Credit Information Review

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April 2000

Monetary and Credit Policy for 2000-2001

Dr.Bimal Jalan, Governor, Reserve Bank of India, in a meeting with the chief executives of banks presented the annual Monetary and Credit Policy on April 27, 2000. Extracts :

Stance of the Policy

Governor mentioned that against the background of the developments in the economy last year and economic prospects during 2000-2001, an important objective of monetary policy in the current year is to provide sufficient credit for growth while ensuring that there is no emergence of inflationary pressures on this account. On current assessment, the prospects of achieving these objectives look reasonably promising. In line with the continuing overall stance of policy, at the beginning of the new financial year on April 1, 2000, the RBI announced a number of measures to enhance liquidity and reduce the cost of funds to banks. Following these measures public sector banks have also announced a reduction in their lending and deposit rates.

Governor mentioned that for purposes of monetary policy formulation on the basis of current trends, growth in real GDP may be placed at 6.5 to 7.0 per cent in 2000-2001, assuming a normal agricultural crop and continued improvement in industrial performance. Assuming the rate of inflation to be around 4.5 per cent, the projected expansion in M3 for 2000-2001 is about 15.0 per cent. Governor, however, stressed that the above outlook can change in the event of unanticipated domestic or international events. On the inflation front, in particular, there is need for continuous vigilance and caution. The Reserve Bank will continue to monitor domestic monetary and external developments, and take necessary monetary action through the use of instruments at its disposal, as necessary.

Based on the experience of some industrialised countries, there is a view that, in India also, monetary policy, to be transparent and credible, should have an explicit narrowly defined objective like an inflation mandate or target. Governor mentioned that while technically this appears to be a sound proposition, there are several constraints to its adoption in the Indian context like fiscal dominance, the absence of fully integrated financial markets which remain still imperfect and segmented and the high frequency data requirements including those on a fully dependable inflation rate for targeting purposes which are yet to be met. Under these circumstances, it is necessary to carefully measure and balance between possible outcomes, after taking into account movements in a variety of monetary and other indicators.

While there has been a significant softening of interest rates in the last 13 months, Governor mentioned that there are several structural factors which constrain greater flexibility in the interest rate structure in India. Among some of these factors, which have to be taken note of are : the post-tax return on contractual savings being still higher than deposit rates, banks offering fixed rates against floating rates on deposits and higher transaction costs. Governor mentioned that while much greater flexibility in the structure of interest rates in tune with changes in the inflationary environment is desirable, there is no "quick fix" solution to engineer a sharp fall in nominal deposit and lending rates of banks. Vigorous action has to be taken by banks to reduce their transaction costs and the volume of NPAs, and improve risk management. This requires action on a number of areas, including legal reforms for recovery of dues and restructuring of weak banks and reduction in fiscal deficit.

Financial Sector Reforms and Monetary Policy Measures

Governor reviewed 'structural measures' in the recent period introduced to strengthen the financial system and to improve the functioning of the various segments of financial markets. Governor mentioned that while there has been substantial progress in achieving some of these objectives, for example, development of money market, secondary market in government securities, deregulation and operational flexibility to banks, etc., the pace of progress has been relatively slow and there is scope for improvements in areas like retailing of government securities, risk management and internal control systems and loan recovery and settlement procedures. Governor added that the financial reforms initiated in recent years will be carried forward keeping in view the actual experience in implementation and other relevant developments. The following announcements were made in the policy:

**Introduction of Liquidity Adjustment Facility (LAF)
replacing Interim Liquidity Adjustment Facility (ILAF)**

Following the recommendation of an Internal Group, it has now been decided to proceed with the implementation of a full-fledged LAF. The new scheme will be introduced progressively in convenient stages in order to ensure smooth transition.

In the first stage, with effect from June 5, 2000, the Additional CLF and level II support to PDs will be replaced by variable rate repo auctions with same day settlement.

In the second stage, the effective date for which will be decided in consultation with banks and PDs, CLF and level I liquidity support will also be replaced by variable rate repo auctions.

With full computerisation of PDO and introduction of RTGS expected to be in place by the end of the current year, in the third stage, a collateralised LAF through electronic transfers will be introduced.

The proposed LAF is a more flexible scheme because the quantum of adjustment as also the rates would be flexible, responding immediately to the needs of the system.. There will be no change in the export credit refinance scheme which will continue as before.

Development of Financial Markets

In an effort to carry forward the reforms towards widening and deepening of the financial markets, the following measures are being introduced for further development of the markets :

(a) *Money Market*

In order to provide more flexibility for pricing of rupee interest rate derivatives and to facilitate some integration between money and foreign exchange markets, the use of 'interest rates implied in the foreign exchange forward market' is allowed as a benchmark.

