3

MONETARY AND BANKING DEVELOPMENTS

The monetary growth target for 1996-97 was set at around the same level as in the previous year, given the desire to maintain both real growth and inflation at close to last year's levels. Actual money growth during 1996-97 so far has, however, been considerably higher than that during the corresponding period of last year. This is true of both broad money (M3) and narrow money (M1). However, the growth of M3 has remained close to the 16 per cent projected growth path. The slow-down in industrial growth (as indicated by variations in the IIP) has reduced the demand for credit from the commercial sector .The excess demand pressure on banks has eased, while the flow of savings into bank deposits has increased. This has been followed by an easing of interest rates. Call money rates and auction rates for both 91 days and 364 days treasury bills have fallen.

2. Reserve money has declined in absolute terms during the current financial year so far, primarily due to a sharp fall in refinance availed of by commercial banks. Lower recourse to the RBI by the Central Government has also reduced reserve money growth. However, the money multiplier has gone up because of the reduction in the cash reserve ratio (CRR) from 14 per cent to 10 per cent. A reduction of the CRR also reduces the implicit taxation on banks and increases their potential profitability.

3. The process of financial sector reforms has continued during 1996-97. Interest rates on domestic term deposits of over one year have been decontrolled. The interest rate on term deposits of 30 days to one year has been reduced to 10 per cent. Selective credit controls have been removed from bank advances against most commodities. Many banks have reduced their prime lending rates by one to one and a half per cent points. There has been further liberalisation of rules governing consortium finance in the case of multiple bank lending. State Bank of India with all its subsidiaries and 11 out of 19 nationalised banks have attained eight per cent capital to risk weighted assets ratio. Select banks will be permitted to offer finer cross currency rates. Banks can now extend foreign currency loans on the resource base of Foreign Currency Non-Resident (Banks) Accounts. Disbursement of financial assistance by development finance institutions has maintained almost the same growth rate in 1996-97 as in 1995-96.

Monetary Trends and Developments

Monetary Trends in 1995-96

Money Growth

4. The spurt in prices during 1994-95 prompted necessary changes in the stance of monetary policy in the first half of 1995-96. This had the desired effect of moderating inflation, which moved down to single digit rate by mid-April 1995 and remained on a downward trend till the end of 1995-96. The year was marked by exchange rate volatility, but such volatility was reduced by the end of the year.

5. Industry grew by 11.6 per cent (as per IIP) during 1995-96. Because of rising industrial growth rates, coupled with a slowdown in availability of funds from such sources as capital markets and GDR issues, demand for bank credit by the corporates from the banking sector expanded rapidly during 1995-96. There was also upward pressure on nominal interest rates which were fairly high over most of 1995-96.

6. Broad money (M3) recorded a significantly lower growth (13.2 per cent) in 1995-96 than the 15.5 per cent growth that had been projected for the year, as well as the 22.3 per cent growth seen in 1994-95. (Table 3.1) The growth rate was also the lowest observed since 1982-83. The growth rate of narrow money (M1) was even lower at 11.5 per cent as against the high of 27.5 per cent registered in 1994-95. The order of expansion of broad money at 13.2 per cent in 1995-96 could be partly attributable to the unusually high base of March 31, 1995 and the

TABLE 3.1

Sources of Change in Money Stock (M3)

Variations during[1]

	Financial Year			Annual		Financial Year			Annual	
	1995-96 Mar.31 to Mar.31	1995-96 Mar.31 to Jan.19	1996-97 Mar.31 to Jan.17	1995-96 Jan.20 to Jan.19	1996-97 Jan.19 to Jan.17	1995-96 Mar.31 to Mar.31	1995-96 Mar.31 to Jan.19	1996-97 Mar.31 to Jan.17	1995-96 Jan.20 to Jan.19	1996-97 Jan.19 to Jan.17
			(Rs. crore)					(Per cent)		
I. M1 (Money supply with the public)	22106	8163	11507	25571	25450	11.5	4.2	5.4	14.6	12.7
II. M3 (Aggregate monetary resources)	70409	43647	63697	76756	90459	13.2	8.2	10.6	15.4	15.7
i) Currency with the public	17480	15870	13084	18886	14694	17.4	15.8	11.1	19.3	12.6
ii) Demand deposits with banks	4669	-10649	-2507	3545	12811	5.3	-12.1	-2.7	4.8	16.5
iii) Time deposits with banks	48304	35485	52190	51185	65009	14.2	10.5	13.5	15.8	17.4
iv) Other deposits with RBI	-43	2942	930	3140	-2055	-1.3	86.9	27.8	98.6	-32.5
III. Sources of change in M3 (1+2+3+4-5)										
1. Net bank credit to Government (A+B)	34991	28230	29464	35062	36225	15.7	12.7	11.4	16.3	14.5
A) RBI's net credit to Government (i+ii)[2]	19871	14961	3986	21121	8896	19.6	14.7	3.3	22.2	7.6
i) Central Government[3]	19855	17091	5608	21106	8372	20.1	17.3	4.7	22.2	7.2
ii) State Governments	16	-2130	-1622	15	524	0.6	-83.0	-62.8	3.6	120.5
B) Other banks' credit to Government	15120	13269	25478	13940	27329	12.5	11.0	18.7	11.6	20.4
2. Bank credit to commercial sector (A+B)	48179	33964	17974	54413	32189	16.5	11.6	5.3	20.0	9.9
A) RBI's credit to commercial sector[4]	262	-93	-568	-72	-213	4.0	-1.4	-8.3	-1.1	-3.3
B) Other banks' credit to commercial sector	47917	34057	18542	54485	32402	16.7	11.9	5.6	20.5	10.1
3. Net foreign exchange assets of the banking sector[5]	-628	-458	11481	5345	11311	-0.8	-0.6	14.9	7.4	14.6
4. Government's currency liabilities to the public	7	58	461	271	410	0.3	2.4	19.3	12.5	16.8
5. Banking Sector's net non-monetary liabilities other than time deposits	12139	18146	-4317	18335	-10324	19.0	28.4	-5.7	28.8	-12.6

1. Data for RBI relate to March 31 after closure of Government Accounts. Variations in respect of scheduled commercial banks are based on data for last reporting Friday of March. The data for 1995-96 are not strictly comparable with those of 1994-95, as M3 data for 1994-95 include scheduled commercial banks' data for 27 fortnights while for data for 1995-96 include 26 fortnights. All figures are provisional.
2. Includes special securities.
3. Includes Rs.751.64 crore (equivalent of SDR 211.95 million) incurred on account of Reserve Asset subscription to the IMF towards the quota increase.
4. Excludes, since the establishment of NABARD on July 12, 1982, its refinance to banks.
5. Inclusive of appreciation in the value of gold following its revaluation close to international market price effective October 17, 1990. Such appreciation has a corresponding effect on RBI's net non-monetary liabilities.

growth of reserve money of 14.8 per cent as against 22.1 per cent in 1994-95. In fact, taking March 17, 1995 as the base, the growth of broad money turns out to be close to the long run average.

Reserve Money

7. A major source of reserve money growth in 1995-96 was net RBI credit to the Government, which expanded by 19.6 per cent (Rs.19871 crore) (Table 3.2) as against only 2.2 per cent (Rs. 2178 crore) growth in 1994-95. It accounted for nearly four-fifths of the expansion of reserve money (Rs. 25054 crore). Net foreign exchange assets of RBI, which accounted for over three fourths of the expansion in reserve money in 1994-95, declined by Rs.628 crore. The fall in the rate of growth of deposits from 22.2 per cent in 1994-95 to 12.4 per cent in 1995-96 was larger than the decline in the rate of broad money growth. Currency with public grew by 17.4 per cent compared to the 22.3 per cent growth in 1994-95. Underlying the sharper fall in the growth of M1 relative to that of M3, was a shift in the pattern of deposits away from demand deposits. Demand deposit growth fell dramatically to 5.3 per cent. This was less than half of the 14.2 per cent growth in time deposits. This pattern may partly be a reflection of the upward revision of the ceiling rate of interest on time deposits upto 2 years' maturity and of complete deregulation of interest rates on time deposits of over 2 years.

