

### III. MONETARY AND LIQUIDITY CONDITIONS

Monetary and liquidity aggregates witnessed some moderation during the second quarter of 2008-09, reflecting decline in capital inflows. Expansion in bank credit to the commercial sector during 2008-09 so far has remained strong and above the Reserve Bank's policy projection of 20.0 per cent for 2008-09 as indicated in the Annual Policy Statement (APS, April 2008). Year-on-year (y-o-y) growth in broad money ( $M_3$ ) as on September 26, 2008 was above the indicative trajectory of 17.0 per cent set out in the First Quarter Review (July 2008) of the APS<sup>1</sup> for 2008-09. Accretion to bank deposits, led by time deposits, continued to remain strong, although with some moderation. Banks' investments in SLR securities as a proportion of their net demand and time liabilities (NDTL) remained lower than at end-March 2008 and as compared with a year ago. The Reserve Bank has continued to actively manage liquidity during 2008-09 so far by using all the policy instruments at its command, including cash reserve ratio (CRR), operations under the market stabilisation scheme (MSS), operations under the liquidity adjustment facility (LAF) and conduct of open market operations (OMO).

#### Monetary Survey

Broad money ( $M_3$ ) growth, on a year-on-year (y-o-y) basis, was placed at 19.0 per cent as on September 26, 2008 as compared with 21.5 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 - was lower at 19.4 per cent as on September 26, 2008 than 21.3 per cent a year ago. Growth in liquidity aggregate,  $L_1$ , was 18.7 per cent at end-September 2008 as compared with 20.7 per cent a year ago (Table 20 and Chart 8).

In view of the continued inflationary pressures, monetary policy recognised the need to smoothen and enable an adjustment of overall demand on an economy-wide basis to bring down inflation from the current high levels and stabilise inflationary expectations. Accordingly, the CRR was raised by 150 basis points in four phases during April-September 2008-09 to 9.0 per cent. The estimated amount of liquidity impounded in the first round on account of the

<sup>1</sup> APS for 2008-09 (April 2008) projected the broad money growth in the range of 16.5-17.0 per cent. This was revised to 17.0 per cent in the First-Quarter Review (July 2008) of the APS.

**Table 20: Monetary Indicators**

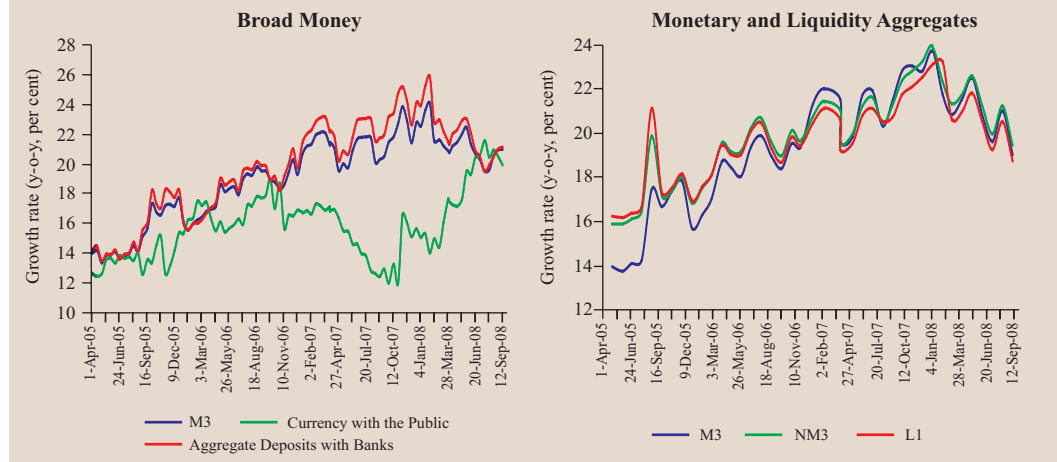
(Amount in Rupees crore)							
Item	Outstanding as on September 26, 2008	Variation (year-on-year)					
		September 28, 2007		March 31, 2008		September 26, 2008	
		Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8
I. Reserve Money*	9,75,081	1,59,261	26.6	2,19,427	30.9	2,17,685	28.7
II. Narrow Money (M <sub>1</sub> )	11,37,129	1,34,277	15.8	1,84,864	19.1	1,55,325	15.8
III. Broad Money (M <sub>3</sub> )	42,71,086	6,35,669	21.5	6,90,629	20.8	6,82,060	19.0
a) Currency with the Public	5,86,989	52,350	12.1	84,571	17.5	1,00,602	20.7
b) Aggregate Deposits	36,78,683	5,83,446	23.2	6,04,485	21.4	5,81,625	18.8
i) Demand Deposits	5,44,726	82,053	20.1	98,721	20.8	54,890	11.2
ii) Time Deposits	31,13,957	5,01,392	23.8	5,05,765	21.5	5,26,735	20.2
of which: Non-Resident Foreign Currency Deposits	62,595	-2,786	-4.3	-10,525	-15.6	516	0.8
IV. NM <sub>3</sub>	42,93,140	6,31,713	21.3	7,08,101	21.3	6,96,334	19.4
of which: Call Term Funding from FIs	1,09,895	3,922	4.6	20,668	24.1	21,287	24.0
V. a) L <sub>1</sub>	44,08,647	6,37,572	20.7	7,07,403	20.6	6,94,959	18.7
of which: Postal Deposits	1,15,507	5,859	5.3	-698	-0.6	-1,375	-1.2
b) L <sub>2</sub>	44,11,579	6,37,572	20.7	7,07,403	20.8	6,94,959	18.7
c) L <sub>3</sub>	44,36,226	6,36,657	20.5	7,08,236	20.4	6,94,943	18.6
VI. Major Sources of Broad Money							
a) Net Bank Credit to the Government (i+ii)	9,68,627	73,768	9.2	72,842	8.7	90,658	10.3
i) Net Reserve Bank Credit to Government	-61,862	-85,441	-	-1,15,632	-	12,564	-
of which: to the Centre	-61,827	-86,092	-	-1,16,772	-	13,450	-
ii) Other Banks' Credit to Government	10,30,489	1,59,209	20.1	1,88,474	22.7	78,094	8.2
b) Bank Credit to the Commercial Sector	27,66,160	3,92,834	21.2	4,39,834	20.6	5,21,187	23.2
c) Net Foreign Exchange Assets	13,72,326	2,09,006	26.0	3,81,952	41.8	3,58,843	35.4
d) Government Currency Liability to Public	9,624	793	9.9	1,064	12.9	844	9.6
e) Net Non-Monetary Liabilities of the Banking Sector	8,45,651	40,731	7.9	2,05,063	36.0	2,89,471	52.0
<i>Memo:</i>							
Aggregate Deposits of SCBs	34,42,138	5,62,024	24.3	5,85,006	22.4	5,68,403	19.8
Non-food Credit of SCBs	24,97,292	3,72,438	22.9	4,32,846	23.0	4,96,821	24.8
*: Data pertain to October 10, 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 + Term borrowing by FIs + Certificates of deposit issued by FIs.							
L <sub>3</sub> = L <sub>2</sub> + Public deposits of NBFCs.							
<b>Note:</b> 1. Data are provisional. Wherever data are not available, the data for last available month is repeated as estimates.							

