks, unlike the approach taken during the Pandemic"**, Governor reiterated the same through various responses in press conference that Indian monetary policy will be more driven by the domestic growth-inflation dynamics and not by the approach taken by the Global Central Banks.

The governor mentioned about different characteristics of inflation basket in global market and in India highlighting that many global inflationary pressures like for instance used cars prices in US, truck drivers wages in Europe, global food basket & wages may not be directly applicable for the Indian market. India's stable INR on back of healthy forex reserves and a moderate Current Account Deficit (CAD), which is expected to be well funded by Foreign Direct Investments (FD)I inflows provide cushion to MPC to carry on with domestic driven monetary policy.

Big divide in RBI's inflation projections vs. market expectations; only time will tell

Very surprisingly and quite contrary to the global trend & market expectations, RBI sounded very comfortable on inflation for now and maintained the Q4FY22 average inflation at 5.7% and H1FY23 at 4.9%-5% before moderating to 4%-4.2% in H2FY23. FY22 average inflation is also maintained at 5.3% which is expected to moderate sharply to 4.5% in FY23. While the commodity prices, especially the crude have increased sharply over last few months (higher crude prices have not been fully transferred to consumers yet), Governor re-iterated many ~~a~~ times during press conference that a detailed assessment has been done with various scenarios and the comfort is taken from the expected moderation in food prices, supply side interventions by government and subdued private consumption. As many a times in the past, this time again the market expectations are quite on a higher side (may be by 40-50 bps higher than RBI's projections) and only the time will tell the actual inflation trajectory over next few months. Looking back over last 2 years during the times of un-precedented disruption by pandemic, it is the RBI who has been proved more right on inflation trajectory. Having said that, we also are in the camp to believe that RBI's inflation projections are on a lower side unless global commodity prices, especially the Crude prices retreat.

Liquidity management further normalized

RBI has shown its intent towards an accommodative liquidity stance, in line with the accommodative policy rate stance while gradually re-calibrating the liquidity in a timely and a non-disruptive way which is supportive of economic recovery. As pandemic led disruptions continue to recede, RBI has taken further steps to normalize the liquidity framework in a non-disruptive way while keeping the systemic liquidity in surplus mode. Variable Reverse Repo Rate (VRRR) and Variable Repo Rate (VRR) auctions would be done based on the evolving liquidity & financial conditions and 14 day VRRR / VRR will be used as the main liquidity tool, fine tuned with different tenors. Fixed Rate Reverse repo and MSF operations have been restored to earlier timings.

Not much on higher fiscal supply in FY23 and inclusion in global bond indices – a tad negative

RBI did not provide much insights neither on its stance on supporting huge fiscal supply of government securities in FY23 nor on the prospects of inclusion of sovereign bonds in global bond indices, something which was keenly watched by the market participants. Nonetheless, the Governor tried to address these concerns with increase in FPI[3] limits by Rs 1 lakh crores under Voluntary Retention Route (VRR), potential of higher collection on small savings and RBI's proactive steps to ensure orderly completion of the government borrowing (with the support of market).

Well calibrated and a telegraphed monetary policy action to avoid any surprises

Considering the high-level of uncertainty at many fronts, both the Governor as well as the Deputy Governor reiterated couple of times that MPC would take a well telegraphed approach and will spell out in advance about the future policy actions to avoid any surprises or suddenness. Looking in the rear mirror, both the last policies did not have any expectations set in advance by RBI about the reverse repo rate hike. Even on the liquidity recalibration, RBI has maintained a well-articulated strategy.

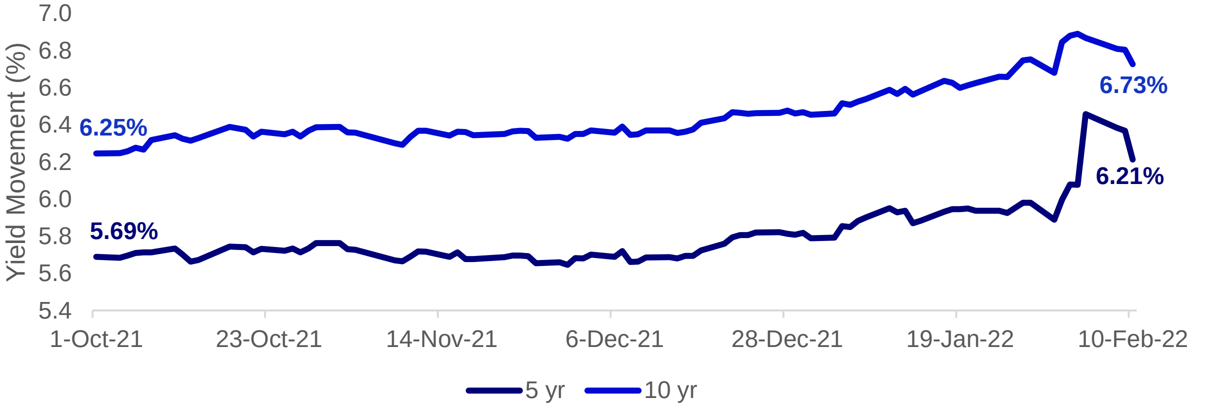
We also expect a gradual withdrawal of loose monetary policies – "Repo Rate lower for longer"

For India, 2022 is expected to be a tale of two halves. In first half, we expect MPC to continue to focus on growth impetus till the time economic recovery becomes well entrenched and broad based. Recent emergence of new Covid-19 variant will also warrant the continuation of monetary policy support. While the headline inflation may test the 6% mark during this period, RBI is expected to take comfort from the moderation in inflation trajectory, going forward. Nonetheless, RBI may continue with its policy normalisation in this period through further liquidity recalibration and narrowing of policy rate corridor. In the 2nd half, RBI may make a smooth transition to inflation control towards the medium-term target of 4%, without losing an oversight on continuation of growth recovery. During this time, we expect RBI to begin with a gradual repo rate hike cycle, while remaining prepared to take proactive actions to support growth recovery, if needed. Overall, we expect "RBI to maintain Lower Repo Rate for Longer" in order to provide necessary support to revive & sustain growth on durable basis, while keeping a close watch on inflation trajectory.