Minimum maturity for Certificates of Deposit is reduced to 15 days.

The facility to non-bank entities for routing transactions through PDs would be further extended upto end-December 2000.

It is proposed to review and evolve a time bound programme of withdrawing permission to non-bank entities for lending in the call/notice money market coinciding with the development of repo market.

It has been decided to modify the current guidelines for issue of CPs in consultation with market participants.

The minimum daily requirement for maintaining CRR balances, is reduced from 85 per cent to 65 per cent.

(b) Government Securities Market

Consequent upon the delegation of powers by the Government to RBI, as part of development of the repo market, State Government securities have been made eligible for undertaking repos. RBI has also widened the scope of participation in the repo market to all the entities having SGL and Current Account with RBI, Mumbai.

It is proposed to introduce a scheme for banks and primary dealers providing for automatic invocation of undrawn refinance/liquidity support from RBI for facilitating smooth securities settlement.

It has been decided to allow entities to sell the securities after they have been allotted to them, in primary issues, thus enabling sale, settlement and transfer on the same day.

In respect of both 14 day Treasury Bills, the day of payment has been changed from Saturday to Monday or the next working day.

A detailed review of liquidity support to PDs will be made and modifications will be introduced in consultation with PDs.

Taking into account the principles for capital adequacy for market risk evolved by regulatory bodies such as the International Organisation of Securities Commissions (IOSCO) and the Bank for International Settlements (BIS), fresh guidelines for capital adequacy standards for PDs are being evolved, which will be finalised in consultation with PDs.

(c) Debt Securities Clearing Corporation

Action is being taken to set up a Debt Securities Clearing Corporation which will inter alia pave the way for further opening up of the repo market to PSU bonds and bonds of Financial Institutions held in demat form in depositories.

Banks' Entry into Insurance Business

Detailed guidelines to banks for entry into insurance are issued. Banks will be required to obtain prior approval of RBI for entering into insurance area. Banks having minimum net worth of Rs.500 crore, and satisfying other criteria in regard to capital adequacy, profitability, etc., will be allowed to undertake insurance business through joint venture on risk participation basis. RBI will consider bank's equity contribution in the joint venture up to 50 per cent. However, higher equity contribution by a promoter bank may be allowed initially, on a highly selective basis, pending divestment of the equity in excess of 50 per cent within the period prescribed under the amended insurance statutes. Banks which do not satisfy the above criteria will be allowed on a 'without risk participation' basis upto 10 per cent of their net worth or Rs.50 crore, whichever is lower, as strategic investors.

Interest Rate Policy

After consultation with banks, with the objective of providing more operational flexibility and eliminating rigidities, following measures are being introduced:

Banks which have moved over to declaration of tenor-linked PLRs should indicate the specific tenor for which the declared PLRs is applicable.

The restriction on fixed rate term loans being extended only for project loan is now being withdrawn. Banks will henceforth have the freedom to offer all loans on fixed or floating rates complying with PLR stipulations.

Banks at their discretion will have the option to choose the current swap rates while offering FCNR (B) deposits enabling to refer to the swap rates quoted on any online screen based information system.

Banks would be permitted as in the case of domestic term deposits to offer differential rates of interest on NRE /FCNR(B) deposits on size group basis.

Liberalisation of Export Credit Refinance Facility

Representations have been received from some institutions that the manner in which the export credit refinance limit is fixed under the existing scheme precludes the use of Export Bill Rediscounting Schemes by banks, which is of benefit to exporters. It has, therefore, been decided to liberalise the scheme by introducing the following modification:

For the purpose of fixing refinance limits, the outstanding export credit (including export bills rediscounted with institutions like EXIM Bank and refinance obtained from NABARD/EXIM Bank will form the basis.

Drawal of refinance will be on the basis of export credit eligible for refinance, i.e., after excluding export bills rediscounted with other banks/EXIM Bank and refinance from NABARD/EXIM Bank,

The scheme will come into force effective fortnight beginning May 6, 2000.

Post-award Clearance of Project Proposals for Exports -
Enhancement of Limit

It has been decided that the above value limits for clearance for post-award proposals for ADs should be raised from Rs.25 crore to Rs.50 crore and that for Exim Bank from Rs.100 crore to Rs.200 crore.

Gold Deposit Scheme - Allowing Banks to lend Gold to Other Nominated Banks

Banks are being permitted to deploy the gold mobilised under the Gold Deposit Scheme by lending it to other nominated banks.

Resource Mobilisation by All-India Financial Institutions : Greater Flexibility

FIs are given flexibility in the matter of fixing interest rates on term deposits without reference to SBI rates.

