MONETARY AND CREDIT POLICY FOR THE FIRST HALF OF 1998-99*

This statement consists of three parts: (i) Review of Macro-Economic and Monetary Developments in 1997-98, (ii) Stance of Monetary Policy for 1998-99, and (iii) Changes in Monetary and Credit Policy Measures.

I Review of Macro-Economic and Monetary Developments in 1997-98

1. The monetary and credit policy announced by my distinguished predecessor Dr.C. Rangarajan in April 1997, had projected a growth of 15.0 to 15.5 per cent in broad money (M_3) during 1997-98. The real GDP growth was projected at 6.0 – 7.0 per cent, and the rate of inflation was expected to be around six per cent in 1997-98. In the October 1997 policy statement, after a review of developments in the first half of the year, the M_3 growth target for the year was retained at 15.0 – 15.5 per cent. The real GDP growth was, however, expected to be at the lower end of the range indicated in April, i.e. about 6.0 per cent.

2. The actual results for the year, however, show that broad money (M_3) growth in 1997-98 was significantly higher at 17.0 per cent as compared with 16.0 per cent in the previous year. In absolute amounts, aggregate money supply increased by Rs.1,19,361 crore, as compared with Rs.96,931 crore in 1996-97. The increase was on account of a substantial expansion of domestic credit to both Government and commercial sectors, and an increase in net foreign exchange assets. The rise in banking sector's credit to Government was reflected in the rise in the gross fiscal deficit of the Central Government to 6.1 per cent of GDP as against the target of 4.5 per cent. In gross terms, Government's market borrowings amounted to Rs.59,637 crore as against Rs.36,152 crore in 1996-97. Bank credit to commercial sector increased by 14.3 per cent (Rs.53,940 crore) in 1997-98 as against an increase of 9.1 per cent (Rs.31,364 crore) in the preceding year.

3. Reserve money showed an increase of Rs.26,200 crore (13.1 per cent) as against an increase of Rs.5,576 crore (2.9 per cent) in 1996-97. Net Reserve Bank credit to Central Government increased by Rs.12,914 crore during the financial year 1997-98 as against an increase of Rs.1,934 crore during 1996-97. Net foreign exchange assets of the RBI increased by Rs.21,025 crore (22.2 per cent) in 1997-98 as compared with an increase of Rs.20,773 crore (28.0 per cent) in 1996-97.

4. The growth in aggregate deposits in 1997-98 was also sharply higher than projected. Aggregate deposits of scheduled commercial banks increased by Rs.95,749 crore (18.9 per cent) during 1997-98 as compared with an increase of Rs.71,780 crore (16.5 per cent) in 1996-97. The conventional non-food bank credit of scheduled commercial banks showed a larger increase of Rs.38,524 crore (14.2 per cent) during 1997-98 than the increase of Rs.26,581 crore (10.9 per cent) in 1996-97.

5. Total flow of funds from banks to commercial sector comprising conventional

* **Announced on April 29, 1998.**

non-food credit, banks' investments in bonds/debentures/shares issued by public sector undertakings and private corporate sector and commercial paper, etc., increased by Rs.51,353 crore (17.6 per cent) during 1997-98 which was substantially higher than the amount of Rs.31,566 crore (12.2 per cent) in the previous year. Thus, there was a considerable acceleration in the flow of funds from banks to commercial sector during 1997-98. There was also a significant increase in the funds mobilised by corporates from financial institutions and GDRs during 1997-98 as compared with 1996-97.

6. Official estimates of the real GDP growth for 1997-98 are not yet available. However, advance estimates of the Central Statistical Organisation (CSO) indicate that the actual growth rate may be in the region of 5.0 per cent, which is much lower than anticipated. This is largely accounted for by a lower than projected increase in agricultural output which is partly a consequence of an unusually high growth rate in this sector during 1996-97. It will be recalled that growth in agriculture is now estimated by CSO to be as high as 7.9 per cent in 1996-97. Given the much larger base of agricultural output in 1996-97, indications are that 1997-98 may show a sharp deceleration. So far as industrial output is concerned, growth in 1997-98 is expected to be around 6.0 per cent.

