CHAPTER 7
MONETARY AND CREDIT DEVELOPMENTS

Average annual growth of money supply in the past three years has been over 17 per cent. This had already given rise to an overhang of liquidity in the economy. In 1989–90 so far, overall aggregate monetary resources (M3) and narrow money (M1) has grown more rapidly than in the previous year. There has been a spurt in currency and demand deposits on the component sides. On the sources side, net bank credit to Government recorded a faster growth indicative of increasing strain on Government finances. Bank credit by scheduled commercial banks also grew at a higher rate primarily because of a positive growth in food credit this year so far in contrast with its return-flow last year and there was also a higher increase in non-food credit in absolute terms.

7.2 The basic thrust of the credit policy pursued by the Reserve Bank of India(RBI) during 1989–90 remained on providing necessary support to production and trade while ensuring restraint on excess liquidity growth and consequent inflationary pressures.

7.3 While the Statutory Liquidity Ratio (SLR) was left unaltered at 38 per cent, a uniform Cash Reserve Ratio (CRR) came to be prescribed for all net demand and time liabilities of the Scheduled Commercial Banks effective July 1, 1989 replacing different CRRs for different types of deposits. In view of existing high level of refinance drawn from RBI by the banks which add to the reserve money, RBI came to restrict its refinance on export credit by first shifting the base from monthly average of such credit by banks for 1986 to that for 1987 and then by reducing the limit to 75 per cent from 100 per cent of the increase in export credit over such monthly average. The banks have also been directed to ensure that their incremental non-food credit deposit ratio does not exceed 60 per cent during the fiscal year 1989-90. Banks which exceed this stipulated ratio will have to pay additional interest of 3 percentage points on the refinance drawn from RBI to the extent of excess non-food credit over the stipulated ratio or the refinance drawn whichever is lower. These measures are aimed at both moderating the unusual spurt in non-food credit and urging the banks to be more self-reliant in their operations. While the selective credit control on bank advances against the stocks of vegetable oils and oilseeds came to be liberalised, bank advancs against the stocks of wheat, sugar, gur and khandsari were subjected to higher margin requirements.

7.4 With regard to interest rates the major changes relate to the rates of interest on direct lending to agriculture by commercial banks, export credits and the deposit rate on term deposits of 46-90 days. A major development during the year is the liberalisation of the short-term money market with the removal of ceilings on call money rates, the decision to permit Certificates of Deposit and Commercial Paper at market determined rates and an expansion in the operations of the Discount and Finance House of India.

7.5 For monitoring trends in the monetary area it may be recalled that exercises were taken up since 1986-87 for setting annual indicative monetary targets for internal use in Government. These targets are reviewed periodically. While increases in both net bank credit to the Government (NBCG) and net Reserve Bank Credit to the Central Government (NRCCG) for the full financial year 1988-89 were contained within the respective targets, NRCCG was moving above its targeted growth path almost throughout the year till the early part of March, 1989. The actual growth of M3 exceeded the target, inter alia, because of higher than projected increase in net foreign exchange assets of the banking sector and in bank credit by the scheduled commercial banks as also lower than projected increase in net non-monetary liabilities of the banking sector. For the current financial year 1989-90 also, a similar exercise

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of setting indicative monetary targets and monitoring them has been carried out. The experience of the past few years with these indicative projections is that the actual behaviour of monetary magnitudes fluctuates greately during the year. Further the instruments available for short-term corrections are not effective for fine tuning the rate of growth in money supply. Moreover, the growth in output is particularly difficult to predict and unforeseen variations in production reduce the usefulness of monetary targetting exerecise. Hence the exercise is best thought of as a broad check of consistency between fiscal and monetary policy.

Monetary Trends during 1988-89

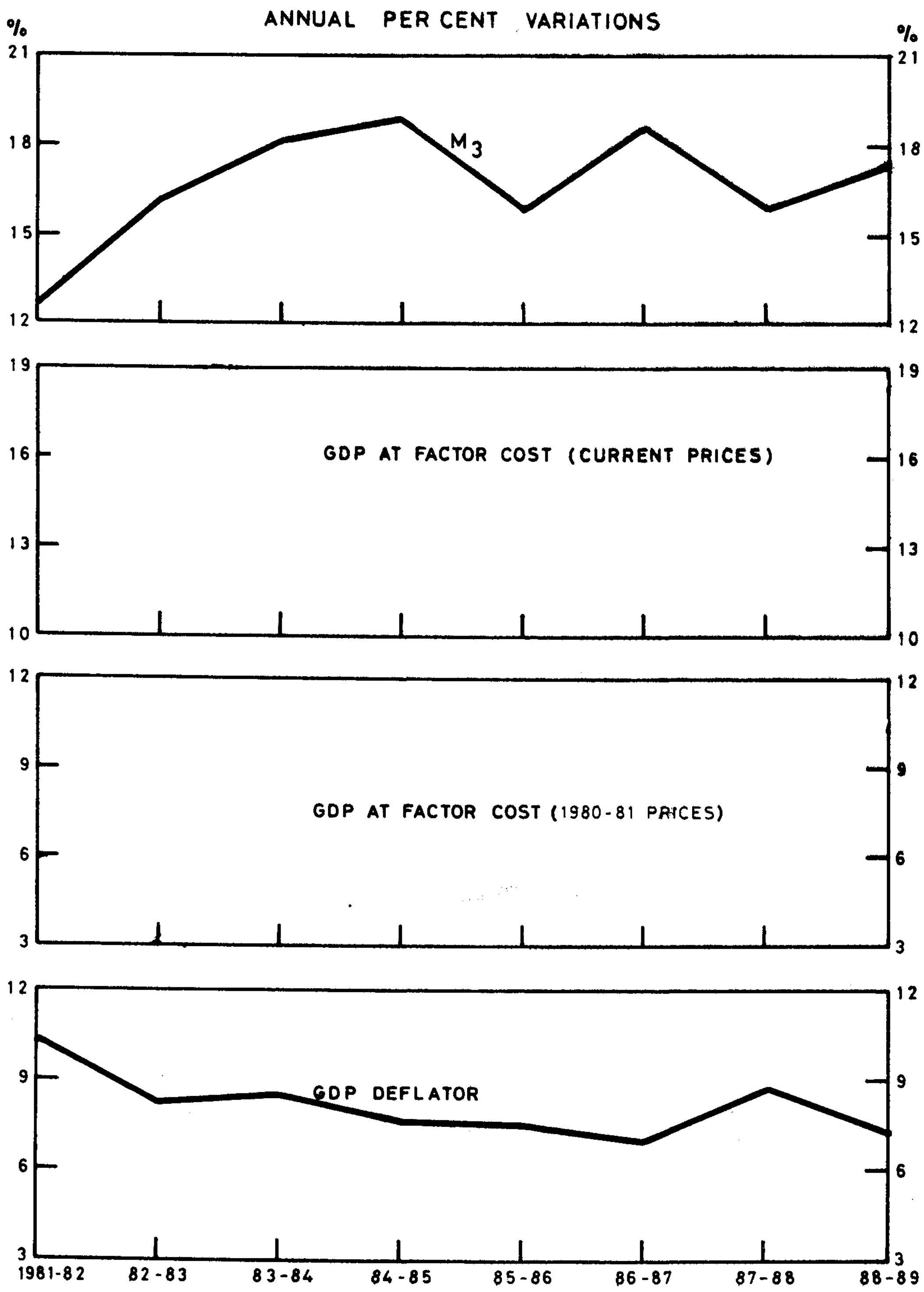
7.6 With the changing of the commercial banks' accounting year to the financial year period, there occurred an unusual year-end bulge in bank desposits and credit in the last week ending March 31, 1989. Demand deposits showed an increase of Rs. 4,579 crores or by 19.6 per cent in this one week; aggregate deposits increased by Rs. 7,010 crores or by 5.0 per cent. Likewise, non-food credit expanded by Rs. 4,643 crores (5.5 per cent) during the same week. These increases were not reflective of financial transactions associated with any enduring economic activity but were partly the result of application of interest on deposits and advances and partly the consequence of closing of accounts by banks on March 31. This quantum jump in bank deposits and credit of banks has seriously vitiated the utility of March 31, 1989 data for making an assessment of the underlying banking and monetary trends. Keeping this in view, the review of banking and monetary trends during 1988-89, as also the current financial year, has been attempted on the basis of an adjusted set of data, i.e., March 31, 1989 data for RBI and Government while data for scheduled commercial banks' operations are based as on March 24, 1989.

