

CHAPTER 6  
MONETARY AND CREDIT SITUATION

**Introduction**

6.1 The years 1976-77 to 1978-79 are characterised by unusually rapid rates of monetary expansion. Increase in money supply during these years was at an annual average rate of 18.3 per cent, while the corresponding growth in real national income was only 4.5 per cent. Continued monetary expansion at this rate was bound to create conditions favourable to an inflationary upsurge which could be triggered by any one of a number of factors.

6.2 As a matter of fact prices remained comparatively stable in 1977-78, and through most of 1978-79, because of higher agricultural production and a satisfactory performance in industry. However, inflationary pressures surfaced in February 1979 and prices started rising immediately after the presentation of the budget. The emergence of a number of domestic supply constraints and imported inflation occurring in a situation of considerable liquidity in the system led to a continuing and sharp rise in prices throughout 1979-80.

6.3 Although the Reserve Bank of India (R.B.I.) tried to restrict monetary expansion through various credit control measures aimed at restricting the expansion of bank credit, its success was somewhat limited because of a number of factors. Firstly, the

continuing recourse to large R.B.I. credit by the Government meant a considerable increase in reserve money in the system which enabled the banking system to expand credit further. Secondly, alternative sources of finance were available to banks in the form of Participation Certificates from surplus funds available with financial institutions such as the LIC and the Unit Trust. Lastly, the availability of a large volume of relatively liquid assets such as treasury bills in the banking system enabled the banks to rediscount them with the Reserve Bank and use the proceeds for expanding credit further. Since the penal rate of interest applied for the failure to maintain the Statutory Liquidity Ratio is only modest (3 per cent over the Bank Rate), it does not deter the banks from adopting such a course.

**Money Supply in 1978-79**

6.4 During 1978-79, money supply with the public expanded by Rs. 3,643 crores showing a substantial increase of 19.8 per cent compared with an increase of 14.7 per cent during 1977-78. This high growth rate resulted from a substantial expansion in reserve money (28.6 per cent) arising from two autonomous factors on the monetary system viz., large increase in Government borrowing from the Reserve Bank and continued growth in net foreign assets of the R.B.I.

TABLE 6.1  
*Sources of Change in Reserve Money Variations*

	Out-standings as on March 31, 1976	Variations during				
		1976-77	1977-78	1978-79	1978-79 Mar. 31 to Mar. 30	1979-80* Mar. 31 to Mar. 28
		(Rs. crores)				
1. Net RBI credit to Government . . . . .	6915	303 (4.4)	169 (2.3)	1613 (21.8)	1180 (16.0)	2551 (28.3)
2. RBI credit to banks . . . . .	1315	89 (6.8)	-478 (-34.0)	191 (20.6)	178 (19.2)	110 (9.8)
3. RBI credit to commercial sector. . . . .	734	164 (22.3)	56 (6.2)	296 (31.0)	295 (30.9)	281 (22.5)
4. Net foreign exchange assets of RBI . . . . .	924	1675 (181.3)	1933 (74.4)	899 (19.8)	974 (21.5)	63 (1.2)
5. Government's currency liabilities to the public . . . . .	555	13 (2.3)	25 (4.4)	-2 (-0.3)	10 (1.7)	-3 (-0.5)
<b>MINUS</b>						
6. Net non-monetary liabilities of RBI . . . . .	2636	252 (9.6)	564 (19.5)	-133 (-3.8)	-140 (-4.0)	611 (18.4)
<b>RESERVE MONEY (1 + 2 + 3 + 4 + 5 - 6) . . . . .</b>	<b>7807</b>	<b>1991 (25.5)</b>	<b>1143 (11.7)</b>	<b>3130 (28.6)</b>	<b>2775 (25.4)</b>	<b>2390 (17.0)</b>

\*Provisional/Partially Revised.

NOTE : Figures in brackets are percentage variations.

6.5 The relationship between growth of reserve money in the system and the consequent expansion in money supply is not an inflexible one. The money multiplier, which is the ratio of money supply to reserve money is not a constant. It can vary depending upon the impact of a number of factors such as the public demand for currency which reduces the reserve money available to the banking system, the impact of reserve deposit ratios and the efficacy of credit control measures which affect the extent of credit expansion allowed on a given base of reserve money. However, while it is in principle possible to control the volume of credit which the banking system can create on any given base of reserve money, it is much more difficult to do so when reserve money is expanding rapidly. This has been an important factor contributing to the high rate of monetary expansion in the recent years and the limited effectiveness of credit control measures.

6.6 Reserve money has expanded relatively rapidly in the past three years increasing by 25.5 per cent in 1976-77, 11.7 per cent in 1977-78 and 28.6 per cent in 1978-79. In both 1976-77 and 1977-78, the growth of reserve money was almost entirely because of the growth in net foreign assets of the R.B.I. However, in 1978-79, the principal factor behind the expansion was the very large increase in net R.B.I. credit to the Government with the increase in net foreign assets playing a secondary role.

