RESERVE BANK OF INDIA

First Quarter Review of Monetary Policy 2011-12

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Governor

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ABBREVIATIONS

bps	-	Basis Points
CAD	-	Current Account Deficit
CPI	-	Consumer Price Index
CRR	-	Cash Reserve Ratio
ECB	-	European Central Bank
EMEs	-	Emerging Market Economies
FAO	-	Food and Agriculture Organisation
FDI	-	Foreign Direct Investment
GDP	-	Gross Domestic Product
HSBC	-	Hongkong and Shanghai Banking Corporation Ltd.
IEA	-	International Energy Agency
IIP	-	Index of Industrial Production
IMF	-	International Monetary Fund
IOS	-	Industrial Outlook Survey
IW	-	Industrial Workers
LAF	-	Liquidity Adjustment Facility
LPG	-	Liquefied Petroleum Gas
M_3	-	Broad Money
MSP	-	Minimum Support Price
NDTL	-	Net Demand and Time Liabilities
OMC	-	Oil Marketing Company
PMI	-	Purchasing Managers' Index
Q	-	Quarterly
RBI	-	Reserve Bank of India
REER	-	Real Effective Exchange Rate
SCBs	-	Scheduled Commercial Banks
SLR	-	Statutory Liquidity Ratio
US	-	United States of America
WEO	-	World Economic Outlook
WPI	-	Wholesale Price Index
Y-o-Y	-	Year-on-Year

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By

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Introduction

The Reserve Bank's Annual Policy Statement of May 3, 2011 highlighted several risk factors to the growth-inflation outlook. Many of these risks have materialised. On the global front, the sovereign debt problems that have beset the euro area over the past year now threaten larger economies in the region. In the US, concerns over a sovereign default loom over financial markets, with potentially disruptive consequences for global capital flows. Japan is dealing with the challenges of recovering from the impact of the *tsunami* amidst deeper recessionary tendencies.

2. In striking contrast to advanced economies, emerging market economies (EMEs) have generally been dealing with rising inflation, caused by a combination of elevated commodity prices and robust domestic demand. While the two-speed recovery has been spoken about for some time, its very different impact on advanced economies and EMEs is now clearly visible.

3. From the perspective of India's macroeconomic policy imperatives, a critical consideration is the effect that global conditions will have on commodity prices. Since the May 3 Statement, the prices of many commodities, including that of crude oil, have shown signs of softening, reflecting weakening demand in advanced economies. Had this trend consolidated, it would have provided some welcome relief from inflationary pressures. However, one quarter later, the downtrend has not yet proved to be very strong. Prices are generally still high compared with last year. With no immediate prospects of monetary tightening in the advanced economies, the impact of weakening demand appears to be offset by that of abundant liquidity.

4. On the domestic front, a revised and rebased index of industrial production (IIP) suggested that earlier signals of a growth deceleration in the second half of 2010-11 were exaggerated. In fact, the growth momentum remained strong throughout the year. However, data for April-May 2011 suggest that some moderation might be under way, reflecting in part a lagged response to the monetary tightening that has been effected since October 2009.

5. Notwithstanding signs of moderation, inflationary pressures are clearly very strong. Importantly, the softening of commodity prices over the past three months did not translate into

a decline in either headline wholesale price index (WPI) inflation or non-food manufacturing inflation. If the softening reverses, commodity prices are likely to exert inflationary pressures for some time, making moderation in demand necessary to bring inflation down.

6. Overall, the current balance of global and domestic factors suggests that monetary policy needs to persist with a firm anti-inflationary stance. Moreover, moderating domestic growth will certainly help ease inflationary pressures, which may be reinforced by possible softening in global commodity prices.

7. This policy review is set in the context of the above uncertain global and domestic economic environment. It should be read and understood together with the detailed review in *Macroeconomic and Monetary Developments* released yesterday by the Reserve Bank. This Statement is organised in four sections: Section I provides an overview of the global and domestic macroeconomic developments; Section II sets out the outlook and projections for growth, inflation and monetary aggregates; Section III explains the stance of monetary policy; and Section IV specifies the monetary policy measures.

