

III. MONETARY AND LIQUIDITY CONDITIONS

Growth in monetary and liquidity aggregates remained strong during 2007-08 so far. Accretion to bank deposits remained buoyant, led by time deposits. Year-on-year (y-o-y) growth of broad money (M_3) on October 12, 2007 was higher than that at end-March 2007, hovering above the indicative trajectory of 17.0-17.5 per cent for 2007-08 set out in the Annual Policy Statement (April 2007). Growth in bank credit moderated during 2007-08 so far from the strong pace of the preceding three years. Banks' investments in SLR securities, as a proportion of their net demand and time liabilities (NDTL), were somewhat higher than the end-March level. Liquidity conditions during the second quarter of 2007-08 were influenced largely by movements in cash balances of the Governments and capital inflows. The Reserve Bank continued with the policy of according high priority to active management of liquidity and thereby modulated liquidity through issuances of securities under the market stabilisation scheme (MSS), operations under the liquidity adjustment facility (LAF) and changing the cash reserve ratio (CRR) as and when warranted.

Monetary Survey

For the purpose of monetary policy formulation, the Annual Policy Statement of April 2007 projected the rate of broad money (M_3) growth at around 17.0-17.5 per cent for 2007-08 in consonance with the outlook on economic growth and inflation. Consistent with the projections of money supply, the growth in aggregate deposits in 2007-08 was placed at around Rs.4,90,000 crore, while that of non-food credit including investments in bonds/debentures/shares of public sector undertakings and private corporate sector and commercial paper (CP) was projected at 24.0-25.0 per cent. Growth in M_3 , year-on-year (y-o-y), was 21.8 per cent on October 12, 2007 as compared with 21.3 per cent at end-March 2007 and 18.9 per cent a year ago. Expansion in the residency-based new monetary aggregate (NM_3) – which does not directly reckon non-resident foreign currency deposits such as FCNR(B) deposits – also accelerated to 21.5 per cent on October 12, 2007 from 19.5 per cent a year ago. Growth in liquidity aggregate, L_1 , at 20.3 per cent at end-September 2007, was also higher than 19.3 per cent a year ago (Table 19 and Chart 8).

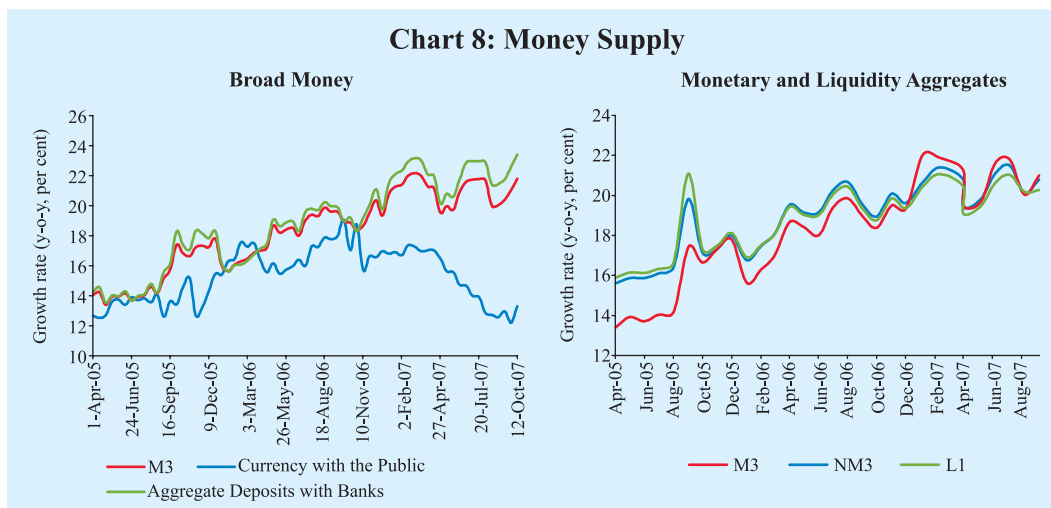
Growth of currency with the public decelerated during 2007-08. Growth in demand deposits was lower than that at a year ago and also lower than that at end-March 2007. Consequently, growth in narrow money (M_1), y-o-y, slowed down to 14.6 per cent on October 12, 2007 from 19.1 per cent a year ago and 16.8 per cent

