CHAPTER 8

MONETARY AND CREDIT DEVELOPMENTS

Money Supply recorded an average annual growth rate of about 17 per cent during the first four years of the Seventh Five Year Plan and reached a peak of 19.7 per cent growth in the terminal year of the Plan, creating a liquidity overhang in the economy. However, in 1990-91 all the components of money supply recorded lower rates of growth mainly due to large and originally unplanned draw down of external reserves although the absolute growth in both Net Bank Credit to Government (NBCG) and Net Reserve Bank Credit to Central Government (NRCCG) was very large because of the expanded budgetary deficits of the Governments. While there was larger growth in food credit to finance the higher food procurement as a consequence of the bumper crop in 1990-91, growth in non-food credit was noticeably smaller. The expansion of total bank credit from the commercial banks has, therefore, been modest during 1990-91 as compared with 1989-90.

8.2 During 1990-91 particularly towards its end Reserve Bank had to initiate specific and substantive credit policy measures to restrict bank finance for imports since balance of payments situation deteriorated leading to massive draw down of foreign exchange reserves.

8.3 In the context of the liquidity overhang and inflationary pressures menifest in the economy, the Reserve Bank of India (RBI) maintained its basic policy stance of moderating the expansion in money and credit. It aimed at meeting the genuine requirements of credit for production and trade; seeking at the same time to prevent bank advances from being used for speculative purposes and to moderate excessive growth of liquidity.

8.4 Among the general credit control measures. the Cash Reserve Ratio (CRR) was left unchanged at its existing legal maximum of 15 per cent of all net demand and time liabilities of scheduled commercial banks. (as stipulated from July. 1989) and the Statutory Liquidity Ratio (SLR) was raised from 38 percent to 38.5 per cent of all net demand and time liabilities of scheduled commercial banks, except for Non-Resident External (Rupee) Accounts and Foreign Currency Non-Resident Accounts and made effective from September 22, 1990. The SLR for the latter two categories of account was also raised from 25 per cent to 30 per cent with effect from the fortnight beginning July 28, 1990.

8.5 Though the selective credit controls on bank advances were tightened against the stocks of oilseeds and vegetable oils (including vanaspati) by raising margins on advances on July 2, 1990 such controls were relaxed in the case of wheat and later on withdrawn (including advances for roller flour mills) from July 2, 1990 in response to improved supply situation. Minimum margins on advances against the stocks of paddy/rice and 'other foodgrains' (other than wheat and pulses) which were also brought down by 15 percentage points across-the-board, effective october 10, 1990 in view of good kharif foodgrain production in 1990-91 season, were raised again with effect from January 8, 1991 because of spurt in their prices and restored to the levels prescribed prior to October 10, 1990. Keeping in view the urgent need for export promotion, the export credit refinance was liberalised by the Reserve Bank effective from January 1, 1991 from 75 per cent to 100 per cent refinance of the increase in export credit over the monthly average level of export credit for the financial year 1988-89.

8.6 An important step towards rationalisation of the interest rates structure was taken by Reserve Bank of India when it introduced a new regime of lending rates for scheduled commercial banks with effect from 22nd September, 1990 and replaced the earlier programme-specific, sector-specific and region-specific interest rates for advances by interest rates related to the size of advances, except for export credit and the Differential Rates of Interest (DRI) Scheme.

8.7 During 1990-91 Reserve Bank of India took some further steps to promote the growth of the money market. Guidelines for the issue of Commercial Paper (CP) and Certificates of Deposit (CD) were relaxed to broad-base their primary markets and also to enlarge the scope of the secondary market. General Insurance Corporation of India (GIC), Industrial Development Bank of India (IDBI) and National Bank for Agriculture and Rural Development (NABARD) were permitted to participate in the call/notice money market only as lenders, effective May 2, 1990. Subsequently, effective October 20, 1990 all the participants in the bills rediscounting market (who were not then operating in call/notice money market) were also allowed to enter the call market as lenders. To encourage the bill culture, interest rate at two percentage points above the relevant cash credit interest rate has been prescribed with effect from January 1, 1991 for the book debt-finance which exceeds the prescribed norm of 75 percent of limits sanctioned to borrowers of scheduled commercial banks for financing inland credit sales.

TABLE 8.1

Average Annual Rate of Growth in monetary aggregates

(Percentage)

Item	1980-81 to 1984-85	1985-86 to 1989-90
I. M3*	16.7	17.6
(a) Currency with the public .	14.3	15.4
(b) Demand Deposits with Banks	16.1	15.8
(c) Time Deposits with Banks .	18.1	18.9
Sources of M3*		
(i) Net Bank credit to Government of which :	20.5	18.4
Net RBI credit to Central Govt.	22.2	17.8
(ii) Bank Credit to Commercial Sector	18.3	16.5
(iii) Net Foreign Exchange Assets of the Banking Sector . .	(—)1.1	16.7
(iv) Government's Currency liabilities to the public . . .	5.6	15.2
(v) Net Non-Monetary Liabilities of the banking sector . .	19.9	15.7
II. Reserve Money* . . .	16.5	17.2
III. Money Multiplier (Values are in absolute number) .	3.44	3.41

Note : 1. On 31st March basis after the closure of Government accounts.

*Values are in per cent.

Monetary Trends in the Last Decade

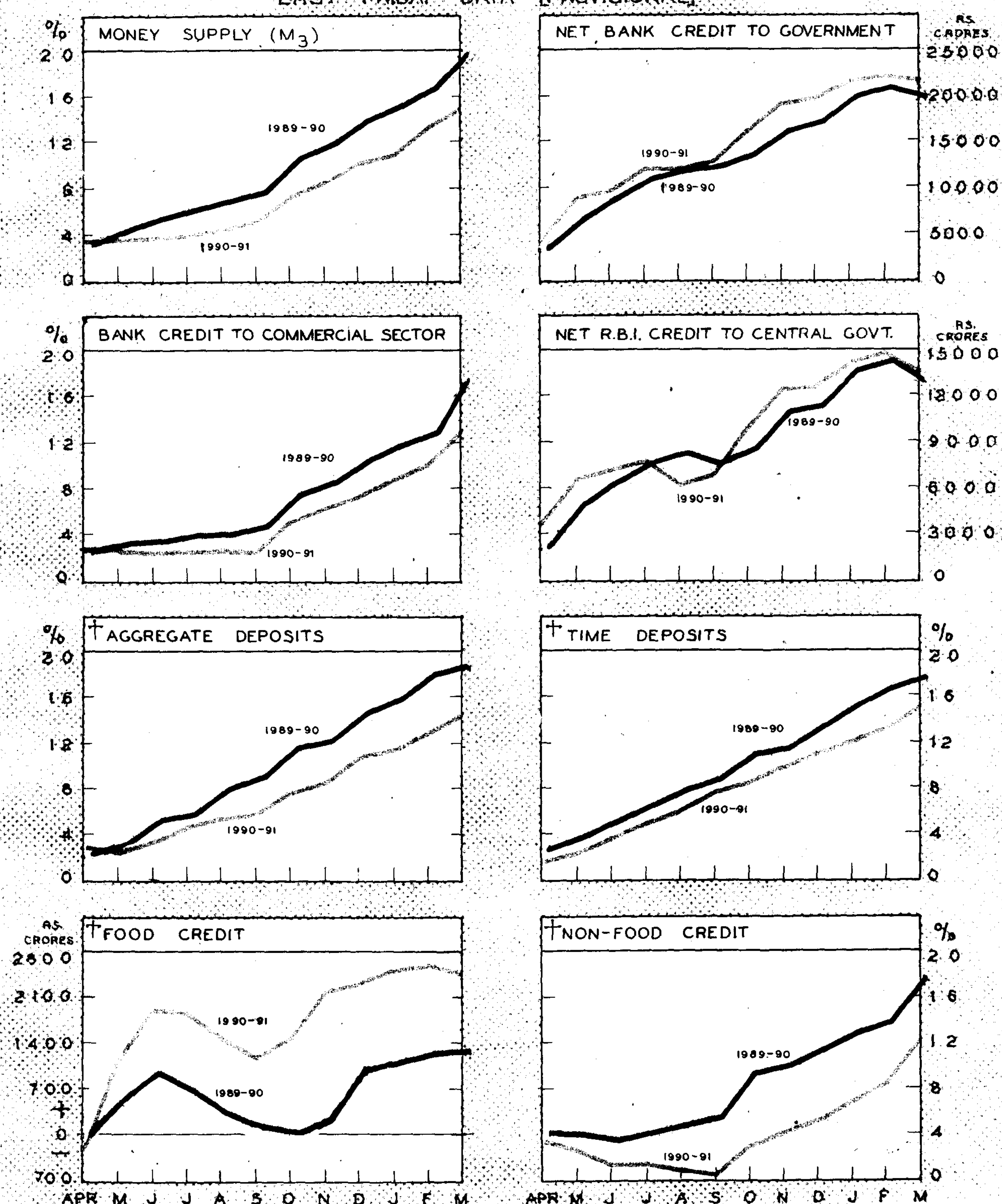
8.8 The last decade covering the Sixth and Seventh Five Year Plans was indeed a period of significant monetary expansion, Broad money supply (M3) increased by 16.7 per cent per annum on an average in the Sixth Five Year Plan (1980-81 to 1984-85) and further by 17.6 per cent per annum in the Seventh Plan (Table 8.1). The acceleration in the rate of monetary growth was attributable to the rise in the annual average rate of growth of Reserve Money (RM) from 16.5 per cent in the Sixth Five Year Plan to 17.2 per cent in the Seventh Five Year Plan. The money multiplier remained more or less stable at 3.4 during this decade, Among the components of money supply, the currency with the public and the time deposits with banks registered higher growth rates during the Seventh Plan, although there was some deceleration in the growth rate of demand deposits with banks during the Seventh Plan.

8.9 The last decade, however, was very important from the angle of institutional and policy developments in the financial sector. Network of branches of the scheduled commercial banks recorded significant expansion in this period rising from 35,548 on June 30, 1981 to 60,101 on March 31, 1991. Aggregate deposits mobilised by them grew from Rs. 40,413 crores to Rs. 2,00,062 crores in this period. Similarly large expension is found in total bank credit which rose to Rs. 1,19,888 crores from a level of Rs. 21,332 crores in this period. Disbursement of financial assistance by financial institutions rose from Rs. 1,603 crores in 1980-81 to Rs. 10,002 crores in 1989-90. The money market which was quite narrow at the beginning of the decade witnessed not only a steep increase in the scale of turnover but also in the number of participants and instruments traded. The capital market became both more broadbased and active than before with the increase in number of scrips, size of issues and number of investors buying them. The growing importance of middle-class and small investors who made mutual funds a force to reckon with in the capital market is another landmark of the decade. The Discount and Finance House of India was set up as a specialised institution entrusted with the task of the development of the money market and the Securities Exchange Board of India was also established as the agency for

CHART 8.1

GROWTH IN SELECTED MONETARY INDICATORS

LAST FRIDAY DATA [PROVISIONAL]



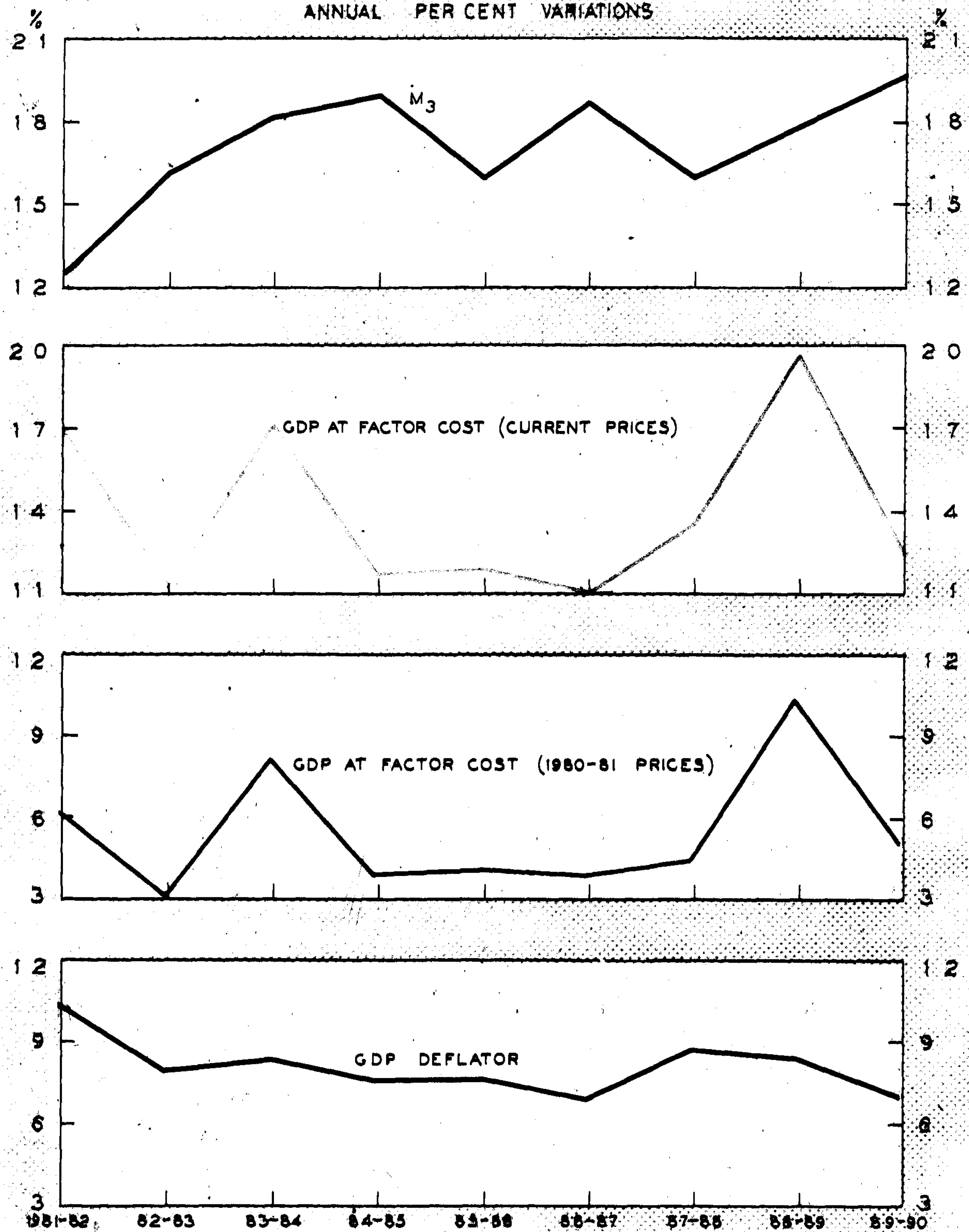
† DATA RELATE TO SCHEDULED COMMERCIAL BANKS

NOTE :- BASE YEAR DATA FOR MARCH, 31.