7.7 During the financial year 1988-89 both narrow money (Ml) and broad money (M3) expanded at a higher rate than in 1987-88. M1 grew by a higher rate of 14.0 per cent in 1988-89 as against an increase of 13.7 per cent in 1987-88. Similarly, the growth in M3 of 17.7 per cent was larger than that of 15.9 per cent in 1987-88. The larger expansion in both demand and time deposits mainly accounts for the higher growth of broad money. Demand deposits with banks increased by 12.9 per cent as against only 7.8 per cent growth in 1987-88 and the time deposits increased by 19.8 per cent as against an increase of 17.2 per cent in the preceding year. This larger deposits growth is due to a much faster growth in real income in 1988-89 than in 1987-88 and partly to restrictions imposed on portfolio management activities by banks which used to depress the growth of bank deposits and particularly demand deposits. But for the smaller expansion of 14.2 per cent in currency with public as against 18.2 per cent expansion in 1987-88 the growth in M3 would have been higher in 1988-89.

7.8 Looked at from the sources angle, the acceleration in the growth of money supply (M3) in 1988-89 took place despite the smaller growth in net bank credit to Government which had usually been the principal source for acceleration in money supply. In 1988-89 spurt in bank credit to commercial sector (19.0 per cent as against 13.5 per cent growth in 1987-88) mainly accounted for the larger expansion in M3. The spurt in bank credit to commercial sector was due to higher growth both in RBI credit to commercial sector and other banks' credit to the same sector (Rs. 1,734 crores and Rs. 18,661 crores, respectively as against growth of Rs. 396 crores and Rs. 12,350 crores in 1987-88). On the other hand, net bank credit to Government recorded a smaller increase of 14.3 per cent against that of 17.1 per cent in 1987-88 mainly on account of lower rate of growth in other banks' credit to Government. As against a decline of Rs. 157 crores in 1987-88, RBI credit to State Government increased by Rs. 425 crores. The net RBI credit to Central Government expanded by Rs. 6,503 crores, as against Rs. 6,559 crores in 1987-88. Net foreign exchange assets of the banking sector increased by Rs. 784 crores as against Rs. 805 crores in 1987-88.

7.9 Bank credit also witnessed a sharp rise of 20.1 per cent compared to only 11.4 per cent growth in 1987-88. This is to a large extent attributable to the recovery of agriculture and upward trend in industrial production. This will be evident from the higher rise of 22.8 per cent in non-food credit in 1988-89 as against that of

MONEY OUTPUT AND PRICES



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17.4 per cent recorded in 1987-88. However, the decline in food credit (though smaller at Rs. 1,421 crores than the decline of Rs. 2,914 crores in 1987-88) following further depletion in the stocks of foodgrains with public sector agencies, served to moderate to some extent the overall growth of gross bank credt in 1988-89

Monetary Trends During 1989-90

7.10 There has been considerable monetary expansion in the current financial year. Narrow money (M1) has grown by 15.5 per cent upto January 26, 1990 as against the growth of only 9.0 per cent in the corresponding period of the last financial year. Broad money (M3) has also recorded a higher rise of 14.9 per cent as against 14.5 per cent in the relevant period of 1988-89. Among the components, currency with the public has recorded a very high growth of 15.6 per cent compared to only 9.0 per cent in 1988-89. The faster growth in money supply (M1) than that in broad money (M3) this year so far is mainly on account of a sharp rise of 16.3 per cent in demand deposits compared with 9.7 per cent last year. The growth of time deposits decelerated from 17.6 per cent last year to 14.6 per cent this year.

7.11 On the sources side, net bank credit to Government has increased by Rs. 20,387 crores (21.1 per cent) which is much higher than the increase of Rs. 14,641 crores (17.4 per per cent) in the corresponding period of 1988-89. But bank credit to commercial sector though higher in absolute terms this year, has recorded a smaller growth of 10.9 per cent than that of 11.6 per cent last year. Net foreign exchange assets of the banking sector recorded a larger decline of Rs. 724 crores (11.3 per cent) in this year so far than the decline of Rs. 497 crores (8.8 per cent) in the relevant period of 1988-89.

7.12 In the current financial year so far, growth of net RBI credit to government has recorded a significant increase of Rs. 14,056 crores as against that of Rs 8,457 crores in the last financial year. While States' indebtedness to RBI recorded a sharper decline of Rs. 1,200 crores in the current financial year so far than that of Rs. 878 crores in the previous financial year, net RBI credit to Central Government escalated by a larger margin of Rs. 15,256 crores than the increase of Rs. 9,335 crores in the corresponding period of 1988-89. Details may please be seen in Table 7.1.

7.13 Selected indicators relating to the financial operations of the scheduled commercial banks are presented in Table 7.2. In the current year so far i.e. between March 24, 1989 and January 26, 1990, growth in aggregate deposits is larger than in the previous financial year (Rs. 21,963 crores as against Rs. 20,080 crores). The larger increase in aggregate deposits is attributable mainly to the spurt in demand deposits (Rs. 4,438 crores as against increase of Rs. 2,259 crores in 1988-89). Time deposits have recorded lower increase of Rs. 17,525 crores as against Rs. 17,821 crores in 1988-89. Non-food credit has recorded higher growth in absolute terms (Rs. 10,682 crores as against Rs. 9,759 crores), in percentage terms, however, there has been a deceleration in non-food credit growth to 12.7 per cent in the current year so far compared to 13.9 per cent in the comparable period of the previous year. At the same time, food credit has recorded a positive growth (Rs. 1,043 crores) as against a large decline in the same period in the last financial year.

Reserve Money

7.14 Net RBI credit to Government which constitutes the principal source of total reserve money stood at a very high level of 103.3 per cent of the latter at the end of financial year 1986-87 but thereafter declined to 98.5 per cent in 1987-88 and further to 94.7 per cent in the last financial year. The major component of this source is net RBI credit to Central Govrnment which accounted for 102.5 per cent and 93.9 per cent of the variations in net RBI credit to Government in 1987-88 and 1988-89, respectively.

7.15 In 1988-89 the reserve money recorded a smaller expansion of 17.7 per cent compared to 19.4 per cent expansion in the preceding year. This seems somewhat surprising in view of higher rate of money supply growth in 1988-89 than in 1987-88. This apparently contradictory trend may be explained by the fact that 17.7 per cent expansion in reserve money took place in 1988-89 on the top of continued high rates of growth in reserve money in the preceding two years i.e. 1987-88 and 1986-87 (by

19.4 per cent and 17.4 per cent, respectively). Among the important sources of reserve money, while net RBI credit to Government recorded a growth of around 13.8 per cent in 1987-88 and of 13.1 per cent in 1988-89 RBI credit to banks in these two years recorded a very high order of growth i.e. 60.9 in 1987-88 and 59.4 per cent in 1988-89. Most remarkable is the sharp rise in RBI credit to commercial sector by Rs. 1,734 crores (45.8 per cent) in 1988-89 as against only Rs. 396 crores (11.7 per cent) in 1987-88 and in net non-monetary liabilities of RBI by Rs.2,711 crores (19.1

TABLE 7.1

Sources of Change in Money Stock

(Rs. crores)

