3

MONETARY AND BANKING DEVELOPMENTS

Monetary management in 1995-96 moderated money supply growth and thus restored the downtrend in inflation. After many years money supply growth is likely to be within the target of 15.5 per cent set at the beginning of the financial year. The annual growth of scheduled commercial banks' non-food credit has also kept pace with industrial growth, growing at an annual rate of 26.5 per cent till fortnight ending January 5, 1996. Government borrowing from the banking system grew much less than in the last financial year. Its growth rate in the first three quarters was also lower than the growth rate of credit to the commercial sector. Instead of 'crowding out' private sector borrowing, Government borrowing from the market was to some extent displaced by the surge in commercial credit demand. This in turn spilled over into Government borrowing from the RBI and reserve money growth. Government borrowing from RBI substituted for other ways of increasing reserve money for keeping monetary growth from slowing excessively, in the context of slowing growth of net foreign exchange assets.

2. In a major forward movement in the ongoing process of financial sector reforms, decontrol of interest rates was extended to deposit rates. Banks were permitted to set their own interest rates for domestic term deposits of over two years. Interest rates on post-shipment credit in Rupees for over 90 days were also decontrolled. RBI's intervention in the forex market and the consequent rise in call money rates helped in speedy stabilisation of the rupee-dollar rate .In the context of a growing demand for funds for production, this unsterilised intervention led to tightening of liquidity in the short end of the financial market and pushed up the inter bank call money rates to very high levels in November 1995. Subsequent partial sterilisation of the dollar sale by RBI through its refinance and reverse repos facilities to banks, eased liquidity pressures. This and other policy actions such as reduction of the average Cash Reserve Ratio (CRR) to 14 per cent for domestic demand and time liabilities and 10 per cent for Non-Resident External (Rupee) Accounts, removal of CRR on Foreign Currency Non-Resident Accounts (Banks) and Non-Resident Non-Repatriable (NRNR) deposits, and exemption of incremental deposits in Non-Resident Accounts from CRR stipulation, brought the rate back to normal levels.

3. Under the Ombudsman Scheme for Banks 1995, eight ombudsmen were appointed by RBI out of a total fifteen ombudsmen to be appointed for the country to look into and redress bank customers' grievances in a quick and inexpensive manner. Public sector banks had undergone a rigorous programme of reforms and implementation of new prudential norms in the three year period ending with 1994-95. They have now come out of this trying period financially stronger and operationally more efficient, as their consolidated results for the year ending March 1995 show. The Industrial Development Bank of India (IDBI) entered into the capital market for the first time, with a large public issue. Growth in financial assistance sanctioned and disbursed by development finance institutions (DFIs) kept pace with increasing demand for funds from the industrial sector, with the disbursements growing by 22.4 per cent in FY 1995-96 till December, 1995.

Monetary Trends and Developments

Monetary Trends in 1994-95

Money Growth

4. Financial year 1994-95 was characterised by an upturn in the growth of money supply. This was partly because 1994-95 had 27 fortnights of data, compared to the usual 26 (as in 1993-94) as the last reporting Friday of 1994-95 coincided with March 31, 1995, the closing day for bank accounts in that year. Up to March 17, 1995 money supply (M3) increased by 17.8 per cent in 1994-95. The additional fortnight caused a sharp acceleration of M3 growth to 22.2 per cent (provisional) for the full financial year 1994-95. (Table 3.1).

TABLE 3.1

Sources of Change in Money Stock

Variations during[1]

	Financial Year			Annual		Financial Year			Annual	
	1994-95 Mar.31 to Mar.31	1994-95 Mar.31 to Jan. 6	1995-96 Mar.31 to Jan. 5	1994-95 Jan. 7 to Jan. 6	1995-96 Jan. 6 to Jan. 5	1994-95 Mar.31 to Mar.31	1994-95 Mar.31 to Jan. 6	1995-96 Mar.31 to Jan. 5	1994-95 Jan. 7 to Jan. 6	1995-96 Jan. 6 to Jan. 5
	(Rs. crore)					(Per cent)				
1. M1 (Money supply with the public)	40694	22735	8309	32183	26268	27.0	15.1	4.3	22.8	15.1
II. M3 (Aggregate monetary resources)	96395	60862	39350	77513	74883	22.2	14.0	7.4	18.6	15.1
i) Currency with the public	18488	14408	14253	17149	18332	22.5	17.5	14.1	21.6	19.0
ii) Demand deposits with banks	21351	8160	-8491	14005	4700	32.4	12.4	-9.7	23.3	6.3
iii) Time deposit with banks	55701	38127	31041	45330	48615	19.6	13.4	9.1	16.4	15.1
iv) Other deposits with RBI	855	166	2547	1029	3236	33.9	6.6	75.4	61.9	120.3
III. Sources of change in M3 (1+2+3+4-5)										
1. Net bank credit to Government (A+B)	18498	13184	24112	11502	29426	9.1	6.5	10.8	5.6	13.6
A) RBI's net credit to Government (i+ii)[2]	2178	-2664	14269	-10499	19111	2.2	-2.7	14.1	-9.8	19.8
i) Central Government	2131[3]	-594	16534	-10502	19259	2.2	-0.6	16.7	-9.8	20.0
ii) State Governments	47	-2070	-2265	3	-148	1.9	-82.2	-88.3	0.7	-33.0
B) Other banks' credit to Government	16320	15848	9843	22001	10315	15.6	15.1	8.1	22.3	8.6
2. Bank credit to commercial sector (A+B)	51881	32151	29529	37117	49259	21.8	13.5	10.2	15.9	18.2
A) RBI's credit to commercial sector[4]	148	2079	-96	2229	-2027	2.3	32.3	-1.5	35.4	-23.8
B) Other banks' credit to commercial sector	51733	30072	29625	34888	51286	22.4	13.0	10.5	15.4	19.6
3. Net foreign exchange assets of the banking sector[5]	23298	16753	487	34258	7032	44.3	31.8	0.6	97.5	10.1
3a. Excluding revaluation of gold	23330					44.3				
4. Government's currency liabilities to the public	389	155	-134	203	100	19.6	7.8	-5.6	10.5	4.7
5. Banking sector's net non-monetary liabilities other than time deposits (a+b)	-2329	1381	14643	5567	10934	-3.8	2.2	24.6	9.6	17.3

1 Variations in respect of scheduled commercial banks are based on data for last reporting friday of March Data for RBI and others are for March 31. All figures are provisional.
2. Includes special securities.
3. Includes Rs.751.64 crore (eqivalent of SDR's 211.95 million) incurred on account of Reserve Asset subscription to the IMF towards the quota increase.
4 Excludes, since the establishment of NABARD,its refinance to banks.
5. Inclusive of appreciation in the value of gold follwing its revaluation close to international market price since October 17, 1990. Such appreciation has a corresponding effect on RBI's net non-monetary liabilities.

Reserve Money

5. For the second successive year, the major source of increase in reserve money was the build-up of net foreign exchange assets (NRFEA) of the RBI. The increase of RBI net foreign assets constituted 76 per cent of reserve money increase in 1994-95. Though down from a contribution of 103 per cent in the previous year, it was still historically large. A sharp increase of Rs.7918 crore in RBI refinance to commercial and co-operative banks partially replaced the remaining contribution of NRFEA, and constituted 25.9 per cent of Reserve Money increment in 1994-95. This compared with a Rs.4260 crore decline of RBI credit to scheduled commercial banks in 1993-94. For the second year in a row, the Government's contribution (NRCG) was a miniscule 4.6 per cent of the total (3.1 per cent in 1993-94). The last two years were therefore unique in that for the first time in nearly two decades monetary growth was not attributable to the monetisation of the budget deficit of the Centre. The agreement between the Central Government and the RBI restricted the growth of its borrowing from RBI through ad hoc treasury bills to Rs.6000 crore for 1994-95. The Central Government did not borrow against ad-hoc treasury bills during the greater part of the year, and the net increase in ad-hoc treasury bills during 1994-95 was only Rs.1750 crore (Table 3.2)

TABLE 3.2
Sources of Change in Reserve Money
Variations during[1]

	Outstanding as on March 31, 1994	Financial Year 1994-95 Mar.31 to Mar.31	Financial Year 1994-95 Mar.31 to Jan. 6	Financial Year 1995-96 Mar.31 to Jan. 5	Annual 1994-95 Jan. 7 to Jan. 6	Annual 1995-96 Jan. 6 to Jan. 5	Financial Year 1994-95 Mar.31 to Mar.31	Financial Year 1994-95 Mar. 31 to Jan. 6	Financial Year 1995-96 Mar.31 to Jan. 5	Annual 1994-95 Jan. 7 to Jan. 6	Annual 1995-96 Jan. 6 to Jan. 5
			(Rs.crore)				(per cent)				
1. Net RBI credit to Government[2]	99300	2178	-2664	14269	-10499	19111	2.2	-2.7	14.1	-9.8	19.8
2. RBI credit to banks[3]	5552	7918	6918	1530	5729	2530	142.6	124.6	11.4	85.0	20.3
3. RBI credit to commercial sector	6445	148	2079	-96	2229	-2027	2.3	32.3	-1.5	35.4	-23.8
4. Net foreign exchange assets of RBI[5]	51422	23298	16639	373	34144	7032	45.3	32.4	0.5	100.7	10.3
4a.Excluding revaluation of gold		23330					45.4				
5. Government's currency liabilities to the public	1990	389	142	-134	203	100	19.5	7.1	-5.6	10.5	4.7
6. Net non-monetary liabilities of RBI	26037	3324	-2308	5675	-2580	11307	12.8	-8.9	19.3	-9.8	47.7
7. Reserve Money (1+2+3+4+5-6)	138672	30607	25435	10267	34386	15439	22.1	18.3	6.1	26.5	9.4

1. Variations are worked out on the basis of March 31 data after closure of Government accounts. Figures for 1995-96 are provisional.
2. Includes special securities.
3. Includes claims on NABARD.
4. Excludes, since the establishment of NABARD, its refinance to banks.
5. Variations are inclusive of appreciation in the value of gold following its revaluation close to the international market price since October 17,1990. Such appreciation has a corresponding effect on RBI's net non-monetary liabilities.

