

## Monetary trends and developments

### Broad money ( $M_3$ )

3.4 Growth in  $M_3$  of 12.2 per cent at end-March 2005 was lower than both the 14.0 per cent projected by the RBI in its Annual Policy Statement for 2004-05 and 16.7 per cent at end-March 2004. Growth in all the three components of  $M_3$  – currency with the public, demand deposits and time deposits with banks – was lower at end-March 2005 (13.0 per cent, 9.8 per cent and 12.4 per cent, respectively) than at end-March 2004 (16.0 per cent, 30.1 per cent and 14.7 per cent, respectively). However, relative to the previous year, growth in sources of  $M_3$  displayed some diversity with net domestic credit growing faster (13.3 per cent compared to 11.7 per cent during 2003-04) and net foreign exchange assets (NFA) of the banking sector growing slower (23.3 per cent compared to 33.7 per cent during 2003-04). Much of the net domestic credit expansion in 2004-05 was from growth in bank credit to the commercial sector (22.8 per cent) while net bank credit to government increased by only 0.4 per cent. (Table 3.1)

3.5 The deceleration in money supply growth observed in 2004-05 appears to have been reversed in the current year.  $M_3$  in 2005-06 up to January 20, 2006 grew at a much higher 13.2 per cent as compared to 9.2 per cent observed in the corresponding period of the previous year. The year-on-year growth of  $M_3$  at 16.4 per cent on January 20, 2006 was not only higher than the projected growth of 14.5 per cent in RBI's Annual Policy Statement for 2005-06, but also higher than the rate observed a year ago. In the current financial year up to January 20, 2006, the three main components of  $M_3$  – currency with the public, demand deposits and time deposits with banks – grew by 13.5 per cent, 17.7 per cent and 12.5 per cent, respectively, which were significantly higher than the growth observed during the same period of the previous year. Strong industrial performance and overall higher

business confidence index have led to higher demand for the bank credit during the current financial year. During 2005-06, bank credit to commercial sector has continued to remain the main source of growth of  $M_3$ ; from a high base of Rs. 12,80,539 crore (inclusive of conversion of IDBI into bank) at end-March 2005, it grew 21.2 per cent to Rs. 15,52,471 crore on January 20, 2006. On the other hand, outstanding net bank credit to government increased to Rs 7,79,855 crore on January 20, 2006 from Rs. 7,57,905 crore (inclusive of conversion of IDBI into bank) at end-March 2005. The other main source of  $M_3$  – NFA of the banking sector – grew at a much slower rate of 0.4 per cent during the current financial year so far up to January 20, 2006 compared to 13.9 per cent observed during the corresponding period of the previous year owing to the widening of the current account balance and slow down in capital inflows. (Table 3.1)

3.6 In terms of annual average growth, the historic trend of  $M_3$  growing at a marginally higher rate than GDP at current prices appears to have continued in the recent past. The velocity of money came down from 1.48 in 2003-04 to 1.47 in 2004-05, and is likely to have gone down further.

### Reserve money ( $M_0$ )

3.7 Growth in reserve money ( $M_0$ ) decelerated from 18.3 per cent during 2003-04 to 12.1 per cent during 2004-05 reflecting a deceleration in the growth of the main source of  $M_0$ , namely NFA of the RBI, from 35.2 per cent at end-March 2004 to 26.5 per cent at end-March 2005. Nevertheless, NFA flow at Rs. 1,28,377 crore was significantly high. The accretion to NFA of the RBI during 2004-05 also led to a further rise in the NFA to  $M_0$  ratio from 111.0 per cent at end-March 2004 to 125.3 per cent at end-March, 2005. The year 2004-05 was also characterised by extensive use of MSS and LAF operations by the RBI, with the outstanding balances under the two