	Variations during			
	1987-88	1988-89	1988-89	1989-90
	March 31, to March 31	March 31, to March 31 (adjusted)$	March 31, 1988 to January 27, 1989 (P)	March 31, 1989 (adjusted)$ to January 26, 1990, (P)
1	2	3	4	5
I. M1 (Money Supply with the public)	7039 (13.7)	8222 (14.0)	5251 (9.0)	10349 (15.5)
II. M3 (Aggregate monetary resources)	22422 (15.9)	28950 (17.7)	23636 (14.5)	28634 (14.9)
(i) Currency with the public	5177 (18.2)	4761 (14.2)	3019 (9.0)	5977 (15.6)
(ii) Demand deposits with banks	1774 (7.8)	3164 (12.9)	2380 (9.7)	4535 (16.3)
(iii) Time deposits with banks	15383 (17.2)	20728 (19.8)	18385 (17.6)	18285 (14.6)
(iv) 'Other' deposits with RBI	88	297	—148	—163
III. Sources of change in M3 (1+2+3+4—5)				
1. Net Bank Credit to Government (a+b)	12350 (17.1)	12105 (14.3)	14641 (17.4)	20387 (21.1)
(a) RBI's net credit to Government (i+ii)	6402	6928	8457	14056£
(i) To Central Government	6559	6503	9335	15256
(ii) To State Governments	—157	425	—878	—1200
(b) Other Banks' Credit to Government	5948	5177	6184	6331
2. Bank Credit to Commercial Sector (a+b)	12746 (13.5)	20395 (19.0)	12439 (11.6)	13991 (10.9)
(a) RBI's credit to Commercial Sector*	396	1734	607	—581
(b) Other Banks' Credit to Commercial Sector	12350	18661	11832	14572
3. Net Foreign Exchange Assets of the Banking Sector	805 (16.7)	784 (14.0)	—497 (—8.8)	—724 (—11.3)
4. Government's Currency Liabilities to the Public	188 (15.8)	85 (6.2)	45 (3.3)	20 (1.4)
5. Banking Sector's Net Non-monetary Liabilities other than Time Deposits (a+b)	3667 (11.4)	4419 (12.4)	2992 (8.4)	5040 (12.6)
(a) Net Non-monetary liabilities of RBI	781	2711	2000	971
(b) Net non-monetary liabilities of other banks (residual)	2886	1708	992	4069

P—Provisional

* Excludes, since the establishment of NABARD, its refinance to banks.

£ Includes an amount of Rs. 421 crores representing the replacement of non-negotiable non-interest bearing securities issued to IMF by RBI claims on Central Government for facilitating repurchases from the Fund.

$ While variations in respect of sheduled commercial banks are worked out on the basis of their data for the last reporting Friday of March, i.e. March 24, 1989, those for the RBI and others are based on the data for March 31, 1989 after closure of the Government accounts.

Notes : 1. Figures may not add up to totals because of rounding.
2. Figures in brackets are percentage variations.
3. Reserve Bank data are on the basis of closure of Government accounts.

TABLE — 7.2

Scheduled Commercial Banks— Variations in Selected Indicators

(Rupees crores)

	Variations during			
	1987-88	1988-89	1988-89	1989-90
	(March 31, to March 31)	(March 31, 1988 to March 24, 1989)	(March 31, 1988 to January 27, 1989*)	(March 24, 1989 to January 26, 1990*)
1	2	3	4	5
1. Aggregate Deposits (a+b)	15315	21897	20080	21963
(a) Demand Deposits	1040	2569	2259	4438
(b) Time Deposits	14275	19328	17821	17525
2. Borrowings from R.B.I.	847	1303	—1400	—2194
3. Cash in hand and balances with R.B.I. (a+b)	3348	3761	2733	3772
(a) Cash in hand	4	145	169	197
(b) Balances with R.B.I.	3344	3616	2564	3575
4. Net balances with R.B.I. [3(b)-2]	2497	2313	3964	5769
5. Money at call and short notice	—865	1499	75	—1773
6. Gross Bank Credit (a+b)	7492	12470	8286	11725
(a) Public food procurement credit	—2349	—1490	—1473	—1043
(b) Non-food credit	9841	13960	9759	10682
of which :				
to priority sector £	4020	5137	..	..
7. Investments in Government and other approved securities (a+b)	8118	7674	8337	8933
(a) Goverment securities	5815	4954	6070	6230
(b) Other approved securities	2303	2720	2267	2703
8. Balances with other banks in current account	—266	180	136	261
9. Credit-deposit ratio@	61.1	60.4	..	..
10. Non-food credit-deposit ratio@	59.2	59.9	..	..
11. Investment-deposit ratio@	39.7	39.0	..	..

* Provisional

.. Not available.

@ Percentage at the end of the period.

£ Data relate to 50 banks which account for 95 per cent of gross bank credit. Variations are based on last reporting Friday data.

per cent) as against only Rs. 781 crores (5.8 per cent) in 1987-88. Details of changes in reserve money by sources have been presented in Table 7.3

7.16 An important trend in reserve money growth is that in 1988-89 one of its major source viz,, net RBI credit to Central Government (NRCCG) at the end of several fortnights showed much large increases over its March 31, 1988 level than the increase of Rs. 7,484 crores estimated for the full financial year in the Central Budget for 1988-89. In fact, after the sixteenth fortnight, at the end of each fortnight NRCCG showed higher increase over its March 31, 1988 level than Rs. 7,484 crores, though finally on 31st March, 1989 increase in NRCCG over its level on March 31, 1988 was to the tune of only Rs. 6,503 crores—lower than even Rs. 7,484 crores as per 1988-89 (BE). As Centre's Budget deficit is the principal factor contributing to the expansion in NRCCG it can be rightly inferred that Centre's Budget deficit also behaved in the same fashion, reaching much higher levels within the year than the final year end figure of Rs. 5,810 crores at which it stood finally on March 31, 1989 as per RBI's accounts. In fact at the end of 18th, 19th and 23rd fortnights of 1988-89,Centres Budget deficit as per RBI's accounts even exceeded Rs. 10,000 crores. The enclosed chart shows fortnightly deviations of increase in NRCCG and of Centre's Budget deficit in 1988-89 over their acutal annual figure by plotting them as percent of their actual annual level (i.e. as on March 31, 1989).

TABLE 7.3

Sources of Change in Reserve Money

(Rs. crores)

	Outstanding as on March 31, 1986	Variations during†				
		1986-87	1987-88	1988-89	1988-89 March 31, 1988 to January 27, 1989@	1989-90 March 31, 1989 to January 26, 1990@
1	2	3	4	5	6	7
1. Net RBI credit to Government	38,678	7,607 (19.7)	6,402 (13.8)	6,928 (13.1)	8,457 (16.1)	14,056$ (23.6)
2. RBI credit to banks £	2,462	298 (12.1)	1,681 (60.9)	2,638 (59.4)	—1,007 (—22.7)	—2,679 (—37.8)
3. RBI credit to commercial sector*	3,052	342 (11.2)	396 (11.7)	1,734 (45.8)	607 (16.0)	—581 (—10.5)
4. Net foreign exchange assets of RBI	3,741	880 (23.5)	795 (17.2)	785 (14.5)	—497 (—9.2)	—724 (—11.7)
5. Government's currency liabilities to the public	940	252 (26.8)	188 (15.8)	85 (6.2)	45 (3.3)	20 (1.4)
6. Net non-monetary liabilities of RBI	10,707	2,737 (25.6)	781 (5.8)	2,711 (19.1)	2,000 (14.1)	971 (5.7)
7. Reserve Money (1+2+3+4+5—6)	38,166	6,642 (17.4)	8,681 (19.4)	9,459 (17.7)	5,605 (10.5)	9,121 (14.5)

† Variations are worked out on the basis of March 31 data after closure of Government accounts.

@ Provisional.

