Insights- Monetary Policy Review

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MPC stays on course with a 50 bps repo rate hike to keep the inflation & inflationary expectations under check. Sharp increase in FY23 CPI projection to 6.7% in June 2022 from 5.7% in April 2022 is a reality check and well acknowledged. No Cash Reserve Ratio (CRR) hike comforts the market that RBI may withdraw liquidity over a multi-year time frame only. Overall, a lesser hawkish policy than market expectations. Nonetheless, we expect rate hikes to continue as MPC remains data dependent and stands ready & pro-active to limit inflation pressure while assessing risks to growth.

Key decisions/Highlights

All Monetary Policy Committee (MPC) members unanimously voted to **increase the policy rate by 50 bps at 4.90%.**

The **standing deposit facility (SDF) rate** stands adjusted to **4.65%** and the **marginal standing facility (MSF) rate** and the **Bank Rate** to **5.15%.**

MPC decided to remain **focused on withdrawal of accommodation** to ensure that inflation remains within the target going forward, while supporting growth.

On the assumption of a normal monsoon in 2022 and average crude oil price (Indian basket) of US$105 per barrel, Consumer Price Index (CPI) inflation is now projected at **6.7% in 2022-23 (revised upwards from 5.7% in April 2022), with Q1 at 7.5% (up from earlier 6.3%); Q2 at 7.4% (up from earlier 5.8%); Q3 at 6.2% (up from 5.4%); and Q4 at 5.8% (up from 5.1%), with risks broadly balanced.**

Real GDP growth projections have been **retained at same levels, for 2022-23 it is projected at 7.2%, with Q1 at 16.2%; Q2 at 6.2%; Q3 at 4.1%; and Q4 at 4.0%,** with risks broadly balanced**.**

RBI **increased** the existing **limits on individual housing loans by cooperative banks**; for Tier I /Tier II **Urban Co-operative Banks** limit is revised from Rs.30 lakh/ Rs.70 lakh to **Rs.60 lakh/ Rs.140 lakh**, respectively. For **Rural Co-operative Banks** (RCBs), limits will increase from Rs.20 lakh to **Rs.50 lakh** for RCBs with assessed net worth less than Rs.100 crore; and from Rs.30 lakh to **Rs.75 lakh** for other RCBs.

State Co-operative Banks and District Central Co-operative Banks allowed to extend finance to Commercial Real Estate – Residential Housing within the existing aggregate housing finance limit of 5% of their total assets.

Rupay credit cards would be **linked to Unified Payments Interface (UPI).**

RBI stays on course by focusing on withdrawal of accommodative policy stance; hikes repo rate by 50 bps

Today's hike in repo rate by 50 bps came in line with our expectations. The policy announcement is in continuation to MPC's focused shift from growth supporting policy to an inflation controlling policy, which it had already established in the last two policy announcements. The hike of 40 bps in May was part of reversal of 75 + 40 bps repo rate cut undertaken by MPC during pandemic led ultra-accommodative mode. With the current 50 bps hike, RBI is moving closer to the pre-pandemic policy repo rate of 5.15%.

Further, the MPC has dropped the phrase "remain accommodative" from the stance, which also signals MPC's focus on normalization of policy rate at a faster pace. The priority to combat inflation paves way for further rate hikes going ahead with repo rate seen at 5.75% to 6.00% by April 2023.

Reality check with sharp increase in FY23 CPI projections as inflationary pressures have become more entrenched

The inflation print has breached RBI's upper tolerance band of 6%, for 4 consecutive months now, and the still elevated inflationary pressures led by global commodity price surge including food items prompted RBI to sharply revise the inflation projections upwards to 6.70% for FY23, from 5.70% projected in April'2022 and 4.50% projected in February'2022. The inflation trajectory given by MPC assumes oil prices at US$105 per barrel and normal monsoon this year. We believe upside risk to the trajectory can emanate from geopolitical crisis, elevated commodity prices and high domestic food inflation. However, the recent pro-active measures by government in form of excise duty cut on petrol & diesel and ban on wheat export might provide some respite to the inflation. As uncertainties persist, we feel that RBI would be closely monitoring these factors and continue to prioritize inflation management.

