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RBI MONETARY POLICY

DECEMBER 2021

HIGHLIGHTS

MPC holds rates and guidance, RBI continues behind-the-scenes normalisation

RBI's Fifth Bi-monthly Monetary Policy Review: 2021-22:
MPC unanimously holds rates and retains its accommodative stance – as long as necessary to revive and sustain growth on a durable basis, while mitigating the impact of COVID-19 on the economy.

RBI indicated further shift of fixed rate reverse repo into variable rate reverse repo, effectively driving up short term rates.

Policy Actions
Repo, Reverse repo, MSF & Bank rate also kept steady, CRR held constant at 4%

Amount of 14 day variable rate reverse repo, along with fine-tuning operations to increase – effectively reducing the amount that banks can place overnight with RBI at 3.35%. This helps achieving another increase in short-term rates

GROWTH-INFLATION DYNAMICS

Near-term inflation projections were raised given current pressures, with projections for H1FY23 at around 5% with risks broadly balanced. Persistence of core inflation was noted as a policy concern, but disinflationary effects of the government's supply side measures on edible oils and cuts to duties were also duly noted.

Language on growth continued to brighten, with improving consumption seen and conditions for capex seen over the medium term. Risks to growth from global factors and the Omicron variant provided a rhetorical offset, with the output gap seen as large, and growth not yet self-sustaining or durable. Projections for FY22 were retained at 9.5%

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LIQUIDITY AND EXTERNAL SECTOR

Liquidity has emerged as a key arena of operation in managing short term rates in the background, without having to tinker with the reverse repo rate. Inline with this shift, RBI step-up to drive the liquidity away from overnight fixed rate bucket towards higher cost 14-day bucket can be seen as effective tightening of conditions.

The global economy is seeing some loss of momentum, partly on account of rapid rise of COVID cases in the Eurozone and fears over the new Omicron variant. But high inflation is showing signs of getting intense, prompting a number of central banks to guide markets on near to medium term tightening. A contrast is China, which is seen pivoting to an easing policy.

POLICY STANCE AND GUIDANCE

The policy stance remains one of caution, carrying out tightening in the background but not formally raising interest rates, given a number of risks to growth despite good recent trends.

A formal rate hike is likely in the medium term once uncertainty dissipates and other developed market central banks carry out rate rises.

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order since lockdown.

Date	Measures Announced
March 27, 2020	• Repo Rate cut by 75 basis points to 4.4%; • Reverse Repo Rate cut by 90 basis points to 4%; • Cash Reserve Ratio (CRR) cut by 1% to 3% for a period of 1 year. • TLTRO (Targeted Long-Term Operations) for Rs 1 tn, for upto 3 years • MSF window extended to 3% from 2% of NDTL, • 3-month moratorium on payment of interest of all term loans, • 3-months deferment of interest on working capital facilities, • NFSR implementation delayed by 6 months and banks permitted to trade in NDF from 30 June.
March 27, 2020	First TLTRO for Rs. 250 bn
April 3, 2020	Second TLTRO for Rs. 250 bn
April 7, 2020	RBI increased tenor allowed for states/UTs overdraft to 21 consecutive working days from 14 days previous, and to 50 working days in a quarter from 36 days previous
April 9, 2020	Third TLTRO for Rs. 250 bn
April 17, 2020	• Reverse repo cut by 25 bps to 3.75%; • TLTRO 2.0 of Rs 500 bn, for small and mid-sized NBFC and MFIs; • LCR requirements of SCBs cut from 100% to 80%, • Special refinance of Rs 500 bn to NABARD, SIDBI and NHB, • Hike in WMA (Ways & Means Advances) limit for states by 60% over and above the levels as on 31 Mar until 30 Sep. • NPA classification will exclude 3-month moratorium period till May end • NBFCs' loans to delayed commercial real estate projects can be extended by a year without restructuring;
April 20, 2020	RBI enhances WMA limit for remaining part of H1-FY21 to Rs 2 trillion.
April 27, 2020	Announces special 90-day repo liquidity facility for MFs up to Rs 500 bn.
May 22, 2020	• Repo Rate cut by 40 basis points to 4%; • Reverse Repo Rate cut by 40 basis points to 3.35%; • Extends moratorium on term loan repayments for 3 months. • To support exports/imports, RBI has increased pre and post-shipment credit facility and extended line of credit for Rs 150 bn to EXIM bank for 90 days. • Rs 150 bn facility created for SIDBI to be extended by another 90 days. • Permits banks to extend margins on working capital facilities to original levels by 31 March 2021 and group exposures of banks to be increased from 25% to 30% of eligible capital base by 30 June, 2021.

