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RESERVE BANK OF INDIA

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RBI Statement on Recent Global Developments

Developments relating to the US economy last week have significantly increased uncertainty about its prevailing condition. A sharp fall in US equity markets on Thursday was followed by a downgrade in the long-term US sovereign rating by rating agency Standard & Poor's from AAA to AA+ with negative outlook on Friday. Two other rating agencies, Moody's and Fitch, had recently maintained their AAA rating, but suggested that this could change. The downgrade has raised concerns of continuing turmoil in global financial markets, as investors re-allocate portfolios in response to heightened risk perceptions stemming from both developments.

As Friday's market behaviour demonstrated, India is not insulated from such developments. It may, however, be noted that in the worst phase of the recent global financial crisis, the economy grew by 6.8 per cent, suggesting high resilience emerging from domestic factors. While downside risks to growth may have increased in the wake of global developments, they are likely to have limited impact. However, the policy and regulatory framework must anticipate and be prepared to respond to turbulent financial market conditions arising out of external developments.

In the immediate future, the Reserve Bank's priority is to ensure that adequate rupee and forex liquidity are maintained in domestic markets to prevent excessive volatility in interest rates and exchange rates. Rupee liquidity is being provided through the Repo window of the Liquidity Adjustment Facility (LAF). As of now, the banking system does not face any liquidity pressures as evident from the low level of dependence on liquidity injections under the LAF. In any case the banking system currently has an adequate stock of Statutory Liquidity Ratio (SLR) securities, which are eligible for Repo transactions. Further, the capacity of the LAF to inject liquidity has recently been augmented by the introduction of the Marginal Standing Facility (MSF), which allows banks to draw down SLR securities up to a further one per cent of their Net Demand and Time Liabilities (NDTL) in order to meet liquidity requirements. This will help stabilize the call rate within the LAF corridor, which is currently 7-9 per cent.

As regards forex liquidity, in anticipation of financial market turbulence related to the US debt ceiling impasse, the Reserve Bank made an assessment of the ability of the forex reserve portfolio to meet potential forex requirements in the event of significant capital outflows. This exercise indicated that there were sufficient liquid reserves to meet the demand for forex even in stress scenarios.

The Reserve Bank is closely monitoring all key indicators and will continuously assess the impact of global developments on Rupee and forex liquidity and macroeconomic stability. We will respond quickly and appropriately to the evolving situation..

Alpana Killawala
Chief General Manager