8. The slow-down in monetary growth witnessed during the first half of 1995-96 got moderated in the second half of 1995-96. This was, at least, partly

TABLE 3.2

Sources of Change in Reserve Money

Variations during[1]

	Outstanding as on March 31, 1995	Financial Year			Annual		Financial Year			Annual	
		1995-96 Mar.31 to Mar.31	1995-96 Mar.31 to Jan.19	1996-97 Mar.31 to Jan.17	1995-96 Jan.20 to Jan.19	1996-97 Jan.19 to Jan.17	1995-96 Mar.31 to Mar.31	1995-96 Mar.31 to Jan.19	1996-97 Mar.31 to Jan.17	1995-96 Jan.20 to Jan.19	1996-97 Jan.19 to Jan.17
		(Rs.crore)					(per cent)				
1. Net RBI credit to Government[2]	101478	19871	14961	3987	21122	8897	19.6	14.7	3.3	22.2	7.6
2. RBI credit to banks[3]	13470	8485	-2270	-15349	2543	-4594	63.0	-16.9	-69.9	29.4	-41.0
3. RBI credit to commercial sector[4]	6593	262	-93	-568	-72	-213	4.0	-1.4	-8.3	-1.1	-3.3
4. Net foreign exchange assets of RBI[5]	74720	-628	-458	11482	5344	11312	-0.8	-0.6	15.5	7.8	15.2
5. Government's currency liabilities to the public	2379	7	58	461	271	410	0.3	2.4	19.3	12.5	16.8
6. Net non-monetary liabilities of RBI	29358	2943	5436	5584	11589	3091	10.0	18.5	17.3	49.9	8.9
7. Reserve Money (1+2+3+4+5-6)	169282	25054	6762	-5571	17619	12721	14.8	4.0	-2.9	11.1	7.2

1. Variations are worked out on the basis of March 31 data after closure of Governments accounts. Figures for 1995-96 and 1996-97 are provisional.
2. Includes special securities.
3. Includes claims on NABARD.
4. Excludes, since the establishment of NABARD, its refinance to banks.
5. Variations are inclusive of appreciation in the value of gold following its revaluation close to the international market price since October 17, 1990. Such appreciation has a corresponding effect on RBI's net non-monetary liabilities.

related to developments in the foreign exchange market. Volatility in exchange rates during October 1995, and during January 1996 to early February 1996, resulted in RBI's intervention in the foreign exchange market. RBI's supply of dollars in the market temporarily sucked out liquidity from the system and generated an upward pressure on the inter bank call money rate. As exchange rate volatility declined, RBI reduced the CRR and conducted reverse repos to bring call money rates back to normal bands.

9. The rate of growth of "other banks' " (commercial and co-operative banks) credit to Government and the commercial sector decelerated to 12.5 per cent and 16.7 per cent, respectively. Net bank credit to Government (i.e. including RBI credit) grew at 15.7 per cent, which was slower than the 16.5 per cent growth in total bank credit to the commercial sector. Because of a much slower growth of food credit, non-food credit (including credit to industry) grew significantly faster than the total bank credit to the commercial sector. Scheduled commercial banks' non-food credit grew by 22.5 per cent in 1995-96 compared to 29.8 per cent in 1994-95. A remarkable deceleration in annual inflation rate followed a moderation in money supply growth in 1995-96. However, inspite of the reported liquidity crunch, the industrial and the GDP growth rates are estimated to have been fairly high in 1995-96.

Monetary Trends in 1996-97

Objective and targets

10. Monetary policy for 1996-97 sought to consolidate the gains on the inflation front. Over the last few years, the importance of price stability has increased the world over, as it is also an important ingredient in the stability of market determined exchange rates. The RBI's monetary and credit policy for 1996-97 was formulated with the twin objectives of price stability and adequate supply of bank credit to the productive sectors of the economy. Broad money (M3) growth for 1996-97 was initially projected at 15.5 per cent to 16 per cent, assuming a 6 per cent growth in real GDP. The credit policy for the second half of 1996-97, formulated after a review of monetary and credit trends in the first half, has reiterated the 15.5 to 16 per cent growth rate projection.

Money Supply

11. Growth of both narrow money and broad money has been faster in 1996-97 than in 1995-96. Up to the fortnight ended January 17, 1997, broad money (M3) grew by 10.6 per cent as against 8.2 per cent in the corresponding period of 1995-96. There has been a step-up in the annual growth of M3 from 13.2 per cent on March 31, 1996 to 15.7 per cent on January 17, 1997. Narrow money (M1)

also recorded a higher growth of 5.4 per cent compared to 4.2 per cent growth in 1995-96 till January 19, 1996. The gradual acceleration in money supply growth was not, however, due to any acceleration of reserve money growth. On the contrary, reserve money has declined by 2.9 per cent during this financial year up to January 17, 1997, in contrast to the expansion of 4.0 per cent in corresponding period of the last year. Annual growth has meanwhile decelerated from 14.8 per cent on March 31, 1996 to 7.2 per cent on January 17, 1997. The acceleration in money supply growth is, therefore, primarily the result of policy measures such as substantial reduction in the CRR (for details see section on CRR). As a result, the money multiplier increased from 3.10 on March 31, 1996 to 3.53 on January 17, 1997.

12. Decline in reserve money in absolute terms in 1996-97 so far may primarily be attributed to a large reduction in refinance from the RBI availed of by the commercial banks. This reflects their improved liquidity conditions because of CRR cuts. Net RBI Credit to Government (NRCG), historically an inportant source of reserve money growth, also grew by only Rs. 3986 crore (3.3 per cent), about one-fourth of the Rs. 14961 crore expansion (14.7 per cent) in the corresponding period of 1995-96. These factors more than offset the expansionary effect on reserve money, of the large contribution made by net foreign exchange assets of RBI in this financial year. The net foreign exchange assets of RBI increased by Rs. 11482 crore as compared to the decline of Rs. 458 crore in the corresponding period of 1995-96.

Credit

13. The structure of net bank credit to Government has undergone a sharp change in this financial year. The net RBI credit to the Government as a proportion of net bank credit to the Government is only 14 per cent during the 1996-97 so far, as compared to 53 per cent in the corresponding period of 1995-96. The slower growth in net RBI credit to Government was largely compensated by the 18.7 per cent expansion in "other banks'" credit to the government during the year. The growth of "other banks'" credit to the commercial sector has been correspondingly weaker at 5.6 per cent or less than half of the 11.9 per cent growth in the comparable period of 1995-96. The growth of bank credit to the commercial sector has also been lower at 5.3 per cent during 1996-97 up to January 17, 1997. It recorded a 11.6 per cent growth in the last financial year up to January 19, 1996.

14. While non-food credit has recently shown signs of a moderate pick-up, the overall growth rate so far is just over one-third of the growth registered in the corresponding period of 1995-96. The slowing of bank credit has also been accompanied by a noticeable fall in interest rates. Given the accelerated growth of deposits with the banking system, the slowing down of credit growth, despite falling interest rates, mainly indicates a lower off-take of credit by the corporate sector. This could be attributed to a number of factors, including the delayed presentation of the Central Budget which might have led to postponement of investment decisions. Other reasons for slowing down of demand for credit include factors like excess capacity in certain sectors and a decline in export/import growth. Infrastructural constraints (like power shortage) also led to a fall in the industrial growth rate and that subdued the demand for bank credit. Bank lending rates remained sticky for some time despite increased liquidity with the commercial banks following CRR reductions. A decline in the proportion of low-cost deposits (like current and savings bank deposits) in total deposits put pressure on the interest costs of banks. Banks did not reduce their interest rates immediately, in order to avoid a dent in interest "spread" that would have affected their profits. With inflation falling sharply at the end of 1995-96, real interest rates rose, contributing to lower demand for credit.