CHART 8.2

MONEY OUTPUT AND PRICES

ANNUAL PER CENT VARIATIONS



supervising the functioning of the stock exchange. Housing finance al got a fillip with the setting up of the National Housing Bank by the RBI as the apex institution to promote housing finance and stipulate financial and management codes for the new housing finance institutions. The Credit Rating Information Services of India Limited (CRISIL) was set up as the first rating agency in India.

8.10 As regards monetary policy, emphasis on supporting production and trade activities continued with the efforts to prevent the growth of excess liquidity and speculative use of bank advance. With this end in view both CRR and SLR were revised upwards from time to time. In this process CRR rose from 6 per cent in 1980-81* to 15 per cent in 1989-90 and SLR from 34 per cent to 38 per cent.

Monetary trends during 1989-90

8.11 There was considerable acceleration in the growth of money supply in 1989-90. Not only did narrow money (MI) record a growth of 21.4 per cent in 1989-90, compared with only 14.1 per cent growth in the previous financial year, broad money (M3) also registered a growth of 19.3 per cent which has been the highest in the eighties. A higher rate of growth in money supply relative to that in the year 1988-89 was reflected in higher order of growth of two of its major components, viz. currency with the public and demand deposits [Table 8.2] However, time deposits with banks registered a some what lower rate of growth of 18.3 percent than that of 19.8 percent in 1988-89.

8.12 In the Economic Survey for 1989-90, mention was made of an unusual year-end bulge in bank deposits and credit with the change of accounting year in 1988-89 from calendar year to the financial year. Towards the end of the bank's financial year 1989-90 there were again sharp and unusual increases in aggregate deposits and credit, even though Reserve Bank sought to prevent this by declaring a fortnight shut-out period (March 24 to April 6, 1990) for availing its discretionary refinance without prior sanction. These increases in aggregate deposits and credit of the banks distort the end-March data for assessing the basic underlyig monetary and credit developments in 1989-90, particularly considering the fact that the decline in deposits and credit in the first week of 1990-91, viz., week ending April 6,1990, was nearly one-half of the increase in deposits and credit during March 23 and March 31, 1990. The Reserve Bank again announced shut-out period for discretionary refinance without prior sanction and this time for three fortnights (March 9 to April 9, 1991) Banks were again advised by the Reserve Bank to avoid window-dressing by inflating deposits (with the help of volatile deposits).

8.13 On the sources side, the continued acceleration in money supply growth (17.8 per cent in 1988-89 and 19.3 percent in 1989-90) may to a large extent be attributed to persistent fiscal imbalances. In 1989-90 the Reserve Bank Credit to Government recorded a large growth of Rs. 14,068 crores which is nearly double the increase of Rs. 6,928 crores in 1988-89. RBI's Net Credit to Central Government accounted for major share of this increase.

Monetary Trends during 1990-91

8.14 Money supply growth was somewhat subdued during 1990-91. Accordng to data available upto March 22, 1991 Narrow Money (M1) increased by 15.4 per cent upto March 22, 1991 as against a much higher rise of 22.2 per cent upto March 23,1990. In 1990-91 Broad Money (M3) also registered a lower growth of 15.1 per cent, compared with higher growth of 19.4 per cent in the relevant period of 1989-90. As the Table 8.2 will show, all the components of M3 showed a smaller rates of growth in 1990-91 than those in 1989-90. Quite significant was the deceleration in the growth of deposits, both demand and time, in 1990-91. There was a deceleration in the growth of time deposits from 19.8 per cent in 1988-89 to 18.3 per cent in 1989-90. During 1990-91 also the increase was 15.0 per cent upto March 22, 1991 as against 17.3 per cent in the correspondig period of 1989-90. Demand deposits also registered a significantly lower growth of 11.2 per cent in the 1990-91, as compared with 23.3 per cent in 1989-90.

8.15 As in 1989-90 one of the major sources of money supply growth in 1990-91 was the Net Bank Credit to Government (NBCG). It recorded an expansion of Rs. 21,138 crores in 1990-91 up to

* The cash balances held under the earlier incremental cash reserve ratio which was discontinued remained impounded and as such the effective CRR was much higher at a little over 10.5 per cent.

TABLE 8.2

Sources of Change in Money Stock

(Rs. crores)

	Variations during$			
	1988-89 March 31, to March 31	1989-90 March 31, to March 31 (P)	1989-90 March 31, 1989 to March 23, 1990 (P)	1990-91 March 31, 1990 to March 22, 1991 (P)
1	2	3	4	5
I. M_1 (Money supply with the Public)	8231	14274	14822	12497
	(14.1)	(21.4)	(22.2)	(15.4)
II. M_3 (Aggregate monetary resources)	28959	37160	37291	34693
	(17.0)	(19.3)	(19.4)	(15.1)
(i) Currency with the Public	4770	7971	8237	7060
	(14.2)	(20.8)	(21.5)	(15.2)
(ii) Demand deposits with banks	3164	6399	6173	3825
	(12.9)	(23.8)	(23.3)	(11.2)
(iii) Time deposits with banks	20728	22886	22469	22196
	(19.8)	(18.3)	(17.9)	(15.0)
(iv) 'Other' deposits with RBI	297	—96	112	1612
III. Sources of change in M_3 (1+2+3+4—5) . . .				
1. Net Bank Credit to Government (a+b)	12105	20676	20137	21138
	(14.3)	(21.4)	(20.9)	(18.0)
(a) RBI's net credit to Goverment £ (i+ii)	6928	14068(a)	13434(a)	12960(b)
(i) to Central Government	6503	13813	14344	14486
(ii) to State Governments	425	255	—910	—1526
(b) Other Banks' credit to Government	5177	6608	6703	8178
2. Bank Credit to Commercial Sector (a+b)	20395	23822	20911	18253
	(19.0)	(18.6)	(16.4)	(12.0)
(a) RBI's credit to commercial sector*	1734	825	—317	—837
(b) Other banks' credit to commercial sector . . .	10661	22997	21228	19090
3. Net Foreign Exchange Assets of the Banking Sector . .	1128	—133	—212	1350@
	(19.9)	(—2.0)	(—3.1)	(20.2)
4. Government's Currency Liabilities to the Public . . .	95	80	19	27
	(6.9)	(5.4)	(1.3)	(1.7)
5. Banking Sector's Net Non-monetary Liabilities other than time Deposit (a+b)	4764	7285	3564	6075
	(13.3)	(18.0)	(8.8)	(12.7)
(a) Net non-monetary liabilities of RBI	2711	600	1310	8648@
(b) Net non-monetary liabilities of other Banks (residual) .	2053	6685	2254	—2573

P —Provisional.

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

£ —Includes as amount of (a) Rs. 722 crores (b) Rs. 325 crores representing the replacement of non-negotiable non-interest bearing securities issued to IMF by RBI claims no Central Government for facilitating repurchases from the fund.

$ —While variations in respect of scheduled commercial banks are worked out on the basis of their data for the last reporting Friday of March, i.e. March, 24, 1989 and March 23, 1990, those for the RBI and others are based on the data for March 31, 1989 and March 31, 1990.

@ —Inclusive of appreciation in the value of gold (Rs. 6,304 crore) following its revaluation close to international market price since October 17, 1990. Such appreciation has a corresponding effect on a RBI's net non-monetary liabilities.

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.

March 23, 1991 in contrast to a lower expansion of Rs. 20,137 crores in the corresponding period of 1989-90. However, in percentage terms, the rate of expansion in NBCG in 1990-91 at 18·0 per cent was lower than that of 20.9 per cent in 1989-90. The net foreign exchange assets of the banking sector has declined, consequent upon the worsening of the balance of payments situation in the economy and tended to moderate the growth of money supply in 1990-91. Though revaluation of gold holding of Reserve Bank close to international market price with effect from October 17, 1990 enhanced the rupee value of net foreign exchange assets of the Reserve Bank by Rs 6,304 crores in 1990–91, it had a corresponding effect on net non-monetary liabiilities of the Bank, neutralising thereby the effect on money supply. Inclusive of gold revaluation net foreign exchange assets of the banking system recorded an increase of Rs. 1350 crores in 1990–91 in contrast to a decline of Rs. 212 crores in 1989–90. But excluding effect of the revaluation of gold holdings, net foreign exchange assets of the banking system, showed a decline of Rs. 5,023 crores.

8.16 Another factor responsible on the sources side for the modest growth rate in M3 in 1990–91 was the lower expansion in bank credit to the commercial sector by the commercial and co-operative banks i.e. other bank credit to the commercial sector it recorded an increase of Rs. 19,090 crores, in 1990–91 as compared with Rs. 21,228 crores in 1989–90, mainly due to smaller growth in bank credit by the commercial banks in 1990–91 as a result of waiver of loans under the Agricultural and Rural Debt Relief Schemes.

TABLE 8.3

Scheduled Commercial Banks—Variations in Selected Indicators

(Rs. crores)

Items	Variations during			
	1988-89 (March 31, 1988 to March 24, 1989)	1989-90 (March 24, 1989 to March 23, 1990)	1989-90 (March 24, 1989 to March 23, 1990*)	1990-91 (March 23, 1990 to March 22, 1991*)
1	2	3	4	5
1. Aggregate Deposits (a+b)	21897	26809	25915	24230
(a) Demand Deposits	2569	5514	5548	3518
(b) Time Deposits	19328	21295	20367	20712
2. Borrowings from R.B.I.	1303	—1128	—1128	1069
3. Cash in hand and balances with R.B.I.	3761	2291	2273	545
(a) Cash in hand	145	204	186	147
(b) Balances with R.B.I.	3616	2087	2087	398
4. Net Balances with R.B.I. [3(b)—2]	2313	3215	3215	—671
5. Money at call and short notice	1499	—1172	—1209	—615
6. Bank Credit (a+b)	12470	16734	15820	14731
(a) Public food procurement credit	—1490	1237	1237	2500
(b) Non-food bank credit	13960	15497	14583	12231
of which : to Priority Sector@	5149	6168	..	..
7. Investments in Government and other approved securities	7674	9707	9695	10697
(a) Government securities	4954	6477	6535	7995
(b) Other approved securities	2720	3230	3160	2702
8. Balances with other banks in current account	180	247	181	183
9. Credit-Deposit Ratio †	60.4	60.8	60.5	60.8
10. Non-food Credit Deposit Ratio †	59.9	59.6	59.3	58.4
11. Investment-Deposit Ratio †	39.0	38.6	38.8	39.3

*Provisional. ..Not available.

† Percentage at the end of the period.

@ Data relate to 50 banks (49 from March 1990 due to merger) which account for 95 per cent of bank credit, and variations relate to last reporting Fridays of March.

Note : Variations are based on last reporting Friday data.

8.17 Data relating to the operations of the scheduled commercial banks (as presented in Table 8.3) indicate that in 1990–91 from March 23, 1990 to March 22, 1991, the growth of their aggregate deposits (particularly demand deposits) decelerated relative to their growth in 1989–90, mainly because of noticeably smaller growth of demand deposits. There was, however a sharp increase (Rs. 2,500 crores) in food credit by the scheduled commerial banks in 1990–91 compared with an increase of Rs. 1,238 crores in the same period of 1989–90. On the other hand, non-food credit recorded a lower order of growth partly because of the modest growth of deposits with the commercial banks, and larger increase in food credit and partly the larger internal generation of resources and recourse to non-bank sources in financing of its activities by the corporate sector. It is also attributable to the waiver of loans under the Agricultural and Rural Debt Relief Scheme, 1990.

Reserve Money

8.18 As in earlier years, net RBI Credit to Government was the single most important source of growth in reserve money which hold the key to large monetary expansion in 1989–90. It accounted for 96.1 per cent of the expansion in reserve money in 1989–90, compared with 73.2 per cent in 1988–89 and 73.7 per cent in 1987–88. Among the components, increase in net RBI credit to Central Government amounted to 98.2 percent and 93.9 percent of the increase in net RBI credit to Government in 1989–90 and 1988–89 respectively.

