RBI Monetary Policy Review

August, 2022

L&T Financial Services
Mutual Fund

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 to increase the policy repo rate under the Liquidity Adjustment Facility (LAF) by 50 bps to 5.40% with immediate effect

- Consequently, the Standing Deposit Facility (SDF) rate was adjusted to 5.15% and the Marginal Standing Facility (MSF) rate and Bank Rate adjusted to 5.65%

- The MPC also decided to remain focused on the withdrawal of accommodation to ensure that inflation remained within the target going forward, while supporting growth

However, the decision to remain focused on the withdrawal of accommodation was not unanimous, with Prof. Jayanth Varma expressing his reservation on this part of the resolution.

Considering a base case assumption of a normal monsoon and an average crude price (Indian basket) of USD 105/bbl the growth and inflation projections have been mentioned below:

- Real GDP growth for FY2023 has been retained at 7.2% with the following quarterly projections: Q1 FY2023 at 16.2%, Q2 at 6.2%, Q3 at 4.1%, Q4 at 4.0% and Q1 FY2024 at 6.7%, with risks broadly balanced

- CPI projection for FY2023 has also been retained at 6.7% with slight revisions in the Q2 and Q3 projections: Q2 FY2023 at 7.1%, Q3 at 6.4%, Q4 at 5.8% and Q1 FY2024 at 5.0%, with risks evenly balanced

The Governor mentioned that although headline inflation has eased from the highs witnessed in April, inflation continues to remain uncomfortably high and is projected to stay above the upper tolerance level for the next couple of quarters. Today's policy action is a step to disallow inflation expectations becoming destabilized. On liquidity, the Governor mentioned that the RBI will conduct two-way fine-tuning operations, Variable Rate Repo (VRR) and Variable Rate Reverse Repo (VRRR) operations of various tenors, depending on the evolving liquidity conditions.

Market Movement:

While market participants were expecting RBI to hike rates by 35 bps and provide a slightly dovish tone given the recent favourable move in Crude prices, the MPC continued on their path of bringing down inflation to within permissible limits by raising policy rates by 50 bps and further committing to the inflation mandate. This resulted in a sharp sell-off post the MPC announcement with yields moving higher across the curve. Money market rates moved higher by 5-10 bps. Corporate bonds across segments rose by 10-15 bps day-on-day. 5-year G-Sec moved intra-day higher by 25 bps, G-Sec in the 10-15 year segment moved intra-day higher by 20 bps, while longer end G-Sec moved up by 10 bps during the day.

Outlook

The global narrative took an about turn over the past month with US recession worries overshadowing Fed rate hike related worries, which in turn led to rapid repricing lower of the peak fed funds rate to below 3.5% (versus almost 4.25%+ earlier). With the 2-10s rapidly inverting to more than -35 bps over the past month and US 10-year yield falling to as low as 2.55%, markets quickly priced in rate cuts in mid to end of CY23, expecting the Fed to turn growth supportive. In our view, this may be a misinterpretation of Powell's comments during the FOMC, and we may see markets price out the rate cuts in CY23 once again and possibly go back to pricing in more rate hikes as well. However, there are too many uncertainties on the global front, now with the China-Taiwan-US geopolitical situation adding to the already hot cauldron, and hence one needs to be prepared for rapid changes of narratives as data keeps coming over the coming few months.

Over the past few weeks, here too domestically, markets have been rallying sharply across the curve, based on falling oil prices, US Treasury yields and also importantly reducing terminal rate expectations from the RBI MPC. With the RBI Governor and the MPC broadly sticking to their guns, without giving any hints of a pause coming any time soon, markets have been reminded that the MPC is serious about getting inflation back closer to the 4% target and in fact, sees the current strong growth momentum as being supportive of executing the required rate hikes without much growth sacrifice.

