

3Q Review of Statement on Monetary Policy for FY10

Policy Rates unchanged; CRR hiked by 75 bps. Inflation a big worry, Calibrated exit to continue, Shift of stance from 'managing the crisis' to 'managing the recovery' hinted.

Policy Rates Unchanged but CRR hiked:

- Reserve Bank of India (RBI) today kept the key policy rates unchanged.
 - Repo Rate: 4.75%, Reverse Repo Rate: 3.25%
- Cash Reserve Ratio (CRR) hiked by 75 bps to 5.75% in two stages; 50 bps from Feb 13 followed by 25 bps from Feb 27, 2010.

Reasons for this action:

- A sustainable growth recovery outlook justifies the continuation of exit from expansionary monetary policy. Policy instruments still in consistent with crisis situation. But a shift of stance from 'managing the crisis' to 'managing the recovery' is required.
- Though inflation is supply driven, a broadbased recovery increases the risk of these pressures spilling into wider inflationary process.
- But recovery yet to be on firm footing and strong anti-inflationary measures may adversely impact recovery process.

Expected Outcomes

- The CRR hike will remove Rs. 36,000 cr of excess liquidity from the system that will help anchor inflationary expectations.
- The growth recovery will be supported without compromising inflation.
- The calibrated exit will align policy instruments with the current and evolving state of the economy.

Inflation, Growth Target Revised Up While Credit Growth Lowered:

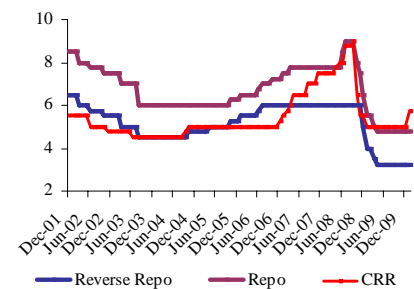
- The inflation expectation for March end 2010 is revised up to 8.5%, GDP growth to 7.5% in FY10. Credit growth revised down to 16% from 18%.

Bottomline:

- In its well articulated monetary policy document, RBI's is clearly worried about inflation. Growth outlook has improved but still needs nurturing.
- RBI feels that as recovery gains momentum, it is important that there is a co-ordination in the fiscal and monetary exits. It mentions the risks of large fiscal deficit and the how important it is for the Govt to return to the path of fiscal consolidation.
- Upcoming budget, fiscal deficit and borrowing numbers would be closely watched.
- **Exit from expansionary monetary policy to continue. We will see RBI hiking policy rate in a calibrated manner based on IIP, 3Q GDP and inflation numbers.**

Economy Update

Trend in Key Policy Rates



Monetary Policy Stance (Focus shifts more to inflation)

- Anchor inflation expectations and keep a vigil on the trends in inflation and be prepared to respond swiftly and effectively through policy adjustments as warranted.
- Actively manage liquidity to ensure that credit demands of productive sectors are adequately met consistent with price stability.
- Maintain an interest rate environment consistent with price stability and financial stability, and in support of the growth process.

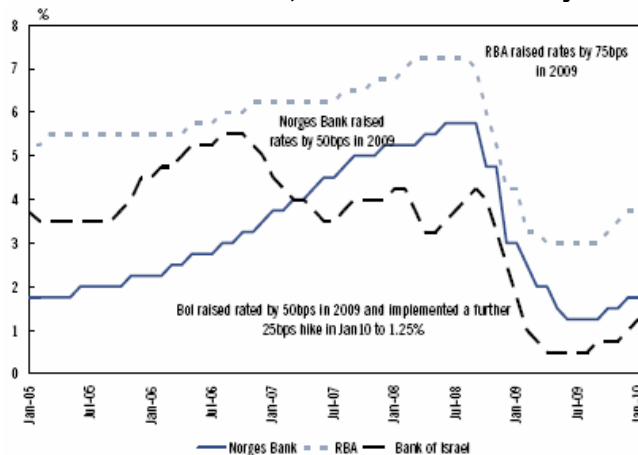
Higher GDP and Inflation Forecast but Monetary Targets Revised Downwards

Macro Indicators	Earlier Projection for FY10	Projection for FY10	Present Rate
GDP	6.0% with upward bias	7.5	7.9% (2Q FY10)
Inflation (end Mar)	6.5% with upward bias	8.5	7.38% in Dec
Money Supply (M3)	17.0%	16.5%	16.5%
Aggregate Deposit	18.0%	17.0%	16.8%
Non-Food Credit Growth	18.0%	16.0%	14.4%

