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## **Liquidity Management – Modified Arrangements**

It may be recalled that in the Third Quarter Review of Annual Statement on Monetary Policy for the Year 2006-07, the Reserve Bank had stated that, "over the remaining part of the year, management of liquidity would receive priority in the policy hierarchy" (Paragraph 89). It was also stated that, "the Reserve Bank retains the option to conduct overnight repo or longer term repo under LAF depending on market conditions and other relevant factors. The Reserve Bank will continue to use this flexibility including the right to accept or reject tender(s) under the LAF, wholly or partially, if deemed fit, so as to make efficient use of LAF in daily liquidity management" (paragraph 95).

### **Existing Arrangements**

The Reserve Bank has been currently conducting liquidity management largely through the Liquidity Adjustment Facility (LAF), which is intended as a window for adjusting day-to-day liquidity mismatches, and the Market Stabilisation Scheme (MSS), which is used for addressing large swings in liquidity conditions which could have a more durable character.

Under the existing MSS programme being conducted in accordance with the annual ceiling for 2006-07 fixed at Rs.70,000 crore, the issuance of Treasury bills under MSS has been undertaken through regular weekly auctions with an MSS portion of 91-day Treasury Bills of Rs.1,500 crore and those for the fortnightly 182-day and 364-day Treasury bills of Rs.1,000 crore each. While announcing the resumption of MSS T-bills programme as above, it was stated that the Reserve Bank would retain the flexibility of reviewing the auctions under the MSS from time to time, in response to evolving circumstances. Under the existing MSS programme, an amount of Rs.16,457 crore has been sterilised in the current financial year so far, of which Rs.14,341 crore has been in the first half of 2006-07. The outstandings under MSS as of today is Rs.45,457 crore.

The LAF has switched to a significant surplus mode with substantial net absorptions being made in recent days. Under the existing arrangements, the LAF absorbs any excess liquidity offered by scheduled commercial banks (excluding RRBs) and primary dealers at a fixed rate. However, the Reserve Bank has always maintained that banks should use the LAF window for equilibrating very short term mismatches over temporary periods.

## **MSS – Modified Arrangements**

On a review of the liquidity conditions, it has been decided that the MSS will now use a mix of Treasury bills and dated securities in a more flexible manner keeping in view the capital flows in the recent period, the assessment of volatility and durability of capital flows, and the paramount importance attached to liquidity management in containing inflation. The Reserve Bank would, subject to variations in liquidity, announce every Friday the possibility and the quantum of MSS issuances for the succeeding week. These announcements would cover issuances of Treasury Bills and dated securities under MSS. Their auctions would be conducted in accordance with provisions of Memorandum of Understanding between the Reserve Bank of India and the Government of India dated March 25, 2004 under which Reserve Bank and the Government of India agree on an annual ceiling and the Reserve Bank decides the amount, tenor, modalities and the timing of issue.

In line with the above decisions, the auction schedule for the MSS for the next week would be as follows:

### **Schedule for Issuance of T-Bills/dated securities under MSS for week ending March 9, 2007**

<b>Auction Date</b>	<b>Nature of Instrument</b>	<b>Auction Amount</b>
March 6, 2007	6.65%GS 2009	Rs. 6,000 crore
March 7, 2007	(i) 91-Day Treasury Bill	Rs. 1,500 crore
	(ii) 182-Day Treasury Bill	Rs. 1,000 crore

The auction for Treasury bills under MSS would continue to take place by notifying the amounts under MSS every week along with the regular auction calendar as has been the existing practice. The Reserve Bank would retain the flexibility of reviewing the schedule of auctions under the MSS from time to time, in response to evolving circumstances.

## **LAF – Modified Arrangements**

On a review of the liquidity conditions, it has been decided that in view of the enhanced MSS programme being put in place and the need to restore LAF as a facility for equilibrating very short-term mismatches, the Reserve Bank would modulate the liquidity it absorbs through the daily reverse repo auctions. Accordingly, starting March 5, 2007 (Monday), daily reverse repo absorptions would be limited to a maximum of Rs.3,000 crore each day comprising Rs.2,000 crore in the First LAF and Rs. 1,000 crore in the Second LAF. In case of partial rejection of bids, allocations would normally be made proportionately on a *pro-rata* basis. While bidding in LAF auctions, scheduled commercial banks (excluding RRBs) and primary dealers should ensure that clear funds are available with them to cover the bid at the time of its submission.

The above modified arrangements for LAF and MSS being put in place are expected to facilitate the maintenance of appropriate liquidity in the system and to respond more swiftly to the evolving liquidity situation in line with the objectives and stance of the monetary policy.

**Alpana Killawala**  
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