Mid-Term Review of Monetary and Credit Policy for 1999-2000

Introduction

As in the previous year, this Statement on Mid-term Review of Monetary and Credit Policy consists of three parts: (i) Mid-term Review of Macroeconomic and Monetary Developments in 1999-2000; (ii) Stance of Monetary Policy for the second half of 1999-2000; and (iii) Financial Sector Reforms and Monetary Policy Measures. The mid-term assessment of macro-economic developments is in line with the earlier projections and, by and large, it is proposed to continue with the direction and thrust of policy measures announced in April 1999 for the rest of the year. The stance of monetary policy for the second half of 1999-2000 would also remain broadly the same as in the first half.

I. Mid-Term Review of Macroeconomic and Monetary Developments in 1999-2000

Domestic Developments

2. According to the latest meteorological report, the rainfall in terms of quantum and spatial distribution was generally satisfactory. During the year, upto end September 1999, 28 out of 35 meteorological sub-divisions covering 81 per cent of the area and 67 per cent of the districts in the country received normal to excess rainfall. Seven meteorological subdivisions received deficient rainfall, of which the deficiency was marginal in three sub-divisions. The overall assessment of the Meteorological Department is that the monsoon has been "normal" (90 per cent of the long-term average of 903 mm). The best estimate at present is that the *Kharif* crop would be of the order of 102 - 103 million tonnes, about the same as the last year's level. Assuming the expected improvements in the *Rabi* crop, it is likely that agricultural production for the year 1999-2000 will be higher than the previous year.

3. So far as the industrial sector is concerned, after a period of deceleration, there are now welcome signs of a recovery. The Index of Industrial Production (IIP) registered a growth of 6.0 per cent in the current financial year (April-August 1999) as compared with 4.2 per cent during the corresponding period of the previous year. The increase in the IIP was mainly due to revival of growth in demand for manufactured products and is reflected in the significant improvement in the manufacturing output growth by 6.7 per cent as against 4.2 per cent in the comparable period of the previous year. Signs of recovery were observed in steel, cement and certain other sectors. This is reflected also in the turnaround in the demand for non-food bank credit, and in the buoyancy seen in the stock and fixed income securities markets.

4. According to the preliminary estimate of the Central Statistical Organisation (CSO), the Gross Domestic Product (GDP) during the first quarter of the current year grew at 5.5 per cent as against 3.6 per cent in the previous year. Assuming that the recovery in industrial production witnessed in the first half of the year will gather further momentum during the rest of the year, and there is no unexpected setback on the agricultural front, growth in GDP in the current year is projected to be in the range of 6 to 6.5 per cent. This is consistent with the range of 6 to 7 per cent, indicated in the April Statement.

5. The rate of inflation on a point-to-point basis on October 9, 1999 was 2.51 per cent as against 8.07 per cent at the same time last year. On an average basis, the annual inflation rate is lower at 4.33 per cent as against 6.28 per cent at the same time last year. The drop in wholesale prices has also been reflected in the sharp fall in the Consumer Price Index (CPI). In August 1999, the CPI inflation rate was on a point-to-point basis as low as 3.15 per cent as against 15.04 per cent in August 1998. Allowing for some increase in prices due to seasonal factors later in the year and adjustment lags in administered prices, the inflation rate for the current year as a whole is likely to be lower than that of 4.8 per cent in the previous year. Food stocks at the end of August 1999 were 29.90 million tonnes, which is higher by 4.04 million tonnes over the same time last year. High level of food stocks combined with a low rate of inflation, should provide greater manoeuvrability in managing the economy in the event of any unexpected shocks.

6. The rate of growth in money supply (M_3) during the current financial year upto October 8, 1999 has been 7.9 per cent compared with 10.1 per cent in the corresponding period of the previous year. Annual growth in M_3 (October 8, 1999 over October 9, 1998) was 16.0 per cent as against 21.1 per cent in the comparable period of the preceding year (excluding the contribution of receipts under Resurgent India Bonds, the increase in M_3 last year was 18.7 per cent). Aggregate deposits of scheduled commercial banks in the current year upto October 8, 1999 showed an increase of Rs.53,487 crore (7.5 per cent) as compared with Rs.66,978 crore (11.2 per cent). Excluding Resurgent India Bonds, the increase in the current year so far was 7.7 per cent against 8.2 per cent in the same period last year. On the basis of current trends, the projected growth in aggregate deposits of Rs.1,18,500 crore for the year as a whole looks realistic. In the light of the real sector trends and the expected inflation outlook, which are more or less consistent with the April Statement, the projected order of monetary expansion of 15.5 - 16.0 per cent indicated in the April Statement, appears reasonable.

7. Reserve money showed a lower expansion by Rs.6,322 crore (2.4 per cent) in the current financial year so far upto October 22, 1999 as against an increase of Rs.11,623 crore (5.1 per cent) in the comparable period of previous year. Currency in circulation increased by 7.7 per cent in the current financial year so far as against 9.4 per cent in the last year. On an annual basis, currency expansion was 14.6 per cent as against 13.6 per cent a year ago. The net foreign exchange assets of RBI showed an increase of Rs.5,618 crore as compared with an increase of Rs.9,472 crore in the previous year. Net RBI credit to Government showed a lower increase of Rs.6,044 crore than Rs.13,710 crore in the previous year, mainly due to a decline in credit to State Governments of Rs.3,843 crore as against a decline of Rs.307 crore in the previous year. On the components side, the large increase in currency in circulation was the characteristic feature of the reserve money expansion. Any possible expansion in currency till December/January 1999-2000 in the context of the millennium change is expected to reverse to normal before the year end.

8. Domestic and international developments have so far allowed the Reserve Bank to keep liquidity in the system at a comfortable level without too large an expansion of reserve money. As per current expectations, it appears that, with some appropriate adjustments, there should be no difficulty in meeting fully the liquidity needs of different sectors.

9. There has also been a significant pick up in the bank credit and other flows to the commercial

sector from the banking system during the current year, especially from the fortnight ending July 2, 1999. Scheduled commercial banks' credit expanded by Rs.19,237 crore (5.2 per cent) upto October 8, 1999 as against an increase of Rs. 11,645 crore (3.6 per cent) in the previous year. Food credit increased by Rs.4,436 crore as against Rs.3,464 crore in the previous year. Non-food bank credit increased by Rs.14,802 crore (4.2 per cent) as against an increase of Rs.8,181 crore (2.6 per cent) in the previous year. Together with the provisional data on investments in commercial paper, investments in bonds / shares / debentures of PSUs and private corporate sector, the flow of resources from scheduled commercial banks to the commercial sector increased by Rs.21,116 crore (5.3 per cent) as against Rs.17,540 crore (5.1 per cent) in the previous year. Banks' investments in instruments issued by financial institutions and mutual funds this year increased by Rs.1,498 crore as against Rs.3,136 crore last year. Total resource flow to the commercial sector including capital issues, GDRs and borrowings from financial institutions increased by Rs.41,046 crore as compared with Rs.33,573 crore in the previous year.

