

## RBI key rate hike more than expected

by [Keerti](#) on July 28th 2010 and filled under [Other](#)



It was no surprise that the Reserve Bank of India (RBI) raised interest rates more aggressively owing to the fact that runaway inflation was above 10 percent for the past five months. The RBI lifted the repo rate, at which it lends to banks, by 25 basis points to 5.75 percent. This was more or less in line with my expectations. However I had expected a 25 basis point increase in the reverse repo rate, at which it absorbs excess cash from the system, but the apex bank has raised the same by 50 basis points to 4.50 percent. I feel inflationary pressures and an improving growth condition have made it easy for the RBI to decide on this hike as it was targeting an inflation rate between 5.5 to 6 percent. The Central Bank also noted that the economy will grow by 8.5 percent, up from earlier projection of 8 percent this fiscal, which I think is pretty achievable. Amid ongoing tight liquidity in the banking system the RBI has left the cash reserve ratio (CRR) for banks at 6.00 percent, which could be a matter of concern for the industry in general and small and medium enterprises (SMEs) in particular (who are always credit starved) because the move would put pressure on banks' interest rates. With the increase in short-term lending rate and short-term borrowing rate coming into effect immediately, I feel monetary tightening of the RBI may continue with the repo rate going up to 6.5 percent by March 2011. My apprehension comes from the fact that although the RBI is trying to balance between rising inflation and the need to sustain growth, if inflation remains high, we can expect another 25 basis points increase in September when it comes out with its monetary review.