RBI: Policy rates unchanged, SLR cut releases funds for private sector

The Reserve Bank of India left interest rates unchanged citing inflationary pressures, but cut the statutory liquidity ratio by a percentage point to 23% to increase the flow of credit to industry.

RBI kept its policy repo rate at 8 per cent and left the cash reserve ratio for banks at 4.75 per cent. CRR is the share of deposits banks must keep with the RBI.

"In the current circumstances, lowering policy rates will only aggravate inflationary impulses without necessarily stimulating growth," RBI Governor Duvvuri Subbarao wrote in the monetary policy review, adding the central bank's primary focus remains inflation control.

Although there is no cut in key repo rate, the rate at which it lends to banks, or even a cash reserve ratio, the proportion of deposits that bank keep with RBI, lowering of SLR could bring down market interest rates as it would release close to Rs. 55,000 crores into the sytem.

This would release the funds for private sector where interest rates could ease at least for the top rated companies and it would also improve the profitability of banks by almost 1 percentage point.

SLR cut will "maintain liquidity to facilitate smooth flow of credit to productive sectors to support growth," RBI Subbarao wrote in the review. "In the current circumstances, lowering policy rates will only aggravate inflationary impulses without necessarily stimulating growth. As the multiple constraints to growth are addressed, the Reserve Bank will stand ready to act appropriately.

The central bank raised the year end inflation forecast to 7%, from 6.5% as deficient monsoon and high international crude prices may push prices up, RBI governor Duvvuri Subbarao said. The central bank indicated that the Wholesale price index (WPI) has been sticky above levels of 7%. "Non-manufactured inflation has not declined and serious supply side constraints remain," the bank said in a statement. Subbarao emphasised that the RBI's primary focus is to manage inflation.

The bank stated that the policy review action was is meant to anchor inflationary expectations.The slumping industrial output has led the central bank to cut the gross domestic product forecast to 6.5% from 7.3% forecast in April.

While growth has slowed significantly inflation remains elevated causing concern to the central bank. The challenge for monetary policy is to firmly contain inflation, said Subbarao.

"The Reserve Bank of India struck a hawkish stance in its monetary policy statement," said Anubhuti Sahay, an economist at Standard Chartered Bank in Mumbai. "Overall it affirms our view that any rate cut from the RBI is unlikely in rest of 2012."

"Headline inflation has persisted even as demand has moderated and the pricing power of corporates weakened," Subbarao wrote.

"Non-food manufactured products inflation has also not declined to the extent warranted by the growth moderation. This reflects severe supply constraints and entrenchment of inflation expectations," he wrote.

"The SLR cut will infuse extra liquidity which will bring down lending rates in future," Shailendra Bhandari, MD & CEO ING Vysya Bank told ET. "Margins would also improve by 1 to 2 basis point," he added.

"RBI has not lifted its feet off the inflation pedal. RBI has made it clear it would provide liquidity in the system without stoking inflation. RBI may be expanding its balance sheets through open market operations if need be. Banks will be able to use the liquidity freed up from holding securities as SLR to lend to productive sectors. Yields on ten year bonds are currently at elevated levels, more as a knee jerk reaction. In the near term the markets should settle at 8.15%," said N S Venkatesh, Head, Treasury, IDBI Bank.

(Economic Times)