Financial Intermediation and Markets

A growing economy needs investment to sustain its growth process. Such investments can be quickly and efficiently undertaken if investors have access to a well-developed financial market. Historically, banks have played the role of intermediaries matching savers with investors. However, the modern world of business requires a much more sophisticated level of intermediation. It is no longer sufficient to have an efficient means of allocating savers' funds to investors; one also needs financial markets to allocate risk and to re-allocate capital from inefficient to more efficient projects. Given the institutional nature of banks, it is not possible for them to provide all these functions of a modern financial market. Banks are one of the many players within a financial set up which has banks, insurance companies, pension funds, mutual funds, venture capital funds, and the stock and commodity exchanges. Together, they perform the various types of intermediation necessary in a global world.

5.2 Since 1991, when India had a bank-dominated financial market where the capital market was totally controlled by administrative officers, it has made remarkable progress to become one of the most developed financial markets among emerging economies. It still has a long way to go, but its current state of development is well reflected in the fact that there is a growing group of experts who want to see Mumbai as an international financial centre. Of more immediate significance to us, however, is how to use financial markets to enable everyone to participate in the growth process and distribute the process of wealth creation across all individuals. This chapter summarizes the major developments in this sector in India in the last year.

BANK CREDIT

5.3 With the transition of the Indian economy to a higher growth trajectory, the provision of adequate and timely availability of bank credit to the productive sectors of the economy has acquired importance. As public sector banks still own about 71 per cent of the assets of the banking system, they continue to play an important role in responding to the changes in the economic environment. As the banking regulator and supervisor and as the monetary policy authority, the Reserve Bank of India (RBI) continues to guide the banking system, including foreign, private sector and public sector banks, to meet emerging economic challenges.

Policy Intervention

5.4 A number of policy initiatives have been taken by the RBI/Finance Ministry to make the banking system more responsive to the needs of the market as well as to strengthen its role in making growth more inclusive. Some of the measures initiated to widen the credit delivery include: (i) permitting the use of banking facilitators/correspondents; (ii) augmentation of credit flow to the agriculture and other priority sectors as also to the distressed farmers and the areas hit by natural calamities; (iii) simplification of systems and procedures; (iv) information technology to address the last mile problem; and, (v) providing greater operational flexibility to the Regional Rural Banks (RRBs).

Access to banking facilities

5.5 A large number of people, especially in rural areas, do not have bank accounts. Banks have been encouraged to make available "no-frills" bank accounts with “nil” or very low minimum balances making such accounts accessible to public at large. The RRBs have also been advised to allow limited overdraft facilities in “no–frills” accounts without any collateral. Banks are required to make available all the printed material used by retail customers in the regional language concerned. All the State Level Bankers’ Committee (SLBC) convenor banks have been advised to initiate action for identifying at least one district in their State/Union Territory for 100 per cent financial inclusion. Guidelines have been issued to banks to enhance their outreach by utilizing "business facilitators" and "business correspondents" models. Banks are also entering into agreements with the Indian postal authority for using the wide network of post offices as business correspondents.

Directed credit

5.6 Efforts to widen and intensify the credit delivery mechanism have also continued. The guidelines on lending to the priority sector were revised, effective April 30, 2007, to expand its ambit. The target and sub-targets for the sector are being linked to (i) adjusted net bank credit (ANBC) or (ii) credit-equivalent amount of off-balance sheet exposure, as on March 31 of the previous accounting year. The broad categories of the priority sector for scheduled commercial banks now include: (i) Agriculture (direct and indirect finance), (ii) Small enterprises (direct and indirect finance), (iii) Retail trade, (iv) Micro-credit, (v) Education loans and (vi) Housing loans.

5.7 All SLBC convenor banks were advised on May 8, 2007, to review their institutional arrangements for delivering credit to the Small and Medium Enterprises (SME) sector, particularly in 388 clusters identified by the United Nations Industrial Development Organization (UNIDO) spread over 21 States of the country. Public sector banks were advised to operationalize at least one specialized Small Scale Industry (SSI) branch in every district and centre having a cluster of SSI units. At end-March 2007, 636 specialized SSI bank branches were in operation as compared to 629 at end-March 2006.

5.8 To ensure steady flow of credit to various segments of SSI, new instructions were given in April and July 2007. Banks were advised in July 2007 to ensure that (i) 40 per cent of total advances to small enterprises sector should go to micro (manufacturing) enterprises having investment in plant and machinery up to Rs. 5 lakh and micro (service) enterprises having investment in equipments up to Rs. 2 lakh; (ii) 20 per cent of the total advances to small enterprises sector should go to micro (manufacturing) enterprises with investment in plant and machinery above Rs. 5 lakh but less than Rs. 25 lakh and micro (service) enterprises with investment in equipments above Rs. 2 lakh but less than Rs. 10 lakh.

5.9 The revised priority sector guidelines envisaged that foreign banks having a shortfall in the stipulated priority sector lending target/sub-targets would be required to contribute to the Small Enterprises Development Fund (SEDF) to be set up by the SIDBI, or for such other purpose as may be stipulated by the RBI from time to time. The corpus of SEDF would be decided by the RBI on a year-on-year basis. The tenors of deposits shall be for a period of three years or as decided by the RBI from time to time.

Credit subsidy

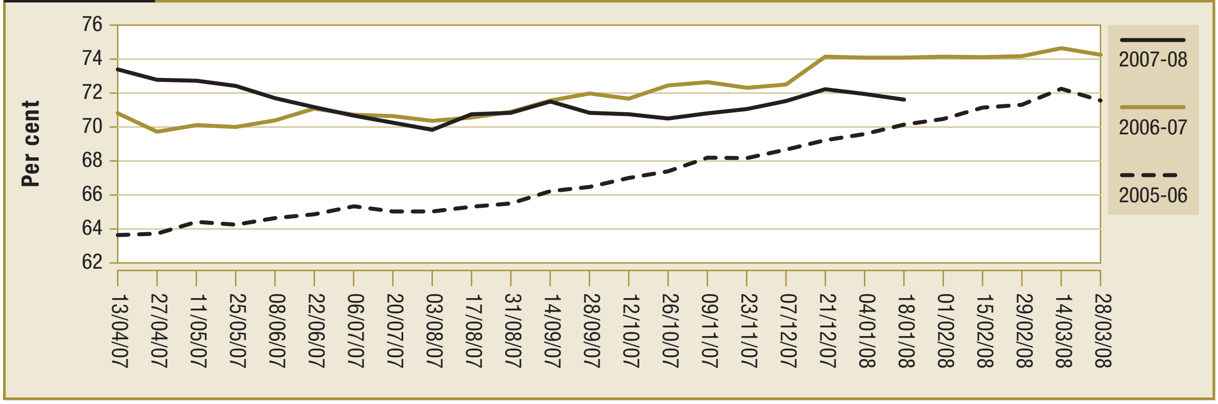
5.10 From the *kharif* and *rabi* of 2005-06 commercial banks had provided interest relief of two percentage points in the interest rate on the principal amount up to Rs. 1 lakh on each crop loan granted by them. The Government had also ensured that the farmers receive short-term credit at 7 per cent rate of interest on loans up to Rs. 3,00,000 on the principal amount with effect from *kharif* 2006-07. The public sector banks and RRBs were advised that the Government would provide interest rate subvention of 2 per cent per annum to them in respect of the short-term production credit up to Rs. 3,00,000 provided to farmers. The Union Budget 2007-08 announced that the 2 per cent subvention scheme for short-term crop loans would continue in 2007-08.

Bank Credit and Investment

Bank credit

5.11 The credit-deposit (C-D) ratio reached an all-time high of 74 per cent at end-March 2007. This was despite a deceleration in the Scheduled Commercial Banks’ (SCBs) credit growth to 28 per cent at end-March 2007 from 30.8 per cent at end-March 2006. RBI’s policy interventions have reduced credit growth sharply during the current financial year, with the SCBs’ credit growing by only 21.5 per cent till January 4, 2008, compared

Figure 5.1 Credit-deposit ratio



to 30.8 per cent on January 5, 2007. Concomitantly, the non-food credit by SCBs as on this date was well below the indicative target of 24-25 per cent growth for 2007-08. The C-D ratio has consequently decreased to 71.8 per cent as on January 4, 2008 (Figure 5.1), compared to 74 per cent on January 5, 2007. Any further deceleration in the credit provided by SCBs would not only worsen the credit deposit ratio but would also have a detrimental impact on the overall economic growth.

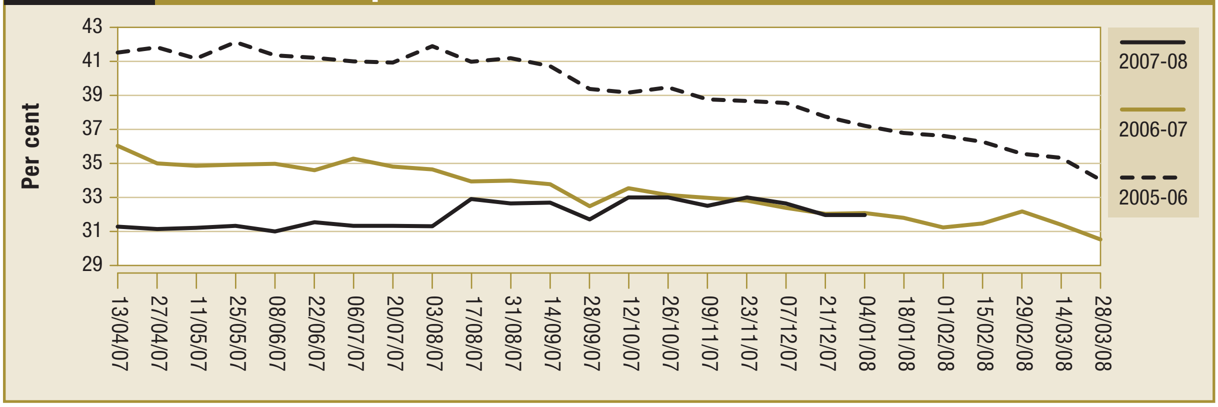
Bank investments

5.12 Investments by SCBs in SLR (statutory liquidity ratio) securities grew by 10.2 per cent during 2006-07 compared to a decline of 3.1 per cent during 2005-06. This was mainly due to significant improvement in the mobilization of deposits, in particular the term deposits by SCBs. They were Rs. 7,90,432 crore at end-March 2007 compared to Rs. 7,17,454 crore at end-March 2006. The increase in investments was largely in the Government securities (Rs. 74,239 crore) compared to the decline of Rs. 19,514 crore during 2005-06. During the current financial year 2007-08 too, there has been an upward trend in the SLR investments; these investments (up to January 4, 2008) had expanded by Rs. 1,64,458 crore. They remain above the statutory minimum of 25 per cent.

