October 29, 1999

# RESERVE BANK OF INDIA

## *PRESS RELEASE*

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

- **Developments in macro-economic, monetary and price situations are favourable.**
- **Credit Policy to support industrial growth with price stability.**
- **Sufficient liquidity to be made available for growth.**
- **CRR cut by one percentage point. This will release additional lendable resources of Rs.7,000 crore.**
- **Incremental CRR of 10 per cent on FCNR(B) deposits withdrawn. This will release lendable resources of Rs.1,060 crore.**
- **Interest rate surcharge of 30 per cent on import finance withdrawn.**
- **The minimum interest rate of 20 per cent on overdue export bills withdrawn.**
- **Emphasis upon simplification of procedures and cutting delays for NRIs/FDI and improving credit delivery to exporters and other important sectors.**
- **Further Measures to develop Money Market.**
- **New measures for Deposit Insurance and valuation of securities under consideration.**
- **Special facilities for Y2K preparations.**

Dr.Bimal Jalan, Governor, Reserve Bank of India, in a meeting with the Chief Executives of banks today presented the Mid-term Review of Monetary and Credit Policy 1999-2000. In his Statement, Governor reviewed the macro-economic conditions and spelt out that the stance of monetary policy for the second half of 1999-2000 would remain broadly the same as in the first half. He also announced a number of policy measures towards improving liquidity and credit delivery and for further development of financial markets.

**Domestic Developments**

2. Governor said that assuming that the recovery in industrial production witnessed in the first half of the year would gather further momentum during the rest of the year, and there was no unexpected setback on the agricultural front, growth in GDP in the current year was likely to be in the range of 6 to 6.5 per cent consistent with the range of 6 to 7 per cent, indicated in his April Statement.

3. Governor felt that allowing for some increase in prices due to seasonal factors later in the year and adjustment lags in administered prices, the inflation rate for the current year as a whole was likely to be less than 4.8 per cent in the previous year. He further added that the high level of food stocks combined with low rate of inflation

should provide greater manoeuvrability in managing the economy in the event of any unexpected shocks.

4. Referring to the trends in monetary aggregates, which in the current year are marked by subdued growth, Governor said that in the light of the real sector trends and the expected inflation outlook, the projected order of monetary expansion of 15.5 – 16.0 per cent indicated in the April Statement, appeared reasonable.

5. Governor felt that any possible expansion in currency in circulation till December/ January 1999-2000 in the context of the millennium change was expected to reverse to normal before the year end.

6. While mentioning that the domestic and international developments so far had allowed the Reserve Bank to keep liquidity in the system at a comfortable level without much expansion in reserve money, Governor observed that as per current expectations, it appeared that with some appropriate adjustments there should be no difficulty in meeting fully the liquidity needs of different sectors. He also drew attention to the significant pick up in the bank credit and other flows to the commercial sector from the banking system during the current year.

7. Referring to the RBI's strategy of combining auction issues with acceptance by private placement of dated securities of the Government consistent with market conditions and the release of such securities through open market sales, Governor said that the strategy had helped to contain the volatility in securities prices and reduce the associated risks to major participants like banks and primary dealers. Governor, however, mentioned that while the RBI's policy had proved to be highly effective in keeping interest rates relatively stable, an issue that needed to be considered was whether it was a desirable policy of debt management from the long term point of view .As the secondary market develops and turnover increases, he said it should be possible to exclusively rely on auctions to sell Government paper and that was the direction in which RBI would like to move. Governor further mentioned that an important requirement for the secondary market in government securities to develop was for Government's net borrowing requirements to be sustainable. In the interest of maintaining stable interest rate environment, Government's borrowing programme needed to be kept within reasonable limits. This would also reinforce the process of recovery in industrial sector and enable banks to adequately meet the demand for non-food bank credit.

8. In the context of monetary management, Governor stated that a critical factor was the fiscal outlook for the rest of the year. Governor stressed the need for determined action to increase revenues, reduce deficits in the public sector, and reduce expenditure through appropriate policy actions. As recently announced by the Government, he mentioned that it was imperative that necessary actions to correct fiscal distortions are taken as early as possible. He mentioned that fiscal slippages were no longer a matter of domestic concern alone as all over the world, international agencies and investors kept a close watch on emerging trends in Government finances, as they had a bearing on future macro-economic stability.

**External Developments**

9. The two-year period since September 1997 presented major challenges for the management of the external sector, when the country had to cope with global effects of a series of intense crises in East Asia , Russia and Brazil, continued uncertainties in industrial economies like Japan and other unfavourable external developments after the Pokhran Test. Stating that while there were signs of an upturn in the world economy in the last six months, Governor said that the external situation continued to be characterised by several uncertainties as the management of the external sector in the first half of the current year also had to cope with some uncertainties in investment outlook consequent upon dissolution of the Lok Sabha in April 1999 and the ensuing electoral process.

