

### III. MONETARY AND LIQUIDITY CONDITIONS

Expansion in monetary and liquidity aggregates has remained strong during 2007-08 so far. Accretion to bank deposits, led by time deposits, remained buoyant. Year-on-year (y-o-y) growth of broad money ( $M_3$ ) as on January 4, 2008 was higher than that at end-March 2007, and was also 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, consistent with policy projections. Banks' investments in SLR securities, as a proportion of their net demand and time liabilities (NDTL), were higher than at end-March. The Reserve Bank continued with the policy of active management of liquidity through increases in the cash reserve ratio (CRR), issuances of securities under the Market Stabilisation Scheme (MSS), operations under the liquidity adjustment facility (LAF) and conduct of open market operations (OMO).

#### Monetary Survey

Broad money growth ( $M_3$ ), year-on-year (y-o-y), was higher at 22.4 per cent on January 4, 2008, as compared with 21.3 per cent at end-March 2007 and 20.8 per cent a year ago. This reflected a strong expansion in aggregate deposits, which on a year-on-year basis, remained higher than the projected trajectory of Rs.4,90,000 crore for 2007-08 set out in the Reserve Bank's Annual Policy Statement. Monetary expansion was mainly driven by sizeable accretion of net foreign exchange assets. The other major source of monetary expansion, *i.e.*, bank credit to the commercial sector decelerated during the same period. Non-food credit (inclusive of non-SLR investments) decelerated and was close to the policy projection of 24.0-25.0 per cent. 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 22.5 per cent on January 4, 2008 from 20.0 per cent a year ago, mainly reflecting the decline in non-resident foreign currency deposits during this period. Growth in liquidity aggregate,  $L_1$ , at 22.4 per cent at end-December 2007 was also higher than that of 19.4 per cent a year ago (Table 19 and Chart 8).

Taking into consideration the trends in monetary aggregates and in order to absorb excess liquidity from the system, the Reserve Bank has increased the CRR by 250 basis points since December 2006. The ceiling on the outstanding amount under the Market Stabilisation Scheme (MSS) for the year 2007-08 was also successively raised on four occasions to Rs.2,50,000 crore.

**Table 19 : Monetary Indicators**

Item	Outstanding as on January 04, 2008	(Amount in Rupees crore)					
		Variation (year-on-year)					
		January 05, 2007		March 31, 2007		January 04, 2008	
		Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8
I. Reserve Money*	8,38,050	1,06,877	20.0	1,35,961	23.7	1,96,231	30.6
II. Narrow Money (M <sub>1</sub> )	10,12,613	1,35,416	18.2	1,38,820	16.8	1,33,759	15.2
III. Broad Money (M <sub>3</sub> )	37,50,334	5,26,566	20.8	5,80,733	21.3	6,86,925	22.4
a) Currency with the Public	5,35,191	66,845	16.8	70,352	17.0	70,245	15.1
b) Aggregate Deposits	32,10,170	4,59,021	21.5	5,09,754	22.1	6,17,035	23.8
i) Demand Deposits	4,72,448	67,871	19.9	67,841	16.7	63,869	15.6
ii) Time Deposits	27,37,721	3,91,150	21.8	4,41,913	23.2	5,53,166	25.3
<i>of which: Non-Resident</i>							
Foreign Currency Deposits	58,143	10,341	18.7	7,833	13.2	-7,608	-11.6
IV. NM <sub>3</sub>	37,64,344	5,12,266	20.0	5,71,550	20.8	6,91,978	22.5
<i>of which: Call Term Funding from FIs</i>	91,561	2,499	3.1	2,692	3.2	7,699	9.2
V. a) L <sub>1</sub>	38,37,283	5,08,857	19.4	5,83,181	20.5	7,01,133	22.4
<i>of which: Postal Deposits</i>	1,16,994	13,166	13.0	11,631	11.2	2,629	2.3
b) L <sub>2</sub>	38,40,215	5,08,857	19.3	5,83,181	20.4	7,01,133	22.3
c) L <sub>3</sub>	38,66,183	5,10,771	19.3	5,85,255	20.3	7,02,478	22.2
VI. Major Sources of Broad Money							
a) Net Bank Credit to the Government (i+ii)	8,46,043	25,976	3.3	71,582	9.3	39,069	4.8
i) Net Reserve Bank Credit to Government	-1,49,592	-19,253	-	-2,384	-29.3	-1,49,280	-
<i>of which: to the Centre</i>	-1,50,278	-19,845	-	-3,024	-58.6	-1,49,358	-
ii) Other Banks' Credit to Government	9,95,635	45,228	5.9	73,967	9.8	1,88,349	23.3
b) Bank Credit to Commercial Sector	23,55,379	4,28,305	28.0	4,30,358	25.4	3,95,215	20.2
c) Net Foreign Exchange Assets	11,15,219	1,84,656	28.0	1,86,985	25.7	2,71,263	32.1
d) Government Currency Liability to Public	8,851	-487	-5.6	-467	-5.3	697	8.5
e) Net Non-Monetary Liabilities							
of the Banking Sector	5,75,158	1,11,883	25.2	1,07,725	23.2	19,319	3.5
<i>Memo:</i>							
Aggregate Deposits of SCBs	29,88,207	4,44,241	22.9	4,99,260	23.7	6,00,761	25.2
Non-food Credit of SCBs	21,05,235	4,16,418	31.9	4,16,006	28.4	3,82,155	22.2

\* : Data pertain to January 18, 2008.

SCBs: Scheduled Commercial Banks. FIs: Financial Institutions. NBFCs: Non-Banking Financial Companies.

NM<sub>3</sub> is the residency-based broad money aggregate and L<sub>1</sub>, L<sub>2</sub> and L<sub>3</sub> are liquidity aggregates compiled on the recommendations of the Working Group on Money Supply (Chairman: Dr. Y.V. Reddy, 1998).

L<sub>1</sub> = NM<sub>3</sub> + Select deposits with the post office saving banks.

