PART TWO : THE WORKING AND OPERATIONS OF THE RESERVE BANK OF INDIA

VIII - Monetary and Credit Policy

Developments During 2000-01
Institutional Measures

Introduction

8.1 The macroeconomic environment since the second half of the 1990s has rendered the conduct of monetary policy complex and subject to conflicting pulls. While output considerations may warrant monetary easing, it has been necessary to guard against monetary expansion turning excessive in a situation of slowing down of output growth which could cause the emergence of inflationary pressures and expectations. Moreover, the policy setting has been complicated by the impact of brief, yet significant, supply shocks to the price level within the general ebbing of demand-pull factors, structural rigidities resulting in the downward inflexibility of interest rates, the continuous pressure of the Government's market borrowing programme and sporadic episodes of volatility in the financial markets. The on-going integration of financial markets across the world, the phenomenal increase in financial turnover, the 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 have added additional dimensions to the conduct of monetary policy.

8.2 A factor which further complicates the conduct of monetary policy during certain periods is the difficulty of an appropriate assessment of the potential inflationary pressures. While there is little disagreement that in the medium- to long-run, inflation is largely caused by monetary expansion, in the short-run, price fluctuations could be affected by non-monetary and supply side factors. Under these conditions, monetary and credit policies have been deployed in support of the overall macroeconomic policy objectives, *albeit,* with a flexible approach under which tightening or easing of monetary conditions can be swiftly undertaken.

8.3 The conduct of monetary management has undergone significant changes in the 1990s in terms of objectives, framework and instruments, reflecting broadly the progressive liberalisation of the Indian economy. The Reserve Bank announced a multiple indicator approach in 1998-99, which accords the necessary flexibility to respond to changes in domestic and international economic and financial market conditions more effectively.While the growth in broad money (M_3)continues to be used as an important indicator of monetary policy, interest rates along with information on currency, credit extended by banks and financial institutions, the fiscal position, trade, capital flows, the inflation rate, the exchange rate and and transactions in foreign exchange available on high frequency basis are juxtaposed with output data for drawing policy perspectives. This shift has been gradual and a logical outcome of measures taken over the period of structural reforms.

8.4 A major transformation has also taken place in the operating procedures of monetary policy. The reform of monetary and financial sectors has enabled the Reserve Bank to expand the

array of instruments of indirect monetary control and at the same time reduce reliance on reserve requirements. The liquidity management in the system is carried out through open market (including repo) operations (OMO), supplemented by access to the Reserve Bank's standing facilities. The Liquidity Adjustment Facility (LAF) operations combined with strategic OMO have evolved as the principal operating procedure of monetary policy.

8.5 During 2000-01, the stance of monetary policy, as in the recent past, was to ensure that all legitimate credit requirements were met consistent with price stability. Assuming a real GDP growth of 6.5-7.0 per cent (revised to 6.0-6.5 per cent in the October 2000 mid-term review), a normal agricultural crop, improvement in industrial activity and an inflation rate of around 4.5 per cent, indicative projections were given for the key information variables: M_3 growth at about 15.0 per cent, commercial bank deposit growth at 15.5 per cent (or Rs.1,25,000 crore) and adjusted non-food credit growth (inclusive of non-SLR investments) at around 16.0 per cent for the year. Alongside the day-to-day operations for monetary and liquidity management, policy initiatives were undertaken to bring about institutional changes so as to strengthen the transmission of monetary policy impulses and to improve and focus the delivery of credit.

8.6 Developments during 2000-01, which are covered in the following sub-sections, encompass issues in the day-to-day management of liquidity in the money and gilt segments, including LAF operations. Institutional measures designed to improve the operational effectiveness of monetary policy are the focus of the subsequent sub-section, which also covers changes in the operating procedure under the LAF, maintenance of cash reserve requirements, rationalisation of interest rates, strengthening of the credit delivery mechanism in respect of rural credit, export credit and small-scale industries (SSI) and the institution of credit delivery mechanisms after the Gujarat earthquake and the monetary policy stance for 2001-02.

DEVELOPMENTS DURING 2000-01

Liquidity Management

8.7 In April 2000, the Reserve Bank reduced, by one percentage point each, (i) the CRR on eligible demand and time liabilities of commercial banks to 8.0 per cent, in two equal stages, effective April 8 and April 22, 2000 augmenting lendable resources by Rs.7,200 crore; (ii) the Bank Rate to 7.0 per cent, effective the close of business on April 1, 2000; and (iii) the fixed rate repo rate to 5.0 per cent, effective April 3, 2000. The Reserve Bank also cut the savings deposit rate of scheduled commercial banks by 0.5 percentage point to 4.0 per cent, effective April 1, 2000.