10. Governor felt that viewed against the background of external and domestic uncertainties, developments in respect of both the exchange rate of the rupee as well as movement in foreign exchange reserves have been reasonably satisfactory. Governor stated that foreign exchange reserves at US $ 33.07 billion substantially exceed the total stock of short-term debt and portfolio flows. Emphasising that as a matter of conscious policy, India would continue to keep its short-term as well as forward liabilities at a manageable level in relation to the size of its reserves, Governor mentioned that the primary objective of the Reserve Bank in regard to the management of the exchange rate was to maintain orderly conditions in the foreign exchange market, to meet temporary supply-demand gaps which might arise due to uncertainties or other reasons and to curb destabilising and self-fulfilling speculative activities.

11. Governor observed that there was some evidence of pick up in exports during the first five months of current year when exports grew by 4.6 per cent in dollar terms and it was necessary that the momentum was kept up. Governor said that despite the effect of increase in oil prices, the expectation is that the current account deficit in 1999-2000 would still be below 2 per cent of GDP, in view of encouraging developments in respect of invisibles, particularly private remittances and software exports.

12. In order to improve the delivery of export credit, Governor informed that the Reserve Bank had set up a Bankers' Group at the operational level (comprising senior officials from commercial banks and the Reserve Bank). So far, the Group has held 22 meetings with Chief Executives of major banks and also held parallel interactive sessions with the exporters in 14 major export centers. The experience seems to have proved useful in improving the credit delivery to exporters.

13. Observing that an important priority of the Government and the Reserve Bank of India was to create an environment which was favourable to investment and strengthening of financial links with the non-resident Indian community abroad, Governor announced provision of following further facilities to NRIs without the need for approval of the Reserve Bank :

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

(ii) General permission to Indian companies for issuing non-convertible debentures by way of public issue to NRIs/OCBs on repatriation basis.

(iii) To delegate the powers to Authorised Dealers to permit portfolio investment by NRIs/PIOs/OCBs in shares/debentures.

14. With simplification of procedures for foreign direct investment, Governor mentioned that in respect of all cases of foreign direct investments, which were in line with Government Policy, case-by-case approval of RBI was no longer required.

**Stance of Monetary Policy for the Second Half of 1999-2000**

15. Recalling April Statement that "the current stance of monetary policy will continue to be in the direction of facilitating adequate availability of liquidity along with stable medium and long-term interest rates, with policy preference for softening to the extent circumstances permit." , Governor said that during this year so far, while liquidity conditions have been on the whole comfortable and medium and long-term rates have tended to soften, there has been some pressure at the shorter end of the yield curve. He mentioned that in order to cool down the pressures on call money market, during first half of October, the Reserve Bank opened a purchase window for Treasury bills as part of its open market operations and that it was the intention of RBI to continue with that practice as and when considered necessary and, over time, to develop a two-way market operations in Treasury bills. He further mentioned that in due course, with further development of Treasury bills market, such action should enable RBI to confine its activities to secondary market operations in Treasury bills, obviating the need for any devolvement in primary auctions.

16. While agreeing that in view of the decline in inflation rates in the past few months, and a relatively favourable outlook for the year as a whole, there was a case for a further downward movement in the structure of interest rates, he stressed that prime lending rates of banks for commercial credit was entirely within the purview of the banks and as such the decisions in regard to interest rates have to be taken by banks themselves in the light of various factors, including their own cost of funds, their transaction costs, and interest rates ruling in the non-banking sector, etc.

17. He added that while greater flexibility in interest rates was a most desirable objective, it had to be recognised that banks faced several structural and other constraints such as high levels of cost of funds and non-interest operating expenses, overhang of NPAs and interest tax which contributed to high lending rates. Interest rates on contractual savings like Provident Fund, national Savings Scheme were higher than long-term deposit rates of banks. High levels of Government borrowing also gave an upward bias to interest rate structure. High level of CRR also raised the average cost of funds for banks.

18. He felt that from the short-term and long-term points of view, in the context of financial sector deregulation and industrial liberalisation, priority needed to be given to removing some of these constraints so that the interest rate structure could be made more flexible during different phases of the business cycle.

19. Referring to the measures taken during this year to regulate liquidity, Governor said that the medium/long-term objective of monetary policy would continue to be in reducing the average level of CRR, while in the short-term it could be varied in both directions depending on the behaviour of monetary indicators.