CRR hikes was Rs.57,750 crore<sup>2</sup>. Furthermore, the Reserve Bank during April-September 2008-09 also increased the repo rate by 125 basis points to 9.0 per cent.

On a review of the prevailing liquidity situation in the context of global and domestic developments, the Reserve Bank reduced CRR by 250 basis points to

<sup>2</sup> Between December 2006 and September 2008, the Reserve Bank increased CRR by 400 basis points and the estimated amount of liquidity impounded in the first round due to hikes in the CRR was Rs. 1,32,250 crore.

Chart 8: Money Supply



6.5 per cent with effect from the fortnight beginning October 11, 2008. As a result of this reduction in the CRR, an amount of about Rs.1,00,000 crore was expected to be released into the banking system. Moreover, on October 20, 2008, the Reserve Bank announced a reduction of the repo rate by 100 basis points to 8.0 per cent with immediate effect.

Currency with the public grew by 20.7 per cent (y-o-y) as on September 26, 2008 as compared with 12.1 per cent a year ago. Growth in demand deposits (y-o-y) as on September 26, 2008 at 11.2 per cent was lower than that of 20.1 per cent a year ago. Narrow money growth ( $M_1$ ), y-o-y, was 15.8 per cent as on September 26, 2008 the same as a year ago. The strong growth in time deposits has continued in 2008-09 so far, although with some moderation. The growth of time deposits was placed at 20.2 per cent (y-o-y) as on September 26, 2008, lower than 23.8 per cent a year ago (Table 21). The strong growth in time deposits could be attributed, *inter alia*, to robust economic activity, higher interest rates on bank deposits relative to postal deposits and extension of tax benefits under Section 80C for bank deposits. During 2007-08, accretion to postal deposits decelerated significantly up to November 2007. Beginning December 2007, there were net outflow from small saving schemes (Chart 9). In order to revive interest in postal deposits, the Government announced in December 2007 some incentives, including tax benefits for certain postal deposits. However, net outflows continued up to August 2008, latest period for which data are available.

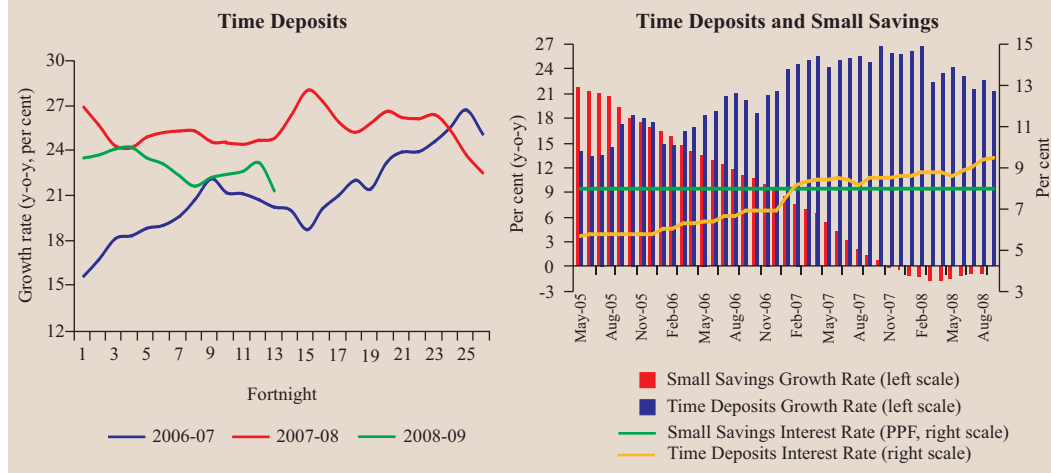
On a financial year basis, growth in  $M_3$  during 2008-09 (up to September 26, 2008) was 6.6 per cents as compared with 8.2 per cent during the corresponding period of the previous year. Currency with the public expanded by

**Table 21: Monetary Aggregates - Variations**

(Rupees Crore)								
Item	2007-08 (up to Sept. 28)	2008-09 (up to Sept. 26)	2007-08				2008-09	
			Q 1	Q 2	Q 3	Q 4	Q 1	Q 2
1	2	3	4	5	6	7	8	9
<b>M<sub>3</sub> (1+2+3 = 4+5+6+7-8)</b>	<b>2,72,933</b>	<b>2,64,364</b>	<b>73,824</b>	<b>1,99,109</b>	<b>1,16,442</b>	<b>3,01,254</b>	<b>87,661</b>	<b>1,76,703</b>
	<b>(8.2)</b>	<b>(6.6)</b>						
<b>Components</b>								
1 Currency with the Public	3,482	19,513	18,237	-14,756	47,723	33,366	36,317	-16,804
	(0.7)	(3.4)						
2 Aggregates Deposits with Banks	2,71,367	2,48,506	56,023	2,15,344	69,536	2,63,583	55,496	1,93,010
	(9.6)	(7.2)						
2.1 Demand Deposits with Banks	14,149	-29,681	-44,030	58,180	-7,275	91,847	-79,731	50,050
	(3.0)	(-5.2)						
2.2 Time Deposits with Banks	2,57,217	2,78,188	1,00,053	1,57,164	76,811	1,71,736	1,35,228	1,42,960
	(10.9)	(9.7)						
3 'Other' Deposits with Banks	-1,915	-3,655	-436	-1,479	-817	4,305	-4,152	497
<b>Sources</b>								
4 Net Bank Credit to Government	43,734	61,550	28,117	15,618	-36,493	65,601	35,777	25,773
	(5.2)	(6.8)						
4.1 RBI's Net Credit to Government	-76,849	51,347	-22,154	-54,695	-65,787	27,004	-13	51,360
4.1.1 RBI's Net Credit to the Centre	-77,413	52,809	-21,825	-55,588	-65,078	25,719	1,430	51,379
4.2 Other Banks' Credit to Government	1,20,583	10,203	50,270	70,313	29,294	38,597	35,791	-25,588
5 Bank Credit to the Commercial Sector	1,14,895	1,96,248	-30,547	1,45,442	86,877	2,38,062	36,975	1,59,272
	(5.4)	(7.6)						
6 NFEA of Banking Sector	1,00,304	77,194	-17,945	1,18,249	94,204	1,87,444	66,858	10,336
6.1 NFEA of the RBI	1,16,686	1,14,268	-2,745	1,19,430	94,681	1,58,610	1,03,932	10,336
7 Government's Currency Liabilities to the Public	520	300	166	354	312	232	125	175
8 Net Non-Monetary Liabilities of the Banking Sector	-13,480	70,928	-94,033	80,553	28,459	1,90,084	52,074	18,854
<b>Memo:</b>								
1 Non-resident Foreign Currency Deposits with SCBs	-5,382	5,660	-4,202	-1,181	-3,490	-1,653	2,048	3,611
2 SCB' Call-term Borrowing from Financial Institutions	2,772	3,391	-2,984	5,756	7,441	10,455	-1,116	4,506
3 Overseas Borrowing by SCBs	902	13,407	-6,928	7,830	1,734	9,909	9,494	3,914
SCBs: Scheduled Commercial Banks. NFEA: Net Foreign Exchange Assets.								
<b>Note:</b> 1. Data are provisional.								

