



Confederation of Indian Industry

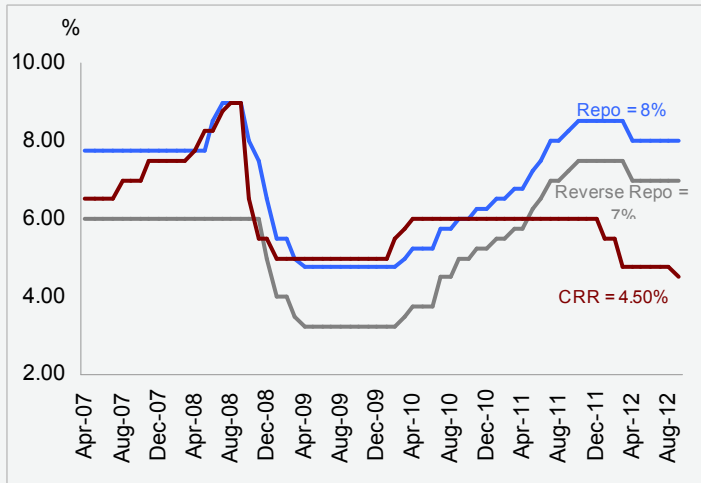
Economy Update - Monetary Policy



RBI cuts CRR but keeps the repo rate unchanged

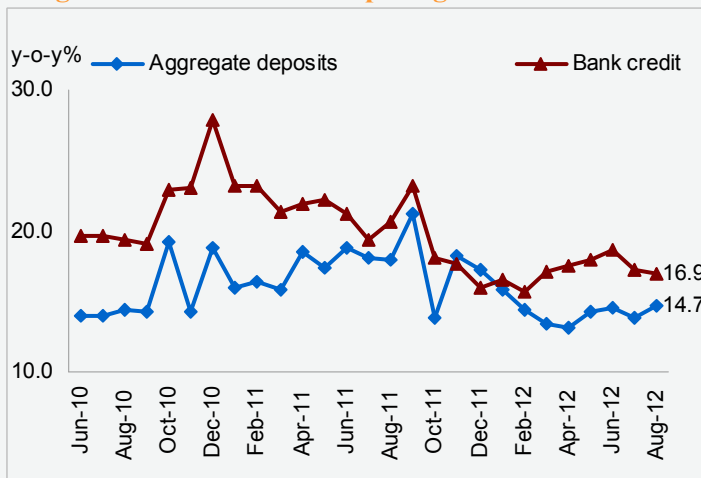
17 September, 2012

CRR cut by 25 bps, while repo rate unchanged



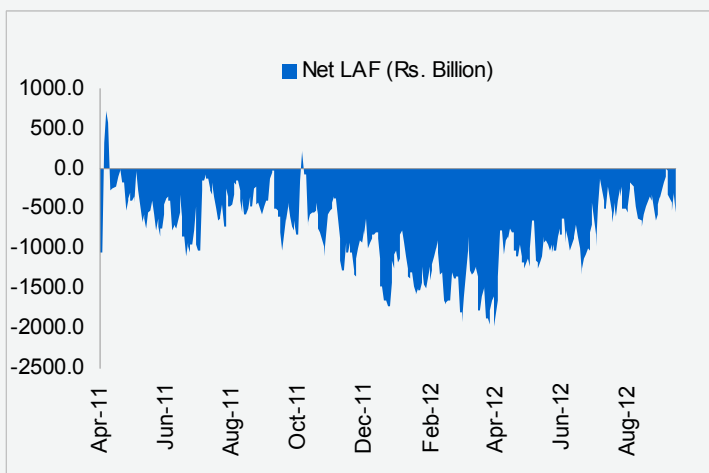
Recognizing the potential for liquidity shortage in the economy, the Reserve Bank of India (RBI) cut the Cash Reserve Ratio (CRR) by 25 bps to 4.50 per cent though it decided to keep the repo rate unchanged at 8 per cent in its mid-quarter monetary policy meeting held today. Additional liquidity in the system would help the current situation, where availability and cost of credit have been a challenge, particularly for the SMEs. However, the Central Bank was widely expected to oblige with a much needed interest rate cut as the government has done its bit on the fiscal side by announcing a slew of policy reforms last week aimed at fiscal consolidation and to boost investment levels in the economy. However, stubbornly high levels of inflation dissuaded the RBI from a rate cut. CII remains hopeful for an interest rate reduction in the next policy review of RBI.

Wedge between credit and deposit growth narrows



Bank credit growth to the commercial sector moderated to 16.9 per cent as of end-August 2012 as compared to a robust 20.7 per cent posted in last year. Though the RBI implemented a frontloaded policy rate reduction of 50 bps in April 2012, there hasn't been significant pass-through into banks' lending rates until July-end. However in the last month, a few banks have cut their lending rates concomitant with a reduction in the fixed deposit rates by a few. The reduction in lending rates by banks have been motivated by an expected jump in the credit demand in the forthcoming festival season. Today's CRR cut will help banks mobilize more resources to lend to the productive sectors of the economy.

Liquidity conditions remain tight



Liquidity conditions remained tight in the period post the first-quarter monetary policy review of RBI held on July 31, 2012. The average liquidity deficit stood at Rs 395 billion for the period August 1– September 14, 2012. This is expected to worsen in the next few weeks on account of advance tax payments and the onset of festival related currency demand. In these conditions, the appropriate liquidity management assumes importance in order to ensure that drawals under the Liquidity Adjustment Facility broadly remains within the RBI's indicative target of +/-1 per cent of net demand and time liabilities (NDTL) of banks, thereby facilitating monetary policy transmission and enabling adequate flow of credit to the productive sectors of the economy. In this regard, the RBI's move to reduce the CRR by 25 bps was indeed a prudent one.

Source: RBI

Outlook: CII was hopeful of a repo rate reduction in the mid-quarter monetary policy review held today by the RBI, especially since government has done its bit by announcing steps to rein in fiscal deficit and revive the investor sentiments in the economy. The RBI instead chose to cut the CRR which we felt was also a prudent thing to do keeping in mind the current tight liquidity scenario. Demand pressures according to RBI have eased and therefore, a cut in headline rates was a reasonable expectation from the Central Bank. Thus, we remain hopeful for a cut in the next policy.