Monetary and Liquidity Conditions

Table 19: Monetary Indicators

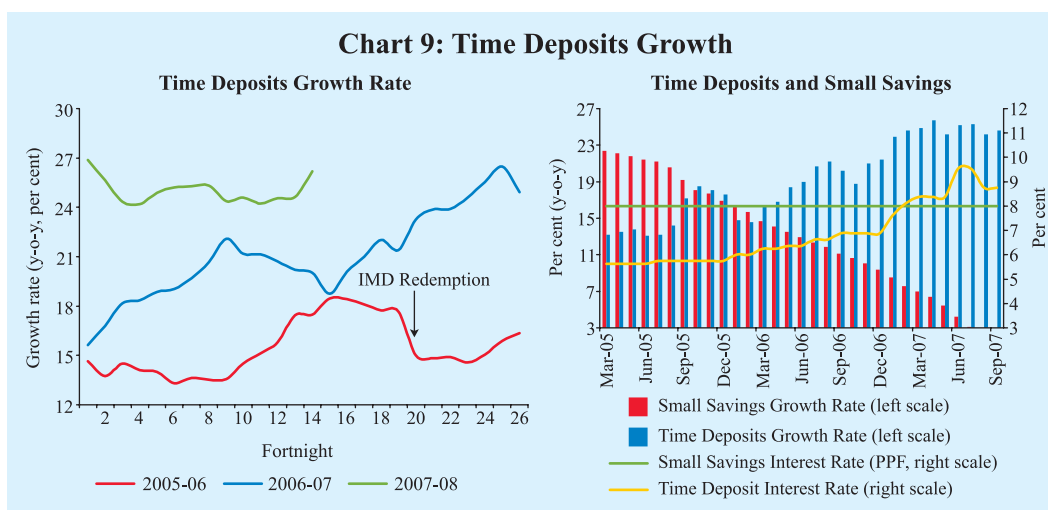
(Amount in Rupees crore)							
Item	Outstanding as on October 12, 2007	Variation (year-on-year)					
		October 13, 2006		March 31, 2007		October 12, 2007	
		Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
I	2	3	4	5	6	7	8
I. Reserve Money*	7,66,077	1,03,533	20.2	1,35,961	23.7	1,50,089	24.4
II. Narrow Money (M ₁)	9,65,335	1,35,118	19.1	1,38,820	16.8	1,22,995	14.6
III. Broad Money (M ₃)	35,82,288	4,66,603	18.9	5,80,733	21.3	6,41,464	21.8
a) Currency with the Public	5,01,934	64,539	17.0	70,352	17.0	58,738	13.3
b) Aggregate Deposits	30,75,386	4,01,717	19.2	5,09,754	22.1	5,83,198	23.4
i) Demand Deposits	4,58,433	70,232	21.7	67,841	16.7	64,729	16.4
ii) Time Deposits	26,16,953	3,31,485	18.8	4,41,913	23.2	5,18,469	24.7
of which: Non-Resident Foreign Currency Deposits	60,702	-13,518	-17.3	7,833	13.2	-3,817	-5.9
IV. NM ₃	35,89,296	4,82,094	19.5	5,71,550	20.8	6,36,279	21.5
of which: Call Term Funding from Financial Institutions	86,143	5,914	7.5	2,692	3.2	1,417	1.7
V. a) L ₁	36,99,875	4,98,517	19.3	5,83,181	20.5	6,23,759	20.3
of which: Postal Deposits	1,16,886	13,775	14.2	11,631	11.2	5,863	5.3
b) L ₂	37,02,807	4,98,528	19.3	5,83,181	20.4	6,23,759	20.3
c) L ₃	37,28,871	5,02,412	19.3	5,85,404	20.3	6,24,245	20.1
VI. Major Sources of Broad Money							
a) Net Bank Credit to the Government (i+ii)	8,46,054	39,879	5.2	71,582	9.3	35,336	4.4
i) Net Reserve Bank Credit to Government	-1,36,711	14,109	-	-2,384	-29.3	-1,39,487	-
of which: to the Centre	-1,36,812	13,928	-	-3,024	-58.6	-1,39,378	-
ii) Other Banks' Credit to Government	9,82,765	25,769	3.3	73,967	9.8	1,74,823	21.6
b) Bank Credit to Commercial Sector	22,25,003	3,77,232	26.0	4,30,358	25.4	3,94,626	21.6
c) Net Foreign Exchange Assets	10,39,928	1,21,983	18.1	1,86,985	25.7	2,43,963	30.6
d) Government Currency Liability to Public	8,694	-753	-8.6	-467	-5.3	705	8.8
e) Net Non-Monetary Liabilities of the Banking Sector	5,37,392	71,737	16.6	1,07,725	23.2	33,165	6.6
<i>Memo:</i>							
Aggregate Deposits of SCBs	28,58,033	3,88,528	20.4	4,99,260	23.7	5,69,061	24.9
Non-food Credit of SCBs	19,82,156	3,70,226	30.0	4,16,006	28.4	3,77,759	23.5
* : Data pertain to October 19, 2007.							
SCBs : Scheduled Commercial Banks. FIs : Financial Institutions. NBFCs : Non-Banking Financial Companies.							
NM ₃ is the residency-based broad money aggregate and L ₁ , L ₂ and L ₃ are liquidity aggregates compiled on the recommendations of the Working Group on Money Supply (Chairman: Dr. Y.V. Reddy, 1998).							
L ₁ = NM ₃ + Select deposits with the post office saving banks.							
L ₂ = L ₁ + Term deposits with term lending institutions and refinancing institutions (FIs) + Term borrowing by FIs + Certificates of deposit issued by FIs.							
L ₃ = L ₂ + Public deposits of non-banking financial companies.							
Note : 1. Data are provisional.							
2. Data reflect redemption of India Millennium Deposits (IMDs) on December 29, 2005.							
3. Data for postal deposits pertain to August 2007, while liquidity aggregates pertain to September 2007.							

at end-March 2007. On the other hand, growth in time deposits accelerated from 18.8 per cent on October 13, 2006 to 23.2 per cent at end-March 2007 and further to 24.7 per cent on October 12, 2007. Concomitantly, the accretion to postal deposits decelerated significantly during the year (Chart 9). The higher order of increase in time deposits can be attributed, *inter alia*, to higher economic activity, increase in interest rates on bank deposits, unchanged interest rates on postal deposits and extension of tax benefits under Section 80C for bank deposits.



On a financial year basis, growth in M_3 during 2007-08 (up to October 12, 2007) was 8.2 per cent as compared with 7.7 per cent during the comparable period of the previous year (Table 20).

Bank credit to the commercial sector exhibited some moderation during 2007-08 so far from the strong pace of the previous three years. Scheduled commercial banks' (SCBs') non-food credit expanded by 23.5 per cent, y-o-y, as on October 12, 2007 as compared with 28.4 per cent at end-March 2007 and 30.0 per cent a year ago¹. The deceleration in credit growth coupled with the



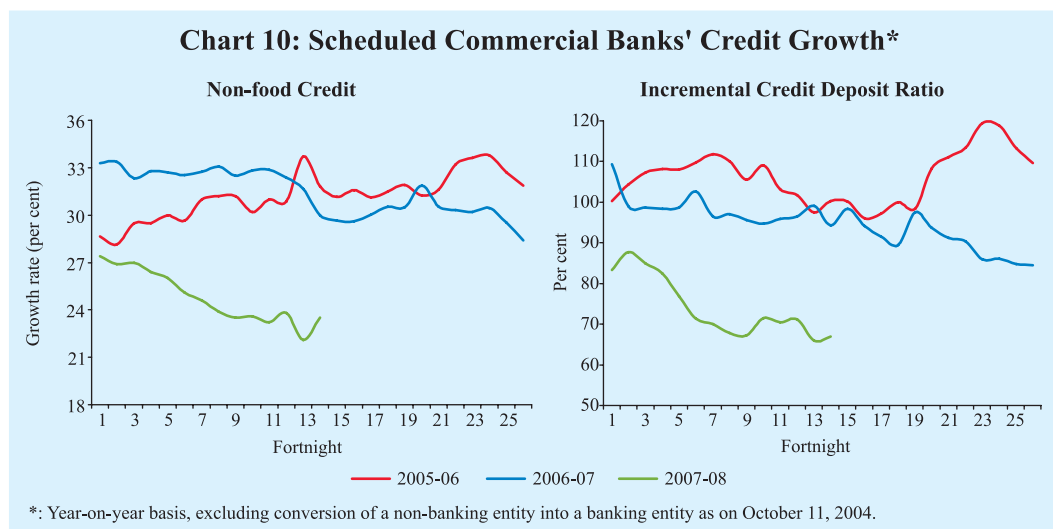
¹ The growth in adjusted non-food credit, that also includes investments in bonds/debentures/shares and commercial paper (CP), was 22.1 per cent, y-o-y, on October 12, 2007 as compared with 28.0 per cent a year ago.

