

CHAPTER 6
MONETARY AND CREDIT DEVELOPMENTS

6.1 An unprecedented increase in money supply of Rs. 2699 crores or 20.3 per cent took place in the fiscal year 1976-77. The three principal factors responsible for this expansion of money supply were : (a) an increase in bank credit to the commercial sector; (b) an increase in net foreign exchange assets of the banking sector ; (c) an increase in net bank credit to Government. Of these, the most important one was the increase in bank credit to the commercial sector. Bank credit to the commercial sector rose by Rs. 3240 crores in 1976-77 as compared to Rs. 2883 crores in 1975-76. The next in importance was the increase

in net foreign exchange assets of the banking sector. These recorded an increase of Rs. 1675 crores in 1976-77 as compared to Rs. 525 crores in 1975-76. The increase in net bank credit to Government was, however, lower at Rs. 640 crores. An increase in time deposits with banks of as much as Rs. 2604 crores or 28.4 per cent and growth in other non-monetary liabilities of the banking system exercised a contractionary influence on money supply. The overall increase in non-monetary liabilities in 1976-77 was, however, lower by Rs. 302 crores compared to that in 1975-76.

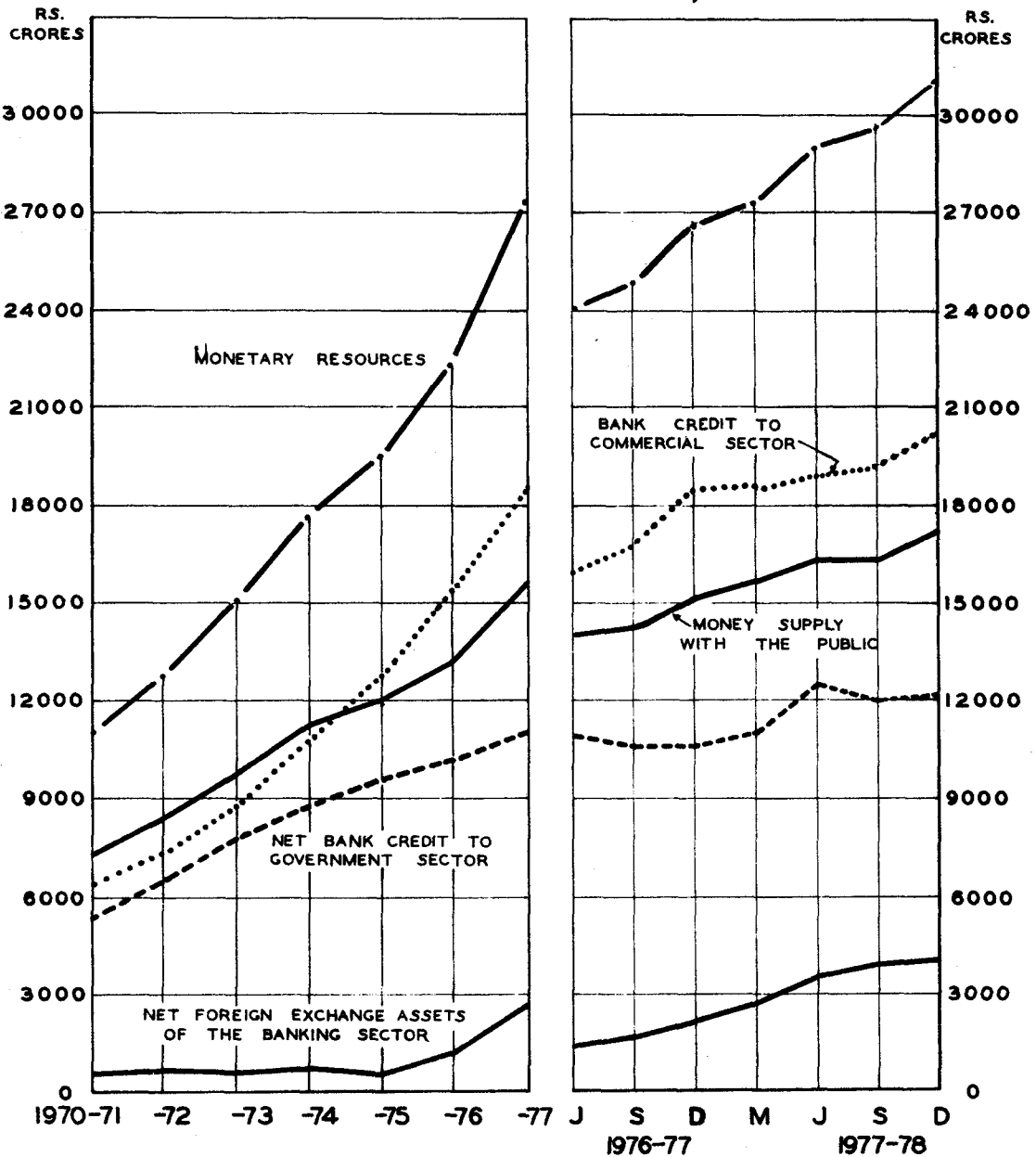
TABLE 6.1
Analysis of Variations in Money Stock