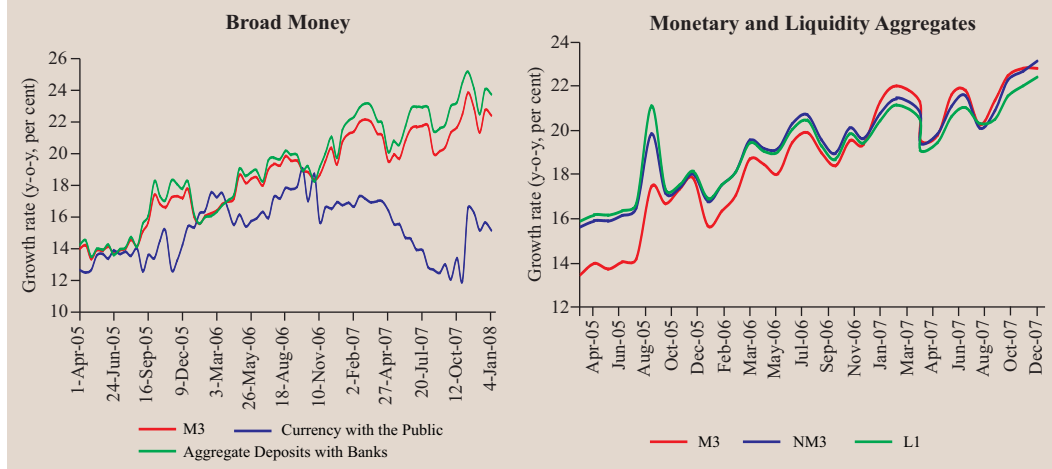
L<sub>2</sub> = L<sub>1</sub> + Term deposits with term lending institutions and refinancing institutions (FIs) + Term borrowing by FIs + Certificates of deposit issued by FIs.

L<sub>3</sub> = L<sub>2</sub> + Public deposits of NBFCs.

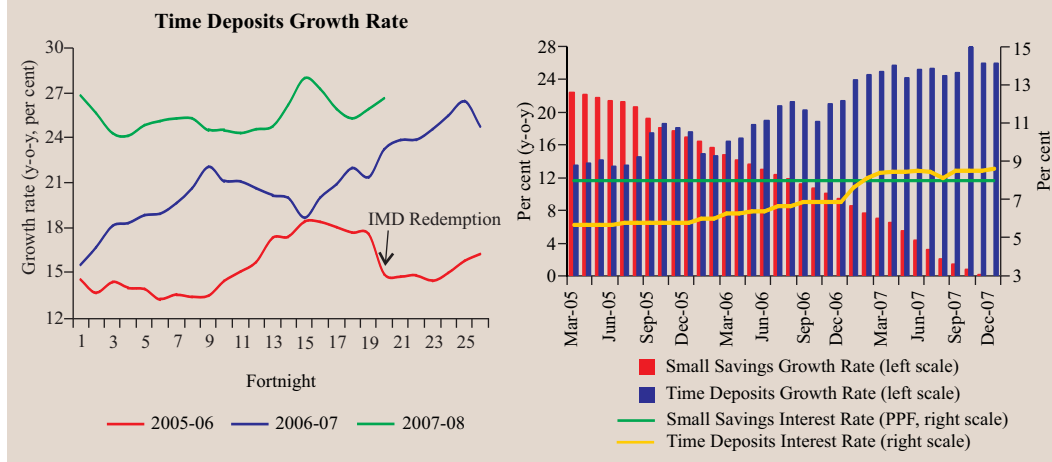
**Note :** 1. Data are provisional. Wherever data are not available the estimates for the last available month have been repeated.

2. Liquidity aggregates pertain to end-December 2007.

On a year-on-year basis, currency with the public increased by 15.1 per cent, lower than the growth of 16.8 per cent in the corresponding period of the previous year. Growth in demand deposits was also lower than a year ago as well as that at end-March 2007. Growth in narrow money (M<sub>1</sub>), y-o-y, was

**Chart 8: Money Supply**


15.2 per cent as on January 4, 2008 as compared with 18.2 per cent a year ago and 16.8 per cent at end-March 2007. The growth in broad money was higher, reflecting buoyancy in time deposits which accelerated from 21.8 per cent on January 5, 2007 to 23.2 per cent at end-March 2007 and further to 25.3 per cent on January 4, 2008. 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 robust 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. In order to

**Chart 9: Time Deposits Growth**


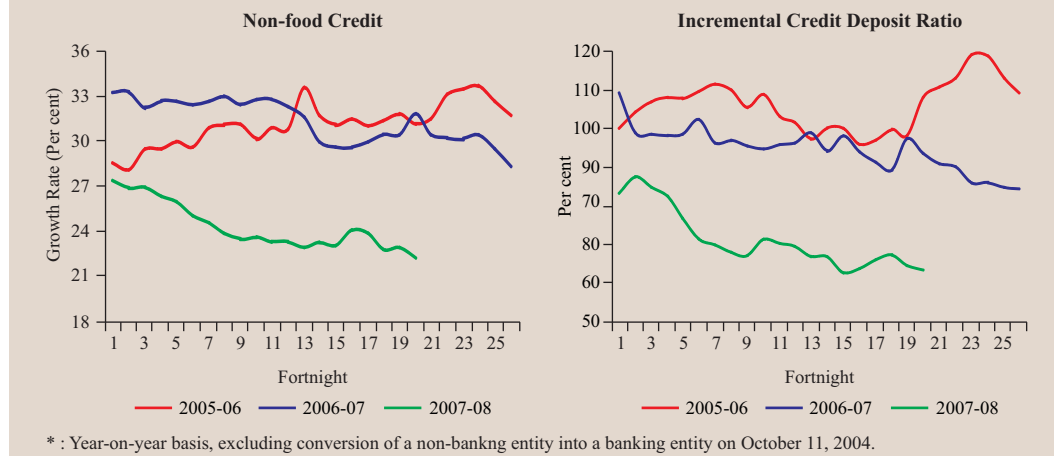
revive saving interest in postal deposits, the Government of India announced in December 2007, incentives including tax benefits for certain postal deposits.

Growth in  $M_3$ , on a financial year basis, during 2007-08 (up to January 4, 2008) at 13.3 per cent was higher than that of 12.2 per cent in the corresponding period of the previous year. Notwithstanding a sharp accretion during the third quarter of 2007-08 on account of festive season currency demand in November, currency with the public decelerated during the current financial year so far (up to January 4, 2008) (Table 20).