Money Multiplier

6. The money multiplier at the end of 1994-95 was 3.135, close to the lower levels (3.132) it had fallen to at end 1993-94. The within-year declining trend seen in 1993-94 continued in early 1994-95, but was reversed in the second quarter of the year, with a slow and gradual rise since then. As mentioned in the last Economic Survey, the 1993-94 fall was due to the cautiousness of banks, following the introduction of new prudential norms, coupled with low credit demand from the corporate sector. Both these factors gradually reversed over 1994-95.

Demand for Money and Credit

7. The shift in the method of financing the fiscal deficit by borrowing from RBI through ad hocs and from banks through SLR, towards market based borrowing, continued in 1994-95. "Other" banks' credit to Government grew by 15.6 per cent in 1994-95. Much of the increase however came in the first quarter of 1994-95, when commercial banks' liquidity ratios were comfortably above SLR levels. In the first three quarters of the year "other" banks' credit to government exceeded their credit to the commercial sector. There was a surge in commercial demand for credit starting around the middle of September, 1994. Given the market based nature of Government borrowing, this was reflected in a rise in the cut-off yields on 91 day treasury bills. Cut-off yields on 364 day treasury bills similarly showed an uptrend from November, 1994, confirming that Government borrowing in most of 1993-94 and 1994-95 was market based.

8. There were complaints of "liquidity crunch" and "crowding out" by government borrowing, towards the end of 1994-95. The facts did not support such complaints. Other bank credit to commercial sector expanded by Rs. 7684 crore in the third quarter of 1994-95, double the rate of credit expansion to government. In the fourth quarter "other" banks' credit to commercial sector expanded by a phenomenal Rs.26590 crore, while credit to government contracted by Rs. 3423 crore. Similarly non-food credit showed a phenomenal increase in 1994-95, growing 23.5 per cent up to March 17, 1995 and 29.8 per cent up to March 31, 1995. In contrast, bank credit to Government, expanded by only 9.1 per cent in 1994-95.

9. Monetary growth in 1994-95 exceeded the revised projection of 16 per cent growth made by the RBI in September, 1994. This was partly

because of the continuous surge in capital inflows, accompanied by a current account deficit which remained low, despite a rise in GDP growth from 5.0 per cent in 1993-94 to 6.3 per cent in 1994-95.

Monetary Policy and System Reforms

Monetary Objective

10. The downtrend in inflation observed in the first half of 1994-95 was reversed in the second half of the year. This was accompanied by a sustained rise in industrial production throughout the year, which averaged 8.7 per cent in 1994-95. With production growth back on track and increased pressure on the price front, the objective of monetary policy viz. inflation control had to be pursued with a greater vigour. As always, the objective of inflation control has to be balanced against the needs of the economy for credit for maintaining production and growth momentum.

Money Supply Target

11. In the credit policy announced for the first half of 1995-96, RBI examined the broad macro-economic trends and estimated GDP growth rate at 5.5 per cent in 1995-96. Given this GDP growth rate and the objective of limiting the inflation rate at around 8 per cent, an increase of 15.5 per cent in M3 was projected for the financial year 1995-96. This also took account of the substantial money supply growth in both 1993-94 and 1994-95. In the credit policy for the second half of 1995-96, RBI reiterated the need "to ensure that the growth in money supply (M3) stays within the targetted growth of 15.5 per cent in 1995-96."

Monetisation of Fiscal Deficit

12. The 1994-95 agreement between RBI and the Central Government to limit the Centre's borrowing through ad hoc treasury bills proved effective. During 1994-95, the targetted ceilings for the budget deficit and of issue of ad hoc treasury bills (Rs. 6000 crore) were easily met and the level of the ad hoc treasury bills issued remained well below Rs. 9000 crore throughout the year. The agreement for 1995-96 (BE) set a year-end ceiling of Rs.5000 crore for 1995-96(BE). The within-year (ten consecutive working days) threshold for issue of ad hocs, above which RBI was free to sell government securities or treasury bills, was left unchanged at Rs.9000 crore. The potential monthly mismatch between revenue and capital inflows and expenditure outflows was expected to rise in absolute value along with a rise in budgeted values of these variables. A sharp reduction in government's market borrowing during the first half of 1995-96 has been an important factor in increasing this mismatch, thus keeping the Centre's borrowing against ad hocs well above the intra- year ceiling. RBI took steps on a number of occasions to bring it down to within-the-year ceiling by selling government papers. The net increase in ad hocs was only Rs.1990 crore on December 29,1995 but is expected to rise in last quarter of 1995-96.

Interest Rate Policy

13. Bank interest rate deregulation was extended from the lending side (Table 3.3) to the deposit side in the credit policy for the second half of 1995-96 announced on September 29, 1995. From October 1,1995 scheduled commercial banks were free to fix their own interest rate on domestic term deposits with a maturity of over 2 years. The ceiling interest rate on domestic term deposits of 46 days to 2 years was, however, left unchanged at 12 per cent. The stipulation of at least three maturities with a minimum interest rate differential of 0.25 per cent point imposed in April 1992, was also withdrawn. Banks have to obtain their respective board's approval for setting interest rate on maturity above 2 years, be watchful about asset-liability maturities mismatches and careful about getting locked into excessively long deposit maturities.

Open Market Operations

14. Due to slow down in foreign exchange inflows and large expansion in non-food bank credit, open market operations during 1994-95 were lower than in the previous year. On face value basis the sale of securities by RBI from its portfolio in 1994-95 at Rs.2291 crore were far less than the sales (Rs.9717 crore) in 1993-94. Purchases at Rs.1440 crore were higher than the Rs.1142 crore in 1993-94. The net sales in 1994-95 were Rs.748 crore compared to Rs.9837 crore in 1993-94. During 1995-96 (upto December 31, 1995) open market operations remained subdued, with sales of Rs.1423 crore and purchases of Rs.961 crore.

Short Term Money Management

15. The close linkage between foreign exchange markets and short term money markets, observed in developed countries, manifested itself prominently for the first time in India. A sharp rise in industrial production increased demand for credit as well as for imports. The increased credit demand was reflected in rising call money rates and certificate of deposit rates, as well as in increased volatility of call rates. Rising imports and lower portfolio and aid inflows were not however reflected in exchange rate changes in late 1994-95 or early 1995-96. This lack of comprehension by foreign exchange markets was manifested in falling 3 month and 6 month forward premia during the early part of 1995-96. This contradiction between fundamentals (demand-supply) and market perception, resulted in increasing volatility in foreign exchange markets, followed by

TABLE 3.3

Changes in Lending Rates[1] of Scheduled Commercial Banks

	Credit limit	Before April 8 1993	Rates effective April 8, 1993	June 24, 1993	Sept.2, 1993	March 1, 1994 Term loan (3 yr & above)	March 1, 1994 Other advances	October 18 1994
i)	Up to and including Rs. 7500	11.5						
ii)	Over Rs.7500 and up to Rs.25000	13.5	12.0	12.0	12.0	12.0	12.0	12.0
iii)	Over Rs. 25000 and up to Rs 2 lakh	16.5	16.5	16.0	15.0	14.0	15.0	13.5
iv)	Over Rs. 2 lakh (minimum)	17.0	17.0	16.0	15.0	14.0	15.0	Free[2]

1 Other than those for export credit.
2 Banks have to take the approval of their board of directors for fixing and declaring their prime lending rate which could be the same uniformly applicable to all their branches.

rising foreign exchange premia. In October-November 1995, when heightened speculations led to excessive volatility RBI intervened by selling substantial amount of dollars. Such intervention reduces money supply by withdrawing rupee from the banking system, and raises inter bank call money rates. A rise in short term rates helps in stablising foreign exchange markets. Call money rates, however, rose to excessive heights, given the undeveloped state of the markets, necessitating a softening of the impact of the foreign exchange intervention. RBI injected funds into the call market through reverse repos and refinance facilities to banks, against government and other approved securities. These measures stabilized the rupee-dollar exchange rate and brought down the call money rate to 12-13 per cent by end November 1995.

Monetary Management

16. Given the temporary excess demand in the foreign exchange market a number of measures were taken to restore equilibrium. The ceiling interest rate on fresh Non-Resident (External) Rupee Accounts (NRER) deposits (of 6 months to 3 years and over) made after October 1, 1995, from 8 per cent to 10 per cent. This will maintain the differential between the interest rate on domestic term deposits and that on NRER deposits, and keep the latter attractive for NRIs. The ceiling interest rate on NRER deposits was again raised by 2 percentage points to 12 per cent with effect from October 31, 1995. At the same time, CRR on incremental deposits in NRER and NRNR accounts above October 27, 1995 levels were eliminated. CRR on incremental FCNR (B) deposits above November 24, 1995 levels was also eliminated. On December 8,1995 the CRR on outstanding FCNR (B) deposits was reduced from 15 per cent to 7.5 per cent and CRR on FCNR (B) and NRNR deposits was finally fully removed on January 6, 1996.