	Variations during			
	1975-76	1976-77	1976-77 (upto 21-1-77)	1977-78 (upto 20-1-78)
	(Rs. crores)			
I. M1 (Money Supply)	1350	2699	1650	1401
	(11.3)	(20.3)	(12.4)	(8.7)
(a) Currency with the public	359	1168	852	588
	(5.7)	(17.4)	(12.7)	(7.5)
(b) Deposit money	991	1531	798	813
	(17.6)	(23.1)	(12.1)	(10.0)
II. Sources of change in money supply				
1. Net bank credit to Govt. (a+b)	1086	640	63	1002
	(11.4)	(6.0)	(0.6)	(8.9)
(a) RBI's net credit to Govt. (i+ii)	260	303	-266	4
(i) To Central Government	198	546	-124	317
(ii) To State Governments	62	-244	-142	322
(b) Other banks' credit to Govt.	827	336	328	998
2. Bank credit to commercial sector (a+b)	2883	3240	2702	1425
	(22.6)	(20.8)	(17.3)	(7.6)
(a) RBI's credit to commercial sector	71	164	111	84
(b) Other banks' credit to commercial sector	2812	3077	2591	1340
3. Net foreign exchange assets of banking sector	525	1675	1196	1544
	(126.8)	(178.4)	(127.4)	(59.1)
4. Government's currency liabilities to the public	24	13	4	23
	(4.5)	(2.3)	(0.7)	(4.0)
5. Non-monetary liabilities of banking sector (a+b+c)	3170	2868	2314	2593
	(28.2)	(19.9)	(16.1)	(15.0)
(a) Time deposits with banks	1581	2604	2374	2172
	(20.9)	(28.4)	(25.9)	(18.5)
(b) Net non-monetary liabilities of RBI	1042	252	39	315
(c) Other net non-monetary liabilities of banks	547	12	-99	106
III. M3 (i.e. money supply with the public plus time deposits)	2930	5303	4024	3573
	(15.0)	(23.6)	(17.9)	(12.9)

Note:—Figures in brackets are percentage variations.

MONEY SUPPLY WITH THE PUBLIC AND MONETARY RESOURCES

(AS ON LAST FRIDAY)



MINISTRY OF FINANCE, ECONOMIC DIVISION.

6.2 In the fiscal year 1977-78 till January 20, 1978, money supply has shown an increase of Rs. 1401 crores or 8.7 per cent as compared with an increase of Rs. 1650 crores or 12.4 per cent in the corresponding period of last year. All the three factors, namely, bank credit to the commercial sector, net foreign exchange assets of the banking sector and net bank credit to Government have contributed more or less equally to the expansion during this period. However, the increase in net bank credit to Government this year has been very sharp i.e., Rs. 1002 crores in this period as compared to only Rs. 63 crores in the corresponding period last year. The increase in net foreign exchange assets of the banking sector has also been larger this year at Rs. 1544 crores due to the continued rise in invisible receipts as against

Rs. 1196 crores in the corresponding period last year. Bank credit to the commercial sector, however, shows a much smaller increase this year, namely, Rs. 1425 crores as compared to Rs. 2702 crores last year. This was due to a deceleration in the growth of public food procurement as well as other advances.

