



April 8, 2021

## Monetary Policy Review

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### Rates Unchanged, Liquidity Support Continues

As expected, the monetary policy committee (MPC) kept rates unchanged and decided to maintain an accommodative stance for as long as needed in yesterday's monetary policy. The RBI continued its focus on growth by providing liquidity support despite some upside risks to inflation. The RBI also announced measures to reduce bond price volatility like the government security acquisition plan (GSAP 1.0), another variant of the open market operations (OMO) calendar that the market participants were hoping for. A few measures to support the development of non-bank payment services were also introduced.

### Growth Outlook Assessment of The Economy

- Global growth is gradually recovering aided by vaccination drive, accommodative monetary policy, and further sizeable stimulus, but remains uneven across countries.
- High-frequency indicators suggest economic activity is normalising despite the surge in infections. Rural demand remains buoyant, while urban demand has gained traction supported by vaccinations.
- While the recent surge in Covid-19 infections adds uncertainty to the domestic growth outlook, India is better prepared to meet challenges posed by infections and resulting restrictions.
- The MPC retained growth projection at 10.5% for FY22, with 26.2% growth in Q1, 8.3% in Q2, 5.4% in Q3 and 6.2% in Q4.

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## Inflation Outlook

- The MPC revised CPI inflation projection to 5% for Q4FY21 (from 5.2%), 5.2% for H1FY22 (from 5-5.2%), 4.4% for Q3FY22 (from 4.3%) and 5.1% for Q4FY22.
- According to the MPC, bumper food grains production in FY21 should result in softening of food grain prices, however temporal and spatial progress of the south-west monsoon in 2021 will also impact food inflation.
- High international commodity prices and logistics costs may push input prices higher for manufacturing firms.

## Liquidity Measures

- **G-Sec acquisition plan (G-SAP1.0)** the RBI will buy INR 1 Lakh crore worth of G-Sec from the secondary market under this program in Q1FY22.
- **Other liquidity measures to continue simultaneously** like OMOs, operation twist and liquidity adjust facility (LAF).
- **Variable Rate Reverse Repo (VRRR) auctions to continue**, extended to long-duration bonds as well.
- **TLTRO extended** to Sept 30, 2021 from Mar 31, 2021 earlier.
- **Liquidity facility for All India Financial Institutions** like NABARD, SIDBI, NHB and EXIM bank worth INR 50,000 crore for fresh lending during FY22.

## Other Major Announcements

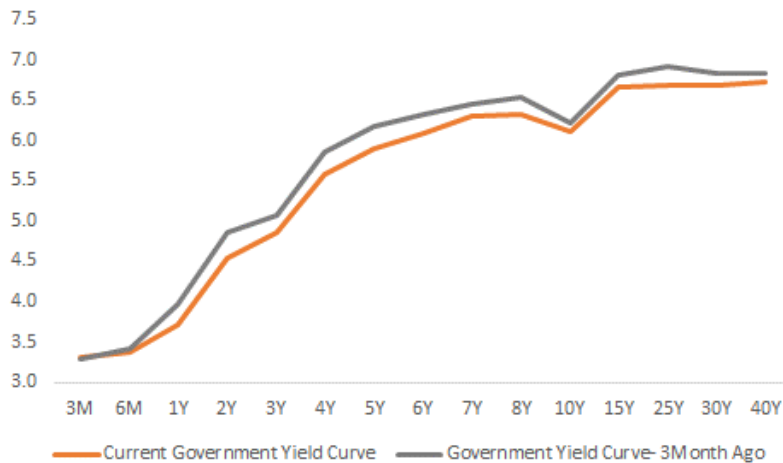
- **Enhancement of max. balance limit for payment banks** to INR 2 Lakh per individual, up from INR 1 Lakh.
- **ARC committee** to review the working of asset restructuring companies (ARCs) and recommend measures.
- **RTGS and NEFT for non-bank payment system operators** like prepaid payment instruments (PPI), card networks, white-label ATM operators, etc. RTGS and NEFT were open to only banks earlier.
- **Cash withdrawal from non-banks**, customers can now withdraw cash from full-KYC PPIs of non-bank issuers.
- **Mandatory interoperability of full-KYC for prepaid payment instruments**, the current limit on outstanding balance also increased to INR 2 Lakh from 1 Lakh.
- **Loan limit enhancement under PSL**, the RBI has increased loan limit under priority sector lending (PSL) to INR 75 lakhs from INR 50 Lakhs against pledge/hypothecation of agricultural produce.
- **Ways and Means Advance (WMA) limits** to States and UTs enhanced to INR 47,010 crore from INR 32,225 crore. This could help states meet their short-term fund requirements. This will also reduce SDL borrowing to some extent.

## Outlook

The market had been longing for an RBI open market operations (OMO) calendar which has now come in the form of GSAP 1.0. While the RBI had carried out OMOs last year as well (it purchased INR 3.13 lakh crore of G-Secs last fiscal year), the GSAP 1.0 provides clarity to market participants. The GSAP1.0 is in addition to the other liquidity measures available with the RBI. Additionally, the government announced its H1FY22 borrowing calendar which was largely in line with expectations. The GSAP1.0 should reduce volatility in bond prices, especially given the extent of the borrowing planned for FY22. Bond prices reacted positively to this. The 10-year Indian government bond yield closed 4bps lower at 6.08% today.

The yield curve had become quite steep with term premiums (difference between the long duration and short duration yields) much higher than historic averages. The purchase of long-term bonds via the GSAP and variable reverse repo to absorb excess liquidity should support a gradual reduction in term premiums and flattening of the yield curve.

**Yield curve is quite steep**



Source: Bloomberg, Sanctum Wealth

We have been maintaining that the bottom of the rate cycle is past us and bond yields are likely to rise going forward. However, RBI measures suggest that the rise in yields could be more gradual with lower volatility than anticipated earlier. The steepness of the curve makes the 5-to-7-year bucket attractive for a three year+ holding period. We continue to suggest a barbell strategy for debt investors with short duration papers that get repriced quickly at one end and opportunistic direct bonds, carefully selected structured credits, and select few roll-down funds capturing our preferred bucket mentioned earlier at the other end

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