Given the policy actions taken so far by the MPC and in the event of Crude prices staying below the MPC's baseline assumption, the easing of inflation might happen sooner than expected. While weaker global growth and lower oil/commodity prices may have a sobering impact on our inflation trajectory, we still believe the MPC would want to take rates closer to the 6% level (lower versus our earlier expectation of 6-6.5%), especially in light of recent articles and speeches by RBI DG Michael Patra suggesting the need to return to a positive real rate scenario. So while near term, markets are likely to take yields higher, back to where we were before this recent exuberance, we continue to believe that at levels close to 7-7.25%, the 3-4 year part of the yield curve offers good relative value vis-à-vis other points on the curve, for investors who are looking at a medium-term investment horizon.

Markets are now a lot more volatile, with frequent sharp moves in both directions. While this on the one hand warrants caution, on the other – this also means more opportunities for dynamically managed funds to be able to tactically, as well as strategically deliver alpha. With majority of the mid to longer end yields in range of 7-8%, broadly absolute levels are not bad either. Hence, for investors desiring alpha through duration calls, funds like the L&T Flexi Bond Fund, L&T Gilt Fund and L&T Resurgent India Bond Fund are all lucrative opportunities to be considered by medium to long term investors.

L&T Gilt Fund | L&T Flexi 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		

L&T Resurgent India Bond Fund

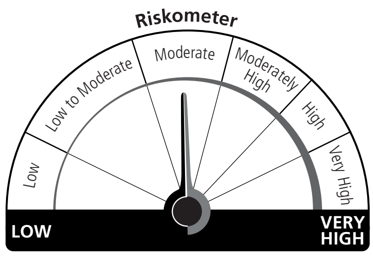
Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)		B-III	

This product is suitable for investors who are seeking*

L&T Gilt Fund
(An open-ended debt scheme investing in government securities across maturity. A relatively high interest rate risk and relatively low credit risk)
- Generation of returns over medium to long term
- Investment in Government Securities

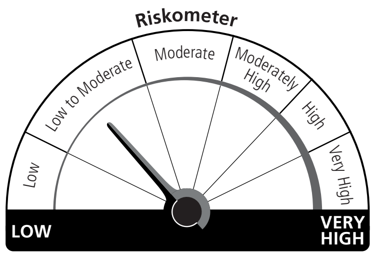
L&T Resurgent India Bond Fund
(An open ended medium term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 years to 4 years (please refer to page no. 18 under the section "Asset Allocation Pattern" in the SID for details on Macaulay's Duration)#. A relatively high interest rate risk and moderate credit risk)
- Generation of income over medium term
- Investment primarily in debt and money market securities

Riskometer is as of July 31, 2022



Investors understand that their principal will be at moderate risk

L&T Flexi Bond Fund
(An open-ended dynamic debt scheme investing across duration. A relatively high interest rate risk and relatively low credit risk)
- Generation of reasonable returns over medium to long term
- Investment in fixed income securities



Investors understand that their principal will be at moderate risk

***Investors should consult their financial advisers if in doubt about whether the product is suitable for them.**

Source: RBI Press Release, internal

Disclaimer – The article (including market views expressed herein) is for general information only and does not have regard to specific investment objectives, financial situation and the particular needs of any specific person who may receive this information. The article provides general information and comparisons made (if any) are only for illustration purposes. Investments in mutual funds and secondary markets inherently involve risks and recipient should consult their legal, tax and financial advisors before investing. Recipient of this document should understand that statements made herein regarding future prospects may not be realized. Recipient should also understand that any reference to the indices/ sectors/ securities/ schemes etc. in the article is only for illustration purpose and are NOT stock recommendation(s) from the author or L&T Investment Management Limited, the asset management company of L&T Mutual Fund ("the Fund") or any of its associates. Any performance information shown refers to the past and should not be seen as an indication of future returns. The value of investments and any income from them can go down as well as up. The distribution of the article in certain jurisdictions may be restricted or totally prohibited and accordingly, persons who come into possession of the article are required to inform themselves about, and to observe, any such restrictions.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully. CL09772