

Insights – Monetary Policy Review

Status quo maintained on policy rates, as expected. Various other measures announced to boost the market confidence. Overall positive for rates over the medium term.

October 9, 2020

Key Decisions / Highlights:

- Policy Repo rates maintained at 4%. All Monetary Policy Committee (MPC) members voted for the status quo.
- Accordingly, other policy rates are unchanged. Reverse Repo rate – 3.35% & Marginal Standing Facility (MSF) rate and Bank rate – 4.25%.
- MPC maintained its accommodative stance on policy rates, to continue with accommodative stance at least in the current financial year and into the next financial year. Five out of the six members voted to continue with this accommodative stance at least during the current financial year and into the next financial year.
- Inflation projected at 6.8% for Q2 2020-21, at 5.4%-4.5% for H2 2020-21 and 4.3% for Q1 2021-22, with risks broadly balanced.
- Real Gross Domestic Product (GDP) growth in FY21 projected to be negative at (-)9.5%, with risks tilted to the downside.
- Size of Open Market Operations (OMOs) in G-sec increased to Rs. 20,000 crores.
- Open Market Operations announced in State Development Loans (SDLs) as a special case in FY21.
- On tap Targeted Long-Term Repo Operations (TLTRO) for banks of amount Rs. 1 lakh crores for 3 years linked with floating rate repo rate.
- In a bid to boost banks' investment in government bonds, the enhanced Held to Maturity (HTM) limit (raised from 19.5% to 22% of net demand and time liabilities currently) has been extended by a year to 31 March 2022.
- Increase in single retail borrower limit from Rs. 5 crores to Rs. 7.5 crores.
- Risk weights for home loans linked to only loan-to-value (LTVs); earlier linked with LTVs & ticket size.

Our Views

While RBI maintained the status quo on policy rates, as widely expected by the market, RBI's tone can be well described as more dovish & market supportive as compared to the last policy meet in first week of August. This reinforced our belief of the need to have

conducive conditions for benign interest rates and supportive financial markets given the gravity of ongoing economic challenges.

For the first time post pandemic, RBI gave its projection of a GDP contraction of 9.5% in FY21 with downward risks and reiterated the more urgent need to revive growth & mitigate the impact of Covid-19. Not only the MPC indicated to look through the current high inflation which appears to be transitory in nature as led by supply side constraints, it also expects the inflation to moderate towards the target over 3QFY21 and 4QFY21. We believe that negative growth outlook, easing inflationary expectations and accommodative monetary policy stance provides headroom for further rate reduction. Additionally, we expect the RBI to maintain interest rates low over the considerably longer-term period so as to provide the support to economy.

RBI through its various measures has also tried to address the major concern – ability of the market to absorb heavy borrowings by Central & State government in 2HFY21. Increased Open market operations in G-Sec (though a OMO calendar could have been better), extension of HTM period for banks upto March 2022 and first- time OMO in SDLs are expected to address the demand-supply constraints to an extent and is expected to cap the interest rates, especially in the longer end.

RBI has again re-iterated its stance on surplus systemic liquidity with an on-tap TLTRO of upto Rs. 1 lakh crores at floating repo rate with tenors upto 3 years which can be availed by banks to deploy funds in corporate bonds / Non-Convertible Debentures (NCDs), Commercial paper (CPs) and also for incremental loans for some specific sectors. We expect this measure to improve transmission and reduce corporate bond yields, especially the shorter tenor segment.

Overall, we continue to remain overweight on duration and with no major triggers over next few months, we expect the yield curve to drift downwards with a curve flattening bias. We expect RBI to maintain its market supportive stance and use its conventional as well as unconventional tools to ensure financial stability of the market & orderly completion of central / state scheduled borrowings over next few months. We continue to keep a close watch on Central / State Govt's fiscal situation amidst the pandemic that may require additional borrowings and expect the RBI to take similar supportive measures accordingly.

At present, foreign institutional investor (FII) investors' behaviour has not changed much, they see emerging markets (EMs) as risk on. However, if low interest rates continue, FIIs flow will likely pick up. Investors are recommended to remain invested in debt funds in line with their investment horizon.

Further, we continue to remain credit averse and particularly at a time when banking system is just emerging from a 6-month loan moratorium. The challenges of the banks (led by rise in NPA, drop in capital adequacy) poses hurdles for any pickup in credit growth. We believe credit dispersion will continue, with very high-quality credits benefitting from this but the lower quality credits continuing to be avoided for the time being. From a credit quality perspective, we have and will continue to stick to high quality credits – primarily Public Sector Undertaking (PSUs) and blue-chip AAA credits¹.

¹The above strategy is based on current views and is subject to change from time to time.

Fund positioning²

With a likely downward bias in interest rates, our several debt schemes are expected to reap the benefits of capital gains over next few months. More specifically, Invesco India Banking & PSU Debt Fund and Invesco India Gilt Fund with positioning in longer tenor segment are expected to be benefitted by both, the downward shift in yield curve and also with the flattening of the curve. Similarly, Invesco India Short Term Fund, largely positioned in 3-5 years space, Invesco India Corporate Bond Fund largely positioned in 2-3 years space and Invesco India Treasury Advantage Fund provides investment opportunities depending on the investor's risk appetite on rate volatility. All the above funds have maintained highest asset quality and as of now are deployed in 100% AAA rated assets (on long term rating basis).

²**Disclaimer-** The above fund positioning is based on current views and is subject to change from time to time. The information 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.

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 Gilt Fund

(An open ended debt scheme investing in government securities across maturity)

Suitable for investors who are seeking*:

- Credit risk free returns over medium to long-term
- Investments primarily in securities issued and guaranteed by the Central and the State Government across maturities

***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

***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)

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

***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.

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