5.13 The current financial year has witnessed a spurt in SLR investments due to continued higher aggregate deposit mobilization coupled with lower offtake of credit. On a year-on-year basis as on January 4, 2008, the increase in SLR investments was Rs. 1,89,349 crore (with investment in the Government securities at Rs. 1,85,524 crore) compared to an increase of Rs. 42,836 crore (investments in Government securities at Rs. 45,379 crore) during the corresponding period of the previous year. The investment-deposit ratio as on January 4, 2008, was the same as was on January 5, 2007, at 32 per cent (Figure 5.2). This was higher than the level as at end-March 2006.

5.14 Non-SLR investments by SCBs during 2006-07 had expanded by Rs. 3,929 crore. During the current financial year (up to January 4, 2008) these investments increased by Rs. 4,679 crore

Figure 5.2 Investment-deposit ratio



compared to a decline of Rs. 32 crore during the corresponding period of the previous year.

Sectoral deployment of bank credit

5.15 As per the sectoral credit data relating to 51 SCBs (covering about 90 per cent of SCBs credit) there was deceleration in the overall credit expansion during the year 2006-07 compared to the earlier year. During the current financial year, (as on last Friday of November 2007) bank credit expansion has further slowed down.

Priority sector lending

5.16 As per the RBI stipulation, domestic banks and foreign banks operating in India are required to provide 40 per cent and 32 per cent, respectively, of their adjusted net bank credit to priority sector. The credit to priority sector extended by SCBs during 2006-07 followed the overall trend in the expansion of credit during the year. It had expanded by a lower amount of Rs. 1,22,472 crore (24 per cent growth) compared to Rs. 1,35,222 crore (36.1 per cent) during 2005-06. Loans extended to agriculture was higher at Rs. 56,305 crore (32.4 per cent) compared to Rs. 49,606 crore (39.9 per cent) in the previous year. The credit to SSI sector was higher at Rs. 25,888 crore (28.4 per cent) compared to Rs. 16,831 crore (22.7 per cent). During 2007-08, the credit to the priority sectors on the last reporting Friday of November 2007, increased by 20.5 per cent compared to 25.1 per cent during the corresponding month of the previous year (Table 5.1).

Export Credit

5.17 Apart from the commercial banks, the Export-Import Bank of India (Exim Bank) is also financing different stages of exports. Availability of adequate export credit at competitive rates continues to be an important factor of export performance. While export credit as a proportion of net bank credit (NBC) has gone down steadily in the current decade (Table 5.2), in the first nine months of the current year, export credit as percentage of NBC increased marginally. Export credit as proportion of exports reached a high of 29.5 per cent as on December 21, 2007.

Lending to sensitive sectors

5.18 Credit to real estate by SCBs expanded by 41.5 per cent at end-March 2007 compared to 78.7 per cent growth at end-March 2006. The 91.9 per cent share of the real estate sector in the total credit of Rs. 4,03,532 crore extended to

Table 5.1 Sectoral deployment of gross bank credit

Items	Per cent[1]				Per cent share in total			
	2005-06	2006-07	Nov-06	Nov-07	2005-06	2006-07	Nov-06	Nov-07
Gross bank credit	38.0	27.6	29.1	22.0	100.0	100.0	100.0	100.0
1. Public food procurement credit	-1.0	14.3	-8.9	-2.5	2.8	2.5	3.4	2.4
2. Gross non-food bank credit	39.6	27.9	30.4	22.6	97.2	97.5	96.6	97.6
(a) Priority sectors (i+ii+iii)[2]	36.1	24.0	25.1	20.5	35.3	34.3	35.2	34.1
i. Agriculture and allied activities[3]	39.9	32.4	31.5	21.5	12.0	12.5	11.7	11.9
ii. Small-scale industry	22.7	28.4	21.1	34.5	6.3	6.3	6.4	6.0
iii. Housing	47.5	21.5	28.1	20.8	9.2	8.8	9.3	9.2
iv. Other priority sectors	30.0	10.4	15.2	6.2	7.8	6.7	7.8	7.0
(b) Medium and large industries	31.5	25.2	26.5	23.4	31.8	31.2	32.1	31.5
(c) Wholesale trade (excluding food procurement)	25.4	25.1	38.0	13.7	2.7	2.7	2.6	2.8
(d) Other sectors	58.2	36.5	41.6	25.3	27.3	29.2	26.6	29.2
Of which:								
1. Housing	19.2	32.5	33.4	16.1	3.6	3.7	12.5	13.2
2. Consumer durables	-20.9	28.9	11.2	-4.4	0.5	0.5	0.7	0.6
3. Real estate loans	97.1	69.8	77.7	33.4	1.8	2.5	1.7	2.4
4. Loans to individuals[4]	27.4	-13.7	-6.4	-7.1	0.4	0.2	0.4	0.3

Source: Reserve Bank of India.

Note: Data is provisional and accounts for 90 per cent of bank credit of SCBs.
1. **As on the last reporting Friday of the year/month.**
2. **Exclude investments in eligible securities.**
3. **Indirect finance not included.**
4. **Against shares and debentures/bonds.**

Table 5.2 Export credit

Outstanding as on	Export credit (Rs. crore)	Variations (per cent	Export credit as per cent of NBC	Export credit as per cent exports
March 24, 2000	39118	9.0	9.8	24.5
March 23, 2001	43321	10.7	9.3	21.3
March 22, 2002	42978	-0.8	8.0	20.6
March 21, 2003	49202	14.5	7.4	19.3
March 19, 2004	57687	17.2	7.6	19.7
March 18, 2005	69059	19.7	6.3	18.4
March 31, 2006	86207	24.8	5.7	18.9
March 30, 2007	104926	21.7	5.4	18.4
Dec. 22, 2006	97763	13.4[b]	5.6	26.5
Dec. 21, 2007[a]	117719	12.2	5.5	29.5

Source: Reserve Bank of India.

[a] Over the corresponding figure as on March 30, 2007 (variation)

[b] Variation over March 31, 2006

Note : 1. Data up to March 2004 relate to select banks accounting for 90 per cent of bank credit

2. March 18, 2005, onwards, data pertain to all scheduled banks excluding RRBs availing export credit refinance from the RBI.

sensitive sectors continued to be high (Table 5.3). The outstanding credit extended to the capital market at end-March 2007 increased by 37.4 per cent compared to an expansion of 40.6 per cent at end-March 2006.

Table 5.3 Lending to sensitive sectors by SCBs

Sector	At end-March			
	2006	2007	2006	2007
	Rs. crore		Per cent to total	
(i) Capital market	22303	30637	7.8	7.6
(ii) Real estate	262053	370689	91.7	91.9
(iii) Commodities	1413	2206	0.5	0.6
Total	**285770**	**403532**	**100.0**	**100.0**

5.19 Total exposure of SCBs to the sensitive sectors was 20.4 per cent of aggregate bank loans and advances in 2006-07 as compared to 18.8 per cent in the previous year.

Agricultural credit

5.20 To improve credit flow to the agriculture sector, the Government initiated a number of policy measures, from time to time, like farm credit package and Special Agricultural Credit Plans (SACP). The Union Finance Minister in his Budget speech for 2006-07 had urged the banks (including cooperative banks and RRBs) to disburse Rs. 1,75,000 crore as credit to agriculture sector during 2006-07. The overall achievement during 2006-07 was Rs. 2,03,296 crore. Also, new farmers covered under the institutional credit system were 8.35 million as against the target of 5 million. Encouraged by the achievement, Budget 2007-08 set a higher target of Rs. 2,25,000 crore for disbursement of credit and further addition of 5 million new farmers as borrowers to the banking system. Up to November 30, 2007, the flow of credit to this sector was Rs. 1,37,760 crore which is about 61 per cent of the target (Table 5.4).

Kisan Credit Card (KCC) Scheme

5.21 To provide adequate and timely credit support to the farmers from the formal banking system in a flexible, hassle-free and cost-effective manner the Kisan Credit Card (KCC) scheme was introduced in 1998-99. The KCC scheme has now been extended to borrowers of the long-term cooperative credit structure, thus paving the way for acceptance of KCC as a single window for a comprehensive credit product. To give further fillip to the KCC scheme, NABARD advised all RRBs to achieve the targets of issuing at least 150 KCCs by each branch of RRB during 2007-08. Since inception of the KCC scheme, the banking system

Table 5.4 Institutional credit to agriculture and allied activities

(Rs. crore)

Agencies	2002-03	2003-04	2004-05	2005-06	2006-07[a]	2007-08[b]
Cooperative banks	23,716.38	26,958.79	31,424.23	39403.77	42,479.80	33,070.17
RRBs	6,069.79	7,581.15	12,404.00	15222.90	20,434.65	15,924.56
Commercial banks	39,773.60	52,440.85	81,481.14	125858.90	1,40,381.93	88,764.83
Total	**69,559.77**	**86,980.79**	**1,25,309.37**	**1,80,485.57**	**2,03,296.38**	**1,37,759.56**

Source: NABARD [a] Provisional [b] Up to November 30, 2007

Table 5.5 Agency-wise KCCs issued

(lakh)

Year	Cooperative banks	RRBs	Commercial banks	Total
1998-99	1.56	0.06	6.22	7.84
1999-00	35.95	1.73	13.66	51.34
2000-01	56.14	6.48	23.90	86.52
2001-02	54.36	8.34	30.71	93.41
2002-03	45.79	9.64	27.00	82.43
2003-04	48.78	12.75	30.94	92.47
2004-05	35.56	17.29	43.95	96.80
2005-06	25.98	12.49	41.65	80.12
2006-07	22.97	14.06	48.08	85.11
2007-08[a]	14.01	10.29	7.21[b]	31.51
Total	**341.10**	**93.13**	**273.32**	**707.55**
% Share	**48.21**	**13.16**	**38.63**	**100.00**

Source: NABARD and RBI.
[a] **As on November 30, 2007**
[b] **Up to June 30, 2007**

has issued 707.55 lakh KCCs up to November 30, 2007 (Table 5.5).

5.22 During 2006-07, the total number of KCCs issued were 85.11 lakh and the amount sanctioned was Rs. 46,729 crore. As per the available information for 2007-08 (as on November 30, 2007), the amount sanctioned was Rs. 25,263 crore.

5.23 With the renewed emphasis by the Government on increasing credit flow to the agriculture sector, NABARD advised cooperative banks and RRBs to identify and cover all farmers including defaulters, oral lessees, tenant farmers, sharecroppers and others, who might have been left outside the fold of the KCC scheme for any reason, as also new farmers so that all farmers are covered under the scheme by March 31, 2007. Further, the banks were advised to issue KCCs in a hassle-free manner and extend crop loans only through KCC and renew them so as to ensure "quality in operations". To make the operation more user-friendly and comprehensive in its coverage of credit needs of the farmers through a single window, NABARD has extended the scope of KCC to cover term loans for agriculture and allied activities and reasonable component for consumption loan. The scheme has also been extended to the clientele of the State Cooperative Agriculture and Rural Development Banks (SCARDBs).