Monetary and Liquidity Conditions

Table 20: Monetary Aggregates – Variations								
Item	(Rupees crore)							
	2006-07 (up to Oct. 13)	2007-08 (up to Oct. 12)	2006-07				2007-08	
			Q1	Q2	Q3	Q4	Q1	Q2
1	2	3	4	5	6	7	8	9
M ₃ (1+2+3 = 4+5+6+7-8)	2,11,279 (7.7)	2,72,010 (8.2)	55,411	1,68,401	62,951	2,93,970	76,194	1,87,954
Components								
1. Currency with the Public	30,077 (7.3)	18,464 (3.8)	23,797	-2,878	27,587	21,847	17,526	-13,937
2. Aggregates Deposits with Banks	1,82,630 (7.9)	2,56,075 (9.1)	33,227	1,70,827	35,866	2,69,833	59,104	2,03,387
2.1 Demand Deposits with Banks	-12,684 (-3.1)	-15,796 (-3.3)	-42,399	43,794	-8,252	74,697	-42,542	52,573
2.2 Time Deposits with Banks	1,95,315 (10.3)	2,71,870 (11.6)	75,626	1,27,033	44,118	1,95,136	1,01,646	1,50,814
3. 'Other' Deposits with Banks	-1,429	-2,528	-1,613	452	-502	2,291	-435	-1,496
Sources								
4. Net Bank Credit to Government	44,124 (5.8)	7,877 (0.9)	23,431	14,175	-13,204	47,180	24,833	9,669
4.1 RBI's Net Credit to Government	-5,361	-1,42,463	53	2,826	-12,754	7,490	-25,483	-54,695
4.1.1 RBI's Net credit to Centre	-2,593	-1,38,948	3,071	2,584	-12,568	3,889	-21,825	-55,588
4.2 Other Banks' Credit to Government	49,484	1,50,340	23,378	11,349	-451	39,690	50,315	64,364
5. Bank Credit to Commercial Sector	1,37,374 (8.1)	1,01,642 (4.8)	14,930	1,44,204	78,099	1,93,125	-31,873	1,40,392
6. NFEA of Banking Sector	69,771	1,26,749	58,087	20,197	43,160	65,542	-17,945	1,19,430
6.1 NFEA of RBI	74,726	1,41,949	71,845	11,392	27,250	82,682	-2,745	1,19,430
7. Government's Currency Liabilities to the Public	-766	407	-920	155	166	132	244	164
8. Net Non-Monetary liabilities of the Banking Sector	39,225	-35,335	40,117	10,330	45,269	12,009	-1,00,937	81,700
Memo:								
1. Non-resident Foreign Currency Deposits with SCBs	5,243	-6,407	3,917	1,671	1,233	1,011	-3,849	-2,110
2. SCB' Call-term Borrowing from Financial Institutions	1,582	307	3,118	-1,576	-4,468	5,618	-2,984	5,609
3. Overseas Borrowing by SCBs	431	-112	3,301	-3,685	-2,774	5,229	-6,928	7,443
SCBs : Scheduled Commercial Banks. NFEA : Net Foreign Exchange Assets.								
Note : Figures in parentheses are percentage variations.								

acceleration in deposits growth led to a reduction in the incremental credit-deposit ratio (y-o-y) of SCBs to 67.0 per cent as on October 12, 2007 from 94.3 per cent a year ago and 110.0 per cent at end-March 2006 (Chart 10).

Disaggregated sectoral data available up to August 17, 2007 show that about 41 per cent of incremental non-food credit (y-o-y) was absorbed by industry, compared to 33 per cent in the corresponding period of the previous year. The expansion of incremental non-food credit to industry during this period was led by infrastructure (power, port, telecommunication), textiles, iron and steel, engineering, petroleum, food processing, chemicals, vehicles and construction



industries. The infrastructure sector alone accounted for around 27 per cent of the incremental credit to the industry as compared with 21 per cent in the corresponding period of the previous year. The agricultural sector absorbed around 13 per cent of the incremental non-food gross bank credit expansion. Personal loans accounted for nearly 22 per cent of the incremental non-food credit; within personal loans, the share of incremental housing loans stood at 44 per cent. Growth in loans to commercial real estate remained high (Table 21).

Apart from bank credit, the corporate sector continued to fund their requirements through non-bank sources such as from capital markets, external commercial borrowings (ECBs) and internal funds. Resources raised through domestic equity issuances during second quarter of 2007-08 were higher than that during the corresponding period of the previous year. Resources raised from international markets through American depository receipts (ADRs) and global depository receipts (GDRs) during the second quarter of 2007-08 were also significantly higher than that during the corresponding period of the previous year. Net mobilisation under ECBs almost doubled during 2006-07 (April-March) and the data for the first quarter of 2007-08 show that the momentum is maintained. Internal generation of funds continued to provide a strong support to the funding requirements as profits after tax of select non-financial non-government companies during the first quarter of 2007-08 were more than 30 per cent higher than the corresponding period of the previous year (Table 22).