8.8 The foreign exchange market conditions began to tighten from mid-May 2000, mainly on account of a sharp increase in the oil import bill and the drying up of capital flows. The Reserve Bank undertook a series of monetary measures to bridge the demand-supply gap in the foreign exchange market. First, an interest rate surcharge of 50 per cent of the actual lending rate on bank credit for imports was introduced with effect from May 26, 2000 as a temporary measure. Essential categories, such as export-related imports, bulk imports in respect of crude oil, petroleum products, fertilisers, edible oil and other essential commodities imported through Government agencies were, however, exempted from the interest surcharge. Secondly, the

Reserve Bank indicated that it would meet genuine market requirements including Government debt service payments as considered necessary. Arrangements to meet fully or partially the foreign exchange requirements for import of crude oil by the Indian Oil Corporation were also announced. Thirdly, exporters were advised not to delay repatriation of export proceeds beyond the due date. In order to discourage any delay in the realisation of export proceeds, banks were required to charge interest at 25 per cent per annum (minimum) in respect of overdue export bills from the date the bill falls due for payment. Finally, banks were advised to enter into transactions in the foreign exchange market only on the basis of genuine requirements and not for the purpose of building up speculative positions (Chart VIII.1).

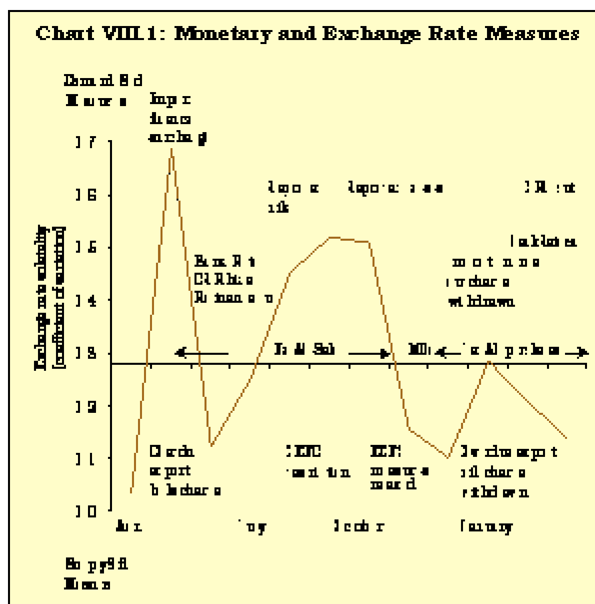

Chart VIII.1: Monetary and Exchange Rate Measures

8.9 The Reserve Bank undertook active operations in the foreign exchange market (net sales of US $ 1,948 million) in May-June 2000. This put pressure on money market conditions, driving up banks' and primary dealers' (PDs) recourse to the Reserve Bank and nudging up call rates above the Bank Rate especially during the latter half of May and June. The decline in foreign currency assets of the Reserve Bank was largely off-set by private placements and reverse repo operations. This resulted in an increase in the Reserve Bank's net domestic assets, particularly the net credit to the Centre.

8.10 The introduction of the LAF in June 2000 provided the Reserve Bank with an effective instrument to adjust liquidity and transmit interest rate signals to the markets. The LAF operations contained the movement of money market rates within a stable corridor and created the enabling conditions for the emergence of a short-term rupee yield curve.

8.11 Reverse repo auctions were conducted at progressively higher interest rates to push up short-term interest rates with a view to ensuring orderly conditions in the foreign exchange market. The renewal of foreign exchange market pressures in July 2000 prompted a further tightening of monetary conditions on July 21, 2000. The Bank Rate was increased by a percentage point to 8.0 per cent as at the close of business on July 21, 2000. The CRR was increased by 0.5 percentage point to 8.5 per cent in two equal stages, effective July 29 and

August 12, 2000, respectively. Limits available to banks on account of standing liquidity facilities were temporarily halved in two equal stages, effective July 29, 2000 and August 12, 2000, respectively.

