CHAPTER 6

MONETARY AND CREDIT TRENDS AND POLICIES

6.1 In 1975-76, while the basic policy of dear money and controlled credit expansion was continued, the emphasis of credit policy was on greater flexibility in responding to changing economic situation. Such a change in emphasis was consistent with the rising trend in agricultural and industrial production and a need to build up stocks of essential commodities. It was also designed to assist further investment and production, specially in priority areas. The rapid growth of bank deposits during the year facilitated to a large extent the adoption of such flexibility in the implementation of credit policy and the banking system's reliance on Reserve Bank to finance credit expansion other than for public food procurement was moderate.

6.2 The strict monetary regime of 1974-75 had contributed to a deceleration in the rate of growth of money supply from 15.4 per cent in 1973-74 to 6.9 per cent in 1974-75 which was the lowest rate recorded since 1962-63 and was only about two-thirds of the annual average for the decade 1961-62 to 1970-71. Consequent to the hike in interest rates on term deposits in July, 1974, the time deposits showed a much higher rate of growth during the busy season of 1974-75 as compared to the busy season of 1973-74. On the other hand, there was a marked deterioration in the growth rate of demand deposits in the 1974-75 busy season compared to the preceding busy season of 1973-74. As a result, while there was a deceleration in the rate of growth of monetary resources from 17.3 per cent in 1973-74 to 11.0 per cent in 1974-75, this deceleration was less pronounced than the decline in the rate of growth of money supply. During the current year till February 6, 1976, however, the expansion of money supply has been at a higher rate than monetary resources as compared to the corresponding period of 1974-75.

TABLE 6.1

Variations in money supply and monetary resources

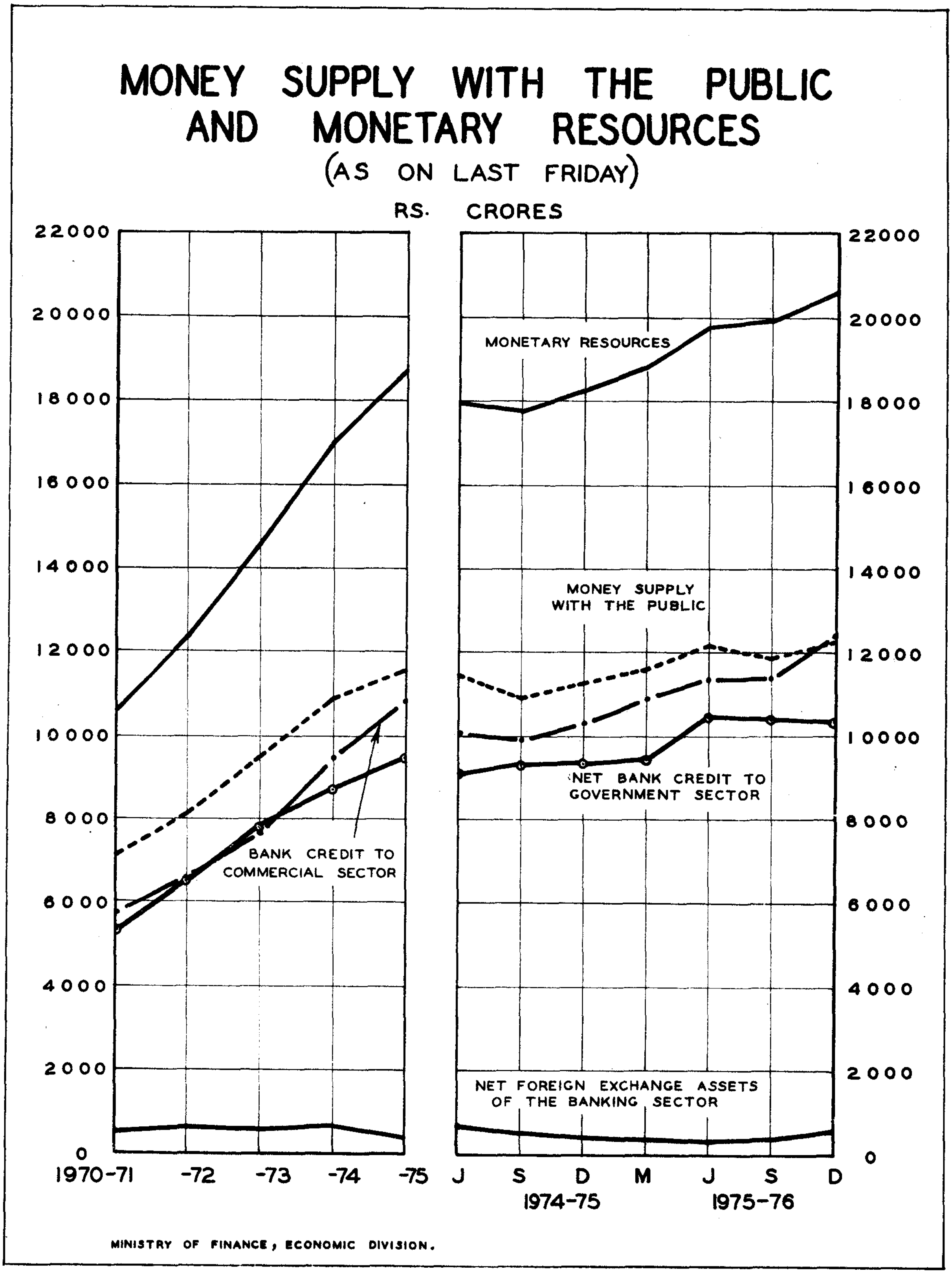
(Rs. crores)