Micro-finance

5.24 The Self-Help Group (SHG)-bank linkage programme continued to be the main micro-finance model by which the formal banking system reaches the microentrepreneurs (including farmers). Launched in 1992 as a pilot project, it has since proved its efficacy as a mainstream programme for banking by the poor who mainly comprise the marginal farmers, landless labourers, artisans and craftsmen and others engaged in small business like hawking and vending in the rural areas. The main advantages of the programme are timely repayment of loans to banks, reduction in transaction costs both to the poor and the banks, doorstep "saving and credit" facility for poor and exploitation of the untapped business potential of the rural areas. In all 498 banks (50 commercial banks, 96 amalgamated RRBs and 352 cooperative banks) are actively participating in the programme. As on December 31, 2007, bank loan of Rs. 20,114 crore was availed of by 30.51 lakh SHGs (Table 5.6). The average bank loan availed of per SHG and per family amounted to Rs. 65,924 and Rs. 4,708, respectively. The outreach of the programme has enabled an estimated 427 lakh poor households to gain access to micro-finance from the formal banking system.

Table 5.6 Progress under SHG-bank linkage

Year	New SHGs financed by banks			Bank loan[a] (Rs. crore)		
	During the year		Cumulative	During the year		Cumulative
	No.	Growth (%)	No.	Amount	Growth (%)	amount
2002-03	255,882	29	717,360	1,022.34	87	2,048.68
2003-04	361,731	41	1,079,091	1,855.53	81	3,904.21
2004-05	539,365	49	1,618,456	2,994.25	62	6,898.46
2005-06	620,109	15	2,238,565	4,499.09	50	11,397.55
2006-07	686,408	11	2,987,441	6,643.19	47	18,040.74
2007-08[b]	126,068		3,051,041	2072.78		20,113.52

[a] **Includes repeat loans to existing SHGs.**

[b] **As on December 31, 2007.**

Rural Infrastructure Development Fund

5.25 The Rural Infrastructure Development Fund (RIDF) is operated by NABARD with funds raised from the scheduled commercial banks (public sector banks and private sector) which are unable to meet their targets for priority sector and/or agriculture lending. The fund has completed 12 years of its operations. RIDF XIII has been set up with the NABARD with a corpus of Rs. 12,000 crore for 2007-08. The separate window opened under the RIDF XII for financing of rural roads under the Bharat Nirman with a corpus of Rs. 4,000 crore during 2006-07 has been continued for the year 2007-08 with an additional corpus of Rs. 4,000 crore. Out of the total corpus of the RIDF (RIDF I to XIII) aggregating to Rs. 72,000 crore (excluding Rs. 8,000 crore allocated for the Bharat Nirman), the amount sanctioned and disbursed to the State Governments, as on January 11, 2008, was Rs. 69,883 crore and Rs. 41,360 crore, respectively. During 2007-08 (up to January 11, 2008), the amount sanctioned and disbursed was Rs. 8,592 crore and Rs. 3,800 crore, respectively. The first six tranches RIDF I to VI have been closed. The seventh tranche was closed on December 31, 2007; however, disbursements would be made till March 31, 2008. The phasing period of implementation in respect of projects under RIDF VIII to X tranches has been extended up to March 31, 2008. The scheduled dates of closure of RIDF XI and XII are March 31, 2008 and March 2009, respectively.

Bank Performance

Banking regulations

5.26 To prepare banks for the implementation of BASEL II norms, a three-track approach has been adopted by the RBI with regard to capital adequacy rules. In the first track are commercial banks. They are required to maintain capital for credit risk and market risk as per BASEL I framework. In the second track are the cooperative banks. They are required to maintain prescribed capital for credit risk as per BASEL I framework and through surrogates for market risk. The RRBs, which are on the third track, have to maintain a minimum capital which may not be on par with BASEL I rules.

5.27 The guidelines on sale/purchase of NPAs were revised in May 2007, whereby it was stipulated that at least 10 per cent of the estimated cash flow should be realized in the first year and at least 5 per cent in each half year thereafter, subject to full recovery within three years.

Financials

5.28 The income, expenditure and profitability of SCBs improved at a faster rate in 2006-07. Total income increased at a robust rate of 25.1 per cent during 2006-07 compared to 16 per cent during 2005-06. Income was, however, 8 per cent of total assets at end-March 2007, only marginally higher than the 7.9 per cent at end-March 2006. Return on advances registered a higher growth rate of 7.9 per cent at end-March 2007 compared to 7.3 per cent at end-March 2006 mainly due to hardening of interest rates. Consequently, interest income was 6.9 per cent of assets at end-March 2007 compared to 6.7 per cent of assets at end-March 2006. "Other income" to assets ratio declined from 1.3 per cent as at end-March 2006 to 1.1 per cent at end-March 2007.

5.29 SCBs' expenditure also accelerated in line with income, growing at 24.9 per cent during 2006-07, up from a growth of 15.9 per cent during 2005-06. This was mainly due to a doubling of the rate of growth of interest expenditure to 34.3 per cent compared to a growth of 15.9 per cent in 2005-06. In contrast, the growth of operating expenses decelerated from a growth rate of 18.1 per cent during 2005-06 to 12 per cent in 2006-07. This owed to lower increase in the wage bill during 2006-07. Accordingly, banks' burden (excess of non-interest expenditure over non-interest income) declined marginally to 0.8 per cent of assets in 2006-07 from 0.9 per cent in 2005-06. The efficiency ratio, defined as operating expenses as a percentage of net interest income plus non-interest income, improved substantially to 50.2 per cent during 2006-07 from 52.1 per cent during 2005-06.

5.30 Higher interest income and moderation in the operating expenses during 2006-07 positively impacted on the operating profits of SCBs. There was a 21.2 per cent increase in the operating profits of SCBs during 2006-07 compared to 6.6 per cent during 2005-06. All banks except the State Bank Group registered higher operating profit. The operating profit as a proportion of total assets of SCBs, however, declined marginally to 1.9 per cent in 2006-07 from 2 per cent in 2005-06. The rate of return

Table 5.7 Working results of scheduled commercial banks

Items	Public sector banks 2005-06	Public sector banks 2006-07	Foreign banks 2005-06	Foreign banks 2006-07	Old pvt. sect banks 2005-06	Old pvt. sect banks 2006-07	New pvt. sect banks 2005-06	New pvt. sect banks 2006-07	SCBs 2005-06	SCBs 2006-07
1	2	3	4	5	6	7	8	9	10	11
					(Rs. crore)					
A. Income	159780	188979	17662	24956	11593	13088	31721	49177	220756	276201
I) Interest Income	137874	168108	12291	18019	10372	11643	24851	39501	185388	237271
II) Other income	21905	20872	5371	6937	1221	1445	6870	9676	35368	38929
B. Expenditure	143240	168827	14593	20371	10727	11966	27612	43834	196173	244998
I) Interest expended	80503	103457	5150	7615	6247	7092	15261	25802	107161	143965
II) Intermediation cost	41308	43255	5854	7741	3089	2969	8949	12354	59201	66319
III) Provisions and contingencies	21429	22116	3590	5015	1392	1905	3402	5678	29812	34714
C. Operating Profit	37968	42268	6658	9600	2257	3027	7511	11021	54394	65917
D. Net profit (A-B)	16539	20152	3069	4585	866	1122	4109	5343	24582	31203
E. Net interest income (Spread)	57371	64651	7141	10404	4125	4552	9590	13699	78227	93306
F. Total assets	2014874	2439986	199358	278016	149972	160562	421659	584842	2785863	3463406
					(As per cent of total assets)					
A. Income	7.9	7.7	8.9	9.0	7.7	8.2	7.5	8.4	7.9	8.0
I) Interest Income	6.8	6.9	6.2	6.5	6.9	7.3	5.9	6.8	6.7	6.9
II) Other income	1.1	0.9	2.7	2.5	0.8	0.9	1.6	1.7	1.3	1.1
B. Expenditure	7.1	6.9	7.3	7.3	7.2	7.5	6.5	7.5	7.0	7.1
I) Interest expended	4.0	4.2	2.6	2.7	4.2	4.4	3.6	4.4	3.8	4.2
II) Intermediation cost	2.1	1.8	2.9	2.8	2.1	1.8	2.1	2.1	2.1	1.9
III) Provisions and contingencies	1.1	0.9	1.8	1.8	0.9	1.2	0.8	1.0	1.1	1.0
C. Operating profit	1.9	1.7	3.3	3.5	1.5	1.9	1.8	1.9	2.0	1.9
D. Net profit (A-B)	0.8	0.8	1.5	1.6	0.6	0.7	1.0	0.9	0.9	0.9
E. Net interest income (Spread)	2.85	2.65	3.58	3.74	2.75	2.83	2.27	2.34	2.81	2.69
F. Total assets	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Memo item										
1. Operating expenses as per cent of net income	52.1	50.6	46.8	44.6	57.8	49.5	54.4	52.9	52.1	50.2

(RoR), defined as the ratio of net profit to total assets of SCBs, remained static at 0.9 per cent at end-March 2007 as was observed at end-March 2006 (Table 5.7).

5.31 With the rise in profits, there was a sharp decline in the amount raised by the SCBs from the domestic primary market. The total mobilization by SCBs through public issues during 2006-07 was Rs. 1,066 crore only compared to Rs. 11,067 crore during 2005-06.

Interest spread

5.32 Net interest income or spread, defined as the difference between interest income and interest expenses, of SCBs as a proportion of total assets was 12 basis points lower at 2.69 per cent during 2006-07 compared to 2.81 per cent in 2005-06. The highest spread during 2006-07 at 3.74 per cent was observed in respect of foreign banks followed by old private sector banks (2.83 per cent), and the PSBs (2.65 per cent) (Table 5.7).

Non-performing assets (NPAs) of the banking sector

5.33 With the availability of a number of legal options for recovery of bad loans for the financial sector, the gross non-performing assets of SCBs as proportion of total assets declined to 1.5 per cent during 2006-07 from 1.8 per cent during 2005-06. The amount recovered and written off (Rs. 26,243 crore) was more than the fresh addition (Rs. 26,211 crore) of NPAs during the year. Gross NPAs of SCBs, which had declined by Rs. 8,276 crore in 2005-06, declined further by Rs. 611 crore in 2006-07. During 2006-07, the largest number of cases for NPA recoveries were referred to Lok Adalat (1,60,368) followed by SARFAESI Act (60,178) and Debt Recovery Tribunals (DRT) (4,028). In terms of amounts, the largest amount of Rs. 3,749 crore (out of the amount involved of Rs. 9,058 crore) was recovered under SARFAESI Act followed by Rs. 3,463 crore (out of the amount involved of Rs. 9,156 crore) under DRT.

Capital adequacy ratio

5.34 Rapid credit expansion by SCBs, necessitated introduction of stiffer prudential norms by the RBI for maintaining quality of credit. Risk-weighted assets of SCBs at end-March 2007 increased to Rs. 24,12,236 crore from Rs. 17,97,207 crore at end-March 2006. Concomitantly, capital funds of SCBs kept pace with the risk-weighted assets and increased to Rs. 2,96,191 crore at end-March 2007 from the level of Rs. 2,21,363 crore at end-March 2006. The capital to risk-weighted assets ratio (CRAR) during 2006-07 remained at 12.3 per cent, unchanged from the previous year. It was substantially higher than the RBI stipulated minimum CRAR of 9 per cent.