Commercial banks have mobilised large amounts of deposits during 2007-08 so far. Issuances of fresh capital and internal generation of funds by banks were also higher than a year ago. Strong expansion in the sources of funds along with the moderation in credit growth enabled banks to deploy their funds in

Table 21: Deployment of Non-food Gross Bank Credit

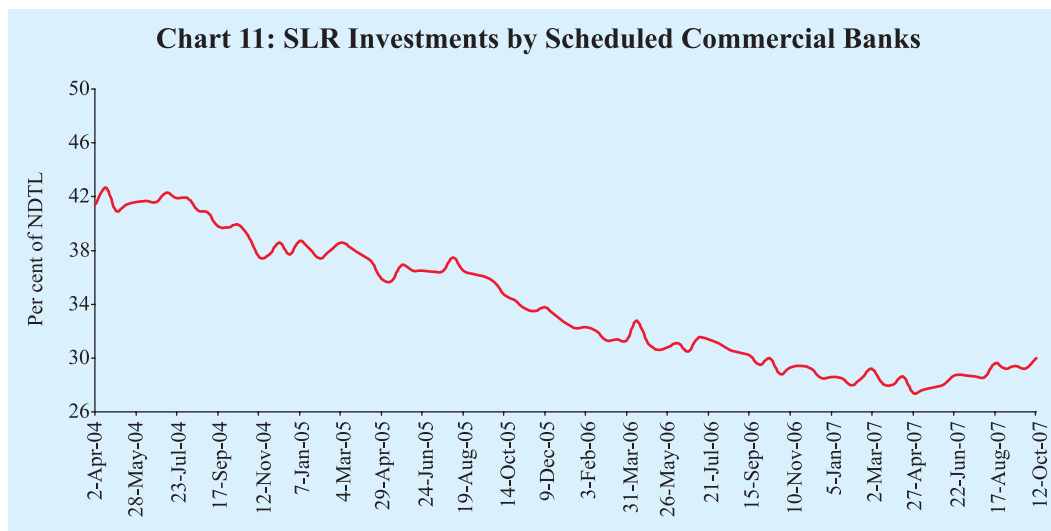
(Amount in Rupees crore)					
Sector/Industry	Outstanding as on August 17, 2007	Year-on-Year Variation			
		August 18, 2006		August 17, 2007	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
Non-food Gross Bank Credit (1 to 4)	18,09,338	3,48,501	34.8	3,41,920	23.3
1. Agriculture and Allied Activities	2,20,534	44,630	35.0	43,326	24.4
2. Industry (Small, Medium and Large)	7,10,984	1,13,606	29.0	1,40,531	24.6
Small Scale Industries	1,19,379	15,926	21.6	28,510	31.4
3. Personal Loans	4,64,057	–	–	76,649	19.8
Housing	2,35,168	–	–	33,489	16.6
Advances against Fixed Deposits	40,272	7,238	28.1	7,071	21.3
Credit Cards	15,220	–	–	4,786	45.9
Education	16,926	–	–	5,145	43.7
Consumer Durables	8,515	630	8.3	334	4.1
4. Services	4,13,763	–	–	81,416	24.5
Transport Operators	27,655	–	–	8,117	41.5
Professional & Other Services	25,619	–	–	9,131	55.4
Trade	1,04,932	–	–	19,563	22.9
Real Estate Loans	46,665	13,262	80.1	16,145	52.9
Non-Banking Financial Companies	45,326	9,656	49.6	13,673	43.2
<i>Memo:</i>					
Priority Sector	6,31,221	1,23,756	32.4	1,06,015	20.2
Industry (Small, Medium and Large)	7,10,984	1,13,606	29.0	1,40,531	24.6
Food Processing	39,524	5,887	26.8	8,391	27.0
Textiles	79,362	16,117	39.1	17,378	28.0
Paper & Paper Products	11,499	1,666	24.6	1,813	18.7
Petroleum, Coal Products & Nuclear Fuels	33,252	5,563	34.2	8,752	35.7
Chemical and Chemical Products	55,360	8,750	28.5	7,672	16.1
Rubber, Plastic & their Products	9,247	2,668	64.4	1,913	26.1
Iron and Steel	65,643	15,040	45.4	11,335	20.9
Other Metal & Metal Products	20,423	4,801	44.0	2,756	15.6
Engineering	45,179	5,615	20.3	8,759	24.0
Vehicles, Vehicle Parts and Transport Equipments	24,923	5,163	52.8	5,532	28.5
Gems & Jewellery	23,417	5,516	41.0	1,657	7.6
Construction	19,877	4,302	45.7	5,237	35.8
Infrastructure	1,54,300	24,222	29.4	37,509	32.1
– : Not available.					
Note : 1. Data are provisional and relate to select scheduled commercial banks.					
2. Owing to change in classification of sectors/industries and coverage of banks, data for 2006 are not comparable with earlier data.					

Government and other approved securities, which increased by 22.9 per cent, y-o-y, on October 12, 2007 as compared with 3.2 per cent a year ago (Table 23). Commercial bank's holdings of such securities as on October 12, 2007, at 30.0 per cent of their NDTL were the same as that of a year ago and somewhat higher than 28.0 per cent at end-March 2007 (Chart 11). Excess SLR investments of SCBs, which increased to Rs.1,56,851 crore on October 12, 2007 from Rs.1,27,842 crore a year ago and Rs.84,223 crore at end-March 2007. Banks' balances with the Reserve Bank expanded, reflecting the impact of the increase in

Table 22: Select Sources of Funds to Industry								
(Rupees crore)								
Item	2005-06	2006-07	2006-07				2007-08	
			Q1	Q2	Q3	Q4	Q1	Q2
1	2	3	4	5	6	7	8	9
A. Bank Credit to Industry #	1,26,804	1,41,543	-2,336	49,290	28,415	66,174	-15,603	29,253 *
B. Flow from Non-banks to Corporates								
1. Capital Issues (i+ii)	13,781	29,180	10,627	1,882	10,840	5,831	13,788	6,228
i) Non-Government Public Ltd. Companies (a+b)	13,408	29,180	10,627	1,882	10,840	5,831	13,261	4,238
a) Bonds/Debentures	245	585	0	0	491	94	0	0
b) Shares	13,163	28,595	10,627	1,882	10,349	5,737	13,261	4,238
ii) PSUs and Government Companies	373	0	0	0	0	0	527	1,990
2. ADR/GDR Issues	7,263	16,184	4,965	2,130	924	8,165	1,251	9,899
3. External Commercial Borrowings (ECBs)	45,078	88,472	20,498	14,232	16,077	37,665	33,115	-
4. Issue of CPs	-1,517	4,970	6,931	4,795	-908	-5,848	8,568	6,971 ^
C. Depreciation Provision +	28,883	37,095	8,449	8,892	9,172	10,338	10,173	-
D. Profit after Tax +	67,506	1,11,107	24,845	27,710	28,698	31,251	32,699	-
- : Not Available. ^ : Up to September 15, 2007. * : Up to August 17, 2007. # : Data pertain to select scheduled commercial banks. Figures for 2005-06 are not comparable with those for the later period due to increase in number of banks selected in the sample. + : Data are based on abridged results of select non-financial non-Government companies. Data for the full year may not add up to the quarterly totals due to difference in the composition and number of companies covered in each period (see Chapter 1).								
Note :								
1. Data are provisional.								
2. Data on capital issues pertain to gross issuances excluding issues by banks and financial institutions. Figures are not adjusted for banks' investments in capital issues, which are not expected to be significant.								
3. Data on ADR/GDR issues exclude issuances by banks and financial institutions.								
4. Data on external commercial borrowings include short-term credit. Data for 2005-06 are exclusive of the IMD redemption.								

