

# FLASH - India

## Credit policy announced for 1Q FY11

July 27, 2010

The Reserve Bank of India (RBI) announced the **First Quarter Policy Statement for the Year 2010-11** on July 27, 2010.

The RBI continued its long overdue but anticipated transformation from growth-orientated 'dove' to inflation-fighting 'hawk' in its latest Monetary Policy Review. As expected, it revised both its growth and inflation forecasts up; a key stepping stone to the further policy tightening it delivered today. In this note, we assess the impact on the outlook for credit growth and on Indian financial markets in general.

The system is currently short of liquidity by Rs 40,000 – 60,000 crore (USD 8.5 – 12.75 bn)\*. We believe, with the move of increasing the Liquidity Adjustment Facility (LAF) rates, this tightness in liquidity will remain for some time. Until we see aggressive spending or reduced borrowing by the government, liquidity will not return in the system, thus keeping short term rates elevated. Banks might have to increase deposit rates to generate liquidity, however to maintain their Net Interest Margins (NIM), they will also need to raise lending rates. Raising lending rates at this point in time may affect the overall demand for credit (RBI's target of non-food credit growth for FY 2011 is 20%, whereas the actual growth rate achieved for FY 2010 was 17.1%).

For long-term interest rates, the hikes in repo and reverse repo rates have already been factored in by market participants. The 10-year benchmark G-sec Bond, that is currently trading at a yield of 7.70%, is expected to peak near 7.80% levels. This level could see some value buying from long-only investors. Moody's upgraded India's local currency Government Bond rating to Ba1 with a positive outlook on July 26, 2010, from Ba2. This is expected to attract foreign portfolio inflows into the category.

From an equity market perspective, we do not foresee any major reaction to the hike as most of the rates action has already been factored into prices.

For reference, the highlights of the Policy are:

Components	Previous (%)	Current (%) (Jul 27, 2010)
<b>SLR (Statutory Liquidity Ratio)</b>	25	25
<b>CRR (Cash Reserve Ratio)</b>	6	6
<b>Bank Rate</b>	6	6
<b>Repo Rate</b>	5.5	5.75
<b>Reverse Repo Rate</b>	4	4.5
<b>Inflation outlook</b>	5.5	6
<b>Growth outlook (real GDP)</b>	8	8.5
<b>M3 growth outlook</b>	17	17
<b>Non-food credit growth outlook</b>	20	20
<b>Deposit Growth</b>	18	18

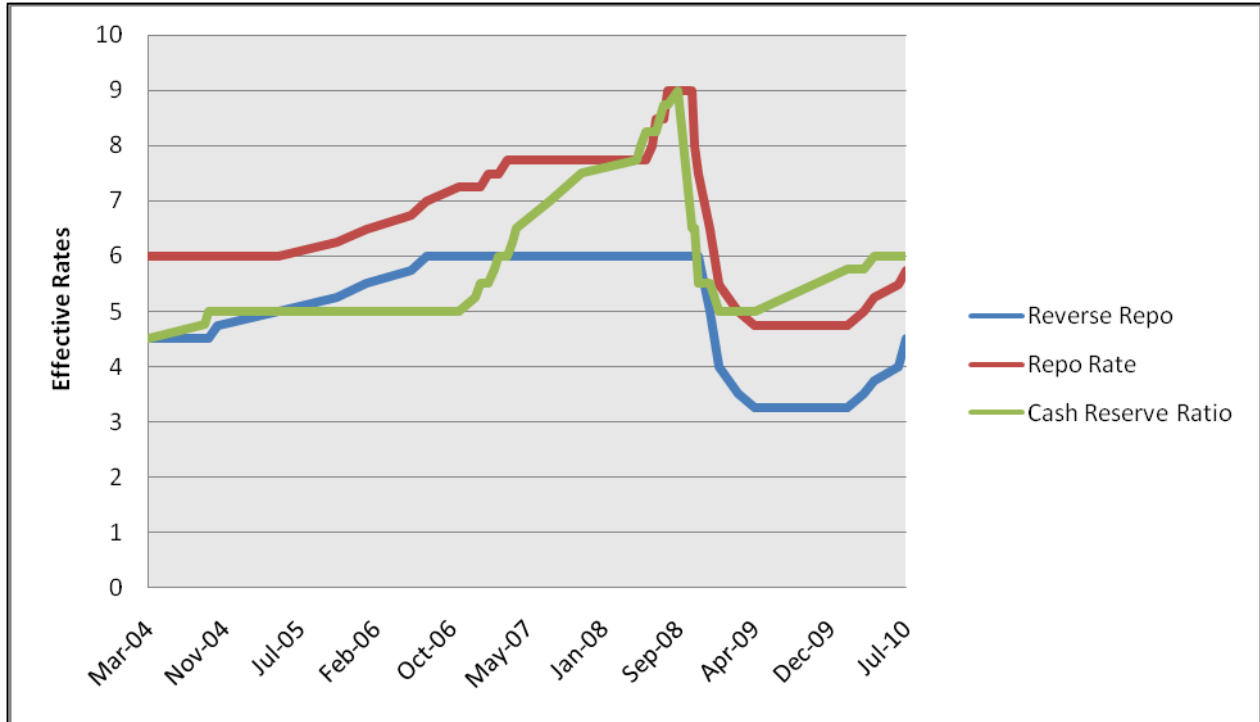
Source: RBI. Please refer to: [www.rbi.org.in](http://www.rbi.org.in) for detailed policy documents.

\* 1 USD = 47 INR (Rs)



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History Of Key Rate changes:



Source : FIM, India



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