8.19 In 1989–90 reserve money registered a higher growth of 23.2 per cent than that of 17.7 per cent recorded in 1988–89. Reserve money growth and consequent monetary expansion would have been still higher in 1989–90, had not there been a fall in net foreign exchange assets of the Reserve Bank by 2.1 per cent in that year in contrast to its positive growth in 1988–89 by 14.5 per cent.

8.20 Net Reserve Bank credit to Govenment, the most important source of reserve money recorded a very high order of growth of 23.6 per cent in 1989–90 as compared with 13.1 per cent in 1988–89. On the other hand, an increase in RBI credit to commercial and cooperative banks and to commercial sector in 1989–90 was lower at 5.6 per cent and 14.9 percent compared to the increase of 59.4 per cent and 45.8 per cent respectively in 1988–89.

8.21 An important characteristic of the reserve money growth in 1989-90 is that one of its major sources, namely, Net RBI Credit to Central Government (NRCCG) at the end of most of the fortnights showed much larger increases over its March 31, 1989, level than the increase of Rs. 7,337 crores estimated for the full financial year in the Central Budget for 1989–90. The increase in NRCCG over March 31, 1989 level came to exceed budget estimates right from the end of fifth fortnight as against seventh fortnight in 1988–89. While in 1988–89 there were several fortnights after the eight fortnight at the end of which increase in NRCCG over March 31, 1988 level was lower than the budget estimates (Rs. 7484 crores), in 1989–90 after the fifth fortnight increase in NRCCG (over March 31, 1989 level) at the end of each fortnight always exceeded the budget estimate of Rs. 7,337 crores and finally at the end of the financial year reached a level of Rs. 13,813 crores, which was 88.3 per cent higher than the budget estimate. As the Centre's budget deficit is the principal factor explaining the expansion in NRCCG, it also behaved in a similar manner. It exceeded the budgetary estimate at the end of fifth fortnight and generally kept on rising till it reached a peak of Rs. 14,273 crores at the end of the twenty sixth fortnight and finally reached a level of Rs. 10,624 crores at the end of 1989–90 as per RBI's accounts.

8.22 During 1990-91 from March 31, 1990 to March 22, 1991, rate of growth in reserve money was substantially lower at 6.0 per-cent than its growth by 16.1 per cent in the corresponding period of 1989-90. Almost all the sources of reserve money have shown similar trend in 1990-91. For instance, its principal source *viz.* Net RBI Credit to Government rose by Rs. 12,960 crores (17.6 per cent) which was lower than the increase of Rs. 13,434 crores (22.5 per cent) in 1989-90. Decline in RBI credit to commercial sector was also larger in 1990-91 (Rs. 837 crores as against Rs. 317 crores in 1989-90). Details of changes in reserve money have been presented in Table 8.4.

CHART 8.3

INCREASE IN NRCCG AND CENTRAL BUDGETARY DEFICIT

(FORTNIGHTLY DEVIATIONS — 1989-90)

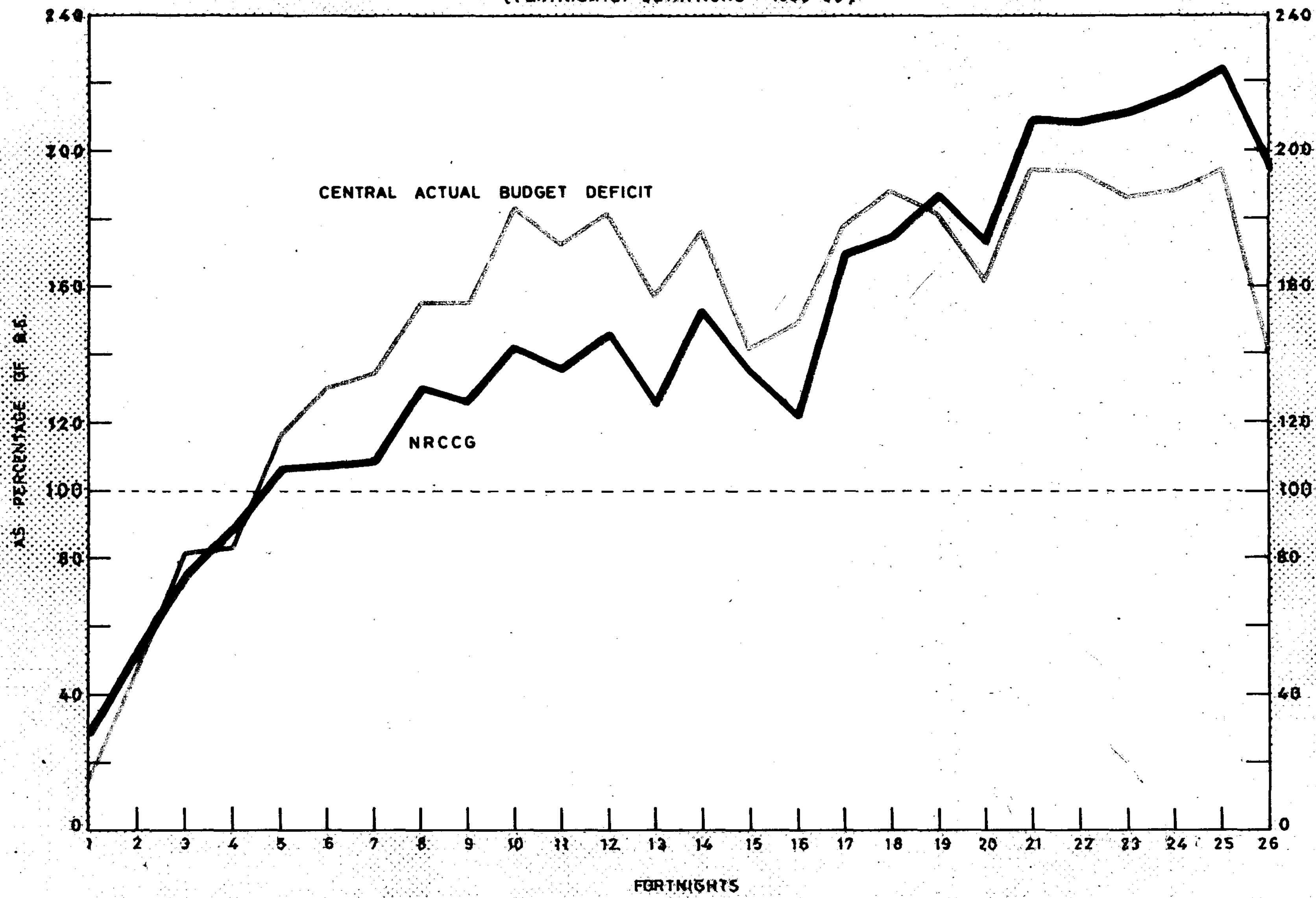


TABLE 8.4

Source of Change in Reserve Money

(Rs. crores)

	Outstanding as on March 31, 1987	Variations during†				
		1987-88	1988-89	1989-90@	1989-90 March 31, 1989 to March 23, 1990@	1990-91 March 31, 1990 to March 22, 1991@
1	2	3	4	5	6	7
1. Net RBI credit to Government$	46,285	6,402	6,928	14,068 (a)	13,434 (a)	12,960(b)
		(13.8)	(13.1)	(23.6)	(22.5)	(17.6)
2. RBI credit to Banks£ . . .	2,760	1,681	2,638	393	—1,448	—214
		(60.9)	(59.4)	(5.6)	(—20.5)	(—2.9)
3. RBI credit to commercial sector* .	3,394	396	1,734	825	—317	—837
		(11.7)	(45.8)	(14.9)	(—5.7)	(—13.2)
4. Net foreign exchange assets of RBI	4,621	795	785	—133	—212	1,350**
		(17.2)	(14.5)	(—2.1)	(—3.4)	(22.2)
5. Government's currency liabilities to the public	1,192	188	95	80	19	27
		(15.8)	(6.9)	(5.4)	(1.3)	(1.7)
6. Net non-monetary liabilities of RBI	13,444	781	2,711	600	1,310	8,648**
		(5.8)	(19.1)	(3.5)	(7.7)	(49.3)
7. Reserve Money (1+2+3+4+5—6)	44,808	8,681	9,469	14,633	10,166	4,638
		(19.4)	(17.7)	(23.2)	(16.1)	(6.0)

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

@ Provisional.

£Includes claims on NABARD.

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

$Includes an amount of (a) Rs. 722 crore (b) Rs. 325 crore 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.

**Inclusive of appreciation in the value of gold (Rs. 6,304 corore) following its revaluation close to the international market price since October 17, 1990, Such appreciation has a corresponing effect on RBI's net non-monetary liabilities.

Sectoral Deployment of Bank Credit

8.23 The Sectoral distribution of bank credit by scheduled commercial banks is set out in Table 8.5. These data relate to credit deployed by 50 scheduled commercial banks (49 from March, 1990, and 48 from August, 1990 because of merger) constituting about 95 per cent of bank credit. During 1989-90 gross bank credit as a whole registered a lower rate of expansion (19.8 per cent) than 22 per cent growth in 1988-89, though in absolute terms the expansion in gross bank credit was larger in 1989-90 (Rs. 16,943 crores) than that (Rs. 15,468 crores) in the previous financial year. Food credit recorded an increase in 1989-90 in contrast to its decline in 1988-89.

TABLE 8.5

Sectoral Deployment of Gross Bank Credit

(Rs. crores)

On the Last reporting Friday basis	Variations during									
	1987-88		1988-89		1989-90		April—January 1989-90		April—January 1990-91	
	Rs. crores	per cent	Rs. crores	per cent	Rs. crores	per cent	Rs. crores	per cent	Rs. crores	per cent
I. Gross Bank Credit	7691	12.3	15468	22.0	16943	19.8	12036	14.0	104.24	10.2
1. Public Food Procurement . .	—2914	—57.1	—1421	—64.9	1237	160.9	1043	135.6	2532	126.2
2. Gross Non-food credit (a+b+c+d)	10605	18.5	16889	24.8	15706	18.5	10993	12.9	7892	7.8
(a) Priority Sector (i+ii+iii)	4020	16.0	5149	17.7	6168	18.0	4505	13.2	1716	4.2
(i) Agriculture	1439	13.6	1941	16.2	2584	18.5	1914	13.7	59	0.4
(ii) Small Scale Industry	1712	18.8	2315	21.4	2415	18.4	1796	13.7	1200	7.7
(iii) Other Priority Sectors	869	16.2	893	14.3	1169	16.4	795	11.1	457	5.5
(b) Industry (Medium & Large) . .	3797	17.8	7032	28.0	6087	18.9	4585	14.2	3841	10.0
(c) Wholesale Trade (Other than food Procurement) (i+ii+iiii+iv)	518	16.8	1169	32.5	705	14.5	495	1034	103	1.9
(i) Cotton Corporation of India .	—18	—16.5	—54	—59.3	103	278.4	—4	—10.8	—39	—27.9
(ii) Food Corporation of India (Fertilizer) . .	22	14.8	31	18.1	28	13.9	30	14.9	—19	—8.3
(iii) Jute Corporation of India .	—56	—28.3	—44	—31.0	—44	—44.9	—28	—28.6	20	37.0
(iv) Other Trade	570	21.7	1236	38.7	618	14.0	497	11.2	141	2.8
(d) Other Sectors .	2270	28.4	3539	34.5	2746	19.9	1408	10.2	2232	13.5
II. Export Credit (Included under item 2) . .	771	24.5	2224	56.8	2104	34.3	1740	28.3	446	5.4
Priority Sector Advances as percentage of Net Bank Credit (including inter-bank participations) in the last month of the period)		44.1		43.2		42.4	42.7		40.1	

Note : Date are provisional and relate to 50 (49 from March 1990 and 48 from August, 1990 due to marger) 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 participantions. Net Bank credit data are exclusive of bills rediscounted with RBI, IDBI, Exim Bank and other approved financial institutions.

8.24 There was a significant increase in credit to priority sector in 1989-90 (Rs. 6,168 crores) which formed 42.4 per cent of net bank credit at the end of March, 1990, as against 43.2 per cent a year ago. Credit to agriculture recorded a rise of Rs. 2,584 crores (18.5 per cent) as compared with that of Rs. 1,941 crores (16.2 per cent) in 1988-89. Advances to small scale industries expanded by Rs. 2415 crores, higher than the expansion of Rs. 2315 crores in 1988-89, though in percentage terms increase in 1989-90 was lower than in 1988-89 (18.4 per cent as against 21.4 per cent).

8.25 Large and medium industries too received additional bank credit to the tune of Rs. 6,087 crores (or 18.9 per cent) as against a very high order of increase of Rs. 7,032 crores (or 28 per cent) in 1988-89. The advances to wholesale trade (other than food procurement) recorded an expansion of Rs. 705 crores (or 14.8 per cent) in 1989-90, as against that of Rs. 1,169 crores (or 32.5 per cent) in 1988-89. Export credit also grew by lower margin of Rs. 2,104 crores (or 34.3 per cent) as against Rs. 2,224 crores (or 56.8 per cent) in 1988-89.

8.26 Data on sectoral deployment of bank credit during 1990-91 are available for the ten month period i.e. April 1990–January 1991. In this period medium and large industries received additional credit of Rs. 3,841 crores (10.0 per cent) as against Rs. 4,585 crores (14.2 per cent) in April 1989–January 1990. However, it accounted for nearly 49 per cent of the additional gross non-food credit (Rs. 3,841 crores) disbursed in the first ten months of 1990-91. The growth of priority sector credit in this period of 1990-91 has been considerably lower at Rs. 1716 crores (4.2 per cent) than that of Rs. 4,505 crores (13.2 per cent) in the corresponding period of 1989-90 Credit to agriculture, small-scale industry and other priority sectors recorded lower growth in April 1990–January 1991 than those in April 1989–January 1990. Export credit rose only by Rs. 446 crores (5.4 per cent) against a rise of Rs. 1,740 crores (28.3 per-cent) in the corresponding period of 1989-90. There has been a sizeable increase in credit for public food procurement by Rs. 2,532 crores as against expansion of Rs. 1,043 crores in corresponding period of 1989-90.