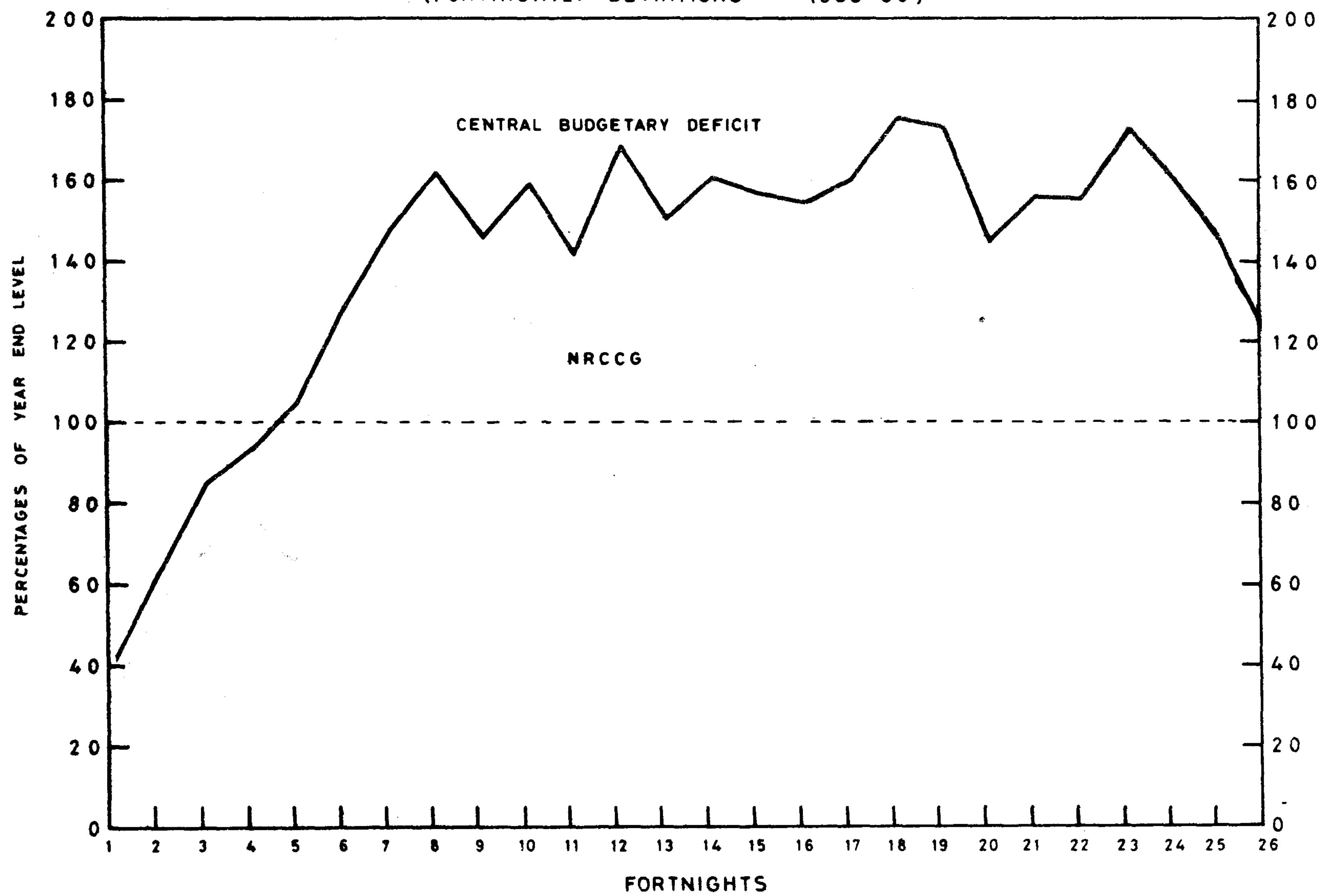
£ Includes claims on NABARD.

* Excludes, since the establishment of NABARD, its refinance to banks.

$ Includes an amount of Rs. 421 crores representing the replacement of non-negotiable non-interest bearing securities issued to IMF by RBI claims on Central Government for facilitating repurchases from the Fund.

INCREASE IN NRCCG AND CENTRAL BUDGETARY DEFICIT

(FORTNIGHTLY DEVIATIONS — 1988-89)



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7.17 In both 1986-87 and 1987-88, Centre's Budget deficit as per RBI accounts and NRCCG remained above their budgetted/year end level in several fortnights and in 1988-89 movement in Centre's budget deficit and NRCCG over their budgetted level was very persistent. Needless to say, orderly growth in money supply throughout the year is desirable and large within year fluctuations in a key monetary variable like NRCCG should be avoided as far as possible. However, such fluctuations may also partly be attributed to various seasonal and other factors relating to the very nature of public finance. For example, the receipts of the Central Government from taxes and small savings tend to bunch in certain months/quarters of the year. Nevertheless, from the point of view of monetary management, what matters is not just the year-end budget deficit or NRCCG stock, but also the average level throughout the year.

7.18 In the current year so far (i.e. between March 31, and January 26, 1990) reserve money has recorded a much higher growth of Rs. 9,121 crores (14.5 per cent) as against an increase of Rs. 5,605 crores (10.5 per cent) in the corresponding period of 1988-89. The comparatively higher growth in reserve money in this financial year so far, has occured despite a significant decline in RBI credit to commercial sector (Rs. 581 crores) and larger decline in RBI credit to banks (Rs. 2,679 crores as against Rs. 1,007 crores in the corresponding period last year) and in net foreign exchange assets of RBI (Rs. 724 crores) only because of much larger rise in net RBI credit to Government Rs. 14,056 crores as against Rs. 8,457 crores a year ago, and a lower increase of Rs. 971 crores in net non-monetary liabilities of RBI compared to that of Rs. 2,000 crores in the similar period of the previous year.

Sectoral Deployment of Credit

7.19 It is important not only to analyse the growth of total bank credit over the years but also to review the sectoral deployment of such credit. Priority sector advances which include advances to agriculture, small scale industries, weaker sections of the community and small transport operators indicate very clearly that banks function as an important catalyst in the socio-economic growth process of the country; not only the scheduled commercial banks have to earmark 40 per cent of their total net bank credit for priority sector, they were also required to attain a target of 17 per cent of their total advances to agriculture by March, 1989. This target was further raised in the current financial year to 18 per cent to be attained by March, 1990. In the current financial year the Indian branches of the foreign banks have also been directed to earmark about 10 per cent of their total advances to the priority sector which includes small scale industries.

7.20 Table 7.4 presents the broad sectoral pattern of the incremental credit deployed by 50 scheduled commercial banks which account for about 95 per cent for bank credit in the country. It shows that credit to priority sectors as a percentage of the net bank credit in the last month of the financial year had been exceeding the 40 per cent target, though in 1988-89 the percentage of priority sector credit to net bank credit declined by one percentage point to 43.1 from 44.1 at the end of March, 1988. In the first half of the current financial year also though the percentage of priority sector credit to total net bank credit exceeded 40 per cent, it was lower at 42.4 per cent as compared with 43.9 per cent in the corresponding period of the last financial year.

7.21 As in 1987-88, in 1988-89 also agriculture and small scale industries accounted for the bulk of Rs. 5,137 crores of increase in priority sector advances. Credit to agriculture registered a higher growth rate of 16.1 per cent (Rs. 1,939 crores) as against a growth rate of 13.6 per cent (Rs. 1,439 crores) in 1987-88. Similarly, advances to small scale industries rose by 21.3 per cent (Rs. 2,307 crores) as compared with a rise of 18.8 per cent (Rs. 1,712 crores) in the previous year. Other priority sectors like retail trade, small business, rural artisans and small transport operators accounted for an increase of Rs. 891 crores (14.3 per cent) as against an increase of Rs. 869 crores or 16.2 per cent in 1987-88).

7.22 Credit to large and medium industries increased by 27.8 per cent (Rs. 7,005 crores) which is ten percentage points higher than the growth rate of 17.8 per cent (Rs. 3,797 crores) in the previous year. The advances to wholesale trade other than food procurement registered a growth rate of 32.4 per cent which is nearly twice its growth rate of 16.8 per cent in 1987-88. Another noticeable feature of non-food bank credit expansion during 1988-89 has been the sharp increase in export credit by 56.8 per cent, which has far exceeded its rate of growth of 24.5 per cent in 1987-88.

TABLE 7.4

Sectoral Deployment of Gross Bank Credit

(Rs. crores)

On the last reporting Friday basis	Variations during									
	1986-87		1987-88		1988-89		April-September 1988		April-September 1989	
	Rs. crores	Per cent	Rs. crores	Per cent	Rs. crores	Per cent	Rs. crores	Per cent	Rs. crores	Per cent
I. Gross Bank Credit	7356	13.3	7691	12.3	15418	21.9	4135	5.9	6860	8.0
1. Public Food Procurement	—431	—7.8	—2914	—57.1	—1421	—64.9	—866	—39.5	60	7.8
2. Gross Non-food Credit (a+b+c+d)	7787	15.7	10605	18.4	16839	24.7	5001	7.3	6800	8.0
(a) Priority Sector (i+ii+iii)	3484	16.2	4020	16.0	5137	17.7	1856	6.4	2540	7.4
(i) Agriculture	1512	16.7	1439	13.6	1939	16.1	770	6.4	946	6.8
(ii) Small Scale Industry	1292	16.5	1712	18.8	2307	21.3	782	7.2	1053	8.0
(iii) Other Priority Sectors	680	14.5	869	16.2	891	14.3	304	4.9	541	7.6
(b) Industry (Medium & Large)	2934	15.9	3797	17.8	7005	27.8	1784	7.1	3067	9.5
(c) Wholesale Trade (Other than food procurement) (i+ii+iii+iv)	14	0.4	518	16.8	1166	32.4	370	10.3	290	6.1
(i) Cotton Corporation of India	—51	—31.9	—18	—16.5	—54	—59.3	—91	—100.0	—37	—100.0
(ii) Food Corporation of India (Fertilizer)	8	5.7	22	14.8	31	18.1	17	9.9	16	7.9
(iii) Jute Corporation of India	71	55.9	—56	—28.3	—82	—57.7	—49	—34.5	—38	—63.3
(iv) Other Trade	—14	—0.5	570	21.7	1271	39.8	493	15.4	349	7.8
(d) Other Sectors	1355	20.5	2270	28.4	3531	34.4	991	9.7	903	6.6
II. Export Credit (included under item 2)	737	30.6	771	24.5	2225	56.8	474	12.1	882	14.4
Priority Sector Advances as Percentage of Net Bank Credit (including inter-bank participations) in the last month of the period	42.2		44.1		43.1		43.9		42.4	