I. The State of the Economy

Global Economy

8. The pace of global expansion moderated in Q2 of 2011. Several factors contributed to this - high oil and other commodity prices, supply chain disruptions from Japan, sovereign debt concerns in the euro area, and continued weakness in the US housing and labour markets.

9. Concerns over the euro area sovereign debt problem re-emerged on the back of Greece's deteriorating fiscal position, downgrading of Portugal's sovereign debt rating, and most significantly, signs of stress in Italy's sovereign debt. There is heightened anxiety about whether the euro area will be able to agree on an economically viable, fiscally sustainable and politically feasible solution to the vexing sovereign debt problem. In this regard, the agreement reached by the euro zone leaders in their meeting on July 21, 2011 is a positive development. However, its effective implementation remains to be seen.

10. Medium-term sovereign debt sustainability issues are also under debate in the US, although the near-term focus is on the constraints posed by the existing debt ceiling. The unemployment rate edged up in the US and showed no improvement in other major advanced economies. The US national home price index declined further in Q1 of 2011.

11. International prices of oil and other commodities softened in the weeks after the May 3 Policy Statement on the back of a slowdown in economic activity, but they remain at elevated levels. Crude prices, which moderated

in June 2011 on account of the decision of the International Energy Agency (IEA) members to release 60 million barrels of crude from their strategic reserves to offset supply disruptions, have edged up again. Brent crude price has ruled above US$ 110 a barrel in July 2011 so far. On a year-on-year (y-o-y) basis, the World Bank's index of energy prices was up by 39 per cent in June 2011. Also, the Food and Agriculture Organisation's (FAO) food price index in June 2011 was 39 per cent higher than in June 2010.

12. Despite sluggish economic activity, inflationary pressures also emerged in advanced economies under the impact of high commodity prices. Core inflation has picked up in the US and the euro area. In view of headline inflation remaining above its target, the European Central Bank (ECB) raised its policy rate in July 2011, its second rate hike since it began to exit from its expansionary monetary stance in April 2011.

13. Reflecting high commodity prices as well as strong demand, headline as well as core inflation in EMEs remained elevated in the first half of 2011. Inflation in China reached a 3-year high of 6.4 per cent in June 2011. Many EMEs persisted with monetary tightening in Q2 of 2011.

Domestic Economy

14. GDP grew by 8.5 per cent during 2010-11. This estimate could undergo some upward revision since the new IIP series (base: 2004-05) shows that industrial growth did not moderate in the second half of 2010-11 as earlier thought. Latest available data for 2011-12, however, suggest some moderation in economic activity. The increase in the IIP by 5.7 per cent in April-May 2011 was lower as compared with the increase of 10.8 per cent in the corresponding period of last year. Merchandise trade, however, registered strong growth with exports expanding by 46 per cent during Q1 of 2011-12.

15. According to the Reserve Bank's order books, inventories and capacity utilisation survey (OBICUS), capacity utilisation in Q4 of 2010-11 increased significantly to 77.4 per cent. However, the forward-looking industrial outlook survey (IOS), conducted during June 2011, showed a decline in the overall business sentiment in Q1 of 2011-12 and further slippage for the following quarter. The HSBC purchasing managers' index (PMI) for June 2011 showed moderation in the growth of manufacturing activity, although the PMI for services moved up marginally.

16. The south-west monsoon has been one per cent below normal so far (July 20, 2011). However, the Reserve Bank's production weighted rainfall index at 104 shows an above normal trend so far. Area-wise, 88 per cent of the country received excess/normal rainfall. Significantly, *kharif* sowing this season (up to July 22, 2011) in respect of pulses, coarse cereals, oilseeds and cotton has been lower compared with the same period of last year.