6.3 The increase in non-monetary liabilities of the banking sector has been Rs. 2593 crores as against Rs. 2314 crores in the corresponding period last year and has, therefore, exercised a greater contractionary influence. It must be noted, however, that the increase in time deposits with the banks has been Rs. 2172 crores this year as compared to Rs. 2374 crores in the comparable period last year.

TABLE 6.2

Variations in Money Supply

	Currency with the public	Deposit money	M1 (Money supply with the public)	M3 (M1+time deposits with banks)	Currency as percentage of money supply (end of the period)
1971-72	430 (9.8)	519 (17.3)	949 (12.9)	1673 (15.2)	57.7
1972-73	637 (13.3)	741 (21.0)	1378 (16.6)	2321 (18.3)	56.1
1973-74	883 (16.2)	617 (14.5)	1500 (15.5)	2611 (17.4)	56.4
1974-75	25 (0.4)	750 (15.4)	775 (6.9)	1926 (10.9)	53.0
1975-76	359 (5.7)	991 (17.6)	1350 (11.3)	2930 (15.0)	50.3
1976-77	1168 (17.4)	1531 (23.1)	2699 (20.3)	5303 (23.6)	49.1
1977-78 (upto 20-1-78)	588 (7.5)	813 (10.0)	1401 (8.7)	3573 (12.9)	48.6
1976-77 (upto 21-1-77)	852 (12.7)	798 (12.1)	1650 (12.4)	4024 (17.9)	50.5

Note : Figures in brackets indicate percentage variations.

6.4 A striking feature of the monetary situation in 1976-77 was a marked increase in the currency component of money supply. Currency with the public increased by Rs. 1168 crores as compared to an increase of Rs. 359 crores in 1975-76. However, the long-term declining trend in the percentage of currency to money supply continued in 1976-77. In 1977-78, the currency component of money supply has not increased very much and declining trend in the percentage of currency to money supply has been maintained.

6.5 In interpreting the data on money supply variations given above, it must be noted that the Reserve
68 M of Fin./77

Bank has revised the compilation and presentation of the money supply data early in 1977-78, according to the recommendations of the Second Working Group on Money Supply. The main difference between the new series and the old series in respect of money supply with the public is that the new series has a wider coverage of data relating to the co-operative sector. In addition to the data relating to the State Co-operative Banks which were included in the earlier series, data regarding the lower tiers of the co-operative sectors, namely, the Central Co-operative Banks, Urban Co-operative Banks and the Salary Earners' Societies have also been covered in the new series.

Scheduled Commercial Banks Trends

6.6 In 1976-77, the activities of commercial banks had contributed substantially to monetary expansion. This year, however, the trend has been different. Between last Friday of March 1977 and January 20, 1978, gross bank credit increased by Rs. 1226 crores which was 56 per cent of the credit expansion during the comparable period last year. The major reason for the lower increase in credit was a much smaller increase in food credit. Public food procurement credit increased by Rs. 131 crores during the current financial year as compared to an increase of Rs. 715 crores in the corresponding period last year. This was to be expected considering that the Food Corporation of India continued to add to the stocks of food with them last year, whereas this year no such increase has taken place. Bills rediscounted with the RBI by scheduled commercial banks recorded a decline of Rs. 39 crores during this period in 1977-78 as compared to a decline of Rs. 8 crores during the same period last year.

6.7 The increase in non-food gross bank credit was also smaller this year. It was Rs. 1095 crores till January 20, 1978 as compared to an increase of Rs. 1476 crores during the corresponding period last year. This seems to be due to a lower rate of growth in industrial production and a decline in the inventories held by industries like steel, cotton textiles and coal. In 1976-77, large imports of items like edible oils, raw cotton and fibres also added to the demand for

credit. Although some of these import programmes have continued, there has not been much of an increase in the net demand for credit in the current year due to faster turnover and return flow of funds. Similarly, exports have been growing at a much lower rate than last year and would, therefore, need proportionately less credit. Thus, on the whole, the growth in the demand for credit from the commercial sector has been smaller this year as compared to last year.