15. The existence of large non-performing assets (NPA) has made banks extremely cautious with regard to fresh loans and very vigilant in credit appraisal. The frequent questioning of the lending judgement and associated enquiries by investigating agencies, also made banks cautious. They also had the option of investing in high return and low risk government securities and the bonds of various financial institutions. These instruments have become more liquid because of measures taken by the RBI. Low capital adequacy ratios appear to have influenced some banks to invest in these instruments rather than expanding commercial credit.

Interest Rates

16. The easing of monetary policy has been reflected in call money rates which have been ruling easy from the very beginning of the current financial year. The average call money rate declined from a high of 13.15 per cent at the beginning of the current financial year to between 5.99 and 10.65 per cent in September 1996. The call money rate fell further to 4.24 per cent on January 17, 1997. The cut-off yields on 91 day treasury bills have fallen from 12.97 per cent on April 4,1996 to 8.08 per cent as on January 24, 1997. The cut-off yields on 364 day treasury bills have also fallen from 13.12 per cent on April 10, 1996 to 10.33 per cent on January 15, 1997.

17. The easy monetary conditions are also reflected in the success of the Government's market borrowing programme and in the decline of interest rates on Government loans. In most of the auctions

of treasury bills and dated securities, devolvement on the RBI has been smaller than in the previous year. The yield to maturity (YTM) on treasury bills especially on 91 day treasury bills, has come down. The coupon rates on dated securities of the Central Government have also come down during 1996-97 to 13.72 per cent on 4 year securities (from 14.26 per cent in 1995-96) and to 13.85 per cent on 10 year securities (from 14 per cent in 1995-96).

Cash Reserve Ratio

18. There was a significant reduction of the CRR required to be maintained by the banks against their total net demand and time liabilities. The CRR was reduced from 14 per cent to 13 per cent in two phases of 0.5 per cent point each, effective April 27 and May 11, 1996. The CRR on Non Resident (External) Rupee Accounts [NR(E)RA] was brought down to zero. There was another phase of CRR reduction to 12 per cent, effective July 6, 1996. CRR was further reduced by one per cent point in two phases of 0.5 per cent point each to 11 per cent effective from October 26, 1996 and November 9, 1996, respectively Further one per cent point reduction to 10 per cent was made in two phases of 0.5 per cent point each from the fortnight beginning January 4 and 18,1997, respectively.

19. All these reductions of CRR freed cash balances and augmented the lendable resources of the scheduled commercial banks. It was estimated that during 1996-97 up to December 1996, the CRR reductions augmented the lendable resources of the banks by about Rs. 13575 crore and a further amount of Rs. 4275 crore would have been released in January 1997. This will bring the total amount released through CRR cuts to Rs. 17850 crore in the current financial year. With zero CRR liability on NR(E)RA, NR(NR)RD,and FCNR(B) accounts, effective CRR on total net demand and time liabilities will fall below 10 per cent by March 1997.

Refinance facilities

20. With a view to rationalising the scheduled commercial banks' refinance from the RBI, the export credit refinance formula was changed from April 13, 1996. Refinance would continue to be provided on outstanding export credit eligible for refinance (rupee export credit and post-shipment export credit denominated in US Dollars taken together). Refinance would, however, be only 45 per cent of the outstanding export credit as on February 16, 1996 plus 100 per cent of the increase after this date. This reduced the potential refinance by about Rs.1200 crore, while CRR reductions simultaneously released sizeable cash balances. Effective from the fortnight beginning November 9, 1996, the refinance rate on outstandings upto February 16, 1996 was reduced from 45 per cent to 20 per cent. The rate of interest on export credit refinance continues to be at 11 per cent per annum. In view of the low utilisation of export credit refinance during the recent period and the release of resources through reduction in CRR, adequate resources are expected to be available for financing export credit.

21. The refinance facility against government securities was withdrawn with effect from July 6, 1996 in the wake of the CRR reductions. The unutilised government securities refinance limit, which now stands abolished, was to the tune of Rs.3385 crore.

Statutory Liquidity Ratio (SLR)

22. The effective SLR of the scheduled commercial banks is estimated to have fallen to 28.0 per cent of their total net demand and time liabilities (NDTL) at end March 1996. Banks are required to maintain (a) 25 per cent SLR on incremental domestic NDTL over September 30, 1994 level, (b) 31.5 per cent on this level, (c) 30 per cent SLR on FCNRA deposits and India Development Bonds and (d) zero SLR on other foreign currency liabilities. Consequent to the reduction in SLR on outstanding liabilities under NR(E)R Accounts from 28 per cent in March end, 1996 to 25 per cent effective from April 13, 1996, average SLR on outstanding NDTL got further reduced, though marginally. Since the growth of aggregate deposits has been strong in this financial year, the effective SLR on total outstanding NDTL came down to 27 per cent by end December 1996.

Interest Rates on Export Credit

23. It was decided to free the rate of interest on post-shipment export credit of medium and long term maturity (i.e., deferred export credit for the period beyond 180 days). Accordingly, with effect from July 5, 1996, commercial banks were free to decide this interest rate after securing the approval of their Board. They could fix their own interest rates on post-shipment rupee export credit for the period over 90 days and up to 180 days from the date of advance. Banks were also free to determine the interest rates on export credit beyond six months from the date of shipment. The interest rate on post-shipment rupee export credit up to 90 days, however, remained at 13.0 per cent. Exporters had represented to the RBI that the benefit of prescribed interest rate at 13.0 per cent per annum was denied to them, if the usance period of the export bill (including transit period) exceeded 90 days. Therefore, effective from October 21, 1996, banks can charge only 15.0 per cent for post-shipment rupee export credit for periods beyond 90 days and up to six months from the date of shipment; this rate

of interest would apply only for the period beyond 90 days and not from the date of advance. This measure was expected to reduce the effective cost of credit to the exporter and make exports more competitive.

Banking Policy and Trends

Systemic Reforms

24. Reforms introduced in the banking sector are a continuous process aimed at improving financial strength and functional efficiency of the commercial banks and bringing them up to the international standards. While the banking sector remains open to private initiatives, attempts to strengthen the public sector banks and improve their operational and technical efficiency continued.

Working Results

25. In 1995-96 the net profit of State Bank of India group at Rs.793 crore was slightly less than the Rs.846 crore in 1994-95 (Table 3.3). Nationalised banks, which had a small profit of Rs.269 crore in 1994-95, showed a net loss of Rs.1165 crore in 1995-96. The increase in operating profit to Rs. 3646 crore in 1995-96 from Rs.2937 crore in 1994-95 was offset by higher provisions. Out of the 19 nationalised banks seven banks suffered net losses and three out of them had operating losses.

26. Working results of the scheduled commercial banks in the last two financial years are presented in Table 3.4. Sub-totals are available for nationalised banks, SBI group of banks, private sector banks and foreign banks. For all banks together, every component of expenditure increased as a percentage of working funds in 1995-96. Interest income and 'other' incomes also increased as a percentage of working funds in 1995-96. The increase in expenditure from 9.5 per cent to 10.7 per cent was larger than the increase in income from 9.9 per cent to 10.9 per cent. Consequently, in 1995-96, profits declined as a percentage of working funds for the banking sector as a whole. In contrast, private sector banks showed higher profit in 1995-96, because, as a percentage of working funds, their income rose more sharply (from 8.2 per cent to 11.8 per cent) than their expenditure (7 per cent to 10.3 per cent).