their NDTL as well as the increase in the CRR. Banks' holdings of foreign currency assets declined, while their overseas borrowings expanded.

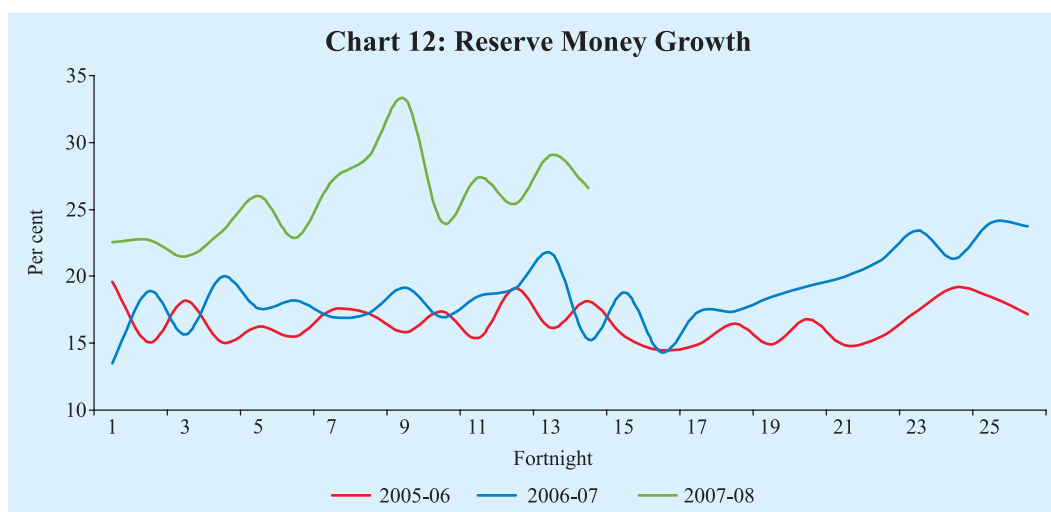
Table 23: Scheduled Commercial Bank Survey						
(Amount in Rupees crore)						
Item	Outstanding as on Oct. 12, 2007	Variation (year-on-year)				
		As on Oct. 13, 2006		As on Oct. 12, 2007		
		Amount	Per cent	Amount	Per cent	Per cent
1	2	3	4	5	6	6
Sources of Funds						
1. Aggregate Deposits	28,58,033	3,88,528	20.4	5,69,061	24.9	
2. Call/Term Funding from Financial Institutions	86,143	5,914	7.5	1,417	1.7	
3. Overseas Foreign Currency Borrowings	31,793	-2,097	-6.5	1,528	5.0	
4. Capital	36,392	2,049	6.9	4,845	15.4	
5. Reserves	2,14,549	33,184	25.2	49,511	30.0	
Uses of Funds						
1. Bank Credit	20,19,175	3,66,463	28.8	3,81,334	23.3	
of which: Non-food Credit	19,82,156	3,70,226	30.0	3,77,759	23.5	
2. Investments in Government and Other Approved Securities	9,42,920	23,508	3.2	1,75,748	22.9	
a) Investments in Government Securities	9,23,532	25,608	3.5	1,73,765	23.2	
b) Investments in Other Approved Securities	19,388	-2,100	-10.8	1,983	11.4	
3. Investments in Non-SLR Securities	1,78,920	10,850	7.8	28,935	19.3	
4. Foreign Currency Assets	29,669	13,803	51.7	-10,852	-26.8	
5. Balances with the RBI	2,18,684	11,151	9.8	93,605	74.8	
Note: Data are provisional.						



Reserve Money Survey

Reserve money expanded by 24.4 per cent, y-o-y, as on October 19, 2007 (14.9 per cent adjusted for the first round effects of the hikes in the CRR²) as compared with 20.2 per cent a year ago (Chart 12).

During the financial year 2007-08 (up to October 19, 2007), reserve money expanded by 8.0 per cent (3.7 per cent adjusted for the first round effect of the hikes in the CRR) as compared with 7.5 per cent in the corresponding period of 2006-07. Growth in bankers' deposits with the Reserve Bank increased by 18.7



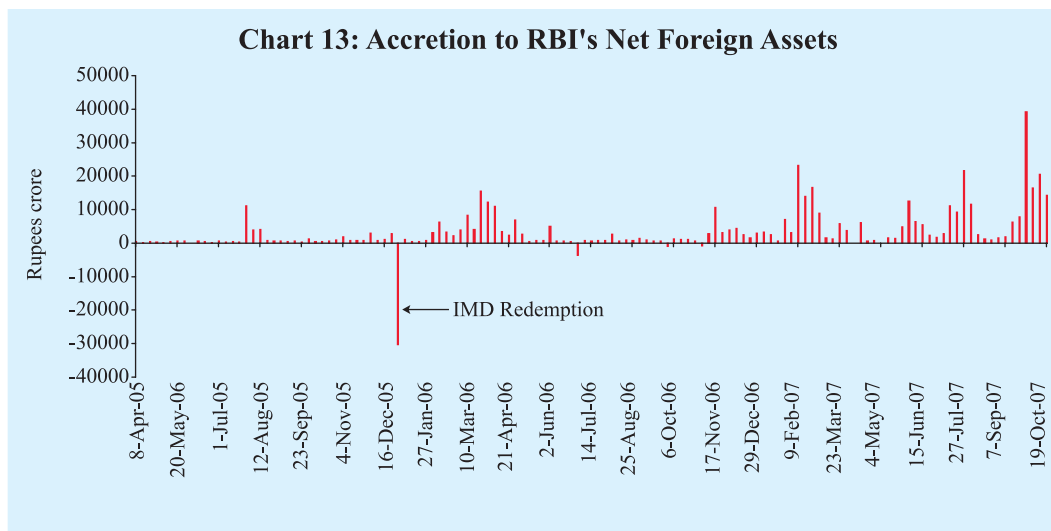
² The CRR was increased by 200 basis points in stages between December 2006 and August 2007. Such increase in CRR in the first round, is estimated to have impounded banks' resources of Rs.58,500 crore.