Growth in bank credit to the commercial sector moderated somewhat during 2007-08 (up to January 4, 2008) from the strong pace of the previous

**Table 20 : Monetary Aggregates - Variations**

	(Rupees Crore)								
Item	2006-07 up to Jan. 05	2007-08 up to Jan. 04	2006-07				2007-08		
			Q 1	Q 2	Q 3	Q 4	Q 1	Q 2	Q 3
1	2	3	4	5	6	7	8	9	10
M <sub>3</sub> (1+2+3 = 4+5+6+7-8)	3,33,864 (12.2)	4,40,056 (13.3)	55,411	1,68,401	62,951	2,93,970	76,191	1,97,025	1,19,300
<b>Components</b>									
1. Currency with the Public	51,828 (12.5)	51,721 (10.7)	23,797	-2,878	27,587	21,847	17,434	-14,231	47,535
2. Aggregates Deposits with Banks	2,83,577 (12.3)	3,90,858 (13.9)	33,227	1,70,827	35,866	2,69,833	59,194	2,12,735	72,520
2.1 Demand Deposits with Banks	2,192 (0.5)	-1,780 (-0.4)	-42,399	43,794	-8,252	74,697	-42,505	58,255	-5,577
2.2 Time Deposits with Banks	2,81,385 (14.8)	3,92,638 (16.7)	75,626	1,27,033	44,118	1,95,136	1,01,698	1,54,480	78,098
3. 'Other' Deposits with Banks	-1,541	-2,523	-1,613	452	-502	2,291	-436	-1,479	-756
<b>Sources</b>									
4. Net Bank Credit to Government	40,379 (5.3)	7,866 (0.9)	23,431	14,175	-13,204	47,180	24,833	16,479	-38,624
4.1 RBI's Net Credit to Government	-8,448	-1,55,344	53	2,826	-12,754	7,490	-25,483	-54,695	-65,787
4.1.1 RBI's Net credit to Centre	-6,079	-1,52,413	3,071	2,584	-12,568	3,889	-21,825	-55,588	-65,078
4.2 Other Banks' Credit to Government	48,828	1,63,210	23,378	11,349	-451	39,690	50,315	71,174	27,164
5. Bank Credit to Commercial Sector	2,67,159 (15.8)	2,32,017 (10.9)	14,930	1,44,204	78,099	1,93,125	-31,817	1,46,814	92,490
6. NFEA of Banking Sector	1,17,762	2,02,040	58,087	20,197	43,160	65,542	-17,945	1,18,249	94,681
6.1 NFEA of RBI	1,06,806	2,18,422	71,845	11,392	27,250	82,682	-2,745	1,19,430	94,681
7. Government's Currency Liabilities to the Public	-600	564	-920	155	166	132	140	354	70
8. Net Non-Monetary liabilities of the Banking Sector	90,837	2,431	40,117	10,330	45,269	12,009	-1,00,980	84,870	29,318
<b>Memo :</b>									
1 Non-resident Foreign Currency Deposits with SCBs	6,476	-8,965	3,917	1,671	1,233	1,011	-3,849	-1,181	-3,392
2. SCB' Call-term Borrowing from Financial Institutions	719	5,725	3,118	-1,576	-4,468	5,618	-2,984	5,756	6,943
3. Overseas Borrowing by SCBs	-4,088	1,958	3,301	-3,685	-2,774	5,229	-6,928	7,830	3,366
SCBs: Scheduled Commercial Banks.					NFEA: Net Foreign Exchange Assets.				
<b>Note:</b> 1. Figures in parentheses are percentage variations.									

**Chart 10: Scheduled Commercial Banks' Credit Growth\***

three years. Non-food credit by scheduled commercial banks (SCBs) expanded by 22.2 per cent, y-o-y, as on January 4, 2008 as compared with 28.4 per cent at end-March 2007 and 31.9 per cent a year ago. The deceleration in credit growth coupled with the acceleration in deposit growth led to a decline in the incremental credit-deposit ratio (y-o-y) of SCBs to 63.3 per cent as on January 4, 2008 from 93.7 per cent a year ago (Chart 10).

Disaggregated sectoral data available up to November 23, 2007 show that about 43 per cent of incremental non-food credit (y-o-y) was absorbed by industry, as compared with 34 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 and telecommunication), iron and steel, textiles, engineering, food processing, vehicles, petroleum, chemicals and construction industries. The infrastructure sector alone accounted for over 28 per cent of the incremental credit to industry as compared with 18 per cent in the corresponding period of the previous year. The agricultural sector absorbed around 12 per cent of the incremental non-food bank credit expansion. Personal loans accounted for nearly 23 per cent of incremental non-food credit as compared with 29 per cent a year ago; within personal loans, the share of incremental housing loans stood at 40 per cent. Growth in loans to commercial real estate remained high, notwithstanding some moderation (Table 21).

Apart from bank credit, the corporate sector continued to meet its funding requirements from non-bank sources such as capital markets, external commercial borrowings and internal generation of funds. Resources raised through domestic equity issuances during the first nine months of 2007-08 (Rs.31,897 crore) were higher by 40 per cent than the corresponding period of