6.7 The growth in reserve money at 28.6 per cent created the conditions which resulted in the increase of 19.8 per cent in money supply in 1978-79. Bank credit to commercial sector expanded by Rs. 4,314 crores compared with Rs. 2,372 crores in 1977-78. Net bank credit to the Government from the banking system as a whole showed a smaller increase of Rs. 2,046 crores in 1978-79 compared with Rs. 2,211 crores in 1977-78, although as

TABLE 6.2  
Analysis of Variations in Money Stock

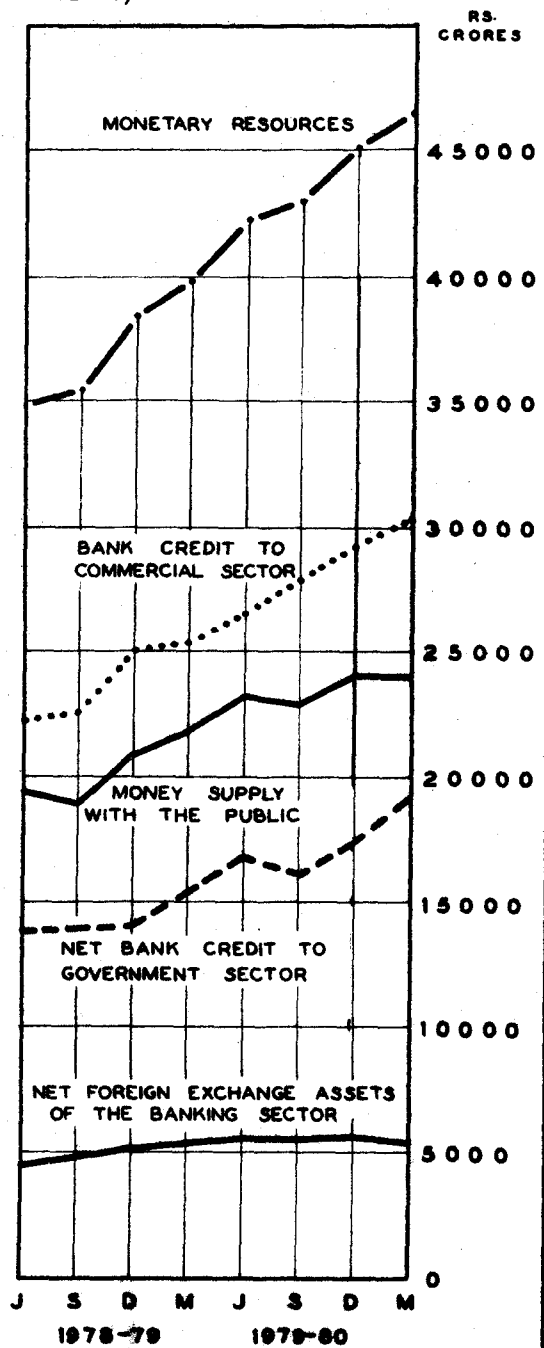
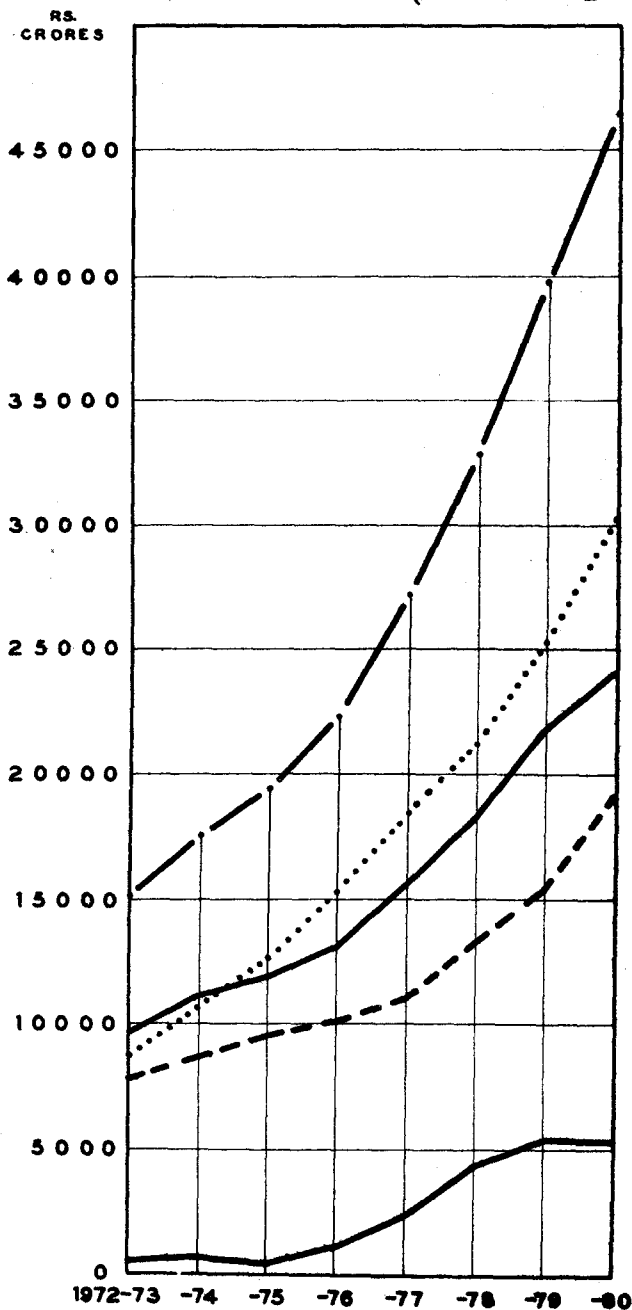
	(Rs. crores)			
	Variations during			
	1977-78 Mar. 31 to Mar. 31	1978-79 Mar. 31 to Mar. 31	1978-79+ upto Mar. 30, 1979	1979-80+ upto Mar. 28, 1980
I. M <sub>1</sub> (Money supply)	2359 (14.7)	3643 (19.8)	3437 (18.7)	2265 (10.3)
(a) Currency with the public	758 (9.6)	1588 (18.4)	1580 (18.3)	1469 (14.4)
(b) Deposit money	1601 (19.6)	2055 (21.1)	1857 (19.0)	796 (6.7)
II. Sources of change in money supply :				
(1) Net bank credit to Government (a + b)	2211 (19.6)	2046 (15.2)	1921 (14.3)	3740 (24.1)
(a) RBI's net credit to Govt. (i + ii)	169	1613	1180	2551
(i) To Central Government	175	2093	1417	2299
(ii) To State Governments	345	-481	-238	252
(b) Other banks' credit to government	2041	433	741	1189
(2) Bank credit to commercial sector (a + b)	2372 (12.6)	4314 (20.3)	4132 (19.5)	5031 (19.7)
(a) RBI's credit to commercial sector	56	296	295	281
(b) Other banks' credit to commercial sector	2315	4018	3837	4750
(3) Net foreign exchange assets of banking sector	1917 (75.8)	899 (20.1)	974 (21.9)	63 (1.2)
(4) Government's currency liabilities to the public	25 (4.4)	-2 (-0.3)	10 (1.7)	-3 (-0.5)
(5) Non-monetary liabilities of banking sector (a + b + c)	4166 (24.2)	3615 (16.9)	3600 (16.9)	6566 (26.3)
(a) Time deposits with banks	2765 (23.5)	3555 (24.5)	3551 (24.5)	4294 (23.8)
(b) Net non-monetary liabilities of R.B.I.	564	-133	-140	611
(c) Other net non-monetary liabilities of banks	837	193	189	1661
III. M <sub>3</sub> (i.e., money supply plus time deposits)	5124 (18.4)	7198 (21.9)	6988 (21.2)	6559 (16.4)

