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RBI's Mid Quarter Monetary Policy Review

RBI Leaves Key Rate Unchanged

The Reserve Bank of India (RBI), in its Mid Quarter Monetary Review has given little relaxation to us just by indicating that **future actions will be towards lowering the rates, responding to the risk to growth and inflation.** Albeit policy stance for this meet remains in line with our as well as general consensus. The RBI has kept Repo Rate, Reverse Repo Rate under the liquidity adjustment facility (LAF) unchanged at 8.50%, 7.50% respectively and the Marginal Standing Facility (MSF) and Bank Rate unchanged at 9.5%. The RBI also left the Cash Reserve Ratio (CRR) unchanged at 4.75%, as it has reduced by 75bps from 5.5% to 4.75% on March 9. The sharp deterioration in the growth trajectory has increased the pressure on RBI to pause its policy stance. Non-manufactured products inflation remains elevated at an uncomfortably high level of 5.68% in February 2012.

The Index of Industrial Production (IIP), moderated to 4.0 per cent during 2011-12 (April-January) from 8.3 per cent in the corresponding period a year ago. While growth in the capital goods and intermediate goods sectors was negative, growth in the basic goods and consumer goods sectors decelerated marginally.

GDP growth (y-o-y) decelerated to 6.1 per cent in Q3 of 2011-12 from 6.9 per cent in the previous quarter. This was mainly, because of slowdown in industrial activity. However, the RBI's projection of GDP growth for 2011-12 is at 7%.

The headline inflation forecast of 7% in Mar'12 has been left unchanged. However, RBI believe that inflation risk remains high but the future trajectory is clearly on the lower side.

On the liquidity front, liquidity conditions have remained in deficit mode. However the deficit increased significantly, beginning from the second week of November 2011. The daily average borrowings under the liquidity adjustment facility (LAF) is more than 1.2 trillion rupees till date. However, RBI believes that liquidity situation has since improved and expected to ease further in the weeks ahead.

RBI believes that the performance in Q4 of 2011-12 is expected to be better than that in previous quarter and there continues to be significant suppressed inflation in fuel, fertilizer and power as administered prices do not fully reflect the costs of production.

RBI has signaled that Monetary Policy actions are likely to reverse the cycle, responding to the risk to growth and inflation.

