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October 6, 2008

RBI Reduces CRR for Liquidity Management

It may be recalled that on September 16, 2008, the Reserve Bank announced several measures to alleviate the pressures on domestic financial markets brought on by external developments in response to the bankruptcy/sell-out/restructuring of some of the world's largest financial institutions. Since then, there has been a sharp deterioration in the global financial environment with the number of troubled financial institutions rising, stock markets weakening and money markets strained. Central banks across the world have stepped up their liquidity operations, including coordinated actions, and some have banned/limited short selling of financial stocks. These new developments have impacted domestic money and forex 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 current liquidity situation in the context of global and domestic developments, it has been decided to reduce the CRR from its current level of 9.0 per cent of net demand and time liabilities (NDTL) by 50 basis points to 8.5 per cent of NDTL with effect from the fortnight beginning October 11, 2008. As a result of this reduction in the CRR, an amount of about Rs 20, 000 crore would be released into the system. This measure is ad hoc, temporary in nature and will be reviewed on a continuous basis in the light of the evolving liquidity conditions.

Active liquidity management is a key element of the current monetary policy stance. Liquidity modulation through a flexible use of a combination of instruments has, to a significant extent, cushioned the impact of the international financial turbulence on domestic financial markets by absorbing excessive market pressures and ensuring orderly conditions. In view of the evolving environment of heightened uncertainty, volatility in global markets and the dangers of potential spillovers to domestic equity and currency markets, liquidity management will continue to receive priority in the hierarchy of policy objectives over the period ahead. The Reserve Bank will continue with its policy of active demand management of liquidity through appropriate use of the CRR stipulations and open market operations (OMO) including the MSS and the LAF, using all the policy instruments at its disposal flexibly, as and when the situation warrants.

The overall stance of monetary policy in 2008-09 accords high priority to price stability, well-anchored inflation expectations and orderly conditions in financial markets while being conducive to continuation of the growth momentum, as set out in the Annual Policy Statement and reiterated in the First Quarter Review of July 2008. The overriding priority for monetary policy is to eschew any further intensification of inflationary pressures and to firmly anchor inflation expectations.

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