	Currency with the public	Deposit money	Money supply with the public	Monetary Resources	Currency as percentage of money supply (end of the period)
1960-61	+167 (8.6)	+32 (4.3)	+199 (7.5)	+423 (11.9)	73.1
1965-66	+277 (10.0)	+166 (12.3)	+443 (10.7)	+653 (11.8)	66.8
1970-71	+366 (9.1)	+356 (14.5)	+723 (11.2)	+1244 (13.2)	61.0
1971-72	+434 (9.9)	+511 (18.2)	+945 (13.1)	+1665 (15.6)	59.3
1972-73	+640 (13.3)	+651 (19.6)	+1291 (15.9)	+2178 (17.7)	57.9
1973-74	+887 (16.2)	+561 (14.1)	+1448 (15.4)	+2510 (17.3)	58.4
1974-75	+29 (0.5)	+718 (15.9)	+747 (6.9)	+1869 (11.0)	54.9
1975-76 (upto 6.2.76)	+208(3.3)	+572(10.9)	+780(6.7)	+2071(11.0)	53.1
1974-75 (upto7.2.75)	−8(−0.1)	+453(10.0)	+445(4.1)	+1500(8.8)	56.0

Note— Figures in brackets indicate percentage variations over the preceding year.

6.3 A striking fact which stands out from the Table 6.1 is that over the years the currency component of money supply has shown a declining tendency, the actual decline in its percentage to total money supply having been from 73.1 per cent in 1960-61 to 53.1 per cent in 1975-76 (as on February 6, 1976). Conversely, the share of deposit money has been increasing rapidly in money supply. As a result, the value of the money multiplier has tended to go up. Partly for this reason, it has become possible to finance a somewhat larger volume of credit with a given quantity of money supply.

5.4 In 1975-76 upto February 6, 1676, the expansion of money supply has been of the order of 6.7 per cent as compared to an increase of 4.1 per cent in the corresponding period of 1974-75. In absolute terms, the expansion during this period was of the order



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of Rs 780 crorse as against that of Rs. 445 crores in the same period of 1974-75. In the first four months of the year 1975-76, money supply expanded by Rs. 433 crores as compared to the increase of Rs. 468 crores in the corresponding period of 1974-75. In the subsequent six months (August-January) of 1975-76, the increase was of the order of Rs. 239 crores which contrasts with the decrease of Rs. 83 crores in the corresponding period of 1974-75. The acceleration of the rate of expansion of money supply since August 1975 as compared to the same period of 1974-75 is attributable mainly to higher bank lending for financing inventories of food and fertilisers, and increase in net foreign exchange assets of the banking sector.

Factors affecting Money Supply

6.5 During the current financial year upto February 6, 1976, the net bank credit to Government showed an increase of Rs. 697 crores or 7.3 per cent as against that of Rs. 975 crores or 11.2 per cent in the corresponding period of 1974-75. In the first four months of the current year, the net bank credit to Government increased by Rs. 1234 crores which was nearly twice as much as that of Rs. 652 crores in the same period of 1974-75. This sharp expansion was attributable partly to certain temporary factors such as delay in the recoveries by Government from the Food Corporation of India against food imports. In the subsequent six months, however, net bank credit to Government declined by Rs. 593 crores in contrast with an increase of Rs. 292 crores in the corresponding months of 1974-75.

6.6 Bank credit to the commercial sector increased by Rs. 1507 crores or by 13.4 per cent upto February 6, 1976 since the beginning of the current financial year as against an increase of Rs. 1245 crores or by 13.1 per cent in the corresponding period of 1974-75. In the first four months of 1975-76, the total bank credit to the commercial sector declined by Rs. 16 crores in contrast to an increase of Rs. 439 crores in the corresponding period of 1974-75. In the next six months, August, 1975—January, 1976, however, there was a steep increase of Rs. 1421 crores in bank credit to the commercial sector as compared to a smaller increase of Rs. 682 crores in the same months of 1974-75.

6.7 The net foreign exchange assets of the banking system recorded an increase of Rs. 165 crores in the current financial year upto February 6, 1976 in contrast to a decline of Rs. 372 crores in the corresponding period last year. If one ignores the effect of changes in the foreign exchange assets of the banking system, the increase in money supply during the current financial year upto February 6, 1976 works out to 5.3 per cent as compared to 7.5 per cent in the same period last year.

6.8 Thus, it will be seen that the two major factors viz., credit to the commercial sector and foreign exchange assets of the banking system, have contributed to larger expansion of money supply this year. The major contractionary influence was the increase of Rs. 1604 crores in the non-monetary liabilities of the banking system between March 31, 1975 and February 6, 1976 as against a smaller increase of Rs. 1429 crores in the corresponding period of 1974-75. This was due to the higher growth of time deposits during the current year and the larger accretions on account of impounding of a portion of additional dearness allowance. The slower growth in net bank credit to Government during the current financial year, particularly since December, 1975, has also exercised a restraining influence on the growth of money supply so far.