17. Inflation continues to be the dominant macroeconomic concern. The headline WPI inflation rate was 9.7 per cent in April 2011. The provisional inflation figure was 9.1 per cent in May 2011 and 9.4 per cent in June. Given the recent pattern, these numbers are likely to be revised upwards. Thus, the

headline WPI inflation rate for Q1 of 2011-12 remained stubbornly close to double digits and inflationary pressures continued to remain broad-based. Both the level and the persistence of WPI inflation are a cause for concern.

18. Non-food manufactured products inflation was 7.0 per cent in April 2011. According to provisional data, it rose to 7.3 per cent in May and remained high at 7.2 per cent in June. This should be seen in comparison with the average non-food manufactured product inflation of 4 per cent over the last six years. The persistence of high non-food manufactured products inflation suggests that producers, operating at high levels of capacity utilisation, are able to pass on rising commodity input prices and wage costs to consumers. Early corporate results for Q1 of 2011-12 suggest some moderation in margins. However, such moderation so far has been modest, implying that pricing power persists.

19. Fuel group inflation increased in June 2011 due, in part, to the impact of the administered price increases on June 25, 2011, even though non-administered fuel prices, especially that of aviation turbine fuel, declined.

20. Inflation in respect of protein rich items such as egg, fish, meat and milk remains elevated. According to the 66th Round of Consumer Expenditure Survey of the National Sample Survey Office (NSSO), the share of food items in total consumer expenditure declined between 2004-05 and 2009-10. However, during the same period, the share of protein-rich items in total consumer expenditure increased both in rural and urban areas.

21. Inflation, as measured by the consumer price indices (CPI), has been declining but remains high. Reflecting the moderation in food inflation, CPI inflation for industrial workers (CPI - IW) dropped from 9.4 per cent in April to 8.7 per cent in May 2011. With the latest reading of 108.8 in June 2011 (base: 2010=100), the new all-India CPI too suggests persistence of price pressures.

22. In response to the monetary policy measures initiated by the Reserve Bank, scheduled commercial banks (SCBs) have been raising their domestic deposit rates. During 2010-11, the modal term deposit rate of all SCBs rose by 165 basis points (bps). It rose further by about 60 bps during April-July, 2011.

23. As SCBs raised their deposit rates, they saw response by way of an acceleration in growth of deposits from 17.4 per cent, y-o-y, in early April 2011 to 18.4 per cent in early July 2011. Simultaneously, currency growth decelerated from 18.4 per cent to 15.0 per cent in the corresponding period. On the back of good deposit growth, y-o-y broad money supply (M_3) increased by 17.1 per cent in early July 2011 outpacing the Reserve Bank's indicative trajectory of 16 per cent. Though a decline in the currency-deposit ratio is desirable for efficient financial intermediation, paradoxically, its immediate impact in terms of a higher money multiplier may be in the form of increased inflationary pressure.

24. Year-on-year non-food credit growth decelerated from 21.3 per cent in March 2011 to 19.5 per cent

as on July 1, 2011, but it was still above the May 3 Statement indicative projection of 19 per cent. Non-food credit growth was broad-based with credit to industry, services and personal categories registering higher growth. Disaggregated data suggest that credit to the industrial sector continued to be led by infrastructure.

25. The Reserve Bank's estimates show that the total flow of financial resources from banks, domestic non-bank and external sources to the commercial sector during Q1 of 2011-12 was lower at ₹ 2,40,000 crore as compared with ₹ 2,63,000 crore during the corresponding period of last year.

26. The Base Rate system, introduced since July 1, 2010, has improved the transparency in lending rates and also enabled a more informed assessment of the transmission of monetary policy impulses to banks' lending rates. Since July 2010, the modal Base Rate of banks has increased by 225 basis points. The Base Rate system of loan pricing coupled with deficit liquidity conditions has increased both the strength and the transparency of the monetary transmission process.