5.35 During 2006-07, the SBI Group significantly improved its CRAR from 11.9 per cent at end-March 2006 to 12.3 per cent at end-March 2007. CRAR for foreign and new private sector banks was 12.4 per cent and 12 per cent, respectively, at end-March 2007 compared to 13 per cent and 12.6 per cent, respectively, at end-March 2006.

Technology

5.36 Banks' programmes of technological upgradation through computerization, automation and development of communication networks continued apace. The cumulative expenditure during September 1999 to March 2007 was Rs. 12,826 crore. These programmes are designed to improve the processes and procedures, promote rapid product development through alternative delivery channels, reduce transaction costs and eventually lead to higher productivity. They also help in changing the image and outlook of the banking sector. Technology is also being leveraged to expand the banking outreach particularly to rural areas. The number of branches providing "core banking solutions" (CBS) rose rapidly to 44.4 per cent at end-March 2007 from 28.9 per cent at end-March 2006. The number of Automated Teller Machines (ATM) at end-March 2007 was 27,088 compared to 20,267 at end-March 2006.

All India financial institutions (AIFIs)

5.37 Loans sanctioned and disbursed by AIFIs improved during 2005-06 and 2006-07. Loans sanctioned during 2006-07 were 12.9 per cent higher (Rs. 31,238 crore), following a 41 per cent increase (Rs. 27,666 crore) during 2005-06. Disbursements grew even more strongly during 2006-07 by 82.8 per cent (to Rs. 38,656 crore) on top of an increase of 38 per cent during 2005-06 to Rs. 21,146 crore (Table 5.8). Keeping pace with the higher disbursements by AIFIs at end-March 2007, their combined balance sheet registered an increase of 14.9 per cent compared to 8.2 per cent at end-March 2006. Deposits with AIFIs increased by 51.5 per cent at end-March 2007 compared to 8.7 per cent at end-March 2006. Borrowings were also higher at 18.2 per cent at end-March 2007 compared to 8.8 per cent at end-March 2006. However, there was capital erosion by Rs. 543 crore in 2006-07 resulting in the reduction of the capital base to Rs. 4,888 crore. Nevertheless, AIFIs continued to have significantly higher capital adequacy ratio than the minimum stipulated norm of 9 per cent at end-March 2007.

Table 5.8 Loans by all-India financial institutions

Items	April-March	
	2005-06	2006-07
A. Sanctions		
(a) DFI[a]	12108	12479
(b) Investment Institutions[b]	15558	18759
AIFIs (a+b)	27666	31238
B. Disbursements		
(a) DFI[a]	9375	10799
(b) Investment Institutions[b]	11771	27857
AIFIs (a+b)	21146	38656

Source: RBI

Notes: [a] Relates to IFCI, SIDBI, IIBI, IFCI-Venture Captial Fund, ICICI Venture and TFCI.

[b] Relates to LIC and GIC.

All data are provisional.

Non-banking financial companies (NBFCs)

5.38 With the exit of many NBFCs from deposit taking business, the total number of NBFCs, consisting of NBFCs-D (deposit taking NBFCs), residual non-banking companies (RNBCs), mutual benefit companies (MBCs), miscellaneous non-banking companies (MNBCs) and Nidhi companies registered with RBI declined from 13,014 at end-June 2006 to 12,968 at end-June 2007. The number of NBFCs-D declined from 428 at end-June 2006 to 401 at end-June 2007 (Table 5.9).

5.39 Despite the significant decline in the number of reporting NBFCs-D, the assets, public deposits and net own funds of NBFCs increased by Rs. 12,549 crore, Rs. 2,074 crore and Rs. 795

Table 5.9 Non-banking financial companies registered with RBI (number)

End-June	Total	Accepting public deposits
1999	7,855	624
2000	8,451	679
2001	13,815	776
2002	14,077	784
2003	13,849	710
2004	13,764	604
2005	13,261	507
2006	13,014	428
2007	12,968	401

Source: Reserve Bank of India.

crore, respectively. The ratio of deposits of reporting NBFCs to the aggregate deposits of SCBs dropped to 0.95 per cent at end-March 2007 from 1.07 per cent at end-March 2006.

5.40 Total assets/liabilities of NBFCs-D (excluding RNBCs) sharply increased by 29.8 per cent (Rs. 49,097 crore) at end-March 2007 from Rs. 37,828 crore at end-March 2006. On the liabilities side, the highest increase was achieved by "other liabilities" (98.4 per cent) followed by "borrowings" (31.4 per cent) and "paid-up capital" (27.8 per cent). On the assets side, significant increase was achieved by "other assets" (98 per cent) followed by investment (74.5 per cent). Bill discounting business declined by 83.2 per cent during 2006-07.

5.41 During 2006-07, there was a turnaround in the financial performance of NBFCs-D largely on account of substantial increase in fund-based income (26.8 per cent) compared to an increase of 5.3 per cent during 2005-06. Fee-based income, however, continued the declining trend observed during the previous year (during 2006-07 income from this source declined by 7.6 per cent on top of the decline of 61.2 per cent in 2005-06). The overall income of NBFCs-D during 2006-07 increased by 25.7 per cent compared to the decline of 0.1 per cent during 2005-06.

5.42 The percentage increase of operating expenditure of NBFCs-D during 2006-07 was marginally higher at 33.9 per cent compared to 33.6 per cent during 2005-06. However, financial expenditure and other expenditure recorded substantial increases of 30.5 per cent and 22.3 per cent, respectively, during 2006-07, as compared to increases of 0.3 per cent and nil, respectively, during 2005-06. Net profit (profit after tax) declined by 6.7 per cent in 2006-07.

5.43 The asset quality of NBFCs-D continued to improve during 2006-07. Gross NPAs and net NPAs as percentage of gross advances of reporting NBFCs-D declined to 1.9 per cent and 0.4 per cent, respectively, at end-March 2007 compared to 3.6 per cent and 0.5 per cent, respectively, at end-March 2006.

5.44 Capital adequacy ratio norms were made applicable to NBFCs in 1998. Accordingly, rated NBFCs were required to maintain a minimum capital (consisting of Tier-I and Tier-II capital) of 12 per cent (15 per cent in the case of unrated deposit taking loan/investment companies) of the risk-weighted assets and of risk-adjusted value of off-balance sheet items. Total of Tier-II capital cannot exceed 100 per cent of Tier-I capital at any point of time. The number of NBFCs-D with a CRAR less than 12 per cent declined to 13 at end-March 2007 from 37 at end-March 2006.

CAPITAL AND COMMODITY MARKETS

5.45 The capital and commodity markets remained buoyant during 2007. Relatively stable macroeconomic conditions as reflected in moderate rate of inflation, growth-conducive interest rate situation, improved fiscal conditions and larger investor participation augured well for capital and commodity markets as measured in terms of volume and value of transactions.

Capital Market

5.46 The Indian capital market attained further depth and width in business transacted during 2007. The Bombay Stock Exchange (BSE) Sensex, which had been witnessing an upswing since the latter part of 2003, scaled a high of 20,000 mark at the close of calendar year 2007. The National Stock Exchange (NSE) Index rose in tandem to close above the 6,100 mark at the end of 2007. Both the indices more than tripled between 2003 and 2007, giving handsome yearly returns. Alongside the growth of business in the Indian capital market, the regulatory and oversight norms have improved over the years, ensuring a sound and stable market.

Table 5.10 Resource mobilization through primary market

(Rs. crore)

Mode	Calendar Year			
	2004	2005	2006	2007
1. Debt	2,383	66	389	594
2. Equity	33,475	30,325	32,672	58,722
Of which, IPOs	12,402	9,918	24,779	33,912
Number of IPOs	26	55	75	100
Mean IPO size	477	180	330	339
3. Private Placement	93,506	83,812	117,407	1,11,838[a]
4. Euro Issues (ADR/GDR)	2,029	9,788	11,301	41,567
Total (1 to 4)	131,393	123,991	161,769	2,12,721

Source: SEBI and RBI (for Euro Issues)
[a] Till November 2007

Primary Market

5.47 The primary capital market grew in 2006 and 2007 after the set back of 2005. The amounts raised and the number of new issues which entered the market increased in 2007. The total amount of capital raised through different market instruments during 2007 was 31.5 per cent higher than during 2006, which itself had seen a rebound of 30.6 per cent over the lows of 2005 (Table 5.10).

5.48 Component-wise, private placement at Rs. 1,11,838 crore (up to November 2007) accounted for the major share during 2007. The total equity issues mobilized was Rs. 58,722 crore, of which Rs. 33,912 crore was accounted for by the Initial Public Offerings (IPOs). During 2007, the total number of IPOs issued was 100 as compared to 75 in the previous year.

5.49 In line with the rising trend in resources raised in the primary market, the net inflow of savings into mutual funds increased by over 30 per cent in 2007 to Rs. 1,38,270 crore (Table 5.11).

Table 5.11 Trends in resource mobilization (net) by mutual funds

(Rs. crore)

Sector	Calendar year			
	2004	2005	2006	2007
1. UTI	-1,487	1,273	6,426	9,245
2. Public Sector	-1,262	4,446	12,229	8,259
3. Private Sector	7,524	19,735	86,295	1,20,766
4. Total (1 to 3)	4,775	25,454	1,04,950	1,38,270

Source: SEBI

The sharp increase in funds flowing into mutual funds during 2007 was partly due to buoyant equity markets and partly to efforts made by the Indian mutual funds to introduce innovative schemes. Income/debt-oriented schemes fared relatively better during the year compared to other schemes. The private sector mutual funds outperformed the public sector mutual funds in terms of resource mobilization in 2007. The share of UTI and other public sector mutual funds in total amount mobilized gradually declined over the years to 17.8 per cent in 2006 and further to 12.7 per cent in 2007.

Secondary Market

5.50 In the secondary market segment, the market activity expanded further during 2007-08 with BSE and NSE indices scaling new peaks of 21,000 and 6,300, respectively, in January 2008. Although the indices showed some intermittent fluctuations, reflecting change in the market sentiments, the indices maintained their north-bound trend during the year. This could be attributed to the larger inflows from Foreign Institutional Investors (FIIs) and wider participation of domestic investors, particularly the institutional investors. During 2007, on a point-to-point basis, Sensex and Nifty Indices rose by 47.1 and 54.8 per cent, respectively. The buoyant conditions in the Indian bourses were aided by, among other things, India posting a relatively higher GDP growth amongst the emerging economies, continued uptrend in the profitability of Indian corporates, persistence of difference in domestic and international levels of interest rates, impressive returns on equities and a strong Indian rupee on the back of larger capital inflows.

5.51 Amongst the NSE indices, both Nifty and Nifty Junior delivered record annual equity returns (current year-end index divided by previous year-end index multiplied by 100) of 54.8 per cent and 75.7 per cent, respectively, during the calendar year 2007 (Table 5.12 and Figure 5.3). While Nifty gave compounded returns of 34.4 per cent, Nifty Junior recorded compounded returns of 38.4 per cent per year between 2003 and 2007.