**Table 3.1 : Sources of change in money stock (M<sub>3</sub>)**

Items	Outstanding balances as on		Variations during									
			Mar. 31	Mar. 31	Mar. 31	Jan. 23	Jan. 21	Mar. 31	Mar. 31	Mar. 31	Jan. 23	Jan. 21
	March 31,	Jan. 20,	2004	2004	2005	2004	2005	2004	2004	2005	2004	2005
	2005	2006	to	to	to	to	to	to	to	to	to	to
	(net)	Mar. 31	Jan. 21	Jan. 20	Jan. 21	Jan. 20	Mar. 31	Jan. 21	Jan. 20	Jan. 21	Jan. 21	Jan. 20
		2005	2005	2006	2005	2006	2005	2005	2006	2005	2005	2006
1	2	3	4	5	6	7	8	9	10	11	12	13
			<i>Rs. crore</i>					<i>Percent</i>				
I. M <sub>1</sub> (Narrow Money)	646263	742752	67547	37516	96489	87511	126520	11.7	6.5	14.9	16.6	20.5
II. M <sub>3</sub> (Broad Money) (1+2+3+4)	2250425	2551911	244749	184012	297973	266992	358710	12.2	9.2	13.2	13.9	16.4
1. Currency with the public	355768	403925	40797	32030	48157	40974	56924	13.0	10.2	13.5	13.4	16.4
2. Demand deposits with banks	284017	334180	25391	5095	50163	44491	70459	9.8	2.0	17.7	20.3	26.7
3. Time deposits with banks	1604162	1809159	177202	146496	201484	179481	232190	12.4	10.3	12.5	12.9	14.7
4. "Other" deposits with RBI	6478	4647	1359	391	-1831	2046	-863	26.5	7.6	-28.3	59.1	-15.7
III. Sources of change in money stock (M <sub>3</sub> )												
1. Net bank credit to Governemnt (A+B)	745713	779855	2809	7157	21950	25790	17601	0.4	1.0	2.9	3.6	2.3
A. RBI's net credit to Government	-17975	27323	-62883	-30719	45298	-38222	13134	-	-	-	-	-
( i ) Central Government	-23258	27364	-60178	-25897	50622	-37277	16341	-	-	-	-	-
( ii ) State Governments	5283	-41	-2705	-4822	-5324	-945	-3207	-	-	-	-	-
B. Other banks credit to Government	763688	752532	65692	37876	-23348	64012	4467	9.4	5.4	-3.0	9.5	0.6
2. Bank credit to commercial sector (A+B)	1247658	1552471	231508	173046	271931	220896	330393	22.8	17.0	21.2	22.8	27.0
A. RBI's credit to commercial sector	1390	2339	-671	-172	949	-175	450	-32.6	-8.3	68.3	-8.5	23.8
B. Other banks' credit to commercial sector	1246268	1550132	232179	173218	270982	221071	329943	22.9	17.1	21.2	22.9	27.0
3. Net foreign exchange assets of the banking sector	649255	651754	122669	72966	2499	95765	52202	23.3	13.9	0.4	19.0	8.7
4. Government's currency liabilities to the public	7448	8618	152	140	1170	155	1182	2.1	1.9	15.7	2.1	15.9
5. Banking sector's net non- monetary liabilities other than time deposits	441210	440786	153949	110856	-424	117176	42669	53.6	38.6	-0.1	41.7	10.7
<b>Memorandum Items</b>												
1. Money multiplier (M <sub>3</sub> /M <sub>0</sub> )	4.61	4.77	-	-	-	-	-	-	-	-	-	-
2. Velocity of money	1.47	-	-	-	-	-	-	-	-	-	-	-
3. Net domestic assets	1601170	1900157	122080	111046	295474	171227	306508	8.3	7.5	18.4	12.1	19.2
4. Net domestic credit	1993371	2332326	234317	180203	293881	246686	347994	13.3	10.2	14.4	14.6	17.5
<p>Note: 1. All figures are provisional. RBI data relate to end March after closure of Government accounts. Variations in respect of scheduled commercial banks (SCBs) are based on data for last reporting Friday of March. SCBs' time deposits include Rs17, 945 crore on account of proceeds from RIBs (Resurgent India Bonds), since August 28,1998 and Rs 25, 662 crore from India Millennium Deposits (IMDs) since November 17, 2000.</p> <p>2. Outstanding balances as on March 31, 2005 are net of conversion of IDBI into bank.</p>												

