

Outlook

3.59 There has been a distinct downward movement in interest rates and significant improvement in the liquidity in the current year. The increase in foreign exchange assets and cuts in CRR have also added to the liquidity. However, these favourable developments have failed to result in an appreciable increase in credit flow to the commercial sector. The dismal performance of the stock market and absence of alternative avenues of investment have led to an increase in bank deposits despite falling deposit rates.

3.60 The industrial slowdown resulted in deceleration of credit to the commercial sector last year. With industrial sector showing signs of recovery, credit off take has somewhat improved in the current year. Growth in non-food credit in the current year (up to January 10, 2003) has been 11.4 percent, net of mergers, as compared with a growth of 9.1 percent in the corresponding period last year. With lack of credit demand, commercial banks have been investing heavily in Government securities. SCBs investments in Government and other approved securities at Rs. 85,738 crore during the current financial year

(up to January 10, 2003) is much higher than the amount of Rs. 63,082 crore invested in these securities in the corresponding period last year. Investments in Government securities by commercial banks now constitute 37.8 of their net demand and time liabilities (NDTL) as compared with the statutory stipulation of 25 percent. Reflecting easy liquidity conditions, interest rates on Government securities continue to maintain the downward trend. Yield on 7.4 percent 12-year Government Paper reached a low of 6.13 percent on December 31, 2002. Commercial banks cannot continue to increase their investment in low yielding Government securities.

3.61 Commercial banks have been maintaining unreasonably large spreads around their PLRs. The reason for such spreads was the default premium on account of NPAs. With the enactment of the "Securitisation, Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002", an enabling environment has been created for banks to reduce interest rates. Introduction of sub-PLR lending and possible reduction in spreads over PLR following the enactment of Securitisation Act may result in a revival of investment demand.