Seasonal Variations in Scheduled Commercial Banks Assets and Liabilities

6.9 The expansion of credit extended by scheduled commercial banks in the busy season of 1974-75 at Rs. 894 crores was about 20 per cent less than that of Rs. 1111 crores in the busy season of 1973-74. Including bills rediscounted with the Reserve Bank, the expansion of gross bank credit in the 1974-75 busy season was Rs. 953 crores or 12.1 per cent as compared to Rs. 1355 crores or 20.7 per cent in the busy season of 1973-74. It is interesting to note, however, that a substantial portion of the expansion in gross bank credit in the 1974-75 busy season was for financing public food procurement operations, while in the preceding busy season, it was for non-food advances. The increase in aggregate deposits of scheduled commercial banks also was somewhat higher in the 1974-75 busy season than in the 1973-74 busy season, though the growth rate of deposits showed a deceleration. However, while demand deposits grew more slowly in the busy season of 1974-75, time deposits showed a sharp increase of Rs. 422 crores (6.4 per cent) in the busy season of 1974-75 as compared to Rs. 270 crores (4.8 per cent) in that of 1973-74. Borrowings by scheduled commercial banks from the Reserve Bank were of a lower order in the busy season of 1974-75 as compared to that of 1973-74 while their deposits with the Reserve Bank showed a smaller decline as compared to the preceding year. The net result was that the indebtedness of scheduled commercial banks to the Reserve Bank increased by Rs. 293 crores in the busy season of 1974-75 as compared to Rs. 471 crores in that of 1973-74. The improved liquidity position of banks also enabled them to increase their investments in Government and other approved securities in 1974-75. The credit-deposit ratio at the end of the 1974-75 busy season was 72.2 per cent as against 73.7 per cent at the end of the 1973-74 busy season.

6.10 During the first two months of the 1975 slack season (May-June), the increase of Rs. 291 crores in the gross bank credit was somewhat higher than that of Rs. 239 crores in the same months of 1974. This was mainly attributable to an increase of Rs. 225 crores in food procurement advances, while the increase for the same purpose in May-June, 1974 amounted to only Rs. 100 crores. In the next two months (July-August, 1975), credit for public food procurement fell sharply by Rs. 219 crores, while non-food gross credit increased contra-seasonally by Rs. 34 crores as against a seasonal decline of Rs. 109 crores for non-food credit in July-August, 1974. In the last two months of the 1975 slack season (September-October), credit for both food and non-food purposes expanded rapidly with the result that for the 1975 slack season as a whole, the total credit expansion at Rs. 664 crores (7.7 per cent) was markedly larger than that of Rs. 128 crores (1.7 per cent) in the 1974 slack season. Bills rediscounted under the Bill Market Scheme also showed a smaller decline of Rs. 80 crores in the slack season of 1975 as compared to that of Rs. 171 crores in the 1974 slack season.

6.11 Thus, a considerable part (Rs. 173 crores) of the increased credit expansion in the 1975 slack season was due to public food procurement advances while such advances declined (Rs. 170 crores) in the slack season of 1974. Even so, the expansion of non-food gross credit at Rs. 411 crores (5.0 per cent) in the 1975 slack season was over three times that of Rs. 127 crores (1.7 per cent) in the 1974 slack season. A considerable part of this increase arose from the need to finance substantial stocks of steel, coal and petroleum products.

6.12 There was a remarkable growth of deposits with scheduled commercial banks from Rs. 912 crores (8.8 per cent) in the 1974 slack season to Rs. 1210 crores (10.1 per cent) in the 1975 slack season. Time deposits increased by 10.8 per cent in the 1975 slack season as compared to 10.3 per cent in the 1974 slack season. There was also a marked acceleration in the rate of increase of demand deposits in the slack season of 1975 to 9.1 per cent from 6.8 per cent in the previous slack season. In part, this was a reflection of the larger increase in bank credit in the 1975 slack season.

6.13 In spite of the favourable out-turn of deposit growth in the 1975 slack season, borrowings of scheduled commercial banks from the Reserve Bank showed a much smaller decline of Rs. 39 crores as compared to that of as much as Rs. 270 crores in the slack season of 1974. Addition to scheduled commercial banks' deposits with the Reserve Bank of Rs. 74 crores in the 1975 slack season was also lower than that of Rs. 93 crores in the 1974 slack season. Scheduled commercial banks' indebtedness to the Reserve Bank (deposits minus borrowings) thus registered a smaller decline of Rs. 113 crores in the 1975 slack season as against a decline of Rs. 363 crores in the 1974 slack season.

6.14 The credit-deposit ratio of scheduled commercial banks at the end of the 1975 slack season at 70.6 per cent was noticeably higher than that of 68.9 per cent at the end of the 1974 slack season. This was due to the increase in food procurement credit. Excluding food advances, the credit-deposit ratio at the end of the 1975 slack season was 65.0 per cent as against 66.0 per cent at the end of the 1974 slack season.

6.15 In the current (1975-76) busy season upto February 6, 1976, scheduled commercial banks' credit had increased by Rs. 988 crores (10.6 per cent) as compared to Rs. 574 crores (7.4 per cent) in the same period last year. Public food procurement credit showed an increase of Rs. 460 crores as compared to a smaller increase of Rs. 132 crores in the same period last year. Bills rediscounted with the Reserve Bank had increased by Rs. 84 crores in this busy season as compared to Rs. 58 crores in the last busy season. Non-food gross bank credit has thus gone up by Rs. 612 crores (7.1 per cent) as against Rs. 500 crores (6.6 per cent) for the same period last year.