**Table 3. 2 : Components and sources of reserve money**

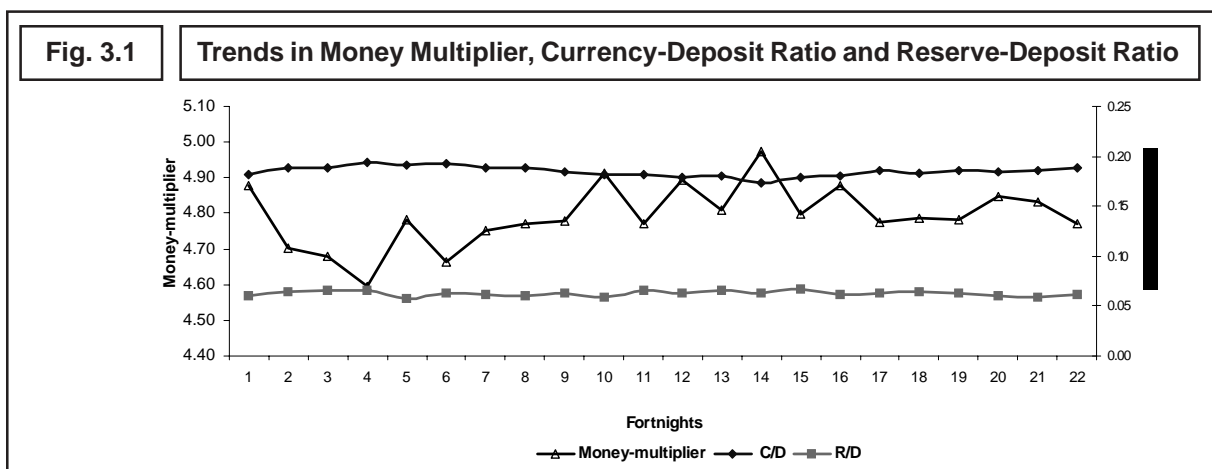
Items	Outstanding balances		Variations during				Percentage variations					
	as on		2004-05	Financial		Year-on-year		Full Year	Financial year		Year-on-year	
	March 31,	Jan. 20,		year so far					so far			
	2005	2006	2004-05	2005-06	2004-05	2005-06	2004-05	2004-05	2005-06	2004-05	2005-06	
1	2	3	4	5	6	7	8	9	10	11	12	13
	Rs. Crore							Per cent				
Reserve Money	489135	534963	52623	29219	45828	61628	69232	12.1	6.7	9.4	15.3	14.9
A: Components												
a. Currency in circulation	368661	417189	41633	30966	48528	41612	59195	12.7	9.5	13.2	13.2	16.5
b. Bankers' deposits with RBI	113996	113127	9631	-2138	-869	17970	10900	9.2	-2.0	-0.8	21.3	10.7
c. "Other" deposits with RBI	6478	4647	1359	391	-1831	2046	-863	26.5	7.6	-28.3	59.1	-15.7
B: Sources												
1. Net RBI credit to Government	-17975	27323	-62882	-30720	45298	-38222	13136	-	-	-	-	-
2. RBI credit to banks	5258	6084	-162	814	826	2677	-150	-3.0	15.0	15.7	75.3	-2.4
3. RBI credit to commercial sector	1389	2339	-672	-172	950	-175	450	-32.6	-8.3	68.4	-8.5	23.8
4. Net foreign exchange assets of RBI	612790	614833	128377	75930	2043	87448	54490	26.5	15.7	0.3	18.5	9.7
5. Government's currency liabilities to the public	7448	8618	152	140	1170	155	1182	2.1	1.9	15.7	2.1	15.9
6. Net non-monetary liabilities of RBI	119776	124235	12191	16775	4459	-9745	-125	11.3	15.6	3.7	-7.3	-0.1
Memo items:												
1. Net domestic assets of RBI	-123655	-79870	-75754	-46711	43785	-25820	14742	158.1	97.5	-35.4	37.5	-15.6
2. Net domestic credit by RBI	-11328	35746	-63716	-30528	47074	-35720	13886	-121.6	-58.3	-415.6	-62.0	63.5

(LAF net of repo and reverse repo) on March 31, 2005 at Rs. 64,211 crore and Rs. 19,330 crore, respectively. With these operations, absolute increase in the  $M_0$  stock during 2004-05 was lower at Rs. 52,623 crore compared to Rs. 67,451 crore during 2003-04. As a proportion of currency in circulation, NFA of the RBI increased from 148.1 per cent on March 31, 2004 to 166.2 per cent on March 31, 2005.

