

RBI Governor announces Monetary and Credit Policy for the year 2000-2001

Highlights

- **Developments in macro-economic, monetary and price situations in 1999-2000 were highly positive and favourable.**
- **Credit Policy to support industrial growth with price stability.**
- **Sufficient liquidity to be made available for credit flow to support growth through reduction in CRR if necessary.**
- **Fullfledged Liquidity Adjustment Facility to be introduced in stages.**
- **Wide-ranging Reforms towards widening and deepening financial markets including money market and government securities market.**
- **Final guidelines for Banks' entry into Insurance business issued.**
- **Liberalised Export Credit refinance facility.**
- **Enhancement of limit for post-award clearance of export projects.**
- **Minimum daily requirement of CRR balances reduced to 65 per cent.**
- **Minimum maturity of Certificates of Deposit reduced to 15 days**
- **Easing of procedures for FIs to raise resources, rationalisation of PLR norms, FCNR(B) deposits.**
- **Moving towards best practices in prudential regulation and supervision.**
- **Improvements in credit delivery mechanisms.**

Dr. Bimal Jalan, Governor, Reserve Bank of India, in a meeting with the Chief Executives of banks today presented the annual Monetary and Credit Policy for 2000-2001. In his Statement, Governor reviewed the macro-economic conditions and spelt out that the Reserve Bank proposes to continue the current stance of monetary policy and ensure that all legitimate requirements for bank credit are met while guarding against any emergence of inflationary pressures due to excess demand. He also announced a number of policy measures towards improving liquidity, wide-ranging measures for the development of financial markets, in particular money and government securities markets, providing operational flexibility to banks and institutions in interest rate policy, improving prudential standards and credit delivery mechanisms.

Domestic Developments

2. Governor said that the GDP growth in 1999-2000 is likely to be 5.9 per cent as compared with 6.8 per cent in 1998-99 and 5.0 per cent in 1997-98. A welcome feature of macro-economic development last year was a substantial acceleration in the growth of industrial output, particularly manufacturing output. The annual rate of inflation as reflected in the movements in the wholesale price index (1981-82=100) during the year was 3.74 per cent (on a point-to-point basis) and was 2.97 per cent (on an average basis). Governor said that inflation rates were significantly lower than in the preceding year.

3. Referring to monetary aggregates, Governor mentioned that during 1999-2000, the annual growth in M₃, on a point to point basis, was 13.6 per cent (provisional) as against 19.2 per cent in 1998-99. The aggregate deposits of the scheduled commercial banks increased by 13.5 per cent as against 19.3 per cent in the previous year. Non-food credit showed an expansion of 16.0 per cent as against an increase of 13.0 per cent in the previous year. The faster growth in bank credit to the commercial sector despite a lower growth in deposits was facilitated by substantial reduction in cash reserve ratio (CRR) and increase in non-deposit sources of funds.

4. While indicating that there was a substantial increase in resources flowing to mutual funds during 1999-2000 partly as a result of tax concessions, Governor added that further growth and development of mutual funds, provided they are able to compete without special concessions, could contribute to the development and stability of the financial system in the long run.

5. Governor pointed out that as a result of the fiscal deficit being higher at 5.6 per cent of GDP as against budgeted figure of 4.0 per cent, gross market borrowings exceeded the budgeted level by Rs. 15,616 crore for 1999-2000. Thanks to favourable macro economic environment, the Reserve Bank was able to meet the large market borrowing requirements of government without without causing upward pressure on interest rates.

6. Governor mentioned that an important monetary development during the year has been the negative growth in the monetised deficit of the Government (i.e., net Reserve Bank credit to Government), by as much as Rs.5,584 crore (a day before the final closing of government accounts) and low growth of reserve money reflecting the success achieved by Reserve Bank in activating its Open Market Operations (OMO). Governor indicated that if the reserve money growth and monetised deficit were of the same order in 1999-2000 as in the previous year. M₃ expansion could have actually been even higher than last year, which would have had an unfavourable effect on the inflationary outlook for the current year.