Refinance facilities

17. Refinance from RBI to banks is currently provided for (i) post shipment export credit denominated in US Dollars (PSCFC) to the limit of Rs.6670 crore (March 31, 1995), (ii) export credit (Rupee) to the limit of Rs.2726 crore and (iii) government and approved securities held by banks. The two tier scheme of export credit (Rupee) refinance at 11 per cent was replaced during the year by the old single tier scheme, and the base was shifted by one year to 1992-93. Refinance is now 100 per cent of increase in such credit over its monthly average level (MAL) in 1992-93. This reduced the rupee export credit refinance limits by Rs.1200 crore. The refinance percentage under PSCFC was also lowered from 80 per cent to 70 per cent, reducing refinance by about Rs.825 crore.

Statutory Liquidity Ratio

18. Average effective SLR declined from 29.5 per cent in March 1995 to 28.7 per cent in September 1995. The average SLR is expected to continue declining to 28.2 per cent by March end 1996 given the SLR of 31.5 per cent on outstanding domestic net demand and time liabilities (NDTL) on September 30, 1994 and lower prescription of SLR of 25 per cent on increment over this level of domestic NDTL and zero SLR on certain specific external liabilities. The system of valuation of SLR securities was, however, changed to make it consistent with the valuation practice adopted by scheduled commercial banks in their balance sheet.

This will tend to lower the value of their SLR portfolio when interest rates are rising and to raise it when it is falling, and act as an automatic stabiliser for Government securities demand.

Cash Reserve Ratio

19. In 1994-95 the Cash Reserve Ratio (CRR) was raised to 15 per cent to meet the monetary pressures arising from large capital inflows. For the same reason the CRR on Foreign Currency Non-Resident Accounts (Banks) and Non-Repatriable deposits was raised to 15 per cent and 7.5 per cent respectively. With these conditions reversed and money growth slowing, the CRR was lowered to 14.5 per cent effective November 11,1995 and 14 per cent effective December 9,1995. Preferential CRRs for NRER, NRNR and FCNRB(B) deposits which were eliminated earlier were reintroduced in 1995-96. This reduction in average CRR and in CRR against FCNR(B) account released about Rs.5050 crore of cash balances to the scheduled commercial banks. Finally CRR on outstanding deposits was removed for FCNR(B) and NRNR schemes and CRR on outstanding NRE deposits was reduced to 10 per cent from 14 per cent with effect from the fortnight beginning January 6, 1996. These measures together also augmented banks' resources by Rs.2475 crore (Box 3.1).

Monetary Trends in 1995-96

Money Supply

20. Money supply growth has decelerated in 1995-96. The latest data available up to January 5, 1996 show the following trends: during 1995-96 money supply has grown by only 7.4 per cent, about half of the growth (14 per cent) in the corresponding period of 1994-95. As a result, the annual (point to point) growth rate of M3 dropped to 15.1 per cent on January 5, 1996 after a sharp upward spike in October, 1995. The growth of narrow money (M1) has been an even lower at 4.3 per cent in 1995-96, about one-fourth of the growth of 15.1 per cent in the comparable period of 1994-95. The lower growth rate of M1 in 1995-96 so far is a reflection of the decline of demand deposits by 9.7 per cent (against an increase of 12.4 per cent in 1994-95) during FY 1995-96. Slower growth of currency with public (14.1 per cent as against 17.5 per cent) in 1994-95) has also added to this. Consequently the annual growth of M1 has fallen sharply to 15.1 per cent on January 5, 1996 from 27 per cent at the end of March 1995.

21. However for a clearer perspective of the monetary trends statistical adjustment is necessary to make the 1995-96 and 1994-95 M3 data comparable in view of the last reporting Friday in March 1995 coinciding with March 31, using March 17, 1995 as a base for 1995-96 and March 18, 1994 as a base for 1994-95. The growth in M3 upto January 5, 1996 was 11.4 per cent in 1995-96 as against 13.9 per cent in 1994-95.

Reserve Money

22. A modest 6.1 per cent growth in reserve money in 1995-96 up to January 5, 1996 has contributed to slower monetary expansion during this period. Reserve money growth was one third of the growth of 18.3 per cent in the corresponding period of 1994-95. Deceleration of reserve money growth started in the second half of 1994-95 and has continued in 1995-96, because of gradual reduction of RBI's net foreign exchange assets, over most of the year.

23. The principal source of reserve money growth in 1995-96 was the expansion of net RBI credit to government (NRCG). It grew by 14.1 per cent in FY 1995-96 up to January 5, 1996, as against an absolute decline of 2.7 per cent in the corresponding period of 1994-95. The NRCG growth is mainly due to a substantial reduction in the contribution of banks to the market borrowing of the government. The latter was the result of rising commercial demand for credit in the context of excess (i.e. above SLR) holding of government and other approved securities and slower growth in bank deposits. Paradoxically, instead of government borrowing "crowding out" commercial credit, 1995 could be called a period in which commercial credit crowded out government borrowing. Given the smaller growth of Rs.1530 crore in RBI credit to banks (expansion of Rs.6918 crore in the comparable period of 1994-95), the small expansion in RBI net foreign exchange assets would have resulted in an even slower growth of reserve money, money supply and credit, if growth in net domestic assets of the Reserve Bank remained at 1994-95 levels.

Credit

24. The current financial year saw a reversal of the pattern that emerged in 1994-95. In 1994-95 "other banks" (commercial and co-operative banks) accounted for 88.2 per cent of the net government borrowing from the banking system - Rs.16320 crore out of Rs.18498 crore . On the other hand, in FY 1995-96 up to January 5, 1996, "other" banks contributed only Rs.9843 crore (growth rate of 8.1 per cent) out of a total of Rs.24112 crore (10.8 per cent) borrowed by the Government from the banking system. In contrast, bank credit to commercial sector expanded by Rs.29529 crore (10.2 per cent) as against Rs.32151 crore (13.5 per cent) in the corresponding period of 1994-95. On the more appropriate March 17, 1995/March 18, 1994 basis, its growth in 1995-96 at Rs. 38822 crore (13.8 per cent) is much higher than Rs. 32799 crore (13.8 per cent) in 1994-95. The uptrend in commercial

Box 3.1
Financial Sector Policy & System Reforms : 1991-92 to 1995-96

- Statutory Liquidity Ratio (SLR) on incremental net domestic demand and time liabilities (NDTL) reduced from 38.5 per cent in 1991-92 to 25 per cent.
- SLR securities to be continuously valued on same basis, as valued for the purpose of balance sheet of banks.
- Incremental Cash Reserve Ratio (CRR) of 10 per cent removed.
- Average CRR on net demand and time liabilities reduced from 15 to 14 per cent. CRR removed from FCNR(B) and NRNR accounts. CRR on NRE deposits outstanding as on October 27, 1995 reduced from 14 per cent to 10 per cent. CRR on increase in NRE deposits removed.
- The prime lending rate of SBI and most other banks on general advances of over Rs. 2 lakh has come down by 2.5 percentage points to 16.5 per cent between 1991-92 and 1995-96.
- Interest rates on deposits and advances of all co-operative banks (except urban co-operative banks) deregulated, subject to a minimum lending rate of 12 per cent. Subsequently, interest rates on advances of primary co-operative banks were also deregulated subject to a minimum lending rate of 13 per cent.
- Bank Interest rate on loans above Rs.2 lakh fully decontrolled. The number of administered interest rates on bank advances reduced from more than 20 in 1989-90 to 2 in 1994-95.
- Interest rate on domestic term deposits above two years and on NRNR accounts decontrolled.
- The State Bank of India Act 1955 amended effective October 15, 1993 to enable the bank to access the capital market and allow 10 per cent voting rights to share holders. SBI raised over Rs. 3200 crore by public issue of equity shares and bonds. The RBI shareholding reduced from 99 per cent to 66 per cent.
- Nationalised banks enabled to access the capital market for debt and equity, through an amendment of The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980. Oriental Bank of Commerce raised Rs.387.24 crore through its first issue.
- Prudential norms for income recognition, classification of assets and provisioning for bad debts introduced for the first time. Provisioning requirement for non-performing advances of less than Rs.25,000 raised to 10 per cent in 1995-96.
- As on March 31, 1995, 13 public sector banks have attained a capital to risk weighted assets ratio of 8 per cent. Full norm of 8 per cent already attained by foreign banks in India and by some Indian banks. All Indian Banks are to attain the norm by end March 1996.
- Recapitalisation of less strong public sector banks through budgetary support of Rs.14987 crore till 1994-95. These banks simultaneously agreed with RBI to strengthen bank management and improve efficiency.
- Nine new private banks have already started functioning. 'In principle' approval given to two other proposals. Banks allowed to raise capital contribution from foreign financial institutions/banks upto 20 per cent and from Non-resident Indians, OCBs upto 40 per cent.
- Banks given freedom to open new branches and upgrade extension counters on attaining capital adequacy norms and prudential accounting standards. Subsequent to the review of the above policy, it has been decided that those banks which achieved 8 per cent CRAR, net profits for last 3 consecutive years, NPAs less than 15 per cent of total outstanding loans and minimum owned funds of Rs.100 crore will be free open branches on their own as per a plan of action drawn up by the concerned individual banks and duly approved by the banks' board of directors. They are permitted to close non-viable branches other than in rural and semi-urban areas.
- A Board of Financial Supervision has been set up with an Advisory Council to strengthen the supervisory system of banks and financial institutions. An independent Department of Supervision also established in RBI in December 1993 for assisting the Board.
- Recovery of debts due to Banks and Financial Institutions Act, 1993, passed to set up Special Recovery Tribunals to facilitate quicker recoveries of loan arrears. Five tribunals started functioning and an Appellate Tribunal set up at Bombay.
- Banking Regulation Act, 1949, amended to enable a banking company to have a non-executive Chairman, upto three directors from among the directors of promoting institutions, to raise the ceiling for the exercise of voting rights for a shareholder to 10 per cent, and to raise the penalities for contravention of the Act.
- Union agreement in October 1993 paved way for faster computerisation in banks.
- Under Banking Ombudsmen Schme 1995, eight Ombudsmen already appointed by RBI out of a total of 15 to look into and resolve customers' grievances in a Quick and inexpensive way.
- IFCI converted into a company and its maiden public issue raised over Rs.600 crore as equity (including premium). IDBI act amended to broad base its ownership pattern IDBI raised capital through its maiden public issue.
- Capital adequacy norms for financial institutions' introduced.
- Prudential norms have been introduced for RRBs in a phased manner. Substantial equity support given to select banks to offset losses.