27. Consistent with the policy stance, liquidity conditions have generally remained in deficit mode so far in 2011-12. The average daily net injection of liquidity through the liquidity adjustment facility (LAF) window during this period till July 22 was around ₹ 48,000 crore, which was within one per cent of NDTL.

28. The 10-year government security yield increased from 8.1 per cent at end-April 2011 to 8.3 per cent in July 2011. However, short-term yields rose faster in response to policy rate hikes and increased issuance of short-term paper, resulting in flattening of the yield curve. One interpretation of the relatively stable long-term yields is that inflationary expectations over the longer-term horizon remain anchored.

29. The real estate market remained firm. The Reserve Bank's quarterly house price index suggests that housing prices rose in most cities in Q4 of 2010-11. The volume of house transactions also picked up in Q4 of 2010-11 in most of the seven cities for which the index is compiled.

30. During April-May 2011, the Central Government's revenue deficit and fiscal deficit turned out to be higher than the levels during the corresponding period of the previous year reflecting lower revenue receipts and higher expenditure. Up to July 18, 2011, the Central Government completed 34 per cent of its budgeted net market borrowing programme, as compared with 37 per cent in the corresponding period of last year.

31. The exchange rate moved in both directions in the range of ₹ 44.05–45.38 per US$ during Q1 of 2011-12. On an average basis, while the 6-currency real effective exchange rate (REER) appreciated by 1.5 per cent, both the 30-currency REER and the 36-currency REER depreciated marginally by around 0.6 per cent.

32. As regards the external sector, the current account deficit (CAD) moderated to 2.6 per cent of GDP in 2010-11 from 2.8 per cent of GDP in the previous year. Apart from sustained invisible receipts, this was due to robust export growth in the second half of

2010-11. In Q1 of 2011-12, export growth remained strong, expanding by 46 per cent over the corresponding quarter of the previous year; imports grew by 31 per cent during the quarter.

33. In Q1 of 2011-12, major components of capital inflows showed an increase. In particular, FDI inflows were US$ 7.8 billion in April-May 2011 compared with US$ 4.4 billion in the corresponding period of last year. ECB approvals were higher at US$ 8.1 billion in April-June 2011 compared with US$ 5.3 billion in the corresponding period of last year. Foreign exchange reserves were at US$ 314.5 billion as on July 15, 2011, up from US$ 304.8 billion at end-March 2011, largely reflecting normal accruals and valuation effects.

II. Outlook and Projections

Global Outlook

Growth

34. Taking into account the loss of momentum of recovery during Q2 of 2011, the IMF, in its June, 2011 Update of World Economic Outlook (WEO), revised downwards its estimates for global growth in 2011 to 4.3 per cent from its April 2011 estimate of 4.4 per cent. More importantly, according to the IMF, downside risks to global growth have increased on account of continuing sluggishness in major advanced economies due to the weak labour and housing markets, and lingering sovereign debt concerns.

