

RBI Credit Policy

Industry: Financials Industry View: Neutral

Sector Update

“Monetary policy 2011-12.”

Highlights of the monetary policy 2011-12

- Repo Rate hiked by 50 bps from 6.75% to 7.25%
- Reverse repo hiked by 50 bps from 5.75% to 6.25%
- Bank rate remains unchanged at 6%
- CRR remains unchanged at 6% of NDTL
- MSF rate set at 8.25%
- Saving account rate hiked from 3.5% to 4% (with an immediate effect)
- M3 growth is placed at 16% for FY12.
- Aggregate deposits of SCBs are projected to grow by 17% in FY12
- Non-food credit of SCBs is projected at 19% in FY12

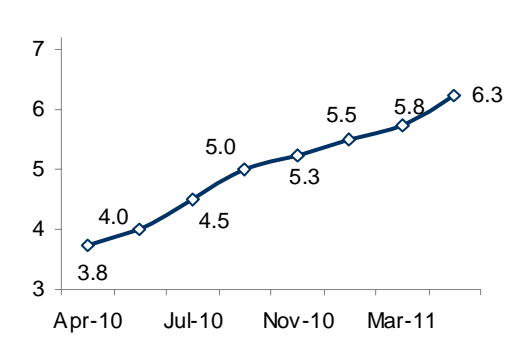
Stance of the monetary policy

- To maintain an interest rate environment that moderates inflation and anchors inflation expectations.
- To foster an environment of price stability that is conducive to sustaining growth in the medium-term, coupled with financial stability.
- To manage liquidity to ensure that it remains broadly in balance, with neither a large surplus neither diluting monetary transmission nor a large deficit choking off fund flows.

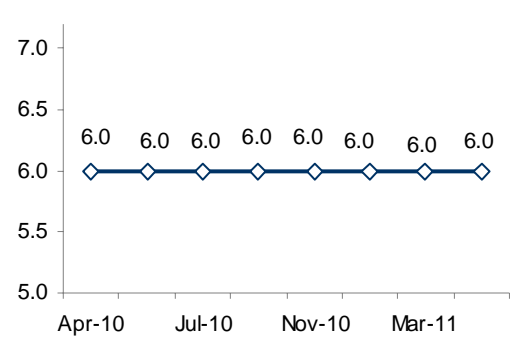
Growth and Macro factors

- Global growth is likely to slow down from 5% in 2010 to 4.4% in 2011. Advanced economies to see lower growth due to waning impact of fiscal stimulus, and high oil and other commodity prices. EMEs growth to decelerate on account of monetary tightening and rising commodity prices.
- **The baseline projection of real GDP growth for 2011-12 is 8%. This estimate is hinged on normal monsoons, oil prices averaging \$110 a barrel.** This compares to 8.6% growth in FY11. This growth was supported by agricultural growth on account of good monsoons and service sector growth. IIP growth decelerated from 10.7% in H1FY11 to 7% in FY11 on account of slowdown in capital goods production and investment spending.
- Inflation remains the primary macroeconomic concern. **The baseline projection for WPI inflation for March 2012 has been projected at 6.0% as compared to ~9% inflation in March 2011.** Inflation over FY11 was driven by food items in April to June 2010, by non food items in August to

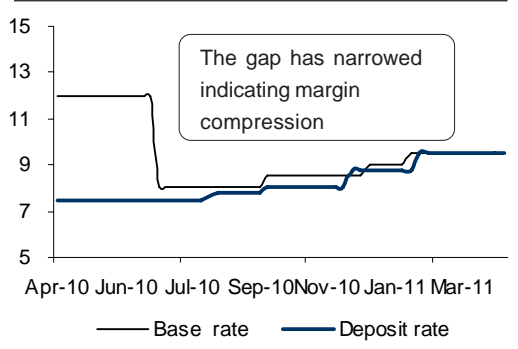
Repo & Reverse repo rate



Cash Reserve Ratio (CRR)



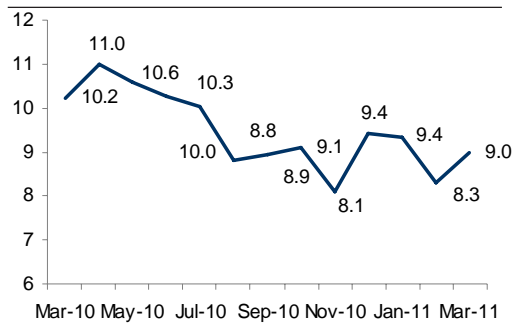
Key rates - PLR / Base rate and Deposit rate



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Wholesale Price Index -Monthly



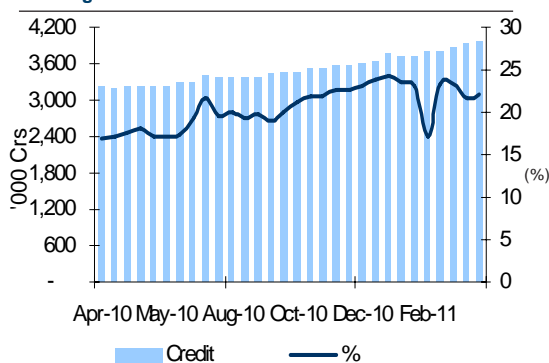
November 2010. Inflation which began heading upwards due to food prices ended FY11 generalized across food and non food articles. Over FY12, the

- Revision in administered fuel and power group prices
- Crude oil prices given the uncertain geopolitical situation in the Middle East and North Africa
- Prices of industrial inputs such as minerals, fibres, rubber, coal and crude oil and wages and the extent to which the increase in input prices translates to output prices.
- Monsoon will be a critical factor

RBI has cited the following that would shape inflation

- **The M3 and non-food credit growth projections for 2010-12 are 16% and 19% respectively** as compared to 15.9% and 21.2% (March 2011).

