प्रेस प्रकाशनी PRESS RELEASE

भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

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July 2, 2010

RBI announces Monetary Policy and Liquidity Management Measures

Monetary Policy Measures

On an assessment of the current macroeconomic situation, it has been decided to take the following monetary policy measures as a part of the calibrated exit from the expansionary monetary policy:

- to increase the repo rate under the Liquidity Adjustment Facility (LAF) by 25 basis points from 5.25 per cent to 5.50 per cent with immediate effect.
- to increase the reverse repo rate under the LAF by 25 basis points from 3.75 per cent to 4.0 per cent with immediate effect.

Liquidity Management Measures

Also, on the basis of an assessment of the current liquidity situation, the Reserve Bank has decided to extend the following liquidity management measures:

i) The additional liquidity support to scheduled commercial banks under the LAF to the extent of up to 0.5 per cent of their net demand and time liabilities (NDTL) currently set to expire on July 2, 2010 is now extended up to July 16, 2010. For any shortfall in maintenance of statutory liquidity ratio (SLR) arising out of availment of this facility, banks may seek waiver of penal interest purely as an *ad hoc* measure.

ii) The second LAF (SLAF) will be conducted on a daily basis up to July 16, 2010.

Rationale for Monetary Policy Measures

There have been significant macroeconomic developments since the April 2010 Monetary Policy Statement. At the global level, the recovery is strengthening. However, the outlook continues to be clouded by uncertainty in the Euro area.

On the domestic front, the revised growth estimates by the Central Statistical Organisation (CSO) for 2009-10 and for Q4 of 2009-10 suggest that the recovery is consolidating. The manufacturing sector has recorded robust growth in recent months, aided among others, by expanding exports. The strong underlying growth momentum is also evidenced by the sharp upturn in the capital goods sector, acceleration in credit growth and the widening current account deficit. The monsoon situation so far has been decidedly better than during last year holding prospects for good agriculture growth. In its April policy review, the Reserve Bank projected real GDP growth for 2010-11 at 8 per cent with an upside bias. More recent data suggest that the upside bias has largely materialised. The growth projection will be reviewed in the First Quarter Review on July 27, 2010.

The developments on the inflation front, however, raise several concerns. Overall WPI inflation increased to 10.2 in May 2010, up from 9.6 per cent in April 2010. Food price inflation and consumer price inflation remain at elevated levels. There has been some moderation in food price inflation, but the price index of food articles continues to increase. More importantly, the prices of non-food manufactured goods and fuel items have accelerated in recent months. Year-on-year WPI non-food manufacturing products (weight: 52.2 per cent) inflation, which was (-) 0.4 per cent in November 2009 and 5.4 per cent in March 2010, rose further to 6.6 per cent in May 2010. Year-on-year fuel price inflation also surged from (-) 0.8 per cent in November 2009 to 12.7 per cent in March 2010 and further to 13.1 per cent in May 2010. Although entirely justified in terms of long-term fiscal and energy conservation objectives, the recent increase in fuel prices will have an immediate impact of around one percentage point on WPI inflation, with second round effects being felt in the months ahead. Significantly, two-thirds of WPI inflation in May 2010 was contributed by non-food items, suggesting that inflation is now very much generalised and that demand-side pressures are evident.

Timing of the Action

This mid-cycle policy action has been warranted by the evolving macroeconomic situation. Even as data for real GDP growth and WPI inflation became available by mid-June 2010, it was considered inadvisable to raise the policy rates as the financial system was dealing with liquidity pressures triggered by sudden build-up in government cash balances occasioned by the larger than anticipated level of 3G spectrum and broadband wireless access auction realisations. Through the month of June, liquidity under LAF operations remained in deficit mode. Consequently, the call rate moved up significantly, resulting in an effective tightening at the short end of the yield curve. The liquidity situation has since begun to ease.

Rationale for Extension of Liquidity Management Measures

In late May 2010, in anticipation of the liquidity pressures on account of payments for 3G spectrum and advance taxes, the Reserve Bank took certain liquidity easing measures. Even as the liquidity situation has begun to ease, these measures are being extended since liquidity tightness may persist.

Expected Outcomes

The above monetary measures should contain inflation and anchor inflationary expectations going forward, while not hurting the recovery process. Easing liquidity and raising rates at the same time may seem apparently inconsistent. It should be noted in this context that the liquidity easing measures have become necessary to manage what is essentially a temporary and unanticipated development. In no way should they be viewed as inconsistent with the monetary policy stance of calibrated exit, which remains focussed on containing inflation and anchoring inflationary expectations without hurting growth.

The Reserve Bank will continue to monitor the macroeconomic conditions, particularly the price situation, and take further action as warranted.

Alpana Killawala
Chief General Manager

Press Release 2010-11/22

Related Notifications	
July 02, 2010	Liquidity Adjustment Facility – Repo and Reverse Repo Rates
July 02, 2010	Standing Liquidity Facilities for Banks and Primary Dealers