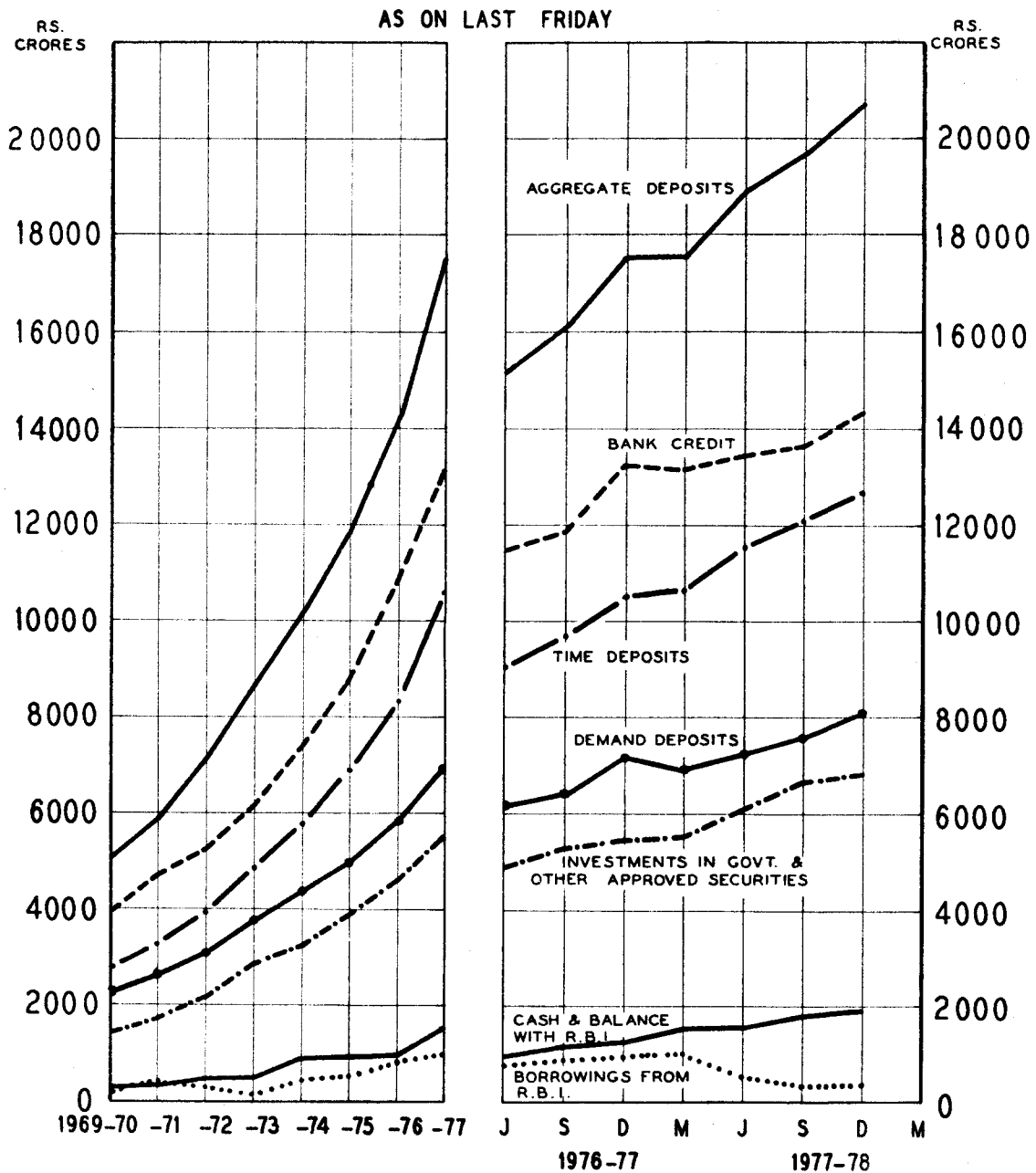
6.8 Although aggregate deposits with scheduled commercial banks recorded a larger growth of Rs. 3407 crores till January 20, 1978 as compared with an increase of Rs. 3004 crores in the same period last year, the rate of increase in deposits declined from 21.2 per cent during this period last year to 19.4 per cent in the current financial year. The growth of time deposits which was 25.9 per cent during the comparable period in 1976-77 fell to 20.5 per cent till January 20 in the current year. However, demand deposits showed a larger increase of 17.7 per cent during 1977-78 so far as compared to a rate of increase of 14.5 per cent in 1976-77.