7. The US dollar value of exports of goods, as per the DGCI&S data, increased by only 2.6 per cent in the first eleven months of 1997-98 as against the rise of 5.6 per cent in the corresponding period of the previous year. Imports in 1997-98 up to February recorded an increase of 5.5 per cent measured in US dollar terms, lower than the 7.8 per cent growth recorded in the first eleven months of 1996-97. Non-oil imports, however, recorded a higher growth in 1997-98 at 13.7 per cent, as compared to 0.6 per cent in the previous year.

8. The slowdown in industrial growth witnessed in the first half of 1997-98 has turned out to be more persistent and widespread than expected. This is a matter of concern for the growth of incomes in the economy as well as for the development of the financial sector. A sharp slowdown in industrial growth has repercussions on the financial position of industrial enterprises, which in turn adversely affects both the demand for and recovery of credit from the banking sector.

9. A related matter of concern is the considerable slowdown witnessed during the year in respect of primary issues of equity in stock exchanges. During 1997-98, non-government public limited companies raised an amount of Rs.3,068 crore through primary public issues as against an amount of Rs.10,450 crore in 1996-97. From a medium and long-term point of view, a healthy development of primary issue market and an equity culture is of vital importance for sustained growth of industry and financial markets in India.

10. The annual rate of inflation during 1997-98, on a point-to-point basis, was 5.0 per cent, which was lower than 6.9 per cent recorded in the preceding year. As on April 11, 1998, the annual rate was 4.8 per cent. This is welcome. It provides some needed room for manoeuvre in respect of monetary and fiscal policy in the year 1998-99. However, it must be emphasised that the maintenance of the rate of inflation at the level witnessed in 1997-98 would depend critically on sustained growth of output in the economy and a careful and productive use of financial resources, both in the public

and private sectors, for capital investment rather than for higher current consumption or fiscal subsidies. This is particularly true now as the growth of liquidity in 1997-98 was higher than envisaged and the growth of industrial output was lower. In this situation, concerted efforts are required on the part of all economic agents to accelerate investment and output in the economy.

11. The developments in some of the Asian currencies gave rise to significant pressures on the exchange rate of the rupee in the second half of the year. Keeping these developments in view, a package of monetary measures was introduced on January 16, 1998. The measures included a hike in the Bank Rate from 9.0 per cent to 11.0 per cent, an increase in the CRR from 10.0 per cent to 10.5 per cent, a hike in the Repo rate from 7.0 per cent to 9.0 per cent and a reduction in the export credit and general refinance limits to banks. These measures were successful in restoring orderly conditions in the foreign exchange markets. With the stabilisation of the foreign exchange market in recent weeks, it became possible for the Reserve Bank to partially reverse the January 1998 measures, including those relating to the Bank Rate and CRR.

12. The impact of January measures on the external position of the country has been favourable. During 1997-98, the foreign currency assets of the Reserve Bank increased by US$3.6 billion – from US$22.4 billion on March 31, 1997 to US$26.0 billion on March 31, 1998. Inclusive of gold and SDR, the total foreign exchange reserves stood at US$29.4 billion on March 31,1998, representing an increase of US$2.9 billion over March 31, 1997. Since January 16, 1998, the foreign currency assets have increased by US$2.5 billion up to March 31, 1998. Foreign exchange reserves increased by US$2.6 billion during this period. Net of outstanding forward sales and purchases, the increase in foreign currency assets at end-March 1998 was US$2.2 billion over the financial year. On the same basis, the increase was US$3.1 billion between January 16, 1998 and end-March 1998. The RBI reference rate was US$1=Rs.39.50 on March 31, 1998 as compared with Rs.40.36 as on January 16, 1998. The six-month forward premium on March 31, 1998 was 7.2 per cent after having touched a high of 20 per cent on January 21, 1998.

13. An important lesson of recent developments is that exchange markets can, after a period of relative calm, become extremely volatile within a very short period of time. This is not the occasion to deal at length with the origins of and lessons emerging from the East Asian financial crisis of 1997, but it is clear that all countries, and developing countries in particular, have to be constantly watchful of developments that may adversely affect exchange markets. There can be no room for complacency in this regard. For monetary and other measures to be effective, it is also necessary to take hard decisions early rather than allow matters to get out of hand and then try to control them. This is particularly relevant since there is a growing integration of financial markets and linkages among money, government securities, and foreign exchange markets. While closer links among different segments of financial markets are desirable for improving allocative efficiency, they also pose new challenges for monetary management.

