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PGIM
India Mutual Fund

RBI’s fourth bi-monthly policy

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At the 4th bi-monthly policy today, the Monetary Policy Committee (MPC) through an unanimous vote decided to hold all the key rates unchanged. At the previous policy, the MPC through a 5-1 vote had agreed to retain an “accommodative stance” for as long as necessary to help revive and sustain durable growth.

The decision to leave both the stance and rates unchanged were supported by RBI’s assessment of the economy that remains lower in size, still having adequate slack and a recovery that remains uneven compared to pre-covid.

RBI acknowledged the pick up in Indian economy and the improving momentum in economic activity reflected through references to higher IIPs, manufacturing PMIs, Services activity volumes, high frequency indicators such as freight traffic, cement dispatches, e-way bills and GST collections. However, it also noted that the size of the GDP despite a stellar 20.1% y/y growth was still a good 9% below the pre-pandemic level. RBI left the full year FY 2022 GDP growth forecast unchanged at 9.5%.

Acknowledging softening price pressures from softer food inflation given a good monsoon, RBI referred to higher commodity prices including oil. RBI lowered the full year FY 2022 CPI forecast to 5.7% (from 5.1% earlier), noting the decelerating monthly momentum in CPI and improving base effects in coming months which will likely lead to lower CPI prints.

As expected, the policy narrative centred around steps to drain out the excess liquidity which is now in excess of INR 12 trillion. New measures include a short term calendar to gradually raise the amount under the 14 day variable reverse repo rate (VRRR) from INR 4 trillion (at present) to INR 6 trillion (by December 3rd). Besides, a new 28 day VRRR is likely to be introduced if the need arises. Even after the additional liquidity suction, RBI estimates liquidity surplus under the fixed rate reverse repo at INR 2.5 to 3 trillion.

Importantly, G-Sec Acquisition Programme (G SAP) is being discontinued given the reasonable anchoring in long end yields that has been achieved and the substantial liquidity of INR 2.37 trillion already injected in the first half of the current fiscal (under G SAP and OMOs) as against INR 3.1 trillion for full FY 2021. Despite the steps initiated to lower support for bonds and the liquidity moderation measures, RBI reiterated its readiness to act if the need arose.

RBI reiterated post these measures that the higher VRRR or prospective liquidity suction measures should not be construed as a “ reversal of the accommodative stance”. RBI stated that VRRR was part of system liquidity and residual liquidity even after the INR 6 trillion (enhanced amount) would remain in excess of INR 2.5 trillion and adequate to support growth.

Today’s steps are likely to lead to a further flattening in the yield curve as the short end reacts to a gradual liquidity withdrawal over time. The longer end will face some pressure following the withdrawal of GSAP which will be construed by the market as being less supportive. Overall, we expect the curve to flatten post today’s policy.

Post today’s policy, we advise asset allocation seeking investors in fixed income to retain the mid end products such as Corporate bond and Banking & PSU fund categories as the core with some allocation to Dynamic bond category depending on their appetite to handle yield volatility. Investors with a shorter horizon (upto 1 year), should allocate to Ultra Short and Low Duration Fund categories.