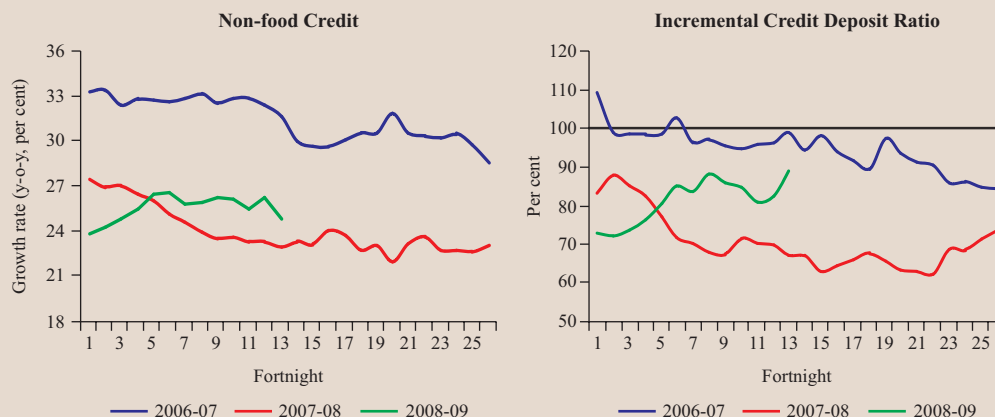
3.4 per cent (up to September 26, 2008) as compared with 0.7 per cent during the corresponding period of the previous year.

Bank credit to the commercial sector increased by 23.2 per cent (y-o-y) as on September 26, 2008 as compared with 21.2 per cent a year ago. Non-food credit by scheduled commercial banks (SCBs) expanded by 24.8 per cent, y-o-y, as on September 26, 2008, higher than 22.9 per cent a year ago. The higher expansion in credit growth relative to the expansion in deposit growth resulted

**Chart 9: Time Deposits Growth**

in an increase in the incremental credit-deposit ratio (y-o-y) of SCBs to 88.8 per cent as on September 26, 2008 from 66.9 per cent a year ago (Chart 10).

Disaggregated sectoral data available up to August 29, 2008 showed that about 45 per cent of incremental non-food credit (y-o-y) was absorbed by industry as compared with 40 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), petroleum, iron and steel, textiles, chemicals, engineering, food processing, construction and vehicles industries. The infrastructure sector alone accounted for 25 per cent of the

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

incremental credit to industry as compared with 26 per cent in the corresponding period of the previous year. The agricultural sector absorbed around 8 per cent of the incremental non-food bank credit expansion as compared with 13 per cent in the corresponding period of the previous year. Personal loans accounted for nearly 17 per cent of incremental non-food credit; within personal loans, the share of incremental housing loans was at 40 per cent. The outstanding credit under credit card witnessed a sharp increase. Growth in loans to commercial real estate remained high, notwithstanding some moderation (Table 22).

In addition to bank credit for financing their requirements, the corporate sector continued to rely on a variety of non-bank sources of funds such as capital markets, external commercial borrowings and internal generation of

**Table 22: Non-food Bank Credit - Sectoral Deployment**

Sector/Industry	Outstanding as on August 29, 2008	(Amount in Rupees crore)			
		Year-on-Year Variations			
		August 31, 2007		August 29, 2008	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
<b>Non-food Gross Bank Credit (1 to 4)</b>	<b>23,14,897</b>	<b>3,58,296</b>	<b>24.4</b>	<b>4,89,183</b>	<b>26.8</b>
<b>1. Agriculture and Allied Activities</b>	<b>2,62,481</b>	<b>44,360</b>	<b>25.0</b>	<b>40,913</b>	<b>18.5</b>
<b>2. Industry (Small, Medium and Large)</b>	<b>9,32,313</b>	<b>1,43,614</b>	<b>25.2</b>	<b>2,18,246</b>	<b>30.6</b>
<i>of which : Small</i>	1,30,554	28,126	31.0	11,559	9.7
<b>3. Personal Loans</b>	<b>5,52,090</b>	<b>82,953</b>	<b>21.4</b>	<b>81,729</b>	<b>17.4</b>
Housing	2,68,804	34,333	17.0	32,792	13.9
Advances against Fixed Deposits	44,100	7,900	23.8	2,999	7.3
Credit Cards	29,056	5,161	49.5	13,461	86.3
Education	23,795	5,411	45.9	6,603	38.4
Consumer Durables	8,003	513	6.3	-691	-7.9
<b>4. Services</b>	<b>5,68,013</b>	<b>87,371</b>	<b>26.3</b>	<b>1,48,295</b>	<b>35.3</b>
Transport Operators	35,989	8,679	44.4	7,772	27.5
Professional & Other Services	38,494	8,193	49.7	13,813	56.0
Trade	1,29,353	20,900	24.5	23,084	21.7
Real Estate Loans	68,196	16,081	52.7	21,595	46.3
Non-Banking Financial Companies	77,039	15,703	49.6	29,683	62.7
<b>Memo:</b>					
<b>Priority Sector</b>	<b>7,66,506</b>	<b>1,09,222</b>	<b>20.8</b>	<b>1,32,078</b>	<b>20.8</b>
<b>Industry (Small, Medium and Large)</b>	<b>9,32,313</b>	<b>1,43,614</b>	<b>25.2</b>	<b>2,18,246</b>	<b>30.6</b>
Food Processing	50,415	9,016	29.0	10,266	25.6
Textiles	96,982	17,777	28.7	18,221	23.1
Paper & Paper Products	14,446	1,973	20.4	2,787	23.9
Petroleum, Coal Products & Nuclear Fuels	62,460	8,069	32.9	29,891	91.8
Chemicals and Chemical Products	69,883	7,277	15.3	14,918	27.1
Rubber, Plastic & their Products	12,128	1,967	26.8	2,827	30.4
Iron and Steel	88,276	11,733	21.6	22,235	33.7
Other Metal & Metal Products	26,429	3,071	17.4	5,691	27.4
Engineering	56,562	9,034	24.8	11,108	24.4
Vehicles, Vehicle Parts and Transport Equipments	33,192	6,641	34.2	7,160	27.5
Gems & Jewellery	27,254	1,926	8.9	3,568	15.1
Construction	31,037	6,286	42.9	10,111	48.3
Infrastructure	2,09,390	37,363	32.0	55,236	35.8
<b>Note:</b> 1.Data are provisional and relate to select scheduled commercial banks.					
2. Data also include the figures of Bharat Overseas Bank, which was merged with Indian Overseas Bank on March 31, 2007.					