Structure of Interest Rates

8.27 In overall economic management and regulation of money supply and credit, interst rates play a vital role. Interest rates can act as a potent tool not only for promotion of savings and direction of investment in desired channels but also in curbing excess liquidity in the system and moderating the pace of inflation in fact, interest rate changes often signal change in the complexion and thrust of monetary policy. In India lending and borrowing rates of banks and financial institutions vis-a-vis the non-financial companies and government are adminstered in the interest of planned economic growth; the administered interest rates have, however, been modified from time to time in the light of broad macro-economic trends in recent years, money market rates and certain commercial lending rates of banks have been freed.

8.28 The most significant step taken with regard to the administered interest rates in 1990-91 Reserve Bank of India has been the rationalisation of lending rates of the scheduled commercial banks. For a long time there prevailed a complex structure of lending rates marked by multiplicity of rates. The structure of interest rates on bank advances taking into account all stipulations had a plethora of different rates prescribed for differentiated characteristics of loans such as type of loan activity, location size, class and efficiency of borrowers. Plethora of interest rates often meant uncertainty and posed difficulties in administration. It, therefore, became necessary to undertake a rationalisation of the existing structure of interest rates on bank advances.

8.29 Reserve Bank, accordingly, made a review of these rates and introduced a new structure of interest rates which links interest rate to the size of advance rather than to its purpose with a view to both rationalizing and simplifying the interest rate structure. However, the existing rates have been retained for Differential Rate of Interest (DRI) Scheme (4 per cent) meant for weaker sections as also for export credit which is subject to an entirely different regime of lending rates supplemented by interest subsidy from the Government.

8.30 The revised structure of lending rates (other than for DRI advaces and export credit) for the scheduled commercial banks, was introduced with effect from September 22 1990(and made applicable equally to working capital and term loans (excluding term loans exceeding Rs. 25,000 to agriculture, small scale industries and road transport operators owning upto two vehicles for whom separate rates have been stipulated). As will be evident from the Table 8.6 the commercial interest rate of 16 per cent (minimum) was retained but made applicable only to loans over Rs. 2 lakhs, while the lowest lending rate has been stipulated at 10 per cent for advances upto and inclusive of Rs. 7,500. The new rate structure would mean that public sector food procurement agencies will have to pay 16 per cent per annum as against 14 per cent charged earlier. The effective interest rate for discounting of bills foı boırowers in the category of 16 peı cent (minimum) will be 1 percentage point lower than lending rate charged to borrowers in this category. As such the effective interest rate on discounting of bills of exchange for such categories of borroweı s will be 15 per cent (minimum).

TABLE 8.6

Structure of Interest Rates: Some Selected Cetegories

(Per cent per annum)

	Rates as on March 31, 1991	Existing Rates
I. Scheduled Commercil Banks		
A. Term Deposit Rates		
(a) Domestic Deposits		
(i) 46 days and above but less than one year	8.0	9.0
(ii) One year and above but less than two years	9.0	10.0
(iii) Two years and above but less than three years	10.0	11.0
(iv) Three years and above	11.0	13.0
(b) Non-Resident (External) Rupee Accounts		
(i) 46 days and above but less than one year	8.5	8.5
(ii) One year and above but less than two years	10.5	10.5
(iii) Two years and above but less than three years	11.0	11.0
(iv) Three years and above but less than five years	12.0	13.0
(v) Five years and above	13.0	14.0
(c) Foreign currency (Non-Resident) Accounts (Effective February 8, 1991)		

	Pound sterling	U.S. Dollar	Deutsche Mark	Japanese Yen
(i) For deposits for 6 months and above but less than 1 year	13.25	7.50	10.00	8.50
(ii) For deposits for 1 year and above but less than 2 years	13.25	8.00	10.25	8.50
(iii) For deposits for 2 years and above but less than 3 years	13.25	8.50	10.50	8.50
(iv) For deposits for 3 years only	13.25	9.00	10.50	8.50

B. Interest Rate Structure for Loans of Scheduled Commercial Banks

(X) General rates on short and long-term loans **Size of limit**	Rates as on March 31, 1991	Existing Rates
1. Upto Rs. 7,500	10.0	10.0
2. Over Rs. 7,500 and Upto Rs. 15,000	11.5	11.5
3. Over Rs. 15,000 and upto Rs. 25,000	12.0	12.0
4. Over Rs. 25,000 and Upto Rs. 50,000	14.0	14.0
5. Over Rs. 50,000 and Upto Rs. 2 lakhs	15.0	15.0
6. Over Rs. 2 lakhs	16.0 (Minimum)	18.5 (Minimum)
(Y) Other Lending rate stipulations		
1. DRI advances	4.0	4.0
2. Term loans to agriculture SSI, transport operations owning upto 2 vehicles Size of limit		
(i) over Rs. 25,000 and upto Rs. 50,000	13.0	13.0
(ii) over Rs. 50,000 and upto Rs. 2 lakhs	14.0	14.0
(iii) over Rs. 2 lakhs	14.0	14·0
3. (i) Loans for purchase of consumer durables (ii) Loans to individuals against shares and debentures/bonds (iii) Personal loans and other non-priority sector advances	banks are free to determine the rates of interest	
4. Export Credit		
(a) Pre-shipment credit		
Upto 180 days	7.50	7.50
Beyond 180 days and in all upto 270 days (wth prior approval of RBI)	9.50	9.50
Against cash incentives, etc. covered by E.C.G.C. Guarantee upto 90 days	7.50	7.50

(b) **Post-shipment credit** Demand Bills for transit period (as specified by FEDAI)	8.65	7.0
Usance Bills	Exist Rates as on March 31, 1991	Existing Rates
Usance bills up to 180 days comprising usance period of export bills/transit period as specified by FEDAI and grace period wherever applicable 8.65	(a) upto 45 days	7.00
	(b) beyond 45 days & upto 90 days	8.6
	(c) beyond 90 days and upto 6 months	18.00@
	(d) beyond 6 months@@	25·00@
Against retention money (for supplies portion only) payable within 1 year from the date of shipment (upto 90 days)	8.65	8.65
(c) **Deferred Credit** Deferred Credit for period beyond 180 days	8.65	8.65
(d) **Duty Draw-back Credit Scheme, 1976** Against duty drawback as provisionally certified by the Customs Authorities upto 90 days	Free of interest	free of interest
(e) Export Credit not otherwise specified	14.00 to 15.50	18.0
II. **Post office savings schemes**		
(i) One year time deposits	9.5**	9.5
(ii) Two year time deposits	10.0	10.0
(iii) Three year time deposits	10.5	10.5
(iv) Five year time deposits	11.0	11.0$
(v) Five year recrurring	11.0$	11.0
(vi) National Savings Certificates (VIII Issues)	12.0£	12.0£
III. **Other financial instruments:**		
(a) Convertible debentures (Ceiling Interest Rate)		
(i) FERA & MRTP	12.5	
(ii) Non-FERA & Non-MRTP Cost.	14.0	
(b) Non-convertible debenture	14.0	

* The effective interest rate on bills discounting facilities to these category of borrowers is one percentage point below the lending rate charged. As such the rate is 15.0 per cent (minimum).

**Compounded half yearly

$ compounded quarterly

£ compounded half yearly

@From the date of advance

@@From the date of shipment.

8.31 Subsequently, effective october 10, 1990, scheduled commercial banks were permitted to freely determine the rates of interest applicable to the following categories of loans: (i) Loans for purchase of consumer durables; (ii) Loans to individuals against shares and debentures/bonds; and (iii) other non-priority sector personal loans. Banks were advised to ensure that while granting loans for purchase of consumer durables they should insist that a reasonable proportion of the cost was met out of the resources of the borrower. Again, while granting loans against share/debentures/bonds, banks were ensure that appropriate margins were imposed. Considering the needs of the priority sector and exports, it is essential that credit to the above three categories of borrowers is kept to a moderate proportion of total credit.

8.32 In recent years, a number of saving instruments have appeared in the market offering attractive rates of interest and the banks had increasingly felt that they were becoming uncompetitive in the changing environment. A new category of deposits of three years and above was, therefore, introduced with effect from October, 10, 1990 at an interest rate of 11 per cent per annum. The revised interest rate would apply only to fresh deposits and on renewals of maturing deposits. All other deposits rates were left unaltered. The new category of bank deposits is expected to help the banks in their deposit mobilisation efforts in the competitive financial market and offer a better rate on the savings to the bank depositors.

8.33 In tune with the rationalisation of interest rates and maturities on domestic term deposits for period under one year initiated in 1988-89, the term deposit rates and maturities or Non-Resident (External) Rupee (NRE) accounts were also rationalised. The maturity range of 15 days to 45 days for these accounts was abolished and a uniform rate of 8.5 per cent was stipulated on all NRE deposits for maturities of 46 days to less than a year. The interest rates for NRE deposits of longer maturities have remained unchanged.

8.34 The scheduled commercial banks used to receive 10.5 per cent per annum interest rate on all of their eligible cash balances held with the Reserve Bank. With a view to stemming the erosion the effectiveness of CRR consequent upon the increasing interest payments on 'eligible' CRR balances maintained by banks and at the same time to avaoid any drastic reduction in such interest income of banks, the Reserve Bank replaced the flat interest rate by a 2-tier formula with effect from the fortnight beginning April 21, 1990. Interest is now paid (a) at a rate of 10.5 per cent per annum on eligible cash balances based net demand and time liabilities (DTL) as on March 23, 1990; and (b) at a rate of 8 percent on eligible cash balances maintained on the increase in net demand and time liabilities after March 23, 1990.

8.35 Along with the reduction in the interest rate payable on eligible cash balances based on net DTL, the Reserve Bank also brought about marginal modification in the scheme of graduated penalties on the shortfalls of CRR payable by Scheduled commercial banks. The modification made the graduated loss of interest less steel and the scheme of graduated penalties was extended from 5 per cent to10 per cent of the absolute amount of CRR required to be maintained. However, in cases where the shortfall exceeded 10 per cent, no interest would be paid on any portion of the eligible cash balances and the penalty was also applicable on the amount of default. Provided the CRR shortfall was within reasonable limits, the new scheme of graduated penalties provided for a softening of the cost of CRR shortfall for the banks. The above scheme was revised with effect from December 29, 1990, in the light of the experience of continued satisfactory compliance by banks. Accordingly, under the amended scheme, banks would earn interest at the normal rate (i.e., 10.5 per cent per annum on 'eligible' cash balances maintained on net DTL as on March 23, 1990 and 8 per cent per annum on 'eligible' cash balances maintained on incremental net DTL thereafter) but the amount of interest so arrived at would be reduced by an amount calculated at a rate of 25 per cent per annum on the amount of the shortfall. By smoothening the decline in the effective interest rate on 'eliglble' cash balances as the shortfall increases, the revised scheme is expected to moderate sharp increaes in call money rates.

8.36 Interest rates on Foreign Currency (Non-Resident) Accounts, for four designated currencies *viz,* namely, Pound qterling, US Dollar, Japanese Yen and Deutsche Mark were revised several times during 1990-91 in consonance with changes in the interest rates on these currencies in overseas markets. The existing structure of interest rates for selected categories of deposits and financial instruments as also for advances of the scheduled commercial banks is indicated in Table 8.6.

Development in Credit Policy

8.37 The monetary Policy adopted by the Reserve Bank of India during 1990–91 as also in the first quarter of 1991-92 has had the basic thrust on controlled expansion of money and credit. It sought to achieve the twin objective s of meeting in full the genuine credit needs of the production and trade sectors and moderating at the same time the liquidity, growth in the system and preventing the speculative use of bank advances so as to contain inflationary pressures in the economy. It has also tried to promote growth, diversification and better health of the financial sector by bringing about institutioal and structural changes and introducing new instruments and revamping the old ones.

8.38 Both general and selective credit control measures were adopted to implement the objectives of the monetary policy. Among the general credit control measures it may be recalled that the Cash Reserve Ratio (CRR) was raised in July, 1989 uniformly for the entire net demand and time liabilities to 15 per cent. In 1990–91 Reserve Bank also took recourse to another potent instrument of general credit control, namely, Statutory Liquidity Ratio (SLR). With the primary objective of moderating the pace of reserve money creation and monetary expansion, effective from the fortnight beginning September 22, 1990, the SLR for net demand and time liabilities of the scheduled commercial banks (excludng FCNR and NRE accounts) was raised by one-half of one percentage point to 38.5 per cent and the SLR on FCNR and NRE accounts was also raised from 25 per cent to 30 per cent effective from the fortnight beginning July 28, 1990. It was estimated that the upward revision of SLR for both domestic and foreign accounts will mean additional Rs. 1800 crores of SLR requirement equivalent to about one percentage point of net demand and time liabilities for the banking system as a whole.

8.39 In the recent period refinance policy has been used as an effective tool of overall monetary control. In November, 1989 export credit refinance was reduced to 75 per cent of the increase as the growth base in export credit from 100 per cent earlier. Furthermore, with effect from August 25, 1990 the base for deciding export credit refinance limit was shifted from the monthly average level of export credit for calender year 1987 to the monthly average level for the financial year 1988-89.} With the moderation in monetary growth and the paramount need to promote exports, effective January 1, 1991, the proportion of refinance was raised from 75 per cent to 100 per cent of the increase in export credit over the above base.

