Chapter II

Developments in Commercial Banking

Introduction

The commercial banking sector plays an important role in the mobilisation of deposits and disbursement of credit to various sectors of the economy. A significant proportion of funds is contributed by deposits which account for more than 80 per cent of the liabilities of scheduled commercial banks (SCBs). The assets portfolio of these banks consists mainly of 'loans and advances' and 'investments in approved securities' and other investments. Loans and advances form around 50 per cent of aggregate deposits. More than 75 per cent of the investments of SCBs is channelised into safe and risk-free assets consisting of both Government and other approved securities.

2.2 During the year 1998-99, the financial performance of SCBs came under pressure and the operating profits of these banks declined by Rs.647.8 crore or 4.4 per cent from Rs.14,640.2 crore in 1997-98 to Rs.13,992.3 crore in 1998-99. Among the SCBs, the only bank group which showed an improvement in the operating profits was the nationalised banks. The operating profits of nationalised banks increased by Rs.388.1 crore or 7.0 per cent from Rs.5,541.4 crore in 1997-98 to Rs.5,929.4 crore in 1998-99. In terms of net profit, the foreign banks alone showed a moderate improvement of Rs.63.4 crore or 10.1 per cent from Rs.630.0 crore in 1997-98 to Rs.693.4 crore in 1998-99, while all other bank groups showed declines.

2.3 As a ratio to total assets, both operating and net profits of all SCBs groups showed decline during the year 1998-99. The other distinguishing feature of the financial performance of SCBs during the year was the decrease in spread and balance sheet exposure and an increase in risk weighted assets ratio (CRAR). The highest decline in operating profits to total assets ratio was witnessed by the foreign banks (1.38 percentage points from 3.91 per cent in 1997-98 to 2.53 per cent in 1998-99), followed by the new private banks (1.08 percentage points from 2.86 per cent in 1997-98 to 1.78 per cent in 1998-99), old private banks (0.76 percentage points from 1.97 per cent in 1997-98 to 1.21 per cent in 1998-99), State Bank of India and associates (0.40 percentage points from 2.03 per cent in 1997-98 to 1.63 per cent in 1998-99) and the nationalised banks (0.11 percentage points from 1.33 per cent in 1997-98 to 1.22 per cent in 1998-99).

2.4 In the foreign bank group, the 'provisions and contingencies' showed a substantial decline of 1.31 percentage points from 2.94 per cent in 1997-98 to 1.63 per cent in 1998-99 and, as a result, the net profit ratio of this group has shown only a negligible decline of 0.07 percentage points from 0.97 per cent in 1997-98 to 0.90 per cent in 1998-99. The highest decline in the net profit ratio was found in the case of State Bank of India group (0.55 percentage points from 1.06 per cent in 1997-98 to 0.51 per cent in 1998-99), followed by the new private bank group (0.52 percentage points from 1.55 per cent in 1997-98 to 1.03 per cent in 1998-99), old private bank group (0.33 percentage points from 0.81 per cent in 1997-98 to 0.48 per cent in 1998-99), and the nationalised bank group (0.25 percentage points from 0.62 per cent in 1997-98 to 0.37 per cent in 1998-99).

2.5 The decline in the 'spread' was the highest in the case of foreign bank group (0.46 percentage point from 3.93 per cent in 1997-98 to 3.47 per cent in 1998-99), followed by the old private sector bank group (0.41 percentage point from 2.57 per cent in 1997-98 to 2.16 per cent in 1998-99), State Bank of India group (0.29 percentage point from 3.14 per cent in 1997-98 to 2.85 per cent in 1998-99), and new private sector bank group (0.25 percentage points from 2.23 per cent in 1997-98 to 1.98 per cent in 1998-99). In the case of nationalised bank group, the 'spread' was at 2.79 per cent during 1998-99 as against 2.78 per cent during 1997-98.

2.6 With a view to assessing the real worth of banks and to aiding the investors in their investment decisions, it is necessary to analyse the behaviour of share prices. During 1998-99, the shares of banks listed on stock exchanges showed substantial reduction in their quoted prices. This has impacted on market capitalisation and turnover of bank scrips (Box II.1).

2.7 The policy environment continued to be characterised by the adoption of various measures aimed at strengthening the banking system in India. The major policy measures adopted during the year 1998-99 included the (i) disclosure of additional information in balance sheet of banks and such information mainly relate to the maturity pattern of loans and advances, movements in non-performing assets and maturity pattern of deposits, (ii) reduction in the time frame for classifying an asset as doubtful from 24 months to 18 months, (iii) announcement of policy guidelines for asset-liability management effective April 1, 1999, (iv) enhancement in the flexibility of norms relating to bridge loans effective January 29, 1999, (v) increase in the proportion of approved securities from 70 per cent to 75 per cent under 'current investments', and (vi) issuance of guidelines for setting-up of Settlement Advisory Committees (SACs) for evolving compromise settlement of non-performing assets of small scale sector.

2.8 The present chapter analyses the performance of commercial banks (sections 2 to 11) and discusses policy measures (sections 12 to 15) adopted during the year 1998-99.

2. Liabilities and Assets Structure of Scheduled Commercial Banks

2.9 An analysis of the assets and liabilities of scheduled commercial banks is carried out using two distinct sources of data: one based on the Section 42 (2) returns data, and the other based on balance sheet data of banks. The Section 42 (2) returns data are first used to present the trends in the major components of the assets and liabilities of the SCBs, followed by an analysis based on the balance sheet data. The latter provides information regarding total liabilities/ assets of banks and this information can be used to compute the composition pattern of such assets/ liabilities, and to assess financial performance of banks.

Deposits

2.10 The aggregate deposits of the SCBs showed an increase of Rs.1,15,540 crore or 19.3 per cent during 1998-99 (April-March) as compared with the increase of Rs.98,722 crore or 19.8 per cent in the previous year (Table II.1). A notable feature of the growth of deposits is the continued significant growth of over 20.0 per cent in time deposits during the year. The time deposits increased by Rs.1,00,630 crore from Rs.4,95,972 crore as on March 27, 1998 to Rs.5,96,602 crore as on March 26, 1999 (Table II.1).

2.11 During the first half of the current financial year (i.e. upto September 24, 1999), the aggregate deposits increased by Rs.47,653 crore or 6.7 per cent from Rs.7,14,025 crore as on March 26, 1999 to Rs.7,61,678 crore as on September 24, 1999. The time deposits component of aggregate deposits too sustained its upward trend during the first half of the year.

Bank Credit

2.12 Banks deploy their funds (deposits) to optimize returns and profits. A large part of the bank credit is allocated to the non-food sector and during the year 1998-99, the non-food credit constituted as much as 90.3 per cent of total bank credit. However, mainly owing to the operation of the cycles in industrial activity and decline in exports, the non-food credit showed a smaller increase of Rs.40,427 crore (13.0 per cent) during

Box II.1: Stock Prices of Indian Banks

One of the factors contributing to the efficient allocation of resources by financial markets is the ability of the market to disseminate timely information on a continuous basis on the instruments traded in the markets. Among other things, such information regarding a corporate entity is disclosed to the public in a variety of ways such as the audited financial statements, the ratings, and the advertisements, However, commercial banks have experienced severe informational asymmetries (see Berger, King and O'Brien 1991; O'Hara 1993). In order to assess the real worth of banks, besides the above noted information base, a fair assessment based on the on-site/ off-site examinations of regulatory authorities is crucial for investors to take appropriate decisions to invest in the stocks of banks.

In India, as a part of financial sector reforms, private sector is encouraged to open banking companies and Government owned public sector banks are being allowed to diversify their activities and float issues in capital market to strengthen their capital-base. In the process, till end-March 1999, eight (8) public sector banks[1] raised capital through equity issues from the new issues market and nine (9)[2] new private sector banks have come into existence in the banking system. The growing capital market activity of commercial banks can be seen in the form of increase in the number of banks listed on recognised stock exchanges from 6 scheduled commercial banks (SCBs) in 1994-95 to 28 SCBs in 1998-99. As at end March 1999, on the National Stock Exchange of India, the shares of 8 public sector banks (PSBs) and 17 private sector banks were listed for secondary market trading (Table 1). However, capital market regulations do not encourage listing of stocks of foreign banks/corporate bodies on Indian stock exchanges.

During the financial year 1998-99 (April-March), the listed banking scrips on Indian stocks exchanges remained depressed with substantial declines in the banking shares of both public sector banks (PSBs) and private sector banks. The analysis of PSBs banking share prices indicated that the share price of Bank of Baroda steeply declined by 54.5 per cent, followed by State Bank of Travancore 54.4 per cent, Bank of India 52.4 per cent, State Bank of India 23.6 per cent, etc. In the case of private sector banks, during the year 1998-99, the share price of Bank of Rajasthan Ltd. declined by 63.8 per cent, and that of the Federal bank by 52.9 per cent, etc. The share price of HDFC Bank Ltd., a private sector bank, showed a decline of mere 1.1 per cent during the year. The decline in share prices of banking scrips was mainly attributed to the declining performance of banks and the

Table 1: Listed Banks on NSE

Name of the Bank	Date of Commencement of Trading on NSE
Public Sector Banks	
State Bank of India	October 24, 1994
Oriental Bank of Commerce	February 8, 1995
Dena Bank	January 22, 1997
Bank of Baroda	February 26, 1997
Bank of India	May 7, 1997
Corporation Bank	December 5, 1997
State Bank of Bikaner & Jaipur	February 4, 1998
State Bank of Travancore	March 3, 1998
Old Private Sector Banks	
Federal Bank Ltd.	November 26, 1994
The Bank of Rajasthan Ltd.	December 28, 1994
The United Western Bank Ltd.	February 8, 1995
The Karur Vysya Bank Ltd.	May 10, 1995
The Lakshmi Vilas Bank Ltd.	May 10, 1995
Vysya Bank Ltd.	May 10, 1995
Bank of Madura Ltd.	September 18, 1996
Nedungadi Bank Ltd.	September 11, 1996
J & K Bank Ltd.	August 3, 1998
City Union Bank Ltd.	September 9, 1998
The South Indian Bank Ltd.	December 14, 1998
New Private Sector Banks	
Bank of Punjab Ltd.	June 14, 1995
HDFC Bank Ltd.	June 14, 1995
Global Trust Bank Ltd.	November 26, 1994
ICICI Banking Corporation Ltd.	September 24, 1997
IndusInd Bank Ltd.	January 29, 1998
UTI Bank Ltd.	December 3, 1998

Source : NSE, Mumbai.

(Contd. ....)

1. The eight public sector banks are: (1) State Bank of India, (2) State Bank of Bikaner & Jaipur, (3) Oriental Bank of Commerce, (4) Dena Bank, (5) Bank of Baroda, (6) Bank of India, (7) Corporation Bank, and (8) State Bank of Travancore.
2. The nine new private sector banks are: 1) IndusInd Bank Ltd., 2) Global Trust Bank Ltd., 3) UTI Bank Ltd., 4) ICICI Banking Corporation Ltd., 5) HDFC Bank Ltd., 6) Times Bank Ltd., 7) Bank of Punjab Ltd., 8) Centurion Bank Ltd., and 9) IDBI Bank Ltd.

(..........Contd.)

concern of the market over the non-performing assets of banks during 1998-99. During the same period of 1998-99, however, the general stock market trend, measured in terms of S&P CNX Nifty Index for selected traded scrips, declined by 38.9 points (3.5 per cent) on NSE. At the end of March 1999, the closing price of banking scrips as against their issue prices also indicated substantial declines. In respect of PSBs, the share price of Bank of India declined by 55.4 per cent as against the issue price and the State Bank of Bikaner & Jaipur share price showed a decline of 57.7 per cent. In the share price of private sector banks too, a substantial decline was witnessed as compared with the issue prices of shares. While IndusInd Bank Ltd. share price showed a decline of 57.8 per cent as compared with issue price, the share price of City Union Bank Ltd. showed a decline of 54.9 per cent at the end-March 1999 (Table 2).

In addition to the decline in share prices, considerable fluctuation (measured by coefficient of variation (CV) was also witnessed during 1998-99. The CV for the State Bank of India scrip increased from 13.4 per cent in 1997-98 to 19.6 per cent in 1998-99 (Table 3). In the private sector banking group, the CV of HDFC Bank Ltd. increased marginally from 9.4 per cent in 1997-98 to 11.9 per cent in 1998-99. It has been observed from the Table that the CV of all selected banking scrips remained generally high during the year 1998-99.

The substantial reduction in share prices can also be mirrored in other two indicators *viz*. turnover and market

Table 2: Price Changes in Banks' Scrips Traded on NSE during 1998-99

Name of the Bank	Issue Price[3] (Rs.)	Close Price as on March 31, 1999 (Rs.)	% change in Price
Public Sector Banks			
1. Corporation Bank	80	78.10	-2.38
2. Bank of India	45	20.05	-55.44
3. State Bank of Bikaner & Jaipur	540	228.25	-57.73
4. State Bank of Travancore	600	226.00	-62.33
Private Sector Banks			
1. ICICI Bank Ltd.	35	27.40	-21.71
2. J & K Bank Ltd.	38	28.00	-26.32
3. UTI Bank Ltd.	21	14.05	-33.10
4. The South Indian Bank Ltd.	32	16.60	-48.13
5. City Union Bank Ltd.	35	15.80	-54.86
6. IndusInd Bank Ltd.	45	19.00	-57.78

Table 3: Coefficient of Variation of Select Scrip Prices

Year	SBI	BoB	BoI	Corporation Bank	ICICI Bank Ltd.	HDFC Bank Ltd.	IndusInd Bank Ltd.
1996-97	2.17	6.63	—	—	—	4.53	—
1997-98	13.43	15.23	24.21	11.83	8.79	9.35	5.47
1998-99	19.61	33.85	30.55	19.70	24.92	11.89	22.22

Table 4: Select Market Indicators of Banks' Shares

	1997-98		1998-99	
Particulars	Turnover	Market Capitalisation	Turnover	Market Capitalisation
All Banks (Rs. crore)	51,165	28,322	26,647	19,561
Top 5 banks (Rs. crore)	49,929	23,269	25,687	16,200
NSE Total of all traded scrips (Rs. crore)	3,70,193	4,81,503	4,14,474	4,91,175
% of All Banks scrips to NSE	13.82	5.88	6.43	3.98
% of Top 5 Banks scrips to Total	97.58	82.16	96.4	82.82

Source : NSE.

3. The price of a share at the time of floating it in the primary market.

(Contd. ....)

(..........Concld.)

capitalisation. While the turnover of banking scrips on NSE has declined in absolute terms from Rs.51,165 crore in 1997-98 to Rs.26,647 crore in 1998-99, market capitalisation of bank stocks also showed steep decline from Rs.28,322 crore in 1997-98 to Rs.19,561 crore in 1998-99 (Table 4).

Further analysis of these two indicators showed that out of 25 banks traded on NSE, the share of top five bank in turnover and capitalisation constituted 96.4 per cent and 82.82 per cent, respectively, during 1998-99. This clearly indicates the skewed pattern of trading of bank stocks on stock exchanges. With the exception of heavy volume in the scrip of State Bank of India, and four other banks, trading activity on the remaining banking scrips was not found to be significant.

The Indian stock exchanges are witnessing reforms in the spheres of trading, clearing and settlement of transactions, etc. Major stock exchanges are giving thrust to international practices in their trading and associated operations. Nevertheless, many banking scrips remain illiquid/ not frequently trading on exchanges. The secondary market has to provide more varying investors' perception, liquidity, and depth for the traded scrips. Further, banking stocks need to be given thrust in view of the banks' need to raise capital from the primary market to meet the regulatory standards in coming years.

References

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the year 1998-99, as compared with the increase of Rs.40,789 crore (15.1 per cent) during the preceding year. As regards food credit, it constitutes only a small share (9.7 per cent in 1998-99) in the total bank credit. The food credit showed an increase of Rs.4,331 crore during 1998-99 on top of the increase of Rs.4,888 crore during the preceding year.

2.13 During the current financial year so far (i.e. upto September 24, 1999), the bank credit increased by Rs.9,557 crore or 2.6 per cent as compared with an increase of Rs.6,611 crore or 2.0 per cent during the corresponding period last year (Table II.1).

2.14 Apart from lending credit to the non-food segment of the commercial sector, the SCBs also invest their funds in various financial papers including commercial papers (CPs), PSU bonds, and the bonds floated by the private corporate sector. The SCBs investment in these papers at Rs.47,949 crore as on March 26, 1999 showed a substantial increase of Rs.14,865 crore or 44.9 per cent over the level of Rs.33,084 crore as on March 27, 1998. The increase in such investment combined with the flow of funds to non-food sector (including bills rediscounted) aggregated to Rs.53,021 crore during 1998-99 as compared to Rs.53,662 crore during 1997-98. The trends in the investment and total funds patterns of SCBs are depicted in Chart II.1 and Chart II.2.

Sectoral Deployment of Bank Credit

2.15 An analysis of the deployment pattern of incremental bank credit during 1998-99 (April-

Chart II.1: Flow of Bank Funds to Commercial Sector: 1997-98 and 1998-99 (September-March)

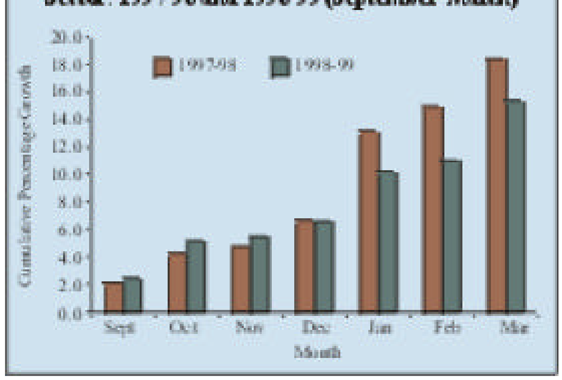


Table II.1: Important Banking Indicators: Scheduled Commercial Banks: 1997-98 and 1998-99

(Amount in Rs. crore)

Item	Outstanding as on					Variations during the financial year		Variations during April - September	
	March 28, 1997	March 27, 1998	March 26, 1999	Sept. 25, 1998	Sept. 24, 1999*	1997-98 over March 28	1998-99 over March 27	1998-99 over March 27	1999-2000* over March 26
1	2	3	4	5	6	7 (3-2)	8 (4-3)	9 (5-3)	10 (6-4)
1. Total Demand and Time Liabilities @	561,982	678,731	820,443	749,923	873,501	116,749	141,712	71,192	53,058
2. Aggregate Deposits (a+b)	499,763	598,485	714,025	661,658	761,678	98,722 (19.8)	115,540 (19.3)	63,173 (10.6)	47,653 (6.7)
(a) Demand Deposits	90,610	102,513	117,423	101,953	111,076	11,903 (13.1)	14,910 (14.5)	-560 -(0.5)	-6,347 -(5.4)
(b) Time Deposits	409,153	495,972	596,602	559,705	650,602	86,819 (21.2)	100,630 (20.3)	63,733 (12.9)	54,000 (9.1)
2a. Ceritificate of Deposits	12,134	14,296	3,717	5,686	3,305	2,162 (17.8)	-10,579 -(74.0)	-8,610 -(60.2)	-412 -(11.1)
2b. Aggregate Deposits (excl. Ceritificate of Deposits)	487,629	584,189	710,308	655,972	758,373	96,560 (19.8)	126,119 (21.6)	71,783 (12.3)	48,065 (6.8)
3. Borrowings from RBI	560	395	2,894	3,306	4,204	-165 -(29.5)	2,499 (632.7)	2,911 (737.0)	1,310 (45.3)
4. Liability to Banks	21,193	32,287	45,204	38,081	47,530	11,094 (52.3)	12,917 (40.0)	5,794 (17.9)	2,326 (5.1)
5. Bank Credit (a+b)	278,402	324,079	368,837	330,690	378,394	45,677 (16.4)	44,758 (13.8)	6,611 (2.0)	9,557 (2.6)
a. Food Credit	7,597	12,485	16,816	16,079	20,532	4,888 (64.3)	4,331 (34.7)	3,594 (28.8)	3,716 (22.1)
b. Non-food credit	270,805	311,594	352,021	314,611	357,862	40,789 (15.1)	40,427 (13.0)	3,017 (1.0)	5,841 (1.7)
c. Non-food credit excluding petroleum credit	268,551	308,902	347,373	312,436	356,463	40,351 (15.0)	38,471 (12.5)	3,534 (1.1)	9,090 (2.6)
6. Investments (a+b)	190,514	218,705	254,594	251,867	289,596	28,191 (14.8)	35,889 (16.4)	33,162 (15.2)	35,002 (13.7)
a. Govt. Securities	158,890	186,957	223,217	220,725	258,367	28,067 (17.7)	36,260 (19.4)	33,768 (18.1)	35,150 (15.7)
b. Other Approved Sec.	31,624	31,748	31,377	31,142	31,229	124 (0.4)	-371 -(1.2)	-606 -(1.9)	-148 -(0.5)
7. Cash Balances (a+b)	53,195	61,306	67,910	66,607	69,600	8,111 (15.2)	6,604 (10.8)	5,301 (8.6)	1,690 (2.5)
a. Cash in hand	3,347	3,608	4,362	3,812	4,235	261 (7.8)	754 (20.9)	204 (5.7)	-127 -(2.9)
b. Balances with RBI	49,848	57,698	63,548	62,795	65,365	7,850 (15.7)	5,850 (10.1)	5,097 (8.8)	1,817 (2.9)
Memorandum Items :									
A Credit-Deposit Ratio	55.7	54.1	51.7	50.0	49.7				
B Non-food credit (excl. Petr.credit) / Deposit Ratio	53.7	51.6	48.6	47.2	46.8				
C Incremental CD Ratio	34.0	46.3	38.7	10.5	20.1				
D Cash Balance-Deposit Ratio	10.6	10.2	9.5	10.1	9.1				
E Investment/Deposit Ratio	38.1	36.5	35.7	38.1	38.0				
F Investment+Credit/Deposit Ratio	93.8	90.7	87.3	88.0	87.7				

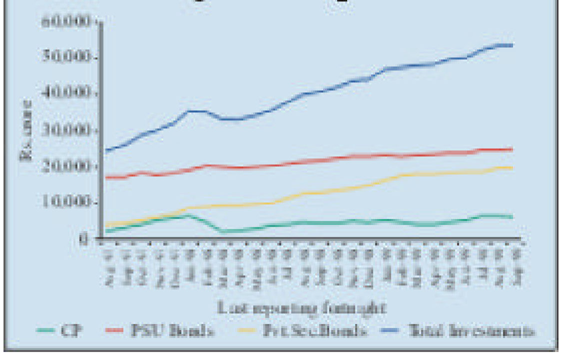
Notes : 1. * Provisional.

@ Excluding borrowings from RBI/IDBI/NABARD.

2. Figures in brackets are percentage variations.

3. Constituent items may not add up to the totals due to rounding off.

Chart II.2: Scheduled Commercial Banks' Investments in CP, PSU Bonds and Private Sector Bonds : August 1997 to September 1999



March) indicates that the priority sector receives a predominant share of total bank credit (40.4 per cent) followed by medium and large industries (34.7 per cent). The remaining 24.9 per cent of bank credit was distributed among other sectors including (i) wholesale trade (other than food procurement) (2.0 per cent), (ii) housing (6.3 per cent), (iii) consumer durables (1.5 per cent) and (iv) other non-priority sector personal loans (5.8 per cent), etc. (Table II.2). The relaxation given by the Reserve Bank for investments in housing and the demand for white goods enabled the banks to extend credit facilities to 'other sectors' under non-food credit.

Export Credit

2.16 Commercial banks extend credit facility to exporters to promote export activities. The Reserve Bank, through various policy measures, has also relaxed norms for commercial banks so as to encourage the flow of credit to the export sector. Banks, however, are required to lend 12 per cent of advances as export credit. During the year under review (1998-99), one of the important measures taken by the Reserve Bank was the downward revision in the refinance rates for export credit (Table II.2). Export credit as a percentage of net bank credit (NBC), however, declined to 10.6 per cent in 1998-99 from 11.4 per cent in the previous year, reflecting decline in exports. It further declined to 10.3 per cent as on June 18, 1999. The outstanding export credit of SCBs at Rs.35,891 crore as on March 26, 1999 showed an increase of Rs.1,944 crore or 5.7 per cent over the outstanding credit of Rs.33,947 crore as on March 27, 1998. As on June 18, 1999, the outstanding export credit amounted to Rs.34,504 crore indicating an increase of Rs.2,833 crore or 8.9 per cent over the same period in the corresponding year.

2.17 During 1998-99 (April-March), export credit refinance limits of SCBs showed a more than three-fold increase from Rs.2,403 crore in March 1998 to Rs.7,269 crore in March 1999. The significant increase in the export credit refinance limit is mainly attributable to the restoration of export credit refinance limit of banks, effective the fortnight beginning May 9, 1998, from 50 per cent to 100 per cent of the increase in export credit eligible for refinance over the level of such credit as on February 16, 1996. During the current financial year, this limit was further increased and this stood at Rs.7,378 crore as on October 8, 1999 (Appendix Table II.1).