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order since lockdown.

Date	Measures Announced

August 6, 2020	• Policy Rates Unchanged
	• Rs. 10,000cr at repo rate to NABARD and NHB
	    • Rs. 5,000cr to NHB to support HFCs (after the Rs. 10,000cr already given),
	    • Rs. 5,000cr to NABARD (after the Rs. 25,000cr already given) to refinance small NBFCs and MFIs
	• The RBI to amend priority-sector lending guidelines to remove regional disparity -- a higher weight would be accorded to districts with lower credit flows.
	• To provide a window under the 'prudential framework on resolution of stressed assets' dated 07 June 2019 to enable lenders to implement a resolution plan for eligible corporate exposures (without change in ownership) and personal loans, while classifying such loans as standard and subject to specific conditions.
	• Restructuring MSME debt so that stressed MSMEs can utilise this provided their accounts with the concerned lender were classified as standard as on 01 March 2020 but this will have to be implemented by 31 March 2021. (Already in place if account was standard as on 01 Jan 20).
	• Maximum loan-to-value of loans sanctioned by banks against gold ornaments & jewellery for non-agricultural purposes, which is currently 75%, has been increased to 90%.
	• Banks investment in debt MFs and debt ETFs will be treated consistently with direct debt investments in terms of capital allocation.

October 9, 2020	• Policy Rates Unchanged • WMA limit for the Centre has been kept at Rs.1.25 lakh crore compared to Rs.35,000 crore in H2FY20. The 60% WMA limit for states has been extended till March 31, 2021. • RBI to up the size of the OMO Purchases to Rs.20,000 crore from Rs. 10,000 crores. • To conduct on tap TLTRO with tenors upto 3 years for upto Rs.1 Lakh crore at floating rate linked to policy rate available up to March 31, 2021. • TLTRO funds availed by banks to be deployed in corporate bonds, commercial papers and non convertible debentures issued by entities in specific sectors. • To conduct OMOs in State Development Loans (SDL) to rationalize spreads over G-sec.

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Date	Measures Announced

October 9, 2020	• Enhanced SLR holdings in HTM category (increased from 19.5% to 22% in September 2020) of NDTL of banks, acquired between 1st September 2020 to 31st March 2021, will be applicable till 31st March 2022.
	• To discontinue system-based automatic caution listing of Exporters.
	• Allowed banks to increase exposure to retail individuals or small business (with turnover of upto Rs 50 crore) from Rs.5 crore to Rs.7.5 crore.
	• To rationalise the risk weights and link them to LTV ratios only for all new housing loans sanctioned up to March 31, 2022.
	• To extend scheme for Co-lending to all NBFCs including HFCs.
	• Other Measures
	  ◦ Round-the-clock availability of RTGS on all days from December 2020.
	  ◦ To grant authorisation for all PSOs (new applicants as well as existing PSOs) on a perpetual basis from earlier limited periods of up to five years.