8.40 Among other measures of general credit control, adopted in 1990-91 a mention may be made of extension of the stipulation of incremental non-food credit-deposit ratio at 60 per cent. This stipulation which was introduced in 1989-90 entailed additional interest charge of three percentage points for banks (which exceeded the stipulated ratio) on refinance drawn by them from the Reserve Bank under all facilities to the extent of the excess non-food bank credit or the refinance drawn, whichever was lower.

8.41 Another important measure introduced in 1990-91 financial year by the Reserve Bank is the introduction of a commitment charge on the unutilised portion of credit limits for the large size borrowers of scheduled commercial banks. Banks have been facing problems of large unutilised credit limits which also pose several difficulties in implementing macro-credit policy. Accordingly, for all borrowers with working capital limits of Rs. 1 crore and above, banks would be required to levy minimum commitment charge of one per cent per annum on the unutilised portion of the quarterly operating limit, subject to a tolerance level of 15 per cent of such limit.

8.42 Suitable use has been made by RBI also of selective credit control measures in respect of bank credit for price-sensitive commodities in its credit management during 1990-91 as also in 1991-92 so far. With effect from December 30, 1989 higher ceiling at 100 per cent of the peak level of credit based on three year period 1984-85, 1985-86 and 1986-87 (November–October) was stipulated for bank advances against wheat, cotton and *kapas*. The minimum margin on bank advances against cotton and kapas was brought down from 45 per cent to 30 per cent. In the case of others *i.e.* other than mills/ processing units/which are expected from selective credit controls Likewise bank advances against unreleased stocks of sugar with mills was subjected to a lower minimum margin of 20 per cent as against 25 per cent stipulated earlier.

8.43 With effect from April 16, 1990 for commodities having credit ceilings, the three year base period noted above was brought forward by two years to the three year period of 1986-87, 1987-88, 1988-89 (November–October) for deciding credit ceiling for bank advances against a particular commodity. The minimum margins on all bank advances against wheat (including advances to roller flour mills) were reduced by 15 percentage points across-the-board. Further in the context of distinct improvement in supply position, all advances against cotton and kapas were also exempted from all provisions of selective credit control effective from April 16, 1990. Similarly, all advances against wheat (including to roller flour mills) came to be exempted from all provisions of selective credit control with effect from July 2, 1990 on a review of price output developments relating to that commodity.

8.44 The commodities which came particularly under strict selective credit control measures were oilseeeds and vegetable oils (including vanspati), minimum margins on bank advances against which were raised twice in succession by 15 percentage points each time across-the-board with effect from May 4, 1990 and July 2, 1990.

8.45 With the harvesting of a good kahrif foodgrains production in 1990-91 and rise in public sector foodgrains stock to a comfortable level following much larger procurement in the year, minimum margins on advances against paddy/rice and "other foodgrains" were reduced by 15 percentage points across-the-board with effect from October 10, 1990. However, in view of subsequent rise in prices, these minimum margins were raised by 15 percentage points, effective January 8, 1991. The minimum margin and level of credit stipulations for all commodities covered under selective credit controls are indicated in Table 8.7.

TABLE 8.7

Minimum Margins and level of Credit Ceilings on Bank advances against commodities subject to selective credit controls (effective April 13, 1991)

(Percentages)

Commodities	Minimum Margins			Level of Credit Ceiling (Base years Three years ending 1988-89 Nov-Oct.)
	Mills/ Processing units	Others	Warehouse Receipts	
1. Paddy/Rice	45	60	45	85
2. Pulses	45	60	45	85
3. Other foodgrains	45	60	45	85
4. Oilseeds (viz., groundnut, rapeseed mustard, cottonseed, linseed, castorseed and all imported oilseeds)	60	75	60	85
5. Vegetable Oils (Viz. groundnut oil, rapeseed/mustard oil, cottonseed oil, linseed oil, castor oil, vanaspati and imported vegetable oils)	60@	75	60	85
6. Sugar				
(a) Buffer		—	—	—
(b) Unreleased stock	20*	—	—	—
(c) Released	75	75	60	—
7. Gur and Khandsari	45	75	60	—

*Reduced to 17.5 per cent, effective May 9, 1991 for a period of 3 months upto August 8, 1991.
@Applicable to registered oil mills.
—Not applicable.
Note : 1. Advance against cotton and kapas were fully exempt from the controls with effect from April 16, 1990.
2. Advances against wheat were fully exempt from the controls with effect from July 2, 1990.

8.46 In view of the difficulties faced by trade and industry in Jammu & Kashmir and Punjab, banks have been permitted by RBI to extend certain concessions/relaxations to bank borrowers and customers in these areas. Such concessions relate to margin, service charges, re-scheduling of repayment, non-levy of penal interest or compound interest in deserving cases, grant need-based additional credit limits, etc.

8.47 Decision of the Government of India to implement a 'debt relief' scheme for farmers, artisans and weavers was announced by the Finance Minister while presenting the Central Budget for 1990-91. In line with the announcement the Government of India approved the Agricultural and Rural Debt Relief Scheme, 1990. The Central Government's scheme covered borrowers of public sector commercial banks and Regional Rural Banks (RRBs). State Governments were advised to formulate a debt relief scheme for the benefit of borrowers in the co-operative sector on the lines of the Central scheme. Public sector commercial banks, RRBs and co-operatives are now implementing the debt relief scheme. The salient features of the Debt Relief Scheme which came into effect on May 15, 1990 are as follows :

(i) The scheme will apply to all eligible loans of banks and co-operative societies. Eligible loan means that part of short-term loans, including converted/rescheduled medium term loan, availed of by an individual borrower on or after April 1, 1986 and instalments of a term loan fall in due after October 2, 1986 which was overdue to a bank on the effective date (October 2, 1989), including overdue interest.

(ii) In the case of public sector banks and RRBs, the Government of India will bear the amount of relief that will be provided by these institutions to the eligible beneficiaries. In respect of State Government schemes for co-operatives approved by Government of India, the burden will be shared equally by the Central and State Governments.

(iii) The relief will be available only to non-wilful defaulters who had borrowed loans from one or more banks irrespective of the quantum of the amount borrowered. However, the relief available will be restricted to a maximum amount of Rs. 10,000 per eligible beneficiary. Non-wilful defaulter is a borrower who did not repay loans and experienced two or more bad crop years, not necessarily consecutive ones, one of which was the year in which the default occurred. In the case of artisans, non-repayment on account of loss of assets will be treated as non-wilful default. A borrower with chronic overdues for over 3 years as on the effective date will also be considered a non-wilful defaulter.

(iv) The cut-off date for determining the beneficiary will be October 2, 1989. The terminal date for the scheme was fixed on March 31, 1991.

8.48 The Reserve Bank of India and the National Bank for Agriculture and Rural Development estimated initially that the quantum of debt relief would be of the order of Rs. 2842 crores. The Government of India earmarked Rs. 1000 crores for this scheme in the Budget for 1990-91. It decided to underwrite in full the burden of debt relief borne by the public sector commercial banks and Regional Rural Banks as also to provide 50 per cent of the assistance to the co-operative banks which would provide debt relief (the remaining 50 per cent to be borne by the State Governments) under the scheme formulated for waiver of co-operative credit by the respective State Governments on the lines of the Central Scheme.

8.49 It is pertinent to note here that the Agricultural and Rural Debt Relief Scheme 1990 underwent several changes in the last financial year after its announcement in the Central Budget for 1990-91. These changes in the scheme included; inter alia, consideration of 'chronic overdues' (overdues even prior to October 2, 1986), debt of farmers who had filed insolvency petitions, extension of the scheme to cover all borrowers, irrespective of the size of their loans and inclusion of fisheries in the purview of the Scheme. These changes, in effect, increased the Government of India's liability in this sphere and led to a greater fiscal burden on the exchequer than originally provided for in the Budget.

8.50 Position reported up to May 4, 1991 indicate that a total of Rs. 7802 crores of debt relief had been provided by the public sector banks, Regional Rural Banks and co-operative banks. Of this Central Government's liability is to the tune of Rs. 5776.67 crores while the concerned State Governments would have to incur an expenditure of Rs. 2025.00 crores to meet their commitments in this regard. The final liability of the Govt. of India will be known only after full data is received of actual loan waiver upto March 31, 1991 from public sector banks, RRBs and co-operative banks. In the Revised Estimates for 1990-91 a supplementary provision of Rs. 500 crores has been made towards the scheme, raising thereby the budget provision of Rs. 1500 crores for the scheme upto the end of that financial year. In Interim Budget 1991-92 the Govt. of India has provided Rs. 1500 crores for the scheme. This will put the cumulative budgetary support to the scheme by the Govt. of India at Rs. 3000 crores. Given the scale of debt relief scheme, it could affects both the profitability and credibility of the Indian banking system unwillingly, it could also affect the farmer's incentive towards prompt repayment of bank debts in the future. It also contributed significantly to the deterioration in the fiscal situation in 1990-91. It also puts a constraint on Supply of Credit for productive purposes and interest may affect the rural credit delivery system.

8.51 In view of the increasing pressure on the balance of payments of the country, importance of credit given by the banks to export assumed great urgency. RBI accordingly advised banks specifically in October 1990 to make substantive efforts to supports exports. It was also been decided to increase the access of banks to its export credit refinance by permitting 100 per cent (as against 75 per cent earlier) refinance of increase in export credit over its monthly average level in 1988-89 at the rate of 9 per cent per annum, effective from January 1, 1991. Higher export credit refinance was estimated to increase bank's access to such refinance by Rs. 1,000 crores during 1990-91.

Credit by Financial Institutions

8.52 Over the three financial years, i.e., 1987-1988 to 1989-1990 there has been an increasing trend in aggregate sanctions and disbursements by all financial institutions. Aggregate assistance sanctioned by them recorded a rise from Rs. 9,171.8 crores in 1987-88 to Rs. 14,073.4 crores in 1988-89 and further to Rs. 15,631.4 crores in 1989-90. Data show an annual average growth rate of 34 per cent in aggregate sanction over these three years. Disbursements of assistance by the financial institutions show a similar rising trend of 22 per cent over the same three years period (Rs. 10001.7 crores in 1989-90 as against Rs. 6788.4 crores in 1987-88). All India Financial Institutions viz., Industrial Development Bank of India (IDBI), Industrial Credit and Investment Corporation of India (ICICI), Industrial Finance Corporation of India (IFCI), Life Insurance Corporation (LIC), General Insurance Corporation (GIC), Industrial Reconstruction Bank of India (IRBI) and Unit Trust of India (UTI) accounted for the major portion of total assistance sanctioned by all financial (term lending) institutions in 1989-90 as also in previous two years.

8.53 Industry-wise major beneficiries during these last three years were textiles, rubber, machinery, food products, cement, transport equipment, electricity generation, fertilizer, iron & steel, electrical and electronic equipments, non-ferrous metals, chemicals and chemical products. Disbursements recorded very significant growth rates in the case of iron & steel, food products, textiles, rubber and machinery.

8.54 Purpose-wise, sanctions of direct assistance by all India financial institutions between 1987-88 and 1989-90 recorded an annual average growth rate of 28 per cent for new project, 76 per cent expansion/diversification existing projects and 29 per cent for modernisation/rehabilitation of existing projects and 33 per cent for supplemental assistance.

8.55 During 1990-91 total assistance sanctioned by all financial institutions including Small Industries Development Bank of India (SIDBI) was to the tune of Rs. 20,140 crores which is 28.8 per cent higher than the assistance of Rs. 15163 crores during 1989-90. Disbursements also recorded an increase of 23.0 per cent in 1990-91 stood at Rs. 12,299 crores as against Rs. 10,001.7 crores disbursed in 1989-90. In 1990-91 to the All-India financial institutions accounted for the lion's share in the sanctions and disbursements made by the all financial institutions Table 4.8 in the Appendix presents institution-wise details of sanctions and disbursements right from 1980-81 to 1990-91.

8.56 During the year 1989-90 various new schemes of assistance were introduced by the term-lending institutions. They include Mahila Udyam Nidhi Scheme, Mahila Vikas Nidhi Scheme, Equipment Credit and Buyers Credit, Asset Credit Scheme. IFCI lent support to the setting up of Rashtriya Gramin Vikas Nidhi at Guwahati. UTI and ICICI together set up their second Venture Capital Fund (VECAUS-II) of Rs. 100 crores. UTI also set up the UTI Institute of Capital market at New Bombay in order to promote advanced professional education training and research in the field of capital market.

8.57 It is also important to note that all-India financial institutions and public sector banks have been promoting some specialised financial institutions in the past two to three years. ICICI along with other financial institutions and nationalised banks promoted in 1986 Shipping Credit and Investment Company of India Ltd. (SCICI) which has been entrusted with the responsibility of extending finance for the acquisition of ships and fishing trawlers, apart from acting as an agent of the Government for rehabilitation of sick companies in the shipping and fishing sector. On cumulative basis, assistance sanctioned by SCICI sanctioned assistance of Rs. 1108.58 crores and disbursed assistance to the tone of Rs. 591.20 crores upto March 31, 1991, IFCI along with other all-India Financial Institutions, State Bank of India, Canara Bank and Bank of India has set up in 1989 the Tourism Finance Corporation of India (TFCI) which will provide both rupees and foreign currency assistance underwrite/directly subscribe to share/debentures, provide facilities of suppliers 'credit, equipment leasing/procurement to enterprises in the field of tourism and related activities. Upto the end of March, 1991, TFCI sanctioned cumulative assistance aggregating at Rs. 137.8 crores out of which a sum of Rs. 52.0 crores were disbused. Similarly thet Stock Holding Corporation of India Ltd., was set up in 1987 by the seven all-India financial institutions to service the securities transaction of these institutions. Government have recently approved the extension of the jurisdiction of this Corporation to cover all public finance institutions and public sector banks.