2.18 An analysis of the utilisation of export credit refinance facility availed of by the SCBs shows that the average utilisation of export credit refinance ranged between 0.5 per cent to 8.6 per cent during April 1998 to August 14, 1998. During the subsequent fortnights of the year 1998-99, the average utilization of export credit refinance has shown a perceptible increase, varying in the range of 70.8 per cent and 97.2 per cent. This can be attributed to the reduction in interest rate on export credit refinance from 9.0 per cent to 7.0 per cent, effective August 6, 1998. With effect from April 1, 1999, export credit refinance is being provided to scheduled commercial banks at the Bank Rate. During April 1999 to October 1999, the average utilisation of export credit refinance was in the range of 46.9 per cent and 95.7 per cent.

Industry-wise Deployment of credit

2.19 An analysis of the industry-wise deployment of gross bank credit indicates that

Table II.2: Sectoral Deployment of Gross Bank Credit by Major Sectors

(Rs. crore)

Sectors	Outstanding as on					Variations during			
	March 28, 1997	March 27, 1998	March 26, 1999	June 19, 1998	June 18, 1999*	Financial year 1997-98	Financial year 1998-99	April-June 1998-99	April-June 1999-2000*
1	2	3	4	5	6	7 (3-2)	8 (4-3)	9 (5-3)	10 (6-4)
I. Gross Bank Credit (1+2)	**258,991**	**300,283**	**342,012**	**295,373**	**338,654**	**41,292**	**41,729**	**-4,910**	**-3,358**
1. Public Food Procurement Credit	7,597	12,485	16,816	16,828	22,221	4,888	4,331	4,343	5,405
2. Non-Food Gross Bank Credit (A+B+C+D)	251,394	287,798	325,196	278,545	316,433	36,404	37,398	-9,253	-8,763
						[100.0]	[100.0]	[100.0]	[100.0]
A. Priority Sectors	**84,880**	**99,507**	**114,611**	**98,064**	**113,433**	**14,627**	**15,104**	**-1,443**	**-1,178**
						(40.2)	**(40.4)**	**(15.6)**	**(13.4)**
(i) Agriculture	31,442	34,869	39,634	34,448	38,393	3,427	4,765	-421	-1,241
						(9.4)	(12.7)	(4.5)	(14.2)
(ii) Small Scale Industries	35,944	43,508	48,483	42,374	47,166	7,564	4,975	-1,134	-1,317
						(20.8)	(13.3)	(12.3)	(15.0)
(iii) Other Priority Sectors	17,494	21,130	26,494	21,242	27,874	3,636	5,364	112	1,380
						(10.0)	(14.3)	-(1.2)	-(15.7)
B. Industry (Medium & Large)	**102,604**	**117,530**	**130,516**	**112,172**	**123,983**	**14,926**	**12,986**	**-5,358**	**-6,533**
						(41.0)	**(34.7)**	**(57.9)**	**(74.6)**
C. Wholesale Trade (other than food procurement)	**12,340**	**13,217**	**13,965**	**12,937**	**13,966**	**877**	**748**	**-280**	**1**
						(2.4)	**(2.0)**	**(3.0)**	**(0.0)**
D. Other Sectors	**51,570**	**57,544**	**66,104**	**55,372**	**65,051**	**5,974**	**8,560**	**-2,172**	**-1,053**
of which :						**(16.4)**	**(22.9)**	**(23.5)**	**(12.0)**
(i) Housing	7,773	9,057	11,404	9,020	11,764	1,284	2,347	-37	360
						(3.5)	(6.3)	(0.4)	-(4.1)
(ii) Consumer durables	2,297	2,527	3,090	2,679	3,269	230	563	152	179
						(0.6)	(1.5)	-(1.6)	-(2.0)
(iii) Non-banking financial companies	5,154	6,227	6,082	5,375	5,565	1,073	-145	-852	-517
						(2.9)	-(0.4)	(9.2)	(5.9)
(iv) Loans to individuals	2,066	1,904	1,625	2,603	1,596	-162	-279	699	-29
						-(0.4)	-(0.7)	-(7.6)	(0.3)
(v) Real Estate Loans	1,546	1,899	1,625	2,104	1,668	353	-274	205	43
						(1.0)	-(0.7)	-(2.2)	-(0.5)
(vi) Other non-priority sector personal loans	12,392	10,133	12,289	9,240	12,534	-2,259	2,156	-893	245
						-(6.2)	(5.8)	(9.7)	-(2.8)
(vii) Advances against Fixed Deposits	1,505	11,815	15,106	12,139	16,405	10,310	3,291	324	1,299
						(28.3)	(8.8)	-(3.5)	-(14.8)
(viii) Tourism and tourism related hotels	—	822	612	423	694	—	-210	-399	82
							-(0.6)	(4.3)	-(0.9)
II. Export Credit (included under item I.2)	**30,008**	**33,947**	**35,891**	**31,671**	**34,504**	**3,939**	**1,944**	**-2,276**	**-1,387**
III. Net Bank Credit (including inter-bank participation)	**245,999**	**297,265**	**339,477**	**292,782**	**336,273**	**51,266**	**42,212**	**-4,483**	**-3,204**
Memorandum Items :									
A. Priority Sector credit as % to NBC	34.5	33.5	33.8	33.5	33.7				
B. Agricultural Sector credit as % to NBC	12.8	11.7	11.7	11.8	11.4				
C. Export Sector credit as % to NBC	12.2	11.4	10.6	10.8	10.3				

Notes : 1. * Provisional.

2. Data relate to selected scheduled commercial banks which account for about 90-95 per cent of bank credit of all scheduled commercial banks. Gross bank credit data include bills rediscounted with RBI, IDBI, EXIM Bank, other approved financial institutions and inter-bank participations.

3. Figures in brackets are proportions to incremental non-food gross bank credit.

out of the bank credit allocated to industry (constituting of small, medium and large industries) during the year 1998-99, infrastructure industries received the maximum share of 15.5 per cent, followed by those of iron and steel (14.1 per cent), electricity (12.0 per cent), chemicals, dyes, paints, etc. (10.1 per cent) and other textiles industries (7.5 per cent). During the year 1998-99, the industries that witnessed substantial declines in bank credit include engineering (7.3 per cent), petroleum (3.6 per cent), rubber and rubber products (2.9 per cent), and jute textiles (1.4 per cent) (Table II.3).

Bank Credit to Sick/Weak Industries

2.20 Commercial banks extend financial assistance for the revival of sick/weak industrial units. Recently, the number of sick/weak industrial units financed by banks declined from 2,37,400 as at end-March 1997 to 2,24,012 as at end-March 1998. The outstanding bank credit to sick/weak industries as a proportion of bank credit allocated to industry also declined from 10.0 per cent as at end-March 1997 to 9.7 per cent as at end-March 1998. The bank credit locked up in small-scale sick industries and non-SSI sick/weak industrial units recorded a significant increase of 13.7 per cent from Rs.13,787 crore as at end-March 1997 to Rs.15,682 crore as at end-March 1998 (Appendix Table II.2).

Credit to Small-Scale Industries

2.21 During the year 1998-99, the Reserve Bank issued guidelines to encourage the growth of small-scale industries (SSI) and to ensure prompt payment of dues by medium/large industrial borrowers to SSI Units. These guidelines include (i) commercial banks should periodically ascertain, from their medium/large industrial borrowers, the extent of their dues to SSI suppliers and the action proposed to be taken by these borrowers to clear off the overdues, if any, to SSIs and (ii) commercial banks should ensure that the medium/large borrowers finance their domestic credit purchases from SSI Units, at least to the extent of 25 per cent by way of bills drawn on and accepted by them.

2.22 The foregoing analysis concerning the deposits and sectoral allocation of bank credit, is now supplemented with analysis based on balance sheet data, and it provides a focus on the asset/liability composition as well as the financial performance of the SCBs[1]. The structure and asset composition of the SCBs is delineated in Chart II.3. The disaggregated details of the assets/liabilities of the scheduled commercial banks, based on balance sheet data, are presented in Tables II.4 to II.7.

2.23 On the liabilities side, deposits constituted the major component (with 81.1 per cent as on March 31, 1999) of total liabilities of the SCBs. A substantial part of bank deposits are from term deposits, and these deposits accounted for 65.3 per cent of the aggregate deposits as on March 31, 1999. As regards the assets of the SCBs, a major share was on account of the ‘loans and advances’, and ‘investments’. As on March 31, 1999, the advances constituted a share of 38.9 per cent while the investments accounted for a share of 35.7 per cent in the total assets of SCBs. The investments portfolio of SCBs is predominated by the investments in safe and risk-less assets, i.e. the Government securities. As on March 31, 1999, the investments in Government and other approved securities constituted as high as 75.8 per cent of the total investments of SCBs. The SCBs investments in non-approved securities constituted relatively a much smaller share of 24.2 per cent of total investment as on March 31, 1999. However, such investments showed a substantial increase of 45.3 per cent compared with the 23.3 per cent increase in investment in Government securities during 1998-99.

1. As at the end of March 1999, there were 105 Scheduled Commercial Banks (SCBs) comprising 27 Public Sector Banks (PSBs), 34 Private Sector Banks (old and new) and 44 Foreign Banks. As at end-March 1998, there were 103 SCBs.

Table II.3: Industry-wise Deployment of Gross Bank Credit

(Rs. crore)

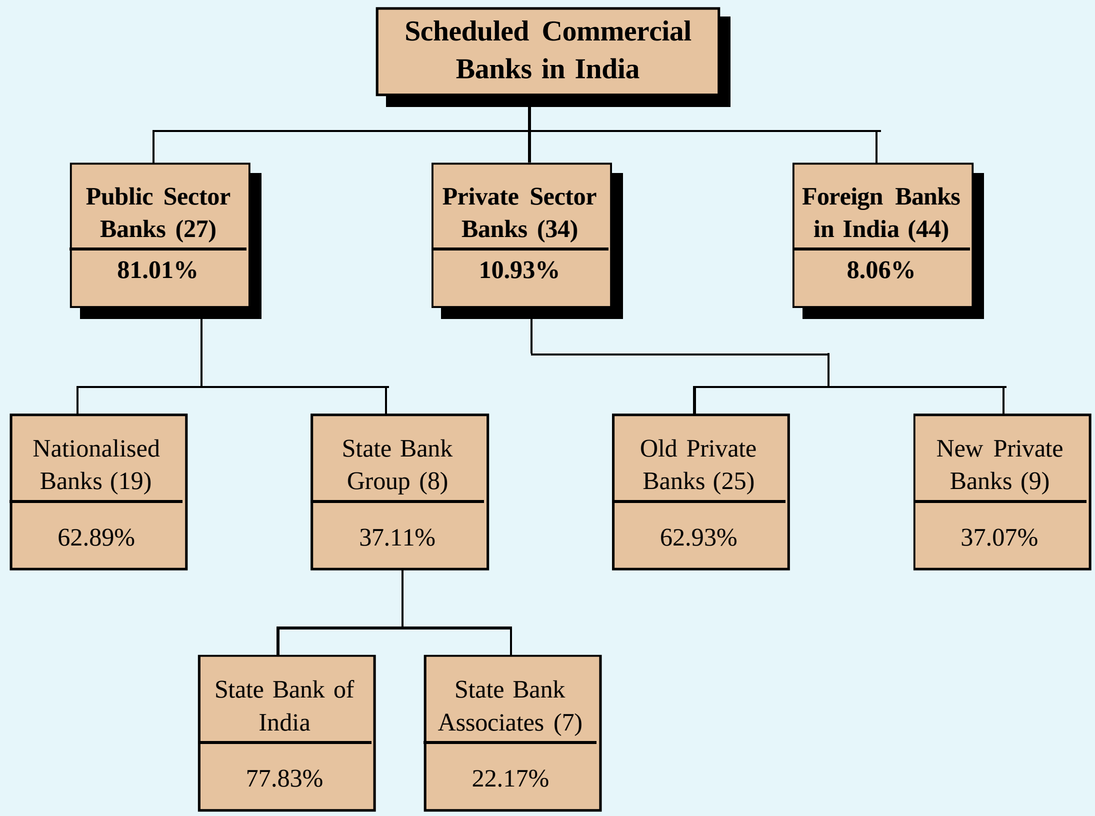
Industry	Outstanding as on					Variations during			
	March 28, 1997	March 27, 1998	March 26, 1999	June 19, 1998	June 18, 1999*	Financial year 1997-98	Financial year 1998-99	April-June 1998-99	April-June 1999-2000*
1	2	3	4	5	6	7 (3-2)	8 (4-3)	9 (5-3)	10 (6-4)
Industry (Total of Small, Medium and Large Scale)	**138,548**	**161,038**	**178,999**	**154,546**	**171,149**	**22,490**	**17,961**	**-6,492**	**-7,850**
1. Coal	570	801	1,114	729	1,032	231	313	-72	-82
2. Mining	65	975	1,360	937	1,349	910	385	-38	-11
3. Iron & Steel	11,668	15,767	18,291	15,405	17,998	4,099	2,524	-362	-293
4. Other Metals and Metal Products	5,276	5,193	5,918	5,302	5,717	-83	725	109	-201
5. All Engineering	22,684	22,833	21,513	20,832	20,598	149	-1,320	-2,001	-915
of which : Electronics	*(4699)*	*(4472)*	*(4872)*	*(4511)*	*(4635)*	*-(227)*	*(400)*	*(39)*	*-(237)*
6. Electricity	3,506	4,652	6,813	5,129	6,960	1,146	2,161	477	147
7. Cotton Textiles	8,053	9,331	10,430	9,363	10,433	1,278	1,099	32	3
8. Jute Textiles	543	1,089	844	1,105	820	546	-245	16	-24
9. Other Textiles	9,685	10,651	12,000	9,927	12,187	966	1,349	-724	187
10. Sugar	2,547	2,959	3,338	2,824	3,399	412	379	-135	61
11. Tea	814	1,028	825	1,035	775	214	-203	7	-50
12. Food Processing	3,655	4,134	4,750	4,326	4,746	479	616	192	-4
13. Vegetable Oils and vanaspati	1,955	2,296	2,710	2,365	2,555	341	414	69	-155
14. Tobacco and Tobbaco Products	934	1,076	1,005	1,007	891	142	-71	-69	-114
15. Paper and Paper Products	2,580	2,742	2,938	2,905	2,902	162	196	163	-36
16. Rubber and Rubber products	1,817	2,534	2,014	2,277	1,818	717	-520	-257	-196
17. Chemicals, Dyes, Paints, etc.	15,393	18,120	19,929	17,610	19,629	2,727	1,809	-510	-300
of which :									
i) Fertilisers	*(2358)*	*(2910)*	*(3577)*	*(2994)*	*(3061)*	*(552)*	*(667)*	*(84)*	*-(516)*
ii) Petrochemicals	*(1923)*	*(2956)*	*(4748)*	*(3029)*	*(4499)*	*(1033)*	*(1792)*	*(73)*	*-(249)*
iii) Drugs & Pharmaceuticals	*(3672)*	*(5219)*	*(5323)*	*(5142)*	*(5415)*	*(1547)*	*(104)*	*-(77)*	*(92)*
18. Cement	1,918	2,502	2,746	2,655	2,846	584	244	153	100
19. Leather and Leather products	2,225	2,478	2,542	2,547	2,446	253	64	69	-96
20. Gems and Jewellery	3,096	3,530	4,124	3,422	4,140	434	594	-108	16
21. Construction	2,494	2,646	2,569	2,326	2,333	152	-77	-320	-236
22. Petroleum	3,374	6,155	5,516	4,318	3,898	2,781	-639	-1,837	-1,618
23. Automobiles including trucks	0	2,870	3,128	2,827	3,525	2,870	258	-43	397
24. Computer Software	0	616	747	673	663	616	131	57	-84
25. Infrastructure	0	3,163	5,945	3,998	6,137	3,163	2,782	835	192
of which :									
i) Power	*0*	*(697)*	*(2109)*	*(982)*	*(2625)*	*(697)*	*(1412)*	*(285)*	*(516)*
ii) Telecommunications	*0*	*(2045)*	*(2273)*	*(2442)*	*(1946)*	*(2045)*	*(228)*	*(397)*	*-(327)*
iii) Roads and Ports	*0*	*(421)*	*(1563)*	*(574)*	*(1566)*	*(421)*	*(1142)*	*(153)*	*(3)*
26 Other Industries	33,696	30,897	35,890	28,702	31,352	-2,799	4,993	-2,195	-4,538
Memorandum Item :									
Industrial Credit as proportion to Net Bank Credit	56.3	54.2	52.7	52.8	50.9				

Notes : 1. * Provisional.

2. Data relate to selected scheduled commercial banks which account for about 90-95 per cent of bank credit of all scheduled commercial banks.

3. No sign is indicated for positive variations.

Chart II.3: Structure and Assets Composition of Scheduled Commercial Banks



Notes : 1. Scheduled Commercial Banks are exclusive of Regional Rural Banks (RRBs).
2. Figures in brackets indicate number of banks in each group.
3. Figures in percentages indicate the share of assets of each sub-group in the total assets of their respective group.
4. The percentage shares have been computed using the assets figures as on end-March 1999.

Credit-Deposit Relationship

2.24 As on March 31, 1999 (as per sanctions), the credit–deposit ratio of SCBs was a shade higher at 55.5 per cent than that of 55.3 per cent in the corresponding period last year. Although the C-D ratio has been widely used as an indicator of deployment of credit, it might not adequately capture the intensity of credit dispensation, as, the economic units may not necessarily avail of bank financing only through the conventional form of credit; they could as well gain resources from banks from the sale of their equities or debentures or bonds or commercial papers. The concept of C-D ratio therefore needs to be broadened to accommodate the investments of banks in such marketable instruments of business entities (Box II.2).

2.25 A region-wise analysis of C-D ratio indicates that with the exception of the northern and western regions, the remaining four regions witnessed decline in C-D ratio during the year 1998-99. As on March 31, 1999, the C-D ratio was the highest at 93.0 per cent for Tamil Nadu,

Table II.4: Consolidated Balance Sheet of Scheduled Commercial Banks as on March 31, 1998 and 1999

(Amount in Rs. crore)

Item	As on March 31, 1998		As on March 31, 1999	
	Amount	% to total	Amount	% to total
1	2	3	4	5
Liabilities				
1. Capital	19,439.35	2.44	18,206.71	1.91
2. Reserves & Surplus	34,003.73	4.27	36,793.46	3.87
3. Deposits	644,068.17	80.97	771,145.55	81.10
3.1 Demand Deposits	95,342.15	11.99	109,572.51	11.52
3.2 Savings Bank Deposits	133,475.75	16.78	158,364.28	16.65
3.3 Term Deposits	415,250.27	52.21	503,208.76	52.92
4. Borrowings	25,780.50	3.24	40,248.48	4.23
5. Other Liabilities and Provisions	72,120.73	9.07	84,503.77	8.89
Total Liabilities	**7,95,412.48**	**100.00**	**9,50,897.97**	**100.00**
Assets				
1. Cash and balances with RBI	71,590.49	9.00	81,384.66	8.56
2. Balances with banks and money at call and short notice	60,311.17	7.58	88,916.55	9.35
3. Investments	271,966.67	34.19	339,633.41	35.72
3.1 In Govt. Securities (a+b)	186,715.78	23.47	230,154.81	24.20
a. In India	184,729.09	23.22	228,006.47	23.98
b. Outside India	1,986.69	0.25	2,148.34	0.23
3.2 In other approved Securities	28,759.59	3.62	27,404.98	2.88
3.3 In non-approved Securities	56,491.30	7.10	82,073.62	8.63
4. Loans and Advances	324,166.54	40.75	369,648.55	38.87
4.1 Bills purchased & discounted	34,285.61	4.31	37,065.86	3.90
4.2 Cash Credit, Overdrafts, etc.	188,008.73	23.64	203,677.56	21.42
4.3 Term Loans	101,872.20	12.81	128,905.13	13.56
5. Fixed Assets	12,760.78	1.60	14,500.45	1.52
6. Other Assets	54,616.83	6.87	56,814.35	5.97
Total Assets	**7,95,412.48**	**100.00**	**9,50,897.97**	**100.00**

followed by Maharashtra (72.8 per cent) (Appendix Table II.3).

3. Financial Performance of Scheduled Commercial Banks

2.26 An analysis of the financial performance of SCBs is carried out using a set of financial ratios computed from the income and expenditure and the balance sheets statements of the banks.

2.27 A profitability analysis of the SCBs indicates that the profits of these banks have shown a decline during the year 1998-99. The operating profits of SCBs declined by 4.4 per cent from Rs.14,640.2 crore in 1997-98 to

Table II.5: Consolidated Balance Sheet of Public Sector Banks as on March 31, 1998 and 1999

(Amount in Rs. crore)

Item	Public Sector Bank Group				Nationalised Bank Group				State Bank Group			
	As on March 31, 1998		As on March 31, 1999		As on March 31, 1998		As on March 31, 1999		As on March 31, 1998		As on March 31, 1999	
	Amount	% to total	Amount	% to total	Amount	% to total	Amount	% to total	Amount	% to total	Amount	% to total
1	2	3	4	5	6	7	8	9	10	11	12	13
Liabilities												
1. Capital	16,070.59	2.47	14,405.63	1.87	15,034.79	3.61	13,369.83	2.76	1,035.80	0.44	1,035.80	0.36
2. Reserves & Surplus	24,698.36	3.80	27,446.60	3.56	13,698.68	3.29	15,277.32	3.15	10,999.68	4.72	12,169.28	4.26
3. Deposits	531,723.09	81.87	636,860.16	82.67	358,120.25	85.95	417,583.17	86.20	173,602.84	74.56	219,276.99	76.70
3.1 Demand Deposits	79,916.12	12.30	89,375.33	11.60	44,639.33	10.71	50,158.34	10.35	35,276.79	15.15	39,216.99	13.72
3.2 Savings Bank Deposits	123,301.47	18.98	145,133.62	18.84	84,537.35	20.29	99,214.83	20.48	38,764.12	16.65	45,918.79	16.06
3.3 Term Deposits	328,505.50	50.58	402,351.21	52.23	228,943.57	54.95	268,210.00	55.37	99,561.93	42.76	134,141.21	46.92
4. Borrowings	14,015.50	2.16	18,367.41	2.38	5,068.66	1.22	8,150.32	1.68	8,946.84	3.84	10,217.09	3.57
5. Other Liabilities and Provisions	62,996.40	9.70	73,241.09	9.51	24,738.48	5.94	30,036.47	6.20	38,257.92	16.43	43,204.62	15.11
Total Liabilities	**6,49,503.94**	**100.00**	**7,70,320.89**	**100.00**	**4,16,660.86**	**100.00**	**4,84,417.11**	**100.00**	**2,32,843.08**	**100.00**	**2,85,903.78**	**100.00**
Assets												
1. Cash and balances with RBI	59,846.13	9.21	68,522.04	8.90	40,340.09	9.68	45,142.81	9.32	19,506.04	8.38	23,379.23	8.18
2. Balances with banks and money at call and short notice	47,865.92	7.37	71,018.23	9.22	25,737.26	6.18	31,774.95	6.56	22,128.66	9.50	39,243.28	13.73
3. Investments	227,093.08	34.96	276,802.19	35.93	154,389.68	37.05	181,629.92	37.49	72,703.40	31.22	95,172.27	33.29
3.1 In Govt. Securities (a+b)	155,765.79	23.98	190,982.95	24.79	103,120.91	24.75	120,634.70	24.90	52,644.88	22.61	70,348.25	24.61
a. In India	153,907.88	23.70	188,939.00	24.53	101,415.76	24.34	118,775.99	24.52	52,492.12	22.54	70,163.01	24.54
b. Outside India	1,857.91	0.29	2,043.95	0.27	1,705.15	0.41	1,858.71	0.38	152.76	0.07	185.24	0.06
3.2 In other approved Securities	27,065.14	4.17	25,560.77	3.32	18,022.48	4.33	17,306.52	3.57	9,042.66	3.88	8,254.25	2.89
3.3 In non-approved Securities	44,262.15	6.81	60,258.47	7.82	33,246.29	7.98	43,688.70	9.02	11,015.86	4.73	16,569.77	5.80
4. Loans and Advances	259,646.96	39.98	297,350.28	38.60	162,221.57	38.93	188,925.16	39.00	97,425.39	41.84	108,425.12	37.92
4.1 Bills purchased & discounted	24,007.24	3.70	24,961.76	3.24	14,026.54	3.37	15,032.26	3.10	9,980.70	4.29	9,929.50	3.47
4.2 Cash Credit, Overdrafts, etc.	158,195.93	24.36	170,173.78	22.09	98,615.24	23.67	106,600.26	22.01	59,580.69	25.59	63,573.52	22.24
4.3 Term Loans	77,443.79	11.92	102,214.74	13.27	49,579.79	11.90	67,292.64	13.89	27,864.00	11.97	34,922.10	12.21
5. Fixed Assets	8,251.14	1.27	9,402.84	1.22	6,439.24	1.55	6,813.59	1.41	1,811.90	0.78	2,589.25	0.91
6. Other Assets	46,800.71	7.21	47,225.31	6.13	27,533.02	6.61	30,130.68	6.22	19,267.69	8.27	17,094.63	5.98
Total Assets	**6,49,503.94**	**100.00**	**7,70,320.89**	**100.00**	**4,16,660.86**	**100.00**	**4,84,417.11**	**100.00**	**2,32,843.08**	**100.00**	**2,85,903.78**	**100.00**

Table II.6: Consolidated Balance Sheet of Private Sector Banks as on March 31, 1998 and 1999