6.16 During the current busy season till February 6, 1976, aggregate deposits of scheduled commercial banks have increased by Rs. 574 crores (4.4 per cent) as against Rs. 384 crores (3.4 per cent) last year, with time deposits showing a higher rate of increase. Scheduled commercial banks' net balances with the Reserve Bank (deposits net of borrowings) have declined by Rs. 540 crores during this busy season till February 6, 1976 as compared to a decline of Rs. 275 crores in the corresponding period last year. Banks' investments in Government and

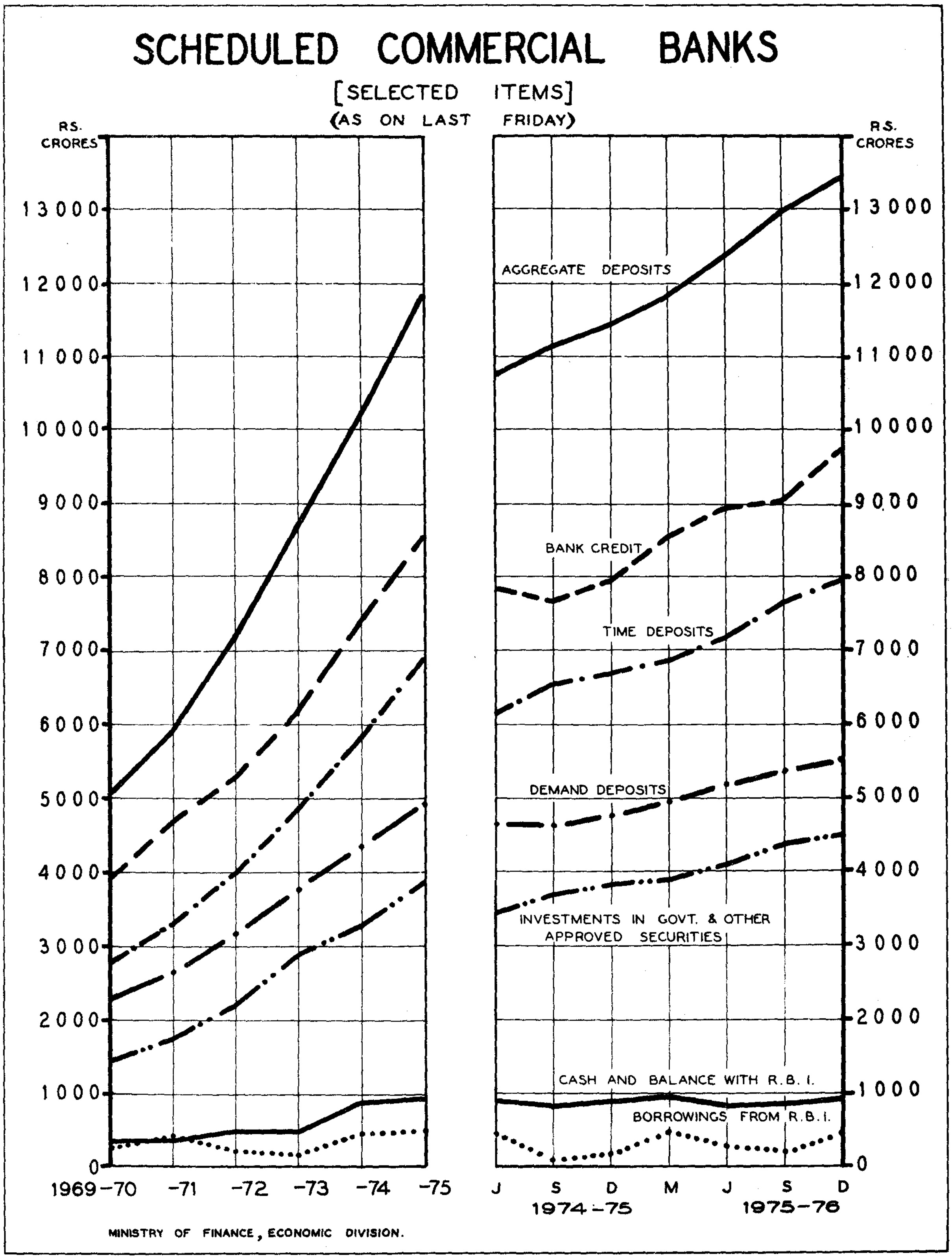
SCHEDULED COMMERCIAL BANKS
[SELECTED ITEMS]
(AS ON LAST FRIDAY)
RS. CRORES
13 000
12 000
11 000
10 000
9 000
8 000
7 000
6 000
5 000
4 000
3 000
2 000
1 000
0
AGGREGATE DEPOSITS
BANK CREDIT
TIME DEPOSITS
DEMAND DEPOSITS
INVESTMENTS IN GOVT. & OTHER APPROVED SECURITIES
CASH AND BALANCE WITH R. B. I.
BORROWINGS FROM R. B. I.
1969-70 -71 -72 -73 -74 -75
J S D M J S D
1974-75
1975-76
MINISTRY OF FINANCE, ECONOMIC DIVISION.

TABLE 6.2

Seasonal variations in scheduled commercial banks' data

(Rs. crores)

	Slack Season			Busy Season				
	1973	1974	1975	1972-73	1973-74	1974-75	1974-75 (Oct. 25 to Feb. 7)	1975-76 (Oct. 31 to Feb. 6)
1. Bank credit of which :	346	128	664	897	1111	894	574	988
(a) Food procurement advances	—57	—170	173	5	138	317	132	460
(b) Other advances	403	298	491	892	923	577	442	528
2. Bills rediscounted under the Bills Rediscounting Scheme	15	—171	—80	19	244	59	58	84
3. Gross bank credit (including bills rediscounted)	361	—43	584	916	1355	953	632	1072
4. Aggregate deposits	899	912	1210	811	677	716	384	574
(a) Demand deposits	251	298	456	335	407	294	110	169
(b) Time deposits	648	614	754	476	270	422	274	405
5. Borrowings from R.B.I.	56	—270	—39	17	253	183	173	627
6. Deposits with RBI	419	93	74	40	—218	—110	—102	87
7. Cash in hand	25	25	11	20	4	6	—12	10
8. Investments in Government and other approved securities	282	472	301	4	157	269	31	142
(a) Government securities	187	349	120	—89	73	223	—1	93
(b) Other approved securities	95	123	181	93	84	46	32	49
9. Credit-deposit ratio (end of the period)	67.3	68.9	70.6	70.3	73.7	72.2	71.5	74.9
10. Investment-deposit ratio (end of the period)	32.9	33.8	33.2	33.0	32.2	34.0	33.0	32.8

other approved securities have, however, gone up by Rs. 142 crores this year as compared to an increase of only Rs. 31 crores in the same period of the last busy season.