NOTE : Data are provisional and relate to 50 scheduled commercial banks which account for about 95 per cent of the bank credit of all scheduled commercial banks. Gross Bank Credit data include bills rediscounted with RBI, IDBI, Exim Bank and other approved financial institutions and inter-bank participations. Net Bank Credit data are exclusive of bills rediscounted with RBI, IDBI, Exim Bank and other approved financial institutions.

7.23 In the current year sectoral break-up of bank credit is available upto September, 1989 during which incremental credit to medium and large industry account for Rs. 3,067 crores (about 45 per cent) of the increase in non-food credit (Rs. 6,800 crores) and priority sector advances contributed another Rs. 2,540 crores. Increase in export credit (Rs. 882 crores) was nearly twice the increase of Rs. 474 crores in the same period of 1988-89. Credit to all the major sectors within non-food category registered higher growth rates during April-September 1989 than in April-September 1988 except credit to wholesale trade which increased at lower rate of 6.1 per cent as against 10.3 per cent recorded during similar period last year.

Structure of Interest Rates

7.24 Interest rate policy is both an important plank of the monetary and credit policy and an important tool of economic management. The interest rate instruments help the monetary authority and development planners to influence not only the volume and the rate of savings and investment but also directions of credit flows and investment to attain desired objectives of economic growth with price stability. Though interest rates in our country are to a large extent administered, they have been revised from time to time in the context of emerging trends and needs.

7.25 In 1988-89 the Reserve Bank had taken an important initiative towards imparting flexibility in the lending rates of the scheduled commercial banks when in October 1988, it introduced a minimum of 16.0 per cent per annum on all bank advances which were till then subject to a fixed (ceiling) rate of 16.5 per cent per annum. This measure gave banks greater freedom in fixing their lending rates, though they were advised by the RBI to exercise their discretion judiciously in deciding interest differentials and to ensure that the range of interest rates charged remained within reasonable limits. It also was designed to benefit disciplined bank borrowers with good track records and credit ratings. In the present financial year another step in this direction of adding flexibility to the administered structure of lending rates was taken when Reserve Bank decided under its busy season credit policy announced on October 9, 1989 to specify a floor rate of 15 per cent for term loans to road transport operators with three or more vehicles and other term loans which the banks used to grant at a fixed rate of 15 per cent effective from October 11, 1989. It is expected that flexibile interest rate on term loans by banks would promote efficiency in the use of such loans. Banks were also advised to use this discretion to charge varying rates of interest on term loans judiciously to ensure that interest rates charged remained within reasonable limits. However, the interest rates on such term loans which carried less than 15 per cent interest rate like term loans to agriculture, special programme, self-employed SC/ST persons etc. were left unaltered.

7.26 Similar floor rate of 16 per cent came to be prescribed also in the case of housing loans exceeding Rs. 3 lakhs with the withdrawal of the earlier ceiling of Rs. 3 lakhs on housing loans to individuals by commercial banks. It was felt that while the present thrust on financing smaller houses should continue there might be some genuine cases for the grant of housing loans exceeding Rs. 3 lakhs to individuals which the banks could accept but with a freedom to charge higher interest rates. It may be noted that earlier banks were to provide term loans for housing over Rs. 1 lakh to Rs. 3 lakhs and charge an interest rate in the range of 14.5 to 16 per cent. These rates and the rates of interest on smaller housing loans including 4 per cent interest rate on housing loans for Scheduled Castes and Tribes upto and inclusive of Rs. 5,000 were left unaltered. Among the other lending rates, interest rate on farm loans and on post and pre-shipment export credit were revised downwards in a bid to give a boost to agricultural production and to encourage export trade. Interest rate on farm loans over Rs. 15,000 to Rs. 25,000 was reduced to 12 per cent from the range of 12.5—14 per cent, while the interest rate range of 14-15.5 per cent on short-term farm loans exceeding Rs. 25,000 was left unaltered. The exiting structure of interest rate on short-term loans to farmers (effective March 1, 1989) is indicated in Table 7.5 below :

TABLE 7.5

Existing Interest Rates on Short-term loans to farmers

(Per cent per annum)

Range of loan	Interest Rate
(i) Upto Rs. 5,000	10.00
(ii) Over Rs. 5,000 and upto Rs. 7,500	10.00
(iii) Over Rs. 7,500 and upto Rs. 10,000	11.50
(iv) Over Rs. 10,000 and upto Rs. 15,000	11.50
(v) Over Rs. 15,000 and upto Rs. 25,000	12.00
(vi) Over Rs. 25,000	14.00—15.50

7.27 As regards export credit, the interest rate on pre-shipment export credit upto 180 days was reduced to 7.5 per cent from 9.5 per cent with effect from March 1, 1989 and that on such credit from 180 days to 270 days was reduced from 11.5 per cent to 9.5 per cent. Correspondingly the interest rate on post-shipment export credit was reduced to 8.65 per cent from 9.5 per cent effective March 1, 1989.

7.28 Yet other important development in the field of interest rate policy is the removal of interest ceiling on money market rates to make them flexible and lend transparency to transactions in the money market. This ceiling on call money market rate was fixed by the Indian Banks Association (IBA) so as to prevent excessive fluctuations in these rates. Even when RBI permitted in October, 1988 the issue of inter bank participations, it was laid down that such participations without risk sharing would be issued at an interest rate to be determined between the issuing bank and the participating bank subject to the ceiling of 12.5 per cent. Simultaneously with the decision to withdraw the 10 per cent ceiling on call/notice money, the ceiling of the 10.5—11.5 per cent rate on inter-bank term money, 12.5 pr cent on rediscounting of commercial bills and on inter-bank participations without risk was also withdrawn. The new instruments viz. CD and CP were allowed to be issued at a freely determined discount rate. It may also be added here that this liberalisation of money market rates of RBI had been preceded by freeing the operations of the Discount and Finance House of India (DFHI) in call/notice money market from the interest rate ceiling set by IBA. These initiatives are in consonance with maturing of Indian money market and diversification of instruments and in the interest of greater flexibility and transparency.

7.29 As regards interest rates on term deposits of the scheduled commercial banks, a number of measures were taken in the last two financial years to bring short term interest rates on deposits in better alignment with other interest rates in the system to yield better return on the deployment of short term funds and to introduce flexibility in the deposit rate structure. In continuation of these measures, effective March 28, 1989, the rate of interest on term deposits of the scheduled commercial banks for 46 to 90 days (excluding FCNR and NRE deposits) was raised to 6 per cent from 4 per cent and the category of term deposits of 15 days to 45 days enjoying 3 per cent interest was abolished, making 46 days the minimum maturity of term deposits. The interest rate on the deposits of 46 to 90 days (excluding FCNR and NRE deposits) was further raised to 8 per cent effective October 11, 1989, thereby making the interest rate same (i.e. 8 per cent) for all term deposits from 46 days to less than a year. Interest rates on Foreign Currency (Non-Resident) Accounts which differ for four different foreign currencies viz. Pound Sterling, Dollar, Yen and Deutsche Mark were revised several times during the year in the light of changes in the interest rate on these currencies in the overseas markets. Interest rates on postal deposits, debentures, small savings schemes were left unaltered excepting that in the case of National Savings Certificate (NSC) VIth and VIIth Issues came to be discontinued in the Central Budget for 1989-90 in which it was announced that a new series of NSC (VIIIth Issue) would be marketed with an interest rate of 12 per cent which would be eligible for tax concession under Sec. 80C but not under 80L. The existing structure of interest rates for some selected categories of deposits and financial instruments is indicated in Table 7.6.

