

RBI Leaves Key Rate Unchanged, CRR Cut By 25bps

The Reserve Bank of India (RBI) has come out with its Mid-Quarter Monetary Policy (Sept 2012) review, albeit the policy stance for this meet almost is in line with general consensus. The RBI has kept Repo Rate, Reverse Repo Rate under the liquidity adjustment facility (LAF) unchanged at 8.00% and 7.00% respectively, and the Marginal Standing Facility (MSF), determined with a spread of 100 basis points above the repo rate, stands at 9% and Bank Rate also unchanged at 9.00%. **The RBI reduced the Cash Reserve Ratio (CRR) by 25bps to 4.50%, which is expected to release around INR17000 crores into the system. However, The RBI stance indicates that it is worried about the inflationary fallout of the diesel price hike, and would wait for some more time before softening its stance on interest rates.** Upside risk on inflation owing to hike in fuel price coupled with depreciating rupee and also, rising Current Account Deficit and Fiscal Deficit have mounted pressure on RBI not to touch the key rates this time.

GDP growth (y-o-y) picked up modestly to 5.5 per cent in Q1 of 2012-13 from 5.3 per cent in the previous quarter. The sluggish momentum of value added in the previous quarter was evident across all sectors of the economy, and particularly in industry. Lead indicators point to slack activity in Q2 as well.

Index of Industrial Production (IIP) growth in July 2012, at 0.1 per cent, was significantly lower than the expansion of 3.7 per cent registered in the corresponding period of last year. The PMI fell marginally to its nine month low of 52.8 in August from 52.9 in May 2012, as a result of output disruptions due to power shortages and declining export orders. The services PMI, however, picked up in August on growth in new orders and employment.

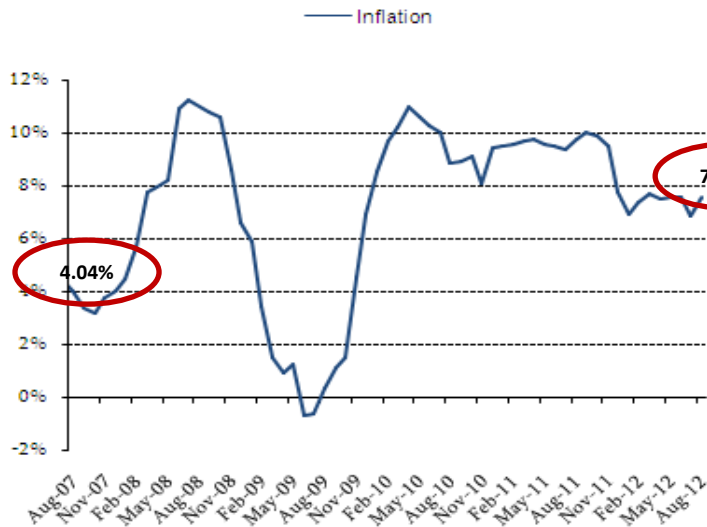
The WPI inflation inched up from 6.87 per cent in July to 7.55 per cent in August 2012, driven mainly by food and fuel prices. Core inflation pressures remained firm with non food manufacturing products inflation inching up from 5.1 per cent in April 2012 to 5.6 per cent in August 2012. Recent upward revision in diesel price and rationalization of subsidy for LPG may push up headline inflation.

On the liquidity front, the liquidity conditions have remained under RBI comfort zone (+/- 1 percent of NDTL) since the FQR. The daily average borrowings under the liquidity adjustment facility (LAF) was at INR53655 crores as on September 17, 2012. However, managing liquidity within the comfort zone remains an objective and the RBI will respond to liquidity pressure. The combined outflows on account of advance tax payments and the onset of festival-related currency demand, could accentuate pressures on liquidity over the next few weeks. Moreover, Money supply (M^3), bank credit and deposits have moderated in relation to their indicative trajectories, reflecting the slowing down of economic activity.