6.9 As a result of the larger increase in deposits and lower growth in credit, the gross credit-deposit ratio of scheduled commercial banks declined from 75.9 per cent at the end of 1976-77 to 69.4 per cent on January 20, 1978. The non-food gross credit-deposit ratio went down more significantly from 63.4 per cent at the end of 1976-77 to 58.4 per cent on January 20, 1978. This ratio was 64.2 per cent on the same

TABLE 6.3
Scheduled Commercial Banks : Variations in Selected Indicators

	(Rs. crores)	
	Variations during	
	1976-77 (Mar. 26, 1976 to Jan. 21, 1977)	1977-78 (Mar. 25, 1977 to Jan. 20, 1978)
1. Aggregate deposits	3004	3407
(a) Demand deposits	844	1228
(b) Time deposits	2160	2179
2. Borrowings from RBI	146	-420
3. Cash and balances with RBI	294	799
(a) Cash in hand	30	125
(b) Balances with RBI	264	674
4. Net balances with RBI [3(b)-2]	118	1094
5. Money at call and short notice	-140	63
6. Bank credit	2199	1265
7. Bills rediscounted with RBI	-8	-39
8. Gross bank credit (6+7)	2191	1226
9. Public food procurement credit	715	131
10. Non-food gross bank credit [8-9]	1476	1095
11. Investments in Government and other approved securities	872	1244
(a) Government securities	593	936
(b) Other approved securities	279	308
12. Balances with other banks in current account	-7	52
13. Gross credit-deposit ratio	77.2	69.4
14. Gross credit (excluding food credit)—deposit ratio	64.2	58.4
15. Investment—deposit ratio	31.9	32.4

SCHEDULED COMMERCIAL BANKS



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day last year. On the other hand, the investment-deposit ratio improved from 31.5 per cent at the end of 1976-77 to 32.4 per cent on January 20, 1978.

6.10 Due to lower credit expansion, banks were able to more than fulfil their statutory and obligatory requirements in regard to cash reserves and liquidity. While bank borrowings from the Reserve Bank of India showed a decline of Rs. 420 crores during the year so far in contrast to an increase of Rs. 146 crores during the same period last year, bank balances with the RBI showed an increase of Rs. 674 crores which was higher than the increase of Rs. 264 crores in the comparable period last year. Banks were also able to invest Rs. 63 crores in money at call and short notice this year in contrast to a disinvestment of Rs. 140 crores during the same period last year.

6.11 Banks have at present a comfortable resources position which they can use to meet the genuine requirements of credit during the current busy season. The demand for credit last year increased substantially because of the continued increase in procurement operations, a large increase in industrial production, substantial stepping up of imports of a number of commodities and a very high rate of growth of exports. This year, the rate of growth of industrial production and of exports has been much lower. Secondly, cash resources of banks have expanded substantially because of a larger accretion of foreign exchange assets. The result of these forces has been a much easier credit situation.

Developments in Credit Policy

6.12 Credit policy was tightened towards the latter half of 1976-77 in view of the sharp expansion in money supply and the improvement in banks' liquidity position. As mentioned in the last year's Economic Survey, in addition to a number of selective credit control measures, the statutory cash reserve ratio was raised from 4 to 5 per cent in September 1976 and further to 6 per cent in November 1976. An additional reserve requirement of 10 per cent of the incremental demand and time liabilities was also imposed. These stipulations were aimed at containing the lendable resources of the banks at a time when deposit growth was buoyant consequent upon increased remittances from abroad and a large increase in food procurement advances. In January 1977, the Reserve Bank of India also advised scheduled commercial banks to undertake a scrutiny of big borrowal accounts with limits exceeding Rs. 50 lakhs and where actual drawal had already reached 60 per cent or more and assess their existing and future needs in the light of their production programmes.

