



PRESS RELATIONS DIVISION, Central Office, Post Box 406, Mumbai 400001
Phone: 2266 0502 Fax: 2266 0358, 2270 3279

RESERVE BANK OF INDIA
www.rbi.org.in
www.rbi.org.in/hindi
e-mail: helpprd@rbi.org.in

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RBI Announces Monetary Measures

In the recent period, monetary policy has been engaged in managing the transition to a higher growth path while ensuring that pressures on actual inflation and inflation expectations are contained. At this juncture, it is important to reinforce the measures already taken for maintaining price stability and anchoring inflation expectations in order to sustain the growth momentum. The role of monetary policy is to maintain stability and so contribute to growth on an enduring basis.

As indicated in the Third Quarter Review of the Annual Statement on Monetary Policy for the year 2006-07, “the outlook for inflation assumes criticality in terms of policy monitoring and action” (paragraph 76). Furthermore, “a judicious balancing of weights assigned to monetary policy objectives would accord priority to stability in order to support growth on a sustained basis” (paragraph 82). Accordingly, it is necessary to reinforce the emphasis on price stability and well-anchored inflation expectations, as set out in the stance of the Third Quarter Review, with a demonstrated commitment in terms of credible policy monitoring and actions. The conduct of monetary policy should continue to demonstrate that inflation beyond the tolerance threshold of the Reserve Bank is unacceptable and that the resolve to ensure price stability is always backed by timely and appropriate policy responses.

In recognition of the cumulative and lagged effects of monetary policy, the Reserve Bank began a graduated withdrawal of accommodation in mid-2004. Since September, 2004 repo/reverse repo rates have been increased by 150 basis points each, the CRR has been raised by 100 basis points, risk weights have been raised in the case of housing loans (from 50 per cent to 75 per cent), commercial real estate (from 100 per cent to 150 per cent) and consumer credit (from 100 per cent to 125 per cent) and general provisioning requirement for standard advances in specific sectors has been raised to 2.0 per cent of standard advances. On February 13, 2007 a further two-stage increase of 25 basis points each in the CRR was announced, effective from the fortnights beginning February 17 and March 3, 2007. Liquidity management was modified on March 2, 2007 to put in place an augmented programme of issuance under the market stabilisation scheme (MSS) with a mix of treasury bills and dated securities in a more flexible manner. In view of the enhanced MSS programme and the need to conduct LAF as a facility for equilibrating very short-term mismatches, daily reverse repo absorptions were limited to a maximum of Rs.3,000 crore, effective March 5, 2007. The stance of monetary policy has progressively shifted from an equal emphasis on price stability along with growth to one of reinforcing price stability with immediate monetary measures and to take recourse to all possible measures promptly in response to evolving circumstances

Since the monetary measures that were announced on February 13, 2007 there have been some notable developments, namely,

(a) The general index of industrial production increased by 11.0 per cent during April 2006 to January 2007 as against 8.0 per cent a year ago, as per the release of the Central Statistical Organisation (CSO) of March 12, 2007.

(b) Year-on-year inflation based on the wholesale price index (WPI), has ruled around 6.5 per cent for the third week in succession up to March 17, 2007 as per the data released today. At a disaggregated level, prices of primary articles, fuel group and manufactured products registered a year-on-year increase of 12.0 per cent, 1.0 per cent and 6.6 per cent as on March 17, 2007 as against 3.7 per cent, 8.9 per cent and 1.7 per cent a year ago.

(c) Inflation based on the consumer price index for industrial workers (CPI-IW), urban non-manual employees (CPI-UNME), agricultural labourers (CPI-AL) and rural labourers (CPI-RL) showed year-on-year increase to 7.6 per cent, 7.8 per cent, 9.8 per cent and 9.5 per cent in February 2007, respectively, from 5.0 per cent, 4.8 per cent and 5.0 per cent and 4.7 per cent, a year ago.

(d) The year-on-year growth in non-food bank credit of scheduled commercial banks (SCBs) was 29.5 per cent as on March 16, 2007 as against 32.7 per cent a year ago.

(e) The year-on-year growth in aggregate deposits of SCBs was 24.8 per cent as on March 16, 2007, over and above 18.0 per cent a year ago.

(f) The year-on-year money supply (M3) growth up to March 16, 2007 was 22.0 per cent as against 16.9 per cent a year ago.

(g) Continuation of accelerated external inflows has resulted in accretion of US \$ 18.6 billion to the foreign exchange reserves, taking their level from US \$ 179.1 billion at the end of January, 2007 to US \$ 197.7 billion on March 23, 2007.

(h) Additional liquidity amounting to Rs.23,894 crore was absorbed under the market stabilisation scheme (MSS) during February 1 - March 30, 2007.

(i) Globally, the process of withdrawal of accommodation in monetary policy is being vigorously pursued. Since mid-February, 2007 among the leading central banks, the European Central Bank and the Bank of Japan have raised key policy rates by 25 basis points each, while the People's Bank of China raised one year lending rates by 27 basis points and the reserve requirements by 50 basis points. There has been no change in the policy rates of the US Federal Reserve, the Bank of England, the Bank of Canada, the Reserve Bank of Australia and the Reserve Bank of New Zealand all of which had undertaken prior policy action.

In the light of the current macroeconomic, monetary and anticipated liquidity conditions, and with a view to containing inflation expectations, it is critical to take demonstrable and determined action on an urgent basis. Accordingly, the following monetary measures are being taken consistent with the stance of the monetary policy:

- (i) It has been decided to increase the fixed repo rate under the LAF by 25 basis points from 7.50 per cent to 7.75 per cent with immediate effect.
- (ii) The other arrangements regarding the operations of LAF announced on March 2, 2007 will continue until further notice.
- (iii) The policy of withdrawal of semi-durable and durable elements of liquidity through treasury bills and dated securities under MSS will continue.

Accordingly, the Reserve Bank would, subject to variations in liquidity conditions, announce auctions of MSS covering issuances of treasury bills and dated securities on a weekly basis. 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.

- (iv) 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 is being increased 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>i.e.</i> , the fortnight beginning from)	CRR on net demand and time liabilities (per cent)
April 14, 2007	6.25
April 28, 2007	6.50

As a result of the above increase in the CRR, an amount of Rs.15,500 crore of resources of banks would be absorbed.

- (v) The interest rate applicable on eligible CRR balances (*i.e.*, the amount of reserves between the statutory minimum CRR and the CRR prescribed by the RBI) shall be reduced to 0.5 per cent per annum from the present 1.0 per cent per annum with effect from the fortnight beginning April 14, 2007.

Active monitoring of macroeconomic, overall monetary and liquidity conditions will continue and all monetary policy actions would be considered in response to the evolving situation.

Alpana Killawala
Chief General Manager

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