**Table 21 : Deployment of Non-food Bank Credit**

(Amount in Rupees Crore)					
Sector/Industry	Outstanding as on November 23, 2007	Year-on-Year Variation			
		November 24, 2006		November 23, 2007	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
<b>Non-food Gross Bank Credit (1 to 4)</b>	<b>19,26,550</b>	<b>3,66,638</b>	<b>30.4</b>	<b>3,52,287</b>	<b>22.4</b>
<b>1. Agriculture and Allied Activities</b>	<b>2,32,124</b>	<b>45,788</b>	<b>31.5</b>	<b>40,863</b>	<b>21.4</b>
<b>2. Industry (Small, Medium and Large)</b>	<b>7,55,440</b>	<b>1,22,984</b>	<b>25.6</b>	<b>1,52,346</b>	<b>25.3</b>
Small Scale Industries	1,30,284	16,850	21.1	33,259	34.3
<b>3. Personal Loans</b>	<b>4,88,413</b>	<b>1,05,034</b>	<b>35.0</b>	<b>81,451</b>	<b>20.0</b>
Housing	2,46,689	53,198	33.4	32,424	15.1
Advances against Fixed Deposits	39,269	1,671	5.4	6,360	19.3
Credit Cards	16,951	3,564	43.3	5,157	43.7
Education	18,992	4,157	47.4	5,856	44.6
Consumer Durables	9,081	957	11.2	-419	-4.4
<b>4. Services</b>	<b>4,50,573</b>	<b>92,832</b>	<b>33.3</b>	<b>77,627</b>	<b>20.8</b>
Transport Operators	29,614	9,676	81.4	7,903	36.4
Professional & Other Services	24,861	6,480	52.8	5,941	31.4
Trade	1,11,835	23,613	34.4	16,828	17.7
Real Estate Loans	50,660	16,603	77.7	12,563	33.0
Non-Banking Financial Companies	53,400	6,850	25.5	18,555	53.3
<i>Memo:</i>					
<b>Priority Sector</b>	<b>6,61,459</b>	<b>1,10,030</b>	<b>25.1</b>	<b>1,11,851</b>	<b>20.4</b>
<b>Industry (Small, Medium and Large)</b>	<b>7,55,440</b>	<b>1,22,984</b>	<b>25.6</b>	<b>1,52,346</b>	<b>25.3</b>
Food Processing	42,966	6,493	24.4	9,916	30.0
Textiles	83,478	15,602	30.3	16,376	24.4
Paper & Paper Products	12,262	2,110	25.6	1,973	19.2
Petroleum, Coal Products & Nuclear Fuels	34,936	9,368	46.2	5,277	17.8
Chemical and Chemical Products	56,284	9,682	23.4	5,224	10.2
Rubber, Plastic & their Products	9,266	1,438	23.6	1,740	23.1
Iron and Steel	76,367	15,349	36.5	18,703	32.4
Other Metal & Metal Products	21,149	5,110	36.5	2,100	11.0
Engineering	48,500	4,950	15.1	10,734	28.4
Vehicles, Vehicle Parts and Transport Equipments	26,091	2,079	12.4	7,248	38.5
Gems & Jewellery	24,380	3,640	19.2	1,823	8.1
Construction	21,754	4,549	39.3	5,880	37.0
Infrastructure	1,63,754	22,034	22.2	42,030	34.5
<b>Note :</b> 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.					

the previous year. Mobilisation in the form of equity issuances through American depository receipts (ADRs) and global depository receipts (GDRs) during April-December 2007 (Rs.11,439 crore) were higher by 43 per cent than a year ago. Net mobilisation through external commercial borrowings (ECBs) during April-September 2007 increased by nearly 50 per cent over the corresponding period of the previous year. Internal generation of funds continued to provide strong support to the funding requirements of the corporate sector, with the profit

after tax of sample non-financial non-government companies during the first and second quarters of 2007-08 being higher than during the corresponding quarters of the previous year (Table 22).

Growth in deposits, issuances of fresh capital and internal generation of funds by banks on the one hand, and moderation in credit growth on the other, enabled banks to deploy their funds in Government and other approved securities, which increased by 24.7 per cent, y-o-y, as on January 4, 2008 as compared with 5.9 per cent a year ago (Table 23). Commercial banks' holdings of such securities as on January 4, 2008 increased to 29.1 per cent of their NDTL from 28.0 per cent at end-March 2007 and 28.6 per cent a year ago (Chart 11). Excess SLR investments of SCBs, thus, increased to Rs.1,33,017 crore on January 4, 2008 from Rs.84,223 crore at end-March 2007 and Rs. 95,975 crore a year ago. Banks' balances with the Reserve Bank expanded, reflecting the impact of the increase in their NDTL as well as the increase in the CRR. Investments by SCBs in non-SLR securities (such as shares/bonds/commercial papers) increased substantially during the year. As regards banks' exposure to the external sector, while banks' overseas borrowings expanded, their holdings of foreign currency assets declined.

**Table 22 : Select Sources of Funds to Industry**

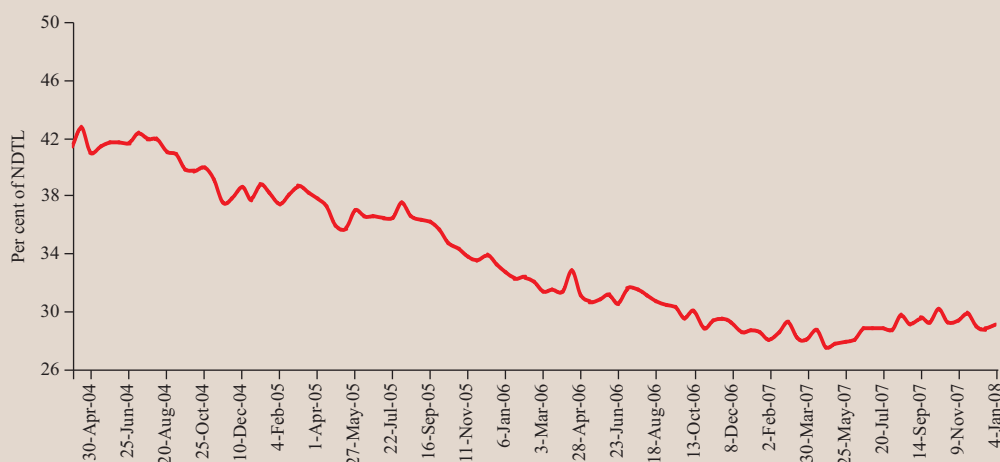
Item	(Rupees Crore)								
			Variation During						
	2005-06	2006-07	2006-07				2007-08		
			Q1	Q2	Q3	Q4	Q1	Q2	Q3
1	2	3	4	5	6	7	8	9	10
<b>A. Bank Credit to Industry #</b>	<b>1,26,804</b>	<b>1,41,543</b>	<b>-2,336</b>	<b>49,290</b>	<b>28,415</b>	<b>66,174</b>	<b>-15,603</b>	<b>59,776</b>	<b>13,933 *</b>
<b>B. Flow from Non-banks to Corporates</b>									
1. Capital Issues (i+ii)	13,781	29,180	10,627	1,882	10,840	5,831	13,788	6,226	14,400
i) Non-Government Public Ltd. Companies (a+b)	13,408	29,180	10,627	1,882	10,840	5,831	13,261	4,236	14,400
a) Bonds/Debentures	245	585	0	0	491	94	0	0	0
b) Shares	13,163	28,595	10,627	1,882	10,349	5,737	13,261	4,236	14,400
ii) PSUs and Government Companies	373	0	0	0	0	0	527	1,990	0
2. ADR/GDR Issues	7,263	16,184	4,965	2,130	924	8,165	1,251	9,899	289
3. External Commercial Borrowings (ECBs)	52,877	1,04,046	24,063	20,867	26,036	33,080	37,321	29,604	-
4. Issue of CPs	-1,517	4,970	6,931	4,795	-908	-5,848	8,568	7,358	7,811 @
<b>C. Depreciation Provision +</b>	<b>28,961</b>	<b>37,095</b>	<b>8,449</b>	<b>8,892</b>	<b>9,172</b>	<b>10,338</b>	<b>10,173</b>	<b>10,576</b>	<b>-</b>
<b>D. Profit after Tax +</b>	<b>60,236</b>	<b>1,11,107</b>	<b>24,845</b>	<b>27,710</b>	<b>28,698</b>	<b>31,251</b>	<b>32,699</b>	<b>34,266</b>	<b>-</b>
-	: Not Available.    *: Up to November 23, 2007.    @: Up to December 15, 2007.								
#	: Data pertain to select scheduled commercial banks. Figures for 2005-06 are not comparable with those for the latter period due to increase in number of banks selected in the sample.								
+	: Data for 2005-06 are based on audited balance sheet, while those for 2006-07 and 2007-08 are based on abridged financial result of the select non-Government non-financial public limited companies. The quarterly data may not add up to annual data due to differences in the number and composition of companies covered in each period.								
<b>Note:</b>	1. Data are provisional.								
	2. Data on capital issues pertain to gross issuances excluding issues by banks and financial institutions and 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.								