December 4, 2020	• On Tap TLTRO - will be expanded to cover other stressed sectors in synergy with the credit guarantee available under the Emergency Credit Line Guarantee Scheme (ECLGS 2.0). • Regional Rural Banks (RRB) will be allowed to access the Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF) of the RBI; and also the Call money market. • Scheduled commercial banks & cooperative banks shall not make any dividend pay-out from the profits of FY20. • Formulate guidelines on dividend distribution policy by NBFCs. • Issue guidelines to large UCBs, NBFCs for adoption of Risk-Based Internal Audit. • Harmonise guidelines on appointment of statutory auditors for commercial banks, UCBs and NBFCs. • Proposed to issue Reserve Bank of India (Digital Payment Security Controls) Directions, 2020 for regulated entities to set up a robust governance structure and implement common minimum standards of security controls for channels like internet, mobile banking, card payments, among others. • Revised draft directions to be issued for credit default swaps. • Revides draft guidelines for derivatives to be issued. • Discussion paper on supervision of NBFCs based on size to be issued in January.

KEY MEASURES ANNOUNCED BY THE RBI

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February 5, 2021	• TLTRO on Tap scheme extended to NBFCs for incremental lending to the specified stressed sectors. • Restoration of CRR in two phases beginning March 2021 (increase to 3.5% on March 27 and 4% on May 22, 2021) • Additional 1% of NDTL dispensation given on statutory liquidity ratio (SLR) for availing funds under the marginal standing facility (MSF) extended by 6 months to end September 30, 2021. • Extension of HTM limits (upto 22% of NDTL) upto March 31, 2023 from March 31, 2020 (to include securities acquired between April 1, 2021 and March 31, 2022). • Defer the implementation of last tranche of the Capital Conservation Buffer (CCB) of 0.625 per cent and also defer the implementation of Net Stable Funding Ratio (NSFR) by another six months from April 1 to October 1, 2021. • Retail investors are being allowed to open gilt accounts with RBI. • Encouraging foreign portfolio investments in defaulted bonds by exempting these investments from short term limit and the minimum residual maturity requirement.
April 7, 2021	• To conduct VRRR auctions of longer maturity. The amount and tenor of these auctions will be decided based on the evolving liquidity and financial conditions • To purchase Rs.1 lakh crore of G-secs under G-SAP in Q1 • Extension of the deadline for the TLTRO scheme by 6 months to September 30. • Fresh lending of Rs.50,000 crore to all Indian financial institutions like NABARD, NHB and SIDBI to maintain a continuous flow of credit. • Extended the use of central payment systems like RTGS and NEFT to non-banking service providers like PPIs and trade platforms regulated by the RBI. • Maximum end-of-day balance for payments banks increased from Rs.1 lakh to Rs.2 lakh. • Committee will be formed to review the working of ARCs • Enhancing ways & means advance (WMA) limit to Rs.47,010 crore, up 46% from current limit of Rs.32,225 crore • Bank lending to NBFCs for on-lending to PSL will be extended till September 30, 2021.

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order since lockdown.

