3

Monetary and Banking Developments

The conduct of monetary policy during 2003-04 was broadly in conformity with the stance and objectives of the Monetary and Credit Policy announced by the Reserve Bank in April, 2003. The key objective continued to be the provision of adequate liquidity to meet credit growth and support investment demand in the economy while continuing a vigil on movements in the price level. An important issue of monetary management that arose in 2003-04 was to deal with the surge in foreign capital flows. During the year, foreign exchange assets of the Reserve Bank of India (RBI) increased by Rs. 1,26,169 crore. RBI had to moderate the impact of these inflows through open market sale of Government securities and repo operations through the Liquidity Adjustment Facility (LAF). The higher growth of broad money (M_3) in 2003-04 at 16.4 per cent as compared to the growth of 14.0 per cent indicated in the annual monetary and credit policy was in line with the higher output growth in the year. Reserve money growth at 18.3 per cent, was the highest in recent years. The higher growth was entirely driven by the increase in the net foreign exchange assets of the RBI. Net RBI credit to Government continued to decline due to open market sale of Government securities to neutralise the impact of large accretion to foreign exchange reserves.

3.2 The downward trend in interest rates continued in 2003-04. RBI reduced the Bank Rate from 6.25 per cent to 6.00 per cent from the close of business on April 29, 2003. The cash reserve ratio (CRR) was reduced by 25 basis points to 4.50 per cent in June, 2003. RBI's advice to scheduled commercial banks (SCBs) to announce benchmark prime lending rates (BPLRs) based on their actual costs fortified the transparency of loan pricing. There was a considerable pick up in the offtake of non-food credit from the second half of the year. A significant development in 2003-04 was the lower than budgeted market borrowings by the Central Government, facilitated by an improvement in the cash position. This, in particular, was aided by the receipts under the State debt-swap scheme, enabling the State Governments to substitute high cost debt owed to the Centre with market borrowings raised at relatively lower interest rates. During the year 2003-04, SCBs improved their profitability on account of higher income from treasury operations and higher spread.