Insights- Monetary Policy Review

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"Don't rock the boat when it is close to the shore, there is a life beyond", the statement by the Governor says it all.

Overall, a well-balanced policy with a continuation of growth support along with a calibrated approach on liquidity management. Status quo on interest rates amidst a still uneven growth recovery and the moderating inflation is more reassuring and confirms to continuation of monetary policy support. 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

Policy **Repo rate remains unchanged at 4%** and Reverse repo rate at 3.35%. All MPC members unanimously voted in favor of keeping the policy rates unchanged.

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 **the accommodative 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 MPC voted 5:1 to continue with the accommodative policy stance.**

The **Consumer Price Index (CPI) based inflation revised downward for FY22 by 40 bps and is now projected at 5.3% (5.7% earlier**); 5.1% in Q2 (5.9% earlier); 4.5% in Q3 (5.3% earlier); and 5.8% in Q4 (no change) with risks broadly balanced. CPI inflation for Q1 FY23 is projected at 5.2% (earlier 5.1%)

Real Gross Domestic Product (GDP) growth projection retained at 9.5% for FY22 consisting of 7.9% in Q2 (7.3% in Q2), 6.8% in Q3 (earlier 6.3%) and 6.1% in Q4 (no change). Real GDP growth for Q1 FY23 is projected at 17.2% (no change).

Liquidity management operations to continue in line with evolving conditions; timelines for couple of liquidity measures extended with a view to support uneven economic recovery.

To **undertake the 14-day variable rate reverse repo (VRRR) auctions** on a fortnightly basis – Rs. 4.0 lakh crores on Oct 8; Rs. 4.5 lakh crores on October 22; Rs. 5.0 lakh crores on November 3; Rs. 5.5 lakh crores on November 18; and Rs. 6.0 lakh crores on December 3.

The RBI **may consider complementing the 14-day VRRR auctions with 28-day VRRR auctions** in a similar calibrated manner depending upon the evolving liquidity conditions.

VRRR auctions primarily used as a tool for rebalancing liquidity as part of liquidity management operations and **should not be interpreted as a reversal of the accommodative policy stance**.

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

Liquidity absorbed under the fixed rate reverse repo to remain ample and will still be at around Rs. 2 to 3 lakh crores till first week of December 2021.

No G-sec Acquisition Programme (G-SAP) operations at this juncture given the controlled fiscal supply and the existing liquidity overhang.

To undertake G-SAP as and when warranted by liquidity conditions and continue to **flexibly conduct other liquidity management operations including Operation Twist (OT) and regular open market operations (OMOs)** to ensure orderly evolution of yield curve

Not rocking the boat as of now - policy rates on hold and accommodative stance is a welcome re-assurance

The policy was set amidst a mixed set of macro indicators in global as well as domestic context. Global backdrop shifted more in favor of tapering of asset purchase programs across many geographies as inflation remains sticky, even as the global growth concerns increased led by energy crisis and China's credit related issues. On the domestic front also, while several MPC members assured about a gradual policy normalization at various public forums, higher than expected VRRR cut-off in last few auctions and a sharp rise in crude prices, worried the market. Subsequently, the market had priced in almost a ~15 bps reverse repo rate hike in this policy, as against no such hike expected a month earlier.

As we expected, MPC decided to continue with its growth supportive stance by keeping policy rates unchanged and maintaining accommodative stance, for the consecutive eighth policy review. We were of view that RBI will guide the market well in advance before normalizing the policy rate corridor through a reverse repro rate hike. On the changing global backdrop, the governor stated that, the MPC has maintained a resolute pause as the growth recovery is still uneven along with a moderating inflation trajectory though elevated, unlike many other countries where the inflation continues to inch up.

