

Mid Quarter Review of Monetary Policy Review 2010-11

Increase in key interest rates.

The Reserve Bank of India (RBI) increased repo and reverse repo rates by 25 and 50 basis point respectively. Meanwhile SLR, CRR and bank rate have been left unchanged.

Policy Rate	Change	Effective Rate
CRR	unchanged	6.0%
Repo rate	+25 basis point	6.0%
Reverse Repo rate	+50 basis point	5.0%
Bank rate	unchanged	6.0%

As per RBI the expected outcomes of the actions are:

- Inflation will be contained without disrupting growth.
- Volatility in overnight call money rate would be reduced.
- To continue the process of normalization of the monetary policy instruments.

Fiscal Deficit to remain in line with Union Budget Estimates 2009-10

Higher than expected realizations on 3G and broadband wireless access (BWA) auctions combined with buoyant tax revenues have virtually eliminated the risk of the fiscal deficit overshooting the targeted 5.5 per cent, even after the supplementary demand for grants is taken into account.

Bank loan rates to increase

Banks might increase the base rate considering the fact that credit demand will pick up in the second half of the year. Since July the repo rate has been increased by 50 basis point from 5.5% to 6.0% and the reverse repo rate by 100 basis point from 4% to 5% leading to an increase in the base rate of the banks. This in turn will lead to an increase in loan rates.

Inflation remains the main concern

Essentially, inflation rates have reached a plateau, but are likely to remain at unacceptably high levels for some months. While prices of food articles, which rose by over 14 per cent in August, is still contributing to the pressure, about two-thirds of the August inflation can be attributed to items other than food articles and products.

Another aspect of concern for RBI with regard to inflation is its implications for real interest rates. The policy actions taken by RBI over the past three quarters have been partly motivated by the need to end the prevalence of negative real interest rates. One important consequence of negative real rates is that banks have seen a deceleration of deposit growth, as savers look for higher returns elsewhere. If bank credit is not to become a constraint to growth, real rates need to move in the direction of encouraging bank deposits.



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