TABLE 7.6

Existing Structure of interest rates : Some Selected Categories

(Per cent per annum)

I. Scheduled Commercial Banks' Deposits :	
(i) 1—45 days	0.0
(ii) 46 days and above but less one year.	8.0
(iii) One year and above but less than two years	9.0
(iv) Two years and above . .	10.0
II. Non-Resident (External) Rupee Accounts :	
(i) 6 months and above but less than one year.	8.5
(ii) One year and above but less than two years	10.5
(iii) Two years and above but less than three years	11.0
(iv) Three years and above but less than 5 years .	12.0
(v) Five years and above . .	13.0

	Pound Sterling	US Dollar	Deutsche Mark	Japanese Yen
III. Foreign Currency (Non-Resident) Accounts :				
	(Rate effective February 21, 1990)			
(i) Six months and above but less than one year.	11.50	8.75	9.25	7.75
(ii) One year and above but less than two years	11.75	9.00	9.75	8.00
(iii) Two years and above but less than three years	12.00	9.50	9.75	8.00
(iv) Three years only	12.00	9.75	9.75	8.00
IV. Other Financial Instruments :				
(i) Convertible debentures :				
(a) FERA & MRTP Cos.			12.5	
(b) Non-FERA & Non-MRTP Cos.			14.0	
(ii) Non-Convertible debentures			14.0	
V. Post Office Savings Schemes :				
(i) One year time deposits.			9.5	
(ii) Two year time deposits.			10.0	
(iii) Three year time deposits .			10.5	
(iv) Five year time deposits.			11.0	
(v) Five year recurring deposits			11.0	
(vi) National Savings Certificates (VIII issue)			12.0	
VI. Bank Advances			16.0 (Minimum)	

Developments in Credit Policy

7.30 In the current financial year 1989-90 the basic thrust of the monetary policy continued to be on the controlled expansion of money and credit so that production activities in the economy would get adequate credit support while the liquidity growth in the system is moderated to contain inflationary pressures. The Reserve Bank has also sought to promote the efficiency of operation of the financial system by bringing about some structural changes, introducing new instruments and strengthening old ones.

7.31 In the very beginning of the current financial year a higher target for farm loan by the scheduled commercial banks came to be stipulated in the Central Budget for 1989-90. The target expressed as a percentage of gross bank credit was raised from 17 per cent to 18 per cent to be attained by the banks by the end of March, 1990. This would mean about additional Rs.4,000 crores of credit for farmers in the current financial year.

7.32 While the Statutory Liquidity Ratio of 25 per cent on FCNR and NRE deposit liabilities and 38 per cent on net time and demand liabilities were left unaltered, banks were asked to maintain a uniform CRR of 15 per cent on their entire net demand and time liabilities including FCNR and NRE Accounts, with effect from the fortnight beginning July 1, 1989. It may be recalled that banks used to maintain earlier a CRR of 11 per cent on their net demand and time liabilities (excluding FCNR and NRE Accounts) and 10 per cent additional CRR on increase in net demand and time liabilities over the level as on November 11, 1983 while for FCNR and NRE deposits lower CRRs of 10 per cent and 3 per cent respectively—all these subject to an overall ceiling of 15 per cent on the entire net demand and time liabilities. Most banks were already operating on an effective CRR of 15 per cent. RBI felt the need for simplyfying the multiple prescriptions into a single prescription. In the case of banks where the existing effective CRR was less than 15 per cent, Reserve Bank set out to individual banks a phased programme of adjustment for attaining a CRR of 15 per cent, beginning from July 29, 1989. Banks were advised to give priority to meeting their reserve requirements over their lending operations and to avoid mismatch of their assets and liability portfolio so that they did not have to rely on money market funds for meeting their reserve requirements.

7.33 Following the normal practice of bringing forward the base for determining export finance each year, RBI brought forward by one year the base period from 1986 (monthly average of export credit) to 1987 (monthly average of such credit) and banks' export credit refinance from RBI was limited to 100 per cent of increase of such credit over the monthly average for 1987. Although this brought down banks' access to export refinance, it would be quickly regained as they expanded export credit, well before they needed to utilise a substantial part of their refinance limits. Again the interest rate on refinance under 182 days Refinance Facility available to banks (upto 50 per cent of their holdings of such treasury bills) was raised from 10.25 per cent to 10.75 per cent per annum with effect from March 28, 1989, in view of the rise in cut-off yields on these bills in latest auctions.

7.34 Reserve Bank's concern at risk management by banks became apparent when it directed the banks to limit exposure of a bank (including all sanctioned and non-funded limits) to an individual business concern and to business concerns of a group at 25 per cent and 50 per cent of that bank's capital funds, respectively. These stipulations were meant to be strictly followed by banks while sanctioning fresh credit limits and they were allowed tweleve months' time to rectify excess, if any. However, credit limit directly allocated by RBI such as food credit was kept out of the purview of these stipulations. Further in the case of portfolio/fund management services provided by banks in respect of medium/long term funds, effective March 28, 1989 a minimum lock-in period of one year came to be stipulated for such portfolio/long term funds. RBI also directed the banks having merchant banking subsidiaries to ensure that their subsidiaries did not do what they themselves were prohibited from doing in respect of portfolio/funds management.

7.35 While reviewing the growth of aggregate deposits, food and non-food credit in October, 1989 RBI found that between March and September, 1989 aggregate deposits registered a growth of Rs. 12,297 crores as against an estimate of Rs. 11,500 crores and the food credit had increased by only Rs. 33 crores (increase of Rs. 890 crores in April-June, 1989 offset by a decline of Rs. 857 crores in the next quarter). However, non-food credit growth surpassed the target of Rs. 3,500 crores for the six month period (April-September) by a margin of Rs. 780 crores (actual figure of growth being Rs. 4,280 crores). In percentage terms on 24th March basis the increase in non-food credit was the same (5.1 per cent) as the increase recorded in the similar period of the previous year though in all possibilities the rate of growth to be recorded by the economy in 1989-90 is definitely slower than that in 1988-89. Further, this increase came on the top of a very strong (in fact the highest in 1980's) growth in non-food credit in 1988-89. It was also found that banks were having an average excess of liquid assets (nearly Rs. 1,100 crores in the fortnight ended August 25, 1989). They had also large amount of unutilised refinance limits. Prices remained under considerable pressure from the beginning of current financial year.

7.36 Reserve Bank, therefore, came to adopt a policy of moderation and restraint in the expansion of money supply and particularly of non-food credit for the second half of the financial year 1989-90. Its busy season credit policy announced on October 9, 1989 indicated a cautious stance with regard to its refinance extended to scheduled commercial banks who were advised not only to exercise utmost caution with regard to expansion of non-food credit but also to be more self-sufficient in funds in their credit operations. Restriction on refinance from RBI to Scheduled Commercial banks was felt necessary in view of the fact that it is a major source of reserve money and has an expansionary effect on money supply.

7.37 Effective November 4, 1989 the limit of the export credit refinance available to banks came to be reduced to 75 per cent from 100 per cent of the increase in export credit over the monthly average level of such credit for 1987. It may be mentioned here that as on October 6, 1989 their export credit refinance limit amounted to Rs. 3,336 crores (or 52.9 per cent of outstanding export credit) compared to Rs. 3,002 crores (or 53 per cent of outstanding export credit) at the end of March, 1989. In spite of the reduction in the limit as stated above export credit refinance to be available to them remained at over Rs. 3,000 crores. Until a few years ago the export credit refinance limit available to banks was only 50 per cent of the increase in export credit over the base year. With CRR reaching at the ceiling level of 15 per cent and SLR being stipulated at 38 per cent, the only potent weapon available in the hands of Reserve Bank for preventing excessive creation of credit appears to be the restriction of its refinance facility.

