

**RBI Governor announces Monetary and Credit
Policy for the year 2002-03**

Highlights

- ? **Growth rate in 2002-03 projected at 6.0 to 6.5 per cent. Inflation to remain low.**
- ? **Monetary conditions and liquidity position highly comfortable.**
- ? **RBI to provide adequate liquidity to meet credit growth and support investment demand.**
- ? **Soft interest rate regime to continue and greater flexibility to interest rate structure in the medium-term.**
- ? **Further cut in CRR by 50 basis points.**
- ? **Bank Rate may be cut by upto 50 basis points depending on monetary developments - No timing fixed yet.**
- ? **No change in interest rate on Savings Account.**
- ? **Interest rate on export credit in foreign currency lowered.**
- ? **Abolition of minimum lending rate for co-operative banks.**
- ? **Banks to declare maximum and minimum lending rates.**
- ? **Banks should provide information on deposit rates on various maturities and effective annualised return to depositors.**
- ? **Facilities for Small Scale Industries liberalised.**
- ? **Further measures to improve credit delivery mechanism to priority sector.**
- ? **Measures to improve flow of credit to housing sector.**
- ? **Further measures to develop Government securities market.**
- ? **Access to call money market to be regulated.**
- ? **CDs to be issued in demat form.**
- ? **More prudential measures to bring financial stability.**
- ? **Measures to improve technology - EFT facilities to be expanded.**
- ? **Real Time Gross Settlement System to be ready for testing in a year's time.**
- ? **Submission of returns by NBFCs: RBI to penalise delays.**

**RBI Governor Announces Monetary and Credit Policy
for the Year 2002-03**

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 2002-03. The Statement covered a review of macro-economic and monetary developments, stance of monetary policy and a wide-ranging package of measures to strengthen the financial system and for development of markets and institutional infrastructure. Governor also dealt with some analytical and practical issues concerning monetary policy, exchange rate and reserves management.

Domestic Developments

2. Governor mentioned that due to the better performance of agriculture and a reasonable growth in the services sector, CSO placed the GDP growth for the year 2001-02 at 5.4 per cent against 4.0 per cent in the previous year. The annual rate of inflation during 2001-02 was highly favourable at 1.4 per cent as against 4.9 per cent in the previous year.

3. Referring to monetary developments during 2001-02, Governor mentioned that the growth in money supply was in line with the projected trajectory, and lower than 16.8 per cent a year ago. The growth in aggregate deposits of scheduled commercial banks at 14.3 per cent was lower than that of 18.4 per cent in the previous year. Governor mentioned that the increase in reserve money during 2001-02 at 11.4 per cent (Rs. 34,514 crore) was higher than that of 8.1 per cent (Rs.22,757 crore) in the previous year. The expansion in reserve money is attributed entirely to the increase in net foreign exchange assets of RBI. Non-food credit registered a lower growth of 12.8 per cent (Rs.60,411 crore) as against an increase of 14.9 per cent (Rs.61,176 crore) in the previous year reflecting slackness in industrial production.

4. Governor mentioned that although the combined slippage in the market borrowing programme of the Centre and the States did not put undue pressure on interest rates due to the availability of ample liquidity and depressed credit demand, he reiterated the urgent need to contain fiscal deficit, as also emphasised in the Budget speech of 2002-03. He said that this will improve the task of monetary and debt management from a medium-term perspective. A reduction in fiscal deficit would impart flexibility to the interest rate regime and, in turn, release government resources for the much needed investment in physical and social infrastructure. Fiscal consolidation will also have a favourable effect on inflationary expectations in the economy.

5. Governor mentioned that despite the high level of Government borrowing programme during 2001-02, in view of low credit demand from the commercial sector, it was possible to maintain adequate liquidity and a softer interest rate environment, as reflected in the perceptible shifts in the yields across maturity spectrum, without engendering inflationary conditions in the economy.

6. Highlighting that easy liquidity conditions and softer interest rate environment made the present overall monetary conditions reasonably comfortable, Governor, however, cautioned that as the experience of recent years confirms, monetary

management has now become much more complex because of several factors, such as the on-going integration of financial markets across the world, the phenomenal increase in financial turnover, liberalisation of the economy, and the rapidity with which unanticipated domestic and international tremors get transmitted to financial markets across the world because of the new technology.

