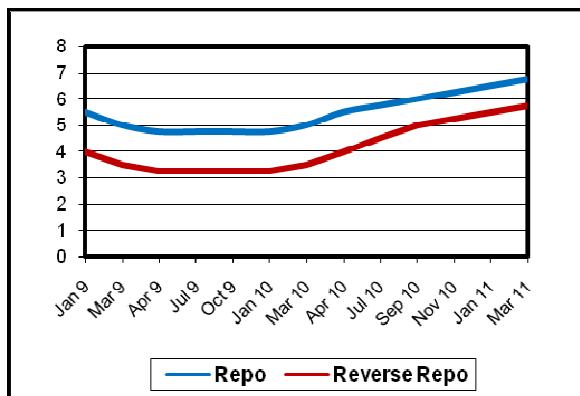


SMERA'S VIEW ON MID-QUARTER MONETARY POLICY REVIEW MARCH 2011

The Reserve Bank of India (RBI) has increased the repo and reverse repo rates by 25 bps to 6.75 per cent and 5.75 per cent, respectively. CRR is left unchanged at 6%. The Reserve Bank of India has hiked key policy rates eight times since March 2010, reaching the current level of 6.75 percent from 5 percent level then. The *transmission mechanism* of repo rate shall impact policy decisions in banks for the next fiscal.



Source: RBI

Graph A

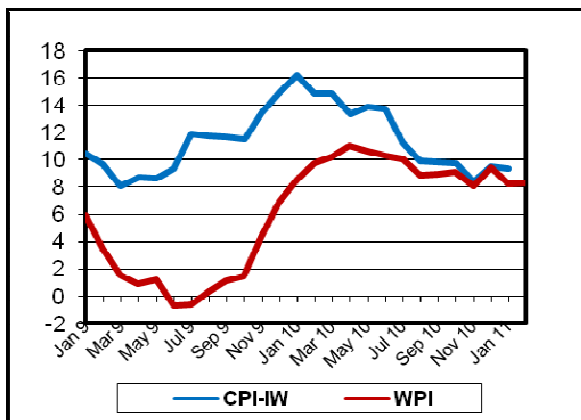
The hardening of interest rates will make finance more expensive for banks/financial institutions. However, the impact on both the rates may be different. Credit expansion in

the recent past has been rather sharp, far outpacing the expansion in deposits. Considering the fact that the growth in bank deposits was about 16 percent against credit growth of about 24 percent, banks have already started increasing term deposit rates.

Although growth in emerging economies remains stable, uncertainty around the world is un-nerving the business world. The effect of such uncertainty is even severe on the SME sector. Access to finance is a major obstacle for existence as well as growth of SMEs and with increasing inflation, the input costs are only escalating for the SMEs. Though as per SMERA research, SMEs have exhibited a greater degree of resilience during and post financial crisis but increasing inflation and hardening of interest rates would affect the performance of SMEs disproportionately

RBI's press release for mid-quarter monetary policy review, March 2011, concludes with a guidance note that the Central Bank is likely to persist with the current anti-inflationary policies. As per the Central Bank, the

underlying inflationary pressures have accentuated and with rising global commodity prices & oil prices threatening to breach USD 100 per barrel, the Central Bank is left with few alternatives to rein the inflation.

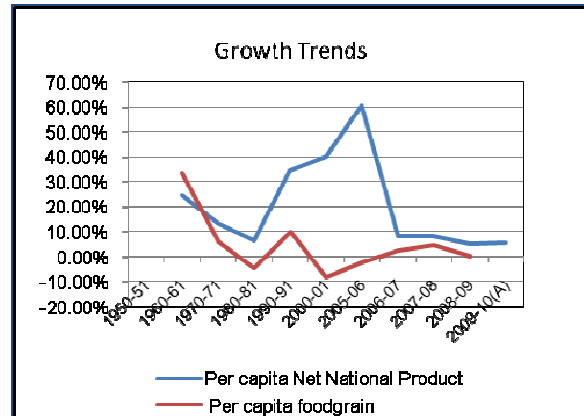


Source: mospi

Graph B

After a minor correction in January, WPI inflation increased in February 2011 with a sharp increase in non-food manufactured products inflation. While it is difficult to control spill over of food inflation into more generalized inflation, the central bank expects that measures to increase agricultural productivity, particularly in items facing structural supply-demand imbalances, will contribute to easing food inflation over time. As per SMERA research, prolonged neglect of agriculture has resulted in steady decline in

per capita production vis-à-vis per capita income thus affecting food inflation as exhibited in the Graph C below:



Source: Economic Survey 2009-10

Graph C

The union budget, 2011, reflects the vision of the government for agriculture & with projection of ease in credit availability in the future, the government has also put a lot of emphasis on improving the infrastructure by creation of food parks, cold chains, agriculture marketing and vegetable clusters. There is a need for a favorable business environment that will speed up the private corporate sector participation in infrastructure facilities to curb high inflation.