8.58 Another remarkable development is the entry of these institutions into the area of venture capital. Venture capital funds provide an alter native way of raising resources, suitable to the specific risk needs of the company. Venture capital assistance is now more readily available with the promotion of venture capital funds by IDBI, ICICI and IFCI. Jointly with the Department of Biotechnology, these three all India financial institutions have promoted during 1990-91 a venture capital company hnown as Biotech Consortium India Limited, with the specific intention of making venture capital available for commercialisation of biotechnology.

8.59 Maintenance and construction of road has since been declared as an industrial concern eligible to financial assistance by IDBI. Energy conservation schemes have been given greater support by linking rebate on interest to the extent of energy saved and raising the limit of assistance from Rs. 4 crores to Rs. 5 crores per unit. Consortium financing arrangements among all India financial institution were modified during last financial year. Besides assistance by way of leasing finance, bills discounting etc. which are already outside these arrangements, assistance to project costing upto Rs. 20 crores has been brought out of the perview of consortium arrangements.

8.60 Effective from August 1, 1990, interest rate structue for industrial finance by term lending institution was liberalised. Earlier to this basic lending rate for term loans of the financial institutions was set at 14 per cent per annum. With the revision a two-tier interest rate structure was introduced, according to which for the first two years or till the completion of the project (whichever is earlier) the interest rate on term loans has been fixed at 14 percent (Tier 1) and for the remaining period basic lending rate would be 15 per cent (Tier 2) the concession rates generally range from 11.5 per cent to 12.5 per cent for Tier 1 and from 12.5 per cent to 13.5 per cent for Tier 2.

8.61 Along with the diversification in the activity of financial institutions and increasing variety of such institutions, there is an on-going trend of encouraging public financial institutions to be more autonomous and self-sufficient in their resources and in accessing the capital market. During 1990-91 for the first time ICICI offered a public issue for Rs. 50 crores. SCICI noted earlier also offered a public issue of Rs. 82 crores including a premium of Rs. 41 crores. ICICI also offered a rights issue of Rs. 18 crores including a premium of Rs. 9 crores. Greater transparency is also being expected of these institutions in the manner in whih they conduct their market operations in the shares of the companies. In the interest of such transparency for any sales of over 1 per cent of the paid-up capital of a company the concerned financial institution is required to provide the general public with information regarding such transaction and the price at which it has been made.

8.62 Any review of the financial operations of the term-lending institutions will indicate that they have a very important role in the credit market of the country and their liabilities and assets have grown quite fast. In addition, they are acting quite closely with the scheduled commercial banks and their earlier compartmentalisation/segmentation into term-loan and working capital categories have been blurred rather significantly and replaced by a degree of continium. In this background it is important to ensure not only that business of these non-bank financial institutions is conducted prudently and their sound financial health is maintained, but also that their credit policies are consistent with the overall monetary policy pursued by RBI.

Developments in the Money Market

8.63 The Indian money market is becoming more and more diversified, as a result of various measures taken over the past several years by RBI and Government Trading in various instruments like 182 Days Treasury Bills, commercial bills and commercial paper had also expanded considerably. The volume of inter-bank call money, short notice money and term money transactions has grown considerably in recent years.

8.64 Until recently only scheduled commercial banks, co-operative banks and the Discount and Finance House of India (DFHI) were permitted to participate both as lenders and borrowers in the call/notice money market, while

Life Insurance Corporation of India (LIC) and Unit Trust of India (UTI) were already allowed to operate as lenders. Effective May 2, 1990 the General Insurance Corporation of India (GIC) the Industrial Development Bank of India, (IDBI), and the National Bank for Agriculture and Rural Development (NABARD) were permitted to participate in this market as lenders. These institution have augmented the flow of funds in the call money market. With a view to further widening the call and notice money market and bringing about a greater integration of various segments of the money market all the participants in the bills/rediscounting market who were till then not operating in the call/notice money market, were granted access into this market as lenders with effect from October 20, 1990.

8.65 Banks with over-extended credit positions have been advised to undertake structural adjustments to correct their chronic and large dependence on the call money market. Revised schedule of graduated penalties on CRR shortfalls, which had softened the penalties, would help to moderate interest rates in the call money market.

8.66 Among the money market instruments, 182 Days Treasury Bills have become most important. Regular fortnightly auctions are being held for these bills. Banks in particular have appreciated the obvious advantages of this versatile money market instrument and are both increasingly participating in the primary auctions and dealing actively in the secondary market for these bills. Inter-bank participations (IBPs) with risk sharing have been issued only by a few banks for small amounts, no bank had so far issued IBPs without risk sharing.

8.67 It may be recalled that Certificates of Deposit (CDs) were introduced by RBI in June 1989 to give investors greater flexibility in the deployment of their short-term funds. The primary market was sought to be expanded by the RBI with the enhancement of the limit for issue of CDs by scheduled commercial banks (excluding RRBs) in the beginning of 1990-91 (effective May 23, 1990) from one per cent of the fortnightly average outstanding aggregate deposits in 1988-89 to two per cent of the fortnightly average outstanding aggregate deposits in 1989-90. This meant a rise in the overall limit for the issue of CDs for the banking system from Rs. 1,264 crores to Rs. 3,018 crores. The denomination of CDs would be in multiples of Rs. 10 lakhs (as against Rs. 25 lakhs stipulated earlier), subject to the minimum size of an issue to a single investor being Rs. 50 lakhs. The limit had been further enhanced to 3 per cent of the banks fortnightly average aggregate deposits and denomination reduced to multiples of Rs. 5 lakhs subject to the minimum size of issue to a single investor being Rs. 25 lakhs, effective December 29, 1990. Consequently, the overall limit for the issue of CDs for the banking system rose to Rs. 4,522 crores. However, secondary market in CDs has not grown very much. The DFHI has begun offering quotas for purchase of CDs.

8.68 Similar relaxations were also made in the guidelines for issue of Commercial Paper (CP) introduced in the market in 1990-91. The relaxed guidelines made effective from April 24, 1990 aimed at broad-basing the primary market as also widening the scope for secondary market and provide, inter alia, that (a) the tangible net-worth of the company issuing CP should not be less than Rs. 5 crores (Rs. 10 crores earlier), (b) working capital (fund based) limit of the company should not be less than Rs. 15 crores (Rs. 25 crores earlier), (c) minimum credit rating from Credit Rating Information Services of India Limited (CRISIL) can be P1 (instead of P1+ earlier) and (d) the CP can also be in multiples of Rs. 10 lakhs (instead of Rs. 25 lakhs earlier) subject to the minimum of an issue to a single investor being Rs. 50 lakhs (as against Rs. 1 crores earlier). It may be appreciated however, that prescription of strict standards for the issue of CPs had been consciously done with a view to preventing the incidence of failure and as the market matures, wider access may be permitted. The CP is meant to be an instrument to provide flexibility to borrowers rather than additionality of funds over and above the eligible credit limit. Furthermore, at the initial stages of its devlopment, it is necessary to regulate an orderly queue for issue.

8.69 Development of bill culture is important for establishment of an efficient payments system. An active secondary market in commercial bills will develop only if the primary market for these bills expands sufficiently. In order to encourage the bill culture, RBI advised, as early as in March 1987 that effective April 1, 1988 the credit limits sanctioned by a bank to the erstwhile Credit Authorisation Scheme (CAS) borrowers against book debts should not be more than 75 per cent of the aggregate limits sanctioned to such borrowers for financing inland credit sales. More than three years had lapsed since this advice was tendered. RBI has therefore, recently advised the scheduled commercial banks that in the case of fund-based working capital limits of Rs. 5 crores and over, with effect from January 1, 1991, interest at 2 percentage points higher than the interest rates on relevant cash credit should be levied on that portion of the book debt finance which exceeds the stipulated norm of 75 per cent of the limits sanctioned to borrowers for financing inland credit sales. It is intended to bring about a reduction in a phased manner in the proportion of permissible level of book debt financing from the current level of 75 per cent and accordingly the banks have been informed to advise their constituents to reduce their reliance on book debt financing.

8.70 As noted earlier, call money rates show considerable volatility. With the freeing of call money rates from May 1, 1989, many banks have been alternating between lending and borrowing and thus are contributing to a reduction in the lopsidedness of the market. Even than it is observed that call money rates generally rise sharply in the first week of the reporting fortnight and subside in the second week after the banks have met their CRR requirements. The rate rose to as high as 58 per cent (on April 6, 1990) and declined to as low as 6.5 per cent (on February 9, 1990). However, though not regulated, interest rate on Commercial Paper ranged between 11.87 per cent and 15.63 per cent. In the case of CDs the rates typically offered for three months were in the range of 11 per cent to 12.5 per cent and for maturity of one year the typical rates ranged between 12.00 per cent and 13.00 per cent. The interest rates offered on CDs appear relatively high, considering the fact that they are subject to reserve requirements.

8.71 The Reserve Bank has initiated further measures to introduce greater flexibility in cash management by banks. At present they are permitted to maintain the stipulated cash balances as an average of a fortnight. With the implementation of the modified scheme of graduated Interest Rate on eligible cash balances of banks and wider access now being provided to them under the discretionary refinance facility, banks should be able to bring about an improvement in their funds management and money market rates would then reflect better the underlying liquidity conditions.

8.72 During recent years the DFHI was able to moderate the stringency in the money market by leaning agains the wind. While DFHI does attempt to provide additional liquidity when stringency develops in the market, in the interest of overall monetary policy it has to limitits dependence on the Reserve Bank. A money market, however, well developed, should not be a source of over-coming structural disequilibria in the sources and uses of funds of the participants. The DFHI should be considered primarily as an agency for evening out short-term dis equilibria in the money market and not as a source for meeting long-term fund requirements.

Institutional Developments in the Financial Sector

8.73 The Discount and Finance House of India Limited (DFHI) has been playing an important role as the appex agency in the Indian money market ever since its inception. It has continued its efforts at fostering the active participation of the scheduled commercial banks and their subsidiaries, state and urban co-operative banks and all India financial institutions in the money market with a view to ensuring that their short-term surpluses and deficits are equilibrated at market-related rates through inter-bank transactions and various money market instruments. During 1990-91 DFHI opened branches at Delhi, Calcutta, Madras, Ahmedabad, and Bangalore in order to decentralise its activities and provide money market facilities at the major money market centres in the country. Apart from its paid up capital of Rs. 150 crores, it has lines of refinance from RBI and a line of credit from the consortium of public sector banks.

8.74 Through its money market operation beginning from April 25, 1988 DFHI has been successful not only in developing 182 Days' Treasury Bills into a highly liquid instrument but also in creating a secondary market for these bills. During 1989-90 cumulative turnover of these bills nearly doubled as compared with the level in 1988-89 and reached a figures Rs. 21,953 crores. In 1990-91 it had increased to Rs. 32,329 crores.

8.75 DFHI's turnover in the inter-bank call (overnight) and short notice (upto 14 days) and term money (over 14 days and upto 90 days) money market has also grown significantly in 1990-91. Its turn-over in the inter-bank call money market amounted to Rs. 1,98,960 crores in 1990-91 as against a turnover of Rs. 87,927 crores during 1989-90. The daily average turnover in this market has significantly increased from Rs. 241 crores in 1989-90 to Rs. 545 crores during the 1990-91. The turnover in short notice money and term money during 1990-91 amounts to Rs. 3,832 crores and Rs. 3,532 crores respectively.

8.76 DFHI started its operations in the secondary market of commercial bills and commercial paper (CP) in 1989-90. The turnover in commercial bills totalled at Rs. 10,682 crores in 1989-90 and stood at Rs. 12,675 crores in 1990-91. Turnover in commercial paper has, however, remained at a modest level of only Rs. 107 crores in 1990-91.

8.77 The secondary market for Certificates of Deposit (CD) has not yet developed because investors in CDs who purchased them at atractive rates, preferred to hold them till maturity. As such there was a nominal turnover in CDs of Rs. 8 crores during 1990-91.

8.78 The National Housing Bank (NHB) which started its operations from July 1988 has been actively involved in the development of housing finance in the country. It is interested not only in the promotion of a sound institutional framework for such finance but has also been striving to augment the supply of real resources i.e., land and building materials, with the accent placed on savings specific to meet the housing needs. These initiatives were continued in the year under review with appropriate modifications and additions in the light of field level exprience and feedback.

8.79 In co-operation with the scheduled commercial banks and co-operative banks, NHB launched Home Loan Account Scheme (HLAS) on July 1, 1989 with a view to mobilising resources from the households, specifically for construction of houses/flates. On the basis of information received, more than 4 lakh people have become HLA member till the end of March, 1991. The amount of deposits totalled Rs. 68 crores. The scheme has since been extended to select housing finance companies.