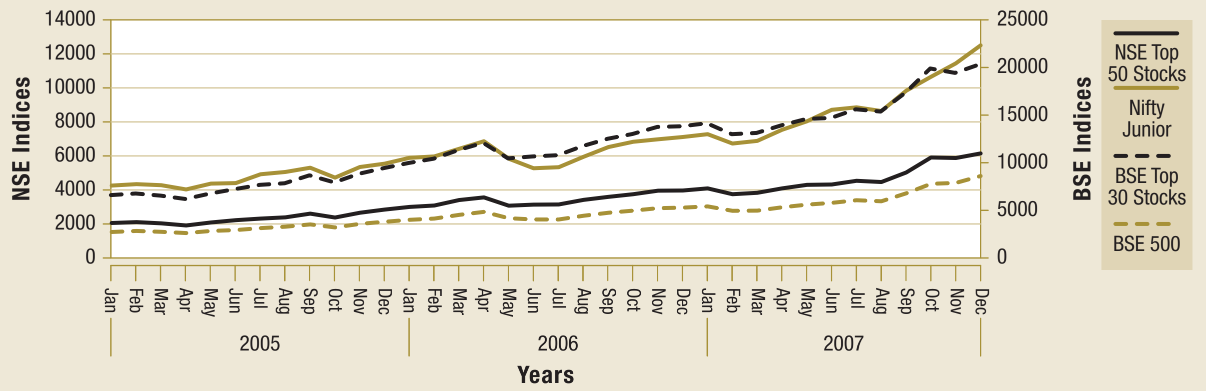
5.52 In terms of month-to-month movement, the NSE indices (Nifty and Nifty Junior) were subdued during February and August 2007, while they showed a rising trend during the rest of the year. The BSE Sensex (top 30 stocks) too echoed a

Table 5.12 Closing values of NSE indices (Nifty 50 and Nifty Junior) at month end

Month	2005	2006	2007	2005	2006	2007
	Nifty 50 (Top 50 Stocks)			Nifty Junior		
January	2,058	3,001	4,083	4,248	5,883	7,268
February	2,103	3,075	3,745	4,338	5,967	6,722
March	2,036	3,403	3,822	4,275	6,412	6,878
April	1,903	3,558	4,088	4,024	6,856	7,527
May	2,088	3,071	4,296	4,365	5,827	8,023
June	2,221	3,128	4,318	4,393	5,264	8,699
July	2,312	3,143	4,529	4,919	5,335	8,850
August	2,385	3,414	4,464	5,053	5,941	8,633
September	2,601	3,588	5,021	5,304	6,510	9,821
October	2,371	3,744	5,901	4,714	6,823	10,643
November	2,652	3,955	5,763	5,342	6,967	11,432
December	2,837	3,966	6,139	5,541	7,106	12,488

Source: National Stock Exchange.

Figure 5.3 Movement of indices of NSE and BSE



similar trend (Table 5.13). The sell-off in Indian bourses in August 2007 could partly be attributed to the concerns on the possible fallout of the sub-prime crisis in the West.

5.53 While the climb of BSE Sensex during 2007-08 so far was the fastest ever, the journey of BSE Sensex from 18,000 to 19,000 mark was achieved in just four trading sessions during

Table 5.13 Closing value of BSE indices (Sensex and BSE-500) at month end

Month	2005	2006	2007	2005	2006	2007
	Sensex			BSE 500		
January	6,556	9,920	14,091	2,726	4,005	5,409
February	6,714	10,370	12,938	2,826	4,130	4,938
March	6,493	11,280	13,072	2,735	4,517	4,955
April	6,154	12,043	13,872	2,611	4,830	5,311
May	6,715	10,399	14,544	2,829	4,158	5,647
June	7,194	10,609	14,651	2,928	4,030	5,781
July	7,635	10,744	15,551	3,125	4,029	6,063
August	7,805	11,699	15,319	3,273	4,424	5,950
September	8,634	12,454	17,291	3,522	4,740	6,774
October	7,892	12,962	19,838	3,199	4,957	7,785
November	8,789	13,696	19,363	3,568	5,228	7,866
December	9,398	13,787	20,287	3,796	5,271	8,592

Source: Bombay Stock Exchange

Table 5.14 Cumulative change in movement of global indices[a]

Index	Cumulative change over end-2003 level			
	2004	2005	2006	2007
BSE Sensex, India	13.08	26.87	33.16	36.53
Hang Seng Index, Hong Kong	13.15	9.64	17.28	22.44
Jakarta Composite Index, Indonesia	44.51	29.65	37.68	41.14
Nikkei 225, Japan	7.61	22.84	17.29	9.43
Kospsi Index, South Korea	10.48	30.26	20.92	23.67
Kuala Lumpur Comp Index, Malaysia	14.23	6.47	11.34	16.15
TSEC Weighted Index, Taiwan	4.23	5.43	9.92	9.62
SSE Composite Index, China	-15.36	-11.93	21.35	36.92

Source: Derived from various country sources.

[a] End Month closing.

October 2007. It further crossed the 20,000 mark in December 2007 and 21,000 in an intra-day trading in January 2008. However, BSE and NSE indices declined subsequently reflecting concerns on global developments. BSE Sensex yielded a compounded return of 36.5 per cent per year between 2003 and 2007. In terms of simple average, BSE Sensex has given an annual return of more than 40 per cent during the last three years. BSE 500 recorded compounded annual return of 38 per cent between 2003 and 2007.

5.54 Among the Asian stock markets, Chinese and Indonesian markets outperformed the Indian markets in terms of cumulative performance over 2003 levels (Table 5.14). While the BSE Sensex rose by 47.1 per cent during 2007, SSE Composite Index (Shanghai, China) rose by 96.7 per cent and the Jakarta Composite Index (Indonesia) increased by around 52 per cent.

5.55 Other international indices which rose appreciably in 2007 were Hang Seng (Hong Kong) by 39.3 per cent, Kospi (South Korea) by 32.3 per cent and Kuala Lumpur Comp Index (Malaysia) by 31.8 per cent (Figure 5.4).

5.56 As the stock indices scaled new highs, investors' wealth as reflected in market capitalization also rose correspondingly. The market capitalization in India nearly doubled in 2007. The markets were more stable in 2007 as measured by the standard deviation of daily volatility of the Indian indices as compared to the previous year (Table 5.15). The price-to-earnings (P/E) ratio, which partly discounts future corporate earnings reflecting investors' expectations of corporate profit, was higher at around 27 by end-December 2007 as compared to around 21 at end-December 2006.

5.57 It is, however, noted that in the period January 2006 to December 2007, the volatility of weekly returns of Indian indices was higher as compared to indices outside India such as S&P

Table 5.15 Equity returns, volatility, market capitalization & P/E ratio

Index	Calendar year 2004	2005	2006	2007
Nifty:				
Returns (per cent)	10.7	36.34	39.83	54.77
End-year market capitalization (Rs. crore)	9,02,831	13,50,394	19,75,603	35,22,527
Daily volatility [a]	1.73	1.11	1.64	1.60
End-year P/E	15.32	17.07	21.26	27.62
Nifty Junior:				
Returns (per cent)	30.8	24.43	28.24	75.73
End-year market capitalization (Rs. crore)	1,65,444	2,18,575	3,33,693	6,43,625
Daily volatility [a]	1.94	1.22	1.96	1.71
End-year P/E	14.19	17.11	21.78	26.48
BSE Sensex:				
Returns (per cent)	13.1	42.3	46.7	47.2
End-year market capitalization (Rs. crore)	7,35,528	12,13,867	17,58,865	28,61,341
Daily volatility [a]	1.6	1.1	1.6	1.5
End-year P/E	17.1	18.6	22.8	27. 7
BSE 500:				
Returns (per cent)	17.5	36.6	38.9	63.0
End-year market capitalization (Rs. crore)	15,80,762	22,81,579	33,36,509	64,70,881
Daily volatility [a]	1.8	1.1	1.6	1.5
End-year P/E	15.2	17.5	20.2	29.1

Source: National Stock Exchange and Bombay Stock Exchange.

[a] **Standard deviation values.**

500 of United States of America and Kospi of South Korea (Table 5.16).

Table 5.16 Volatility of weekly returns on the equity markets (standard deviation)

Class of Stocks	Period Jan 2005-Dec 2006	Jan 2006-Dec 2007
India		
Top 50 (Nifty)	2.01	2.45
Next 50 (Nifty Junior)	2.41	2.85
Sensex	2.96	3.17
BSE 500	3.23	3.30
Outside India		
U.S (S&P 500)	0.95	1.28
Korea (Kospi)	1.84	2.17

Source: National Stock Exchange and Bombay Stock Exchange.

5.58 The valuation of Indian stocks as reflected in P/E multiples of around 27 times at end-December 2007 was the highest amongst the select emerging market economies such as South Korea, Thailand, Malaysia and Taiwan (Table 5.17).

Table 5.17 P/E ratios in select emerging markets

Index/Market	Mar. 2007	Dec. 2007
South Korea KOSPI	11.36	15.04
Thailand SET	10.59	19.92
Indonesia JCI	19.54	18.43
Malaysia KLCI	16.97	16.07
Taiwan TWSE	17.92	20.14
BSE Sensex	20.50	27.67
S&P CNX Nifty	18.38	27.62

Source: SEBI and Bloomberg Financial Services.

5.59 One of the important indicators to assess the size of the capital market is the ratio of market capitalization to GDP. In India as on December 30, 2007, market capitalization (BSE 500) at US$ 1,638 billion was 150 per cent of GDP, which compares well with the other emerging economies as well as select matured markets (Table 5.18).

5.60 The price of a security depends largely on demand and supply conditions and is influenced by the impact cost and liquidity. The liquidity and the impact cost are inversely related. While the impact cost for purchase or sale of Rs. 25 lakh for

Table 5.18 Market capitalization in select countries

Country	Market capitalization (US$ billion) as on 30.12.2007	Market capitalization as per cent of GDP
China	4,459.48	137.3
India	1,638.20[a]	150.0
Japan	4,535.08	104.4
South Korea	1,103.34	116.2
United States of America	17,773.05	128.8

Source: Derived from various country sources.
[a] Market capitalization of BSE 500.

Nifty Junior portfolio improved marginally over the years to 0.14 per cent during 2007, for the Nifty portfolio, it remained stable at 0.08 per cent during the last few years (Table 5.19).

Table 5.19 Equity spot market liquidity: Impact cost (%)

Portfolio	Calendar year			
	2004	2005	2006	2007
Nifty impact cost at Rs. 50 lakh	0.09	0.08	0.08	0.08
Nifty Junior impact cost at Rs. 25 lakh	0.31	0.16	0.16	0.14

Source: NSE.