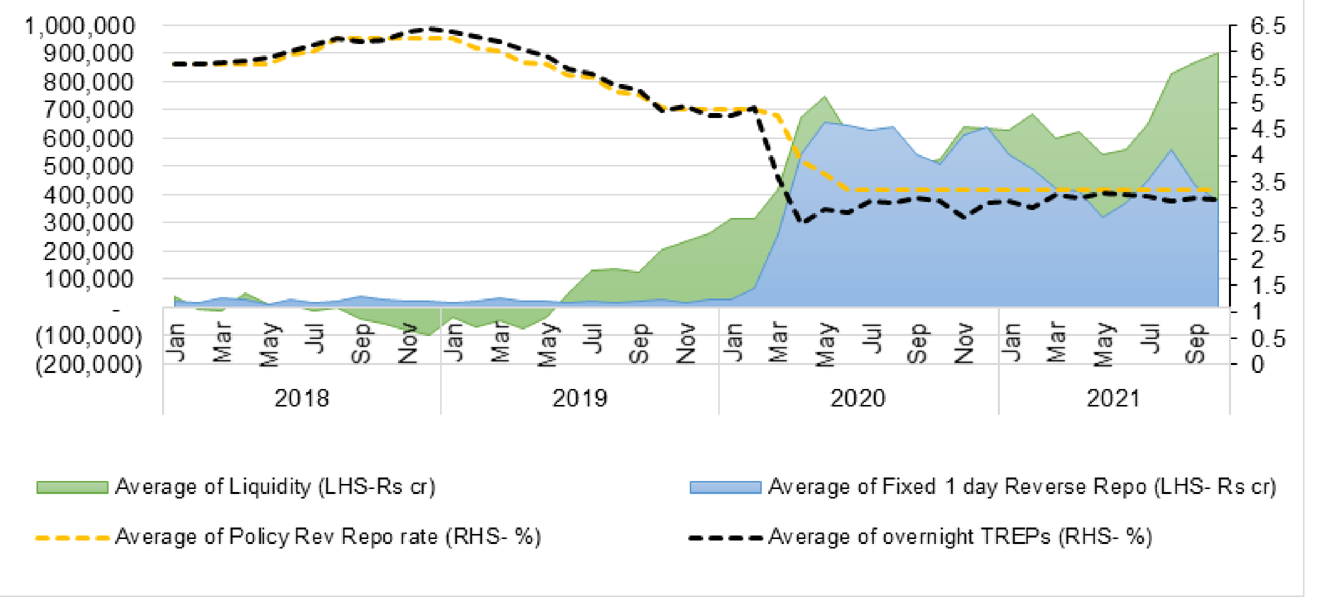
Continuing with a gradual policy normalization through a balanced liquidity recalibration

The market participants were closely watching the policy review in the backdrop of potential liquidity overhang which currently amounted to more than Rs.13 lakh crores. There were concerns that MPC will announce stern measures to absorb significantly high liquidity in the banking system, which could also be a step towards monetary policy normalization going forward. These concerns were allayed to a great extent with MPC again adopting a gradual and a balanced approach towards liquidity withdrawal.

In line with our expectations, MPC 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. 4.0 lakh crores on Oct 8; Rs. 4.5 lakh crores on October 22; Rs. 5.0 lakh crores on November 3; Rs. 5.5 lakh crores on November 18; and Rs. 6.0 lakh crores on December 3. Additionally, it may consider 28-days VRR auctions as an optional tool while retaining the flexibility to conduct fine-tuning liquidity operations of varying amounts as and when required.

The MPC reiterated that VRRR is a tool for rebalancing liquidity as part of liquidity management operations and should not be construed as reversal of accommodative policy stance. Despite the additional quantum, RBI has assured that the liquidity under one day fixed Reverse Repo will remain ample surplus to the tune of Rs. 2–3 lakh crores till 1st week of December.

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



Source: Bloomberg.

As clearly reflected in the above chart, Rs. 2-3 lakh crores of liquidity under 1 day Fixed Reverse Repo will still be much higher than the pre-Covid times (~Rs. 65,000 crores in Feb 2020).

No GSAP announcement a tad negative on market expectations

After the two consecutive GSAP announcements in 1Q & 2Q of FY23, market was expecting a similar GSAP for 3Q as well, although of a much lesser quantum. However, given the existing liquidity overhang, no additional Govt borrowing for GST compensation and the expected expansion of liquidity in the system as government spending increases in line with budget estimates, the MPC assessed that need to undertake GSAP operations currently does not exist. Nonetheless, it is ready to undertake G-SAP operations depending on the evolving liquidity conditions. Additionally, it will continue to flexibly conduct other liquidity management operations including OMO and OT to support gradual evolution of yield curve.

Growth projections remain intact with focus on durable economic recovery

The RBI retains its growth projection for FY22 and Q1FY23 with intermediate GDP estimates for Q2 and Q3 FY22 witnessing improvements. However, RBI noted that impact of elevated input costs on profit margins, potential global financial and commodity markets volatility and a resurgence in COVID-19 infections, may impart downside risks to the growth outlook. It highlighted that economic recovery is uneven and is dependent upon continued policy support.