20. Governor said that apart from price stability, central banks all over the world also accorded importance to financial stability as a policy objective. The Reserve Bank has been making continuous efforts towards strengthening financial soundness by prescribing capital adequacy norms of banks and financial institutions, advising improvements in asset classification and accounting systems and establishing best practice norms for income recognition and provisioning against exposures faced by them. While sustained reforms have significantly improved the outlook in respect of overall financial sector stability in India, RBI would continue to review the position with regard to the issues integral to the maintenance of financial stability in the future.

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

## Financial Sector Reforms and Monetary Policy Measures

22. In the light of the macro-economic and monetary policy developments, Governor announced the following changes in policy :

**Monetary and Credit Policy Measures**

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

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

(iii) The interest rate surcharge of 30 per cent on import finance, is being withdrawn with immediate effect. This will reduce the financing cost of imports for industrial production and investment.

(iv) The stipulation of a minimum rate of 20 per cent interest on overdue export bills is also being withdrawn.

(v) In line with the policy of minimising the country's short-term external borrowing liabilities, the minimum maturity for FCNR(B) deposits is being raised to one year from six months. Banks, however, will continue to have the freedom to offer floating rate deposits (with maturity of one year or more and with interest reset period of six months). At the same time, the requirement by banks to maintain an incremental CRR of 10 per cent on increase in liabilities under FCNR(B) Scheme is being withdrawn, effective from the fortnight beginning November 6, 1999. This will increase the lendable resources of banks by Rs1,060 crore.

**Money Market**

23. The following modifications/measures for further development of money market are being introduced:

(i) The permission given to non-bank entities to lend in the call/notice money market by routing their call/notice money market operations through primary dealers extended upto end-June 2000.

(ii) MMMFs exclusively investing in money market instruments will henceforth come within the purview of SEBI Regulations.

(iii) For operational convenience, it has been decided to henceforth allow MMMFs to be set up as a separate entity in the form of a 'Trust' only.

(iv) It has been decided to permit scheduled commercial banks to offer 'cheque writing' facility to Gilt Funds and to those Liquid Income schemes of mutual funds which predominantly invest in money market instruments.

(v) 'Cheque writing' facility extended to Gilt Funds and to those Liquid Income schemes of mutual funds which predominantly invest in money market instruments, subject to the same safeguards prescribed for MMMFs.

(vi) With a view to providing further flexibility in the use of FRAs/IRS, it has been decided to permit mutual funds, in addition to corporates, to undertake FRAs/IRS for the purpose of hedging their own balance sheet risks.

(vii) With a view to facilitating flow of information and transparency in the functioning of money markets, Reserve Bank proposes to work out in consultation with market participants, modalities of releasing on a daily basis, data on volume and rates in call money market as well as some other relevant data.

**Government Securities Market**

24. On the basis of announcements made in the April policy, several measures have been taken with the objective of improving depth and liquidity in the government securities market . The following action is in progress to further strengthen the development of the market.

- In regard to developing the retail market segment, a Working Group is being constituted to analyse all related aspects.

- An Internal Working Group has been constituted to go into various aspects relating to two-way operations by RBI in the Treasury Bills market.
- Arrangements relating to clearing corporation are under consideration which will pave way for opening the repo market with essential safeguards to PSU bonds and bonds of FIs held in demat form in depositories and traded in recognised stock exchanges. It has been decided to publicise gilt instruments through informative pamphlets.
- It has been decided to advise PDs that they should have self-imposed reasonable leverage ratios with the consent of their Board of Directors.

**Review of Norms Relating to**
**Prime Lending Rates**

25**.** Keeping in view the suggestions received from banks and other market participants, the existing PLR norms have been further reviewed and it has been decided that banks will be given the freedom to charge interest rates without reference to PLR, in respect of the following categories :

- Loans covered by refinancing schemes of term lending institutions.
- Lending to intermediary agencies.
- Discounting of bills.
- Advances/Overdraft against domestic/NRE/FCNR deposits.

**Prudential Norms**

26. As further steps in the direction of strengthening prudential norms, the following measures are announced:

(i) In view of the growing share of investments in the assets of banks, the risk weight of 2.5 per cent for the risk arising out of market price variations is being extended to cover all investments including securities outside the SLR. This, however, will take effect from the year ending March 31, 2001.

(ii) With a view to moving closer to the international standard of 15 per cent, it has been decided to lower the exposure ceiling in respect of an individual borrower from the present level of 25 per cent to 20 per cent of the bank's capital funds effective April 1, 2000. Banks are given two year period for adjustment, where the existing level of exposure is more than 20 per cent.

**Valuation of Investments**

27. An Informal Group on Valuation of Banks’ Investments Portfolio, set up by the Reserve Bank has recently submitted its report recommending new norms for valuation of approved securities. The Group’s report will be circulated among banks and also placed before the Board for Financial Supervision for advice and thereafter a final decision will be taken on the procedure for valuation of investments with effect from April 1, 2000.