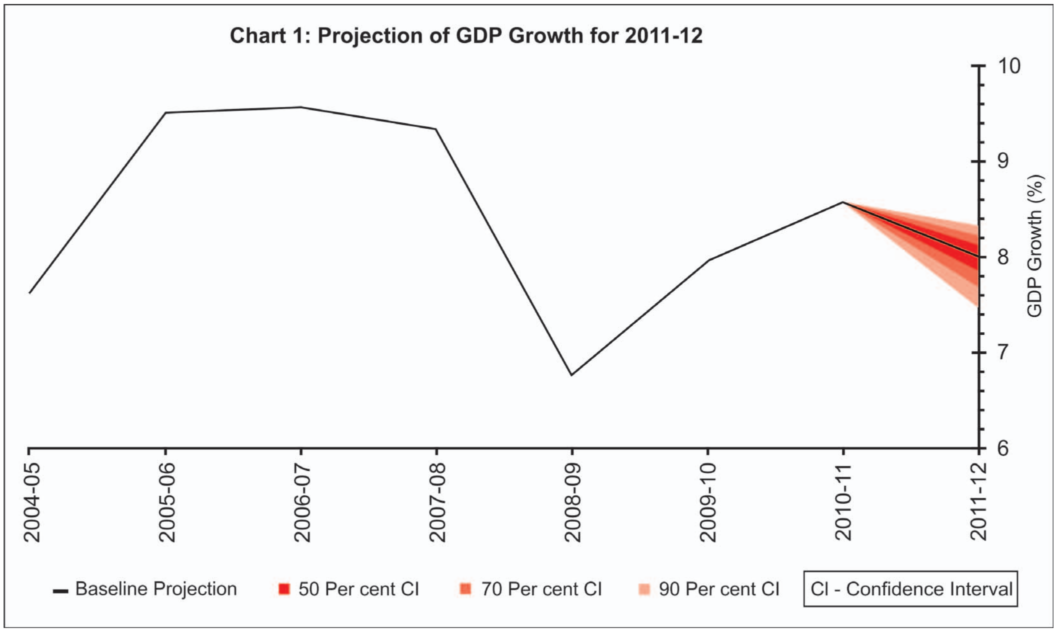
Inflation

35. Globally, while growth is set to decelerate, inflation is expected to edge up in 2011 reflecting higher commodity prices and strong demand in EMEs. Although prices of cotton, rubber and metals have softened in the recent period, crude oil prices continue to be volatile and the outlook on this front remains uncertain. The IMF's projection is that consumer price inflation is likely to increase from 1.6 per cent in 2010 to 2.6 per cent in 2011 in advanced economies, and from 6.1 per cent to 6.9 per cent in emerging and developing economies.

Domestic Outlook

Growth

36. The May 3 Policy Statement projected baseline real GDP growth for 2011-12 at around 8.0 per cent. This estimate, made for policy purposes, was based on the assumption of a normal monsoon and crude oil prices averaging US$ 110 a barrel. Subsequent information suggests that this projection remains valid. The baseline scenario envisages some moderation in growth partly as a result of the monetary stance, but this is consistent with the objective of controlling inflation. However, the extent of moderation will be limited by the overall buoyancy in consumption, in part an outcome of overall increases in real wages. Exports performance, if persists, will also help contain the growth moderation. As regards the monsoon, its performance till the third week of July 2011 was close to normal, which bodes well for overall production. However, its spatial distribution



indicates possible pressure on yields of coarse grains, pulses, oilseeds and cotton. A firmer assessment of agricultural performance will be made in the mid-quarter review to be released in September 2011.

37. Against this backdrop, the baseline projection of real GDP growth is retained at 8.0 per cent, as set out in the May 3 Policy Statement (Chart 1).

38. It is important to recognise that in the absence of appropriate actions for addressing supply bottlenecks, especially in food and infrastructure, questions about the ability of the economy to sustain the current growth rate without significant inflationary pressures come to the fore. The economy's ability to grow rapidly for any length of time without provoking inflation is dependent on implementing policies, with corresponding resource allocations, which will allow the supply of various products and services to keep pace with demand.

Inflation

39. In its May 3 Policy Statement, the Reserve Bank made a baseline projection for WPI inflation for March 2012 at 6.0 per cent with an upside bias. Some of the upside risks have subsequently materialised and added to inflation pressures.

40. First, prices of petroleum products such as petrol, diesel, kerosene and LPG were raised in May/June 2011. The increase in administered petroleum product prices in June 2011 will add about 70 basis points to WPI inflation as a direct impact. In addition, there will be an indirect impact which will play out during the course of the year. There will be further upward pressure on inflation due to another one-off factor. The sharp upward revision in domestic crude prices under the minerals category, with a weight of 0.9 per cent in WPI, added about 40 bps to WPI inflation in April 2011. A similar impact may be felt in March 2012 unless crude prices moderate significantly.

41. Second, minimum support prices (MSPs) for some agricultural commodities, particularly rice and pulses, were increased significantly. This is likely to exert upward pressure on food inflation even if the harvest is good.