+Provisional/Partially Revised.

NOTE : Figures in brackets are percentage variations.

# MONEY SUPPLY WITH THE PUBLIC AND MONETARY RESOURCES

(AS ON LAST FRIDAY)



mentioned above, net R.B.I. credit to the Government rose sharply by Rs. 1,613 crores in 1978-79 compared with an increase of only Rs. 169 crores in the previous year and was, in fact, a major factor fueling the increase in reserve money in the system. The contribution to money supply expansion from net foreign exchange assets of the banking sector was also of a lower order in 1978-79 registering an increase of only Rs. 899 crores compared with the large increase of Rs. 1,917 crores noticed in 1977-78. Non-monetary liabilities of the banking sector also decelerated increasing by only Rs. 3,615 crores in 1978-79 compared with a rise of Rs. 4,166 crores in 1977-78. This also contributed to the expansion in money supply.

6.8 Aggregate monetary resources ( $M_3$ ) comprising of money supply and time deposits of banks showed larger increase by Rs. 7,198 crores in 1978-79 and the rate of growth was higher at 21.9 per cent compared with 18.4 per cent in the previous year.

#### Money Supply Growth in 1979-80

6.9 The rate of growth of money supply in 1979-80 was at a slower pace than in 1978-79. As of March 28, 1980, the money supply during the fiscal year 1979-80 increased by Rs. 2,265 crores, an increase of 10.3 per cent. This is much lower than the 18.7 per cent growth rate recorded in the previous year upto March 30, 1979, but the two figures are not strictly comparable because of definitional changes. In August 1978, the method of classifying savings bank deposits into time and demand components was changed and the effect of the change was to classify a larger proportion of savings bank deposits into time deposits. The new procedure is being adopted by the banks gradually. As such, the result of the change reflected in the figure for March 28, 1980 is greater than in the figure for March 30, 1979, since more banks seem to have adopted the new procedure in 1979-80. Using the same classification method for such banks which have adopted the new procedure for both dates shows that while money supply grew at a slower rate in 1979-80, the deceleration was modest. Final adjusted figures are not yet available, but it appears that the rate of growth of money supply in 1979-80 may be only about 3 per cent lower than in the previous year. The figures for aggregate monetary resources ( $M_3$ ), which include time deposits, are not affected by the change in classification. They grew by 16.4 per cent in 1979-80 (upto March 28, 1980) compared with 21.2 per cent in the previous year (upto March 30, 1979).

6.10 It is worth noting that the growth of reserve money had slowed down during 1979-80 to 17.0 per cent compared with 25.4 per cent in the previous year. Although net R.B.I. credit to the Government showed a substantial increase, the accretion to net foreign assets was very small compared with the previous year. This has removed an important autonomous expansionary element in money supply.

6.11 Bank credit to the commercial sector increased substantially by Rs. 5,031 crores (upto March 28, 1980) compared with Rs. 4,132 crores in the same period of the previous year. The rate of growth also rose marginally from 19.5 per cent in 1978-79 to 19.7 per cent in 1979-80. Net bank credit to the Government increased much faster than in the previous year with both net R.B.I. credit and other banks' credit being much higher.

6.12 A factor which helped to check the growth in money supply expansion in the fiscal year 1979-80 upto March 28, 1980 was the large increase in non-monetary liabilities of the banking system. These have increased by Rs. 6,566 crores (26.3 per cent) compared with Rs. 3,600 crores (16.9 per cent) in the same period last year. However, it is worth noting that time deposits have increased at a slower pace than last year (23.8 per cent compared with 24.5 per cent). Reserve Bank's net non-monetary liabilities which decreased by Rs. 140 crores in this period during 1978-79 have increased by Rs. 611 crores in 1979-80.

