

Views on monetary policy (July '08)

The battle is on

RBI has shown a very firm resolve in its fight against the monster of inflation by increasing repo rate by 50 bps to 9% and Cash Reserve ratio by 25 bps to 9%. RBI has upped its inflation target for FY 09 to 7% and we expect more upward revisions over the next few months. RBI is rightly concerned that sticky commodity prices, expansionary fiscal policy and loose money supply could result in serious build up in long term inflationary expectations. There are visible signs of moderation in economic growth and some softening in global commodity prices; however, price stability seems to be the main priority for the central bank at the moment. Trends in monsoon and sowing pattern so far has not been very encouraging and there is possibility of spike in prices of some of the food items. The global situation remains fluid and RBI should continue to tread a cautious path.

RBI will continue to use all tools at its disposal (CRR, MSS and open market operations) to ensure that systemic liquidity (LAF balances) remains in deficit mode and overnight rates hover around the repo rate. RBI acknowledges that excess money creation and higher credit growth are keeping the buoyancy in aggregate demand and fuelling inflation. RBI is determined to bring down money supply growth to 17% and bank credit growth rate to 20% and it will not hesitate to take further actions in order to achieve these targets.

We maintain a bearish view on bond market and expect yields to inch up further. We expect liquidity conditions to tighten significantly and macro economic environment to deteriorate. Therefore we continue to advise investors a cautious approach towards duration and credit risk. In the current environment, "pleasure is all about avoiding pain."

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