**Table 23 : Scheduled Commercial Bank's Survey**

Item	(Amount in Rupees Crore)				
	Outstanding as on Jan. 04, 2008	Variation (Year-on-Year)			
		As on Jan. 05, 2007		As on Jan. 04, 2008	
		Amount	Per Cent	Amount	Per Cent
1	2	3	4	5	6
<b>Sources of Funds</b>					
1. Aggregate Deposits	29,88,207	4,44,241	22.9	6,00,761	25.2
2. Call/Term Funding from Financial Institutions	91,561	2,499	3.1	7,699	9.2
3. Overseas Foreign Currency Borrowings	33,863	-4,991	-16.2	8,116	31.5
4. Capital	38,768	2,620	8.8	6,301	19.4
5. Reserves	2,20,432	25,750	18.4	54,493	32.8
<b>Uses of Funds</b>					
1. Bank Credit	21,46,518	4,16,401	30.8	3,80,356	21.5
of which: Non-food Credit	21,05,235	4,16,418	31.9	3,82,155	22.2
2. Investments in Government and Other Approved Securities	9,54,889	42,836	5.9	1,89,349	24.7
a) Investments in Government Securities	9,35,579	45,379	6.4	1,85,524	24.7
b) Investments in Other Approved Securities	19,310	-2,543	-14.1	3,825	24.7
3. Investments in non-SLR Securities	1,73,749	10,650	8.4	35,623	25.8
4. Foreign Currency Assets	31,243	12,122	30.8	-20,236	-39.3
5. Balances with the RBI	2,29,581	29,223	28.9	99,241	76.1
<b>Note:</b> Data are provisional.					

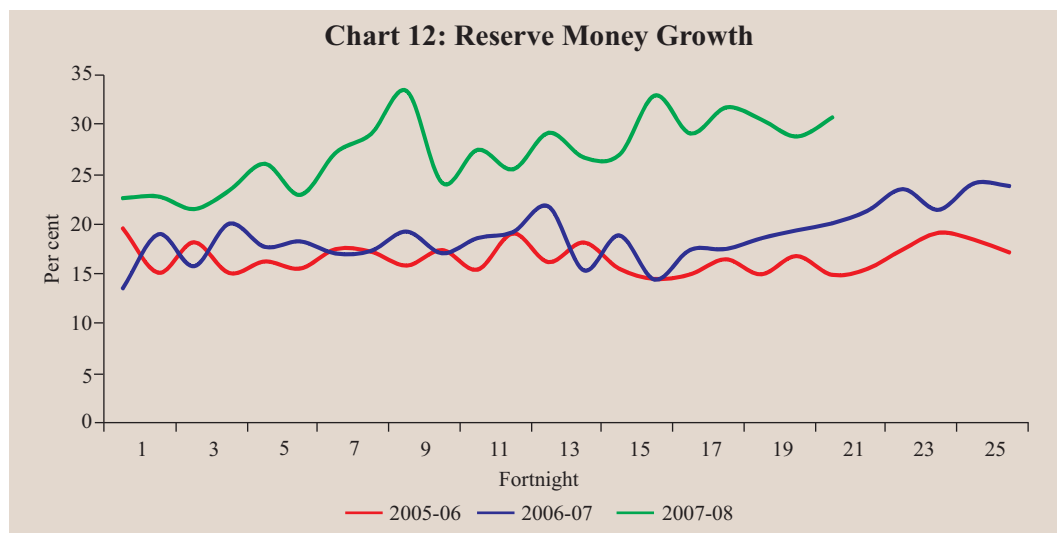
### Reserve Money Survey

Reserve money growth at 30.6 per cent, y-o-y, as on January 18, 2008 was higher than 20.0 per cent a year ago (Chart 12). Adjusted for first round effect<sup>1</sup> of the hike in CRR, the reserve money growth was 21.5 per cent as

**Chart 11: SLR Investments by Scheduled Commercial Banks**

<sup>1</sup>The CRR was increased by 250 basis points in stages between December 2006 and November 2007. The first round impact of the increase in CRR is estimated to have impounded banks' resources of Rs.74,500 crore.





compared with 17.5 per cent a year ago. Intra-year movements in reserve money largely reflected the Reserve Bank's market operations and hikes in the CRR.

