

# Financial Intermediation and Markets

## 5

### CHAPTER

*Historically, banks have played the role of intermediaries between the savers and the investors. However, in the last few decades, the importance and nature of financial intermediation has undergone a dramatic transformation the world over. The dependence on bank credit to fund investments is giving way to raising resources through a range of market based instruments such as the stock and bond markets, new financial products and instruments like mortgage and other assets backed securities, financial futures and derivative instruments like swaps and complex options. Besides transferring resources from savers to investors, these instruments enable allocation of risks and re-allocation of capital to more efficient use. The increase in the breadth and depth of financial markets has also coincided with a pronounced shift among the ultimate lenders who have moved away from direct participation in the financial markets to participation through a range of intermediaries. These developments in international financial markets have been mirrored in the financial market in India. This chapter summarizes the main developments in this sector in India in the last year and highlights the various policy challenges.*

## BANK CREDIT

5.2 Bank credit to productive sectors of the economy has a critical role in sustaining the growth process. While the spread of banking network is a continuous process, the effectiveness of the banking network also depends on the expansion in the scale of operations and the deepening of the credit facilities. The total assets of the scheduled commercial banks (SCBs) have increased from a level of Rs. 3.46 million on March 31, 2007 to Rs. 4.33 million on March 31, 2008. All categories, namely, public sector banks, old private sector banks, new private sector banks and foreign banks have increased their asset base.

5.3 A noticeable trend in the recent years is the growing importance of the competition emerging between the different categories of banks. This is reflected in the changes in the share of assets of different categories of SCBs. Though the share of public sector banks in total assets of SCBs has declined to 69.9 per cent at the end of 2007-08 from 70.5 per cent in 2006-07, they continue to play an important role in the current economic environment. The share of old private sector banks also marginally declined in 2007-08; correspondingly

the share of assets of foreign banks and new private sector banks increased.

5.4 The first six months of the financial year 2008-09 witnessed inflationary pressures in the Indian economy with RBI continuing to address monetary expansion through revisions in policy rates. The second half of 2008-09 was however a period when the RBI initially took steps to ease the liquidity crunch in the money market in September/October 2008, followed up with steps to facilitate continued credit flows to the productive sectors of the economy. Reduction in policy rates were also announced to enhance the liquidity in the system and for reducing the cost of credit to business and industry.

## Bank credit and investment

5.5 The continued boom in the economic activity which had for the third year in succession led to significant expansion of credit by SCBs, moderated during 2008-09. Though bank credit to the commercial sector witnessed strong growth in the first half of the year, it decelerated particularly in the second half of the year. For the full year 2008-09, bank credit to the commercial sector

Table 5.1 : Credit flow from scheduled commercial banks

(Rs. crore)

Credit flow from	Outstanding as on March 27, 2009	Variations (year-on-year)			
		As on March 28, 2008		As on March 27, 2009	
		Amount	Per cent	Amount	Per cent
Public Sector Banks	20,11,591	3,07,310	22.5	3,41,442	20.4
Foreign Banks	1,69,350	36,116	28.5	6,483	4.0
Private Banks	5,23,038	78,301	19.9	51,559	10.9
All Scheduled					
Commercial Banks*	27,70,012	4,30,724	22.3	4,08,099	17.3

Source : RBI

\* Includes Regional Rural Banks

Note : Data are provisional

expanded by 16.9 per cent only, as compared to a growth of 21.0 per cent in 2007-08.

5.6 During 2008-09 (March 27, 2009 over March 28, 2008), there was a moderation in the credit growth of SCBs to 17.3 per cent from a level of 22.3 per cent in the corresponding period of the previous year (Table 5.1). In terms of absolute values also, the slowdown was noticeable, in as much as the expansion in bank credit during 2007-08 was of the order of Rs. 4,30,724 crore which decelerated to Rs. 4,08,099 crore in 2008-09. Non-food credit growth as at end-March 2009 grew by 17.5 per cent as compared to 23.0 per cent growth as at end-March 2008.