Based on a review of regulatory experience, it has been decided to modify the guidelines to FIs for raising resources by issuing bonds and other instruments subject to overall limits. A draft proposal will be circulated among the FIs, and guidelines will be issued after further consultation with FIs.

Prudential Measures

(a) Risk Management Systems in Banks

A review by RBI of the action taken by banks shows that most of the banks are well advanced in setting up a system for an appropriate assessment of risks associated with different types of assets. This process needs to be further accelerated. In this connection, an issue which has received some attention is the appropriate role of banks in providing financial support to individuals as well as to corporates and market intermediaries against the security of shares/debentures/bonds. While RBI has already issued some guidelines for advances against shares, etc., to individuals, stock brokers and corporates, some grey areas remain where there is need for removal of any ambiguities so that policy of banks for supporting the development of capital markets is transparent and known to all concerned, including investors. In order to further develop the operating guidelines for bank financing of equities, the Standing Technical Committee on Co-ordination between RBI and SEBI is being requested to review the status and make suitable recommendations, after appropriate consultations with banks and market participants.

(b) Capital Adequacy Norms for Bank's Subsidiaries

On prudential considerations, banks are advised to voluntarily build-in the risk weighted components of their subsidiaries into their own balance sheet on notional basis. . The additional capital required may be provided in the bank's books in phases beginning from the year ending March 2001.

(c) New Capital Adequacy Framework

In June 1999, the Basle Committee on Banking Supervision had released a consultative paper on 'A New Capital Adequacy Framework' which aims at further strengthening the soundness and stability of the financial system and is designed to better align regulatory capital with underlying risks faced by banks. RBI has finalised and forwarded its comments on the new Framework to the Basel Committee. These comments are available on the RBI's web-site for generating wider discussion.

(d) Monitoring adherence to International Financial Standards and Codes

The Reserve Bank has constituted in association with the Government of India a 'Standing Committee on International Financial Standards and Codes' aiming at identifying and monitoring developments in global standards and codes being evolved in the context of the international developments and consider the applicability of these standards and codes to Indian financial system, and chalk out a road map for aligning India's standards and practices with international best practices. The Standing Committee has set up non-official Advisory Groups in ten major subject areas with outside eminent experts in concerned fields.

(e) Move towards Risk Based Supervision of Banks

There is a growing acceptance that a Risk Based Supervision (RBS) approach would be more efficient than the traditional transaction-based approach. The Reserve Bank would be engaging services of reputed international consultants to draw on other countries' experiences in this regard.

(f) Non-Performing Advances (NPAs) of Banks

Banks will have to more aggressively pursue the recourse to Debt Recovery Tribunals (DRTs) as well as compromise settlement through the Settlement Advisory Committees (SACs) since the operation of SACs is scheduled to lapse on September 30, 2000.

(g) Banks' non-SLR Investments

With a view to ensuring that non-SLR investments by banks are made on sound prudential considerations, with more transparency and guarding against potential risks, draft guidelines for banks' non-SLR investments have been evolved in consultation with banks and financial institutions. Guidelines would be revised duly taking into account the comments and suggestions from banks, financial institutions and others.

Credit Delivery Mechanisms

Banks have been advised to provide credit on reasonable terms to certain sectors like agriculture, micro-credit, etc., as per guidelines issued from time to time. A number of measures have been taken to improve credit delivery system for agriculture. Some parts of the country have been affected by severe drought. RBI has instructed its Regional Offices to remain in close contact with the State Government authorities and local banks and also for convening the meeting of SLBCs so that expeditious action is taken to provide relief as per RBI guidelines, for conversion of short-term loans into medium-term loans, rescheduling of loans, additional needbased loans, etc. In addition, two measures taken are: enhancement of ceiling from Rs.5 lakh to Rs.15 lakh, for classifying advances for distribution of inputs, as indirect advances to agriculture and also treating lending by banks to NBFCs for onlending to agriculture as indirect finance to agriculture.

Following the announcements made by the recent Union Budget in respect of the SSI sector, following action has been taken :

The limit for dispensing with the collateral requirement for loans increased for the tiny sector from Rs.1 lakh to Rs.5 lakh.

To promote credit flow to small borrowers, the composite loan limit is being increased from Rs.5 lakh to Rs.10 lakh.

Public sector banks have been requested to accelerate their programme of SSI branches to ensure that every district and SSI clusters are served by at least one specialised SSI bank branch.

The State Bank of India has entered into an MoU with HDFC to set up a Credit Information Bureau and the modalities for setting up of the Bureau in regard to ownership and equity participation, management structure, security standards, rights and liabilities of the Bureau, etc., are currently being worked out.