7. It is important to emphasise that changes in economic circumstances may again make it necessary to take appropriate monetary measures, which may not be in consonance with the present easy liquidity conditions. He said that keeping these realities in view, it was particularly important for banks and financial institutions to make adequate provisions for unforeseen contingencies in their business plans, and fully take into account the implications of changes in the monetary and external environment on their operations.

External Developments

8. Governor mentioned that despite adverse external developments, India's foreign exchange reserves continued to record a healthy growth during 2001-02 due to moderation in trade deficit and strong capital and other inflows. Foreign exchange reserves increased by as much as US \$ 11.8 billion from US \$ 42.3 billion in end-March 2001 to US \$ 54.1 billion by end-March 2002. Of these, foreign currency assets increased by US \$ 11.5 billion. This was the highest increase recorded in a single year and was evidence of strong domestic and international confidence in India's management of its balance of payments in the post-1991 period. He observed that due to comfortable supply position, the foreign exchange market generally exhibited stable conditions during 2001-02 barring some instances of volatility arising out of occasional uncertainties in market sentiments.

9. Governor mentioned that India's policy for reserve management was judiciously built upon a host of identifiable factors and other contingencies such as, *inter alia*, the size of the current account deficit; the size of short-term liabilities (including current repayment obligations on long-term loans); the possible variability in portfolio investments and other types of capital flows; the unanticipated pressures on the balance of payments arising out of external shocks (such as the impact of the East Asian crisis in 1997-98 or increase in oil prices during 1999-2001); and movements in the repatriable foreign currency deposits of non-resident Indians. A sufficiently high level of reserves is necessary to ensure that even if there is prolonged uncertainty, reserves can cover the "liquidity at risk" on all accounts over a fairly long period.

10. Expressing satisfaction that the recent international research on viable exchange rate strategies in emerging markets has lent considerable support to the exchange rate policy followed by India, Governor said that a number of countries (including those in East Asia) are now following similar policies.

11. Governor referred to the announcement made in the annual policy Statement of April 2001 that a survey would be conducted through an independent outside agency in order to have a feedback on simplification of procedures by RBI for export credit delivery as also the level of exporters' satisfaction with bank services. Quoting the results of the survey, he said that they reflected positive responses to RBI's

initiatives in improving the credit delivery system to exporters. He said that more than three-fourths of exporters were satisfied with overall bank services relating to export credit delivery and nearly one-fourth of exporters perceived them as “excellent” and more than half as “good”. Governor indicated that the report has also made some suggestions for improving the credit delivery to exporters which are being examined by RBI.

II. Stance of Monetary Policy for 2002-03

12. Governor mentioned that while the monetary management in the 2001-02 was largely in conformity with the monetary policy stance announced in the annual policy Statement of April 2001 and reiterated in the Mid-term Review of October 2001, it was fraught with several challenges like overhang of liquidity, global slowdown, external developments after September 11 and the tense situation on the borders.

13. Governor said that, as spelt out in the Mid-term Review of October 2001, RBI has been able to maintain stable interest rate regime throughout the year with a bias towards further softening of the interest rates, as reflected in the yields on government securities in the secondary market which ruled much lower than the yields at the beginning of the financial year. He said that the large market borrowing programme of the Government could be completed at a lower cost without unduly affecting the general interest rates.

14. Governor indicated that for the purpose of monetary policy formulation, for the year as a whole, growth rate of real GDP in 2002-03 is placed at 6.0 – 6.5 per cent, and the rate of inflation is assumed to be slightly lower than 4.0 per cent. Non-food credit (adjusted for investments) is projected to increase by about 15.0 – 15.5 per cent which is expected to adequately meet the credit needs of all the productive sectors of the economy. While the market borrowing programme in respect of some States has come under stress, he indicated that RBI expects to conduct debt management without serious pressure on overall liquidity and interest rates.

15. Governor said that unless circumstances change unexpectedly, RBI will continue to maintain current interest rate environment with a bias towards softer interest rate regime in the medium-term. The long-term objective would be towards realignment of interest rates on all types of debt instruments, both the government and private sector, within a narrow band.