8.12 The permissible balances in banks' Exchange Earners' Foreign Currency (EEFC) accounts were scaled down to 50 per cent of the amount outstanding as on August 11, 2000 and the excess over 50 per cent was required to be converted into rupees by August 23, 2000. Future accretions to such EEFC accounts were restricted to 50 per cent of what was then eligible and such accretion was required to be maintained in liquid form in current/savings accounts. Credit facilities available against EEFC accounts were held in abeyance

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8.13 The Reserve Bank continued to modulate liquidity conditions directly through net foreign currency sales and net primary subscription to government securities, partly offset by net OMO sales. The monetary stance was reinforced through aggressive repo operations under the LAF, with the daily repo rate rising from 8.0 per cent as on August 1, 2000 to 14.5 per cent as on August 14, 2000. The daily repo rates eased to 10.0 per cent by September 11, 2000 as stability returned to the foreign exchange market. Subsequently, as part of the mid-year review of macroeconomic and monetary conditions and the consequent monetary stance in October 2000, the EEFC scheme was reviewed in the light of previous experience and EEFC entitlements were restored to their earlier levels. It was also decided that the EEFC accounts would henceforth be held in the form of current account and credit facilities would not be provided by banks against the EEFC balances.

8.14 In early November 2000, a turnaround in market sentiment following the successful launch of the India Millennium Deposits (IMDs) and subsequent capital inflows allowed the easing of monetary conditions. The improved liquidity conditions facilitated government securities auctions and net OMO sales by the Reserve Bank. The interest rate surcharge of 50.0 per cent on import finance and the interest rate of 25.0 per cent on overdue export credit were withdrawn, effective January 6, 2001. The CRR was reduced by 0.5 percentage point to 8.0 per cent, in two equal stages, effective February 24, 2001 and March 10, 2001, respectively. The Bank Rate was cut by 0.5 percentage point each to 7.5 per cent, effective the close of business on February 16, 2001 and further to 7.0 per cent, effective the close of business on March 1, 2001. The Reserve Bank conducted reverse repo operations to tide over temporary spells of tight liquidity - during January 2001 driven by a rally in the government securities markets and at end-March, on account of the usual balance sheet date considerations.

8.15 The Reserve Bank continued to modulate liquidity conditions through a combination of CRR changes, private placements and open market (including repo) operations in the first quarter of 2001-02. Repos under the LAF were used to absorb liquidity, with the rates easing to 7.0 per cent and further to 6.75 per cent on April 27, 2001 and 6.5 per cent on May 28, 2001 in consonance with easy money market conditions resulting from continued capital flows, poor credit off-take as well as accommodation of the Centre's fiscal deficit *via* ways and means advances and private placements with the Reserve Bank. Reverse repos were conducted during May 8-23, 2001 to tide over a spell of tight liquidity caused by government securities auctions, lending by non-bank participants under the new regulations on lending in the call market and curtailment of liquidity support at the Bank Rate as per the revised LAF scheme. The CRR was

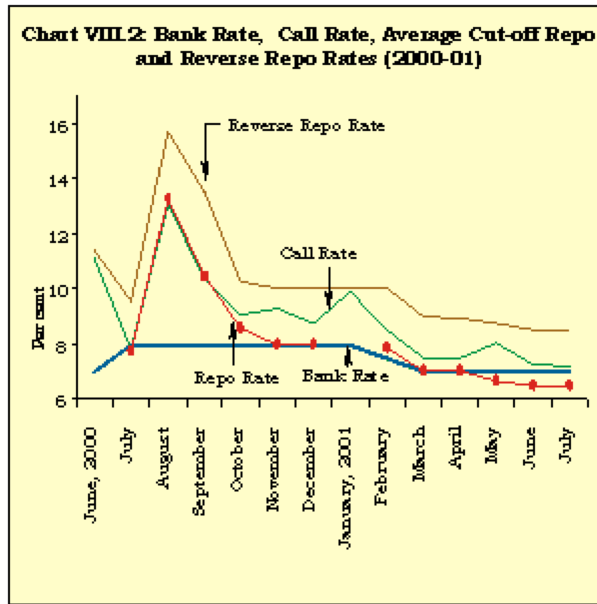
reduced by 50 basis points to 7.5 per cent, effective May 19, 2001, injecting Rs.4,500 crore in terms of lendable resources to the banking system.