5.7 Though the growth in the different sources of funds for the SCBs during 2008-09 was lower than for 2007-08, the growth in deposits with the banking system in 2008-09 was higher than the growth of credit. This reflected in the decline in the incremental credit-deposit ratio (y-o-y) of SCBs from 73.6 per

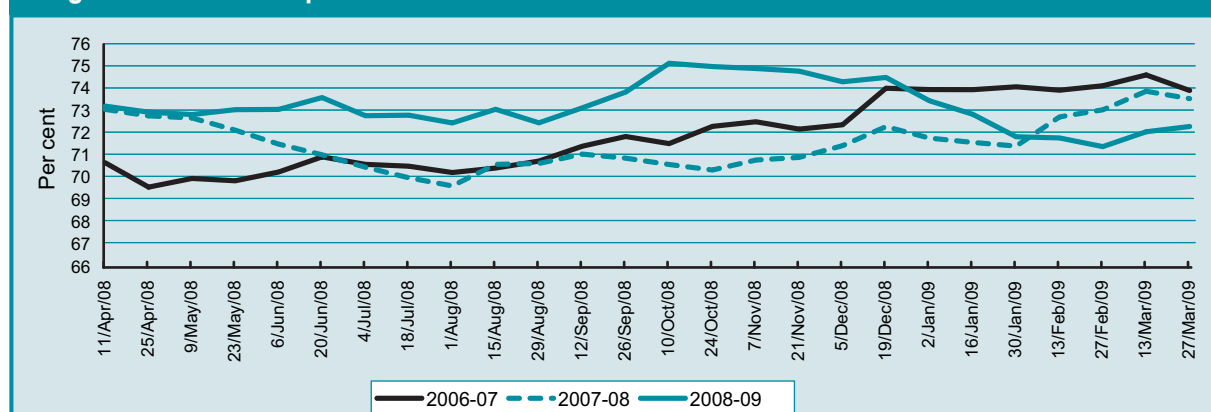
cent in end-March 2008 to a level of 64.4 per cent in end-March 2009.

5.8 The behaviour of the credit-deposit (C-D) ratio also reflected the changes in the monetary sector; C-D ratio which was at 73.9 as of March 31, 2007, marginally declined to 73.8 as of March 31, 2008. In 2008-09, it peaked to 75.2 as of October 10, 2008, but declined thereafter. It stood at 72.3 as of March 27, 2009. The movement of the C-D ratio during the last three years is given in the accompanying figure (Figure 5.1).

#### Scheduled commercial banks' investments

5.9 Investment by SCBs in statutory liquidity ratio (SLR) securities as per cent of their net demand and time liabilities (NDTL) continued to be higher than the stipulated level. As compared to the level of 27.8 per cent at end-March 2008, it increased to a level of 28.1 per cent at end-March 2009. As per information from RBI, after adjusting for Liquidity

Figure 5.1 : Credit deposit ratio



Adjustment Facility (LAF) collateral securities on an outstanding basis, the scheduled commercial banks' holding of SLR securities amounted to 26.7 per cent of NDTL, at end-March 2009, which was higher than the prescribed 24.0 per cent level.

5.10 Non-SLR investment by SCBs during 2008-09 (March 27, 2009 over March 28, 2008) expanded by Rs. 8,615 crore (an increase of 9.0 per cent) compared to Rs. 11,961 crore (an increase of 14.3 per cent) during 2007-08 (March 28, 2008 over March 30, 2007) indicating comfortable liquidity situation with SCBs.

5.11 The investment-deposit ratio at 34.02 as of March 31, 2006 decreased to 30.3 as of March 31, 2007 and marginally increased to 30.4 on March 31, 2008. During 2008-09, the investment-deposit ratio peaked to 31.8 on February 13, 2009 and declined thereafter to 30.4 as of March 27, 2009. The movement of the investment-deposit ratio during the last three years is given in Figure 5.2.

#### Sectoral deployment of bank credit

5.12 SCBs' lower overall gross non-food credit growth during 2008-09 (at 18.1 per cent as compared to 22.3 per cent in 2007-08) reflected itself in the sectoral deployment of bank credit. Data available as on March 27, 2009 is given in Table 5.2. While loans to agriculture & allied activities grew at the rate of 23.0 per cent during 2008-09 (as on March 27, 2009) compared to 19.5 per cent (as on March 28, 2008), credit to industry (comprising of large, medium and small scale sector) grew at 21.6 per cent during 2008-09 (as of March 27, 2009) compared to 24.3 per cent (as of March 28, 2008). Within industry group, the deceleration was noticeable in credit to food processing, textiles, vehicles, vehicle parts and transport equipments. Personal loans during 2008-09 (as of March 27, 2009) grew at a