6.13 While the restrictive credit policy was continued this year, the sluggishness of investment, demand recession in some sectors and fears of slackening of industrial growth called for a certain amount of flexibility in the overall framework of restraint. Against

this background, the basic objectives of the new credit policy, announced by the Reserve Bank of India on May 27, 1977, was to restrain monetary expansion, to promote capital investment, production and exports and to augment supplies of essential consumer goods. An attempt was also made to rationalise costs and the interest rate structure of banks' borrowing and lending.

6.14 In terms of the credit policy, refinance and rediscount accommodation from the Reserve Bank was made highly selective. Refinancing of food procurement credit was to be made available upto 50 per cent of the excess over Rs. 1,500 crores, instead of over Rs. 1,000 crores earlier, the interest rate continuing at 10 per cent. Refinance for exports was provided upto 50 per cent of the incremental performance over the annual average performance in 1976, the rate of interest charged being 10.5 per cent. Rediscounting of inland bills purchased and discounted for which there was a basic limit of 10 per cent and which was available on an automatic basis earlier was made discretionary. The basic refinance facility upto one per cent of the demand and time liabilities as on last Friday of March 1977 at a rate of interest of 10 per cent was made available till the end of March 1978. It was, however, stressed that this facility was to be utilised strictly for meeting day-to-day operational needs. The refinance provided by the Reserve Bank, other than the minimum necessary for operational requirements, was to be based on merits related to a bank's credit-deposit ratio and its sectoral deployment of credit, its involvement in assisting capital investment through provision of term loans and subject to Reserve Bank's satisfaction about its resources planning.

6.15 Selective credit controls were tightened up further in respect of commodities experiencing pronounced price pressures. Thus, in respect of vegetable oilseeds and oils, margins were raised generally by 10 percentage points including such advances by co-operative banks. Simultaneously, with a view to facilitating the uninterrupted flow of imported vegetable oilseeds and oils, minimum margin and ceiling requirements were relaxed for a period of four weeks from the date of arrival of stocks at the ports in the case of oils and eight weeks in the case of oilseeds. A minimum margin of 60 per cent was stipulated on credit outstanding beyond the period allowed in respect of imported oilseeds and oils not covered by selective credit controls e.g., palm kernels and oil, sunflower seed and oil and soyabean and oil. While the banks were advised to make credit available to importers without undue delay, they were also asked to undertake an immediate scrutiny of all their existing advances to trade against indigenous and imported oils and oilseeds with a view to bringing about a faster return flow of funds and ensuring that bank funds were not used

for withholding supplies from the market. To facilitate the offtake of imported cotton, advances to mills were exempted from the minimum margin requirements. Banks were also asked to implement the additional margin requirements of 10 percentage points on all types of advances against book debts and inventories in respect of existing accounts barring some exempted categories—this stipulation, introduced in January 1977, had been somewhat relaxed in February 1977 to meet the seasonal pressure of demand for funds.

6.16 To provide further stimulus to long-term investment, the Reserve Bank advised scheduled commercial banks to charge a rate of interest not exceeding 12.5 per cent (inclusive of interest tax on advances, where applicable) on term loans extended by them for capital investment for periods of not less than three years. With a view to rationalising the cost structure of banks, the Reserve Bank also realigned the interest rates on deposits. The rate of interest on fixed deposits maturing between 91 days and 5 years was reduced by one to two percentage points with effect from June 1, 1977, the rate of interest of 10 per cent allowed on deposits of more than 5 years remaining unchanged. With effect from July 1, 1977, the rate of interest on savings deposits with cheque facility was lowered from 5 to 3 per cent while the rate of interest on savings deposits without cheque facility was retained at 5 per cent per annum. It was also decided to increase the rate of interest on impounded deposits of banks from 5.5 per cent to 6 per cent. The banks were advised that as a result of relief on account of interest liability they were expected to reduce the interest rates on their advances, particularly to the priority sectors.

