

3 June 2014

Monetary Policy

Inflation remains top priority

The RBI has maintained status quo in policy rates, and its resolve to dis-inflate the economy continues. Simultaneously, to provide greater liquidity, it has reduced the reserve requirements. We believe that while the central bank would continue to be in a pause mode for the next three months, the rate cut cycle would start thereafter.

Policy rates untouched. The Reserve Bank of India (RBI), in its second bi-monthly monetary policy meeting held today kept the repo and reverse-repo rates unchanged, at 8% and 7%, respectively. Liquidity under export credit refinance (ECR) has been reduced from 50% of eligible export credit outstanding to 32%. A special term repo facility of 0.25% of NDTL was also announced.

SLR slashed by 50bps, positive for banks. The statutory liquidity ratio (SLR) cut of 50bps, from 23.0% to 22.5% of the banks' net demand and time liabilities (NDTL), is likely to help them support credit growth; 0.5% of NDTL implies ~424bn of resources available for meeting credit demand. All thing being equal, a 50bps SLR cut is likely to increase banks' NII by 0.3-0.5% and PAT by 0.2-0.4%.

Curbing inflation remains the monetary policy's target. If inflation remains on course with the RBI's glide path, there would be no policy rate hike. Only if the slowdown in inflation (while ignoring the base impact) is ahead of the curve, we will see a cut in policy rates. RBI estimate for FY15 GDP growth is unchanged at a central forecast of 5.5%.

Assessment. RBI's reasons for maintaining status quo is similar to those of the last monetary policy meeting. CPI inflation rose in Mar'14 and Apr'14, and is currently elevated at 8.6%. This is due to the hardening of food, beverages and tobacco inflation in the past three months. During the same, time core CPI inflation did not fall, and is unchanged at 7.8%. Secondly, services inflation captured by the CPI at 7.9% in Apr'14 is still high. Thirdly, RBI wants the 75-bp rate-hike over Sep'13—Jan'14 to play out fully. The cut in SLR is to increase liquidity, which is required when the economy revives. The reduction in access to liquidity under ECR is in line with the Patel Committee recommendation, which is compensated by additional liquidity under special term repos.

Outlook and Recommendation. With the change in the political scenario, there is ample reason to believe that balancing growth while controlling inflation is the roadmap of the RBI and government. However, for now, the RBI Governor, Rajan, is walking the talk of slowing down inflation. The risk of El Nino-led poor monsoon can be balanced by government policy actions on food supply, better fiscal consolidation and strengthening exchange rate. We maintain our view of 25-50-bp cut in 3QFY15, followed by another 50-100-bp reduction in CY15.

Repo/Rev. repo: 8.00%/7.00%

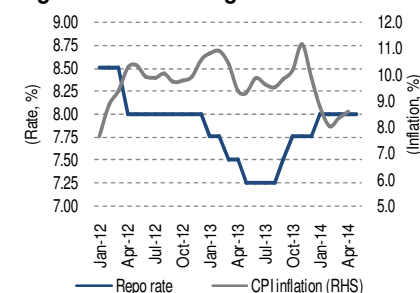
CRR/SLR: 4.0%/22.5%

Fig 1 – RBI's policy rate action

| (%) | 1 Apr, 14 | 3 Jun, 14 | RBI action |
|-----------|-----------|-----------|------------|
| Repo | 8.00 | 8.00 | ↔ |
| Rev. repo | 7.50 | 7.50 | ↔ |
| CRR | 4.00 | 4.00 | ↔ |
| SLR | 23.00 | 22.50 | ↓ |
| MSF | 9.00 | 9.00 | ↔ |

