

FOREWORD : SPECIAL EDITION

With a view to critically analysing the issues of contemporary relevance, the Department of Economic Analysis and Policy of the Reserve Bank introduced a theme based annual **Report on Currency and Finance** from 1998-99. So far, eight reports have been released encompassing several important contemporary issues concerning central banking and macroeconomic aspects relating to India. The last report for the period 2006-08 was released in August 2008.

In September 2006, the Government of India, in consultation with the Reserve Bank, constituted a Committee on Financial Sector Assessment (Chairman: Dr. Rakesh Mohan) to undertake a comprehensive self-assessment of the financial sector. The Committee has made an objective assessment of India's financial sector based on three mutually reinforcing pillars: financial stability and stress testing; legal, infrastructural and market development issues; and assessment of the status and implementation of financial standards and codes. The Report of the Committee is being made available in the public domain.

Since the themes of the last four editions of the **Report on Currency and Finance** were on the major functional areas of the Reserve Bank, it is considered useful to release these issues of the Report on Currency and Finance from 2003-04 to 2006-08 as a special volume along with the **Report of the Committee on Financial Sector Assessment**. This special edition of the **Reports on Currency and Finance** brings together the analytical work of the last four Reports with the objective of providing greater access to research conducted in the Reserve Bank in the areas of monetary policy, central banking, financial markets and the banking sector.

The conduct of monetary policy during the 1990s in India has been shaped by wide-ranging structural reforms. This necessitated significant changes in the monetary policy framework in terms of objectives, instruments and targets. At the heart of monetary reforms lay the containment of the fiscal dominance of monetary policy. In contrast, with the opening up of the economy, monetary management had to contend increasingly with challenges emanating from the large volume and sudden switches in capital flows and episodes of volatility in the financial markets. In this milieu, while price stability and credit availability remained twin objectives of monetary policy, financial stability gradually emerged as a key consideration in the conduct of monetary policy. Against this backdrop, the Report for 2003-04 focussed on the theme of '**The Evolution of Monetary Policy**'. This volume dealt with changes in monetary policy framework in India and attempted an assessment of the effectiveness of monetary policy in achieving its key objectives.

The operations of the Reserve Bank of India have been marked with great flexibility in responding to domestic requirements and international challenges. It has been the endeavour of the Reserve Bank to align regulation and supervision with international best practices with suitable adaptations. The Reserve Bank has been constantly refining its operating procedures and instruments in the direction of developing sound financial markets and financial infrastructure. The balance sheet of the Reserve Bank has undergone a fundamental change over the last seven decades alongwith transformation of the Indian economy. The Report for 2004-05 with its theme as '**The Evolution of Central Banking in India**' attempted to trace the organisational evolution and management development of the Reserve Bank since its inception. It brought out the changing role and functions of the Reserve Bank over seventy years of its existence.

Reforms in the financial markets have encompassed all segments – the money market, the credit market, the government securities market, the foreign exchange market, the equity market and the private corporate debt market. The development of financial markets has been pursued for bringing about a

transformation in the structure, efficiency and stability of markets. Some of the key measures that have been initiated to develop the financial markets include market determined pricing of various financial assets, removal of restrictions on participants, introduction of electronic trading platforms and introduction of new instruments. All these measures have had a significant impact on the structure and efficiency of financial markets. The Report for 2005-06 with the theme as '**Development of Financial Markets and Role of the Central Bank**' attempted to cover the vast canvas of financial market operations as they emerged in India and suggested a way forward for all the market segments for furthering their development.

The efficient functioning of the banking sector is crucial for attaining overall efficiency in the economy through better intermediation of financial resources. Accordingly, wide ranging reforms have been introduced in the banking sector on a continuing basis in India with a view to creating an efficient, strong, competitive and dynamic banking sector. The focus of the reforms has been on deregulating interest rates, removing external constraints, adopting international best practices in regulation and supervision, introducing competition through new private sector banks and foreign banks and providing operational flexibility and functional autonomy to public sector banks. By all accounts, the performance of the banking sector has improved significantly. The Report for 2006-08 focussed on the various aspects of banking operations in India such as managing resource mobilisation; managing capital and risk; lending and investment operations of banks; financial inclusion; competition and consolidation; efficiency, productivity and soundness of the banking sectors and regulatory and supervisory challenges in banking. Keeping in view the magnitude and coverage, this edition of the Report was for the period 2006-08 and was issued as two volumes: Volume I (Chapters I to V) and Volume II (Chapters VI to XI).

This special edition of the Reports on Currency and Finance comprises five volumes: **The Evolution of Monetary Policy**, 2003-04 (Volume I); **The Evolution of Central Banking in India**, 2004-05 (Volume II); **Development of Financial Markets and Role of the Central Bank**, 2005-06 (Volume III); and **The Banking Sector in India: Emerging Issues and Challenges**, 2006-08 (Volume IV and Volume V). The Volume IV comprises Chapters I to VI of the Report on Currency and Finance, 2006-08, while Volume V includes Chapters VII to XI.

The regular edition of the **Report on Currency and Finance** also includes a chapter on 'Recent Economic Developments'. As information contained in this chapter gets updated from time to time with each Report, it has been dropped from the special edition to maintain thematic continuity. However, for technical reasons, page numbers as also chapter, box, chart and table numbers of the original Reports have been retained.

It has been a pleasure to work with a talented pool of researchers in the Reserve Bank of India whose work is reflected in this special edition of the Reports on Currency and Finance, 2003-08. I trust researchers and policy makers as also general public would find this special edition enriching.

December 31, 2008

Rakesh Mohan
Deputy Governor