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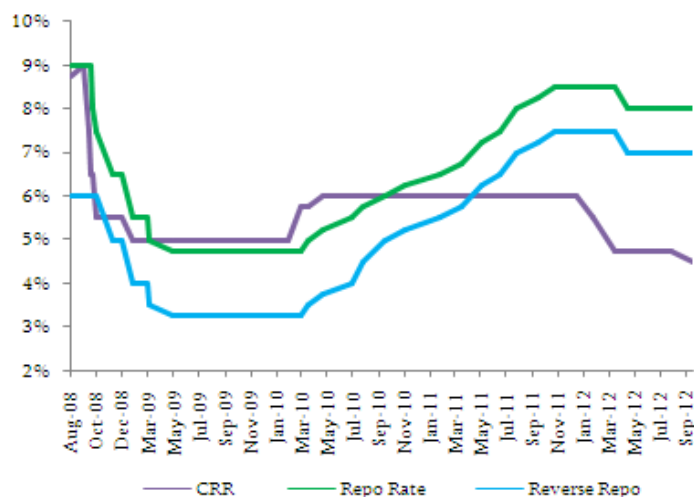
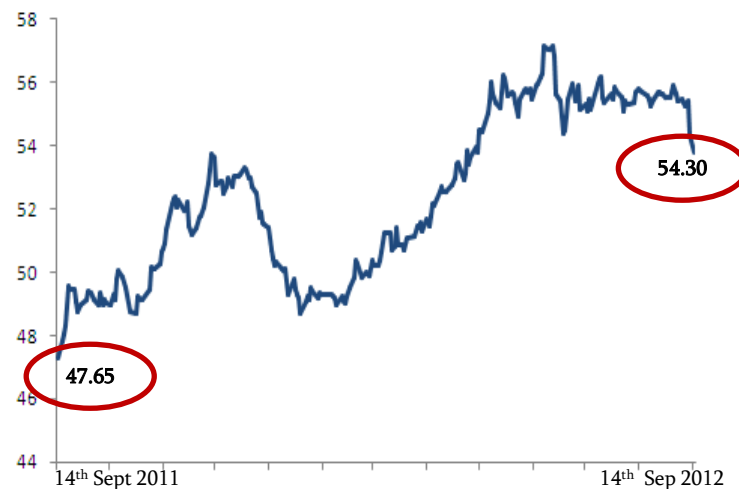
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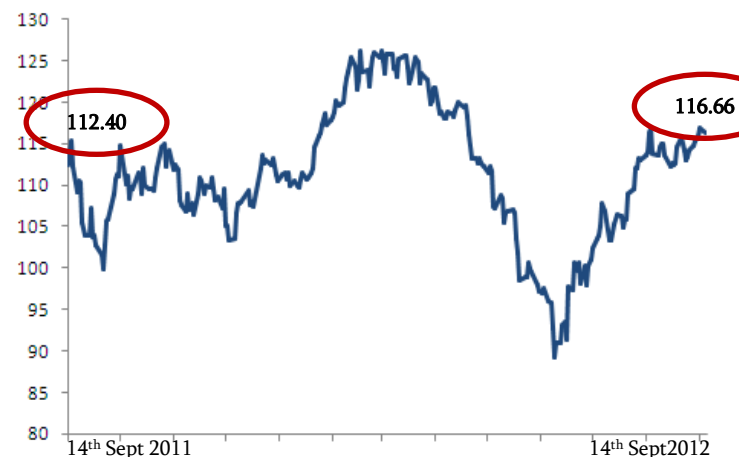
The Indian Rupee touched nearly 54.30 per US dollar on 14th Sept 2012, depreciated nearly 14% in last one year. Depreciation in the Indian rupee against US dollar is mainly because of slowdown in inflow of overseas fund, widening current account deficit and uncertainty of global and domestic economy. The rapid depreciation in Indian rupee has increased the upside risk to inflation.

The WPI inflation inched up from 6.87 per cent in July to 7.55 per cent in August 2012 and is ~3% higher than the RBI comfort level. Slowdown in economic environment, rising fuel price coupled with poor monsoon and depreciating rupee has pushed up the inflation figure. Moreover, we believe that recent upward revision in diesel price and rationalization of subsidy for LPG may elevate the headline inflation again. The Reserve Bank of India closely watches the inflation data, which it considers heavily to determine its monetary policy stance. **Hence, an upside risk on inflation has clearly mounted pressure on RBI to maintained status quo stance .**

Dollar vs. Rupee



Crude Oil Price (IN US \$)



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