27. The contraction of net profit of public sector banks in 1995-96 was mainly due to the large depreciation on banks' investments in Government securities. In the last financial year, public sector banks (SBI group and 19 nationalised banks) were required to provide depreciation on these securities at a market related yield to maturity (YTM) rate which rose in 1995-96. The provision required on this account was, therefore, Rs. 2430 crore. This amounts to about two-thirds of their operating profits during 1995-96. However, this provision for depreciation on investments does not represent a realised loss but is only an "internal reserve" and hence does not involve any cash outgo.

Capital Adequacy

28. Efforts continued in 1995-96 to strengthen the capital base of banks. Six nationalised banks received a total capital contribution of Rs. 850 crore from the Government. Four banks, which had earlier received capital from the Government, have been permitted to refund a part of their respective capital infusions, amounting Rs. 841.93 crore, to the Government. Six nationalised banks received a capital restructuring loan of US $ 80 million in 1995-96, out of an approved Financial Sector Development Loan of US $ 700 million from the IBRD. A further provision of Rs.909 crore has been made in the current financial year's (1996-97) budget for recapitalisation of public sector banks.

29. There was a significant improvement in the capital adequacy status of the public sector banks at the end of 1995-96. The State Bank of India and all its subsidiaries attained 8 per cent capital to risk weighted asset ratio (CRAR) at end March, 1996.

TABLE 3.3
Profits of Public Sector Banks: 1994-95 and 1995-96

	1994-95			1995-96		
	SBI Group	Nationalised Banks	Public Sector Banks	SBI Group	Nationalised Banks	Public Sector Banks
	(Rs. crore)					
1. Income	15948	27000	42947	20567	33098	53665
2. Expenditure, of which	15101	26730	41832	19774	34263	54036
Provisions and contingencies	1737	2668	4405	3130	4810	7940
3. Net profit	846	269	1116	793	-1165	-371

TABLE 3.4

Working Results of Scheduled Commercial Banks for 1994-95 and 1995-96

	SBI group		Other public sector banks		Indian private sector banks[1]		Foreign banks[2]		All scheduled commercial banks	
	1994-95	1995-96	1994-95	1995-96	1994-95	1995-96	1994-95	1995-96	1994-95	1995-96
A. Rupees Crore										
A. Income	15948	20567	27000	33098	2173	3642	4666	6083	50964	65112
i) Interest	13862	17114	23984	29506	1816	3059	3748	4969	44568	56181
ii) Other income	2086	3452	3016	3593	357	583	917	1114	6397	8931
B. Expenditure	15101	19774	26730	34263	1863	3187	3969	5335	48810	64200
i) Interest	8751	10872	16260	20089	1205	2181	2139	3184	29041	37316
ii) Other operating expenses	4613	5772	7802	9364	439	720	1037	1323	14229	17590
iii) Provisions and contingencies	1737	3130	2668	4810	219	286	793	828	5540	9293
C. Profit	846	793	269	-1165	310	455	697	748	2154	912
D. Working Funds	156295	186768	282535	319077	26514	30819	37935	47548	514691	599468
B. Per Cent of Working Funds										
A. Income	10.2	11.0	9.6	10.4	8.2	11.8	12.3	12.8	9.9	10.9
i) Interest	8.9	9.2	8.5	9.2	6.8	9.9	9.9	10.5	8.7	9.4
ii) other income	1.3	1.8	1.1	1.1	1.3	1.9	2.4	2.3	1.2	1.5
B. Expenditure	9.7	10.6	9.5	10.7	7.0	10.3	10.5	11.2	9.5	10.7
i) Interest	5.6	5.8	5.8	6.3	4.5	7.1	5.6	6.7	5.6	6.2
ii) Other operating expenses	3.0	3.1	2.8	2.9	1.7	2.3	2.7	2.8	2.8	2.9
iii) Provisions and contingencies	1.1	1.7	0.9	1.5	0.8	0.9	2.1	1.7	1.1	1.6
C. Profit	0.5	0.4	0.1	-0.4	1.2	1.5	1.8	1.6	0.4	0.2

[1] The data relate to 23 Indian private sector banks only.
[2] The data relate to 30 foreign banks only

In 1994-95 only SBI and one of its subsidiaries had this distinction. Out of 19 nationalised banks, 11 reached the norm of 8 per cent CRAR, and 3 banks had a CRAR of 4 to 8 per cent. From 1995-96 banks were also required to maintain Tier I capital funds to the extent of 5 per cent of their foreign exchange reserves open position limit. Government provided Rs.1506.21 crore in the last financial year, for writing down of the capital base of two public sector banks, for adjustment of their losses.

30. Banks were advised not to include subordinated debt instruments with an initial maturity of less than five years, or debt instruments with one year remaining maturity, as part of their Tier II capital. These instruments are also subject to progressive discount (for inclusion) as they approach maturity. Since the quantum of discount to be applied for instruments of one to five year maturity was not earlier specified, banks were reportedly not following a uniform discounting policy. In view of this, the RBI has specified the rates of discount to be applied to these instruments by maturity. These vary from 100 per cent for instruments of less than one year maturity, to 20 per cent for instruments of more than four years but less than five years maturity.

Customer Services

31. Several measures have been taken to improve the quality of customer services offered by the banks to depositors and borrowers. Around 1400 branches have been fully computerised till end June 1996. Facilities like passbook printing, self service terminals for customers, terminals at customers places etc. have been installed in many of the branches. Efforts are also on to conduct SWIFT (Society for World-wide Inter-bank Financial Telecommunication) training courses for the Indian banking community on a regular basis. Individual banks have constituted task forces to increase the message traffic through SWIFT. In early 1997, the Shared Payment Network System (SPNS) at Mumbai, consisting of 145 ATMs from 38 banks, is expected to go live. It is proposed to extend this network to major cities. RBI launched the electronic clearing service (ECS) in April 1995 at Mumbai and Chennai. It has been extended to New Delhi and Calcutta as well. Once this service is made available across the country, it will reduce the number of physical instruments that pass through the traditional clearing system. The RBI has also started Electronic Funds Transfer (EFT) between Mumbai and Chennai for retail customers.

32. Banks are making an attempt to evaluate services rendered in terms of the expectations and requirements of the customers and to redress customer complaints. These steps include setting up of a customer service division at controlling offices and customer service committees, and introduction of floor managers at large metropolitan and urban branches to provide on-the-spot redressal of customer grievances. Customer service audits are also being conducted periodically to ensure meaningful implementation of Goiporia Committee recommendations. A survey on the quality of customer service in 27 public sector banks is being conducted under the aegis of Indian Banks Association (IBA). This survey will form the basis for a customer service index to provide a rating of public sector banks. This survey is expected to be completed during the first quarter of 1997.

Banking Ombudsmen Scheme

33. Under the Banking Ombudsmen Scheme announced in June 1995 to expedite inexpensive resolution of customer complaints, eleven Ombudsmen are now functioning. They are located in New Delhi, Bhopal, Bangalore, Chandigarh, Hyderabad, Mumbai, Patna, Jaipur, Kanpur, Guwahati and Bhuvaneswar.

Interest Rates

34. Further progress was made towards interest rate deregulation (Table 3.5). With effect from July 2, 1996 the minimum period of time deposits was reduced from 46 days to 30 days. In response to a fall in the annual inflation rate, the maximum interest rate on time deposits of 30 days and up to one year was reduced to 11 per cent. In October 1996, this interest rate was further reduced to 10 per cent. The interest rate on time deposits of over one year was deregulated. The interest rate on NR(E)RA deposits which was "not exceeding 12 per cent" for deposits of maturity over six months, was modified with effect from April 4, 1996. The interest rate of "not exceeding 12 per cent" was retained for NR(E)RA deposits of six months and upto two years. The interest rate on NR(E)RA deposits above two years was deregulated in order to bring them in alignment with domestic term deposits.

