



Confederation of Indian Industry

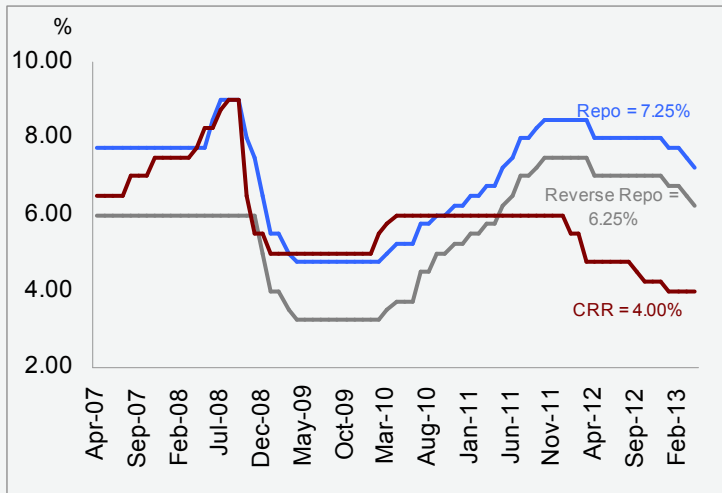
Economy Update - Monetary Policy



Repo rate cut welcome, but falls short of expectations

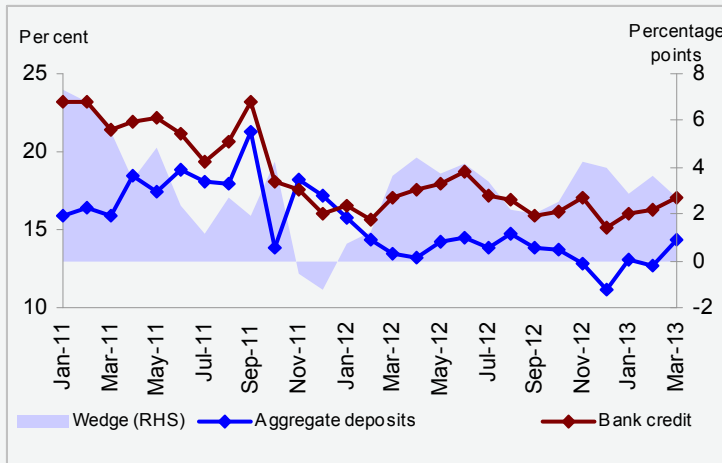
03 May, 2013

Repo rate cut by 25 bps



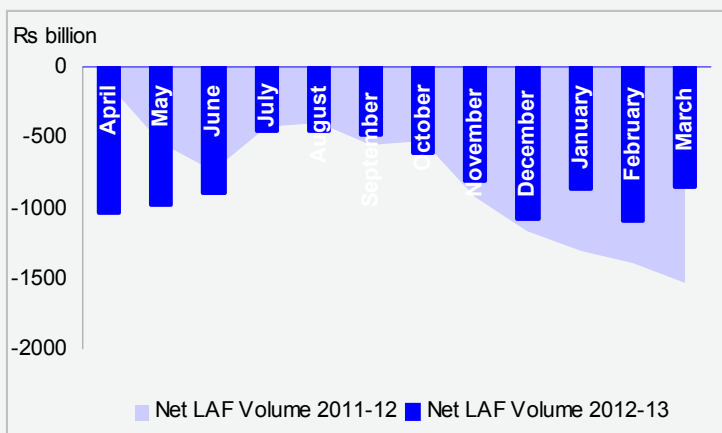
Taking cognizance of the growth slowdown amidst moderating inflation, RBI chose to cut the repo rate by 25 bps in its annual monetary policy review held today. We however, would have been happier, if RBI would have obliged with a larger rate reduction supplemented by a reduction in CRR too. Additionally, RBI also highlighted the fact that more than interest rate reduction, growth prospects are critically hinged on the government actions to remove supply-side bottlenecks that have impeded production and investment. Unless there is a meaningful pick-up in private corporate investment, growth is likely to stay below potential for the third consecutive year in 2013-14. As per RBI's estimates, growth is likely to stay subdued at 5.7 per cent in the current fiscal, with WPI inflation expected to remain range-bound around 5.5 per cent.

Wedge between Credit and Deposit Growth



The wedge between the credit and deposit growth has continued to remain high, thus necessitating banks to tap the inter-bank market to fund this gap. Bank credit growth has remained volatile with a marginal deceleration witnessed in the fourth quarter of 2012-13 as compared to the first three quarters. This is reflective of the muted demand and some risk aversion. Aggregate deposits growth on the other hand has continued to remain modest throughout the year, thus pushing the incremental credit deposit ratio to new highs in the last fiscal. With already tight liquidity conditions, the widening wedge poses a concern as it is likely to worsen the tight liquidity condition. In this regard, we would have been happy, if CRR would also have been cut today.

Liquidity conditions remain tight



Liquidity has continued to remain tight in the fourth quarter of 2012-13 due to persistently high government cash balances with the RBI and elevated incremental credit to deposit ratio for much of the year. The net average liquidity injection under the daily liquidity adjustment facility (LAF) stood at around Rs 940 billion in the final quarter of 2012-13 as compared to Rs 830 billion in the previous quarter. During April 2013 so far, liquidity conditions have eased following significant draw-down of government's cash balances. A CRR cut would have helped to alleviate the liquidity tightness in order to ensure smooth flow of resources to the productive sectors of the economy.

Source: RBI

Outlook: A rate cut of 25 bps, while welcome, falls short of CII's expectations of a 50 bps cut in policy rates which was crucial under the current economic conditions of slowing growth and moderating inflation. A 50 bps cut in policy rates would have provided a strong boost to the economy and made a significant impact on investor sentiment. An aggressive monetary policy stance, at the present juncture should not be perceived as overly accommodative, especially when growth is touching new lows. Past experience also shows that the economy has responded favorably to cut in policy rates.

CII Economy Update is a report prepared by the CII Economic Research Group. Reach us at: ecoresearch@cii.in