#### Trends in Scheduled Commercial Banks' Credit

6.13 As noted above, lending to the commercial sector by the scheduled commercial banks was a major factor pushing up the rate of monetary expansion in 1978-79. In some measure, this was anticipated since the pick up in industrial production noticed since the last quarter of 1977-78 was expected to continue with better availability of power and raw materials. Likewise, because of a good *rabi* crop there were clear indications of food credit to go up as well. The gross bank credit (excluding Participation Certificates) increase in 1978-79 was Rs. 2,845 crores or 18.9 per cent compared with an increase of Rs. 1,699 crores or 12.7 per cent in 1977-78. A substantial part of the bank credit expansion in 1978-79 was accounted for by food credit and credit to priority sectors. While food credit accounted for an increase of Rs. 226 crores as against a decline of Rs. 206 crores in the previous year, the credit to priority sectors claimed as much as Rs. 1,219 crores recording an increase of 29.0 per cent compared with Rs. 828 crores or 24.5 per cent in 1977-78. The outstanding credit to

priority sectors at the end of 1978-79 formed 30.3 per cent of total outstanding bank credit against 27.9 per cent at the end of 1977-78. Despite the smart increase in credit to priority sectors, the banks,

however, failed to reach the target of one-third of outstanding bank credit to the priority sectors stipulated by the Reserve Bank to be achieved by end-March 1979.

TABLE 6.3

*Scheduled Commercial Banks : Variations in Selected Indicators*

(Rs. crores)

	Variations during*		
	1977-78	1978-79	1979-80†
1. Aggregate deposits . . . . .	4645	4805	4769
(a) Demand deposits . . . . .	1924	1520	691
(b) Time deposits . . . . .	2721	3285	4078
2. Borrowings from RBI . . . . .	-636	215	193
3. Cash and balances with RBI . . . . .	643	1048	1061
(a) Cash in hand . . . . .	115	88	61
(b) Balances with RBI . . . . .	528	960	1000
4. Net balances with RBI (3(b)-2) . . . . .	1164	745	807
5. Money at call and short notice . . . . .	88	-50	-14
6. Bank credit . . . . .	1766	2856 (3039)†	3261†
7. Bills rediscounted with RBI . . . . .	-67	-11	3
8. Gross bank credit (6 + 7) . . . . .	1699	2845 (3028)†	3264†
9. Public food procurement credit . . . . .	-206	226	105
10. Non-food gross bank credit (8-9) . . . . .	1905	2619 (2802)†	3369†
11. Investments in Govt. & other approved securities . . . . .	2361	1212	1509
(a) Govt. securities . . . . .	1977	714	807
(b) Other approved securities . . . . .	384	498	702
12. Balances with other banks in current account . . . . .	60	33	70
13. Gross credit—deposit ratio . . . . .	67.8	66.2	68.1†
14. Gross credit (excluding food credit)—deposit ratio . . . . .	58.9	(68.1)† 58.1	61.5†
15. Investment—deposit ratio . . . . .	35.6	(59.9)† 33.7	33.4

\*Based on last Friday of March figures.

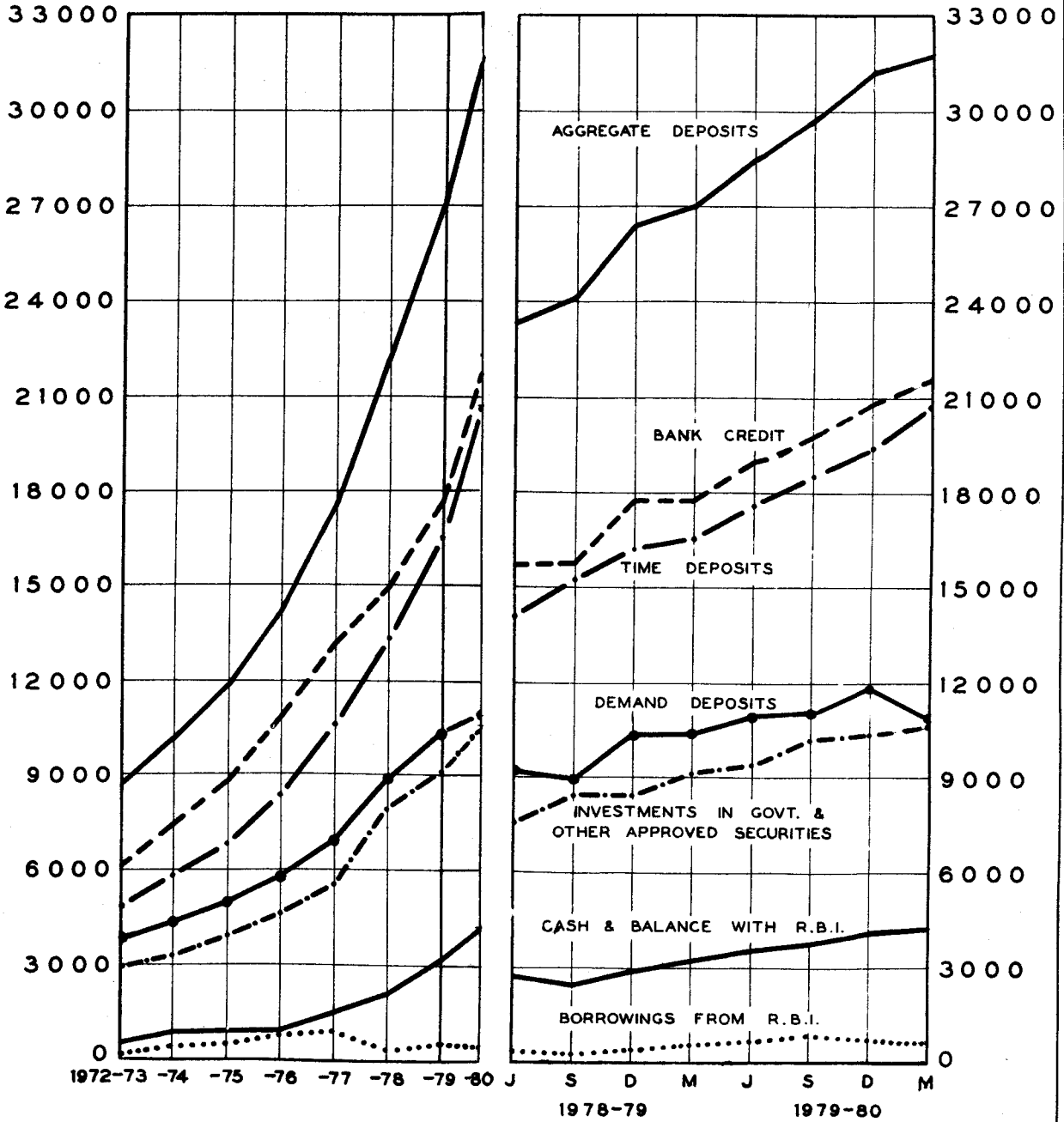
†Provisional/Partially Revised.