Growth in reserve money during the financial year 2007-08 (up to January 18, 2008) was 18.2 per cent (11.6 per cent adjusted for the first round effect of the hikes in the CRR) as compared with 12.0 per cent in the corresponding period of 2006-07. Bankers' deposits with the Reserve Bank expanded by 35.4 per cent during 2007-08 (up to January 18, 2008) as compared with 9.1 per cent during the corresponding period of 2006-07 mainly reflecting the hike in the CRR by 150 basis points during April-December, 2007. Currency in circulation expanded by 12.3 per cent as compared with 13.4 per cent during the corresponding period of the previous year (Table 24).

Expansion in reserve money during 2007-08 (up to January 18, 2008) continued to be driven largely by foreign currency assets (adjusted for revaluation), which rose by Rs.3,11,941 crore as compared with Rs.80,166 crore during the corresponding period of the previous year (Chart 13).

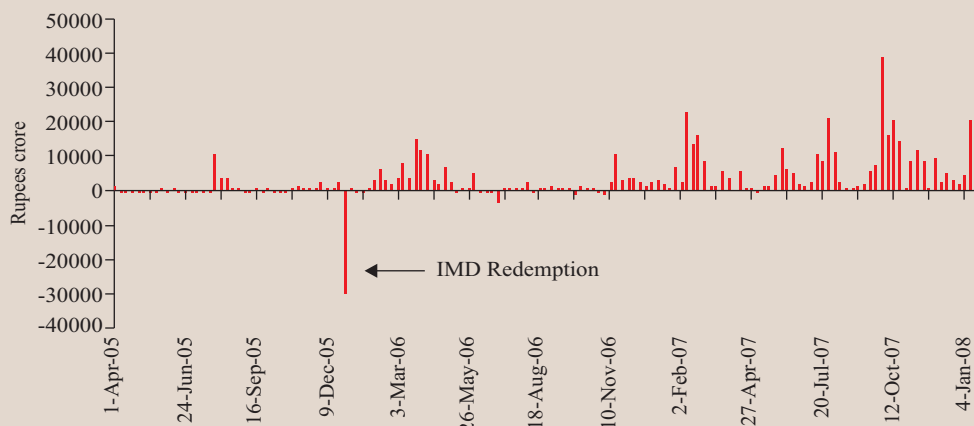
Movements in the Reserve Bank's net credit to the Central Government largely reflected the liquidity management operations by the Reserve Bank and movements in Government deposits with the Reserve Bank. Reserve Bank's holdings of Central Government dated securities declined on account of absorption of liquidity in recent period under the liquidity adjustment facility (LAF). The sterilisation operations of the Reserve Bank under the MSS led to an increase in Central Government deposits with the Reserve Bank. Surplus balances of the Central Government with the Reserve Bank also increased. Reflecting these developments, the Reserve Bank's net credit to the Centre declined by Rs.1,57,815 crore during 2007-08 (up to January 18, 2008) as against an increase of Rs. 6,963 crore during the corresponding period of the previous year.

**Table 24 : Reserve Money - Variations**

(Amount in Rupees Crore)										
1	2006-07 April- March	2006-07 up to Jan. 19	2007-08 up to Jan. 18	Variation						
				2006-07			2007-08			
				Q1	Q2	Q3	Q1	Q2	Q3	
2	3	4	5	6	7	8	9	10	11	
<b>Reserve Money</b>	1,35,961 (23.7)	68,764 (12.0)	1,29,034 (18.2)	13,466	18,665	14,204	89,626	11,604	60,688	26,414
<b>Components (1+2+3)</b>										
1. Currency in Circulation	73,549 (17.1)	57,726 (13.4)	61,964 (12.3)	22,283	-2,011	26,871	26,405	16,840	-13,297	46,539
2. Bankers' Deposits with RBI	61,784 (45.6)	12,319 (9.1)	69,760 (35.4)	-7,204	20,224	-12,165	60,929	-4,800	75,464	-19,369
3. 'Other' Deposits with the RBI	628 (9.1)	-1,280 (-18.6)	-2,690 (-35.9)	-1,613	452	-502	2,291	-436	-1,479	-756
<b>Sources (1+2+3+4-5)</b>										
1. RBI's net credit to Government	-2,384	4,106	-1,61,631	53	2,826	-12,754	7,490	-25,483	-54,695	-65,787
of which: to Centre (i+ii+iii+iv-v)	-3,024	6,963	-1,57,815	3,071	2,584	-12,568	3,889	-21,825	-55,588	-65,078
i. Loans and Advances	0	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	0
iii. RBI's Holdings of Dated Securities	26,763	10,615	-52,149	-27,610	24,944	22,733	6,696	-34,284	4,019	20,874
iv. RBI's Holdings of Rupee coins	-143	-37	93	9	-107	97	-142	128	20	3
v. Central Government Deposits	29,644	3,615	1,05,759	-30,672	22,253	35,398	2,665	-12,330	59,627	85,956
2. RBI's credit to banks and commercial sector	1,990	2,528	-3,282	-3,135	3,107	2,065	-47	-6,450	-1256	848
3. NFEA of RBI	1,93,170 (28.7)	1,14,337 (17.0)	2,51,026 (29.0)	71,845	11,392	27,250	82,682	-2,745	1,19,430	94,681
of which:										
FCA, adjusted for revaluation	1,64,601	80,166	3,11,941	28,107	10,948	31,634	93,913	47,728	1,18,074	1,00,888
4. Governments' Currency Liabilities to the Public	-467	-550	564	-920	155	166	132	140	354	70
5. Net Non-Monetary liabilities of RBI	56,347	51,657	-42,357	54,376	-1,184	2,524	632	-46,142	3,145	3,398
<b>Memo:</b>										
LAF- Repos (+) / Reverse Repos (-)	36,435	19,060	-41,120	-23,060	28,395	22,195	8,905	-32,182	9,067	16,300
Net Open Market Sales # *	5,125	3,656	-1,793	1,536	1,176	389	2,024	1,246	1,560	-3,919
Centre's Surplus	1,164	-400	9,658	-27,320	13,313	38,713	-23,542	-34,597	15,376	54,765
Mobilisation under MSS	33,912	11,429	98,084	4,062	8,940	-3,315	24,225	19,643	48,856	31,192
Net Purchases(+)/Sales(-) from Authorised Dealers	1,18,994	48,402	2,15,605 ^	21,545	0	19,776	77,673	38,873	1,01,814	74,918 ^
NFEA/Reserve Money @	122.2	122.7	133.3	127.0	125.0	126.5	122.2	119.8	125.8	133.4
NFEA/Currency @	171.8	161.2	197.3	164.4	167.7	164.0	171.8	165.7	193.6	194.4
NFEA: Net Foreign Exchange Assets. FCA: Foreign Currency Assets. LAF: Liquidity Adjustment Facility.										
*: At face value. # : Excludes Treasury Bills @ : Per cent, end of period. ^ : Up to November 23, 2007										
<b>Note:</b> 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.										

