



## RBI's Second Quarter Review of Monetary Policy - October 2011

### Policy Impact

On expected lines, RBI announced a +25 bps hike in the key policy rates at today's meeting and followed it up with a statement indicating that the likelihood of further rate action is relatively low. With today's increase, the 'repo' rate now stands at 8.50%. Given RBI's policy and rate guidance, we believe that the monetary tightening cycle has reached its end and expect a pause at the next policy meet.

Although the macro economic review released yesterday, reflected a hawkish undertone, the guidance reflecting the end of the hike cycle, seems to be driven by higher risks to growth and softness in the global macro and growth estimates. Further, RBI expects that the full impact of the past rate hikes is yet to get fully passed on to the borrowers. **RBI indicated that inflation would start falling in December 2011 and then continue a downward trend to touch 7.0% by March 2012.**

Other key announcements at the policy included the '**deregulation of the bank savings rate**' with immediate effect, which hitherto stands at 4%. The deregulation is intended to help in a pass through of the monetary stance of the central bank. Under the new regime, a uniform rate will however be offered by all banks on savings deposits upto 1 lakh.

Other key announcements include proposal to make guidelines on Credit Default Swaps effective in November 2011 and proposal to issue guidelines on short sale of G Secs.

### Revision in monetary indicators by RBI

- Although both Money supply (M3) and non-food credit growth were above RBI's indicative levels, full year estimates for these parameters were retained at 15.5% and 18%, respectively.
- Inflation target by March end is estimated at 7%
- Full year GDP forecast stands revised downwards to 7.6% from 8% earlier (actual Q1- GDP was 7.7%)

### Yield Movements post Policy

- G Secs rallied post policy on comments that the probability of further rate action is relatively low
- Yield on the BM 10 year G sec 7.80% 2021 declined to 8.70% from 8.73% pre policy
- There was no appreciable change in the CD levels. Intra quarter - December ending CDs were however offered 10 bps lower.

### Rate Outlook

Following today's hike, RBI has now raised the repo rate by 375 bps through 13 rate hike decisions since March 2010. Post today's meeting, RBI has indicated that the need for further rate action (in December 11) stands relatively low, since it expects the complete impact of the last few rate actions to be absorbed by the system and some moderation in the inflation trajectory.

With the rate hike cycle having come to an end, short and medium term funds continue to look even more attractive as yield volatility has subsided.

Source: RBI Second Quarter Review of Monetary Policy dated 25/10/2011.

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