



Vikas Garg
Head – Fixed Income



Governor Das's pre-emptive strike on inflation. Surprise timing of policy repo rate hike of 40 bps & CRR increase by 50 bps reflects RBI's rigor to tame inflationary pressure amidst the global uncertainties & its readiness for further policy actions. Though an unscheduled move, outcome is in line with last policy's pivotal shift undertaken by MPC towards prioritizing inflation over growth. Upswing in global commodity prices, expected increase in rates by US Fed tonight and higher than anticipated rise in domestic CPI will keep yields under pressure.

Insights- Monetary Policy Review

May 04, 2022

Key decisions/Highlights

All Monetary Policy Committee (MPC) members unanimously voted to **increase the policy rate by 40 bps at 4.40%**.

The **standing deposit facility (SDF) rate** stands adjusted to **4.15%** and the **marginal standing facility (MSF) rate** and the **Bank Rate** to **4.65%**.

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

The drivers of domestic economic activity are getting stronger for growth however headwinds from **global spillovers** in the form of geopolitical tensions, elevated commodity prices, Covid-19 related lockdowns/restrictions in some major economies, slowing external demand and tightening global financial conditions **pose upside risks to growth**.

The surge in domestic petroleum product prices, global wheat shortages, increasing edible oil process, higher crude oil prices, input costs pressure poses **upward risks to the inflation trajectory**. **We believe that RBI is likely to revise the inflation projections upwards in the next policy announcement.**

RBI increased **Cash Reserve Ratio (CRR) by 50 bps to 4.5%** of net demand and time liabilities (NDTL), effective from the fortnight beginning May 21, 2022. The **withdrawal of liquidity** through this increase in the CRR would be of the order of **Rs. 87,000 crores**.

Inflation takes centerstage, prompts RBI to go for an unscheduled policy repo rate hike

March CPI came at ~7% which was higher than anticipated. Additionally, the still elevated inflationary pressures led by global commodity price surge including food items prompted RBI to go for a pre-emptive strike on inflation by undertaking off the cycle repo rate hike of 40 bps. Even as market was bracing for policy tightening in near months, the timing and quantum of rate hike came faster than expected and caught the market participants off-guard. The Governor justified today's out of turn policy rate action to anchor the inflation expectations amidst alarmingly high global inflation and inflationary pressures seeping into India specifically in items like edible oils, fertilizers, crude oil etc.

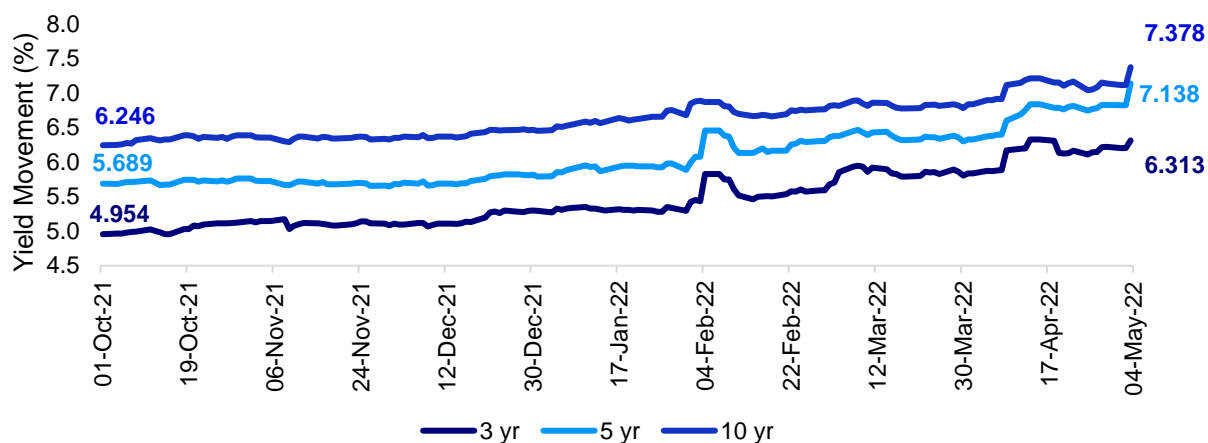
Hike in CRR another step towards reducing the size of liquidity surplus but not a concern given ample systemic liquidity

In line with RBI's stance of reducing the liquidity surplus over a multi-year time frame in a non-disruptive manner, the hike in CRR is a step in a direction to ebb the inflationary pressure. The CRR hike is expected to suck the liquidity to the tune of Rs. ~87,000 crores. Given the current large liquidity surplus (Rs. 6.2 trillion according to Bloomberg data), the more measures to reduce liquidity can be on chart. However, liquidity remains ample and is line with its accommodative stance.