II. Stance of Monetary Policy for 1998-99

14. The stance of monetary policy in 1998-99 has to reflect developments that have taken place during the previous year,

and our broad economic objectives for the current year. Among developments that have to be taken into account are: higher than the projected growth of money supply in relation to growth in GDP in 1997-98; substantial increase in financial flows from banks to the corporate sector despite a slowdown in industrial growth; higher market borrowing requirements of the Government; and continued uncertainty in external currency and product markets. Among the important short term economic objectives are: the need to accelerate industrial investment and output in the economy; maintenance of low rates of inflation; continued pursuit of financial reform; reduction in interest rates; and improvement in credit delivery mechanisms, particularly for agriculture and medium and small sectors. It is clear that the task of achieving a balance among different objectives is not going to be easy and will require constant vigilance on the monetary front. Short-term adjustments in monetary measures, in the light of actual developments, are likely to be unavoidable.

15. Given the rising shares of the industrial and services sectors in GDP and the more recent experience, it is becoming increasingly evident that the Indian economy has the potential of attaining a growth rate of 7 – 8 per cent per year over the medium-term. For the immediate future, i.e. 1998-99, a growth rate of 6.5 to 7.0 per cent needs to be achieved in order to realise this potential. At the beginning of the current financial year, liquidity is comfortable. The Reserve Bank will keep a close watch on liquidity conditions, and ensure that sufficient credit is available to permit the growth potential to be realised. At the same time, it is desirable that inflation rate remains at current levels. An increase in the annual inflation rate beyond 5 to 6 per cent would be neither desirable from the perspective of growth nor beneficial from the societal point of view. Keeping these considerations in view, a reasonable target for M_3 growth in 1998-99 would be 15.0 to 15.5 per cent.

16. Aggregate deposits of scheduled commercial banks are projected to increase by Rs.93,000 crore (15.5 per cent) in 1998-99. Non-food credit from the banks to the commercial sector, including investments in public and private sector bonds/shares/ debentures, commercial paper etc., is envisaged to increase by about 19.0 per cent. This order of growth in lending to the commercial sector should be sufficient to ensure that availability of credit is not a constraint on growth of output in the economy. Banks are advised to plan their credit operations on the assumption that, barring unexpected developments on the price front or in the foreign exchange markets, sufficient liquidity would be available in the current year to finance additional production as per normal banking norms.

17. In the Central Government's interim budget for 1998-99, the gross fiscal deficit of the Centre is provisionally projected at 6 per cent of GDP as per current trends. The budgetary operations of the Government would naturally influence Reserve Bank's liquidity management operations as well as its own support to market borrowing programme. The ultimate level of net RBI credit to Central Government will depend *inter alia* on the size of the final deficit, growth in bank deposits and the overall pick-up in the economy. In the forthcoming full Budget for 1998-99, efforts would need to be made to prune the fiscal deficit to a reasonable level in order to contain the borrowing programme of the Government. If the projected increase in the market

borrowing programme is too high, there could be pressure on interest rates, which in turn could affect the expected rate of inflation and investment in the economy.

18. The developments since January 1998 show that the Bank Rate and short-term Repo rate, announced by the RBI are emerging as signals for the movements in interest rates in the economy, including call money rates. This is an important development as it increases the range of instruments available to the RBI for influencing short-term money and term money market developments, including developments in the foreign exchange market. While movements in the Bank Rate should not be too frequent during the course of the year, the short-term Repo rate can be used much more flexibly, in both directions, to regulate the flow and cost of liquid funds.

19. The variation in Cash Reserve Ratio (CRR) is one of the important instruments for regulating the liquidity flow in the economy. The long term objective of monetary policy is to reduce the average level of CRR for improving the allocative efficiency of the banking system. However, the pace of change as well as intra-year variations in CRR would have to reflect short-term developments in financial markets, including forex markets. Effective April 11, 1998, CRR is 10 per cent of banking sector's net domestic liabilities. The prevailing liquidity conditions are comfortable. This is reflected, for example, in the large outstandings of repos with the Reserve Bank, which are readily available to the banking system. At the end of business on April 27, 1998, such repos amounted to Rs.8,529 crore. In view of this, it is not proposed to effect a further cut in CRR at this point of time. However, changes in this ratio would be announced later in case liquidity conditions and financial market developments so warrant.