Inflation trajectory is moderating; inflation projection revised downward by 40 bps for FY22

The RBI has revised FY22 inflation forecast downwards by 40 basis points acknowledging that CPI headline momentum is moderating with the easing of food prices, which combined with favourable base effects, could bring about a substantial softening in inflation in the near-term. However, it noted that core inflation remains sticky. The inflationary pressures may persist from crude oil prices which remain volatile over uncertainties on the global supply and demand conditions.

Market reaction post policy announcement

Segment	Broad movement of yields today in bps	
	G-Sec	AAA Corporates
3 Months	-2	-7
6 Months	-2	-5
1 year	-4	-5
2 -3 years	1	-3 to -5
4 - 5 years	0	0
10 years	5	6

Data source: Bloomberg.

Post the policy announcement, short end of the curve reacted positively with yields cooling off by 2 to 5 bps as there was no negative surprise on the reverse repo & liquidity front. However, the response was muted as the 14day VRRR cut-off came at a higher-than-expected level. Long end on the other hand reacted negatively in absence of the GSAP announcement.

While we believe that RBI will continue to remain active on OMOs / OTs, no specific announcement on GSAP disappointed the market and the rates hardened today in the 5 yr+ segment. During the press conference, RBI governor indicated that Indian Sovereign bonds are expected to be included in global bond indices within next few months and we believe it would be a huge structural positive for domestic rates, especially in the 5 yr+ segment.

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

Taking cues from policy statement, we feel that RBI will prioritize growth and will continue with its accommodative stance while keeping repo rates lower for longer. However, the policy normalization is already underway through a gradual liquidity calibration which may be followed by restoring of the policy rate corridor back to 25 bps (as before the pandemic) by early next year.

We continue to believe that RBI use all the possible tools to revive & support the growth. We also expect RBI to maintain ample liquidity and conducive financial conditions and draws comfort from the governor's statement that RBI will ensure adequate liquidity to support the process of economic recovery.

We feel that efforts to contain cost push inflation should help inflation remain in RBI's stipulated band and as the moderating trend in inflation continues, it will provide more headroom to MPC to support the growth.

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. Short term rates had already hardened by 15-20 bps earlier in anticipation of reverse repo rate hike and provides cushion. 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, and Invesco India Short Term Fund, 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.**

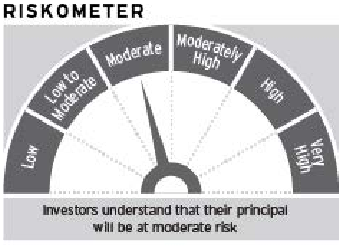
Further, long term rates remain anchored on the back of no negative surprises in the policy review and as RBI remains focussed on orderly evolution of yield curve. Possible inclusion in global bond indices will be a huge structural positive. In such a scenario, **investors with long term horizon and 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)

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)

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

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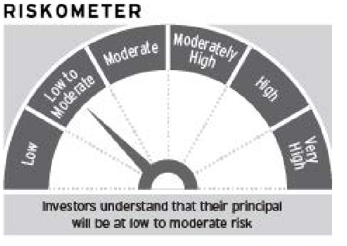
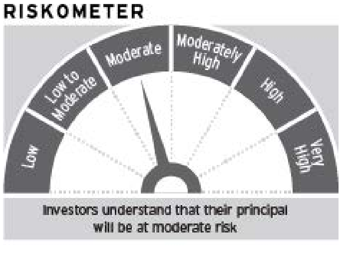


Invesco India Corporate Bond Fund
(An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds)

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.**



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

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^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
Mutual Fund

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)

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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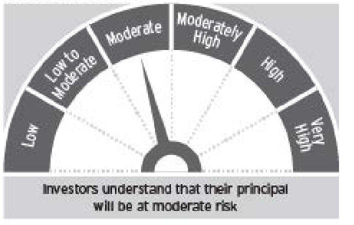
RISKOMETER



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))

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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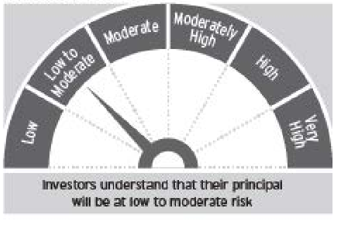
RISKOMETER



Invesco India Money Market Fund
(An open ended debt scheme investing in money market instruments)

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

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