RBI POLICY UPDATE

April 2, 2007

RBI hikes CRR by 50bps

In a bid to slowdown credit growth, control inflation and curb the mounting growth in money supply (M3), the Reserve Bank of India (RBI) on Friday (March 30) hiked the short-term interest rate (repo rate) by 25bps to 7.75% and cash reserve ratio (CRR) by 50bps to 6.50%. The CRR will rise to 6.50% in two tranches, the first on April 14, 2007 and the other on April 28, 2007. This is third consecutive hike in CRR in the last 3-4 months. The RBI has also reduced the interest paid on CRR from 100 bps to 50bps, indirectly making loans costlier for consumers. The latest CRR hike is likely to suck out about Rs 15,500 crore from the banking system. Non-food bank credit continued to grow at 29%, despite the previous repo rate and CRR hikes. Industrial production continues to be robust with IIP rising to 10.9% in January 2007. Rising dollar inflows from FDI and FII has led to rise in forex reserves to US$197 billion, which also infuses liquidity in the system and has been assisting rupee to strengthen further from current Rs 43.49 levels.

Impact

Banks: We expect a marginal fall in interest earnings and in turn banks' profitability due to the current move. However, long-term prospects remain robust due to slight moderation in credit demand. Among our coverage of banking stocks, we expect the current measures to shave off earnings by 0.8% to 1.5% in FY08E and FY09E.

Bond Markets: The bond markets are expected to take a hit with yields in near term anticipated to go up. We expect 10-year benchmark yields to rise 15 to 20bps from previous close of 7.93%.

Call Money: The RBI's move came at a time when liquidity was tight. The central bank had been injecting liquidity through LAF. We believe the sudden hike in rates to control inflation and maintain price stability could lead to a further steep rise in call rates, which currently are hovering around 50% levels.

Our view

The CRR is the best short-term monetary tool to contain liquidity and has been used very tactically to absorb Rs 15,500 crore from the system and control current M3 growth of 22%, which is much higher than targeted 15% for FY07. We believe retail credit growth to taper down and bank stocks to remain stable in medium term after the immediate knee jerk reaction expected in near term. Though the RBI's move may appear negative in the near-term for banks, it should help growth in economy over a longer term.

Expected Impact on profitability

	UTI Bank		Yes Bank		Bank of India	
	Revised PAT	% change	Revised PAT	% change	Revised PAT	% change
FY07E	636.6	0.0	90.3	0.0	879.3	-0.4
FY08E	840.8	-1.1	153.4	-1.0	1,036.1	-0.8
FY09E	1,115.7	-1.2	239.2	-0.9	N.A	N.A

Source : ICICIdirect Research