credit that started in the last quarter of 1994-95 with the recovery of industrial production, continued and even accelerated in the current financial year, with faster growth in industrial production. This is more clearly revealed in the growth of non-food credit which expanded by Rs.35859 crore between March 17 and January 5, 1996 as against Rs.24735 crore between March 18 and January 6, 1995. Larger expansion in non-food credit coupled with a fall in the annual inflation rate to 5.1 per cent on January, 13 1996 shows that monetary policy had balanced these two concerns successfully in the first half of 1995-96.

Banking Policy and Trends

25. Decades of non-commercial orientation, directed lending, loan waivers and rising (though camouflaged) trend in non-performing assets, initially made it difficult for banks to adjust to a market environment having strict prudential norms. The latter included norms for classification of assets, income recognition, provisioning, and a stipulated time schedule for attaining capital adequacy, a greater thrust on prudence and transparency imposed through a reformed system of regulation and supervision. The emerging results suggest that banks are beginning to adjust and adapt to the competitive environment and face the challenge.

Provisions and profits

26. Introduction and application of new accounting norms in April 1992, revealed net losses in 13 public sector banks. By 1994-95 the number of banks reporting losses fell to 8 (from 12) and their losses declined to Rs.625 crore (from Rs.5079 crore in 1993-94). The nationalised banks (other than SBI group) as a whole reported a net profit of Rs.269 crore after posting net loss of Rs.3573 crore in 1992-93 and Rs.4779 crore in 1993-94. The number of public sector banks (including SBI group) declaring operating profits improved significantly from 19 in 1992-93 to 26 in 1994-95, with only one reporting operating loss. Eight banks in the SBI group (SBI and its 7 associates) have continuously increased their profits, from Rs.280 crore in 1991-92 to Rs.846 crore in 1994-95. The number of public sector banks making net profits rose to 19 with a total net profit of Rs.1741 crore for the year ended March 1995 from 15 banks with a net profit of Rs.395 crore in 1992-93 (Table 3.4)

27. There are two main causes behind the higher profitability of the public sector banks (a) a decline in provisions and contingencies following reduction in non-performing assets and (b) generation of larger spread because of better asset and liability management. The ratio of non-performing assets of the public sector banks to their total advances has been brought down to 20 per cent in 1994-95 from 26 per cent in 1992-93. A reduction in non-performing assets has brought about a significant contraction in provisions and contingencies to Rs.4405 crore in 1994-95: Rs.1737 crore for SBI group and Rs.2668 crore for nationalised banks.

28. Better asset-liability management has also increased the spread on bank business, the principal source of bank profitability. In 1994-95 the spread increased to Rs.1147 crore from Rs.866 crore in 1993-94 for the SBI group. It rose to Rs.7724 crore for nationalised banks, more than 20 per cent higher than Rs.5174 crore in 1993-94. The credit- deposit ratio also rose, from 52 to 58 for SBI group, and from 46 to 48 for nationalised banks.

Working results

29. Working results of the scheduled commercial banks for 1993-94 and 1994-95 are presented in Table 3.5 separately for SBI Group and nationalised banks, private sector banks and foreign banks. In 1994-95 expenditure (in particular, the interest expenses) as percentage of working funds fell for all categories of banks. The decline in total expenditure as a percentage of working funds is more marked than the decline in income. Profits as a percentage of working funds improved for all categories of banks with decline in provisioning requirement in 1994-95 (Table 3.5).

TABLE 3.4
Profits of Public Sector Banks:1993-94 and 1994-95

(Rs.crore)

	1993-94			1994-95		
	SBI Group	Other Public Sector Banks	All Public Sector Banks	SBI Group	Other Public Sector Banks	All Public Sector Banks
1. Income	13909	20779	34688	15948	27000	42948
2. Expenditure,of which	13553	25558	39111	15101	26730	41831
Provisions and contingencies	1680	6152	7832	1737	2668	4405
3. Profits (Net of appropriation)	356	-4779	-4423	846	269	1115

TABLE 3.5

Working Results of Scheduled Commercial Banks for 1993-94 and 1994-95

	SBI Group		Other Public Sector Banks		Private Sector Banks		Foreign Banks		All Banks	
	1993-94	1994-95	1993-94	1994-95	1993-94	1994-95	1993-94	1994-95	1993-94	1994-95
				A. Rupees Crore						
A. Income	13909	15948	20779	27000	2353	3455	4085	4561	41125	50964
i) Interest	11901	13862	18287	23984	2051	2973	3341	3749	35581	44568
ii) Other income	2008	2086	2492	3016	302	482	744	812	5544	6396
B. Expenditure	13553	15101	25558	26730	2203	3089	3511	3890	44825	48810
i) Interest	8119	8751	13804	16260	1354	1932	1939	2098	25216	29041
ii) Other operating expenses	3754	4613	5602	7802	564	781	885	1033	10804	14229
iii) Provisions and contingencies	1680	1737	6152	2668	285	376	687	759	8805	5540
C. Profit	357	846	-4779	269	149	367	573	672	-3700	2154
D. Working Funds	140917	156295	212556	282535	22976	38132	33418	37729	409867	514691
				B. Per Cent of Working Funds						
A. Income	9.9	10.2	9.8	9.6	10.2	9.1	12.2	12.1	10.0	9.9
i) Interest	8.4	8.9	8.6	8.5	8.9	7.8	10.0	9.9	8.7	8.7
ii) other income	1.4	1.3	1.2	1.1	1.3	1.3	2.2	2.2	1.4	1.2
B. Expenditure	9.6	9.7	12.0	9.5	9.6	10.2	10.5	10.3	10.9	9.5
i) Interest	5.8	5.6	6.5	5.8	5.9	5.1	5.8	5.6	6.2	5.6
ii) Other operating expenses	2.7	3.0	2.6	2.8	2.5	2.3	2.6	2.7	2.6	2.7
iii) Provisions and contingencies	1.2	1.1	2.9	0.9	1.2	1.0	2.1	2.0	2.1	1.1
C. Profit	0.3	0.5	-2.2	0.1	0.6	1.0	1.7	1.8	-0.9	0.4

System Reforms

Recapitalisation of banks

30. A sum of Rs. 3889.54 crore was released by the Government from December 1994 onwards as additional funds for Tier I capital of 13 nationalised banks. This was followed by Rs.473 crore released to four nationalised banks in February 1995. The recipient banks will invest the capital in 10 per cent GOI Nationalised Banks (Non-Transferable) Special Securities 2006. For Tier II capital, on March 31, 1995 government released Rs.924.58 crore to six public sector banks by subscribing to the promissory notes issued by these public sector banks, as part of World Bank's Financial Sector Development Loan. Total disbursements of capital contribution by Government in 1994-95 was Rs.5287.12 crore, Rs.312.88 crore less than the budgetary provision of Rs.5600 crore. Another Rs.852 crore have been earmarked in this year's central budget for capital assistance to 6 capital deficient public sector banks.

31. The equity base of a number of profit making banks is regarded oversized relative to projected income, making it difficult to access the capital market. Neither the loss making banks can adjust their losses. Banking Companies (Acquisition and transfer of undertakings) Acts 1970/1980 was, therefore amended to enable banks to reduce their paid up capital up to 25 per cent at a time.

Capital Adeqacy Ratio

32. Public sector banks have made progress in moving to the March 1996 target of 8 per cent capital to risk weighted assets ratio (CRAR). By end March, 1994, four public sector banks had a CRAR over 8 per cent, four had a CRAR between 6.7 and 8 per cent, and eight had a CRAR between 4.3 and 6.7 per cent. By end March, 1995 as many as 13 public sector banks reached CRAR of at least 8 per cent, while 10 banks had a CRAR between 4 and 8 per cent and above. Only 4 banks have less than 4 per cent CRAR. Existing private sector banks reached 4 per cent CRAR by March, 1994 and plan a public issue to attain 8 per cent CRAR by March, 1996. All new private sector banks have to start with 8 per cent CRAR.