**Credit Delivery**

28. At present, banks are required to allocate towards housing finance to the extent of 3 per cent of incremental deposits. With a view to providing more flexibility to banks to increase the flow of credit, directly and indirectly through intermediary agencies including Housing and Urban Development Corporation and National Housing Bank, certain changes in the norms for determining the housing finance allocation by banks are being introduced.

29. Banks and financial institutions have been entrusted with special responsibilities for providing credit on reasonable terms to certain sectors, particularly, agriculture, exports, micro-credit institutions, small-scale industries and housing. The Reserve Bank has held review meetings with the Chief Executives of banks to ensure that simplified procedures are actually being implemented at the ground level. It is proposed to hold such review meetings at regular intervals, and to encourage banks to set up internal systems to ensure effective implementation of simplified procedures.

30. Another area where banks and financial institutions can play an important role is that of infrastructure financing. After extensive consultation, RBI introduced in April, 1999 new guidelines to accelerate credit disbursement in infrastructure. It is proposed to review the operation of these new guidelines after one year of operation (i.e., May, 2000), and make such changes as may be required to promote further financing of infrastructure.

31. As announced in the April statement, RBI has set up a special Micro Credit Cell to review the ground realities and in consultation with NABARD and reputed micro-credit institutions, suggest measures to remove any remaining policy and procedural bottlenecks for “mainstreaming micro credit”. The objective is to accelerate the flow of bank credit to micro finance institutions without jeopardizing their decentralised, voluntary and non-bureaucratic character. A high level Task Force on Supportive Policy and Regulatory Framework for Micro Finance set up by NABARD has also recently submitted its report to NABARD. The recommendations made by the Task force are being processed by NABARD in consultation with RBI and Government as appropriate.

**Non-Banking Financial Companies (NBFCs)**

32. RBI has been keen to promote the concept of Self Regulatory Organisation among NBFCs. The Bank proposes to introduce formats of balance sheet with adequate disclosures as recommended by a Committee constituted by the Bank after getting views of the industry and Department of Company Affairs, Government of India.

33. Following measures in respect of NBFC sector are being notified with immediate effect :

(i) The borrowings from mutual funds presently come within the purview of public deposits as described in the Direction on Acceptance of Public

Deposits. It has been decided that borrowings from mutual funds would be excluded from the definition of public deposits.

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

**Deposit Insurance**

34. A Working Group was constituted in the RBI to review the role of deposit insurance in India. The Group has recommended changes in the existing system in regard to coverage, institutions to be brought within the ambits of insurance, regulatory systems, etc. The Report is being released for wider public discussion.

**Year 2000 (Y2K) Preparations**

35. Governor mentioned that all the 103 commercial banks and their 40 subsidiaries have confirmed Y2K readiness as at the end of August, 1999. The MICR cheque clearance system at the Reserve Bank is being replaced by the state of the art Y2K Compliant Systems in all the metropolitan centres. Besides, all the Issue Offices of the Reserve Bank and currency chests at commercially important cities have been asked to store adequate quantities of cash in order to meet any sudden increase in demand.

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

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

***Special Liquidity Support***

(i) With a view to enabling the banks to meet any unanticipated additional demand for liquidity in the context of the century date change, it has been decided to introduce a ‘Special Liquidity Support’ for the period December 1, 1999 to January 31, 2000. Under the ‘Special Liquidity Support’, banks will be eligible to avail of liquidity under Section 17(4)(a) of the Reserve Bank of India Act, 1934 to the extent of their excess holdings of dated Government of India Securities/Treasury Bills over the Statutory Liquidity Ratio (SLR) required to be maintained. The rate of interest on this facility will be 2.5 percentage points over the Bank Rate.

***Flexibility in the treatment of CRR***

(ii) To facilitate banks to tide over the contingency during the millennium change, it has been decided to treat cash in hand maintained by the banks for compliance of CRR for a limited period of two months commencing from December 1,1999 to January 31,2000. It is clarified that the cash in hand which will be counted for CRR purposes, during the above period cannot be treated as eligible asset for SLR purposes simultaneously.

(iii) As already indicated, for operational convenience, the maintenance of CRR by banks is being lagged by two weeks. With the leverage of two weeks available, banks should not have any problem in complying with the CRR requirement around the century date change. Any bank that expects a special problem in meeting its CRR obligations at the end of the year can approach the RBI for appropriate relaxation/assistance.

***Contingency Funding Line from Head Offices Abroad***

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

**Reserve Bank of India,**
**Mumbai,**

**October 29, 1999**