(Amount in Rs. crore)

Item	All Private Sector Bank Group				Old Private Sector Bank Group				New Private Sector Bank Group			
	As on March 31, 1998		As on March 31, 1999		As on March 31, 1998		As on March 31, 1999		As on March 31, 1998		As on March 31, 1999	
	Amount	% to total	Amount	% to total	Amount	% to total	Amount	% to total	Amount	% to total	Amount	% to total
1	2	3	4	5	6	7	8	9	10	11	12	13
Liabilities												
1. Capital	1,589.01	1.97	1,729.07	1.66	440.90	0.80	505.54	0.77	1,148.11	4.44	1,223.53	3.18
2. Reserves & Surplus	3,599.50	4.45	4,221.49	4.06	2,746.86	5.00	3,058.22	4.67	852.64	3.30	1,163.27	3.02
3. Deposits	69,515.78	86.02	86,832.03	83.53	47,778.11	86.92	56,018.70	85.63	21,737.67	84.11	30,813.33	79.97
3.1 Demand Deposits	7,926.60	9.81	11,040.83	10.62	4,996.34	9.09	6,221.59	9.51	2,930.26	11.34	4,819.24	12.51
3.2 Savings Bank Deposits	7,133.35	8.83	9,352.20	9.00	6,388.70	11.62	7,808.59	11.94	744.65	2.88	1,543.61	4.01
3.3 Term Deposits	54,455.83	67.39	66,439.00	63.91	36,393.07	66.21	41,988.52	64.18	18,062.76	69.89	24,450.48	63.46
4. Borrowings	1,908.97	2.36	5,522.07	5.31	1,140.83	2.08	2,423.94	3.71	768.14	2.97	3,098.13	8.04
5. Other Liabilities and Provisions	4,197.57	5.19	5,649.29	5.43	2,859.19	5.20	3,416.68	5.22	1,338.38	5.18	2,232.61	5.79
Total Liabilities	**80,810.83**	**100.00**	**1,03,953.95**	**100.00**	**54,965.89**	**100.00**	**65,423.08**	**100.00**	**25,844.94**	**100.00**	**38,530.87**	**100.00**
Assets												
1. Cash and balances with RBI	7,639.40	9.45	8,622.28	8.29	5,385.03	9.80	5,868.64	8.97	2,254.37	8.72	2,753.64	7.15
2. Balances with banks and money at call and short notice	5,955.81	7.37	8,690.65	8.36	4,093.92	7.45	5,345.03	8.17	1,861.89	7.20	3,345.62	8.68
3. Investments	26,492.54	32.78	36,493.76	35.11	17,766.17	32.32	22,138.50	33.84	8,726.37	33.76	14,355.26	37.26
3.1 In Govt. Securities (a+b)	17,249.31	21.35	22,293.56	21.45	11,709.55	21.30	14,198.78	21.70	5,539.76	21.43	8,094.78	21.01
a. In India	17,120.53	21.19	22,189.17	21.35	11,580.77	21.07	14,094.39	21.54	5,539.76	21.43	8,094.78	21.01
b. Outside India	128.78	0.16	104.39	0.10	128.78	0.23	104.39	0.16	—	—	—	—
3.2 In other approved Securities	1,383.58	1.71	1,539.41	1.48	1,317.76	2.40	1,348.51	2.06	65.82	0.25	190.90	0.50
3.3 In non-approved Securities	7,859.65	9.73	12,660.79	12.18	4,738.86	8.62	6,591.21	10.07	3,120.79	12.08	6,069.58	15.75
4. Loans and Advances	35,206.15	43.57	42,791.52	41.16	24,143.61	43.92	27,751.25	42.42	11,062.54	42.80	15,040.27	39.03
4.1 Bills purchased & discounted	7,415.88	9.18	8,869.61	8.53	4,034.04	7.34	4,300.39	6.57	3,381.84	13.09	4,569.22	11.86
4.2 Cash Credit, Overdrafts, etc.	18,864.63	23.34	21,796.93	20.97	13,331.47	24.25	14,975.72	22.89	5,533.16	21.41	6,821.21	17.70
4.3 Term Loans	8,925.64	11.05	12,124.98	11.66	6,778.10	12.33	8,475.14	12.95	2,147.54	8.31	3,649.84	9.47
5. Fixed Assets	2,417.23	2.99	2,801.99	2.70	1,324.22	2.41	1,346.30	2.06	1,093.01	4.23	1,455.69	3.78
6. Other Assets	3,099.70	3.84	4,553.75	4.38	2,252.94	4.10	2,973.36	4.54	846.76	3.28	1,580.39	4.10
Total Assets	**80,810.83**	**100.00**	**1,03,953.95**	**100.00**	**54,965.89**	**100.00**	**65,423.08**	**100.00**	**25,844.94**	**100.00**	**38,530.87**	**100.00**

Table II.7: Consolidated Balance Sheet of Foreign Banks in India as on March 31, 1998 and 1999

(Amount in Rs. crore)

Item	Foreign Bank Group			
	As on March 1998		As on March 1999	
	Amount	% to total	Amount	% to total
1	2	3	4	5
Liabilities				
1. Capital	1,779.75	2.73	2,072.01	2.70
2. Reserves & Surplus	5,705.87	8.77	5,125.37	6.69
3. Deposits	42,829.30	65.79	47,453.36	61.93
3.1 Demand Deposits	7,499.43	11.52	9,156.35	11.95
3.2 Savings Bank Deposits	3,040.93	4.67	3,878.46	5.06
3.3 Term Deposits	32,288.94	49.60	34,418.55	44.92
4. Borrowings	9,856.03	15.14	16,359.00	21.35
5. Other Liabilities and Provisions	4,926.76	7.57	5,613.39	7.33
Total Liabilities	**65,097.71**	**100.00**	**76,623.13**	**100.00**
Assets				
1. Cash and balances with RBI	4,104.96	6.31	4,240.34	5.53
2. Balances with banks and money at call and short notice	6,489.44	9.97	9,207.67	12.02
3. Investments	18,381.05	28.24	26,337.46	34.37
3.1 In Govt. Securities (a+b)	13,700.68	21.05	16,878.30	22.03
a. In India	13,700.68	21.05	16,878.30	22.03
b. Outside India	—	—	—	—
3.2 In other approved Securities	310.87	0.48	304.80	0.40
3.3 In non-approved Securities	4,369.50	6.71	9,154.36	11.95
4. Loans and Advances	29,313.43	45.03	29,506.75	38.51
4.1 Bills purchased & discounted	2,862.49	4.40	3,234.49	4.22
4.2 Cash Credit, Overdrafts, etc.	10,948.17	16.82	11,706.85	15.28
4.3 Term Loans	15,502.77	23.81	14,565.41	19.01
5. Fixed Assets	2,092.41	3.21	2,295.62	3.00
6. Other Assets	4,716.42	7.25	5,035.29	6.57
Total Assets	**65,097.71**	**100.00**	**76,623.13**	**100.00**

Rs.13,992.3 crore in 1998-99. Accordingly, the ratio of operating profits to total assets declined from 1.84 per cent in 1997-98 to 1.47 per cent in 1998-99 (Chart II.4). The decline in profitability of SCBs can be attributed, *inter alia*, to both the increase in interest expended and the operating losses incurred by nine of these banks. The ratio of net profit to total assets showed a somewhat lesser decline of 0.33 percentage points from 0.82 per cent in 1997-98 to 0.49 per cent in 1998-99, owing to decline in provisions and contingencies of these banks (Chart II.5). The ratio of provisions

Box II.2: Credit-Deposit Ratio of Scheduled Commercial Banks

In recent times, there has been a considerable amount of discussion on the usefulness of credit-deposit ratio (C-D ratio) as a measure of allocation of funds by banks. Credit extended by commercial banks could be in terms of any or combinations of the following: cash credit, overdrafts, demand loans, purchase or discounting of commercial bills and instalment or hire purchase credit. Deposits, on the other hand, consist mainly of demand deposits and term deposits. The C-D ratio provide an indication of the extent of credit deployment for every unit of resource raised.

Total credit extended by scheduled commercial banks showed an increase of around 12 times between 1969 and 1984. The credit-deposit ratio, however, fell by around 7 percentage points to 70.7 per cent by 1984 from 77.4 per cent in 1969. This is reflective of the deployment of resources in increasing measure to meet the statutory liquidity ratio and the cash reserve requirements (Chakravarty Committee, 1985). Subsequently, it declined to 60.7 per cent by 1990 and then to 55.6 per cent by 1995.

Recent trends in the C-D ratio of SCBs indicate that the ratio has declined from 50.3 per cent, as on March 1998 to 47.9 per cent in March 1999. In terms of bank-group, over the period from March 1998 to March 1999, while the ratio has remained at 45.3 per cent for nationalised banks, it has witnessed a significant decline for the State Bank Group (from 56.1 per cent to 49.5 per cent). Other bank groups have also posted moderate to noticeable decline in the C-D ratio over the same period.

Several indicators of credit deployment have been used in the literature. Of this, the oft-quoted ratio has traditionally been the credit-deposit ratio. It, however, needs to be recognized that the C-D ratio does not serve as a reliable indicator of the trends in mobilisation of deposits and deployment of credit. First, while the amounts of both deposit accretion and credit expansion could be very small, the ratio could be high, giving a misleading picture of the C-D ratio. Secondly, with the introduction of new capital adequacy norms, it is not credit deployment *per se*, but the quality of credit that has become of prime concern to banks. Excessive demand for credit might often lead to adverse selection, resulting in banks resorting to what is popularly referred to as 'credit rationing'. The need to ration credit to doubtful borrowers has been triggered by the necessity on the part of the banks to reduce their quantum of non-performing assets. Finally, to the extent that the C-D ratio does not take into account banks' investment in approved securities other than that in governments, and other marketable instruments, it fails to provide a complete picture of the resource deployment by banks.

The introduction of prudential norms has induced a search for newer ratios that can adequately capture the deployment of resources. Of this, the most used has been the credit and investment in Government securities to deposit ratio, which internalizes the SLR requirements. But as financial markets have widened, and as financial reforms have been undertaken to improve the exposure of banks to marketable debt securities and equities, it has become increasingly clear that it is necessary to view credit and investments in marketable instruments, not all of which are officially approved, as the flow of banks funds to private sector. Such flows in relation to deposits provide insights about the extent of bank financing out of every unit of resource mobilised.

and contingencies to total assets marginally declined to 0.98 per cent during 1998-99 from 1.02 per cent in 1997-98.

2.28 The intermediation cost of SCBs measured in terms of the ratio of operating expenses to total assets showed only a negligible increase from 2.63 per cent in 1997-98 to 2.65 per cent in 1998-99. The increasing competition in the banking industry has led to a decline in the 'spread' of SCBs, i.e. net interest income. The spread of SCBs declined from 2.95 per cent in 1997-98 to 2.78 per cent in 1998-99 (Table II.8).

2.29 As a result of the increase in competition among the bank groups and the diversification of activities of banks, the net profit structure of various bank groups has been undergoing changes. An analysis of the net profits structure of SCB groups shows that the share of State Bank of India and its seven Associated Banks (henceforth SBI Group) in the total net profits of SCBs, which was 19.3 per cent in 1991-92, increased to 37.8 per cent in 1997-98 and moved down to 31.5 per cent in 1998-99 (Chart II.6). The share of nationalised banks in the total net profits of SCBs declined from 43.9 per cent in 1991-92 to 39.5 per cent in 1997-

Chart II.4: Bank Group-wise Operating Profit to Total Assets of Scheduled Commercial Banks: 1997-98 and 1998-99

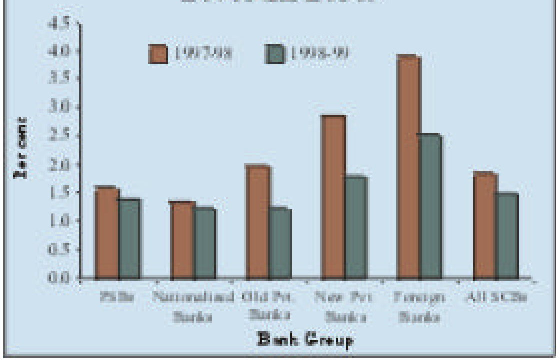
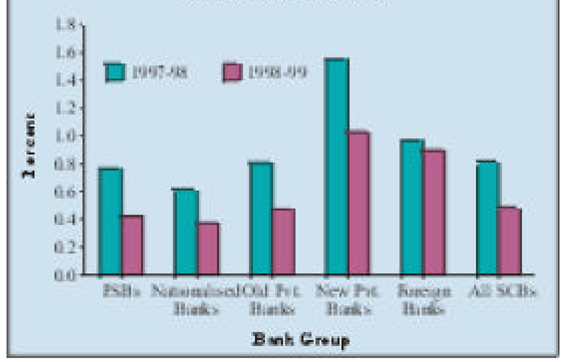


Chart II.5: Bank Group-wise Net Profit to Total Assets of Scheduled Commercial Banks: 1997-98 and 1998-99



98 and further to 38.5 per cent in 1998-99. As regards foreign banks, their net profits as a proportion to total net profits of SCBs declined from 30.4 per cent in 1991-92 to 9.7 per cent in 1997-98; and then improved substantially to 14.9 per cent in 1998-99. The private sector banks, both old and new, have shown substantial improvements in their shares of net profits. The share of private sector banks in the total net profits of SCBs has shown a more than two-fold increase from 6.4 per cent in 1991-92 to 15.2 per cent in 1998-99 (Chart II.6).

Public Sector Banks

2.30 The banking sector in India has been characterised by the predominance of public sector banks (PSBs) with more than 80 per cent share in the total assets of SCBs. An analysis of the combined performance of 27 PSBs shows that the operating profits of these banks increased by 2.96 per cent from Rs.10,273.7 crore in 1997-98 to Rs.10,577.5 crore in 1998-99. The ratio of operating profit to total assets, however, showed a decline from 1.58 per cent in 1997-98 to 1.37 per cent in 1998-99. Similarly, the ratio of net profits to total assets of PSBs also, declined from 0.77 per cent in 1997-98 to 0.42 per cent in 1998-99. The net profits of some of the large-sized PSBs like the State Bank of India, the Bank of India, and the Punjab National Bank came under pressure during the year and this has affected the overall net profits of PSBs (Table II.9). The net profit ratio of these PSBs was below the SCBs average of 0.49 per cent. A disaggregated analysis of PSBs, indicates that the net profits ratio of 14 PSBs was above the average net profit ratio of SCBs. The ratio of intermediation cost to total assets of PSBs (i.e. operating expenses) at 2.65 per cent during 1998-99 almost remained unchanged as compared with last year (2.66 per cent). The 'spread' of public sector banks has shown a marginal decline from 2.91 per cent in 1997-98 to 2.81 per cent in 1998-99 (Table II.9).

2.31 To enable the public sector banks to perform in a more competitive manner, the Government of India has adopted the policy of providing autonomous status to these banks subject to certain benchmarks. The criteria for grading a bank and considering it eligible for

Chart II.6: Net Profit Structure of Bank Groups: 1991-92, 1997-98 and 1998-99

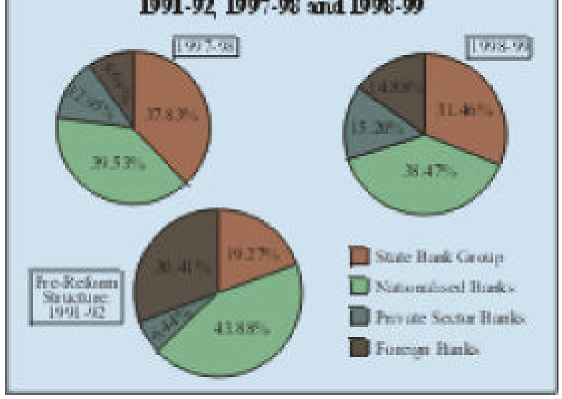


Table II.8: Financial Performance of Scheduled Commercial Banks for the years 1997-98 and 1998-99

(Rs. crore)

Item	1997-98	1998-99	Variation of Column (3) over (2)	
			Absolute	Percentage
1	2	3	4	5
A. Income (i+ii)	**85,856.98 (100.00)**	**1,00,077.61 (100.00)**	**14,220.63**	**16.56**
i) Interest Income	73,750.62 (85.90)	87,370.07 (87.30)	13,619.45	18.47
ii) Other Income	12,106.36 (14.10)	12,707.54 (12.70)	601.18	4.97
B. Expenditure (i+ii+iii)	**79,355.14 (100.00)**	**95,418.11 (100.00)**	**16,062.97**	**20.24**
i) Interest Expended	50,299.42 (63.39)	60,904.99 (63.83)	10,605.57	21.08
ii) Provisions and Contingencies	8,138.31 (10.26)	9,332.81 (9.78)	1,194.50	14.68
iii) Operating Expenses	20,917.41 (26.36)	25,180.31 (26.39)	4,262.90	20.38
of which : Wage Bill	14,091.65 (17.76)	16,649.19 (17.45)	2,557.54	18.15
C. Profit				
i) Operating Profit	14,640.15	13,992.31	-647.84	-4.43
ii) Net Profit	6,501.84	4,659.50	-1,842.34	-28.34
D. Total Assets	**7,95,412.48**	**9,50,897.97**	**1,55,485.49**	**19.55**
E. Financial Ratios (per cent) $				
i) Operating Profit	1.84	1.47	-0.37	—
ii) Net Profit	0.82	0.49	-0.33	—
iii) Income	10.79	10.52	-0.27	—
iv) Interest Income	9.27	9.19	-0.08	—
v) Other Income	1.52	1.34	-0.18	—
vi) Expenditure	9.98	10.03	0.05	—
vii) Interest Expended	6.32	6.40	0.08	—
viii) Operating Expenses	2.63	2.65	0.02	—
ix) Wage Bill	1.77	1.75	-0.02	—
x) Provisions and Contingencies	1.02	0.98	-0.04	—
xi) Spread (Net Interest Income)	2.95	2.78	-0.17	—

Notes : 1. $ Ratios to Total Assets.
2. Figures in brackets are percentage shares to the respective total.

Table II.9: Financial Performance of Public Sector Banks for the years 1997-98 and 1998-99

(Rs. crore)

Item		1997-98	1998-99	Variation of Column (3) over (2)	
				Absolute	Percentage
1		2	3	4	5
A.	**Income (i+ii)**	**67,706.58 (100.00)**	**78,867.07 (100.00)**	**11,160.49**	**16.48**
	i) Interest Income	59,076.17 (87.25)	69,474.31 (88.09)	10,398.14	17.60
	ii) Other Income	8,630.41 (12.75)	9,392.76 (11.91)	762.35	8.83
B.	**Expenditure (i+ii+iii)**	**62,676.91 (100.00)**	**75,608.98 (100.00)**	**12,932.07**	**20.63**
	i) Interest Expended	40,173.57 (64.10)	47,839.75 (63.27)	7,666.18	19.08
	ii) Provisions and Contingencies	5,244.05 (8.37)	7,319.41 (9.68)	2,075.36	39.58
	iii) Operating Expenses	17,259.29 (27.54)	20,449.82 (27.05)	3,190.53	18.49
	of which : Wage Bill	12,623.44 (20.14)	14,839.66 (19.63)	2,216.22	17.56
C.	**Profit**				
	i) Operating Profit	10,273.72	10,577.50	303.78	2.96
	ii) Net Profit	5,029.67	3,258.09	-1,771.58	-35.22
D.	**Total Assets**	**6,49,503.94**	**7,70,320.89**	**1,20,816.95**	**18.60**
E.	**Financial Ratios (per cent) $**				
	i) Operating Profit	1.58	1.37	-0.21	—
	ii) Net Profit	0.77	0.42	-0.35	—
	iii) Income	10.42	10.24	-0.18	—
	iv) Interest Income	9.10	9.02	-0.08	—
	v) Other Income	1.33	1.22	-0.11	—
	vi) Expenditure	9.65	9.82	0.17	—
	vii) Interest Expended	6.19	6.21	0.02	—
	viii) Operating Expenses	2.66	2.65	-0.01	—
	ix) Wage Bill	1.94	1.93	-0.01	—
	x) Provisions and Contingencies	0.81	0.95	0.14	—
	xi) Spread (Net Interest Income)	2.91	2.81	-0.10	—

Notes : 1. $ Ratios to Total Assets.

2. Figures in brackets are percentage shares to the respective total.

autonomous status were set out in the Union Budget presented in March 1998[2]. Based on these criteria, the eligibility for autonomous status is indicated in column (8) of Table II.10. So far, as at end-March 31, 1999 as many as 17 (out of 27) PSBs have become eligible for autonomous status of various banks. Appendix Tables II.4 (A) to (I) present bank-wise data in respect of certain financial parameters for public sector banks.

Nationalised Banks

2.32 The nationalised banks (19) form a predominant part of PSBs. During 1998-99, the assets of the nationalised banks constituted the largest share of 62.9 per cent in the total assets of the PSBs and 50.9 per cent of the total assets of the entire SCBs. An analysis of the financial performance of nationalised banks indicates that the operating profits of these banks increased by 7.0 per cent from Rs.5,541.4 crore in 1997-98 to Rs.5,929.4 crore in 1998-99. The ratio of operating profits to total assets declined marginally by 0.11 percentage point from 1.33 per cent in 1997-98 to 1.22 per cent in 1998-99. The decline in net profits can be attributed to the decline in the net profits of some of the large-sized banks as discussed earlier. The net profit ratio of nationalised banks has declined from 0.62 per cent in 1997-98 to 0.37 per cent in 1998-99 (Table II.11). The intermediation cost of nationalised banks showed a marginal decrease from 2.65 per cent in 1997-98 to 2.63 per cent in 1998-99. The 'spread' of nationalised banks was at 2.79 per cent during 1998-99 as against 2.78 per cent during 1997-98.

State Bank of India and Associates

2.33 The State Bank of India and its 7 Associated banks constitute the second largest segment of the PSBs. During the year 1998-99, the total assets of the State Bank of India and its 7 Associated Banks accounted for 37.1 per cent of the assets of the PSBs. As a proportion to the total assets of the entire SCB sector, the total assets of the SBI group constituted 30.1 per cent in 1998-99. As regards the flow of assets, the total assets of SBI group have shown an increase of 22.8 per cent from Rs.2,32,843.1 crore as on March 31, 1998 to Rs.2,85,903.8 crore as on March 31, 1999.

2.34 An analysis of the financial performance of the SBI group indicates that the operating profits of SBI group recorded a decline of 1.78 per cent from Rs.4,732.3 crore in 1997-98 to Rs.4,648.1 crore in 1998-99. The ratio of operating profit to total assets also declined by 0.40 percentage points from 2.03 per cent in 1997-98 to 1.63 per cent in 1998-99. (Table II.12). The ratio of provisions and contingencies to total assets increased by 0.13 percentage point from 0.98 per cent in 1997-98 to 1.11 per cent in 1998-99. As a result, the ratio of net profits to total assets showed a decline of 0.55 percentage point from 1.06 per cent in 1997-98 to 0.51 per cent in 1998-99. The ratio of 'intermediation cost' to total assets was 2.70 per cent during 1998-99 as against 2.68 per cent during 1997-98. The 'spread' of SBI group during the year 1998-99 showed a substantial decline from 3.14 per cent in 1997-98 to 2.85 per cent in 1998-99.

Indian Private Sector Banks

2.35 With a view to infusing more competition in the banking sector, the policy of providing autonomous status to the public sector banks, as discussed earlier, has been further supplemented by the policy of encouraging the setting up of more private sector banks. So far, in addition to the 25 old private sector banks, as many as 9 new private sector banks have been established.

2. Autonomy granted by the Government of India to PSBs is subject to fulfilling the following criteria: 1. Positive net profits for the last three years. 2. Capital Adequacy Ratio of more than 8 per cent. 3. Net NPA level below 9 per cent of the net advances. 4. Minimum owned funds of Rs.100 crore.