Deposit Insurance

In pursuance of the recommendations of the Advisory Group on Reforms in Deposit Insurance in India, a new law is required to be enacted and relevant proposals in this respect will be forwarded in due course to the Government.

Non-Banking Financial Companies (NBFCs)

The NBFCs which have neither reported having attained the minimum NOF of Rs.25 lakh nor sought extension of time from the RBI are not entitled to accept fresh public deposits. These NBFCs are advised to strictly adhere to the provisions of the Statute, RBI regulations and continue to repay the matured deposits as per the contracted terms. RBI is keen to promote the concept of self regulatory organisation particularly for smaller NBFCs; RBI also proposes to extend to the NBFCs the guidelines on Asset Liability Management; RBI is also considering guidelines for NBFCs for their entry/participation in insurance business and reviewing the regulatory structure and procedures for fixing of interest rates on deposits.

Approach to Universal Banking

The RBI released a 'Discussion Paper' (DP) in January 1999 on the issues relating to Universal Banking for wider public debate. The feedback on the discussion paper indicated that while universal banking is desirable from the point of view of efficiency of resource use, there is need for caution in moving towards such a system by banks and DFIs. It is proposed to adopt the following broad approach for considering proposals in this area:

(a) The principle of "Universal Banking" is a desirable goal. However, banks have certain special characteristics and as such any dilution of RBI's prudential and supervisory norms for conduct of banking business would be inadvisable.

(b) Though the DFIs would continue to have a special role in the Indian financial system, any DFI, which wishes to do so, should have the option to transform into bank (which it can exercise), provided the prudential norms as applicable to banks are fully satisfied. To this end, a DFI would need to prepare a transition path.

(c) The regulatory framework of RBI in respect of DFIs would need to be strengthened.

High Power Committee on Urban Co-operative Banks

The recommendations of the High Power Committee (HPC) constituted in May 1999 are under consideration of RBI in consultation with Government.

Technology Upgradation

With the ultimate goal of designing and developing a multiple deferred/discrete net settlement system and a Real Time Gross Settlement (RTGS), facilitating efficient funds management, house-keeping and customer service, Reserve Bank has taken a number of steps to improve the infrastructure. The major items in the Action Plan for 2000-2001are :

The spread and coverage of the Indian Financial Network - INFINET will soon be extended to cover all the hundred odd commercially important centres in the country.

Priority will be given for integrating the various segments of the Payments and Settlement system and on the introduction of the RTGS.

Technology upgradation and increasing the scope of computerisation in the banking sector.

Regulations Review Authority

The experience in the last one year with Regulations Review Authority (RRA) for reviewing Reserve Bank's rules, regulations and reporting systems has been satisfactory and the Reserve Bank has since extended the term of RRA for a further period of one year from April 1, 2000. Implementation of several suggestions not only paved the way for streamlining several existing procedures and improving customer service, but also helped in reviewing and streamlining Bank's reporting systems. A notable achievement of RRA has been the compilation of Master circulars, subject-wise, in Manual form

Mid-Term Review

A Review of credit and monetary developments in the first half of the current year will be undertaken in October 2000 confining to a review of monetary developments and to such changes as may be necessary in monetary policy and projections for the second half of the year.

Monetary Measures of April 1, 2000

Earlier, on April l, after reviewing the liquidity and market conditions, the Reserve Bank of India had announced :

i) The reduction in Bank Rate by 1.0 percentage point from 8.0 per cent to 7.0 per cent as at the close of business of April 1, 2000.

ii) A reduction in Cash Reserve Ratio (CRR) by 1 percentage point from 9.0 per cent to 8.0 per cent in two stages by 0.5 percentage point each effective from fortnights beginning April 8 and April 22, 2000, respectively.

iii) A reduction in Repo Rate by 1.0 percentage point from 6.0 per cent to 5.0 per cent, effective from April 3, 2000; and

iv) A reduction in Savings Deposit rate of scheduled commercial banks from 4.5 per cent to 4.0 per cent, effective from April 1, 2000.

Edited and published by **Alpana Killawala** for the **Reserve Bank of India**, Press Relations Division, Central Office, Shahid Bhagat Singh Marg, Mumbai 400 001 and printed by her at **Mouj Printing Bureau,** Khatau Wadi, Girgaon, Mumbai 400 004. Annual Subscription : Rs. 12. Subscription to be remitted to the Director, DRRP (Sales Section), DEAP, Reserve Bank of India, Amar Building, Sir P.M. Road, P.B. No. 1036, Mumbai **-** 400 001. **Also available on internet at** www.cir.rbi.org.in