Provisioning and Other Norms

33. New guidelines issued on April 3, 1995, for bank accounts of the year ended March 1995 apply to loans identified as non-performing for the first time in 1994-95. The interest accrued and credited to income account on these loans has either to be reversed or provided for. Detailed guidelines were also issued for valuation of securities under both permanent and current category, which were maintained in the ratio 70 : 30. The proportion of investments to be put in the permanent category

was reduced to 60 per cent in June 1995 for the year ended March 31, 1995 so as to have better perception of assets in the context of rising yields. Bank were told not to provide depreciation on their recapitalisation bonds in which they invest the capital support received from the Government.

34. The method of valuation of securities approved for SLR, was earlier different from the method used in the balance sheet. With effect from the fortnight beginning October 14, 1995, all scheduled commercial banks (excluding RRBs) are required to adopt the same system of valuation of securities for purposes of SLR and balance sheet. This will ensure that banks take account of changing interest rates, and the effect of their bids at auction of Government securities on the value of their existing portfolio.

Debts Recovery Tribunals

35. With the setting up of Debts Recovery Tribunals in two more centres at Ahmedabad and Bangalore, there are now five such tribunals working in five centres, besides the Appellate Tribunal already set up in Bombay. The Delhi High Court quashed the notification to constitute the debts recovery tribunal for Delhi region in March, 1995. However, following a special leave petition from the Government of India, the order of the Delhi High Court has been stayed by the Supreme Court in April, 1995. As the constitutionality of the Recovery of Debt due to Banks and Financial Institutions Act, 1993 has been challenged in various High Courts, Government of India has filed a petition for transfer of cases to the Supreme Court, which has granted stay in all the cases mentioned in the petition. The retirement age of the presiding officers of the Debts Recovery Tribunals and Debts Recovery Appellate Tribunal has been raised through an amendment of the Recovery or Debts Due to Banks and Financial Institution Act, 1993 to attract more suitable persons.

Board for Financial Supervision

36. The Board for Financial Supervision (BFS), has set up an Audit sub committee which will lay down and review the policies governing the audit of banks, financial institutions and non-banking financial companies. The Vice-Chairman of the BFS is the ex-officio Chairman of the Special Committee and its two other members are from the Board. BFS commenced operations in 1995-96 with on-site inspection and off-site supervisory system. It met regularly once a month and its Advisory council five times in 1995 and provided guidance on supervisory initiatives and interventions of RBI. Inspection of banks under new supervision mechanism would commence as part of 1996-97 inspection cycle. There will also be an intensive computerisation of operations in the central and the regional offices of the Department of Supervision in 1996.

Defaulting Borrowers' List

37. The scheme for disclosure of information about defaulting borrowers of banks and financial institutions above the threshold limit of Rs.1 crore, was announced in April, 1994. The objective is to alert banks and financial institutions and put them on guard against borrowers who have defaulted in repayments of their dues. The list of defaulting borrowers updated to March 31 and September 30,1994 were circulated among banks and financial institutions for confidential use. RBI has also published a list of borrowal accounts against which the banks have filed suits for recovery of funds (position as on March 31, 1994).

Banking Ombudsmen Scheme 1995

38. Another step in the difficult process of improving customer service of banks, was the launching in June, 1995, of the Banking Ombudsmen Scheme, 1995. 15 Ombudsmen will be appointed under the scheme to operate at different centres covering the country. They will hear and redress those grievances of customers which have not been resolved to their satisfaction within a stipulated period of 2 months. The scheme covers all scheduled commercial banks and all scheduled primary cooperative banks, and aims to provide a quick and inexpensive facility to resolve customers grievances. The complaints can fall in two areas; (a) deficiency in bank services like non-payment/ delay in collection, handling of cash and currency, non-adherence to working hours, complaints from NRIs and exporters, and (b) complaints concerning loans and advances relating to delay in sanction/ non-observance of prescribed time schedule for disposal of loan applications and non-observance of RBI directions on interest rates. The complaint can be made to the office of the Ombudsmen by post or personally through an application. Eight Ombudsmen, located at Bombay, Bhopal, New Delhi, Chandigarh and Bangalore, Hyderabad, Patna and Jaipur have so far been appointed.

Decontrol and Competition

39. A number of steps were taken during 1995-96 to reduce controls and remove operational constraints in the banking system. These include interest rate decontrol, liberalisation and selective removal of CRR stipulation, freedom to banks to fix their own foreign exchange open position limit and enhanced refinance facilities against government and other approved securities (Box 3.2).

Interest Rate Reforms

40. Interest rate reforms were carried out to promote deposit growth, and to give a greater flexibility to banks to develop an attractive term structure of interest rates for deposits. Keeping the inflation rate in view, the ceiling on interest rates on

Box 3.2
Financial Sector Operational Reforms: 1991-92 to 1995-96

- Bank lending norms liberalised and banks given freedom to decide levels of holding of individual items of inventories and receivables.
- Ceiling on term loans raised to Rs. 1000 crore for projects involving expansion/modernisation of power generation capacities.
- Scope of mandatory consortium arrangement narrowed to 76 large borrowal accounts in place of 934 accounts hitherto. As per the latest data of May 1995, the number of such borrowal accounts are 207. Borrowers allowed to induct new banks into a consortium and banks permitted to leave consortium after two years.
- Loan system introduced for delivery of bank credit. Banks required to bifurcate the maximum permissible bank finance of Rs. 20 crore and above into loan component of 40 per cent (short term working capital loan) and cash credit component of 60 per cent by December 31, 1995.
- Banks allowed to set their own interest rate on Post shipment export credit in Rupees for over 90 days. The interest rate on loans over Rs.2 lakh and that on deposits of maturities above 2 years deregulated.
- The banks were asked to maintain 85 per cent of amount of CRR required to be maintained during a reporting Fortnight from first working to the last but one working day.
- Minimum period of ready forward transactions (repos) in government and other approved securities by banks fixed at three days.
- Banks allowed to reduce their paid up capital at a time upto 25 per cent.
- Banks freed to fix its own foreign exchange open position limit subject to RBI approval .
- Guidelines issued to banks to ensure qualitative improvement in their customer service as a follow-up on the recommendations of the Committee on Customer Service in Banks.
- Convertibility clause no longer obligatory for assistance sanctioned by term lending institutions.
- Floating interest rate on financial assistance (linked to interest rate on 364 day treasury bills) introduced by some all India development banks.

domestic term deposits was raised from 11 per cent to 12 per cent. This was made applicable effective April 18, 1995 to fresh deposits mobilised by the scheduled commercial banks and to renewals of maturing deposits. Deposit growth was reviewed again at the time of the formulation of the busy season credit policy and the deposits rate ceiling on term deposits above 2 years was removed in the busy season credit policy. Between March 31, 1995 and January 5, 1996, aggregate deposits of scheduled commercial banks rose by Rs.19616 crore (5.1 per cent) compared to an increase of Rs.44090 crore (14 per cent) between March 18, 1994 and January 6, 1995. For comparable base years, the picture turns out to be quite different; between March 17, 1995 (adjusted base) and January 5, 1996, aggregate deposits increased by Rs.39777 crore (10.8 per cent) which is also lower than the increase of Rs.44090 crore (14 per cent) during the comparable period of 1994-95.

41. The interest rate on loan/advance against term deposit was earlier specified at 2 percentage point above the interest rate on that deposit. With effect from October 1, 1995, the interest rate on advances of over Rs. 2 lakh against domestic and NRNR deposits was decontrolled. Besides giving greater freedom to banks, this measure will also increase attractiveness of bank deposits. Interest rate stipulation will however continue for the FCNR (A), FCNR (B) and NRER accounts where overall limits on debt inflows have to be kept in view as part of BOP management.

42. The refinance (at an interest rate of 5.5 per cent) against PSCFC credit was reviewed by RBI at the beginning of 1995-96. As exporters retains the forward premium, PSCFC was in effect rupee export credit at foreign currency rates. Taking forward premium into account at that time, the interest rate of 6.5 per cent on PSCFC turned out to be too low. The interest rate on PSCFC was therefore raised to 7.5 per cent. This was followed by a rise in interest rate on its refinance from 5.5 per cent to 6.5 per cent. On further review in October 1995, the interest rates on PSCFC were again modified and differentiated by period with a view to rationalising them and to encourage a quicker turnover. The interest rate was kept at 7.5 per cent on credit for a period upto 90 days. The interest rate was set at 9.5 per cent on credit beyond 90 days and upto 6 months from the date of shipment. Banks were permitted to fix their own interest rates on export credit not otherwise specified under PSCFC. In order to facilitate a faster turnaround of credit under PSCFC scheme, with effect from January 16,1996 the interest rate of credit under this scheme were further revised. The interest rate on credit against demand bills for transit (as specified by FEDAI) and usance bills up to 90 days, which had been 7.5 per cent was raised to 9.5 per cent. The interest rates on credit against usance bills beyond 90 days and up to six months from the date of shipment were deregulated. Banks became free to set their own interest on this credit as also on export credit not otherwise specified for PSCFC. With the changes in the interest rates under this scheme, banks became eligible for refinance under this scheme only against bills upto 90 days as

against 180 days hitherto. Further changes were made in early February, 1996. PSCFC scheme was abolished with effect from February 8, 1996. The interest rate on post shipment Rupee export credit beyond 90 days was deregulated with effect from the same date (Table 3.6).