7. Governor indicated that while RBI had been able to manage a large government borrowing programme without undue strain on interest rates or the overall liquidity environment, it was also clear that such high levels of fiscal deficits are not sustainable over the medium term. Apart from causing substantial increase in interest payments, the large borrowing programmes of Government year after year have also put pressure on the absorptive capacity of the market, holdings of government securities above the Statutory Liquidity Ratio by banks amounting to about Rs.85,000 crore, which is higher than the last year's net borrowings.

8. Governor urged that a national consensus on an effective and time bound programme of fiscal correction is essential so that efforts made in this direction in the Union Budget for 2000-01 could be further intensified.

External Developments

9. Tracing developments in the external sector, Governor cited the sharp increase in prices of crude oil and petroleum products impacting oil import bill by an estimated US \$ 12 billion. After taking into account the recent changes in oil prices as well as changes in EXIM policy, the current account deficit in the year 2000-2001 is still expected to be well below 2 per cent of GDP, due to turnaround in exports and buoyant invisible receipts.

10. Developments in respect of the external sector as well as movements in foreign exchange reserves were satisfactory. Foreign exchange reserves, including gold and SDR, were at their highest (US \$ 38.04 billion), and showed an increase of US \$ 5.55 billion during the course of the year. Net reserves, taking into account forward liabilities increased by US \$ 5.70 billion over the year.

11. Governor mentioned that following the East-Asian crisis and subsequent developments in certain other countries, it is widely recognised in the international fora, that in judging the adequacy of reserves in emerging economies, it is not enough to relate the size of reserves to the quantum of merchandise imports or the size of the current account deficit. It has become increasingly important to take into account the composition of capital flows, particularly short-term external liabilities. An additional factor which has to be built into this assessment is the need to take into account certain contingencies, such as, unanticipated increase in commodity/asset prices. The recent international experience, particularly during the period of the East Asian crisis, also highlighted the fact that the emerging economies have to largely rely on their own resources during external exigencies as there is no “lender of the last resort” to provide additional liquidity at short notice.

12. The overall approach to the management of India’s foreign exchange reserves has reflected the changing composition of balance of payments, and has endeavoured to reflect the “liquidity risks” associated with different types of flows and other requirements. In emerging economies, unanticipated domestic or external developments, including undue volatility in asset prices in equity/bond markets, can create disproportionate pressures in the foreign exchange market. It is, therefore, essential to continue with the pursuit of realistic and credible exchange rate policies, in addition to vigorous implementation of domestic and external sector reforms to further strengthen the balance of payments position over the medium term.

13. Exports, particularly software exports (which technically form part of the invisible receipts in the balance of payments statistics) have done well during the year. In the past 18 months, several measures were introduced to ensure timely delivery of credit to exporters and remove procedural hassles. In order to further improve the credit delivery system, the Reserve Bank would now like to invite exporters, particularly those who are located in non-metropolitan centres, to send their reactions.

14. Over the past two years, the Reserve Bank has also introduced several new facilities for Non-resident Indians (NRIs). The overall objective is to make financial transactions in and out of India by NRIs as flexible and easy as possible, and to reduce the need for seeking individual or specific permission from the Reserve Bank. NRIs are also requested to send in their responses on whether the facilities and procedures are working satisfactorily.

15. Recently, the Government has substantially expanded the automatic route for Foreign Direct Investment (FDI). RBI has already granted general permission to the Indian companies to receive funds and issue shares to their foreign collaborators. In January, 2000 general permission was granted to Indian companies for issue of ADRs and GDRs without any value limits. In addition, companies in IT & entertainment software and certain other knowledge-based sectors have been granted further facilities for overseas acquisition without requiring prior permission of the Government or the Reserve Bank. It is hoped that these facilities would provide sufficient scope for expansion of internationally competitive Indian enterprises at the global level.

II. Stance of Monetary Policy for 2000-2001

16. Governor mentioned that against the background of the developments in the economy last year and economic prospects during 2000-2001, an important objective of monetary policy in the current year is to provide sufficient credit for growth while ensuring that there is no emergence of inflationary pressures on this account. On current assessment, the prospects of achieving these objectives look reasonably promising. In line with the continuing overall stance of policy, at the beginning of the new financial year on April 1, 2000, the RBI announced a number of measures to enhance liquidity and reduce

the cost of funds to banks. Following these measures public sector banks have also announced a reduction in their lending and deposit rates.

