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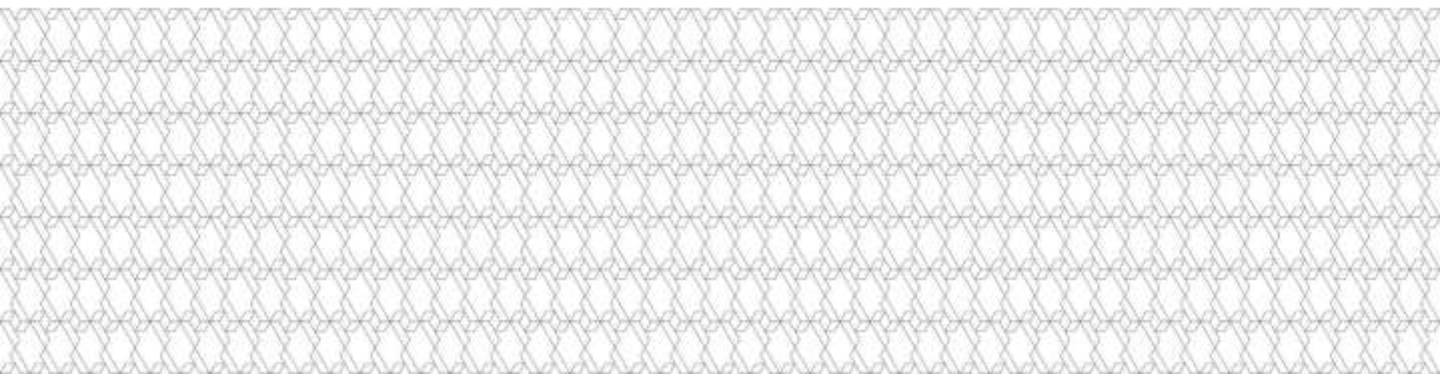
RBI MONETARY POLICY

JUNE 2024



HIGHLIGHTS

MPC holds rates, though with additional dissent

- **MPC's second bi-monthly Monetary Policy Review: 2024-25**
  The MPC voted 4-2 to hold both, rates and stance.

  The MPC eased its language, transitioning from an 'actively disinflationary' policy to only 'disinflationary' policy, This shift suggests that they now have more flexibility in their approach to maintain stability, allowing them some room to maneuver while still prioritizing inflation control.

- **Policy Actions**
  The repo rate was 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

- For FY25, inflation projections are held at 4.5% despite the improving inflation prints and lower core inflation over the past few months.
  The outlook on inflation appears favourable, though the extent of language on inflation has not changed in the way it was seen in the RBI bulletin. Risks from global factors, including in industrial input costs, were noted.

- FY25 GDP growth was projected at 7.2% which is an upgrade from the earlier projection of 7.0%. This upgrade was due to expectations of consumption and investment recovery following the strong FY24PE print of 8.2%.
  Growth was boosted by rural as well as urban consumption demand, global trade, and investments.

LIQUIDITY AND EXTERNAL SECTOR

- The RBI has held its language on being nimble in liquidity management, however, it has indicated communication to bank boards to re-strategise for better asset-liability balance thus implying that credit/deposit growth gaps might linger.

- Comments continued to indicate a comfortable position on the external front with FX reserves at a new high of USD 651.5 bn, albeit boosted by an FX swap carried out in markets.

POLICY STANCE AND GUIDANCE

- **MPCs mild easing of language indicates some increase in the level of comfort with growth and inflation developments, but holding of inflation projections and reference to higher commodity prices signals that progress is likely to be slow.**

- **RBI also indicated review of unsecured retail credit and NBFC lending to see if fresh macroprudential steps might be needed.**

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order in last 1 year.

Date	Measures Announced

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 • 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.

