MPC Focused on Economic Growth

Edelweiss MUTUAL FUND

February 10, 2022

Key takeaways:

The Monetary Policy Committee (MPC) made the following announcements after today's meeting:

- Repo Rate to remain unchanged @ 4% (unanimously voted).
- Monetary Policy Stance continue to remain "Accommodative" (5-1)
- Reverse Repo Rate to remain unchanged @ 3.35%
- The RBI projected GDP growth for FY23 at 7.8%
- CPI inflation projection retained at 5.3% for FY 2021-22, and 4.5% for FY 2022-23
- VRR and VRRR of 14 day tenor – will operate as main liquidity management tool
- Variable rate repo operations of varying tenors will henceforth be conducted as and when warranted.
- RBI has hiked the limit for inflows under the Voluntary Retention Scheme to Rs 2.5 lakh crore from Rs 1.5 lakh crore. This will provide additional sources of capital for domestic debt markets, including government securities.
- E RUPI digital voucher cap raised from Rs 10,000 to Rs 1 lakh and multiple-use permitted

Assessment:

- Belying expectations of bond market participants on taking the first step towards policy normalization, the RBI MPC surprised market participants and unanimously voted to maintain status quo on all policy rates.
- Monetary policy stance was kept accommodative in 5-1 voting. This probably means no rate hike in the near-term, in our view.
- Reverse Repo Rate was surprisingly kept unchanged at 3.35% despite the fact that effective Reverse Repo Rate has moved higher to 3.87% as on Feb 4, 2022. Bond Fund Managers were a bit disappointed with this decision.
- RBI governor was in great mood today as he quoted Late Lata Mangeshkar's song and Mahatma Gandhi in his speech and provided bond market participants with great sense of optimism on India's economic growth going forward. He also pointed out that adverse base effect was rolling over and that the headline inflation was likely to trend lower next year averaging 4.5% in FY23 as compared to 5.3% in FY22. This will probably allow RBI to keep the accommodative stance for a bit longer, in our view.
- To be honest, the governor alluded to the rising crude oil prices a number of times in his speech. However, he was hopeful that it won't have material negative effect on India's Current Account Deficit (CAD) in FY23 and economic growth.
- Overall, the RBI governor's speech was quite comforting to the bond market and helped soothe frayed nerves of investors. He made all positive & dovish comments and refrained from sounding negative or hinting any change in policy down the road. Benchmark 10Y IGB yield declined to ~6.75% after his speech from its pre-policy level of 6.80% amid light market positioning.
- With no-change policy outcome, it will be interesting to see how RBI guides bond market on potential policy normalization in April MPC meeting.
- Till then, we expect benchmark 10Y IGB yield to remain range-bound and trade in a range of 6.65-6.95% from a technical perspective.

What does this mean for the investor?

- RBI 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 remains within the target going forward
- RBI chose to support growth recovery and not panicking on inflation.
- That probably means, RBI to keep the accommodative stance for a bit longer.

What should investors do?

- ✓ RBI governor's dovish policy stance has given bond market participants a much needed respite after the initial shock from the Union Budget of FY23. While higher bond yields are inevitable in FY23, bond market participants are hopeful that RBI's invisible hand will probably guide the bond market when the going gets tough and make the journey a bit more comforting.
- ✓ That said, we expect yield curves to remain steep in FY23. Steeper yield curves are likely to provide patient investors with sufficient risk-adjusted returns amid declining headline inflation.
- ✓ Investors with long-term investment horizon should consider investing in passively-managed bond ETFs / index funds maturing CY2026 onwards for superior tax-adjusted returns by investing in 3-4 instalments between now and Sep 30, 2022, in our view.

Disclaimer:

This document is for information purposes and private circulation only and is not an offer to sell or a solicitation to buy any mutual fund units / securities or to have business relations with Sponsor/ AMC/ Trustee Company and its associates or Edelweiss Mutual Fund. These views alone are not sufficient and should not be used for the development or implementation of an investment strategy. All opinions, figures and estimates included in this document (unless as specified in the document) are as of this date and are subject to change without notice. It should not be construed as investment advice to any party. Neither Sponsor/ AMC/ Trustee Company and its associates nor Edelweiss Mutual Fund or any person connected with it, accepts any liability arising from the use of this information. Utmost care has been exercised while preparing the document, and Sponsor/ AMC/ Trustee Company and its associates or Edelweiss Mutual Fund does not warrant the completeness or accuracy of the information and disclaims all liabilities, losses and damages arising out of the use of this information. The recipient of this material should rely on their investigations and take their own professional advice. Investment decisions of the AMC may not always be profitable.

MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS, READ ALL SCHEME RELATED DOCUMENTS CAREFULLY