INSTITUTIONAL MEASURES

8.16 The sweeping changes occurring in the financial system in recent years have necessitated restructuring and refocusing of the operational framework of monetary policy the world over and India is not an exception in this regard. Financial sector reforms have themselves brought forward these imperatives. The progressive liberalisation of financial markets and key financial prices have entailed a growing market orientation of monetary policy, alongside a gradual shift from direct to indirect instruments and improvement in the channels of credit flow. The Reserve Bank's responsibility for financial stability has provided the rationale for on-going efforts to develop a vibrant and resilient financial system to play the critical allocational role in the financial resource requirements of growth. It is in this context that the bi-annual statements of monetary and credit policy in recent years have focused upon 'structural measures' in order to strengthen the financial system and to improve the functioning of the various segments of the financial markets. The major objectives are to : (i) increase the operational effectiveness of monetary policy; (ii) redefine the regulatory role of the Reserve Bank in the determination of interest rates, margins and credit allocations, while simultaneously strengthening its role in the development of financial markets and the management of overall liquidity in the system; (iii) strengthen prudential and supervisory norms, while at the same time providing banks and financial institutions maximum autonomy in operational matters; (iv) improve the credit delivery system, particularly for agriculture, exports, services, SSI, self-help groups (SHGs) and micro-credit institutions; and (v) develop the technological and institutional infrastructure necessary for an efficient financial sector. The April 2000 monetary and credit policy statement reviewed the progress, highlighting the need for speeding up the development of an active secondary securities market and putting in place of banks' risk management and internal control mechanisms with timely and efficient procedures of loan recovery.

Changes in the Operating Framework of Monetary Policy: Liquidity Adjustment Facility

8.17 Policy initiatives and contemporaneous market development have led to the evolution of a full-fledged LAF in which liquidity is injected (absorbed) through reverse repo (repo) auctions with a view to imparting stability to short-term money market rates and enable orderly market play (Chart VIII.2). The Interim Liquidity Adjustment Facility (ILAF) introduced in April 1999, as a transitional mechanism for providing banks an access to liquidity at fixed interest rates, was replaced by the LAF, effective June 5, 2000. The fixed rate repo gave way to variable rate repo auctions. The Additional Collateralised Lending Facility (ACLF) for banks and Level II liquidity support to PDs were replaced by variable rate reverse repo auctions with same day settlement. Export credit refinance facility remained unchanged.



8.18 Given the satisfactory implementation of the first stage of the LAF during 2000-01, the second stage of the LAF was instituted in the Policy Statement of April 2001. The standing liquidity facilities in the form of the Collateralised Lending Facility (CLF), export credit refinance to banks and collateralised liquidity support to PDs were divided into two parts in approximately 2:1 ratio, *viz*., a normal facility provided at the Bank Rate and a backstop facility at a variable daily rate linked to the cut-off rates in regular LAF auctions at 1 per cent above the reverse repo rate. If reverse repo auctions do not take place on a particular day under the LAF, the back-stop facility would be provided at 2-3 percentage points above the repo rate. In the absence of both repo and reverse repo auctions or in case no bids were received/accepted under either repos or reverse repos, the rate for the back-stop facility would be 1-3 percentage points above the National Stock Exchange's Mumbai Inter-bank Offer Rate (NSE-MIBOR). While the major part of the standing facilities continue to be available at the Bank Rate, a part of such facilities is now priced at market-related rates.

8.19 The limits on export credit refinance were fixed at 15 per cent of the total outstanding export credit eligible for refinance as at the end of the second preceding fortnight, effective May 5, 2001, instead of the earlier system of linking refinance to the incremental export credit over a base date, *viz*., February 16, 1996. The existing refinance limit as on May 4, 2001, as per the earlier formula, is retained as the minimum entitlement up to March 31, 2002. With the announcement of the second phase of LAF, the Reserve Bank has been in the process of moving gradually from a system of segmented refinance to a more fungible system of liquidity adjustment at market-related rates.

8.20 Several measures were also undertaken in the April 2001 monetary and credit policy statement with a view to improving the operating procedures of the LAF. The minimum bid size was reduced from Rs.10 crore to Rs.5 crore to facilitate greater participation by small operators. The timing for receipt of bids was advanced by 30 minutes to 10.30 am so that the announcement of results could be made by 12.00 noon. The back-stop facility was made available till the close of banking hours. Further, the following options are now available to the Reserve Bank with a

view to providing quick interest rate signals in the face of unforeseen exigencies: (i) a switchover to fixed rate repos on overnight basis at interest rates announced as part of auction announcement on the previous evening or before 10.00 am on the day of auction; (ii) introduction of longer-term repos up to a 14-day period as and when required, in addition to overnight repos; and (iii) introduction of multiple price auctions from May 2001. Apart from releasing to the public the weighted average cut-off yield in case of multiple price auctions, the Reserve Bank publishes data on the scheduled commercial banks' aggregate cash balances maintained with it on a cumulative basis during the reporting fortnight with a lag of two days with a view to stabilising market expectations and arresting volatility in call rates.