35. Though there was a significant fall in the inflation rate in 1995-96, real rates of interest on bank advances remained high. The nominal lending rates did not decline immediately following the cuts in CRR which had lowered the cost of bank funds. CRR cuts augmented banks' lendable resources by Rs. 7,252 crore between November 1995 and March 1996 and by Rs. 9300 crore between April 1996 and July 1996. In response to this, a few public sector banks reduced

TABLE 3.5

Current Interest Rates of Scheduled Commercial Banks

(Per cent per annum)

A. **Bank Deposits** (Domestic)	
(a) **Savings deposits**	4.5
(b) **Term deposits**	
(i) 30 days to 1 year (ceiling)	10.0
(ii) Over 1 year	Free
B. **Bank credit**	
I **General credit** (excluding export credit)	
(a) Upto Rs. 25000	12.0
(b) Over Rs.25000 and upto Rs. 2 lakhs	13.5
(c) Over Rs. 2 lakhs	Free[1]
II **DRI advances**	4
III **Rupee export credit**	
(a) Pre shipment credit	
(i) Up to 180 days	13.0
(ii) Beyond 180 days and upto 270 days	15.0
(iii) Against incentives receivable from the Government[2] (upto 90 days)	13.0
(b) Post shipment credit	
(i) Demand bills for transit period. (as specified by FEDAI)	13.0
(ii) Usance bills[3]	
(a) upto 90 days	13.0
(b) beyond 90 days and upto 6 months[4]	15.0
(iii) beyond 6 months[4]	Free
(iv) Against incentives receivable from the Government against ECGC guarantee (upto 90 days)	13.0
(v) Against undrawn balances (upto 90 days)	13.0
(vi) Against retention money[5] (upto 90 days)	13.0
(c) Deferred credit (beyond 180 days)	Free
(d) Export credit not stated otherwise	Free

[1] Banks can fix and declare their own prime lending rate (PLR) with the approval of their Board of Directors. This rate should be the same for all the branches of a bank. Banks are also required to announce the spread over PLR for advances other than consumer credit, along with the announcement of their PLR.

[2] Covered by ECGC Guarantee.

[3] For total period including both usance period of export bills, transit period as specified by FEDAI and grace period, if any.

[4] From date of shipment.

[5] Payable within one year from the date of shipment. (for supplies portion only).

Note: Banks are free to specify interest rates on rupee export credit (beyond 6 months), loans for purchase of consumer durables, loans to individuals against security of shares, debentures/ bonds and other non-priority sector loans.

their PLR from 16.5 per cent to 16 per cent. This lag has been also seen in certain years in the past. In 1977-78 the real lending rate remained at 15 per cent even though the inflation rate dropped virtually to zero from 11.9 per cent in the previous year. Similarly in 1981-82, the real interest rate was as high as 17.1 per cent, when the inflation rate came down to 2.4 per cent from 16.7 per cent in the previous year. Nominal interest rates are observed to adjust to changes in inflation rates only with a lag.

36. In September 1996 the maximum lending rate of 47 banks exceeded PLR plus 4 per cent. For only 18 banks, the maximum lending rate charged was equal to PLR plus 4 per cent. In its busy season credit policy statement, the RBI drew the attention of the banks to the need for an appropriate reduction in the lending rates. It directed them to pass on a part of the gains, of the improved return on their funds (due to lower CRR), to the borrowers. Banks were told that extremely high interest rates might affect the viability of borrowers and their capacity to repay. High rates may eventually result in an increase in the non-performing assets (NPA) of the banks. They were asked to announce the maximum spread over the PLR for all advances (other than consumer credit,) after obtaining the approval of their respective Boards, Customers are more concerned with the actual interest rate charged than with the PLR. As a part of the monetary policy announcements in October 1996, a further reduction in CRR released about Rs. 8,550 crore during October 1996 to January 1997. A number of banks have already responded by bringing down their PLR by 0.5 to 1.5 per cent points, and announcing a 2.5 to 4.5 per cent margin over PLR.

37. In February 1996, the interest rate surcharge on outstandings under import credit sub-limit of cash credit limit, was enhanced to 25 per cent in order to restrain the excessive use of bank credit for financing imports. This surcharge was withdrawn with effect from July 23, 1996, in the context of developments in the foreign exchange market, and also in cognizance of the overall monetary and credit situation.

Provisioning and Other Norms

38. The process of tightening the norms of banking operations continued. From 1996-97 onwards, banks will be required to classify small loans below Rs.25,000/- into the specified four asset categories, and make appropriate provisioning for NPA's. Banks which are not able to do so, in view of the large number of accounts involved, have been granted extension of time up to end March 1998. The concerned banks should, however, make provisions to the extent of 15 per cent of the aggregate amount outstanding in this category of advances for the year ending March 31, 1997. This marks an increase over the 10 per cent provision required to be made during the year ended March 31, 1996. The minimum "mark to market" proportion of the approved securities was also raised to 40 per cent (from 30 per cent) for the year ended March 1996. For the current financial year this proportion has been raised further to 50 per cent. New private sector banks, set up under the guidelines issued by the RBI in January 1993, are required to "mark to market" their entire investments in approved securities from the current financial year. "Mark to market" valuation compels banks to take note of changes in interest rates. It makes them aware of the impact of their bids at the Government securities auction, on the value of their current portfolio.

Debt Recovery Tribunals

39. Six tribunals are functioning at Calcutta, New Delhi, Jaipur, Ahmedabad, Bangalore and Chennai and one Appellate Tribunal is functioning at Mumbai. The functioning of tribunals has been facilitated by the Supreme Court order of March 18, 1996, that notwithstanding any stay order passed on any of the writ petitions, the tribunals shall resume their functions. These tribunals have heard quite a large number of cases involving several hundreds of crores of rupees, and have settled 148 cases involving Rs.196.7 crore. Some new tribunals are under consideration of the Government.

Supervision of banks

40. The Board for Financial Supervision set up an audit sub-committee to examine, on an on-going basis, the system of empanelment and appointment of auditors, and the quality and coverage of audit reports. A working group under the chairmanship of Shri S. Padmanabhan, was set up to review the system of on-site supervision over banks. It has recommended extensive changes in bank inspection. These changes include target appraisal of major portfolios and control systems, and a discriminatory approach to supervision and inspection that distinguishes sound banks from problem banks. A new rating methodology has also been suggested for the banks, on the lines of Capital Adequacy, Asset Quality, Management, Earnings and Liquidity (CAMEL), which is prevalent in the developed countries.

Decontrol and Competition

41. During the current financial year, various measures were taken to enhance the operational efficiency of banks, and stimulate competition in the banking sector. These measures cover further liberalisation of deposit rates, near removal of selective credit controls, a large reduction in the CRR, and greater freedom in foreign exchange advances. (Box 3.1)