20. Monetary policy in the past has been fashioned largely on the lines of specification of the desirable rate of expansion in broad money (M_3) which is worked out on the basis of the response of demand for real money to income growth and the tolerable rate of inflation. Most studies in India have shown that money demand functions have so far been fairly stable. However, the financial innovations that have recently emerged in the economy provide some evidence that the dominant effect on the demand for money in near future need not necessarily be real income, as in the past. Interest rates too seem to exercise some influence on the decisions to hold money.

21. It is not easy to evolve, in the present circumstances, a monetary conditions index or a clear-cut interest rate channel of transmission of effects of monetary policy. The information base required for such an exercise is substantial. In the absence of frequent data on output developments with minimal lags, and on turnovers in different markets, the information on rate movements alone would not give a full picture of the monetary conditions, and therefore, such information should be interpreted with circumspection. It can, however, be utilised in conjunction with other more reliable indicators for purposes of policy-making. As a first step to move in this direction, it is necessary to adopt a multiple indicator approach wherein interest rates or rates of return in different markets (money, capital and government securities markets) along with such data as on currency, credit extended by banks and financial institutions, fiscal position, trade, capital flows, inflation rate, exchange rate, refinancing and transactions in foreign exchange available on

high frequency basis are juxtaposed with output data for drawing policy perspectives. An exercise of this sort should help the Bank to evolve over time a model for estimating liquidity in the economy in the performance of its day-to-day operations.

22. Financial reforms introduced since 1992, have been highly significant. The deregulation and liberalisation of the system have paved the way for the emergence of open market operations and interest rate as important instruments in the conduct of monetary policy. Institutional measures have also been undertaken to promote greater integration of financial markets. Efforts in this direction will continue.

III. Monetary and Credit Policy Measures

23. In two bi-annual statements on credit policy, which are normally made in April and October of each year, it has been customary to announce a host of measures of short term as well as structural nature. In view of several important changes that have taken place in the regulatory framework for financial markets, henceforth it is proposed to give much greater importance to structural measures in the credit and monetary policy statement at the beginning of the financial year. As a matter of policy, such structural measures will not normally be changed in the course of the year and will also be expected to continue over the medium-term. This should help banks, as market participants, to plan their operations and introduce organisational changes with the medium term monetary perspective in view. Short-term measures, such as changes in the Bank Rate, CRR, Repo rates, access to refinance, etc. may also be included if proposed changes in these variables happen to coincide with the timing of the April statement. It will be understood that these short-term credit and regulatory measures are subject to change at short notice in the light of actual developments and emerging external market conditions.

24. A credit policy statement for second half of the year will also continue to be made in October each year. This statement, however, will generally be confined to a review of monetary developments in the first half of the year and to such changes as may be necessary in monetary projections during the second half of the year. However, short-term credit policy measures and structural measures may also be included, if considered necessary, in the October statement. In general, October statement will be confined to a mid-year review of credit and monetary developments.

(a) Structural Measures

25. The two monetary policy statements last year, in April and October 1997, had announced a number of measures to widen and deepen the financial markets. It is proposed to continue this process and to provide greater flexibility to banks in regard to certain aspects pertaining to deposits and lending rates. It is also proposed to continue the process of further enhancing the efficiency of money markets and government securities markets, and to introduce further refinements in repo and reverse repo transactions being undertaken by the Reserve Bank to regulate liquidity conditions in the market.

Money Market

26. During 1997-98, a number of measures were introduced with a view to developing the money market. These included permitting larger number of participants and instruments in the money

market to operate in repos, reducing the minimum size for issue of Certificates of Deposits (CDs), reducing the minimum size of transactions in respect of corporates routing their funds in the call money market through Primary Dealers (PDs), and providing flexibility in the asset side operations of Money Market Mutual Funds (MMMFs). With effect from May 9, 1998, the following further measures will be put into effect :

- The minimum size of operation per transaction by entities routing their lendings through PDs in the call money market will be reduced from Rs.5 crore to Rs.3 crore.

