

## Monetary and Credit Policy

9. It has been customary for RBI to announce a set of measures of both short-term and structural nature in the two bi-annual statements on monetary and credit policy normally released in April and October of each year. Keeping in view the significant changes in the regulatory framework for financial markets, the RBI has decided with effect from the current financial year to give greater importance to structural measures in the monetary and credit policy statement for the first half. Such structural measures will normally continue over the medium term so as to enable banks to plan their operations with the medium term monetary perspective in view. Short-term measures like the Bank Rate, CRR, Repo rates, etc. will be included in the statement for the first half only if they coincide with the timing of its release. These short-term credit and regulatory measures are subject to change at short notice in response to emerging developments in financial markets both

at home and abroad. The October statement (as in 1998) would cover mid-term review of monetary and credit developments (Box.3.2).

### *Forex Developments*

10. Developments in the forex market have a vital bearing on monetary developments. Volatility in the foreign exchange market affects market sentiments and prompts Reserve Bank intervention, including strong monetary policy measures impacting on liquidity. For this reason, the monetary and credit policy for the first half of 1998-99 underscored the compulsion to alter short-term credit and regulatory measures at very short notice. Indeed, this is a clear recognition of the existence of interlinkages among the different segments of the financial market, particularly those between the money market and the forex market. Such linkages necessitated tight monetary policy measures in 1997-98 to withstand the shock from the South-East Asian crisis. In the current financial year, forex developments, including the anticipated

### BOX 3.2

#### Monetary and Credit Policy Measures : 1998-99

##### A. April-September, 1998

- Bank Rate reduced from 10.5 per cent to 10.0 per cent with effect from April 3, 1998 and further to 9.0 per cent w.e.f. April 29, 1998.
- Interest rate on loans upto Rs.2 lakh liberalised but not to exceed the PLR available to the best borrowers.
- Advances against term deposits set at interest rates equal to or less than PLR.
- Export credit refinance restored to 100 per cent from existing 50 per cent of the increase in outstanding export credit eligible for refinance over the level of such credit as on February 16, 1996 with effect from the fortnight beginning May 9, 1998.
- Interest rate on pre-shipment credit upto 180 days reduced from 12 per cent to 11 per cent with effect from April 30, 1998.
- To facilitate 'mark to market' valuation of investment portfolio, banks required to classify a minimum of 70 per cent of their investments in approved securities as 'current' for 1998-99; this ratio to be raised to 100 per cent in the next three years.
- The Repo rate reduced in stages to 5 per cent by June 1998, but on August 20, 1998, it was increased to 8 per cent.
- Increase in Cash Reserve Ratio (CRR) by 1 per cent point to 11 per cent effective from August 29, 1998.

##### B. Mid-Term Review

##### Prudential Measures

- The minimum CRAR raised from the existing 8 per cent to 9 per cent with effect from the year ending March 31, 2000.
- Income recognition and provisioning norms on Government guaranteed advances brought on par with those on other advances with effect from the financial year 2000-2001.
- Provisioning of a minimum of 0.25 per cent introduced for standard assets from the year ending March 31, 2000; the time frame for doubtful assets shortened from 24 to 18 months; provisions to be made in two phases as on March 31, 2001 and March 31, 2002.
- With effect from the year ending March 31, 2000, Government/approved securities will carry a risk weight of 2.5 per cent. Additional risk weight of 20 per cent for securities of government undertakings which do not form part of the market borrowing programme introduced with effect from the financial year 2000-2001.
- The risk weight for Government guaranteed advances which go into default introduced with effect from March 31, 2000.
- Foreign exchange open positions will carry 100 per cent risk weight with effect from year ending March 31, 1999.
- Risk weights on investments in bonds/debentures of PFIs as defined under Section 4A of the Companies Act, 1956 (and certain other FIs notified by RBI) given a uniform risk weight of 20 per cent.

addition to liquidity via Resurgent India Bonds (RIB) inflows prompted the Reserve Bank to raise the Repo rate by 300 basis points to 8 per cent with effect from August 20,1998 and hike CRR from 10 per cent to 11 per cent with effect from August 29,1998.