MPC's actions are in line with its focus on shifting away from ultra-accommodative policy stance; more rate hikes expected to follow

Last scheduled MPC in April 2022 had clearly articulated a pivotal shift away from ultra-accommodative stance adopted during pandemic. This policy action of 40 bps rate hike can be seen as a part reversal of 75 + 40 bps repo rate cut undertaken by MPC during pandemic led ultra-accommodative mode. This also emphasizes that there is further room for policy repo rate hikes of ~75 bps to neutralize ultra-accommodative policy stance. We expect this to happen over next 2-3 MPC meetings, depending upon the inflation trajectory, which will take the policy repo rate back to pre-pandemic levels at 5.15%.

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



Data from October 1, 2021 to May 04, 2022. Source: Bloomberg

Market reaction post policy announcement

Segment	Broad movement of yields in bps (as on May 04, 22)	
	G-Sec	AAA Corporates
3 Months	+20-30	+30-35
6 Months	+25-30	+40-45
1 year	+30-35	+50-60
2 -3 years	+40-45	+40-50
4 - 5 years	+40-45	+40-50
10 years	+26	+35-40

Source: Bloomberg

Fund Positioning

The RBI remains concerned about growing inflationary risks and will be much more data dependent, which will be a function of evolving global factors and domestic macro-economic situation. With policy focus shifting towards inflation control and RBI moving away from ultra-dovish policy, further future rate hike actions are expected.

Against the backdrop of future rate hikes, our fund positioning will be guided by evolving market dynamics as well individual fund's mandates. Extreme steepness of the yield curve may provide merit to go up the curve, however, longer end may remain volatile as the global backdrop becomes further challenging 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 an 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 remains well placed from carry perspective, given the current steepness of the 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 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

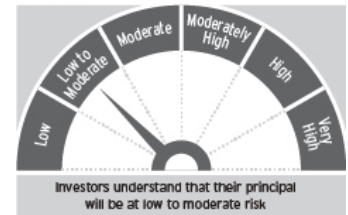
(An open ended short term debt scheme investing in instruments such that the Macaulay duration[^] of the portfolio is between 1 year to 3 years. A moderate interest rate risk and relatively low credit risk.)

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.**

RISKOMETER



Invesco India Corporate Bond Fund

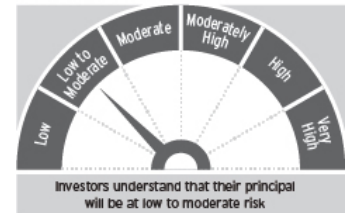
(An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds. A relatively high interest rate risk and relatively low credit risk.)

Suitable for investors who are seeking*:

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

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RISKOMETER



Invesco India Treasury Advantage Fund

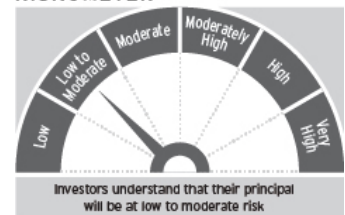
(An open ended low duration debt scheme investing in instruments such that the Macaulay duration[^] of the portfolio is between 6 months to 12 months. A relatively low interest rate risk and relatively low credit risk.)

Suitable for investors who are seeking*:

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

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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.

Invesco India Medium Duration Fund

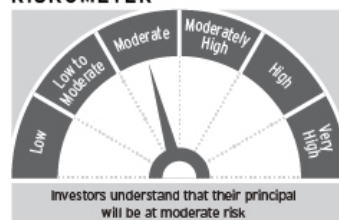
(An open ended medium term debt scheme investing in instruments such that the Macaulay duration[^] of the portfolio is between 3 years and 4 years. A relatively high interest rate risk and moderate credit risk.)

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

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Invesco India Ultra Short Term Fund

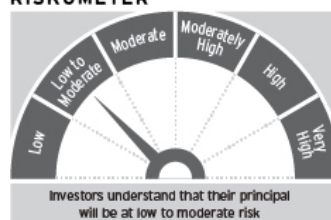
(An open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration[^] of the portfolio is between 3 months to 6 months. A relatively low interest rate risk and moderate credit risk.)

Suitable for investors who are seeking*:

- Income over short term
- Investments in a portfolio of short term money market and debt instruments

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RISKOMETER



Invesco India Money Market Fund

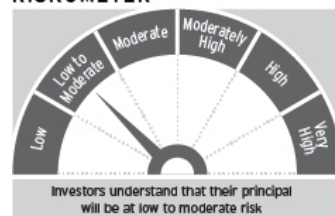
(An open ended debt scheme investing in money market instruments. A relatively low interest rate risk and relatively low credit risk.)

Suitable for investors who are seeking*:

- Income over short term
- Investment in money market instruments

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RISKOMETER



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

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

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