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RBI increases Cash Reserve Ratio (CRR)

It may be recalled that in the Third Quarter Review of the Annual Statement on Monetary Policy for the year 2006-07, the stance of monetary policy was set out. The Review *inter alia* stated :

“Hence, a determined and co-ordinated effort by all to contain inflation without unduly impacting the growth momentum is not only an economic necessity but also a moral compulsion. To the extent the current inflationary pressures are attributable to monetary conditions, it is essential to undertake appropriate measures, in continuation of those already taken and in the light of anticipated developments.” (paragraph 77)

The Review also emphasised that:

“The Reserve Bank’s policies are, therefore, vigilant to any indications of volatility in currency and money markets.”(paragraph 78)

Since the issue of the Third Quarter Review on January 31, 2007, there have been some notable developments:

(a) On February 7, 2007 the Central Statistical Organisation (CSO) released advance estimates of national income which placed real GDP growth for 2006-07 at 9.2 per cent on top of 9.0 per cent in 2005-06.

(b) The general index of industrial production increased by 10.8 per cent during April-December, 2006 as against 8.0 per cent a year ago, as per the CSO's release of February 12, 2007.

(c) Year-on-year inflation based on the wholesale price index (WPI), which was 6.0 per cent on January 13, 2007, *i.e.*, at the time of the release of the the Third Quarter Review, has risen to 6.6 per cent on January 27, 2007 as released on February 9, 2007.

(d) The year-on-year growth in non-food bank credit up to February 2, 2007 was 30.2 per cent as against 33.2 per cent a year ago.

(e) The year-on-year growth of aggregate deposits was 23.2 per cent up to February 2, 2007, over and above 17.5 per cent a year ago.

(f) The Liquidity Adjustment Facility (LAF) had been in an injection mode persistently from January 8, 2007 to February 7, 2007. Now, however, an amount of Rs 3, 000 crore, Rs 1, 750 crore, Rs.2, 155 crore and Rs.4, 090 crore was absorbed through the LAF on February 8, 9, 12 and 13, 2007 respectively, as against average daily injections of liquidity of Rs 9, 814 crore during February 1-7, 2007.

(g) Additional liquidity amounting to Rs 1, 109 crore was absorbed under the Market Stabilisation Scheme (MSS) during February, 2007 (up to February 13).

(h) In the money market, the call money rate which was ruling in the range of 7.72-8.35 per cent during January 8 to February 7, 2007 declined to 6.59 per cent on February 13, 2007.

In view of the paramount need to contain inflation expectations and in the light of current liquidity conditions, it has been decided to increase the cash reserve ratio (CRR) of scheduled commercial banks (SCBs), regional rural banks (RRBs), scheduled co-operative banks and scheduled primary (urban) co-operative banks by one-half of one percentage point of their net demand and time liabilities (NDTL) in two stages, effective from the fortnights indicated below:

Effective Date (i.e., the fortnight beginning from)	CRR on net demand and time liabilities (per cent)
February 17, 2007	5.75
March 3, 2007	6.00

As a result of the above increases in the CRR, an amount of about Rs 14, 000 crore of resources of banks would be absorbed.

It may be noted that the Third Quarter Review of January 31, 2007 had indicated that:

“The Reserve Bank would use all policy instruments, including the CRR, to ensure the appropriate modulation of liquidity in responding to the evolving situation.” (paragraph 89)

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