17. Governor mentioned that for purposes of monetary policy formulation on the basis of current trends, growth in real GDP may be placed at 6.5 to 7.0 per cent in 2000-2001, assuming a normal agricultural crop and continued improvement in industrial performance. Assuming the rate of inflation to be around 4.5 per cent, the projected expansion in M₃ for 2000-2001 is about 15.0 per cent. Governor, however, stressed that the above outlook can change in the event of unanticipated domestic or international events. On the inflation front, in particular, there is need for continuous vigilance and caution. The Reserve Bank will continue to monitor domestic monetary and external developments, and take necessary monetary action through the use of instruments at its disposal, as necessary.

18. Based on the experience of some industrialised countries, there is a view that, in India also, monetary policy, to be transparent and credible, should have an explicit narrowly defined objective like an inflation mandate or target. Governor mentioned that while technically this appears to be a sound proposition, there are several constraints to its adoption in the Indian context like fiscal dominance, the absence of fully integrated financial markets which remain still imperfect and segmented and the high frequency data requirements including those on a fully dependable inflation rate for targeting purposes which are yet to be met. Under these circumstances, it is necessary to carefully measure and balance between possible outcomes, after taking into account movements in a variety of monetary and other indicators.

19. While there has been a significant softening of interest rates in the last 13 months, Governor mentioned that there are several structural factors which constrain greater flexibility in the interest rate structure in India. Among some of these factors, which have to be taken note of are : the post-tax return on contractual savings being still higher than deposit rates, banks offering fixed rates against floating rates on deposits and higher transaction costs. Governor mentioned that while much greater flexibility in the structure of interest rates in tune with changes in the inflationary environment is desirable, there is no “quick fix” solution to engineer a sharp fall in nominal deposit and lending rates of banks. Vigorous action has to be taken by banks to reduce their transaction costs and the volume of NPAs, and improve risk management. This requires action on a number of areas, including legal reforms for recovery of dues and restructuring of weak banks and reduction in fiscal deficit.

III. Financial Sector Reforms and Monetary Policy Measures

20. Governor reviewed ‘structural measures’ in the recent period introduced to strengthen the financial system and to improve the functioning of the various segments of financial markets. Governor mentioned that while there has been substantial progress in achieving some of these objectives, for example, development of money market, secondary market in government securities, deregulation and operational flexibility to banks, etc., the pace of progress has been relatively slow and there is scope for improvements in areas like retailing of government securities, risk management and internal control systems and loan recovery and settlement procedures. Governor added that the financial reform initiated in recent years will be carried forward keeping in view the actual experience in implementation and other relevant developments. The following announcements were made in the policy:

Introduction of Liquidity Adjustment Facility (LAF) replacing Interim Liquidity Adjustment Facility (ILAF)

21. Following the recommendation of an Internal Group, it has now been decided to proceed with the implementation of a full-fledged LAF. The new scheme will be introduced progressively in convenient stages in order to ensure smooth transition.

- In the first stage, with effect from June 5, 2000, the Additional CLF and level II support to PDs will be replaced by variable rate repo auctions with same day settlement.
- In the second stage, the effective date for which will be decided in consultation with banks and PDs, CLF and level I liquidity support will also be replaced by variable rate repo auctions.
- With full computerisation of PDO and introduction of RTGS expected to be in place by the end of the current year, in the third stage, a collateralised LAF through electronic transfers will be introduced.
- The proposed LAF is a more flexible scheme because the quantum of adjustment as also the rates would be flexible, responding immediately to the needs of the system.. There will be no change in the export credit refinance scheme which will continue as before.

Development of Financial Markets

22. In an effort to carry forward the reforms towards widening and deepening of the financial markets, the following measures are being introduced for further development of the markets :

(a) Money Market

- In order to provide more flexibility for pricing of rupee interest rate derivatives and to facilitate some integration between money and foreign exchange markets, the use of 'interest rates implied in the foreign exchange forward market' is allowed as a benchmark.
- Minimum maturity for Certificates of Deposit is reduced to 15 days.
- The facility to non-bank entities for routing transactions through PDs would be further extended upto end-December 2000.
- It is proposed to review and evolve a time bound programme of withdrawing permission to non-bank entities for lending in the call/notice money market coinciding with the development of repo market.
- It has been decided to modify the current guidelines for issue of CPs in consultation with market participants.
- The minimum daily requirement for maintaining CRR balances, is reduced from 85 per cent to 65 per cent.