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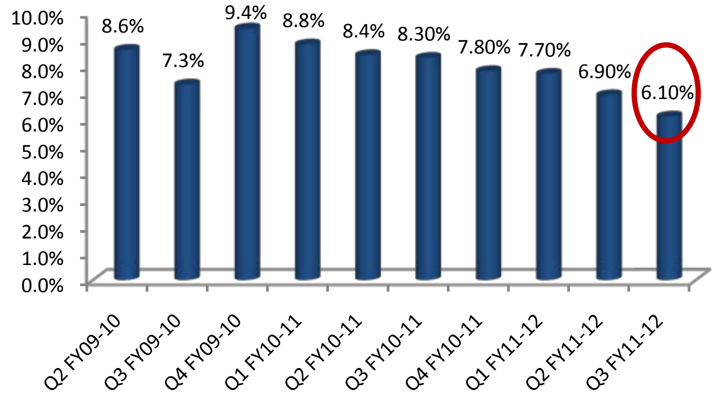
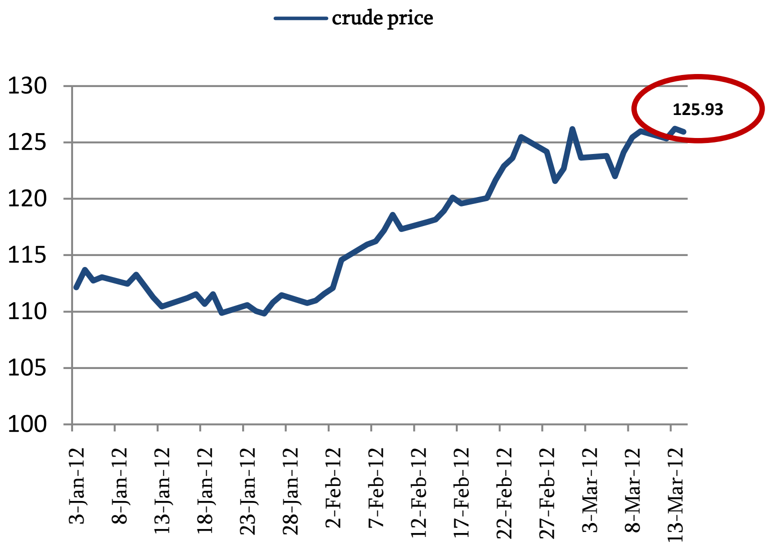
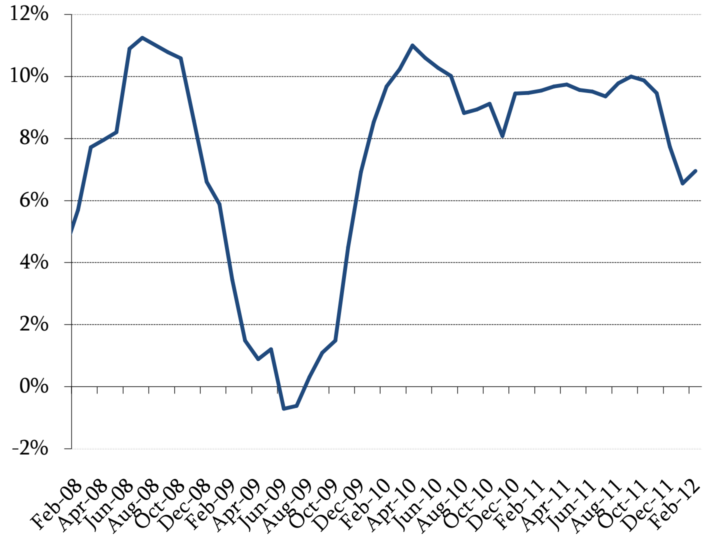
There is sharp decline in growth side. The Indian economy grew at the slowest annual pace in almost three year in the October – December quarter at 6.1% compared poorly with the 8.3% growth in same quarter of previous year and was also lower than the 6.9% of Q2FY12. High inflation, falling industrial output and global uncertainty has hurted the economy activities. Continuing decline in growth adding pressure on RBI to cut the interest rate. **We expect that rate cut is depend on the inflationary impact on the governments spending programme for the next fiscal year and the RBI may pull back the Repo button by 25-50bps in its annual Monetary Policy on April 2012.**



