

Fund House Viewpoint



RBI Cuts Reverse Repo and Repo Rate by 50 bps, leaves CRR unchanged

In an inter-meeting move, the Reserve Bank of India (RBI) cut the repo and reverse repo rates by 50bps each to 5% and 3.50%, respectively. This was in line with the market expectations. Since the liquidity is ample in the system, RBI left the cash reserve ratio (CRR) unchanged at 5%. RBI has cumulatively now cut the repo rate by 400bps from its peak and the reverse repo rate by 250bps. This move of RBI was prompted by weaker than expected global economic condition. RBI in its statement said, “the impact of the global downturn on India has turned out to be deeper and wider than anticipated earlier.”

With rate cuts announced and ample liquidity in the system, we expect the short-end of the curve to ease sharply. The long bonds are expected to gain, but the upside could be limited as some of the market players would look to exit long positions. This will result in yield curve steepening further.

This rate cut is a clear signal from the RBI to commercial banks to cut both deposit and lending rates further. While most public sector banks and some private and foreign

banks have reduced their lending rates, in general lending rates have been slow to adjust and have not come down as much as policy rates, largely due to still-high deposit rates. With easing interest rate cycle, the cost of borrowing of banks is likely to drop and would result in banks lowering their lending rates. However, lower lending rates may not push the credit growth as banks are expected to tighten their lending norms. Credit growth is expected to drop sharply below 15%, indicating credit risk aversion of banks.

This may be the end of rate cut cycle for this fiscal. We expect that RBI would continue to monitor macro-variables, both global and domestic and would take prompt measures to counter slowdown. With fiscal policy effectively remaining inactive until after the election in May (due to the code of conduct), it suggests that monetary policy is now the first line of defence against a growth slowdown. RBI now has a tough job of ensuring smooth financing of the government’s large market borrowings. Thus we feel RBI could cut rates further next fiscal by another 50 bps.

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