

## Mid Quarter Review of Monetary Policy (17 March 2011)

### Changes in Key Interest Rates

RBI increased repo and reverse repo rates by 25 basis points each from 6.5 percent to 6.75 percent and 5.5 percent to 5.75 percent respectively. Meanwhile CRR, SLR and Bank Rate have been retained to their existing levels.

Policy Rate	Change	Effective Rate
CRR	Unchanged	6.0%
Repo rate	+25 basis point	6.75%
Reverse Repo rate	+25 basis point	5.75%
Bank rate	Unchanged	6.0%

As per RBI the expected outcomes of the actions are:

- To control the demand side inflationary pressures and to minimize risk to growth.
- To maintain an interest rate regime consistent with price, output and financial stability.

### Some of the key highlights of the mid quarter policy are:

- RBI has retained the projected 8.6 percent GDP growth for FY 2010-2011.
- The projection of WPI inflation for March 2011 is revised upwards to 8.0% from 7.0%.
- Net liquidity injection through Liquidity Adjustment Factor (LAF) declined from an average of around Rs.93,000 crs in January to Rs.68,000 crs in March (up to March 16) mainly due to increase in government spending and consequent decline in government cash balances with the Reserve Bank. RBI said that there may be short term liquidity pressures in the second half of March 2011 due to advance tax collections. However, going forward the overall liquidity situation is expected to be largely comfortable (+/-) 1% of net demand and time liabilities (NDTL).
- RBI has stated that following the recent strong export performance by the country; current account deficit CAD for 2010-11 is now estimated to come lower at around 2.5 per cent of GDP (earlier expected at 3.5 percent of GDP).
- Non food credit growth stood at 23% YoY in February 2011 well above the projected 20% for FY 2010-11.

The wholesale price index (WPI) increased to 8.31 per cent on account of higher fuel and manufactured product prices. Non-food manufactured products inflation witnessed a sharp increase from 4.8 per cent in January 2011 to 6.1 per cent in February 2011 and continues to stay above its medium term trend. Although food article prices have declined substantially since January 2011, prices of protein sources have continued to remain high reflecting structural demand supply imbalance.



## **Conclusion**

Rising oil prices have contributed to the increase in demand side inflationary pressures along with potential risk to economic growth of the country. In particular, the weak performance of capital goods in the IIP coupled with uncertainty about energy and commodity prices are likely to impact the investment scenario. RBI has also revised its year end inflation target from 7% to 8% and has further indicated that measures will be taken in order to control inflation in the coming period.

We believe that increase in interest rate was already expected and it has been factored in the valuation of the banks and the allied industries and thus this will not have a major negative impact on the banking sector and the sectors related to it in the immediate near term. However, if RBI continues to hike the interest rates for the next 1-2 quarter in order to combat rising inflation then such policy moves may start impacting the future investment decisions of many corporate.

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**NOTE**

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