GOVERNMENT OF INDIA
FINANCE
LOK SABHA

UNSTARRED QUESTION NO:1083
ANSWERED ON:24.10.2008
LIQUIDITY IN THE DOMESTIC MARKET
Rao Shri Errabelli Dayakar

Will the Minister of FINANCE be pleased to state:

(a) whether the outflow of portfolio capital has aggravated the fall of rupee;

(b) if so, the comments of the Government thereupon;and

(c) the details of the steps taken by the Reserve Bank of India to increase the supply of dollars and augment liquidity in the domestic market?

Answer

MINISTER OF STATE IN THE MINISTRY OF FINANCE(SHRI PAWAN KUMAR BANSAL)

(a)to(b) The movement of exchange rate is largely determined by demand-supply conditions in the foreign exchange market.The depreciation of the rupee against US dollar in the current financial year is mainly due to:lower levels of net capital inflows on the supply side arising out of the turbulence in global financial markets,of which net outflows on account of Foreign Institutional Investors is a major component;increased demand from market participants,particularly on account of higher international crude petroleum prices;and the appreciation of the US dollar against major currencies since the worsening of the global financial crisis in September 2008.The exchange rate policy in recent years has been guided by the broad principles of careful monitoring and management of exchange rates with flexibility,without a fixed target or a pre-announced target or a band,coupled with the ability to intervene,if and when necessary.The exchange rate movements are closely monitored and intervention as deemed appropriate in the domestic foreign exchange markets is made by the Reserve Bank of India (RBI) depending upon overall market conditions.

(c): Recently, the RBI has taken a number of measures aimed at improving domestic and foreign currency liquidity as under:

On October 20, 2008, the RBI reduced the repo rate to 8 per cent from the earlier level of 9 per cent.

On September 16, 2008, the RBI announced that it will continue to supply dollars to meet demand-supply gaps directly or through agent banks; modulated interest rates on non-resident deposits to attract capital flows;as a purely temporary measure,scheduled banks were allowed additional liquidity support to the extent of one per cent of their net demand and time liability,which was further enhanced by 0.5 per cent on October 15,2008;the second liquidity adjustment facility introduced on August 1,2008 on reporting Fridays (every two weeks)was made a daily facility (LAF) with effect from September 17,2008.

The RBI reduced the Cash Reserve Ratio from a level of 9.0 per cent as of October 10,2008 to 6.5 per cent with effect from October 11,2008 releasing about Rs.1,00,000 crore additional liquid funds.

On October 14,2008 the RBI also conducted a special 15 day repo at 9 per cent per annum for a notified amount of Rs.20,000 crore under LAF to meet the liquidity requirements of mutual funds.This facility was made daily on October 15,2008.

On October 15,2008,at the request of the Government,the RBI has announced that it would provide Rs.25,000 crore as first installment immediately as liquidity support to concerned financial institutions under the Agriculture Debt Waiver and Debt Relief Scheme.

On October 15,2008,the RBI announced that banks were allowed to borrow funds from their overseas branches and correspondent banks up to a limit of 50 per cent of their unimpaired Tier I capital as at the close of the previous quarter or US $ 10 million whichever is higher as against the existing limit of 25 per cent.Earlier,to obviate the difficulties arising out of a tightening in the money and foreign exchange markets,the public sector oil marketing companies were facilitated through special market operations for oil bonds in June−July 2008.Besides the above measures taken by the RBI, the SEBI has relaxed the restrictions on offshore derivative instruments and decided to increase the Foreign Institutional Investors (FIIs) investment limit in corporate bonds from $3 billion to US$ 6 billion.