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RBI MONETARY POLICY

APRIL 2024

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HIGHLIGHTS

MPC holds rates and stance as expected, strong growth allows unwavering focus on bringing inflation down.

MPC's first bi-monthly Monetary Policy Review: 2024-25

The MPC voted 5-1 to hold both, rates and stance.

There was little change by way of language with comments on actively disinflationary policy, vigilance, and global risks retained. Focus now unwaveringly on inflation, with improved growth language.

There is limited change to liquidity management despite easing conditions in April.

Policy Actions

Repo rate maintained at 6.50%.

Consequently, SDF is at 6.25% and MSF is at 6.75%.

RBI has kept CRR unchanged at 4.50%.

GROWTH-INFLATION DYNAMICS

FY25 inflation projections are at 4.5% with quarterly projections brought down.

MPC comments gave greater priority to language on better inflation numbers but continued to express concern around risks from food inflation as well as from global events.

FY25 GDP projections were retained at 7.0% despite higher numbers indicated by RBI's internal model.

Language on global growth was upgraded with the recent softness in India manufacturing largely glossed over.

LIQUIDITY AND EXTERNAL SECTOR

RBI indicated continuance of the nimble liquidity stance used so far to adjust overnight rates based on the evolving conditions. There was some fear of acting to tighten liquidity in April given the current easy conditions.

Comments continued to repose confidence in manageable current account deficits in FY24 and FY25, with enough in terms of financial inflows to manage these.

POLICY STANCE AND GUIDANCE

The major shift dealt with upgrading of global growth and noting better domestic trends thus justifying a shifting of focus unwaveringly onto inflation.

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order in last 1 year.

Date	Measures Announced
June 8, 2023	• Allowing issuance of RuPay prepaid forex cards, also enabled for issuance in foreign jurisdictions. • Rationalizing licensing framework for Authorized Persons (AP) under FEMA, last revised in 2006. • Extension of timelines by another 2 years up to March 2026 for achieving the targets of Priority Sector Lending (PSL) for Primary (Urban) Cooperative Banks. • Proposed to issue comprehensive guidelines on compromise settlements and technical write-offs which will now be applicable to all regulated entities including co-operative banks. • Decided that SCBs can set their own limits for borrowing in Call and Notice Money Markets within the prescribed prudential limits for inter-bank liabilities to provide greater flexibility for managing their liquidity. • Allowing PPI issuers to issue e-RUPI vouchers, and enabling issuance of vouchers on behalf of individuals

August 10, 2023	• To revise the extant regulations issued in June 2019 and put in place a comprehensive, risk-based framework for administration of financial benchmarks.
	• Consolidation and harmonization of instructions for Supervisory data submission
	• Public tech platform for seamless delivery of credit and digital information, banks can plug and play
	• UPI: Conversational payments, offline payments, and higher limit for small value payments
	  • Users to be able to pay in conversation with AI-powered system
	  • Offline transactions on UPI-Lite system through near-field communications
	  • Transaction limit of Rs. 200 raised to Rs. 500 for small value digital payments in offline mode
	• Transparency in interest rate reset of EMI based floating rate loans
	  • Clear communication on changes, available options including converting to a fixed rate, and schedule of fees
	• NBFC-infrastructure debt funds – easing of regulatory framework
	  • Withdrawal of requirement for sponsor
	  • Permission to finance toll-operate-transfer projects as direct lenders
	  • Access to ECBs
	  • Making tri-partite agreements optional for PPP projects

October 6, 2023	• Project Finance: Comprehensive regulatory framework for projects under implementation to be issued • NBFC middle and base layers to now be able to offset exposures with risk transfers – upper layer NBFCs can already do this • Review of regulatory framework for Financial Benchmark Administrators • Monetary ceiling for gold loans (bullet repayment) at UCBs to be doubled to Rs. 4 lakh, where UCB has met PSL targets and sub-targets by Mar’23

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KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order in last 1 year.

