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**Inflation concerns steer policy rates...****HIGHLIGHTS**

- LAF Repo and Reverse Repo rates hiked by 25 bps
- CRR increased by 25 bps
- Status quo on bank rate and SLR
- Real GDP projection for FY11 at 8% (upward bias)
- Inflation projection March 2011 at 5.5%
- Year end projections for deposits and non-food credit growth at 18% and 20%
- Money supply (M3) growth in FY11 at 17%
- Proposal to classify bonds issued by infrastructure companies under HTM category

**Administered fuel price hike downplays effect of decline in food inflation**

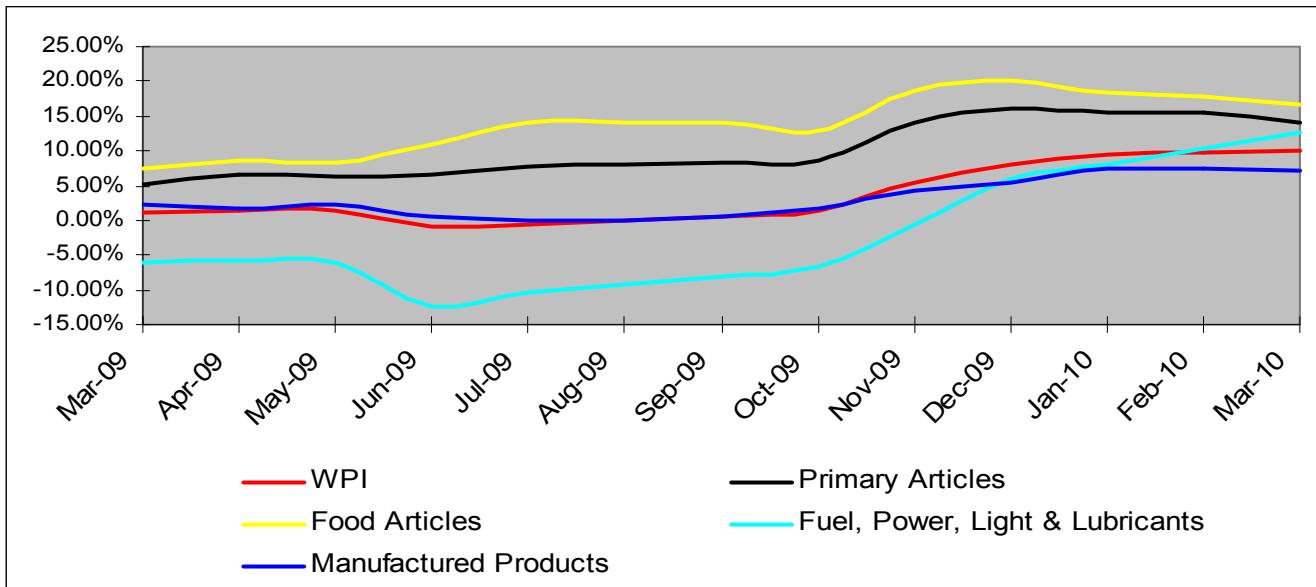
For the third straight month inflation continued to hover close to the 10% mark. On a sequential basis inflation was marginally higher by 2 bps. Key subcomponents that contributed to inflationary pressure rise was the fuel component. While administered fuel – petrol and diesel – were up by about 15% aviation turbine fuel (of lesser significance) was up by a staggering 52%. The primary articles index was well into the mid teens, however, fresh pressure was not evident on this front. Despite the hike in indirect taxes, the manufactured products component played a subdued role. Lower food inflation appears to have contributed to lesser pressure in the manufactured products component.

**Nymex crude price movement**

## Upside risks to inflation – crude oil prices and demand side pressures

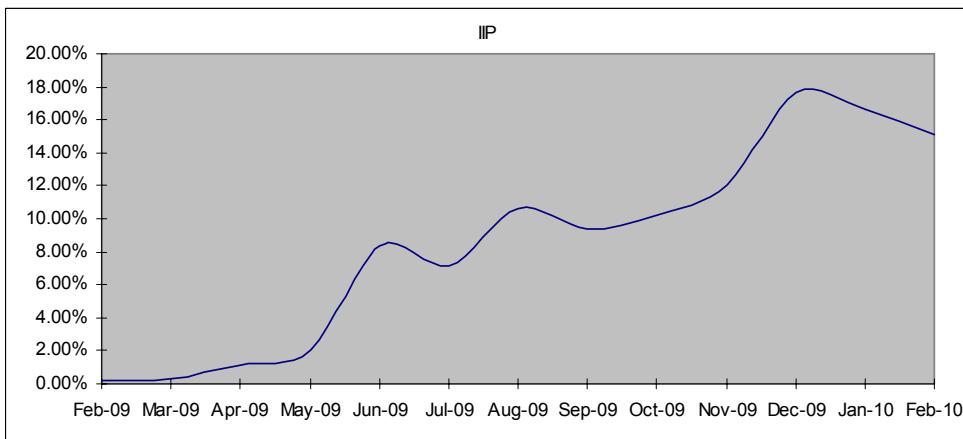
We continue to maintain our stance that food inflation is likely to maintain a downward trend. This, however, is on the premise of a fairly good monsoon. Upside risks to inflation arise from trends in commodity prices and the trickle effects of the recent hikes in administered fuel. A sharp spurt in crude oil prices is likely to result in higher administered fuel prices. This stems from the fact that oil marketing companies would be put on a weak wicket. Going forward, demand side pressures are likely to play a greater role. With strong IIP numbers (double digits for the fifth straight month), greater levels of private consumption could contribute to a more secular trend in the WPI components.

### Trends in Inflation



### Deposit rate likely to inch up

Over the coming month liquidity in the system is likely to remain comfortable despite the hike in CRR that is expected to drain out about Rs 12,500 crore. Auctioning of spectrum by Department of Telecom would be a key event to watch out for as greater than expected auction results could lead to tightening of liquidity. Telecom operators are likely to tap banks contributing to credit growth. Deposit rates are likely to inch up further as banks seek to bolster their funding sources. Over the near term lending rates are likely to be maintained as the system awaits higher credit off-take. As GDP growth and money supply growth kicks in, policy rate adjustments are likely to be the way ahead in monetary policy management.



## Extracts

*Core measures of inflation in major advanced economies are still moderating as the output gap persists and unemployment remains high. Inflation expectations also remain well-anchored. In contrast, core measures of inflation in EMEs, especially in Asia, have been rising.*

*A sharp recovery of growth during 2009-10 despite the worst south-west monsoon since 1972 attests to the resilience of the Indian economy.*

*...the Reserve Bank's industrial outlook survey shows that corporates are increasingly regaining their pricing power in many sectors.*

## Policy Rate Movements

| Week ending | CRR  | Reverse Repo | Repo |
|-------------|------|--------------|------|
| 23-Apr-10   | 6.00 | 3.75         | 5.25 |
| 27-Mar-10   | 5.75 | 3.50         | 5.00 |
| 5-Mar-10    | 5.75 | 3.25         | 4.75 |
| 19-Feb-10   | 5.50 | 3.25         | 4.75 |
| 24-Apr-09   | 5.00 | 3.25         | 4.75 |
| 6-Mar-09    | 5.00 | 3.50         | 5.00 |
| 23-Jan-09   | 5.00 | 4.00         | 5.50 |
| 2-Jan-09    | 5.50 | 4.00         | 5.50 |
| 12-Dec-08   | 5.50 | 5.00         | 6.50 |

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