‡Including Participation Certificates.

# SCHEDULED COMMERCIAL BANKS

(AS ON LAST FRIDAY)

RS. CRORES



6.14 Deposit mobilisation of scheduled commercial banks showed substantial increase during 1978-79. Aggregate deposits rose by Rs. 4,805 crores and were larger than Rs. 4,645 crores in 1977-78. Nevertheless, the rate of accretion to deposits showed a lower growth at 21.6 per cent as against 26.4 per cent recorded in the previous year. Time deposits formed 68.4 per cent of the incremental deposits compared with 58.6 per cent in 1977-78. The higher percentage in time deposits noticed in 1978-79 is partly attributable to a change brought about in the apportionment of savings bank deposits of the banks between time and demand deposits since August 1978. In absolute terms, time deposits increased by Rs. 3,285 crores in 1978-79 as against Rs. 2,721 crores recorded during 1977-78. Even so, the rate of growth of time deposits in 1978-79 marginally declined to 24.6 per cent from 25.6 per cent in 1977-78. In the case of demand deposits, the growth rate as well as the absolute amount mobilised in 1978-79 have come down substantially compared with 1977-78. The increase in demand deposits was only Rs. 1,520 crores in 1978-79 compared with Rs. 1,924 crores in 1977-78 and the rate of growth recorded in the two years was 17.1 per cent and 27.7 per cent respectively. In other words, banks' mobilisation of deposits has slackened in 1978-79.

6.15 The step-up in the banks' investments in Government and other approved securities was Rs. 1,212 crores in 1978-79 which was substantially lower than the increase of Rs. 2,361 crores witnessed during 1977-78. Consequently, the scheduled commercial banks' investment—deposit ratio declined to 33.7 per cent at the end of 1978-79 from 35.6 per cent at the end of 1977-78. However, there was a significant increase in their cash in hand and balances with the Reserve Bank by Rs. 1,048 crores as against only Rs. 643 crores in 1977-78. Banks' borrowings from the Reserve Bank showed a marked increase at Rs. 215 crores during 1978-79 which was in sharp contrast to a decline of Rs. 636 crores in 1977-78.

6.16 In sum, the salient features of scheduled commercial banks' trends during 1978-79 were a faster pace of bank credit expansion gathering further momentum in the second half of the financial year and a deceleration in the rate of growth of bank deposits. This resulted in the banks finding it difficult to meet the demand for credit from own sources and, therefore, taking recourse to augment their resources from outside sources such as Participation Certificates (PCs.).

6.17 Gross bank credit (including Participation Certificates) expansion during the financial year 1979-80 amounted to Rs. 3,264 crores. This, in absolute terms, was higher than the expansion of Rs. 3,028 crores (including PCs) recorded in 1978-79. However, the rate of expansion in gross bank credit at 17.7 per cent in 1979-80 was somewhat lower than that of 19.7 per cent in 1978-79. Even after the exclusion of food credit, the growth rate in gross bank credit shows a nominal decline at 20.8 per cent in 1979-80 compared with 20.9 per cent in 1978-79. Food credit in 1979-80 has declined by Rs. 105 crores as against an increase of Rs. 226 crores recorded in 1978-79.

6.18 The increase in aggregate deposits in the 1979-80 financial year was lower at Rs. 4,769 crores (17.7 per cent) compared with Rs. 4,805 crores (21.6 per cent) of increase during the previous year. Component-wise, accretion to time deposits at Rs. 4,078 crores showed an increase compared with Rs. 3,285 crores increase last year, but the rate of growth at 24.5 per cent was about the same as in last year (24.6 per cent). Demand deposits, on the other hand, showed a sharp deceleration in growth at Rs. 691 crores (6.7 per cent) from Rs. 1,520 crores (17.1 per cent) in the last financial year, perhaps because of more banks adopting the definitional change in the apportionment of demand and time portion of their savings bank deposits during the year. The gross credit—deposit ratio as at the end of the year stood at 68.1 per cent which was the same a year ago.