16. Governor indicated that under normal conditions and barring emergence of any adverse and unexpected developments in the various sectors of the economy, the overall stance of monetary policy for 2002-03 will be:

- ? Provision of adequate liquidity to meet credit growth and support investment demand in the economy while continuing a vigil on movements in the price level.
- ? In line with the above, to continue the present stance on interest rates including preference for soft interest rates.
- ? To impart greater flexibility to the interest rate structure in the medium-term.

III. Financial Sector Reforms and Monetary Policy Measures

Governor announced certain structural and other policy measures to strengthen and rationalise the functioning of various segments of the financial system.

Monetary Measures

(a) Rationalisation and Reduction in Cash Reserve Ratio

17. Pursuant to its medium-term objective of reducing CRR to the statutory minimum level of 3.0 per cent, RBI gradually reduced the CRR from 11.0 per cent in August 1998 to 7.5 per cent in May 2001. As a further step in the direction of moving towards the medium-term objective of reducing the CRR while operationalising the Liquidity Adjustment Facility (LAF) and introducing better prudential standard it is proposed to:

- ? Reduce CRR further from 5.5 per cent to 5.0 per cent effective fortnight beginning June 15, 2002.

The proposed reduction in CRR is being made effective from fortnight beginning June 15, 2002 in view of the prevailing excess liquidity with the banking system as can be seen by the larger turnover in the call money market and the higher average recourse to RBI repos. RBI may, however, advance the effective date of reduction to before the above-announced date in case there is an unexpected change in liquidity conditions.

(b) Bank Rate

18. Governor said that at present, there is substantial excess liquidity in the system which is reflected in the repo amounts received by the Reserve Bank, lower yields on fixed income securities and reduction in deposit and lending rates. Under these circumstances, on balance, it is considered desirable to leave the Bank Rate unchanged. He added that the matter, however, will be kept under constant review. In case the overall liquidity and credit situation warrants, and inflation rate continues to remain low, a reduction in the Bank Rate by up to half a percentage point (50 basis points) will be considered by RBI as and when necessary.

Interest Rate Policy

(a) Interest Rate Flexibility

19. Governor stressed that from the medium-term perspective, it is necessary to initiate measures to make the interest rate structure in India more flexible and reflective of the underlying inflationary situation. Governor said that following measures need to be considered as early as possible:

- ? Encourage introduction of flexible interest rate system for all new deposits with reset at six-monthly intervals. At the same time, the fixed rate option should also be made available to depositors. Illustratively, banks may offer longer term deposits with six-monthly reset conditions and at the same time offer a fixed rate for similar maturity, the interest rate on which may be higher or lower depending on the period of deposit and banks' perception regarding inflation as well as interest rate outlook over the longer period.

- ? Devising schemes for encouraging depositors to convert their existing long-term fixed rate past deposits into variable rate deposits. Commercial banks may consider paying the depositors at the contracted rate for the period of deposit already run and waive the penalty for premature withdrawal if the same deposit is renewed at the variable rate.

(b) Prime Lending Rate and Spreads

20. As per the latest available information, spreads above PLR of some banks are substantial. In the present interest rate environment, it is not reasonable to keep very high spreads over the PLR. Banks are, therefore, urged to review the present maximum spreads over PLR and reduce them wherever they are unreasonably high so that credit may be available to the borrowers at reasonable interest rates. Further, banks should announce the maximum spread over PLR to the public along with the announcement of their PLR.

21. In the interests of customer protection as also meaningful competition, it is necessary to have a greater degree of transparency in regard to actual interest rates for depositors as well as borrowers. In this direction, the following measures are proposed:

- ? Banks should provide information on deposit rates for various maturities and effective annualised return to the depositor. RBI to put the consolidated information on its web site.
- ? Banks should provide information on maximum and minimum interest rates charged to their borrowers. Information to be put on public domain.
- ? Banks urged to switch over to “all cost” concept for borrowers by explicitly declaring the processing charges, service charges, etc. charged to borrowers and announcing them publicly.