10. The Union Budget for 1999-2000 placed the net market borrowings of the Central Government at Rs.57,461 crore and gross borrowings at Rs.84,014 crore. In the current financial year upto October 26, 1999, the Central Government mobilised net borrowings of Rs.57,977 crore, and gross market borrowings of Rs.72,630 crore. As spelt out on earlier occasions, RBI has been combining auction issues with acceptance by private placement of dated securities of the Government consistent with market conditions. The release of such securities through open market sales at opportune moments has helped to contain the volatility in securities prices and reduce the associated risks to major participants like banks and primary dealers. Accordingly, in the current financial year so far, while devolvement including private placements with RBI amounted to Rs.29,267 crore accounting for 40.3 per cent of the gross market borrowings, the reserve money impact of this was neutralised by sales through open market operations conducted by RBI. Upto October 26, 1999, net sales of government securities amounted to Rs.23,695 crore. Thus, RBI's subscriptions in primary issues under the Government borrowing programme, net of open market sales, this year remained at Rs.3,305 crore compared to Rs.8,909 crore in the corresponding period last year.

11. In the current financial year, there has also been a move to elongate the maturity structure of marketable debt of Government. The maturity period of issued securities ranged between 6 years and 20 years. Scheduled commercial banks' investment in government securities increased by Rs.36,648 crore in the current financial year so far (upto October 8, 1999) as against an increase of Rs.27,533 crore in the corresponding period of previous year. Banks are presently holding government securities in excess of SLR prescription by a considerable margin. As mentioned in the April statement, in the interest of maintaining stable interest rate environment, Government's borrowing programme needs to be kept within reasonable limits. This will also reinforce the process of recovery in industrial sector and enable banks to adequately meet the demand for non-food bank credit.

12. While RBI's policy of subscribing to government securities on private placement basis, combined with active open market operations, has proved to be highly effective in keeping interest rates relatively stable, an issue that needs to be considered is whether this is a desirable policy of debt management from the long term point of view. There is merit in the view that ideally government securities should be sold in the market directly through auctions, and the

interest rate determined by the market. However, at the present stage of development, government securities market is not deep or broad enough to correctly reflect the prevailing liquidity conditions or the underlying interest rate outlook based on secondary market transactions. As the secondary market develops and turnover increases, it should be possible to exclusively rely on auctions to sell Government paper. This is the direction in which RBI would like to move. However, one of the important requirements for the secondary market in government securities to develop is for Government's net borrowing requirements to be sustainable. Unfortunately, at present, there is very little flexibility available in regard to either the timing or the size of Government borrowings in the primary market.

13. In the management of monetary policy during the second half of the year, a critical factor is the fiscal outlook for the rest of the year. While gross revenues during the first half have been buoyant, the net revenue of the Central Government is actually a little lower than in the previous year because of the large increases in transfers to States and Union Territories. The Central Government's gross fiscal deficit during the first five months constituted 60.2 per cent of the budget estimate as compared with 52.0 per cent in the previous year. The revenue deficit has also been high and contributed nearly 70.0 per cent to gross fiscal deficit as compared with 52.0 per cent last year. These developments do not augur well for the future unless determined action is taken to increase revenues, reduce deficits in the public sector, and reduce expenditure through appropriate policy actions. As recently announced by the Government, it is imperative that necessary actions to correct fiscal distortions are taken as early as possible. It may also be mentioned that fiscal slippages are no longer regarded as a matter of domestic concern alone. All over the world, international agencies and investors keep a close watch on emerging trends in Government finances, as they have a bearing on future macro-economic stability.

External Developments

14. The two-year period since September 1997 has presented major challenges for the management of the external sector. During this period, India had to cope with the global effects of a series of intense crises in East Asia, Russia and Brazil, in addition to continued uncertainties in industrial economies, particularly Japan. After the Pokhran test last year, India was also confronted with certain other unfavourable external developments, including sanctions imposed by several industrialised countries, the suspension of multilateral lending (except for some sectors), downgrading by international rating agencies, and reduction in investment by Foreign Institutional Investors (FIIs). While there has been improvement in some of these areas and there are signs of an upturn in the world economy in the last six months, the external outlook continues to be characterised by several uncertainties. The management of the external sector in the first half of the current year also had to cope with some uncertainties in investment outlook consequent upon dissolution of the Lok Sabha in April 1999 and the ensuing electoral process.

15. Viewed against the background of external and domestic uncertainties, developments in respect of both the exchange rate of the rupee as well as movement in foreign exchange reserves have been reasonably satisfactory. As on October 22, 1999, the foreign currency assets of the country were higher by US $ 3.70 billion compared with a year ago. Foreign exchange reserves, including gold and SDR were also higher by US $ 3.43 billion. At the present level of foreign exchange reserves (at US $ 33.07 billion), reserves substantially exceed the total stock of short-

term debt and portfolio flows. As pointed out in the April Statement, as a matter of conscious policy, India will continue to keep its short-term as well as forward liabilities at a manageable level in relation to the size of its reserves.

16. The day-to-day movements in exchange rates are market determined. The primary objective of the Reserve Bank in regard to the management of the exchange rate is to maintain orderly conditions in the foreign exchange market, to meet temporary supply-demand gaps which may arise due to uncertainties or other reasons, and to curb destabilizing and self-fulfilling speculative activities. To this end, as in the past, the Reserve Bank will continue to monitor closely the developments in the financial markets at home and abroad, and take such monetary and administrative actions as may be considered necessary from time to time.

17. An important development in regard to balance of payments outlook is the substantial increase in the price of crude oil and petroleum products in the last six months. Crude oil prices have increased from US $ 16.71 per barrel at the beginning of April 1999 to US $ 22.95 per barrel at the end of September 1999. On the whole, the current expectation is that despite the effect of increase in oil prices, the current account deficit in 1999-2000 will still be below 2 per cent of GDP in view of the encouraging developments in respect of invisibles, particularly private remittances and software exports.