42. Third, non-food manufacturing inflation persists at elevated levels, reflecting underlying demand pressures. While early corporate results for Q1 of 2011-12 indicate some moderation in margins, suggesting reduced pricing power, the pass-through of higher commodity prices into more generalised inflation remains significant.

43. Going forward, the inflation outlook will be shaped by the following factors. First, it will depend on the overall performance of the south-west monsoon. Even if there is no major deficiency at the aggregate level, an appropriate spatial and temporal distribution of rainfall during the whole season is crucial. As price pressures in respect of protein-rich items persist, any shortfall in rainfall or its pattern could pose significant risks to food inflation.

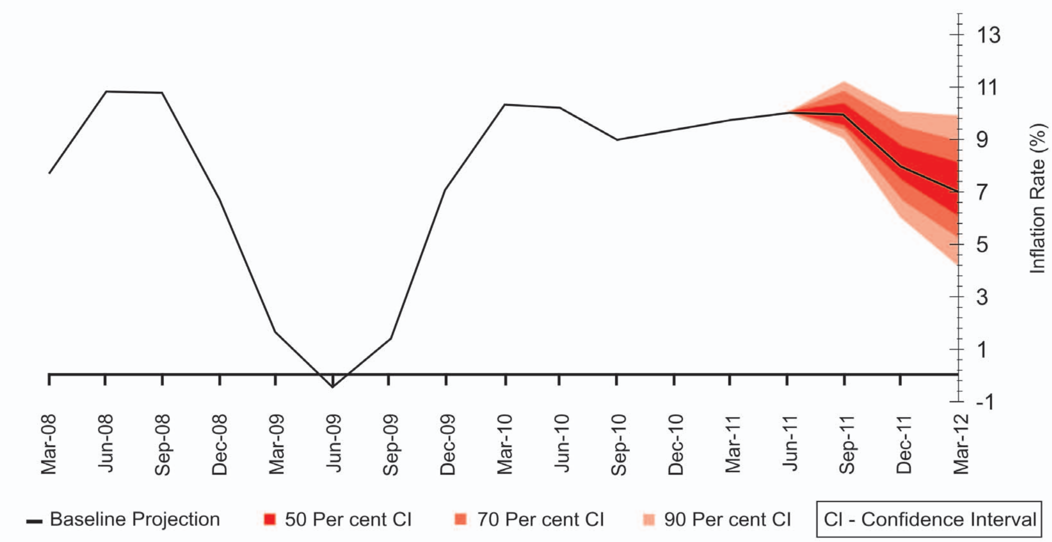
44. Second, the outlook for crude oil prices in the near future is uncertain. The price of the Indian crude basket rose to US$ 114 per barrel as on July 21, 2011 after declining to US$ 110 per barrel in May from US$ 118 per barrel in April. Going by the recent trend, the price of oil could remain volatile as a consequence of the pace of global recovery, liquidity conditions and, importantly, the overall oil supply situation.

45. Third, there is still an element of suppressed inflation in the economy. Despite the recent increase in administered fuel prices, under-recoveries on account of subsidised fuel are estimated at over ₹1,00,000 crore (1.0 per cent of GDP) of which a major portion may have to be borne by the Government. Regardless of how this issue is handled, there will be implications for inflation. If the Government raises administered prices, the inflation implications are straightforward. If the Government absorbs this in the fiscal accounts, the resultant expansionary impact will add to inflation pressures. Notwithstanding the inflationary impact, if the crude prices do not moderate in the near-term, it will be desirable to pass on the increase, both from the perspective of energy conservation and containing demand.

46. Fourth, there are administered items in the WPI basket, whose prices might be increased in the coming months. For instance, coal prices were increased significantly in February 2011. Since coal is an input into electricity generation, administered electricity prices might also increase. But the timing of changes in administered prices is uncertain, which will have a bearing on the inflation path.