Table II.10: Public Sector Banks – List of Banks Eligible for Autonomous Status as on March 31, 1999

(Amount in Rs. crore)

Name of the Bank	Net Profit as on			CRAR	% of net NPAs to net advances	Net owned funds	Banks Eligible for Autonomy
	March 31, 1997	March 31, 1998	March 31 1999	as on 31.3.1999			
1	2	3	4	5	6	7	8
State Bank of India	1,349.25	1,861.20	1,027.80	12.51	7.18	10,402.30	xxx
State Bank of Bikaner & Jaipur	40.48	90.48	91.88	12.26	10.45	419.35	
State Bank of Hyderabad	52.45	97.12	111.53	10.65	8.78	496.09	xxx
State Bank of Indore	17.06	27.71	31.04	12.35	10.10	193.93	
State Bank of Mysore	40.24	50.54	33.58	10.23	10.55	242.49	
State Bank of Patiala	59.03	143.01	101.20	12.47	8.23	657.70	xxx
State Bank of Saurashtra	108.29	126.41	25.36	14.35	7.70	412.12	xxx
State Bank of Travancore	40.25	63.30	43.27	10.27	10.80	381.10	
Allahabad Bank	64.30	129.21	135.00	10.38	12.54	849.07	
Andhra Bank	35.70	75.25	90.04	11.02	4.26	491.57	xxx
Bank of Baroda	276.53	461.35	421.44	13.30	7.70	2,898.44	xxx
Bank of India	360.02	364.51	201.14	10.55	7.28	2,406.66	xxx
Bank of Maharashtra	47.19	56.29	51.89	9.76	8.72	478.25	xxx
Canara Bank	147.40	203.02	225.06	10.96	7.09	2,412.81	xxx
Central Bank of India	150.83	174.89	146.25	11.88	9.79	1,722.92	
Corporation Bank	125.13	166.87	192.03	13.20	1.98	974.60	xxx
Dena Bank	72.91	105.04	110.09	11.14	7.67	696.69	xxx
Indian Bank	-389.09	-301.50	-778.50	Neg.	21.67	-283.25	
Indian Overseas Bank	104.51	113.06	55.34	10.15	7.30	718.63	xxx
Oriental Bank of Commerce	180.25	210.00	230.12	14.10	4.50	1,231.48	xxx
Punjab & Sind Bank	20.00	65.09	60.45	10.94	10.48	373.80	
Punjab National Bank	237.71	477.35	372.12	10.79	8.96	1929.75	xxx
Syndicate Bank	66.96	82.66	142.58	9.57	3.93	698.40	xxx
UCO Bank	-176.23	-96.22	-67.77	9.63	10.83	830.30	
Union Bank of India	215.68	250.10	160.22	10.09	8.70	1,682.62	xxx
United Bank of India	-113.64	9.62	14.70	9.60	14.70	562.93	
Vijaya Bank	18.96	23.31	30.23	10.00	6.72	410.15	xxx

Note: Based on the eligibility criteria prescribed by the government, the banks eligible for autonomous status have been identified at our end and are denoted by 'xxx' in the last column (8).

Table II.11: Financial Performance of Nationalised Banks for the years 1997-98 and 1998-99

(Rs. crore)

Item	1997-98	1998-99	Variation of Column (3) over (2)	
			Absolute	Percentage
1	2	3	4	5
A. Income (i+ii)	**42,835.47**	**49,517.66**	**6,682.19**	**15.60**
	(100.00)	**(100.00)**		
i) Interest Income	37,867.33	44,348.16	6,480.83	17.11
	(88.40)	(89.56)		
ii) Other Income	4,968.14	5,169.50	201.36	4.05
	(11.60)	(10.44)		
B. Expenditure (i+ii+iii)	**40,265.57**	**47,725.23**	**7,459.66**	**18.53**
	(100.00)	**(100.00)**		
i) Interest Expended	26,269.42	30,856.91	4,587.49	17.46
	(65.24)	(64.66)		
ii) Provisions and Contingencies	2,971.48	4,137.01	1,165.53	39.22
	(7.38)	(8.67)		
iii) Operating Expenses	11,024.67	12,731.31	1,706.64	15.48
	(27.38)	(26.68)		
of which : Wage Bill	7,952.95	9,346.79	1,393.84	17.53
	(19.75)	(19.58)		
C. Profit				
i) Operating Profit	5,541.38	5,929.44	388.06	7.00
i.a) Operation profits exclusive of income from recapitalisation bonds	3,839.45	3,969.58	130.13	3.39
ii) Net Profit	2,569.90	1,792.43	-777.47	-30.25
ii.a) Net Profit exclusive of income from recapitalisation bonds	867.97	-167.43	-1,035.40	-119.29
D. Total Assets	**4,16,660.86**	**4,84,417.11**	**67,756.25**	**16.26**
E. Financial Ratios (per cent) $				
i) Operating Profit	1.33	1.22	-0.11	—
i.a) Operating Profits exclusive of recapitalisation bonds	0.92	0.82	-0.10	—
ii) Net Profit	0.62	0.37	-0.25	—
ii.a) Net Profits exclusive of recapitalisation bonds	0.21	-0.03	-0.24	—
iii) Income	10.28	10.22	-0.06	—
iv) Interest Income	9.09	9.15	0.06	—
v) Other Income	1.19	1.07	-0.12	—
vi) Expenditure	9.66	9.85	0.19	—
vii) Interest Expended	6.30	6.37	0.07	—
viii) Operating Expenses	2.65	2.63	-0.02	—
ix) Wage Bill	1.91	1.93	0.02	—
x) Provisions and Contingencies	0.71	0.85	0.14	—
xi) Spread (Net Interest Income)	2.78	2.79	0.01	—
xi.a) Spread exclusive of recapitalisation bonds	2.38	2.38	0.00	—

Notes : 1. $ Ratios to Total Assets.

2. Figures in brackets are percentage shares to the respective total.

Table II.12: Financial Performance of State Bank of India and its Associates for the years 1997-98 and 1998-99

(Rs. crore)

Item		1997-98	1998-99	Variation of Column (3) over (2)	
				Absolute	Percentage
1		2	3	4	5
A.	**Income (i+ii)**	**24,871.11 (100.00)**	**29,349.41 (100.00)**	**4,478.30**	**18.01**
	i) Interest Income	21,208.84 (85.28)	25,126.15 (85.61)	3,917.31	18.47
	ii) Other Income	3,662.27 (14.72)	4,223.26 (14.39)	560.99	15.32
B.	**Expenditure (i+ii+iii)**	**22,411.34 (100.00)**	**27,883.75 (100.00)**	**5,472.41**	**24.42**
	i) Interest Expended	13,904.15 (62.04)	16,982.84 (60.91)	3,078.69	22.14
	ii) Provisions and Contingencies	2,272.57 (10.14)	3,182.40 (11.41)	909.83	40.04
	iii) Operating Expenses	6,234.62 (27.82)	7,718.51 (27.68)	1,483.89	23.80
	of which :Wage Bill	4,670.49 (20.84)	5,492.87 (19.70)	822.38	17.61
C.	**Profit**				
	i) Operating Profit	4,732.34	4,648.06	-84.28	-1.78
	ii) Net Profit	2,459.77	1,465.66	-994.11	-40.41
D.	**Total Assets**	**2,32,843.08**	**2,85,903.78**	**53,060.70**	**22.79**
E.	**Financial Ratios (per cent) $**				
	i) Operating Profit	2.03	1.63	-0.40	—
	ii) Net Profit	1.06	0.51	-0.55	—
	iii) Income	10.68	10.27	-0.41	—
	iv) Interest Income	9.11	8.79	-0.32	—
	v) Other Income	1.57	1.48	-0.09	—
	vi) Expenditure	9.63	9.75	0.12	—
	vii) Interest Expended	5.97	5.94	-0.03	—
	viii) Operating Expenses	2.68	2.70	0.02	—
	ix) Wage Bill	2.01	1.92	-0.09	—
	x) Provisions and Contingencies	0.98	1.11	0.13	—
	xi) Spread (Net Interest Income)	3.14	2.85	-0.29	—

Notes : 1. $ Ratios to Total Assets.
2. Figures in brackets are percentage shares to the respective total.

In 1998-99, the combined assets of these banks (*old* as well as *new*) constituted a share of 10.9 per cent in the total assets of all the SCBs. An analysis of the financial performance of private sector banks indicates that the new private sector banks have performed well above the average of SCBs with the exception of 'spread'.

Old Private Sector Banks

2.36 The old private sector banks constitute an important part of the private sector banks[3]. In the total assets of private sector banks, the old private sector banks constituted a predominant share of 62.9 per cent during 1998-99. However, in the total assets of the entire SCBs sector, the old private sector banks accounted for a share of only 6.9 per cent during 1998-99. An analysis of financial performance of the old private sector banks indicates that their performance during the year 1998-99 was below the average of SCBs with the exception of intermediation cost.

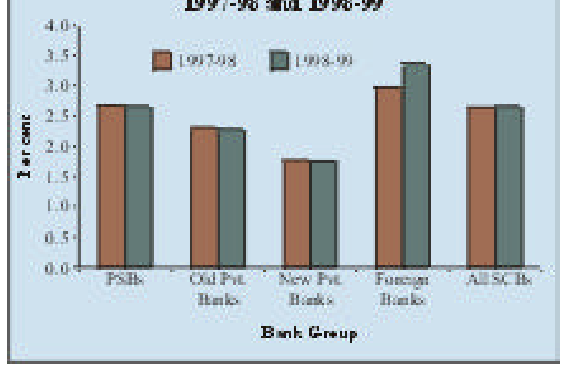
2.37 The old private sector banks registered a substantial decline in their operating profits. The combined operating profits of these banks declined by 26.9 per cent from Rs.1,082.3 crore in 1997-98 to Rs.790.9 crore in 1998-99. As a ratio to total assets, the operating profits of old private sector banks showed a substantial decline from 1.97 per cent in 1997-98 to 1.21 per cent in 1998-99. Among other factors, the increase in both interest expended and operating expenses led to a fall in operating profits. The operating profit ratio of old private sector banks during the year was lower than the average of SCBs operating profit ratio 1.47 per cent. The intermediation cost ratio of old private sector banks was at 2.27 per cent during 1998-99 compared with 2.31 per cent in the previous year. However, the spread of old private sector banks is narrowing down in recent years. The spread of old private sector banks has declined from 2.57 per cent in 1997-98 to 2.16 per cent in 1998-99 (Table II.13). Bank-wise details of financial indicators of private sector banks (*old* and *new*) are given in Appendix Tables II.5 (A) to (H).

New Private Sector Banks

2.38 New private sector banks, though small in number, constitute a significant share (37.1 per cent) in the total assets of all private sector banks. The operating profits of these banks declined by 7.47 per cent from Rs.739.6 crore in 1997-98 to Rs.684.3 crore in 1998-99. The ratio of operating profit to total assets showed a decline of 1.08 percentage points from 2.86 per cent in 1997-98 to 1.78 per cent in 1998-99. However, the operating profit ratio of these banks still remained higher than the average operating profit ratio of 1.47 per cent for SCBs in 1998-99.

2.39 The ratio of intermediation cost to total assets of new private sector banks also declined from 1.76 per cent in 1997-98 to 1.74 per cent in 1998-99. During both the years, the intermediation cost of these banks remained the lowest as compared to the total as well as the sub-groups of SCBs (Chart II.7). A notable feature of the operating cost of these banks is the smaller share of wage-bill as compared to other sub-groups of SCBs. During 1998-99, the wage-bill constituted a share of 17.9 per cent in the

Chart II.7 : Bank Group-wise Intermediation Cost to Total Assets of Scheduled Commercial Banks: 1997-98 and 1998-99



3. Bareilly Corporation Bank Ltd. was placed under moratorium on March 8, 1999 and was subsequently amalgamated with the Bank of Baroda w.e.f. June 3, 1999. The figures for this bank are as on March 8, 1999.

Table II.13: Financial Performance of Old Indian Private Sector Banks for the years 1997-98 and 1998-99

(Rs. crore)

Item	1997-98	1998-99	Variation of Column (3) over (2)	
			Absolute	Percentage
1	2	3	4	5
A. Income (i+ii)	**6,437.80** **(100.00)**	**7,361.03** **(100.00)**	**923.23**	**14.34**
i) Interest Income	5,496.15 (85.37)	6,497.75 (88.27)	1,001.60	18.22
ii) Other Income	941.65 (14.63)	863.28 (11.73)	-78.37	-8.32
B. Expenditure (i+ii+iii)	**5,995.12** **(100.00)**	**7,050.04** **(100.00)**	**1,054.92**	**17.60**
i) Interest Expended	4,083.77 (68.12)	5,087.73 (72.17)	1,003.96	24.58
ii) Provisions and Contingencies	639.65 (10.67)	479.93 (6.81)	-159.72	-24.97
iii) Operating Expenses	1,271.70 (21.21)	1,482.38 (21.03)	210.68	16.57
of which : Wage Bill	769.92 (12.84)	919.95 (13.05)	150.03	19.49
C. Profit				
i) Operating Profit	1,082.33	790.92	-291.41	-26.92
ii) Net Profit	442.68	310.99	-131.69	-29.75
D. Total Assets	**54,965.89**	**65,423.08**	**10,457.19**	**19.02**
E. Financial Ratios (per cent) $				
i) Operating Profit	1.97	1.21	-0.76	—
ii) Net Profit	0.81	0.48	-0.33	—
iii) Income	11.71	11.25	-0.46	—
iv) Interest Income	10.00	9.93	-0.07	—
v) Other Income	1.71	1.32	-0.39	—
vi) Expenditure	10.91	10.78	-0.13	—
vii) Interest Expended	7.43	7.78	0.35	—
viii) Operating Expenses	2.31	2.27	-0.04	—
ix) Wage Bill	1.40	1.41	0.01	—
x) Provisions and Contingencies	1.16	0.73	-0.43	—
xi) Spread (Net Interest Income)	2.57	2.16	-0.41	—

Notes : 1. $ Ratios to Total Assets.

2. Figures in brackets are percentage shares to the respective total.

operating expenses of new private sector bank group, and such share makes a sharp contrast to the share of 62.1 per cent for old private sector bank group, 73.4 per cent for nationalised bank group, and 71.2 per cent for SBI group. The 'spread' of new private sector bank group declined from 2.23 per cent in 1997-98 to 1.98 per cent in 1998-99 (Table II.14).

Foreign Banks

2.40 Total assets of foreign banks[4] as at end-March 1999 constituted 8.1 per cent of the total assets of all SCBs. The operating profits of foreign bank group declined by 23.8 per cent from Rs.2,544.5 crore in 1997-98 to Rs.1,939.6 crore in 1998-99. The ratio of operating profits to total assets declined by 1.38 percentage points from 3.91 per cent in 1997-98 to 2.53 per cent in 1998-99. The decline in operating profits of foreign banks during the year could be attributed to the substantial increase in operational costs, i.e., interest expended (23.2 per cent) and operating expenses (33.6 per cent). During 1998-99, the operating profit ratio of these banks was higher than the SCBs' ratio of 1.47 per cent. The provisions and contingencies showed a decline of 1.31 percentage points from 2.94 per cent in 1997-98 to 1.63 per cent in 1998-99 (Chart II.8). The ratio of net profits to total assets of these banks declined from 0.97 per cent in 1997-98 to 0.90 per cent in 1998-99 (Table II.15).

2.41 On the cost side, the ratio of intermediation cost to total assets increased from 2.97 per cent in 1997-98 to 3.37 per cent in 1998-99. An analysis of cost structure of the SCBs indicates that the intermediation cost ratio of foreign banks at 3.37 per cent is higher than that of all SCBs (2.65 per cent). The wages and automation expenses accounting for a major share in operating expenses led to its increase during the year. The spread of foreign bank group at 3.47 per cent in 1998-99 is higher than the spread of all as well as the sub-groups of SCBs (Chart II.9). However, it is important to note that out of forty four banks, four banks *viz.*, Citibank, ANZ Grindlays Bank Ltd., Standard Chartered Bank, and Bank of

Chart II.8: Bank Group-wise Provisions and Contingencies to Total Assets of Scheduled Commercial Banks: 1997-98 and 1998-99

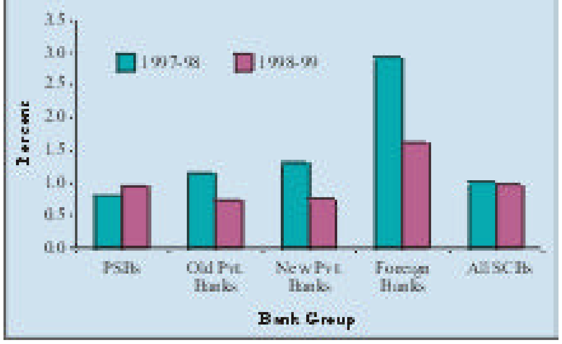
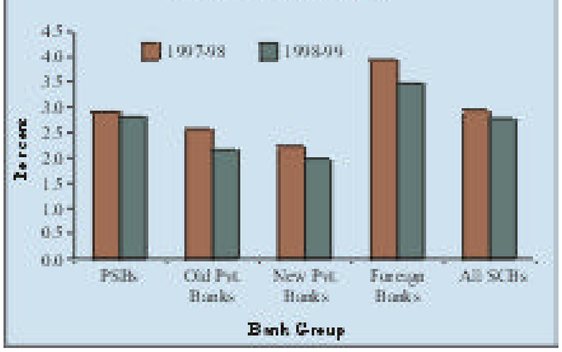


Chart II.9: Bank Group-wise Spread to Total Assets of Scheduled Commercial Banks: 1997-98 and 1998-99



4. During the year, the following changes took place relating to the number of foreign banks in India. The Commercial Bank of Korea stopped doing banking business in India w.e.f. January 1, 1998. Its licence was cancelled on May 18, 1999 and went outside the purview of Banking Regulation Act, 1949 on May 22, 1999. Accordingly, the figures of this bank for the year 1998-99 are not included in this Report. Hanil Bank has been excluded from the Second Schedule to the Reserve Bank of India Act, 1934, vide Reserve Bank of India notification dated August 28, 1999. The British Bank of Middle East has been excluded from the Second Schedule to the Reserve Bank of India Act, 1934, vide Reserve Bank of India notification dated September 25, 1999. Three new foreign banks came into existence and these include (a) Bank Muscat International (w.e.f. 9.9.1998), (b) Morgan Guaranty Trust Company of New York (w.e.f. 24.12.98), and (c) K.B.C. Bank N.V. (w.e.f. 15.02.1999).

Table II.14: Financial Performance of New Private Sector Banks for the years 1997-98 and 1998-99

(Rs. crore)

Item		1997-98	1998-99	Variation of Column (3) over (2)	
				Absolute	Percentage
1		2	3	4	5
A.	**Income (i+ii)**	**3,015.07 (100.00)**	**4,130.49 (100.00)**	**1,115.42**	**36.99**
	i) Interest Income	2,395.21 (79.44)	3,540.88 (85.73)	1,145.67	47.83
	ii) Other Income	619.86 (20.56)	589.61 (14.27)	-30.25	-4.88
B.	**Expenditure (i+ii+iii)**	**2,615.55 (100.00)**	**3,733.44 (100.00)**	**1,117.89**	**42.74**
	i) Interest Expended	1,819.79 (69.58)	2,776.94 (74.38)	957.15	52.60
	ii) Provisions and Contingencies	340.04 (13.00)	287.23 (7.69)	-52.81	-15.53
	iii) Operating Expenses	455.72 (17.42)	669.27 (17.93)	213.55	46.86
	of which : Wage Bill	79.57 (3.04)	119.72 (3.21)	40.15	50.46
C.	**Profit**				
	i) Operating Profit	739.56	684.28	-55.28	-7.47
	ii) Net Profit	399.52	397.05	-2.47	-0.62
D.	**Total Assets**	**25,844.94**	**38,530.87**	**12,685.93**	**49.08**
E.	**Financial Ratios (per cent) $**				
	i) Operating Profit	2.86	1.78	-1.08	—
	ii) Net Profit	1.55	1.03	-1.52	—
	iii) Income	11.67	10.72	-0.95	—
	iv) Interest Income	9.27	9.19	-0.08	—
	v) Other Income	2.40	1.53	-0.87	—
	vi) Expenditure	10.12	9.69	-0.43	—
	vii) Interest Expended	7.04	7.21	0.17	—
	viii) Operating Expenses	1.76	1.74	-0.02	—
	ix) Wage Bill	0.31	0.31	0.00	—
	x) Provisions and Contingencies	1.32	0.75	-0.57	—
	xi) Spread (Net Interest Income)	2.23	1.98	-0.24	—

Notes : 1. $ Ratios to Total Assets.
2. Figures in brackets are percentage shares to the respective total.

Table II.15: Financial Performance of Foreign Banks in India for the years 1997-98 and 1998-99

(Rs. crore)

Item	1997-98	1998-99	Variation of Column (3) over (2) Absolute	Percentage
1	2	3	4	5
A. Income (i+ii)	**8,697.53 (100.0)**	**9,719.02 (100.0)**	**1,021.49**	**11.74**
i) Interest Income	6,783.09 (77.99)	7,857.13 (80.84)	1,074.04	15.83
ii) Other Income	1,914.44 (22.01)	1,861.89 (19.16)	-52.55	-2.74
B. Expenditure (i+ii+iii)	**8,067.56 (100.00)**	**9,025.65 (100.00)**	**958.09**	**11.88**
i) Interest Expended	4,222.29 (52.34)	5,200.57 (57.62)	978.28	23.17
ii) Provisions and Contingencies	1,914.57 (23.73)	1,246.24 (13.81)	-668.33	-34.91
iii) Operating Expenses	1,930.70 (23.93)	2,578.84 (28.57)	648.14	33.57
of which : Wage Bill	618.72 (7.67)	769.86 (8.53)	151.14	24.43
C. Profit				
i) Operating Profit	2,544.54	1,939.61	-604.93	-23.77
ii) Net Profit	629.97	693.37	63.40	10.06
D. Total Assets	**65,097.71**	**76,623.13**	**11,525.42**	**17.70**
E. Financial Ratios (per cent) $				
i) Operating Profit	3.91	2.53	-1.38	—
ii) Net Profit	0.97	0.90	-0.07	—
iii) Income	13.36	12.68	-0.68	—
iv) Interest Income	10.42	10.25	-0.17	—
v) Other Income	2.94	2.43	-0.51	—
vi) Expenditure	12.39	11.78	-0.61	—
vii) Interest Expended	6.49	6.79	0.30	—
viii) Operating Expenses	2.97	3.37	0.40	—
ix) Wage Bill	0.95	1.00	0.05	—
x) Provisions and Contingencies	2.94	1.63	-1.31	—
xi) Spread (Net Interest Income)	3.93	3.47	-0.46	—

Notes : 1. $ Ratios to Total Assets.
2. Number of banks for 1997-98 and 1998-99 are 42 and 44 respectively.
3. Figures in brackets are percentage shares to the respective total.

America NT&SA, accounted for 52.4 per cent, 71.8 per cent, and 87.5 per cent in total assets, operating profits, and net profits of this group respectively. Appendix Tables II.6(A) to (H) provide bank-wise details of certain financial indicators of foreign banks in India.

Off-Balance Sheet Activities of Scheduled Commercial Banks

2.42 The off-balance sheet activities of SCBs include the activities relating to the forward exchange contracts, guarantees and acceptances, endorsement, etc. The off-balance sheet exposures of SCBs have shown a decline of 3.4 per cent from Rs.4,74,094 crore in 1997-98 to Rs.4,57,855 crore in 1998-99. The off-balance sheet exposure (contingent liabilities) as a proportion to the total liabilities of all SCBs has also declined by 11.4 percentage points from 59.6 per cent in 1997-98 to 48.2 per cent in 1998-99. Such decline in off-balance sheet exposures can be attributed to the discernible decline in the proportion of forward exchange contracts by 10.0 percentage points from 45.2 per cent in 1997-98 to 35.2 per cent in 1998-99.

2.43 An intra-sectoral analysis indicates that as a proportion to total liabilities, the highest decline in the off-balance sheet exposures (contingent liabilities) was found in the case of foreign banks (79.6 percentage points from 367.6 per cent in 1997-98 to 288.0 per cent in 1998-99), followed by new private sector banks (30.4 percentage points from 113.5 per cent in 1997-98 to 83.1 per cent in 1998-99), old private sector banks (7.6 percentage points from 31.8 per cent in 1997-98 to 24.2 per cent in 1998-99), and public sector banks (4.3 percentage points from 28.9 per cent in 1997-98 to 24.6 per cent in 1998-99). The decline in such off-balance sheet exposure of all bank groups is mainly attributed to the decline in the proportion of forward exchange contracts in their respective total liabilities. The proportion of forward exchange contracts in total liabilities, declined by 76.9 percentage points (from 328.3 per cent in 1997-98 to 251.4 per cent in 1998-99) in the case of foreign banks, 28.0 percentage points (from 89.4 per cent in 1997-98 to 61.4 per cent in 1998-99) in case of new private sector banks, 8.1 percentage points (from 25.3 per cent in 1997-98 to 17.2 per cent in 1998-99) in case of old private sector banks and 2.9 percentage points (from 16.8 per cent in 1997-98 to 13.9 per cent in 1998-99) in case of public sector banks (Table II.16) (Chart II.10).

4. Non-Performing Assets

2.44 While the non-performing assets (NPAs) of PSBs showed a marginal decline, an increase was witnessed in all other bank groups. During the year 1998-99, number of PSBs with net NPAs upto 10 per cent increased by one to 18 and the number of banks with net NPAs in the range of 10 per cent to 20 per cent declined by one to 8 with one bank continuing to show NPAs above 20 per cent (Table II.17). The number of old private sector banks with the net NPAs below 10 per cent was 17 as against 21 in 1997-98; those above 20 per cent were 3 as against nil in the last three years. In the case of foreign banks, those with net NPAs upto 10 per cent declined from 34 to 27 over the year and those above 20 per cent stood at 3 as against 2 in the last year. The number of foreign banks with net NPAs ranging between 10 to 20 per cent increased to 11 from 6 in the preceding year (Table II.18).