- The minimum lock-in period for CDs and units of MMMFs will be reduced from 30 days to 15 days.

Government Securities Market

27. Significant steps have been taken in the Government Securities market to introduce new instruments, improve transparency, and strengthen the institutional infrastructure. These measures are designed to enhance the efficiency of market clearing mechanisms in the primary market and thereby improve the volume and depth in the secondary market. Recent measures include the introduction of Treasury Bills of varying maturities, preannouncing notified amounts for all auctions, and permitting FIIs to invest in dated Government Securities, etc. It has been decided to take the following measures to further deepen the market:

- The practice of reverse repos with Primary Dealers in specified securities is being dispensed with and instead, liquidity support against the security of holdings in Subsidiary General Ledger (SGL) accounts will be provided.

- 182-Day Treasury Bills auctions on a fortnightly basis will be reintroduced.

- The periodicity of holding 364-Day Treasury Bills auctions will be on a monthly basis as against the present arrangement of fortnightly auctions.

- Foreign institutional investors (FIIs) are currently allowed to operate in all dated Government Securities in the primary and secondary markets, including those with remaining maturities of less than one year. Their entry into the Treasury Bills market was deferred pending rationalisation of auction procedures. In the light of monetary policy of October 1997, the RBI has recently commenced preannouncement of notified amounts in respect of Treasury Bill auctions and exclusion of non-competitive bids from the notified amounts. In view of this development, FIIs will be permitted to purchase/sell Treasury Bills within the overall approved debt ceilings. Treasury Bills normally carry a low rate of interest, but they provide an opportunity for temporary absorption of liquid funds pending investment in longer-term securities.

The necessary circulars giving effect to these measures will be issued shortly.

28. In recent months, open market operations of the RBI, both through outright sales of Government Securities and repo and reverse repo operations have gained considerable momentum. The primary objective of these operations is to absorb or provide liquidity in the market, though under certain circumstances, repos have also been used to signal changes in interest rates. It is proposed to use both fixed interest and auction based repos, as appropriate. Further,

in addition to the current three-day and four-day repos, RBI will in due course use one-day repos (including reverse repos) to absorb (or infuse) liquidity into the system.

Deposit and Lending Rates

29. On the deposits side, barring the domestic savings and FCNR(B) deposits, all other rates are already free. In respect of lending rates, banks are free to determine their lending rate for loans above Rs.2 lakh. Below this amount, there is a stipulation that loans up to Rs.25,000 should carry an interest rate of 12 per cent per annum, and for loans between Rs.25,000 and Rs.2 lakh, the rate should not exceed 13.5 per cent per annum. It is proposed to provide greater freedom to banks in respect of several aspects of their deposit/lending operations as follows:

- The minimum period of maturity of term deposits will be reduced from 30 to 15 days. (As mentioned above, the minimum lock-in-period for Certificates of Deposit and units of Money Market Mutual Funds is also being reduced to 15 days.)

- Banks will be permitted to determine their own penal interest rates for premature withdrawal of domestic term deposits. This will apply in respect of fresh and renewal of deposits. Banks will ensure that the depositors are made aware of the applicable penal rate along with the deposit rate.

- Banks will be permitted to determine their own penal interest rates for premature withdrawal of NRE deposits as in the case of FCNR(B) deposits. This relaxation will apply in respect of fresh and renewal of deposits and depositors would need to be informed of the applicable penal rate.

- Although interest rates on domestic term deposits were deregulated in 1997, a restriction was imposed on banks that they must offer the same rate on deposits of the same maturity irrespective of the size of such deposits. In response to representations received from banks, this restriction is being removed and bank boards will henceforth lay down the policy in this regard.

- In order to remove the disincentive to the flow of credit to small borrowings below Rs.2 lakh, instead of prescribing a specific rate uniformly for all banks, it is being stipulated that the interest rates on loans below Rs.2 lakh should not exceed the Prime Lending Rate (PLR), which is available to the best borrowers, of the concerned bank.

- All advances against term deposits should be at an interest rate equal to PLR or less.

The effective dates of the above changes will be announced by banks as early as possible.

