



## Macro-Economic Updates

July 27, 2010

### **First Quarter Review of Monetary Policy 2010-11: LAF rates go up while corridor narrows**

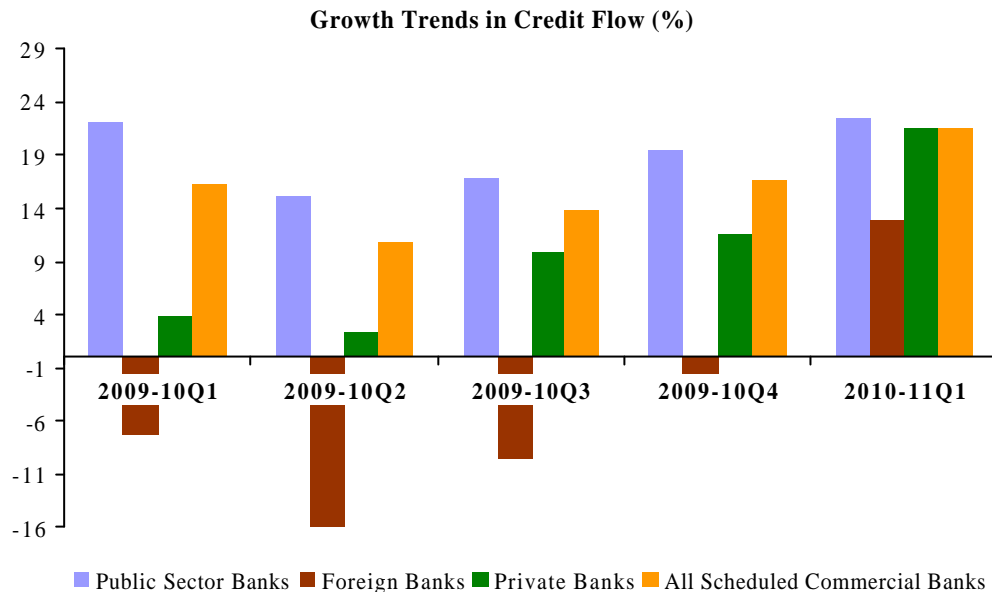
#### **Macro-economic Developments:**

- **Global economy:** Though the growth in Q1 of 2010 was satisfactory at 5%, global economy apparently came under pressure due to the growing concerns over sovereign debt situation in the Euro area.
- **Indian economy:** The recovery turned broad based and gained momentum with the persisting strong growth in industry particularly the manufacturing sector. The lead indicators for services activities also suggest continuation of the growth momentum. In view of this, GDP growth in 2010-11 is expected to be higher than 8.0 % projected in the Annual Monetary Policy Statement in Apr'10.
- **Agriculture:** Cumulative rainfall so far has been slightly higher than the previous year's level but lower than the long period average. The sowing progress of kharif crops in general is higher than the previous year except with respect to a few crops like urad, jowar, maize and soyabean due to deficient monsoon in the respective crop areas.
- **Industry:** Retained the strong growth trends in consumer durables and capital goods indicating the strength on the demand side as well as investment side.
- **Services sector:** The lead indicators for services sector activity indicated acceleration particularly in the segments associated with manufacturing like construction while financial segment remained stable. Other indicators like tourist arrivals, commercial vehicles production and railway freight traffic suggest continuation of the buoyancy in 2010-11.
- **Inflation:** With the apparent spread of inflationary trends to all the sections, the overall WPI-based inflation reached 11.23% in Apr'10 and remained above 10% during the following two months and is expected to remain high during the second quarter.

#### **Monetary Stance in Q1 of 2010-11:**

- **Gross market borrowings** declined by about 7% to Rs.1.51 lakh crore during Q1 of 2010-11 from 1.62 lakh crore in the same period of 2009-10. On the other hand, gross state borrowings increased marginally to Rs.23322 crore from Rs.20266 crore in the respective periods.
- **Deposits growth** continued to decelerate to 14.9% as on Jul 16, 2010 from 17.4% a quarter before and 22% a year before.
- **Credit growth** on the other hand, continued to accelerate to 22.3% by the mid Jul'10 from 16.9% by the end of Mar, 2009-10 and about 17% at the end of Jul'09. The recovery was particularly evident in private and foreign banks. The increase was partly on account of financing of 3G and broadband spectrum auctions.
- **Flow of financial resources** to commercial sector also expanded to Rs.2.5 lakh crore during Apr-Jun 2010 from Rs.61475 crore in the same months of 2009-10.