6.19 Banks' borrowings from the Reserve Bank amounted to Rs. 193 crores as against a slightly larger increase of Rs. 215 crores in the last financial year, but their investments showed a larger increase at Rs. 1,509 crores in 1979-80 compared with Rs. 1,212 crores in 1978-79. Increase in cash in hand and balances with the Reserve Bank was marginally higher at Rs. 1,061 crores during the year compared with Rs. 1,048 crores recorded last year.

### Developments in Credit Policy

6.20 In view of the continuous increases in liquidity in the system, the Reserve Bank has been taking a number of credit control measures over the past few years. These measures have been discussed in previous Economic Survey. In December 1978, the Statutory Liquidity Ratio was raised from 33 to 34 per cent. This was expected to prevent excess liquidity in the system from producing secondary credit expansion. The response to this measure by the banking system, however, was not as expected.

The banks instead of increasing their investments in Government securities continued to expand bank credit and in the process not only used up their own resources but also took recourse to outside sources like Participation Certificates. Meanwhile, after the presentation of the Central budget in February 1979, the price level started moving up rapidly giving impetus to inflationary expectations. Since the banks had defaulted in maintaining the stipulated Statutory Liquidity Ratio and Cash Reserve Ratio and had also not restricted credit expansion in accordance with the Reserve Bank's guidelines, further measures to discipline the banks became necessary. Therefore, with effect from March 30, 1979, the Reserve Bank announced that it would refuse access to refinance/rediscout facilities to such of the banks which did not maintain the Statutory Liquidity Ratio of 34 per cent of their demand and time liabilities, and/or defaulted in respect of stipulated 6 per cent average and 10 per cent in incremental Cash Reserve Ratio. In the case of those banks which, in addition to the above defaults, had also utilised refinance facilities as on March 30, 1979, an additional interest of 3 per cent was to be charged on the portion of refinance/rediscout facilities availed of which equalled the shortfall in Statutory Liquidity Ratio and Cash Reserve Ratio.

6.21 In May 1979, the banks were further advised that their non-food credit expansion in 1979-80 should be significantly less than in the previous year, in both relative and absolute terms. They were also asked to ensure that the return flow of funds from seasonal industries which had availed of large credit from the banks was speeded up. Further, the banks were asked to frame a set of internal guidelines for exercising control on credit at the branches. These included, a full and detailed scrutiny for fixing new credit limits or considering enhancement of existing limits, to disregard price rise for fixing credit limits, dovetailing of additional credit strictly to enhancement of output or permitted inventories and to exercise special care in sanctioning credit and its monitoring in respect of sensitive commodities. In particular, the banks were asked to restrict credit on sensitive commodities to traders.

6.22 To reduce the recourse by the banks on outside sources of funds, all scheduled commercial banks were advised on June 21, 1979, that from July 27, 1979, the outstanding Participation Certificates issued by the banks would be treated as deposits and not contingent liabilities as was the case till then and consequently, would be subject to the Statutory Liquidity Ratio and the Cash Reserve Ratio. However, the banks were allowed to bring their

Participation Certificates under the statutory obligations in a phased manner—50 per cent from last Friday of July 1979, 75 per cent from last Friday of August 1979 and 100 per cent *i.e.*, the entire amount of outstanding Participation Certificates from the last Friday of September 1979. In addition, banks were required to maintain with the Reserve Bank an additional average daily balance of not less than 10 per cent of any increase in Participation Certificates over the outstanding level as on July 27, 1979. Further, the practice of excluding the Participation Certificates from the total bank advances by the banks, which used to understate the credit expansion, was to be corrected. The banks were required to give up this practice and include Participation Certificates issued to financial institutions with total bank advances. In consequence, scheduled commercial banks' data published since July 27, 1979 includes Participation Certificates issued on an outstanding basis.

6.23 Keeping in view the trend in production, stocks and prices, selective credit controls have been adjusted in regard to the sensitive commodities. In the case of raw cotton and kapas, inventory levels in respect of which bank advances to mills might be made with minimum margins were raised in March 29, 1979. In the context of the uptrend in the prices of sensitive commodities, particularly sugar, vegetable oils and oilseeds and pulses, the Reserve Bank, on June 29, 1979, tightened controls on advances against these commodities. In the case of sugar, banks were asked to raise the margin requirements on advances against sugar by 10 percentage points, to withdraw the clean limits of Rs. 25 lakhs permitted to sugar mills from September 1978 and to reduce the credit drawn by sugar factories for holding stocks of sugar in line with the release of stocks from factories. Following the reimposition of Government control over the releases of sugar stocks by mills, differential minimum margins were reintroduced for advances to mills against released stocks and against stocks not released (25 per cent). The banks were asked to refrain from granting additional limits against vegetable oils and oilseeds to parties other than the Government and Government supported organisations. As regards pulses, banks were advised that margin of not less than 45 per cent, as against 35 per cent earlier, on advances against these commodities should be levied for processing units and not less than 60 per cent for others as against 50 per cent earlier. Advances against warehouse receipts might be charged lower margins of 40 and 50 per cent respectively.