30. At present, banks are permitted to take FCNR(B) deposits at rates not more than LIBOR/swap rates. The recent international developments have reiterated the problems related to short-term external liabilities and large unhedged positions of corporates in some of the East Asian countries. Even though such liabilities are very low in India at present, RBI would seek to further encourage the banks to mobilise long-term deposits, while simultaneously discouraging them to mobilise short-term deposits. It has, therefore, been decided that :

- The interest rate ceiling on FCNR (B) deposits of one year and above will be increased by 50 basis points and that on such deposits below one year will be reduced by 25 basis points.

- Banks will be permitted to fix their own overdue interest rates in respect of FCNR(B) and NRE deposits, subject to these deposits being renewed.

- As part of risk management, banks will be advised to monitor unhedged exposures of their clients by building in adequate risk evaluation procedures in their credit appraisal system.

The effective dates in respect of the changes in the rates on FCNR (B) and NRE deposits will be announced by banks as early as possible.

Valuation of Banks' Investments in Approved Securities

31. In April 1992, RBI had advised the banks to bifurcate their investments in approved securities into 'permanent' and 'current' categories and to keep not less than 30 per cent of their investments in 'current' category from the accounting year 1992-93. Over time, the ratio of current investments has been increased to 60 per cent of the approved securities for 1997-98. These measures have been put in place with a view to adopting prudent accounting standards and to move towards "mark to market" valuation of the investment portfolio. In order to continue with the trend, it has been decided that banks shall classify a minimum of 70 per cent of their securities as current investments for the year ending March 31, 1999. It is intended to increase the ratio of current investments in approved securities progressively to 100 per cent in the next three years. This will be in line with international best practice.

Advances against Shares to Individuals

32. As per current regulations, banks are allowed to grant advances against shares and debentures to individuals for meeting contingencies and needs of personal nature or for subscribing to rights or new issues of shares/debentures subject to a ceiling of Rs.10 lakh per borrower. Banks are also required to maintain a minimum margin of 50 per cent for advances against shares. The existing regulations have been reviewed and it has been decided to increase the ceiling to Rs.20 lakh if the advances are secured by dematerialised securities. The minimum margin prescription against dematerialised shares also stands reduced to 25 per cent.

Credit Delivery

33. The importance of accelerating the flow of credit to agricultural sector and small scale industries, in particular, can hardly be overemphasised. While there has been a substantial and welcome increase in the total volume of credit flowing to these sectors over the years, there is a perception that the time taken by banks in sanctioning credit is too long and procedures are complicated. In order to examine the problems faced by the borrowers, in December 1997, the RBI had set up two one-man committees (consisting of Shri.R.V.Gupta and Shri.S.L.Kapur for agriculture and small scale industries, respectively). These committees were requested to visit bank branches in selected districts and get a feedback directly from borrowers as well as professionals in the field. The Committee on Agricultural Credit has recently submitted its report and the Committee on Small Scale Industries is expected to submit its report in the next few

days.

34. In respect of agricultural credit, it is proposed to make several procedural modifications in the light of the Committee's recommendations. These include greater flexibility and discretion to the lending banks in matters of collateral, margin, security, dispensation of "no dues certificates", introduction of a composite cash credit limit to cover the farmers' production, post-harvest and household requirements, etc. The Indian Banks' Association is also being requested to work out simplified application forms for agricultural loans, and banks are being requested to delegate sufficient powers to their branch managers. Necessary circulars will be issued shortly. It is expected that these procedural improvements will lead to a substantial reduction in paper work and simplify the delivery mechanism for flow of credit to farmers. Those recommendations of the Committee which fall within the purview of State Governments or which require consideration by Central Government are being forwarded to them for necessary action.

Prudential Norms and Supervision of Banks

35. An important element of banking sector reforms has been the implementation of the Basle Accord on capital adequacy with the imposition of eight per cent capital adequacy ratio. Similarly, prudential regulations on income recognition, asset classification and provisioning have been prescribed. These measures, which have been implemented in a phased manner, have considerably improved the resilience of the banking system and banks are now much better capitalised. It is proposed to further strengthen the existing capital adequacy, income recognition and provisioning norms. Specific decisions will be taken in the light of the recommendations of the High Level Committee on Banking Sector Reforms under the Chairmanship of Shri M.Narasimham. The Committee, *inter alia,* has also made certain recommendations for strengthening the disclosure and auditing requirements of banks and for transparency in banking operations. The Reserve Bank attaches particular importance to these aspects, and it is proposed to move towards full disclosure and transparency in line with international best practices as early as possible.