funds. Resources raised through domestic equity issuances during the second quarter of 2008-09 (Rs.9,882 crore) were higher than those in the corresponding period of the previous year. Net mobilisation through external commercial borrowings (ECBs) during the first quarter of 2008-09 (Rs.14,663 crore) was lower than (Rs.35,993 crore) the corresponding period of the previous year. Mobilisation through issuances of commercial paper (CPs) during the second quarter of 2008-09 was almost at the same level as during the corresponding period of the previous year. Resources raised in the form of equity issuances through American depository receipts (ADRs) and global depository receipts (GDRs) during the second quarter of 2008-09 so far (Rs.596 crore) were also lower than those during the corresponding period of the previous year. However, internal generation of funds continued to provide a strong support to the funding requirements of the corporate sector, despite the profit after tax of select non-financial non-government companies during April-June 2008-09 witnessing deceleration in comparison with the previous year (Table 23 and Table 11).

**Table 23: Select Sources of Funds to Industry**

Item	(Rupees Crore)							
	2006-07	2007-08	2007-08				2008-09	
			Q1	Q2	Q3	Q4	Q1	Q2
1	2	3	4	5	6	7	8	9
A. Bank Credit to Industry #	1,41,543	1,74,566	-15,603	59,776	40,993	89,400	12,426	47,987 *
B. Flow from Non-banks to Corporates								
1 Capital Issues (i+ii)	29,178	51,479	13,788	6,226	14,400	17,065	2,031	9,882
i) Non-Government Public Ltd. Companies (a+b)	29,178	48,962	13,261	4,236	14,400	17,065	2,031	9,882
a) Bonds/Debentures	585	809	0	0	0	809	0	0
b) Shares	28,593	48,153	13,261	4,236	14,400	16,256	2,031	9,882
ii) PSUs and Government Companies	0	2,517	527	1,990	0	0	0	0
2 ADR/GDR Issues	16,184	13,023	1,251	9,899	289	1,584	4,056	596
3 External Commercial Borrowings (ECBs)	1,04,046	1,60,221	35,993	36,755	43,093	44,380	14,663	-
4 Issue of CPs	5,145	14,903	8,568	7,358	6,629	-7,651	14,256	7,335
C. Depreciation Provision +	45,558	40,664	10,173	10,576	10,961	11,805	11,413	-
D. Profit after Tax +	1,13,081	1,34,291	32,699	34,266	37,470	36,109	35,270	-

- : Not Available

# : Data pertain to select scheduled commercial banks.

\* : July-August 2008.

+ : Data for 2006-07 are based on audited balance sheet, while those for 2007-08 and 2008-09 are based on abridged audited/unaudited financial results of select non-financial non-Government 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 (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.

Scheduled commercial banks' investment in SLR securities expanded by 8.6 per cent (y-o-y) on September 26, 2008, as compared with 21.1 per cent a year ago (Table 24). Commercial banks' holdings of such securities as on September 26, 2008 at 26.1 per cent of their NDTL were lower than 27.8 per cent at end-March 2008 and 29.2 per cent a year ago (Chart 11). Excess SLR investments of SCBs declined to Rs.40,336 crore as on September 26, 2008 from Rs. 98,033 crore at end-March 2008; excess investments in SLR securities were placed at Rs.1,29,325 crore a year ago. Simultaneously, SCBs increased their overseas foreign currency borrowings and also drew down their holdings of foreign currency assets.

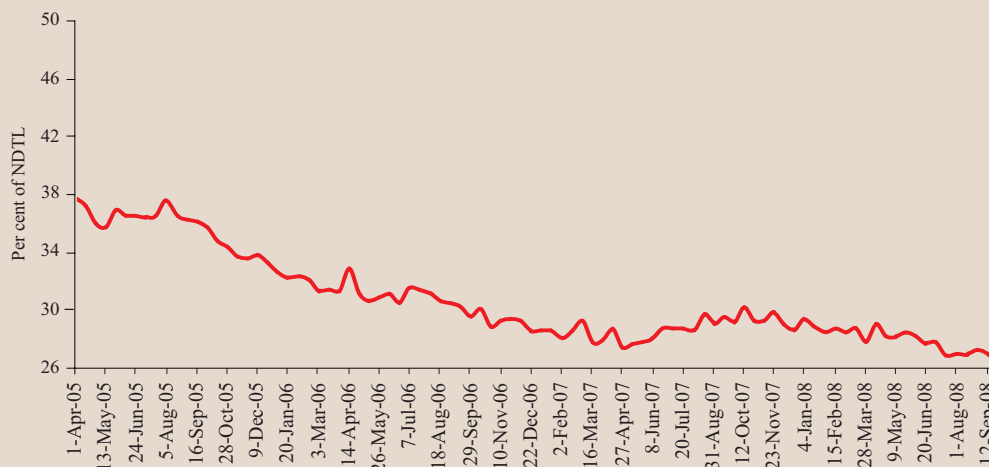
### Reserve Money Survey

Reserve money growth at 28.7 per cent, y-o-y, as on October 10, 2008 was higher than that of 26.6 per cent a year ago (Chart 12). Adjusted for the first round effect of the hike in CRR, reserve money growth was 20.6 per cent as compared with 16.8 per cent a year ago. Intra-year movements in reserve money largely reflected the Reserve Bank's market operations and movements in