Chart II.10: Bank Group-wise Off-Balance Sheet Items to Total Assets of Scheduled Commercial Banks: 1997-98 and 1998-99

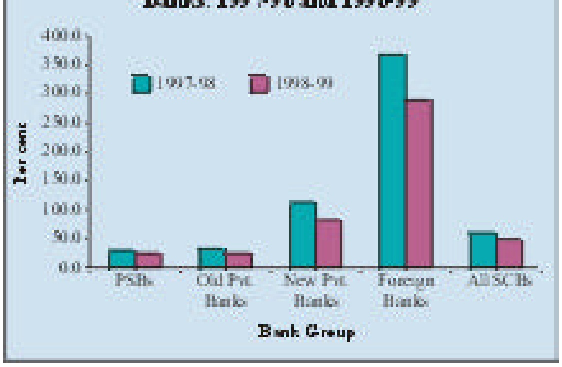


Table II.16: Off-Balance Sheet Exposure of Scheduled Commercial Banks in India: 1997-98 and 1998-99

(Rs. crore)

Item	State Bank Group			Nationalised Banks			Public Sector Banks		
	1997-98	1998-99	Variations	1997-98	1998-99	Variations	1997-98	1998-99	Variations
1	2	3	4	5	6	7	8	9	10
1. Forward exchange contract	37,614.53	42,572.15	13.18	71,455.44	64,608.26	-9.58	1,09,069.97	1,07,180.41	-1.73
	(16.15)	(14.89)	-1.26	(17.15)	(13.34)	-3.81	(16.79)	(13.91)	-2.88
2. Guarantees given	16,757.13	17,670.05	5.45	23,259.33	24,321.51	4.57	40,016.46	41,991.56	4.94
	(7.20)	(6.18)	-1.02	(5.58)	(5.02)	-0.56	(6.16)	(5.45)	-0.71
3. Acceptances,	16,848.35	16,564.52	-1.68	22,044.29	23,570.69	6.92	38,892.64	40,135.21	3.19
endorsements, etc.	(7.24)	(5.79)	-1.44	(5.29)	(4.87)	-0.42	(5.99)	(5.21)	-0.78
Total Contingent Liabilities	**71,220.01**	**76,806.72**	**7.84**	**1,16,759.06**	**1,12,500.46**	**-3.65**	**1,87,979.07**	**1,89,307.18**	**0.71**
	(30.59)	**(26.86)**	**-3.72**	**(28.02)**	**(23.22)**	**-4.80**	**(28.94)**	**(24.58)**	**-4.37**

	New Private Sector Banks			Old Private Sector Banks			Foreign Banks			All SCBs		
	1997-98	1998-99	Variations	1997-98	1998-99	Variations	1997-98	1998-99	Variations	1997-98	1998-99	Variations
	11	12	13	14	15	16	17	18	19	20	21	22
1. Forward exchange	23,099.92	23,663.40	2.44	13,890.47	11,233.17	-19.13	2,13,699.30	1,92,645.03	-9.85	3,59,759.66	3,34,722.01	-6.96
contract	(89.38)	(61.41)	-27.96	(25.27)	(17.17)	-8.10	(328.27)	(251.42)	-76.86	(45.23)	(35.20)	-10.03
2. Guarantees given	3,148.90	4,116.01	30.71	2,044.18	2,540.44	24.28	13,062.20	14,154.24	8.36	58,271.74	62,802.25	7.77
	(12.18)	(10.68)	-1.50	(3.72)	(3.88)	0.16	(20.07)	(18.47)	-1.59	(7.33)	(6.60)	-0.72
3. Acceptances,	3,081.48	4,223.39	37.06	1,559.49	2,062.93	32.28	12,529.12	13,909.63	11.02	56,062.73	60,331.16	7.61
endorsements, etc.	(11.92)	(10.96)	-0.96	(2.84)	(3.15)	0.32	(19.25)	(18.15)	-1.09	(7.05)	(6.34)	-0.70
Total Contingent	**29,330.30**	**32,002.80**	**9.11**	**17,494.14**	**15,836.54**	**-9.48**	**2,39,290.62**	**2,20,708.90**	**-7.77**	**4,74,094.13**	**4,57,855.42**	**-3.43**
Liabilities	**(113.49)**	**(83.06)**	**-30.43**	**(31.83)**	**(24.21)**	**-7.62**	**(367.59)**	**(288.04)**	**-79.54**	**(59.60)**	**(48.15)**	**-11.45**

Notes : 1. Figures in brackets are percentages to Total Assets.

2. The variations relating to the 'amounts' indicate the percentage variation in 1998-99 over 1997-98.

3. The variations relating to the 'percentage to Total Assets given in brackets' indicate the simple change in such figures during 1998-99 as compared to 1997-98.

Table II.17: Distribution of Net NPAs by Number of Public Sector Banks: 1995 to 1999

(Number of banks)

Net NPAs/ Net Advances	End-March				
	1995	**1996**	**1997**	**1998**	**1999**
1. Upto 10 per cent	2	19	17	17	18
2. Above 10 and upto 20 per cent	15	6	9	9	8
3. Above 20 per cent	10	2	1	1	1

Table II.18: Distribution of Net NPAs by Number of Indian Private Sector Banks and Foreign Banks in India: 1996 to 1999

(Number of banks)

Net NPAs/ Net Advances	End-March			
	1996	**1997**	**1998**	**1999**
Old Indian Private Sector Banks				
1. Upto 10 per cent	22	22	21	17
2. Above 10 and upto 20 per cent	3	3	4	5
3. Above 20 per cent	Nil	Nil	Nil	3
New Indian Private Sector Banks				
1. Upto 10 per cent	9	9	9	9
2. Above 10 and upto 20 per cent	Nil	Nil	Nil	Nil
3. Above 20 per cent	Nil	Nil	Nil	Nil
Foreign Banks in India @				
1. Upto 10 per cent	30	36	34	27
2. Above 10 and upto 20 per cent	1	1	6	11
3. Above 20 per cent	Nil	2	2	3

Notes: @ Number of banks having nil NPAs for 1996, 1997, 1998 and 1999 were 12, 16, 14 & 9 respectively. For 1999, 3 banks' NPAs are not available.

2.45 An analysis of NPAs of different bank groups showed that with the exception of public sector banks (PSBs), the other bank groups (i.e. private sector and foreign banks) witnessed increases during 1998-99 (Table II.19). In the case of PSBs, marginal decline in NPAs ratio was mainly aided by an increase in the share of standard assets and commensurate declines in the shares of doubtful and sub-standard assets (Table II.20). However, the declining trend of NPAs of SCBs witnessed till the year 1997-98 could not be sustained in 1998-99. The gross NPAs to total assets of SCBs, however, declined from 6.4 per cent in 1997-98 to 6.2 per cent in 1998-99 and net NPAs to net total assets also declined from 3.0 per cent in 1997-98 to 2.9 per cent in 1998-99.

Public Sector Banks

2.46 An analysis of NPAs of different bank groups indicate that PSBs hold larger share of

Table II.19: Bank Group-wise Gross and Net NPAs of Scheduled Commercial Banks: 1997 to 1999 (as at end-March)

(Amount in Rs. crore)

Bank Groups/Years			Gross NPAs				Net NPAs	
	Gross Advances	Gross NPAs	Per cent to Gross Advances	Per cent to Total Assets	Net Advances	Net NPAs	Per cent to Net Advances	Per cent to Total Assets
1	2	3	4	5	6	7	8	9
Scheduled Commercial Banks								
1997	3,01,698	47,300	15.7	7.0	2,76,421	22,340	8.1	3.3
1998	3,52,697	50,815	14.4	6.4	3,25,522	23,761	7.3	3.0
1999	4,01,253	58,554	14.6	6.2	3,70,397	27,774	7.5	2.9
Public Sector Banks								
1997	2,44,214	43,577	17.8	7.8	2,20,922	20,285	9.2	3.6
1998	2,84,971	45,653	16.0	7.0	2,60,459	21,232	8.2	3.3
1999	3,25,328	51,710	15.9	6.7	2,97,789	24,211	8.1	3.1
All Private Sector Banks								
1997	29,959	2,542	8.5	4.2	28,646	1,539	5.4	2.5
1998	36,753	3,186	8.7	3.9	35,411	1,863	5.3	2.3
1999	44,492	4,643	10.4	4.5	42,717	2,956	6.9	2.8
Old Private Sector Banks								
1997	21,702	2,325	10.7	5.2	20,832	1,385	6.6	3.1
1998	25,580	2,794	10.9	5.1	24,353	1,572	6.5	2.9
1999	29,105	3,773	13.0	5.8	27,692	2,332	8.4	3.6
New Private Sector Banks								
1997	8,257	217	2.6	1.3	7,814	154	2.0	1.0
1998	11,173	392	3.5	1.5	11,058	291	2.6	1.1
1999	15,387	871	5.7	2.3	15,025	623	4.1	1.6
Foreign Banks in India								
1997	27,525	1,181	4.3	2.1	26,853	516	1.9	0.9
1998	30,972	1,976	6.4	3.0	29,652	666	2.2	1.0
1999	31,433	2,201	7.0	2.9	29,890	607	2.0	0.8

Notes: 1. Figures are provisional.
2. Constituent items may not add up to the totals due to rounding off.

Source: 1. Returns submitted by respective banks.
2. Balance sheet of respective banks.

NPAs. During the year 1998-99, the level of gross NPAs to gross advances declined from 16.0 per cent in 1997-98 to 15.9 per cent in 1998-99 facilitated by a marginal reduction in sub-standard and doubtful assets and concomitant increase in standard assets. The share of standard assets to gross advances increased from 84.0 per cent in 1997-98 to 84.1 per cent in 1998-99. Similarly, net NPAs to net advances declined from 8.2 per cent in 1997-98 to 8.1 per cent in 1998-99.

Table II.20: Bank Group-wise Classification of Loan Assets of Scheduled Commercial Banks: 1997 to 1999 (as at end-March)

(Amount in Rs. crore)

Bank Groups/ Years	Standard Assets		Sub-standard Assets		Doubtful Assets		Loss Assets		Total NPAs		Total Advances
	Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount
1	2	3	4	5	6	7	8	9	10	11	12
Scheduled Commercial Banks											
1997	2,54,446	84.3	14,500	4.8	27,165	9.0	5,634	1.9	47,300	15.7	3,01,698
1998	3,01,877	85.6	17,428	4.9	27,146	7.7	6,242	1.8	50,815	14.4	3,52,696
1999	3,42,428	85.3	19,813	4.9	31,301	7.8	7,441	1.9	58,555	14.6	4,01,253
Public Sector Banks											
1997	2,00,637	82.2	12,472	5.1	26,015	10.7	5,090	2.1	43,577	17.8	2,44,214
1998	2,39,318	84.0	14,463	5.1	25,819	9.1	5,371	1.9	45,653	16.0	2,84,971
1999	2,73,618	84.1	16,033	4.9	29,252	9.0	6,425	2.0	51,710	15.9	3,25,328
All Private Sector Banks											
1997	27,417	91.5	1,370	4.6	889	3.0	283	0.9	2,542	8.5	29,959
1998	33,567	91.3	1,766	4.8	1,077	2.9	343	0.9	3,186	8.7	36,753
1999	39,848	89.6	2,655	6.0	1,584	3.6	404	0.9	4,643	10.4	44,492
Old Private Sector Banks											
1997	19,377	89.3	1,199	5.5	885	4.1	241	1.1	2,325	10.7	21,702
1998	22,786	89.1	1,402	5.5	1,068	4.2	324	1.3	2,794	10.9	25,580
1999	25,332	87.0	1,918	6.6	1,456	5.0	398	1.4	3,773	13.0	29,105
New Private Sector Banks											
1997	8,040	97.4	171	2.1	4	0.0	42	0.5	217	2.6	8,257
1998	10,781	96.5	365	3.3	9	0.1	19	0.2	392	3.5	11,173
1999	14,516	94.3	737	4.8	128	0.8	6	0.0	871	5.7	15,387
Foreign Banks in India											
1997	26,392	95.9	658	2.4	261	0.9	261	0.9	1,181	4.3	27,525
1998	28,992	93.6	1,198	3.9	250	0.8	528	1.7	1,976	6.4	30,972
1999	28,962	92.1	1,124	3.6	465	1.5	612	1.9	2,201	7.0	31,433

Notes : 1. Figures are provisional.

2. NPAs consist of assets including (i) Sub-standard, (ii) Doubtful, and (iii) Loss Assets. An asset becomes (i) Sub-standard when it is classified as NPA for a period not exceeding two years, (ii) Doubtful when it remains NPA for a period exceeding two years, and (iii) Loss when it is identified asset either by a bank or an internal or external auditors or under RBI instructions, but not written off.

3. Constituent items may not add up to the totals due to rounding off.

Source : 1. Returns submitted by respective banks.

2. Balance sheet of respective banks.

However, in absolute terms, both gross and net NPAs registered substantial increases. While gross NPAs increased from Rs.45,653 crore in 1997-98 to Rs.51,710 crore in 1998-99 (Table II.19), net NPAs moved up from Rs.21,232 crore in 1997-98 to Rs.24,211 crore in 1998-99. The gross NPAs as a fraction of total assets declined from 7.0 per cent in 1997-98 to 6.7 per cent in 1998-

99 and net NPAs, as a percentage to total assets declined from 3.3 per cent in 1997-98 to 3.1 per cent in 1998-99. Further details are given in Appendix Tables II.7A and II.7B.

2.47 Sector-wise analysis of NPAs of PSBs indicates that the share of NPAs of priority sector has declined from 50.0 per cent at end-March 1995 to 43.7 per cent at end-March 1999. This indicates marked improvements in the loan portfolio of PSBs in the category of 'priority sector' (Table II.21).

Private Sector Banks

2.48 During 1998-99, NPAs of private sector bank (both old and new private sector banks) witnessed significant increases affected by the substantial decline in standard assets. A similar trend was seen in the case of the foreign bank group. While gross NPAs of all private banks increased from 8.7 per cent during 1997-98 to 10.4 per cent during 1998-99, the net NPAs to net advances indicated an increase from 5.3 per cent during 1997-98 to 6.9 per cent during 1998-99. Also another concern is the increase in the share of NPAs to total assets. The gross NPAs to total assets increased from 3.9 per cent in 1997-98 to 4.5 per cent in 1998-99 and that of net NPAs to total assets rose from 2.3 per cent during 1997-98 to 2.8 per cent during 1998-99. Further details are given in Appendix Tables II.7C and II.7D.

Old Private Sector Banks

2.49 Among the private sector bank group, the NPAs of old private sector bank group showed higher increases during 1998-99 mainly due to significant declines in standard assets. The 'standards assets' to total advances declined from 89.3 per cent in 1996-97 to 89.1 per cent in 1997-98 and further to 87.0 per cent in 1998-99.

2.50 The gross NPAs to total advances of old private sector bank group increased from 10.9 per cent in 1997-98 to 13.0 per cent in 1998-99. Similarly, net NPAs to net advances also increased from 6.5 per cent in 1997-98 to 8.4 per cent in 1998-99. Another concern is the increasing share of NPAs to total assets during the year. The gross NPAs to total assets of old private sector bank group moved up from 5.1 per cent during 1997-98 to 5.8 per cent during 1998-99. Likewise, net NPAs to total assets increased from 2.9 per cent in 1997-98 to 3.6 per cent in 1998-99.

New Private Sector Banks

2.51 During 1998-99, the new private sector bank group had the smallest share of NPAs but showed substantial increases in NPAs. Besides, new private sector banks maintained the highest share of 'standard assets' to total advances than all other banking groups even though it has indicated a decline during the year. The gross NPAs to total advances of new private sector bank group increased from 3.5 per cent in 1997-98 to 5.7 per cent in 1998-99 mainly effected by the marginal declines in standard assets. In regard to the share of net NPAs to net advances of new private sector banks, it increased from 2.6 per cent in 1997-98 to 4.1 per cent in 1998-99. The gross NPAs to total assets also increased from 1.5 per cent in 1997-98 to 2.3 per cent in 1998-99. Like wise, the net NPAs to total assets also increased from 1.1 per cent in 1997-98 to 1.6 per cent in 1998-99.

Foreign Banks

2.52 During 1998-99, the NPAs of foreign bank group were on the rise as a result of steady decline in standard assets. The share of standard assets to total advances has come down from 95.9 per cent in 1996-97 to 93.6 per cent in 1997-98 and further to 92.1 per cent in 1998-99. The gross NPAs to total advances increased from 6.4 per cent during 1997-98 to 7.0 per cent during 1998-99. In respect of the share of net NPAs to net advances during 1998-99, it is the lowest among

Table II.21: Sector-wise NPAs of Public Sector Banks: 1995 to 1999

(Rs. crore)

Bank Group	Priority Sector	Non-priority Sector	Public Sector	Total
1	2	3	4	5
March 1995				
1. SBI	6,966	5,495	809	13,271
	(52.5)	(41.4)	(6.1)	(100.0)
2. Nationalised Banks	12,242	12,366	507	25,114
	(48.7)	(49.2)	(2.0)	(100.0)
3. PSBs (1+2)	19,208	17,861	1,316	38,385
	(50.0)	(46.5)	(3.4)	(100.0)
March 1996				
1. SBI	7,041	5,263	816	13,120
	(53.7)	(40.1)	(6.2)	(100.0)
2. Nationalised Banks	12,065	13,804	595	26,464
	(45.6)	(52.2)	(2.3)	(100.0)
3. PSBs (1+2)	19,106	19,067	1,411	39,584*
	(48.3)	(48.2)	(3.6)	(100.0)
March 1997				
1. SBI	7,247	6,291	829	14,368
	(50.4)	(43.8)	(5.8)	(100.0)
2. Nationalised Banks	13,527	15,050	632	29,209
	(46.3)	(51.5)	(2.2)	(100.0)
3. PSBs (1+2)	20,774	21,341	1,461	43,577
	(47.7)	(49.0)	(3.3)	(100.0)
March 1998				
1. SBI	7,470	7,390	662	15,522
	(48.1)	(47.6)	(4.3)	(100.0)
2. Nationalised Banks	13,714	15,717	700	30,130
	(45.5)	(52.2)	(2.3)	(100.0)
3. PSBs (1+2)	21,184	23,107	1,362	45,653
	(46.4)	(50.6)	(3.0)	(100.0)
March 1999(P)				
1. SBI	8,318	9,668	655	18,641
	(44.6)	(51.9)	(3.5)	(100.0)
2. Nationalised Banks	14,289	17,940	841	33,069
	(43.2)	(54.3)	(2.5)	(100.0)
3. PSBs (1+2)	22,607	27,608	1,496	51,710
	(43.7)	(53.4)	(2.9)	(100.0)

Notes : 1. * Revised to Rs.41,661 crore.
P Provisional.
2. Figures in brackets are percentages to the total.
3. Constituent items may not add up to the totals due to rounding off.

various bank groups. The share of net NPAs declined from 2.2 per cent in 1997-98 to 2.0 per cent in 1998-99. The gross NPAs as a percentage of total assets witnessed decline from 3.0 per cent during 1997-98 to 2.9 per cent during 1998-99 and net NPAs to total assets also declined from 1.0 per cent during 1997-98 to 0.8 per cent during 1998-99. Further details are given in Appendix Tables II.7E and II.7F.

NPAs: A Cross-Country Comparison

2.53 Containment of NPAs within a tolerable level is very important for enhancing confidence in the banking sector and for ensuring the contribution of the sector to macroeconomic stability. This is evident from the cross-country analysis of NPAs and on this attention has been focussed since about the middle of 1980s (Box II.3).

Box II.3: NPAs: A Cross-Country Comparison

Since the mid-eighties, banking crises have come to the forefront of economic analysis. Situations of banking distress have quickly intensified and in the process, have become one of the main obstacles to stability to the financial system. According to Lindgren *et.al.*(1996), 73 per cent of the member countries of the International Monetary Fund's (IMF) experienced at least one bout of significant banking sector problems from 1980 to 1996. More importantly, such crises have resulted in severe bank losses or public sector resolution costs. As Caprio and Klingebiel (1996) observe, such costs amounted to 10 per cent or more of GDP in at least a dozen developing country episodes during the past 15 years. Recent studies by Honohan (1996) provide the estimated resolution costs of banking crises in developing and transition economies since 1980 are pegged at US $ 250 billion and reinforce this view.

Such intensity of banking crises has raised the question as to the reasons why such crises occur? Several arguments have been raised in the literature, including, among others, volatility in market environment, the increased leverage of banks, connected lending practices and regulatory forbearance in the face of political economy considerations. However, all these arguments seriously compromise on the objectivity in credit assessment, which has often been instrumental in building-up of the non-performing assets (NPAs) of banks. The accumulation of NPAs is exacerbated by the weaknesses in the accounting, disclosure, and legal framework. In many developing countries, accounting conventions are not rigorous enough to prevent banks and their borrowers from concealing the true size of their NPA portfolio. Often bad loans are made to look good by additional lending to troubled borrowers ("ever-greening"). If loan classification is dependent only on the loan payment status-without regard to the borrower's credit worthiness or to the market value of collateral-then the potential delay in recognizing bad loans can be considerable. And if non-performing loans are systemically understated, loan-loss provisions are apt to be too low, and bank net income and capital will be systemically overstated. Without accurate information on the true financial condition of banks, it is difficult for private investors or supervisors to monitor and discipline errant banks.

Studies have reported that the publicly reported figures on non-performing loans gave little hint of banking crises in Chile and Colombia in the early 1980s. Hausman and Rojas-Suarez (1996) observe that, on the eve of banking difficulties, reported ratios of non-performing to total loans in several Latin American economies were much lower in relation to the size of the subsequent banking problems. In some of the developing countries of the Asia Pacific Economic Co-operation (APEC) forum, a loan is classified as non-performing only after it has been in arrears for at least six months. One-third of total loans in Argentina's public sector banks were non-performing at the end of 1994. Of US $ 20 billion in non-performing loans in the December 1994 portfolio of Banespa-owned by Sao Paolo state of Brazil-more than half was owed by the State. Sheng (1996) cites one South-East Asian country that, until recently, allowed loans that had not been serviced for more than three years to be treated as performing. Mexican banks' planned transition to international accounting standards is expected to double the amount of past-due loans reported (Goldstein, 1996). However, recent loan classification guidelines for the Asian economies reveal that they are gradually moving towards compliance with international best practice (Table 1).

Once problem loans are identified, adequate loan-loss provisions must be established. But studies suggest that guidelines in many developing countries are unclear, weak or altogether absent. For example, as of August 1995, a

(Contd. ....)

(.......Contd.)

Table 1: Loan Classification Guidelines, 1998

Country	Classification of NPAs		Compliance with international best practices [1]
	Categories	Provisions (%)	
Indonesia	1. Current	1	Yes (3 months)
	2. Special mention	5	
	3. Sub-standard	15	
	4. Doubtful	50	
	5. Loss	100	
Korea	1. Sub-standard	20	Yes (3 months)
	2. Doubtful	75	
	3. Loss	100	
Malaysia [2]	1. Unclassified	1.5	Yes (3 months)
	2. Sub-standard	20	
	3. Doubtful	50	
	4. Bad /Loss	100	
Philippines	1. Unclassified	2 [3]	Yes (3 months)
	2. Esp. mentioned	0	
	3. Sub-standard	5 [4]	
	4. Doubtful	25 [4]	
	5. Loss	50	
		100	
Thailand [5]	1. Pass	1	Yes (3 months)
	2. Special mention		
	3. Sub-standard	2	
	4. Doubtful	20	
	5. Loss	50	
		100	

Notes: 1. As defined by the period in which loans are considered past due or non-performing (typically 90 days). For Philippines, effective May 1, 1998, on monthly installment loans.

2. Specific provisions for large loans (above RM 1 million) are made on a case-by-case basis as determined by the bank examiner. All provisions are made against the uncollateralised part of the loan.

3. Or general provision. For Philippines, 1 per cent by October 1, 1998 and 2 per cent by October 1, 1999.

4. By April 15, 1999. for sub-standard loans, the provisions are irrespective of whether the loans are collateralised or uncollateralised.

5. The new classification rules will be effective July 1, 1998, and provisioning rules, gradually over the period July 1998 to July 2000.

Source: Kochhar, K., P. Loungani and M.R. Stone (1998).

(Contd. ....)

(.......Contd.)

Table 2: Loan Classification Guidelines

Country	Loan loss Reserves[a] (A)	Non-performing loans (B)	Coverage Ratio (A/B)
		(percentage to total loans)	
Hong Kong	2.2 [b]	3.1	0.7
India	—	19.5 [c]	—
Indonesia	2.6	11.2	0.2
Korea	1.5	1.0	1.5
Malaysia	9.6	8.2	1.2
Singapore	—	—	1.2
Thailand	1.7	7.6	0.2
Argentina	10.2 [b]	10.5	1.0
Mexico	3.1 [d]	14.8	0.2
Japan	1.0	3.3	0.3
United States	2.7	1.6	1.7

Notes: 1. a. Average 1990-94.
b. Average 1994-95.
c. Relates only to public sector banks.
d. Average 1992-94.

2. Figures may not be strictly comparable.

Source: Goldstein (1996).

group of transition economies (Armenia, Azerbaijan, Georgia, Tajikistan and Ukraine) did not have regulations obliging banks to make provisions for problem loans. Where there are such guidelines, there appears to be wide variation in coverage across countries. Figures of provisioning-coverage ratios (i.e., the ratio of loan-loss reserves to non-performing loans) for a sample of developing countries in the early 1990s reveal that, on average, the developing countries with the highest share of non-performing loans tend to be the ones with the lowest provisioning coverage ratios, although there are a few exceptions (e.g., Argentina and Malaysia) where coverage in the face of a high non-performing loan share is quite conservative (Table 2).