6.24 Since the measures taken to control credit expansion by the Reserve Bank did not achieve the



expected results and the continued expansion in bank credit became a cause for concern especially in the context of emergence of inflationary pressures in the economy, further measures were introduced on August 24, 1979. Banks were required in the case of all cash credit and inland bills accounts of Rs. 25 lakhs and above, to restrict the effective drawing power of a borrower for the period August 23 to end—December 1979 to 80 per cent of the peak level of actual utilisation reached during the two-year period ended June 1979. This measure has since been extended till the end of June 1980. The Reserve Bank's stipulation of non-food credit expansion to be confined to 40 per cent of the growth in deposits of banks was also to continue. Concomitantly, changes were made in the refinance facility available to banks in respect of food procurement credit and Small Farmers' Window. In the case of the former, food credit in excess of Rs. 2,000 crores was made eligible for refinance only to the extent of 30 per cent instead of 50 per cent from last Friday of September 1979 and as for the latter, the date of the outstanding level for claiming eligibility was shifted forward from January 1, 1978 to last Friday of December 1978. Further, banks which had Participation Certificates above the outstanding level as obtaining on July 27, 1979 were asked to bring them down to the level outstanding on that date.

6.25 The continued bank credit expansion and the unabated rise in price index called for some corrective measures in the structure of interest rates both for restraining credit and for attracting term deposits. Maximum lending rates on short-term advances were raised in September 1979 by 3 percentage points to 18 per cent for banks with demand and time liabilities of Rs. 25 crores and above and to 19 per cent for banks with demand and time liabilities below Rs. 25 crores. The general minimum lending rate on advances/cash credit/overdrafts against commodities covered by selective credit controls viz., foodgrains, oilseeds, vegetable oils and vanaspati, cotton and kapas, sugar, gur and khandasari and cotton textiles was raised from 15 per cent to 18 per cent except in the case of sugar mills and specified categories of cotton textile mills, in respect of which the minimum rates were raised from 12½ per cent and 14 per cent to 15½ per cent and 17 per cent respectively. However, certain categories of advances were exempted from these upward revisions and these included advances to priority sectors specified by the Reserve Bank from time to time, pre-shipment and post-shipment export credit, credit to sick units under agreed nursing programmes, credit to Food Corporation of India and to State Governments and their agencies for procurement/

distribution of foodgrains and notified public sector agencies for procurement/distribution of other commodities. The minimum lending rate of all such preferred categories was left unchanged at 12½ per cent. Advances under Credit Authorisation Scheme were, however, subjected to the hike in interest rate by 3 percentage points. While the trading sector was also brought under the newly raised interest rates a differential rate of increase was applied in respect of advances of Rs. 10 lakhs and above which were subjected to an increase of 3 percentage points on the existing rates, while in the case of those below Rs. 10 lakhs the interest rate was increased by 2 percentage points. The retail trade, included in the priority sector, was exempted from the rise in interest rates. For advances to others, the existing rates were put up by (i) 3 percentage points in respect of advances of Rs. 2 crores and above and (ii) 2 percentage points for advances between Rs. 50 lakhs and Rs. 2 crores, while there was no change on advances of less than Rs. 50 lakhs. As regards term loans, the existing ceiling rate of 12½ per cent was continued on loans for capital investment in priority areas and 14 per cent for other purposes.

6.26 With the inflation rate in the economy showing an uptrend it was apprehended that this would adversely affect deposit mobilisation, particularly term deposits. A marked deterioration in the price situation since March 1979 called for a reappraisal of the interest rate structure of the banks, both for lending and on deposits which had been revised downwards in March 1978 against the background of price stability then prevailing. Consequently, lending rates were enhanced as detailed above. Simultaneously, interest rate on deposits maturing between 9 months and one year was stepped up by half a percentage point and on deposits for longer period of maturity of one year and above by one percentage point. The interest payable on savings bank deposits also was raised from 4.5 per cent to 5.0 per cent with effect from October 1, 1979.

6.27 In the field of medium term finance, with the exemption of Agricultural Refinance and Development Corporation from corporation tax, refinance rates and also maximum rates chargeable by the lending institutions to the ultimate borrowers were reduced from March 15, 1979. From that date, banks were asked to charge interest on loans of not less than three years to farmers at the following rates : (i) for minor irrigation and land development at a rate not exceeding 9.5 per cent (as against the earlier rate of 10.5 per cent) and (ii) for diversified purposes (a) at a rate not exceeding 9.5 per cent to small farmers and (b) not exceeding 10.5 per cent to other farmers (as against

the earlier rate of 11 per cent for both). The refinance rates of ARDC were brought down to 6.5 per cent and 7.5 per cent respectively on loans carrying an interest rate of 9.5 per cent and 10.5 per cent respectively.

6.28 Since the banks were not able to confine non-food credit expansion to the limits indicated by the Reserve Bank during 1979-80, it became imperative to continue with existing credit control measures till June 1980. In addition, the Reserve Bank called upon the banks to ensure that the absolute increase in non-food credit (excluding bills rediscounted with R.B.I. but including Participation Certificates) during the 15 months period i.e., end-March 1979 to end-June 1980 not to exceed the absolute expansion that had taken place in such credit during 15 months period from end-March 1978 to end-June 1979. Some changes were also introduced in the existing refinance facilities. Food refinance would be provided from the last Friday of April 1980 to the extent of 30 per cent of the increase in food credit over the level of Rs. 2,200 crores as against the prevailing level of Rs. 2,000 crores. In regard to export refinance, the base period for calculating the refinance limits of 50 per cent of the increase in export credit was shifted from the monthly average for 1977 to the monthly average for 1978. The banks were also given cer-

tain targets in regard to priority sector lending. Public sector banks were asked to aim at raising the proportion of advances to priority sectors in the total advances from 33 $\frac{1}{3}$  per cent to 40 per cent by 1985. The banks were also asked to participate actively in promoting the implementation of the 20 point Economic Programme which is oriented towards improving the economic well-being of the weaker sections of the community by reducing economic inequalities and to ensure efficient production and equitable distribution of essential commodities.

