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भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

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RBI Announces Further Monetary Stimulus

The global financial situation continues to be uncertain. Since the official recognition of recession in the US, the UK, the Euro area and Japan, the downside risks to the global economy have increased. Concomitantly, the policy initiatives in the advanced economies are geared towards managing the recession and defusing potentially deflationary trends. The US has reduced the Federal Funds Rate to 0 - 0.25 per cent. Several other advanced and emerging economies such as Japan, Canada, Republic of Korea, Hong Kong and China too have reduced their policy rates.

2. India's financial sector has remained resilient even in the face of global financial turmoil that is so deep and pervasive. Our financial markets continue to function in an orderly manner. India's growth trajectory has, however, been impacted both by the financial crisis and the follow-on global economic downturn. This impact has turned out to be deeper and wider than earlier anticipated. Concurrently, because of global developments coupled with supply and demand management measures at home, inflation is on the decline.

3. Reflecting these developments, the Reserve Bank has adjusted its policy stance from demand management to arresting the moderation in growth. In particular, the aim of these measures was to augment domestic and forex liquidity and to ensure that credit continues to flow to productive sectors of the economy. Notably, since mid-September 2008, the Reserve Bank has reduced the repo rate under the liquidity adjustment facility (LAF) from 9.0 per cent to 6.5 per cent, reduced the reverse repo rate under the LAF from 6.0 per cent to 5.0 per cent and the cash reserve ratio from 9.0 per cent to 5.5 per cent.

4. The cumulative amount of primary liquidity made available to the financial system through various measures initiated by the Reserve Bank is over Rs. 3,00,000 crore. This sizeable easing has ensured a comfortable liquidity position starting mid-November as evidenced by a number of indicators. Since November 18, 2008, consistent with the policy stance, the LAF window has largely been in the surplus mode. The overnight money market rate has consistently remained

within the LAF corridor since November 3, 2008. The yield on the 10-year benchmark G-Sec has declined from 8.66 per cent on September 29, 2008 to 5.31 per cent on January 1, 2009. Taking the signal from the reductions in the repo and reverse repo rates, all public sector banks and several private sector and foreign banks have reduced their benchmark prime lending rates (BPLRs). Notably, the top five public sector banks have reduced their BPLRs from a range of 13.75-14.00 per cent as on October 1, 2008 to a range of 12.00-12.50 per cent presently.

5. The Reserve Bank has been constantly monitoring the global developments and the domestic economic situation. On the positive side, inflationary pressures have eased significantly. Inflation as measured by year-on-year variations in the wholesale price index (WPI) has declined to 6.38 per cent as on December 20, 2008, down by more than half from the high of 12.91 per cent as on August 2, 2008. However, the consumer price inflation, as reflected in various consumer price indices in the range of 10.38-11.11 per cent as of October-November 2008, has yet to show moderation.

6. At the same time, there is evidence of economic activity slowing down. Exports registered a negative growth for the two recent consecutive months, October-November 2008, for the first time since February 2002. The index of industrial production (IIP) registered a negative growth of 0.4 per cent during October 2008, with the manufacturing sector registering a negative growth of 1.2 per cent, for the first time since April 1994. IIP growth during April-October 2008 at 4.1 per cent was less than half of 9.9 per cent during the corresponding period of the previous year. The services sector, which has been the main engine growth during the last several years, has also been slowing down. Business confidence has been dented significantly. There are clear signs of deceleration in investment demand.

7. Even as some public sector and private sector banks have cut lending rates in response to the Reserve Bank’s monetary policy stance, concerns over rising credit risk together with the slowing of economic activity appear to have moderated credit growth. The Reserve Bank continues to urge banks to monitor their loan portfolio and take early action, including debt restructuring where warranted, to prevent the rise of bad assets down the road and safeguard the gains of the last several years in improving asset quality. At the same time, banks should price risk appropriately and ensure that quality enterprises continue to get funding. The Reserve Bank appreciates that risk management is difficult even in normal circumstances; it is even more difficult in an environment of uncertainty and downturn.

8. On a review of current global and domestic macroeconomic situation, the Reserve Bank has decided to take the following further measures**:**

Repo Rate

- To reduce the repo rate under the liquidity adjustment facility (LAF) by 100 basis points from 6.5 per cent to 5.5 per cent with immediate effect.

Reverse Repo Rate

- To reduce the reverse repo rate under the LAF by 100 basis points from 5.0 per cent to 4.0 per cent with immediate effect.

Cash Reserve Ratio

- To reduce the cash reserve ratio (CRR) of scheduled banks by 50 basis points from 5.5 per cent to 5.0 per cent from the fortnight beginning January 17, 2009.

9. The reduction in the CRR will inject additional liquidity of around Rs. 20,000 crore to the financial system. It is expected that the reduction in the policy interest rates and the CRR will further enable banks to provide credit for productive purposes at appropriate interest rates. The Reserve Bank on its part would continue to maintain a comfortable liquidity position in the system.

10. The fundamentals of our economy continue to be strong. Once the crisis is behind us, and calm and confidence are restored in the global markets, economic activity in India would recover sharply. But a period of painful adjustment is inevitable.

Alpana Killawala
Chief General Manager

Press Release : 2008-2009/1023

Related Press Releases/Notifications:
1.RBI announces Further Measures for Monetary and Liquidity Management
2.Special Fixed Rate Repo Under Liquidity Adjustment Facility
3.Temporary liquidity support for financing agricultural operations
4.Special Refinance Facility (SRF) under Section 17(3B) of the Reserve Bank of India Act, 1934
5.Trade Credits for Imports into India – Review of all-in-cost ceiling
6.Enhancement of NBFCs' capital raising option for capital adequacy purposes
7.Interest Rates on Non-Resident (External) Rupee (NRE) Deposits and FCNR(B) deposits
8.Short-term Foreign Currency Borrowings by Housing Finance Companies
9.Export Credit Refinance Facility: Relaxation
10.Review of Prudential Norms – Provisioning for Standard Assets and Risk Weights for Exposures to Corporates, Commercial Real Estate and NBFC- ND-SI
11. Standing Liquidity Facilities for Banks and Primary Dealers
12. Interest Rate on Special Refinance Facility