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RBI Monetary Policy – Inflation Jitters

June 2022

In line with market expectations, the RBI MPC decided raise policy rates by 50 bps. The decision to raise rates was unanimous. The market was relieved that there were no further liquidity tightening measures following on the 50bps CRR increase in May.

The policy confirms RBI's tilt now to combating inflation over supporting growth. Nevertheless, policy rates remain very accommodative, i.e. the repo rate is well below the current and projected rates of inflation. The change in language around policy stance in our view has made a highly complicated stance to a "complicated stance."

Stance Wordings in May 4th Policy	**8th June 2022 Policy**
Remain accommodative	Dropped
Withdrawal of accommodation	Retained
Supportive of Growth	Retained

Source: RBI Monetary Policy Statement & RBI post policy press conference dated 4th May 2022 & 8th June 2022

The policy stance is no longer a guide to the future course of monetary policy. Instead the statement seems to suggest that further policy actions may be necessary to contain inflation.

The markets in the build up to the policy saw rates across the curve rise by 10-15 bps. Post policy, the markets corrected some of those losses however rates gradually returned to previous day levels towards the end of the day. At the time of writing this note, the 10-year G-Sec was trading at 7.49% down 2 bps from the day earlier.

Key Announcements

(i) Inflation projection revised to 6.7%

Inflation in India since the start of the COVID wave has averaged above the RBI's upper band of 6 months. The commentary in the latest monetary policy now indicates that inflation for the next 3 quarters is also likely to remain above 6%. The projection of inflation now means that the RBI expects 4 continuous quarters (the whole of calendar year 2022) where inflation remains above the 6% threshold.

Inflation Projection as of	**February 2022**	**April 2022**	**June 2022**
For FY 2022-23	4.5%	5.7%	6.7%

Source: RBI monetary policy statement dated 8th June 2022

(ii) Back dating the liquidity withdrawal timeline

In the April monetary policy announcement, the RBI had indicated that it would withdraw excess liquidity over a multi-year time period. Now the period of calculation of the multi-year time frame has been back dated to January 2021. In a manner of speaking we are already in the third year of liquidity withdrawal (Jan 2021 was in FY 21). The implication is that the RBI will look to achieve neutral liquidity position by the end of FY23. This has a material bearing on the short bond & money markets

Our View

The RBI's statement today, was largely a non-event for the market since the market has priced in a large portion of rate hikes. Volatility in the bond markets that were seen in the last few months have been on account of the RBI recognizing headwinds that the markets perceived well ahead of time.

By projecting inflation at 5.8% by March 2023, the target to have policy rate above the rate of inflation implies a terminal repo rate in this hiking cycle of 6% or more. Market pricing for the terminal repo rate (as evidenced by the steep yield curve and OIS rates) already was above 6%.

Incrementally the evolution of actual inflation and liquidity management will drive market trajectory.

Since the start of the year, long-term yields have already risen by over 100 bps. Short-term yields have risen by 150+ bps. For investors, the sharp rise in yields means that markets have already priced in the worst of the rate movements. We believe the markets have priced overnight rates rising to 6%+ over the medium term. With current repo rates at 4.90% this implies 100+ bps of incremental rate hikes factored into bond yields.

The current G-Sec yield curve post 4 years is trading flat with a 4X10 year spread materially below long term averages. Similar trends are visible in the corporate and SDL curve. We had been playing for the curve flattening theme since January across our active portfolios and were using a barbell strategy to build portfolios within stated investment mandates without taking direct exposure to the 1-4-year segment. Now as the theme has played out, we have been recalibrated our portfolios.

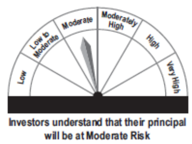
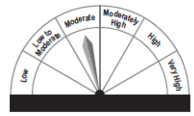
The stance changes on liquidity and the fast tracking of neutralizing liquidity is likely to have an impact on corporate spreads especially AAA V/s G-Sec. In the interim period, as spreads widen, investors would be better suited to favor strategies with a G-Sec & SDL bias.