7.38 Again with effect from November 4, 1989 banks were asked to maintain an incremental non-food credit-deposit ratio of 60 per cent (with March 24, 1989 as the base for determining the increment), failing which they would have to pay additional 3 percentage points interest on their refinance from RBI under all facilities (export, stand-by, discretionary and 182 days' Treasury Bills) to the extent of the excess non-food credit over the stipulated ratio or the refinance drawn, whichever is lower. As is well known, the incremental non-food credit-deposit ratio also remains otherwise below 100 per cent because of banks' CRR and SLR obligations. This restriction on incremental non-food credit-deposit ratio only sought to ensure that the non-food credit growth of the scheduled commercial banks should be commensurate with the growth of their own resources.

7.39 Reserve Bank further announced its decision on October 9, 1989 that with effect from October 21, 1989 banks would have to pay additional 3 percentage points interest on refinance over the call money lending rate of the Discount and Finance House of India, if they were found to be lending in the call money market when they had already outstanding borrowings from RBI under standby/discretionary refinance facilities. Further the banks were warned that facilities of standby and discretionary finance available to them would be withdrawn if they were found to be violating the stipulation flagrantly. As a background to this decision, it may be stated here that banks were cautioned by RBI even in October, 1987 that they could not both draw refinance from RBI and lend in the money market simultaneously and that in case the stipulation was violated flagrantly, continuation of refinance facilities to them would be reconsidered.

7.40 As regards selective credit controls in respect of price-sensitive commodities, it may be recalled that with effect from February 10, 1989, minimum margins on advances against oilseeds and vegetable oils (including vanaspati) were reduced across-the-board by 15 per centage points and ceiling on such advances was raised from 85 per cent to 100 per cent of the peak level of credit to any party during any year of the three years period 1983-84, 1984-85 and 1985-86 (November-October), following an improved out put of these commodities. There was another reduction in minimum margins by 15 percentage points for bank advances against oilseeds and vegetable oils (including vanaspati) in respect of advances to 'others' and 'against warehouse receipts' effective from March 28, 1989, as a consequence of a further review of price-output trends. On the other hand, because of the prevailing high price of wheat in the market, minimum margin in respect of bank advances to processing units/mills in Punjab against stock of wheat was brought up to 45 per cent (or to the same level prevailing in other states) from 30 cent to which minimum margin was reduced on September 19, 1988.

7.41 Again, as in earlier years, for 1989-90 also with effect from March 28, 1989 three year base period specified for the stipulation of ceilings on bank advances subject to selective credit control, was brought forward by one year from 1983-84, 1984-85 and 1985-86 (Noveoer-October) to 1984-85, 1985-86 and 1986-87 (November-October). However, the level of credit ceiling was left unaltered at 100 per cent for oil seeds and vegetable oils (including vanaspati) and 85 per cent for other commodities.

7.42 On a subsequent review of price-output trends with effect from April 22, 1989 the minimum margins on bank advances against wheat were raised across-the-board by 15 percentage points. However, with the improvement in price-output situation these margins were brought back to former levels on July 20, 1989. It may also be mentioned here that effective April 22, 1989 advances to roller flour mills exempt earlier from the credit ceiling stipulation, came to be subject to a credit ceiling of 85 per cent of the peak level of credit maintained by a party in any year of the three year base period noted earlier.

7.43 Minimum margins on advances against the stocks of sugar for processing units/mills were raised effective from July 20, 1989 by 7.5

percentage points in the case of unreleased stocks and by 15 percentage points across-the-board for the released stocks. In the case of gur and khandsari, minimum margins were also similarly raised across-the-board by 15 percentage points with effect from July 20, 1989.

7.44 Towards the end of 1989, following a further review of price-output trends, the credit ceilings and minimum margins came to be revised with effect from December 30, 1989 for certain commodities. Higher ceiling of 100 per cent came to be stipulated for bank advances against wheat, cotton and kapas. Minimum margin on bank advances against cotton and kapas was reduced to 30 per cent from 45 per cent. So also was the minimum margin on bank advances against unreleased stocks of sugar in the case of processing units/mills reduced to 20 per cent from 25 per cent.

7.45 Table 7.7 presents the details of existing margins on bank advances against stocks of commotities covered under selective credit controls.

TABLE 7.7

Minimum Margins on Bank Advances Against Stocks of Commodities covered under Selective Credit Control

(Percentages)

	Effective December 30, 1989		
	Against stock		Against warehouse receipts
	Processing Units/Mills	Others	
1. Paddy/Rice	45	60	45
2. Wheat	45	60	45
3. Other foodgrains (other than paddy/rice and wheat)	45	60	45
4. Pulses	45	6)	45
5. Oilseeds viz., groundnut, rapeseed/mustardseed, linseed, castorseed, cottonseed and all imported oilseeds	30	45	30
6. Vegetable oils viz., Groundnut oil, rapeseed/mustard oil, linseed oil, castor oil, cottonseed oil, vanaspati and imported vegetable oils	30 @	45	30
7. Cotton and kapas	×	30	30
8. Sugar			
(a) Buffer	0	—	—
(b) Unreleased stocks	20	—	—
(c) Released	75	75	60
9. Gur and Khandsari	45	75	60

× Completely exempt from all the stipulations of selective credit control.

@ Applicable to registered oil mills and vanaspati manufacturers.

— Not applicable.

Credit by Term Lending Institutions

7.46 The rising trend in the aggregate sanctions and disbursements by all term lending institutions noticed in the past several years continued in 1988-89. Aggregate assistance sanctioned by them in 1988-89 stood at Rs.14,203 crores which is 54.9 per cent higher than total assistance sanctioned in 1987-88. All India Financial Institutions like IDBI, ICICI, IFCI, LIC, GIC and UTI accounted for an overwhelming portion (83.4 per cent) of the total assistance sanctioned by all financial institutions in 1988-89. Sanctions in the form of Rupee loans recorded a significant rise of 44.1 per cent or Rs.10.973 crores as against 25.7 per cent rise in 1987-88. All India development banks account for about two-thirds of the rupee loans sanctioned in 1988-89. Higher amounts of assistance were received in 1988-89 than in 1987-88 by all industries excepting paper, basic chemicals, metal products and transport equipments. In 1988-89 credit sanctioned to backward areas was to the tune of Rs.5,178 crores which is 56.5 per cent higher than credit of Rs.3,308 crores in the previous financial year. This order of increases in flow of credit in 1988-89 to backward areas is significant since in 1987-88 these areas were sanctioned only 8.7 per cent higher credit over 1986-87 level.

7.47 Data are available for the current financial year only for the six month period i.e. April-September, 1989. During this first half of the current financial year the total assistance sanctioned by all financial institutions was of the order of Rs.6,829 crores—7.6 per cent lower compared to Rs.7,392 crores in the first half of 1988-89. Disbursements were also lower in the first half of 1989-90 at Rs.4,084 crores i.e. 1.3 per cent lower than Rs.4,149 crores disbursed in the corresponding period of 1988-89. In this period too the All India financial institutions accounted for lion's share of sanctions and disbursements made by these all financial institutions. Institution-wise details of sanctions and disbursements are presented in Appendix Table 4.8.

Developments in the money market

7.48 Reserve Bank of India and Government have continued to take various measures to strengthen the Indian money market. In August 1989, Government of India have remitted the stamp duty on usance bills and thereby removed a major administrative constraint in the use of bill system.

7.49 A significant step towards the activation of money market taken by the Reserve Bank has been the total deregulation of money market interest rates with effect from May 1, 1989 introducing thereby greater transparency to the transactions in the money market, details of which have already been given in para 7.28 above. Earlier in March, 1989 Reserve Bank took a decision to introduce Certificates of Deposit (CD) and Commercial Paper (CP) in order to widen the range of money market instruments and give investors greater flexibility in the deployment of their short-term surplus funds. Besides CP would enable the highly rated corporate borrowers to diversify their sources of short-term borrowings.

7.50 The Certificates of Deposit (CD) can be issued only by the Scheduled Commercial Banks in multiples of Rs. 25 lakhs subject to the minimum size of an issue being Rs. 1 crore. With a maturity between three months and one year CDs will be issued at discount to face value, the discount rate to be freely determined and they would be further freely transferable by endorsement and delivery but only after 45 days from the date of issue. CDs would, however, be subject to reserve requirements. Banks would neither be allowed to grant loans against CDs nor can they buy back their own CDs. At any point of time, total outstanding of CDs issued by a bank should not exceed one per cent of its fortnightly average deposits during the financial year 1988-89.