8.80 In consultation with RBI and Government of India NHB introduced certain changes in the scheme to make it more attractive. These changes include, inter alia, linking of amount of loan to accumulated savings as their multiple instead of linking to the size of accomodation earlier, extension of part withdrawal facility, earlier available only for paying registration fees for specific schemes of housing agencies etc., to purchase of a plot allotted in any land development and shelter project refinanced by NHB, reduction in minimum saving period to 3 years from 5 years (in case of allotment of a house/flat in any project financd by the Bank)., permission to withdraw accumulate savings in case of a decision by the saver not to acquire house/flat. The ceiling of Rs. 3 lakhs loan under HLAS has also been removed.

8.81 In 1990-91 provisions of the refinance scheme of NHB introduced in 1989 for eligible housing loans were liberalised in March 1990 and again in October 1990 consequent to the restructuring of the lending rates of scheduled commercial banks by RBI with effect from September 22, 1990. Accordingly, the ceiling for 100 per cent refinance has been increased to Rs. 2 lakhs on housing loans for construction/acquisition of new housing units with built up area not exceeding 40 sqm. In respect of loans for units with more than 40 sqm. built up area, costing not more than Rs. 1.50 lakhs and for major repairs and upgradation, refinance will be 100 per cent upto Rs. 1 lakhs and upto Rs. 30,000 respectively.

8.82 By May, 1991 refinance provided by NHB to all categories of eligible primary lenders amounted to about Rs. 480 crores. NHB also participates in the equity of the housing finance companies to the extent of 20 per cent of their paid up capital on merits of each case. Till now, equity participation/commitment has been of the order of Rs. 4.55 crore in 4 housing finance companies.

8.83 Guidelines have been formulated by NHB to involve public agencies, co-operative housing societies and professional developers in land development and shelter projects (LDSPs) in order to ensure that basic thrust towards housing construction of smaller dwelling units in keeping with its motto "small man first" is maintained. The guidelines, inter alia, prescribe certain parameters, compliance with which would enable agencies to avail of financial support from NHB. Refinance schemes covering loans given by scheduled commercial banks and housing finance companies for execution of LDSPs as also rental housing schemes conforming to NHB's guidelines were introduced. To facilitate timely adjustment of project loans given by banks and housing finance companies, a separate refinance scheme covering housing loans to allottees of plots developed or dwelling units constructed thereunder was also introduced. Till middle of May 1991 it has approved 42 detailed project reports costing Rs. 297.85 crores to enable the development of 17,803 plots and construction of 38,401 dwelling units of various categories. It also has approved projects for the manufacture of low cost building materials with total project cost of around Rs. 17 crores for equity participation of Rs. 76 lakhs under its policy to support building material industry as a part of real sector intervention.

8.84 Several steps have been taken recently to augment the resources of NHB. The paid-up capital of the Bank has been raised to Rs. 200 crores by the contribution of RBI who have also sanctioned a long term loan of Rs. 125 crores to NHB out of the National Housing Credit (Long Term Operations) Fund established by RBI. The bank has also issued 20 year bonds (with 11.5 per cent interest) worth Rs. 160 crores with guarantee from the Government of India. NHB has launched in July 1990 three year non-transferable/non-negotiable Capital Gains Bond Scheme carrying 9 per cent interest rate per annum and providing 100 per cent tax exemption on capital gains arising out of sale/transfer of long term capital assets like land, building, shares and securities, jewellery etc. Under this scheme NHB has collected a sum of Rs. 61.44 crores till middle of April, 1991. The United States Agency for International Development (USAID) has approved a programme to provide loan guarantee for US $50 million to NHB under the USAID Government Housing Guarantee Programme in terms of which developing countries can borrow in the US capital market with US Government guarantee for periods upto 30 years. Under this NHB has raised as first tranche US $25 million (approx. Rs. 48.74 crores). Lastely, it has also succeeded in securing a loan agreement with Overseas Economic Co-operation Fund (OECF) of Japan for 2.97 billion Yen (approx. Rs. 50 crores).

8.85 An important institutional development in the financial sector in 1990-91 has been the setting up of an apex bank for small-scale industries, known as the Small Industries Development Bank of India (SIDBI). With its Headquarter at Lucknow, SIDBI has a network of 26 regional and branch offices. It commenced its operations from April 2, 1990 with a portfolio of Rs. 4,200 crores and it has taken over from IDBI the responsibility of administering Small Industries Development Fund and the National Equity Fund. As the principal financial institution for the promotion, financing and development of small scale industries it will work towards co-ordinating the functions of existing institutions engaged in similar activities. Among its new initiatives are introduction of new schemes to fill the gap existing in the system, technological upgradation and modernisation of existing units, extension of support services for the healthy growth of the small sector and strengthening of the credit delivery system for the sector. Besides, it has schemes for direct assistance to specialised marketing enterpreneur and for the development of industrial areas, direct discounting and rediscounting of trade bills.

8.86 In the Economic Survey 1989-90 it was mentioned that the Reserve Bank decided to initiate steps for establishing domestic factoring services as a first priority and promoting legislative measures to introduce factoring services on a full-fledged basis. Factoring has since been notified as a form of business in which banks/ subsidiaries of banks can engage, under the Banking Regulation Act, 1949. For all the four regions of the country, western, eastern, northern and southern, scheduled banks have applied for launching factoring services and these applications are under consideration. These factoring agencies will help units not only in removing the constraints of working capital but also in credit management and also offer protection to the units by providing necessary expertise in assessing risks. Factors will in turn have the benefit of readily available business from the small scale sector. Persuant of this Government notification, the State Bank of India set up, on February 26, 1991, a new subsidiary called the SBI Factors and Commercial Services Private Limited (SBIFACS), for rendering factoring services to the industrial units in Western India, covering the States of Maharashtra, Madhya Pradesh, Gujarat and Goa and the Union Territories of Dadra, Nagar Haveli, Daman and Diu. While the Bank will have the majority shareholding of 54 per cent, Small Industries Development Bank of India (SIDBI), Union Bank of India, State Bank of Saurashtra and State Bank of Indore will contribute the balance share in the total capital of Rs. 25 crore.

8.87 The Credit Rating Information Services of India Limited (CRISIL), the first credit rating agency of the country, which started its operations in January, 1988, continued to make steady progress in its operations during 1990-91. CRISIL rates debt obligations of Indian companies like debentures, fixed deposit programme, short-term instruments and preference shares at the request of a company . It takes into account various factors like industry risk, market position, financial position, accounting quality profitability operating efficiency and track record of the management of the compnay in assigning credit ratings. CRISIL has developed, initially for State Bank of India, a special product known as 'CREDIT ASSESSMENT' for small-sized finance companies this service is now being used by some of the nationalised banks also as an additional input in their decision making process on the terms of lending to such companies. CRISIL also launched its quarterly publication, CRISIL RATINGSCAN which presents the rationale for ratings assigned, the list of ratings in use as well as ratings reviewed during a quarter and instruments placed under RATINGWATCH for possible review in the rating. During 1990-91 CRISIL also developed a new service called the CRISIL CARD services which provides information on Indian companies. By March, 1991, CRISIL had rated 176 debt instruments issued by 124 companies (including three belonging to public sector) covering a total debt volume of Rs. 4,357 crores. Apart from fixed deposit programmes, convertible and non-convertible debentures, CRISIL had rated 44 commercial paper programmes covering a total volume of Rs. 423 crores. In addtion, CRISIL had completed 'credit assessment' of 44 companies. During 1990-91 the Government has given permission for a second credit rating agency known as the Investment Information and Credit Rating Agency of India Limited (ICRA) to be set up. The new credit rating agency to be promoted by IFCI has accordingly been incorporated and will begin operations shortly.

New Trends in the Financial Sector

8.88 Demand for various types of financial services such as new issues management, corporate counselling, capital structuring and loan syndication is growing in the financial sector. New and risky lines of business also look for support in the nature of venture capital. With the introduction of suitable legislative changes, financial institutions and bank subsidiaries have been permitted to enter this activity. In the context of growing competitive environment in the financial market, commercial banks have diversified into fresh areas of business.

8.89 Over the years mutual funds have grown both in size and importance in the financial market. These funds play a pivotal role in mobilizing savings of the community particularly from middle-class and small investors by providing them the benefits of expert portfolio management aimed at both minimizing risks by spreading them across a large number of securities and realising a fair return on investment. In recent years the Unit Trust of India (UTI) has also been playing a stabilising role in the capital market by intervention at appropriate junctures. As the leading institution in mutual funds industry active since 1964, the UTI mobilized Rs. 18,104.82 crores as on 31st December, 1990 out of which sales mobilised during April-December, 1990 aggregated at Rs. 2,783.86 crores. During full financial year 1990-91 UTI mobilised Rs. 3926 crores. The thrust of its policy has been to convert many potential small investors across the country into actual investors by offering various new attractive schemes.

8.90 Since 1987 some public sector commercial banks viz., State Bank of India (1987), Canara Bank (1987), Indian Bank (1989), Punjab National Bank (1990) and Bank of India (1990) have also set up mutual funds through their merchant banking subsidiaries. The Life Insurance Corporation of India (LIC), also launched its mutual fund in 1989. These mutual funds are reported to have raised over Rs. 1,500 crores in 1989-90. In 1990-91, General Insurance Corporation of India (GIC) has also set up its mutual fund. It is estimated that total resources raised so far through various mutual funds (including UTI) crossed Rs. 20,000 crores mark.

8.91 State Bank of India has taken a further step to raise foreign exchange resources by issuing two series of three year bonds known as NRI bonds (repatriable in Rupees only) that carry an interest rate one percentage point higher than that on FCNR US dollar deposits of three years.

8.92 Another important area in which Indian banks have entered recently is offshore funds. Unit Trust of India took the lead in the field of offshore funds by starting two funds viz., (a) India Fund, launched in July 1986 in collaboration with Merrill Lynch of London and (b) India Growth Fund in August 1989 in collaboration with Merrill Lynch and Nomura Securities International Incorporated, registered as investment company in USA. These funds to which non-resident Indians and foreigners had subscribed, are quoted in the London and New York Stock Exchanges respectively. In 1989-90. State Bank of India has also launched two tranches of its offshore funds, known as Indian Magnum Fund (September, 1989). The Fund listed on the Amsterdam Stock Exchange and managed by a wholly owned subsidiary of the State Bank of India. Further, this subsidiary will be the investment manager for the Indian portfolio (20 per cent) of the multi-country offshore fund called Asian Convertible and Income Fund launched by Asian Development Bank (ADB) in January, 1990. Lastly, Canara Bank came up with its offshore fund called Himalayan Fund NV on June 19, 1990 registered as a limited company in the Netherlands in collaboration with Banque Indosuez, Paris. Fund shares are proposed to be listed in major international stock exchanges.

Recent Policy Developments

8.93 In the financial year 1990-91 money supply (M3) recorded a subdued growth rate of 15.1 per cent while the growth of gross domestic product is expected to have been of the order of 5 per cent (as against 5.2 per cent in 1989-90) particularly because of a slow-down in the performance of the industrial sector. Deteriorating balance of payments position and lagged effect of the liquidity built- up caused by high order of monetary growth in 1988-89 and 1989-90 contributed to the acceleration of inflationary pressure in 1990-91. Both on point-to-point basis and on average annual rate basis price-inflation rate as measured by the wholesale price index has been much higher in 1990-91 than in 1989-90 (12.1 and 10.3 per cent as against 9.1 and 7.5 per cent respectively). Large loss of foreign exchange reserves reflecting the balance of payments crisis has made the import control and export promotion as important an objective of monetary and credit policy as the price stability.

8.94 In matters of credit policy, a development of considerable importance during 1990-91 and the first quarter of 1991-92 has been the deployment of monetary and credit policy measures to curb aggregate demand in general and to restrain in particular demand for the imports of capital goods and other categories of goods in the wake of an acute balance of payments crisis and precipitious loss of foreign exchange reserves. Based on the emerging situation, the Reserve

Bank of India has been undertaking stiffer and stiffer measures so much so that finally cash margins of as much as 200 per cent on imports of good under OGL and 150 per cent on imports under specific licences were imposed. Besides, a levy of 25 per cent interest surcharge on a bank lendings for all import finance was also introduced. A number of specific measures, as also general credit policy measures impinging on the use of bank credit for import purposes as under taken by the Reserve Bank, have been described in subsequent paragraphs of this chapter. In this otherwise restrictive policy stance, care has been taken to ensure that export efforts are not jeopardised and towards that end, the Reserve Bank of India has exempted export credit from the purview of the above regulations. Simultaneously opportunity has been taken to build into the policy package sufficient incentive for the faster realisation of export proceeds. Besides, export refinance facility from the Reserve Bank has been enhanced and export credit stands exempted from the stipulation regarding incremental non-food credit deposit ratio which, excluding export credit, has been set at 45 per cent for 1991-92 (as against 60 per cent including export credit in the previous years).

8.95 Against the above background the monetary and credit policy announced by RBI for the first half of 1991-92 (slack season) reflected the concern of the Reserve Bank for conserving the acutely scarce foreign exchange resources of the country through restriction on credit of the commercial banks for import as also for ensuring that adequate amount of credit is supplied to meet the genuine demands for credit for production, export and internal trade, even as preventing at the same time the speculative use of bank advances. Simultaneously, the credit policy has also sought to enhance the competitive position of the banks in deposit mobilisation and promote money market development.