Date	Measures Announced
October 6, 2023	• Omnibus framework for recognizing Self Regulatory Organisations (SROs) for various REs – draft to be issued • Extension of Payments Infrastructure Development Fund to PM Vishwakarma scheme beneficiaries – to enable emerging modes of payments and expansion in small markets • Card on file tokenization to be moved directly to the issuing bank level • Master direction on Internal Ombudsman mechanism for REs – harmonising guidelines for various categories currently in force
December 8, 2023	• There will now be a unified regulatory framework on connected lending for all regulated entities of the RBI to strengthen the pricing and management of credit. • Introduction of a regulatory framework for web-aggregation of loan products to enhance customer centricity and transparency in digital lending. • Proposal to set up a Fintech Repository which will be operationalized by the Reserve Bank Innovation Hub in April 2024 or earlier. This will help in the increasing partnerships between Banks and NBFCs and FinTechs. • Proposal to increase UPI transaction limit from ₹1 lakh to ₹5 lakh for payments to hospitals and educational institutions. • E-Mandate limit increased to ₹1 lakh per transaction for mutual fund subscriptions, insurance premiums, and credit card repayments. • Establishment of a cloud facility in India for the financial sector to enhance data security, integrity, privacy, scalability, and business continuity. It is intended to be rolled out in a calibrated fashion over the medium term.
February 8, 2024	• Review of the Regulatory Framework for Electronic Trading Platforms (ETPs) • Allowed resident entities to hedge their price of gold in the OTC segment in the IFSC. • Introduction of Programmability and Offline Functionality in Central Bank Digital Currency (CBDC) Pilot. • RBI will put in place a system of principal-based authentication to promote alternative authentication mechanisms. • Banks to provide Key fact statement for all retail and MSME borrowers.
April 5,2024	• Trading of Sovereign Green Bonds in International Financial Services Centre (IFSC). • RBI Retail Direct Scheme - Introduction of Mobile App. • Small Finance Banks (SFBs) are permitted to use only Interest Rate Futures (IRFs) for proprietary hedging. It has now been decided to allow SFBs to use permissible rupee interest derivative products. • Enabling UPI for Cash Deposit Facility. • UPI Access for Prepaid Payment Instruments (PPIs) through Third Party Apps. • Distribution of Central Bank Digital Currency (CBDC) through Non-bank Payment System Operators. • Review of Liquidity Coverage Ratio (LCR) Framework.

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 an investment horizon commensurate with the maturity profile of such funds) and gain from current accruals and capital appreciation in the event of a fall in yields.

Medium Duration:

Given the flattened yield curve there are sufficient buffers in the intermediate duration (3-6 years) segment. Till the time RBI is anchoring the long end of the yield curve, the current yield curve may provide some 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 funds and also gain from current accruals and capital appreciation in the event of a fall in yields.

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 MPC held rates and stance 5-1 as expected, maintaining language around actively disinflationary policy and the need for vigilance in the face of food and other risks to inflation. Language on global growth was upgraded, and emphasis on improving inflation was increased to an extent, but a new line of growth allowing for unwavering focus on inflation corroborates may be no rate cuts in FY25. However, liquidity is likely to be used actively to ease (or tighten) as required by evolving conditions, as indicated by relatively neutral language here. Additionally, Indian government's decision to reduce borrowing led by a cut in supply of shorter-tenor papers in the first half of next fiscal year is likely to support bond demand and lead to a steepening of the yield curve.

The Federal Reserve held steady on interest rates in its March meeting and maintained with its forecast for three interest rate cuts. The FOMC outcome was perceived as being less hawkish than expected primarily in response to the comments made by the FOMC Chairman. The upwards revisions that were made to the GDP growth and inflation along with forecasts of a tight labour market show that the central bank is expecting a 'soft-landing' to unfold. Powell re-iterated that focus is on and there is a need for more debate and data before interest rates are cut.

India's Feb CPI inflation was at 5.09% which was largely flat when compared to the 5.10% figure for Feb and just a touch above Axis Bank Economic Research team expectations of 5.05%. Within these numbers, the silver lining is of slowing inflation in pulses and spices, as the effect of past impulses fades away. Despite this, risks of fresh impulses remain, with behaviour of vegetable and fruit prices on a seasonal basis watched. These risks might be driven by changes in weather patterns, limited reservoir storage, as well as domestic and global political developments.

With scope for action on rates and stance, moves on liquidity, macroprudential, and linguistic shifts will provide guidance on the policy bias going forward. Use of language around 'actively disinflationary' policy, 'vigilance' and credit market transmission will continue to provide clues as to the future evolution of the policy. With this, Indian bond yields could see push-and-pull effects during CY2024 that could lead to increase in market volatility. The uncertainty in direction of yields would prevail in the next year and hence yields are likely to oscillate in a tight range in the short

IMPACT ON THE MUTUAL FUND INDUSTRY:

term. In the medium term, India's growth and stability, falling inflation and inclusion in key global bond indices could lead to change in stance by the RBI leading to gradual rate cuts over FY25. We believe the 3 to 6 years segment appears to be in a favourable position from a risk-reward perspective. Being cognizant of the environment, we continue being Neutral and remain constructive on the short to medium end of the yield curve, with a quality approach on bonds as the risks on inflation prevail. The benchmark yields are up by 3 bps at 7.11% from last policy, while for the day it is up by 2 bps (at the time of writing). We expect interest rates at the shorter end to remain high, while the longer end may be anchored in the short term.

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

With a 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:

Markets had not expected any major change in today's policy, but the shift of focus unwaveringly onto inflation give a slightly hawkish tone. Liquidity is expected to tighten from May onwards with seasonal trends.

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), Medium Duration funds, 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 profile of the schemes. Investors can consider investing in **Medium/Long Duration** funds as per their risk appetite with an investment horizon of at least 2-3 years to avoid any intermittent volatility.

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