Maintenance of Cash Reserve Requirements

8.21 In the recent period, several measures have been undertaken with a view to enabling banks to choose an optimum strategy for holding intra-reporting period bank reserves. In November 1999, a lagged reserve maintenance system was introduced under which banks were allowed to maintain reserve requirements on the basis of the last Friday of the second (instead of the first) preceding fortnight. From May 6, 2000, banks were required to maintain a minimum of 65.0 per cent (instead of the earlier 85.0 per cent) of the CRR balances on a daily basis from the first working day to the thirteenth day of the fortnight and adjust the balances accordingly on the reporting Friday (*i.e.,* the fourteenth day). From August 11, 2001, the daily minimum requirement of 65.0 per cent was reduced to 50.0 per cent for the first seven days of the reporting fortnight and 65.0 per cent for the rest of the days inclusive of the reporting Friday (which earlier did not have a minimum prescription). The interest rate on eligible balances was hiked by 2 percentage points to 6.0 per cent, effective April 21, 2001 with a view to eventually aligning it with the Bank Rate. Further, in order to facilitate the emergence of an inter-bank term money market, inter-bank term liabilities with a maturity of 15 days and above were exempted from the maintenance of minimum CRR of 3 per cent.

Interest Rates

8.22 The October 1999 mid-term review of the monetary and credit policy had underscored the need to address the structural constraints hindering the downward flexibility of interest rates in India, *viz.*, high operating expenses of public sector banks, overhang of NPAs, the practice of offering fixed interest rates on deposits and its consequences for the average cost of funds, the large government borrowing programme, the rigidities in interest rates on contractual saving and the high level of CRR.

8.23 In April 2000, as part of the efforts to ease the rigidities in the interest rate structure, the restriction on fixed rate loans extended only for project loans was withdrawn. Banks were given the freedom to offer all loans on fixed or floating rates while complying with PLR stipulations. The norms relating to the PLR have been progressively liberalised in the recent period. In April 2001, banks were allowed to offer loans at sub-PLR rates, thereby removing the practice of treating the PLR as a floor for loans above Rs.2 lakh.

8.24 On domestic term deposits, the minimum maturity period of 15 days was reduced to seven days in respect of wholesale deposits (Rs.15 lakh and above). Bank boards were accorded

the freedom to formulate their own rules regarding penal interest rates on premature withdrawal. Considerable freedom was also allowed in respect of interest rates for renewal of overdue term deposits. Banks have also worked out schemes to offer higher and fixed rates of interest on term deposits of senior citizens. As regards Foreign Currency Non-Resident (Banks) [FCNR(B)] deposits, banks were allowed to use current swap rates for fixing interest rate ceilings for the following week. Since April 2001, the earlier mark-up of 50 basis points over the LIBOR/swap rates in determining the ceiling rate was done away with. Banks were also allowed, as in the case of domestic term deposits, to offer differential rates of interest on NRE/FCNR(B) deposits, depending on size; however, for FCNR(B) deposits, the freedom to offer such rates was subject to the overall ceiling prescribed.

Credit Delivery

8.25 An integral element of the conduct of monetary and credit policy has been the direction of bank credit to certain sectors such as agriculture, exports, SSIs, infrastructure, housing, micro-credit institutions and SHGs. Policy stipulations have been reinforced through incentives to ensure the adequate allocation of credit by banks in favour of these sectors. Besides improving the volume and terms of credit, policy efforts have been directed towards enhancing and simplifying the access to credit by simplifying documentation procedures and decentralising the sanctioning to the branch level.