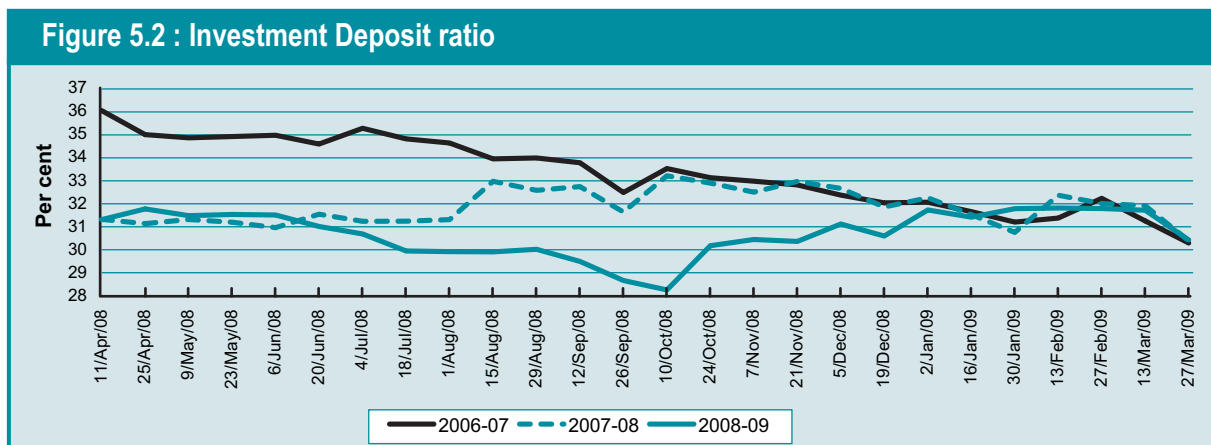
lower rate of 10.8 per cent compared to 12.1 per cent (as of March 28, 2008); advances under personal loans for housing and consumer durables have witnessed deceleration. Loans to commercial real estate and non-banking financial companies remained high in 2008-09, posting a growth of 44.6 per cent and 25.1 per cent respectively.

#### Priority sector lending

5.13 A target of 40 per cent of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of Off-Balance Sheet Exposures (OBE), whichever is higher, had been stipulated for lending to the priority sector by domestic SCBs (both public and private sector). Within this, sub-targets of 18 per cent and 10 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, had been stipulated for lending to agriculture and the weaker sections respectively. However, to ensure that the focus of the banks on the direct category of agricultural advances does not get diluted, the indirect lending in excess of 4.5 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, are not reckoned for computing performance under the 18 per cent sub-target. All agricultural advances under the 'direct' and 'indirect' categories are reckoned in computing the performance under the overall priority sector target of 40 per cent of ANBC or Credit Equivalent amount of OBE, whichever is higher.

5.14 A target of 32 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, had been stipulated for lending to the priority sector by foreign banks having offices in India. Within the overall target of 32 per cent to be achieved by foreign banks, the advances to micro & small enterprises and export sectors were not to be less than 10 per cent and 12 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, respectively.

Figure 5.2 : Investment Deposit ratio



**Table 5.2 : Deployment of gross bank credit by major sectors**

(Rs. crore)

Sector	Outstanding as on 27-Mar 2009	Annual Variation			
		2007-08*		2008-09**	
		Absolute	%	Absolute	%
Non-food gross bank credit (1 to 4)	2,602,290	401,650	22.3	399,400	18.1
1. Agriculture & Allied Activities	338,656	44,966	19.5	63,313	23.0
2. Industry (Small, Medium & Large)	1,054,390	169,536	24.3	187,515	21.6
of which, Small Enterprises	257,027	76,932	65.2	62,185	31.9
3. Personal Loans	562,479	54,730	12.1	54,991	10.8
Housing	276,957	26,802	11.6	19,165	7.4
Advances against Fixed Deposits	48,676	4,170	10.2	3,671	8.2
Credit Card Outstanding	28,000	8,094	44.2	1,607	6.1
Education	28,579	5,324	35.0	8,047	39.2
Consumer Durables	8,187	-390	-4.2	-612	-7.0
4. Services	646,765	132,419	31.5	93,580	16.9
Transport Operators	39,302	9,486	33.5	1,484	3.9
Professional and Other Services	45,373	3,201	13.4	18,240	67.2
Trade	144,377	17,059	16.0	20,656	16.7
Real Estate Loans	91,575	19,235	43.6	28,261	44.6
Non-Banking Financial Companies	98,853	30,094	61.5	19,835	25.1
Priority Sector	915,886	111,414	17.5	168,506	22.5
INDUSTRY (Small, Medium and Large Scale)	1,054,390	169,536	24.3	187,515	21.6
Food Processing	53,779	9,371	23.4	4,397	8.9
Textiles	102,695	17,483	22.1	6,206	6.4
Paper & Paper Products	15,983	1,874	16.2	2,521	18.7
Petroleum, Coal Products and Nuclear Fuels	68,147	5,715	15.9	26,546	63.8
Chemicals and Chemical Products	75,555	6,560	11.7	13,095	21.0
Rubber, Plastic & their Products	13,587	1,898	20.5	2,439	21.9
Iron and Steel	99,159	18,858	29.6	16,557	20.0
Other Metal and Metal Products	29,604	4,906	24.5	4,705	18.9
Engineering	65,807	10,690	24.4	11,355	20.9
Vehicles, Vehicle Parts and Transport Equipments	34,642	8,366	40.1	5,421	18.6
Gems & Jewellery	28,537	1,233	5.2	3,454	13.8
Construction	38,505	7,952	39.8	10,556	37.8
Infrastructure	269,972	61,745	43.1	64,852	31.6