18. An important area of concern for the management of the balance of payments continues to be that of exports. Partly because of slowdown in the world economy and also the East Asian economic crisis, exports in 1998-99 declined by 3.9 per cent in US dollar terms. There is some evidence of pick up in exports during the first five months of the current year when exports grew by 4.6 per cent in US dollar terms. It is necessary that this momentum is kept up. In the previous year, several measures for improving the delivery of export credit in foreign currency to exporters at internationally competitive interest rates (with a maximum spread of 1.5 per cent over the LIBOR) were initiated. Some measures were also announced in the April 1999 Statement in order to ensure the timely availability of export credit and remove procedural hassles. These measures included provision of 'On Line credit' to exporters, extension of 'Line of Credit' for longer duration for exporters with good track record, peak/non-peak credit facilities to exporters, permission for interchangeability of pre-shipment and post-shipment credit and meeting the term loan requirements of exporters for expansion of capacity and modernisation of machinery and upgradation of technology. Improvements have also been made in the procedure for handling of export documents and fast track clearance of export credit at specialised branches of banks. In August 1998, the Reserve Bank issued new simplified guidelines for sanction of credit facilities for software services, project services and software products and packages.

19. In order to improve the delivery of export credit, the Reserve Bank has set up a Bankers Group at the operational level (comprising senior officials from commercial banks and the Reserve Bank). So far, the Group has held 22 meetings with Chief Executives of major banks and also held parallel interactive sessions with the exporters as also base-level officials of the commercial banks at 14 major export centres in the country in addition to discussions with industry associations. Based on the deliberations in these meetings, the Reserve Bank has issued further guidelines to banks relating to simplification of application forms in respect of medium and small exporters and deployment of trained and experienced staff in branches dealing with

export finance. The experience seems to have proved useful in improving credit delivery to exporters.

20. In addition to foreign currency credit, exporters also have access to rupee credit at a concessional rate of 10 per cent per annum at present. The six month forward premium on sales of export proceeds has generally ranged between 5 and 6 per cent per annum in the last six months. Taking into account the premium available to exporters on forward sales, the cost of credit in rupee would work out to 4 - 5 per cent per annum, which compares favourably with the prevailing international rates of interest for corporate borrowers.

21. An important priority of the Government and the Reserve Bank of India is to create an environment which is favourable to investment and strengthening of financial links with the non-resident Indian community abroad. In line with this approach, earlier this year, procedures applicable to operations of bank accounts and financial transactions in India by nonresident individuals of Indian nationality/ persons of Indian origin were drastically simplified and a Non-Resident (special) Rupee (NRSR) account was introduced in addition to other existing facilities for nonresident Indians. The objective of the measures taken so far is to eliminate the need for case by case permission and to provide as far as possible a 'domestic' treatment to NRI community (in addition to the special facilities available to them in respect of foreign exchange transactions). New measures taken in the recent past include: (i) the extension of general permission under the Portfolio Investment Scheme, available to individual NRIs to Overseas Corporate Bodies; (ii) the permission to buy/sell equity shares/ debentures through brokers under the Portfolio Investment Scheme; and (iii) the general permission to purchase shares of Indian companies from other NRIs, PIOs/ OCBs. With immediate effect, it is proposed to provide the following further facilities to NRIs without the need for approval of the Reserve Bank :

(i) Authorised Dealers may grant rupee loans and overdrafts in India to NRIs against the security of shares/ securities/ debentures or immovable properties held by such persons in India for purposes other than investment.

(ii) General permission to Indian companies for issuing non-convertible debentures by way of public issue to NRIs/OCBs on repatriation basis. The Indian companies, for such issues, need not obtain approval of the Reserve Bank.

(iii) At present, NRIs/PIOs/OCBs are permitted portfolio investments in shares/debentures. These permis- sions by RBI are originally for a period of 5 years which can be renewed by designated banks. It has now been decided to delegate the powers to Authorised Dealers to permit portfolio investment by NRIs/PIOs/OCBs in shares/debentures.

22. Foreign Direct Investment (FDI) proposals are approved under the automatic route by RBI and under the approvals granted by Foreign Investment Promotion Board (FIPB) in the Central Government. In order to simplify FDI investment procedures, RBI has granted general permission to the Indian companies under the automatic route to receive funds and issue shares to their foreign collaborators without approval of RBI. The same benefit has been extended to foreign investments approved by the FIPB. Thus, in respect of all cases of foreign direct

investments, which are in line with Government policy, case-by-case approval of RBI is no longer required.

II. Stance of Monetary Policy for the Second Half of 1999-2000

23. In view of the paramount need to support industrial recovery, the Monetary and Credit Policy Statement in April had stated that "the current stance of monetary policy will continue to be in the direction of facilitating adequate availability of liquidity along with stable medium and long-term interest rates, with policy preference for softening to the extent circumstances permit." This stance of monetary policy was already reflected in the measures announced by the Reserve Bank on March 1,1999, when the repo rate was reduced by 2 percentage points and the Bank Rate and the Cash Reserve Ratio were reduced by 1 percentage point and 0.50 percentage point, respectively. The Cash Reserve Ratio was further reduced by 0.50 percentage point in April 1999. Following the RBI's measures, banks and financial institutions also announced their decisions to lower prime lending rates.

24. In line with the above stance, during the first half of the current financial year, the Reserve Bank has been closely monitoring the overall liquidity conditions in the market as well as the behaviour of interest rates. So far as liquidity conditions are concerned, by and large, they have remained generally easy owing *inter alia*, to growth in bank deposits and the cuts in Cash Reserve Ratio announced in March and April 1999. Non-food bank credit has also recorded an increase during this period by Rs.14,802 crore in contrast with an increase of Rs.8,181 crore during the first half of 1998-99. The increase in investments by banks in commercial paper, bonds/shares/ debentures of PSUs and private corporate sector during this period, however, showed an increase of about Rs.6,314 crore during April-September 1999 against Rs.9,359 crore in the corresponding period of 1998-99.

25. There has been a reduction in yields and interest rates on Government securities and Certificates of Deposit in the first half of the current year. So far as the Government securities are concerned, the yields have fallen by 46 basis points for 10-year paper in October 1999 compared with the yields in March 1999. The discount rates on Certificates of Deposit have declined from 10.00 per cent to 8.50 per cent for three months maturity and from 12.50 per cent to 11.00 per cent for one year maturity, between April and early September, 1999. There was also a decline in prime lending rates of public sector banks from the range of 12.75 - 14.50 per cent at the end of February 1999 to 12.00 - 13.50 per cent in October 1999.

26. While liquidity conditions have generally been easy, overnight call money rates have tended to be firm during the first half of the year compared with the position in the corresponding period of last year. The fortnightly average rates were in the region of 7.7 to 9.9 per cent for the most part as compared with 6.1 to 9.8 per cent last year. Part of the reason for this may be attributed to the pick-up in demand for credit and greater opportunities for investments in medium and long-term paper. (In the first fortnight of October 1999, however, call money rates, shot up to a high of 20.0 per cent for a few days mainly because of miscalculation of CRR requirements by some banks and low level of lending by major lenders in the call market).

