Institutional Equity Research

Banking | India

RBI Mid Quarter Monetary Policy Review December 2012

December 18, 2012

Key rates	Current quantum (%)
CRR	4.25
SLR	23.00
Repo	8.00
Reverse Repo	7.00
MSF	9.00
Bank Rate	9.00

Status quo on expected lines; stance sees a meaningful shift towards growth

RBI's move of keeping the key policy rates unchanged and maintaining a probable accommodation at end F13e was on expected lines. A clear departure from an only inflation focused stance, the guidance in mid-quarter review has clearly offered a clear shift towards growth focused policy. The Central Bank feels that inflationary pressures have most likely started to ebb and any uptick shall be final tailwinds. Growth is now likely to be supported through policy measures which are most likely to be initiated from January 2013. While a direct liquidity support in form of a CRR cut (which was expected) was not extended this time, a regular line of support has been assured / reiterated to smoothen, lower liquidity pressures – a likely hint of more OMOs.

We present takeaways.

Key macro variables stabilizing: While reviewing the domestic economy, the RBI has highlighted that GDP growth had been impacted by slowing manufacturing, uncertain external economy, and sticky headline inflation. The fiscal and current account deficits continue to remain challenging.

However, the policy review also has noted the slight strengthening observed recently in key macro variables: the firming up of industrial activity, likelihood of a better farm output, improving business sentiment (better order books etc) along with an easing inflation.

Focus on inflation replaced by growth: RBI has clearly indicated it is now prepared to shift its stance from an inflation focused to an accommodating, growth focused policy. While highlighting recent WPI trends as 'comforting' and 'likelihood of steady moderation…in 2013-14', RBI has underscored the need to move towards a policy stance that addresses factors that now challenge growth. .

The WPI inflation, which is still much above the RBI's comfort level, is expected to recede by the end of the year, however not before seeing an uptick initially in 4QF12. The exit inflation for March 2013 had been revised to 7.5% in the previous review.

Our View: rate cut likely in next review – quantum a key to watch out for: Two factors – a) progress on fiscal consolidation, and b) trends in inflation shall be key determinants of the extent of policy easing RBI shall undertake. The government has been trying to aggressively consolidate its finances and achieve budgeted deficit. It is also likely that WPI reading in Jan 2013 shows an uptick compared to Dec 2012, like RBI believes.

However, given the stance in the mid-quarter review, we would like to believe this uptick might not prove deterrent to continuing policy easing. Therefore, with an aim to support growth, RBI may undertake a repo rate cut of 25bps in the January 2013 policy review. We also do not rule out the possibility of another 25bps easing in repo rate by April 2013 if inflation continues to ebb.

We expect that if a further fiscal consolidation is targeted by the government in F14e supported by a comfortable outlook on WPI, a 150-200 bps rate easing is likely to follow.

Key to investment Ratings

Guide to the expected return over the next 12 months. **1=BUY** (expected to give absolute returns of 20 or more percentage points); **2=ACCUMULATE/ADD** (expected to give absolute returns between 10 to 20 percentage points); **3=REDUCE** (expected to give absolute returns between 0 to 10 percentage points); **4=SELL** (expected to give absolute negative returns)