Table 3.6

Structure of Interest Rates of Scheduled Commercial Banks

(Per cent per annum)

A. Bank Deposit (Domestic)	
a. Savings deposits	4.5
b. Term Deposits	
(i) (46 days to 2 years) : (ceiling)	12.0
(ii) Over 2 years	Free
B. Bank Credit	
I General Credit (excluding export credit)	
(a) Upto Rs. 25000	12
(b) Over Rs.25000 and upto Rs. 2 lakhs.	13.5
(c) Over Rs. 2 lakhs	Free
II DRI advances	4
III Rupee Export Credit	
(a) Preshipment credit	
(i) Up to 180 days	13
(ii) Beyond 180 days and upto 270 days	15
(iii) Against incentives receivable from Government (upto 90 days)	13
(b) Post shipment credit	
(i) Demand bills for transit period. (as specified by FEDAI)	13
(ii) Usance bills[1]	
(a) upto 90 days	13
(b) beyond 90 days and upto 6 months.	Free
(c) beyond 6 months[2]	Free
(iii) Aginst incentives receivable from Government against ECGC guarantee (upto 90 days)	13
(iv) Agianst undrawn balances (upto 90 days)	13
(v) Agianst retention money.[3] (upto 90 days)	13
(c) Deferred credit (beyond 180 days)	
(d) Export credit not stated otherwise	free
(IV) Post shipment export credit in US Dollars(PSCFC)	
Scheme abolished from Febuary 8, 1996.	

1 For total period including both usance period of export bills, transit period as specified by FEDAI and grace period, if any.

2 from date of shipment.

3 (for supplies portion only) payable within one year from the date of shipment.

Note: Banks are free to specify interest rates on rupee export credit (beyond 6 months), loans for purchase of consumer durables, loans to individuals against security of shares, debentures/bonds and other non-priority sector loans as also against commodities coming under the purview of selective credit controls.

Private Sector Banks

43. Nine new private sector banks have started functioning and there are two more proposals for setting up of new private sector banks with 'in principle' approval from RBI, the latest being that of the Development Co-operative Bank Ltd., Bombay (January, 1995).

Loan System

44. Banks were advised to introduce the system of loans from April 1995 for large borrowers with assessed maximum permissible bank finance (MPBF) of Rs.20 crore and above to promote more efficient credit management and utilisation. The cash credit component was to fall below 75 per cent of MPBF with a minimum loan component of 25 per cent (for short term against working capital requirement). Commercial paper and bills would be part of the cash component. The loan will generally, be a demand loan for one year but it will be for six months in the case of seasonal industries. Banks, consortia, syndicates are required to review the loan accounts and renew the same in time so as to ensure smooth availability of funds but they can recall the loan in case of unsatisfactory performance of the borrower. Except for a few banks, all scheduled commercial banks were found in September 1995 to have completed the bifurcation of the credit limits for the large borrowers. Since then the cash credit component has been reduced to 60 per cent and loan component raised to 40 per cent. RBI has desired the new ratios to become effective by December 31, 1995 or the next quarterly review of the borrowal account whichever is earlier. The final compliance reports as on December 31, 1995 by banks are required to be submitted by January 15 , 1996.

Liberalisation of Daily CRR

45. The requirement for banks to maintain at least 85 per cent of their balance on daily basis was found to create problems during holiday periods. The stipulation was relaxed from September 30, 1995, so that this was applicable only from the first working day of the reporting fortnight. Banks are no longer required to keep minimum CRR balance on the last working day of the reporting fortnight.

Refinance against Government/Approved Securities

46. To increase the liquidity of scheduled commercial banks' SLR eligible securities, the proportion of refinance against these securities was raised from 0.5 per cent to 1.0 per cent of fortnightly average outstanding aggregate deposits in 1994-95 (as against 1991-92 earlier). There will be two sub-

limit limits of 0.5 percent each. One will be against the collateral of treasury bills at an interest rate of 12.5 per cent annum, and the other against dated Government and other approved securities at an interest rate of 14.0 per cent. The value of limits under this refinance facility would consequently increase, as a result, from Rs. 1,025 crore to Rs.3,385 crore.

Foreign Exchange Open Position

47. Banks' overnight open position limit for foreign exchange was Rs.15 crore for each bank, irrespective of the volume and nature of business, the structure of the bank's owned funds, and of cross-currency exposures. In accordance with the recommendations of the Expert Group on Foreign Exchange markets in India chaired by Shri O.P. Sodhani, each bank can now fix its own overnight open position limit; such limit will however, specifically need to be approved by the RBI. For prudential reasons, banks must maintain Tier-1 capital funds of 5 per cent of the open position limit, in addition to the existing capital adequacy requirements. A number of banks have determined their own limits and had the same approved by RBI (Box 3.3).

Selective credit controls

48. There has been no change in the selective credit controls imposed by RBI against price sensitive essential commodities (Table 3.7).

Reform of RRBs

49. Expert groups were constituted to examine the major issues concerning managerial and financial restructuring of Regional Rural Banks (RRBs), to devise future course of action in their further reorganisation, and to study the role which could be assigned to self help groups and NGO's in improving rural credit delivery system. To ensure that the restructuring of RRBs is sustained and durable, prudential norms are being introduced this year along the lines of those for commercial banks. RRBs will be required to adopt new income recognition norms and exposure limits for borrowers. Provisioning norms will be introduced from 1996-97.

50. To provide an impetus to rural housing, RRBs will be allowed to provide hosing loans, subject to a maximum of Rs.1 lakh per borrower, to individuals in the lower/middle income group. Such loans should not exceed 5 per cent of the RRB's incremental deposits during the year.

TABLE 3.7

Selective Credit Controls on Bank Advances (Effective April 18, 1995)

(Per cent)

		Minimum Margins			Credit Ceiling
		Mills/ processing units	Others	Warehouse receipts	Nov.1993-Oct.1994
1.	Pulses	60	75	60	85
2.	Other foodgrains(other than paddy/ rice ,wheat and pulses)	45	60	45	100
3.	Oilseeds (Viz. groundnut, rapeseed/ mustard, cottonseed, linseed, castorseed and all imported oilseeds)	601	75	60	85
4.	Vegetable oils (viz. groundnut oil, rapeseed/mustard oil, cottonseed oil, linseed oil, castor oil vanaspati and all imported oils)	60	75	60	85
5.	Sugar				
	a) Buffer	0	-	-	-
	b) Unreleased stock	-	-	-	
	c) Released	75	753	60	-
6.	Gur and khandsari	45	75	60	-
7.	Cotton and kapas	2/	60	45	1004/

\- Not applicable

1. Applicable to registered oil mills and Vanaspati manufacturers.
2. Exempt from the stipulations.
3. Applicable to other than cotton mills including spinning mills.
4. A concessional minimum margin of 25 per cent (effective May 27-November 30, 1994) against stocks of sugar imported on a cash basis for a period not basis for a priod not exceeding 8 weeks (reduced to 6 weeks from September 3, 1994) after the arrival of sugar stocks in India. This concession was available up to the end of November, 1994.

Box 3.3
Monetary Policy and Credit Control Measures 1995-96

- Money supply (M3) growth target of 15.5 per cent in 1995-96.
- The ceiling interest rate on term deposits of 46 days to 2 years prescribed at 12 per cent, and that on Non-Resident External(Rupee) Accounts deposits also raised to 12 per cent.
- Decontrol of interest rates for scheduled commercial banks' term domestic deposits of over two years.
- Interest rate on Post-shipment export credit in Rupees for over 90 days deregulated.
- Export Credit (Rupee) Refinance by RBI to scheduled commercial banks, to be 100 per cent of the increase in export credit over the monthly average level of 1992-93.
- Interest Rate on post-shipment export credit in US Dollars (PSCFC) upto 90 days raised to 7.5 per cent and that on such credit beyond 90 days and upto six months from the date of shipment raised to 9.5 per cent. Banks permitted to fix their own interest rates on PSCFC above 90 days and export credit not otherwise specified for PSCFC. The PSCFC scheme was later abolished with effect from February 8, 1996.
- The interest rate on refinance against such credit also raised to 6.5 per cent. Refinance limit reduced from 80 to 70 per cent of the outstanding PSCFC credit.
- Effective from October 31, 1995 a 15 percent interest surcharge imposed on the outstandings under the import credit sub-limit. It was later raised to 25 per cent in February 1996.
- "Loan System" introduced in April 1995. Cash credit component restricted to 75 per cent of the maximum permissible bank finance (MPBF) for borrowers with assessed MPBF of Rs.20 crore and above. The balance 25 per cent to be sanctioned by way of a short term loan for working capital purposes.
- Cash Credit component reduced to 60 per cent in September 1995, with bifurcation to be completed latest by December 31,1995.
- The overall limit for lending by banks/financial institutions to non-banking finance companies (NBFCs) reduced : to three times the net owned funds (NOF) of equipment leasing/hire purchase companies with not less than 75 per cent of their assets (gross income) in equipment leasing and hire purchase ; to two times the NOF of other equipment leasing/hire purchase companies and equal to NOF of other non-banking finance companies.
- Bridge loans by banks and financial institutions banned.
- Effective from April 29, 1995 , rediscounting of commercial bills and derivative usance promissory notes required to be for a minimum period of 15 days.
- Private mutual funds approved by SEBI permitted to enter call/notice money/bill rediscounting market as lenders.
- Effective September 30, 1995 refinance limits against government and other approved securities raised from 0.5 per cent to 1 per cent of fortnightly average outstanding aggregate deposits in 1994-95 (April-March).
- Rate of interest on bank advances of over Rs.2 lakh to depositors against term deposits deregulated.
- Daily minimum 85 per cent CRR requirement liberalised to be maintained only from the first working day of the reporting fortnight and not to apply on the last working day of the fortnight.
- Effective October 18, 1995 CRR on increase in NRER deposits, over level as on October 27,1995, eliminated.
- The average CRR reduced from 15 per cent to 14.5 per cent effective from fortnight of November 11,1995 and to 14 per cent effective from fortnight of December 9, 1995 and that on CRR on NRER deposits up to the level outstandings as on October 27,1995 reduced to 10 per cent effective from the fortnight beginning January 6,1996. From the same fortnight CRR on FCNR (B) and NRNR deposits removed.
- Scheduled commercial banks (including RRB's) required to adopt the same system of valuations of securities for SLR as for their balance sheets.
- Effective September 30, 1995, the minimum period for ready forward transcations (Repos) fixed at three days.
- Each scheduled commercial bank allowed to fix its own overnight open exchange position limit subject to approval by RBI. New limits of 16 banks approved.