Nonetheless, volatility may remain high in 2022

Year 2022 is expected to remain volatile for financial assets as the world adjusts to lesser availability of fiscal, monetary and most crucially - the liquidity support for economic recovery, as the normalcy gathers pace & controlling of inflation becomes a key task for Central Banks. Additionally, wide difference in inflation expectations of RBI & market and another record high G-Sec borrowing in FY23 in the absence of RBI's stated support, we expect interest rates to remain volatile, especially at the longer end.

Interest rate movement of 5 yr G-sec and 10 yr G-sec



Data from October 1, 2021 to February 10, 2022. Source: Bloomberg.

Market reaction post policy announcement

Segment	Broad movement of yields today in bps	
	G-Sec	AAA Corporates
3 Months	-10	-15
6 Months	-15	-20
1 year	-15	-20
2 -3 years	-15	-10-15
4 - 5 years	-15	-15-20
10 years	-7	-6-8

Source: Bloomberg

Fund Positioning

Against the backdrop of heightened volatility, one of the biggest challenges in 2022 will be to manage the return vs. the volatility expectations. Extreme steepness of the yield curve may provide merit to go up the curve, however, longer end may remain volatile as the global backdrop changes to relatively tighter money policies for tackling inflation. While, we expect a general hardening of interest rates across the curve in 2022, we believe that the curve will undergo a flattening with extreme short end getting more impacted as compared to the longer end of the curve.

We feel that 6 months to 1 year segment of the yield curve provides opportunity to risk-averse Investors amidst expectations of liquidity re-calibration & Reverse repo rate hike over next few months. Our funds like **Invesco India Ultra Short Term Fund, Invesco India Money Market Fund and Invesco India Treasury Advantage Fund with a defensive positioning are suited for such investors**.

For investors looking at the core allocation, the 2 to 5 year segment of the yield curve remains attractively placed from carry perspective, given the current steepness of yield curve. To us, it is a sweet spot on the yield curve – neither too short which gets impacted by low gross yields, nor too long that can get impacted by the rate volatility. Our funds such as, like **Invesco India Corporate Bond Fund, Invesco India Short Term Fund, and Invesco India Medium Duration Fund** having a large proportion deployed in this segment can be looked at by such investors.

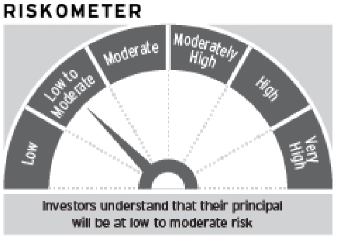
Invesco India Short Term Fund

(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.**



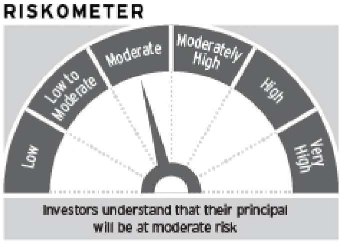
Invesco India Corporate Bond Fund

(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.**



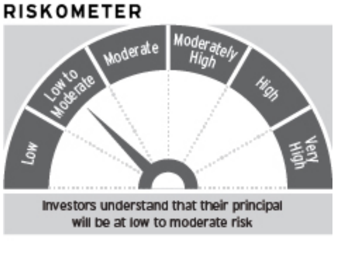
Invesco India Treasury Advantage Fund

(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.

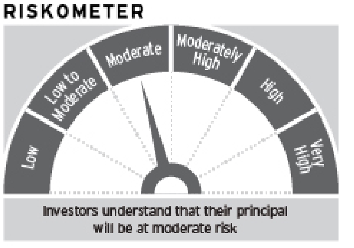
Note - Macaulay duration of a bond is the number of years taken to recover the initial investment of a bond. It is calculated as the weighted average number of years to receive the cash flow wherein the present value of respective cash flows is multiplied with the time to that respective cash flows. 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.**

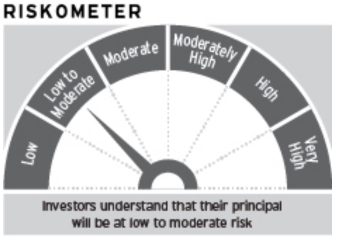


Invesco India Ultra Short Term Fund
(An open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration^ of the portfolio is between 3 months to 6 months. A relatively low interest rate risk and moderate credit risk.)

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.**

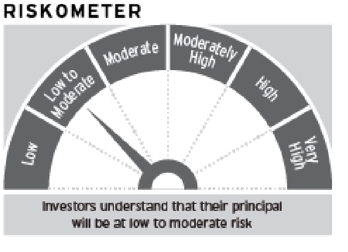


Invesco India Money Market Fund
(An open ended debt scheme investing in money market instruments. A relatively low interest rate risk and relatively low credit risk.)

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.**



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Potential Risk Class Matrix

Scheme Name	Potential Risk Class			
Invesco India Treasury Advantage Fund Invesco India Money Market Fund	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	Potential Risk Class			
Invesco India Short Term Fund	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	Potential Risk Class			
Invesco India Corporate Bond Fund	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	Potential Risk Class			
Invesco India Ultra Short Term Fund	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	Potential Risk Class			
Invesco India Medium Duration Fund	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	

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