Global Monetary Policy Cycle Turning

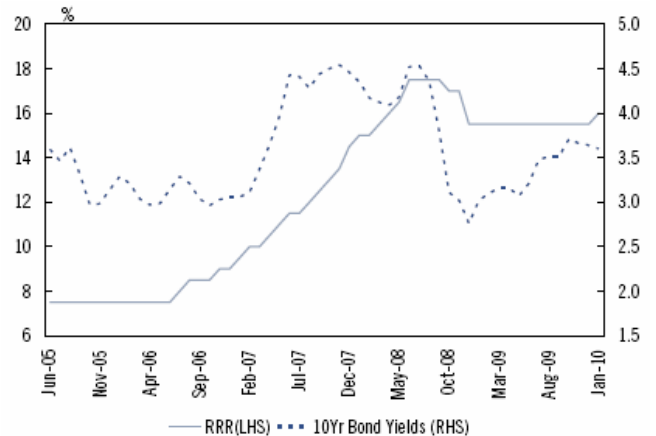
With a recovery underway, several central banks have already begun the process of monetary exit

Central banks of Israel, Australia and Norway



The Bank of Israel was the first central bank to hike rates in 2009. Norges Bank normalised rates from 1.5% to 1.75% in 2009. In Australia, the RBA raised key cash rate from 3.0% to 3.75% in 2009.

Central banks of China



Earlier this month, the PBOC raised its reserve requirement ratio (RRR) by 50bps to 16%. This followed the PBOC's move of raising the auction yields of central bank bills.

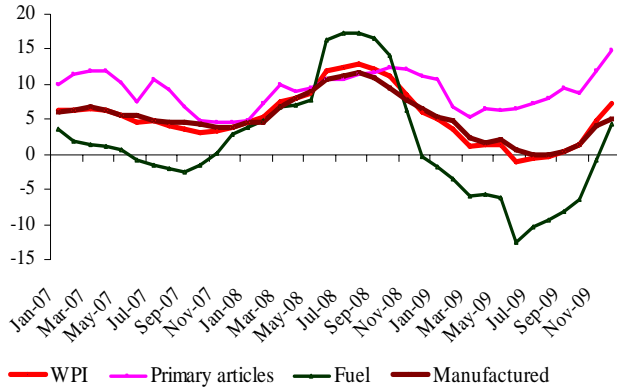
Mixed Market Reaction

- Bond market had already priced in change in policy rate and did not react much to the policy report. The shorter end seems to have moved up a tad in line with the squeeze in liquidity.
- Equity market immediately reacted negatively to higher than expected CRR hike but seem to have recovered since then.

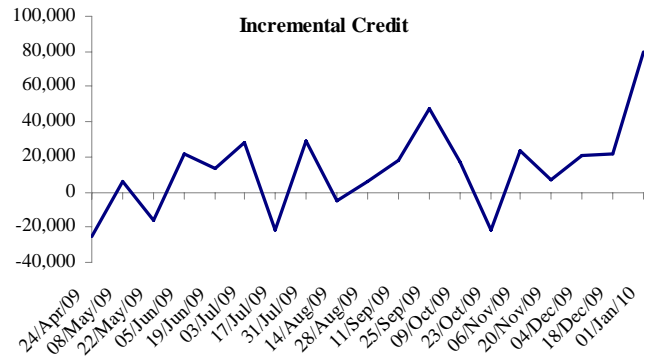
Macro Backdrop

Inflation on uptrend. Incremental credit showing signs of recovery

WPI Inflation crossed 7% in Dec and is expected to touch 8% in Jan. It will peak in Feb/Mar.



Incremental credit has improved. Credit growth is now at 13.7% yoy vs. the 12 year low of 9.7% in Oct'09.



Though food prices are the key drivers of inflation, there is slow build up of demand-side core inflationary pressures. Rising commodity prices and return of pricing power in a few sectors (autos, cement, steel, processed food and rubber products) points to further pick-up in core inflation. Liquidity in the system continues to remain high with banks depositing huge amount with RBI under LAF

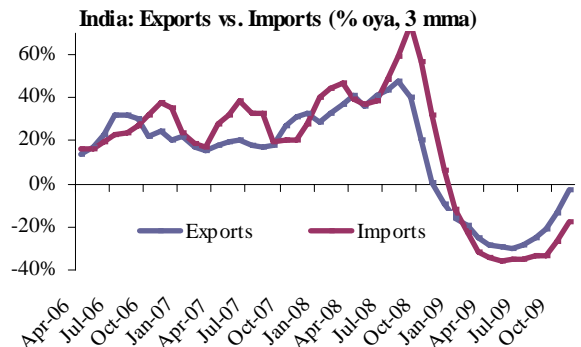
Availability of low cost alternate sources of funds (ECBs, CPs) has substituted for bank credit and is partially responsible for weak credit off-take. Credit growth is a lagging indicator of economic activity, as companies first borrow only for working capital and then borrow for capital investment only when they operate at full capacity as demand picks up and outlook improves.

