HSBC Mutual Fund

RBI Monetary Policy

August 10, 2023

Announcement

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

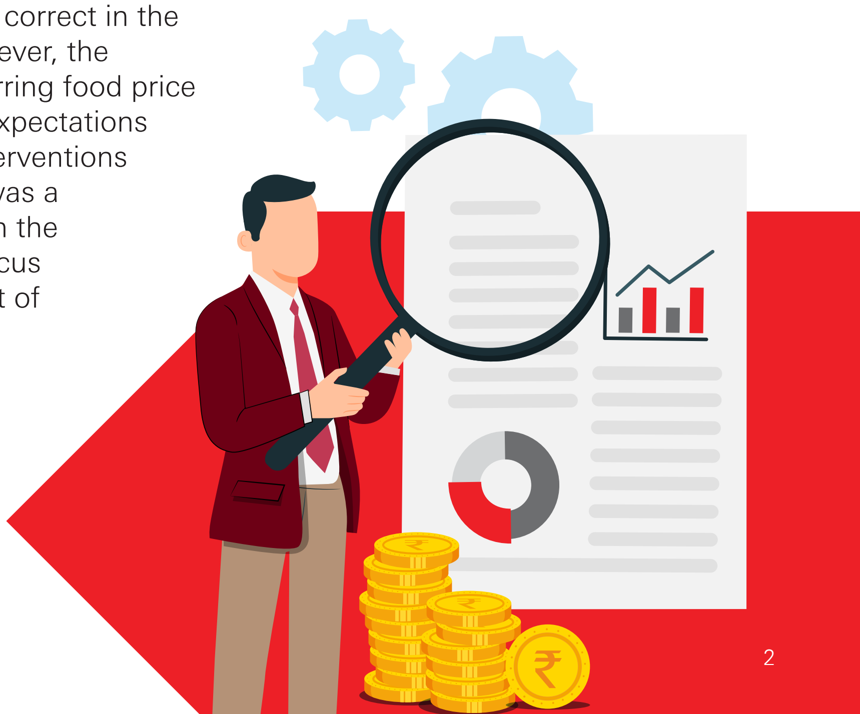
- The MPC unanimously decided to keep the policy Repo Rate unchanged at 6.50%
- Consequently, the Standing Deposit Facility (SDF) rate remains unchanged at 6.25% and the Marginal Standing Facility (MSF) rate and Bank Rate at 6.75%, respectively
- The MPC also decided by a majority of 5 out of 6 members 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 FY24 has been retained at 6.5%, with quarterly projections remaining unchanged. Q1 FY2025 growth is projected at 6.6%. On the other hand, the inflation forecast for FY2024 has been revised upwards to 5.4% from 5.1% (in June policy), with risks evenly balanced. Q2 FY2024 inflation forecast has been revised sharply upwards to 6.2% (from 5.2% projected earlier) and Q3FY2024 inflation forecast has been revised upwards to 5.7% (from 5.4%). CPI inflation for Q1 FY2025 is estimated by RBI to be at 5.2%.

On liquidity, the Governor mentioned that surplus liquidity in the system has gone up in recent months on the back of return of INR 2000 denomination notes to the banking system. RBI further noted that the market response to the RBI's 14-day Variable Rate Reverse Repo auctions (VRRR) have been lukewarm. In this backdrop, RBI has required scheduled banks, with effect from the fortnight beginning August 12, 2023, to maintain an incremental CRR (I-CRR) of 10% in the increase in their Net Demand and Time Liabilities (NDTL) between May 19, 2023 and July 28, 2023. RBI mentioned that this is purely a temporary measure for managing the liquidity overhang. The I-CRR will be reviewed on September 8, 2023, or earlier, to ensure adequate liquidity ahead of the festive season.

On the external front, the Governor highlighted that the Rupee has remained stable since January 2023 and noted that RBI expects the Current Account Deficit (CAD) to remain eminently manageable with a narrowing Trade Deficit and healthy service exports and remittances.

The policy statement mentioned that the recent spike in inflation was driven largely by vegetable prices and is likely to correct in the coming months, with fresh market arrivals. However, the Governor noted that frequent incidences of recurring food price shocks could pose a risk to anchoring inflation expectations and noted the criticality of timely supply side interventions to manage the severity of these shocks. There was a reiteration that "bringing headline inflation within the tolerance band was not enough" and that the focus remained firmly on aligning inflation to the target of 4.0%. In this backdrop, the policy statement mentioned a "preparedness to undertake policy measures if the situation so warrants."



Outlook and Market Movement

The RBI policy was broadly in line with consensus expectations, except for the measures on liquidity. The revision in the inflation forecast for Q2 and Q3 of FY2024 was expected given the recent spike in vegetable prices, and the RBI has chosen to look through this spike, in line with market expectations. The market reaction to the policy was therefore muted. The money market segment has moved up by 3-10 bps, with the maximum impact in the absolute shorter end. The shorter end of the G-Sec yield curve (up to 5 year) is marginally negative, while the longer end of the curve (10-year and beyond) is flat to 1-2 bps lower.

With regard to the liquidity measures, it is estimated that there could be an impact of about INR 1 Lakh Crs of surplus liquidity being drained out. This could lead to overnight rates and rates at the shorter end of the money market curve moving higher in the near term. We have seen rates at the shorter end of the money market curve inch higher by 5-10 bps post policy.

With the RBI policy now behind us, the focus is likely to shift once again to developments in global markets, As the narrative in global bond markets seems to be moving to "higher for longer", US treasury yields continue to stay above 4% as of now.

While so far Indian bond markets have been somewhat de-linked from the volatile US Treasuries market, the correlation between the two can potentially increase going forward, with yields possibly inching higher gradually over the coming few months, given the global backdrop. Such an up-move in yields, if it were to materialize, would be an opportunity to add duration in our view and for investors also, provide a good entry point into longer duration bond funds.

Past performance is not an indicator of future returns. Source: RBI Policy Statement, HSBC MF. Data as of August 10, 2023

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