BOX 3.1
Credit Policy Measures
1996-97

- Cash Reserve Ratio (CRR) reduced by one per cent point from 14 per cent to 13 per cent (in two phases of 0.5 per cent point each) effective from April 27 and May 11, 1996 respectively. CRR further reduced to 12 per cent effective July 6, 1996, to 11 per cent by November 9, 1996, and to 10 per cent by January 18, 1997.
- Effective April 13, 1996, CRR removed and SLR reduced from 30 per cent to 25 per cent, for Non-Resident External (Rupee) Accounts, and interest rate on term deposits of over 2 years under these accounts deregulated with effect from April 4, 1996.
- Effective April 13, 1996, Export Credit Refinance at 11 per cent was made available for 45 per cent of the outstanding export credit as on February 16, 1996 plus 100 per cent of the increase in such credit over that level.
- With effect from the fortnight beginning November 9, 1996, scheduled commercial banks were provided export credit refinance to the extent of 20 per cent of the outstanding export credit eligible for refinance (instead of 45 per cent then prevalent) upto the level of such credit on February 16, 1996 plus 100 per cent of increase in export credit eligible for refinance over the level on February 16, 1996.
- For borrowers with assessed maximum permissible bank finance of over Rs.20 crore, cash credit component reduced to 40 per cent from 60 per cent, thus raising loan component to 60 per cent, in April 1996. The loan component was further raised to 75 per cent in October 1996.
- The minimum period of loan component reduced from 1 year to 6 months which will be permitted to be renewed or rolled over.
- In view of the further reduction in the cash credit component, the amount of commercial paper that can be issued is not restricted to the cash credit component.
- Selective credit controls : Effective April 4, 1996, minimum margins reduced across-the-board by 15 per cent points. Buffer stock and unreleased stock of sugar are subject to zero and 20 per cent margins respectively. Credit ceiling, wherever the level of credit ceiling was prescribed at 85 per cent, raised by 15 per cent points along with the advancement of reference period for this purpose. Effective July 2, 1996, the selective credit control stipulations were relaxed in respect of sugar, gur and khandsari and cotton and kapas.
- With effect from October 21, 1996, selective credit controls on pulses, coarse grains, oilseeds etc. were lifted. They will remain for bufferstock and the unreleased stocks of sugar to sugar mills. The minimum margin on unreleased stocks of sugar was lowered by 5 per cent points to 15 per cent effecitve October 21, 1996. With this relaxation, the valuation of stocks of sugar will revert to the method that existed prior to July 1, 1996. Banks are free to fix prudential margins on advances against sensitive commodities.
- The target for export credit of SCBs by end March, 1997 was increased from 10 per cent of each bank's net credit to 12 per cent.
- Effective July 2, 1996, the minimum period of term deposits of banks reduced from 45 to 30 days, the maximum interest rate on term deposits of 30 days and upto 1 year reduced to 11 per cent from 12 per cent, and the interest rate on term deposits of over 1 year deregulated.
- Interest rates on term deposits for maturity of 30 days and upto 1 year reduced from (not exceeding) 11 per cent per annum to (not exceeding) 10 per cent per annum effective October 21, 1996. For deposits of more than 1 year maturity, the deposit rate must be determined by banks with prior approval of their respective Boards.
- Effective October 21, 1996 banks should charge interest rate of 15 per cent per annum for post-shipment rupee export credit for the period beyond 90 days and upto 6 months. The higher interest rate will apply only for the period beyond 90 days and not from the date of advance.
- To increase transparency, the banks were required to announce the maximum spread over the PLR for all advances other than consumer credit, after prior approval of their respective Boards.
- Banks were permitted (as per the announcement of October 19, 1996) to provide foreign currency denominated loans to their customers under which the foreign exchange risk is borne by the borrowers for meeting either their foreign currency or rupee requirements, provided the loans are not for consumer durables or personal loans and are from the resource base consisting of funds of FCNR(B) Scheme and Inter Bank Foreign Currency Deposits (IBFCD) scheme.
- In case of consortium lending, the ground rules of the consortium arrangements are to be framed by the participating banks. In the case of existing consortia, the participating banks may undertake a review of the rules and make suitable changes.
- Scheduled commercial banks were allowed to subscribe to shares and debentures in the primary market, inclusive of devolvement through underwriting and investments in mutual funds, upto 5 per cent of the incremental deposits of the previous year. Purchase of shares and debentures in the secondary market has been allowed from November 30, 1996, within the ceiling of 5 per cent of incremental deposits of the previous year.

Private Sector Banks

42. Ten new private sector banks have started functioning, out of the thirteen "in principle" approvals given for setting up of new banks in the private sector. In the 1996-97 budget, an announcement was made that new private local area banks, with jurisdiction over three contiguous districts, would be set up. These banks will help in the mobilisation of rural savings and in channelling them into investments in the local areas. The RBI has issued guidelines for setting up such banks. It has already granted "in principle" approval to two local area private banks, one each in Maharashtra and Karnataka.

Loan System

43. The progress towards a loan system of bank credit continued. For borrowers with Maximum Permissible Bank Finance (MPBF) of Rs. 20 crore and above, the 'loan component' was increased to 60 per cent in April 1996 and further to 75 per cent in October 1996. The loan system of credit delivery was extended to borrowers with MPBF of over Rs.10 crore and up to Rs. 20 crore and the loan component was fixed at 40 per cent in April 1996. It was raised to 60 per cent in October 1996. The cash credit component, therefore, stands reduced to 40 per cent. The minimum period of the loan was reduced to six months from one year. Renewal/rollover of the loan component was permitted. The 'bills limit' for inland sales could henceforth be carved out of the loan component in the case of all borrowers. Further, the commercial paper that can be issued would not henceforth be restricted to the 'cash credit' component. With the move towards a loan system for delivery of bank credit, the role of MPBF in credit appraisal is under examination by a committee under the auspices of the Indian Banks Association.

Consortium Finance

44. In the case of multiple lending, obligatory consortium arrangement exists only beyond the threshold limit of Rs.50 crore. The rules for such consortia were liberalised by the RBI in October 1996. The ground rules of consortium arrangement, namely, number of participating banks, minimum share of each bank, entry/exit of a bank from the consortium, grant of any facility to the borrower by a non-member bank, etc., could be framed by the participating banks. This would also apply to existing consortia.

Forex transactions

45. The Expert Group on Foreign Exchange Markets, chaired by Shri O.P. Sodhani, had made several recommendations. Among these was one relating to Aggregate Gap Limits arising out of maturity mismatches. From April 1996, banks were freed to set their own limits. They could do this based on their foreign exchange operations, risk taking capacity, balance sheet size and other relevant parameters. These limits require specific approval from the RBI. Banks with a higher limit are expected to monitor their exposure continuously, by marking mismatches to market. This will lead to better management of foreign exchange assets and liabilities by banks.

46. In response to another recommendation of the Group, it was decided in April 1996, to permit select banks to initiate cross-currency positions (including open exchange positions) in overseas markets. These banks will now be able to offer finer cross-currency rates to their customers. Earlier, banks were debarred from initiating such cross currency trading positions, and were only permitted to square a position acquired in local foreign exchange market.

Foreign Currency Loans

47. In October 1996, banks were given permission to provide foreign currency denominated loans to their customers (who would bear the foreign exchange risk), for meeting either foreign currency or rupee requirements. The resource base for such loans is to consist of Foreign Currency Non-Resident Accounts (Banks) (FCNR (B)) accounts, and not a buy-sell swap. No personal loans and consumer durable loans can be provided under this facility. It is specifically designed to meet the credit requirements of the productive sectors. Banks are free to decide on the tenor and interest rates of these loans, within the prudential framework, and the existing credit monitoring guidelines.

Selective Credit Controls

48. At the beginning of the current financial year in April 1996, there was an across-the-board liberalisation of selective credit controls on bank advances against price-sensitive essential commodities. In the context of the favourable price-supply situation, bank advances against a large number of price-sensitive essential commodities, were exempted from selective credit controls from October 21, 1996. These commodities include pulses, other foodgrains (viz. coarse grains), oilseeds (viz. groundnut, rapeseed/mustard, cottonseed, linseed, castorseed), oils thereof including vanaspati, all imported oilseeds and oils, sugar, gur and khandsari and cotton and kapas to 'others' (other than cotton mills including spinning mills). However, selective credit controls were retained for advances against buffer stock and unreleased stocks of sugar to sugar mills. In the case of unreleased stocks of sugar, the margin was reduced from 20 per cent to 15 per cent, effective October 21, 1996. In the case of buffer stock of sugar, the existing prescription of a zero per cent margin continued (Table 3.6).

