Outlook

34. Monetary policy is conducted by rule and/or by discretion: by rule if policy makers reveal in advance how policy will respond to various situations and then adhere to the revealed policy stance; and by discretion if policy makers enjoy the freedom to size up the situation case by case and choose the most appropriate policy to deal with the emerging situation. The monetary and credit policy for the first half of the current financial year indicated the need for discretion in regard to short-term policy measures like change in Bank Rate, CRR, Repo rate, etc. The outlook in respect of these key variables would therefore depend on the emerging developments in financial markets at home as well as abroad. However, given the excess liquidity in the banking system and the relatively poor credit offtake, there may be some scope for softening in interest rates. The recent reduction in interest rate on small savings may be considered as an example.

35. The slowdown in economic activity, especially the deceleration in industrial production, implies weak demand for credit, which is also partly due to relatively high interest rates. The need to bring down interest rates poses a serious challenge to the conduct of fiscal and monetary policy. Efforts to lower interest rates also imply the need to bring down intermediation costs, especially in the case of public sector banks. Since timely availability of finance is as important as cost, financial intermediation by NBFCs also assumes importance. Recent modifications effected by the Reserve Bank in the regulatory framework for acceptance of public deposits by equipment leasing/hire purchase companies and loan/investment companies place the NBFCs in a better position to channel financial savings to productive sectors of the economy. As regards finance for infrastructure sector, innovative financing arrangements like "Takeout Financing" developed by financial institutions to attract non-traditional lenders like banks to infrastructure sector would add to the flow of funds for infrastructure projects. This would not only stimulate demand via income creation but also reduce the inflationary potential of high monetary growth via capacity addition in the real sector.