

Debt Market Perspective - HSBC Mutual Fund

RBI-MPC policy outcome broadly meets market expectations

Amid global developments the outlook for 2025 is slated to see volatility as uncertainties, particularly around global trade, tariffs and the potential upending of the global supply chains could weigh business optimism. For India, the domestic factors continue to drive the policy decisions, so far. The Union Budget provided near-equal stimulus to both consumption (personal income tax cuts amount to INR1 trn) and Capital Expenditure (budget outlays rise by INR1 trn), while lowering the fiscal deficit (to 4.4% of GDP for FY26 from 4.8% in FY25). The change in the helm at the RBI also appears to have seen a change in the strategy of liquidity and currency management. Following today's decision, the RBI and the MPC under the new Governor have taken a pragmatic policy approach as it goes easy in its approach on both monetary and regulatory policy.

Since the US Presidential Elections outcome, the bands of uncertainty have widened around some factors.

Key global developments and Central Bank policy outcomes that swung market sentiments.

In no rush – the FOMC will watch the data before adjusting the rates lower

After having quickly lowered the policy rates by ~100 bps in CY24, the FOMC is seen go slow on further rate cuts. At the end-Jan policy, the FOMC maintained status quo on expected lines while it upgraded its assessment on the economy. The FOMC Chair stated that 'with the policy stance significantly less restrictive than it had been and the economy remaining strong, we do not need to be in a hurry to adjust our policy stance'. He downplayed the prospects of a rate cut emerging in March. The Fed will continue to remain data dependent in determining the future course of rate actions. Meanwhile, the BOE eased policy rates by 25bps to 4.50%. The Eurozone continued with policy easing and lowered the key benchmark rates as disinflation sustained. While the major AEs have eased, the US Fed has turned cautious and the BoJ has hiked. The resilience seen in the US economic indicators and the uncertainty has kept the dollar firm and the US Treasury yields too have remained firm, moving to a high of 4.79% before ending at 4.54% in Jan'25.

RBI seems to have let go of its tight hold on the currency

Amid the global FX volatility largely caused by a strong dollar amid looming uncertainties under the new statesmanship of President Donald Trump. During January, USDINR was one of the worst performing currencies in the EM basket. While the dollar strength played out, what was also observed is that there was a possible shift in the RBI's strategy on currency movements. The RBI's FX interventions and the FX Reserves position indicate that the RBI has let go of its tight hold on the currency and now is letting the currency find its course with bouts of strategic FX interventions. The Rupee depreciated 3.2% as of 6-Feb closing from 7-Nov-24 closing levels of 84.38. In the said period, the dollar index has appreciated by 2.4%. While this is largely in sync with the EM currencies, USDINR is trading with a sharp depreciation bias. At the RBI-MPC press conference, the Governors' reiteration on its exchange rate policy of smoothening volatility without compromising on market efficiency. FX reserves slid further during the month to USD 630 bn, due to RBI intervention from US\$ 640 bn in December. The fallout of RBI's intervention in the currency market coupled with government cash balance has been a drag on banking system liquidity.

RBI provides liquidity boost: The liquidity conditions tightened substantially in the last couple of months due to RBI's FX intervention and currency demand. The system liquidity saw a deficit of INR 2 tn while the RBI announced daily Repo auctions and also conducted OMO purchases to the tune of ~INR 510 bn in January as of last data available. This comes following the 50 bps cut in the CRR which was announced in December, which injected INR 1.16tn by end-December. Subsequently, on 27-Jan the RBI further deployed three policy instruments to inject liquidity: 1) OMO purchase auctions worth INR 600 bn in three tranches; 2) a 56-day VRR operation worth INR 500bn (on 07-Feb); and 3). a USDINR buy/sell swap worth USD 5 bn for a tenor of six months. In total, this should infuse liquidity of INR 1.5 tn.

MPC Announcement: Going Easy

RBI strikes a balance in its policy given the existing macro-economic conditions and global uncertainties

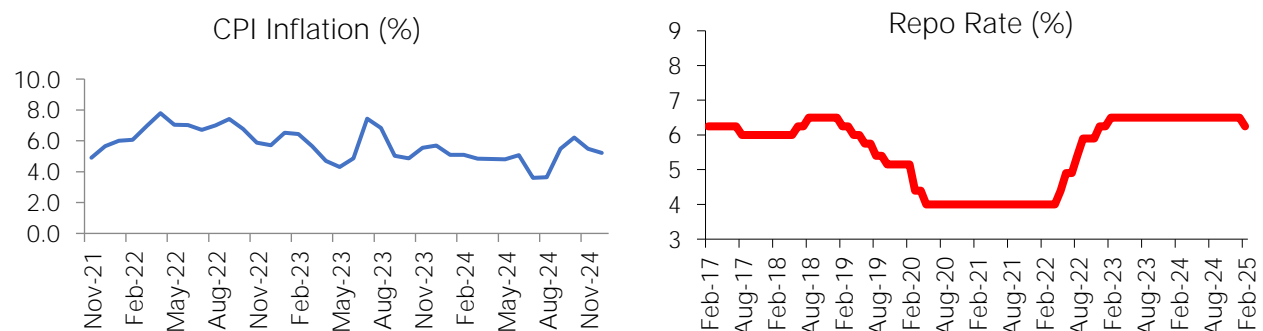
- The MPC unanimously decided to lower the policy Repo Rate by 25 bps to 6.25% and retain the stance as 'neutral'. Consequently, the SDF rate stands at 6.00% and the MSF rate at 6.50%
- The neutral stance implies that the MPC deliberately does not want to give any forward guidance on its future course of action

Our Take:

The new RBI governor played out a balancing act, by easing rates, while clearly being mindful of the global market volatility and its potential impact on our currency, and hence maintaining a cautious tone. While more on the liquidity front was expected, the remarks from the Governor indicate that the RBI could inject liquidity in the ensuing days, as liquidity conditions are likely to remain tight despite the earlier announced measures. The RBI's "proactive" approach on liquidity suggests that more policy instruments might be deployed as and when required, basis the evolving liquidity conditions.

The neutral stance in some way rules out aggressive policy easing, while also not giving any forward guidance to the market on the future trajectory. We believe the MPC is likely to cut rates by another 25bps in April 2025 given that risks to growth are on the downside and headline inflation is likely to trend closer to the medium-term target of 4.0%. While we still ascribe a limited probability to a third cut over June / September, it would be completely dependent on the global environment settling down and domestic growth-inflation balance evolving favorably.

While the initial reaction of bond markets has been one of disappointment, with yields inching up by 3-5bps, we believe interest rates will continue to soften over the next few months. The policy action comes in the milieu of recent liquidity measures which coupled with fiscal consolidation leading to favorable G-Sec supply-demand dynamics (more so with RBI's OMO Purchases), all of which should keep rates benign. Given this backdrop, we continue to maintain a positive duration bias across the funds. Investors may stay invested and add duration to their portfolios wherever possible subject to their risk return frameworks.



Abbreviations:

SDF: Standing Deposit Facility
MSF: Marginal Standing Facility
CRR: Cash Reserve Ratio
OMO: Open Market Operations
GDP: Gross Domestic Product
CPI: Consumer Price Index
G-Sec: Government Securities
FOMC: Federal Open Market Committee
ECB: European Central Bank
BOJ: Bank of Japan
BOE: Bank of England

Source – Bloomberg, RBI, HSBC MF Research, Data as on 7 Feb 2025 or as latest available.

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