The current yield curve presents material opportunities for investors in the 4-7-year segment. This category also offers significant margin of safety given the steepness of the curve. For investors with medium term investment horizon (3 Years+), incremental allocations to duration may offer significant risk reward opportunities. For investors with short term investment horizons (6 months - 2 years) floating rate strategies continue to remain attractive as interest rate resets and premiums offer competitive 'carry' and low volatility. Credits can also be considered as ideal 'carry' solutions in the current environment.

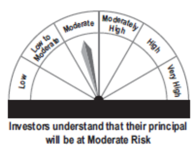
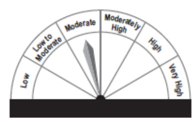
Product	Macaulay Duration	Current Positioning
Axis Floater Fund	1 Year	Actively managed floating rate strategy. 80:20 strategy aims to mitigate duration & interest rate risks.
Axis Short Term Fund	1.57 Years	Actively managed short bond strategy which targets opportunities in the 1-3 year segment
Axis Strategic Bond Fund	2.41 Years	50% AAA % 50% AA portfolio actively managed best ideas fixed income strategy
Axis CRISIL SDL 2027 Debt Index Fund	4.05 Years	Target maturity strategy with a maturity date of 31st May 2027

Allocation and strategy is based on the current market conditions and is subject to changes depending on the fund manager's view of the markets. Data as on 31st May 2022

Product Labelling

Fund Name & Benchmark	Product Labelling	Product Riskometer	Benchmark Riskometer	Potential Risk Matrix (PRC)
AXIS FLOATER FUND (An open ended debt scheme predominantly investing in floating rate instruments. A relatively high interest rate risk and moderate credit risk.) **Benchmark:** CRISIL Low Duration Debt Index	This product is suitable for investors who are seeking* • Regular income over short term investment horizon • To invest predominantly in floating rate instruments (including fixed rate instruments converted to floating rate exposures using swaps/derivatives) *Investors should consult their financial advisers if in doubt about whether the product is suitable for them.			Potential Risk Class

Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)		B-III	

Fund Name & Benchmark	Product Labelling	Product Riskometer	Benchmark Riskometer	Potential Risk Matrix (PRC)
Axis Short Term Fund (An open ended short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 1 year to 3 years. A relatively high interest rate risk and moderate credit risk.) **Benchmark:** NIFTY Short Duration Debt Index B-II	This product is suitable for investors who are seeking* • Regular income while maintaining liquidity over short term • Investment in debt and money market instruments *Investors should consult their financial advisers if in doubt about whether the product is suitable for them.			Potential Risk Class

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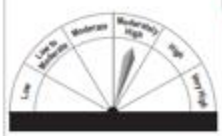
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)		B-III	

Fund Name & Benchmark	Product Labelling	Product Riskometer	Benchmark Riskometer	Potential Risk Matrix (PRC)
AXIS STRATEGIC BOND FUND (An open ended medium term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 years to 4 years. A relatively high interest rate risk and relatively high credit risk.) **Benchmark:** NIFTY Medium Duration Debt Index C-III	This product is suitable for investors who are seeking* • Optimal returns over medium term • Investment in diversified portfolio of debt and money market securities to generate optimal risk adjusted returns while maintaining liquidity *Investors should consult their financial advisers if in doubt about whether the product is suitable for them.			Potential Risk Class

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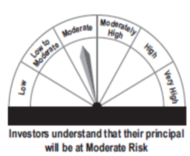
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)			C-III

Fund Name & Benchmark	Product Labelling	Product Riskometer	Benchmark Riskometer	Potential Risk Matrix (PRC)
AXIS CRISIL SDL 2027 DEBT INDEX FUND (An open-ended Target Maturity Index Fund investing in constituents of CRISIL IBX SDL Index – May 2027 A Relatively High Interest Rate Risk and Relatively Low Credit risk) **Benchmark:** CRISIL IBX SDL Index - May 2027	This product is suitable for investors who are seeking* • Income over long term • Investments in state government securities (SDLs) replicating the composition of CRISIL IBX SDL Index – May 2027, subject to tracking errors. *Investors should consult their financial advisers if in doubt about whether the product is suitable for them.			Potential Risk Class

Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)	A-III		

* Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

Disclaimer

Source of Data: RBI Governor' Statement, RBI Monetary Policy Statement & RBI post policy press conference dated 8th June 2022, Axis MF Research

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