December 2012

CRISIL MonetaryPolicyReview

RBI postpones rate cut to 2013

Overview: The Reserve Bank of India (RBI), in its monetary policy review on December 18, 2012, kept the repo rate unchanged at 8 per cent while reiterating its guidance of policy easing in the next quarter. The cash reserve ratio was also held constant at 4.25 per cent. Although WPI inflation for November fell to a 10-month low of 7.24 per cent, upward revision in inflation figures for earlier months suggests an upward bias to the November data. What is comforting, however, is that core inflation indicators have declined sharply in recent months, reflecting slowing demand-side pressures in the economy. Non-food manufacturing inflation fell to 4.5 per cent in November from 5.8 per cent in August. CRISIL Core Inflation Indicator (CCII*) fell to 5.7 per cent in November from a peak of 6.5 per cent in September. While primary and fuel inflation of earlier months were revised significantly upwards, revisions in core inflation have been relatively minor, confirming weak demand conditions in the economy.

In 2013-14, WPI inflation is likely to moderate further due to the lagged impact of slowing GDP growth (demand) this year on core inflation (prices) for next year. The lag between GDP growth and core inflation in India has historically been around one year. With GDP growth expected to slow sharply to around 5.5 per cent in 2012-13, from 6.5 per cent last year, average core inflation next year is expected to be much lower than in the current fiscal. While continued revisions in administered fuel prices will keep WPI inflation in 2013-14 above the RBI's comfort level of 4-5 per cent, RBI is likely to lower rates in January in anticipation of lower core inflation going forward.

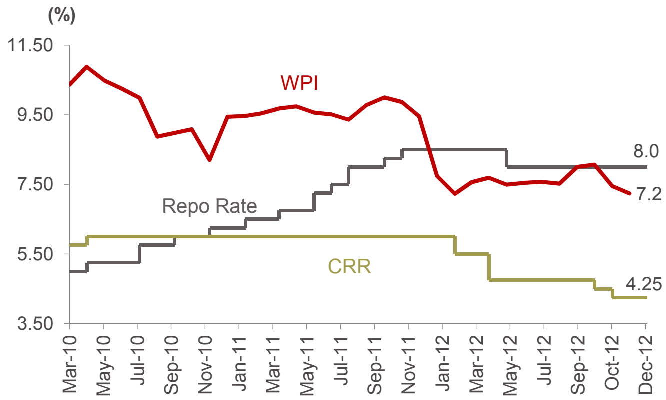
Core inflation follows growth with a 1- year lag

- With GDP growth at sub-5.5 per cent levels in H1 2012-13, core inflation is expected to remain low next year, creating space for monetary policy easing in early 2013.
- As GDP growth slowed to 6.7 per cent in 2008-09, core inflation fell sharply in the following year. Similarly, with growth slowing from 8.4 per cent to 6.5 per cent in 2011-12, average core inflation (CCII*) so far this fiscal has been lower at 5.4 per cent vis-à-vis 6.9 per cent last year.

Note: FY12*: CCII-next year is average CCII from Apr-Nov'13; Source: Ministry of Industry, CRISIL Research

Momentum in reforms paves way for rate cut

- The RBI has, since April 2012, refrained from reducing rates, citing high risks to inflation from rising fiscal deficit and reiterating that rate cuts alone cannot boost growth, unless the government implements economic reforms to improve the investment climate.
- Inflation now appears to be on a downward trajectory. Recent reforms momentum by the government, including the Cabinet approval of the land acquisition bill and a national investment board for fast tracking large infrastructure projects, have paved the way for monetary policy easing in the next quarter.

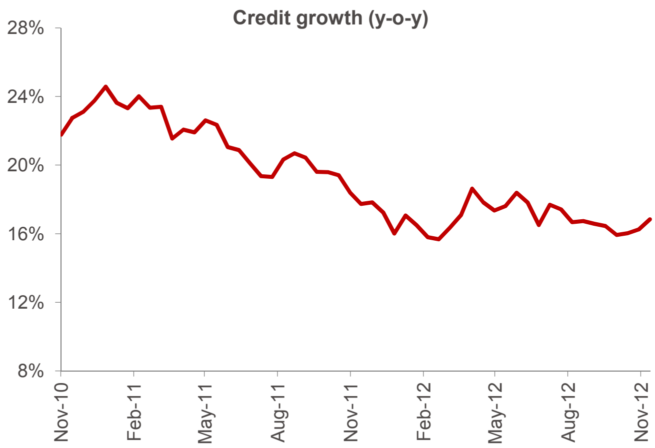


Source: RBI, CRISIL Research

CCII* adds processed food to and takes out base metals from RBI's core inflation measure –non-food manufacturing inflation

Credit offtake to grow by 15-16 per cent in 2012-13

- Aggregate bank credit growth moderated to 16.8 per cent y-o-y as on November 16, 2012 from 19.4 per cent on March 30, 2012 on account of deceleration in growth across industry segments, such as textiles, metals, infrastructure and commercial real estate.
- Aggregate bank credit is expected to grow by 15-16 per cent in 2012-13 on account of higher demand for retail loans as number of banks have cut interest rates on these loan products, slight pick-up in investment activity in the second half of the year and refinancing of foreign currency loans with domestic debt.



Source: RBI, CRISIL Research

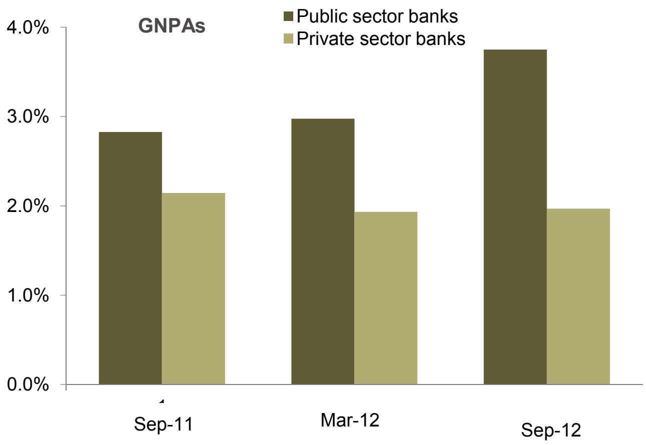
Deposits to grow by 14-15 per cent in 2012-13

- Growth in bank deposits slowed down to 13.5 per cent y-o-y as on November 16, 2012, as demand for funds moderated and inflation eroded into household savings. Reduction in rates on term deposits during H1 2012-13 has also affected mop-up of deposits.
- In 2012-13, bank deposits are expected to grow by a moderate 14-15 per cent, owing to a decline in deposit rates, high inflation, moderation in credit growth and lower emphasis on mobilisation of high cost deposits by public sector banks.

Source: RBI, CRISIL Research

Gross non-performing assets for public sector banks show a significant increase

- Aggregate gross NPAs of all public sector banks (PSBs) rose to 3.7 per cent, as of September 2012 (a 90 bps increase y-o-y). On the other hand, GNPAs of private sector banks declined by 18 bps y-o-y to 2.0 per cent due to better credit underwriting, upgradation of accounts and improved recoveries.
- Total restructured assets for few large PSBs (contributing around 50 per cent of total outstanding credit of SCBs) stood at 6.3 per cent of advances, as of September 2012.



Source: CRISIL Research

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