36. At present, as mentioned above, the exposures in respect of short-term foreign currency loans and for other cross-border operations in case of Indian banks are quite low. However, in the light of recent developments in East Asia, it is proposed to further strengthen the prudential regulations to cover such risks, keeping in view the international best practices and our country specific requirements.

Roles of Banks and Development Finance Institutions (DFIs)

37. In recent years, in major international financial centres, there has been a blurring of boundaries between different types of financial institutions, and there is an increasing trend towards emergence of multifunctional financial groups. Non-banking institutions have taken over banks or offered banking services, just as banks have entered substantially into non-banking financial activities. In India also, to some extent, this trend is evident and representations are being received from term-lending institutions as well as banks for harmonising the prevailing regulatory requirements applicable to them in respect of access to different types of funds (e.g. short-term deposits) and/or obligations in respect of Statutory Liquidity Requirements/

Cash Reserve Ratios etc. In order to deliberate on these issues and to make appropriate recommendations, in December 1997, the Reserve Bank had set up a Working Group of Chairmen of some commercial banks and development finance institutions under the Chairmanship of Shri S.H.Khan, Chairman and Managing Director, Industrial Development Bank of India. The Group has recently finalised its recommendations, and its full report is expected to be submitted shortly.

38. The issues involved in moving towards the concept of "universal banking" and abolishing the distinction between banks (which are at the heart of the payment system and the main repository of unsecured liquid funds from the public) and development finance institutions (which, *inter alia*, raise and provide long term funding for industrial and other projects) are fundamental. This is particularly so in a developing country like India where debt and securities markets are not fully developed and where financing of development projects, particularly infrastructure projects, presents special problems. Recent experience in East Asia has also made it clear that a clear distinction needs to be made between access of banks/financial institutions to short term cross-border financing and other forms of long term funds. Keeping these considerations in view, and in consultation with Government of India, it is proposed to prepare a "Discussion Paper", which will contain Reserve Bank's draft proposals for bringing about greater clarity in the respective roles of banks and financial institutions and for greater harmonisation of facilities and obligations applicable to them. This paper will also take into account those recommendations of the Narasimham Committee which have a bearing on the issues considered by the Working Group.

(b) Credit Policy Measures

39. In addition to the above measures, which are primarily of a longer term nature, it is proposed to introduce the following credit policy measures. These measures are subject to change during the course of the year at short notice depending on developments in domestic credit and foreign exchange markets.

a) Bank Rate

- Bank Rate is being reduced by one percentage point from 10.0 per cent to 9.0 per cent with immediate effect. (Annexure I sets out related rates of interest.)

b) Refinance Limits for Exports

- Export credit refinance will be restored to 100 per cent (instead of present 50 per cent) of the increase in outstanding export credit eligible for refinance over the level of such credit as on February 16, 1996, with effect from the fortnight beginning May 9, 1998.

c) Rate of Interest on Exports

- Interest rate on pre-shipment export credit up to 180 days is being reduced from the existing 12 per cent to 11 per cent with immediate effect.
- Interest rate against incentives receivable from Government covered by ECGC guarantee in respect of pre-shipment credit up to 90 days is being reduced from the existing 12 per cent to 11 per cent with immediate effect. (*Vide* Annexure II.)

40. All other credit policy measures will

continue as before. As mentioned earlier, so far as the CRR is concerned, no change is being announced at this point of time as liquidity conditions are quite comfortable. Further changes in CRR would be announced during the course of the year in the light of evolving circumstances. It is also clarified that changes in the Bank Rate, Repo rates, access to refinance, and other measures may be announced from time to time, and not necessarily at the time of the bi-annual credit policy statements.

