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Banking

Mid-Quarter Monetary Policy Review

Sector Update

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- RBI hikes the Repo rate by 25bps to 8.25% and accordingly the reverse repo stand adjusted at 7.25% and MSF (Marginal Standing Facility) at 9.25%
- Though RBI maintain its hawkish stance, we expect the correlation between M1 and WPI Mfg inflation to help bring the inflation down by Nov-Dec 2011
- RBI Sees downside risk to GDP growth target of 8%. Bond yield not likely to come off, as fiscal deficit running off target
- We do not expect any immediate increase in lending or deposit rates by banks, as any further increase will have adverse impact on credit demand and asset quality

Raise repo rate by 25bps to 8.25%

RBI hikes the Repo rate by 25bps to 8.25% and accordingly the reverse repo rate and the marginal standing facility stand adjusted at 7.25% (100bps spread below repo rate) and 9.25%. The SLR, CRR remains unchanged and so does the bank rate.

	Repo.	Rev. Repo.
March 2011	6.75	5.75
May 2011	7.25	6.25
June 2011	7.50	6.50
July 2011	8.00	7.00
Sept 2011	8.25	7.25

Source: RBI, Emkay Research

Maintain hawkish stance

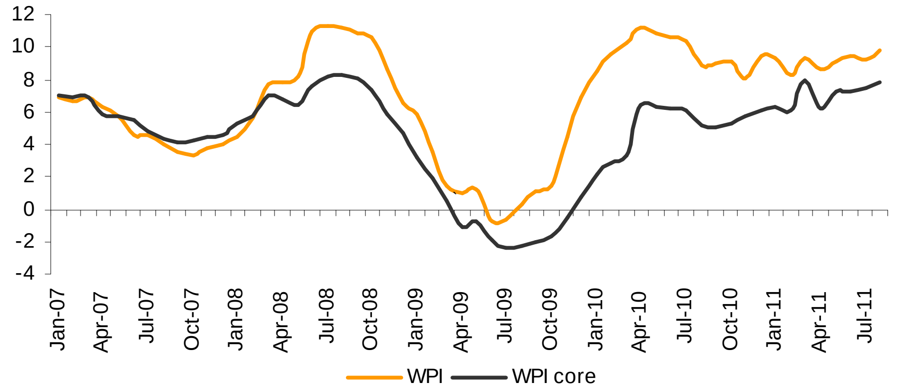
RBI maintains its hawkish stance, as inflation continue to remain well above its comfort zone. Though RBI acknowledges some slow down in domestic demand due to tight monetary policy, however also stated that demand pressures still persists. RBI stated that any change from its current stance would be driven by any downward movement in inflation and implications of global developments.

"However, in the current scenario, with the likelihood of inflation remaining high for the next few months, rising inflationary expectations remain a key risk. This makes it imperative to persevere with the current anti-inflationary stance."

"Going forward, the stance will be influenced by signs of downward movement in the inflation trajectory, to which the moderation in demand is expected to contribute, and the implications of global developments.."

- RBI Mid quarter monetary policy review – September 2011

Rising Core inflation a worry for RBI

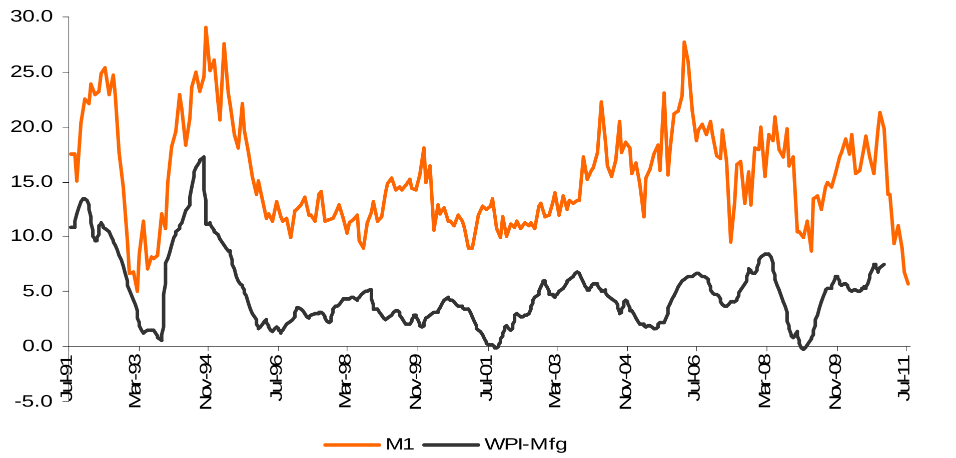


Source: Ministry Of Commerce & Industry

Inflation likely to trend down by Nov-Dec 2011

Growth in M1 has good correlation with inflation with 5-m lag effect. Last two months has seen significant deceleration in M1 driven by RBI's action. Hence we expect the inflation to follow the trend by Nov-Dec'11.

Growth in M1 vs WPI mfg



Source: Office of the Economic Adviser,

Do not expect any increase in lending or deposit rates

We do not expect an immediate transmission of rates by banks to customers, as any further increase would have an adverse impact on credit growth and asset quality.

As fiscal deficit running higher, bond yields not likely to come off

We do not expect the bond yield to come off, as the fiscal deficit is running higher. The fiscal deficit for year till Jul'11 is already at 55% of the full year budgeted estimates. We believe that there is a strong possibility of the government borrowing programme to get revised upwards by ~10% or Rs350-400bn, which will further push the bond yields upwards.

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