**Table 24: Scheduled Commercial Bank Survey**

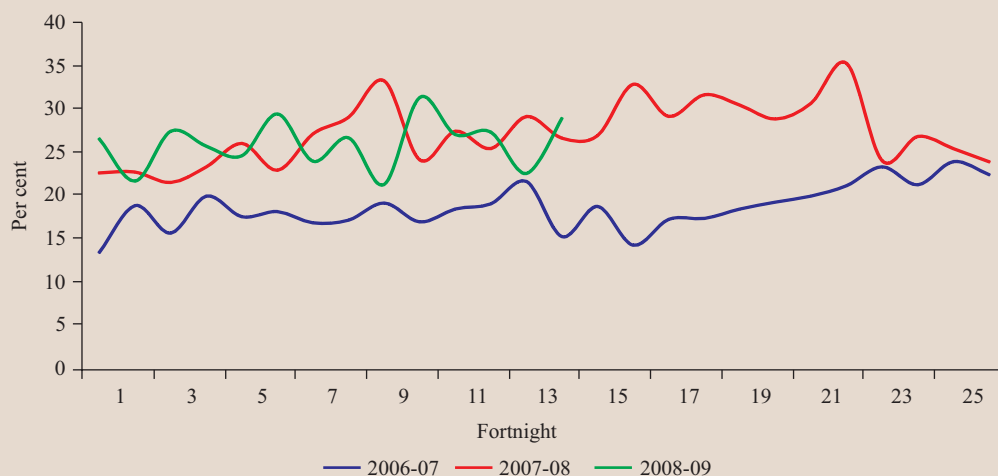
Item	Outstanding as on Sept. 26, 2008	(Amount in Rupees Crore)			
		Variation (Year-on-Year)			
		As on Sept. 28, 2007		As on Sept. 26, 2008	
		Amount	Per Cent	Amount	Per Cent
1	2	3	4	5	6
<b>Sources of Funds</b>					
1. Aggregate Deposits	34,42,138	5,62,024	24.3	5,68,403	19.8
2. Call/Term Funding from Financial Institutions	1,09,895	3,922	4.6	21,287	24.0
3. Overseas Foreign Currency Borrowings	57,858	3,357	11.4	25,051	76.4
4. Capital	45,258	4,814	15.2	8,790	24.1
5. Reserves	2,76,460	53,063	32.3	59,130	27.2
<b>Uses of Funds</b>					
1. Bank Credit	25,42,467	3,75,988	22.6	5,04,988	24.8
of which: Non-food Credit	24,97,292	3,72,438	22.9	4,96,821	24.8
2. Investments in Government and Other Approved Securities	9,87,240	1,58,344	21.1	78,087	8.6
a) Investments in Government Securities	9,68,533	1,60,387	21.8	73,443	8.2
b) Investments in Other Approved Securities	18,708	-2,042	-12.7	4,643	33.0
3. Investments in non-SLR Securities	1,54,383	12,730	8.9	-1,925	-1.2
4. Foreign Currency Assets	25,851	2,102	5.5	-14,657	-36.2
5. Balances with the RBI	3,18,301	1,14,222	81.4	63,732	25.0
<b>Note:</b> Data are provisional.					



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

bankers' deposits with the Reserve Bank in the wake of hikes in the CRR and large expansion in demand and time liabilities.

During the financial year 2008-09 (up to October 10, 2008), reserve money grew by 5.0 per cent as compared with an increase of 6.8 per cent in the corresponding period of the previous year. Bankers' deposits with the Reserve Bank expanded by 3.0 per cent (up to October 10, 2008) as compared with 17.5 per cent during the corresponding period of 2007-08. Currency in circulation expanded by 7.0 per cent as compared with 3.3 per cent during the corresponding period of the previous year (Table 25). On the sources side, net Reserve Bank's

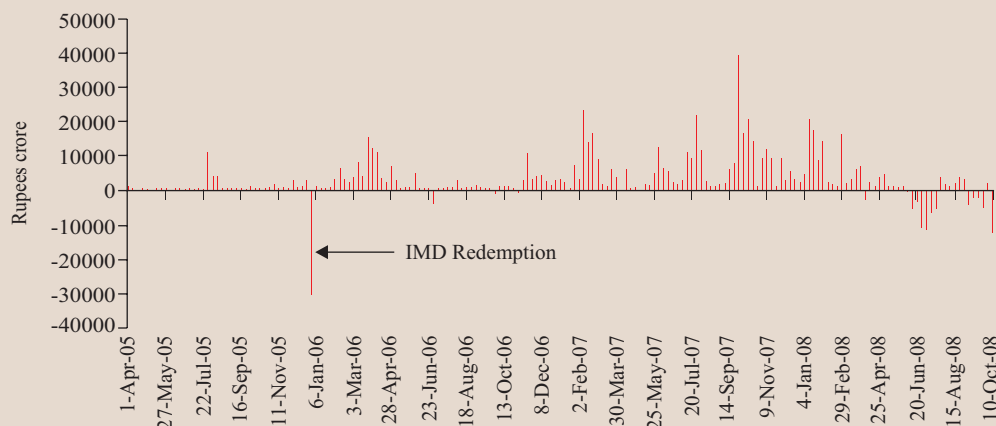
**Chart 12: Reserve Money Growth**

**Table 25 : Reserve Money - Variations**

(Amount in Rupees crore)									
Item	2007-08 (April- March)	2007-08 (Up to Oct. 12)	2008-09 (Up to Oct. 10)	2007-08				2008-09	
				Q1	Q2	Q3	Q4	Q1	Q2
1	2	3	4	5	6	7	8	9	10
<b>Reserve Money</b>	<b>2,19,427</b>	<b>48,405</b>	<b>46,663</b>	<b>11,630</b>	<b>60,688</b>	<b>26,595</b>	<b>1,20,514</b>	<b>3,274</b>	<b>25,169</b>
<b>Components (1+2+3)</b>		<b>(6.8)</b>	<b>(5.0)</b>						
1. Currency in Circulation	86,702	16,449 (3.3)	41,091 (7.0)	16,866	-13,297	46,781	36,352	36,759	-14,546
2. Bankers' Deposits with RBI	1,31,152	34,468 (17.5)	9,807 (3.0)	-4,800	75,464	-19,369	79,857	-29,333	39,219
3. 'Other' Deposits with the RBI	1,573	-2,512 (-33.5)	-4,234 (-46.7)	-436	-1,479	-817	4,305	-4,152	497
<b>Sources (1+2+3+4-5)</b>									
1. RBI's net Credit to Government	-1,15,632	-1,39,134	81,933	-22,154	-54,695	-65,787	27,004	-13	51,360
of which: to Centre (i+ii+iii+iv-v)	-1,16,772	-1,38,948	83,006	-21,825	-55,588	-65,078	25,719	1,430	51,379
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	17,421	-55,508	54,511	-34,284	4,019	20,874	26,812	-39,239	56,975
iv. RBI's Holdings of Rupee Coins	121	115	-51	128	20	3	-31	-1	-26
v. Central Government Deposits	1,34,314	83,555	-28,547	-12,330	59,627	85,956	1,062	-40,670	5,570
2. RBI's Credit to Banks and Commercial Sector	-2,794	-7,789	3,859	-6,450	-1,256	848	4,064	-3,358	4,963
3. NFEA of RBI	3,69,977	1,41,949 (16.4)	95,028 (7.7)	-2,745	1,19,430	94,681	1,58,610	1,03,932	10,336
of which : FCA, adjusted for revaluation	3,70,550	2,02,876	-24,581	47,728	1,18,074	1,00,888	1,03,860	15,535	-31,641
4. Governments' Currency Liabilities to the Public	1,064	520	300	166	354	312	232	125	175
5. Net Non-Monetary Liabilities of RBI	33,187	-52,859	1,34,457	-42,812	3,145	3,459	69,395	97,411	41,666
<b>Memo:</b>									
Net Domestic Assets	-1,50,550	-93,544	-48,365	14,375	-58,743	-68,086	-38,096	-1,00,658	14,833
LAF- Repos (+) / Reverse Repos (-)	21,165	-65,730	41,150	-32,182	9,067	16,300	27,980	-45,350	51,480
Net Open Market Sales # *	-5,923	2,997	-19,232	1,246	1,560	-3,919	-4,810	-8,696	-10,535
Centre's Surplus	26,594	-24,274	-27,812	-34,597	15,376	54,765	-8,950	-42,427	6,199
Mobilisation under the MSS	1,05,419	89,811	3,548	19,643	48,855	31,192	5,728	6,040	-628
Net Purchases(+)/Sales(-) from Authorised Dealers	3,12,054	1,76,166	-28,886 ^	38,873	1,01,814	87,596	83,771	3,956	-32,842 ^
NFEA/Reserve Money @	133.1	133.1	136.5	119.8	125.8	133.4	133.1	143.8	141.1
NFEA/Currency @	209.2	193.6	210.6	165.7	193.6	194.3	209.2	213.5	220.3
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 August 29, 2008.									
<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.									