5.61 The turnover in the spot and derivatives market, both on NSE and BSE, continued to show an upward trend. During 2007, NSE and BSE spot market turnover showed a rise of over 60 per cent and 47 per cent, respectively, over the previous year. In respect of NSE and BSE derivatives, the increase was around 70 per cent and 200 per cent, respectively (Table 5.20).

Table 5.20 Market turnover

(Rs. crore)

Market	Calendar year			
	2004	2005	2006	2007
NSE Spot	11,70,298	18,88,112	19,16,227	30,93,982
BSE Spot	5,33,483	7,01,025	9,61,653	14,14,727
NSE Derivatives	25,86,738	39,26,843	70,46,665	1,19,40,877
BSE Derivatives	19,173	1,965	18,071	2,19,824

Source: NSE and BSE.

5.62 The spot market turnover (one-way) for NSE and BSE (together) amounted to Rs. 45,08,709 crore. In the derivatives market, the NSE and BSE turnover added up to Rs. 1,21,60,701 crore during 2007, showing a quantum growth over the previous year. During 2007, as a proportion of market capitalization of Nifty, the turnover in NSE spot and derivative markets was 87.8 per cent and 339 per cent, respectively. The turnover in BSE spot and derivatives accounted for 22 per cent and 3 per cent, respectively, of market capitalization of BSE 500.

5.63 In terms of institutional players, both FIIs and mutual funds leveraged their activity in the equity market during the year. While the net investment by FIIs in both spot and derivative markets witnessed quantum increases during 2007, the corresponding gross buy and sell by FIIs too increased significantly. In 2007 FIIs net activity (gross buy/gross sell) constituted 17.3 per cent of the spot market and 9 per cent of the derivative market (Table 5.21). The number of registered FIIs rose to 1,219 at the end of 2007 from 1,044 in the corresponding period of last year; the number of sub-accounts also increased to 3,644 from 3,045 over the same period.

5.64 The assets under management of mutual funds grew by 1.7 times from Rs. 3.23 lakh crore during 2006 to Rs. 5.50 lakh crore in 2007 (Table 5.22).

DEBT MARKET

5.65 The Indian debt market has two segments, viz. Government securities market and corporate debt market.

Government securities market

5.66 The fresh issuance of Government of India (GoI) dated securities in 2007 amounted to Rs. 1,62,000 crore as compared to Rs. 1,47,000 crore in 2006. The market capitalization of GoI securities increased from Rs. 11,31,558 crore at end-2006 to Rs. 13,18,419 crore at end-December 2007. The zero-coupon rate on one-year bonds, which ranged between 6.11 per cent and 7.29 per cent during 2006, edged up during 2007 to the range of 6.78 and 8.07 per cent. Similarly, the range of zero-coupon rate on 10-year bonds showed an increase from 7.2-7.97 per cent in 2006 to 7.5-8.37 per cent during 2007.

Table 5.21 Transactions of FIIs

(Rs. crore)

Transactions	Calendar year		
	2005	2006	2007
End-year number of FIIs	823	1,044	1,219
End-year number of sub-accounts	2,273	3,045	3,644
1. Equity market activity			
a. Spot			
Gross buy	2,86,021	4,75,623	8,14,877
Gross sell	2,38,839	4,39,083	7,43,391
Net (Gross buy - Gross sell)	47,182	36,540	71,486
(Proportion of FII turnover to total turnover) (one-way)	(10.1)	(15.9)	(17.3)
b. Derivatives activity			
Gross buy	2,54,322	5,64,887	10,93,260
Gross sell	2,49,875	5,64,182	10,90,117
Net (Gross buy - Gross sell)	4,447	705	3,143
(Proportion of FII turnover to total turnover) (one-way)	(6.4)	(8.0)	(9.0)
c. Total Equity (a+b)			
Gross buy	5,40,343	10,40,510	19,08,137
Gross sell	4,88,714	10,03,265	18,33,507
Net (Gross buy - Gross sell)	51,629	37,245	74,629
2. Debt			
Gross buy	7,015	11,061	31,418
Gross sell	12,533	7,012	21,990
Net (Gross buy - Gross sell)	-5,518	4,049	9,428
3. Total FII Investment (1+2)			
Gross buy	5,47,358	10,51,571	19,39,554
Gross sell	5,01,247	10,10,277	18,55,497
Net (Gross buy - Gross sell)	46,111	41,294	84,057
Total FII investment (net) in US$ million[a]	**10,467**	**9,031**	**20,837[b]**

Source: SEBI

[a] At 1US$ = Rs. 40.34

[b] Total FII investment (net) excluding derivatives is US$ 19,533 million.

Corporate debt market

5.67 As in the past, private placements appear to have dominated the mobilization of resources in the corporate primary debt market. The yield rate on corporate debt papers (with AAA rating) for five-year maturity ranged between 7.26 per cent and 8.45 per cent in 2005-06, 8.43 per cent and 9.44 per cent in 2006-07, and 9.19 per cent and 10.80 per cent in 2007-08 (April-December). Figure 5.5 gives the comparative yield rates on zero coupon GoI Bonds and Indian Corporate Debt Papers (AAA rating) during 2007. The market capitalization of corporate bonds which was Rs. 49,155 crore at end-December 2006 rose to Rs. 68,074 crore at end-December 2007.

Policy and Regulatory Changes

5.68 During 2007, several policy initiatives relating to the capital market were taken. The salient developments in the primary and secondary markets, as well as FII investment and mutual funds are delineated below.

Primary Market Regulations

5.69 During 2007, SEBI amended Disclosure and Investor Protection (DIP) Guidelines to

(i) Permit "Fast Track Issues" for well established and compliant listed companies so as to enable such companies to access the capital market in a time effective manner.

Table 5.22
Assets under management of mutual funds

(Rs. crore)

Schemes	At end of calendar year			
	2004	2005	2006	2007
Money Market	59,447	64,711	97,757	1,12,349
	(39.5)	(32.5)	(30.2)	(20.4)
Gilt	4,876	3,730	2,057	1,975
	(3.2)	(1.9)	(0.6)	(0.4)
Income	47,451	52,903	86,350	1,97,342
	(31.5)	(26.6)	(26.7)	(35.9)
Growth	31,551	67,144	1,19,538	1,92,129
	(21.0)	(33.7)	(36.9)	(34.9)
Balanced	5,472	6,833	9,170	19,938
	(3.6)	(3.4)	(2.8)	(3.6)
Equity-Linked Savings Scheme	1,740	3,927	8,726	19,063
	(1.2)	(2.0)	(2.7)	(3.5)
Gold Exchange Traded Funds	...	...	...	467
	...	...	...	(0.1)
Other Exchange Traded Funds	...	...	...	6674
	...	...	...	(1.2)
Total	**1,50,537**	**1,99,248**	**3,23,598**	**5,49,936**

Source: SEBI

Figures in parentheses indicate percentage of total.

(ii) Allow all categories of investors to apply in an IPO of Indian Depository Receipts (IDRs) and reduced the minimum application value in an IDR issue to Rs. 20,000 from Rs. 2 lakh.

(iii) Mandate use of Permanent Account Number (PAN) in all applications irrespective of value.

(iv) Enable companies making public issues to issue securities to retail individual investors/retail individual shareholders at a discounted price.

(v) Include mandatory grading of IPOs under the eligibility criteria for an IPO.

(vi) Relax certain provisions like minimum dilution requirements and minimum period of holding of pre-issue capital to be issued in an offer for sale, eligibility of shares for the purpose of computation of promoters' contribution, etc., to facilitate Government companies/ corporations, statutory authorities/ corporations or any special purpose vehicle set up by any of them, which are engaged in infrastructure sector, to raise funds in the Indian primary market through IPOs.

(vii) Remove the stipulation that debt instruments issued through public/rights issues shall be of at least investment grade to widen the corporate bond market. Further, issuers now need to obtain rating from only one credit rating agency instead of two.

5.70 Other initiatives included the following:

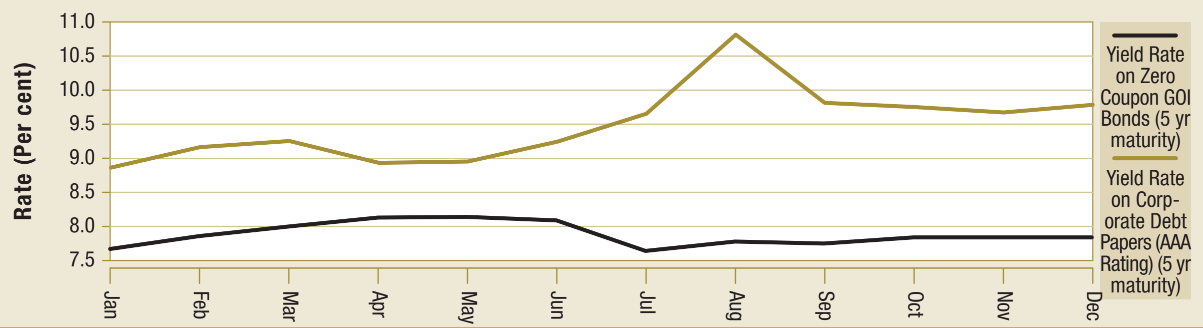
Under the overall guidance of SEBI, BSE and NSE jointly launched a common electronic platform at www.corpfiling.co.in [also referred as Corporate Filing and Dissemination System (CFDS)] on April 1, 2007. This portal acts as:

(i) A common place for filing of information on listed companies, and

(ii) A common place for viewing information about listed companies.

5.71 A subcommittee appointed by the SEBI Committee on Disclosures and Accounting (SCODA) has been given the task of integrating initial and continuous disclosures of listed companies. The main objective of this exercise is to reduce duplication of disclosures by issuers/

Figure 5.5 **Monthly yield rates on zero coupon GOI bonds & Indian corporate debt papers**



intermediaries/investors and improving access to the information placed on the public domain.

5.72 A group called GRIP (Group on Review of Issue Process) appointed by the Primary Market Advisory Committee has been given the task of reviewing the entire issue process with the objective of making the process

(i) More efficient in terms of time and cost and align it with international standards;

(ii) Widely accessible to all;

(iii) Leverage the existing infrastructure and databases of Indian securities market; and

(iv) Bring more efficiency in discovering price of public issues.

5.73 SEBI registered VCFs, desirous of making investments in offshore venture capital undertakings, can submit their proposal for investment directly to SEBI for prior approval, without separate permission from RBI.

5.74 To provide a better framework for delisting of securities from the stock exchanges, SEBI has initiated work for converting the SEBI (Delisting of Securities) Guidelines, 2003 into Regulations.

5.75 With the objective of developing the corporate bond market, SEBI has proposed the simplification of the primary debt market issuance process. Some of the major features of the proposed regulations include rationalization of disclosure requirements, enhanced responsibilities to merchant bankers for exercising due diligence and issuance of certificates in regard to new issuances, and mandatory listing of private placement of debt.

5.76 SEBI has proposed Regulations for "Public Offer and Listing of Securitized Debt Instruments". The draft regulations provide for a system of special purpose distinct entities which could offer securitized debt instruments to the public or could seek listing of such instruments.

