Angel Securities
Institutional Investment Services

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3QFY2010 Monetary Policy Review

Draining out the Excess Liquidity

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- **RBI hikes CRR by 75bp to 5.75% in two stages**
- **Keeps Repo, Reverse Repo unchanged**
- **Reiterates its stance of shifting from 'managing the crisis' to 'managing the recovery'**
- **Concerned about likely transmission of inflation to other sectors as the growth momentum picks up**
- **Sets the advances and deposits growth forecast at 16.0% and 17%, respectively for FY2010**
- **Raises baseline projection for GDP growth for FY2010 to 7.5%**
- **Raises baseline projection for WPI Inflation for FY2010 to 8.5%**
- **Aims to maintain interest rate environment consistent with price stability and financial stability without compromising on growth.**

CRR hiked to 5.75%

RBI increased the cash reserve ratio (CRR) of scheduled banks by 75bp from 5.0% to 5.75% of their net demand and time liabilities (NDTL) in two stages; the first stage of increase of 50bp will be effective the fortnight beginning February 13, 2010, followed by the next stage of increase of 25bp effective the fortnight beginning February 27, 2010. As a result of the increase in the CRR, about Rs36,000 crore of excess liquidity is expected to be absorbed from the system.

Domestic liquidity to remain comfortable

Banks remain flush with liquidity, having deployed an excess of almost Rs 4 lakh crore in risk-free investments like government bonds and reverse repo auctions, as strong domestic savings continue to drive 20% growth in deposits even though credit growth is at 12-13% yoy. Excluding valuation changes, Forex reserves increased by US $8.6bn during 2QFY2010 as against net outflow of US $17.9bn in 3QFY2009; the net increase was driven by strong inflows of risk capital (FII and FDI) of US $17bn as against net outflow of US $5bn during 3QFY2009. While the current account deficit is also expanding, robust capital inflows (including revival going forward in ECBs as well) are expect to drive strong net forex inflows going forward, that should support comfortable growth in domestic money supply. Hence, we believe that banks' lending and deposit rates are unlikely to go up in next 3 to 4 months.

Credit Growth Picking Up, but remains below desired levels of RBI

Year-on-year increase in non-food bank credit to the commercial sector, at 14.4% as on January 15, 2010, was significantly lower than the 22.0% growth a year ago. However, the total flow of financial resources from banks, domestic non-bank and external sources to the commercial sector during 2009-10 (up to January 15, 2010) at Rs5,89,000cr was only marginally lower than Rs.5,95,000 crore in the corresponding period of the previous year. Thus, the non-bank sources of finance have, to a large extent, mitigated the impact of the slow down in bank credit growth.

In view of the increased availability of funds from domestic non-bank and external sources, RBI has reduced indicative credit growth projection to 16% for current fiscal (from the 18% projected earlier). Accordingly RBI also reduced the projected M3 growth and deposits growth to 16.5% and 17% respectively.

Banking Sector outlook

We believe that presently low interest rates, combined with reducing leverage in borrowers' balance sheets due to equity raising and rising earnings, will help revive credit demand from 4QFY2010E onwards. Further Monetary tightening measures in the coming policies are unlikely to dampen demand anytime soon; rather, such measures are likely only if Capital inflows are robust in the first place, which will actually improve the GDP growth, Savings and Investment and Banking sector growth outlook. In a rising interest rate environment, the banks with a strong CASA ratio and lower duration investment book are expected to be better positioned to protect their NIMs.

Within the sector, we prefer private banks, in light of their stronger core competitiveness and likelihood of marketshare gains as the external environment becomes more conducive from FY2011E onwards. ICICI Bank, Axis bank and HDFC Bank remain our top pick in the sector.

Exhibit 1: CASA Ratio

Bank	% CASA
Bank of India	33.0
Punjab Nat. Bank	39.5
Union Bank	32.3
Corporation Bank	23.3
Indian Overseas Bank	30.0
Indian Bank	31.1
Dena Bank	35.5
ICICI Bank	39.6
HDFC Bank	51.7
Axis Bank	42.8
Yes Bank	10.1

Source: RBI, Angel Research

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Ratings (Returns) :	Buy (> 15%) Reduce (-5% to -15%)	Accumulate (5% to 15%) Sell (< -15%)	Neutral (-5 to 5%)