Table 24: Reserve Money

Item	(Amount in Rupees crore)									
	2006-07	2006-07	2007-08	Variation						
	(April	(Up to	(Up to	2006-07				2007-08		
	March)	Oct. 20)	Oct. 19)	Q1	Q2	Q3	Q4	Q1	Q2	
1	2	3	4	5	6	7	8	9	10	
Reserve Money	1,35,961 (23.7)	42,932 (7.5)	57,060 (8.0)	13,466	18,665	14,204	89,626	11,708	60,480	
Components (1+2+3)										
1. Currency in Circulation	73,549 (17.1)	37,319 (8.7)	22,589 (4.5)	22,283	-2,011	26,871	26,405	16,943	-13,487	
2. Bankers' Deposits with RBI	61,784 (45.6)	7,047 (5.2)	36,984 (18.7)	-7,204	20,224	-12,165	60,929	-4,800	75,464	
3. 'Other' Deposits with the RBI	628 (9.1)	-1,434 (-20.9)	-2,513 (-33.5)	-1,613	452	-502	2,291	-435	-1,496	
Sources (1+2+3+4-5)										
1. RBI's net credit to Government	-2,384	11,988	-1,46,754	53	2,826	-12,754	7,490	-25,483	-54,695	
of which: to Centre (i+ii+iii+iv-v)	-3,024	15,029	-1,43,116	3,071	2,584	-12,568	3,889	-21,825	-55,588	
i. Loans and Advances	0	0	0	0	0	0	0	0	0	
ii. Treasury Bills held by the RBI	0	0	0	0	0	0	0	0	0	
iii. RBI's Holdings of Dated Securities	26,763	491	-51,024	-27,610	24,944	22,733	6,696	-34,284	4,019	
iv. RBI's Holdings of Rupee coins	-143	-132	96	9	-107	97	-142	128	20	
v. Central Government Deposits	29,644	-14,670	92,189	-30,672	22,253	35,398	2,665	-12,330	59,627	
2. RBI's credit to banks and commercial sector	1,990	-377	-7,770	-3,135	3,107	2,065	-47	-6,450	-1,256	
3. NFEA of RBI	1,93,170 (28.7)	77,310 (11.5)	1,71,080 (19.8)	71,845	11,392	27,250	82,682	-2,745	1,19,430	
of which : FCA, adjusted for revaluation	1,64,601	42,544	2,17,201	28,107	10,948	31,634	93,913	47,728	1,18,074	
4. Governments' Currency Liabilities to the Public	-467	-766	407	-920	155	166	132	244	164	
5. Net Non-Monetary liabilities of RBI	56,347	45,224	-40,098	54,376	-1,184	2,524	632	-46,142	3,162	
Memo:										
LAF Repos (+) / Reverse Repos (-)	36,435	8,730	-61,135	-23,060	28,395	22,195	8,905	-32,182	9,067	
Net Open Market Sales # *	5,125	2,945	3,338	1,536	1,176	389	2,024	1,246	1,560	
Centre's Surplus **	1,164	-19,117	-28,071	-27,320	13,313	38,713	-23,542	-34,597	15,376	
Mobilisation under MSS	33,912	11,860	1,02,241	4,062	8,940	-3,315	24,225	19,643	48,856	
Net Purchases(+)/Sales(-) from Authorised Dealers	1,18,994	21,545	93,268 +	21,545	0	19,776	77,673	38,873	54,395 +	
NFEA/Reserve Money @	122.2	121.8	135.4	127.0	125.0	126.5	122.2	119.8	125.8	
NFEA/Currency @	171.8	160.3	196.9	164.4	167.7	164.0	171.8	165.7	193.6	
NFEA : Net Foreign Exchange Assets. FCA : Foreign Currency Assets. LAF : Liquidity Adjustment Facility.										
* : At face value. + : Up to August 31, 2007. # : Excludes Treasury Bills. @ : per cent, end of period.										
** : Excludes minimum cash balances with the Reserve Bank in case of surplus.										
Note : 1. Data are based on March 31 for Q4 and last reporting Friday for all other quarters.										
2. Figures in parentheses are percentage variations during the fiscal year.										

per cent during 2007-08 (up to October 19, 2007) as compared with an increase of 5.2 per cent during the corresponding period of 2006-07. Currency in circulation expanded by 4.5 per cent as compared with 8.7 per cent during the corresponding period of the previous year (Table 24).

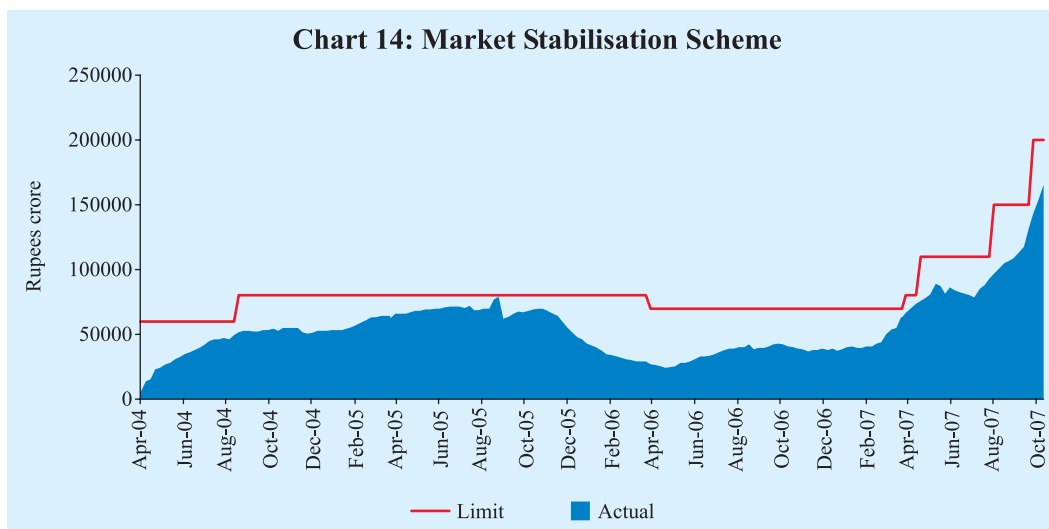
On the sources side, reserve money continued to be driven by the Reserve Bank's foreign currency assets (adjusted for revaluation), which rose by Rs.2,17,201 crore in 2007-08 (up to October 19, 2007) as compared with Rs.42,544 crore during the corresponding period of the previous year (Chart 13).