7.51 CP would be issued by a listed company (listing on stock exchange, however, not required for public sector companies) which have a net worth of at least Rs. 10 crores and a working capital (fund based) limit of not less than Rs. 25 crores. With maturity ranging from three months to six months, they would also be issued like CDs at a discount to face value (discount rate being freely determined) in multiples of Rs. 25 lakhs subject to the minimum size of an issue being Rs. 1 crore CPs would be freely transferable by endorsement and delivery. Since it is in the nature of an unsecured promissory note not leading to any specific transaction, it would attract stamp duty and be privately placed with investors (excluding non-residents) through the agency of banks and other financial institutions.

7.52 The company issuing CP would have to obtain every six months a specified rating from an agency approved by the Reserve Bank. It can raise money through such CP upto a maximum amount equivalent to 20 per cent of its working capital (fund based) limit. Banks would not be permitted to either underwrite or co-accept the issue of CP. However, Reserve Bank would authorise the timing of issue of CP by the eligible companies in order to ensure an orderly queue and once an issue is actually placed, the concerned bank would be required to suitably adjust the working capital (fund based) limit for the company.

7.53 The Reserve Bank has since issued guidelines for the issue of CP on January 3, 1990, according to which a company will have to obtain P1+rating from Credit Rating Information Services of India Ltd. (CRISIL) and also classification under Health Code Number 1 from its financing banks and it has also to maintain the current ratio of 1.33:1, to be eligible to issue CP. Non-Resident Indians can invest in CP only on a non-repatriable basis and such CP will also be non-transferable. As CP will be curved out of the working capital limit of the company, there will be no rise in its overall short-term financing facilities.

7.54 The Reserve Bank has been also urging the borrowers to moderate their reliance on money market and limit it to marginal requirements for equilibrating their sources and uses of funds. Similarly, lenders have been advised to ensure that their activities were conducive to the emergence of a stable and mature money market. In the interest of stability and depth of the money market, the participants in the market should move between lending and borrowing activities.

7.55 The Study Group which was appointed by the Rreserve Bank to examine the feasibility and mechanics of starting factoring organisations and make recommendation regarding their constitution, organisational set up and scope, etc. submitted its report in January, 1989. Most of the recommendations in the report were accepted, in principle, by the Reserve Bank which decided in March, 1989 to initiate steps to establish domestic-factoring services as a first priority and to extend it later to exports in the light of experience at home and felt needs for such services. The Reserve Bank would take steps to promote special legislative measures to introduce factoring services on a full fledged basis, as recommended by the Study Group.

7.56 Following the withdrawal of ceiling of 10 per cent per annum on call money rate from May 1, 1989, the rates grew sharply to a range of 30-34 per cent by the later part of May, 1989 but thereafter they subsided rather quickly to level as low as 5 per cent. Borrowers found it unremunerative to borrow at such high rates and alternative sources of funds at lower rates were also available. The slack season too led to easing of underlying demand for funds.

Institutional Developments in the Financial Sector

7.57 The Discount and Finance House of India Limited commenced its operations on April 25, 1988. It has been endeavouring to bring into the fold of the Indian money market the entire financial system comprising the scheduled commercial banks, public sector banks, foreign banks and private sector banks, co-operative banks, Scheduled State co-operative banks and Scheduled urban co-operative banks, all-India financial institutions and non-banks in the public and private sectors so that their short-term surpluses and deficits are equilibrated at market related rates/prices through inter-bank transactions in the case of banks and through money market instruments in the case of banks and others.

7.58 It is participating in the inter-bank call and short notice money market and inter-bank term deposit market, both as borrower and a lender. Apart from dealing in the money market instruments such as 182 Days Treasury Bills, commercial bills, Certificates of Depsoit and Commercial Paper, it is also serving as an arranger of Inter-bank Participations. The DFHI has consolidated its business by achieving significantly higher turnover in its operations in each section of its activity in the current financial year so far when compared with its turnover in the previous year. The details of its activities upto February 3, 1990 and in the whole of the financial year 1988-89 are presented in the following paragraphs:-

(a) The DFHI's turnover in the inter-bank call and short notice money market in the current financial year so far amounted to Rs. 76,686 crores as against a turnover of Rs. 20,362 crores during the preceding financial year, its daily average lendings in this market having significantly increased from Rs. 84 crores in 1988-89 to Rs. 247 crores in 1989-90 (upto February 3, 1990).

(b) The DFHI was authorised by the Reserve Bank of India to borrow and lend short-term money (15-90 days) effective 1st December, 1989. The DFHI's turnover in the current financial year so far aggregated Rs. 170 crores.

(c) The DFHI's turnover in 182 Days Treasury Bills in the current financial year so far amounted to Rs. 17,169 crores as against a turnover of Rs. 11,024 crores during the financial year 1988-89. On the basis of the fortnightly average outstanding of 182 Days Treasury Bills in the system during April 1989 to February 3, 1990, the DFHI has been able to turnover the system's holding by 22 times. Because of its 'repose' facilitiy provided to All-India financial institutions, banks and mutual funds they are able to earn an income by investing their money for short periods and also raise money for short periods without having to divest their investment.

(d) The DFHI achieved a turnover of Rs. 8,954 crores in rediscounting commercial bills/derivative usance promissory notes in current year so far as compared to a turnover of Rs. 2,866 crores during the financial year 1988-89. The bid and offer rediscount rates were varied depending upon the cost of funds and conditions in the money market. The introduction of the derivative promissory note as an instrument for rediscounting commercial bills has greatly facilitated this acitivity.

(e) With the introduction of CDs and CPs, the DFHI has commenced its operations in the secondary market in these instruments. The DFHI has commenced quoting its prices for purchase/sale of these money market instruments.

7.59 In order to play its role in the secondary market effectively, the DFHI has raised its authorised share capital from Rs. 100 crores to Rs. 250 crores and its paid-up capital from Rs. 100 crores to Rs. 150 crores. Furthermore, it has established refinance lines from the Reserve Bank of India and lines of credit from the consortium of public sector banks and from the Unit Trust of India so as to raise sufficient resources for financing its activities.

7.60 National Housing Bank (NHB) started its operations from July, 1988 as an apex institution in the field of housing finance. The NHB endeavoured to involve the existing institutional credit system in the formulation of its policies with a view to ensuring effective co-ordination with them, it also took up the task of stipulating certain financial and management codes/norms for the new housing finance institutions (HFI) to be eligible for financial support from NHB. Further, it emphasised the need for augmentation of the supply of land and building materials in advance of creation of demand for them and accumulation of savings in advance of the decision of a person to acquire a house/flat. Under its Refinance Scheme housing loans sanctioned by the scheduled banks, housing finance companies (HFCs) and State level Apex co-operative finance societies on or after January 1, 1989 are eligible for refinance. In April, 1989 the National Hosuing Bank announced its guidelines for providing financial assistance for integrated as well as time-bound land development and shelter projects to be undertaken by public agencies such as Housing Boards and Area Development Authorities. Upto December, 1989, NHB has cleared, in principle, 40 such projects at an estimated cost of Rs. 250 crores. NHB has also formulated guidelines for financing housing projects to be undertaken by co-operative housing finance societies professional developers as also rental housing schemes. The most important initiative taken by NHB towards augmenting the flow of resources for house construction is the launching of Home Loan Account Scheme through scheduled banks on July 1, 1989 for individuals who do not own any dwelling unit.

7.61 The Credit Rating Information Services of India Limited (CRISIL) which was set up jointly by ICICI, UTI, LIC, GIC, Asian Development Bank and some other institutions as the first credit rating agency in the country, started its operations in January, 1988. CRISIL's principal objective is to rate debt obiligations of Indian companies, thereby providing a guide to investors as to the risk of timely payment of interest and principal on a particular debt instrument. It rates debentures, fixed deposit programmes, short-term instruments and preference shares on receipt of request to the effect from the company. However, the ratings of CRISIL relate to particular debt instruments and is not a rating for the company as a whole. By December, 1989 CRISIL has rated 81 debt instruments issued by 59 companies (3 belong to public sector) covering a total debt volume of Rs. 2,340 crores. Apart from Fixed Deposit programmes, convertible and non-convertible debentures, CRISIL had rated Commercial Paper programmes covering a total volume of Rs. 155 crores.