47. Keeping in view the domestic demand-supply balance, the global trends in commodity prices and the likely demand scenario, the baseline projection for WPI inflation for March 2012 is revised upward from 6.0 per cent with an upside bias, as indicated in the May 3 Policy Statement, to 7.0 per cent (Chart 2). As indicated in the May 3 Policy Statement, inflation is expected to remain at an elevated level for a few more months, before moderating towards the later part of the year.

Chart 2: Projection of WPI Inflation (y-o-y) – 2011-12



48. Notwithstanding the current inflation scenario, it is important to recognise that in the last decade, the average inflation rate, measured in terms of both WPI and CPI, had moderated to around 5.5 per cent. As mentioned in the May 3 Policy Statement, the Reserve Bank is strongly of the view that controlling inflation is imperative both for sustaining growth over the medium-term and for increasing the potential growth rate. This is a critical attribute of a favourable investment climate, on which the economy's potential growth depends. Fiscal consolidation can contribute to a sustainable growth path by rebalancing demand away from government consumption and towards investment.

49. Monetary policy will, therefore, condition and contain perceptions of inflation in the range of 4.0-4.5 per cent, with particular focus on the behaviour of the non-food manufacturing component. This will be in line with the medium-term objective of 3.0 per cent inflation consistent with India's broader integration into the global economy. The achievement of this objective will be helped by concerted policy actions and resource allocations to address domestic supply bottlenecks, particularly on the food and infrastructure fronts.

Monetary Aggregates

50. The current trends in money supply (M_3) and credit growth remain above the indicative trajectory of the Reserve Bank. Keeping in view the evolving growth-inflation dynamics, the indicative projection of M_3 growth for 2011-12 is revised downwards from 16.0 per cent, as set out in the May 3 Policy Statement, to 15.5 per cent. Non-food bank credit growth projection is also revised downwards from 19.0 per cent to 18.0 per cent.

Risk Factors

51. The indicative projections of growth and inflation for 2011-12 are

subject to several risks as detailed below.

i) Notwithstanding some moderation, global commodity prices, especially that of oil, continue to weigh on both domestic growth and inflation. The future path of crude oil prices is uncertain. Should the recovery in advanced economies pick up, there may be upward pressure on prices. On the other hand, should the recovery stall, the easy liquidity conditions will continue to prevail leading to continued speculative positions which may prevent prices from softening.

ii) The uncertain global macro-economic environment poses a challenge for the domestic economy from the perspective of financing the current account deficit. In this context, the composition of capital flows remains a concern. In recent months, some shift in composition of capital flows towards FDI has been observed. This trend needs to be reinforced through policy actions to improve the quality of financing of the current account deficit.

iii) There are risks to the food inflation outlook. First, although the monsoon has been close to normal so far, deficient rainfall in August coupled with higher MSP could result in an upward movement in cereals and pulses price inflation. Second, inadequate supply response could keep price inflation of protein-rich items such as egg, meat, fish, milk and pulses high.

iv) The Central Government budgeted a fiscal deficit of 4.6 per cent of GDP for 2011-12. Subsequent developments have made the achievement of this target much more of a challenge. On the expenditure side, the subsidy burden will, in all likelihood, overshoot the budgeted amount in 2011-12 significantly, despite the recent revision in petroleum product prices. On the revenue side, while the tax cuts announced in June 2011, as part of the upward price adjustment of petroleum products, will primarily help in bringing down the magnitude of under-recoveries of oil marketing companies (OMCs), the revenue loss to the Central Government from such tax cuts (about 0.3 per cent of GDP) will impact both the fiscal and revenue deficits. The large fiscal deficit has been a key source of demand pressures. Fiscal consolidation is, therefore, critical to managing inflation. While meeting quantitative targets, the Government also needs to focus on the quality of expenditure to sustain the fiscal consolidation process, which, in turn, will help contain aggregate demand and raise potential output.

