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RBI POLICY REVIEW

Tightening ends; growth to take precedence

India Equity Research | Economy

In the mid-quarter monetary policy review, the Reserve Bank of India (RBI) has left the repo rate and CRR unchanged, as expected. The accompanying statement is on the dovish side, with the central bank acknowledging downside risks to its FY12 growth projection of 7.6% while expressing confidence about its inflation projection of 7% by March 2012 despite INR weakness and sticky crude oil prices. Overall, this policy marks the end of the current tightening cycle. Incrementally, the balance of the policy is clearly shifting in favour of managing growth compared to managing inflation earlier and we suspect that reversal in the rate cycle will happen sooner than later. On liquidity front, while RBI is not overly concerned, it will be conducting more OMOs to address high deficit conditions at LAF.

Rates left unchanged, as expected

In the mid-quarter monetary policy review, the RBI has kept its policy rates and CRR unchanged, in line with expectations. The repo rate currently stands at 8.50%, reverse repo at 7.50% and CRR at 6%. The policy statement's overall tone was more dovish, wherein the central bank explicitly stated that "monetary policy actions are likely to reverse the cycle, responding to the risks to growth". Clearly, policy rates have peaked and as inflation recedes in coming months, managing growth will be "dominant factor" influencing RBI's policy decisions.

Inflation momentum moderating

Mint Street is becoming more confident that inflation concerns are receding, stating that "reassuringly, headline momentum indicators……shows continuing signs of moderation". Moreover, INR depreciation and elevated crude oil prices do not seem to have alarmed the central bank. As per RBI, while depreciation in INR and elevated crude oil prices will pressurise inflation, expected moderation in aggregate demand, decline in non-oil commodity prices and moderation in food prices are likely to limit its impact. Accordingly, it retained its March 2012 inflation projection of 7%.

Growth slowdown acknowleged

Unlike in the past policy documents, this time RBI made no mention of the demand pressures in the economy. Further, it acknowledged sharp moderation in industrial growth and was concerned about the deceleration in investments. Moreover, given the current global and domestic situation, the central bank is of the opinion that downside risks to its earlier FY12 (7.6%) growth projection have increased significantly. Accordingly, Mint Street is expected to cut its growth projections in third quarter monetary policy review in January.

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OMOs to continue to ease liquidity

RBI sees no significant stress in the money market. However, given the fact the LAF borrowing is persistently higher than its target (~INR 89,000 crore in recent weeks versus target of ~INR 50,000 crore), the central bank has committed to continue open market operations (OMO) as seem appropriate.

Policy focus to tilt in favour of growth

Overall, RBI halting its rate tightening cycle in face of slowing growth and moderating inflation momentum is in line with expectations. Now, balance of the policy is clearly shifting in favour of managing growth compared to managing inflation earlier. This means that as growth slows down intensifies further, in the coming months, RBI will step in and reverse its policy rates sooner rather than later. On liquidity front, while RBI is not overly concerned, it will be conducting more OMOs to address high deficit conditions at LAF.

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