8.96 As explained in the initial paragraphs, the Reserve Bank has sought to restrict the commercial bank's finance for imports with a view to conserving scarce foreign exchange. Some measures were initiated during the months of September-December, 1990. However, as the foreign exchange situation deteriorated particularly since mid-March 1991, the credit policy measures concerning import finance, were progressively tightened by the Reserve Bank. Thus there were restrictions on the sale of foreign exchange for import of capital goods which are now required to be channelled through the foreign currency lines of credit available with the financial institutions. After March 19, 1991 banks have been advised to insist on margin requirements of $133\frac{1}{3}$ per cent and 110 per cent for imports under OGL and for imports under specific licence respectively at the time of opening of Letters of Credit (LC) for import of goods other than capital goods. Effective April 22, 1991, the minimum required cash margin for LC for OGL import has been further raised to 200 per cent and for import under specific licence to 150 per cent. These restrictions will not however, apply to departmental imports of Government, imports of POL, fertilizer, foodgrain, edible oil, newsprint, life saving drugs and life saving equipments upto Rs. 2 lakhs. Further, with effect from April 23, 1991, RBI has waived the requirement of minimum cash margin against post-payment import replenishment licences as Government of India decided to issue such licence after the export proceeds have been realised.

8.97 Since it is also necessary to encourage early repatriation of export proceeds by the exporters and make delayed repatriation costly in the month of April, 1991. RBI has therefore, twice revised upwards the interest rate on post-shipment credit of more than 90 days. The interest rate will be 18 per cent (as against 8.5 per cent earlier) on such credit, if proceeds are repatriated after 90 days. The applicable interest rate will rise to 25 per cent for the entire period from the date of advance, if the proceeds are repatriated after 180 days.

8.98 Major reforms introduced and initiatives taken by RBI in its credit policy announced on April 12, 1991 for the first half of the current financial year 1991-92 include:

(a) An upward revision in the interest rate on deposits of three years and above from 11 per cent to 12 per cent. This would bring the maximum deposit rate of the commercial banks into better alignment with the yield on alternative savings instruments and reflect the current inflation rate. Interest rates on the Non-Resident (External) Rupee Deposits for maturities of (i) 3 years to less than 5 years and (ii) 5 years and above were also similarly raised from 12 per cent and 13 per cent to 13 per cent and 14 per cent respectively.

(b) upward revision of interest rate on bank advances of over Rs. 2 lakhs from 16 per cent (minimum) to 17 per cent (minimum) and on discounting of bills for this category of borrowers from 15 per cent (minimum) to 16 per cent (minimum) with effect from April 13, 1991 in line with the upward revision of the highest deposit rate and keeping in view the urgent need to control monetary expansion. Interest rates on term loans to agriculture, small-scale industry and transport operators (upto two vehicles) have been left unaltered.

(c) Stipulation of non-food credit (excluding export credit)—deposit ratio at 45 per cent in place of the incremental net non-food credit deposit ratio of 60 per cent. The base date for this ratio has been fixed at March 22, 1991 and the ratio would be monitored cumulatively on a fortnightly basis and the defaulting banks will be charged additional 3 percentage points interest rate with effect from the fortnight beginning April 20, 1991 on refinance drawn from the RBI under all facilities (export, stand-by, discretionary and 182 Days Treasury Bill).

(d) Introduction of a new formula for determining export credit refinance limit for the scheduled commercial banks:—effective July 27, 1991 banks will be provided export refinance to the extent of 50 per cent of the increase in export credit over the monthly average level of 1988-89 upto the monthly average of 1989-90 plus 100 per cent of the increase over the monthly average level of export credit in 1989-90. This would help the banks in catering to the additional credit needs of the export sector without facing resource constraints.

(e) The three-year base period—1986-87, 1987-88 and 1988-89 (November—October) shifted to new base of 1987-88 through 1989-90 (November—October) for determining credit ceilings of banks advances subject to selective credit controls April 13, 1991, the level of credit ceilings applicable on oilseeds/vegetable oils has been reduced to 85 per cent from 100 per cent of the peak level of credit in the base period mentioned above, in view of adverse price-output developments in respect of these commodities. Effective the same date, the interest rate on all advances against the commodities covered under the selective credit control was changed to 17 per cent (minimum).

8.99 Among the initiatives taken for the development of money market under this new credit policy are:

(a) To enable banks to effectively compete with other institutions for raising bulk funds from the market and to give them flexibility to raise funds from the market in need, CD limits for banks have been enlarged to 5 per cent of their fortnightly average outstanding aggregate deposits in 1989-90. Guidelines for the issue of Commercial Paper (CP) have been relaxed to facilitate wider participation and also to ensure a greater degree of flexibility of operation. Inter alia, the working capital (fund-based) limit of the company has been reduced to Rs. 10 crores (instead of Rs. 15 crores earlier) the ceiling on issue of CP has been raised to 30 per cent from the limit noted above, and the denomination of CP could be in multiples of Rs. 5 lakhs (Rs. 10 lakhs earlier) subject to the minimum size of an issue to a single investor being Rs. 25 lakhs (face value) instead of Rs. 50 lakhs (face value) earlier. The proposals for issue of CP by eligible com panies will not be required to be approved by Reserve Bank of India from May 30, 1991.

(b) Such entities as can observe a minimum size of operations of Rs. 20 crores per transaction (permitted only through DHFI) will be allowed access as lenders to the call/notice money and bills rediscounting market.

(c) Decision to permit scheduled commercial banks and their subsidiaries to set up Money Market Mutual Fund:—This would provide an additional short-term avenue to investors and bring money market instruments within the reach of individuals and small bodies. A broad framework of the scheme for Money Market Mutual Fund (MMMF) has also been set out. The minimum size of investment for MMMF would be Rs. 1 lakh and repurchases could be subject to a minimum lock-in period of 3 months. The funds mobilised by MMMFs would not be subject to reserve requirements and could be invested in specified short-term money market instruments with a priority attached to 182 Days Treasury Bills (minimum 20 per cent of the funds to be held in these bills). A Task Force consisting of representatives of banks and the RBI will work out the detailed operative guidelines and the documentation for these Funds.

8.100 Another recently adopted measure by RBI towards the moderation of monetary demand in order to contain the overall demand is the reintroduction of Incremental Cash Reserve Ratio (ICRR) for the scheduled commercial banks over and above the usual CRR of 15 per cent. With effect from May 4, 1991 the scheduled commercial banks are required to maintain an ICRR of 10 per cent on their increase in net demand and time liabilities over the level reached on May 3, 1991. The effect of this stipulation will vary from bank to bank depending upon a particular bank's rate of growth of such liabilities. A rate of interest of 8 per cent will be paid on these additional cash balances **maintained under the Incremental Cash Reserve Ratio.**

8.101 Due to the difficulties experienced by banks in effectively implementing measures of credit restraint under the existing cash credit system, there was a sizeable gap between the limit sanctioned and the actual utilisation. In view of the imperative need to restrain credit expansion in the immediate few months particularly in the context of the need to conserve foreign exchange reserves, banks were advised that, in the case of all accounts of borrowers with aggregate credit limits of Rs. 1 crore and over from banks, the effective drawing power under the limits for cash credit and inland bills for the period May 9, 1991 upto September 30, 1991 was limited to 100 per cent of the peak levels of actual utilisation during the corresponding period of May 9—September 30 in the past three years. Banks were required to ensure that this method of arriving at the effective drawing limit did, in no case, result in raising the cash credit limits as they stood on May 8, 1991. However, limits authorised by the Reserve Bank of India, as also export credit, (export finance limits sanctioned for pre-shipment and post-shipment purpose) and sick/weak units where rehabilitation packages have been sanctioned would be outside the framework of this stipulation. Some flexibility has been allowed in their application of the peak utilisation in case of newly-established units which are due to start production and in case of existing units undergoing the process of expansion, diversification or modernisation. In case of sugar industry, the banks would sanction need-based credit limits not exceeding 110 per cent of the peak level of actual utilisation.

8.102 On May 8, 1991, the Reserve Bank of India announced some fresh restrictions on credit expansion in order to conserve foreign exchange reserves. It is stipulated that for a bank borrower charged a rate of 17 per cent (minimum), the use of bank credit to finance imports should be earmarked under a separate sub-limit of his total cash credit limit and the outstandings under this import credit sub-limit will attract also an additional interest surcharge of 25 per cent (thus implying an interest rate of 21.25 per cent for drawals of import finance). This surcharge, which will be levied on finance of all imports subject to "nil" cash margin as well as imports subject to prescribed margin, will however not be applicable to bank finance provided to meet the cost of imported inputs covered by export packing credit. The surcharge will be applicable to: (a) drawal of bank finance for providing cash margin; and (b) past commitments or transactions in the pipeline for finance of capital goods imports. While the outstandings under the import sub-limit will stand reduced, when the cash margin on import is released, repayment to the import sub-limit will be allowed from sale-proceeds only after a minimum interval of one month. Effective May 31, 1991 the Reserve Bank advised the banks to exempt import of goods other than capital goods, under suppliers' credit for one year and above from the requirement of prescribed minimum cash margin of 50 per cent (imposed on March 19, 1991). Effective June 6, 1991, in the interest of export promotion, manufacturer—exporters of finished leather/leather products, chemical and pharmaceuticals, engineering goods, garments and marine products have been permitted to import other than capital goods without any cash margin to the extent of 10 per cent of their actual export realisation from the General Currency Area subject to the ceiling of Rs. 2.5 crore in a year. Imports of hides and skins from USSR have been fully exempt from the requirement of prescribed cash margins. The above relaxation, however, will be available where no export bill remains outstanding beyond a period of six months from the date of export. Opening of Letter of Credit for import of capital goods from USSR, Czechoslovakia and Romania (during the valid period of the agreements with each of them) have been permitted, effective June 13, 1991.

8.103 In view of the likely shortage of funds for the scheduled commercial banks consequent upon the stipulation of the incremental CRR, RBI has formally advised the banks to freeze, for the period May 9 to September 9, 1991, drawing powers of borrowers with aggregate cash credit and bills limits of Rs. 1 lakh and above to 100 per cent of the peak levels of actual utilisation during May 9 through September 30 of first three years 1988-89, 1989-90 and 1990-91.

8.104 In consideration of increase in the arrears of cane price paid to sugarcane farmers and need to provide relief to them with effect from May 9, 1991, RBI has lowered the minimum margin applicable on bank advances against the unreleased stocks of sugar in the case of processing units/mills from 20 per cent to 17.5 per cent for a period of 3 months, i.e., upto August 8, 1991 after which the minimum margin would revert back to 20 per cent.

8.105 With effect from July 4, 1991, the Reserve Bank introduced a fresh set of monetary measures in a bid to curb imports and reduce aggregate demand. These measures seek to reinforce the cautious monetary policy stance of the Reserve Bank and are consistent with other instruments of policy being recently activated to achieve a speeder adjustment in the imbalances in external payments.

8.106 The important changes are as follows :— First there is an upward revision in the Bank Rate from 10 per cent to 11 per cent. The Bank Rate had remained at 10 per cent for quite a long time. Some interest rates on RBI credit are linked to this rate and consequent upon this rise in the Bank Rate these interest rates will also go up by one percentage point. Secondly, RBI has also enhanced the interest rate on its refinance facilities. Thirdly, RBI has raised interest rate on bank advances of over Rs. 2 lakhs from 17 per cent (minimum) to 18.5 per cent (minimum). However the term loans to agriculture, small scale industry and transport operators (upto two vehicles) will continue to be covered by the rates prescribed earlier. Finally the interest rates on term deposits of the scheduled commercial banks have also been raised across-the-board by one-percentage point to enable them to compete more effectively with alternative savings instruments in market. The new interest rates on the term deposits of the scheduled commercial banks and refinance facilities of the RBI are indicated below :

	Rate of interest (Per cent)	
	Old	Revised
I. Term Deposits		
(a) 46 days to less than one year	8.0	9.0
(b) One year to less than two years	9.0	10.0
(c) Two years to less than three years . . .	10.0	11.0
(d) Three years and above .	12.0	13.0
II. Refinance facilities of the Reserve Bank		
(a) Export refinance . .	9.0	9.5
(b) Standby refinance . .	12.5	13.5
(c) Discretionary refinance .	14.0 (minimum)	17.0 (minimum)
(d) Food refinance . .	11.5	14.0

OUTLOOK

8.107 The current environment in the financial sector is more open and competitive than before. The recent measures taken by the RBI and Government in the financial sector are in consonance with the economic liberalisation measures introduced in the fields of industry, foreign trade and technology. The money market is no longer segmented and regulated as it used to be earlier. Both the commercial banks and the financial institutions have diversified from their traditional areas of operation and their business has become more competitive. Greater stress has, therefore, been laid on efficiency in banks and financial institutions.

8.108 Liberalisation and competition generate pressures on the profitability of banks and financial institutions. Therefore, there is a need to pay greater attention to improvement in their financial viability. It is particularly urgent that the capital of banks and financial institutions is increased to enable them to absorb shocks. While Reserve Bank of India is continuously striving for improvement in technology in financial operations, institutional development and liberalisation of the regulatory framework, these banks and institutions should gear themselves to meet the challenges of the changing market environment.

8.109 To conclude the review of monetary and credit developments during in 1990-91 and thereafter a word of caution appears necessary that although monetary growth was comparatively modest in 1990-91, relative to 1989-90 there is a liquidity overhang in the economy with strong inflationary potential and that the country has too meagre a stock of foreign exchange to augment the aggregate supply of goods and services signficantly through imports. As noted earlier, net RBI credit to Government and particularly to Central Government, the principal source of reserve money growth, holds the key to monetary expansion. Since the budget deficit is the major component of Net Reserve Bank Credit to Central Government (NRCCG), moderation of monetary expansion will require control of the budget deficit. Fiscal discipline is, therefore, an important pre-requisite for monetary discipline.