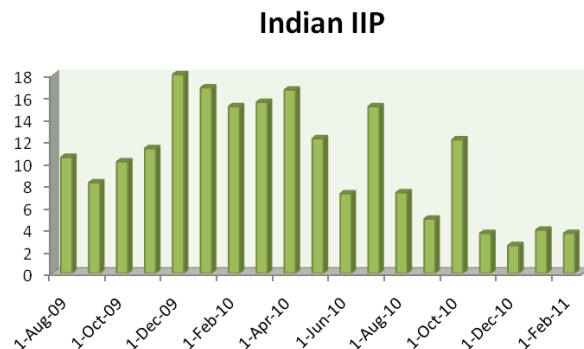


May 2, 2011

Event Update: RBI Annual Monetary policy

The Annual Monetary policy by the RBI is scheduled for 3rd May. This policy seems to be no different from the past eight meetings which have seen a 25bps rate hike. This time however, the quantum of rate hike is still to be determined and would be a major factor to be watched.

The RBI has been seen walking a tight rope between managing high inflation and a lower industrial production. On the Inflation front; despite raising rates eight times in a year's time the RBI hasn't managed to bring it down. With a near double digit inflation figure of 8.98% in March the need for 50 bps hike is more imminent rather than a 25bps one. But keeping the slowing growth in mind we might see the RBI restrict itself to a 25 bps hike.



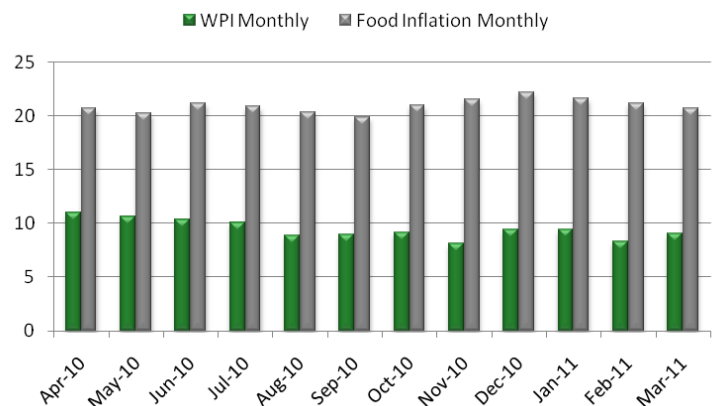
The RBI has left us with two scenarios for 3rd May; below is given our overview on these scenario's

CASE - I: 25 BPS HIKE

Keeping in view the considerable rise in headline inflation and the lower industrial growth over the past few months; the RBI might again settle for its calibrated approach of raising rates and go for a 25 bps hike. The IIP has been considerably falling in contrary to the inflation which has been rising. The IIP for FEB 2011 came at a disappointing 3.6%. The Capital goods suffered the most as it fell into negative territory.

CASE - II: 50 BPS HIKE

The headline Inflation which is soaring at 8.98% has raised further fears in the mind of the RBI as these figures are much higher than the projection of 7-8%. These figures might force the RBI to think more aggressively and resort to raising rates by 50bps. The rise in the inflation can be attributed to the demand side rather than the supply side. The fall in food prices was helpful but the rising oil prices kept the inflation at elevated levels.



May 2, 2011

OUTLOOK:

A 25bps hike has been factored in; as short term borrowing prices have shown in the past few weeks. This hike is unlikely to impact the investor sentiments. But on the other hand on basis of ever so rising inflation; the central banks decides to be aggressive and raise rates by 50 bps it could send the bond yields higher and the currency to appreciate as an immediate effect. This hike will also result in higher interest rate scheme, which could force the bankers to raise both the deposit and lending rates; leading the corporate to borrow at higher rates. This could in turn hurt the industrial production numbers further.

Technical Outlook:

Currency pair USD/INR May Mcx-Sx futures closed higher on Monday at 44.5450 levels. It opened the week at 44.4750 levels which eventually turned out to be the day's low. However the rupee still trades below most of its short term moving averages on the daily chart (namely the 5 EMA currently at 44.626 and the 8 EMA currently 44.663) suggesting that the bias is still towards the downside. As long as it trades below the above mentioned levels it could continue to trend lower. However a reversal on the upside could be expected only on a sustained trade above 44.63 levels which could propel the pair to test resistance at 44.73 and then 44.81. However the downside could be limited as the pair is trading near the recent low of 44.39 which could act as a support in the short term. Support below 44.39 is at 44.28 we could expect the pair to trade in a range of 44.38-44.73 levels in the next few days.

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