## Liquidity Management

The Reserve Bank continued to ensure the maintenance of appropriate liquidity in the system during 2007-08 so far such that all legitimate requirements of credit were met, particularly for productive purposes, consistent with the objective of price and financial stability. In order to achieve this objective, the Reserve Bank used the various policy instruments at its disposal

**Chart 13: Accretion to RBI's Net Foreign Assets**

in a flexible manner to manage liquidity. Capital flows and variation in cash balances of the Central Government remained the key drivers of liquidity conditions.

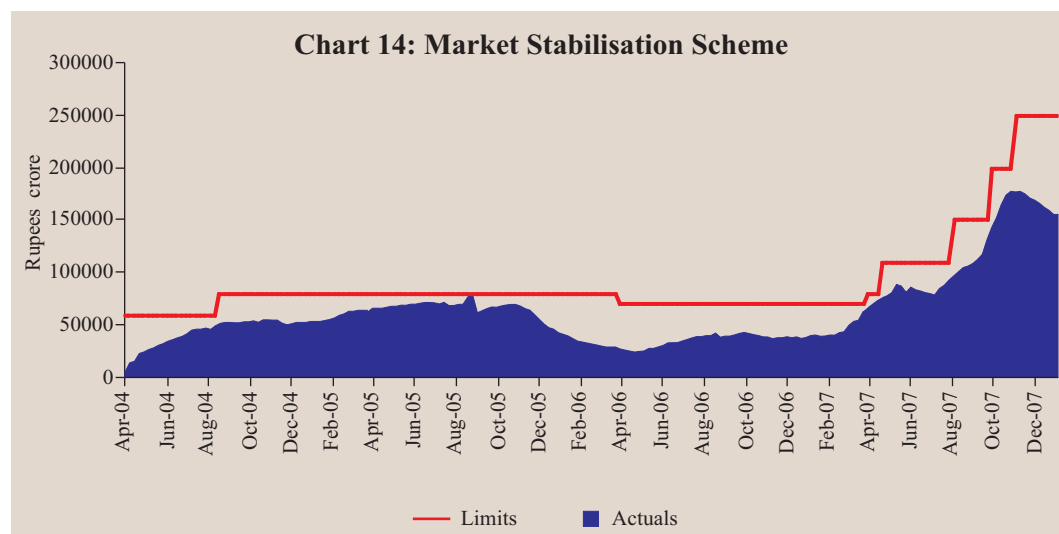
The first quarter of 2007-08 was generally characterised by easy liquidity conditions interspersed with transient periods of tightness (Table 25). The LAF operations shifted gradually from an injection mode to an absorption mode. However, as the liquidity absorption through reverse repos had been capped at Rs. 3,000 crore under the modified arrangement of LAF between March 5 and August 5, 2007, the Reserve Bank predominantly managed liquidity through the two-stage 50 basis points increase in CRR in April 2007 and increased issuances of government securities under the MSS. The ceiling for outstandings under the MSS was raised from Rs.80,000 crore to Rs.1,10,000 crore on April 27, 2007 (Chart 14). The brief periods of liquidity tightness witnessed during this quarter were assuaged through repos under LAF (Chart 15).

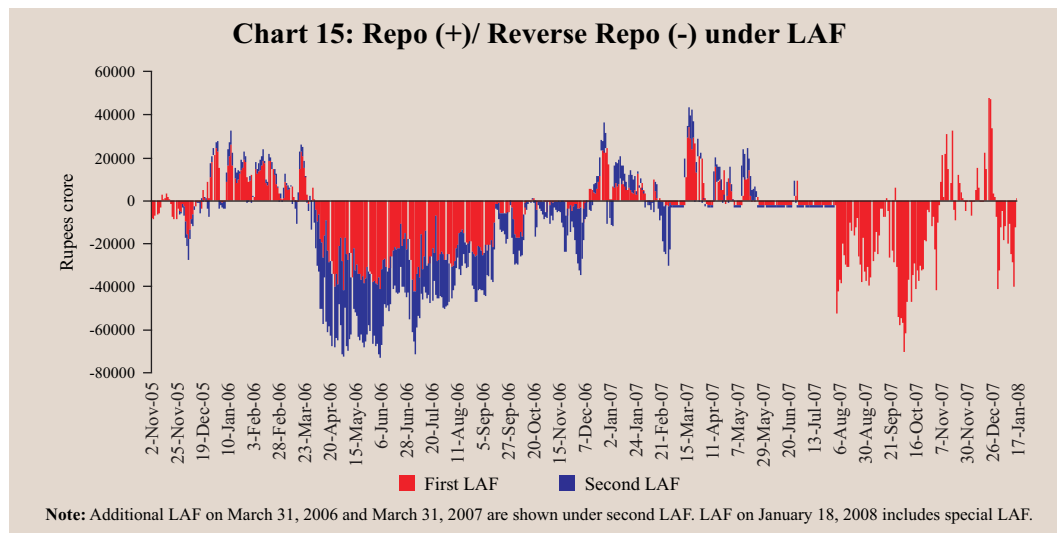
In the second quarter, consequent upon the withdrawal of the ceiling on daily reverse repos under the LAF with effect from August 6, 2007, the Reserve Bank absorbed liquidity through large daily reverse repos under LAF in addition to sizeable absorptions under MSS. The ceiling for outstandings under the MSS was raised to Rs.1,50,000 crore in August 2007. The cumulative impact of the hike in CRR by 50 basis points to 7.0 per cent in August 2007 and also market operations under the MSS moderated the daily reverse repos bids by the close of the quarter. The liquidity conditions mostly remained easy in early September 2007 due to decline in Government cash balances. Some tightness was, however, observed during the end of the month mainly on account of quarterly advance tax outflows and there were liquidity injections through repo window on September 21 and 28, 2007.