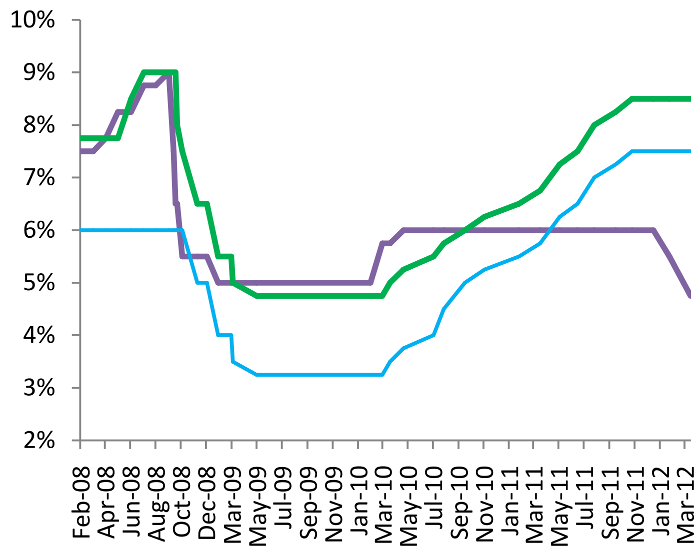
GDP Trend

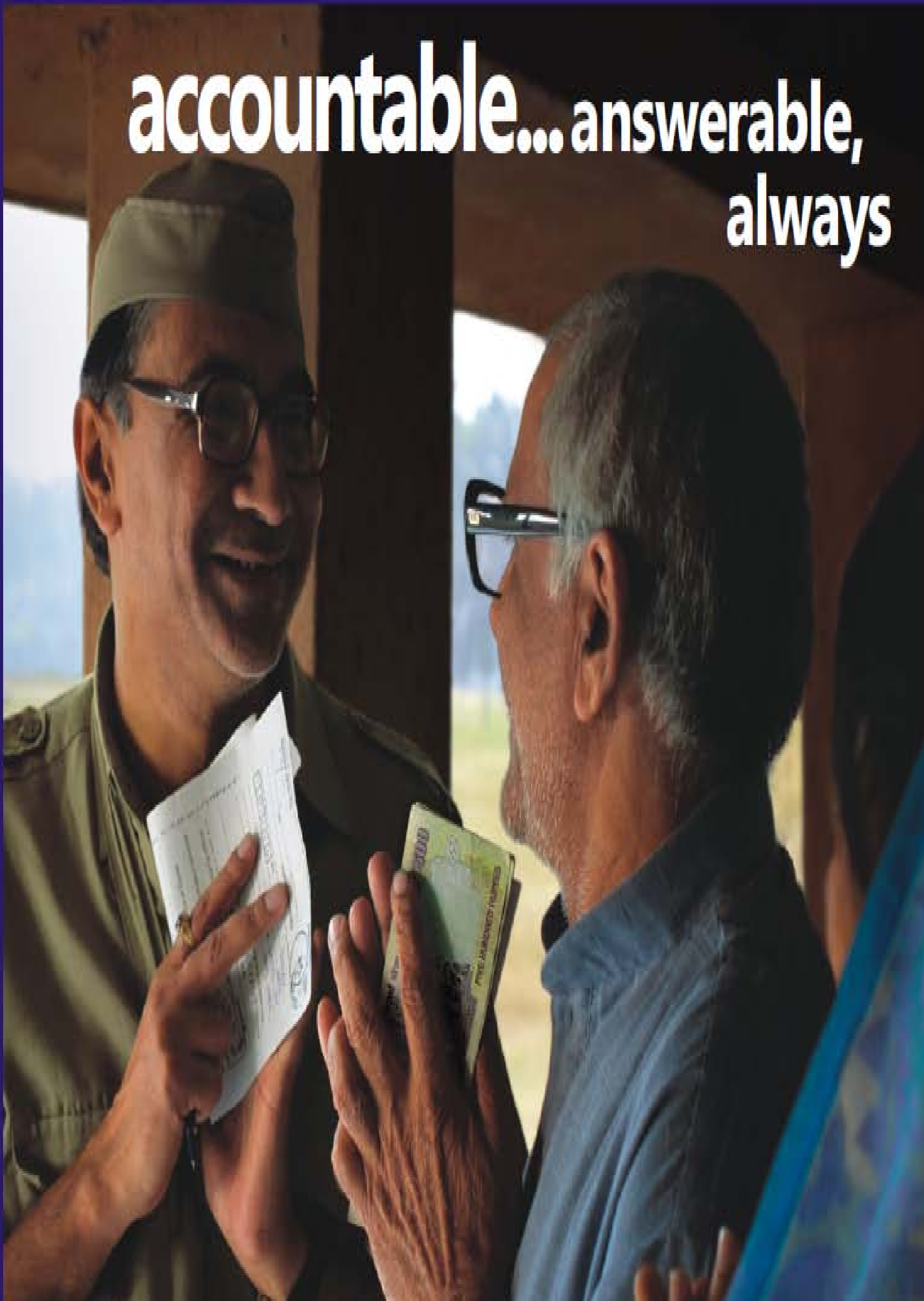


The sharp up of 12% to $125.93 per barrel in the crude oil prices since January this year, due to the rising geopolitical tensions and rupee depreciation against US dollar has brought back the fears of its damaging impact on inflation and economic growth. **India's dependence on imports for its crude oil needs, made it more vulnerable in such a scenario and also added pressure on RBI to delay the policy rate cuts till April 2012.**



Inflation Trend





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