(c) Interest rate on Savings Account - No Change

22. Although the nominal interest rate on savings account is 4.0 per cent per annum, the yield works out to 3.4 per cent per annum only as interest is payable on the minimum balance between tenth and last day of each month. Governor said that although there is an apparent case for deregulation of interest rates on savings account also, as nearly four-fifths of such savings deposits are held by households, including households in rural and semi-urban areas, on balance, it is not considered as opportune time to deregulate the interest rate on savings account for the present.

(d) Interest Rate on Export Credit

23. In order to make the interest rate even more competitive, ceiling rate on foreign currency loans for Indian exporters by banks on export credit is reduced to LIBOR plus 0.75 percentage point from the present LIBOR plus 1.0 percentage point.

(e) Deemed Exports

24. In view of the representation that some exporters still do not get the advantage of the concessional rate of interest in case of deemed exports, Governor urged the

banks to widely publicise the concessionality in the interest rates for deemed exports and make these available to all eligible exporters.

(f) Abolition of Minimum Lending Rate for Co-operative Banks

25. In order to provide greater flexibility to co-operative banks in a competitive environment, it is proposed:

- ? To withdraw the stipulation of MLR for all co-operative banks with immediate effect to provide freedom for determining their lending rates taking into account their cost of funds, transaction cost, etc. with the approval of their managing committees.
- ? To ensure transparency in the interest rates charged by co-operative banks, banks are requested to publish the minimum and maximum interest rates charged by them, and display this information in every branch.

(g) Liberalisation of Investment Norms of Funds Mobilised under FCNR (B) Deposits

26. To ease restrictions on banks for deploying FCNR(B) deposits and in order to avoid asset-liability mismatches, banks are permitted to invest their FCNR(B) deposits in longer term fixed income instruments with appropriate rating prescribed for the money market instruments.

(h) Interest Rate on FCNR (B) Deposits

27. The ceiling rate of FCNR(B) deposits is reduced to LIBOR/SWAP rates for the corresponding maturities minus 25 basis points from LIBOR/SWAP rate.

(i) Relaxation on Borrowing from and Investment in Overseas Market by Banks

28. In order to enable banks to have greater operational flexibility the following measures are announced.

- ? Banks allowed to borrow upto 25 per cent of their unimpaired Tier I capital from overseas market within the banks' Open Position Limit and maturity mismatch limits (Gap Limits) for which detailed guidelines will be issued.
- ? The existing limit of 15 per cent of unimpaired Tier I capital for investment in overseas market raised to 25 per cent of unimpaired Tier I capital.

(j) Crystallisation of External Commercial Borrowings

29. To facilitate banks to crystallise the foreign exchange liability in rupees in select cases and to provide greater freedom and flexibility to banks in their funds management, it is proposed to grant permission with appropriate safeguards for crystallisation of ECBs into rupee loans where it is considered necessary by banks to do so.

Credit Delivery Mechanism

(a) Priority Sector Lending

30. In order to further improve credit delivery mechanism for the priority sector, and in particular to agriculture, the following measures are proposed:

- ? Increase in the limits for financing of distribution of inputs for allied activities under priority sector increased to Rs.25 lakh from the present limit of Rs.15 lakh.
- ? Increase in credit limit for farmers for marketing crops (pledge financing) from Rs.1 lakh to Rs.5 lakh and repayment schedules of such credit extended to 12 months from 6 months at present.
- ? To avoid double counting, sponsor banks asked to exclude funds provided to RRBs for on-lending to priority sector, while meeting the target.

(b) Credit Facilities for Small-Scale Industries

31. The credit facilities for the SSI units are further liberalised and banks are allowed to increase the limit of dispensation of collateral requirement for loans from the existing Rs.5 lakh to Rs.15 lakh on the basis of good track record of the units and the financial position of small scale industrial (SSI) units.

(c) Securitisation and Risk Weights for Housing Finance

32. To further improve the flow of credit to the housing sector, the prudential requirements for housing finance by banks and investment by banks in securitised debt instruments of Housing Finance Companies (HFCs) are liberalised as follows:

- ? Risk weight of 50 percent on residential housing properties against 100 percent stipulated earlier.
- ? Risk weight of 50 per cent for the purpose of capital adequacy for investments in mortgage-backed securities (MBS) of residential assets by HFCs supervised by NHB. Investment by banks in MBS of housing assets which include commercial properties to attract 100 per cent risk weight.
- ? Investments by banks in MBS to be reckoned for inclusion in the prescribed allocation of 3.0 per cent (by HFCs supervised by NHB).