TABLE 3.6

Selective Credit Controls on Bank Advances

(Per cent)

	Effective July 2, 1996				Effective October 21, 1996		
	Minimum Margins			Level of Credit ceiling 1994-95 (Nov.-Oct.)	Minimum Margins		
	Mills/ processing units	Others	Warehouse receipts		Mills/ processing units	Others	Warehouse receipts
1. Pulses	45	60	45	100			Exempt
2. Other foodgrains(other than paddy/ rice ,wheat and pulses)	30	45	30	100			Exempt
3. Oilseeds (Viz. groundnut, rapeseed/ mustard, cottonseed, linseed, castorseed and all imported oilseeds)	45	60	45	100			Exempt
4. Vegetable oils (viz. groundnut oil, rapeseed/mustard oil, cottonseed oil, linseed oil, castor oil vanaspati and all imported oils)	45[1]	60	45	100			Exempt
5. Sugar							
a) Buffer stock	0	—	—		0	—	Exempt
b) Unreleased stock	20	—	—		15	—	Exempt
c) Released stock	45	45	30				Exempt
6. Gur and khandsari	30	45	30				Exempt
7. Cotton and kapas	Exempt	30	30	110[2]			Exempt

— Not applicable

1 Applicable to registered oil mills and Vanaspati manufacturers.

2 Applicable to other than cotton mills including spinning mills.

Sectoral Deployment of bank credit

49. During 1995-96, gross bank credit increased at a lower rate of 17.6 per cent as compared to 25.6 per cent in 1994-95. The rate of growth of gross non-food credit at 20.1 per cent in 1995-96 was also lower than that of 26.6 per cent in the previous financial year. Export credit, as well as credit to agriculture and small scale industry, recorded lower increases in 1995-96 as compared to those in 1994-95.

50. For the current financial year, the data on sectoral deployment of gross bank credit are available up to September 1996. During this period, gross bank credit declined by 1.7 per cent, as against an increase of 3.9 per cent during the comparable period of the last financial year (Table 3.7).

Priority Sector Advances

51. During the current financial year, domestic scheduled commercial banks (excluding RRBs) are required to attain a target of 40 per cent (of net bank credit) for priority sector advances. They have also been asked to attain an export credit norm of 12 per cent of net bank credit. In order to augment agricultural advances, a major component of priority sector advances, they have opened 69 specialised agricultural finance branches, besides agricultural development branches, up to end March 1996. As regards credit to SSI, 169 specialised branches were put in operation in 1995-96. The RBI has asked banks to operationalise 100 more such branches in 1996-97. Banks are also monitoring the functioning of specialised and high-tech agricultural branches. They are co-ordinating their efforts with developmental agencies like NABARD, National Horticulture Board, agricultural and marine development and export agencies. Some banks have also taken steps to train agricultural development officers with the help of agricultural universities and research institutions.

Rural Credit

52. By at the end of October, 1996, NABARD sanctioned Rs.2010 crore out of the Rural Infrastructural Development Fund (RIDF), to 23 State Governments, for rural infrastructural development. For the same purpose, RIDF II has been set up in 1996-97 at NABARD, with a corpus of Rs. 2500 crore. The RBI has sanctioned to NABARD a general line of credit to the tune of Rs.5500 crore, to meet the short-term requirements of co-operative banks and RRBs, in this financial year. Commercial banks were advised to set up a minimum of one specialised

TABLE 3.7
Sectoral Deployment of Gross Bank Credit
Variations during[1]

On the last reporting Friday	1994-95	1995-96	April-September 1995-96	April-September 1996-97	1994-95	1995-96	April-September 1995-96	April-September 1996-97
	(Rs.crore)				(Per cent)			
I. Gross bank credit	40128	34712	7594	-3865	25.6	17.6	3.9	-1.7
1. Public food procurement	1368	-2484	331	-1355	12.5	-20.2	2.7	-13.8
2. Gross non-food credit (a+b+c+d)	38760	37196	7263	-2510	26.6	20.1	3.9	-1.1
a) Priority sector (i+ii+iii)	10281	9230	2143	697	19.1	14.4	3.3	0.9
i) Agriculture	2775	3102	905	849	13.1	12.9	3.8	3.1
ii) Small scale industry	5021	4246	506	-1010	22.2	15.4	2.0	-3.2
iii) Other priority sectors	2485	1882	678	858	24.7	15.0	5.4	5.9
b) Medium and large industries	16807	18436	3952	-1626	29.0	24.7	5.3	-1.7
c) Wholesale trade (excluding food procurement)	2419	2244	568	-1328	33.0	23.0	5.8	-11.1
d) Other sectors	9253	7286	600	-253	34.4	20.2	1.7	-0.6
II. Export credit [2]	7965	4641	570	-4022	46.6	18.5	2.3	-13.5

1 All figures after 1995-96 are provisional.
2 Also included in non-food credit.

Note : Data relate to 47 scheduled commercial banks which account for 90-95 per cent of the banks credit of all scheduled commercial banks. Gross bank credit data included bills rediscounted with RBI,IDBI, Exim Bank and other approved financial institutions.

TABLE 3.8
Scheduled Commercial Banks - Selected Indicators
Variations during

Items	Financial year 1995-96 March 31 to March 29	Financial year 1995-96 March 31 to Jan.19	Financial year 1996-97 March 29 to Jan.17	Annual 1995-96 Jan.20 to Jan.19	Annual 1996-97 Jan.19 to Jan.17
			(Rs. crore)		
1. Aggregate deposits (a+b)	46960	20802	41725	48439	67883
a) Demand deposits	3711	-10233	-2653	2587	11291
b) Time deposits	43249	31035	44378	45852	56592
2. Borrowings from RBI	-2568	-2341	-4355	2278	-4582
3. Cash in hand and balances with RBI	-9221	-12748	-3754	-5658	-227
a) Cash in hand	141	-176	52	293	369
b) Balances with RBI	-9362	-12572	-3806	-5951	-596
4. Net Balances with RBI (3b-2)	-6794	-10231	549	-8229	3986
5. Money at call and short notice	1827	273	427	-836	1981
6. Bank Credit (a+b)	42455	29490	11510	47034	24475
a) Public food procurement credit	-2484	-852	-1089	-2344	-2721
b) Non-food bank credit	44939	30342	12599	49379	27196
7. Investments in approved securities	15529	12924	22868	14138	25473
a) Government securities	14542	12527	23758	13418	25773
b) Other approved securities	987	397	-890	720	-300
8. Balances with other banks in current account	-179	-995	-511	263	305
I. Credit-Deposit Ratio (per cent)	58.6	141.8	27.6	97.1	36.1
II. Investment-Deposit Ratio (per cent)	38.0	62.1	54.8	29.2	37.5

Note : All data are provisional.

agricultural finance branch in each State to adequately deal with high-tech agricultural loans. Up to end March 1996, 69 such specialised branches have been set up. A consortium of public sector banks was set up, under a scheme launched in 1995-96, for financing viable KVIC units. Till end of June, 1996 Rs. 325 crore had been disbursed to KVIC.

Non-Banking Financial Companies

53. The Reserve Bank of India (Amendment) Ordinance, 1997 confers wide ranging powers on RBI, for controlling the functioning of non-bank financial companies. The ordinance has defined a non-banking financial company (NBFC) as a financial institution which is a company, or a non-banking institution which is a company and which has, as its principal business, the receiving of deposits under any scheme or arrangement or in any other manner, or lending in any manner.

54. As per the ordinance, no NBFC can commence or carry on business, (a) without obtaining from RBI a certificate of registration; and (b) having net owned funds of Rs.50 lakh or such other amount, not exceeding Rs. 200 lakh, as the RBI may specify. The existing NBFCs with a net owned fund of Rs.50 lakh and up to Rs.200 lakh are required to apply for registration to the RBI within six months from the date of issue of the ordinance. The registered NBFCs are required to create a reserve fund to which, not less than 20 per cent of the net profits will be transferred annually. Smaller NBFCs have been allowed three years time to build up a net owned fund of Rs.50 lakh.