Movements in the Reserve Bank's net credit to the Central Government largely reflected liquidity management operations by the Reserve Bank and movements in Government deposits. During 2007-08 (up to October 19, 2007), the Reserve Bank's holdings of Central Government's dated securities declined largely on account of increased absorption of liquidity under the LAF reverse repo. On the other hand, the sterilisation operations of the Reserve Bank under the MSS led to an increase in Central Government deposits with the Reserve Bank. Reflecting these developments, the Reserve Bank's net credit to the Centre declined by Rs.1,43,116 crore during 2007-08 (up to October 19) as against an increase of Rs.15,029 crore during the corresponding period of the previous year.

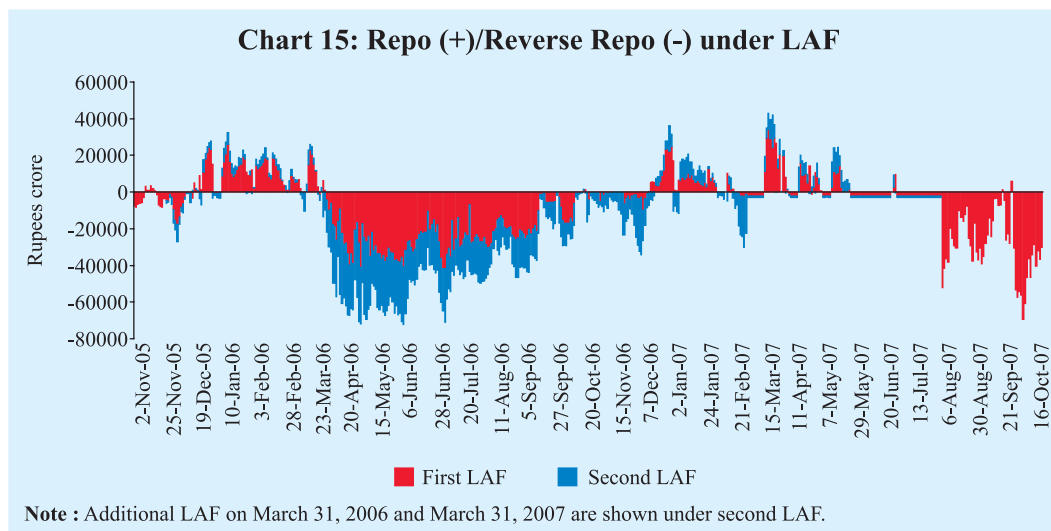
Liquidity Management

The Reserve Bank continued with its policy of active management of liquidity flexibly using various policy instruments at its disposal such as CRR, LAF and MSS. In the second quarter of 2007-08, variation in Government balances and capital inflows remained the key drivers of liquidity conditions. The Reserve Bank withdrew the ceiling of Rs.3,000 crore on daily reverse repo under LAF effective from August 6, 2007, while retaining the discretion to re-impose a ceiling as appropriate. The second LAF, which was introduced from November 2005 and had been conducted between 3:00 pm and 3:45 pm on a daily basis, was also withdrawn with effect from August 6, 2007. The Government, in consultation with the Reserve Bank, revised the ceiling for the outstanding under the MSS for the year 2007-08 to Rs.1,50,000 crore on August 8, 2007 from Rs.1,10,000 crore with Rs.1,35,000 crore set as the threshold of future revision of the ceiling. In view of the continuing large capital flows, the ceiling for the outstanding under



the MSS for the year 2007-08 was further increased to Rs.2,00,000 crore on October 4, 2007, with the threshold limit for revision set at Rs.1,85,000 crore (Chart 14). This was in consonance with the modified arrangement of the Reserve Bank's liquidity management to enhance the MSS programme and to use it more flexibly keeping in view the capital flows in the recent periods, the assessment of volatility and durability of the flows, and to restore LAF as a facility for equilibrating very short-term mismatches.

During the first quarter of 2007-08, liquidity pressures eased gradually from April 4, 2007 onwards partly on account of reduction in the Centre's cash balances from Rs.50,092 crore at end-March 2007 to Rs.32,023 crore by mid-April 2007. Consequently, the amount injected through LAF repos declined and liquidity was absorbed under the LAF reverse repos during April 9-15, 2007. The absorption under reverse repos, however, remained limited within the ceiling of Rs.3,000 crore as per the modified arrangements put in place on March 5, 2007. From mid-April 2007 onwards, liquidity conditions tightened, partly due to the hikes of 25 basis points each in the CRR effective from the fortnights beginning April 14, 2007 and April 28, 2007, leading to daily net injection of liquidity averaging Rs.9,629 crore during April 16-May 27, 2007. Liquidity pressures again started easing from May 28, 2007 onwards, reflecting increase in Government expenditure and the Reserve Bank's operations in the foreign exchange market. The LAF window shifted to an absorption mode from May 28, 2007 and remained so throughout the quarter except during June 28-July 2, 2007, when liquidity was injected through net repo operations to the tune of Rs.9,009 crore daily on an average (Chart 15). Outstanding balances under the MSS rose from Rs.62,974 crore at end-March 2007 to Rs.81,137 crore by June 29, 2007 (Table 25).



