HSBC Mutual Fund

RBI Monetary Policy

December 8 , 2023

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Announcement

The Monetary Policy Committee (MPC) came out with their bi-monthly policy statement on 8 December 2023. Some of the key announcements are as follows:

- The MPC unanimously decided to keep the policy Repo Rate unchanged at 6.50%
- Consequently, the Standing Deposit Facility (SDF) rate remains unchanged at 6.25% and the Marginal Standing Facility (MSF) rate and Bank Rate at 6.75%
- The MPC also decided by a majority of 5 out of 6 members to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth. Prof. Jayanth Varma voted against this part of the resolution

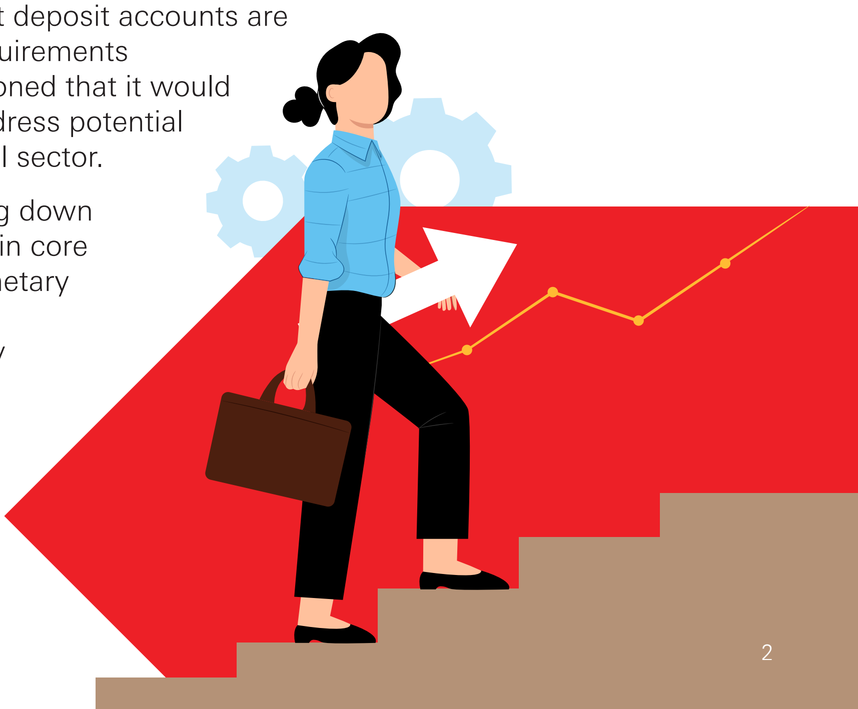
The growth forecast for FY 2024 has been revised upwards sharply to 7.0% from 6.5%, driven by a higher-than-expected GDP outcome in Q2 FY2024 while projections for Q3 and Q4 have also been revised upwards by 50 bps and 30 bps, respectively to 6.5% and 6%. Q1 FY 2025 growth is projected at 6.7% (vs 6.6% projected in the October policy) while Q2 and Q3 FY 2025 GDP are projected at 6.5% and 6.4%, respectively.

RBI's Inflation forecast has been retained for FY 2024 at 5.4% with estimates for the remaining quarters and Q1 FY 2025 also remaining unchanged. Q2 and Q3 FY 2025 inflation prints are estimated at 4% and 4.7%, respectively.

On liquidity, the governor noted that system liquidity turned into deficit mode in September 2023 and noted an overall tightening of liquidity conditions, which was significantly higher than what was envisaged in the October policy statement, obviating the need for Open Market Operations (OMO) sales so far. It mentioned that the evolution of liquidity conditions so far has been in line with the monetary policy stance. However, as government spending picks up, liquidity conditions are likely to ease going forward and the RBI noted that it would be nimble in its liquidity management based on how the liquidity conditions evolve.

On the external front, the governor noted the relatively low volatility of the rupee and buoyant service exports and remittances which is expected to partly offset the trade deficit. An increase in foreign portfolio flows, net inflows under External Commercial Borrowings (ECBs) and non-resident deposit accounts are expected to help meet the external financing requirements comfortably. On financial stability, the RBI mentioned that it would continue to be pre-emptive in taking steps to address potential risks and preserving the resilience of the financial sector.

The RBI noted the significant progress in bringing down inflation and mentioned that the continued drop in core inflation was reflective of the impact of past monetary policy actions. However, it noted that headline inflation remains volatile due to continued supply side shocks, which could add to generalized price pressures and interrupt the ongoing disinflationary process. Hence it mentioned that monetary policy must continue to be actively disinflationary to ensure anchoring of inflation expectations and ensure fuller transmission.



The unchanged policy rate and stance were in line with consensus. Given the growth momentum, a revision in the GDP growth forecast was also anticipated. The overall tone of the policy was on expected lines with the RBI striking a balanced note. This was reflected in the governor mentioning that policy makers should not be carried away by a few months of good data, while also noting the need to be mindful of overtightening.

Market Movement and Outlook

Given this backdrop of a balanced RBI policy in line with consensus, government bond yields and corporate bonds levels remained broadly unchanged across the curve. 10-year G-Sec remained at ~7.24%.

With regards to the need and timing of OMO sales, the RBI has linked it to the evolving liquidity conditions which removes some amount of uncertainty on the timing of the OMO sales.

Globally, rates could remain volatile going forward. Indian bond markets have so far been less volatile relative to global bond markets both on the upward and the downward move in global bond yields. While markets still await any announcement of possible index inclusion in the Bloomberg bond index, Foreign Portfolio Investor (FPI) inflows have started coming in post the JP Morgan GBI-EM index inclusion announcement and demand supply equation for G-Sec remains favorable in the near term, with relatively lower net supply for the second half of this financial year.

Given the above backdrop, any correction in the Indian bond market may provide an opportunity to add duration and provide a good entry point. Corporate bond and SDL spreads have also widened due to the increase in supply and may provide an opportunity to lock in spreads going forward. In our view, the risk–reward has turned in favor of careful deployment into certain areas which may offer potentially favourable risk-adjusted returns.

Past performance is not an indicator of future returns. Source: RBI Press Release & HSBC MF estimates as on Nov 2023 end or as latest available.

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