RBI Third Quarter Monetary Policy Review

29th January 2013

RBI announced the Third Quarter Monetary policy review today.

Policy actions undertaken are as follows:

- CRR cut from 4.25% to 4%.
- Repo Rate cut from 8% to 7.75%
- Reverse repo cut from 7% to 6.75%
- Margin Stabilization Facility (MSF) rate cut from 9% to 8.75%
- SLR left unchanged at 23%

RBI reduced Repo & CRR rates by 25bps in this review. CRR cut will release 18,000 crores of additional liquidity in the system. Repo cut indicates that RBI's focus is now shifting towards reviving growth. Although the policy tone remains hawkish, RBI has noticed that 'both headline wholesale price inflation and its core component, non-food manufactured products inflation, have softened through the third quarter.' RBI further states that several indicators such as the weaker pricing power of corporates & the possibility of international commodity prices stabilizing suggest that inflationary pressures have peaked. The expected inflation number at end of FY13 has been lowered to 6.8% from 7.5% earlier. RBI believes that the further moderation in inflation is likely to be muted considering the new government measures to correct petroleum products underpricing.

RBI sounds more concerned about growth observing that 'overall economic activity remains subdued. Investment activity has been way below desired levels and consumption demand too has started to decelerate.' RBI believes that recently announced government policy measures will take some times to revive the investment cycle. The full year GDP growth guidance has been lowered to 5.5% from 5.8% earlier.

Our Equity View: We expect a further 25 bps cut in repo rate in the March policy when core inflation is expected to moderate further. We maintain a positive stance on Tier I Private sector banks on lower interest rates and good Q3 results. Most public sector banks continue to struggle with asset quality issues and one needs to be selective in that space. Automobiles should also benefit from easing of rates leading to a revival in demand.

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