Agricultural Advances

51. At present, produce marketing loans provided by commercial banks to farmers upto Rs.25,000 for a period not exceeding six months, are reckoned as direct agricultural advances. Such credit forms part of priority sector advances. It has been decided to enhance this limit from Rs.25,000 to Rs.1 lakh, provided borrowers draw credit from one bank.

Sectoral Deployment of Bank Credit

52. Gross credit given by banks has increased from Rs.9718 crore in 1993-94 to Rs.40746 crore during 1994-95 (Table 3.9). Expansion in food credit was at Rs.1368 crore, only about one-third of Rs.4146 crore given in 1993-94. Bank credit to agricultural sector rose by Rs.2778 crore, more than double the Rs.1245 crore in 1993-94. Expansion of credit to small scale industries (Rs.4995 crore) was also about twice the growth of Rs.2591 crore in 1993-94. Export credit increased very substantially by Rs.8296 crore, 4.5 times higher than the expansion of Rs.1730 crore in 1993-94. Though priority sector advances of Rs.10261 crore in 1994-95 was more than double the Rs.4048 crore given in 1993-94 they were about 25 per cent of gross bank credit (43 per cent in 1993-94). In 1994-95 there was a very large expansion of credit to medium and large industries of Rs.17476 crore, as against a fall of Rs. 771 crore in 1993-94, and as such, percentage of priority sector advances fell in 1994-95.

Priority Sector advances

53. Data relating to 47 scheduled commercial banks which account for about 90-95 per cent of bank credit to all scheduled commercial banks reveal that during the current financial year so far (i.e. April to August 1995) bank credit to priority sectors witnessed a marginal decline of Rs.100 crore in

TABLE 3.8

Scheduled Commercial Banks - Selected Indicators

Variations during

Items	Financial year						Annual	
	1993-94 March 19 1993 to March 18 1994	1994-95 March 18 1994 to March 17 1995[1]	1994-95 March 18 1994 to March 31 1995[1]	1994-95 March 18 1994 to Jan. 6 1995[1]	1995-96 March 31 1995 to Jan. 5 1996[1]	1995-96 March 17 1995 to Jan. 5 1996[1]	1994-95 Jan 7 1994 to Jan 6 1995[1]	1995-96 Jan. 6 1995 to Jan. 5 1996[1]
			(Rs.crore)					
1. Aggregate deposits (a+b)	46560	51566	71727	44090	19616	39777	54465	47253
a) Demand deposits	10111	9306	20331	8340	-8508	2517	12719	3483
b) Time deposits	36449	42260	51396	35750	28124	37260	41746	43770
2. Borrowings from R.B.I.	194	4762	5602	4911	1429	2269	4158	2120
3. Cash in hand and balances with RBI	19215	10769	12958	12363	-6794	-4605	-15854	-6199
a) Cash in hand	-10	339	689	117	-230	120	203	342
b) Balances with R.B.I.	19225	10430	12269	12246	-6564	-4725	15651	-6541
4. Net Balances with R.B.I. (3b-2)	19031	5668	6667	7335	-7993	-6994	11493	-8661
5. Money at call and short notice	-564	686	259	-262	967	540	341	1488
6. Bank Credit (a+b)	12435	38277	47144	27510	25408	34275	30038	45042
a) Public food procurement credit	4164	2247	1368	2775	-705	-1584	2604	-2112
b) Non-food bank credit	8271	36030	45776	24735	26113	35859	27434	47154
of which to priority sector[4]	**4048**	**10261**	**10261**	**941[2]**	**-100[3]**	**-100[3]**	**5268[2]**	**9220[3]**
7. Investments in approved securities	26866	15342	16731	16011	10924	12313	21741	11644
a) Government securities	25256	15260	16484	15667	9517	10741	21335	10334
b) Other approved securities	1610	82	247	344	1407	1572	406	1310
8. Balances with other banks in current account	-349	269	1353	218	-1028	56	105	107
9. Credit-Deposit Ratio	52.2	55.3	54.7	53.4	58.3	58.3	53.4	58.3
10. Investment-Deposit Ratio	42.1	40.3	42.1	41.3	39.4	39.4	41.3	39.4

1 Provisional
2 Up to August 1994
3 Up to August 1995
4 Data are provisional and relate to 47 scheduled commercial banks. For details see footnote of Table 3.9: Data are on gross basis.

TABLE 3.9

Sectoral Deployment of Gross Bank Credit

Variations during[1]

On the last reporting Friday	1993-94	1994-95	April-August 1994-95	April-August 1995-96	1993-94	1994-95	April-August 1994-95	April-August 1995-96
			(Rs.crore)					(Per cent)
I Gross bank credit	9718	40746	1813	-967	6.6	26.0	1.2	-0.5
1. Public food procurement	4164	1368	623	1845	61.8	12.5	5.7	15.0
2. Gross non-food credit (a+b+c+d)	5554	39378	1190	-2812	3.9	27.0	0.8	-1.5
a) Priority sectors (i+ii+iii)	4048	10261	941	-100	8.1	19.0	1.7	-0.2
i) Agriculture	1245	2772	49	8	6.2	13.1	0.2	0.0
ii) Small scale industry	2591	4995	228	-239	13.0	22.1	1.0	-0.9
iii) Other priority sectors	212	2494	664	131	2.1	24.8	6.6	1.0
b) Medium and large industries	-771	17476	-469	-711	-1.3	30.2	-0.8	-0.9
c) Wholesale trade (excluding food procurement)	361	2419	68	-30	5.2	33.0	-0.9	-0.3
d) Other sectors	1916	9222	650	-1971	7.6	34.3	2.4	-5.5
II. Export credit[2]	1730	8296	1881	-1290	11.3	48.6	11.0	-5.1
Priority sector advances as proportion of net bank credit.[3]					35.3	33.2	35.4	33.2

1 All figures after 1993-94 are provisional.
2 Also included in non food credit.
3 As on last Friday of the period.
Note: Data relate to 47 selected scheduled commercial banks which account for 90-95 per cent of the banks credit of all scheduled commercial banks. Gross bank credit data include bills rediscounted with RBI,IDBI, Exim Bank and other approved financial institutions.

contrast with an increase of Rs.941 crore during the comparable period of 1994-95. The percentage of priority sector advances to total net bank credit was 33.2 per cent at the end of August 1995, same as at the end of 1994-95.

Small Scale Industries

54. Among the steps taken to increase the flow of credit to the small scale industries (SSI) sector, was a special programme to open 100 specialised SSI branches in 85 identified districts by March 1996. 56 branches were set up by the end of the year 1995.

Special Schemes/Funds

55. Finance Minister in his budget speech for 1995-96 announced the setting up of the following schemes: (a) Rural Infrastructural Development Fund of Rs.2000 crore in the National Bank for Agriculture and Rural Development (NABARD), (b) provision of credit to Khadi and Village Industries Commission (KVIC) by a consortium of banks, and (c) financing of primary weavers' co-operative society by Scheduled Commercial Banks. This is to make up the shortfall in priority sector credit of these banks and to utilise bank funds for rural development, promotion of khadi and village industries and economically disadvantaged groups like weavers.

Rural Infrastructural Development Fund (RIDF)

56. RIDF has been built out of the contributions by scheduled commercial banks (which have not met the 18 per cent agricultural credit target) up to a maximum of 1.5 per cent of their bank credit. This contribution will be reckoned as indirect agricultural lending under priority sector advances. It will be kept in the form of deposits with a maturity of upto 5 years carrying a floating rate of interest equivalent to one half of one percentage point above the maximum permissible rate on term deposits or the average of the maximum interest rates on term deposits of five major banks. The fund is being used to provide loans to state governments for a period upto 5 years, for specific projects cleared by a Committee consisting of the Chairman and the Managing Director, NABARD and representatives of the Government, RBI and State Bank of India (SBI) on the NABARD Board.

Credit to KVIC

57. A SBI led consortium containing banks which have a shortfall in priority sector advances will provide credit to KVIC. These banks have been allotted a pro-rata share, depending on their shortfall after allocation of their contribution to the RIDF. This consortium will provide Rs.1000 crore of loans to KVIC against government guarantee, at an interest 1.5 per cent below the average prime lending rate of five major banks in the consortium. KVIC is to on-lend to viable khadi and village industry units, either directly or through state level khadi and village industries boards (KVIBs). In view of the availability of internal resources, KVIC has not drawn upon this line of credit so far.