6.17 The credit-deposit ratio which was 74.9 per cent as on February 6, 1976 was significantly higher than that of 71.5 per cent a year ago; if food procurement credit is excluded, the respective percentages would be 66.1 per cent and 68.2 per cent. Since the beginning of the financial year, bank credit for food procurement has increased by Rs. 588 crores (upto February 6, 1976) as against an increase of only Rs. 18 crores in the same period of 1974-75.

Money Market Conditions

6.18 Conditions in the money market during the slack season of 1975 generally remained comfortable since the last week of May. The call money rate in Bombay reached its lowest point of 2.75-4 per cent on July 25, 1975 and it generally ruled much lower than last year's levels till the end of October, 1975. In the second week of November, 1975 (i.e., at the beginning of the busy season), it touched the ceiling of 15 per cent. Although there was a decline in the second half of November, 1975, the call money rate moved up again to the ceiling level of 15 per cent on December 12, 1975 following the demand for funds for advance tax payments. Thereafter, the rate continued to be more or less at 15 per cent in Bombay market till the middle of February, 1976 which was higher than the call money rate of 10-12 per cent prevailing in February last year.

Developments in Credit Policy

6.19 The principal objective of the credit policy for the 1975 slack season announced by the Reserve Bank on May 8, 1975 was the consolidation of gains in the struggle against inflation, consistent with the need to meet the genuine credit needs of all priority sectors. In pursuance of this objective, the expansion of bank credit was sought to be limited to an amount which could be met out of the banks' own resources after providing for statutory requirements of liquidity. The statutory cash and liquidity ratios were left unchanged. The basic refinance limit equal to one per cent of the total demand and time liabilities of banks as of the last Friday of September 1974 was also extended upto October, 1975 on the understanding that it would be used for inescapable clearing and other operational needs. At the same time, all special discretionary refinancing limits were to be gradually withdrawn so that the banks would start the busy season of 1975-76 with a minimum indebtedness to the Reserve Bank. Banks were also directed to plan their resources in such a way that credit expansion for 1975-76 as a whole, would be about 63-64 per cent of their deposit accretions during the year. In the case of preshipment credit for exports, in general, the maximum period for which the concessionary rate of interest of 11.5 per cent per annum was applicable, continued to be 90 days, in view of the need to ensure faster turn round of funds as well as better credit discipline. However, in the case of specified medium and heavy engineering goods, the period of concessionary rate of interest of 11.5 per cent was increased to 180 days. For a further period of 45 days for preshipment exports in general and 90 days for the specified engineering goods in particular, banks were advised to charge a maximum rate of 13.5 per cent per annum, on account of delays attributable to reasons beyond the control of exporters.

6.20 The formula for the preceeding busy season of providing refinance to banks equal to 50 per cent of the increase in outstanding food credit between Rs. 300 crores and Rs. 450 crores and full refinance of an increase above Rs. 450 crores was also left unchanged. Other refinance accommodation was subject to the Reserve Bank's discretion and banks' compliance with policy objectives. Banks were also asked to expand their operations for purposes of fertiliser distribution and term lending for high priority projects.

6.21 On account of the favourable trend of deposit growth in the 1975 slack season, the commercial banks were able to meet larger demands for credit without availing of the refinance limits from the Reserve Bank in full. The incremental credit-deposit ratio in the 1975 slack season was about 55 per cent as compared with that of 14 per cent in the 1974 slack season. Against the entitlement of Rs. 293.4 crores of refinancing for the outstanding level of food procurement credit of Rs. 743.4 crores at the end of the 1975 slack season, banks availed of refinancing from the Reserve Bank only to the extent of Rs. 183 crores. The increase in other borrowings from the Reserve Bank at the end of the 1975 slack season was also only Rs. 24.7 crores against the limit of Rs. 120.4 crores. Nor was the limit of Rs. 100 crores for rediscounting of outstanding bills utilised beyond Rs. 87.4 crores. Further, the commercial banks were able to maintain the liquidity ratio at 34 per cent against the statutory requirement of 33 per cent at the end of the slack season.

6.22 The credit policy for the 1975-76 busy season as announced by the Reserve Bank on November 1, 1975, seeks to reconcile the requirements of stability with the need for stimulating production, particularly in the priority sectors. While the overall emphasis continues to be on restraint, some flexibility in the operation of credit policy has been considered desirable in the light of the changing economic situation.