Date	Measures Announced
May 5, 2021	• On-tap liquidity window of ₹50,000 crore with tenors of up to three years at the repo rate is being opened till march 31, 2022 to ease access to emergency health services. • SLTRO of ₹10,000 crore at repo rate for the SFBs, to be deployed for fresh lending of up to ₹10 lakh per borrower till October 31, 2021. • SFBs are now being permitted to reckon fresh lending to smaller MFIs (with asset size of up to ₹500 crore) for on-lending to individual borrowers as priority sector lending up to March 31, 2022. • Credit disbursed to MSME borrowers (upto 25 lakh) up to the fortnight ending October 1, 2021 extended till December 31, 2021. • Individuals, small businesses and MSMEs having aggregate exposure of upto ₹25cr eligible under Resolution Framework 2.0 for restructuring. • Individual borrowers, small businesses who have availed restructuring of their loans under Resolution Framework 1.0 can increase the moratorium and/or extending the residual tenor up to a total of 2 years. • Banks are allowed to utilise 100% of floating provisions/ countercyclical provisioning buffer held ason Dec 31,2020 for making specific provisions for NPA with prior approval of their board is permitted up to Mar 31,2022. • The max no. of days of OD in a qtr is being increased from 36 to 50 and the no. of consecutive days of OD from 14 to 21 for state govts.
June 4, 2021	• On-tap liquidity window for Contract-intensive sectors (tourism, travel agents, tour operators, adventure/heritage facilities, aviation ancillary services) to the tune of Rs. 15,000 crores with tenors of up to 3 years at repo rate until March 31, 2022. Banks can park their surplus liquidity upto the size of the loan book created under the scheme with RBI under reverse repo window at 40 bps higher than the reverse repo rate. • Special Liquidity facility to SIDBI to an extent of Rs. 160,000 crores to facilitate short and medium-term credit needs of MSMEs. • Enhancement of aggregate exposure for restructuring under Resolution Framework 2.0 to Rs. 50 crores as against Rs. 25 crores earlier. • Permitted Authorised Dealer banks to place margins on behalf of their FPI clients for their transactions in G-secs (including SDL and Treasury Bills), within the credit risk management framework of banks. • Permitted Regional rural banks to issue CDs to eligible investors. Banks have been allowed to buy back issued CDs ahead of the redemption date to ensure greater flexibility in liquidity management. • NACH will be available all days of the week.

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order since lockdown.

Date	Measures Announced

August 6, 2021	• Propose to conduct fortnightly VRRR auctions of Rs.2.5 lakh crore on August 13, 2021; Rs.3.0 lakh crore on August 27, 2021; Rs.3.5 lakh crore on September 9, 2021; and Rs.4.0 lakh crore on September 24, 2021.
	• Propose to conduct two more auctions of Rs.25,000 crore each on August 12 and August 26, 2021 under G-SAP 2.0.
	• To extend the on-tap TLTRO scheme further by a period of three months, i.e. till December 31, 2021.
	• To provide comfort to banks on their liquidity requirements, including meeting their LCR requirement, relaxation which is currently available till September 30, 2021 is being extended for a further period of three months, i.e., up to December 31, 2021.
	• Deferral of Deadline for Achievement of Financial Parameters under Resolution Framework 1.0
	• RBI Amends Rules For Smoother Transition Away From Libor banks can:
	  • Extend export credit in foreign currency using any other widely accepted alternative reference rate in the currency concerned.
	  • Change in reference rate from Libor/Libor-related benchmarks to an alternative reference rate will not be treated as restructuring
	• RBI has decided to defer the deadline for achievement of four financial parameters under Resolution Framework 1.0 for Covid related stress to October 1, 2022 earlier was required to be met by March 31, 2022.

October 8, 2021	• Withdrawing secondary market G-SAP due to existing liquidity overhang. However, would step-in to undertake G-SAP as and when warranted by liquidity conditions including OTs and OMOs. • Proposed to undertake the 14-day VRRR auctions on a fortnightly basis and may also consider 28-day VRRR auctions in a similar calibrated fashion to complement the 14-day VRRR. • On Tap Special Long-Term Repo Operations (SLTRO) for Small Finance Banks (SFBs) extended to December 31, 2021. • Proposed to introduce a framework for retail digital payments in offline mode across the country • Enhancing Transaction Limit in IMPS to Rs.5 lakh from Rs.2 lakh • Ways and Means Advances (WMA) Limits and Relaxation in Overdraft (OD) Facility for the State Governments / UT extended to Mar 31, 2022 • Priority Sector Lending - Permitting Banks to On-lend through NBFCs - Continuation of Facility further extended to march 31, 2022 • Introduce the Internal Ombudsman Scheme (IOS) for certain categories of NBFCs having higher customer interface.

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order since lockdown.