Annexure I

Interest Rates on Advances from Reserve Bank and Penal Rates which are at present linked to the Bank Rate

Sr. No.	Advances to	Existing Rates	New Rates (Effective April 29, 1998)
		(Per cent per annum)	
1	**Scheduled Commercial Banks**		
i.	Export Credit Refinance Facility	Bank Rate (10.0)	Bank Rate (9.0)
ii.	General Refinance Facility		
	(a) First Four Weeks	Bank Rate (10.0)	Bank Rate (9.0)
	(b) Second Four Weeks	Bank Rate *plus* one percentage points (11.0)	Bank Rate *plus* one percentage point (10.0)
2	**State Co-operative Banks (SCBs)**		
	Towards general banking business such as clearing adjustments, liquidity, etc.	Bank Rate *plus* 1.5 percentage Points (11.5)	Bank Rate *plus* 2.5 percentage points (11.5)
3	**NABARD**		
	General Line of Credit (GLC)		
i.	**GLC I**		
	To provide Refinance in respect of loans and advances for the purposes of seasonal agricultural operations (SAO) made by SCBs and Regional Rural Banks (RRBs)	Bank Rate *minus* 5.5 percentage points (4.5)	Bank Rate *minus* 4.5 percentage points (4.5)
ii.	**GLC II**		
	To provide refinance to SCBs, RRBs and Commercial banks for refinancing Weavers' Co-operative Society and for other approved short-term purposes	Bank Rate *minus* 5.0 percentage points (5.0)	Bank Rate *minus* 4.0 percentage points (5.0)
4	**Primary (Urban) Co-operative Banks**		
i.	Export Credit Refinance Facility	Bank Rate (10.0)	Bank Rate (9.0)
ii.	For SSI	Bank Rate *minus* 1.0 percentage point (9.0)	Bank Rate (9.0)
5	**SIDBI** [from NIC(LTO) Fund Out of the Loan Repayment made by IDBI]	Bank Rate *minus* 1.5 percentage points (8.5)	Bank Rate *minus* 0.5 percentage point (8.5)

Annexure I

Interest Rates on Advances from Reserve Bank and Penal Rates which are at present linked to the Bank Rate

Sr. No.	Advances to	Existing Rates	New Rates (Effective April 29, 1998)
		(Per cent per annum)	
6.	**Primary Dealers (PDs)**		
	To enable PDs to effectively fulfill their obligations, the RBI is extending liquidity support to them through Repos Operations in		
	(a) 91 day and 364 day auction Treasury bills) (b) Central Government dated Securities)	Bank Rate (10.0)	Bank Rate (9.0)
7.	**State Financial Corporations**	Bank Rate *minus* 1.0 percentage point (9.0)	Bank Rate (9.0)
8	**Government of India**		
	a) Shortfall in minimum balances	Bank Rate *minus* 1.0 percentage point (9.0)	Bank Rate (9.0)
	b) Ways and Means Advances	Bank Rate *minus* 1.0 percentage point (9.0)	Bank Rate (9.0)
	c) Overdraft	Bank Rate *plus* 1.0 percentage point (11.0)	Bank Rate *plus* 2.0 percentage points (11.0)
9.	**State Governments**		
	a) Shortfall in minimum balances	Bank Rate *minus* 1.0 percentage point (9.0)	Bank Rate (9.0)
	b) Ways and Means Advances	Bank Rate *minus* 1.0 percentage point (9.0)	Bank Rate (9.0)
	c) Overdrafts	Bank Rate *plus* 1.0 percentage point (11.0)	Bank Rate *plus* 2.0 percentage points (11.0)
Penal Interest Rates on shortfalls in reserve requirements depending on duration of shortfall		Bank Rate *plus* 3 percentage points (13.0) or Bank Rate *plus* 5 percentage points (15.0)	Bank Rate *plus* 3 percentage points(12.0) or Bank Rate *plus* 5 percentage points (14.0)

Annexure II

Interest Rates on Pre-Shipment Rupee Export Credit of Scheduled Commercial Banks

(Per cent per annum)

	Interest Rates	
	Existing	**New (Effective April 30, 1998)**
Pre-Shipment Rupee Export Credit		
a) (i) Upto 180 days	12.0	11.0
(ii) Beyond 180 days and upto 270 days	14.0	14.0
b) Against incentive receivable from Government covered by ECGC Guarantee up to 90 days	12.0	11.0