Monetary Trends and Developments

Money Supply

4. As set out in the monetary and credit policy for the first half of the current financial year, financial innovations witnessed in recent years have made it difficult to project the desirable rate of broad money growth on the basis of the response of demand for real money to GDP growth and inflation. This is partly because interest rate and exchange rate channels have become active in the monetary transmission process in response to financial sector liberalisation. The annual growth rate of 15.0 - 15.5 per cent in broad money set for 1998-99 is the same as that for 1997-98. This reflects the concern of the monetary authority to prevent inflation rate from rising beyond 5-6 per cent. Actual M3 growth in 1997-98 was 17.6 per cent, which exceeded the target by 2.1-2.6 percentage points but turned out to be only marginally above the long-run (1981-98) average annual growth rate of 17.2 per cent. This needs to be kept in view while analysing the trends in money supply in the current financial year.

5. Growth rates in M1 and M3 till January 15,1999 exceeded the corresponding growth rates in 1997-98 (Table 3.1). The higher growth of M1 reflects the relatively higher growth rate in currency with the public (15.1 per cent) till January 15, 1999 than that (10.0 per cent) in

BOX 3.1

Major Recommendations of RBI's Working Group on Money Supply

- Sectorisation of the domestic economy into four exclusive sectors viz., (i) households, (ii) non-financial commercial sector, (iii) general government and (iv) financial corporations comprising (i) the banking sector consisting of the Reserve Bank of India and the banking system in India and (ii) other financial corporations comprising (a) development financial institutions including term-lending and refinancing institutions, (b) insurance companies, (c) mutual funds and (d) non-banking financial companies accepting public deposits. In addition, non-residents would constitute the 'rest of the world sector' which can have transactions with any of the domestic sectors.
- Compilation of monetary aggregates on a residency basis by excluding non-resident repatriable foreign currency fixed deposits such as FCNR(B) deposits.
- Replacement of the present concept of net non-monetary liabilities (NNML) of banking sector by new balancing items comprising (i) capital accounts and (ii) other items (net) in conformity with the international practice.
- Broader definition of bank credit to the commercial sector by including items not reflected in the conventional bank credit, viz., banks' investments in non-SLR securities, such as commercial paper, shares, debentures and bonds issued by the commercial sector.
- Strengthening of the statistical system in order to enlarge the coverage of financial statistics by compiling comprehensive analytical surveys of the Reserve Bank of India, commercial and cooperative banks and the organised financial sector at regular intervals.
- The following four monetary aggregates and three liquidity aggregates in conformity with the norm of progressivity in terms of liquidity have been proposed along with a comprehensive financial sector survey.

A. Monetary Aggregates

M_0 = Currency in Circulation + Bankers' Deposits with the RBI + 'Other' Deposits with the RBI;

M_1 = Currency with the Public + Demand Deposits with the Banking System + 'Other' Deposits with the RBI = Currency with the Public + Current Deposits with the Banking System + Demand Liabilities portion of Savings Deposits with the Banking System + 'Other' Deposits with the RBI;

M_2 = M1 + Time Liabilities portion of Savings Deposits with the Banking System + Certificates of Deposit issued by Banks + Term Deposits (excluding FCNR(B) deposits) with a contractual maturity of up to and including one year with the Banking System = Currency with the Public + Current Deposits with the Banking System + Term Deposits (excluding FCNR(B) deposits) with a contractual maturity up to and including one year with the Banking System; and

M_3 = M2 + Term Deposits (excluding FCNR(B) Deposits) with a contractual maturity of over one year with the Banking System + Call borrowings from 'Non-Depository' Financial Corporations by the Banking System.

B. Liquidity Aggregates

L_1 = M3 + all Deposits with the Post Office Savings Banks (excluding National Savings Certificates).

L_2 = L1 + Term Deposits with Term Lending Institutions and Refinancing Institutions (FIs) + Term Borrowing by FIs+ Certificates of Deposit issued by FIs; and

L_3 = L2 + Public Deposits of Non-Banking Financial Companies.

C. Financial Sector Survey (FSS) = Aggregate Assets and Liabilities of the Financial Corporations.

TABLE 3.1

Growth of Alternative Measures of Money Stock

Money	1997-98 Mar. 31 to Mar. 31	1997-98 Mar. 31 to Jan. 16	1998-99 Mar. 31 to Jan. 15
Broad Money(M3)	17.6	11.2 (16.9)	13.2 (19.8)
Narrow Money(M1)	11.1	4.7 (11.7)	7.2 (13.7)
Reserve Money	13.1	4.1 (10.3)	10.7 (20.4)
M3 multiplier	3.65	3.75	3.73

Note:—

(i) All the figures are provisional.