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December 8, 2023	• 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.
June 7, 2024	• Proposed to revise the definition of bulk deposits as 'Single Rupee term deposit of Rs.3 crore and above' for SCBs (excluding RRBs) and SFBs. • Proposed to rationalise the extant FEMA guidelines on export and import of goods and services. • Proposed to establish a Digital Payments Intelligence Platform for network level intelligence and real-time data sharing across the digital payments' ecosystem. • Inclusion of Recurring Payments with Auto-Replenishment Facility under the e-mandate Framework • Introduction of Auto-Replenishment of UPI Lite Wallet – Inclusion under the e-mandate 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 up to 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.

IMPACT ON THE MUTUAL FUND INDUSTRY:

- **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.

- **Long Term Income Funds / Gilt Funds / Dynamic Bond Funds**:

  MPC maintained the status quo, with no major change in rates, stance, or liquidity. As a result, bond yields remained largely unchanged following the policy announcement. RBI Governor reiterated the MPC's commitment to achieving a 4% inflation target and emphasized that the RBI's policy decisions are driven by domestic developments, not by a "follow the Fed" approach. Notably, the increase in dissenting votes from one to two may be considered a marginally positive sign for yields, despite the overall unchanged policy stance.

  The bond yields in India gradually edged lower during the first half of May'24 tracking a decline in US yields, resumption of FPI debt flows and the buyback announcement by RBI. The yields fell sharply in the second half of May'24 below 7%, after the central bank approved the transfer of a record amount of Rs 2.11 tn ($25.40 bn) as surplus to the government for FY24, thus boosting demand. The Lok Sabha election outcomes being contrary to expectations, the bond yields hardened as it was driven by possibility of fiscal loosening and likely higher spending for the lower income strata due to formation of a coalition government.

  The FOMC minutes showed that most members remained concerned about the lack of progress on inflation. The emphasis was to ensure that policy remains as restrictive as possible to facilitate the disinflation process. However, the committee maintained that inflation was expected to move towards the 2% threshold in the medium-term, although it could take longer than previously assumed. The minutes

IMPACT ON THE MUTUAL FUND INDUSTRY:

showed that members believed that labour market re-balancing was taking hold slowly. While growth remains strong, the economy was expected to gradually slow down led by household consumption moderating. The committee is waiting for more evidence before it takes any decision on when it might want to consider easing policy. Overall, slow disinflation and gradual re-balancing of the labour market could allow for the FOMC to commence easing in H2CY24. However, the risk of a further delay remains if progress is slower than anticipated. We expect a possibility of 25bps-50bps worth of cumulative rate cuts over CY2024.

The IMD indicated that after a year of El Nino, 2024 will be a year of La Nina (above normal monsoon) which bodes well for the rural demand. Indian bond yields could see a push-and-pull effect during CY2024 that could lead to market volatility. The uncertainty in direction of yields would prevail with any escalation on geopolitical tension, rise in crude price, further delay in rate cuts in global markets during the year and progression of monsoon in the short term. For the medium term, India's growth and expectation of political stability and policy continuity, falling inflation and inclusion in global bond indices could lead to change in stance by the RBI which will eventually lead to gradual rate cuts in later part of FY25.

The market participants were increasingly stocking up on long-term bonds, especially those with 10-year and 14-year maturities. They were doing it since a few months on expectations of capital appreciation following inclusion of domestic bonds in JP Morgan bond indices. On the other hand, the short-term bonds were less in demand due to liquidity deficit within the system and uncertainty around rate cuts. However, with the recent record surplus transfer of dividend, we expect short-term government bonds to outperform long-term bonds in the short term as liquidity is likely to improve.

The benchmark yields are down by 3 bps at 7.02% from last policy, while for the day it is up by 1 bps (at the time of writing). We believe the 3 to 6 years segment appears to be in a favorable 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.

- **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

- The policy was largely in line with the market expectations given that risk still prevails from monsoon, stronger growth conditions and global input prices for metals and others. However, the dissent, which was seen moving closer in the past two MPC minutes, and the rewording of some phrases indicate moves in a favorable direction.

- 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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