**February, 2022**

# Markets whipsawed again!

The Monetary Policy Committee (MPC) came out with their bi-monthly policy statement today.

**Some of the key announcements are as follows:**

- The MPC members unanimously voted for keeping the policy Repo Rate unchanged at 4.0%
- The Reverse Repo Rate under Liquidity Adjustment Facility (LAF) and the Marginal Standing Facility (MSF) rate have also been kept unchanged at 3.35% and 4.25% respectively
- The MPC decided with a 5 to 1 majority 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 remained within the target going forward
- Real GDP growth for FY2023 is projected at 7.8%, with the following quarterly estimates: Q1 FY2023 at 17.2%, Q2 at 7.0%, Q3 at 4.3% and Q4 at 4.5%
- The projection for CPI inflation for FY2022 has been retained at 5.3% with Q4 FY2022 estimated at 5.7%. CPI inflation for FY2023 is projected at 4.5% with the following quarterly estimates: Q1 FY2023 at 4.9%, Q2 at 5.0%, Q3 at 4.0% and Q4 at 4.2%, with risks broadly balanced

**Some of the other non-policy related announcements are as follows:**

- Extension of On-tap liquidity facilities for emergency health services and contact-intensive sectors
- Enhancement of limits under Voluntary Retention Route (VRR) scheme from INR 1.5 Lakh Crs to INR 2.5 Lakh Crs, to facilitate long term investment by FPIs in Government securities and corporate bonds
- Review of Credit Default Swaps (CDS) guidelines to facilitate the development of a credit derivatives market and deepen corporate bond market in India
- Permission for Banks to deal in foreign currency settled - Rupee Derivatives market

Markets were expecting a hike in Reverse Repo Rate, however, there was no such announcement. Pertaining to liquidity management, the Governor mentioned that variable rate repo operations of varying tenors will be conducted basis the evolving liquidity and financial conditions. The Governor also mentioned that variable rate repo and variable rate reverse repo operations of 14-day tenor will operate as the main liquidity management tool, supported by fine tuning operations to manage unanticipated liquidity requirements. Although there was no announcement regarding any OMO/OT purchase by the Governor, he did mention that the RBI will continue to focus on smooth completion of the government borrowing programme and that market participants also have a stake in the orderly evolution of financial conditions and the yield curve.

**Market Impact**

In the absence of any Reverse Repo hike and with the RBI downplaying inflation worries, markets witnessed a sharp relief rally across segments. Money market rates moved lower by 10-15 bps, G-Sec and corporate bonds in the 1-5 year segment rallied by 15 bps, while the longer end moved lower by around 7-10 bps.

## Our Take

Yields across segments are now at or lower than the pre-budget levels. While markets had gone into the budget hoping for a positive surprise on the GoI borrowing numbers, it turned out to be a shocker on the negative side leading to a sharp move higher in yields. The reverse happened today, with the RBI Governor surprising everyone with an extremely dovish tone in his statements and Q&A, leading to a complete undoing of the earlier selloff. The trajectory of monetary policy normalisation expected hitherto by the markets (40 bps reverse repo hike by April, stance change in June, with 3-4 hikes in rest of FY23) is now shrouded in uncertainty given the MPC's CPI forecast of ~4% in H2 FY23, which seems to imply that there is no need for any significant rate hikes if RBI's projections were to come true.

Risks from surging oil prices, rising US / DM bond yields and GoI's huge borrowing program in FY23 have all been remarkably downplayed by the Governor. While we do expect the markets to now price in rate hikes to a much lesser extent than before, ***we continue to view these risks as significant - which could lead to a lingering disconnect between RBI's messaging versus the market's pricing of these risks, causing more volatility in bond markets over the coming few quarters.***

**Source:** RBI Press Release, internal