

CREDIT POLICY 2007-08

April 25, 2007

Cholamandalam Securities Ltd

Domestic Developments -

- The Real GDP growth estimated at 9.2 per cent for 2006-07,
- The inflation rate is at 5.7 per cent in end-March
- The average price of the Indian Crude basket is currently at US \$ 64.0 per barrel.
- Money Supply (M3) growth, increased by 20.8 per cent in 2006-07 as compared with 17.0 per cent in 2005-06.
- Aggregate deposits of scheduled commercial banks increased by 23.0 per cent during 2006-07 as against 18.1 per cent in 2005-06.
- Non-food credit increased by 28.0 per cent on top of 31.8 per cent in the previous year, exhibiting some moderation from the sustained growth during 2003-06.

Global Developments

- According to the International Monetary Fund, global real GDP growth, on a purchasing power parity basis, is expected to be 4.9% in 2007 compared to 5.4 % in 2006.
- Global inflation has picked up in the wake of increase in commodity prices, which is likely to pose risks to inflation expectations as international crude prices have started rising again.
- Monetary policy authorities the world over are watchful on inflation expectations, excessive volatility in asset prices, under pricing of risks and disorderly conditions in currency markets.

Views of RBI -

- While there is evidence of structural changes underlying the recent Indian growth experience, there are also indications that the upsurge of demand pressures may contain a cyclical component. Cyclical factors stated –
 - Persistence of high growth in bank credit and money supply
 - Widening of the trade deficit with increase in non oil imports together indicate pressures on aggregate demand.
 - The steady increase in prices of manufactured goods
 - Resurgence of pricing power among corporates
 - Indications of wage pressures in some sectors
 - Strained capacity utilisation and elevated asset prices.
- A significant worrisome feature of domestic developments in 2006-07 is the firming up of inflation, which represents the key downside risk to the evolving macroeconomic outlook. The recent hardening of international crude prices has heightened the uncertainty surrounding the inflation outlook. Domestically primary food articles have contributed significantly to inflation, as well the prices of manufactured products account for well above 50 per cent of inflation.
- Capital flows into emerging market economies reflects the improvement in macroeconomic performance, search for higher yields and a stronger appetite for risk. Consequently, reversals of capital flows can pose challenges to emerging economies.

Monetary Measures

Status quo maintained for now-

- Bank Rate kept unchanged at 6.0 per cent.
- Reverse Repo Rate and Repo Rate kept unchanged at 6.00 per cent and 7.75 per cent, respectively.
- Cash reserve ratio (CRR) of scheduled banks at 6.5 per cent with effect from the fortnight beginning April 28, 2007, as announced on March 30, 2007.
- The risk weight on the residential housing loans up to Rs.20 lakh to individuals to be reduced from the existing 75 per cent to 50 per cent.
- The risk weight on loans up to Rs.1 lakh against gold and silver ornaments to be reduced to 50 per cent from the existing level of 125 per cent.

RBI's Monetary Outlook for 2007-08

- Towards attaining Real GDP growth in 07-08 at around 8.5 per cent
- To contain inflation close to 5.0 per cent in 2007-08
- To contain M_3 in 2007-08 at around 17.0-17.5 per cent
- Adjusted non-food credit is projected to increase in the range of 24.0-25.0 per cent in 2007-08.
- **The 2007-08 monetary policy in 2007-08 would be conditioned by the global and domestic developments. Monetary policy, while contributing to growth, is strongly in favor of reinforcing the emphasis on price stability and anchoring inflation expectations for the period ahead.**

Implications –

- **Near term interest rate expected to remain stable**
- **Economic growth is expected to translate into 9 - 10% growth in manufacturing and service sector to maintain double digit growth**

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