3.8 In sharp contrast to the deceleration observed in the previous year, in the current financial year 2005-06 up to January 20, 2006,  $M_0$  growth accelerated to 9.4 per cent from 6.7 per cent observed during the

corresponding period of the previous year. However, on a year-on-year basis,  $M_0$  growth at 14.9 per cent on January 20, 2006 was lower than 15.3 per cent observed on the corresponding date of 2005. In 2005-06, in spite of the deceleration of the growth of NFA of the RBI – on both financial year and year-on-year basis – it continued to dominate growth of  $M_0$  in terms of its contribution: it contributed 11.7 percentage points to the overall 14.9 per cent growth of  $M_0$ . (Table 3.2)

3.9 The money-multiplier (the ratio of  $M_3$  to  $M_0$ ) rose from 4.59 at end-March 2004 to 4.61 at end-March 2005 and further to 4.77 on January 20, 2006. However, the money-



multiplier on January 20, 2006 was still marginally higher than 4.71 observed a year ago. During the current financial year, among the components of money multiplier as on January 20, 2006, the currency-deposit ratio remained stable at 0.188 which was observed a year ago suggesting no change in public preference for deposits or currency on these two dates, while the reserve-deposit ratio was lower at 0.061 than 0.064 observed on the corresponding date of last year and was still higher than the required level under CRR.

### **Liquidity management**

3.10 During the current financial year, a considerable slow down in reserve inflows through the external balance of payments has been observed. The increase in NFA of the banking sector during April 1, 2005 - January 20, 2006 at Rs. 2,499 crore was substantially lower than the increase of Rs. 72,966 crore observed during the corresponding period of the previous year. The lower order of increase in NFA largely reflected the redemption of IMDs in December, 2005. Concomitantly, the outstanding balances under MSS, which reflect the RBI's efforts to sterilise excessive and disorderly reserve inflows, after rising from Rs. 64,211 crore at end-March 2005 to Rs. 78,908 crore in September 2005, fell to Rs. 34,852 crore on February 3, 2006.

3.11 The amounts absorbed by the RBI through the LAF operations reflected the liquidity conditions in the system. From a level of Rs. 19,330 crore on March 31, 2005, the outstanding amount under LAF reverse repos increased to Rs. 38,930 crore on April 1, 2005 and further to Rs. 51,390 crore on September 5, 2005. Thereafter, it declined over the period. In the context of the redemption of IMDs, the RBI also injected liquidity during December 2005 and January 2006 through repo operations. In order to assuage the liquidity conditions, auctions of Treasury Bills (TBs) under MSS were cancelled effective November 6, 2005. Moreover, to fine-tune the management of liquidity and in response to

suggestions from the market participants, the RBI introduced a Second Liquidity Adjustment Facility (SLAF) effective November 28, 2005. First LAF operations are conducted in the forenoon between 9.30 a.m. and 10.30 a.m. and SLAF are conducted on all working days except Saturday between 3.00 p.m. and 3.45 p.m. On a review of the macroeconomic, monetary and liquidity conditions, including the redemptions of IMDs, the RBI decided on December 30, 2005 to suspend the issue of TBs and dated securities under MSS. However, within the overall MSS ceiling for 2005-06, the RBI would retain the flexibility of conducting auctions under MSS from time to time with sufficient notice to the market, in response to evolving liquidity conditions in the system. As on February 3, 2006 the outstanding reverse-repo amount was Rs. 2,505 crore while that under repo was Rs. 5,115 crore.

3.12 Absorption of excess liquidity under reverse-repo (LAF) and MSS came down substantially from about Rs. 83,500 crore (3.7 per cent of  $M_3$ ) on March 31, 2005 to Rs. 40,178 crore (1.6 per cent of  $M_3$ ) on January 20, 2006. However, from mid-December 2005, signs of liquidity tightening were observed, partly on account of redemption of IMDs of the State Bank of India on December 29, 2005. Total outgo under IMDs redemption was about Rs. 32,000 crore. To address the build up of the tightening of liquidity, the RBI responded by injecting liquidity through repo operations (daily average) injection of Rs. 25,131 crore during December 26, 2005 - January 2, 2006 and again Rs. 19,939 crore during January 9, 2006 to February 2, 2006.

3.13 The emergent liquidity scenario also reflected the rapid increase in the bank credit to the commercial sector during the current financial year. The banking system, despite higher growth rate of deposits, also took recourse to augmenting liquidity through other means like borrowings to fund the increased demand for credit.