27. The hardening of short-term interest rates was also reflected in an increase in the cut-off

yields on Treasury Bills. The yields on 91-day and 364-day Treasury Bills showed an increase during the first half of the current financial year of about 46 basis points and 75 basis points respectively, over the corresponding period of last year. On the whole, while liquidity conditions have been comfortable and medium and long-term rates have tended to soften, there has been some pressure at the shorter end of the yield curve.

28. In order to cool down the pressures on call money market during the first half of October, the Reserve Bank opened a purchase window for Treasury bills as part of its open market operations. It is the intention of RBI to continue with this practice as and when considered necessary and, over time, to develop a two-way market operations in Treasury bills. In due course, with further development of Treasury bills market, such action should enable RBI to confine its activities to secondary market operations in Treasury bills, obviating the need for any devolvement in primary auctions.

29. In view of the decline in inflation rates in the past few months, and a relatively favourable outlook for the year as a whole, there is a case for a further downward movement in the structure of interest rates. The Reserve Bank has already indicated its policy preference for softening of interest rates to the extent circumstances permit. It, however, needs to be stressed once again that prime lending rates of banks for commercial credit are entirely within the purview of the banks and are no longer set by the Reserve Bank. The interest rates which are subject to regulation are only the rate of interest on savings accounts (which is 4.5 per cent), and rates of interest on export credit and credit for small and tiny sectors, including DRI schemes, up to an amount of Rs. 2 lakh. Decisions in regard to interest rates, therefore, have to be taken by banks themselves in the light of various factors, including their own cost of funds, their transaction costs, and interest rates ruling in the non-banking sector, etc.

30. While greater flexibility in interest rates is a most desirable objective, it has to be recognised that banks face several structural and other constraints. Among these are:

- For the public sector banks, the average cost of funds is in the region of 8 per cent. The non-interest operating expenses work out to 2.5 to 3.0 per cent of total assets, putting pressure on the required spread over cost of funds leading to high lending rates. Relatively high overhang of NPAs together with interest tax pushes further the lending rates.

- Banks do have the freedom to offer variable interest rates on longer term deposits. However, the preference of depositors for as well as the traditional practice with banks is to offer fixed interest rates on term deposits. The effect of this practice is to reduce the flexibility that banks have in lowering their lending rates since the rates on the existing stock of deposits cannot be lowered.

- There is persistent and large volume of market borrowing requirements by the Government giving an upward bias to the entire interest rate structure.

- Interest rates on contractual savings like Provident Fund, National Savings Scheme are substantially higher than long-term deposit rates of banks. Provident Fund rates are generally in the region of 12 per cent and National Savings Scheme rate on 4-year deposits is 11 per

cent as compared with the bank deposit rate of 10-12 per cent for similar maturity. Similarly, private sector mutual funds offer a much higher rate of interest than those offered by banks on their term deposits. Compared to bank deposits, many of the other saving schemes and mutual funds carry larger tax benefits.

- The level of CRR continues to be high in view of the need to control the overall expansion of liquidity in the system. A high level of CRR also raises the average cost of funds for banks.

31. From the short-term and long-term points of view, in the context of financial sector deregulation and industrial liberalisation, priority needs to be given to removing some of the above constraints so that the interest rate structure can be made more flexible during different phases of the business cycle. An important policy priority of the Reserve Bank, Government as well as banks must be to undertake concrete steps in this direction as early as possible.

32. As mentioned in the April Statement, the Bank Rate and short-term repo rate have been increasingly perceived by the markets as signals for movements in market rates of interest, particularly call money rates. The changes in CRR have served as one of the important instruments for regulating liquidity, and have been effective in meeting the short-term challenges in domestic money and forex markets. The Interim Liquidity Adjustment Facility has also helped in keeping the money market rates range bound. The medium/long-term objective of monetary policy will continue to be in reducing the average level of CRR, while in the short-term it could be varied in both directions depending on the behaviour of monetary indicators.

33. With the use of multiple indicator approach, the position in the financial markets will continue to be assessed by movements in money market interest rates, exchange rate, foreign exchange reserves, credit to Government and commercial sector and fiscal position of the Government besides real sector developments. Constant efforts are being made to explore the relationships among different sectors of the economy through a short-term operational model which will also be useful in understanding the transmission mechanism of monetary policy. In this respect, the estimates of the new monetary aggregates (based on the recommendations of the Working Group on 'Money Supply: Analytics and Methodology of Compilation'), both from the component and sources side, compiled and released in the October issue of RBI Bulletin are likely to be helpful.

34. Apart from price stability, central banks all over the world also accord importance to financial stability as a policy objective. RBI has been making continuous efforts towards strengthening financial soundness by prescribing capital adequacy norms of banks and financial institutions, advising improvements in asset classification and accounting systems and establishing best practice norms for income recognition and provisioning against exposures faced by them. Following the recommendations of the Narasimham Committee II, the RBI had, in October 1998, announced , *inter alia*, a range of specific prudential norms for banks which have since been progressively implemented. The thrust in this direction was carried forward in the April 1999 Statement enabling banks not only to adopt prudent accounting standards but also to allow some measure of freedom in managing loan accounts, and operation of ALM guidelines for financial institutions. Moving further from the gains of ALM system, banks are encouraged

to put in place comprehensive risk management systems to take care of credit risk, market risk and operational risk. After holding consultations with banks, RBI has recently provided detailed guidelines in this regard. RBI also places utmost importance on the quality and standards of supervision which have been progressively refined under the dispensation of the Board for Financial Supervision (BFS) ever since its establishment. Sustained reforms in this area during the last few years have significantly improved the outlook with respect to overall financial sector stability in India. RBI would continue to review the position with regard to the issues integral to the maintenance of financial stability in the future.

35. The Bank's overall stance of policy for 1999-2000 would continue to be : provision of reasonable liquidity; stable interest rates with preference for softening to the extent possible within the existing operational and structural constraints; orderly development of financial markets and ensuring financial stability.

III. Financial Sector Reforms and Monetary Policy Measures

Monetary and Credit Policy Measures

36. In the light of the macro-economic and monetary policy developments reviewed in the previous sections, it is proposed to make the following changes in policy :

(i) The Cash Reserve Ratio (CRR) maintained by the scheduled commercial banks is being reduced by one percentage point from the present level of 10 per cent to 9 per cent in two instalments, the first, effective the fortnight beginning November 6, 1999 and the next, effective the fortnight beginning November 20, 1999. This will increase the lendable resources of banks by Rs.7,000 crore.