Secondary Market Regulations

5.77 To implement the Budget announcement on creation of a unified platform for trading of corporate bonds, SEBI stipulated that an authorized reporting platform be established to capture all information related to trading in corporate bonds as accurately and as close to execution as possible. Permission was accorded for setting up trading platforms at BSE and NSE for corporate bonds.

5.78 It was made mandatory for companies issuing debentures to disseminate all the required information in the event of: (i) default by issuer company to pay interest on debentures or redemption amount; (ii) failure to create a charge on the assets; and (iii) revision of rating assigned to the debentures.

5.79 SEBI has stipulated that Permanent Account Number (PAN) would be the sole identification number for all participants in the securities market, irrespective of the amount of transaction with effect from July 2, 2007.

5.80 Sixteen stock exchanges successfully completed their demutualization process during August-September 2007 by diluting at least 51 per cent of their equity shareholding to public, other than shareholders having trading rights. Presently, there are 18 corporatized and demutualized stock exchanges in the country.

5.81 On December 20, 2007, SEBI permitted short selling by institutional investors, in addition to the retail investors who were allowed to short sell hitherto.

5.82 SEBI has approved the introduction of seven new products - mini-contracts on equity indices, options with longer life/tenure, volatility index and Futures and Options (F&O) contracts, options on futures, bond indices, exchange-traded currency (foreign exchange) futures & options, and introduction of exchange-traded products to cater to different investment strategies. The mini derivatives contract on index (Sensex and Nifty) with a minimum contract size of Rs. 1 lakh was introduced from January 1, 2008.

5.83 SEBI has proposed additional regulations to the SEBI (Prohibition of Insider Trading) Regulations, 1992, with a view towards incorporating an additional corporate governance measure which aligns the interests of a company's shareholders to that of the company's insiders. This seeks to compel an "insider" to surrender such profits to the company in any of his/her transaction concerning equity based securities of the company (including its parent's or subsidiary's shares) in the event both the buy and sell sides of the transaction are entered into within six months of the other. Such a regulation would check insiders, who have greater access to price sensitive company information, from taking advantage for making short-term profits.

5.84 During the year the investment limit for FIIs in Government Securities was enhanced from US$ 2 billion to US$ 2.6 billion. In October 2007 SEBI prohibited FIIs and their sub-accounts from issuing or renewing Participatory Notes using offshore derivative instruments like futures and options.

5.85 In respect of Mutual Funds, SEBI amended the SEBI (Mutual Funds) Regulations, 1996, to disallow a trustee of a mutual fund to act as a trustee or a director on the asset management company of any other mutual fund and specifying the methodology for the valuation of gold for the purpose of gold exchange traded funds.

5.86 Guidelines were issued restricting the limit of parking of funds by mutual funds to 15 per cent of their net assets in short-term deposits with all scheduled commercial banks with a sub-limit of 10 per cent with any one scheduled commercial bank. Also, SEBI increased the limit for overseas investment by each mutual fund from US$ 200 million to US$ 300 million.

5.87 With effect from January 4, 2008, entry load by mutual funds was waived for investors making applications for investment in mutual fund schemes directly. SEBI has proposed Real Estate Investment Trust Regulations with a view to encourage and facilitate growth of such trusts in India. In pursuance of Budget (2007-08) announcement SEBI has appointed a committee on the launch of dedicated infrastructure funds (DIF) by mutual funds. In consonance with the international practices, SEBI proposes to introduce the fast-track model for the launch of products by mutual funds.

COMMODITY FUTURES MARKET

5.88 Commodities which were traded in the commodity futures market during 2007 included a variety of agricultural commodities, spices, metals, bullion and crude oil. The total volume of trade in the commodity futures market rose from Rs. 34.84 lakh crore in 2006 to Rs. 36.54 lakh crore in 2007, notwithstanding the suspension of trading of wheat, rice, urad and tur (Table 5.23).

Table 5.23 Turnover on commodity futures markets

(Rs. crore)

Name of the Exchange	Calendar year		
	2005	2006	2007
Multi Commodity Exchange (MCX), Mumbai	6,33,324	20,25,663	27,30,415
National Multi Commodity Exchange, Ahmedabad	12,107	1,11,462	25,056
National Commodity and Derivatives Exchange, Mumbai	8,83,209	12,43,327	7,74,965
National Board of Trade, Indore	50,889	73,691	82,272
Others	57,816	30,342	41,779
Total	**16,37,345**	**34,84,485**	**36,54,487**

Source: Ministry of Consumer Affairs

5.89 The daily average value of trade in the commodity exchanges improved from Rs. 13,000 crore during 2006 to more than Rs. 15,000 crore in 2007. While the commodities traded at the exchanges included major agricultural commodities, the major share of the turnover was accounted for by spices, crude oil and natural gas.

5.90 The Multi Commodity Exchange (MCX) continued to be the largest commodity futures exchange during 2007 both in terms of turnover volume and number of contracts (Table 5.24 and Figure 5.6).

5.91 The growth of MCX commodity future index at 8 per cent during 2007 was somewhat lower as compared to the international commodity futures indices of Dow Jones AIG Commodity Index Cash

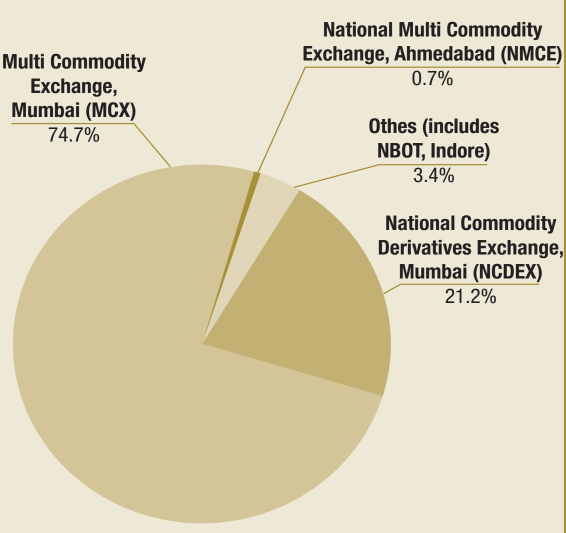
Table 5.24 Number of contracts traded in National Exchanges

(in lakh)

Name of the Exchange	Calendar year		
	2005	2006	2007
Multi Commodity Exchange, Mumbai	110.8	310.5	452.1
National Multi Commodity Exchange, Ahmedabad	10.1	31.4	12.1
National Commodity and Derivatives Exchange, Mumbai	247.4	307.1	236.5

Source: Ministry of Consumer Affairs

Figure 5.6 **Indian commodity exchanges market share (in terms of turn-over) (End-Dec 2007)**



Index (DJAIG) (11 per cent) and Reuters/Jefferies Commodity Research Bureau (RJCRB) (17 per cent) (Figure 5.7).

Regulation of Commodity Futures Market

5.92 The commodity futures markets facilitate price discovery process and provide for risk management. Their effectiveness depends on the participation of all the stakeholders. At the same time it is important to ensure that such trading does not become an instrument for pronounced speculation.

5.93 The Forward Markets Commission (FMC), under the Department of Consumer Affairs, which is the regulator for commodity futures trading under the provisions of Forward Contracts (Regulation) Act, 1952, continued with its proactive approach towards regulation and development of the markets. FMC gave special emphasis to create awareness about these markets among the participants in the physical markets including farmers. FMC has initiated various steps to attract larger participation of all the stakeholders in the supply-chain so as to make the price discovery process more efficient. An Ordinance has been issued on January 31, 2008 converting FMC into an independent regulatory body.

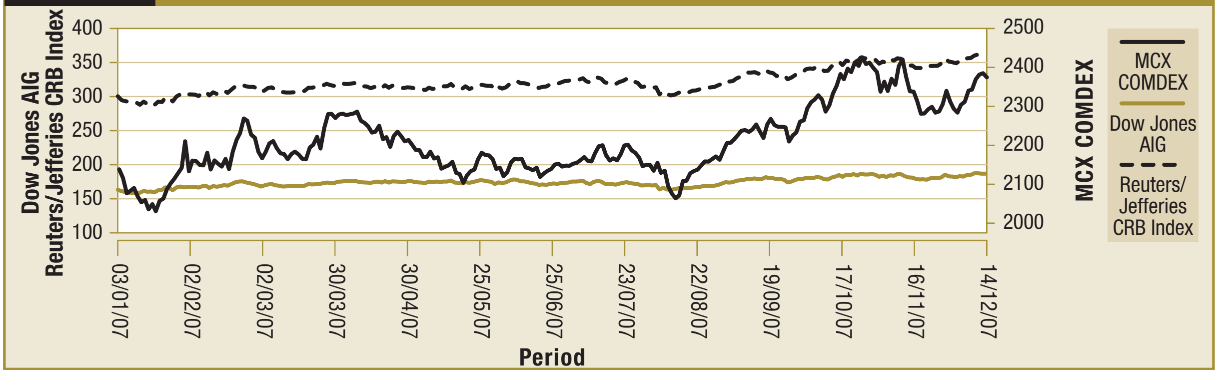
Policy Developments

5.94 Major policy developments during 2007 included FMC initiating a process of dissemination of futures and spot prices at various mandis, post offices, rural branches of commercial banks and other areas frequented by participants including farmers. Dissemination of price information is expected to help such participants to cover their price risk in their pre-sowing and post-harvest decisions. On January 30, 2008, Foreign Direct Investment (FDI) upto 26 per cent and FII investment upto 23 per cent (subject to no single investor holding more than 5 per cent) were allowed in Commodity Exchanges.

5.95 FMC in association with the various State Governments, agricultural universities, academic institutions, NGOs, commercial banks, and others, has been organizing the awareness/training programmes exclusively targeted at farmers. During 2007, 43 awareness programmes were organized exclusively for the farmers. The awareness programmes are designed to make farmers aware of the benefits of the futures market and to utilize the price signals emanating from the futures exchanges in taking various decisions.

5.96 Direct participation of the farmers in the commodity futures markets is somewhat difficult at this stage as the large lot size, daily margining,

Figure 5.7 **Movement of MCX and other international indices**



high membership fees, etc., work as deterrent for farmers' participation in these markets. Farmers can directly benefit from futures market if institutions are allowed to act as aggregators on behalf of farmers.

INSURANCE AND PENSION FUNDS

Insurance

5.97 The insurance sector was opened up for private participation with the enactment of the Insurance Regulatory and Development Authority Act, 1999. While permitting foreign participation in the ventures set up by the private sector, the Government restricted participation of the foreign joint venture partner through the FDI route to 26 per cent of the paid-up equity of the insurance company.

New entrants

5.98 Since opening up, the number of participants in the sector has gone up from six insurers (including the Life Insurance Corporation of India, four public sector general insurers and the General Insurance Corporation (GIC) as the national re-insurer) in the year 2000 to 37 insurers operating in the life, non-life and re-insurance segments as at December 2007. This includes specialized insurers, viz., Export Credit Guarantee Corporation; Agricultural Insurance Company and two stand-alone health insurance companies. Of the 17 life insurance companies, as many as 15 are in joint venture with foreign partners. Of the 10 insurers which have been set up in the non-life segment, 9 are in collaboration with the foreign partners. In addition, two stand-alone health insurance companies have been set up in collaboration with joint venture foreign partners. Thus, as on date, 26 insurance companies in the private sector have been granted registration in the country in collaboration with established foreign insurance companies from across the globe.