credit to the Centre increased by Rs.83,006 crore as against a decrease of Rs.1,38,948 crore during the corresponding period of the previous year. The Reserve Bank's foreign currency assets (adjusted for revaluations) decreased by Rs.24,581 crore as against an increase of Rs.2,02,876 crore during the corresponding period of the previous year (Chart 13).

Movements in the Reserve Bank's net credit to the Central Government during 2008-09 so far (up to October 10, 2008) largely reflected the liquidity management operations by the Reserve Bank and movements in Government

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

deposits with the Reserve Bank. Surplus balances of the Central Government with the Reserve Bank declined. The Reserve Bank's holdings of Central Government dated securities increased, reflecting injection of liquidity under the liquidity adjustment facility (LAF) during this period. 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 increased by Rs.83,006 crore during 2008-09 so far (up to October 10, 2008) as against a decline of Rs.1,38,948 crore during the corresponding period of the previous year.

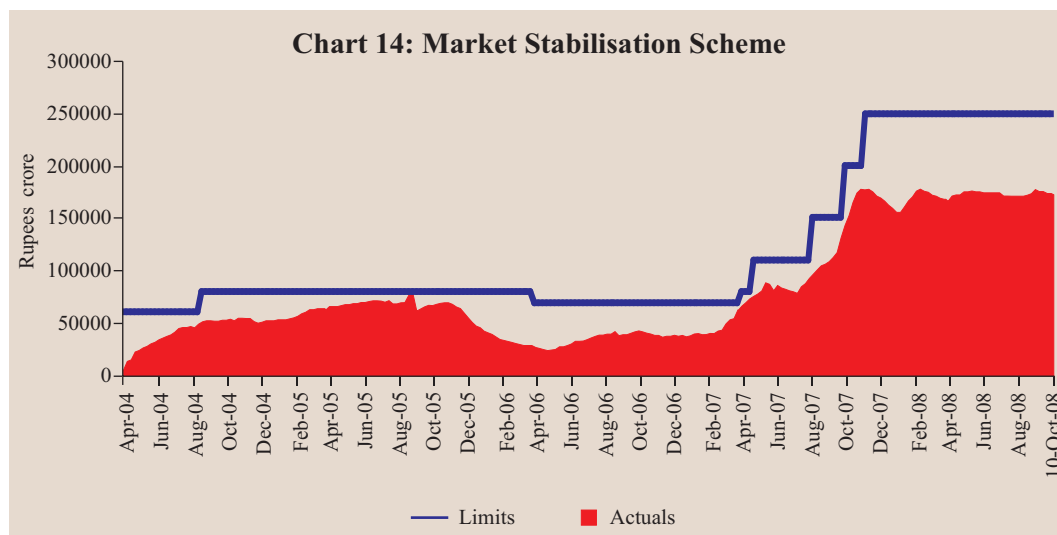
### **Liquidity Management**

The Reserve Bank continued with its policy of active management of liquidity during the current financial year through appropriate use of the CRR, and OMO, including MSS and LAF, and other policy instruments at its disposal flexibly. The objective is to maintain appropriate liquidity in the system such that all legitimate requirements of credit are met, consistent with the objective of price and financial stability. Developments, on both international and domestic fronts, particularly from mid-September 2008, have impacted domestic liquidity conditions. Nonetheless, liquidity modulation through a flexible use of a combination of instruments has, to a significant extent, cushioned the impact of international financial turbulences on domestic financial market by absorbing excessive market pressure and ensuring orderly conditions. During 2008-09 so far, variations in cash balances of the Central Government and the Reserve Bank's foreign exchange operations remained the key drivers of liquidity conditions.