There exist several policy measures that can significantly reduce the incidence of banking crises in emerging economies. Pertinent from the present point of view are effective implementation of existing restrictions on connected lending to limit undue concentration of credit risk, careful screening of loan applicants and stricter asset classification and provisioning practices. In this connection, there is a need for mechanisms that can improve the structure of incentives for bank owners, managers and creditors in the direction of bank soundness. Alongside, it is necessary to have some rule-based, prompt corrective action elements into the bank supervisory process that can enhance supervisory effectiveness amidst pressures for forbearance.

What lessons do such NPA norms hold for a country like India? In India, NPAs are defined as an advance that has not been serviced, as a result of 'past dues' accumulating for 180 days and over. In respect of the Indian banking system, due to the time lag involved in the process of recovery and the detailed safeguards/procedures involved before write-offs could be effected, banks, even after making provisions for the advances considered irrecoverable, continue to hold such advances in their books: these are termed as Gross NPAs together with the provisions. The provision-adjusted NPAs in Indian banking system, i.e., Net NPAs constituted only 8.1 per cent of the net advances of banks as on March 1999 which are not as alarming as Gross NPAs. In line with the recommendations of the Narasimham Committee and as

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(.......Concld.)

an endeavour to move towards international best practices, the time period for classifying an asset as NPA has progressively been reduced, while ensuring consistency with financial stability and macroeconomic policy. In this context, it is important to recognize that in many respects, asset classification norms in India are considerably tighter than the international best practices. In certain countries, an advance is considered as 'un-collectable' and classified as 'loss' asset only after it has remained past due or doubtful for a considerable length of time, whereas in India, an advance is to be classified as 'loss', the moment it is considered 'un-collectable'. Secondly, in certain other countries, the available securities are deducted from the 'doubtful' advance to arrive at the net doubtful portion, whereas in India, provision is required to be made even on the secured portion. Thirdly, while in India the provision required to be made in respect of the portion not covered by the realisable value of securities in 'doubtful' advance is 100 per cent, in other countries, it is 75 per cent or even 50 per cent. The concept of collateral also differs in as much as security of standby nature like guarantee of the promoter/third party, net worth of the promoter/guarantor is not considered as security in India. This implies that prudential norms in India are in several aspects stricter than the international best practices and the provisions made are significantly above the requirement of prudence.

It also needs to be appreciated that safety and soundness, as envisaged in the CRAR and NPA levels, are two distinct, yet inter-related aspects of banking. Banking, in the ultimate analysis, is an exercise in risk management and in an increasingly deregulated scenario where banks are increasingly resorting to non-traditional banking and off-balance sheet activities, capital is the only resource available to banks to absorb the adverse effects of any eventuality. However, capital adequacy ratios provide an effective cushion mainly in an upswing. But they might prove to be inadequate in downturns, as firms find it difficult to service their loans. As each firm tries to satisfy their capital adequacy standards, the whole system may find its strategy completely undermined, eventually resulting in a worsening of capital adequacy standards. It is therefore necessary to find out the levels of NPAs at which confidence in banking can be maintained at high levels and, at the same time, the level of CRAR needed to sustain the NPA level.

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5. Capital to Risk-Weighted Assets Ratio

2.54 The role of Capital to Risk-Weighted Assets Ratio (CRAR) is well documented in the recent literature on banking and financial stability. At the end March 1999, all PSBs have already achieved 9 per cent CRAR, barring one. There were 4 banks with CRAR between 8 and 10 per cent as at end-March, 1999 (Tables II.22 and II.23). Further details are given in Appendix Tables II.8A to II.8C.

6. Regional Rural Banks

2.55 The regional rural banks (RRBs), supplement the efforts of SCBs, co-operatives and

Table II.22: Distribution of CRAR – Public Sector Banks: 1997-98 and 1998-99

(Number of banks)

Banks	1997-98				1998-99			
	Below 4 per cent	Between 4-8 per cent	Between 8-10 per cent	Above 10 per cent	Below 4 per cent	Between 4-8 per cent	Between 8-10 per cent	Above 10 per cent
1	2	3	4	5	6	7	8	9
1. SBI	—	—	—	1	—	—	—	1
2. SBI Associates	—	—	1	6	—	—	—	7
3. Nationalised Banks	1	—	6	12	1	—	4	14
Total	**1**	**—**	**7**	**19**	**1**	**—**	**4**	**22**

Table II.23: Distribution of CRAR – Indian Private Sector Banks and Foreign Banks in India: 1997-98 and 1998-99

(Number of banks)

Bank Groups	1997-98				1998-99			
	Below 4 per cent	Between 4-8 per cent	Between 8-10 per cent	Above 10 per cent	Below 4 per cent	Between 4-8 per cent	Between 8-10 per cent	Above 10 per cent
1	2	3	4	5	6	7	8	9
1. Old Private Sector Banks	2	2	6	15	2	2	3	18
2. New Private Sector Banks	—	—	2	7	—	—	2	7
3. Foreign Banks	—	—	12	30	1	—	14	29

rural development banks and cater to the specialized credit requirements of the rural sector. At present, there are 196 RRBs catering to the credit requirements of 451 districts. In recent years, RRBs showed (i) increase in profits, (ii) improvements in recovery performance of loans and (iii) decline in the holdings of their non-performing assets (NPAs). RRBs are also adapting themselves to the evolving regulatory standards.

Mobilisation and Deployment of Funds

2.56 The total outstanding deposits (demand and time) of all RRBs showed a substantial increase of Rs.4,450 crore or 21.2 per cent from Rs.20,977 crore as on March 27, 1998 to Rs.25,428 crore as on March 26, 1999 (Table II.24). Their borrowings showed a more than two-fold increase from Rs.3.71 crore as on March 27, 1998 to Rs.7.90 crore as on March 26, 1999. On the asset side, bank credit showed an increase of Rs.1,330 crore or 13.7 per cent from Rs.9,687 crore as on March 27, 1998 to Rs.11,016 crore as on March 26, 1999.

2.57 The investments of RRBs continued to increase during 1998-99. They were up by 41.9 per cent, a shade higher than that of 41.8 per cent in the preceding year (Table II.24). A large part of their investment is channelised into other approved securities. The share of investment in other approved securities increased from 71.3 per cent as on March 27, 1998 to 76.2 per cent as on March 26, 1999. In contrast, the share of investment in government securities in total investment declined from 28.7 per cent in 1997-98 to 23.8 per cent in 1998-99.

Table II.24: Important Banking Indicators of RRBs: 1997 to 1999

(Rs. crore)

Item	March 28, 1997	March 27, 1998	March 26, 1999	Variations 1997-98	Variations 1998-99
1	2	3	4	5 (3-2)	6 (4-3)
1. Liabilities to the Banking System	**125.31**	**136.70**	**151.11**	**11.39 (9.1)**	**14.41 (10.5)**
2. Liabilities to Others	**17,542.24**	**21,659.75**	**26,318.53**	**4,117.51 (23.5)**	**4,658.78 (21.5)**
2.1 Aggregate Deposits (a+b)	16,971.34	20,977.37	25,427.83	4,006.03 (23.6)	4,450.46 (21.2)
(a) Demand Deposits	2,946.53	3,804.79	4,688.33	858.26 (29.1)	883.54 (23.2)
(b) Time Deposits	14,024.81	17,172.58	20,739.50	3,147.77 (22.4)	3,566.92 (20.8)
2.2 Borrowings	0.59	3.71	7.90	3.12 (528.8)	4.19 (112.9)
2.3 Other Demand & Time Liabilities*	570.31	678.67	882.80	108.36 (19.0)	204.13 (30.1)
3. Assets with the Banking System	**7,593.85**	**9,414.68**	**11,319.45**	**1,820.83 (24.0)**	**1,904.77 (20.2)**
4. Bank Credit	**8,544.02**	**9,686.69**	**11,016.47**	**1,142.67 (13.4)**	**1,329.78 (13.7)**
5. Investments (a+b)	**2,487.66**	**3,527.61**	**5,006.90**	**1,039.95 (41.8)**	**1,479.29 (41.9)**
a. Govt. Securities	722.91	1,011.09	1,190.54	288.18 (39.9)	179.45 (17.7)
b. Other Approved Securities	1,764.75	2,516.52	3,816.36	751.77 (42.6)	1,299.84 (51.7)
6. Cash Balances	**225.99**	**253.22**	**299.59**	**27.23 (12.0)**	**46.37 (18.3)**
Memorandum Items :					
a. Cash Balance-Deposit Ratio	1.3	1.2	1.2		
b. Credit-Deposit Ratio	50.3	46.2	43.3		
c. Investment/Deposit Ratio	14.7	16.8	19.7		
d. Investment+Credit/Deposit Ratio	65.0	63.0	63.0		

Notes: 1. * includes Participation Certificates issued to others.
2. Figures in brackets are percentage variations.

2.58 An analysis of the investment-deposit and credit-deposit ratio indicates that there was a perceptible shift in the assets portfolio of RRBs. The aggregate investment-deposit ratio of RRBs increased from 14.7 per cent as on March 28, 1997 to 16.8 per cent as on March 27, 1998 and then to 19.7 per cent as on March 26, 1999, while the credit-deposit ratio declined from 50.3 per cent to 46.2 per cent and further to 43.3 per cent over the same period. The investment and credit to deposit ratio stood at 63.0 per cent in 1998-99 as in the previous year.

Table II.25: Purpose-wise Disbursements of Loans and Advances of RRBs: 1997 and 1998

(Rs. crore)

	Purpose	As at end-March	
		1997	1998
	1	2	3
1.	Short term (crop loans)	1,203	1,413
2.	Term loan for agriculture and allied activities	588	640
3.	Investments		6
I	**Total Agriculture (1 to 3)**	**1,791**	**2,059**
		(45.6)	**(44.4)**
4.	Rural artisans, village and cottage industries	218	194
5.	Other Industries		162
6.	Retail trade and Self- employed, etc.	619	625
7.	Consumption loans	300	123
8.	Other purposes *	1,088	1,471
II	**Total Non-Agriculture (4 to 8)**	**2,225**	**2,575**
		(55.4)	**(55.6)**
	Total (I+II)	**4,016**	**4,634**
		(100.0)	**(100.0)**

Notes: 1. * include indirect advances.

2. Figures in brackets are percentages to the total.

Source: NABARD.

Purpose-wise Disbursements of Loans and Advances

2.59 Data on purpose-wise disbursements of loans and advances of RRBs are not as yet available for end-March 1999. As on March 31, 1998, the non-agricultural advances[5] constituted a larger share of 55.6 per cent, while the agricultural advances accounted for 44.4 per cent of the total advances (Table II.25). A significant proportion of agricultural loans is in the form of short-term crop loans. As at end-March 1998, the short-term crop loans at Rs.1,413 crore constituted a share of 68.6 per cent, while the term loans at Rs.640 crore accounted for a relatively smaller share of 31.1 per cent.

Financial Performance of RRBs

2.60 Of the 196 RRBs, the audited results on financial performance are available for 177 RRBs for the year 1998-99. An analysis of the financial performance of these RRBs shows that there have been significant improvements in both the number of profit-making banks as well as the profitability of these banks during 1998-99 as compared to 1997-98. The number of profit-making RRBs increased from 109 in 1997-98 to 132 in 1998-99. The operating profits of these banks showed more than a two-fold increase from Rs.114.47 crore in 1997-98 to Rs.304.66 crore in 1998-99 (Table II.26). The ratio of operating profits to total assets also showed more than a two-fold increase

5. Non-agricultural advances consist of advances to rural artisans, village and cottage industries, retail trade and self-employed, etc., and indirect advances.

Table II.26: Financial Performance of Regional Rural Banks: 1997-98 and 1998-99

(Rs. crore)

Item	1997-98			1998-99		
	Loss Making (68)	Profit Making (109)	177 RRBs	Loss Making (45)	Profit Making (132)	177 RRBs
1	2	3	4	5	6	7
A. Income (i+ii)	**651.48**	**1,856.22**	**2,507.70**	**525.33**	**2,630.03**	**3,155.36**
(i) Interest Income	618.22	1,765.00	2,383.22	493.18	2,517.81	3,010.99
(ii) Other Income	33.26	91.22	124.48	32.15	112.22	144.37
B. Expenditure (i+ii+iii)	**877.16**	**1,587.19**	**2,464.35**	**695.71**	**2,230.93**	**2,926.64**
(i) Interest Expended	542.42	1,079.20	1,621.62	433.47	1,520.22	1,953.69
(ii) Provisions and Contingencies	30.85	40.27	71.12	24.33	51.61	75.94
(iii) Operating Expenses	303.89	467.72	771.61	237.91	659.10	897.01
of which: Wage Bill	268.49	403.03	671.52	209.49	572.71	782.20
C. Operating Profit/Loss	**-194.83**	**309.30**	**114.47**	**-146.05**	**450.71**	**304.66**
D. Net Profit/Loss	**-225.68**	**269.03**	**43.35**	**-170.38**	**399.10**	**228.72**
E. Total Assets	**8,889.51**	**18,036.97**	**26,926.48**	**6,953.64**	**25,762.53**	**32,716.17**
F. Financial Ratios (per cent) $						
(i) Operating Profit/Loss	-2.19	1.71	0.43	-2.10	1.75	0.93
(ii) Net Profit/Loss	-2.54	1.49	0.16	-2.45	1.55	0.70
(iii) Income	7.33	10.29	9.31	7.55	10.21	9.64
(iv) Interest Income	6.95	9.79	8.85	7.09	9.77	9.20
(v) Other Income	0.37	0.51	0.46	0.46	0.44	0.44
(vi) Expenditure	9.87	8.80	9.15	10.00	8.66	8.95
(vii) Interest Expended	6.10	5.98	6.02	6.23	5.90	5.97
(viii) Operating Expenses	3.42	2.59	2.87	3.42	2.56	2.74
(ix) Wage Bill	3.02	2.23	2.49	3.01	2.22	2.39
(x) Provisions and Contingencies	0.35	0.22	0.26	0.35	0.20	0.23
(xi) Spread (Net Interest Income)	0.85	3.80	2.83	0.86	3.87	3.23

Notes: 1. Date related to audited balance sheets of 177 RRBs.
2. $ Ratios to Total Assets

Source: NABARD.

from 0.43 per cent in 1997-98 to 0.93 per cent in 1998-99, and this adjusted for the decline in the ratio of provisions and contingencies to total assets from 0.26 per cent to 0.23 per cent during the same period, led to a substantial improvement in the net profit ratio. The net profit ratio showed more than a four-fold increase from 0.16 per cent in 1997-98 to 0.70 per cent in 1998-99. The increase in profitability of RRBs can be attributed, *inter alia*, to both the decline in the ratio of intermediation cost to total assets and an increase in the 'spread'. The intermediation cost ratio (i.e. operating expenses to total assets) declined by 0.2 percentage points from 2.9 per cent in 1997-98 to 2.7 per cent in 1998-99. The decline in the intermediation cost can be attributed, *inter* *alia*, to the decline in the wage ratio from 2.5 per cent in 1997-98 to 2.4 per cent in 1998-99. The 'spread' of 177 RRBs increased by 0.4 percentage points from 2.8 per cent in 1997-98 to 3.2 per cent in 1998-99.

State-wise Recovery Performance of RRBs

2.61 During the year ending June 1998, RRBs showed improvements in recovery of loans. At the All-India level, the loan recovery to demand ratio of RRBs at 60.54 per cent during 1997-98 (July-June) was higher than that in the previous year (56.9 per cent). A state-wise analysis of recovery performance shows that Kerala registered the maximum recovery rate of 88.1 per cent during 1997-98 followed by Tamil Nadu with recovery rate of 79.37 per cent, Gujarat (72.33 per cent) and Punjab (72.11 per cent). Tripura showed the lowest recovery rate of 11.61 per cent during the year.

Non-performing Assets

2.62 The asset quality of RRBs has shown significant improvements in recent years. In the total loans, the share of standard assets has shown steady increase with the commensurate decline in the share of non-performing assets during 1996 to 1998. The share of standard assets in the total loans steadily increased from 56.9 per cent as at end-March 1996 to 63.2 per cent as at end-March 1997 and then to 67.2 per cent as at end-March 1998, while the share of non-performing assets concomitantly declined from 43.1 per cent to 36.8 per cent and then to 32.8 per cent over the same period (Table II.27).

2.63 A further analysis in terms of the composition of non-performing assets of RRBs shows that a significant proportion of NPAs is in the doubtful category followed in descending order, by the sub-standard and loss assets categories. In line with the decline in total NPAs, the doubtful and loss assets categories of NPAs also showed steady declines during 1996 to 1998. The sub-standard category of NPAs which declined from 9.3 per cent as at end-March 1996 to 8.2 per cent as at end-March 1997, increased marginally to 8.5 per cent as at end-March 1998 (Table II.27). The net NPAs as a percentage of net loans constituted 20.3 per cent in 1997-98 and 21.3 per cent in 1996-97.

2.64 The frequency distribution of gross NPAs as percentage to loans and advances of RRBs is given in Table II.28. It may be seen from the table that, in 1997-98, the number of RRBs having NPA to loans and advances ratio greater than 50 per cent has been lower than those in both 1996-97 and 1995-96. This indicates that in 1997-98 several RRBs lowered their NPAs as a fraction of their loans and advances. The median

Table II.27: Classification of Loan Assets of all RRBs

(Per cent)

Category	As at end-March		
	1996	1997	1998
1	2	3	4
1. Standard Assets	**56.9**	**63.2**	**67.2**
2. Non-Performing Assets	**43.1**	**36.8**	**32.8**
2.1 Sub-standard	9.3	8.2	8.5
2.2 Doubtful	28.0	24.0	20.4
2.3 Loss	5.8	4.6	3.9

Table II.28: Frequency Distribution of Gross NPAs as Per Cent of Loans and Advances of RRBs

Range (Per cent)	Number of RRBs		
	1995-96	1996-97	1997-98
1	2	3	4
Below 10	4	10	12
10 – 20	21	26	33
20 – 30	23	35	46
30 – 40	35	27	30
40 – 50	29	42	37
50 – 60	28	25	21
60 – 70	34	21	13
70 – 80	16	7	3
80 – 90	5	3	1
90 - 100	1	0	0
Total	**196**	**196**	**196**
Median NPA Ratio	**45.2**	**40.0**	**32.3**

value of the NPA ratio has declined over the 3 years from 45.2 per cent in 1995-96 to 40.0 per cent in 1996-97 and 32.3 per cent in 1997-98. This implies that 50 per cent of the 196 RRBs in 1997-98 had NPAs less than 32.3 per cent of their total loans and advances. This shows that the improved performance of RRBs as a whole has been due to the improved performance by several banks rather than very good performance on the part of a few.

Regulatory Control and Supervision of RRBs

2.65 The following are the major regulatory control measures introduced during the year to strengthen the supervisory mechanism of RRBs.

i) RRBs have been exempted from the provisions of the proviso to sub-sections (1) and (1A) of Section 42 of the RBI Act, 1934, for a further period of two years upto December 31, 2000. This allows them to continue to maintain cash reserves at 3 per cent of their demand and time liabilities.

ii) Effective fortnight beginning January 7, 1995, RRBs are required to maintain a minimum of 85 per cent of their CRR balances on each of the first 13 days of the reporting fortnight. On the 14th day, they will be allowed to lower the cash balances to adjust the average of daily balances. The main objective of this measure is to stabilize the cash balances of banks held with the Reserve Bank.

Recapitalisation of RRBs

2.66 The process of recapitalisation of RRBs which is being followed since 1994-95, was continued during the year 1998-99, though with reduced budgetary allocations. The budgetary allocations for recapitalisation were reduced from Rs.400 crore during 1997-98 to Rs.152.65 crore during 1998-99. However, the decline in the budgetary allocation was offset by the provision of additional equity support aggregating to Rs.305.30 crores in 1998-99. The Union Budget for 1999-2000 has made a provision of Rs.168

crores for the recapitalisation of RRBs (Table II.29).

Table II.29: Recapitalisation of Regional Rural Banks: 1994-95 to 1999-2000

Year	Amount (Rs. crore)
1	2
1994-95	300.00
1995-96	447.00
1996-97	400.00
1997-98	400.00
1998-99	152.65
1999-2000*	168.00

Note: * Budget estimate.

2.67 With a view to strengthening the capital base of RRBs and improving their financial performance, some RRBs have been identified as eligible, based on certain criteria[6], for fresh infusion of funds under Phase V of the recapitalisation process. The categories of RRBs considered eligible for recapitalisation include:

1. RRBs partially recapitalised during 1996-97 and 1997-98.
2. RRBs considered for the first time in 1998-99.

2.68 Based on the above criteria, 10 RRBs have been partially recapitalised in 1996-97 and 9 have been given further capital in 1997-98. 24 RRBs were provided additional equity for the first time. With the infusion of capital under Phase V, 175 of the total of 196 RRBs stand fully/partially recapitalised while 2 RRBs do not need recaptialisation support. This leaves only 19 RRBs outside the ambit of the recapitalisation program.

Other Policy Initiatives

2.69 The NABARD introduced several policy initiatives for improving the overall performance of the RRBs during the year 1998-99. These are as follows:

- In order to monitor the performance of RRBs, especially the weak ones, sponsor banks have been advised to undertake quarterly/half-yearly reviews of the banks coming under their jurisdiction. NABARD, RBI and GOI may selectively participate in the half-yearly review meetings.
- To hasten the process of turn around of RRBs and to further strengthen them, sponsor banks have been advised to explore the possibility of the merger of RRBs coming under them and operating in contiguous areas.
- In order to evolve an early warning system as part of the supervisory function of the NABARD, an off-site surveillance system has been introduced to supplement on-site inspection.
- The Government of India, in consultation with NABARD, has framed Appointment and Promotion Rules (1998) for the staff of RRBs.
- Kisan Credit Cards are being introduced in the RRBs to facilitate the provision of credit to farmers.
- RRBs have been encouraged to adopt self-help groups for channeling credit to the poor on a sustainable basis.

7. Regional Spread of Banking

2.70 In the on-going phase of banking sector reforms, banks have been given freedom in regard to the opening up of branches subject to the approval of the Reserve Bank of India. An analysis of branch expansion of banks shows that the number of bank offices as at end-March 1999 has increased by 851 or 1.3 per cent from 64,267 as on last Friday of March 1998 to 65,118 as on

6. Criteria adopted for selection of eligible RRBs include the following: (a) improvement in recovery performance; (b) deposit growth, (c) advances growth, (d) percentage of standard assets to the total loans and advances as on March 31, 1998, and (e) percentage of derecognised interest to total interest on loans and advances as on March 31, 1998.

March 31, 1999. During the same period, the number of centres, having bank offices, stood at 36,083. In as many as 31,036 centres (86 per cent of total) there were only single offices. There were 34 centres which had more than 100 offices each as at end-March 1999. At present, on an average, a bank office serves a population of 14,829.

2.71 The number of branches of commercial banks stood at 64,918 as on June 30, 1999 (excluding non-scheduled banks branches). The southern region registered the highest share of 27.2 per cent (Appendix Tables II.9 and II.10).

2.72 A disaggregated analysis of deposits and credit per bank shows that Delhi had the highest average deposit of Rs.5,548 lakh per office. This was followed by Chandigarh (Rs.3,113 lakh). At the all-India level, the deposits and credit per office worked out to Rs.1,078 lakh and Rs.598 lakh, respectively as on March 31, 1999. In regard to credit too, Delhi ranked first with an average outstanding credit of Rs.4,084 lakh per office, followed again by Chandigarh (Rs.2,610 lakh) as on March 31, 1999.

8. Scheduled Commercial Banks' Operations in Money Market Instruments

Call/Notice Money Market

2.73 The Reserve Bank of India has taken several initiatives during the year 1998-99 to further strengthen the call money market. To increase the width and depth of call money market, the Reserve Bank has allowed two additional mutual funds (MFs) as lenders in the call money market during the year. Besides, seventeen corporates were allowed to participate in the market and lend through primary dealers (PDs). The call rates remained in the range of 0.5 per cent to 12.5 per cent during 1998-99, with the exception of two occasions. The call market witnessed some volatility during the second half of August 1998 when policy changes were made by the Reserve Bank to stem the pressure in the foreign exchange market.

2.74 There has been sharp increase in the total turnover in the call money market during the year 1998-99. The daily average turnover increased by 3.3 per cent from Rs.23,613 crore during the fortnight ended March 27, 1998 to Rs.24,381 crore during the fortnight ended September 25, 1998, and then further by 39.8 per cent to Rs.33,009 crore during the fortnight ended March 26, 1999. An analysis of the participant-wise turnover indicates that there was a perceptible increase (75.7 per cent) in the turnover of SCBs from Rs.12,107 crore during the fortnight ended March 27, 1998 to Rs.19,773 crore during the fortnight ended March 26, 1999. Trends witnessed during 1998-99 continued during the current financial year as well. The daily average total turnover and the turnover of SCBs increased to Rs.34,211 crore and Rs.22,199 crore, respectively, during the fortnight ended August 13, 1999.

Certificates of Deposit

2.75 Certificates of Deposit (CDs) are issued by banks for meeting their short-term funds requirements. During 1998-99, banks were maintaining better liquidity in view of the low off-take/demand for credit and, therefore, the CDs market remained sluggish. Accordingly, the level of CDs outstandings showed a steep decline from Rs.14,296 crore as on March 27, 1998 to Rs.3,717 crore as on March 26, 1999. As a result, the interest rates declined from the range of 7.2 per cent to 26.0 per cent as on March 27, 1998 to the range of 8.0 per cent to 12.5 per cent as on March 26, 1999 (Appendix Table II.11). As on August 27, 1999, the outstanding amount of CDs issued by SCBs was Rs.3,293.32 crore.