Source: RBI

Fig 2 – Rate unchanged



Source: RBI and Gol

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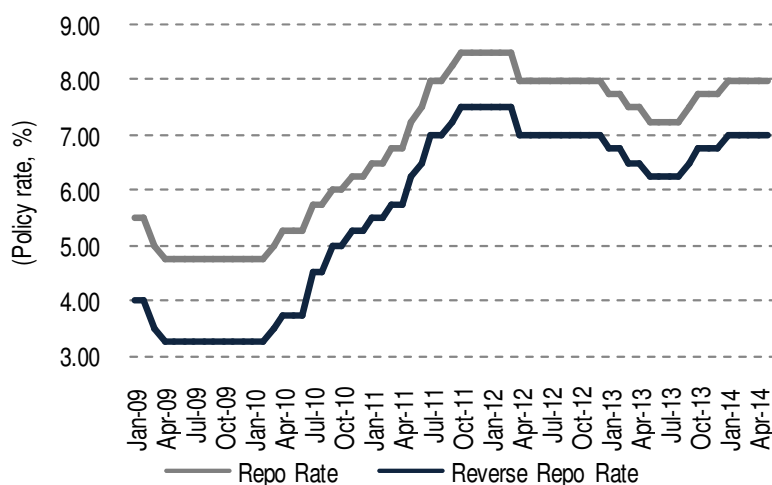
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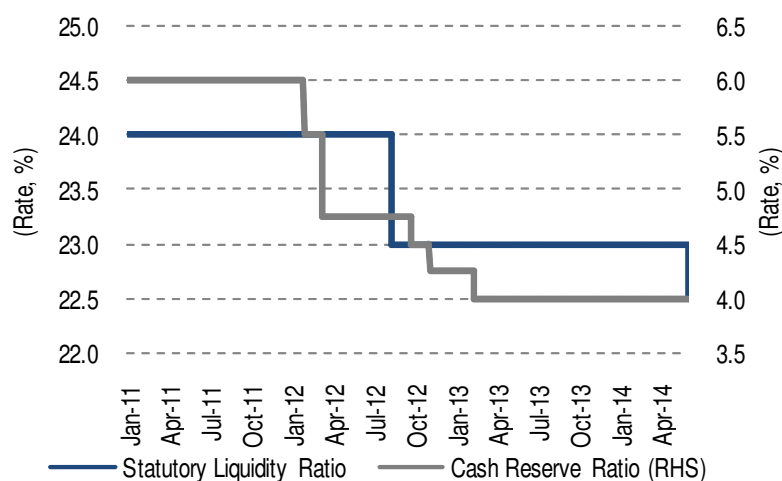
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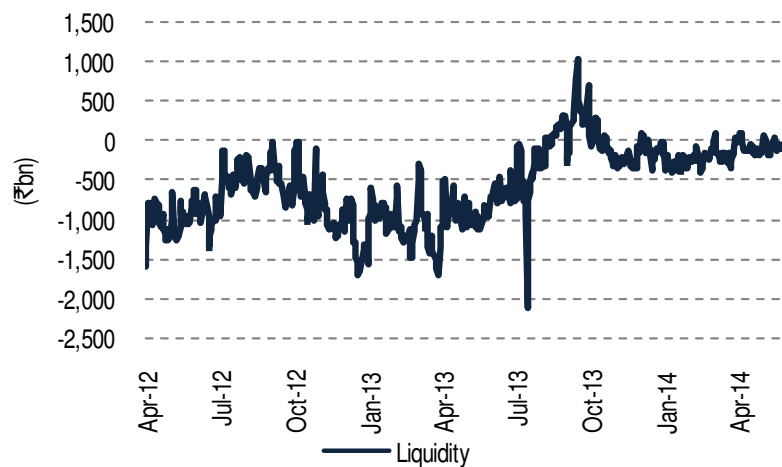
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Fig 3 – Repo and reverse-repo rates unchanged

