Credit Information Review

273
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Monetary and Credit Policy for 2002-03

Dr. Bimal Jalan, Governor, in a meeting with the Chief Executives of banks presented the annual Monetary and Credit Policy for 2002-03. The Statement covered a review of macro-economic and monetary developments, stance of monetary policy and a wide-ranging package of measures to strengthen the financial system and for development of markets and institutional infrastructure. The Governor also dealt with some analytical and practical issues concerning monetary policy, exchange rate and reserves management.

The Governor indicated that for the purpose of monetary policy formulation, for the year as a whole, growth rate of real GDP in 2002-03 is placed at 6.0 – 6.5 per cent, and the rate of inflation is assumed to be slightly lower than 4.0 per cent. Non-food credit (adjusted for investments) is projected to increase by about 15.0 – 15.5 per cent which is expected to adequately meet the credit needs of all the productive sectors of the economy.

The Governor indicated that under normal conditions and barring emergence of any adverse and unexpected developments in the various sectors of the economy, the overall stance of the monetary policy for 2002-03 would be :

? Provision of adequate liquidity to meet credit growth and support investment demand in the economy while continuing a vigil on movements in the price level.

? To continue the present stance on interest rates including preference for soft interest rates.

? To impart greater flexibility to the interest rate structure in the medium-term.

Financial Sector Reforms and Monetary Policy Measures

The Governor announced certain structural and other policy measures to strengthen and rationalise the functioning of various segments of the financial system.

Monetary Measures

(a) Rationalisation and Reduction in Cash Reserve Ratio : As a further step in the direction of moving towards the medium-term objective of reducing the CRR while operationalising the Liquidity Adjustment Facility (LAF) and introducing better prudential standard the Reserve Bank has proposed reducing CRR further from 5.5 per cent to 5.0 per cent effective fortnight beginning June 15, 2002. The proposed reduction in CRR is being made effective from fortnight beginning June 15, 2002 in view of the prevailing excess liquidity with the banking system.

HIGHLIGHTS

? Growth rate in 2002-03 projected at 6.0 to 6.5 per cent. Inflation to remain low.

? Monetary conditions and liquidity position highly comfortable.

? RBI to provide adequate liquidity to meet credit growth and support investment demand.

? Soft interest rate regime to continue and greater flexibility to interest rate structure in the medium-term.

? Further cut in CRR by 50 basis points.

? Bank Rate may be cut by upto 50 basis points depending on monetary developments - No timing fixed yet.

? No change in interest rate on Savings Account.

? Interest rate on export credit in foreign currency lowered.

? Abolition of minimum lending rate for co-operative banks.

? Banks to declare maximum and minimum lending rates.

? Banks should provide information on deposit rates on various maturities and effective annualised return to depositors.

? Facilities for Small Scale Industries liberalised.

? Further measures to improve credit delivery mechanism to priority sector.

? Measures to improve flow of credit to housing sector.

? Further measures to develop Government securities market.

? Access to call money market to be regulated.

? CDs to be issued in demat form.

? More prudential measures to bring financial stability.

? Measures to improve technology - EFT facilities to be expanded.

? Real Time Gross Settlement System to be ready for testing in a year's time.

? Submission of returns by NBFCs: RBI to penalise delays.

(b) Bank Rate : The Governor said that at present, there is substantial excess liquidity in the system which is reflected in the repo amounts received by the Reserve Bank, lower yields on fixed income securities and reduction in deposit and lending rates. Under these circumstances, on balance, it is considered desirable to leave the Bank Rate unchanged. He added that the matter, however, would be kept under constant review. In case the overall liquidity and credit situation warrants, and inflation rate continues to remain low, a reduction in the Bank Rate by up to half a percentage point (50 basis points) would be considered by the Reserve Bank as and when necessary.

Interest Rate Policy

(a) Interest Rate Flexibility : The Governor stressed that from the medium-term perspective, it is necessary to initiate measures to make the interest rate structure in India more flexible and reflective of the underlying inflationary situation.

The Governor said that following measures need to be considered as early as possible :

? Encourage introduction of flexible interest rate system for all new deposits with reset at six-monthly intervals. At the same time, the fixed rate option should also be made available to depositors.