6.17 To exercise a more effective control on larger accounts, credit limits against fixed deposits were brought within the purview of the Credit Authorisation Scheme in October 1977 which requires prior permission from the Reserve Bank for large sized loans. Regulatory measures were also taken to discourage the use of bank credit for speculative inventory holding in cement, turmeric, foodgrains (other than public food procurement), cotton and kapas.

6.18 As a result of the review of the credit policy in December 1977, the Reserve Bank of India asked the commercial banks to relax and enlarge their credit deployment for agriculture and small-scale industry. More specifically, banks were asked to grant direct individual loans upto Rs. 2,500 to small farmers at a maximum rate of interest of 11 per cent irrespective of whether the loan is short, medium or long-term. Such loans were made eligible for 50 per cent refinance from the Reserve Bank at the Bank Rate of nine per cent. The rate of interest on term loans of not less than three years given to far-

mers for minor irrigation and land development was pegged at 10.5 per cent. To stimulate capital investment in the small-scale sector, banks were required to charge not more than 11 per cent interest on term loans of not less than three years to small-scale units covered under the Credit Guarantee Scheme and those promoted by technicians, small road transport operators and small units in the specified backward areas. Banks have also been directed to extend to small farmers and small-scale units the practice of collecting interest on agricultural advances at the time of repayment instead of compounding of interest on current dues.

6.19 Public sector banks have been specifically advised to enlarge the flow of their credit to the neglected sectors such as agriculture, small industry, road transport operators, retail trade and small business, professional and self-employed people and education in such a manner that by March 1979, these sectors will account for 33 per cent of their aggregate credit as compared to the level of about 27 per cent now. In order to extend credit facilities to small borrowers in the rural areas, public sector banks have been advised to achieve a credit-deposit ratio of at least 60 per cent by March 1979 in their rural and semi-urban branches separately. With the same end in view, the Differential Rate of Interest Scheme was amended in May 1977 and extended to the entire country. Efforts are also being made to enlarge the net-work of branches of commercial banks in the rural areas. The Reserve Bank has advised the commercial banks that from January 1, 1977, they will be required to open 4 branches at unbanked rural centres to be entitled to open one branch at a metropolitan or any other banked centre. Under the Lead Bank Scheme, banks have also been advised to formulate District Credit Plans by March 1978 so that credit assistance to small farmers can be extended in a systematic manner. In addition, a committee has been set up to review the role of Regional Rural Banks. Another important development was the appointment of a committee to study all aspects of the functioning of the public sector banks including the branch expansion programme, lending to priority and weaker sections of the society and to suggest measures for improving the efficiency of banks.

Sectoral Use of Bank Credit

6.20 According to provisional data available till the end of November 1977, out of the gross bank credit expansion of Rs. 816 crores during the current year, Rs. 66 crores went to food credit and Rs. 750 crores to non-food credit. Rs. 358 crores (44 per cent) of the incremental credit was utilised for advances to priority sectors which include agriculture, small industry and other small borrowers. The increase in

the credit to large and medium industry, both in the public and private sectors, was limited to Rs. 99 crores or 13 per cent of the increase in non-food credit during this period. The principal groups which utilised the credit were iron and steel, other metals and metal products, engineering, textiles, chemicals

and rubber. This low growth was due to the deceleration in the growth of industries like steel, engineering and cotton textiles. At the same time, since inventories in some of these industries are much smaller this year the increase reflects a greater credit availability for industry as a whole. Credit to the

TABLE 6.4
Sectoral Deployment of Gross Bank Credit

	Outstanding as on		Variations
	March 25, 1977	November 25, 1977	March 25, 1977 to November 25, 1977
1. Gross Bank Credit	13329	14145	816
Of which :			
(a) Food credit	2190	2256	66
2. Non-food gross bank credit	11139	11889	750
(b) Credit to large and medium industry (public & private sector)	5539	5638	99
(c) Credit to small industry	1403	1520	117
(d) Credit to wholesale trade (other than food)	999	1170	171
Of which :			
(i) To Cotton Corporation of India	132	130	-2
(ii) To Food Corporation of India (for fertiliser)	23	159	136
(iii) To Jute Corporation of India	31	4	-27
(e) Credit to agriculture	1343	1456	113
(f) Credit to small borrowers etc.	632	760	128
(g) Unclassified	1223	1345	122
3. Total advances to priority sectors (c, e and f above)	3378	3736	358

sugar industry declined by Rs. 92 crores over this period because it was a slack season for sugar.