(ii) Figures in brackets denote year-on-year growth rates.

(iii) M3 multiplier is as at end-March for 1997-98 and as on January 16/15 for 1997-98/1998-99.

the corresponding period of 1997-98. The higher M3 growth reflects the higher growth in both currency with the public and time deposits with banks. The Working Group (Box 3.1) on Analytics and Methodology of Compilation of monetary aggregates (June 1998) has made a number of recommendations for compiling more meaningful and relevant measures of money stock in a changed and more liberal economy.

6. An analysis of variations in the components of broad money (Table 3.2) reveals that the growth in time deposits in the current financial year was stronger than that in 1997-98. Besides inflows under the Resurgent India Bonds (RIBs), interest rate deregulation of short-term time deposits and the increased risk perception associated with competing deposit takers such as non-bank finance companies (NBFCs) contributed to the significant growth in time

TABLE 3.2

Sources of Change in Money Stock (M3)

Variations during

	Financial Year (Rs. crore)			Annual (Rs. crore)		Financial Year (Per cent)			Annual (Per cent)	
	1997-98 Mar.31 to Mar.31	1997-98 Mar.31 to Jan. 16	1998-99 Mar. 31 to Jan. 15	1997-98 Jan. 17 to Jan. 16	1998-99 Jan. 16 to Jan. 15	1997-98 Mar. 31 to Mar. 31	1997-98 Mar. 31 to Jan. 16	1998-99 Mar. 31 to Jan. 15	1997-98 Jan. 17 to Jan. 16	1998-99 Jan. 16 to Jan. 15
I. M1 (Narrow Money)	26607	11408	19294	26459	34493	11.1	4.7	7.2	11.7	13.7
II. M3 (Broad Money) (1+2+3+4)	123541	78507	109277	112858	154311	17.6	11.2	13.2	16.9	19.8
1. Currency with the public	13095	13207	21973	14159	21862	9.9	10.0	15.1	10.8	15.0
2. Demand deposits with banks	13101	-2497	-2419	12666	13179	12.4	-2.4	-2.0	14.0	12.8
3. Time deposits with banks	96934	67099	89983	86400	119818	21.0	14.5	16.1	19.6	22.7
4. Other deposits with RBI	411	698	-260	-366	-547	12.9	21.9	-7.2	-8.6	-14.1
III. Sources of change in money stock (M3) (1+2+3+4-5)										
1. Net bank credit to Government (A+B)	42000	30493	52017	32305	63523	14.6	10.6	15.7	11.3	19.9
(A) RBI's net credit to Government (i+ii)	10979	3164	18080	2009	25895	8.8	2.5	13.4	1.6	20.3
(i) Central Government	12914	5367	17693	1693	25240	10.7	4.4	13.2	1.4	20.0
(ii) State Governments	-1936	-2203	387	317	654	-55.6	-63.3	25.1	33.1	51.3
(B) Other banks' credit to Government	31021	27329	33937	30295	37628	18.9	16.6	17.4	18.8	19.6
2. Bank credit to commercial sector (A+B)	55882	27843	33598	45076	61638	14.9	7.4	7.8	12.6	15.3
(A) RBI's credit to commercial sector	1938	1574	4400	1534	4764	31.0	25.2	53.7	24.4	60.9
(B) Other banks' credit to commercial sector	53944	26269	29199	43542	56874	14.6	7.1	6.9	12.3	14.4
3. Net foreign exchange assets of the banking sector	21073	12893	13209	22142	21389	20.0	12.2	10.4	23.0	18.1
4. Government's currency liabilities to the public	202	311	441	421	332	6.9	10.6	14.1	15.0	10.3
5. Banking Sector's net non-monetary liabilities other than time deposits	-4384	-6967	-10013	-12913	-7430	-6.1	-9.7	-14.9	-16.7	-11.5

Note : All figures are provisional. 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. Scheduled commercial banks' time deposits include Rs. 17,944.9 crore on account of proceeds from RIBs (Resurgent India Bonds), since August 28, 1998.

deposits. As regards sources of change in M3, net bank credit to Government, comprising both net Reserve Bank credit to Government (monetised deficit) and other banks' credit to Government (investment in Government securities), increased by 15.7 per cent till January 15, 1999 as against 10.6 per cent in the corresponding period of 1997-98.

