

Mid-Quarter Monetary Policy Review: December 2010

Statutory liquidity ratio decreased by 100 basis point

The Reserve Bank of India (RBI) decreased statutory liquidity ratio for banks by 100 basis points from 25% to 24% of their Net demand and time liabilities (NDTL) effective from December 18, 2010. But earlier RBI has waived penalty even on lower SLR till it is above 23%. This was up to 28 January. So on liquidity front this will not have any impact but will make it more of long term solution than short term.

Also, the additional liquidity support under the Reserve Bank's liquidity adjustment facility (LAF) will be available to the extent of 1% of the NDTL effective from December 18, 2010 to January 28, 2010.

CRR, repo and reverse repo rates have been left unchanged

| Policy Rate | Change | Effective Rate |
|-------------------|-----------|----------------|
| CRR | unchanged | 6.0% |
| Repo rate | unchanged | 6.25% |
| Reverse Repo rate | unchanged | 5.25% |

GDP growth forecasted at 8.5% remains unchanged

The Reserve Bank of India has been optimistic of its growth estimate projection for 2010-11 to 8.5%. Good monsoons this year helped recover agriculture growth. The other leading indicators like index of industrial production (IIP), the purchasing managers index (PMI) and of service sector activity have continued to increase at a robust pace.

WPI inflation projected at 5.5% per cent by end-March 2011 involves upside risk

The Wholesale Price Index (WPI) inflation has declined to 7.5% in November 2010 after staying higher in double digits for last 5 months before October 2010. However, additional factors like higher global commodity prices and rising domestic input costs have added to upward pressure on WPI inflation. RBI is cautious at current inflation levels and has indicated upside risk to it.

Liquidity Deficit beyond the comfort level of RBI

At the time of second quarter review, the government has large cash balances of around Rs.84000 cr. But now the banks have been borrowing Rs.100000 cr. under LAF. The deficit has been intensified by sluggish growth in bank deposits. To overcome this, RBI will conduct open market operation (OMO) auction for purchase of government securities for an aggregate amount of Rs. 48000 cr in the next month ahead.

Conclusion

There have been significant global and domestic developments since last meeting. Despite of the concerns regarding increasing unemployment rate in US and sovereign debt problems in Europe, emerging markets like India has seen robust growth. Significant growth in international commodity prices which has risen recently has put an upward pressure on inflation in most emerging market economies. The RBI's move in decreasing SLR and adjusting LAF was thus to release primary liquidity, to stabilize overnight inter-bank interest rate and bring down liquidity deficit in the economy.



Sunil Jain – VP Equity Research

Tel.: 022 3027 2377

Email: sunil.jain@nirmalbang.com

Pradeep Mundra

Tel.: 022 3027 8238

Email: pradeep.mundra@nirmalbang.com

NOTE

Disclaimer

This Document has been prepared by Nirmal Bang Research (Nirmal Bang Securities PVT LTD). The information, analysis and estimates contained herein are based on Nirmal Bang Research assessment and have been obtained from sources believed to be reliable. This document is meant for the use of the intended recipient only. This document, at best, represents Nirmal Bang Research opinion and is meant for general information only. Nirmal Bang Research, its directors, officers or employees shall not in anyway be responsible for the contents stated herein. Nirmal Bang Research expressly disclaims any and all liabilities that may arise from information, errors or omissions in this connection. This document is not to be considered as an offer to sell or a solicitation to buy any securities. Nirmal Bang Research, its affiliates and their employees may from time to time hold positions in securities referred to herein. Nirmal Bang Research or its affiliates may from time to time solicit from or perform investment banking or other services for any company mentioned in this document.