

## Industry Flash

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# India Banks

## Credit Policy: CRR Hike – Will Deposit Rates Fall?

- **Hikes CRR by another 50bp** — The RBI has done it again; hikes the Cash Reserve Ratio (CRR) by 50bps, to 750bps. With this, the CRR has been raised 250bps over the last year. This was a general market expectation; not necessarily ours. RBI's objective; suck out rising liquidity in the system; cost, borne by banks.
- **The cost - 5bps in margins, and less to lend** — Banks earn no return on CRR deposits—will knock off 5bps of margin. This is not large; but the overall cost of the CRR is now 75bps (on 7.5% CRR), and only rising. Equally important, is a rising structural negative for banks – a third of deposits are now impounded (SLR+CRR), leaving them with less for return generating lending.
- **Will rates go up? We think deposit rates will fall** — Conventional wisdom suggests banks could raise rates and pass through higher costs. With surplus liquidity with banks, moderating credit demand (little appetite for higher rates), and high deposit rates – we actually believe banks will start cutting their deposit rates, and protect margins. We believe the margin problem in the system (Government banks have struggled with margins in 2Q08) is with high deposit rates (and excess liquidity) – rationale move is to lower them.
- **A soft policy otherwise; in measures, and direction** — This policy has few other material measures, for banks. Maintains 24-25% growth forecasts, cautions on equity and property prices (but no specific restrictions), worries on foreign flows and inflation, but caution is in tone/text, rather than action, for now.

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**Figure 1. Changes in Macro Interest Rates**

Effective dates	Oct-06	Dec-06	Jan-07	Jan-07	Feb-07	Mar-07	Apr-07	Apr-07	Aug-07	Oct-07
Bank rate	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
CRR	5.0	5.3	5.5	5.5	5.8	6.0	6.3	6.5	7.0	7.5
Reverse Repo	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Repo rate	7.3	7.25	7.3	7.5	7.5	7.8	7.8	7.8	7.8	7.8

Source: Citi Investment Research

See Appendix A-1 for Analyst Certification and important disclosures.

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