Date	Measures Announced

December 8, 2021	• Proposed to enhance the 14-day VRRR auction amounts on a fortnightly basis : Rs.6.5 lakh crore on December 17; and further to Rs.7.5 lakh crore on December 31. January 2022 onwards, liquidity absorption will be undertaken through the auction route.
	• Banks will be able to dip up to 2% of NDTL instead of 3% for overnight borrowing under the MSF from January 1, 2022.
	• Infusion of Capital in Overseas Branches and Subsidiaries of Banks and Retention/Repatriation/Transfer of Profits by these entities
	• UPI: Simplification, Deepening and Enhancement of Limits:
	  • launch UPI-based payment products for feature phone users
	  • process flow for small value transactions simpler through a mechanism of ‘on-device’ wallet in UPI applications; and
	  • enhance the transaction limit for payments through UPI for the Retail Direct Scheme for investment in G-secs and IPO applications from Rs.2 lakh to Rs.5 lakh.
	• Guidelines for transition from LIBOR to Alternative Reference Rate

IMPACT ON THE MUTUAL FUND INDUSTRY:

Liquid Funds:

These schemes will continue to generate returns around the operating rate due to their portfolio composition i.e. being invested at the shorter end of the money market segment. Liquid funds have low average maturity as they concentrate more on high quality papers including CPs, CDs and other debt securities with residual maturity of upto 3 months.

Ultra Short Term / Low Duration / Money Market Funds (Maturity Up to 1 Year):

These schemes predominantly invest in below 1 year maturity paper. The strategy adopted by these schemes is to hold the paper till maturity and capitalize on the running yield. Hence, returns in this category will continue to remain relatively attractive depending on the positioning of the fund.

Short Duration Funds:

Schemes in this category are predominantly invested in Corporate Bonds, CPs and CDs while a few of them also have some exposure to G-Secs. We continue to remain bullish at the shorter end of the curve. Investors may consider these funds (with the investment horizon commensurate with the maturity profile of such funds) and gain from current accruals.

Medium Duration Funds:

Given the current steepness in the curve there are reasonable opportunities in the intermediate duration (3-5 years) segment. Till the time RBI is managing the yield curve, the steepness of the curve may provide cushion even if there are mark-to-market losses. Investors may consider those funds with high quality portfolios and where the investment horizon is commensurate with the maturity profile of the fund and also gain from current accruals.

Credit Risk Funds:

We remain cautious on Credit Risk Funds as they have failed to prove their mettle in the last 2-3 years with the overhang of defaults and erosions of NAV on the back of mark-to-market impacts due to the aforementioned. The uncertainty around credit funds which are in an open ended avatar continues to pose risks to investors. Much also depends on the liquidity conditions in the market and redemption pressure on these funds. Thus, we think there is a systemic risk in the market within the credit space. Hence, it makes sense for one to stay away from these funds at the current juncture till the dust settles or risks in the credit markets shows signs of waning.

IMPACT ON THE MUTUAL FUND INDUSTRY:

Long Term Income Funds / Gilt Funds / Dynamic Bond Funds:
The 10-year benchmark yields lowered slightly after rallying for two straight months. However, it was up by 3 bps at 6.347% from the close of last policy, while for the month ended November 2021 it was down by 6 bps closing at 6.326%. But the shorter end of the yield curve either ended flat or a bit higher compared to the previous month, resulting in moderation of term premium. Corporate yields on the higher duration side also softened with the 10-year AAA PSU bond yield closing at 6.90% on Nov 30, 2021 compared to 6.97% in the previous month. Spread assets also benefitted from falling yields with the 10-year AA-bond closing at 9.72% on Nov 30, 2021 compared to 9.93% a month ago. Interbank call money rates remained below the RBI's repo rate of 4% in November amid surplus liquidity in the system. Widening its tools to bring down excess liquidity, the RBI absorbed a total Rs.1 lakh crore in 2 auctions of the new 28-day VRRR. This is in addition to the 7-day and 15-day VRRR it uses to absorb excess banking liquidity and guide short term interest rates to its policy rate.