Rural Credit

8.26 In terms of the statutory responsibility under Section 54 of the Reserve Bank of India Act, 1934, the Reserve Bank has endeavoured to (i) institutionalise rural credit; (ii) enlarge its coverage; and (iii) ensure provision of timely and adequate credit to as large a segment of the rural population as possible so as to achieve anticipated growth rates in agricultural production and employment. Banks are required to meet targets and sub-targets set under priority sector lending. During 2000-01, the scope of priority sector lending was rationalised to include bank finance to agriculture through non-banking financial companies (NBFCs) and finance for distribution of inputs for activities allied to agriculture up to Rs.15 lakh (raised from Rs.5 lakh). Keeping in view the importance of agriculture in the economy, the domestic commercial banks have been advised to lend a minimum of 18 per cent of net bank credit to agriculture, of which indirect lending to agriculture should not exceed 4.5 per cent of net bank credit (NBC). A time frame of two years has been set within which both public and private sector banks should achieve the target of 18 per cent of net bank credit for lending to agriculture as also the target stipulated for lending to the priority sector and weaker sections. This would, however, be without prejudice to the allocation under the RIDF for not meeting the targets for lending under priority sector/agriculture during the intervening period. Banks have also been advised to step up direct lending to agriculture.

8.27 Banks are allocated amounts on the basis of the shortfall from stipulated levels in priority sector lending for deposit in the Rural Infrastructure Development Fund (RIDF). Pursuant to the announcement in the Union Budget for 2001-02, RIDF-VII was established in the NABARD with a corpus of Rs. 5,000 crore (Table 8.1). A sum of at least Rs.750 crore would be earmarked out of RIDF-VII for rural electrification work. In the case of RIDF-I to VI, the rate of interest on

deposits placed in the Fund was uniform for all banks irrespective of the extent of their shortfall. It has now been decided to link the interest on RIDF deposits to banks' performance in lending to agriculture. Accordingly, banks will receive interest from the NABARD on their contribution to RIDF-VII at rates inversely proportional to the shortfall in agricultural lending. Banks would be paid an interest rate of 10.0 per cent on the entire deposit to be made in RIDF-VII if the shortfall in lending to agriculture in terms of percentage to net bank credit works out to less than 2 percentage points, 9.0 per cent for a 2-4.99 percentage point shortfall, 8.0 per cent for a 5-8.99 percentage point shortfall and 7.0 per cent for shortfalls of 9 percentage points and above.

8.28 Public sector banks were set annual targets for the issue of Kisan Credit Cards (KCC) during 2001-02 to achieve the overall target of 33 lakh set for commercial banks. All eligible farmers are to be covered under the scheme within the next three years. Cumulatively, 43.77 lakh KCCs, involving a sum of Rs.10,626 crore, have been issued by public sector banks from the inception of the scheme up to March 2001. Banks have also been advised to provide a personal insurance package to the KCC holders to cover them against accidental death or permanent disability up to a maximum amount of Rs. 50,000 and Rs. 25,000, respectively. As per the model scheme, the premium burden will be shared by banks and the KCC holders in 2:1 ratio.

8.29 Banks were also advised to make efforts for the speedy implementation of the *Swarnajayanti Gram Swarojgar Yojana* launched in the preceding year. The flow of credit to agriculture under the Special Agricultural Credit Plan (SACP), introduced in 1994-95, has been improving significantly year after year. For 2000-01, public sector banks had set a disbursement target of Rs.25,893 crore, against which the actual disbursement amounted to Rs.24,654 crore.

Export Credit

8.30 Several measures have been taken to ensure timely and adequate flow of credit to the export sector. Besides improving the access to credit through on-line facilities, longer maturity lines of credit and term loans, fast track clearance of export documents was instituted at specialised bank branches. A Monitoring Group of Bankers, set up in 1999, met with bank officials, exporters and industry associations including field-level visits at 21 major export centres. Exporters' responses were directly invited by the Reserve Bank, including on its website. Guidelines issued for the implementation of these suggestions, include, *inter alia,* institution of a flexible approach by banks in negotiating bills drawn against letters of credit (LCs) over and above limits, increasing discretionary powers at the bank branch level for sanction of export credit, according further flexibility in disbursing enhanced/*ad hoc* limits pending sanction, waivers of LCs/export orders, *etc*. Exporters whose suggestions could not be implemented have been informed of the reason for non-acceptance.