Commercial Paper

2.76 The scheduled commercial banks' investments in commercial paper (CP) showed a significant increase during the year 1998-99. Reflecting the easy liquidity conditions and the declining interest rates in the money market, the effective discount rates on CP showed steady decline during the year, enabling the corporates to float CP and raise sufficient funds from the SCBs. During the year 1998-99, the outstanding investments of SCBs in CP increased from Rs.1,500 crore as on March 31, 1998 with an effective discount rate in the range of 13.6 per cent to 15.8 per cent to Rs.4,588 crore as on September 30, 1998 with an effective discount rate in the range of 7.7 per cent to 13.3 per cent. However, following the liquidity tightening measures introduced on August 20, 1998, the effective discount rate on CP increased subsequently.

2.77 During the period September 30, 1998 to February 28, 1999, there was no appreciable change in the outstanding investments of SCBs in CP. As on February 28, 1999, the outstanding investments by SCBs in CP amounted to Rs.5,367 crore with an effective discount rate in the range of 10.2 per cent to 13.0 per cent. In March 1999, the Reserve Bank reduced both CRR and fixed repos rate which eased the liquidity conditions in the money market. As a result, the amount of outstanding CP steadily increased and aggregated to Rs.7,658 crore as on September 30, 1999 with an effective discount rate in the range of 10.0 per cent to 13.0 per cent (Appendix Table II.12).

Bills Rediscounting Market

2.78 The bills rediscounting market has witnessed some improvements in terms of the increase in number of players. During the financial year 1998-99, two mutual funds viz., Kotak Mahindra and Infrastructure Leasing and Financial Services have been permitted to participate as lenders in the bills rediscounting market. For the current financial year upto September 30, 1999, three more mutual funds, *viz*., the Dundee Mutual Fund, the ING Saving Trust Mutual Fund and the Cholamandalam Cozenove Mutual Fund have been permitted to participate as lenders in the market.

2.79 The bills rediscounted by commercial banks showed nearly a three fold increase from Rs.286 crore as at end-March 1998 to Rs.792 crore as at end-January 1999. During the subsequent period, the market was in low key and as at end-March 1999 the outstanding bills rediscounted by banks with financial institutions stood at Rs.473 crore. Subsequently, with some improvement in the market, the outstanding amount of bills rediscounted, recouped to Rs.544 crore as at end-September 1999.

9. PLRs and Spread of PLRs of Scheduled Commercial Banks

Lending Rates

2.80 Since the introduction of reforms in banking sector, banks have been given freedom to determine their interest rates. The lending rates of banks are now in alignment with the market and, to a larger extent, the cross-subsidisation of interest rates has been withdrawn. With a view to strengthening the freedom of determining the lending rates by banks effective April 29, 1998, interest rates on credit limits upto Rs.2 lakh were not to exceed the Prime Lending Rate (PLR). Following the reduction in the Bank Rate from 10.0 per cent to 9.0 per cent in April 1998, a number of scheduled commercial banks revised their PLR downwards by 0.5-2.0 percentage points. Reflecting the easy liquidity conditions in the market, the PLR of banks was ruling in the range of 12.75 per cent to 14.5 per cent during April to July 1998. Subsequently, in August 1998, with a view to maintaining orderly conditions in the forex market, a number of monetary policy measures were initiated including the hike of 1 percentage point in CRR from 10.0 per cent to 11.0 per cent and 3 percentage points in fixed repos from 5.0 per cent to 8.0 per cent. With the exception of one bank, the SCBs maintained their PLR steady in the range of 12.75 per cent to 14.5 per cent despite the increase in interest rates of financial papers like CP, CDs and Government securities.

2.81 In view of the lower inflation rates, RBI announced reduction in the Bank Rate by one percentage point, Repo Rate by 2.0 percentage points and Cash Reserve Ratio (CRR) by 0.5 percentage point on March 1, 1999. This signaled the reduction of PLR by PSBs by 0.75 percentage point to 1.0 percentage point and accordingly the PLR of PSBs was in the range of 12.0 to 14.0 per cent. However, the foreign and majority of the private sector banks kept their PLR unchanged as these rates were in the range of 12 per cent-16.5 per cent during the same period and the 'spread' of majority of the banks was 4.0 per cent above their PLR. During the current financial year upto September 24, 1999, the PLR of PSBs has further come down by 0.5 percentage points to range between 12.0 per cent to 13.75 per cent (Table II.30). The PLR of private sector banks has been in the range of 10.5 per cent to 16.5 per cent, and that for foreign banks was in the range of 10.5 per cent to 18.5 per cent.

10. Scheduled Commercial Banks and Government Securities Market

2.82 The scheduled commercial banks, by subscribing to the primary issues of government securities, not only enable the government to raise resources for developmental activities but also invest their funds in risk free securities with assured returns. During the year 1998-99, the subscription of banks to the primary issues of dated securities amounted to Rs.19,746 crore. This constituted 23.58 per cent of the gross market borrowings of the Central Government and 17.7 per cent of the incremental aggregate deposits during 1998-99. As mentioned in the last year's Report, the State Bank of India received subscription for Resurgent Investment Bonds (RIB) to the extent of US $ 4.2 billion; of this, US $ 4.05 billion has been sold back to the Reserve Bank. This generated an additional liquidity of Rs.17,308 crore in the money market. Banks invested excess funds in T-Bills and dated securities of Government pending the utility of the RIB resources. Therefore, to provide liquidity for the banks investing in securities, the Reserve Bank extended a special liquidity support facility by way of refinance similar to the terms and conditions of General Refinance Facility (GRF). This facility was given upto March 31, 1999.

2.83 Besides the above mentioned initiatives, the Reserve Bank took several steps to develop the primary market for Government securities. Among others, the Reserve Bank has withdrawn the minimum period of three days for ready forward (repo) transactions effective October 31, 1998 to enable banks and other participants in the repos market to adjust their liquidity in a more flexible manner.

2.84 The Reserve Bank has instructed Schedule Commercial Banks on March 30, 1999 to create a new reserve account called the "Investment Fluctuation Reserve Account" in order to credit the excess provision towards depreciation on investments. This should be shown as a separate item in Schedule 2 – "Reserves and Surplus" under the head "Reserves and other Reserves" and this will also be eligible for Tier II capital. Earlier, the excess provision towards depreciation on investments was transferred to Capital Reserve Account by way of appropriation in the Profit and Loss Account. The existing amount of excess provision towards depreciation on investments held under Capital Reserve Account should be transferred to "Investment Fluctuation Reserve Account" as on March 31, 1999. The amount held in "Investment Fluctuation Reserve Account" could be utilised to meet, in future, the depreciation requirement on investment in securities.

2.85 The trends in the average yield on Government securities in the primary market since 1994-95 are presented in Table II.31. During 1998-99, the average yield on various Government securities issued in the primary market has increased for the 14 days, 91 days

Table II.30: Distribution of Prime Lending Rate of Public Sector Banks

Month/ Year	PLR Range							
	12.0	12.5	12.75	13.0	13.25 – 13.75	14.0	14.5	Total No. of Banks
1	2	3	4	5	6	7	8	9
1998								
25-September	—	—	1	10	15	—	1	27
			(3.7)	(37.03)	(55.6)		(3.7)	
23-October	—	—	1	10	15	—	1	27
			(3.7)	(37.03)	(55.6)		(3.7)	
20-November	—	—	1	10	15	—	1	27
			(3.7)	(37.03)	(55.6)		(3.7)	
18-December	—	—	1	10	15	—	1	27
			(3.7)	(37.03)	(55.6)		(3.7)	
1999								
29-January	—	—	1	10	16	—	—	27
			(3.7)	(37.03)	(59.3)			
26-February	—	—	1	10	15	1	—	27
			(3.7)	(37.03)	(55.6)	(3.7)		
26-March	7	1	1	5	12	1	—	27
	(25.9)	(3.7)	(3.7)	(18.5)	(44.4)	(3.7)		
23-April	7	3	2	5	9	1	—	27
	(25.9)	(11.1)	(7.4)	(18.5)	(33.3)	(3.7)		
21-May	6	4	2	5	9	1	—	27
	(22.2)	(14.8)	(7.4)	(18.5)	(33.3)	(3.7)		
18-June	5	5	2	5	9	1	—	27
	(18.5)	(18.5)	(7.4)	(18.5)	(33.3)	(3.7)		
30-July	9	6	2	5	5	—	—	27
	(33.3)	(22.2)	(7.4)	(18.5)	(18.5)			
27-August	9	6	2	6	4	—	—	27
	(33.3)	(22.2)	(7.4)	(22.2)	(14.8)			
24-September	9	6	2	6	4	—	—	27
	(33.3)	(22.2)	(7.4)	(22.2)	(14.8)			

Note: Figures in brackets represents percentage distribution of banks.

and 364 days treasury bills. However, the average yield for medium to long term dated securities remained steady during the year. The increased depth in secondary market for Government securities could be witnessed in the rise in the volume of outright transaction of Government dated securities, treasury bills and State Government Securities. During the year 1998-99, the turnover of all these instruments amounted to Rs.3,71,542 crore of which dated securities constituted 76.3 per cent. During the year 1999-2000 (upto September 24, 1999), the turnover in government securities in Mumbai aggregated Rs.3,94,382.8 crore. Of this, the share of dated securities showed a higher share of 89.0 per cent (Appendix Table II.13).

Table II.31: Yields on Government Securities in the Primary Market: 1994-95 to 1999-2000

(Per cent)

Year	Maturities					
	Treasury Bills @			Dated Securities $		
	14 Days	91 Days	364 Days	2 Year	5 Year	10 Year
1	2	3	4	5	6	7
1994-95	—	9.16	10.15	—	12.00 12.71	12.35
1995-96	—	12.67	12.80	13.25 13.50	13.25 13.85	13.75 14.00
1996-97	—	9.67	11.67	13.50 13.62	13.75 13.55	13.85 13.65
1997-98	5.67	6.83	7.15	—	12.69 11.15	13.05 12.15
1998-99	7.79	8.57	9.51	11.40	11.10- 11.78	12.00- 12.25
1999-2000*	8.29	9.01	10.18	—	—	11.48- 11.99

Note : @ Average implicit yield at cut-off prices.
$ Coupon Rates.
* April-October.

2.86 The yield on Government securities as at end-March 1998 was lower than that at end-March 1999, particularly at the shorter and medium end of the maturity spectrum. The yield curve remained steeper during 1998-99 as compared to 1999-2000 (upto September 1999). The lower short-term rates during 1998-99 reflected the policy objective of promoting economic growth by bringing down the level of CRR and the Bank Rate, after ensuring stability in the forex market during the year.

2.87 During the year 1999-2000, the yield difference between 5 year bond and 364 days T-bills declined from 1.57 per cent at end-March 1999 to 0.61 per cent at end-September 1999, by 96 basis points. In the case of 10 year bond, the yield difference declined by 73 basis points from 1.93 per cent as at end-March 1999 to 1.20 per cent as at end-September 1999. The decline in the yield spread has also coincided with a general downward shift in the yield curve in the medium and long-term segment. On the other hand, short rates have moved up in successive quarters since March 1999.

11. Rural Credit

2.88 The SCBs supplement the efforts of the National Bank for Agriculture and Rural Development (NABARD) and the co-operative banking sector in extending credit facilities to the rural sector of the economy. The rural credit extended by NABARD and the co-operative banking sector, is discussed in Chapter-III. As regards the SCBs credit to rural sector, the priority sector advances as well as the credit extended under various schemes, showed increases during the year 1998-99.

Bank Group-wise Distribution of Priority Sector Advances

Priority Sector Advances by Public Sector Banks

2.89 The priority sector advances of PSBs increased by Rs.15,881 crore or 17.4 per cent from Rs.91,319 crore as on the last Friday of March 1998 to Rs.1,07,200 crore as on the last Friday of March 1999. The priority sector advances of PSBs constituted 43.5 per cent of their Net Bank Credit (NBC) as on the last Friday of March 1999. In the priority sector advances as on the last Friday of March 1999, the largest proportion is shared by small-scale industries (39.8 per cent), followed by agriculture (37.4 per cent) and a group of other priority sectors (22.8 per cent). Agricultural advances of PSBs increased by Rs.5,773 crore or 16.8 per cent from Rs.34,305 crore as on last Friday of March 1998 to Rs.40,078 crore as on last Friday of March 1999. The agricultural advances, as on last Friday of March 1999 constituted 16.3 per cent of NBC (Appendix Table II.14).

Priority Sector Advances by Private Sector Banks

2.90 Private sector banks are also required to fulfill targets applicable to PSBs in respect of priority sector assistance and also for agriculture and allied activities. During the period ending the last reporting Friday of March 1999, the private sector banks deployed credit under the priority sector scheme amounting to Rs.14,155 crore, which constituted 41.4 per cent of NBC. Of this, the share of SSI constituted 18.9 per cent of NBC (Appendix Table II.15).

Priority Sector Advances by Foreign Banks

2.91 The Reserve Bank has stipulated that foreign banks operating in India are required to achieve a target of 32 per cent of their NBC in lending to the priority sector with two specific sub-targets of 10 per cent for SSI and 12 per cent for exports. During the period ending last Friday of March 1999, the foreign banks' assistance for export credit has shown an increase of Rs.728 crore or 14.7 per cent from Rs.4,950 crore as on the last Friday of March 1998 to Rs.5,678 crore as on the last Friday of March 1999. As a proportion to net bank credit, the export credit constituted as high as 25.0 per cent and this is more than twice the target of 12.0 per cent. The advances provided to SSI increased by Rs.376 crore (18.0 per cent) from Rs.2,084 crore as on the last Friday of March 1998 to Rs.2,460 crore as on the last Friday of March 1999 (Appendix Table II.16), accounting for 11.0 per cent in NBC.

Schemes for Rural Development

Integrated Rural Development Programme

2.92 Integrated Rural Development Programme (IRDP) is one of the important schemes formulated by the Government with the objective of alleviating poverty and providing income-generating assets to the beneficiaries in rural areas. During 1997-98, out of 16.97 lakh beneficiaries of IRDP, 46.13 per cent belong to SC/ST. During the year 1998-99, (i.e. upto February 1999), under the IRDP scheme, bank credit to the tune of Rs.1,641.98 crore was disbursed to 12.68 lakh beneficiaries (Table II.32).

2.93 An analysis of recovery performance of IRDP scheme indicates that the recovery of loans constituted 33.1 per cent of credit as at end-March 1999 as against 32.9 per cent in the corresponding period last year. IRDP and its allied schemes have been restructured into a new scheme *viz*., Swarnjayanti Gramin Swarojgar Yojana (SGSY) with effect from April 1, 1999.

Prime Minister's Rozgar Yojana for Educated Unemployed Youth

2.94 The Prime Minister's Rozgar Yojana for Educated Unemployed Youth (PMRY) is another

Table II.32: Advances under IRDP

Year	Number of beneficiaries (lakh)	Total Credit (Rs. crore)
1	2	3
1992-93	20.69	1,037
1993-94	25.38	1,408
1994-95	22.15	1,451
1995-96	20.90	1,701
1996-97	18.89	1,953
1997-98	16.97	1,991
1998-99 (P)	12.68	1,642

Note: P - Provisional.

important scheme promoted by the Government for which banks provide financial assistance to the beneficiaries. The PMRY scheme aims at improving the economic well-being of the unemployed youths throughout the country through various forms of financial/technical assistance. The progress under the scheme is as given in Table II.33.

Lead Bank Scheme

2.95 The main focus of Lead Bank Scheme (LBS) is to enhance the proportion of bank finance to priority sector. The scheme controls and co-ordinates the activities of banks and other developmental agencies. The LBS has covered 567 districts as on March 31, 1999 as against 536 districts as on March 31, 1998. During the year 1998-99, 31 new districts have been formed as a result of reorganisation/bifurcation, and these districts were allotted to PSBs.

2.96 Under LBS, the sectoral targets set for the years 1997-98 and 1998-99 are given in Table II.34. As high as 98.4 per cent of the target was achieved during the year 1997-98. At the sectoral level, 99.4 per cent of the target was achieved each in the case of (i) agriculture and allied activities, and (ii) small scale industries. In the case of services sector, 94.2 per cent of the target was achieved.

Institutional Developments

Local Area Banks

2.97 With a view to providing institutional mechanism for promoting rural savings as well as for providing credit for viable economic activities in the local areas, the Reserve Bank announced a set of guidelines on August 24, 1996 for the setting up of Local Area Banks (LABs)

Table II.33: Financial Assistance under PMRY

(Amount in Rs. crore)

Year	Target (Number of youths)	Sanctions		Disbursements	
		Number of youths	Amount	Number of youths	Amount
1	2	3	4	5	6
1993-94	42,040	30,029	188.55	23,035	137.02
1994-95	2,39,215	1,85,803	1,054.99	1,58,863	872.67
1995-96	3,21,360	2,87,218	1,678.88	2,41,843	1,378.07
1996-97	3,07,163	2,71,768	1,653.06	2,28,487	1,352.10
1997-98	3,45,000	2,63,361	1,589.31	2,08,976	1,218.96
1998-99(P)	3,54,350	2,62,091	1,562.90	1,46,525	835.72

Note: P - Provisional.

in the private sector. As on June 30, 1999, eight LABs have been given approval in principle: one each in Maharashtra, Punjab, Andhra Pradesh, Tamil Nadu, Rajasthan and Gujarat and two in Karnataka. So far, the Reserve Bank received 215 applications for the setting up of LABs and of these, 194 applications have been disposed off. These banks are essentially expected to bridge the gap in credit availability and to enhance the institutional credit framework in the rural and semi-urban areas.

12. Prudential Regulatory Measures

Loan Review Mechanism

2.98 During 1998-99, in October 1998, the Reserve Bank advised commercial banks to adopt a Loan Review Mechanism for larger advances soon after their sanction, and monitor any weakness that may develop in such accounts for initiating timely corrective action.

Reduction in the time frame for sub-standard assets

2.99 To move further toward the international standards regarding provisioning norms, the Reserve Bank has decided that an asset should be classified as doubtful, if it has remained in the sub-standard category for 18 months instead of 24 months by March 31, 2001. In this context, banks have been permitted to meet the additional provisioning requirements in two phases i.e. as on March 31, 2001 and March 31, 2002.

Balance Sheet of Banks – Disclosure of Information

2.100 During the year 1998-99, the Reserve Bank issued guidelines for improving transparency in the financial statements of banks. From the accounting year ending March 2000, banks have been advised to disclose the following additional information in the 'Notes to Accounts':

- Maturity pattern of loans and advances.
- Maturity pattern of investment in securities.
- Foreign currency assets and liabilities.
- Movements in NPAs.
- Maturity pattern of deposits.
- Maturity pattern of borrowings.
- Lending to sensitive sectors[7].

Regulatory Reviews

2.101 During 1998-99, a review of the various

Table II.34: Annual Credit Plan of Financial Institutions under Lead Bank Scheme

(Amount in Rs. crore)

	Sector	1997-98			1998-99
		Target	Achievement	Per cent to Achievement	Target
	1	2	3	4	5
a)	Agriculture & Allied activities	28,143.91	27,984.76	99.4	34,590.09
b)	Small Scale Industries	9,810.51	9,748.38	99.4	12,096.74
c)	Services	8,681.75	8,176.81	94.2	10,976.23
	Total	**46,636.17**	**45,909.95**	**98.4**	**57,663.06**

7. The sensitive sectors have been defined as sectors which are sensitive to arrest price fluctuations such as real estate, capital market and such other sectors as defined by the Reserve Bank of India from time to time.

instructions issued to banks on procedural and financial aspects was undertaken with a view to not only giving a sharper focus to regulatory practices and ensuring stricter compliance but also providing more autonomy to banks. Accordingly, banks were given autonomy in the following areas: (i) acquisition of premises on lease/rental basis; (ii) issue of rupee denominated subordinated loans as Tier II capital subject to certain conditions; (iii) acquisition and disposal of immovable property for banks' own business; and (iv) full autonomy to private and public sector banks for opening of branches subject to fulfillment of certain conditions.

Bridge Loan

2.102 During 1998-99, norms relating to bridge loans were further made flexible by the Reserve Bank. In addition to the expected equity flows/ issues, banks have been advised that they could extend bridge loans against expected proceeds on non-convertible debentures, external commercial borrowings, global depository receipts and/ or funds in the nature of foreign direct investments provided the bank concerned is satisfied that the borrowing company has already made firm arrangements for raising the aforesaid resources/ funds.

Venture capital

2.103 In order to encourage the flow of funds for venture capital, it has been decided in April 1999 that the overall ceiling of 5 per cent of incremental deposits of the previous year, will stand automatically enhanced to the extent of the bank's investment in venture capital (including units of dedicated venture capital funds meant for 'Information Technology'). This would be subject to the condition that the venture capital funds/companies are registered with the SEBI.

Investments in Shares and Debentures

2.104 The Reserve Bank brought out a consolidated circular on August 28, 1998 incorporating certain changes in the existing guidelines relating to advances against shares/ debentures/bonds. It also covers guidelines to banks to grant working capital facilities to stock brokers registered with the SEBI and who have complied with capital adequacy norms prescribed by SEBI/stock exchanges to meet the cash flow gap between the delivery and payment for DVP transactions undertaken on behalf of the institutional clients *viz*. FIs, FIIs, mutual funds and banks. The circular further indicates that the margins may be determined by the banks themselves, and banks on their part may also institute adequate safeguards and monitoring mechanism.

Investment portfolio of banks – Classification of investments under "permanent" and "current" category

2.105 In March 1999, banks were advised that the excess of provision towards depreciation on investments should be appropriated to "Investment Fluctuation Reserve account" instead of "Capital Reserve" account and shown as a separate item in Schedule 2-"Reserve and Surpluses" under the head "Revenue and Other Reserves". This amount will be eligible for inclusion in Tier II capital. In April 1999, banks have been advised that by March 31, 2000, they should classify a minimum of 75 per cent of their investments in approved securities as "current" investments.

Settlement Advisory Committee

2.106 In the Union Budget for 1999-2000, it was indicated that to settle chronic cases specially those relating to the small scale sector in a timely and speedy manner, PSBs would be encouraged to set up settlement advisory committees. Accordingly, the Reserve Bank has communicated guidelines to all PSBs for the constitution of Settlement Advisory Committees (SACs) for compromise settlement of non-performing assets of the small scale sector. The guidelines would cover all non-performing assets (NPAs) which are chronic and at least three years old as on March 31, 1999 and will be operative only up to September 30, 2000. The guidelines will apply to borrowal accounts that have become non-performing in the small scale industrial sector and small businesses, including trading and personal segment and agricultural sector. It can also cover the cases pending before the courts/Debt Recovery Tribunals (DRTs). However, consent decree to reflect the compromise settlement will have to be obtained in such cases. The Reserve Bank has advised all the public sector banks that their boards may lay down norms for compromise settlements and frame suitable guidelines for SAC on the basis of the guidelines set out by the Reserve Bank. Once the settlement amount is calculated as per the Reserve Bank guidelines, it should normally be paid at one time. The bank's board should review the decisions taken by the SAC and also ensure that the process of settlement is completed within six months.

13. Customer Service

2.107 The Reserve Bank and the Government of India have been issuing guidelines to banks to offer better customer service with higher scale of customer satisfaction. During the year, the following measures were undertaken by the Bank in the matter of Customer Service:

(i) Operation of bank accounts by old/sick/incapacitated customers: The Reserve Bank has issued guidelines for operation of accounts by old/sick/incapacitated customers. Accordingly, if a person cannot be physically present in the bank to withdraw the amount, he/she may authorise a person on his/her behalf to withdraw the money.

(ii) Citizens' Charter of banks: To bring greater transparency in customer service, the PSBs have published "Citizens' Charters" providing information regarding various banking activities offered to customers and also regarding the availability of grievances redressal mechanism for dealing with customers' complaints.

(iii) Nomination facility in Deposit Accounts: Banks have been advised to indicate on the face of the pass book/term deposit receipt about registration of nomination in the account. This would minimise the hardships caused to family members of the deceased depositors in settlement of claims.

14. Para Banking Activities

Subsidiary for Satellite Dealership

2.108 During the year, the Bank of Madura Ltd. has been permitted to set up a subsidiary in the name of "Madura Securities Ltd." for undertaking satellite dealership in the Government securities market.

Housing Finance by Banks

2.109 During 1998-99, the Corporation Bank has been granted final approval to set up a wholly owned housing finance subsidiary with a paid-up capital of Rs.10 crore subject to usual terms and conditions.

15. Supervisory Issues

Financial Supervision

2.110 The term of the Board for Financial Supervision (BFS) which is the supervisory authority for financial supervision has been extended upto March 27, 2000 or till the Central Board of the Reserve Bank is reconstituted, whichever is earlier. The Board held thirteen meetings during the period July 1998 to June 1999. The main supervisory issues addressed by the Board are as follows:

(i) Off-site surveillance system for banks, All India Financial Institutions and NBFCs.

(ii) On-site inspection of banks, AIFIs and NBFCs.

(iii) Asset quality, capital adequacy measures and prudential norms of banks.

(iv) Strengthening internal control, management information system, fraud monitoring procedures, etc. within the supervised institutions as an extension of the task of supervision.

