



Highlights of the Second Quarter Review of Monetary Policy 2010-11

The Reserve Bank of India in its Mid Term Review hiked the Repo & Reverse Repo rate by 25 bps each to 6.25% & 5.25% respectively but indicating a low probability of further rate hikes in the near future.

The Central bank continues to be concerned on the inflation front even though admitting the recent moderation in the WPI. They have also noted the upside risk to domestic inflation from global commodity prices arising from the expected quantitative easing measures from global central banks.

On the liquidity front, the RBI has noted that a deficit in the money market liquidity was in line with its anti inflationary stance, excessive deficit could be disruptive for overall credit growth & the financial markets as a whole. Thus they have been monitoring the situation closely & have recently announced liquidity easing measures. The RBI has also announced buy back of Government Bonds for an amount of Rs.12000 crs in line with this thought. This buy back is from the RBI, unlike the one announced last week by the government. The RBI has also indicated that they would not like liquidity deficit in excess of 1% of Net Demand and Time Liability. (NDTL).

Going ahead we expect the RBI to wait for a couple of months and monitor the effects of recent rate hikes on inflation before taking any further monetary action. We expect inflation to moderate towards closer to RBI's estimate of 5.50% by the end of this fiscal, coupled with the fact that most of the government borrowing would be done by December 2010, laying the ground for a cautiously bullish sentiment for government bonds. The RBI would closely monitor the liquidity situation & make sure the deficit does not go beyond a certain limit affecting growth, but the deficit could cause short term rates to be at elevated levels.

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