Table 8.1: Rural Infrastructure Development Fund

(Amount in Rupees crore)

RIDF	Corpus	Year established	Amount Sanctioned	Amount Disbursed	Disbursement as percentage to Sanction
1	2	3	4	5	6
I	2,000	1995-96	1,898.64	1,742.45	91.8

II	2,500	1996-97	2,588.78	2,093.68	80.9
III	2,500	1997-98	2,665.34	1,907.72	71.6
IV	3,000	1998-99	3,119.86	1,423.13	45.6
V	3,500	1999-2000	3,639.34	1,255.15	34.5
VI	4,500	2000-01	4,632.67	1,062.12	22.9
VII	5,000	2001-02	717.16	Nil	

Note :. Data up to June 2001

8.31 In the April 2001 policy announcement, a significant rationalisation of prescribed interest rates on export credit was undertaken. A ceiling rate on rupee export credit is now indicated, linked to the relevant-tenor PLR, and banks are free to charge interest rates below the prescribed rate, effective May 5, 2001. The ceiling rate on foreign currency loans for exports was set at LIBOR *plus* 1.0 percentage point, effective April 19, 2001. The revisions in the interest rates are applicable not only to fresh advances but also to the existing advances for the remaining period.

Small-Scale Industry

8.32 The total credit provided by public sector banks to SSIs, at Rs.48,445 crore as on the last Friday of March 2001, worked out to 14.2 per cent of the net bank credit and 33.1 per cent of the total priority sector advances of these banks. Out of the advances of the SSI sector, the advances to cottage industries, *khadi* and village industries, artisans, tiny industries, *etc*., at Rs.26,019 crore, constitute 53.7 per cent of the advances to the SSI sector.

8.33 The limit for investment in plant and machinery for considering a unit as SSI was brought down to Rs.1 crore from the earlier Rs.3 crore in order to give a fillip to small units with low investment. The investment limit for tiny units continues to be Rs.25 lakh. Investment in plant and machinery in respect of industry-related Small-Scale Service/Business Enterprises (SSSBE) was increased to Rs.10 lakh from Rs.5 lakh. Commercial banks were advised to dispense with collateral requirements for the tiny sector for loans up to Rs.5 lakh. Similarly, to promote the credit flow to small borrowers, the composite loan limit for providing working capital and term loans through a single window was increased from Rs.10 lakh to Rs.25 lakh. Under the Credit-Linked Capital Subsidy Scheme for Technology Upgradation of SSI, introduced in October 2000, a 12 per cent back-ended capital subsidy was made admissible on loans granted to the SSIs by scheduled commercial banks/designated State Financial Corporations (SFCs) for technology upgradation in certain selected sectors.

8.34 The momentum provided for improving credit delivery systems for small-scale borrowers in the Union Budget, 2000-01 was carried forward. Public sector banks are to make concerted efforts to operationalise at least one specialised SSI branch in every district and centres having cluster of SSI units. The lead banks of the districts were advised to take steps for operationalising specialised SSI branches in their respective districts and centres in the districts having a cluster of SSI units. The convenor of the State-Level Bankers Committee (SLBC) in each state monitors the progress in the operationalisation of specialised SSI branches. Banks were also required to fix separate sub-limits in respect of purchases from SSIs while sanctioning/ renewing credit limits of large corporate borrowers (Rs.10 crore and above). Banks were advised to complete the process of operationalising SSI branches by December 31, 2000. As at end-March

2001, there were 390 specialised SSI bank branches operating in the country.

8.35 A Credit Guarantee Fund Scheme for Small Scale Industries was introduced by the Central Government with effect from August 2000 for the purpose of providing guarantees to a substantial extent in respect of credit facilities up to Rs.25 lakh to borrowers in the SSI sector, without any collateral security and/ or third party guarantees. The scheme covers eligible credit facility extended by the lending institutions, effective June 1, 2000.

Micro-credit

8.36 Guidelines were issued to banks in February 2000 to streamline micro-credit and enhance the outreach of micro-credit providers. Recognising micro-credit interventions as an effective tool for poverty alleviation, a Micro Finance Development Fund, with a start-up contribution of Rs.100 crore from the Reserve Bank, NABARD and select public sector banks, was set up in the NABARD to, *inter alia*, promote research, action research, management information systems and dissemination of best practices in micro-finance. By March 31, 2001, 2,63,825 SHGs were credit linked, with the cumulative bank loans extended to the groups amounting to Rs. 480.88 crore. The coverage of an additional one lakh SHGs by the NABARD and SIDBI set during 2000-01 was achieved. The target for the year 2001-02 is to extend linkages with SHGs across the country so as to link 1 lakh additional SHGs to provide access to credit to an additional 20 lakh families.