- **Base rate came into effect from Jul 1, 2010** in the place of benchmark prime lending rate (BPLR) to improve the efficiency in the credit pricing and enhance the transmission of monetary policy measures. Majority of the banks have set their base rate in the range of 7.25 to 8%.



#### Policy measures taken during Q1 of 2010:

- **Cash Reserve Ratio (CRR)** for SCBs is increased by 25bps to 6% of their NDTL with the effect from the fortnight beginning April 24, 2010 and retained at that level during Q1.
- **LAF Repo and Reverse Repo rates** were increased by 50bps each in two tranches since Apr'10
  - 25bps each to 5.25% and 3.75% respectively, on Apr 24, 2010.
  - 25bps each to 5.50% and 4.00% respectively, on Jul 2, 2010.
- **Statutory Liquidity Ratio (SLR)** for SCBs **kept at 25%** of their NDTL during the Q1 of 2010.
- **Measures to ease liquidity:**
  - Additional liquidity support under the LAF to SCBs to the extent of up to 0.5% of their NDTL was announced on May 26, 2010 and a second LAF (SLAF) was also made available on a daily basis.
  - Both these facilities were initially available till July 2, 2010, were later extended. The additional liquidity support facility was extended up to July 16, 2010 while the SLAF remains extended up to July 30, 2010.
  - The issuance of T-Bills reduced to Rs.16000 crore in Jun'10 from over Rs.36000 crore in Apr and May 2010.
  - The Government bought back securities worth Rs.9,614 crore in June 2010.

### Policy Measures Announced for Q2 of 2010

- **LAF rates increased:** Repo rate increased by 25bps to 5.75% while Rev repo rate increase by 50bps to 4.50% with immediate effect.
- The **Bank Rate has been retained** at 6.0 per cent.
- **The cash reserve ratio (CRR)** and **statutory liquidity ratio (SLR)** of SCBs have been kept unchanged at 6.0 % and 25% of their NDTL, respectively.

#### These measures intend to

- Moderate inflation by reining in demand pressures and inflationary expectations.
- Maintain financial conditions conducive to sustaining growth.
- Generate liquidity conditions consistent with more effective transmission of policy actions.
- Reduce the volatility of short-term rates in a narrower corridor.

#### Mid-quarter review of monetary policy:

- In view of the rapidly changing global as well as domestic economic conditions, the RBI has decided to review its monetary policy stance more frequently and proposed to undertake a mid-quarter reviews at an interval of one and half months after each quarterly review.
- Mid-quarter reviews will be announced in June, September, December and March by way of a press release, providing a rationale for either action or maintenance of the *status quo*.

**Outlook:** The policy measures announced by the RBI in the first quarter review of monetary policy 2010-11 are in line with the expectations of the market. In view of the rising inflationary expectations and strengthening economic recovery, the RBI may continue the normalizing process in mid-quarter review scheduled for Sept 16, 2010 in order to bring policy rates to the level consistent with the evolving growth and inflation scenario, while taking care not to disrupt the recovery.

#### Trends in Major Monetary Indicators (%)

Indicators	Jul, 2009	Oct, 2009	Jan, 2010	Apr, 2010	Jul, 2010
Money Supply (M3) growth	20.0	18.9	16.5	16.8	15.3
Money Base (RM) growth	-0.7	-4.0	18	16.9	24.2
SLR	24.0	25.0	25.0	25.0	25.0
CRR	5.0	5.0	5.0	6.0	6.0
Repo	4.75	4.75	4.75	5.25	5.75
Reverse Repo	3.25	3.25	3.25	3.75	4.50
<b>Sectoral flow of credit (as on May 21, 2010)</b>					
Agriculture	24.5	25.6	21.4	24.4	21.0
Industry	21.2	17.9	14.2	20.1	25.8
Real estate	52.0	41.5	15.3	0.9	1.2
Housing	5.0	5.4	7.3	8.3	9.6
NBFCs	31.5	30.8	19.5	25.8	17.5
Overall	17.6	13.3	10.4	15.9	18.1

Source: Reserve Bank of India

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