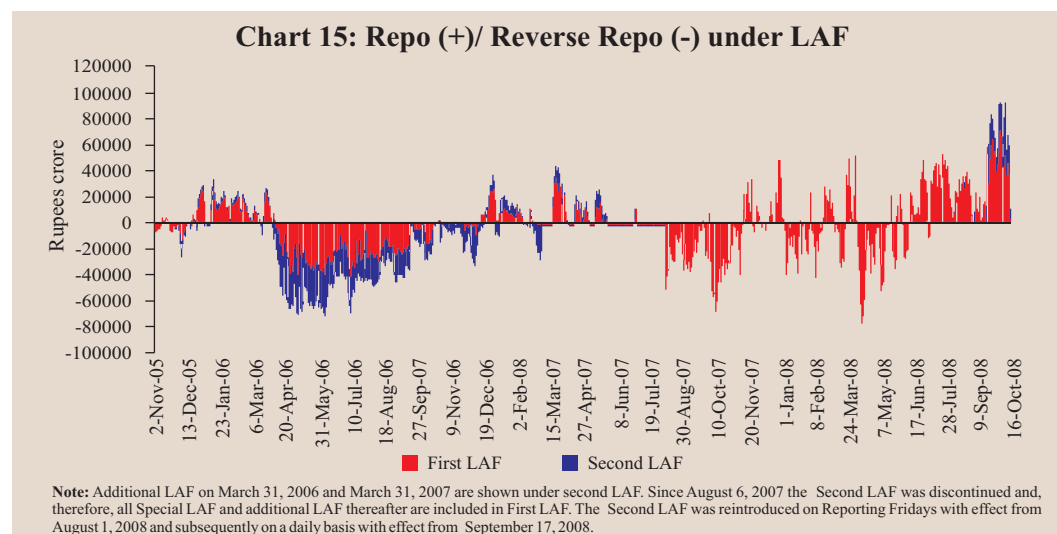
Liquidity conditions eased at the beginning of the first quarter of 2008-09 on account of substantial reduction in the cash balances of the Central Government (Table 26). On a review of the then prevailing liquidity situation, the Reserve Bank announced a two-stage hike in CRR of 25 basis points each to 8.0 per cent, effective from the fortnights beginning April 26, 2008 and May 10, 2008, respectively. The auctions under the MSS were resumed in April 2008 after a gap of around two months. The average daily net liquidity absorption through the LAF was Rs.26,359 crore during April 2008 and the outstanding balances under MSS were placed at Rs.1,72,444 crore on April 25, 2008. In view of the evolving liquidity situation, the Reserve Bank, in its Annual Policy Statement issued on April 29, 2008, announced a further increase in the CRR by 25 basis points to 8.25 per cent with effect from the fortnight beginning May 24, 2008. Reflecting the impact of the CRR hikes, the surplus liquidity available in the banking system declined in May 2008 and the average daily net absorption through LAF declined to Rs.11,841 crore during the month. No auction of dated securities under the MSS was conducted during May 2008 and the outstanding balances under the MSS were placed at Rs.1,75,362 crore on May 30, 2008 (Chart 14). On a review of the then prevailing macroeconomic and overall monetary conditions and with a view to containing inflationary expectations, the Reserve Bank increased the repo rate under the LAF by 25 basis points to 8.0 per cent with effect from June 12, 2008. Liquidity conditions turned into deficit mode from June 10, 2008, with the build-up in Central Government balances in the face of advance tax collections. Consistent with the stance of monetary policy set out in the Annual Policy Statement (April 2008)

**Table 26: Reserve Bank's Liquidity Management Operations**

(Rupees Crore)								
Item	2007-08	2007-08				2008-09		
		Q1	Q2	Q3	Q4	Q1	July	August
1	2	3	4	5	6	7	8	9
<b>A. Drivers of Liquidity (1+2+3+4+5)</b>	<b>2,04,026</b>	<b>51,146</b>	<b>1,11,169</b>	<b>-1,694</b>	<b>43,405</b>	<b>28,473</b>	<b>6,411</b>	<b>19,920</b>
1. RBI's net purchases from Authorised Dealers	3,12,054	39,791	1,00,896	88,545	82,822	-8,555	-24,424	4,093
2. Currency with the Public	-84,571	-12,946	9,465	-47,131	-33,957	-30,639	1,222	10,194
3. Surplus cash balances of the Centre with the Reserve Bank	-26,594	49,992	-30,771	-49,820	4,005	40,073	21,470	-2,351
4. WMA and OD	0	15,159	-15,159	0	0	0	0	0
5. Others (residual)	3,137	-40,850	46,739	6,712	-9,465	27,595	8,142	7,983
<b>B. Management of Liquidity (6+7+8+9)</b>	<b>-1,17,743</b>	<b>-53,943</b>	<b>-68,621</b>	<b>-11,189</b>	<b>16,010</b>	<b>-51,239</b>	<b>5,011</b>	<b>-43,445</b>
6. Liquidity impact of LAF Repos	21,165	-20,290	-2,825	27,795	16,485	-18,260	11,170	-35,660
7. Liquidity impact of OMO (Net) *	13,510	10	40	5,260	8,200	1,062	735	4,547
8. Liquidity impact of MSS	-1,05,419	-18,163	-50,336	-28,244	-8,675	-6,041	3,106	-2,331
9. First round liquidity impact due to CRR change	-47,000	-15,500	-15,500	-16,000	0	-28,000	-10,000	-10,000
<b>C. Bank Reserves (A+B) #</b>	<b>86,283</b>	<b>-2,797</b>	<b>42,548</b>	<b>-12,883</b>	<b>59,415</b>	<b>-22,766</b>	<b>11,422</b>	<b>-23,525</b>
(+) : 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 Oil bonds.								
<b>Note</b> : Data pertain to March 31 and last Friday for all other months.								



which, *inter-alia*, accorded high priority to price stability and well-anchored inflation expectations, and on the basis of the available information on domestic and global macroeconomic and financial developments, the Reserve Bank on June 24, 2008 increased the repo rate under the LAF by 50 basis points to 8.50 per cent with effect from June 25, 2008 and also increased the CRR by 50 basis points to 8.75 per cent in two stages (25 basis points each) with effect from the fortnights beginning July 5 and July 19, 2008, respectively. No auction under MSS was conducted during June 2008 and the outstanding balance as on June 27, 2008 was placed at Rs.1,74,433 crore. The average daily net injection during June 2008 through the LAF was Rs. 8,622 crore (Chart 15).



Keeping in view the systemic implications of liquidity and other related issues faced by public sector oil marketing companies (OMCs) arising from the unprecedented escalation in international crude oil prices, the Reserve Bank announced Special Market Operation (SMO) on May 30, 2008 for the smooth functioning of financial markets and for overall financial stability. These operations commenced from June 5, 2008. Under SMO, the Reserve Bank in the first leg of operation purchased oil bonds held by public sector OMCs in their own accounts, through designated banks, subject to an overall ceiling of Rs.1,500 crore (revised upwards from Rs.1,000 crore on June 11, 2008) on any single day. In the second leg the Reserve Bank provided equivalent foreign exchange through designated banks at market exchange rate to the oil companies. The settlement of the foreign exchange and the Government securities legs of the operations were synchronous so that there was no liquidity impact on account of these operations. The total amount of oil bonds purchased by the Reserve Bank under SMO aggregated Rs.19,325 crore. The SMO was an exceptional measure for minimising potential adverse consequences for financial markets in a transparent manner. This operation was terminated effective August 8, 2008.