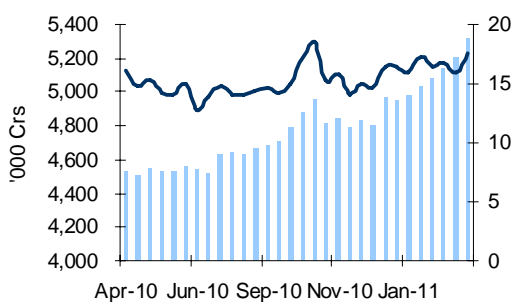
Credit growth



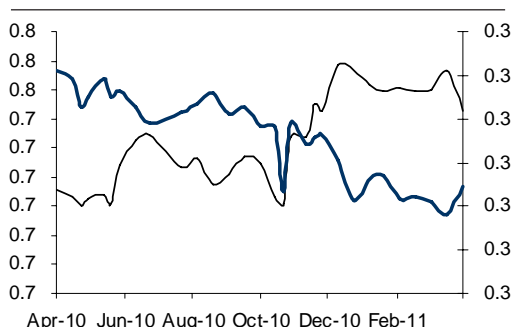
Interpretations

- The tone of the monetary policy is hawkish and has moved from the calibrated approach to a more aggressive stance on inflation. The upsurge of global commodity prices and their pass through to domestic manufactured goods has shifted policy stance from 'nurturing growth, while trying to contain the spill-over of supply side inflation' to a dominant stance on inflation.
- The cumulative impact of monetary actions over the past 15 months will continue to be felt over the course of 2011-12, contributing to moderation in both growth and inflation rates.
- The recent rate hikes are likely to impact bank margins negatively. Cost of funds is likely to go up by 50-100 bps for most banks over the next couple of quarters. Although bankers have indicated that significant portion of hikes are likely to get passed on to customers, we believe that the system may not be able absorb a complete pass on of costs without significant impact on demand.
- Largely banks have been able to support NIMs during Q4FY11 with base rate hikes effected in Jan and Feb 2010. However, we believe that much of the lending rate hikes have been effected and rising cost of funds will drag margins by 15-50 bps in FY12.
- We believe that higher input prices and interest rates will take their toll on infra investment and corporate capex. A large part of the infra credit growth (H2FY11) was driven by sanction which were initiated a year back. However, we expect the volatility in prices and slow down in demand to put disbursements under pressure in FY12. Although consumption demand (linked to infra spend over the past 2 quarters) is likely to sustain growth over next couple of quarters, it is not likely to gather momentum in H2FY12.

Deposit growth



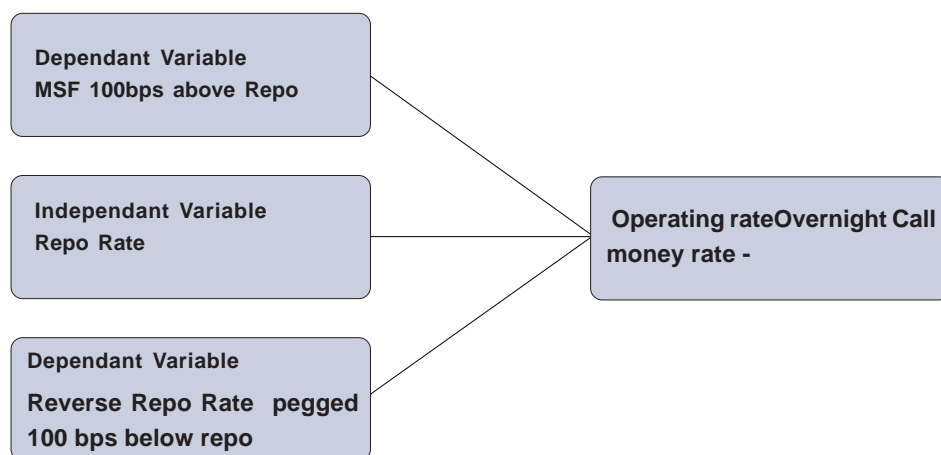
C/D and I/D ratios



Changes in the monetary policy

- The weighted average overnight call money rate will be the operating target of monetary policy.
- The repo rate will be the only one independently varying policy rate.
- The reverse repo rate will be pegged at a fixed 100bps below the repo rate.
- RBI has instituted a new Marginal Standing Facility (MSF), effective 7th May,2011. Banks can borrow overnight from the MSF up to 1% of their respective NDTL @ 100 bps above the repo rate.

Revised Corridor - Fixed width of 200 bps


Difference in the situation which has driven the policy stance

	2010-11	2011-12
Inflation	Was largely driven by higher food prices	Inflation has moved from food to a more generalised inflation Prices of oil, industrial inputs, wages and other commodities
Domestic growth	Policy driven to support growth and hence the approach was calibrated rate hikes	Economic recovery is largely on track and the economy is operating near to full capacity
Inflation concern	Fueled by supply side factors	Fueled by demand side factors
Global	Uncertainty on global markets	Although global concerns have abated, new concerns (short term and medium term risks have arisen)
Stance of the policy	Gradual tightening Calibrated approach to bring down inflation while nurturing growth	Check inflation by checking demand Growth could be sacrificed for controlling inflation

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