(ii) In order to improve the cash management by banks, as a measure of simplification, it has been decided to introduce a lag of two weeks in the maintenance of stipulated CRR by banks. This change in the procedure for calculation of reserve maintenance will be effective from the fortnight beginning November 6, 1999.

(iii) The interest rate surcharge of 30 per cent on import finance, which has been in force since January 1998, is being withdrawn with immediate effect. This will reduce the financing cost of imports for industry.

(iv) At present, banks are required to charge a minimum rate of 20 per cent interest on overdue export bills. This stipulation is also being withdrawn with immediate effect, and banks will henceforth have the freedom to decide the appropriate rate of interest on overdue export bills. However, the present procedures for ensuring that there is no deliberate attempt to delay repatriation of export receipts will remain in force.

(v) In line with the policy of minimising the country's short-term external borrowing liabilities, the minimum maturity for FCNR(B) deposits is being raised to one year from six months. Banks, however, will continue to have the freedom to offer floating rate deposits (with a maturity of one year or more, and interest reset period of six months). At the same time, the requirement by banks to maintain an incremental CRR of 10 per cent on increase in liabilities under FCNR(B) Scheme (over the level prevailing as on April 11, 1997) is being withdrawn, with effect from the fortnight beginning November 6, 1999. This will increase the lendable resources of banks by Rs.1,061 crore.

37. As emphasised in the earlier Policy Statements, it is reiterated that the above measures, including the level of the CRR to be maintained by banks, are subject to change from time to time.

38. In the last few years, following the Reports of high level Committees (such as the Narasimham Committee) and various technical groups and working groups, the Reserve Bank has announced a number of measures for the development and reform of the financial sector, including money and debt markets. An attempt is made here to review the development in respect of certain measures announced in April 1999 with a view to bring about modifications where necessary.

Interim Liquidity Adjustment Facility (ILAF)

39. This facility, announced in the April Statement, has provided a mechanism for injection and absorption of liquidity available with banks from time to time. The ILAF is operated through a combination of repo, export credit refinance, collateralised lending facilities and open market operations. The experience in operating this facility in the last six months has generally been satisfactory and substantial use has been made of export credit refinance and collateralised lending facilities under this scheme in order to overcome mismatches in the supply and demand for liquid funds. The fortnightly average utilisation under this facility including export credit refinance has ranged between Rs.4,119 crore and Rs.7,697 crore during April-October 1999. Primary dealers also availed of liquidity support in the range of Rs.1,293 crore and Rs.7,406 crore during the same period. In the light of the feedback received from the market participants, in the first week of this month, the scheme was made more flexible by removing the requirement of 'cooling period' (after the use of this facility by banks for two blocks of two weeks each). The operation of this facility will be kept under constant review and further refined in consultation with participants.

Money Market

40. An important step announced in April 1999 in the direction of development of the money market was the introduction of rupee derivative products (Forward Rate Agreements/Interest Rate Swaps). The guidelines issued in this respect have been widely welcomed by the market participants and at present the notional principal amount of outstanding of FRAs/ IRS is around Rs.1,700 crore. It is expected that the volumes in the market will pick up over time, once banks and institutions complete the documentation formalities.

41. The April statement announced certain facilities for enabling non-bank participants to deploy their short-term resources in the repo market and for development of Money Market Mutual Funds (MMMFs). After a review of the working of the measures announced in April, the following modifications/measures are being introduced in the operation of various money market schemes :

(i) It was indicated in the April 1999 policy statement that the permission given to non-bank entities to lend in the call/notice money market by routing their call/notice money market operations through primary dealers will be available only upto end-December 1999. On a review, it has been decided to extend this facility upto end-June 2000.

(ii) Money Market Mutual Funds (MMMFs) which exclusively invest in money market instruments are governed by the MMMF guidelines issued by the Reserve Bank of India. On a review, it is felt that from the angle of a consistent policy with regard to investor protection, it would be desirable to bring the MMMFs under the umbrella of SEBI Regulations, like other Mutual Funds. Accordingly, henceforth, MMMFs will come within the purview of SEBI Regulations. Once SEBI Regulatory framework for MMMFs is in place, RBI would withdraw its guidelines and advise banks/financial institutions that in future, MMMFs would be governed by SEBI regulations. However, banks and financial institutions desirous of setting up MMMFs will have to seek necessary clearance from RBI for undertaking this additional activity before approaching SEBI for registration.

(iii) At present, Money Market Mutual Funds (MMMFs) can be set up either departmentally in the form of a Money Market Deposit Account (MMDA), or as a separate entity, viz., a 'Trust'. For operational convenience, it has been decided to henceforth allow MMMFs to be set up as a separate entity in the form of a 'Trust' only. As the banks to whom 'in-principle' approvals were already given have not so far opera- tionalised MMDAs, RBI proposes to withdraw the permission already granted after consulting them.

(iv) It has been decided to permit scheduled commercial banks to offer 'cheque writing' facility to Gilt Funds and to those Liquid Income schemes of mutual funds which predominantly invest in money market instruments (not less than 80 per cent of their corpus) subject to the same safeguards prescribed for Money Market Mutual Funds. Operating guidelines to banks are being issued separately.

(v) With a view to providing further flexibility in the use of FRAs/IRS, it has been decided to permit mutual funds, in addition to corporates, to undertake FRAs/IRS with banks, primary dealers and financial institutions for the purpose of hedging their own balance sheet risks. Mutual funds cannot, however, undertake market making in FRAs/IRS.

(vi) With a view to facilitating flow of information and transparency in the functioning of money markets, Reserve Bank proposes to work out in consultation with market partici- pants, modalities of releasing on a daily basis, data on volume and rates in call money market as well as some other relevant data. This will enable market participants to gauge liquidity conditions more effectively and contribute to smooth functioning of the short-term markets, in particular the call/notice money market.

Government Securities Market

42. On the basis of announcements made in the April policy, the following measures have been taken with the objective of improving depth and liquidity in the government securities market :

- Price based auction of government dated securities.
- Auction of 182-day Treasury Bills.
- A calendar of Treasury Bills issuance.
- Availment of ways and means advances by State Governments against collateral of Treasury Bills, in addition to Government of India dated securities.
- Minimum bidding commitment of Primary Dealers (PDs) to cover 100 per cent of notified amounts in Treasury Bills auctions.
- Underwriting of dated securities issues by PDs upto 100 per cent of the notified amounts.
- Entry of non-banking entities in the two way repos market.

43. These measures have generally been received well by the market participants and are working satisfactorily. The following action is in progress to further strengthen the development of the market :

- In regard to developing the retail market segment, a Working Group is being constituted to analyse all related aspects of retailing government securities and make recommenda- tions for improving the retail segment of the market.

- An Internal Working Group has been constituted to go into various aspects relating to two-way operations by RBI in the Treasury Bills market.

