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Note Released: 10-Oct-08

India Econ Flash

RBI Cuts CRR Again – 100bps to 7.5%; Expect Policy Makers to Remain on the Move

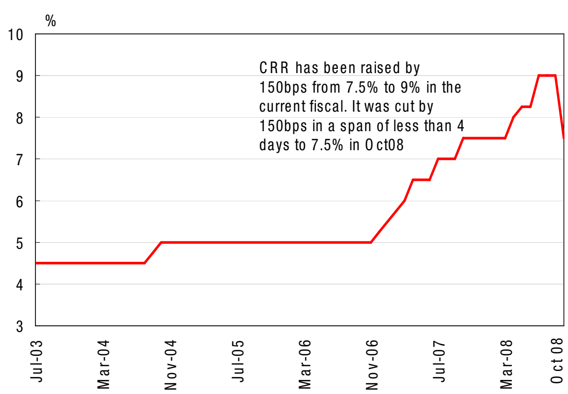
- **RBI cuts CRR by 100bps to 7.5%:** Barely 4 days after it reduced the CRR by 50bps from 9% to 8.5% (*see https://www.citigroupgeo.com/pdf/SAP20797.pdf*) , responding to global developments and synchronized central bank actions across the globe, the RBI has just reduced the CRR by 100bps to 7.5%. Both these moves are effective October 11 and will inject a total of Rs600bn (US$12.5bn) in the system.

- **Expect Liquidity Management to Remain a Priority:** Given the rise in risk aversion coupled with liquidity injection being one of the key priorities world over, we expect the RBI to continue to be active in injecting liquidity using a combination of further CRR cuts, unwinding of the Market Stabilisation Bonds, reducing the SLR and via the repo window. The RBI has said it *'would respond swiftly and even preemptively to any adverse external developments impinging on domestic financial stability, price stability and inflation expectations and the continuation of the growth momentum of the Indian economy'*

- **As regards policy rates,** given the worsening global situation, cuts are not ruled out. However, with growth in M3 at 21%, credit at 26% and inflation at 12%, the RBI has little leeway unless a sharp fall in commodity prices results in quicker easing in inflation to single digit levels.

- **Policy Makers to remain on the Move:** As mentioned before, in a bid to calm nervous markets amidst growing global turmoil and improve domestic liquidity conditions the policy officials have taken a number of measures since 16 Sept08. Looking ahead, we expect to see still further easing across the capital account (NRI Deposit/ECB Norms, a relaxation of FII limits in debt markets/Banks overseas borrowing) as well as a reduction in CRR/SLR and unwinding of MSS to ensure that adequate credit is available for the real economy.

Trends in the Cash Reserve Ratio (CRR)



Source: RBI

Quick Re-cap of Measures Taken Since 16 Sept 2008

Date	Measure
16-Sep-08	**RBI** raised interest rate ceilings on **NRI deposits** and provided **additional liquidity** by: (a) permitting banks to avail additional liquidity support under the LAF up to 1% of their net demand and time liabilities; and (b) Extending the Secondary LAF (SLAF) to a daily basis.
22-Sep-08	**MoF** raised **overseas borrowing** caps for infrastructure companies for rupee expenditure from US$100m to US$500m. Also raised all-in-cost ceiling from Libor + 350 to Libor + 450 bps.
6-Oct-08	**SEBI** lifts the curbs on **P-Notes.** This implies that: (1) Cap on issuance of P-notes in the cash segment removed; (2) Ban on P-notes with derivatives as underlying removed, fresh positions can be created beyond 40% of assets under custody; and (3) The 18-month deadline set earlier for unwinding of current positions also lifted.
6-Oct-08	**RBI** reduced the **Cash Reserve Ratio** by 50bs to 8.5% - first cut since June 2003.
7-Oct-08	**MoF** expands definition of infrastructure companies to include mining, exploration and refining companies for **ECB** purposes.
10-Oct-08	**RBI** reduces **CRR** by 100bps to 7.5%

Source: RBI

Appendix: Text of RBI Measures

"On October 6, 2008 the Reserve Bank of India announced a reduction of the cash reserve ratio (CRR) for scheduled banks by 50 basis points to 8.5 per cent of net demand and time liabilities (NDTL) with effect from the fortnight beginning October 11, 2008. This measure was undertaken with a view to injecting liquidity into domestic financial markets so as to alleviate the pressures brought on by the deterioration in the global financial environment. In the ensuing days, the global situation has worsened further. International stock markets and money markets had been adversely affected in a significant manner. Central banks across the world have responded to these extraordinary developments by synchronised policy actions including measures for liquidity infusion.

In the context of the abrupt changes in the international financial environment, it is important to note that the macroeconomic fundamentals of the Indian economy are strong and resilient and that India's financial system is sound, well-capitalised and well-regulated. Money and forex markets in India have been operating in a relatively orderly manner. The current domestic market conditions are essentially a reflection of the adverse developments and extreme uncertainty in international financial markets.

Market participants are assured that the Reserve Bank stands ready to respond swiftly to meet any liquidity requirements that may arise in the context of the highly volatile external situation.

Accordingly, on a review of the evolving liquidity situation in the context of global and domestic developments, it has been decided to reduce the Cash Reserve Ratio (CRR) by 150 basis points to 7.50 per cent of NDTL with effect from the fortnight beginning October 11, 2008 instead of the 50 basis points reduction announced on October 6, 2008. As a result of this reduction in the CRR, an amount of about Rs 60,000 crore would be released into the system (instead of the injection of Rs 20, 000 crore announced earlier).

The Reserve Bank is monitoring developments closely and continuously and would respond swiftly and even preemptively to any adverse external developments impinging on domestic financial stability, price stability and inflation expectations and the continuation of the growth momentum of the Indian economy. The Reserve Bank is committed to maintaining financial stability and active and flexible liquidity management using all policy instruments is an integral part of this objective"

Dated 10th October, 2008

http://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=19233 for details

Disclosure Appendix

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