? Devising schemes for encouraging depositors to convert their existing long-term fixed rate past deposits into variable rate deposits.

(b) Prime Lending Rate and Spreads : Banks were urged to review the present maximum spreads over PLR and reduce them wherever they are unreasonably high so that credit may be available to the borrowers at reasonable interest rates. Further, banks should announce the maximum spread over PLR to the public along with the announcement of their PLR.

In the interests of customer protection as also meaningful competition, it is necessary to have a greater degree of transparency in regard to actual interest rates for depositors as well as borrowers. In this direction, the following measures are proposed :

? Banks should provide information on deposit rates for various maturities and effective annualised return to the depositor. The Reserve Bank would put the consolidated information on its web site.

? Banks should provide information on maximum and minimum interest rates charged to their borrowers. The Information should be put on public domain.

? Banks urged to switch over to "all cost" concept for borrowers by explicitly declaring the processing charges, service charges, etc., charged to borrowers and announcing them publicly.

(c) *Interest Rate on Savings Account - No Change :* Although the nominal interest rate on savings account is 4.0 per cent per annum, the yield works out to 3.4 per cent per annum only as interest is payable on the minimum balance between tenth and last day of each month. The Governor said that although there is an apparent case for deregulation of interest rates on savings account also, as nearly four-fifths of such savings deposits are held by households, including households in rural and semi-urban areas, on balance, it is not considered as opportune time to deregulate the interest rate on savings account for the present.

(d) *Interest Rate on Export Credit :* In order to make the interest rate even more competitive, ceiling rate on foreign currency loans for Indian exporters by banks on export credit has been reduced to LIBOR plus 0.75 percentage point from the present LIBOR plus 1.0 percentage point.

(e) Deemed Exports : In view of the representation that some exporters still do not get the advantage of the concessional rate of interest in case of deemed exports, the Governor urged banks to widely publicise the concessionality in the interest rates for deemed

exports and make these available to all eligible exporters.

(f) Abolition of MLR for Co-operative Banks : In order to provide greater flexibility to co-operative banks in a competitive environment, the Reserve Bank has proposed :

? To withdraw the stipulation of Minimum Lending Rate (MLR) for all co-operative banks with immediate effect to provide freedom for determining their lending rates taking into account their cost of funds, transaction cost, etc., with the approval of their managing committees.

? To ensure transparency in the interest rates charged by co-operative banks, banks have been requested to publish the minimum and maximum interest rates charged by them, and display this information in every branch.

(g) Liberalisation of Investment Norms of Funds Mobilised under FCNR (B) Deposits : To ease restrictions on banks for deploying FCNR(B) deposits and in order to avoid asset-liability mismatches, banks have been permitted to invest their FCNR(B) deposits in longer term fixed income instruments with appropriate rating prescribed for the money market instruments.

(h) Interest Rate on FCNR (B) Deposits : The ceiling rate of FCNR(B) deposits has been reduced to LIBOR/SWAP rates for the corresponding maturities minus 25 basis points from LIBOR/SWAP rate.

(i) Relaxation on Borrowing from and Investment in Overseas Market by Banks **:** In order to enable banks to have greater operational flexibility, the following measures have been announced :

? Banks allowed to borrow up to 25 per cent of their unimpaired Tier I capital from overseas market within the banks' Open Position Limit and maturity mismatch limits (Gap Limits) for which detailed guidelines will be issued.

? The existing limit of 15 per cent of unimpaired Tier I capital for investment in overseas market raised to 25 per cent of unimpaired Tier I capital.

(j) Crystallisation of External Commercial Borrowings : To facilitate banks to crystallise the foreign exchange liability in rupees in select cases and to provide greater freedom and flexibility to banks in their funds management, it is proposed to grant permission with appropriate safeguards for crystallisation of ECBs into rupee loans where it is considered necessary by banks to do so.

Credit Delivery Mechanism

(a) Priority Sector Lending : In order to further improve credit delivery mechanism for the priority sector, and in particular to agriculture, the following measures have been proposed :

? Increase in the limits for financing of distribution of inputs for allied activities under priority sector to Rs.25 lakh from the present limit of Rs.15 lakh.