- Arrangements relating to clearing corporation are under consideration which will pave the way for opening the repo market to PSU bonds and bonds of FIs held in demat form in depositories and traded in recognised stock exchanges with essential safeguards. As a part of this, detailed guidelines to widen further the number of participants in the repos market through exchange traded repos with adequate safeguards to manage risks will also be finalised.

- It has been decided to publicise gilt instruments through informative pamphlets.

- It has been decided to advise PDs that they should have self-imposed reasonable leverage ratios with the consent of their Board of Directors.

Review of Norms Relating to Prime Lending Rates

44. Currently, loans upto Rs.2 lakh carry the prescription of 'not exceeding PLR' and on loans above Rs.2 lakh, the PLR is the minimum lending rate. A set of measures was announced in the April Statement to provide more operational flexibility to banks in the applicability of PLR. Keeping in view the suggestions received from banks and other market participants, the existing PLR norms have been further reviewed and it has been decided that banks will be given the freedom to charge interest rates without reference to PLR, in respect of the following categories :

- Loans covered by refinancing schemes of term lending institutions.

- Lending to intermediary agencies.

- Discounting of bills.

- Advances/Overdraft against domestic/NRE/FCNR(B) deposits.

The present position and the proposed changes are indicated in the Annexure I.

Prudential Norms

45. In order to strengthen the financial system, an important priority in the past few years has been to introduce appropriate norms in respect of capital adequacy, income recognition and

provisioning. An attempt has also been made to move towards full disclosure, transparency and effective supervision of banking operations in line with international best practices. It is expected that effective implementation of measures in these areas would help in not only strengthening the financial sector but also providing support to the growth of the real economy. As further steps in these directions, the following measures are being notified:

(i) In the Mid-term Statement on Monetary and Credit Policy for 1998- 99, a risk weight of 2.5 per cent was introduced for the risk arising out of market price variations for investments in government and other approved securities, with effect from the year ending March 31, 2000. In view of the growing share of investments in the assets of banks, the risk weight of 2.5 per cent is being extended to cover all investments including securities outside the SLR. This, however, will take effect from the year ending March 31, 2001.

(ii) As of now, a bank's exposure to an individual borrower is subject to a prudential ceiling of 25 per cent of the bank's capital funds. The In-House Working Group constituted by the Reserve Bank in 1998 to review the present exposure norms, had recommended moving closer to the international standard of 15 per cent, in phases. Accordingly, it has been decided to lower the exposure ceiling in respect of an individual borrower from the present level of 25 per cent to 20 per cent of the bank's capital funds effective April 1, 2000. Where the existing level of exposure as on October 31, 1999, is more than 20 per cent, banks would be expected to reduce the exposure to 20 per cent of capital funds over a two year period (i.e., by end October, 2001).

Valuation of Investments in Approved Securities

46. It was announced as part of the April Statement that with effect from the year ending March 31, 2000, banks will have to classify a minimum of 75 per cent of their investments in Government and other approved securities as 'Current Investments'. An 'Informal Group on Valuation of Banks' Investments Portfolio', set up by the Reserve Bank, has recently studied all aspects relating to valuation of investments in the light of international practices and has recommended that banks may classify their investments into three categories viz., 'Held for Trading', 'Available for Sale' and 'Permanent'. The Group has suggested norms for classification as also changes in accounting procedures. The Group has also recommended for discontinuation of the RBI's practice of prescribing year end YTMs for valuation purposes. The summary of Group's recommendations is provided in Annexure II. The Group's report will be circulated among banks for comments and also placed before the Board for Financial Supervision for advice. Thereafter, a final decision will be taken on the procedure for valuation of investments with effect from April 1, 2000.

Credit Delivery

47. Banks and financial institutions have been entrusted with special responsibilities for providing credit on reasonable terms to certain sectors, particularly, agriculture, exports, micro-credit institutions, small-scale industries and housing. In addition to improving the terms and volume of assistance to these sectors, an important priority is to improve and simplify procedures, reduce documentation requirements and decentralise decision making to branch

levels. Surveys have shown that simplification and decentralisation of credit delivery mechanisms are just as important in improving access to credit as preferential interest rates or policy directives. The Reserve Bank has held review meetings with the Chief Executives of banks to ensure that simplified procedures are actually being implemented at the ground level. It is proposed to hold such review meetings at regular intervals, and to encourage banks to set up internal systems to ensure effective implementation of simplified procedures.

48. Another area where banks and financial institutions can play an important role is that of infrastructure financing. After extensive consultation, RBI introduced in April, 1999 new guidelines to accelerate credit disbursement in infrastructure. These guidelines addressed important aspects relating to the financing of infrastructure projects, such as, the criteria for financing, the types of financing, the appraisal, the regulatory compliance/ concerns, the administrative arrangements and the inter-institutional guarantees, among others. Financing of infrastructure projects is characterised by large capital costs, long gestation period and high leverage ratios. In order to facilitate free flow of credit to infrastructure projects, several policy measures have already been effected by RBI. The stipulation regarding the ceiling on the quantum of term loans which can be granted by banks for a single project (Rs.1,000 crore for power projects and Rs.500 crore for other projects) has been dispensed with; banks can now sanction term loans to infrastructure projects within the overall ceiling of the prudential exposure norms. Subject to certain safeguards, banks are also permitted to exceed the group exposure norm of 50 per cent, to the extent of 10 per cent, provided the additional exposure is for the purpose of financing infrastructure projects. It is proposed to review the operation of these new guidelines after one year of operation (i.e., May, 2000), and make such changes as may be required to promote further financing of infrastructure.

49. In order to facilitate co-ordination and resolution of issues relating to projects assisted jointly by banks and development financial institutions, a Standing Coordination Committee has now been set up by the Industrial Development Bank of India. It is expected that this Committee will help in improving co-ordination and reducing delays in providing credit to infrastructure and other sectors.

Housing Finance

50. Banks have an important role to play in providing credit to the housing sector in consonance with the National Housing Policy. From time to time, new measures have been announced to increase the flow of bank finance to this sector. At present, banks are required to allocate towards housing finance to the extent of 3 per cent of incremental deposits. With a view to providing more flexibility to banks to increase the flow of credit, directly and indirectly through intermediary agencies including Housing and Urban Development Corporation and National Housing Bank, some changes in the norms for determining the housing finance allocation by banks are being introduced. Details are provided in Annexure III.