(d) Rural Infrastructure Development Fund

33. Pursuant to the announcement made in the Union Budget, funds for RIDF VIII enhanced to Rs. 5,500 crore and interest rate on loans to States from RIDF linked to the Bank Rate.

(e) Micro-credit

34. Scheduled commercial banks and NABARD to take immediate steps in forming linkages with self help groups (SHGs) across the country so as to achieve the target of 1.25 lakh persons for 2002-03.

Money Market

(a) Moving further towards Pure Inter-bank Call Money Market

35. Depending on the date when NDS/CCIL becomes fully operational, RBI to announce the date to move to stage II wherein non-bank participants would be allowed to lend, on average, in a reporting fortnight upto 75 per cent of their average lending in call market during 2000-01.

(b) Reliance on Call/Notice Money Market

36. To carry the reforms further in the money market the following steps are proposed:

- ? Scheduled commercial banks' daily lending in the call/notice money market not to exceed 25 per cent of their owned funds as at the end of March of the previous financial year.
- ? Scheduled commercial banks daily borrowings in the call/notice money market not to exceed 100 per cent of their owned funds or 2.0 per cent of aggregate deposits as at the end of March of the previous financial year, whichever is higher.
- ? The existing borrowers and lenders are allowed to unwind their positions in excess of the prudential limits by the end of August 2002.
- ? The daily borrowings of State Co-operative Banks (SCBs) and District Central Co-operative Banks (DCCBs) in the call/notice money market not to exceed 2.0 per cent of their aggregate deposits as at the end of March of the previous financial year.
- ? RBI to consider allowing temporary access to call/notice market to any banks facing mismatches on request. Increased access over stipulated norms may be permitted by RBI for a longer period for banks with fully functional ALM system satisfactory to RBI.
- ? Constitution of a Working Group with representatives from eligible entities to recommend by June 30, 2002, the criteria for fixing the limits for Primary Dealers (PDs) in call/notice money market and suggest a road map for phasing them out from the call money market.

(c) Collateralised Lending Facility

37. Due to the inherent superiority of the LAF in moderating liquidity in the financial system, CLF will be phased out with effect from the fortnight beginning October 5, 2002. CLF could be reintroduced for a temporary period in future, if considered necessary in the light of changes in monetary conditions.

(d) Certificates of Deposit

38. With effect from June 30, 2002, banks and FIs required to issue CDs only in the dematerialised form. Existing outstandings of CDs to be converted into the demat form by October 2002.

Government Securities - Review of Recent Developments

(a) Uniform Price Auction

39. RBI to continue to take recourse to uniform price auctions on an experimental and selective basis during this calendar year also as considered necessary.

(b) Negotiated Dealing System

40. All entities having SGL Accounts with RBI have been advised to become members of NDS by May 31, 2002.

(c) Government Securities Act

41. Replacement of the existing Public Debt Act, 1944 by Government Securities Act may be introduced in the present Parliament Session as proposed by Finance Minister in his Budget speech for 2002-03.

(d) Retailing of Government Securities through Non-competitive Bidding

42. Banks advised to promote schemes for sale/purchase of government securities over their counters to retail investors through demat accounts with depositories or with CSGL account holders. PDs and banks may also provide both sale and purchase facility to ensure that the retail investors are assured of liquidity of such investments. Retail sale of government securities may be promoted for availing of automatic finance at attractive rates.

(e) Floating Rate Bonds

43. Considering both the advantages and risks, issue of further FRBs in the current year would be examined.

(f) Calendar for Dated Securities

44. Out of the total expected market borrowing by the Government for first six months, a calendar for an amount of Rs.68,000 crore already announced. Remaining market borrowing programme for the first half of the year, as in the past, will be announced from time to time depending upon the emerging requirement of the Government and market conditions.