? Increase in credit limit for farmers for marketing crops (pledge financing) from Rs.1 lakh to Rs.5 lakh and repayment schedules of such credit extended to 12 months from 6 months at present.

? To avoid double counting, sponsor banks asked to exclude funds provided to RRBs for on-lending to priority sector, while meeting the target.

(b) Credit Facilities for Small-Scale Industries : Credit facilities for the small scale industrial (SSI) units have been further liberalised and banks have been allowed to increase the limit of dispensation of collateral requirement for loans from the existing Rs.5 lakh to Rs.15 lakh on the basis of good track record and the financial position of the units.

(c) Securitisation and Risk Weights for Housing Finance : To further improve the flow of credit to the housing sector, the prudential requirements for housing finance by banks and investment by banks in securitised debt instruments of Housing Finance Companies (HFCs) have been liberalised as follows :

? Risk weight of 50 per cent on residential housing properties against 100 per cent stipulated earlier.

? Risk weight of 50 per cent for the purpose of capital adequacy for investments in mortgage-backed securities (MBS) of residential assets by HFCs supervised by National Housing Bank (NHB). Investment by banks in MBS of housing assets which include commercial properties to attract 100 per cent risk weight.

? Investments by banks in MBS to be reckoned for inclusion in the prescribed allocation of 3.0 per cent (by HFCs supervised by NHB).

(d) Rural Infrastructure Development Fund : Pursuant to the announcement made in the Union Budget, funds for RIDF

VIII have been enhanced to Rs. 5,500 crore and interest rate on loans to States from RIDF have been linked to the Bank Rate.

(e) Micro-credit : Scheduled commercial banks and NABARD have been advised to take immediate steps in forming linkages with self help groups (SHGs) across the country so as to achieve the target of 1.25 lakh persons for 2002-03.

Money Market

(a) The Governor announced certain measures to move further towards pure inter-bank call money market. To reduce banks' reliance on call/notice money market, the Governor proposed to restrict scheduled commercial banks' daily lending in the call/notice money market to 25 per cent of their owned funds as at the end of March of the previous financial year; and their daily borrowings in the call/notice money market to 100 per cent of their owned funds or 2.0 per cent of aggregate deposits as at the end of March of the previous financial year, whichever was higher. The existing borrowers and lenders were, however, allowed to unwind their positions in excess of the prudential limits by the end of August 2002.

The Governor also announced constitution of a Working Group with representatives from eligible entities to recommend by June 30, 2002, the criteria for fixing the limits for primary dealers (PDs) in call/notice money market and to suggest a road map for phasing them out from the call money market.

(b) Collateralised Lending Facility : Due to the inherent superiority of the LAF in

moderating liquidity in the financial system, CLF would be phased out with effect from the fortnight beginning October 5, 2002. CLF could be reintroduced for a temporary period in future, if considered necessary in the light of changes in monetary conditions.

(c) Certificates of Deposit : With effect from June 30, 2002, banks and FIs are required to issue CDs only in the dematerialised form. Existing outstandings of CDs to be converted into the demat form by October 2002.

Government Securities

(a) *Uniform Price Auction :* The Reserve Bank would continue to take recourse to uniform price auctions on an experimental and selective basis during this calendar year also as considered necessary.

(b) *Negotiated Dealing System :* All entities having SGL

Accounts with the Reserve Bank have been advised to become members of NDS by May 31, 2002.

(c) *Government Securities Act :* Replacement of the existing Public Debt Act, 1944 by Government Securities Act to be introduced in the present Parliament Session as proposed by Finance Minister in his Budget speech for 2002-03.

(d) *Retailing of Government Securities through Non-competitive Bidding :* Banks have been advised to promote schemes for sale/purchase of government securities over their counters to retail investors through demat accounts with depositories or with CSGL account holders. PDs and banks may also provide both sale and purchase facility to ensure that the retail investors are assured of liquidity of such investments. Retail sale of government securities may be promoted for availing of automatic finance at attractive rates.

(e) *Floating Rate Bonds :* Considering both the advantages and risks, issue of further floating rate bonds (FRBs) in the current year would be examined.