6.23 The commercial banks' basic refinance limit from the Reserve Bank (which is more or less automatically available for meeting essential operational needs) has been increased by a modest amount of Rs. 20 crores by making it equal to one per cent of their demand and time liabilities as of the last Friday of September 1975. In view of the larger credit requirements for food procurement, certain changes were also made in the formula for refinancing of food credit. Banks have been made eligible to claim 50 per cent of the increase in outstanding public food procurement credit between Rs. 450 crores and Rs. 600 crores as against Rs. 300 crores and Rs. 450 crores earlier. Full refinance is available in respect of the excess of outstanding credit above Rs. 600 crores against Rs. 450 crores earlier. If public food procurement advances exceed Rs. 900 crores, as they already have, the nature and size of assistance to be provided to banks is to be discussed with the individual banks. All other refinance accommodation would be strictly at the discretion of the Reserve Bank at enhanced rates of interest ranging from 11.5 per cent to 18 per cent and not on the basis of net liquidity ratio system as hitherto. The discretionary accommodation would be determined on the basis of several criteria such as banks' general compliance with policy objectives, their credit-deposit ratio, sectoral deployment of credit and performance of individual banks in the field of export credit. Special discretionary assistance provided in the past for financing petroleum companies and public sector undertakings was also discontinued except for special cases.

6.24 In the context of a progressive implementation of the recommendations of the Study Group on follow up of bank credit, details of which are given later in this chapter and in the interest of flexibility, the busy season policy provides for the following changes :

(a) The additional margins on book debts and inventories imposed in November, 1973 (10 per cent on advances each against inventories and books debts arising out of sales to Government and semi-government bodies and 20 per cent on advances against other book debts) have been withdrawn;

(b) The minimum limits in respect of prior credit authorisation have been raised from the level of Rs. 1 crore to Rs. 2 crores for undertakings in the private sector; and

(c) The system of levying a commitment charge of one per cent per annum on the unutilised portion of cash credit limits has been withdrawn following the restructuring of the existing system of cash credit accommodation into a loan component and a demand cash credit component.

6.25 As regards selective credit controls, the busy season policy provides for reduction of margins in respect of free-sale sugar from 25 per cent to 15 per cent, groundnuts in Maharashtra and Gujarat from 75 per cent to 60 per cent, paddy to rice mills from 45 per cent to 35 per cent and cotton textiles including yarn and fabrics and yarn made out of man-made fibres from 40 per cent to 30 per cent. Banks have also been advised to adopt a degree of flexibility in respect of margins against stocks of controlled varieties of cloth by allowing a reduction by five percentage points. In the case of essential consumer goods, other than foodgrains, banks are required to maintain a margin of 10 per cent on stocks in respect of advances to State/Central Government distribution agencies subject to Government guarantees.

6.26 The sectoral priorities indicated in the busy season policy were public food procurement, agriculture, fertiliser distribution, exports, public sector manufacturing units, industries in mass consumption and core areas and small borrowers including small-scale industries. The busy season policy also recognised the need for stimulating investment in the priority sectors which would influence the revival of demand for industries such as steel, transport equipment and industrial machinery. The commercial banks were therefore, advised to provide longer term loans for periods beyond three years at a rate of interest not exceeding 15 per cent.

6.27 It will thus be seen that the credit policy during 1975-76 while continuing to lay due emphasis on credit discipline, has sought to respond in a flexible manner to the changing economic scene. In view of the difficulties faced by the jute industry, banks were authorised in April, 1975 to assess the credit requirements of individual jute mills on the basis of a maximum inventory level of finished goods intended for exports not exceeding nine weeks' production as against the then existing maximum permissible level of six weeks. In view of the continued slackness in demand for Jute goods, in December, 1975, banks were also advised to work out credit limits for individual jute mills in respect of jute goods intended for domestic sales on the basis of inventory level not exceeding six weeks' production as against the then existing limits of four weeks. Prior approval under the credit authorisation scheme was also waived if the increase in credit did not exceed 10 per cent of the then existing level. In July, 1975, banks were allowed to extend the concession permitting them to grant *ad hoc* limits, upto specified amounts, to sick textile mills without obtaining the Reserve Bank's prior authorisation. To encourage exports of consultancy services, banks were directed in August, 1975 to consider granting suitable preshipment credit facilities for meeting the expenses of technical and other staff employed for the project and purchase of materials. The list of industries eligible for packing credit facilities at concessional rate of interest was also enlarged to include commercial vehicles, including mopeds, locomotives and central heating and industrial cooling equipment. Further, in November, 1975, the ceiling limits for the eligible credit facilities under the Credit Guarantee Scheme were enhanced for transport operators, traders and business enterprises in view of the rise in costs. Banks were also advised to use due flexibility in the application of inventory norms for cotton spinning mills in view of a large accumulation of stocks of cotton yarn.

6.28. As mentioned in the last year's Economic Survey, the interim recommendations of the Study Group to frame guidelines for follow up of bank credit were implemented in November, 1974. The final report of the Study Group was submitted in August, 1975. Its recommendations which have been implemented are far-reaching and comprehensive and are expected to promote rational use of bank credit in line with broad national priorities. The Study Group has suggested norms for inventories for 15 industries instead of 10 in the interim report and has also revised some of the norms recommended by it in its interim report in the light of further study and experience gained by the commercial banks. The Reserve Bank has instructed the commercial banks to adopt a phased programme for the implementation of norms for inventories and receivables as recommended by the Study Group. The commercial banks have been authorised to charge a higher rate of interest on the credit utilised for financing inventories in excess of the prescribed norms, if such excess continues to persist over a period of more than two months. Banks have, however, been given the discretion to exercise the control with due flexibility and understanding of the circumstances which may warrant deviation from the norms. The borrowers to be covered by the system initially are those with aggregate limits of more than Rs. 10 lakhs in each case. For industries the norms for which have not been specified, the purpose and spirit of the norms are to be kept in view.