Industrial production rebounded but exports also moved to positive territory



Nov IIP growth was partially helped by low base and policy stimulus. But obviously the positive momentum has gained traction. Currently the growth is driven by construction, infrastructure and auto sectors. Growth is becoming more broad-based spreading from consumption-driven growth to a consumption and investment driven recovery.

Indian exports increased by 18.2%yoy in Nov.



Exports moved to positive territory reversing the downtrend seen in the past 13 months in a row. It is encouraging that non-oil imports increased in Nov over previous month indicating improved domestic activities.

Source: RBI, CMIE, Citigroup

Timeline of Measures Taken by RBI since 16-Sept-08

Date	Measures
16 th Sep'08	<ul style="list-style-type: none"> • Raised interest rate ceilings on NRI deposits. • Provided additional liquidity by: <ul style="list-style-type: none"> (a) permitting banks to avail additional liquidity support under the LAF up to 1% of their net demand and time liabilities (a de-facto SLR cut) and (b) Extended the Secondary LAF (SLAF) to a daily basis.
6 th Oct'08	<ul style="list-style-type: none"> • Reduced the Cash Reserve Ratio by 50bs to 8.5% - first cut since June 2003.
10 th Oct-08	<ul style="list-style-type: none"> • Reduces CRR by 100bps to 7.5%
14 th Oct-08	<ul style="list-style-type: none"> • Announces 14-day Term Repo Facility to meet liquidity requirements of Mutual Funds.
15 th Oct-08	<ul style="list-style-type: none"> • RBI cuts CRR by 100bps to 6.5%. • Allowed banks to borrow up to 0.5% of their NDTL to meet liquidity requirements of Mutual Funds. • Special Mkt Operations for Oil bonds instituted once again • Interest rates on NRI Deposits increased. • Rs250bn under the Agricultural Debt Waiver Scheme made available to banks immediately.
20 th Oct'08	<ul style="list-style-type: none"> • RBI cuts Repo Rate by 100bps to 8%.
24 th Oct'08	<ul style="list-style-type: none"> • During its policy meet on 24th Oct, RBI maintained status que and kept rates unchanged at: <ul style="list-style-type: none"> - Repo Rate: 8% - Reverse Repo Rate: 6% - CRR: 6.5%
1 st Nov'08	<ul style="list-style-type: none"> • Repo rate cut by 50bp to 7.5%. • CRR cut by 100bp to 5.5%. • SLR cut of 100bps to 24%. • A special refinance facility under which banks will be provided refinance up to 1% of bank's NDTL on 24 October 2008 at repo rate up to a max period of 90 days. • Banks can borrow upto an aggregate 1.5% of NDTL for financing NBFCs and mutual funds. With this move, effective SLR stands at 22.5%. • Buy back of MSS securities to fund fiscal slippage.
7 th Nov'08	<ul style="list-style-type: none"> • Reserve Bank of India to provide forex liquidity to Indian public and private sector banks having foreign branches or subsidiaries, through forex swaps of tenors upto three months.
6 th Dec'08	<ul style="list-style-type: none"> • RBI reduced policy rates: <ul style="list-style-type: none"> - The repo rate under the LAF is reduced by 100 bps from 7.5% to 6.5% bringing the total reduction to 250bps since October. - The reverse repo rate was reduced by 100 basis points from 6.0% to 5.0%. It is the first such cut in the current cycle. • Measures for troubled sectors such as Real Estate, SME Segment, Exporters, and FCCBs.
2 nd Jan'09	<ul style="list-style-type: none"> • RBI cuts the Repo Rate and Reverse Repo rate by 100bps each to 5.5% and 4% respectively; and the CRR by 50bps to 5%.
27 th Jan'09	<ul style="list-style-type: none"> • No changes to rates in 3Q Policy Review, but timelines for refinance facilities extended to Sept'09.
4 th Mar'09	<ul style="list-style-type: none"> • RBI Reduces Repo, Reverse Repo Rates by 50bps each to 5% and 3.5% respectively.
21 st Apr'09	<ul style="list-style-type: none"> • RBI cut repo rate and reverse repo rate by 25 basis points to 4.75% and 3.25%. RBI left the cash reserve ratio (CRR) unchanged.
28 th July'09	<ul style="list-style-type: none"> • Left key rates unchanged
27 th Oct'09	<ul style="list-style-type: none"> • Key policy rates unchanged. SLR hiked back to 25%. • Unconventional measures withdrawn. Provisioning for banks increased.
29 th Jan'10	<ul style="list-style-type: none"> • CRR hiked by 75 bps in two stages from Feb 13, Policy rates kept unchanged.

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