Growth dynamics holding as of now

RBI sounded confident on the growth recovery across the segments and retained the projection at 7.20% for FY23. This stems from that fact that capacity utilization in manufacturing sector has seen improvement and is expected to further increase in FY23. The governor also highlighted that the urban demand is recovering, while the rural demand is likely to gain impetus on back on normal monsoon and improvement in agricultural prospects.

No Cash Reserve Ratio (CRR) hike and reassurance of ample liquidity was a welcome respite

The market participants drew comfort from the fact that the RBI did not announce CRR hike, which was widely anticipated by the market. The previous two policy actions- the introduction of Standing Deposit Facility (SDF) and repo rate hike, has pushed the operating rates up and moderated the system liquidity. RBI articulated that while the surplus liquidity would be withdrawn gradually, it would still be adequately available to support the economy. Currently, the weighted average call rate is closer to the SDF rate (i.e. at 4.65% as of June 08, 2022) and we believe RBI would calibrate liquidity so as to make repo rate the operating rate.

Governor reiterates the orderly completion of G-Sec borrowing program; actions still missing

While the Governor re-iterated the availability of various policy tools to complete the G-Sec borrowing in an orderly manner, absence of any specifics will make it difficult to absorb huge supply of bonds. Meanwhile, the market remains concerned about fiscal estimates moving up marginally by 0.2% of GDP on account of cutting fuel taxes and fertilizer subsidies announced, which in turn may translate to increase in gross market borrowing by Rs. 1.50 trillion.

Current inflation-growth dynamics warrants further rate hikes going ahead, which is in line with MPC's focus on withdrawal of accommodative policy

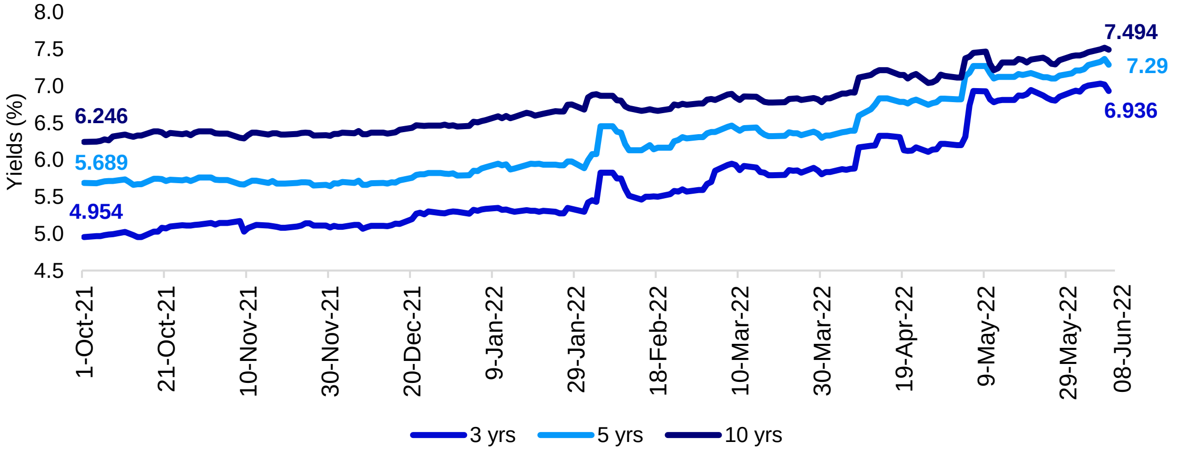
MPC has clearly articulated its concern on inflation which is reflected in the revised inflation forecasts. We believe supply side disruptions, geopolitical tensions and commodity prices pose risks to inflation outlook, while the growth seems to be fairly supported by domestic factors. We expect inflation trajectory to be key priority for MPC and the future rate actions would be largely driven by the inflation prints in coming month, price control measures taken by the government and how monsoon pans out & its impact on the food prices.

With the 90 bps hike being done over a 2-month period, RBI is trying to show urgency to get ahead of inflation. At the current juncture, our view is that RBI is likely to move towards a repo rate of 5.75% to 6.00% by April 2023 from the current 4.90%.