6.29 An important recommendation of the Study Group is that a part of the working capital gap* should be financed by owned funds and long term borrowings. Bank financing should be limited to a maximum of 75 per cent of the such gap. The increase in the use of long term or owned funds for financing such gap is envisaged to take place progressively. In the second stage, borrowers will be required to provide for a minimum of 25 per cent of total current assets out of long term or owned funds. In the third stage, which has not yet been implemented, the borrowers are expected to finance the entire core current assets and 25 per cent of other current assets out of long term or owned funds. As regards type of credit, the Study Group has recommended that bank financing should be split into loan and demand cash credit. Loans should be restricted to a minimum level of borrowing which the borrower expects to use throughout the year. Fluctuating finance requirements should be met by a system of demand cash credit which should be periodically reviewed. The Study Group has also made a number of recommendations for improvements in the information system which has been introduced, to start with, in respect of borrowers with limits aggregating Rs. 1 crore and above. The information system is designed to increase banks' surveillance over the need and use of bank credit.

6.30 The recommendations of the Group constitute an important step forward towards rational credit planning. At the same time, it has to be recognised that in Indian conditions, industry-wise norms have to be implemented with due flexibility, especially, when parts of the industrial sector are faced with recessionary tendencies. A Committee of Direction has been set up by the Reserve Bank to review the progress of implementation of the recommendations of the Study Group and to revise the norms in the light of changing needs.

6.31 Another important development during the year was the submission of the report, in July, 1975, of the Study Group on non-banking companies set up by the Reserve Bank, in June, 1974, to review regulations regarding raising of deposits by these companies from the public. As mentioned in the last year's Economic Survey, directions were issued in the beginning of February, 1975 that non-banking companies accepting deposits in the form of unsecured loans should bring them down from the then existing ceiling of 25 per cent of paid up capital and free reserves, net of accumulated losses, to 15 per cent by the end of December, 1975. The major recommendation of the Study Group is that while the acceptance of deposits by non-banking non-financial companies may not be prohibited altogether, it should be discouraged and reduced in due course. The Study Group has suggested that the reduced ceiling of 15 per cent in respect of unsecured loans may be abolished in two stages, viz., 5 per cent from January 1, 1977 and the remaining 10 per cent from January 1, 1978. The Study Group has also suggested that non-banking non-financial companies should keep a portion of the deposits maturing during the course of the year in liquid assets and should in their advertisements, present their financial position in a more informative manner. As regards non-banking financial companies, the Study Group was of the view that considering the nature of their operations, they should be regulated broadly on the same lines as banks and should be under the close surveillance of the Reserve Bank. At the same time, the activities of non-banking financial companies were justified by reference to the geographical or functional gaps that exist in the financial system. A selective approach to the regulation of the non-banking financial companies was thus recommended. The Group recommended exemptions from deposit ceiling restrictions of nidhis as also deposits with housing finance companies. As for hire purchase finance companies and loan companies, the Group recommended the imposition of a ceiling on deposits like non-financial companies with a view to introducing a measure of discipline among the companies and offording a degree of protection to the depositors' interest.

6.32 The recommendations of the Study Group were accepted by the Government in November, 1975. However, consequent to representations made by the companies, the time limit for the reduction of the limit on unsecured loans guaranteed by directors and deposits received from share holders etc., from

* Working capital gap is defined as the difference between current assets and current liabilities excluding bank borrowings.

25 per cent of paid up capital and free reserves to 15 per cent, which was to expire on December 31, 1975, has been extended for a further period of 6 months, i.e., upto the end of June, 1976.

Rural Banking Development

6.33 Since the nationalisation of 14 major commercial banks in July, 1969, there has been rapid progress in the opening of bank branches in the rural areas. The number of rural branches of commercial banks increased from 1832 in June, 1969 to 7376 in December, 1975 and the proportion of rural branches to the total net work of bank branches increased from 22.2 per cent in June, 1969 to 36.1 per cent in December, 1975. Out of every 100 new branches opened by the nationalised banks between June, 1969 and December, 1975, 46 were opened in the rural areas. The business of rural branches both in regard to mobilisation of deposits and extension of advances has been impressive as compared to the banking system as a whole. While the overall deposit growth of commercial banks had gone up by 148 per cent between June, 1969 and December 1974, the deposits of rural branches of banks increased by 550 per cent during this period. Similarly, while the advances extended by commercial banks have increased by 129 per cent between June, 1969 and December, 1974 those of rural branches increased by 818 per cent. The accelerated increase in deposits and advances of rural branches has, however, to be viewed against the very low base from which they started in June, 1969. Rural branches accounted for only 8 per cent of total deposits with commercial banks and the corresponding percentage of advances was only 6 per cent in December, 1974. Taking into account the credit given to the rural areas directly by banks as also indirectly, such as for ensuring for the farmers reasonable prices for their output or for distribution of essential inputs to them, the credit given by the banks to the rural areas may even exceed the deposits collected from the rural areas. However, institutional credit still accounts for about one-third of the rural credit requirements and a substantial portion of such credit is still met by private and unorganised money lenders.