(v) Registration and prudential norms of NBFCs.

2.111 During the period July 1998 to June 1999, the BFS discussed various memoranda placed by the Department of Banking Supervision of the Reserve Bank on the performance of banks, financial institutions and subsidiaries of banks covering the period ended on March 31, 1997 and 1998 and in some cases period ended September 1998. The Board gave directions on several regulatory and supervisory issues that came up during the course of deliberations. As a part of supervision, for evaluating the financial performance and conditions of commercial banks and financial institutions, financial regulators employ a combination of on-site and off-site modes of surveillance mechanisms. In the on-site examination, the supervisors evaluate the health of banks in terms of rating system, preferably on a yearly basis, besides the banks' adherence to regulatory requirements in day-to-day operations. However, with the growing nature of financial integration, globalisation and use of technology at large scale, more complexities have developed in banking transactions alongwith associated risks. Hence, regulators have to supplement the surveillance with off-site monitoring so as to capture 'early warning signals' of financial system and to deter financial crisis of the nature of East Asia or Latin America. Off-site surveillance is catching up in many developing countries by strengthening their management information systems (MISs) and use of technology in banking transactions.

2.112 The off-site monitoring success is linked to the effective use of select parameters. Among them, the analysis of financial statements and reports submitted by banks preferably at short-term intervals, periodic meetings with the management of banks and assessment by independent rating agencies form a major part. Apart from these, an in-depth analysis of secondary market movements of listed bank scrips would provide an insight into the level of confidence about the financial performance of banks by the investing public. These alongwith on-site inspection reports, would enable the regulators to formulate judgments of banks' performance and suggest corrective policies, as and when required.

2.113 In India, the supervisory process of on-site monitoring is complemented by off-site monitoring, with the setting up of off-site surveillance (OSMOS) system in 1995 under the umbrella of Board for Financial Supervision (BFS). The OSMOS receives mandated quarterly/half-yearly/annual returns from commercial banks and these returns help to prepare 'early warning signals.' Besides, the Board reviews the monitoring done by the DBOD in regard to frauds and house-keeping in banks such as reconciliation of entries in inter-branch accounts, inter-bank accounts including Nostro Accounts and the balancing of books of accounts. The Board has reviewed the progress in the Information Technology and steps taken to address Y2K (Year 2000) problem in banks. Under the directions of the Board, the following working groups have been set up in the Reserve Bank:

(i) to frame guidelines on write off/compromise settlements.

(ii) to prepare a checklist for inspecting officers of the Reserve Bank to evaluate the internal audit system in banks inspected by them.

(iii) to conduct an in-depth study of frauds of Rs.1 crore and above reported by commercial banks during the last three years.

(iv) to suggest solutions for speedy reconciliation of outstanding entries under NOSTRO Accounts.

(v) to suggest appropriate measures to regulate Non-SLR Investments and bringing in more transparency, accountability and risk perception.

2.114 Efforts towards further building up of supervisory skills in the Reserve Bank to meet the new demands of supervision in relating to changing practices, have been geared up. The need and applicability of tailor-made training programmes, dovetailed to suit supervisory requirements, are being assessed with the help of the Department for International Development, U.K. covering all vital aspects of banks' functioning including treasury operations, asset-liability management and risk assessment.

Asset-Liability Management System in Banks

2.115 In a fairly deregulated and liberalised environment, the banks have to determine their own interest rates on deposits and advance in both domestic and foreign currencies on a dynamic basis. The interest rates on banks' investments in government and other securities are market related. Intense competition for business involving both assets and liabilities, together with increasing volatility in the domestic interest rates as well as foreign exchange rates, has brought pressure on the management of banks to maintain a good balance among spreads, profitability and long-term viability. Imprudent liquidity management can put banks' earnings and reputation to a greater risk.

2.116 Banks need to address these risks in a structured manner by upgrading their risk management system and adopting more comprehensive Asset-Liability Management (ALM) practices than done hitherto (Box II.4). The Core Principles enunciated by the Basle Concordant have highlighted the ALM as the fundamental base on which successful banking is built. Taking into account the importance of the management of asset-liability and the prescription thereof in accordance with the Basle Core Principles, the Reserve Bank had issued draft guidelines in September 1998 for putting in place a comprehensive Asset-Liability Management (ALM) System in banks. Subsequently, the draft guidelines were reviewed by the Reserve Bank in the light of the issues raised/suggestions made by the banks. The final guidelines, revised on the basis of the feedback received, were implemented effective April 1, 1999. Banks have been advised to set up an internal Asset-Liability Committee headed by the Chief Executive Officer/Chairman and Managing Director or Executive Director. The Management Committee or any specific Committee of the Board is required to oversee the implementation of the ALM system and review its functioning periodically.

Audit Sub-Committee

2.117 During 1998-99, the Audit Sub-Committee met thrice, and reviewed the need for making provision for net debits in respect of long outstanding entries in inter-branch accounts, assignment of risk weight to items like Indira Vikas Patra, Kisan Vikas Patra, PSU bonds, debentures, etc., while computing CRAR and examining the disclosure and transparency in final accounts of banks.

2.118 The recommendations of the Committee also included procedural changes in the appointment of statutory auditors of PSBs and financial institutions so as to plan (i) timely auditing, (ii) guidelines to statutory auditors of registered non-banking companies, (iii) specific requirement of reporting to the Reserve Bank, regarding any violation/non-compliance of provisions of the RBI Act, and (iv) NBFC directions on acceptance of public deposits and adherence to prudential norms.

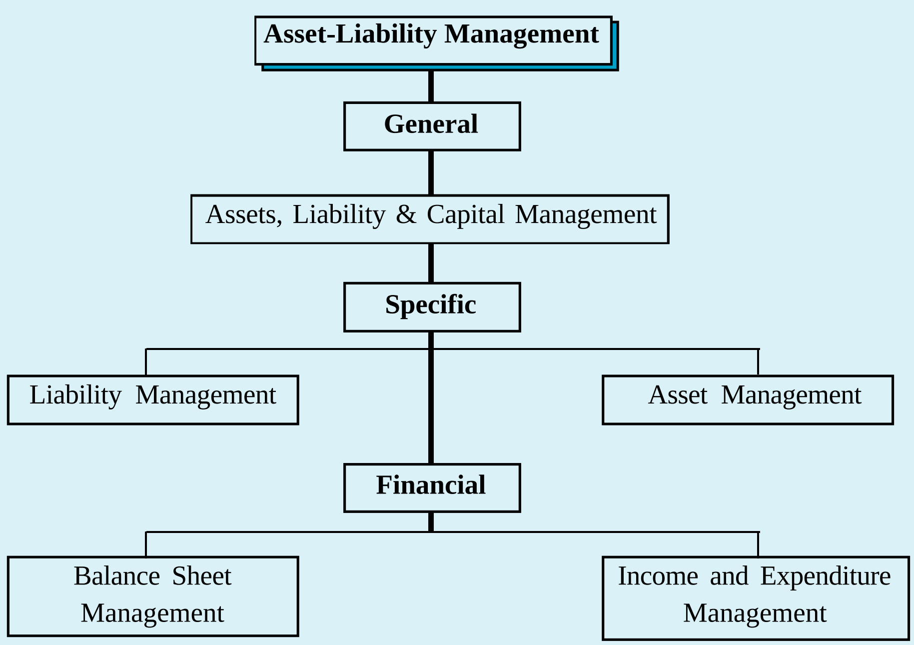
Box II.4: Asset-Liability Management

In liberalised financial markets, banks' assets and liabilities variations are considerably influenced by interest rate and exchange rate volatility. The competitive environment in the banking system due to removal of various barriers in their operations has added pressure to the importance of financial management. Unlike in the repressed financial market, banks have to manage not only credit risk but a variety of other financial risks including interest rate, exchange rate, liquidity, settlement, and transfer risks to maximise profit and minimise risks. The complexity of financial risks requires that a strong and dedicated risk management system is put in place covering: (1) assets, liabilities and off-balance sheet risks, (2) information and scientific risk management techniques and (3) dedicated asset-liability managers or committee (ALCO). Asset-Liability management as a mean of risk management technique is an important function in a bank (Chart). It primarily focuses on how various functions of the bank are adequately co-ordinated, essentially covering planning, directing, and controlling of the levels, changes and mixes of the various balance sheet accounts.

In Asset-Liability Management (ALM), bank is strategically concerned with management of market risk consisting of (a) interest rate risk, (b) foreign exchange risk, (c) equity price risk and (d) commodity price risk. Also ALM function covers liquidity management and capital planning. ALM has been a concern for bank management as a result of market volatility, financial innovations, regulatory initiatives and increasing awareness of top management in the banking system. Broadly, the ALM objectives are to control the volatility of net interest income and net economic value of a bank. The supplementary objectives cover control of volatility in all target accounts, control of liquidity risk, and ensure an acceptable balance between profitability and growth rate. In order to achieve these results, the asset- liability managers or ALCO must be guided by policies that specifically address the bank's overall asset-liability management goals and risk limits, and by information that relates directly to its asset-liability positions.

The banking industry, to compete in a free market

Chart: Asset-Liability Management Structure



(Contd. ....)

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conditions, has to give utmost priority for managing and minimising risks inherent in banking operations. Across the world, it was observed that failure[1] of risk management and control systems were significant factors for bank failures. The success of asset-liability management depends on the effective existence of (1) Information and Policies, and (2) Risk Management System.

1. Information and Policies

The primary objective of ALM is to ensure that there are asset-liability managers and an asset-liability committee (ALCO) that manages the bank's balance sheet in such a manner so as to minimise the volatility in its earnings, liquidity, and equity to changes in market conditions. The attainment of this objective may be manifested in such results as stable net interest margins, optimal earnings, adequate liquidity, and effective control of financial risks. To reach these objectives, the information base in a bank has to be strong and sound. ALCO must be aware of policies which would address asset-liability management goals and risk limits, and by information that relates directly to its asset-liability position[2]. Although framing policies/goals are important in ALM, it is equally important that prompt and effective implementation of the same are taking place in the system. For the purpose of effective functioning of ALCO, two major policies should be addressed by the bank management: (1) ALCO authority, purpose, membership, and (2) performance targets (e.g. net interest margins, ROA, etc.) to be achieved.

In managing financial risks, the management of interest rate risk dominates the ALM function of a bank. Therefore, the important determinant of a bank's exposure to interest rate risk is the extent to which its assets and liabilities are mismatched. Here, mismatch refers to the timing cashflows of assets and liabilities. Mismatches in the management of assets and liabilities can be avoided, provided the banks improve timeliness, accuracy, and completeness of the basic risk management information. Even the problems identified in loan portfolio should be communicated so as to avoid any major funds problems to asset-liability managers.

2. Risk Management System

In view of the increasing market risks in banking operations, banks should be able to accurately measure and adequately control market risk. Banks should have in place a well-structured risk management system. A risk management process that includes measuring risks, controlling risks and monitoring risks will help banks to attain these goals.

a) Measuring Risk

Due to difficulty in measuring interest rate risks and also the controversies present in the understanding of the concept, measurement of interest rate risks assumes greater importance in the ALM function. A bank's overall risk can be defined as the probability of failure to achieve an expected value and can be measured by the standard deviation of this value. In addition, the expected value must serve as a comprehensive indicator of the bank's performance under changing market conditions. It has been observed that banks' risk exposure depends upon volatility of interest rates and asset prices in the financial market, the banks' maturity/sensitivity gaps, the duration and interest rate elasticity of its assets and liabilities and the ability of the management to measure and control the exposure. In the management of banks' assets and liabilities, interest risk management lays the foundation for a good ALM.

b) Risk analysis and management

Interest rate risk can be analysed in the following four methods :

1. Gap analysis.

(Contd. ....)

1. Experiences in developed financial markets have indicated two major difficulties inherent in the asset-liability management process. These are the failure to: (1) adopt meaningful policies; and (2) implement the policies once they are adopted.
2. According to Scott (1992), the information required for ALM are (1) historical, current and projected data on the bank's assets-liability portfolios, including any projected additions, maturities, and repricing; (2) interest rates and yields as its current and projected portfolios; (3) market limitations on the banks' ability to adjust its product prices; and (4) changes in the bank's balance sheet caused by customers' decisions to prepay their loans, withdraw their deposits before maturity, and transfer their business to other banks.

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2. Duration analysis.
3. Value at Risk (VaR).
4. Simulation.

Gap analysis is the most important basic technique used in analysing interest rate risk. It measures the difference between a bank's assets and liabilities and off-balance sheet positions which will be repriced or will mature within a predetermined period. (Gap is the difference between rate-sensitive assets minus rate sensitive liabilities). The duration analysis estimates the average amount of time required before the discounted value or the present value of all cash flows (e.g. principal and interest) can be recovered by an asset holder including that of bank's depositor. The concept can be used for all assets, liabilities and off-balance sheet items. Another concept which is also used is Value at Risk (VaR) model. VaR estimates the maximum potential loss in a position over a given holding period for a given confidence level. Another interest rate risk analysis method is simulation model which attempts to determine whether the model adequately captures the banks' current and projected cash flows, taking into account the different interest rate and market price scenarios. Simulation model is simply an interactive process and not an optimization model.

As banks are prone to more market risk in a liberalised and more competitive environment, ALM model is very much useful for the senior management of a bank to take several important decisions. ALM function will be effective from April 1, 2000. The issues are to be considered for better management ALM function are as follows:

Policy issues

Strengthening of information technology in commercial banks would be an important prerequisite to implement effectively ALM system in banks. The data base of banks has to cover all operations of branches for a detailed analysis of assets and liabilities and for forecasting a comprehensive projection of liquidity conditions under various scenarios. The software packages used must be well tested and have extensive computing power to analyse the massive amount of Asset/Liability data under alternative interest rate scenarios.

It is well understood that every financial transaction or commitment has implications for a bank's liquidity. As banks are very much concerned with converting illiquid assets into liquid assets, a proper liquidity management with associated liquidity policies would help the management in formulating business strategy. A schedule of liquidity reviews and less frequent, but more in depth reviews should be provided for. These reviews provide the opportunity to re-examine and refine a bank's liquidity policies and practices in the light of a bank's liquidity experience and developments in its business. For banks with an international presence, the treatment of assets and liabilities in multiple currencies adds a layer of complexity for two reasons. First, banks are often less well known to liability holders in foreign currency markets. In the event of market concerns, especially if they relate to a bank's domestic operating environment, these liability holders may not be able to distinguish rumour from fact. Second, in the event of a disturbance, a bank may not always be able to mobilise domestic liquidity to meet foreign currency funding requirements. Hence, better liquidity management becomes an important concern when banks indulge in multi currency transaction.

ALCO is a most powerful body in the ALM framework. Hence, for taking business decision the boards of banks rely on ALCO reports. The membership of ALCO in a bank should be broad-based rather than confined to representation from treasury and investment areas.

Although, a bank may formulate robust policies and strategies for ALM, unless the staff members are adequately trained and skilled manpower is available, the success of ALM would be limited.

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Debt Recovery Tribunals

2.119 The establishment of Debt Recovery Tribunals (DRTs) under the Recovery of Debts, due to Banks and Financial Institutions Act, 1993 was one of the most important steps taken by the Government for expeditious adjudication and recovery of debts due to banks and financial institutions. The Report of the Second Narasimham Committee, while identifying the shortcomings of DRTs, had recommended that these DRTs should be vested with the powers of attachment before judgement, for appointment of receivers and for preservation of property.

2.120 Recognizing the importance of DRTs, the Reserve Bank constituted a Working Group in March 1998 (Chairman: Shri N.V. Deshpande) to review the functioning of the DRTs, and suggest measures to improve their efficacy for recovery of debts. The Working Group, in its report submitted in August 1998, made a number of recommendations addressing both the structural aspects relating to the functioning of the DRTs as well as legal lacunae observed in the Act. The Government of India has broadly accepted the recommendations made by the Group and a bill, *viz*., the Recovery of Debts due to Banks and Financial Institutions (Amendment) Bill 1999 was introduced in the Parliament seeking amendments to certain provisions of the Act.

2.121 Simultaneously, in line with the Budget announcements in 1998-99, an Expert Group was constituted by the Government under the Chairmanship of Shri T. R. Andhyarujina, former Solicitor General of India, to suggest appropriate amendments in the legal framework affecting the banking sector. The Expert Group would examine the legal lacunae observed in the functioning of DRTs and suggest amendments in various external legislations affecting the banking sector such as, the Transfer of Property Act, foreclosure laws, Stamp Act, Indian Contract Act, DRT Act, etc.

Frauds in Banks

2.122 The Reserve Bank monitors frauds in banks and cautions banks with a view to enabling them to put in place appropriate safeguards. The Advisory Board on bank frauds set up in March 1997 under the Chairmanship of a former Deputy Governor of the Reserve Bank (Shri S.S. Tarapore), is examining the issue on a continuous basis. Under the revised dispensation, the Board functions under the aegis of the Central Bureau of Investigation (CBI), but the Reserve Bank provides full secretarial and other support to the Board. The Board gives advice on the cases referred to it by CBI (earlier RBI), officials of public sector banks of the rank of a general manager and above regarding their role and responsibility in such cases.

2.123 In order to enhance managerial effectiveness both at micro as well as macro levels, the Central Vigilance Commission (CVC) notified, with effect from January 1, 1999, the Special Chapter on Vigilance Management in Public Sector Banks for inclusion in the Vigilance Manual. The Special Chapter was finalised in consultation with the Reserve Bank, the Indian Banks' Association, the Central Bureau of Investigation and the Ministry of Finance. The CVC has reiterated that the Special Chapter has been prepared keeping in mind the special needs of bank managers and the problems faced by them in their day-to-day functioning.

2.124 The major changes brought about by the above Chapter include empowerment of the office of the CVC and its superintendence over the functioning of the Delhi Special Police Establishment, in so far as it relates to investigation and progress thereof of offences alleged to have been committed under the prevention of Corruption Act, 1988. The Commission has been given the powers of a civil court and its jurisdiction is co-terminus with the executive powers of the Union. The Advisory

Board on Bank Frauds (ABBF), which was earlier set up by the Reserve Bank, has since been redesigned as the Central Advisory Board on Bank Frauds (CABBF) and would now form part of the organisational infrastructure of the Central Bureau of Investigation (CBI).

Y2K Compliance of Commercial Banks

2.125 In order to address the Y2K problem in banks, the Reserve bank has devoted a great deal of attention to Year 2000 compliance issues. Accordingly, a high Level Working Group headed by a Deputy Governor was constituted during 1998-99 to monitor compliance efforts and give strategic direction to the departments of the Reserve Bank exercising supervisory jurisdiction over various segments of the financial system.

2.126 The Department of Banking Supervision has articulated a highly focused supervisory strategy to ensure that Y2K issues are appropriately addressed within each bank and financial institution consisting of:

- Establishment of targets and benchmarks for the industry.
- Issue of supervisory guidance on Y2K issues.
- Off-site monitoring of compliance efforts.
- Unaudited certification of compliance by banks.
- Verification of compliance efforts through on-site supervisory examinations.
- Proactive supervisory pressures and enforcement action.
- Ensuring that contingency planning by banks is in place.

2.127 The approach adopted by the Reserve Bank has created awareness about the Y2K problems and activised the top managements of both banks and financial institutions to devise appropriate strategies so as to proactively address the issues in the context of their domestic and cross-border operations (Box II.5).

2.128 Banks and financial institutions have reported completion of the entire exercise

Box II.5: Y2K Preparedness of Banks

In recent years, the Indian financial sector has witnessed spurt in activities in the field of information technology. The usage of computer system, net working, satellite communication, etc. in banking operations have revolutionised the banking services. Viewed from this background, the computer-based communication systems in banks will have to face challenges of likely malfunctioning of systems at the turn of the century i.e. Year 2000. The year 2000 problem is receiving pro-active attention of the financial community. Further, the interconnectedness of financial institutions and their various external dependencies add complexity to the risk management considerations associated with Year 2000. The serious impact of Y2K problem in various activities of banking organisations may be listed out below:

- Calculation of Interest.
- Current data may be erased or archived as old data.
- Bank may not have access to legacy databases with implications for both operations and management information system (MIS).
- Functionality and data integrity may be impaired.
- Affects automatic computation of forward rates, delivery, pick-up, payment and receipt schedules. Exposes banks to Product Delivery Risk.
- ATMs and Shared Payment Networks may not function.
- Computer activated time locks and burglar alarms with embedded chips may not function.
- Credit risk implications due to customers, correspondents and counter parties not being compliant.
- Questions of credibility and credit rating also arise.
- Crises of confidence due to information asymmetry and liquidity risk if customers are not taken into confidence.
- Y2K problem is resource intensive and has implications for the bank's bottom line.
- Y2K problem for banks may end up in legal risk.

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While deciding the exposure limit of a customer, banks should factor in Y2K risk assessment of their customers and counter parties in their credit appraisals. However, it has to be recognised that the scope and impact of the year 2000 problem for banks depends largely on the level of automation and networking.

The degree of usage of information and technology and the consequent sophistication of such automation present a mixed picture. The 104 scheduled commercial banks in India have a network of approximately 64000 branches. Of these, around 2800 branches are fully computerised. There are another 16345 and 15550 branches with stand alone PCs and Ledger Positing Machines, respectively. Basically, these are mainly used for front office purposes and to a limited extent for back office automations. There are also 435 bank offices with mini computers. Mainframes are mainly limited to clearing and settlement, management information system (MIS), Credit Card transactions processing and inter-branch reconciliation. Another 17 controlling offices of banks are equipped with mainframes. In order to meet Y2K requirements, banks are upgrading their level of technology with the latest versions of compliant hardware and software with better features and processing speeds.

Recognising the problems of Year 2000, the Reserve Bank has taken the initiatives and sharply focussed its attention to ensure that the banks appropriately address the problem. A High Level Working Group headed by Deputy Governor of the Reserve Bank has been constituted to monitor the compliance efforts and give strategic directions and proactively ensure that all institutions address the Y2K problem. Supervisory initiatives have been taken since 1997 with the issue of circulars to all commercial banks advising them to put in place appropriate time bound strategies to assess, convert and validate all systems and applications so as to achieve fully compliant systems. The focus involves creation of awareness about the Y2K problem and to activate the top management of banks to have an appropriate strategy in place to address the problems in the context of their domestic and cross-border operation.

100 per cent Y2K readiness has been reported by all the commercial banks as at end August 1999. Other segments of the financial sector, viz, Regional Rural Banks, Primary Dealers and financial institutions-both at the central and state levels have made efforts at achieving full Y2K compliance and have so far progressed remarkably well in this task. The feedback regarding the participation by the banks in the mandatory test recommended by Society for Worldwide Interbank Financial Telecommunication (SWIFT) has revealed that all the 60 banks, which are members of SWIFT have successfully completed testing. Up-to-date information on Y2K related issues available from Bank for International Settlements (BIS), Federal Reserve and other countries including Bank of England is shared by the Reserve Bank with all banks. It, however, needs to be kept in mind that achieving full compliance is often dependent on certain exogenous factors like lags in promised delivery schedules by vendors and the need to customise and transport Y2K compliant versions of packages across a number of geographically dispersed branches, which often leads to time overruns.

Banks have to ensure that the remedial measures are complete and all of them undertake continuous testing programmes. Secondly, contingency planning has to be put in place so as to counter Technology Systems Risk. Contingency plans have to ensure that all economic activities would continue to function in an efficient manner during the transition to the twenty-first Century. This would help the banking business to survive in the event of failure of computer systems and their back-ups. Therefore, contingency plans should take care of two major risks: (a) operational risks arising out of failures in internal systems and problems with facilities provided in the organisation and (b) credit and liquidity risks of banks. Thirdly, banks should address their external dependencies particularly in relation to their exposure to customers, correspondents and counter parties. Fourthly, the impact of embedded systems needs to be assessed and mitigated. This is basically due to the fact that embedded systems have high degree of impact when failure occurs. Fifthly, banks will have to critically examine the resources that they would have to put up in place in the event of Year 2000 failure. Sixthly, banks have to ensure that they do not face reputational risks. Banks should adopt clear cut approaches to create credibility and instill confidence of the public in their operations. They have also to ensure that there are transparent practices and measures adopted in tackling Year 2000 problems. These issues are to be addressed with the full involvement and commitment of the Top Management and the Board of Directors. Banks are encouraged to get third party certification and audit of their Y2K readiness.

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including renovating/replacing systems and its validation through testing/implementing tested system. They have worked out contingency plans and their validation and testing are presently going on.

2.129 A separate Y2K Project Cell was formed in the Department of Banking Supervision to spearhead the Reserve Bank's supervisory initiative on Y2K and monitor the compliance efforts in the financial sector (including non-banking subsidiaries of commercial banks, financial institutions, primary urban co-operative banks, etc.). The Cell also seeks feedback in respect of the compliance efforts of institutions whose position falls within the scope of surveillance of other bodies/ institutions (SFCs/ SIDCs, Housing Finance Companies, Regional Rural Banks, State and District Co-operative Banks, etc.).

2.130 The compliance efforts of banks and financial institutions are monitored through a monthly reporting system. On-site verification of compliance efforts in respect of commercial banks and financial institutions is carried out through the regional offices of the Department of Banking Supervision. The banks and other institutions in the financial sector supervised by the Reserve Bank have been advised to keep their Board of Directors suitably apprised of their progress at least bi-monthly.