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RBI MONETARY POLICY

OCTOBER 2021

HIGHLIGHTS

MPC holds rates, while acknowledging pickup in recovery, favourable inflation dynamics

RBI's Fourth Bi-monthly Monetary Policy Review: 2021-22:
The MPC unanimously held rates and retained 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 by a 5-1 majority.

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

14-day VRRR amount increased to Rs 6 tn from Rs 2 tn at the August meet, while no G-SAP amount declared due to existing liquidity overhang.

GROWTH-INFLATION DYNAMICS

RBI revised its inflation projection significantly lower for FY22, with Q2 at 5.1% vs 5.9% previously, Q3 at 4.5% from 5.3% previously, while Q4 was held steady at 5.8%. Softer inflation was seen in line with weak seasonal performance in food prices and presence of adequate buffer stocks, though core inflation remaining sticky and vigilance of pass-through of high input inflation was also noted. The statement also indicated that the RBI will remain watchful around evolving inflation.

Statement notes recovery in high frequency indicators, though overall activity has remained muted. The MPC retained GDP growth for FY22 at 9.5%. Commentary around growth was upbeat, but the presence of elevated global commodity prices, financial market volatility and supply-side bottle necks were seen as downside risks.

LIQUIDITY AND EXTERNAL SECTOR

RBI indicated that it would continue to constrict overnight liquidity through absorption in price term reverse repos as it moves towards more normal monetary policy with hints of further abstraction as conditions continue to improve.

The global economic recovery has remained muted since August on worries around the rapid spread of the Delta variant, with loss in trade volumes seen on account of supply side bottlenecks. Risk conditions weakened in September on concerns around slowing of the Chinese economy and uncertainty around the US debt ceiling. However, global central banks increasingly began to express tightening bias, on accelerating inflation pressures seen from higher commodities.

POLICY STANCE AND GUIDANCE

The policy encapsulates brightening outlook around growth and increase in concerns around inflation, as well as eventual approach towards normalization - guided by the nature of recovery and durability of the inflation move towards target.

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.

<table>
<tr><th>Date</th><th>Measures Announced</th></tr>
<tr><td>August 6, 2020</td><td>
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.
</td></tr>
<tr><td>October 9, 2020</td><td>
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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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.

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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

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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.

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 there could be further erosion of NAVs and hence returns due to a mark-to-market impact (timing mismatches, further possible downgrades, etc). It will also depend on the liquidity conditions in the market and redemption pressure on these funds. Thus, we think there is an elevated 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 yield was volatile during the month. Yields have risen by almost 16 basis points in the last 20 days from the low of 6.12% (22nd Sep 2012), tracking a sharp rise in US Treasury yields after the Federal Reserve indicated sooner-than-expected tapering of its bond purchases and with crude oil prices hitting $82/barrel. However, statement from our Hon'ble Finance Minister supported the bond yields after the government refrained from adding to its near-record borrowing plan for the year which was earlier indicating that the government may borrow an additional amount of Rs 1.6 trillion. Though from the previous policy the yields are marginally up by 4 bps to 6.27% (7th Oct 2021).

Since 2019, India is marching towards inclusion in global bond indices. Indian bonds are also under review for inclusion by JPMorgan Chase & Co., which typically assesses its index this month, while Bloomberg Index Services Ltd. last week said there is currently no estimated timeline in place for India's inclusion in the Bloomberg Global Aggregate Index. Moreover, FTSE Russell has said it continues to engage with Indian authorities and will provide an update to the market in March 2022. Morgan Stanley said that it expects India to be included in global bond indices in early 2022. As per Morgan Stanley, the index inclusion will attract $170 billion to $250 billion in bond inflows in the next decade whereas Goldman Sachs estimates passive inflows of around $35-40 billion if India joined both indices.

The last MPC meeting's minutes were largely balanced, in general, except for dissent by one MPC member on stance. Most MPC members were in consensus about the strengthening of recovery over the past couple of months but also remained cautious about the fragile nature of it and risk to the same from the possible 3rd wave. Further, most were of the opinion that elevated retail inflation was driven by supply chain disruption and aggregate demand remained weak. Since the last meeting, the Reserve Bank of India's withdrawal of liquidity from the banking system has further weighed on sovereign debt. The central bank has started making its bond purchase program liquidity-neutral by including an equivalent sell leg to the auctions. It has also started shorter variable rate repo auctions to modulate shorter-term liquidity.

The global reopening continued, as increasing number of developed markets lifted restrictions. Macro-economic data was strong, although much of the developed world appears to be at or just past the peak rate of growth. The Delta variant continues to pose a risk to the global outlook, but for developed economies, this is more likely to be in the form of supply constraints than further lockdowns. While uncertainty has increased, it is unlikely to derail the recovery. The Fed is content with the progress made on inflation, which it still believes will be transitory, and expects the labour market to reach the bar for tapering shortly. Debt futures

IMPACT ON THE MUTUAL FUND INDUSTRY:

markets are expecting the first rate hike for the US in 2023, and for Europe in 2025, and both the central banks are likely to do their utmost to keep expectations where they are. The US treasury yield rose to three-month high at 1.57% as investors awaits Federal Reserve policymakers for clues on when the central bank could taper its pandemic-era economic support. Investors were also keeping an eye on developments surrounding debt-laden China Evergrande, after the property giant missed a bond payment deadline last week.

On the domestic front, the improvement in fiscal deficit numbers, initial moderation in CPI, surplus liquidity of more than Rs.7-8 tn and active RBI intervention may result in range bound yields in the near term. Moreover, market would be quite relieved that the government is not changing its borrowing program. Additionally, any uptick in prices of crude oil only darkens the outlook for inflation and that could create problems for the RBI, which has been trying to keep yields low to encourage growth. Besides this, markets continue to watch the shape of the recovery with improved mobility and easing of containment measures. This will help determine the evolving stance of the RBI on liquidity management and the yield curve going ahead. Even then, the 10y yield is likely to be allowed to rise only gradually (or evolve in an orderly fashion). The bond yields may remain in a tight range in the near future supported by the RBI's bond purchases and over the medium term, inflation and potential monetary policy normalization will play a more important role. Beyond the near - term pandemic concerns, we believe that we are at the fag-end of the interest rate cycle. Given that, the policy stance to maintain ample liquidity is positive for short end of the yield curve, while the long end also gets supported by the active yield management by RBI through the G-SAP 2.0 and regular OMOs, but the longer end may remain volatile due to inflation & global factors. We believe that the yields in the short to mid part of the curve continues to provide opportunity from a risk-reward perspective. Even with yields tending to inch up, the higher accrual should provide a cushion to mitigate some of the erosion in price. Duration strategies continues to be wary as interest rates are expected to remain volatile. 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.

(P.S.: 10 year benchmark (6.10% GS2031) up by 5 bps to 6.32% at the close)

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:

With liquidity gradually being tightened, the availability of money market assets through MFs is likely to increase in the medium term. This might see the return of pricing power with MFs. The rest of the yield curve will likely be allowed to rise slowly as RBI continues to oversee the gradual evolution of the yield curve. Even with yields tending to inch up, the higher accrual should provide a cushion to mitigate some of the erosion in price.

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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