During the second quarter of 2007-08, the Reserve Bank continued to absorb liquidity using the reverse repo window under the LAF. The sustained capital inflows and the decline in Government balances were reflected in the large

Table 25: Reserve Bank's Liquidity Management Operations

Item	(Rupees crore)									
	Variations									
	2006-07 (April- March)	2006-07				2007-08				
	Q1	Q2	Q3	Q4	Q1	July	August	September		
1	2	3	4	5	6	7	8	9	10	
A. Drivers of Liquidity (1+2+3+4+5)	61,739	36,247	-16,896	-25,641	68,028	51,935	51,012	22,854	-	
1. RBI's net Purchases from Authorised Dealers	1,18,994	21,545	0	22,461	74,988	39,791	41,562	11,915	-	
2. Currency with the Public	-70,352	-19,648	-1,270	-27,033	-22,400	-12,235	4,954	3,836	-144	
3. Surplus Cash balances of the Centre with the Reserve Bank@	-1,164	40,207	-26,199	-30,761	15,590	49,992	0	-20,807	-9,964	
4. WMA and OD	0	0	0	0	0	15,159	5,040	-20,199	0	
5. Others (residual)	14,260	-5,856	10,574	9,693	-150	-40,772	-544	48,109	-	
B. Management of Liquidity (6+7+8+9)	-24,257	-39,003	32,026	31,625	-48,905	-53,943	-18,735	-47,787	-2,099	
6. Liquidity impact of LAF Repos	36,435	-35,315	40,650	33,600	-2,500	-20,290	-11,887	-13,863	22,925	
7. Liquidity impact of OMO (Net) *	720	545	145	25	5	10	25	0	15	
8. Liquidity impact of MSS	-33,912	-4,233	-8,769	4,750	-25,660	-18,163	-6,873	-18,424	-25,039	
9. First round liquidity impact due to CRR change	-27,500	0	0	-6,750	-20,750	-15,500	0	-15,500	0	
C. Bank Reserves (A+B) #	37,482	-2,756	15,130	5,984	19,123	-2,008	32,277	-24,933	34,195	

- : Not Available.
 (+) : Indicates injection of liquidity into the banking system. (-) : Indicates absorption of liquidity from the banking system.
 # : Includes vault cash with banks and adjusted for first round liquidity impact due to CRR change.
 * : Adjusted for Consolidated Sinking Funds (CSF) and including private placement.
 @ : Excludes minimum cash balances with the Reserve Bank in case of surplus.

Note : For end-March, data pertain to March 31; for all other months data pertain to last Friday.

absorption of liquidity of Rs.52,070 crore on August 6, 2007 through reverse repo after the withdrawal of the ceiling for reverse repo³. The large reverse repo absorption declined gradually with the increase in Government cash balances from the second week of August and the impact of increase in CRR by 50 basis points to 7.0 per cent effective the fortnight beginning August 4, 2007. The amount of liquidity impounded due to the first round impact of the hike of the CRR was Rs.15,500 crore. Liquidity was further absorbed following the auction of dated securities and through MSS operations in August 2007. The outstanding amount of MSS reached Rs.1,06,434 crore on August 31, 2007 from Rs.92,954 crore on August 3, 2007 (Table 26).

Table 26: Liquidity Management

(Rupees crore)				
Outstanding as on last Friday of	LAF	MSS	Centre's Surplus with the RBI @	Total (2 to 4)
1	2	3	4	5
2006				
January	-20,555	37,280	39,080	55,805
February	-12,715	31,958	37,013	56,256
March*	7,250	29,062	48,828	85,140
April	47,805	24,276	5,611	77,692
May	57,245	27,817	-1,203	83,859
June	42,565	33,295	8,621	84,481
July	44,155	38,995	8,770	91,920
August	23,985	42,364	26,791	93,140
September	1,915	42,064	34,821	78,800
October	12,270	40,091	25,868	78,229
November	15,995	37,917	31,305	85,217
December	-31,685	37,314	65,582	71,211
2007				
January	-11,445	39,375	42,494	70,424
February	6,940	42,807	53,115	1,02,862
March*	-29,185	62,974	49,992	83,781
April	-9,996	75,924	-980	64,948
May	-4,690	87,319	-7,753	74,876
June	-8,895	81,137	-15,159	57,083
July	2,992	88,010	-20,199	70,803
August	16,855	1,06,434	20,807	1,44,096
September	-6,070	1,31,473	30,771	1,56,174
October (as on Oct. 19)	31,950	1,65,215	21,921	2,19,086
@ : Excludes minimum cash balances with the Reserve Bank in case of surplus. * : Data pertain to March 31. Note : 1. Negative sign in column 2 indicates injection of liquidity through LAF repo. 2. Negative sign in column 4 indicates injection of liquidity through WMA/overdraft. 3. Between March 5 and August 5, 2007, daily reverse repo absorptions were restricted to a maximum of Rs.3,000 crore comprising Rs.2,000 crore in the First LAF and Rs.1,000 crore in the Second LAF.				

³ The ceiling of Rs.3,000 crore for reverse repo, which was prevalent effective March 5, 2007, was removed effective August 6, 2007.

The average daily absorption of liquidity under the LAF declined gradually from Rs.42,059 crore during August 6-9, 2007 to Rs.25,553 during August 10-August 17, 2007 and further to Rs.12,126 during August 21-27, 2007. The absorption of liquidity under the LAF increased again during August 28-September 13, 2007 mainly resulting from a decline in Government cash balances. Liquidity was further absorbed during August 27-September 10, 2007 through auction of dated securities (Rs.14,000 crore), which was reflected in the moderation of the amount absorbed under LAF in the second week of September.

Advance tax outflows from the banking system to the Government in mid-September resulted in a decline in absorptions under LAF reverse repos. The Central Government's cash balances with the Reserve Bank also increased to Rs.38,453 crore by September 19, 2007 from Rs.13,258 crore on September 14, 2007 and averaged Rs.38,202 crore during September 23-28, 2007. The Reserve Bank injected liquidity through repo operations on September 21, 2007 (Rs.1,200 crore), for the first time in this quarter, and subsequently once more on September 28, 2007 (Rs.6,070 crore). Towards end-September, however, liquidity conditions generally remained easy following large inflow of foreign capital and the Reserve Bank broadly continued with net absorption of liquidity except on those two occasions. During October 2007, reflecting some decline in Government surplus and large capital inflows, liquidity in the system eased further, leading to average daily absorption of Rs.43,077 crore under reverse repo during October 1-23, 2007.