Industry Development

Life insurance industry

5.99 The total premium underwritten by the industry has grown from Rs. 34,898 crore in 2000-01 to Rs. 1,56,041 crore in 2006-07. The first year premium, which is a measure of new business secured, underwritten by the life insurers during 2006-07 was Rs. 75,617 crore as compared to Rs. 9,708 crore in 2000-01. During the current year, the life industry has reported growth of 1.41 per cent in new business premium underwritten during the period April to November 2007. The first year premium underwritten during the period under report was Rs. 44,696 crore as against Rs. 44,073 crore in the corresponding period of the previous year.

Non-life insurance industry

5.100 The non-life insurers (excluding specialized institutions like ECGC and AIC) underwrote premium within India to the tune of Rs. 24,905.47 crore in 2006-07, as against Rs. 9,807 crore in 2000-01. Two of the fastest growing segments are motor and health accounting for 42.73 and 12.77 per cent of the premium underwritten in India in 2006-07. The premium underwritten in these two segments alone in 2006-07 was Rs. 11,080 crore and Rs. 3,311 crore, respectively. During the current year, the non-life insurers underwrote premium of Rs. 18,509 crore during April to November 2007 as against Rs. 16,560 crore in the corresponding period of the previous year. Post-de-tariffing, while the growth in premium has slowed down on account of reduction in rates, the number of policies underwritten has shown an increase.

Penetration and density

5.101 The potential and performance of the insurance sector is universally assessed in the context of two parameters, viz., insurance penetration and insurance density. Insurance penetration is defined as the ratio of premium underwritten in a given year to the GDP. Insurance density is defined as the ratio of premium underwritten in a given year to the total population (measured in US$ for convenience of comparison). The insurance penetration was 2.32 (life 1.77 and non-life 0.55) in the year 2000 when the sector was opened up to the private sector, and has increased to 4.80 in 2006 (life 4.10 and non-life 0.6). The increase in the levels of insurance penetration has to be assessed against the average growth of over 8 per cent in the GDP in the last three years. Insurance penetration in some of the emerging economies in Asia, i.e., Malaysia, Thailand and China, during the same period was 4.9, 3.5 and 2.7, respectively. The insurance density in India was US$ 9.9 in 2000 which has increased to US$ 38.4 in 2006. The comparative figures for Malaysia, Thailand and China during the same period were US$ 292.2, US$ 110.1 and US$ 53.5, respectively.

5.102 The Insurance Regulatory and Development Authority (IRDA), set up under the statute, is the regulator for the insurance sector. During 2007-08, the IRDA has carried forward the process of de-tariffing of the general insurance sector, creation of the motor pool effective April 1, 2007, implementation of the micro-insurance regulations, and amendments to the obligations towards the rural and social sectors.

Policy Developments

5.103 Several policy initiatives were taken in the insurance sector during 2007 (Box 5.1). To further deregulate the insurance sector, IRDA had done away with the tariffs on the rates of general insurance products from January 1, 2007. This measure was aimed at providing better choices to policyholders, differentiated rates consistent with the level of risks borne as well as overall improvement in risk management.

5.104 The IRDA (Obligations of Insurers towards the rural and social sectors) Regulations, 2002, had laid down the obligations of the insurers for the first five years of operations. Amendments to the regulations incorporating the obligations of the insurers up to the tenth year and thereafter have been notified during 2007.

5.105 IRDA has advised all insurance companies to furnish details of the initiatives taken to promote micro-insurance as a viable business opportunity, with particular reference to understanding the constraints faced by them. With a view to synergizing the efforts of all State Governments which are promoting the poverty alleviation programmes, the IRDA has requested the State Governments to publicize the concept of micro-insurance through their various agencies.

Box 5.1 Recent initiatives taken in the insurance sector

In the insurance sector the major policy initiatives included:

- De-tariffing of the general insurance industry
- Obligations towards the rural & social sectors
- Micro-insurance

Pension Sector: Highlights

5.106 The pension sector essentially encompasses the organized sector. The majority of the country's workforce in the unorganized sector has no access to formal channels of old-age income support. Only about 12 per cent of the working population in India is covered by some form of retirement benefit scheme. Besides the problem of limited coverage, the existing mandatory and voluntary pension system has been characterized by limitations like fragmented regulatory framework, lack of individual choice and portability, lack of uniform standards, low real rate of returns, etc. India's need for comprehensive reforms in the pension system is thus self-evident.

5.107 The major developments in the pension sector include the introduction by the Government of the New Pension System (NPS) from January 1, 2004, through a notification dated December 22, 2003, for new entrants to the Central Government service, except to the Armed Forces of the Union. The Government has constituted a regulatory body, namely, the Pension Fund Regulatory and Development Authority (PFRDA).

5.108 The main feature of the NPS is based on defined contribution. New entrants to the Central Government service contribute 10 per cent of their salary and dearness allowance (DA), which is matched by the contribution by the Central Government (Tier-I). Once the NPS architecture is fully in place, employees will have the option of a voluntary [Tier-II) withdrawable account (in the absence of the facility of General Provident Fund (GPF)] to which Government will make no contribution. Employees will normally exit the system at or after the age of 60 years. At the time of exit, it is mandatory for them to invest 40 per cent of the pension wealth to purchase an annuity to provide a lifetime pension for the employee and his dependents. The remaining 60 per cent will be paid to the employee in lump sum at the time of exit. Individuals would have the flexibility to leave the pension system prior to the age of 60. However, in this case, mandatory annuitization would be 80 per cent of the pension wealth. The new system will have a central record keeping and accounting infrastructure and several fund managers to offer investment options with varying proportions of investment in fixed-income instruments and equity.

5.109 The Pension Fund Regulatory and Development Authority Bill, 2005, was introduced in Parliament on March 21, 2005. It has been approved by the Standing Committee on Finance which recommended its passage with certain modifications. This is under consideration of the Government.

5.110 As per data available (as on February 1, 2008), approximately 2.85 lakh employees were covered under the NPS. An amount of approximately Rs. 1,177 crore, including the Government contribution and interest component has been credited into the pension account. Nineteen State Governments have also notified similar schemes for their new recruits.

5.111 The PFRDA has appointed three sponsors for pension funds for managing the corpus under the New Pension System for the Government employees after due consideration. These are the State Bank of India, UTI Asset Management Company Private Limited and Life Insurance Corporation of India. They have incorporated the pension funds as companies under the Companies Act, 1956. The entire architecture of the NPS is expected to be operationalized by May 31, 2008. The accumulation and contribution of subscribers of NPS would be invested as per the investment guidelines prescribed for the non-government provident funds. An alternate option of investing 100 per cent of the corpus in the Government securities would also be available to the subscribers.

CHALLENGES AND OUTLOOK

5.112 As the Indian economy has entered a higher growth trajectory, the investment demand is expected to remain strong in the short to medium term. The banking sector is equipped to meet the growing demand for resources; it is however, necessary that credit expansion is non-inflationary and the productive sectors receive adequate credit at a resonable cost. This may call for the banking sector to review the spreads suitably, thereby ensuring that credit offtake by productive sectors is maintained facilitating the growth momentum of the economy.

5.113 With a vibrant capital market, the Indian corporates would step up their access to the primary market to raise resources both through equity and debt issues. Alongside, the overseas issues (ADR/GDR) too are expected to gain in importance to supplement the domestic resource mobilization by the corporates. The Government's efforts to streamline the regulatory framework and to bring business transparency may enhance activity in the primary capital market in terms of increase in the number of debt and equity issues as well as larger participation of investors, particularly retail investors.

5.114 The performance of Indian stock prices in the secondary market hinges broadly on long-term and short-term factors. In the long run, strong world output growth is important to sustain the investment activity across the globe. Since India's growth performance is relatively better among the emerging economies, the country would continue to attract significant cross-border portfolio investments. In the short term, expectation of higher relative returns from investment in India, favourable risk perception of investors and improved global liquidity would help the country in being an attractive destination for investment. Going forward, despite the possible subdued global growth, the strong fundamentals of the Indian economy in tandem with higher growth would help in sustaining the interest of domestic and foreign investors in the Indian market.

5.115 Domestically, corporate earnings are expected to remain encouraging. Strong projected economic growth and supportive policy initiatives would enhance investors' preference to invest in financial instruments, such as equity and debt papers. If the recent pick-up in the amount of resource mobilization by mutual funds and the assets they manage are any indication reflecting increased preference for investment in the capital market via mutual funds, the resources available with the Indian financial institutions would increase. This would find its way to the capital market. The recent efforts of the insurance companies to broaden the geographical outreach and increase in innovative products would strengthen their resource base and may stimulate their participation in equity and debt markets. The continuation of initiatives towards policy reforms in the area of insurance and pension funds would provide the credibility to the Government's efforts to carry forward the economic reforms, auguring well for the capital market as well.

5.116 Against the backdrop of expected expansion of activity in the Indian capital market, the importance of ensuring healthy and orderly conditions in the market becomes more urgent. Ensuring stable conditions in the market is the responsibility of policymakers, regulators as well as market participants. While the policy initiatives are required to be well calibrated to transmit the right policy signals unambiguously, the regulators need to remain proactive and vigilant to obviate the occurrence of any irregularities in the conduct of business in the market. Investors' awareness is equally important from the market stability angle as investment in equities could be based on incomplete analysis and guided by short-term speculative gains. Individual investors need to take informed decisions and remain cautious. They would do well to resist from commonly observed "herd mentality" and "panic" in their buying and selling operations.

5.117 The growing importance of insurance and pension funds would provide impetus and broaden the horizon of the Government securities market. The provisions in the Government Securities Act, 2006, which allow nomination, pledging and stripping of securities are expected to expand the Government securities market, particularly its retail segment. With the RBI setting up a group to suggest measures to activate the interest rate futures market, the transparency and price discovery process of interest rates on the Government securities would be enhanced. However, a major policy challenge is in the area of corporate debt market. A high-level Committee on Corporate Bonds and Securitization set up by the Government had gone into the various issues relating to corporate debt market such as corporate debt issuance, pricing, trading and settlement. The various recommendations of the Committee are under different stages of implementation.

5.118 The commodity exchanges, which have grown from strength to strength in the last few years, measured in volume of turnover as well as number of transactions, are expected to perform well in the near to medium term also. In terms of transactions in the futures markets, besides gold and crude oil, other commodities, especially agricultural commodities, have gradually started gaining in importance. This would help in deepening the process of price discovery. While an Ordinance has been issued for ensuring autonomy to the Forward Markets Commission, the legislation for the purpose would further strengthen commodity futures trading in India and help the process of price discovery and provide an effective mechanism for price-risk management.