Source : RBI

\* March 28, 2008/ March 31, 2007

\*\* March 27, 2009/ March 28, 2008

Note : Data are provisional and relate to select scheduled commercial banks.

5.15 The public, private sector and foreign banks, had achieved the overall priority sector lending targets as on the last reporting Friday of March 2008. The broad picture regarding priority sector advances is given in Table 5.3.

5.16 As non-achievement of priority sector targets could be a matter of concern, suitable initiatives in the banking sector have also been taken. In order to improve and enhance the flow of credit to the priority sector, the following policy initiatives were taken during the year 2007-08:

- In order to augment the resources of Regional Rural Banks (RRBs) for the purposes of lending, all loans granted by commercial banks/sponsor banks to RRBs for on-lending to agriculture and allied activities sector were

made eligible to be classified as indirect finance to agriculture in the books of commercial banks/sponsor banks. Consequently, the amount lent by RRBs out of funds borrowed from commercial banks/sponsor banks, would not be classified by RRBs as part of their priority sector advances. The RRBs need not also include such lending as part of their bank credit for the purpose of computing achievement level under priority sector lending;

- Banks were allowed to classify 100 per cent of the credit outstanding under general credit card (GCCs) and overdrafts up to Rs. 25,000 (per account) granted against 'no-frills' accounts in rural and semi-urban areas as indirect finance to agriculture sector under the priority sector;

**Table 5.3 : Particulars of priority sector advances**

<b>A. PUBLIC SECTOR BANKS</b>			
(Rs. crore)			
Detail	As on the last reporting Friday of		
	March 2006	March 2007	March 2008 (provisional)
Total priority sector advances	4,09,748(40.3%)	5,21,376(39.7%)	6,08,963(44.6%)
Total advances to agriculture	1,55,220(15.3%)	2,02,614(15.4%)	2,48,685(17.4%)
Total advances to micro & small enterprises *	82,434(8.1%)	1,02,550(7.8%)	1,48,651(10.9%)
Advances to weaker sections	78,158(7.7%)	93,747(7.1%)	1,26,935(9.3%)

<b>B. PRIVATE SECTOR BANKS</b>			
Detail	As on the last reporting Friday of		
	March 2006	March 2007	March 2008 (provisional)
Total priority sector advances	1,06,586(42.8%)	1,44,549(42.9%)	1,63,223(47.5%)
Total advances to agriculture	36,712(13.6%)	52,034(12.7%)	57,702(15.4%)
Total advances to micro & small enterprises *	10,421(4.2%)	13,136(3.9%)	46,069(13.4%)
Advances to weaker sections	4,174(1.7%)	5,223(1.6%)	7,228(2.1%)

<b>C. FOREIGN BANKS</b>			
Detail	As on the last reporting Friday of		
	March 2006	March 2007	March 2008 (provisional)
Total priority sector advances	30,439(34.4%)	37,831(33.4%)	50,301(39.5%)
Total advances to micro & small enterprises*	8,430(9.5%)	11,637(10.3%)	15,489(12.2%)
Total Export credit (includes SSI export)	17,326(19.6%)	20,711(18.3%)	29,007(22.8%)

Source : RBI

\* Figures for March 2006 and 2007 represent small scale industries. In terms of revised guidelines on lending to priority sector, micro & small enterprises defined on basis of Micro, Small and Medium Enterprises Development Act, 2006.

Note: 1. The figures in parenthesis show percentage of advances to Net Bank Credit.

2. Indirect agriculture is reckoned only up to 4.5% of the ANBC or credit equivalent of off-balance sheet exposures, whichever is higher.

- RRBs were allowed to sell loan assets held by them under priority sector categories in excess of the prescribed priority sector lending target of 60 per cent; and
- In order to ensure that the sub-target of lending to the weaker sections is achieved, the domestic scheduled commercial banks were advised that the shortfall in achievement of sub-

target of lending to weaker sections will also be taken into account for the purpose of allocating amounts for contribution to the Rural Infrastructure Development Fund (RIDF) maintained with NABARD or funds with other financial institutions, as specified by the Reserve Bank of India, with effect from April 2009.