

Outlook

3.73 The opening up of the economy, while providing immense opportunities for growth, has changed the focus of monetary management a great deal. The RBI has been effectively managing the capital flows, and the introduction of MSS has considerably improved its manoeuvrability. The enactment of the Fiscal Responsibility and Budget Management (FRBM) Act in 2003 and its operationalisation in 2004-05 is expected to impart more flexibility to RBI in its management of monetary policy.

3.74 The RBI has been making consistent efforts to make lending rates of banks more transparent and to align them with deposit rates. The introduction of BPLRs has, to an extent, addressed the problem of downward rigidity of lending rates. The widening interest spread suggests that further efforts are needed to tackle the problem of downward rigidity of lending rates. The continuing reduction in the NPA levels and interest expenditure should enable banks to set the lending rates on a more realistic basis. This would go a long way in sustaining the growth in non-food credit.

3.75 The initiatives of the Government and the RBI have started yielding results in terms of improvements in credit delivery. Further efforts are required to sustain improvements in the credit flow to agriculture. In this context, there is a need for banks to focus their efforts on commercial crops besides cereals. The constraints in lending to the small scale sector need to be addressed in view of its employment potential. The interest spread charged on loans to the SME sector, relative to large industries sector, needs to be reasonable, reflecting the differential costs, and should be brought down through realignment of lending rates and better credit assessment.

3.76 The declining role of DFIs poses a challenge to banks in meeting the long term requirement for funds. Adherence to the FRBM Act stipulations is likely to reduce the exposure of commercial banks to Government paper and enable banks to undertake more long-term financing to the commercial sector. For this, banks need to hone up their skills in project financing.