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RBI MONETARY POLICY

DECEMBER 2022

HIGHLIGHTS

MPC raises repo rate by 35 bps and retains stance indicating battle against inflation to be continued

MPC's fifth bi-monthly Monetary Policy Review: 2022-23
The MPC increased its repo rate by 35 bps to 6.25% in a 5-1 move. Stance on focusing on withdrawal of accommodative conditions retained with battle of inflation to be continued. Further calibrating tightening warranted to break core inflation persistence.

Policy Actions
Repo rate hiked by 35 bps to 6.25%.
Consequently, SDF at 6.00% and MSF at 6.50%.
RBI kept CRR unchanged at 4.50%.

GROWTH-INFLATION DYNAMICS

FY23 inflation projections were held at 6.7%, with Q3 at 6.6% (previously 6.5%), and Q4 at 5.9% (5.8% previously), with risks evenly balanced. Winter crop arrivals are positive, but cereal, spices, milk offsetting risks. Shift to services inflation, sticky core and demand led pass through of core seen as major risks.

Growth projections were downgraded to 6.8% from 7%, given geopolitical tensions, tightening global financial conditions and slowing external demand. Language sees, our growth remains resilient in the world of slowing growth, with positive trends in both consumption and capex.

LIQUIDITY AND EXTERNAL SECTOR

There are hints of discomfort around easy liquidity, with comments from participants leading to wean away from overhang of liquidity surpluses. Dynamics depend upon cash in circulation (CIC) and forex flows.

Comments on manageable CAD and increasing forex reserves indicate concerns around INR depreciation have begun to fade. Return of portfolio inflows boosting liquidity – indicates potential RBI rebuilding of reserves at stronger level of INR.

POLICY STANCE AND GUIDANCE

Policy was accommodative, both on monetary and liquidity fronts. No let-up on bringing inflation to more manageable levels – first below 6% and then closer to 4% target.

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order in last 1 year.

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

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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

February 10, 2022	• Extension of On-tap Liquidity Facilities for Emergency Health Services (Rs.50,000 Cr) and Contact-intensive Sectors (Rs.15,000 Cr) from March 31, 2022 to June 30, 2022. • Proposed to enhance the Voluntary Retention Route (VRR) limit for investments under the scheme by Rs.1.0 lakh crore from Rs.1.5 lakh crore at present to Rs.2.5 lakh crore with effect from April 1, 2022. • Proposed to increase the cap of e-RUPI vouchers issued by the Central and State governments from Rs.10,000 to Rs.1,00,000 per voucher and permit such e-RUPI vouchers to be used more than once (until the amount of the voucher is completely redeemed). • Proposed to increase the NACH mandate limit from Rs.1 crore at present to Rs.3 crore for TReDS related settlements to facilitate the financing of trade receivables of MSMEs.
April 8, 2022	• RBI has decided to introduce the width of the LAF corridor to 50 bps which was the level pre-pandemic. The floor of the corridor will now be provided by the newly instituted standing deposit facility (SDF), which will be placed 25 bps below the repo rate, i.e., at 3.75% • Risk weights for housing loans which were rationalized in October 2020, has been extended to March 31, 2023 to facilitate higher credit flow. • Enhance the present limit under HTM category from 22% to 23% of NDTL till March 31, 2023. • HTM limits would be restored from 23% to 19.5% in a phased manner starting from the quarter ending June 30, 2023. • Due to the transformative change in the financial landscape, a committee will be set up to examine customer service regulations in RBI Regulated entities. • It is now proposed to make card-less cash withdrawal facility available across all banks and ATM networks using the UPI.

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order in last 1 year.

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June 8, 2022	• Measures announced for the cooperative banking sector: 1. Individual housing loans limit extended by Urban Cooperative Banks (UCBs) and Rural Cooperative Banks (RCBs) and are revised upwards by over 100% taking into account increase in house prices. 2. Proposed to permit RCBs (State Cooperative Banks and District Central Cooperative Banks) to extend finance to 'commercial real estate – residential housing' (i.e. loans for residential housing projects), within the existing aggregate housing finance limit of 5% of their total assets. 3. UCBs to extend doorstep banking services to customers, especially senior citizens and differently abled. • To facilitate recurring payments like subscriptions, insurance premia, education fee, etc. of larger value under the framework, the limit is being enhanced from ₹5,000 to ₹15,000 per transaction. • At present, UPI facilitates transactions by linking savings/current accounts through users' debit cards. It is now proposed to allow linking of credit cards on the UPI platform (Rupay credit cards).
August 5, 2022	• Proposed to enable Standalone Primary Dealers (SPDs) to offer all foreign exchange market-making facilities as currently permitted to Category-I Authorised Dealers, subject to prudential guidelines. • SPDs will be permitted to undertake transactions in the offshore Rupee Overnight Indexed Swap (OIS) market with non-residents and other market makers. • Enabling Bharat Bill Payment System (BBPS) to Process Cross-Border Inbound Bill Payments • Inclusion of Credit Information Companies (CICs) under the Reserve Bank-Integrated Ombudsman Scheme (RB-IOS) 2021 and Introduction of the Internal Ombudsman (IO) Mechanism • Proposed to set up a committee to undertake an in-depth examination of the issues, including the need for transition to an alternative benchmark for MIBOR, and suggest the way forward.
September 30, 2022	• Discussion Paper on Expected Loss (EL) Based Approach for Loan Loss Provisioning by Banks • Discussion Paper on Securitisation of Stressed Assets Framework (SSAF)
December 7, 2022	• Banks will now be allowed to include securities acquired between Sept 1, 2020 and Mar 31, 2024. The HTM limits would be restored from 23% to 19.5% in a phased manner starting from the quarter ending June 30, 2024. • The capabilities in UPI will be further enhanced by introducing single-block-and-multiple-debits functionality. • With a view to providing greater flexibility, resident entities will now be permitted to hedge their gold price risk on recognised exchanges in the IFSC.

