

## Monetary Measures

Key Rates	Measures
CRR	Unchanged at 6%
Reverse Repo rate	raised by 50 bps to 6.25% (affixed at 100 bps below repo)
Repo Rate	hiked by 50 bps to 7.25%
MSF Rate	8.25% (affixed at 100 bps spread over repo)
Bank Rate	unchanged at 6.0%
SLR	24%
Bank savings Rate	hiked by 50 bps to 4%.

## Policy Undercurrents

Snapshot of Latest Monthly Inflation in Percent (March 2011)		
Groups	YoY	
	FY10	FY11
WPI	10.23	8.98
<b>PRIMARY</b>	22.16	12.96
Food	20.65	9.47
Non-Food	20.43	25.88
Minerals	37.94	12.22
<b>FUEL</b>	13.81	12.92
Liquefied	0.45	14.99
Petrol	16.77	23.14
High	15.04	6.22
<b>MANUFACTURED</b>	5.19	6.21

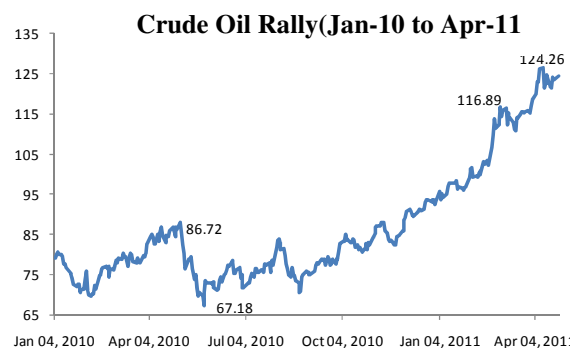
Source: RBI

Inflation management and containment has emerged as the key concern for the annual monetary policy for FY12. WPI Inflation for March-11 was estimated at 8.98%. The inflation in the primary goods segment, the fuel segment and the manufacturing segment estimated at 12.96%, 12.92%, and 6.21% respectively for the same period.

However, it is the inflation in the international prices of core commodities, especially crude oil, that has further aggravated the inflation situation

and outlook. For instance, the price of the Europe Brent spot as of 26<sup>th</sup> April 2011 was at US\$ 124.55 p/b. This is a 43.62% price hike over 2010.

RBI believes that this rally in the crude oil may amplify the oil import bill and consequently widen the trade and current account deficit. RBI also has expressed concern regarding the attainability of the fiscal target in light of the expanding oil subsidy bill. But, it



is the long term impact of the general inflation on the economic growth that has attracted more worry.

Consequently, the RBI stance has given priority to inflation management and price stability over growth. RBI has hiked the repo and the reverse repo rate by 50 bps each to 7.25% and 6.25% respectively. Additionally, the new Marginal Standing Facility(MSF) rate, (which has been instituted to help the banks manage their liquidity requirement) has been ascertained at 8.25%.At the same time, the bank savings rate has been increased by 50 bps to 4%.

It is clear that RBI is aiming to restrain the imported inflation from spilling over into the general economy. The rates hikes is expected to curb aggregate demand and thereby reduce the stimulus to inflation.

From the mutual funds perspective, the RBI stricture, requiring the banks to cap their investments in liquid funds upto 10% of their net-worth, has come as a surprise. The banks have been given a leeway of around 6 months to comply with this mandate. This is likely to reduce the liquid fund aum over the period. Albeit, RBI may have taken this step to mitigate any unwarranted spillover on the fund-houses from the liquidity variations in the banking sector.

The debt market has been discreet in its reaction to these measures. It believes that the stance is more hawkish than expected, and may augur a largely bearish outlook. It is expected that the yield curve may push upwards in the coming weeks.

This hardening of yields may provide high carry opportunity for FMPs with 1-year and above maturities. Additionally, the schemes with the short-term average maturities (3-6 months) may also provide high-carry benefits. This is because, with the older maturities emerging as the fresh near-term paper, the resultant re-pricing of the said asset may provide higher carry on the overall portfolio.

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