Brief comment on RBI 3rd Quarter Review (January 29, 2013)

The III quarter review brought out by RBI has introduced minor changes to the reference rates as indicated in the table below. The changes appear to have been made more out of compulsion arising out of the posturing made it after the clamour for rate reduction had increased post II Quarter Review, rather than any major macro-economic reforms.

Parameter	**Position after 3rd Quarter Review**	**Changes, if any**	**Remarks**
Cash Reserve Ratio (CRR)	4%	(-) 0.25%	An infusion of about Rs. 18,000 crore additional free funds in the hands of banks. Similar infusion of Rs. 17,500 crore was made during the 2nd Quarter review and the mid-term review prior to that. Thus, in all about Rs. 53,000 cr additional free funds have been made in the current year.
Statutory Liquidity ratio (SLR)	23%	Nil	
Repo Rate	7.75%	(-) 0.25%	
Reverse Repo Rate	6.75%	(-) 0.25%	
Marginal Standing facility	8.75%	(-) 0.25%	
Baseline projections for- GDP growth rate Headline inflation (WPI)	 5.5% 7.5%		 Reduced from 7.3% (Apr 12), 6.5% (Jul 12) and 5.8% (Oct 12) Increased from projected annual rate of 6.5% (in Apr 12) & 7% (in Jul 12)
Growth rate in Money Supply (M3) Non-food credit (credit for other than agriculture)	 12.9% 16.2%		 Down from 14% Marginally up from 16%

RBI has justified its monetary policy measures based on –

a) Global economic prospects having improved modestly and inflation receding modestly in most emerging economies (though concerns still remain).

b) Domestic growth remaining sluggish with industrial activity having weakened. The GDP growth rate has been at 5.5% in Q1 and 5.3% in Q2. Also, contracting exports for the 8th month in succession. Projected growth rate in GDP for current financial year has been revised downward to 5.5%.

c) Consumption demand slowing (in comparison with supply side constraints cited in the earlier reviews. RBI's position till the last quarter has been that unless supply side corrective measures are undertaken, the effect of monetary policy stance would have a limited impact on the inflation).

d) Headline inflation (WPI) having softened (even though food inflation and CPI remaining high; pressure on inflation likely to continue especially with increasing diesel prices in the short to medium term and in the absence of significant corrections on the supply side).
e) Risk aversion in the banking system constraining credit flow.
f) Reform measures being undertaken like FDI in retail, aviation and insurance sector, deferment of GAAR, reduction in subsidy on fuel and efforts undertaken by GOI in fiscal correction.

The serious concerns that still remain are –

a) Widening CAD to historically high levels. Fiscal deficit remaining at even higher levels. The attraction of financing CAD with inflows that are inherently volatile in nature making the economy far more vulnerable.
b) Global risks remaining elevated.
c) Crowding out of private investment in view of high CAD

The monetary measures announced by RBI, thus appears to more towards posturing it made in the past and not necessarily out of prudence. It is hoped that the RBI measures would be supported by GOI towards fiscal consolidation in the forthcoming budget. However, given that this being the penultimate year in the current 5-year term the political pressures and having a greater leaning on the social causes (RTE, MNREGA etc.) cannot be ruled out. This quarter too, the ball is very much in the Governments' court, which has to take measures to induce investments on the infrastructure front, which in turn could trigger a higher sustainable growth without additionally fueling inflation. The silver lining of the III QR is the possibility of revival of industries that highly rate sensitive (like realty and home loans, auto sector) and / or the overall improvement in the economic sentiment.

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