

## Call Money Market

4.39 The comfortable liquidity situation facilitated a reasonably stable call money market in the current financial year. The firmness in call rates during January 2001 eased in the following months on account of reduction in the Bank Rate and CRR. This eased liquidity, which was reflected in the reduction of the repo rate from 7.00 per cent to 6.75 per cent on April 27, 2001. In May, call rates firmed up following a rally in government securities and adverse sentiment arising out of the commencement of the first stage of phasing out of non-bank participants from the call money market. However, injection of liquidity through reverse repo eased liquidity, leading to further reduction of repo rate from 6.75 per cent to 6.50 per cent.

4.40 Brief episodes of market volatility were contained using the Liquidity Adjustment Facility (LAF), which has emerged as an important tool for adjusting liquidity through absorption/injection of liquidity on a day-to-day basis. The following measures relating to Stage II of LAF announced/implemented as part of the Monetary and Credit Policy for 2001-02 therefore assume significance.

- The standing liquidity facilities available from RBI under LAF have been split in two parts: (a) normal facility constituting about two-thirds of the limit at the Bank Rate and (b) back-stop facility constituting about one-third of the limit at a variable daily rate, which will be linked to cut-off rates emerging in

regular LAF auctions. In the absence of such rates, back-stop facility will be linked to the NSE-Mumbai-Inter-Bank Offer Rate (NSE-MIBOR).

- The minimum bid size for LAF has been reduced from Rs. 10 crore to Rs. 5 crore to facilitate participation of smaller operators.
- In order to provide quick interest rate signals, when required, RBI has chosen an additional option to switch over to fixed rate repos on overnight basis; such options are sparingly used, and the rate of interest is announced as part of the auction announcement.
- RBI also will have the option to introduce long term repos up to 14-day period as and when required. The Reserve Bank has introduced a fortnightly repo auction since November 5, 2001.

4.41 Auctions under LAF were conducted on uniform price basis, which means a single repo rate for all the successful bidders. Some bidders may, therefore, tend to be indiscriminate in their bidding. To overcome this problem, a multiple price auction was introduced on an experimental basis in May, 2001, and based on experience, it has been extended. The weighted average cut-off yield in case of a multiple price auction is released to public which along with cut-off price, provides a band for call money market to operate. Except for fairly brief periods, the call money rates remained easy and moved within the repo-reverse repo corridor (Figure 4.10).