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:

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.

IMPACT ON THE MUTUAL FUND INDUSTRY:

Long Term Income Funds / Gilt Funds / Dynamic Bond Funds:
The RBI hikes repo rate by 35 basis points (bps) in December'22 policy, the fifth straight increase in the current cycle, as policymakers extended their battle to tame stubbornly above-target retail inflation rate. The RBI has now raised rates by a total 225 bps since its first unscheduled mid-meeting hike in May but inflation continues to remain elevated - a phenomenon that is affecting much of the global economy. Indian bonds yields oscillated in a tight range (7.20% - 7.50%) since last policy meeting, while reacting to series of announcement across the globe and domestically. The benchmark 10-year government bond yield fallen by around 13 bps to close at 7.27% from the last policy, while it went up by 2 bps on the policy day. The 10-year bond yield has largely remained on a downward trajectory due to a broad-based positive sentiment. The curve tracked lower oil prices and concerns about weakened demand in China, minutes of the US Federal Reserve's November meeting signaling a slower pace of rate hikes moving forward, better-than-expected demand at the auction and retail inflation easing to a three-month low in October, raising bets that the RBI may slow down its pace of interest rate hikes.

Month of November was eventful from global perspective. US fed had hiked rates by 75bps for a fourth straight meeting to 3.75 - 4% band with statements that the central bank might dial down the pace of rate increases leading to a sharp buying interest in the US treasuries paper and weaker dollar. However, the market rate peak remains above 5% in mid-2023. Currently, US yields are trading in a tight range of +/- 10 bps at 3.55%, a sharp fall from 4.218%, post the FOMC announcement. Later during the month, minutes of fed meeting signalled a leaning towards 50 bps hike in December policy. Europe is on the brink of recession along with high inflation which made ECB raise rate by 75bps in Oct'22. Chinese data on growth and inflation continues to come lower on the back of zero covid policy.

The MPC/RBI have indicated conditions still being supportive, with rates below those seen in 2019 - true for real rates as well as rates offered by banks to the economy. But transmission has been far faster in market rates, helped by changes in the liquidity stance. The relentless weakening of the INR appears to have halted for now, with the USD seeing limited upward momentum, but INR is largely flat on an NEER basis. Further rate hikes, if any will depend upon the expected inflation trajectory, which is still evolving

IMPACT ON THE MUTUAL FUND INDUSTRY:

& dependent upon geo-political uncertainty. Going ahead rate hike impacts and global slowdown might affect our growth. Currently we see a mixed environment of slowing growth and elevated inflation coupled with monetary policy tightening to stem inflation and inflationary expectations which have been persistent in the economy.

Given that, combination of challenging global backdrop and RBI's rate hike to rein inflation may cause interest rates to be volatile with an upward bias. We expect bear flattening of yield curve to continue, as larger repricing of rate hikes is expected to happen at the shorter end of the curve, while there could be limited upsurge at the longer end of the curve. The near-term direction would be dictated by inflation evolution, high frequency data, rate hikes by global central banks and domestic balance of payment situation amidst high current account deficit & FPIs outflow, both of which can put pressure on INR and can influence RBI's decision for pre-emptive rate hikes. A recessionary/stagflation environment and tightening of global monetary conditions is expected to create challenges for asset prices and induce higher market volatility. The yields will continue to be volatile over the next few months, and are likely to oscillate in a tight range between 7.20%-7.60% in the near term. Given the interest rate trajectory, it would be prudent for investors to be conservative. It is expected that the RBI shall take requisite measures going forward to support growth and ensure adequate liquidity in the banking system.

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:

Policy commensurate without expectations of another rate hike in the upcoming meeting but language around conditions still being accommodative and battle against inflation leaves door open for further action.

We remain constructive on the short to medium end of the yield curve; **Short Duration funds, Banking & PSU Debt funds, Corporate Bond funds, Debt Index funds (Target Maturities), Floating Rate funds, Money Market funds, Low Duration 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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