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## Is RBI Really that Dovish...

The MPC meeting today, left the policy rates unchanged while retaining the accommodative stance. The decision to leave the policy rates unchanged was unanimous though Prof. Jayanth Varma dissented from the view of retaining the accommodative stance. The MPC statement further stated that the accommodative stance will continue as long as necessary to revive and sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward.

- The RBI MPC expects **real GDP growth in FY2022 to be at 9.5%**
- The MPC projects **headline CPI inflation at 5.3% for FY2022 and CPI inflation is projected at 5.0% in 1Q and Q2 for FY23.**

Though the MPC left the reverse repo rate unchanged, the focus of RBI has clearly shifted to liquidity management. RBI increased the quantum of variable rate reverse repo (VRRR) of 14-day tenor to INR 7.5 trillion by December 31. Further the Governor stated that from January 2022 onwards, liquidity absorption will be undertaken mainly through the auction route.

### Our View:

The RBI decision to increase the amount under the 14 day VRR auctions while referring to the Liquidity Management Framework of February 2020, means that the majority of the excess liquidity will be absorbed in VRRR Auctions near the policy repo rate at 4% which will result in gradual increase in the short term money market rates. So even without an explicit hike in the reverse repo rate, RBI is guiding market towards higher overnight / money market rates. Our view is also supported by the fact that unlike the last policy when RBI explicitly mentioned that they will keep banking liquidity between INR 2 trillion to INR 3 trillion in overnight Liquidity Adjustment Facility (LAF), in this policy there is no such guidance.

We also think inflation will overshoot the RBI inflation target of 5% for H1 FY2023.

Further the curve can flatten going ahead as the overnight rate can hit 4% in January 2022, earlier than expected. We expect the benchmark 10 year to trade in a range of 6.25% to 6.45% over the next couple of months.

We continue to believe that the process of monetary policy normalization has started but it will be a slow and gradual one. Our advice to investors will be to remain invested in short duration products like Banking PSU Funds and the Corporate Bond category for investment horizon of 1-3 years and Ultra Short and Money Market funds for investment horizon of less than 1 year.