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Monetary and Banking Developments

The current year is characterised by easy liquidity conditions in the banking system, signs of a pick up in non-food credit, and a fall in interest rates, including in the yields on Government securities. The drop in interest rates has been facilitated by relatively lower inflation. The downward trend in interest rates witnessed in recent years was strengthened with the Reserve Bank of India (RBI) reducing the Bank Rate by 25 basis points to 6.25 percent in its Mid-Term Review of Monetary and Credit Policy (October 29,2002). During the last five years, there has been a 4.75 percentage points reduction in the Bank Rate. At its present level, the Bank Rate is the lowest since 1973. The reduction in the cash reserve ratio (CRR) by 50 basis points to 5.0 percent from June 1, 2002 and further to 4.75 percent from the fortnight beginning November 16, 2002 eased liquidity conditions in the economy. The RBI, in its Annual Monetary and Credit Policy Statement (April 29,2002), set the tone for lower interest rates by advising banks to review the maximum and minimum spreads over their prime lending rates (PLRs) and to reduce them wherever they are high so that credit is available at reasonable interest rates. Banks were also advised to announce a maximum spread over PLR. The PLR of five major commercial banks declined from 11.00-12.00 percent to 10.75 - 11.50 percent in the current year. A noticeable development in the current year is significant sub-PLR lending by commercial banks.

3.2 Scheduled commercial banks' (SCBs) non-food credit in the current financial year (up to January 10, 2003), increased by 19.7 percent as compared with 9.1 percent in the corresponding period last year. Excluding the impact of the merger of ICICI with ICICI Bank, the growth in non-food credit in the current financial year so far has been 11.4 percent. The revival in industrial production may lead to a further increase in the off take of non-food credit.

3.3 The RBI in its Annual Policy Statement had projected the expansion of broad money (M_3) at 14.0 percent for 2002-03. In the current financial year (up to January 10, 2003), broad money grew by 9.8 percent (net of mergers) as compared with 11.2 percent in the corresponding period last year.The year-on-year growth in M_3 as on January 10, 2003 amounted to 12.8 percent (net of mergers) compared with 14.5 percent last year. One of the noticeable features in the current year is the lower growth of reserve money despite an impressive growth in the net foreign exchange assets (NFA) of the RBI. In the current financial year (up to January 24, 2003), reserve money grew by 2.9 percent as compared with 4.7 percent in the corresponding period last year.

3.4 The enactment of the "Securitisation, Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002" is an important landmark in the ongoing reforms in the financial sector. This Act enables the setting up of asset management companies, addressing the problem of non-performing assets (NPAs) of banks and financial institutions and enhancing creditor rights. The other major policy initiatives in the current year include, introduction of supervisory rating system based on capital adequacy, assets quality, management, earnings, liquidity, systems and control (CAMELS) model for financial institutions on lines similar to banks, withdrawal of the stipulation of minimum lending rate for all cooperative banks, imparting greater transparency in actual interest rates for depositors as well as borrowers by stipulating that banks should provide information relating to deposit rates and effective annualised returns on deposits for various maturities and the maximum and minimum interest rates charged on their lendings. Banks have also been advised to switch over to “all cost” concept by explicitly declaring processing charges, service charges, etc., charged to borrowers.