#### Sectoral Deployment of Gross Bank Credit

6.29 One of the major objectives of banks' nationalisation was to bring about a significant structural transformation in the composition of credit by a conscious diversion of bank credit on an increasing scale to the weaker sections of the community. The priority sectors identified for the purpose of giving bank credit were in consonance with the furtherance of this objective. There has been an impressive rise in the flow of aggregate credit to priority sectors, although regional and rural/urban pattern of deployment of such credit still presents a wide range of variations.

6.30 Data on sectoral deployment of gross bank credit for the financial year 1978-79 and for the period April—December 1979 are tabulated below :

TABLE 6.4  
Sectoral Deployment of Gross Bank Credit

	(Rs. crores)			
	Variations during			
	1977-78	1978-79+	April—December 1978-79	
I. Gross Bank Credit (1 + 2) . . . . .	1895	2895	2736	2476
1. Public food procurement credit . . . . .	(14.2)	(19.0)	(17.9)	(13.6)
2. Gross non-food bank credit (a + b + c + d) . . . . .	2101	2669	2336	1983
(a) Priority sectors . . . . .	(18.8)	(20.1)	(17.6)	(12.4)
(i) Agriculture . . . . .	828	1219	957	1063
(ii) Small-scale industries . . . . .	(24.5)	(29.0)	(22.7)	(19.6)
(iii) Other priority sectors . . . . .	322	496	426	520
(b) Industry (medium and large) . . . . .	(24.0)	(29.8)	(25.6)	(24.1)
(iii) Other priority sectors . . . . .	276	497	416	380
(c) Wholesale trade (other than food procurement) . . . . .	(19.7)	(29.6)	(24.8)	(17.5)
(i) Cotton Corporation of India . . . . .	230	226	115	163
(ii) Food Corporation of India (Fertilizer) . . . . .	(37.0)	(26.1)	(13.3)	(14.9)
(iii) Jute Corporation of India . . . . .	731	882	810	556
(iv) Other trade . . . . .	(13.2)	(14.1)	(12.9)	(7.8)
(d) Other sectors . . . . .	325	261	165	48
II. Export credit (included under item 2) . . . . .	(32.5)	(19.7)	(12.5)	(3.0)
	29	20	-43	6
	161	24	37	-32
	-27	24	12	24
	162	193	159	50
	217	307	404	316
	(17.4)	(21.0)	(27.6)	(17.8)
	91	246	60	65
	(7.9)	(19.8)	(4.8)	(4.4)

+Provisional.

- NOTES : 1. Data relate to banks which account for about 95 per cent of gross bank credit. Further, these data besides taking into account the bills rediscounted with the R.B.I. also include bills rediscounted with the IDBI and other approved institutions and Participation Certificates.

2. Figures in brackets are percentage variations.

6.31 Advances to priority sectors increased by Rs. 1,219 crores in 1978-79 and accounted for 45.7 per cent of total non-food gross incremental credit in that year. In 1977-78, the corresponding percentage was only 39.4 per cent. Though, in absolute terms, credit has increased by Rs. 882 crores to large and medium scale industries which compares with an increase of Rs. 731 crores in 1977-78, in terms of percentage, it accounts for 33.0 per cent of non-food credit as against 34.8 per cent in the previous year. Wholesale trade, after excluding the statutory corporations, has received slightly more bank credit at Rs. 193 crores or 7.2 per cent, while last year at Rs. 162 crores it had accounted for 7.7 per cent of incremental gross credit. The export credit has shown a substantial rise at Rs. 246 crores in 1978-79 compared with only Rs. 91 crores in the earlier year.

6.32 In the 1979-80 financial year upto December 1979, non-food gross credit increased by Rs. 1,983 crores, of which priority sector credit has accounted for by Rs. 1,063 crores in the first nine months of 1979-80; which is 11 per cent more than the credit extended to these sectors in the corresponding period of the previous year. The increase in credit to priority sectors formed 54 per cent of total non-food credit increase in the first nine months of 1979-80 as against 41 per cent in the similar period last year. Among the non-priority sectors, the increase in credit given to medium and large industry was less than the increase recorded in the same period last year. Credit to small-scale industries also increased at a lower rate of 17.5 per cent compared with 24.8 per cent in this period last year.

6.33 The foregoing review of the monetary and credit situation in the country brings out the limitations of monetary measures by themselves to check effectively inflationary pressures in the economy. To some extent, this is because of the banking system not responding in full measure to the corrective measures initiated by the Reserve Bank. The banks' increased recourse to Participation Certificates bears evidence to the fact that at a time when the Reserve Bank's policy was clearly towards restricting credit expansion, the banks, guided by considerations of their own economic viability, have tried to circumvent the Reserve Bank's regulations. Banks also seem to face a difficult situation since a substantial part of their funds get preempted under statutory liquidity regulations into securities which earn a low rate of return, rising costs of operation, high rates on deposits and regulation of their lending into different segments not all of which yield adequate return. Under the circumstances the commercial banks find it a difficult task, to fulfil the twin objectives of profitability and social responsibility.

6.34 On the basis of the experience of the last few years, it is apparent that the restrictive monetary policy has not had as much impact as was hoped for in slowing down inflation. That is because reserve money creation has taken place without interruption and restrictionist policy under these circumstances would have had to assume draconian proportion. Since foreign exchange reserves growth, which was one of the factors responsible for reserve money growth, has slowed down, it is necessary that in the coming years, fiscal policy will minimise budget deficit in order to enable monetary and credit policy play its proper role in the control of inflation.