(b) Government Securities Market

- Consequent upon the delegation of powers by the Government to RBI, as part of development of the repo market, State Government securities have been made eligible for undertaking repos. RBI has also widened the scope of participation in the repo market to all the entities having SGL and Current Account with RBI, Mumbai.

- It is proposed to introduce a scheme for banks and primary dealers providing for automatic invocation of undrawn refinance/liquidity support from RBI for facilitating smooth securities settlement.
- It has been decided to allow entities to sell the securities after they have been allotted to them, in primary issues, thus enabling sale, settlement and transfer on the same day.
- In respect of both 14 day Treasury Bills, the day of payment has been changed from Saturday to Monday or the next working day.
- A detailed review of liquidity support to PDs will be made and modifications will be introduced in consultation with PDs.
- Taking into account the principles for capital adequacy for market risk evolved by regulatory bodies such as the International Organisation of Securities Commissions (IOSCO) and the Bank for International Settlements (BIS), fresh guidelines for capital adequacy standards for PDs are being evolved, which will be finalised in consultation with PDs.

(c) Debt Securities Clearing Corporation

23. Action is being taken to set up a Debt Securities Clearing Corporation which will *inter alia* pave the way for further opening up of the repo market to PSU bonds and bonds of Financial Institutions held in demat form in depositories.

Banks' entry into Insurance Business

24. Detailed guidelines to banks for entry into insurance are issued. Banks will be required to obtain prior approval of RBI for entering into insurance area. Banks having minimum net worth of Rs.500 crore, and satisfying other criteria in regard to capital adequacy, profitability, etc., will be allowed to undertake insurance business through joint venture on risk participation basis. RBI will consider bank's equity contribution in the joint venture up to 50 per cent. However, higher equity contribution by a promoter bank may be allowed initially, on a highly selective basis, pending divestment of the equity in excess of 50 per cent within the period prescribed under the amended insurance statutes. Banks which do not satisfy the above criteria will be allowed on a 'without risk participation' basis upto 10 per cent of their net worth or Rs.50 crore, whichever is lower, as strategic investors.

Interest Rate Policy

25. After consultation with banks, with the objective of providing more operational flexibility and eliminating rigidities, following measures are being introduced:

- Banks which have moved over to declaration of tenor-linked PLRs should indicate the specific tenor for which the declared PLRs is applicable.
- The restriction on fixed rate term loans being extended only for project loan is now being withdrawn. Banks will henceforth have the freedom to offer all loans on fixed or floating rates complying with PLR stipulations.
- Banks at their discretion will have the option to choose the current swap rates while offering FCNR (B) deposits enabling to refer to the swap rates quoted on any online screen based information system.

- Banks would be permitted as in the case of domestic term deposits to offer differential rates of interest on NRE /FCNR(B) deposits on size group basis.

Liberalisation of Export Credit Refinance Facility

26. Representations have been received from some institutions that the manner in which the export credit refinance limit is fixed under the existing scheme precludes the use of Export Bill Rediscounting Schemes by banks, which is of benefit to exporters. It has, therefore, been decided to liberalise the scheme by introducing the following modification:

- For the purpose of fixing refinance limits, the outstanding export credit (including export bills rediscounted with institutions like EXIM Bank and refinance obtained from NABARD/EXIM Bank) will form the basis.
- Drawal of refinance will be on the basis of export credit eligible for refinance, i.e., after excluding export bills rediscounted with other banks/EXIM Bank and refinance from NABARD/EXIM Bank,

The scheme will come into force effective fortnight beginning May 6, 2000.

Post-award Clearance of Project Proposals for Exports – Enhancement of Limit

27. It has been decided that the above value limits for clearance for post-award proposals for ADs should be raised from Rs.25 crore to Rs.50 crore and that for Exim Bank from Rs.100 crore to Rs.200 crore.