Liquidity conditions eased in the first week of July 2008 mainly on account of a decline in the cash balances of the Central Government, but tightened significantly from July 7, 2008, reflecting the impact of a two-stage CRR hike announced in June 2008 as also the foreign exchange operations conducted by the Reserve Bank. The average daily net liquidity injection through LAF was Rs.27,961 crore during July 2008. Auctions under the MSS, which were kept in abeyance from mid-May 2008, were resumed on July 9, 2008 and the actual balance under the MSS was placed at Rs.1,71,327 crore as on July 25, 2008. In response to suggestions from the market participants for fine tuning the management of bank reserves on the last day of the maintenance period, the Reserve Bank introduced a Second LAF (SLAF) on reporting Fridays effective from August 1, 2008. Keeping in view the assessment of the economy, including the outlook for growth and inflation, the Reserve Bank in its First Quarter Review of the Annual Statement on Monetary Policy hiked the repo rate by 50 basis points to 9 per cent effective from July 30, 2008 and the CRR by 25 basis points to 9 per cent with effect from the fortnight beginning August 30, 2008.

During August 2008, liquidity conditions continued to remain in a deficit mode mainly on account of the two-stage CRR hike implemented in the previous month (July 2008). The average daily net liquidity injection through LAF declined somewhat to Rs.22,560 crore during the month. There was no dated security auction under the MSS in August 2008 and the actual balance under the MSS was placed at Rs.1,73,658 crore as on August 29, 2008 (Table 27).

**Table 27: 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>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	985	1,66,739	70,657	2,38,381
February	8,085	1,75,089	68,538	2,51,712
March*	-50,350	1,68,392	76,586	1,94,628
April	32,765	1,72,444	36,549	2,41,758
May	-9,600	1,75,362	17,102	1,82,864
June	-32,090	1,74,433	36,513	1,78,856
July	-43,260	1,71,327	15,043	1,43,110
August	-7,600	1,73,658	17,393	1,83,451
September	-56,480	1,73,804	40,358	1,57,682
October ( Up to October 10)	-91,500	1,71,940	48,774	1,29,214

@: 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.

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. The Second LAF that was discontinued from August 6, 2007 was reintroduced on Reporting Fridays with effect from August 1, 2008 and subsequently on a daily basis with effect from September 17, 2008.

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

Tight liquidity conditions persisted in September 2008 mainly on account of the quarter-ending advance tax outflows and a hike in CRR by 25 basis points from the fortnight beginning August 30, 2008 (as announced earlier). The bankruptcy/sell out/ restructuring of some of the world's largest financial institutions beginning mid-September 2008 brought some pressures on the domestic money and foreign exchange markets, in conjunction with temporary local factors such as advance tax outflows. In order to alleviate these transient pressures which were related largely to external developments, the Reserve Bank announced certain monetary measures on September 16, 2008 viz., (i) continuance of sale of foreign exchange by the Reserve Bank either directly or through agent banks to meet any demand-supply gap, (ii) increase in interest rate ceilings in respect of FCNR(B) by 50 basis points (*i.e.* to LIBOR/Swap rates *minus* 25 basis points) and NR(E)RA deposits by 50 basis points (*i.e.* to LIBOR/

Swap rates *plus* 50 basis points); (iii) additional liquidity support under the LAF with effect from September 17, 2008, which allowed banks to obtain additional liquidity support to the extent of up to one per cent of their net demand and time liabilities and seek waiver of penal interest; (iv) reintroduced SLAF on a daily basis with effect from September 17, 2008 that was earlier discontinued from August 6, 2007. It was indicated that these measures were ad hoc, temporary in nature and would be reviewed on a continuous basis in the light of the evolving liquidity conditions. The average daily net liquidity injection was Rs.42,591 crore during September 2008. There was no auction under the MSS since September 3, 2008 and the actual balance under the MSS was Rs.1,73,804 crore as on September 26, 2008.

Subsequent to the announcement of the above mentioned measures on September 16, 2008, the global financial environment deteriorated with the number of troubled financial institutions rising, stock markets weakening and the money markets coming under stress. Central banks in several major advanced and emerging market economies responded to these extraordinary developments by synchronised policy actions, including measures for liquidity infusion. These developments have impacted the domestic money and foreign exchange markets with a marked increase in volatility and a sharp squeeze on market liquidity as reflected in the movements in overnight interest rates and the high recourse to the LAF. On a review of the liquidity situation in the context of global and domestic developments, on October 10, 2008, the Reserve Bank announced a reduction of CRR by 150 basis points to 7.5 per cent effective from the fortnight beginning October 11, 2008 (instead of the 50 basis points reduction announced on October 6, 2008). As a result of the reduction in CRR, around Rs.60,000 crore was expected to be released into the banking system (instead of the injection of Rs.20,000 crore announced earlier). On October 14, 2008, the Reserve Bank conducted a special 14-day fixed rate repo at 9 per cent per annum for a notified amount of Rs.20,000 crore with a view to enabling banks to meet the liquidity requirements of mutual funds. Till October 17, 2008, a cumulative amount of Rs.7,005 crore was availed under this facility.

On a further review, in the context of the indirect impact of the continuing uncertain global situation on domestic financial markets, the Reserve Bank announced the following measures on October 15, 2008. First, the CRR was reduced by another 100 basis points to 6.5 per cent with retrospective effect from the fortnight beginning October 11, 2008. This measure was expected to release an additional Rs.40,000 crore into the banking system. Second, the 14-day special repo facility (announced on October 14, 2008) was decided to be conducted on a daily basis until further notice up to a cumulative



amount of Rs.20,000 crore for the same purpose. Third, purely, as a temporary measure, banks were allowed to avail of additional liquidity support exclusively for the purpose of meeting the liquidity requirements of mutual funds to the extent of up to 0.5 per cent of their NDTL. This support will terminate 14 days from the closure of this special term repo facility. This accommodation will be in addition to the temporary measure announced on September 16, 2008 permitting banks to avail of additional liquidity support to the extent of up to 1 per cent of their NDTL. Fourth, It was also announced that the Reserve Bank will institute a facility similar to SMO, when oil bonds become available. Fifth, the Reserve Bank announced an immediate disbursement of Rs.25,000 crore to scheduled banks and NABARD as the first installment under the Agricultural Debt Waiver and Debt Relief Scheme. Sixth, interest rate ceilings were further raised on FCNR(B) deposits by 50 basis points (*i.e.*, to LIBOR/Swap rates *plus* 25 basis points) and on NR(E)RA deposits by 50 basis points (*i.e.*, to LIBOR/Swap rates *plus* 100 basis points). Finally, banks were permitted to borrow funds from their overseas branches and correspondent banks up to a limit of 50 per cent of their unimpaired Tier I capital as at the close of the previous quarter or US\$ 10 million, whichever is higher, as against the existing limit of 25 per cent. These measures would be reviewed on a continuous basis in the light of the evolving liquidity conditions.

In view of the global liquidity constraint as reflected by some signs of strains in domestic credit markets in recent weeks, and to maintain financial stability, the Reserve Bank on October 20, 2008 announced a reduction of the repo rate by 100 basis points to 8.0 per cent with immediate effect.