7. An analysis of reserve money growth (Table 3.3) shows a significant expansion by 13.4 per cent in net RBI credit to Government (monetised deficit) till January 15, 1999 as against a lower growth rate of 2.5 per cent in the corresponding period of 1997-98. During this period, the RBI credit to banks and commercial sector also registered strong growth by 86.4 per cent and 53.7 per cent respectively. The former reflects the significant growth in the utilisation of export credit refinance following the reduction in refinance rate for banks from 9 per cent to 7 per cent effected in August, 1998. The substantial increase in the net non-monetary liabilities (NNML) of the Reserve Bank by 41.6 per cent till January 15, 1999 as against a lower increase by 29.4 per cent in the corresponding period of 1997-98 is worth noting in this context. This reflects the increase in the item "other liabilities" of the Reserve Bank on account of gains from revaluation of its foreign exchange assets in rupee terms, which constitute a part of NNML of the Reserve Bank. Keeping in view the unexplained changes noticed in NNML, RBI's Working Group on Money Supply (1998) has proposed to replace the present concept of NNML by balancing items comprising capital accounts and other items (net) in conformity with the international practice (Box 3.1).

Credit

8. As in 1997-98, the flow of non-food credit from commercial banks remained negative during most of the first half of the current financial year. This reflected in part the relatively poor demand for funds from the corporate sector. The relatively high interest rate despite comfortable liquidity in the financial system may also have contributed to the poor off-take of credit. During the current financial year, the non-food credit off-take registered a growth rate of 6.8 per cent till January 15, 1999 as against 7.1 per cent in the corresponding period of 1997-98. However, as in the previous year, this was supplemented by the investment by banks in the debt/equity instruments like commercial papers, debentures, shares, etc. The flow of funds via such investments increased at a lower rate by 34.3 per cent till December 4, 1998 as against a

TABLE 3.3

Sources of Change in Reserve Money

Variations during[1]

	Outstanding as on March 31, 1997	Financial Year			Annual		Financial Year			Annual	
		1997-98	1997-98	1998-99	1997-98	1998-99	1997-98	1997-98	1998-99	1997-98	1998-99
		Mar.31 to Mar.31	Mar.31 to Jan.16	Mar.31 to Jan.15	Jan. 17 to Jan. 16	Jan. 16 to Jan. 15	Mar.31 to Mar.31	Mar.31 to Jan. 16	Mar.31 to Jan. 15	Jan. 17 to Jan. 16	Jan. 16 to Jan. 15
			(Rs.crore)						(per cent)		
1. Net RBI credit to Government[2]	124181	10979	3164	18080	2010	25895	8.8	2.5	13.4	1.6	20.3
2. RBI credit to banks[3]	7005	91	564	6133	964	5660	1.3	8.0	86.4	14.6	74.8
3. RBI credit to commercial sector[4]	6247	1938	1574	4400	1535	4764	31.0	25.3	53.7	24.4	60.9
4. Net foreign exchange assets of RBI[5]	94817	21073	12893	13209	22136	21389	22.2	13.6	11.4	25.9	19.9
5. Government's currency liabilities to the public	2918	202	311	441	421	332	6.9	10.6	14.1	15.0	10.3
6. Net non-monetary liabilities of RBI	35184	8035	10340	17959	7627	15654	22.8	29.4	41.6	20.1	34.4
7. Reserve Money (1+2+3+4+5-6)	199984	26248	8166	24304	19437	42386	13.1	4.1	10.7	10.3	20.4

1. **Variations are worked out on the basis of March 31 data after closure of Governments accounts. Figures for 1997-98 and 1998-99 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.**

higher growth rate of 64.2 per cent in the corresponding period of 1997-98. As a result, the total flow of funds from commercial banks comprising both non-food credit and investment in debt/equity instruments increased at a lower rate of 9.7 per cent till January 15, 1999 as against 11.5 per cent during the corresponding period of previous financial year. Net bank credit to Government expanded by 15.7 per cent till January 15, 1999 as against 10.6 per cent in the corresponding period of 1997-98. Other banks' credit to Government (investment in Government securities) during this period was also higher at 17.4 per cent than that at 16.6 per cent in 1997-98 , which reflects the higher level of Government borrowing in the current financial year. As a result, RBI support to Central Government borrowing (Centre's monetised deficit) increased significantly by 13.2 per cent till January 15, 1999 as against a lower growth of 4.4 per cent in the corresponding period of 1997-98.