(g) Satellite Dealer System

45. Based on the views of the Primary Dealers Association of India and the Technical Advisory Committee on Money and Government Securities it is decided that no new SDs will be licensed. Existing SDs will be required to make action plans, satisfactory to RBI, for termination of their operations as SDs by May 31, 2002.

(h) Issue of Long-Term Bonds for Insurance Companies and Others

46. Proposal to continue RBI's policy of issuing long-term bonds to meet the requirements of such investors.

(i) Automatic Debit Mechanism

47. In view of the recommendation of the Technical Committee of State Finance Secretaries on State Government Guarantees, and keeping in view the need to maintain integrity of the public debt segment of debt markets it is proposed:

- ? To dispense with automatic debits where there are no legal or other compulsions in the future and as general policy.
- ? To suggest amendments to such provisions in case of legal compulsions.
- ? To review all the existing automatic debits in consultation with State Governments and others concerned, with a view to dispensing with such mechanisms wherever feasible.

Prudential Measures

(a) New Basel Capital Accord

48. An internal group to invite representatives from select banks to provide inputs into the development of the modified approach as well as the upcoming Quantitative Impact Study (QIS). Banks are expected to constitute an expert internal team to study the methodology of the new proposals and its likely impact.

(b) Counterparty and Country Risks

49. RBI to shortly issue draft guidelines on country risk management and provisioning therefor in consultation with banks, IBA and other market participants.

50. Banks advised to study the Basel framework on capital for market risk as envisaged in Amendment to the Capital Accord to incorporate market risks published in January 1996 by BCBS and prepare themselves to follow the international practices in this regard at a suitable date to be announced by RBI.

(c) Prevention of Money Laundering

51. RBI is in the process of issuing a Master Circular setting out the policy, procedures and controls required to be introduced by banks.

(d) Reduction in Transition Period of a Sub-standard Asset to Doubtful Category

52. Consistent with the recommendations of Narsimham Committee II and with a view to moving closer to international best practices, it is proposed that:

- ? With effect from March 31, 2005, an asset would be classified as doubtful if it remained in the sub-standard category for 12 months. Banks are permitted to phase the consequent additional provisioning over a four-year period, with a minimum of 20 per cent each year.

(e) Corporate Debt Restructuring

53. RBI constituted a High Level Group (Chairman: Shri Vepa Kamesam, Deputy Governor) to review the operations of the CDR scheme to identify the operational difficulties, if any, in smooth implementation of the scheme and to suggest measures to make the scheme even more effective. As an interim measure, and pending recommendations of the High Level Group constituted by the RBI, it has been decided that permission for debt restructuring will be made available by RBI on the basis of specific recommendations of CDR “Core-Group”, if a minimum of 75 per cent (by value) of the lenders constituting banks and financial institutions (FIs) consent for CDR, irrespective of differences in classification of the assets by banks/FIs.

(f) Investment Fluctuation Reserve

54. On the basis of feedback, it is decided that IFR should be computed with reference to investments in two categories, viz., “Held for Trading” and “Available for Sale”. It will not be necessary to include the investment under “Held to Maturity” category, which is not meant to be traded, for purposes of computation of IFR.

Non-Banking Financial Companies***(a) Formation of SRO for NBFC sector***

55. Representatives of NBFC Associations have agreed to constitute SRO at the earliest.

(b) Submission of Returns by NBFCs

56. RBI to impose penalties as provided for in the Reserve Bank of India Act, 1934 as also launch court proceedings, besides considering rejection/cancellation of the CoR of NBFCs having public deposits of Rs.50 crore and above, in case of default in the submission of returns. Stipulation in respect of the size of NBFCs will be progressively reduced over time.

Rationalisation of Current Account Facility with the Reserve Bank

57. Current account facility to be extended only to scheduled commercial banks and scheduled co-operative banks, and PDs. This facility would be phased out over time for entities other than those indicated above.

International Financial Standards and Codes

58. The Standing Committee is in the process of synthesising the views and comments of all the Advisory Groups and the final report will be placed shortly in the public domain for wider dissemination and appropriate follow-up action.

Mid-term Review

59. A review of credit and monetary developments in the first half of the current year will be undertaken in October 2002.

Alpana Killawala
General Manager

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