In the west, focus is turning to the pace, duration and flexibility of tapering. The boost from discretionary fiscal action in Developed Markets is fading, but the central banks remain supportive for now. The 'fiscal cliff' could be countercyclical for growth. Policymakers in Asia are focused on gradual normalisation, although The People's Bank of China has struck a more dovish tone recently. The Fed has moved away from its ultra-loose policy and has announced tapering of the monthly bond buying program by US$20bn from November 2021 onwards. As the market undergoes the transition of gradual tightening in monetary policy, we may witness volatility going forward.

India Q2 GDP grew 8.4% YoY, well in line with Axis Bank Economic Research team projection of 8.3%, with overall industrial growth rising above the pre-pandemic level for the first time. Recent market chatter around the centre breaching fiscal targets in FY22 seems highly unlikely as strong fiscal trends seen so far. Core sector IIP saw an improvement, with overall activity at its highest levels since the pandemic. The recent print of Oct'21 CPI has led to upward revision of our (Axis Bank Economic Research team) projection to 5.4% for FY22, with risks tilted to the upside. The impact of the recent excise duty cut by the Union government and VAT reduction by more than 20 states on petrol and diesel is expected to start reflecting from the November print of retail inflation. Despite base effects, still-high fuel costs, input cost pressures and seasonal turn in some food prices in coming months, could even see higher inflation later in the fiscal year, as we reckon supply-side bottlenecks, higher imported commodity inflation and high pump prices would pose a countering upside pressure on inflation.

IMPACT ON THE MUTUAL FUND INDUSTRY:

The bond market has been volatile over the past few weeks as concerns about new lockdowns related to the spread of COVID-19 in Europe increased demand for the safe haven bonds, though the move was likely exaggerated by impaired liquidity that has plagued the market for the past few weeks. On the domestic front, the RBI continued with its balancing act of accommodative stance and liquidity normalisation. Given that, bond yields may remain in a tight range in near future. Citing faster-than-expected recovery, rising consumer confidence, and the resultant spending spike the growth forecast remains optimistic. However, there are multiple near-term risks to inflation trajectory – rising vegetable prices due to unseasonal rains, transmission of higher raw material prices to output inflation, continued pass-through of rising Brent crude to domestic fuel prices, and spillover of persistent global inflationary pressures. Over the medium term, inflation and potential monetary policy normalization will play a more important role in shaping the interest rate trajectory. Given the uncertainty over the interest rate trajectory, it would be prudent for investors to be conservative. Given that, with the economies healing in India growth should continue to pick up (albeit a bit unevenly), and accordingly inflationary expectations and interest rate cycle will need to be recalibrated. It is expected that the RBI shall take requisite measures going forward to support growth and ensure surplus liquidity in the banking system, with a dual objective of improving the financial conditions and managing the yield curve.

Conservative Hybrid Funds ***(Erstwhile: Monthly Income Plans (MIPs)***:

With between 10% to 25% allocation to equity, returns of CHFs are largely determined by the vagaries of the equity markets as against the debt markets. These funds are therefore suitable for investors who have a reasonably long time horizon & are comfortable with taking exposure to equities.

OUTLOOK

IMPACT ON THE MUTUAL FUND INDUSTRY:

The current policy continued the MPC/RBI bias for incrementalism across a number of parameters, rather than enforcing step changes. This is likely to continue in future policy meets going forward as well, with a formal hike to the reverse repo rate in 2022. The hike is likely to have no impact on markets, as they have already factored in the effect wrt RBI's liquidity measures. On a signalling basis, RBI's recent sales of government securities in secondary markets will be watched closely.

We remain constructive on the short to medium end of the yield curve. **Medium Duration funds, Short Duration funds, Corporate Bond funds, Banking & PSU Debt funds, Floating Rate funds, Low Duration funds, Money Market funds and Ultra Short Duration funds** can be considered by investors with an investment horizon commensurate with the maturity and duration of the schemes. Having said that, one should consider aspects such as exit load, capital gains tax and asset allocation amongst others while evaluating their investment options.

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