Gold Deposit Scheme - Allowing Banks to Lend Gold to Other Nominated Banks

28. Banks are being permitted to deploy the gold mobilised under the Gold Deposit Scheme by lending it to other nominated banks.

Resource Mobilisation by all-India Financial Institutions : Greater Flexibility

- FIs are given flexibility in the matter of fixing interest rates on term deposits without reference to SBI rates.
- Based on a review of regulatory experience, it has been decided to modify the guidelines to FIs for raising resources by issuing bonds and other instruments subject to overall limits. A draft proposal will be circulated among the FIs, and guidelines will be issued after further consultation with FIs.

Prudential Measures

(a) Risk Management Systems in Banks

29. A review by RBI of the action taken by banks shows that most of the banks are well advanced in setting up a system for an appropriate assessment of risks associated with different types of assets. This process needs to be further accelerated. In this connection, an issue which has received some attention is the appropriate role of banks in providing financial support to individuals as well as to corporates and market intermediaries against the security of shares/debentures/bonds. While RBI has already issued some guidelines for advances against shares, etc., to individuals, stock brokers and corporates, some grey areas remain where there is need for removal of any ambiguities so

that policy of banks for supporting the development of capital markets is transparent and known to all concerned, including investors. In order to further develop the operating guidelines for bank financing of equities, the Standing Technical Committee on Co-ordination between RBI and SEBI is being requested to review the status and make suitable recommendations, after appropriate consultations with banks and market participants.

(b) Capital Adequacy Norms for Bank's Subsidiaries

30. On prudential considerations, banks are advised to voluntarily build-in the risk weighted components of their subsidiaries into their own balance sheet on notional basis. The additional capital required may be provided in the bank's books in phases beginning from the year ending March 2001.

(c) New Capital Adequacy Framework

31. In June 1999, the Basel Committee on Banking Supervision had released a consultative paper on 'A New Capital Adequacy Framework' which aims at further strengthening the soundness and stability of the financial system and is designed to better align regulatory capital with underlying risks faced by banks. RBI has finalised and forwarded its comments on the new Framework to the Basel Committee. These comments are available on the RBI's web-site for generating wider discussion.

(d) Monitoring adherence to International Financial Standards and Codes

32. The Reserve Bank has constituted in association with the Government of India a 'Standing Committee on International Financial Standards and Codes' aiming at identifying and monitoring developments in global standards and codes being evolved in the context of the international developments and consider the applicability of these standards and codes to Indian financial system, and chalk out a road map for aligning India's standards and practices with international best practices. The Standing Committee has set up non-official Advisory Groups in ten major subject areas with outside eminent experts in concerned fields.

(e) Move towards Risk Based Supervision of Banks

33. There is a growing acceptance that a Risk Based Supervision (RBS) approach would be more efficient than the traditional transaction-based approach. The Reserve Bank would be engaging services of reputed international consultants to draw on other countries' experiences in this regard.

(f) Non-Performing Advances (NPAs) of Banks

34. Banks will have to more aggressively pursue the recourse to Debt Recovery Tribunals (DRTs) as well as compromise settlement through the Settlement Advisory Committees (SACs) since the operation of SACs is scheduled to lapse on September 30, 2000.

(g) Banks' non-SLR Investments

35. With a view to ensuring that non-SLR investments by banks are made on sound prudential considerations, with more transparency and guarding against potential risks, draft guidelines for banks' non-SLR investments have been evolved in consultation with banks and financial institutions. Guidelines would be revised duly taking into account the comments and suggestions from banks, financial institutions and others.

Credit Delivery Mechanisms

36. Banks have been advised to provide credit on reasonable terms to certain sectors like agriculture, micro-credit, etc., as per guidelines issued from time to time. A number of measures have been taken to improve credit delivery system for agriculture. Some parts of the country have been affected by severe drought. RBI has instructed its Regional Offices to remain in close contact with the State Government authorities and local banks and also for convening the meeting of SLBCs so that expeditious action is taken to provide relief as per RBI guidelines, for conversion of short-term loans into medium-term loans, rescheduling of loans, additional needbased loans, etc. In addition, two measures taken are: enhancement of ceiling from Rs.5 lakh to Rs.15 lakh, for classifying advances for distribution of inputs, as indirect advances to agriculture and also treating lending by banks to NBFCs for onlending to agriculture as indirect finance to agriculture.