Micro Credit

51. As indicated in the April Policy Statement, Micro Credit Institutions and Self Help Groups (SHGs) are important vehicles for generation of income and delivery of credit to self employed

persons, particularly women, in rural and semi-urban areas. Banks have since been advised to include flow of micro credit in their corporate strategy/plan and to review the progress on a quarterly basis. As announced in the April statement, RBI has set up a special Micro Credit Cell to review the ground realities and in consultation with NABARD and reputed micro-credit institutions, suggest measures to remove any remaining policy and procedural bottlenecks for "mainstreaming micro credit". The objective is to accelerate the flow of bank credit to micro finance institutions without jeopardising their decentralised, voluntary and non-bureaucratic character. The Cell is expected to complete its field work, and submit findings, within a year. A high level Task Force on Supportive Policy and Regulatory Framework for Micro Finance set up by NABARD has also recently submitted its report to NABARD. The recommendations made by the Task Force are being processed by NABARD in consultation with RBI and Government as appropriate.

Non-Banking Financial Companies (NBFCs)

52. RBI has instituted a comprehensive regulatory and supervisory framework for the NBFC sector in January 1998, pursuant to the amendments effected to the Reserve Bank of India Act, 1934. As part of the consultative process, RBI has constituted an Informal Advisory Group consisting of representatives of the NBFC sector. While helping orderly growth of this important sector, steps are also being taken to increase investors' awareness of their own responsibility in regard to investments made by them. Considering the large number of NBFCs functioning, their geographical distribution and their diversified activities, RBI has been keen to promote the concept of self regulatory organisation among NBFCs, particularly for smaller NBFCs, and discussions with industry are continuing. A Committee constituted by the Bank to suggest formats of balance sheet with adequate disclosures has also submitted its report. The Reserve Bank proposes to introduce these formats and disclosure norms as recommended by the Committee after getting the views of the industry and the Department of Company Affairs of the Government of India.

53. The registration process for larger NBFCs envisaged under the Act is now more or less complete. Of 10,486 applications of NBFCs which were *prima facie* eligible, registration has been granted to 7,855 NBFCs, out of which 624 NBFCs have been permitted to accept public deposits. Further, applications of 1,167 companies have been rejected for registration as on August 31, 1999. In addition, as many as 26,904 companies with Net Owned Funds (NOF) below Rs.25 lakh have been given time under the RBI Act upto January 8, 2000 to achieve the minimum level of Rs.25 lakh. All NBFCs in this category should strictly adhere to the above time limit. RBI may not in the normal course, grant extension of time to those NBFCs which have not attained the prescribed minimum NOF of Rs.25 lakh by the stipulated date and accordingly their applications may not be considered for registration.

54. The following further measures in respect of NBFC sector are being notified with immediate effect :

(i) The borrowings from mutual funds presently come within the purview of public deposits as described in the Direction on Acceptance of Public Deposits. It has been decided that borrowings from mutual funds would be excluded from the definition of public deposits.

(ii) NBFCs should give public notice of 3 months in leading newspapers before they decide to close a branch or before effecting sale or transfer of ownership.

Deposit Insurance

55. India is a pioneer in introducing deposit insurance. However, subsequent developments in the financial sector as a whole have resulted in a review of deposit insurance systems in many countries. The approaches include private insurance, differentiated premia, voluntary insurance, separation of insurance from regulatory/ supervisory bodies, extending insurance to non-banks, etc. A Working Group was constituted in the RBI to review the role of deposit insurance in India. The Group conducted a detailed survey of the nature of deposit insurance in India with regard to instruments, institutions and regulatory framework, including a review of the international experience in this regard. The Group has recommended changes in the existing system in regard to deposit coverage, institutions to be brought within the ambit of deposit insurance, regulatory systems to be put in place, risk-based premium, the parameters relevant for assessment of risk and ownership and capital of deposit insurance agency. The Report is being released for wider public discussion.

Regulations Review Authority (RRA)

56. In April 1999, the RBI had set up a Regulations Review Authority (RRA) with a view to reviewing any procedural regulation or requirement of RBI which was not considered necessary or relevant by banks, market participants, foreign investors, NRIs, Indian citizens and experts. Since its inception, RRA has so far received 150 applications covering more than 200 suggestions relating to various operational areas of the Bank. Of this, nearly 50 per cent, covering about 115 suggestions have been disposed of and the remaining are at various stages of processing. Some of the procedural suggestions accepted for implementation are (i) doing away with the requirement of sample test checking of freshly printed MICR cheques, (ii) freedom to banks in fixation of service charges, (iii) displaying of information on NBFCs registered, (iv) changes in the structure of MMMFs, (v) arrangements for greater dissemination of information to public, and (vi) procedure for quicker dissemination on FIIs' investment limits. The RRA has also set up a number of technical groups with membership from both within and outside the Bank, to review and recommend changes in the current practices pertaining to regulation, documentation and reporting.

Year 2000 (Y2K) Preparations

57. The Reserve Bank has been closely monitoring the Year 2000 (Y2K) readiness in the financial sector so that business continuity is assured. The MICR cheque clearing systems at the Reserve Bank have been replaced by the state of the art Y2K compliant systems. The systems are already in operation in Mumbai, Chennai and Delhi and will soon go on stream in Calcutta and thus become fully operational in the metropolitan cities. All the 103 commercial banks and their 40 subsidiaries have confirmed Y2K readiness as at the end of August, 1999. Besides, all the Issue Offices of the Reserve Bank and currency chests at commercially important cities have been asked to store adequate quantities of cash in order to meet any sudden increase in demand.

In line with the international practices, all banks shall remain closed for public transactions on January 1, 2000.

58. To enable the banking system to tide over the century date change liquidity needs, a contingency plan has been put in place including the following measures :

Special Liquidity Support

(i) With a view to enabling the banks to meet any unanticipated additional demand for liquidity in the context of the century date change, it has been decided to introduce a 'Special Liquidity Support' for the period December 1, 1999 to January 31, 2000. Under the 'Special Liquidity Support', banks will be eligible to avail of liquidity under Section 17(4)(a) of the Reserve Bank of India Act, 1934 to the extent of their excess holdings of dated Government of India Securities/ Treasury Bills over the Statutory Liquidity Ratio (SLR) required to be maintained. The rate of interest on this facility will be 2.5 percentage points over the Bank Rate. This facility will be in addition to the Collateralised Lending Facility (CLF and ACLF) and export credit refinance facility provided to all scheduled commercial banks, at present. Banks, not holding significantly higher amounts of Government of India securities beyond that indicated by the required SLR, are encouraged to have standby arrangement for liquidity support with those banks which are eligible for Special Liquidity Support. Detailed operating guidelines will be issued separately.