**Table 25 : Reserve Banks' Liquidity Management Operations**

(Amount in Rupees Crore)											
1	Variation										
	2006-07 April- March	2006-07				2007-08					
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Oct.	Nov.	Dec.
2	3	4	5	6	7	8	9	10	11	12	
<b>A. Drivers of Liquidity (1+2+3+4+5)</b>	61,739	36,247	-16,896	-25,641	68,028	51,924	1,10,645	-	37,306	3,531	-
1.RBI's net Purchases from Authorised Dealers	1,18,994	21,545	0	22,461	74,988	39,791	1,00,896	-	48,795	31,583	-
2.Currency with the Public	-70,352	-19,648	-1,270	-27,033	-22,400	-12,143	8,940	-46,944	-19,187	-17,041	-10,715
3.Surplus Cash balances of the Centre with the Reserve Bank	-1,164	40,207	-26,199	-30,761	15,590	49,992	-30,771	-49,820	7,036	-12,933	-43,923
4.WMA and OD	0	0	0	0	0	15,159	-15,159	0	0	0	0
5.Others (residual)	14,260	-5,856	10,574	9,693	-150	-40,876	46,739	-	663	1,922	-
<b>B. Management of Liquidity (6+7+8+9)</b>	<b>-24,257</b>	<b>-39,003</b>	<b>32,026</b>	<b>31,625</b>	<b>-48,905</b>	<b>-53,943</b>	<b>-68,621</b>	<b>-11,189</b>	<b>-67,009</b>	<b>6,264</b>	<b>49,556</b>
6.Liquidity impact of LAF Repos	36,435	-35,315	40,650	33,600	-2,500	-20,290	-2,825	27,795	-24,205	19,455	32,545
7.Liquidity impact of OMO(Net)*	720	545	145	25	5	10	40	5,260	0	0	5,260
8.Liquidity impact of MSS	-33,912	-4,233	-8,769	4,750	-25,660	-18,163	-50,336	-28,244	-42,804	2,809	11,751
9.First round liquidity impact due to CRR change	-27,500	0	0	-6,750	-20,750	-15,500	-15,500	-16,000	0	-16,000	0
<b>C. Bank Reserves (A+B) #</b>	<b>37,482</b>	<b>-2,756</b>	<b>15,130</b>	<b>5,984</b>	<b>19,123</b>	<b>-2,019</b>	<b>42,024</b>	<b>-12,937</b>	<b>-29,703</b>	<b>9,795</b>	<b>6,971</b>
-	: 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.										
<b>Note</b>	: For end-March, data pertain to March 31; for all other months data pertain to last Friday.										

The third quarter commenced with surplus liquidity due to a decline in surplus balances of the Central Government and net purchase of foreign exchange by the Reserve Bank. Daily absorption under the LAF averaged Rs.36,665 crore in October 2007. The continued inflow of foreign capital





necessitated an upward revision in the ceiling for outstandings under MSS to Rs.2,00,000 crore on October 4, 2007 and further to Rs.2,50,000 crore on November 7, 2007.

Liquidity conditions came under some stress towards the end of October and early part of November 2007 on account of festive season currency demand and increase in Central Government balances with the Reserve Bank. Liquidity absorption under the reverse repo window of the LAF, therefore, declined to Rs.10,384 crore during November 1-11, 2007. Liquidity conditions tightened from November 12, 2007 due to impact of CRR hike of 50 basis points to 7.5 per cent with effect from the fortnight beginning November 10, 2007 and the increase in surplus balances of the Central Government. The Reserve Bank, therefore, had to inject liquidity; the average daily net liquidity injection under LAF was at Rs.10,341 crore during November 12-30, 2007. The investment of Central government surplus cash balances in dated securities (up to Rs.20,000 crore) which was temporarily suspended between October 4, 2007 and November 19, 2007 was restored with a tightening of liquidity conditions. The tight liquidity conditions continued in December 2007 on account of quarterly advance tax outflows. Average daily net injection under the LAF amounted to Rs.10,804 crore in December 2007.

Liquidity conditions started easing from the beginning of January 2008 partly on account of reduction in surplus balances of the Central Government with the Reserve Bank. The average liquidity absorption under the reverse repo was Rs.18,057 crore during January 1-23, 2008. The steady increase in MSS outstandings is reflected in the significant build up of liquidity overhang since

August 2007. The outstandings under the MSS amounted to Rs.1,61,058 crore as on January 18, 2008 (Table 26).

During the course of 2007-08, the stock of Government securities in Reserve Bank's portfolio got reduced by Rs. 12,485 crore (up to January 18, 2008) mainly on account of periodic redemptions. In order to replenish its stock of Government securities the Reserve Bank resorted to purchases of government securities through open market operations, beginning December 2007. During 2007-08 (up to January 18, 2008) the total amount of Government securities purchased under open market operations was Rs. 8,070 crore. Such operations are liquidity neutral up to the amount of redemption of Government securities in the portfolio of the Reserve Bank.

**Table 26 : Liquidity Management**

(Rupees crore)				
Outstanding as on Last Friday	LAF	MSS	Centre's Surplus with the RBI @	Total (2 to 4)
1	2	3	4	5
<b>2006</b>				
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
<b>2007</b>				
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	2992	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	18,135	1,74,277	23,735	2,16,147
November	-1,320	1,71,468	36,668	2,06,816
December	-33,865	1,59,717	80,591	2,06,443
<b>2008</b>				
January (up to Jan. 18)	11,935	1,61,058	59,650	2,32,643

@ : 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. 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. Negative sign in column 4 indicates injection of liquidity through WMA/overdraft.