#### Bank Rate

11. The monetary and credit policy announced on April 29, 1998 reduced the Bank Rate to 9 per cent, which has since remained unchanged.

#### Interest Rates : Reforms/Liberalisation

12. In order to remove the disincentive to the flow of credit to small borrowers, it was decided with effect from April 29,1998 that the interest rates on loans upto Rs. 2 lakh should not exceed the prime lending rate (PLR) applicable to prime borrowers of over Rs. 2 lakh of the concerned bank. It was also announced on April 29,1998 that all advances against term deposits would be at interest rates equal to or less than PLR. In order to encourage flow of funds to the industrial sector, the ceiling for banks' advances to individuals against shares and debentures has been raised from Rs. 10 lakh to Rs. 20 lakh per borrower. With a view to promoting the use of depository by investors, this facility has been extended only to loans/advances secured by shares/debentures held in dematerialised form. The minimum margin prescribed against dematerialised shares was also reduced to 25 per cent.

13. The measures in regard to deposits taken during the current financial year related to reduction in minimum period of maturity of term deposits from 30 to 15 days, permission to banks to determine penal interest rates for premature withdrawal of domestic as well as NRE term deposits, removal of restrictions regarding uniform interest rates on deposits of the same maturity irrespective of size in respect of domestic term deposits of Rs.15 lakh and above, etc. Further, to facilitate mobilisation of long-term external deposits, the interest rate ceiling on FCNR(B) deposits of one year and above was raised by 50 basis points while in the case of such deposits below one year and the floating rate deposits the ceiling was reduced by 25 basis points.

14. The comfortable liquidity situation reflected in strong growth in bank deposits facilitated market absorption of Government debt in the current financial year. Except in respect of short

term instruments like Commercial Papers (CPs) and Treasury Bills, interest rates did not come under significant pressure. While the interest rates on CPs hardened *vis-a-vis* last year, the implicit yield in respect of Treasury Bills moved up significantly after the hike in repo rate by 300 basis points with effect from August 20, 1998. Call money rates, which mostly remained below the Bank Rate, also came under pressure in August, 1998 due to the hike in repo rate. The Prime Lending Rate (PLR) of commercial banks and the Medium Term Lending Rate (MTLR) of IDBI somewhat softened in the current financial year. The excess liquidity in the system *vis-a-vis* low credit offtake implies the need to bring down interest rates (Table 3.4).

#### Cash Reserve Ratio (CRR)

15. The CRR to be maintained by scheduled commercial banks (excluding RRBs) was reduced to 10 per cent with effect from the fortnight beginning April 11, 1998. Effective from August 29, 1998, the CRR was raised by 1 percentage point to 11 per cent. This was done to curb the scope for arbitrage provided by the excess liquidity in the banking system, especially in the wake of the RIB inflows. Keeping in view this scenario, the Mid-term Review of monetary and credit policy announced on October 30, 1998 did not effect any change in CRR.

**TABLE 3.4**  
**Interest Rate Trends**

Interest Rate	As on 3-4-98	As on 15-5-98	As on 6-1-99
1. Bank Rate	10.00	9.00	9.00
2. MTLR	14.50	14.00	14.00
3. PLR	13.50- 14.00	12.75- 13.00	12.75- 13.00
4. Deposit Rate	10.0- 12.0	9.0- 12.0	9.0- 11.5
5. Call Money (low/high)	2.50- 6.50	7.00- 9.00	8.50- 9.00
6. CDs	8.25- 24.00	6.00- 16.50	8.25- 13.00*
7. CPs	11.75- 18.00	8.50- 13.75	9.75- 13.00

\* Fortnight ended October 23, 1998.

Notes : MTLR : Medium Term Lending Rate;

PLR : Prime Lending Rate relating to five major banks.  
Deposit Rate relates to five major banks for term deposits of more than one year maturity and call money rates are as reported by DFHI. CDs are Certificates of Deposits issued by banks and CPs are Commercial Papers issued by Companies.