55. The RBI can now, (a) specify from time to time a minimum percentage of investment for NBFCs in unencumbered "approved" securities, (b) determine their policies and give directions to any or all NBFCs on capital adequacy, provisioning and other prudential norms, as also on the deployment of funds, (c) direct them on balance sheet, profit and loss accounts and disclosure of liabilities, (d) levy fines and penalty on a NBFC for contravention and default, as also cancel its registration, (e) prohibit a NBFC from accepting deposits and alienate its assets, and (f) file a winding up petition for continued violation of the provisions of the Act and/or failure to comply with any direction or orders of the RBI.

All India Financial Institutions

56. During the last financial year 1995-96, sanctions of financial assistance by development finance institutions recorded a growth rate of 18.5 per cent, while disbursements grew by 17.4 per cent. For investment institutions, the financial assistance sanctioned and disbursed declined by 31.4 per cent and 6.0 per cent, respectively, because of sluggish capital market conditions. During the first nine months of the current financial year (April-December 1996), the all India financial institutions disbursed Rs. 26813 crore as against Rs. 23187 crore disbursed in April-December 1995, implying an annual growth rate of 15.6 per cent. However, financial assistance sanctioned by them recorded a decline of 26.6 per cent. It appears that these institutions are mostly disbursing the pending sanctions of 1995-96. Development finance institutions disbursed Rs. 22256.9 crore as against Rs. 19088.1 crore in April-December 1995, the annual growth rate being 16.6 per cent. Assistance sanctioned by them, however, declined by 30 per cent (Table 3.9). As UTI has become part of SEBI mutual fund discipline its loan sanctions and disbursements are being eliminated, as per SEBI guidelines relating to mutual funds.

57. Most of the development finance institutions raised resources during the year through issue of bonds. Their interest rates have also become more or less market-based, in consonance with the on-going liberalisation in the financial sector. Their interest rates increased in 1995-96 and in the first half of 1996-97 , reflecting higher demand for funds on account of revival in real sector activities. Since October 1996, the minimum lending rate of DFIs, (excluding interest tax) has been reduced to 16.5 per cent from 17 per cent earlier.

58. All India financial Institutions and the SBI, led by IDBI, set up the North Eastern Development Finance corporation Ltd. (NEDFI) in the last financial year to cater exclusively to the financial needs of the industries in the North Eastern Region. The National Securities Depository Ltd. (NSDL), promoted by IDBI, UTI and National Stock Exchange of India (NSE) in December 1995, to maintain an electronic record of securities ownership details, started operations on November 8, 1996. IDBI got linked to the Society for Worldwide Interbank Financial Telecommunication (SWIFT) network that processes and exchanges messages relating to overseas banking and foreign exchange business.

59. In 1995-96, Small Industries Development Bank of India (SIDBI) set up a Technology Development and Modernisation Fund. This has an initial corpus of Rs.200 crore. It will directly assist the SSIs in enhancing their export capabilities. SIDBI has also relaxed the norms under special schemes, to facilitate a greater flow of funds to industrially backward areas. It has widened the scope of the National Equity Fund and extended it to cover the whole country except for metropolitan cities. ICICI expanded its fee-based corporate advisory services to facilitate the creation of better projects and improvement in business environment. It initiated

TABLE 3.9

Assistance by All India Financial Institutions

(Rs.crore)

	1994-95	1995-96	April-December	
			1995	1996
A. Sanctions				
All India Financial Institutions	57262.0	64115.1	46780.1	34466.3
	(43.2)	(12.0)		(-26.3)
a) Development Finance Institutions	48410.7	57352.8	41917.4	29359.6
	(61.0)	(18.5)		(-30.0)
b) Investment Institutions	10001.3	6862.3	4962.7	5106.7
	(-7.6)	(-31.4)		(2.9)
B. Disbursements				
All India Financial Institutions	31876.0	36311.9	23187.0	26813.0
	(24.3)	(13.9)		(15.6)
a) Development Finance Institutions	25837.6	30338.5	19088.1	22256.9
	(38.5)	(17.4)		(16.6)
b) Investment Institutions	6513.4	6123.4	4148.9	4556.1
	(-17.3)	(-6.0)		(9.8)

a) Development Finance Institutions-IDBI, IFCI, ICICI, SIDBI, IRBI, SCICI, RCTC, TDICI and TFCI.
b) Investment institutions - LIC, GIC and UTI.
Note: i) Data for April-December, are provisional.
ii) Figures in parenthesis indicate percentage changes.
iii) Figures for All India Financial Institutions are net of inter-institutional flows.
Source: Industrial Development Bank of India.

efforts in areas such as public sector restructuring and infrastructure projects. Industrial Reconstruction Bank India (IRBI) has moved into business oriented activities from simple revival of sick units and also expanded its merchant banking activities. The Industrial Reconstruction Bank (Transfer of Undertakings and Repeal) Ordinance, 1997 has been promulgated on January 24, 1997 with a view to converting IRBI into a company under Companies Act, 1956, and transforming it into a full fledged financial institution.

Outlook

60. Economic policy instruments act on the economic system with a lag. This is as true of the monetary policy as of other instruments such as trade and foreign exchange policy. A mis-perception appears to be developing that a change in reserve money or CRR should instantaneously lead to a change in the growth of various monetary and credit variables. Historical experience shows that the effect of money supply on inflation has an average lag of about one year. The effect of monetary policy on the real economy is bound to be subject to a more variable and uncertain lag. This is why monetary policy all over the world is framed in a medium term perspective with gradual and small changes to meet the exigencies of the economic environment.

61. There is reason to believe that the tightening of monetary policy in 1995-96, to counter the inflationary effect of the surge in capital inflows and the resulting faster monetary growth in the previous year, may have been too sharp. The policy has since been adjusted during 1996-97 to bring it in line with targets which are still valid. We must now be careful to avoid over-compensating in the opposite direction by easing money supply too far above the target level, and thus building up inflationary pressures for the next year. Any short-term temptation of depending solely on monetary policy, to solve problems arising from other policy imperatives, should be avoided.

62. With an increasingly open economy, the link between domestic and foreign market conditions, has also to be increasingly kept in view. This is one of the legitimate reasons why monetary policy was kept tighter than it could have been, if these linkages were ignored. Though, in the absence of capital account convertibility, these linkages are still rudimentary, they will rapidly become much closer, if we move towards capital account convertibility in the years to come. One outcome of such a move will be to reduce the effectiveness of the monetary policy instruments in macro-economic management. This will require that other instruments, such as fiscal policy, be made more flexible so as to manage the macro-environment.

63. The financial system plays a critical role in channelising savings from individuals to the organised sector of the economy. The opening and expansion of the financial sector, is vital for fast growth of the modern industrial sector. It also has implications for macro-economic management, which do not appear to be widely recognised as yet. With the development of the capital market and of the non-bank financial system, savings in the form of bank deposits can no longer be equated with total financial savings. Thus, the credit provided by banks to industry and agriculture is only a part of the flow of savings intermediated by the financial system. An excessive reliance on bank credit as a measure of investible resources for industry, can lead to incorrect policies. Bank interest rates and bank credit remain an important part of the flow of savings from individuals to the industrial sector. There is a danger, however, that an excessive focus on these elements, to the neglect of other policies, will lead to re-igniting inflation. This, in turn, can have unpleasant consequences for the balance of payments.

64. Such a focus also detracts attention from the urgent need for de-controlling, developing and integrating the entire financial system, stretching from call and other money markets to the market for government and private securities, and better monitoring of non-bank financial companies. Such integration will also convert the interest rate into a genuine price, for equilibrating the supply of savings and the demand for savings for physical investment. This will make it easier for both government and private participants to plan their own savings and investment programmes. With a more open economy, the supply of savings from abroad into the financial sector, is also becoming an important input into the equilibration of demand for and supply of savings. Market flexibility and integration, on the lines indicated above, will also make it easier for the system to absorb fluctuations in such flows. Government owned institutions will need to be given sufficient flexibility, so that they are able to respond as quickly and effectively as the less constrained private institutions.