Besides the inflationary pressures, another key monitorable to keep a watch on is the Balance of Payment situation which can also influence RBI's decision for pre-emptive rate hikes. Though not alarming as of now as supported by healthy forex (Fx) reserve of ~USD 600 bn, but incremental drag due to high Current Account Deficit which is expected to be ~3.0% of GDP in FY23 and FPI's sell off (~USD 25 bn outflow in 2022 so far) can add to the complications for RBI for maintaining healthy Fx cushion & currency stability.

With challenging global backdrop as many Central Banks tightens the monetary policies to tame inflationary pressures, huge fiscal supply and RBI's expected fast withdrawal of ultra-accommodative policy, we expect interest rates to remain volatile with an upward bias.

Interest rate movement of 3 yr G-sec, 5 yr G-sec and 10 yr G-sec



Data from October 1, 2021 to June 08, 2022. Source: Bloomberg

Market reaction post policy announcement

Segment	Broad movement of yields in bps (as on June 08, 2022)	
	G-Sec	AAA Corporates
3 Months	-10	-10
6 Months	+7	-5
1 year	+2	-5
2 -3 years	-10	-5 to -10
4 - 5 years	-10	-5 to -10
10 years	-2	0

Source: Bloomberg

Fund Positioning

With the policy focus clearly shifting to inflation management, the concern continues to be on growing inflationary risks. RBI will be much more data dependent and will be watchful of evolving global factors and domestic macro-economic situation with regards to future rate actions.

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.

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

For investors looking at the core allocation, the 1 to 3 year segment of the yield curve remains well placed from carry perspective. Hence for us, the sweet spot remains the short end of the yield curve which stands to benefit from the absolute level of relatively high yields, while not getting impacted by the rate volatility, in comparison to the longer end of the curve. Our funds such as, like **Invesco India Short Term Fund, Invesco India Corporate Bond Fund, and Invesco India Medium Duration Fund** having a large proportion deployed in this segment can be looked at by such investors.

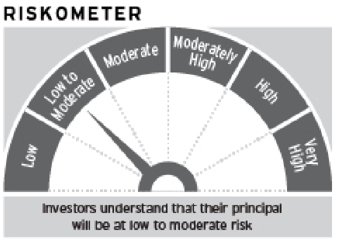
Invesco India Short Term Fund

(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.**



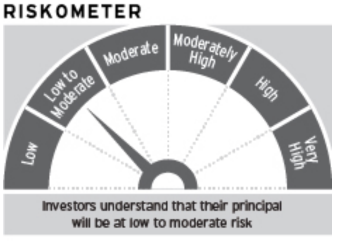
Invesco India Corporate Bond Fund

(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.**



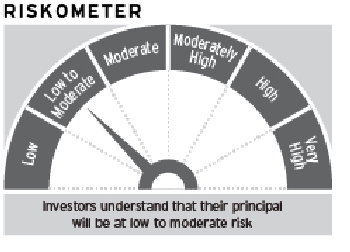
Invesco India Treasury Advantage Fund

(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.

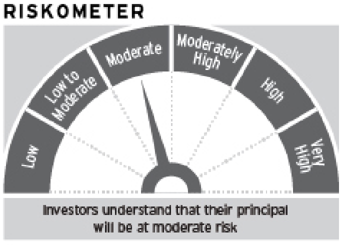
Invesco India Medium Duration Fund

(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.**



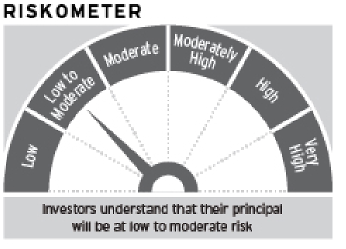
Invesco India Ultra Short Term Fund

(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.**



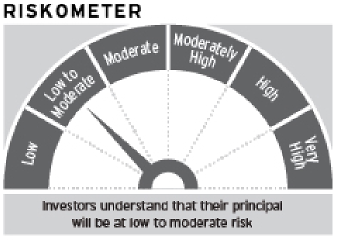
Invesco India Money Market Fund

(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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Invesco Mutual Fund

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 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	

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