6.21 A little more than a fifth of the increase in non-food credit extended during this period was deployed for wholesale trade other than food. This includes a credit of Rs. 136 crores to the Food Corporation of India for import of fertilisers. While there has been no comparable increase in the import operations of the Cotton Corporation of India during this year as during last year, the import of fertilisers has increased in the current year.

6.22 As regards bank credit against commodities covered under selective credit controls, there was a decline of Rs. 245 crores till the end of October 1977 from the last Friday of March 1977 as against a smaller decline of Rs. 163 crores during the corresponding period last year. The decline in the case of foodgrains, linseed, castor seed, castor oil and vegetable oil was larger than last year. The decline in the overall size of such credit took place in spite of a smaller reduction in credit extended to sugar and groundnut. With regard to sugar, the larger

carryover stocks with the industry seem to have been responsible for a larger outstanding volume of credit. Bank advances against imported cotton declined by Rs. 65 crores during the current year as compared to a nominal decline of Rs. 3 crores during the comparable period last year. The restrictive credit policy also resulted in a larger decline in advances against indigenous cotton and kapas as well as raw jute.

6.23 Thus, the monetary and credit situation during 1977-78 presents a mixed picture. Although the overall rate of monetary expansion has been somewhat lower during the current financial year so far, the basic factors of an increase in net foreign exchange assets of the banking sector and in net bank credit to Government have continued to provide an expansionary impulse to money supply. The improved supply situation, particularly with regard to sensitive commodities like edible oils and cotton, and the tight credit policy seem to have been able to hold the price level down till now. But any signs of a change in the supply situation could spark off inflationary price increases as the liquid monetary resources in the economy can be easily used for speculative inventory build-

ing. Therefore, there is continued need for maintaining a tight reign on bank credit. The policy of preventing the deployment of credit for speculation without, at the same time, starving genuine production requirements, needs to be continued further.

6.24. A disquieting feature of the working of scheduled commercial banks is the decline in the rate of growth of time deposits. Time deposits are an important form of savings and ought to be encouraged to increase the overall volume of savings in the economy. To some extent, a decline in time deposits may reflect not so much a decline in the total volume of savings but a shift to some other financial asset on which the yield is somewhat higher. It could also indicate that those who held time deposits earlier due to the interest earned on them, particularly on short maturities, now find the rate offered an insufficient compensation for the loss of liquidity. This may have resulted in a conversion of time deposits into demand deposits.

6.25 The decline in the credit-deposit ratio of banks and the lower increase in commercial bank credit to the non-food sector raises the question whether the tight credit policy has had adverse effects

on the economy. This does not seem to be the case. While credit policy overall has been restrictive it has been discriminatory between credit for inventory building and credit for production needs. The latter needs have been met to the extent required and, as was mentioned earlier, the lower level of inventories in certain industries means a greater availability of credit for industry as a whole. Also, a smaller increase in non-food credit appears to be a reflection of lower demand rather than a withholding of credit. As has been noted elsewhere in the Survey, a number of factors have led to a slower growth of industrial production. Investment in the organised sector also is not showing any signs of a great recovery. It seems that these factors rather than a tight credit policy are responsible for the slackness noted above. The restrictiveness of monetary and credit policy only aims at neutralising the increase in money supply due to exogenous factors and preventing the flow of funds into undesirable channels. The present policy is unlikely to come in the way of a revival of the economy if other factors favour it because of the existence of sufficient liquidity in the system and the Reserve Bank's willingness to meet genuine credit requirements.