Flexibility in the treatment of CRR

(ii) Normally, banks maintain minimum cash in their own vaults since it is an idle asset, without the benefit of earning any interest. In the context of date change at the turn of the century, in order to meet any additional demand for bank notes as a contingency, banks may have to keep larger vault cash for meeting their business transactions. At present, such cash in hand with the bank though an eligible asset for SLR, is not counted for CRR requirements. To facilitate banks to tide over the contingency during the millennium change, it has been decided to treat cash in hand maintained by the banks for compliance of CRR for a limited period of two months commencing from December 1,1999 to January 31, 2000. It is clarified here that the cash in hand which will be counted for CRR purposes, during the above period, cannot be treated as eligible asset for SLR purposes simultaneously.

(iii) As already indicated, for operational convenience, the maintenance of CRR by banks is being lagged by two weeks. As such, for maintaining CRR during the fortnight beginning January 1, 2000, the NDTL base would be December 17, 1999. With the leverage of two weeks available, banks should not have any problem in complying with the CRR requirement around the century date change. Nevertheless, any bank that expects a special problem in meeting its CRR obligations at the end of the year can approach the RBI for appropriate relaxation/assistance.

Contingency Funding Line from Head Offices Abroad

(iv) Some banks have desired to put in place a contingency funding line from their head offices

abroad to meet liquidity problems if any, arising during the century date change. As per the extant stipulations, repayments of borrowings from abroad by banks (i.e., authorised dealers), is allowed only if they have no outstanding borrowings either from the RBI or other bank/financial institution in India and are clear of all money market borrowings for a period of at least four weeks before the repayment. It has been decided to temporarily permit foreign banks to bring in Head Office funds and repatriate such funds during the period of two months from December 1, 1999 to January 31, 2000 without the above restriction.

ANNEXURE I

MODIFICATIONS IN NORMS RELATING TO PRIME LENDING RATES (PLR)

Sr. No.	Subject	Present position	Proposed Changes
1.	Interest rates on loans granted by banks for which refinance has been obtained from term lending institutions	Subject to PLR norms.	Banks would be given the freedom to charge lending rates on loans covered by refinance, as per stipulations of the refinancing agencies.
2.	Interest rates on bank lending to intermediary agencies including housing finance intermediary agencies.	Intermediary agencies are provided bank credit presently at a fixed rate of 1.5 percentage points less than PLR of respective banks for credit limits over Rs.2 lakh. Bank lending to housing finance intermediary agencies is subject to the stipulation that the interest rate should be below the PLR. Where the loans are routed through Primary Agricultural Credit Societies (PACS)/ Large Adivasis Multipurpose Societies (LAMPS)/ Farmers Service Societies (FSS), the rate of interest to be charged by banks is currently 1.5 per cent lower than rates to the ultimate borrowers in the case of advances of over Rs.25,000 and upto Rs.2 lakh and for credit limits above Rs.2 lakh the rate is 1.5 percentage points below the appropriate PLR.	Banks will have freedom to charge interest rates for lending to intermediary agencies without reference to PLR.
3.	Bill discounting by banks.	The effective rate of interest on discounting of bills for borrowers over Rs.2 lakh should be subject to PLR.	Bill discounting by banks will be outside the purview of PLR norms.
4.	Interest rate on advances/ overdrafts against Domestic/NRE/ FCNR(B) deposits	In cases where deposit rates are equal to or more than PLR or less than one percentage point below PLR, the banks have freedom to charge suitable rates of interest on advances against domestic/ NRE term deposits without reference to the ceiling of PLR. Rupee loans against NRE deposits to depositors are charged at less than PLR if the loans are repaid in foreign currency whereas loans and overdrafts against FCNR(B) deposits are subject to PLR norms.	Banks are free to charge interest rates on loans against domestic/NRE/ FCNR(B) deposits, without reference to PLR.

ANNEXURE - II

SUMMARY OF THE RECOMMENDATIONS OF THE INFORMAL GROUP ON VALUATION OF BANKS' INVESTMENTS PORTFOLIO

1. Banks may classify their entire investments in Government and other "approved" securities under three categories viz. "Held for Trading", "Available for sale" and "permanent". The "permanent" component should

not exceed 25 per cent of total investment in approved securities. However, banks have the freedom to classify the entire investment portfolio in Government and other "approved" securities as "Held for Trading" or "Available for sale".

2. Securities classified in "Held for Trading" category should be marked to market on a monthly if not more frequent basis. While the depreciation should be recognised in the Income Account, appreciation, if any, being unrealised, should be appropriated to the "Investment Fluctuation Reserve" through Income Account.

3. Securities in "Available for sale" category should also be marked to market at the year end or at more frequent intervals as decided by the Board of Directors. The gain or loss on revaluation may be taken to the Investment Fluctuation Reserve Account without routing through the income account. In the event that balance in the reserve account is insufficient, provision for depreciation should be made in the income account. In the event of sale/realisation of any investment from this category, the actual amount realised may be recognised in the income account.

4. Securities held in "permanent" category can be carried at cost unless it was more than the face value, in which case the premium has to be amortised over the period remaining for maturity of the security.

5. Banks can shift investments from one category to the other only with the approval of the Board of Directors.

6. As Government securities across a wide maturity spectrum are traded and market prices are available, RBI need not prescribe financial year-end YTM. Banks may refer to the prices available in SGL transactions, NSE trades/quotes, price list of RBI at the year-end and value the securities to the satisfaction of auditors.

7. RBI also need not prescribe the methodology for valuation of all the non-approved securities comprising PSU bonds and non-PSU bonds and debentures and they could be valued at "fair value" by individual banks taking the yield spread between the sovereign yield and the yield on the concerned bonds/similar bonds into consideration.

8. All the recommendations made above could be made applicable to all banks including new private sector banks.

ANNEXURE III

HOUSING FINANCE - CHANGES IN NORMS

Present Position	Change
Direct housing loans only upto Rs.5 lakh in all the areas, i.e., rural/semi-urban and urban/metropolitan areas, are treated as priority sector advances.	In Urban and Metropolitan areas, the limit will be Rs.10 lakh.
Loans extended by banks to housing intermediary agencies are reckoned as part of housing finance allocation provided the loan per borrower by such intermediary agencies does not exceed Rs.5 lakh in rural/semi-urban areas and Rs.10 lakh in urban/ metropolitan areas.	All indirect housing loans extended by banks to these agencies against the loans sanctioned by them will be reckoned as part of housing finance allocation.
The investment in bonds issued by National Housing Bank/ Housing and Urban Development Corporation exclusively for financing of housing is reckoned for inclusion under priority sector advances, provided the loan size per dwelling unit does not exceed Rs.5 lakh.	All the investment in bonds issued by National Housing Bank/ Housing and Urban Development Corporation exclusively for financing of housing irrespective of the loan size per dwelling unit will be reckoned for inclusion under priority sector advances.