III. The Policy Stance

52. Since October 2009, when the Reserve Bank signalled the reversal of its crisis driven expansionary monetary policy stance, it has raised the cash reserve ratio (CRR) by 100 bps. It has also raised the policy rate (the repo rate) ten times by a cumulative 275 bps. As the liquidity in the system transited from surplus to deficit, the effective tightening has been of the order of 425 bps.

53. The monetary policy response in 2010-11 was calibrated on the basis of India specific growth-inflation dynamics in the broader context of global uncertainties and perceived slowdown in the second half of the year. However, considering the persistence of inflation above the comfort level of the Reserve Bank, and based on the premise that high inflation is inimical to long-term growth, the Reserve Bank has persevered with its anti-inflationary stance in 2011-12.

54. Against the backdrop of global and domestic macroeconomic conditions, outlook and risks, our policy stance for 2011-12 has been conditioned by the following major considerations.

55. First, demand pressures have remained strong. As indicated in the May 3 Policy Statement, inflation was expected to remain elevated in the first half of 2011-12. Actual inflation so far has been even higher than expected. The sharp revision in non-food manufactured products inflation during February-April 2011 confirms the assessment of strong demand pressures. Crude oil prices remain volatile and are a major risk. The recent increase in domestic administered fuel prices and the minimum support price for certain food items will keep inflation under pressure.

56. Second, there are signs that growth is beginning to moderate, particularly in respect of some interest sensitive sectors. However, there is no evidence of a sharp or broad-based slowdown as yet. Several indicators such as exports and imports, indirect tax collections, corporate sales and earnings and demand for bank credit suggest that demand is moderating, but only gradually. As such demand side inflationary pressures continue to prevail. Although the impact of past monetary policy actions is still getting transmitted, considering the overall growth and inflation scenario, there is a need to persevere with the anti-inflationary stance.

57. Against the above backdrop, the stance of the monetary policy of the Reserve Bank will be as follows:

- Maintain an interest rate environment that moderates inflation and anchors inflation expectations.
- Manage the risk of growth falling significantly below trend.
- Manage liquidity to ensure that monetary transmission remains effective, without exerting undue stress on the financial system.

IV. Monetary Measures

58. On the basis of current assessment and in line with the policy stance outlined in Section III, the Reserve Bank announces the following policy measures:

Repo Rate

59. It has been decided to:

- increase the policy repo rate under the liquidity adjustment facility (LAF) by 50 basis points from 7.5 per cent to 8.0 per cent with immediate effect.

Reverse Repo Rate

60. The reverse repo rate under the LAF, determined with a spread of 100 basis points below the repo rate, automatically adjusts to 7.0 per cent with immediate effect.

Marginal Standing Facility (MSF) Rate

61. The Marginal Standing Facility (MSF) rate, determined with a spread of 100 basis points above the repo rate, stands recalibrated at 9.0 per cent with immediate effect.

Bank Rate

62. The Bank Rate has been retained at 6.0 per cent.

Cash Reserve Ratio

63. The cash reserve ratio (CRR) of scheduled banks has been retained at 6.0 per cent of their net demand and time liabilities (NDTL).

Expected Outcomes

64. It is expected that these policy actions will:

- reinforce the cumulative impact of past actions on demand;
- maintain the credibility of the commitment of monetary policy to controlling inflation, thereby keeping medium-term inflation expectations anchored; and
- reinforce the point that in the absence of complementary policy responses on both demand and supply sides, stronger monetary policy actions are required.

Guidance

65. Going forward, the monetary policy stance will depend on the evolving inflation trajectory, which, in turn, will be determined by trends in domestic growth and global commodity prices. A change in stance will be motivated by signs of a sustainable downturn in inflation.

Mid-Quarter Review of Monetary Policy

66. The next mid-quarter review of Monetary Policy for 2011-12 will be announced through a press release on Friday, September 16, 2011.

Second Quarter Review of Monetary Policy 2011-12

67. The Second Quarter Review of Monetary Policy for 2011-12, including developmental and regulatory policies, is scheduled on Tuesday, October 25, 2011.

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