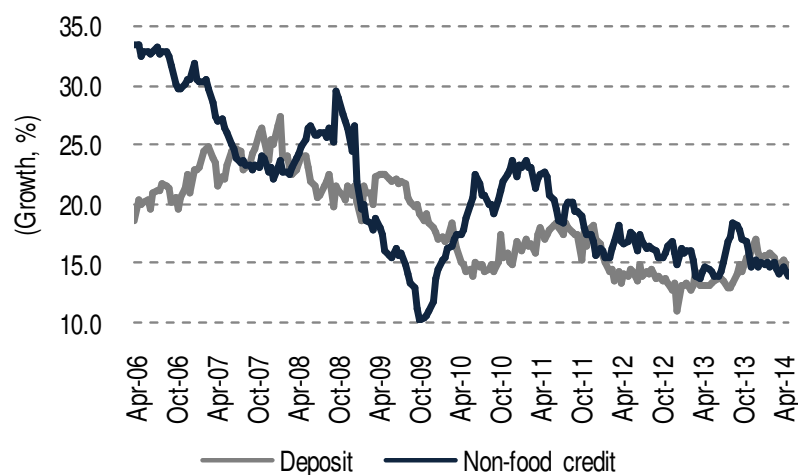
Source: RBI, Anand Rath Research

Fig 4 – SLR cut, CRR unchanged

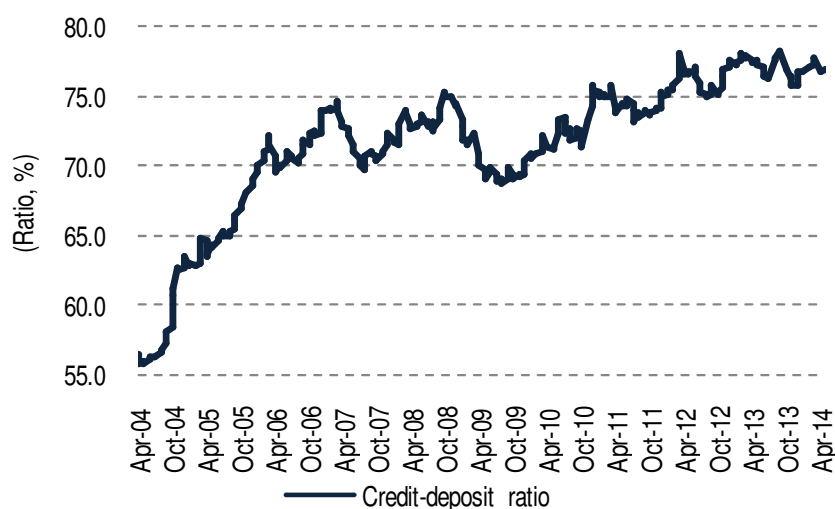
Source: RBI, Anand Rath Research

Fig 5 – Net liquidity in the RBI's comfort zone

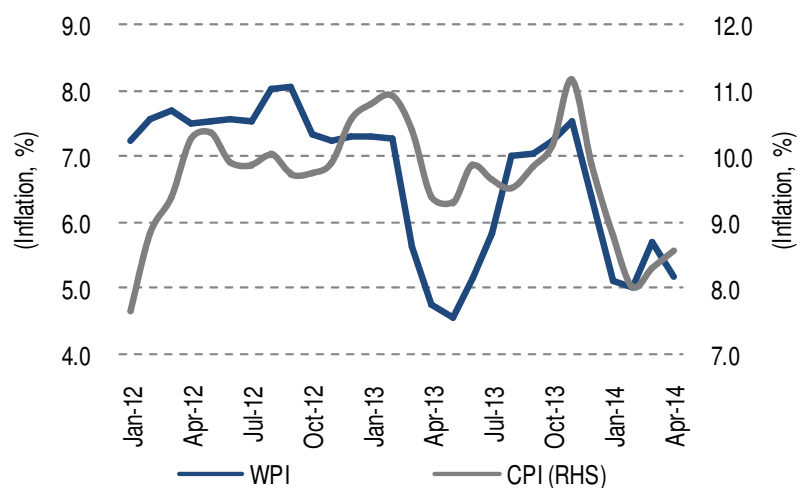
Source: RBI, Anand Rath Research

Fig 6 – Deposit and credit growth low

Source: RBI, Anand Rath Research

Fig 7 – Credit-deposit ratio around 77% since Oct'13

Source: RBI, Anand Rath Research

Fig 8 – Sharp correction in inflation since Nov'13

Source: CSO, Anand Rath Research

Appendix

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