

View on RBI's Credit Policy July 2009

As expected, the interim credit policy announced today proved to be a non-significant event and the RBI decided to maintain the status-quo on the key policy rates. However, it revised its FY10 GDP forecasts to 6% ('with an upward bias') and its inflation forecast to 5% (previously 4%), while warning that food price inflation is at elevated levels. RBI also reiterated that it has sufficient headroom to manage the government's borrowing program and that it is ready to reverse its expansionary policy quickly and effectively as and when needed. The Central bank remains focused on maintaining an accommodative monetary stance until there are definitive and robust signs of economic recovery.

In our view, despite the warning bells sounded by the RBI on growth and inflation, we do not believe that prospects for the interest rate market have turned negative. Though rising inflation remains a concern, the underlying reason for the pressure remains the rising food inflation, it will not spur RBI to action.

The banking system liquidity remains comfortable and bank deposit growth remains far in excess of loan growth, resulting in gradually declining loan-deposit ratios and rising investment-deposit ratios. With credit growth still remaining uncertain, the trend line is likely to continue for some more time. Though the general lending rates in the economy have come down, in RBI view the banking sector have more room to reduce lending rates further.

Since growth remains the prime priority, RBI will not tighten liquidity and change its accommodative stance any time soon or at least until there are definite signs of robust recovery. The current rate structures signify more of a demand and supply imbalances than the economic outlook. The yield curve is likely to remain supported on the back of RBI's OMO. It looks we are entering a phase of sideways consolidation with a mild positive outlook on the interest rate market, though volatility is something which cannot be ruled out.

If nothing else, market has crossed the hurdle and lots of uncertainties and if's and but's pertaining to "RBI's stance" are stated fairly clearly.

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