

Money Market Developments

4.38 The Committee on Banking Sector Reforms (Narasimham Committee II, 1998) recommended Liquidity Adjustment Facility (LAF) as a means to further develop the short-term money market through provision of adequate liquidity. Accordingly, RBI introduced the interim LAF (ILAF) in April, 1999, pending further upgradation in technology and legal/procedural changes to facilitate electronic transfer and settlement. ILAF provided a mechanism for liquidity management through a combination of repos, export credit refinance and collateralised lending facilities supported by open market operations (OMOs) at set rates of interest. Based on the experience of ILAF, an Internal Group of RBI recommended phased implementation of full-fledged LAF. In the first phase, ACLF for banks and Level II support for PDs (both at Bank Rate +2 per centage points) have been replaced by variable reverse repo auctions with effect from June 5, 2000. Also, the fixed rate repo has been replaced by variable rate repo auctions. In August, 2000, repo auctions of tenures ranging between three to seven days were introduced. The quantum of adjustment as well as the rates under LAF are flexible in response to the changing/emerging

needs of the system. Also, the funds made available by RBI through LAF meet primarily the day to day liquidity mismatches in the system and not the normal financing requirements of eligible institutions.

Call Money Market

4.39 The call money market came under pressure in June 2000, when call rates firmed up, reflecting reverse repo cut-off rates which were kept high under the Liquidity Adjustment Facility (LAF) introduced with effect from June 5, 2000. The repo rates were kept high to stem the pressure on the rupee in the forex market. During July 2000, call rates remained steady in the 7-8 per cent range. However, the forex market uncertainty necessitated liquidity tightening measures, and the RBI set higher cut-off rates (14-15%) for its repo auctions during August 2000. This led to sharp increase in call rates to around 14 per cent during most part of August 2000. With stability returning to the forex market, repo cut-off rates were progressively reduced. Since mid-September, call rates have generally hovered below the 10 per cent level (Fig. 4.5).