(f) *Calendar for Dated Securities :* Out of the total expected market borrowing by the Government for first six months, a calendar for an amount of Rs.68,000 crore has already been announced. Remaining market borrowing programme for the first half of the year, as in the past, will be announced from time to time depending upon the emerging requirement of the Government and market conditions.

(g) *Satellite Dealer System :* The Governor reviewed the recent developments in government securities market and stated that based on the views of the Primary Dealers Association of India and the Technical Advisory Committee on Money and Government Securities it is decided that no new SDs will be licensed. Existing SDs will be required to make action plans, satisfactory to the Reserve Bank, for termination of their operations as SDs by May 31, 2002. He also proposed to continue the Reserve Bank's policy of issuing long-term bonds to meet the requirements of such investors.

(h) *Issue of Long-Term Bonds for Insurance Companies and Others :* The Governor also proposed to continue the Reserve Bank's policy of issuing long-term bonds to meet the requirements of such investors.

(i) *Automatic Debit Mechanism :* In view of the recommendation of the Technical

Committee of State Finance Secretaries on State Government Guarantees, and keeping in view the need to maintain integrity of the public debt segment of debt markets it is proposed :

? To dispense with automatic debits where there are no legal or other compulsions in the future and as general policy.

? To suggest amendments to such provisions in case of legal compulsions.

? To review all the existing automatic debits in consultation with State Governments and others concerned, with a view to dispensing with such mechanisms wherever feasible.

Prudential Measures

(a) *New Basel Capital Accord :* An internal group to invite representatives from select banks to provide inputs into the development of the modified approach as well as the upcoming Quantitative Impact Study (QIS). Banks are expected to constitute an expert internal team to study the methodology of the new proposals and its likely impact.

(b) *Counterparty and Country Risks :* The Reserve Bank would shortly issue draft guidelines on country risk management and provisioning therefor in consultation with banks, Indian Banks' Association (IBA) and other market participants.

Banks have been advised to study the Basel framework on capital for market risk as envisaged in Amendment to the Capital Accord to incorporate market risks published in January 1996 by BCBS and prepare themselves to follow the international practices in this regard at a suitable date to be announced by the Reserve Bank.

(c) *Prevention of Money Laundering :* The Reserve Bank is in the process of issuing a Master Circular setting out the policy, procedures and controls required to be introduced by banks**.**

(d) *Reduction in Transition Period of a Sub-standard Asset to Doubtful Category :* Consistent with the recommendations of Narsimham Committee II and with a view to moving closer to international best practices, it is proposed that :

? With effect from March 31, 2005, an asset would be classified as doubtful if it remained in the sub-standard category for 12 months. Banks are permitted to phase the consequent additional provisioning over a four-year period, with a minimum of 20 per cent each year.

(e) Corporate Debt Restructuring : The Reserve Bank constituted a High Level Group (Chairman: Shri Vepa Kamesam, Deputy Governor) to review the operations of the CDR scheme to identify the operational difficulties, if any, in smooth implementation of the scheme and to suggest measures to make the scheme even more effective. As an interim measure, and pending recommendations of the High Level Group constituted by the Reserve Bank, it has been decided that permission for debt restructuring will be made available by the Reserve Bank on the basis of specific recommendations of CDR "Core-Group", if a minimum of 75 per cent (by value) of the lenders constituting banks and financial institutions (FIs) consent for CDR, irrespective of differences in classification of the assets by banks/FIs.

(f) Investment Fluctuation Reserve : On the basis of feedback, it is decided that IFR should be computed with reference to investments in two categories, viz., “Held for Trading” and “Available for Sale”. It will not be necessary to include the investment under “Held to Maturity” category, which is not meant to be traded, for purposes of computation of IFR.

Non-Banking Financial Companies

(a) Formation of SRO for NBFC sector : Representatives of NBFC

Associations have agreed to constitute SRO at the earliest.

(b) Submission of Returns by NBFCs : The Reserve Bank would impose penalties as provided for in the Reserve Bank of India Act, 1934 as also launch court proceedings, besides considering rejection/cancellation of the CoR of NBFCs having public deposits of Rs.50 crore and above, in case of default in the submission of returns. Stipulation in respect of the size of NBFCs will be progressively reduced over time.

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