37. Following the announcements made by the recent Union Budget in respect of the SSI sector, following action has been taken :

- The limit for dispensing with the collateral requirement for loans increased for the tiny sector from Rs.1 lakh to Rs.5 lakh.
- To promote credit flow to small borrowers, the composite loan limit is being increased from Rs.5 lakh to Rs.10 lakh.
- Public sector banks have been requested to accelerate their programme of SSI branches to ensure that every district and SSI clusters are served by at least one specialised SSI bank branch.

38. The State Bank of India has entered into an MoU with HDFC to set up a Credit Information Bureau and the modalities for setting up of the Bureau in regard to ownership and equity participation, management structure, security standards, rights and liabilities of the Bureau, etc., are currently being worked out.

Deposit Insurance

39. In pursuance of the recommendations of the Advisory Group on Reforms in Deposit Insurance in India, a new law is required to be enacted and relevant proposals in this respect will be forwarded in due course to the Government.

Non-Banking Financial Companies (NBFCs)

40. The NBFCs which have neither reported having attained the minimum NOF of Rs.25 lakh nor sought extension of time from the RBI are not entitled to accept fresh public deposits. These NBFCs are advised to strictly adhere to the provisions of the Statute, RBI regulations and continue to repay the matured deposits as per the contracted terms. RBI is keen to promote the concept of self regulatory organisation particularly for smaller NBFCs; RBI also proposes to extend to the NBFCs the guidelines on Asset Liability Management; RBI is also considering guidelines for NBFCs for their entry/participation in insurance business and reviewing the regulatory structure and procedures for fixing of interest rates on deposits.

Approach to Universal Banking

41. The RBI released a 'Discussion Paper' (DP) in January 1999 on the issues relating to Universal Banking for wider public debate. The feedback on the discussion paper indicated that while universal banking is desirable from the point of view of efficiency of resource use, there is need for caution in moving towards such a system by banks and

DFIs. It is proposed to adopt the following broad approach for considering proposals in this area:

- (a) The principle of “Universal Banking” is a desirable goal. However, banks have certain special characteristics and as such any dilution of RBI’s prudential and supervisory norms for conduct of banking business would be inadvisable.
- (b) Though the DFIs would continue to have a special role in the Indian financial system, any DFI, which wishes to do so, should have the option to transform into bank (which it can exercise), provided the prudential norms as applicable to banks are fully satisfied. To this end, a DFI would need to prepare a transition path.
- (c) The regulatory framework of RBI in respect of DFIs would need to be strengthened.

High Power Committee on Urban Co-operative Banks

42. The recommendations of the High Power Committee (HPC) constituted in May 1999 are under consideration of RBI in consultation with Government.

Technology Upgradation

43. With the ultimate goal of designing and developing a multiple deferred/discrete net settlement system and a Real Time Gross Settlement (RTGS), facilitating efficient funds management, house-keeping and customer service, Reserve Bank has taken a number of steps to improve the infrastructure. The major items in the Action Plan for 2000-2001 are :

- The spread and coverage of the Indian Financial Network – INFINET will soon be extended to cover all the hundred odd commercially important centres in the country.
- Priority will be given for integrating the various segments of the Payments and Settlement system and on the introduction of the RTGS.
- Technology upgradation and increasing the scope of computerisation in the banking sector.

Regulations Review Authority

44. The experience in the last one year with Regulations Review Authority (RRA) for reviewing Reserve Bank's rules, regulations and reporting systems has been satisfactory and the Reserve Bank has since extended the term of RRA for a further period of one year from April 1, 2000. Implementation of several suggestions not only paved the way for streamlining several existing procedures and improving customer service, but also helped in reviewing and streamlining Bank’s reporting systems. A notable achievement of RRA has been the compilation of Master circulars, subject-wise, in Manual form

Mid-Term Review

45. A Review of credit and monetary developments in the first half of the current year will be undertaken in October 2000 confining to a review of monetary developments and to such changes as may be necessary in monetary policy and projections for the second half of the year.

Alpana Killawala
General Manager

Press Release : 1999-2000/1438