6.34 The New Economic Programme announced by the Prime Minister on July 1, 1975, therefore, contained a plan for the liquidation of rural indebtedness and provided for legislation for a moratorium on the recovery of debt from landless labourers, small farmers and artisans. This pre-supposed institutionalisation of the rural credit structure and enlargement of its coverage particularly for the smaller farmers. Apart from the need for enlarging the number of cooperative and commercial banks, the Government has decided upon a phased programme of opening 50 State sponsored, regionally based and rural oriented commercial banks of a new type to supplement and not to supplant the other institutional agencies in the field of rural credit such as cooperatives and commercial banks. These new types of rural banks are designed to obtain refinance from the Reserve Bank and apex commercial banks at concessional rates, managed economically with the help of manpower resources with rural orientation and pay particular attention in deploying credit at reasonable rates of interest to small and marginal farmers, landless labourers and rural artisans. The interest rate on deposits with the rural banks will generally be half a per cent higher than other commercial banks. The capital of these regional rural banks will be subscribed by the Central and State Governments and the sponsoring banks. Five such banks were set up on October 2, 1975.

Deployment of Bank Credit

6.35 As mentioned in the last year's Economic Survey, there has been a considerable expansion in advances by public sector banks to agriculture and other neglected sectors. The percentage share of advances to agriculture, small scale industries, road and water transport operators, retail trade and small business, professional and self-employed persons and education, to total advances by public sector banks increased from 14.9 per cent in June, 1969 to 26.0 per cent in June, 1975. The step-up in 1974-75 (July to June) was mainly in respect of agriculture from 8.7 per cent in June, 1974 to 10.0 per cent in June, 1975. During the busy season of 1974-75, public food procurement credit accounted for 31.2 per cent of the increase in gross bank credit as against 13.3 per cent in the busy season of 1973-74. The percentage share of the priority sectors also increased from 15.4 per cent in the 1973-74 busy season to 19.7 per cent in the 1974-75 busy season mainly because of an increase in the share of agriculture to 8.4 per cent of the gross credit in the 1974-75 busy season from 2.4 per cent during the previous busy season. There was, however, a decline in the share of small scale industries due to a qualitative check on advances to this sector as well as in export credit due to a faster turn-over of credit resulting from a reduction in the period of preferential credit for exports in 1974. As already mentioned, some relaxations in the period of export credit at preferential rates of interest have been introduced since the 1975 slack season. According to provisional data available, export credit has recorded an increase of nearly Rs. 160 crores between July, 1975 and December, 1975.

6.36 During the slack season of 1975, there was a marked step-up in the deployment of credit for food procurement. In addition, credit extended to public sector undertakings, particularly steel companies, petroleum companies and major industries in the private sector also showed a significant increase.

TABLE 6.3

Sectoral Deployment of Gross Bank Credit @

(Rs. corres)

	Variations during					
	Busy season 1973-74			Busy season 1974-75		
	Public sector	Private sector	Total	Public sector	Private sector	Total
	1	2	3	4	5	6
1. Public Food Procurement credit	+ 187 (49.3)	...	+ 187 (13.3)	+ 306 (68.6)	...	+ 306 (31.2)
2. Priority Sectors (including Export Credit)	+ 13 (3.4)	+ 203 (19.8)	+ 216 (15.4)	+ 8 (1.8)	+ 186 (34.7)	+ 194 (19.7)
(a) Small scale Industries	+ 4 (1.0)	+ 154 (15.0)	+ 158 (11.2)	+ 1 (0.2)	+ 77 (14.4)	+ 78 (7.9)
(b) Agriculture	+ 8 (2.1)	+ 25 (2.4)	+ 33 (2.4)	+ 7 (1.6)	+ 76 (14.2)	+ 83 (8.4)
(c) Other Priority Sectors	+ 1 (0.3)	+ 24 (2.4)	+ 25 (1.8)	...	+ 33 (6.1)	+ 33 (3.4)
3. All Other Sectors* (including Export Credit)	+ 179 (47.2)	+ 824 (80.2)	+ 1003 (71.3)	+ 132 (29.6)	+ 350 (65.3)	+ 482 (49.1)
4. Non-Food Credit (2+3)	+ 192 (50.7)	+ 1027 (100.0)	+ 1219 (86.7)	+ 140 (31.4)	+ 536 (100.0)	+ 676 (68.8)
5. Of Item 4—Export Credit	+ 42 (11.1)	+ 179 (17.4)	+ 221 (15.7)	+ 9 (2.0)	— 22	— 13
6. Total Gross Credit (1+4)	+ 379 (100.0)	+ 1027 (100.0)	+ 1406 (100.0)	+ 446 (100.0)	+ 536 (100.0)	+ 982 (100.0)

@Including Bills rediscounted with the R.B.I.

*Includes large and medium industries and wholesale trade.

NOTES : 1. Figures in brackets are proportions to Gross Bank Credit.

2. This table is based on data collected from 59 major banks. Hence the figures of total credit are not strictly comparable with the figures in the previous table.

6.37 To conclude, on present indications, the rate of expansion of money supply during 1975-76 will be significantly larger than in 1974-75. As the supply position in the economy in 1975-76 has been favourable and the overall velocity of circulation may have been reduced due to curbs on the activities of the black-money economy, the larger expansion of money supply during 1975-76 has not been associated with an upward pressure on prices. However, this does not imply that a high rate of growth of money supply can be sustained year after year without adverse effects on prices. For one thing, faster growth of economy in 1975-76 was in large measure due to favourable weather conditions and one cannot always plan on the basis of optimum weather conditions. Moreover, monetary planning for 1976-77 must take note of the fact that the contractionary effect on money supply exerted by an increase in the banking system's non-monetary liabilities due to immobilisation of a part of additional dearness allowance payments since July, 1974 may not be operative in 1976-77. Accordingly, due care has to be exercised to ensure that the needed stimulus to investment and production is provided in a manner which does not lead to a situation in which the growth of money supply is far in excess of the rate of growth of output.