8.37 As mentioned in the last year's Annual Report, a Rs.1,000 crore consortium scheme is in place under which the banking system provides finance to Khadi and Village Industries Boards (KVIBs). The credit provided by banks to the Khadi and Village Industries Commission (KVIC) under this scheme will be reckoned as their indirect lending to the SSIs under the priority sector. These loans are provided at 1.5 per cent below the average prime lending rates of five major banks in the Consortium. As at end-July 2001, an amount of Rs.458 crore was outstanding out of an amount of Rs.738 crore disbursed by the Consortium under the scheme.

8.38 To help overcome the hurdles being faced by women in accessing bank credit and credit plus services, the Central Government has drawn up a 14-point Action Plan for public sector banks to strengthen credit delivery to women, particularly in the tiny and SSI sectors. Public sector banks are required to apprise the progress made in implementing every action point to the Government and the Reserve Bank on a quarterly basis commencing from the quarter ended March 2001.

Measures for Gujarat Earthquake

8.39 In view of the devastating effect of earthquake in Gujarat in January 2001, the Reserve Bank announced a package of relief measures for the State. The WMA limit and the terms of overdraft regulations to the Government of Gujarat were relaxed. The loan classification status in case of borrowers affected by the earthquake was frozen on an 'as-is-where-is' basis up to March 31, 2003. With regard to standard assets, no demand for recovery would be made for two years while in regard to loans not classified as standard assets, no penalties would be levied in the event of non-receipt of repayments due during the next two years. During this period, banks

would charge simple interest at 10 per cent per annum till end-March 2003. The affected small traders, small business, self-employed and small road transporters, *etc*., would be sanctioned fresh loans up to Rs.1 lakh for the purpose of restoration/rehabilitation of their business at interest rates not exceeding PLR. Banks were advised to grant loans up to Rs.2 lakh at interest rates not exceeding PLR for repairs/reconstruction of houses/shops damaged by the earthquake. Provisions were made for sanction of additional limits/ rescheduling of existing limits for affected SSI, business, trade and industry, under a need-based approach, with interest on additional limits at PLR up to Rs.10 lakh and at banks' discretion beyond Rs.10 lakh. The PLR would be that of the State Bank of India. Interest on rescheduled loans would be charged at 10 per cent per annum at a simple rate up to March 2003. Loans for repair/construction of houses and shops and to small traders, small business, self-employed and small road transport operators, *etc.,* would be reckoned as priority sector lending. Waiver of processing fees for the affected beneficiaries and relaxations in the recovery of principal and interest in respect of agricultural loans, provisions for reschedulement up to 7 years, long-term loan of Rs.1,000 crore at 6.0 per cent rate of interest per annum repayable over 18 years to enable NHB to provide refinance assistance and relief/concessions for affected exporters are other measures taken to mitigate the losses due to the Gujarat earthquake.

The Monetary Policy Stance for 2001-02

8.40 Against the background of easy liquidity conditions in the early part of the year, notwithstanding the turbulence in equity markets in March 2001, the monetary stance for 2001-02 is to ensure that all legitimate requirements for credit are adequately met consistent with price stability. Towards this objective, the Reserve Bank continues its policy of active management of liquidity through OMO, including two-way sale/purchase of treasury bills, and further reduction in CRR as and when required. Unless circumstances change unexpectedly, or current problems in some segments of the market are not resolved soon, on the present reckoning, it would also be possible to maintain the current interest rate environment and explore the possibility of some further softening in medium- and long-term rates over time, following the stance of interest rate flexibility announced in the Union Budget for 2001-02. The monetary policy stance takes note of the fiscal deficit of the Centre budgeted at 4.7 per cent of GDP and the consequent size of the borrowing programme and envisages a real GDP growth of 6.0-6.5 per cent and an inflation rate projected within 5 per cent. Consistent with this macroeconomic outlook, the growth rates projected for the key information variables are: about 14.5 per cent and commercial bank aggregate each for M_3 deposits and 16-17 per cent for adjusted non-food credit of commercial banks.

8.41 The exchange rate management, within this monetary stance, will continue to focus on managing volatility and ensuring orderly market conditions with no fixed "target" for the exchange rate. The approach would be one of watchfulness, caution and flexibility. The policy for building adequate levels of international reserves will continue with due consideration to the liquidity risks associated with various types of capital flows. The progressive liberalisation of the capital account would be carried forward while the pace and sequencing will be determined by evolving macroeconomic and external conditions.

8.42 The major thrust of financial sector reforms would continue to be on the development of

financial markets, strengthening of the financial system and prudential and supervisory norms, improvement in credit delivery and modernisation of the technological environment of the financial sector.