

FOREWORD

Comprehensive economic reforms have been in process in India for a little over a decade and a half. The main objective of reforms has been to realise the full growth potential of the economy. The efficient functioning of the banking sector is crucial for attaining overall efficiency in the economy through better intermediation of financial resources. Accordingly, wide ranging reforms have been introduced in the banking sector on a continuing basis with a view to creating an efficient, strong, competitive and dynamic banking sector. The focus of the reforms has been deregulating interest rates, removing external constraints, adopting international best practices in regulation and supervision, introducing competition through new private sector banks and foreign banks and providing operational flexibility and functional autonomy to public sector banks. By all accounts, the performance of the banking sector has improved significantly but it is now faced with several newer challenges. The Indian economy is on a high growth path and the banking sector has a crucial role to play in sustaining the growth process. Basel II, which would become fully operational from end-March 2009, poses several challenges not only in terms of implementation but also in terms of raising capital. India is progressively moving towards fuller capital account convertibility which raises several regulatory and supervisory challenges. The operating environment for banks has changed as a result of which banks are increasingly diversifying. Several financial conglomerates have also emerged, necessitating appropriate regulatory arrangements. Technology has led to innovations of complex financial products posing challenges for the regulators. It is, therefore, apposite to have an in-depth analysis of various aspects of banking operations in India with a view to assessing their strengths and weaknesses, various challenges faced by the banking sector and what needs to be done to deal with them.

With a view to critically analysing the issues of contemporary relevance in the area of central banking, the Department of Economic Analysis and Policy of the Reserve Bank introduced theme based **Report on Currency and Finance** from 1998-99. So far, eight Reports have been released encompassing several important issues concerning central banking. Special mention may be made of the Reports brought out in the last three years which analysed in detail **The Evolution of Monetary Policy** in the 2003-04 Report, **The Evolution of Central Banking in India** in the 2004-05 Report and **Development of Financial Markets and Role of the Central Bank** in 2005-06. Along with these three Reports, this Report covers most of the functions of the Reserve Bank. The theme of this year's Report is "**The Banking Sector in India : Emerging Issues and Challenges**". The thrust of the Report is on delineating the various existing and emerging challenges faced by the banking sector and to suggest measures to address them. The Report, wherever possible, has benchmarked the performance/practices of the Indian banking sector against the international best practices. The focus of the Report is on scheduled commercial banks, although other segments of the banking sector such as urban co-operative banks, regional rural banks have also been dealt with, wherever appropriate and where relevant data are available. Keeping in view the magnitude and coverage of this Report, this edition of the Report on Currency and Finance is for the period 2006-08 and is being issued as two volumes, *i.e.*, Volume I (Chapter I to V) and Volume II (Chapter VI to XI).

The Report has been prepared in the Department of Economic Analysis and Policy with the active involvement of operational departments. Dr. Janak Raj, Adviser, supervised and coordinated the entire work of the Report, under the overall supervision of Dr. G.S. Bhati, the then Principal Adviser.

The core team involved in the drafting of the Report comprised Asha P Kannan, Nishita Raje, Rajan Goyal, Muneesh Kapur, Dhritidyuti Bose, Kumudini Hajra, J K Khundrakpam, Rekha Misra, Anupam Prakash, P K Panda, Anupam Sonal, A Karunakaran, Abhiman Das, Bhupal Singh, Sunil Kumar, J B Singh, PSS Vidyasagar, Rajeev Jain, Rajmal, Jai Chander, Pankaj Setiya, G. Jeyakumar, Prabhat Gupta, R. Shukla, J Bernard, R. Sudeep, Ashish Kumar Verma, Kumarjit Mandal, Dipankar Mitra, Snehal Herwadkar, Binod B Bhoi, S. Chinngaihlian, Arun Vishnu Kumar, Samir R. Behra, A. N. Yadav, Avdhesh Shukla, Asish Thomas George, Rakhe P. B., Thangzason Sonna, Rakesh Kumar, Indrani Manna, Subhajit Roy and Abhilasha.

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Contributions by operational departments, viz., Department of Banking Operations and Development, Department of Banking Supervision, Department of Statistics and Information Management, Monetary Policy Department, Rural Planning and Credit Department, Urban Banks Department, Department of Information Technology and Deposit Insurance and Credit Guarantee Corporation are highly appreciated.

I place on record my deep appreciation of the professional skills and utmost dedication of the officials of the Department of Economic Analysis and Policy, without which it would not have been possible to bring out this Report.

Rakesh Mohan
Deputy Governor

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