Resolution of the Monetary Policy Committee (MPC) September 28 and 30, 2022

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) at its meeting today (September 30, 2022) decided to:

- Increase the policy Repo rate under the liquidity adjustment facility (LAF) by 50 bps to 5.90% with immediate effect.
- Consequently, the Standing Deposit Facility (SDF) rate stands adjusted to 5.65% and the Marginal Standing Facility (MSF) rate and the Bank Rate to 6.15%.
- The MPC also decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

These decisions are in consonance with the objective of achieving the medium term target for consumer price index (CPI) inflation of 4% within a band of +/- 2%, while supporting growth.

The RBI also announced measures on Developmental and Regulatory Policies relating to (i) Regulation and Supervision; and (ii) Payment and Settlement Systems.

MPC's Outlook:

The monetary policy announcement was largely in line with expectations on most of the fronts. We'd rather say that at the margin it was relatively dovish as the markets were expecting the RBI to sound more hawkish given how aggressive the major global central banks have been in their rate hikes as well as their rhetoric. The expectations of the hawkish tone by the markets, was also evident from the fact that when the Governor started his speech highlighting the global uncertainties and issues and tightening of financial conditions globally, the benchmark bond yield rose sharply. However, as the announcement progressed the Governor sounded more positive indicating India being a beacon of hope amidst the global uncertainty, and the policy tone turned out to be a lot more balanced, leading to a decline in benchmark bond yield. Nonetheless, the RBI did focus its attention on the global uncertainties and highlighted the tightening financial conditions and its impact in the global economy, highlighting that the economic activity in India has been stable. While the governor pointed out weakening of global growth momentum and downside risks to global trade, he gave comfort on the balance of payments situation stating that "In the final analysis, we remain confident of meeting our external financing requirements comfortably." A small disappointment could be from the perspective of lack of indication on OMOs as a tool to manage bouts of deficit liquidity conditions. In this context the RBI decided to merge the 28-day VRRR with the fortnightly 14-day auctions and conduct only 14-day VRRR. As per the RBI, the current liquidity tightness is likely to ease in H2FY22 as the government spending speeds up generally in the later half of the fiscal year.

On the inflation front, RBI kept its FY23 inflation forecast unchanged. The RBI expects Consumer Price Index (CPI) inflation to be at 6.7% YoY in FY23, with Q2FY23 at 7.1%; Q3FY23 at 6.5%; and Q4FY23 at 5.8%, and risks evenly balanced. CPI inflation for Q1FY24 is projected at 5.0%. That said, RBI highlighted the uncertainties surrounding the inflation trajectory, stating that high and protracted uncertainty surrounding the course of geopolitical conditions weighs heavily on the inflation outlook. The other risk factors that the RBI highlighted for inflation, included risk of crop damage from excessive/unseasonal rains; elevated imported inflation; uncertain Crude oil price outlook; and incomplete passthrough of some easing of input costs. On the positive side for inflation outlook, the RBI highlighted certain factors such as softening of Commodity prices and rising recession risks in advanced economies (AEs), recovery in sowing auguring well for Kharif output and comfortable reservoir levels augur well for the Rabi crop.

Citing the downside risks to economic growth, the RBI revised the real GDP growth projections marginally lower. The real GDP growth for FY23 has been projected at 7% YoY with Q2FY23 at 6.3% YoY; Q3FY23 at 4.6% YoY; and Q4FY23 at 4.6% YoY. For Q1FY24, it is projected at 7.2% YoY. In the August policy, the RBI has projected real GDP growth for FY23 at 7.2% YoY, with Q1FY23 at 16.2% YoY; Q2FY23 at 6.2% YoY; Q3FY23 at 4.1% YoY; Q4FY23 at 4.0% YoY and Q1FY24 at 6.7% YoY. The RBI highlighted, that headwinds from geopolitical tensions, tightening global financial conditions and the slowing external demand pose downside risks to net exports and hence to India's GDP outlook. That being said, the RBI continued to remain positive on growth prospects of the economy on account of factors such as improving outlook for agriculture and allied activities and rebound in services; expected expansion in industrial activity; rural demand catching up and expectations of urban demand strengthening and; positive outlook on demand conditions and sales prospects.

Impact on the Bond Market and outlook:
The bond market reaction to the monetary policy was muted as the outcome was in line with expectations. Yield on the old 10 year benchmark G-sec 6.54% G-sec 2032 bond was trading at a level of 7.38% at the time of writing of this report, same as that of its previous close. The high frequency data points released between the August and today's monetary policy were largely in line with expectations with some deviations, which could have given the RBI the comfort to maintain a balanced approach in its tone. The capital markets have seen a fair bit of volatility recently and that may have guided the RBI to refrain from giving a forward guidance. The RBI governor himself highlighted that forward guidance can be hazardous in the present context. An important take away from the monetary policy today was that current comfortable macro-economic variables exude confidence to the policy makers in their policy responses. Domestically, despite the lower than expected GDP growth in Q1FY23, and elevated inflation, on a relative basis, Indian macros are more stable than the rest of the world economies. While the RBI seemed a bit more positive on economic growth, with only a minor downward revision in GDP forecast, we cannot remain decoupled from the global growth slowdown for longer. Should growth slowdown accentuate from here on, the RBI may have to recalibrate the monetary policy to address the growth concerns. Globally also, while the fight against inflation is a top priority, growth slowdown beyond a level, brings in other set of major economic problems which may call for the policy pivot. Inflation problem seems to be lasting for much longer than earlier anticipated. Thus, going forward, high frequency growth indicators will be extremely important to track, both globally as well as domestically to get a sense of the trajectory of monetary policies (while currently the general market expectations are of further aggressive tightening). Bond markets are likely to continue witnessing bouts of volatility given the macro-economic uncertainties accentuated by rising geo-political tensions as well as erratic climatic conditions.

Fixed Income Mutual Fund Investment Strategy:- Given the expected volatility and uncertainty and expectations of flattening of the yield curve, staying invested at the short and the very short end of the yield could be better from risk reward perspective currently. Thus, investors should look at funds oriented towards the shorter end of the yield curve for relative stability in the near term and to benefit from the reset in interest rates on the higher side. For this one can look at Short Duration Funds, Money Market Funds, Ultra Short Duration and Low Duration Funds for a horizon of 12 months and above. For investors looking for accrual strategies, they can consider Target Maturity Index Funds that invest in a mix of better quality bonds with investment horizons matching the maturity of the funds. Investors can gradually move up the yield curve to benefit from better accruals at higher rates. Investors who are comfortable with volatility and have a longer investment horizon could look at Dynamic Bonds for a horizon of 24 months and above. For a horizon of 3 months and above Arbitrage and Money Market Funds can be considered. Whereas, for a horizon of up to 3 months investors can consider Overnight Funds and Liquid Funds. Investors should invest in line with their risk profile and product suitability.

HDFC Bank House, 1 st Floor, C.S. No. 6 \ 242, Senapati Bapat Marg, Lower Parel, Mumbai 400 013. Phone: (91)-22-66527100, ext 7111, Fax: (91)-22-24900983 \ 24900858

HDFC BANK is a AMFI-registered Mutual Fund Distributor & a Corporate Agent for insurance products.