Outlook

3.63 Credit evinced sharp growth during 2004-05, and has continued in the current financial year. This presents both opportunities and challenges to all the stakeholders in the financial sector. Expansion in financial intermediation is generally associated with increased growth and efficiency; at the same time, excessive credit growth without adequate safeguards could lead to some erosion in credit quality. Policy, therefore, has to strike a balance between credit quality and the associated risks, while allowing bank lending to contribute to higher growth and efficiency.

3.64 Tackling the issues of price management while meeting the credit needs of the various sectors are likely to be the continuing challenges of monetary policy. In this context, the increasing openness of the economy will require a revisit of the instruments for regulating liquidity in the system. A slow-down in foreign reserve inflows relative to earlier years and a growing tempo of credit off-take may exert upward pressure on interest rates and make for a case for considering the unwinding of MSS to release the required liquidity into the system.

3.65 So far banks have been able to finance the credit boom efficiently with a CRAR of 12.8 per cent considerably higher than the 8.0 per cent BASEL norm and 9.0 per cent RBI stipulation. But by end-March 2007, banks are required to conform to BASEL II norms, and this will require additional capitalisation. Recent guidelines issued by the RBI for raising additional capital funds through the issue of innovative perpetual debt instruments, without impinging on the Government equity structure in PSBs, will help banks to acquire BASEL II norms.

3.66 In view of the rapid growth of bank credit, there may be a need for further capitalisation of banks and for developing strict management techniques/methods for the prudent evaluation of investment proposals.