Primary Weavers Cooperative Societies

58. The scheme is designed to increase the flow of credit to a large number of weavers employed in the handloom sector. NABARD's current refinance to primary weavers' cooperative societies (PWCS) would also be available to commercial banks, in addition to cooperative banks. To receive loans the societies should have a satisfactory working record and not be indebted to the district central cooperative banks. NABARD is to make available a line of credit to commercial banks and handloom co-operatives at 9.5 per cent per annum. In the latter case, NABARD will get a subsidy of 2.5 per cent from state governments. The advances made by commercial banks to handloom cooperatives will be reckoned as indirect finance to the small scale industries (SSI) sector and form part of their priority sector advances.

Refinance from NABARD

59. As on October 31, 1995, NABARD has sanctioned limits (for short term agricultural operations) of Rs. 4034 crore to state cooperative banks and of Rs. 685 crore to Regional Rural Banks. Upto November 30, 1995 NABARD disbursed an investment credit of Rs. 1370 crore. NABARD has also taken steps to ensure adequate credit flow to agricultural production for areas of retarded credit flow. The relaxations given in May 1994 to state cooperative banks and RRBs with regard to their attainment of at least 40 percent recovery ratio for being eligible for refinance from NABARD up to June 30,1995, has been further extended by one year to June 30, 1996. Thus, the state cooperative banks and RRB's will have refinance from NABARD up to June 30, 1996 even if they do not have a recovery ratio of at least 40 per cent of demand.

All India Financial Institutions

60. Sanctions by all India financial institutions (AIFIs) grew by 46.8 per cent and their disbursements of assistance grew by 24.3 per cent in 1994-95. Both these investment parameters indicate significantly improved intermediation through AIFIs, compared to growth levels achieved in 1993-94. Sanctions by nine development finance institutions, viz. IDBI,IFCI,ICICI, SIDBI, IRBI, SCICI, RCTC, TDIC, and TFCI increased by 65 per cent in 1994-95. Disbursements by DFIs, an indicator of direct lending or flow of funds for creation of capacity in industrial sector, rose by 38.6 per cent, mirroring the growth in the real sector of the economy (Table 3.10).

61. In the first nine months of 1995-96 (April-December 1995) the growth of sanctions and disbursements of financial assistance by AIFIs have been lower, because of a decline in sanctions and disbursements by investment institutions (IIs). There is a decline of 43.1 per cent in sanctions and 15.2 per cent in disbursements by investment institutions. The depressed performance of sanctions and disbursements by investment institutions, discernible

TABLE 3.10

Assistance by All India Financial Institutions

(Rs.crore)

	1993-94	1994-95	April-December 1994	April-December 1995
A. Sanctions				
All India Financial Institutions	40317.9	59183.8	42422.8	48823.0
	(24.1)	(46.8)		(15.1)
a) Development Finance Institutions	30402.9	50178.3	33724.9	43869.6
	(40.4)	(65.0)		(30.1)
b) Investment Institutions	10820.6	10155.5	8697.9	4953.4
	(-14.1)	(-6.1)		(-43.1)
B. Disbursements				
All India Financial Institutions	25621.2	31849.4	20165.7	22894.6
	(15.0)	(24.3)		(13.5)
a) Development Finance Institutions	18623.8	25811.0	15388.9	18858.9
	(27.3)	(38.6)		(22.4)
b) Investment Institutions	7876.7	6513.3	4776.8	4035.7
	(-16.2)	(-17.3)		(-15.2)

a) Development Finance Institutions-IDBI,IFCI, ICICI,SCICI, SIDBI,IRBI,SCICI,RCTC, TDICI and TFCI.
b) Invetstment Institutions -LIC,GIC and UTI.
Note: i) Data for 1994 and 1995 are provisional.
ii) Figures in brackets indicate percentage changes.
iii) Figures for AIFIs are net of inter-institutional flows.
Source: Industrial Development Bank of India.

since the second half of 1994-95, is mainly attributable to the subdued capital market conditions and the withdrawal of funds by corporates from these institutions. Consequently, sanctions by AIFIs grow by at 15.1 per cent, while disbursements moved up by 13.5 per cent. Sanction by DFI's have, however, grown by 30.1 per cent, while their disbursements grew at a slower pace of 22.4 per cent.

Policy Reforms

62. In March 1995, Parliament ratified the amendment of the IDBI Act 1964, following an ordinance promulgated to this effect in October 1994. The amended Act permits the Board to broadbase IDBI's ownership pattern by issuing equity capital to persons other than the Central Government. This is subject to Government holding not dipping below 51 per cent. Following the amendment, IDBI launched its first-ever public issue of equity shares in July 1995. This was the largest equity offering in the Indian stock market so far. IDBI now has nearly 4 lakh public shareholders, a restructured Board with 4 public nominees, and greater functional autonomy and operational flexibility.

63. IDBI and SIDBI have pledged to pick up a 35 per cent equity stake in the North Eastern Development Finance Corporation Ltd. (NEDFI), the Guwahati based development bank proposed by the Finance Minister in his 1995-96 Budget Speech. The new institution, with an initial paid-up equity

base of Rs.100 crore and an authorised capital of Rs.500 crore, is expected to commence operations soon. The broad objective of NEDFI will be to accelerate the process of development of North Eastern India by, inter alia, assisting in the creation and expansion of industrial enterprises, particularly in the medium scale sector, encouraging and promoting the participation of private capital in industrial enterprises and assisting in the creation, expansion and modernisation of infrastructure.

64. IDBI expanded the range of its forex services, obtained membership of Society for Worldwide Interbank Financial Telecommunications (SWIFT) user group in India, and entered into corporate trusteeship by accepting assignments as mortgage trustee and trustee to odd-lot shareholders. Its mutual fund and stock broking subsidiaries commenced operations during the year, while its banking subsidiary - IDBI Bank Ltd-opened its first branch at Indore in November 1995.

65. ICICI provided a thrust to its advisory services, aimed at creation of better projects and improving the business environment, while its business consultancy services focused on restructuring, transformation and financial re- engineering. It also set up joint ventures with state governments of West Bengal and Kerala for development of infrastructure sectors in these states.

66. SIDBI's venture capital fund became operational in 1994-95 with an enhanced corpus of Rs.20 crore. SIDBI introduced new schemes of assistance during the year, including PSCFC to exporting SSIs, direct equity investment in SSIs and financial assistance to enable well-run export-oriented units to acquire ISO-9000 series certification. It also entered into MOUs with banks for joint financing of SSIs and set up a Technology Bureau for small enterprises in New Delhi in collaboration with Asian and Pacific Centre for Transfer of Technology.

67. With the progressive opening up of infrastructure sub-sectors to private participation and given the special characteristics of such projects, DFIs have been targeting finance of infrastructure projects as a key focus area. Currently, negotiations are on with the World Bank for a $ 1.3 billion infrastructure loan to be routed through select FIs, including IDBI. In view of the large financial requirements of infrastructure projects, All India Financial Institutions have formed a joint Committee to appraise the finances and financial implications of proposed projects in power and telecom over the next quinquennium.

68. The DFI's interest rates have become more sensitive to market conditions. In October 1994, their prime landing rate (PLR) was reduced by 0.5 per cent in response to easy money conditions. Following tightening of money markets, consequent upon a steep rise in demand for non-food credit during the second half 1994-95, reference lending rate of FIs was increased to 15.5 per cent in early 1995. Their minimum lending rate was subsequently increased to 16 per cent (excluding interest tax) in October 1995, following a rise in banks' PLR to 16.5 per cent and perceived liquidity constraints. IDBI and IFCI have also effected upward revisions in the applicable rates under their variable interest loan schemes.

Outlook

69. Financial sector reform is characterised by a delicate balance between the need to give market participants and regulators time to learn how to operate a market system, and the need to complete market reform, including a comprehensive regulatory system, so that new channels for rent seeking arising from incomplete or partial reform would not open up. The former aspect was illustrated by the unpreparedness exhibited by market participants in the beginning of 1995 about rising interest rates. Interest rates on both 91 day and 364 day treasury bills had been rising steadily over the last half of 1994-95.

70. The introduction of the Primary Dealers system for Government securities is the first step in developing a secondary as well as retail market for government securities. A much wider and deeper government securities market is, in turn, a prerequisite for a modern system of money management. It is also an essential element of developing a long term debt market. Before the start of reforms the statutory liquidity ratio and the control of banks had generally hidden the cost of delay in this area. It is important to move forward expeditiously on a number of financial reform areas.

71. In the last Economic Survey we had raised the problems of short term money management. These can only be addressed by a faster development of short term markets such as "call money market" and 91 day treasury bill market. One approach could be to expand the former from an "inter-bank" to a wider financial market, and to make the 91 day treasury bill auctions more reflective of market conditions. Short term money management has now been complicated by the problems associated with the management of the foreign exchange market. The short term money and foreign exchange markets have close economic linkage and the problems and difficulties in one can and will, affect the other. Reforms which foster development of the foreign exchange market are, therefore, equally important and urgent.

72. In many respects the financial sector (including foreign exchange market) reforms are the most "technical" among the many different reforms on the national agenda. The task before us is clear: to accelerate and complete the reforms, so as to make India a competitive force in international financial markets.