

RBI, in its mid-quarter policy review, increased the repo rate by 25bps to 7.50%; Reverse repo rate and Marginal standing facility (MSF) rate now stands at 6.50% and 8.50%, respectively. CRR and SLR are maintained at 6% and 24% respectively.

Highlights:

- Global economic environment has worsened in both advanced and emerging market economies (EMEs), impacted by higher commodity prices, Japanese natural disaster, and European sovereign crisis. Headline inflation has risen in the advanced economies despite negative output-gap; many EMEs persisted with monetary tightening to contain inflation.
- Domestic economy: GDP has decelerated, consumption is robust, and investment is moderating. Economic indicators like new IIP series, exports, imports, credit, corporate earnings growth and profit margins remained satisfactory, reflecting steady demand and intact pricing power.
- Inflation persists at an uncomfortable level, much above the medium-term trend rate of 4%, but consistent with the projections made by the RBI in the annual policy statement. Pattern in the non-food manufactured products inflation is a matter of particular concern. Besides reflecting high commodity prices, it also suggests more generalized inflationary pressures; rising wages and costs of service inputs are apparently being passed on by producers along the entire supply chain.
- Monetary transmission has been quite strong. The higher cost of credit is restraining credit growth, but it still remains fairly high, suggesting that economic activity is holding course.
- Liquidity conditions have remained with the anti-inflationary stance of the RBI

The policy statement is fairly hawkish, inflation remaining the key concern while expecting the growth to moderate. Year-ending inflation is projected at 6% by RBI but this target has upside risks. Diesel price hike is yet to come through as the meeting date is yet to be decided. Primary article inflation reported today has jumped up by 2% led by higher prices of food articles. Inflation is estimated to remain above 9% till November'11 and then drop due to high base effect. The growth target is set at 8% by the central bank.

L&T Finance Holdings Limited (indirect Holding Company of L&T Investment Management Limited) is proposing, subject to market conditions and other considerations, to make a public issue of securities and has filed a Draft Red Herring Prospectus (DRHP) with the Securities and Exchange Board of India (SEBI). The DRHP is available on the website of SEBI at www.sebi.gov.in and the respective websites of the Book Running Lead Managers at www.jmfinancial.in, investment-banking, <http://www.barclayswealth.com/india-offerdocuments.htm>, <http://www.creditsuisse.com/in/ipo/> and www.equirus.com. Investors should note that investment in equity shares involves a high degree of risk and for details relating to the same, see 'Risk Factors' in the aforementioned DRHP.

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Key Takeaway

Contain inflation and anchor inflationary expectations by reining in demand side pressures; and mitigate the risk to growth from potentially adverse global developments. The statement only reiterates RBI's firm stance on controlling domestic inflationary pressures. Moreover, the RBI also has retold that in order to control inflation and bring it down to acceptable levels in the medium term, short run deceleration in growth would be "unavoidable".

Outlook

The upside bias on interest rate outlook might continue and 50 basis points of tightening in interest rates would happen over the remainder of the fiscal year. Higher interest and inflation rate are likely to have a severe impact on consumption and investments in FY12. The short term rates are expected to tighten marginally however liquidity conditions being comfortable might not move rates significantly higher. The bond yields are expected to move in a band of 8.20% to 8.50% for the 10 year benchmark government security.

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